Directorate of Distance Education

UNIVERSITY OF JAMMU
JAMMU

SELF LEARNING MATERIAL
FOR
B.COM SEMESTER -VI

COURSE NO. BCG-602 **Lesson No.1-12**
INSURANCE MANAGEMENT **Unit I-IV**

Course Co-ordinator
Rohini Gupta Suri

http: / www.distanceeducationju.in
Printed and Published on behalf of the Directorate of Distance Education, University of Jammu, Jammu by the Director, DDE, University of Jammu, Jammu.

INSURANCE MANAGEMENT

Course Contributor :

Dr. Manisha Dev

Review & Editing :

Rohini Gupta Suri

Sethi Art Printers/450/Dec. 2018

UNIVERSITY OF JAMMU
B.COM. SIXTH SEMESTER

INSURANCE MANAGEMENT

C.No. BCG 602	Max. Marks = 100
Time: 3 Hrs.	Internal Assessment = 20
	External Exam. = 80

OBJECTIVE: The basic objective of this course is to provide knowledge of insurance and risks involved thereof.

UNIT-I: INTRODUCTION

Evolution of insurance business; Basic nature of insurance; Importance of insurance; Types and classifications of insurance; Brief introduction to IRDA 1999.

UNIT-II: RISK MANAGEMENT

Basic concept of risk, classification of risks and process of risk management; Identification and evaluation of risk--Risk analysis; Risk control--Loss prevention and its importance; Risk finance and transfer of risk.

UNIT-III: LIFE INSURANCE

Economic, legal and actuarial principles of life insurance; Basic elements in computation of premium; Peculiarity of Life insurance products and classification; Procedures for settlement of various types of claims

UNIT-IV: NON-LIFE INSURANCE PRODUCTS AND CLAIM MANAGEMENT

Principles of indemnity; Causa proximo; Subrogation; Bank Assurance- Meaning, benefits to banks, causes of growth of bank-assurance; Procedures for settlement for claims in life & Marine insurance.

SKILL DEVELOPMENT (GUIDELINES FOR CLASS ROOM TEACHING AND INTERNALASSESSMENT)

- ❖ List the features of an existing insurance product.
- ❖ List the fact s to be considered for fixation of insurance premium.
- ❖ Draw a sketch regarding the terms of settlement of claims.
- ❖ Identify some new areas where insurance concept could be introduced.
- ❖ Create deep understanding of all concepts specified in the syllabus.

BOOKS RECOMMENDED.

1 Panda, Ghansham	:Principles of Insurance, Kalyani Publishing House, New Delhi
2 Mittal, Alka & Gupta, S.L.	:Principles of Insurance and Risk Management, Sultan Chand & Sons, New Delhi
3 Mishra, M.N & Mishra, S.ll	:Insurance Principles and Practice, S. Chand, New Delhi
4 Gupta, P.K	:Fundaments of Insurance, Himalaya Pub., New Delhi
5 Periasamy, P	:Principles and Practice of Insurance, Himalaya Pub., New Delhi
6 Rajeda	:Principles of Risk Management and Insurance, Pearson Pub, New Delhi
7 Tripathi & Pal	:Insurance-Theory and Practice, PHI Learning Pub., New Delhi
8 Gupta, R.C & Jain, T.C	:Insurance and Risk Management, Alpha Pub., New Delhi

NOTE FOR PAPER SETTER

Equal weightage shall be given to all the units of the syllabus. The external paper shall be of the two sections viz, A & B .

Section-A: This section will contain four short answer questions selecting one from each unit. Each question carries 5 marks .A candidate is required to attempt all the four questions. Total weightage to this section shall be 20 marks.

Section-B: This section will contain eight long answer questions of 15 marks each. Two questions with internal choice will be set from each unit . A candidate has to attempt any four questions selecting one from each unit. Total weightage to this section shall be 60 marks.

INTRODUCTION

STRUCTURE

1.1 INTRODUCTION

Every risk involves the loss of one or other kind. In older time, the contribution by the person was made at the time of loss. Today, only one business, which offers all walks of life, is insurance business. Owing to growing complexity of life, trade and commerce, individual and business firms and turning to insurance to manage various risks. Every individual in this world is subject to unforeseen uncertainties which may make him and his family vulnerable. At this place, only insurance helps him not only to survive but also recover his loss and continue his life in a normal manner. Insurance is an important aid to commerce and industry. Every business enterprise involves large number of risks and uncertainties. It may involve risk to premises, plant and machinery, raw material and other things. Goods may be damaged or may be destroyed due to fire or flood. Some risk can be avoided by timely precautions and some are unavoidable and are beyond the control of a business. These unavoidable risks can be protected by insurance.

Insurance is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the premium. Insurance allows individuals, businesses and other entities to protect themselves against significant potential losses and financial hardship at a reasonably affordable rate. We say "significant" because if the potential loss is small, then it doesn't make sense to pay a premium to protect against the loss. After all, you would not pay a monthly premium to protect against a loss because this would not be considered a financial hardship for most. Insurance is appropriate when you want to protect against a significant monetary loss. Take life insurance as an example. If you are the primary breadwinner in your home, the loss of income that your family would experience as a result of our premature death is considered a significant loss and hardship that you should protect them against. It would be very difficult for your family to replace your income, so the monthly premiums ensure that if you die, your income will be replaced by the insured amount. The same principle applies to many other forms of insurance. If the potential loss will have a detrimental effect on the person or entity, insurance makes sense. Everyone that wants to protect themselves or someone else against financial hardship should consider insurance. This may include:

- Protecting family after one's death from loss of income
- Ensuring debt repayment after death
- Covering contingent liabilities
- Protecting against the death of a key employee or person in your business
- Buying out a partner or co-shareholder after his or her death
- Protecting your business from business interruption and loss of income
- Protecting yourself against unforeseeable health expenses
- Protecting your home against theft, fire, flood and other hazards
- Protecting yourself against lawsuits
- Protecting yourself in the event of disability
- Protecting your car against theft or losses incurred because of accidents
- And many more

1.2 OBJECTIVES

After going through this unit you should be able to understand:

i) The history of insurance business.

ii) The basic nature of insurance

iii) The importance of insurance

iv) The types and classification of insurance

1.3 EVALUATION OF INSURANCE BUSINESS

In India, insurance has a deep-rooted history. Insurance in various forms has been mentioned in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmashastra) and Kautilya (Arthashastra). The fundamental basis of the historical reference to insurance in these ancient Indian texts is the same i.e. pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. The early references to Insurance in these texts have reference to marine trade loans and carriers' contracts.

Insurance in its current form has its history dating back until 1818, when Oriental Life Insurance Company[3] 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 as 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 1971 and it commence business on 1 January 1973.

The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. 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 December2000, 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 Limited.

Insurance in India refers to the market for insurance in India which covers both the public and private sector organisations. It is listed in the Constitution of India in the Seventh Schedule as a Union List subject, meaning it can only be legislated by the Central government. The insurance sector has gone through a number of phases by allowing private companies to solicit insurance and also allowing foreign direct investment. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014.[1] However, the largest life-insurance company in India, Life Insurance Corporation of India is still owned by the government and carries a sovereign guarantee for all insurance policies issued by it.

Meaning of Insurance

Insurance is a contract between two parties. One party is the insured and the other party is the insurer. Insured is the person whose life or property is insured with the insurer. That is, the person whose risks are insured is called insured. Insurer is the insurance company to whom risk is transferred by the insured. That is, the person who insures the risk of insured is called insurer. Thus insurance is a contract between insurer and insured. It is a contract in which the insurance company undertakes to indemnify the insured on the happening of certain event for a payment of consideration. It is a contract between the insurer and insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against. Some definitions of insurance are given below:

According to Gosh and Agarwal, “insurance may be defined as a co-operative form of distributing a certain risk over a group of persons who are exposed to it'

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

In the words of Jon Megi, “Insurance is a plan wherein persons collectively share the losses of risks”. Thus, insurance is a device by which a loss likely to be caused by uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join themselves against such an event. The document which contains all the terms and conditions of insurance (i.e. the written contract) is called the 'insurance policy'. The amount for which the insurance policy is taken is called 'sum assured'. The consideration in return for which the insurer agrees to make good the loss is known as 'insurance premium'. This premium is to be paid regularly by the insured. It may be paid monthly, quarterly, half yearly or yearly. History of Insurance in India

Terms used in Insurance

Insured: The party or the individual who seeks protection against a specified task and entitled to receive payment from the insurer in the event of happening of stated event is known as insured. An insured is normally in insurance policy holder.

Insurer: The party who promises to pay indemnity the insured on the happening of contingency is known as insurer. The insurer is an insurance company.

Beneficiaries: The person or the party to whom the policy proceeds will be paid in the event of the death or happening of any contingency is called beneficiary. Contract An agreement binding at law between two or more parties is called contract.

Premium: The amount which is paid to the insurer by the insured in consideration to insurance contract is known as premium. It may be paid on monthly, quarterly, half yearly, yearly or as agreed upon it is the price for an insurance policy.

Insured sum: The sum for which the risk is insured is called the insured sum, or the policy money or the face value of the policy. This is the maximum liability of the insurer towards the insured.

Peril: A peril is an event that causes a personal or property loss by fire, windstorm, explosion, collision premature death, sickness, floods, dishonesty etc.

Hazard: Hazard is a condition that may create, increase or decrease the chances of loss from a given peril.

Exposure: An exposure is a measure of physical extent of the risk. An individual who owns a business house may be subjected to economic loss and individual loss because of his business and personal exposure.

Cover note: An unstamped document issued by or on behalf of insurers as evidence of insurance pending issue of policy.

Damages: Monetary compensation award at law for a civil wrong or breach of contract. Indemnity Compensation for actual loss suffered is call indemnity.

Reinsurance: Reinsurance is a method where by the original insurer transfer all or part of risk he has assumed to another company or companies with the object of reducing his own commitment to an reducing his own commitment to an amount that he can bear for his own account commensurate with his financial resources in the event of loss. It was originally confined to offers and acceptances on individual risk known as facultative reinsurance transactions.

Double Insurance: Double insurance implies that subject matter is insured in two or more insurance companies (insurers) and the total sum insured exceeds the actual value of subject matter. In other words, the same subject matter is insured in more than one insurer.

No claim bonus: The bonus is getting under the policy, if the claim is not reported during the policy period and after that the time renewal (in time) then as per the policy term no claim bonus is avail for the vehicle insurance policy and the rate of bonus is different in different general insurance companies, and the maximum rate should be up to 50% as per the norms.

1.4 BASIC NATURE OF INSURANCE

Insurance follows important characteristics– These are follows

1. Sharing of risk Insurance is a co-operative device to share the burden of risk, which may fall on happening of some unforeseen events, such as the death of head of family or on happening of marine perils or loss of by fire.

2. Co-operative device Insurance is a co-operative form of distributing a certain risk over a group of persons who are exposed to it. A large number of persons share the losses arising from a particular risk

3. Large number of insured persons The success of insurance business depends on the large number of persons Insured against similar risk. This will enable the insurer to spread the losses of risk among large number of persons, thus keeping the premium rate at the minimum.

4. Evaluation of risk For the purpose of ascertaining the insurance premium, the volume of risk is evaluated, which forms the basis of insurance contract.

5. Payment of happening of specified event On happening of specified event, the insurance company is bound to make payment to the insured. Happening of specified event is certain in life insurance, but in the case of fire, marine of accidental insurance, it is not necessary. In such cases, the insurer is not liable for payment of indemnity.

6. Transfer of risk Insurance is a plan in which the insured transfers his risk on the insurer. This may be the reason that may person observes, that insurance is a device to transfer some economic losses would have been borne by the insured themselves.

7. Spreading of risk Insurance is a plan which spread the risk & losses of few people among a largenumber of people. John Magee writes, “Insurance is a plan by which large number of people associates themselves and transfers to the shoulders of all, risk attached to Individuals”.

8. Protection against risks Insurance provides protection against risk involved in life, materials and property. It is a device to avoid or reduce risks.

9. Insurance is not charity Charity pays without consideration but in the case of insurance, premium is paid by the insured to the insurer in consideration of future

payment.

10. Insurance is not a gambling Insurance is not a gambling. Gambling is illegal, which gives gain to one party and loss to other. Insurance is a valid contact to indemnity against losses. Moreover, Insurable interest is present in insurance contracts it has the element of investment also.

11. A contract Insurance is a legal contract between the insurer and insured under which the Insurer promises to compensate the insured financially within the scope of insurance Policy, the insured promises to pay a fixed rate of premium to the insurer.

12. Social device: Insurance is a plan of social welfare and protection of interest of the people. Rieged and miller observe“ insurance is of social nature”.

13. Based upon certain principle: Insurance is a contract based upon certain fundamental principles of insurance, which includes utmost good faith, insurable interest, contribution, indemnity, causa Proxima, subrogation etc, which are operating in the various fields of insurance.

14. Regulation under the law: The government of every country enacts the law governing insurance business So as to regulate, and control its activities for the interest of the people. In India General insurance act 1972 and the life insurance act 1956 are the major enactment in this direction.

15. Insurance is for pure risk only: Pure risks give only losses to the insured, and no profits. Examples of pure Risks are accident, misfortune, death, fire, injury, etc., which are all the sided risks and the ultimate results in loss. Insurance companies issue policies against pure risk only, not against speculative risks.

16. Based on mutual goodwill: Insurance is a contract based on good faith between the parties. Therefore, both the parties are bound to disclose the important facts affecting to the contract before each other. Utmost good faith is one of the important principles of insurance.

Basic Principles of Insurance

1. Nature of contract: Nature of contract is a fundamental principle of insurance contract. An insurance contract comes into existence when one party makes an offer or proposal of a contract and the other party accepts the proposal. A contract should be simple to be a valid contract. The person entering into a contract should enter with

his free consent.

2. Principal of utmost good faith: Under this insurance contract both the parties should have faith over each other. As a client it is the duty of the insured to disclose all the facts to the insurance company. Any fraud or misrepresentation of facts can result into cancellation of the contract.

3. Principle of Insurable interest: Under this principle of insurance, the insured must have interest in the subject matter of the insurance. Absence of insurance makes the contract null and void. If there is no insurable interest, an insurance company will not issue a policy. An insurable interest must exist at the time of the purchase of the insurance. For example, a creditor has an insurable interest in the life of a debtor, A person is considered to have an unlimited interest in the life of their spouse etc.

4. Principle of indemnity: Indemnity means security or compensation against loss or damage. The principle of indemnity is such principle of insurance stating that an insured may not be compensated by the insurance company in an amount exceeding the insured's economic loss. In type of insurance the insured would be compensation with the amount equivalent to the actual loss and not the amount exceeding the loss. This is a regulatory principal. This principle is observed more strictly in property insurance than in life insurance. The purpose of this principle is to set back the insured to the same financial position that existed before the loss or damage occurred.

5. Principal of subrogation: The principle of subrogation enables the insured to claim the amount from the third party responsible for the loss. It allows the insurer to pursue legal methods to recover the amount of loss, For example, if you get injured in a road accident, due to reckless driving of a third party, the insurance company will compensate your loss and will also sue the third party to recover the money paid as claim.

6. Double insurance: Double insurance denotes insurance of same subject matter with two different companies or with the same company under two different policies. Insurance is possible in case of indemnity contract like fire, marine and property insurance. Double insurance policy is adopted where the financial position of the insurer is doubtful. The insured cannot recover more than the actual loss and

cannot claim the whole amount from both the insurers.

7. Principle of proximate cause: Proximate cause literally means the 'nearest cause' or 'direct cause'. This principle is applicable when the loss is the result of two or more causes. The proximate cause means; the most dominant and most effective cause of loss is considered. This principle is applicable when there are series of causes of damage or loss.

1.5 IMPORTANCE OF INSURANCE

1. Assures for financial compensation: Insurance provides financial security to the insured. It gives guarantee of compensation against large financial losses in return of small premium.

2. Reduction of risks: Human beings are exposed to different kinds of financial risks, which may cause large financial losses. It is not possible to eliminate the risks but it can be forecasted and reduced by applying some precautionary measures. Insurance helps in reducing risks by suggesting for pre caution measures on one side and by sharing the losses to a group of person who has agreed to join the common pool.

3. Encouragement to saving and investment: In the insurance agreement, the insured has to pay a certain regular premium to the insurer in return to the compensation of the probable future loss or compensation at old age or compensation after his/her death. Insurance is thus a method of collecting saving from the parties willing to get secured from the financial risks. Hence, it encourages persons to make regular savings.

4. Basis of credit: An insured can easily get loan by pledging insurance policy as a security from the insurance company itself. Besides, financial institutions grant credit facilities on the pledge of the properties which are being insured.

5. Maintains economic stability: Financial risks and uncertainties pushes the entire economy into instability. It is a very bad sign to total business and social sectors. Insurance assures the compensation of the financial losses caused by the specified future events and considerably helps in maintaining economic stability.

6. Promotes business activities: Business sector is more risky sector. The chances of fire in the go down, loss of stocks by theft, explosion in the ship, train or plane etc. are

more frequent in this sector. Insurance takes away these risks and promotes and develops business activities in consideration to a nominal charge i.e premium.

7. Provides employment opportunities: As insurance has become business in the modern day business world, hundreds of entrepreneurs and thousands of employees have been engaging in this line. Hence, by establishing and developing insurance companies, it has provided employment opportunities to thousands of people as per their qualification and calibre.

Benefits of Insurance

Benefit of insurance can be divided into these categories -

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

It can be explained as under -

1. **Benefits to Individual**

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

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

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

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

2 Benefits to Business or Industry

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

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

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

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

3. Benefits to the Society

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

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

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

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

Functions of Insurance

The functions of insurance can be studied into two parts (i) Primary Functions, and (ii) Secondary Functions.

A) Primary Functions

(i) Insurance provides certainty: Insurance provides certainty of payment at the uncertainty of loss. The uncertainty of loss can be reduced by better planning and administration. But, the insurance relieves the person from such difficult task. Moreover, if the subject matters are not adequate, the self provision may prove costlier. There are different types of uncertainty in a risk. The risk will occur or not, when will occur, how much loss will be there? In other words, there are uncertainty of happening of time and amount of loss. Insurance removes all these uncertainty and the assured is given certainty of payment of loss. The insurer charges premium for providing the said certainty.

(ii) Insurance provides protection: The main function of the insurance is to provide protection against the probable chances of loss. The time and amount of loss are uncertain and at the happening of risk, the person will suffer loss in absence of insurance. The insurance guarantees the payment of loss and thus protects the assured from sufferings. The insurance cannot check the happening of risk but can provide for losses at the happening of the risk.

(iii) Risk-Sharing: The risk is uncertain, and therefore, the loss arising from the risk is also uncertain. When risk takes place, the loss is shared by all the persons who are exposed to the risk. The risk-sharing in ancient time was done only at time of damage or death; but today, on the basis of probability of risk, the share is obtained from each and every insured in the shape of premium without which protection is not guaranteed by the insurer.

B) Secondary functions: Besides the above primary functions, the insurance works for the following functions:

(i) Prevention of Loss: The insurance joins hands with those institutions which are engaged in preventing the losses of the society because the reduction in loss causes lesser payment to the assured and so more saving is possible which will assist in reducing the premium. Lesser premium invites more business and more business cause lesser share to the assured. So again premium is reduced to, which will stimulate more business and more protection to the masses. Therefore, the insurance assist financially to the health organisation, fire brigade, educational institutions and other organisations which are engaged in preventing the losses of the masses from

death or damage.
(ii) It Provides Capital: The insurance provides capital to the society. The accumulated funds are invested in productive channel. The dearth of capital of the society is minimised to a greater extent with the help of investment of insurance. The industry, the business and the individual are benefited by the investment and loans of the insurers.
(iii) It Improves Efficiency: The insurance eliminates worries and miseries of losses at death and destruction of property. The carefree person can devote his body and soul together for better achievement. It improves not only his efficiency, but the efficiencies of the masses are also advanced.
(iv) It helps Economic Progress: The insurance by protecting the society from huge losses of damage, destruction and death, provides an initiative to work hard for the betterment of the masses. The next factor of economic progress, the capital, is also immensely provided by the masses. The property, the valuable assets, the man, the machine and the society cannot lose much at the disaster.

1.6 TYPES AND CLASSIFICATIONS OF INSUREANCE

Insurance cover various types of risks and include various insurance policies which provide protection against various losses.
There are two different views regarding classification if insurance:-

I. From the business point of view; and
II From the risk points of view

I. Business Point of View:
The insurance can be classified into three categories from business point of view: (i) Life Insurance, (ii) General Insurance, and (iii) Social Insurance.
(i) Life Insurance: Life Insurance is different from other insurance in the sense that, here, the subject matter of insurance is life of human being. The insurer will pay the fixed amount of insurance at the time of death or at the expiry of certain period. At present, life insurance enjoys maximum scope because the life is the most important property of the society or an individual. Each and every person requires the insurance. This insurance provides protection to the family at the premature death or

gives adequate amount at the old age when earning capacities are reduced. Under personal insurance a payment is made at the accident. The insurance is not only a protection but is a sort of investment because a certain sum is returnable to the insured at the death or at the expiry of a period. The business of life insurance is wholly done by that Life insurance Corporation of India.

(ii) General Insurance : The general insurance includes property insurance, liability insurance and other forms of insurance. Fire and marine insurances are strictly called property insurance. Motor, theft, fidelity and machine insurances include the extent of liability insurance to a certain extent. The strictest form of liability insurance is fidelity insurance, whereby the insurer compensates the loss to the insured when he is under the liability of payment to the third party.

(iii) Social Insurance: The social insurance is to provide protection to the weaker section of the society who is unable to pay the premium for adequate insurance. Pension plans, disability benefits, unemployment benefits, sickness insurance and industrial insurance are the various forms of social insurance. With the increase of the socialistic ideas, the social insurance is an obligatory duty of the nation. The Government of a country must provide social insurance to its masses.

II.Risk Point of View: Insurance is divided into property liability and other form from high point of view

A. Property Insurance: Under the property insurance property of person/persons are insured against a certain specified risk. The risk may be fire or marine perils, theft of property or goods, damage to property at accident.

(a) Marine Insurance: Marine insurance provides protection against loss of marine perils. The marine perils are collision with rock, or ship attacks by enemies, fire and capture by pirates, etc. These perils cause damage, destruction or disappearance of the ship and cargo and non-payment of freight. So, marine insurance insures ship (Hull), cargo and freight. Previously only certain nominal risks were insured but now the scope of marine insurance had been divided into two parts: (i) Ocean Marine Insurance and (ii) Inland Marine Insurance. The former insures only the marine perils while the latter covers inland peril which may arise with the delivery ofcargo (goods) from the godown of the insured and may extend up to the receipt of the cargo by the buyer (importer) at his godown.

(b) Fire Insurance: Fire insurance covers risks of fire. In the absence of fire insurance, the fire waste will increase not only to the individual but to the society as well. With the help of fire insurance, the losses, arising due to fire are compensated and the society is not losing much. The individual is protected from such losses and his property or business or industry will remain approximately in the same position in which it was before the loss. The fire insurance does not protect only losses but it provides certain consequential losses also. War risk, turmoil, riots, etc., can be insured under this insurance, too.

(c) Miscellaneous Insurance: The Property, goods, machine, furniture, automobile, valuable articles, etc., can be insured against the damage or destruction due to accident or disappearance due to theft. There are different forms of insurances for each type of the said property whereby not only property insurance exists but liability insurance and personal injuries are also insured.

B. Liability Insurance:

The general insurance also includes liability insurance thereby the insured is liable to pay the damage of property or to compensate the less of personal injury or death. This insurance is seen in the form of fidelity insurance, automobile insurance and machine insurance, etc.

C. Other Forms:

Besides the property and liability insurances, there are certain other insurances which are included under general insurance. The examples of such insurances are export-credit insurances, State employees insurance, etc., whereby the insurer guarantees to pay certain amount at the certain events. This insurance is extending rapidly these days.

1. Personal Insurance: The personal insurance includes insurance of human life which may suffer loss due to death, accident and disease. Therefore, the personal insurance is further sub-classified into life insurance, personal accident insurance and health insurance.

2. Property Insurance: The property of an individual and of the society is insured against the loss of fire and marine perils, the crop is insured against unexpected decline in production, unexpected death of the animals engaged in business, break-down of machines and theft of the property and goods.

3. Liability Insurance: The liability insurance covers the risks of third party, compensation to employees, liability of the automobile owners and reinsurances.

4. Guarantee Insurance: The guarantee insurance covers the loss arising due to dishonesty, disappearance and disloyalty of the employers or second. The party must be a party of the contract. His failure causes loss to the first party. For example, in export insurance, the insurer will compensate the loss at the failure of the importers to pay the amount of debt.

1.7 BREIF INTRODUCTION TO IRDA 1999

Introduction: Regulation of Insurance Business in India

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

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

The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The

Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests.

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

Today there are 24 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 23 life insurance companies operating in the country.

Beside IRDA Act and Insurance Act, 1938, there are some common Act/Regulation to the General and Life Insurance Business in India and some Acts have been made for specific requirement of Life Insurance/General Insurance

Acts/Regulations common to General and Life Insurance Business in India

The following Acts regulate the Insurance Business in India.

Insurance Act, 1938

IRDA Act, 1999

Insurance Amendment Act, 2002

Exchange Control Regulations (FEMA)

Insurance Co-op Society

Indian Stamp Act, 1899

PP-IL&P 58

Consumer Protection Act, 1986

Insurance Ombudsman

Regulations governing/ affecting Life Insurance Business in India

The following Acts govern /regulate the life insurance business in India.

LIC Act, 1956

Amendments to LIC Act

Regulations Affecting General Insurance Business in India

The following Acts affect, circumscribe or regulate in some way or the other, some aspect of the General Insurance Business in India.

General Insurance Nationalization Act, 1972

Amendments to GIN Act, 1972

Multi-Modal Transportation Act, 1993

Motor Vehicles Act. 1988

Inland Steam Vessels Amendment Act, 1977

Marine Insurance Act, 1963

Carriage of Goods by Sea Act, 1925

Merchant Shipping Act, 1958

Bill of Lading Act, 1855

Indian Ports (Major Ports) Act, 1963

Indian Railways Act, 1989

Carriers Act, 1865

Indian Post Office Act, 1898

Carriage by Air Act, 1972

Workmen's' Compensation Act, 1923ESI Act, 1948

Public Liability Insurance Act. 1991

Why Regulation of Insurance Businesses is required?

Any industry wherein the stakes of the public are high would come within the purview of a Regulation – reason being that failure of such companies could result in serious implications on the economy of the country at large.

Insurance business involves collection of money from various Policyholders, investing them properly, honouring the obligations of the Policyholders and providing an efficient service. It is important to ensure that the entities providing these services stick to their commitments. Failure to honour commitments by such entities could have major repercussions on the financial services industry.

After liberalisation and entrance of Private players in Insurance business and Seeing the large numbers of customers and high risk potential, Government of India constituted the Insurance Regulatory and Development Authority in Year 1999.

Insurance Regulatory and Development Authority (IRDA) is an autonomous apex statutory body which regulates and develops the insurance industry in India. It was constituted by a parliament of India act called Insurance Regulatory and Development Authority Act, 1999 and duly passed by the government of India .The agency operates its headquarters at Hydrabad, Andhra Pradesh where it shifted from Delhi in 2001. Promote and ensure orderly growth of the insurance business and re-insurance business. IRDA issue the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration and Protect 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. Further, it regulates investment of funds by insurance companies, regulating maintenance of margin of solvency, adjudication of disputes between insurers and intermediaries or insurance intermediaries. The IRD Act has established the Insurance Regulatory and Development Authority ("IRDA" or "Authority") as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies. The IRDA Act also carried out a series of amendments to the Act of1938 and conferred the powers of the Controller of Insurance on the IRDA. The members of the IRDA are appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration etc. The Authority consists of a chairperson, not more than five whole-time members and not more than four part-time members. Every Chairperson and member of IRDA appointed shall hold office for a term of five years. However, Chairperson shall not hold office once he or she attains 65 years while whole time members shall not hold office beyond 62 years. Central Government may remove any member from office if he or she is adjudged insolvent or is physically or mentally incapacitated or has been convicted of an offence involving moral turpitude or has acquired financial or other interests or has abused his position. Chairperson and the whole time members shall not for a period of two years from the date of cessation of office in IRDA, hold office as an employee with Central Government or any State Government or with any company in the insurance sector.

IRDA has played a very important role in the growth and development of the sector by protecting policyholders' interests; registering and regulating insurance companies; licensing and establishing norms for insurance intermediaries, regulating and overseeing premium rates and terms of non-life insurance covers; specifying financial reporting norms, regulating investment of policyholders' funds and ensuring the maintenance of solvency margin by insurance companies; ensuring insurance coverage in rural areas and of vulnerable sections of society; promoting professional organisations connected with insurance and all other allied and development functions. The IRDA Bill was passed in December 1999 and became an Act in April 2000. In July 2000, immediately after the first meeting of the Insurance Advisory Committee, 11 essential regulations relevant for players entering the Indian market were notified.

Constitution of Insurance Regulatory and Development Authority

The IRD Act has established the Insurance Regulatory and Development Authority ("IRDA" or "Authority") as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of holders of insurance policies. The IRDA Act also carried out a series of amendments to the Act of1938 and conferred the powers of the Controller of Insurance on the IRDA. The members of the IRDA are appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration etc. The Authority consists of a chairperson, not more than five whole-time members and not more than four part-time members.

Every Chairperson and member of IRDA appointed shall hold office for a term of five years. However, Chairperson shall not hold office once he or she attains 65 years while whole time members shall not hold office beyond 62 years.

Central Government may remove any member from office if he or she is adjudged insolvent or is physically or mentally incapacitated or has been convicted of an offence involving moral turpitude or has acquired financial or other interests or has abused his position. Chairperson and the whole time members shall not for a period of two years from the date of cessation of office in IRDA, hold office as an employee with Central Government or any State Government or with any company in the insurance sector. The IRDA is a ten member body appointed by the Government of India consisting of :

- Chairman
- Five whole-time members
- Four part-time members

Powers /Functions of IRDA

Under Section 14 of the IRDA Act, IRDA has the following powers:

(a) Issue of Certificate of Registration to insurance companies, renew, modify, withdraw, suspend or cancel the certificate of registration

(b) Protection of interests of policyholders in matters concerning assignment of policies, nomination, insurable interest, claim settlement, surrender value and other terms and conditions of insurance contract

(c) Specification of requisite qualifications, practical training and code of conduct for insurance agents and intermediaries

(d) Specification of code of conduct for surveyors and loss assessors

(e) Promoting efficiency in the conduct of insurance business

(f) Promoting and regulating professional organizations connected with insurance and reinsurance business

(g) Levying fees and other charges for carrying out the purposes of the Act

(h) Calling for information from or undertaking inspection of insurance companies, intermediaries and other oganisations connected with insurance business

(i) Control and regulation of rates, advantages, terms and conditions that may be offered by general insurance companies

(j) Specifying the form and manner in which books of account shall be maintained by insurance companies and intermediaries

(k) Regulation of investments of funds by insurance companies

(l) Regulation of maintenance of margin of solvency

(m) Adjudication of disputes between insurers and insurance intermediaries

(n) Supervising the functioning of Tariff Advisory Committee

(o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations

(p) Specifying the percentage of insurance business to be undertaken by insurers in rural or social sectors

(q) Such other powers as may be prescribed.

Thus, the growth Performance of the insurance industry has been increased tremendously since the establishment of IRDA in India, which supervise and controlled the entire insurance industry. The increase in no. of insurer both in life and non-life, growth in insurance penetration and density, increase in no. of policies issued and increase in the speed of claims settlement and in many more aspects the IRDA is playing a prominent role in the Indian insurance sector.

1.8 SUMMARY

Insurance is defined as a co-operative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to ensure themselves against that risk. Risk is uncertainty of a financial loss. It should not be confused with the chance of loss which is the probable number of losses out of a given number of exposures. It should not be confused with peril which is defined as the cause of loss or with hazard which is a condition that may increase the chance of loss. Finally, risk must not be confused with loss itself which is the unintentional decline in or disappearance of value arising from a contingency. Wherever there is uncertainty with respect to a probable loss there is risk. Every risk involves the loss of one or other kind. The function of insurance is to spread the loss over a large number of persons who are agreed to co-operate each other at the time of loss. The risk cannot be averted but loss occurring due to a certain risk can be distributed amongst the agreed persons. They are agreed to share the loss because the chances of loss, i.e., the time, amount, to a person are not known. Anybody of them may suffer loss to a given risk, so, the rest of the persons who are agreed will share the loss. The larger the number of such persons the easier the process of distribution of loss, In fact; the loss is shared by them by payment of premium which is calculated on the probability of loss. In olden time, the contribution by the persons was made at the time of loss. The insurance is also defined as a social device to accumulate funds to meet the uncertain losses arising through a certain risk to a person insured against the risk.

1.9 GLOSSARY

Insured sum: The sum for which the risk is insured is called the insured sum, or the policy money or the face value of the policy. This is the maximum liability of the insurer towards the insured.

Peril: A peril is an event that causes a personal or property loss by fire, windstorm, explosion, collision premature death, sickness, floods, dishonesty etc.

Hazard: Hazard is a condition that may create, increase or decrease the chances of loss from a given peril.

Exposure: An exposure is a measure of physical extent of the risk. An individual who owns a business house may be subjected to economic loss and individual loss because of his business and personal exposure.

Cover note: An unstamped document issued by or on behalf of insurers as evidence of insurance pending issue of policy.

1.10 SELF ASSESSMENT QUESTIONS

1. What is insurance? Explain its basic nature.

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2. Discuss the benefits of insurance.

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3. Discuss the importance of insurance.

4. Explain the functions of IRDA

5. Explain the various types of insurance.

1.11 SUGGESTED READING

- Ghansham Panda : Principles of Insurance, Kalyani Publishing House, New Delhi
- M.N Mishra & S.B Mishra: Insurance Principles and Practice, S. Chand, New Delhi
- P.K Gupta: Fundaments of Insurance, Himalya Pub., New Delhi
- Rajeda: Principles of Risk Management and Insurance, Pearson Pub., New Delhi
- R.C Gupta & T.C Jain: Insurance and Risk Management, Alpha Pub., New Delhi

RISK MANAGEMENT

STRUCTURE

2.1 INTRODUCTION

The entire business process has to face number of risks and uncertainties. Uncertainty comes from changes in economic, social and political trends. In business and also in real life, those are dangers and risks of every kind. The concept of risk may be defined as the possibility of unfavourable results following any occurrence. Risk arise due to uncertainties in regard to cost, loss or damage. The loss or damage may be related to financial loss or non-financial loss. The term uncertainty used to indicate instructions where the possibility of occurrence of a result, which is not quantifiable, so that it not possible to insure against uncertainty.

The International Risk Management Standard AS/NZS ISO 31000:2009 (the

Standard) provides the principles and guidelines for risk management. According to the Standard, “the success of risk management will depend on the effectiveness of the management framework providing the foundations and arrangements that will embed it throughout the organisation at all levels.” Within the Standard the expressions, 'risk management' and 'managing risks', are both used. In general terms risk management refers collectively to the principles, framework and process for managing risks effectively, and managing risks refers to the application of these principles, framework and process to particular risks.

Insurance has become an increasingly important part of developed economies, as a financial mechanism for individuals and organizations—including critical infrastructure owners and operators—to manage risks. A risk, as defined by the insurance industry, consists of three components—hazard, vulnerability, and exposure—all of which can change over time.9 Many critical infrastructure risks are covered by the insurance industry, providing financial compensation mechanisms against selected risks. Risk management is not about removing all risk, but about operating at an acceptable or optimal level of risk; hence, through insurance, owners and operators can choose to manage risks in three ways—accepting, mitigating, or transferring them.

2.2 OBJECTIVES

After reading this lesson, you should be able:

- To know the concept of risk.
- To know the process of risk management.
- To know the classification of risk.
- To know the risk finance and transfer of risk.

2.3 CONCEPT OF RISK

Risk is part of every human endeavour. From the moment we get up in the morning, drive or take public transportation to get to school or to work until we get back into our beds (and perhaps even afterwards), we are exposed to risks of different degrees.

What makes the study of risk fascinating is that while some of this risk bearing may not be completely voluntary, we seek out some risks on our own (speeding on the highways or gambling, for instance) and enjoy them. While some of these risks may seem trivial, others make a significant difference in the way we live our lives. On a loftier note, it can be argued that every major advance in human civilization, from the caveman's invention of tools to gene therapy, has been made possible because someone was willing to take a risk and challenge the status quo.

Risk is the potential of loss (an undesirable outcome, however not necessarily so) resulting from a given action, activity and/or inaction. The notion implies that a choice having an influence on the outcome sometimes exists (or existed). Potential losses themselves may also be called "risks". Any human endeavor carries some risk, but some are much riskier than others.

Risk can be defined in seven different ways

1. The probability of something happening multiplied by the resulting cost or benefit if it does.
2. The probability or threat of quantifiable damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through pre-emptive action.

'Risk, in insurance terms, is the possibility of a loss or other adverse event that has the potential to interfere with an organization's ability to fulfil its mandate, and for which an insurance claim may be submitted'.

What is risk management?

Risk management ensures that an organization identifies and understands the risks to which it is exposed. Risk management also guarantees that the organization creates and implements an effective plan to prevent losses or reduce the impact if a loss occurs.

A risk management plan includes strategies and techniques for recognizing and confronting these threats. Good risk management doesn't have to be expensive or time consuming; it may be as uncomplicated as answering these three questions:

1. What can go wrong?

2. What will we do, both to prevent the harm from occurring and in response to the harm or loss?

3. If something happens, how will we pay for it?

Risk management provides a clear and structured approach to identifying risks. Having a clear understanding of all risks allows an organization to measure and prioritize them and take the appropriate actions to reduce losses. Risk management has other benefits for an organization, including:

- Saving resources: Time, assets, income, property and people are all valuable resources that can be saved if fewer claims occur.
- Protecting the reputation and public image of the organization.
- Preventing or reducing legal liability and increasing the stability of operations.
- Protecting people from harm.
- Protecting the environment.
- Enhancing the ability to prepare for various circumstances.
- Reducing liabilities.
- Assisting in clearly defining insurance needs.

An effective risk management practice does not eliminate risks. However, having an effective and operational risk management practice shows an insurer that your organization is committed to loss reduction or prevention. It makes your organization a better risk to insure.

Risk management is concerned with the conversion of a firms assets and earning power against risks of accidental loss. Risk management may be defined as "the identification, analysis and economic control of those risks which can threaten the assets or earning capacity of an enterprise".

Features of Risk Management:- Risk management has the following features :

a) Risk management is a scientific approach to the problem of dealing with only pure risks and not any other risks faced by an individual or business.

b) Risk management gives importance to insurable and uninsurable risks and to me suitable techniques for problems dealing with all pure risks.

c) It mainly emphasizes reducing the cost of handling risk by using appropriate methods.

Importance of Risk Management

Risk management is of vital importance in the day to day business and human activities. It is essential for not only prevention of risks but also for reduction of risks. It provides maximum social advantage. It plays a significant role in bringing about social political and economic development of a country. The importance of risk management is given as follows.

1. To evacuate the risks of business.
2. To effective handling of priding the risk, monitoring and insuring against risk.
3. To introduce various plans and techniques to minimise the risks.
4. To give advice and make suggestions for handling the risks, and
5. To create awareness about risks among the people.

Objective of Risk Management

Following are the important objectives of risk management:

a) Protecting employees from accident is an important objective of risk management.

b) Due attention gives on cost of handling risks

c) Effective utilization of resources, and

d) Maintaining good relations with society and public

Insurance and Risk Management

Generally, the insurance management function is limited to property insurance, liability insurance, workmen's compensation insurance and suretyship. However, some firms include their programs for pension, group life, hospitalization etc., with in the duties of the insurance manager. The insurance executives must understand and negotiate an almost limitless number of forms of insurance of which the following are among the most important.

(1) Automobile Insurance: Numerous forms of policies are available covering automobile bodily injury and property damage, automobile collision insurance, comprehensive liability, non-ownership liability against liability from operation by others etc.

(2) Marine Insurance: Probably, the oldest form of insurance. This covers merchandise being carried by ocean-going vessels on a per voyage basis, or an open form that covers all voyage and all shipments, blanket.

(3) Power Plant Insurance; This title applies to almost any type of power plant equipment or appliances including steam, electric, internal combustion, and refrigeration, and insures against accident or breakdown.

(4) Workmen's Compensation Insurance: A form to comply with compulsory Workmen's Compensation Acts. It is statutory in form and varies by state.

(5) Valuable Papers Insurance: This form of insurance provides all risks coverage on valuable papers, usually on an agreed amount basis.

(6) Export Credit Insurance: Covers agreed percentage of loss sustained because of insolvency of firms to whom the assured has extended credit, and based on that credit, exported merchandise or services to them.

(7) Fire Legal Liability Insurance: Coverage against liability of the P* firm for damage to property of other caused by the fire, including P property in the care, custody or control of the insured.

(8) Employer's Liability Insurance: Provides for the protection for the firm against liability arising out of injury to employees apart from that imposed by the Workmen's Compensation Laws.

2.4 CLASSIFICATION OF RISKS

With regards insurability, there are basically two categories of risks;

I. Speculative or dynamic risk; and

II. Pure or static risk

I Speculative or Dynamic Risk

Speculative (dynamic) risk is a situation in which either profit OR loss is possible. Examples of speculative risks are betting on a horse race, investing in stocks/bonds and real estate. In the business level, in the daily conduct of its affairs, every business establishment faces decisions that entail an element of risk. The decision to venture into a new market, purchase new equipments, diversify on the existing product line, expand or contract areas of operations, commit more to advertising, borrow additional capital, etc., carry risks inherent to the business. The outcome of such speculative risk is either beneficial (profitable) or loss. Speculative risk is uninsurable.

II Pure or Static Risk

The second category of risk is known as pure or static risk. Pure (static) risk is a situation in which there are only the possibilities of loss or no loss, as oppose to loss or profit with speculative risk. The only outcome of pure risks are adverse (in a loss) or neutral (with no loss), never beneficial. Examples of pure risks include premature death, occupational disability, catastrophic medical expenses, and damage to property due to fire, lightning, or flood. It is important to distinguish between pure and speculative risks for three reasons. First, through the use of commercial, personal, and liability insurance policies, insurance companies in the private sector generally insure only pure risks. Speculative risks are not considered insurable, with some exceptions.

Second, the law of large numbers can be applied more easily to pure risks than to speculative risks. The law of large numbers is important in insurance because it enables insurers to predict loss figures in advance. It is generally more difficult to apply the law of large numbers to speculative risks in order to predict future losses. One of the exceptions is the speculative risk of gambling, where casinos can apply the law of large numbers in a very efficient manner.

Finally, society as a whole may benefit from a speculative risk even though a loss occurs, but it is harmed if a pure risk is present and a loss occurs. For instance, a computer manufacturer's competitor develops a new technology to produce faster computer processors more cheaply. As a result, it forces the computer manufacturer into bankruptcy. Despite the bankruptcy, society as a whole benefits since the competitor's computers work faster and are sold at a lower price. On the other hand, society would not benefit when most pure risks, such as an earthquake, occur.

OTHER RISKS

Besides insurability, there are other classifications of Risks. Few of them are discussed below:

I Fundamental Risks and Particular Risks

Fundamental risks affect the entire economy or large numbers of people or groups within the economy. Examples of fundamental risks are high inflation, unemployment, war, and natural disasters such as earthquakes, hurricanes, tornadoes, and floods. Particular risks are risks that affect only individuals and not the entire community. Examples of particular risks are burglary, theft, auto accident, dwelling fires. With particular risks, only individuals experience losses, and the rest of the community are left unaffected.

The distinction between a fundamental and a particular risk is important, since government assistance may be necessary in order to insure fundamental risk. Social insurance, government insurance programs, and government guarantees and subsidies are used to meet certain fundamental risks in our country. For example, the risk of unemployment is generally not insurable by private insurance companies but can be insured publicly by federal or state agencies. In addition, flood insurance is only available through and/or subsidized by the federal government.

II Subjective Risk

Subjective risk is defined as uncertainty based on a person's mental condition or state of mind. For example, assume that an individual is drinking heavily in a bar and attempts to drive home after the bar closes. The driver may be uncertain whether he or she will arrive home safely without being arrested by the police for drunken driving. This mental uncertainty is called subjective risk.

III Objective Risk

Objective risk is defined as the relative variation of actual loss from expected loss. For example, assume that a fire insurer has 5000 houses insured over a long period and, on an average, 1 percent, or 50 houses are destroyed by fire each year. However, it would be rare for exactly 50 houses to burn each year and in some years, as few as 45 houses may burn. Thus, there is a variation of 5 houses from the expected number of 50, or a variation of 10 percent. This relative variation of actual loss from expected loss is known as objective risk. Objective risk declines as the number of exposures increases. More specifically, objective risk varies inversely with the square root of the number of cases under observation. Now assume that 5 lacs instead 5000 houses are insured. The expected number of houses that will burn is now 5000, but the variation of actual loss from expected loss is only 50. Objective risk is now 50/5000, or 1 percent.

Objective risk can be statistically measured by some measure of dispersion, such as the standard deviation or coefficient of variation. Since objective risk can be measured, it is an extremely useful concept for an insurance company or a corporate risk manager.

As the number of exposures increases, the insurance company can predict its future loss experience more accurately because it can rely on the "Law of large numbers." The law of large numbers states that as the number of exposure units increase, the more closely will the actual loss experience approach the probable loss experience. For example, as the number of homes under observation increases, the greater is the degree of accuracy in predicting the proportion of homes that will burn.

IV Static Risks

Static risks are risks connected with losses caused by the irregular action of nature or by the mistakes and misdeeds of human beings. Static risks are the same as pure risks and would, by definition, be present in an unchanging economy.

V Dynamic Risk

Dynamic risks are risks associated with a changing economy. Important examples of dynamic risks include the changing tastes of consumers, technological change, new methods of production, and investments in capital goods that are used to produce new and untried products.

Static and dynamic risks have several important differences –

(a) Most static risks are pure risks, but dynamic risks are always speculative risks where both profit and loss are possible.

(b) Static risks would still be present in an unchanging economy, but dynamic risks are always associated with a changing economy.

(c) Dynamic risks usually affect more individuals and have a wider impact on

society than do static risks.
(d) Dynamic risks may be beneficial to society but static risks are always harmful.

VI Financial and Non-financial Risks

A financial risk is one where the outcome can be measured in monetary terms. This is easy to see in the case of material damage to property, theft of property or lost business profit following a fire. In cases of personal injury, it can also be possible to measure financial loss in terms of a court award of damages, or as a result of negotiations between lawyers and insurers. In any of these cases, the outcome of the risky situation can be measured financially.

There are other situations where this kind of measurement is not possible. Take the case of the choice of a new car, or the selection of an item from a restaurant menu. These could be construed as risky situations, not because the outcome will cause financial loss, but because the outcome could be uncomfortable or disliked in some other way. We could even go as far as to say that the great social decisions of life are examples of non-financial risks: the selection of a career, the choice of a marriage partner, having children. There may or may not be financial implications, but in the main the outcome is not measurable financially but by other, more human, criteria.

Insurance is primarily concerned with risks that have a financially measurable outcome. But not all risks are capable of measurement in financial terms. One example of a risk that is difficult to measure financially is the effect of bad publicity on a company - consequently this risk is very difficult to insure.

However, this is a good point to stress how innovative some insurers are in that they are always looking for ways to provide new covers, which the customers want. The difficult part is to be innovative and still make a profit.

2.5 PROCESS OF RISK MANAGEMENT

Principles of Risk Insurance Management

'These principles of risk insurance management have been discussed

1. Principles of Risk Identification: Proper identification of risk is essential to

achieve the several objectives of risk management such as preserving the operating effectiveness of the organization, minimizing the cost of handling risk etc. Without proper identification of risk, a firm's operations have no meaning and direction. The success of the risk insurance management depends on proper risk identification.

2. Principles of Risk Analysis: The risk manager should select various statistical tools to analyze the identified risk on the basis of principles of analysis in order to achieve the objectives of risk management. Analysis of a risk is necessary not only to know the level of severity of risk, but also to determine the accuracy and relevance of risk exposure at each stage.

3. Principles of Risk Assessment: Necessary steps are to be taken by the executives in order to make an assessment of cost of risk. This is essential to keep reducing the cost of risk within control.

4. Principles of Taking Corrective Decision: Corrective decision is an integral part of the risk manager's job. In risk management, decision making is a process involving information, choice of alternative actions, to the achievement of certain stated goals.

5. Principles of Alternative Course of Action: The final choice from among the several alternatives will be based on how efficiently the risk manager's chosen alternative will produce results which come up to the desired level. In some cases, the decision as regards the final alternative will be objective, but in a majority of cases it is subjective, based on the Majority of cases are subjective based on the value judgement of the risk manager concerned. 6. Principles of Risk Control: Effective control provides the yardstick measure the effectiveness of performance at various levels of handling risk to achieve the risk management objectives, various financial mechanisms can be used to control risk. This is essential to keep the cost of risk within control.

7. Principles of Risk Retention: This principle provides a valuable frame work within which managers may make their decisions. When the risk has been identified, the risk manager can look to the principles of risk retention, as to how the effects are to be financed. For example, loss on account of faulty production planning can be improved by developing new technologies. High production cost may be minimized

by effective control system.

8. Principles of Risk Transfer: Principles of risk transfer help to analyze the transfer of financial effect of risk to another party. Generally, business people are unwilling to bear such risks which create losses to the firm and so want to transfer them. Many natural risks or losses can be avoided through insurance.

2.5.1 IDENTIFICATION AND EVALUATION OF RISK

Risk identification: considered as the fundamental step to detect the uncertain events that can upset the good working order in the supply chain. − Risk assessment: is necessary step for selection of suitable corrective actions for the risk identified, it refers to assignment the probability of occurrence of the events. In the end of this step, the risks can be classified in very unlikely event, improbable event, moderate event, probable event, very probable event

2.5.2 RISK ANALYSIS

Risk Analysis is the process of identifying, analyzing and communicating the major risks. Risk analysis is the estimation of the risk associated with the identified hazards. It is the qualitative or quantitative process of linking the likelihood of occurrence and severity of harms. In some risk management tools, the ability to detect the harm (detectability) also factors in the estimation of risk. Risk analysis involves risk assessment, risk management and risk communication.

Risk assessment consists of the identification of hazards and the analysis and evaluation of risks associated with exposure to those hazards. Quality risk assessments begin with a well-defined problem description or risk question. When the risk in question is well defined, an appropriate risk management tool and the types of information that will address the risk question will be more readily identifiable. As an aid to clearly defining the risk(s) for risk assessment purposes, three fundamental questions are often helpful:

1. What might go wrong?
2. What is the likelihood (probability) it will go wrong?

3. What are the consequences (severity)?

Risk communication is the sharing of information about risk and risk management between the decision makers and others. Parties can communicate at any stage of the risk management process. The output/result of the quality risk management process should be appropriately communicated and documented. Communications might include those among interested parties (e.g., regulators and industry; industry and the patient; within a company, industry, or regulatory authority). The included information might relate to the existence, nature, form, probability, severity, acceptability, control, treatment, delectability, or other aspects of risks to quality. Communication need not be carried out for each and every risk acceptance. Between the industry and regulatory authorities, communication concerning quality risk management decisions might be effected through existing channels as specified in regulations and guidances.

2.5.3 RISK CONTROL

Risk control includes decision making to reduce and/or accept risks. The purpose of risk control is to reduce the risk to an acceptable level. The amount of effort used for risk control should be proportional to the significance of the risk. Decision makers might use different processes, including benefit-cost analysis, for understanding the optimal level of risk control. Once risk and identified and analyzed, it is important to plan and adopt a suitable strategy for controlling the risk. Risk planning and controlling is the stage which comes after the risk analysis process is over.

There are five major methods of handling and controlling risk.

(a) Risk avoidance;

(b) Risk retention;

(c) Risk transfer;

(d) Loss control; and

(e) Insurance.

Risk Avoidance

Risk avoidance is one method of handling risk. For example, you can avoid the risk of being pick pocketed in Metropolitan cities by staying out of them; you can avoid the risk of divorce by not marrying; a career employee who is frequently transferred can avoid the risk of selling a house in a depressed real estate market by renting instead of owning; and a business firm can avoid the risk of being sued for a defective product by not producing the product.

But as a practical matter, not all risks can or even should be avoided. For example, you can avoid the risk of death or disability in a plane crash by refusing to fly. But is this practical and desirable? The alternatives are not appealing. You can drive or take a bus or train, all of which take considerable time and often involve great fatigue. Although the risk of a plane crash is present, the safety record of commercial airlines is excellent, and flying is a reasonable risk to assume. Or one may wish to avoid the risk of business failure by refusing to go into business for oneself. But a person may have the necessary skills and capital to be successful in business, and risk avoidance may not be the best approach for him to follow in this case.

Risk Retention

Risk retention is a second method of handling risk. An individual or a business firm may retain all or part of a given risk. Risk retention can be either active or passive.

Active Risk Retention

Active risk retention means that an individual is consciously aware of the risk and deliberately plans to retain all or part of it. For example, a motorist may wish to retain the risk of a small collision loss by purchasing an own damage insurance policy with a Rs. 2,000 voluntary excess. A homeowner may retain a small part of the risk of damage to the house by purchasing a Householders policy with substantial voluntary excess. A business firm may deliberately retain the risk of petty thefts by employees, shoplifting, or the spoilage of perishable goods. Or a business firm may use risk retention in a self-insurance program, which is a special application of risk retention. In these cases, the individual or business firm makes a conscious decision to retain part or all of a given risk. Active risk retention is used for two major reasons. First, risk retention can save money. Insurance may not be purchased at all, or it may be purchased with voluntary excesses; either way, there is often a substantial saving in the cost of insurance. Second, the risk may be deliberately retained because commercial insurance is either unavailable or can be obtained only by the payment of prohibitive premiums. Some physicians, for example, practice medicine without professional liability insurance because they perceive the premiums to be inordinately high.

Passive Risk Retention

Risk can also be retained passively. Certain risks may be unknowingly retained because of ignorance, indifference, or laziness. This is often dangerous if a risk that is retained has the potential for destroying a person financially. For example, many persons with earned incomes are not insured against the risk of long-term disability under either an individual or group disability income plan. However, the adverse financial consequences of a long-term disability generally are more severe than premature death. Thus, people who are not insured against the risk of long-term disability are using the technique of risk retention in a most dangerous and inappropriate manner.

In summary, risk retention can be an extremely useful technique for handling risk, especially in a modern corporate risk management program. Risk retention, however, is appropriate primarily for high frequency, low severity risks where potential losses are relatively small. Except under unusual circumstances, an individual should not use the technique of risk retention to retain low frequency, high severity risks, such as the risk of catastrophic losses like earthquake and floods.

Loss Control

Loss control is another important method for handling risk. Loss control consists of certain activities undertaken to reduce both the frequency and severity of losses. Thus, loss control has two major objectives:

(a) Loss prevention.

(b) Loss reduction.

Loss prevention

Loss prevention aims at reducing the probability of loss so that the frequency of losses is reduced. Several examples of personal loss prevention can be given.

Automobile accidents can be reduced if motorists pass a safe driving course and drive defensively. Dropping out of college can be prevented by intensive study on a regular basis. The number of heart attacks can be reduced if individuals watch their weight, give up smoking, and follow good health habits.

Loss prevention is also important for business firms. For example, a boiler explosion can be prevented by periodic inspections by a safety engineer; occupational accidents can be reduced by the elimination of unsafe working conditions and by strong enforcement of safety rules; and fire can be prevented by forbidding workers to smoke in an area where highly flammable materials are being used. In short, the goal of loss prevention is to prevent the loss from occurring.

Loss reduction

Although stringent loss prevention efforts can reduce the frequency of losses, some losses will inevitably occur. Thus, the second objective of loss control is to reduce the severity of a loss after it occurs. For example, a warehouse can install a sprinkler system so that a fire is promptly extinguished, thereby reducing the loss; highly flammable materials can be stored in a separate area to confine a possible fire to that area; a plant can be constructed with fire resistant materials to minimize a loss; and fire doors and fire walls can be used to prevent a fire from spreading.

Loss control-Ideal method for handling risk

From the viewpoint of society, loss control is the ideal method for handling risk. This is true for two reasons. First, the indirect costs of losses may be large, and in some instances, they can easily exceed the direct costs. For example, a worker may be injured on the job. In addition to being responsible for the worker's medical expenses and a certain percentage of earnings (direct costs), the firm may also incur sizeable indirect costs: a machine may be damaged and must be repaired; the assembly line may have to be shut down; costs are incurred in training a new worker to replace the injured worker; and a contract may be cancelled because goods are not shipped on time. By preventing the loss from occurring, both indirect costs and direct costs are reduced.

Second, the social costs of losses must also be considered. For example, assume that the worker in the preceding example dies from the accident. Substantial social costs are incurred because of the death. Society is deprived forever of the goods and services that the deceased worker could have produced. The worker's family loses its share of the worker's earnings and may experience considerable grief and financial insecurity. And the worker may personally experience great pain and suffering before he or she finally dies. In short, these social costs can be reduced through an effective loss control programme.

2.5.4 Risk Financing

Risk financing is the determination of how an organization will pay for loss events in the most effective and least costly way possible. Risk financing involves the identification of risks, determining how to finance the risk and monitoring the effectiveness of the financing technique that is chosen.

Risk financing is designed to help a business align its desire to take on new risks in order to grow, with its ability to pay for those risks. Businesses must weigh the potential costs of their actions and whether the action will help the business reach its objectives. The business will examine its priorities in order to determine whether it is taking on the appropriate amount of risk in order to reach its objectives, whether it is taking the right types of risks, and whether the costs of these risks are being accounted for financially.

Companies have a variety of options when it comes to protecting themselves from risk. Commercial insurance policies, captive insurance, self-insurance, and other alternative risk transfer schemes are available, though the effectiveness of each depends on the size of the organization, the organization's financial situation, the risks that the organization faces and the organization's overall objectives. Risk financing seeks to choose the option that is the least costly, but it also must ensure the organization has the financial resources available to continue its objectives after a loss event occurs.

The process for determining risk financing typically involves a company forecasting the losses that they expect to experience over a period of time and then determining the net present value of the costs associated with the different risk financing alternatives available to them. Each option is likely to have different costs, depending on the risks that need coverage, the loss development index that is most applicable to the company, the cost of maintaining a staff to monitor the program and any consulting, legal, or external experts that are needed.

Risk Financing Measures:

It is a set of actions or activities conducted with the sole aim of meeting an individual's or an organizations' Risk Financing Goals.

Following are some of the main Risk Financing Measures:

Guaranteed Cost Insurance: This options references to those insurance policies in which premium and limits are defined in advance. This type of insurance is funded risk transfer measure. These type of insurance typically designed to cover property, liability, personnel, net income loss exposures. Some of the benefits includes claims-handling and liability claim defense that comes packaged with these type of insurance.

Self Insurance: It can also be described as an informal retention plan. Under this option an organization would pay for potential losses through its own cash flow or liquid assets. There is no formal payment procedure or method of recording losses. It may only be suitable for those losses that have to be paid over time because under this option, organization gets benefit of better cash flow (as compared to guaranteed cost insurance) specially if the loss category is retained. This may be suitable for high frequency but low severity loss exposures. In US, not all states allow self insurance in all loss exposure categories and as such each organization may need to understand the state it operates in and may need to get qualified before this option is feasible.

Large deductible options: This option is similar to Self Insurance with Excess Coverage Insurance. This allows for a lower cost of premium and protection against high severity losses.

Captives: Captive is a subsidiary firm formed to insure loss exposure of its parent company and parents affiliates. A Captive firms requires and investment of capital (by its parents) to have the ability to pay for the losses as well as to pay for its operation expenses (accounting, auditing, legal and underwriting). There are several types of group captives (Single Captive, Group Captive or special types such as Risk Retention Group, Rent-A-Captive or Protected Cell Company)

Finite Risk Insurance Plans: Finite Risk Insurance plans differs from Guaranteed Cost Insurance plan in the sense that a large percentage of the insured's premium under this agreement is used to create a fund to pay for insured's own losses. Rest of the premium is used to transfer a limited portion of risk of loss to an insurer. It is also unique in the sense that insurer shares a large percentage of its profit from the plan.

Pools

Retrospective Rating Plans

Hold-harmless agreements

Capital Market Solutions

2.5.5 TRANSFER OF RISK

Risk transfer is another technique for handling risk. Risks can be transferred by several methods, among which are the following:

(a) Transfer of risk by contracts;

(b) Hedging price risks; and

(c) Conversion to Public Limited Company.

Transfer of risk by contracts

Unwanted risks can be transferred by contracts. For example, the risk of a defective television or stereo set can be transferred to the retailer by purchasing a service contract, which makes the retailer responsible for all repairs after the warranty expires. The risk of a substantial increase in rent can be transferred to the landlord by a long-term lease. The risk of a substantial price increase in construction costs can be transferred to the builder by having a firm price in the contract rather than a cost-plus contract.

Hedging price risks

Hedging price risks is another example of risk transfer. Hedging is a technique for transferring the risk of unfavourable price fluctuations to a speculator by purchasing and selling futures contracts on an organized exchange, such as NSE.

In recent years, institutional investors have sold stock index futures contracts to hedge against adverse price declines in the stock market. This technique is often called portfolio insurance. However, it is not formal insurance but is a risk transfer technique that provides considerable protection against a decline in stock prices.

Conversion to Public Limited Company

Incorporation is another example of risk transfer. If a firm is a sole proprietorship, creditors for satisfaction of debts can attach the owner's personal assets, as well as the assets of the firm. If a firm incorporates, however, creditors for payment of the firm's debts cannot attach the personal assets of the stockholders. In essence, by incorporation, the liability of the stockholders is limited, and the risk of the firm having insufficient assets to pay business debts is shifted to the creditors.

INSURANCE AND REINSURANCE AS A RISK TRANSFER TECHNIQUES

Insurance and reinsurance are both forms of financial protection which are used to guard against the risk of losses. Losses are guarded against by transferring the risk to another party through the payment of an insurance premium, as an incentive for bearing the risk. Insurance and reinsurance are similar in concept even though they are quite different to each other in terms of how they are used.

INSURANCE

Insurance is a more commonly known concept that describes the act of guarding against risk. An insured is the party who will seek to obtain an insurance policy while the insurer is the party that shares the risk for a paid price called an insurance premium. The insured can easily obtain an insurance policy for a number of risks. The most common types of insurance policy taken out is a vehicle/auto insurance policy as this is mandated by law in many countries. Other policies include home owner's insurance, renter's insurance, medical insurance, life insurance, liability insurance, etc.

The insured who takes out a vehicle insurance will specify the losses against which he wishes to be insured. This may include repairs to the vehicle in case of an accident, damages to the party who is injured, payment for a rented vehicle until such time the insured's vehicle is fixed, etc. The insurance premium paid will depend upon a number of factors such as the insured's driving record, driver's age, any medical complications of the driver, etc. If the driver has had a reckless driving record he may be charged a higher premium as the probability of loss is higher. On the other hand, if the driver has had no previous accidents then the premium will be lower since the probability of loss is relatively low.

Reinsurance

Re insurance is when an insurance company will guard themselves against the risk of loss. Reinsurance in simpler terms is the insurance that is taken out by an insurance company. Since insurance companies provide protection against the risk of loss, insurance is a very risky business, and it is important that an insurance company has its own protection in place to avoid bankruptcy. Through a reinsurance scheme, an insurance company is able to bring together or 'pool' its insurance policies and then divide up the risk among a number of insurance providers so that in the event that a large loss occurs this will be divided up throughout a number of firms, thereby saving the one insurance company from large losses.

Insurance vs Reinsurance

Insurance and reinsurance are similar in concept in that they are both tools that guard against large losses. Insurance, on the one hand, is a protection for the individual, whereas reinsurance is the protection taken out by a large insurance firm to ensure that they survive large losses. The premium that is paid by an individual will be received by the company that provides the insurance whereas the insurance premium paid for reinsurance will be divided among all the insurance companies in the pool that bear the risk of loss.

2.6 SUMMARY

Risk management such as a systematic application of management policies, procedures and practices to assess and manage risks. In the literature review, there are several methodologies for the realization of these steps depending on it is a proactive strategy (i.e. predict risks and implement measures to prevent undesirable effects) or reactive strategy (i.e. following the occurrence of risks). Insurance is a valuable risk-financing tool. Few organizations have the reserves or funds necessary to take on the risk themselves and pay the total costs following a loss. Purchasing insurance, however, is not risk management. A thorough and thoughtful risk management plan is the commitment to prevent harm. Risk management also addresses many risks that are not insurable, including brand integrity, potential loss of tax exempt status for volunteer groups, public goodwill and continuing donor support.

2.7 GLOSSARY

Subjective Risk: Subjective risk is defined as uncertainty based on a person's mental condition or state of mind.

Objective Risk: Objective risk is defined as the relative variation of actual loss from expected loss.

Static Risk: Static risks are risks connected with losses caused by the irregular action of nature or by the mistakes and misdeeds of human beings.

Dynamic Risk: Dynamic risks are risks associated with a changing economy. Important examples of dynamic risks include the changing tastes of consumers, technological change, new methods of production, and investments in capital goods that are used to produce new and untried products.

2.8 SELF ASSESSMENT QUESTIONS

1. What is the concept of risk?

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2. Discuss the classification of risk.

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3. Discuss the principles of risk management.

4. Explain the term risk analysis.

5. Explain the various steps of risk management process.

2.9 SUGGESTED READING

- Ghansham Panda : Principles of Insurance, Kalyani Publishing House, New Delhi
- M.N Mishra & S.B Mishra: Insurance Principles and Practice, S. Chand, New Delhi
- P.K Gupta: Fundaments of Insurance, Himalya Pub., New Delhi
- Rajeda: Principles of Risk Management and Insurance, Pearson Pub., New Delhi
- R.C Gupta & T.C Jain: Insurance and Risk Management, Alpha Pub., New Delhi

LIFE INSURANCE

STRUCTURE

3.1 INTRODUCTION

In India, insurance started with life insurance. It was in the early 19th century when the Britishers on their postings in India felt the need of life insurance cover. It started with English Companies like. 'The European and the Albert'. The first Indian insurance company was the Bombay Mutual Insurance Society Ltd., formed in 1870. In the wake of the Swadeshi Movement in India in the early 1900s; quite a good number of Indian companies were formed in various parts of the country to transact insurance business. To name a few: 'Hindustan Co-operative' and 'National Insurance' in Kolkata; 'United India' in Chennai; 'Bombay Life', 'New India' and 'Jupiter' in Mumbai and 'Lakshmi Insurance' in New Delhi.

Life insurance could be a contract for payment of a total of cash to the person assured (or failing him/her to the person entitled to receive the same) on the happening of the event insured against. Sometimes the contract provides for the payment of associate degree quantity on the date of maturity or at nominal dates at periodic intervals or on unfortunate death, if it happens earlier. Among different factor the contract additionally provides for the payment or premium sporadically to the corporation by the assured. Life assurance is universally acknowledged to be an establishment that eliminates "risks", subbing definitely for uncertainty and is available to the death or of total permanent incapacity of the wage earner. By and huge, life assurance is civilizations partial answer to monetary uncertainties caused by untimely death.

Life insurance is a business proposition resting on the combined operation of law of mortality and interest. We all know that time of our death is uncertain and in case of untimely death of a person his family could be put into great financial hardship. The science of life insurance revolves around the principle of providing some financial relief to the loved ones of a person in case of his sudden death. The first essential for working of life insurance is calculation of risk to fix the amount of contribution (premium) to be made by each policy-holder according to his age, medical history, habits, occupation etc. so that the fund should be adequate to meet the whole claims.The probability of death or the law of mortality is used for this purpose.

3.2 OBJECTIVES

After reading this lesson, you should be able:

- To know the concept of Life insurance
- To know the principles of life Insurance
- To know the basic elements in computation of premium
- To know the life insurance products

3.3 CONCEPT AND PRINCIPLES OF LIFE INSURANCE

Life Insurance – Concept

Life insurance (or life assurance, especially in the Commonwealth), is a contract between an insurance policy holder and an insurer or assurer, where the insurer promises to pay a designated beneficiary a sum of money (the benefit) in exchange for a premium, upon the death of an insured person (often the policy holder). Depending on the contract, other events such as terminal illness or critical illness can also trigger payment. The policy holder typically pays a premium, either regularly or as one lump sum. Other expenses (such as funeral expenses) can also be included in the benefits.

Life policies are legal contracts and the terms of the contract describe the limitations of the insured events. Specific exclusions are often written into the contract to limit the liability of the insurer; common examples are claims relating to suicide, fraud, war, riot, and civil commotion.

Life-based contracts tend to fall into two major categories:

Protection policies – designed to provide a benefit, typically a lump sum payment, in the event of specified event. A common form of a protection policy design is term insurance.

Investment policies – where the main objective is to facilitate the growth of capital by regular or single premiums. Common forms (in the U.S.) are whole life, universal life, and variable life policies.

WHY LIFE INSURANCE

The risk of death is covered under insurance scheme but not under ordinary savings plans. In case of death, insurance pays full sum assured, which would be several times larger than the total of the premiums paid. Under ordinary savings plans, only accumulated amount is payable.

It Encourages Compulsory Saving After taking insurance, if the premium is not paid, the policy lapses. Therefore, the insured is forced to go on paying premium. In other words it is compulsory. A savings deposit can be withdrawn very easily.

Easy Settlement and Protection against Creditors Once nomination or assignment is made, a claim under life insurance can be settled in a simple way. Under M.W.P. Act, the policy moneys become a kind of trust, which cannot be taken away, even by the creditors.

It helps to Achieve the Purpose of the Life Assured If a lump sum amount is received in the hands of anybody, it is quite likely that the amount might be spent unwisely or in a speculative way. To overcome this risk, the life assured can provide that the claim amount be given in instalments.

Peace of Mind The knowledge that insurance exists to meet the financial consequences of certain risks provides a form of peace of mind. This is important for private individuals when they insure their car, house, possessions and so on, but it is also vital importance in industry and commerce.

Loss Control Insurance is primarily concerned with the financial consequences of losses, but it would be fair to say that insurers have more than a passing interest in loss control. It could be argued that insurers have no real interest in the complete control of loss, because this would inevitably lead to an end to their business.

Social Benefits The fact that the owner of a business has the funds available to receiver from a loss provides the stimulus to business activity we noted earlier. It also means that jobs may not be lost and goods or services can still be sold. The social benefit of this is that people keep their jobs, their sources of income are maintained and they can continue to contribute to the national economy.

Investment of Funds Insurance companies have at their disposal large amounts of money. This arises from the fact that there is a gap between the receipt of a premium and the payment of a claim. A premium could be paid in January and a claim may not occur until December, if it occurs at all. The insurer has this money and can invest it.

Invisible Earnings We have already said that insurance allows people and organizations to spread risk among them. In the same way, we can also say that countries spread risk. A great deal of insurance is transacted in the UK in respect of property and liabilities incurred overseas. London is still very much the centre of world insurance and large volumes of premium flow into London every year; these are described as invisible earnings.

Insurance Facilitates Liquidity If a policyholder is not in a position to pay the premium, he can surrender the policy for a cash sum.

Loan Facility and Tax Relief The person can also take a loan for a temporary period to tide over the difficulty. Sometimes, a life insurance policy is acceptable as security for a commercial loan. By paying the insurance premium, the insured obtains significant reliefs in Income Tax and Wealth Tax.

Basic Principles of Life Insurance

1. Insurable interest The insured must have insurable interest in the life assured. In absence of insurable interest, Contract of insurance is void. Insurable interest must be present at the time of entering into contract with insurance company for life insurance. It is not necessary that the assured should have insurable interest at the time of maturity also.

2. Utmost good faith: The contract of life insurance is a contract of utmost good faith. The insured should be open and truthful and should not conceal any material fact in giving information to the insurance company, while entering into a contract with insurance company. Misrepresentation or concealment of any fact will entitle the insurer to repudiate the contract if he wishes to do so.

3. Not a contract of indemnity: The life insurance contract is not a contract of indemnity. A Contract of life insurance is not a contract of indemnity. The loss of life cannot be compensated and only a fixed sum of money is paid in the event of death of the insured. So, the life insurance contract is not a contract of indemnity. The loss resulting from the death of life assured cannot be calculated in terms of money.

Features of Life Insurance

Since the life insurance is not an indemnity contract, the insurer, in his part, is required to pay a definite sum of money agreed on maturity of policy at the death or anamount in instalment for a fixed period or during life. As such, contrary to other insurance policies, it has some distinct features. The essential features of life insurance are as follows:

1. Insurable interest: The insured or policyholder must have an insurable interest for a valid life insurance contract. Insurable interest arises out of pecuniary relationship which exists between the insurer and policy holder, the former or insurer stands to loose by the death of the policy holder or latter and or continuous to gain by his survival. In life insurance contract, a person may have insurable interest for his own life as well as lives of his relatives such as wife, son, daughter etc. No person can purchase life insurance policy for a third person unless he has financial interest in his

life.
2. Utmost good faith: The life insurance requires that the principle of utmost good faith should be preserved by both the parties; insurer and insured. Utmost good faith between the parties is necessary in all kinds of contracts. The insured in particular, must disclose all facts accurately and completely with respect to the object of life policy.
3. Warranties: Warranties are the representations in life insurance which are embodied in the policy and expressly or impliedly forming part of the basis of the contract. Warranties are the integral part of the contract. These are the bases of the contract between insured and insurer and if any statement or information or presentation, whether material or non-material, is untrue the contract may be void and the premium paid by insured may be forfeited by the insurance company or insurer.
4. Assignment and nomination: The life insurance policy can be assigned free for a legal consideration or love and affection. The insured may assigned to anybody on any ground. As such, the assignment shall be complete and effectual only on the execution of such endorsement either on the policy itself or by a separate deed.
5. Return of premium: Generally, the amount of premium paid cannot be refunded. however, for the reason of equity, the premium may be refunded. If it is the case of misrepresentation or breach of warranty, the insured, in the absence of any express condition to the contrary, can claim for return of premium paid. But, in case of guilty of fraud in obtaining policy, the insured cannot claim the amount of premium to be returned.

Importance of Life Insurance

The following point shows the role and importance of insurance:

Insurance has evolved as a process of safeguarding the interest of people from loss and uncertainty. It may be described as a social device to reduce or eliminate risk of loss to life and property. Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop financial institutions and reduce uncertainties by improving financial resources.

1. Provide safety and security:

Insurance provide financial support and reduce uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss. Insurance provides a cover against any sudden loss. For example, in case of life insurance financial assistance is provided to the family of the insured on his death. In case of other insurance security is provided against the loss due to fire, marine, accidents etc.

2. Generates financial resources:

Insurance generate funds by collecting premium. These funds are invested in government securities and stock. These funds are gainfully employed in industrial development of a country for generating more funds and utilised for the economic development of the country. Employment opportunities are increased by big investments leading to capital formation.

3. Life insurance encourages savings:

Insurance does not only protect against risks and uncertainties, but also provides an investment channel too. Life insurance enables systematic savings due to payment of regular premium. Life insurance provides a mode of investment. It develops a habit of saving money by paying premium. The insured get the lump sum amount at the maturity of the contract. Thus life insurance encourages savings.

4. Promotes economic growth:

Insurance generates significant impact on the economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those results into economic growth and development. Thus, insurance plays a crucial role in sustainable growth of an economy.

5. Medical support:

A medical insurance considered essential in managing risk in health. Anyone can be a victim of critical illness unexpectedly. And rising medical expense is of great concern. Medical Insurance is one of the insurance policies that cater for different type of health risks. The insured gets a medical support in case of medical insurance policy.

6. Spreading of risk:

Insurance facilitates spreading of risk from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large number of persons get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer.

7. Source of collecting funds:

Large funds are collected by the way of premium. These funds are utilised in the industrial development of a country, which accelerates the economic growth. Employment opportunities are increased by such big investments. Thus, insurance has become an important source of capital formation.

Types of Life Insurance Policies

1. **Term Policy:** In case of Term assurance plans, insurance company promises the insured for a nominal premium to pay the face value mentioned in the policy in case he is no longeralive during the term of the policy. Term assurance policy has the following features:

   (a) It provides a risk cover only for a prescribed period. Usually these policies are short term plans and the term ranges from one year onwards. If the policyholder survives till the end of this period, the risk cover lapses and no insurance benefit payment is made to him.

   (b) The amount of premium to be paid for these policies is lower than all other life insurance policies. As savings and reserves are not accumulated under this policy, it has no surrender value and loan or paid-up values are not allowed on these policies.

   © This plan is most suitable for those who are initially unable to pay high premium.

   (d) when income is low as required for Whole Life or Endowment policies, but requires life cover for a high amount.

2. Whole Life Policy: This policy runs for the whole life of the assured. The sum assured becomes payable to the legal heir only after the death of the assured. The whole life policy can be of three types.

a. Ordinary whole life policy – In this case premium is payable periodically throughout the life of the assured.

b. Limited payment whole life policy – In this case premium is payable for a specified period (Say 20 Years or 25 Years) Only.

c. Single Premium whole life policy – In this type of policy the entire premium is payable in one single payment.

3. Endowment Life Policy: In this policy the insurer agrees to pay the assured or his nominees a specified sum of money on his death or on the maturity of the policy whichever is earlier. The premium for endowment policy is comparatively higher than that of the whole life policy. The premium is payable till the maturity of the policy or until the death of the assured whichever is earlier. It provides protection to the family against the untimely death of the assured.

4. Health insurance schemes: An individual is subject to uncertainty regarding his health. He may suffer from ailments, diseases, disability caused by stroke or accident, etc. For serious cases the person may have to be hospitalized and intensive medical care has to be provided which can be very expensive. It is here that medical insurance is helpful in reducing the financial burden. These days the vulnerability to lifestyle diseases such as heart, cancer, neurotic, and pollution based, etc are on the increase. So it makes sense for an individual to go for medical insurance cover.

5. Joint Life Policy: This policy is taken on the lives of two or more persons simultaneously. Under this policy the sum assured becomes payable on the death of any one of those who have taken the joint life policy. The sum assured will be paid to the survivor(s). For example, a joint life policy may be taken on the lives of husband and wife, sum assured will be payable to the survivor on the death of the spouse.

6. With Profit and without Profit Policy: Under with profit policy the assured is paid, in addition to the sum assured, a share in the profits of the insurer in the form of bonus. Without profit policy is a policy under which the assured does not get any share in the profits earned by the insurer and gets only the sum assured on the maturity of the policy. With profit and without profit policies are also known as participating and non–participating policies respectively.

7. Double Accident Benefit Policy: This policy provides that if the insured person dies of any accident, his beneficiaries will get double the amount of the sum assured.

8. Annuity Policy: Under this policy, the sum assured is payable not in one lump sum payment but in monthly, quarterly and half-yearly or yearly instalments after the assured attains a certain age. This policy is useful to those who want to have a regular income after the expiry of a certain period e.g. after retirement. Annuity is paid so long as the assured survives. In annuity policy medical check-up is not required. Annuity is paid so long as the assured survives.

9. Policies for Women: Women, now a days are free to take life assurance policies. However, some specially designed policies suit their needs in a unique manner; important policies for women are A. Jeevan Sathi is also known a Life Partner plan where the husband and wife are covered under this endowment policy B. Jeevan Sukanya

10. Group Insurance: Group life insurance is a plan of insurance under which the lives of many persons are covered under one life insurance policy. However, the insurance on each life is independent of that on the other lives. Usually, in group insurance, the employer secures a group policy for the benefit of his employees. Insurer provides coverage for many people under single contract.

11.Policies For Children: Policies for children are meant for the various needs of the children such as education, marriage, security of life etc. Some of the major children policies are:

a) Children's deferred assurances
b) Marriage endowment and educational annuity plans
c) Children endowment policy

12. Money Back Policy: In this case policy money is paid to the insured in a number of separate cash payments. Insurer gives periodic payments of survival benefit at fixed intervals during the term of policy as long as the policyholder is alive.

3.4 BASIC ELEMENTS IN COMPUTATION OF PREMIUM

There are three important elements in the computation of premium. They are (1) mortality, (2) expenses of management, (3) expected yield on its investment.

1. Mortality The mortality tables are prepared by the insurers on the basis of their experience over a number of years. Though the rate of mortality increases with the increase in age, all insurers charge a level premium which remains constant over the entire duration of the policy term. It is the actuarial science which provides the method to assess such increasing risk and convert it into a level premium. This prediction or estimation of mortality is true for a very large group of insured people and not for any individual insured. Thus the small premium charged from the total group is used to pay a big sum assured to the unfortunate few who die early. It is also called pooling of resources. Insurance is also known to be a co–operative action.
2. Expenses of management Any insurer has to incur expenses for conducting the insurance business. These expenses are not of constant nature. They keep on increasing due to inflationary market conditions. Huge expenses are incurred for procurement of new business, for payment of commission to the agent and other incidental expenses like preparation of policy document etc. Expense is also incurred for servicing of the policies, e.g. collection of renewal premium, valuation to determine bonus payable, payment of Survival Benefit and Death claim and Maturity Benefit etc.
3. Expected yield on investment : As the above two elements go to increase the premium rate, the expected yield on investment of the collected endowment component of premium goes to reduce the premium rate. However, as the future yield cannot be determined exactly, it is necessary for a prudent insurer to keep a reserve to take care of unexpected fall in the rate of yield.

Calculation of premium

Calculation of premium is done after the underwriting decision has been taken. The underwriting decision is taken after an evaluation of the longevity taking into consideration all such factors which are supposed to influence the proposer's life span. It can be a decision where the risk is taken at ordinary rates. In otherwords only the premium rates as they appear in the rate table are applicable, after allowing for rebates on account of mode of payment and large sum assured. This can be explained with an example:

Age nearer birthday - 30 years

Plan of assurance - Endowment with profit

Term of assurance - 20 years

Sum assured - Rs. 5,000

Mode of payment of premium- Half–yearly.

Tabular premium per thousand sum assured as given in the manual for agents is Rs.53.19 for age 30 and Term 20 years. Rebates allowed are 1.5% for half–yearly mode and there is no rebate for sum assured below Rs 25000/=

Tabular premium Rs.53.19

Rebate for Half-yearly mode Rs.0.79 Rs.52.40

Adjustment for S.A. 5000 Nil

Balance Rs.52.40

Yearly premium for SA Rs.5000 (Rs.52.40x5)=Rs.262.00

Half-yearly premium = Rs.262/2 =Rs. 131.00

If the mode of payment in the above example would have been yearly, we would have reduced Rs.53.19 by 3% i.e. Rs.1.60. Had the mode been quarterly, we would not need any adjustment. Similarly if the mode of payment would have been monthly, we would have increased the tabular premium of Rs.53.19 by 5%. Similarly if the sum assured would have been Rs. 25000, we would reduce Rs.52.40 by Rs.1/- before multiplying it with the sum assured, i.e. Rs. 25 only and not Rs. 25,000 as the tabular premium is for a sum assured of Rs. 1,000. Similarly if the sum assured would be Rs. 50,000 or more, we would reduce Rs. 52.40 by Rs.2/- before multiplying it by the sum assured, as explained above. The underwriting decision is always not as simple as is shown in the above example. The underwriting decision may impose many riders, because of which the premium gets increased. These riders may be (1) due to the extra benefits wanted by the proposer e.g. accident benefit, premium waiver benefit etc. (2) due to extra risk perceived by the underwriter on the basis of health, occupation or even for reasons of sex. Let us explain the effect of these riders on the premium by an illustration Plan of assurance - Endowment assurance with profit Term of assurance 20 years Mode Half-yearly Age nearer birthday 45 years Sum assured – Rs. 20,000 Double Accident benefit –Yes @ Rs 1/= per 1,000 Calculation : - Tabular premium for age 45, Term 20 yrs is Rs.52.19 Adjustment for Hly. Mode @ 1.5% 0.78 Balance Rs. 51.41 Less adjustment for S.A. Rs. 20,000/- Nil Rs. 51.41 Annual premium for Rs. 20,000 SA i.e. (Rs. 51.41 x 20) Rs. 1028.20 Add extra for Double accident benefit which is Rs.1/- per thousand for Rs. 20,000 Rs. 20.00 Annual premium for Rs. 20,000 with DAB Rs. 1,048.20 Half-yearly instalment premium Rs. 524.10 Rounded up to the nearest rupee Rs. 524.00 The rates of extra premium for the extra benefits like double accident benefit or premium waiver benefit are given in the manual or prospectus issued by the insurer. The extra for premium waiver benefit depends upon the age of the proposer and is to be waived in case of the death of the proposer either due to disease or accident. This is normally applied to an insurance proposal on the life of a child. Extra premium on account of health and occupation is decided by the underwriter and is mentioned in the underwriting decision.

These extra premiums are charged in order to take care of the extra mortality expected in this group of life on account of substandard health or hazardous occupation. Imposing a lien - constant or decreasing for a limited period of one year or six month is another way to deal with the perceived problem of extra mortality. During the lien period, the liability of the insurer is reduced. In case of joint life plan, there are two lives with two different ages. In order to calculate premium, we need a mean age. There is a table provided in the manual to find the mean age, depending upon the difference in the two ages. Sex extra is generally levied for those ladies who have not yet undergone a full time delivery and who are not expected to go to a qualified doctor at the time of delivery. Once this extra is paid, this risk of child birth is accepted. However such extra is not levied where the lady in question is educated and belongs to a well to do family and is therefore expected to have the delivery with the help of a qualified lady doctor. Persons who are physically handicapped, such as blind by one eye, disabled due to polio etc. are denied the benefit of double accident benefit even if it is asked for. However over the years, insurers have softened their stand, while considering proposals on the life of such physically and socially disadvantaged persons. This may not be an acceptable position strictly on medico actuarial considerations, but social considerations also have their impact. Since the sum assured in such cases is very small, these small deviations from strict actuarial consideration are acceptable.

3.5 PECULIARITY OF LIFE INSURANCE PRODUCTS AND CLASSIFICATIONS

Section 2(11) of the Insurance Act, 1938 defines Life Insurance Business as follows:
"life insurance business" means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include–

(a) the granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance,

(b) the granting of annuities upon human life; and

(c) the granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons;

This definition is proposed to be amended in the Insurance Law Amendment Bill, 2008 where for the words “annuities payable out of any fund”, the words “benefit payable out of any fund" have been substituted;

While under the current Act, health insurance has not been identified as a separate sector, the Bill proposes to introduce a separate sub-section to define health insurance business as follows:

Life insurance products can be broadly classified into:

(a) Pure protection plans;

(b) Protection cum savings plans;

(c) Pure savings and pension plans;

These can be further classified into:

I. Term insurance & Health Insurance plans

II. Endowment & Money-back plans

III. Whole life plans

IV. Pension and savings plans

V. Unit linked insurance plans (ULIPs)

VI. Variable Insurance plans (VIPs)

Further, apart from stand-alone health insurance companies providing health insurance products, health insurance is also provided by life insurance companies both as riders to other products as well as standalone health plans.

A. PURE PROTECTION INSURANCE

A pure protection plan is a simple risk cover insurance product where the sum assured becomes payable upon the happening of the risk event during the term of the policy. The two variants of a pure protection plan are:

1. Term Insurance plan

A term insurance plan provides a pure risk cover where the sum assured becomes payable upon death of the life assured during the term of the policy. Since there is only a risk cover, the premiums are usually low and affordable and the policy assures a financial security to the family members upon death of the life assured. The term of the policy is fixed and where the life assured survives the full term, no amount is payable. Some variants of pure protection plans also assure a return of some or whole of the premiums paid if the life assured survives the term of the policy. The benefit arising to the insurance company in such case is the income out of the premiums invested during the term.

2. Health Insurance plan

A health insurance plan provides a pure risk cover where the sum assured becomes payable upon the life assured being diagnosed of certain identified illness during the term of the policy. Health insurance is also popularly known as Medical Insurance or Mediclaim that covers medical expenses including hospitalization expenses. The type and amount of health insurance depends upon the scope of illnesses covered and the extent of expenses required to be covered. Health insurance benefits are also available as riders in group insurance plans.

While life is very uncertain, a person may not stay healthy & fit throughout their life. Therefore it is prudent to have health cover at every stage of life. If a major illness like heart failure is diagnosed & the funds for treatment cannot be immediately arranged. It may lead to loss of life. If the family resorts to costly personal loans for treatment & the life of the person cannot be saved then the family could incur huge debts. Having health insurance cover can help to overcome this problem.

The age of a person at the time of taking the health cover is very vital. Usually health plans are annually renewable policies, the cost will increase as the person gets older, regardless of the age of the policyholder when the policy commences.

Some of the critical illnesses that are usually covered under a health insurance plan are: − Blindness − Stroke − Major organ transplant − Multiple Sclerosis − Paraplegia − Arota Surgery − Kidney failure − Heart attack − Cancer − Coma

The list of illnesses differs between various health plans of different insurance companies and the premium would also differ according to the illnesses covered.

B. PROTECTION + SAVINGS INSURANCE

Life insurance is usually a long term contract and thus is used world over as an effective investment instrument. In Protection cum Savings insurance products, in addition to getting a pure term insurance cover, the policyholder is also able to leverage long term savings. Life insurance plans are an excellent choice for providing for Protection needs, Long term goals such like children's education and marriage, retirement and others.

In such plans, the premium payable is divided into two parts:

− Premium for life coverage – provides financial protection in case of death

− Premium for savings element – Is invested by the insurance company on behalf of the policyholders.

The returns earned from investment are set-off against the expenses and the surplus is shared among policyholders in the form of bonuses. Here the investment risk is borne by the Insurance company.

(1) Endowment Insurance – An endowment insurance offers death cover if the life insured dies during the term of the policy and also offers a Survival benefit if the life insured survives until the maturity of the policy.Some of the key features of an Endowment insurance plan are -

- If the life insured survives the entire term of the plan, then a specified amount is paid to him/her on maturity of the plan
- If the life insured dies before the maturity of the plan, then the death cover benefit is paid to the nominee/beneficiary
- Savings element: After deducting the death cover charges & administration charges from the premium, the remaining amount is invested by the insurance company. The returns earned are later paid back to the life insured in the form of bonuses.
- Goal-based investment: Helps in accumulating money for specific plans like a child's higher education or marriage, etc.
- Some insurance companies also allow partial withdrawal or loans against these policies
- There are different variants under this plan –
  - Higher death cover than the maturity benefit
  - Maturity benefit is double the death cover, known as a double endowment insurance plan

(2) Whole of Life Insurance – A term insurance plan with an unspecified period is called a whole life plan. Some plans also have a savings element to them. The insurance company declares bonuses for these plans based on the returns earned on investments. As the name of the plan specifies, this plan covers the individual throughout their entire life. On the death of the life insured, the nominee/beneficiary is paid the sum insured along with the bonuses accumulated up until that point in

time. During the individual's lifetime they can make partial withdrawals to meet emergency requirements. An individual can also take out loans against the policy. Although, incase of Whole Life Plans, sum assured is payable only on death, some insurers pay the sum assured when life insured completes a certain age. For example, 80 years, 90 years, 100 years, etc.

3. Unit Linked Insurance Plan: A Unit Linked Insurance Plan or 'ULIP' as it is popularly known is basically a combination of insurance as well as investments, similar to a protection cum savings plan. While a part of the premium paid is utilized to provide insurance cover to the policy holder the remaining portion is invested in various equity and debt schemes. A fund is created from a pool of premiums collected from policyholders and the fund is used to invest in various market instruments (debt and equity) in varying proportions similar to mutual funds. The significant difference between a protection cum savings plan and a ULIP is that the investment risk in a ULIP is borne bythe policyholder (similar to a Mutual Fund), whereas the risk is borne by the Insurance company in the other case. The Policy holders can select the type of funds (debt or equity) or a mix of both based on their investment need and risk appetite. ULIP policy holders are allotted units and each unit has a net asset value (NAV) that is declared on a daily basis. The NAV is the value based on which the net rate of returns on ULIPs are determined. The NAV varies from one ULIP to another based on market conditions and the fund's performance.

Features - ULIP policy holders can make use of features such as top-up facilities, switching between various funds during the tenure of the policy, reduce or increase the level of protection, options to surrender, additional riders to enhance coverage and returns as well as tax benefits.

Types - There are a variety of ULIP plans to choose from based on the investment objectives of the investor, his risk appetite as well as the investment horizon. Some ULIPs allocate a larger portion of the invested capital in debt instruments while others purely invest in equity. Again, all this is totally based on the type of ULIP chosen for investment and the investor preference and risk appetite.

Charges - Unlike traditional insurance policies, ULIP schemes have a list of applicable charges that are deducted from the payable premium. The notable ones include policy administration charges, premium allocation charges, fund switching charges, mortality charges, and a policy surrender or withdrawal charge. Some Insurer also charge "Guarantee Charge" as a percentage of Fund Value for built in minimum guarantee under the policy.

Risks - Since ULIP returns are directly linked to market performance and the investment risk in investment portfolio is borne entirely by the policy holder, one needs to thoroughly understand the risks involved and one's own risk absorption capacity before deciding to invest in ULIPs.

4. Variable Insurance Plan: Variable life insurance is a permanent life insurance policy with an investment component. Variable universal life insurance can help meet the needs of those who want life insurance protection with the potential to build cash value. The policy has a cash value account, which is invested in a number of sub-accounts available in the policy. A sub-account act similar to a mutual fund, except it's only available within a variable life insurance policy. A typical variable life policy will have several sub-accounts to choose from, with some offering upwards of 50 different options. The cash value account has the potential to grow as the underlying investments in the policy's sub-accounts grow - at the same time, as the underlying investments drop, so may the cash value. The appeal to variable life insurance lies in the investment element available in the policy and the favorable tax treatment of the policy's cash value growth. Annual growth of the cash value account is not taxable as ordinary income. Furthermore, these values can be accessed in later years and, when done properly through loans using the account as collateral, instead of direct withdrawals, they may be received free of any income taxation. Similar to mutual funds and other types of investments, a variable life insurance policy must be presented with a prospectus detailing all policy charges, fees and sub-account expenses.

C. PURE SAVINGS AND PENSIONS

Pure savings and Pension plans address the risk of living too long. In the age of medical advancement where the mortality rates have declined and life span has increased significantly, it is important that the individual saves enough to meet his financial needs during the age when his earning capacity diminishes. In the Indian context, with the growth of the Indian economy, the nuclear family system is fast spreading and therefore old aged parents are left to fend for themselves. In order to mitigate the risk of not being able to meet financial needs during such old age, the savings and pension plans are effective tools.

These plans should be looked at two parts:

Savings or accumulation stage – Deferred Annuity Plans. Under the deferred annuity plan, the policyholder contributes a small amount on a monthly/quarterly/ annual basis and on maturity, the sum assured is used to buy a pension plan (immediate annuities) that will provide a monthly income throughout retirement. These plans are best when bought at a young age as the corpus depends upon the period of accumulation.

The term of the policy is called deferment period. During this period, the insurance company will invest the lump sum amount on behalf of the policyholder and earn returns on it. The maturity of the policy is called vesting where the accumulated corpus will be used to pay a regular annuity to the policyholder.

At the time of vesting the policyholder can decide whether to buy the immediate annuity plan from the same insurance company or some other life insurer of his choice. This option to choose the pension provider is known as the open market option.

At the time of vesting the policyholder will also have the choice of selecting the type of annuity plan that he would like from the annuity options available to him. The annuity payout will depend on the type of annuity chosen and the rates prevailing at the time of vesting.

The deferred annuity plans are available both in traditional and ULIP forms. In India the deferred annuity plans are largely driven by tax benefits.

Payout or annuity stage – Immediate Annuity Plans. An annuity is a series of regular payments from an annuity provider (insurance company) to an individual (called the annuitant) in return for a lump sum (purchase price) or installment premiums for a specified number of years. Annuities are usually sold by life insurance companies. They may be purchased by a single lump sum payment or under a deferred annuity plan. The premium (purchase price) may be made by the person who is to be the annuitant or another annuity purchaser such as the annuitant's employer, other personal benefactor or a pension scheme.

The tax laws in India stipulate that upon vesting of a deferred annuity plan, only 1/3rd of the vested amount can be paid out as a lumpsum and the balance should be necessarily paid out only as annuities. Some of the types of immediate annuities available in the market are:

− Life Annuity

− Life Annuity with returns

− Joint Life Annuity

− Guaranteed Annuity

− Increasing Annuity

3.6 PROCEDURES FOR SETTLEMENT OF VAROUS TYPES OF CLAIMS

Death Claim

Step One: Intimation of Claim The claimant must submit the written intimation as soon as possible to enable the insurance company to initiate the claim processing. The claim intimation should consist of basic information such as policy number, name of the insured, date of death, cause of death, place of death, name of the claimant etc .Claim intimation form can be availed from nearest branch of the insurance company or/and by downloading it from the company website.

Step Two: Documentation The claimant will be required to provide the following documents along with a claimant's statement:

I. Certificate of Death

II. Proof of age of the life assured (if not already given)

III. Deeds of assignment / reassignments (if required)

IV. Policy document

V. Any other document as per requirement of the insurer For early death Claim, (If the claim has accrued within three years from the beginning of the policy), the following additional requirements may be called for:

a) Statement from the hospital if the deceased had been admitted to hospital

b) Certificate of medical attendant of the deceased giving details of his/her last illness

c) Certificate of cremation or burial to be given by a person of known character and responsibility present at the cremation or burial of the body of the deceased

d) Certificate by employer if the deceased was an employee In special cases as per following the poof of death will be different from the standard specification In case of an air crash the certificate from the airline authorities would be necessary certifying that the assured was a passenger on the plane. In case of ship accident a certified extract from the logbook of the ship is required. In case of death from medical causes, the doctors' certificate and/or treatment records may be required. If the life assured had a death due to accident, murder, suicide or unknown cause the police inquest report, panchanama, post mortem report, etc would be required.

Step Three: Submission of required Documents for Claim Processing For faster claim processing, it is essential that the claimant submits complete documentation as early as possible.

Step Four: Settlement of Claim As per the regulation 8 of the IRDA (Policy holder's Interest) Regulations, 2002, the insurer is required to settle a claim within 30 days of receipt of all documents including clarification sought by the insurer. If the claim requires further investigation, the insurer has to complete its procedures within six months from receiving the written intimation of claim. After receiving the required documents the company calculates the amount payable under the policy. For this purpose, a form is filled in which the particulars of the policy, bonus, nomination, assignment etc. should be entered by reference to the Policy Ledger Sheet. If a loan exists under the policy, then the section dealing with loan is contacted to give the details of outstanding loan and interest amount, which is deducted from the gross policy amount to calculate net payable claim amount. Generally all claim payments would be made through the electronic fund transfer.

Maturity & Survival Claims

The payment by the insurer to the insured on the date of maturity is called maturity payment. The amount payable at the time of the maturity includes a sum assured and bonus/incentives, if any. The insurer sends in advance them intimation to the insured with a blank discharge form for filling various details in it. It is to be returned to the office along with Original Policy document, ID proof, Age proof if age is not already submitted, Assignment /reassignment, if any and Copy of claimant's Bank Passbook & Cancelled Cheque. Settlement procedure for maturity claim is simple after receipt of completed and stamped discharge form from the person entitled to the policy money along with policy documents, claim amount will be paid by account payee cheque.

Regarding maturity claims certain points are to be remembered:

If the life assured is reported to have died after the date of maturity but before the receipt is discharged, the claim is to be treated as the maturity claim and paid to the legal heirs. In this case death certificate and evidence of title is required. Where the assured is known to be mentally deranged, a certificate from the court of law under the Indian Lunacy Act appointing a person to act as guardian to manage the properties of the lunatic should be called. For Survival Benefit claim, Policy bond and discharge voucher is required.

Rider Claims: The life insurance policy can be attached with different riders like accidental rider, Critical illness Rider, Hospital cash Rider, waiver of Premium Rider etc. For different Riders different proceedings can be opted for claim settlement. In some cases the claim may proceed as well as with the death Claim (Like Waiver of premium rider, accidental death Rider etc). But in some other cases different documents can be required for along with the duly filled Claim form & Policy Copy: For Critical Illness Rider, necessary medical documents such as first investigation report, Doctor's prescription, Discharge Summery etc are required For Accidental disability rider, Attested copy of FIR, Doctor Certificate of disability, Photograph of the injured with reflecting disablement, Original Medical bills with prescriptions/ treatment papers etc are required. For Hospital cash rider medical documents are required such as Medical & Investigation report, Prescriptions, Medical and Investigation Bills, Discharge Card etc.

Importance of Proper Documentation in Claim Processing: It is noted that in many cases the life insurance claim has been denied by the insurer because the claimant has failed to follow some step or not able to submit the necessary information to the company. So it is recommended that when you claim for life insurance, take proper steps and documentation.

3.7 SUMMARY

Life insurance makes the family financially secure after the untimely death of the breadwinner. Life insurance is also a savings instrument. Life insurance helps in meeting responsibilities of people even after death like higher education of children, their marriages, etc. Life insurance also provides old age benefits, which can be had in the form of annuities or a lump sum after retirement. Creditors can also use it in case the debtor dies without repaying the loan amount by getting the lives of the debtors insured, where the policy money or the sum assured will belong to the creditor in case of non-repayment. Partners of a partnership firm can get the lives of the partners insured in order to repay the share of the dead partner to the heirs. A firm can get the life of its key man insured as the death of the key man may cause the firm to suffer huge financial losses, and this money so got can be used to recruit a new person in place of the deceased employee and also meet the losses during the transitional period (i.e. from the time of death of the key person till the recruitment and training of a new employee). Group insurance policies can also be taken as a welfare measure on the lives of the employees as a whole, improving and boosting the morale of the employees resulting in improved productivity. As with all other products and services that are bought, sold, or traded, life and health insurance is subject to the laws of supply and demand.

3.8 GLOSSARY

- **Warranties:** Warranties are the representations in life insurance which are embodied in the policy and expressly or impliedly forming part of the basis of the contract.
- **Rider Claims:** The life insurance policy can be attached with different riders like accidental rider, Critical illness Rider, Hospital cash Rider, waiver of Premium Rider etc.

3.9 SELF ASSESSMENT QUESTIONS

1. What is Life insurance?

2. Discuss the principles of life insurance.

3. Discuss the importance elements of computations of premium.

4. Explain the importance of life insurance.

5. Explain the various types of products of life insurance.

3.10 SUGGESTED READING

- Ghansham Panda : Principles of Insurance, Kalyani Publishing House, New Delhi
- M.N Mishra & S.B Mishra: Insurance Principles and Practice, S. Chand, New Delhi
- P.K Gupta: Fundaments of Insurance, Himalya Pub., New Delhi
- Rajeda: Principles of Risk Management and Insurance, Pearson Pub., New Delhi
- R.C Gupta & T.C Jain: Insurance and Risk Management, Alpha Pub., New Delhi

NON-LIFE INSURANCE PRODUCTS AND CLAIM MANAGEMENT

STRUCTURE

4.1 INTRODUCTION

One of the most important principles, indemnity, can be quoted to be the cornerstone of insurance. The need to be compensated, or at least indemnified, for loss or damage suffered is the very basis of insurance. In insurance parlance, this is the bread and butter of insurance, or the second face of marketing.

What if the unthinkable occurs-a fire takes place, there is an accident, a burglary or an illness occurs? What if...? Contemplation of the negative aspects makes a prospect introspect on the need for adequate insurance cover. But once the policy is availed of, the most important aspect is the speed and ease with which the insured is compensated or indemnified in the event of a claim.

That is why, claims servicing is the second face and even more important face of marketing. It is the actual delivery of the product – tangible delivery of an intangible service.

Servicing of customers at the time of claim is the most important and vital aspect of any insurance service. A satisfied customer is the best public relations officer of an insurance company. An insured having suffered a loss, is always in a damaged or vulnerable condition; alleviation of some of the suffering by ensuring speedy processing and settlement of the claim is the best and most excellent aspect of any insurance. Here in this lesson, we will discuss various aspects of claim settlement in different forms of general insurance The business of insurance aims to protect the economic value of assets or life of a person. Through a contract of insurance the insurer agrees to make good any loss on the insured property or loss of life (as the case may be) that may occur in course of time in consideration for a small premium to be paid by the insured.

4.2 OBJECTIVES

After reading this lesson, you should be able:

- To know the principle of indemnity.
- To know the principles of Causa Proxim.
- To know the principle of Subrogation.
- To know the concept of banking assurance
- To know the procedures for settlement for claims in fire insurance.

4.3 PRINCIPLE OF INDEMNITY

Indemnity according to the Cambridge International Dictionary is "Protection against possible damage or loss" and the Collins Thesaurus suggests the words "Guarantee", "Protection", "Security", "Compensation", "Restitution" and "Reimbursement" amongst others as suitable substitute for the word "Indemnity". The words protection, security, compensation etc. are all suited to the subject of Insurance but the dictionary meaning or the alternate words suggested do not convey the exact meaning of Indemnity as applicable in Insurance Contracts. In Insurance the word indemnity is defined as "financial compensation sufficient to place the insured in the same financial position after a loss as he enjoyed immediately before the loss occurred." Indemnity thus prevents the insured from recovering more than the amount of his pecuniary loss. It is undesirable that an insured should make a profit out of an event like a fire or a motor accident because if he was able to make a profit there might well be more fires and more vehicle accidents. As in the case of Insurable Interest, the principle of indemnity also relies heavily on the financial evaluation of the loss but in the case of life and disablement it is not possible to be precise in terms of money. Insurance may be for less than a complete indemnity but it may not be for more than it. Similarly in the case of partial loss if some part of the car needs to be replaced the Insurer will not pay the full value of the new part. He shall assess how much the old part had run and after deduction of a proportionate sum he shall pay the balance amount. An insured is not entitled to new for old as otherwise he would be making a profit from the accident. However there are two modern types of policy where there is a deviation from the application of this principle. One is the agreed value policy where the insurer agrees at the outset that they will accept the value of the insured property stated in the policy (sum insured) as the true value and will indemnify the insured to this extent in case of total loss. Such policies are obtained on valuable pieces of Art, Curious, Jewellery, Antiques, Vintage cars etc. The other type of policy where the principle of strict indemnity is not applied is the Reinstatement policy issued in Fire Insurance. Here the Insured is required to insure the property for its current replacement value and the Insurer agrees that in the event of a total loss he shall replace the damaged property with a new one or shall pay for the replacement in full. Other than these there are Life and Personal Accident policies where no financial evaluation can be made. All other Insurance policies are subjected to the principle of strict Indemnity. In most policy documents the word indemnity may not be used but the courts will follows this principle in case of any dispute coming before them.

Indemnity means guarantee or assurance to put the insured in the same position in which he was immediately prior to the happening of the uncertain event. The insurer undertakes to make good the loss. It is applicable to fire, marine and other general insurance. Under this the insurer agreed to compensate the insured for the actual loss suffered. Indemnity means security, protection and compensation given against damage, loss or injury. According to the principle of indemnity, an insurance contract is signed only for getting protection against unpredicted financial losses arising due to future uncertainties. Insurance contract is not made for making profit else its sole purpose is to give compensation in case of any damage or loss. In an insurance contract, the amount of compensations paid is in proportion to the incurred losses. The amount of compensations is limited to the amount assured or the actual losses, whichever is less. The compensation must not be less or more than the actual damage. Compensation is not paid if the specified loss does not happen due to a particular reason during a specific time period. Thus, insurance is only for giving protection against losses and not for making profit. However, in case of life insurance, the principle of indemnity does not apply because the value of human life cannot be measured in terms of money.

HOW IS INDEMNITY PROVIDED?

The Insurers normally provide indemnity in the following manner and the choice is entirely of the insurer 1) Cash Payment 2) Repairs 3) Replacement 4) Reinstatement

1. Cash Payment: In majority of the cases the claims will be settled by cash payment (through cheques) to the assured. In liability claims the cheques are made directly in the name of the third party thus avoiding the cumbersome process of the Insurer first paying the Insured and he in turn paying to the third party.

2. Repair: This is a method of Indemnity used frequently by insurer to settle claims. Motor Insurance is the best example of this where garages are authorized to carry out the repairs of damaged vehicles. In some countries Insurance companies even own garages and Insurance companies spend a lot on Research on motor repair to arrive at better methods of repair to bring down the costs.

3. Replacement: This method of Indemnity is normally not preferred by Insurance companies and is mostly used in glass Insurance where the insurers get the glass replaced by firms with whom they have arrangements and because of the volume of

business they get considerable discounts. In some cases of Jewellery loss, this system is used specially when there is no agreement on the true value of the lost item.

4. Reinstatement: This method of Indemnity applies to Property Insurance where an insurer undertakes to restore the building or the machinery damaged substantially to the same condition as before the loss. Sometimes the policy specifically gives the right to the insurer to pay money instead of restoration of building or machinery. Reinstatement as a method of Indemnity is rarely used because of its inherent difficulties e.g., if the property after restoration fails to meet the specifications of the original in any material way or performance level then the Insurer will be liable to pay damages. Secondly, the expenditure involved in restoration may be much more than the sum Insured as once they have agreed to reinstate they have to do so irrespective of the cost.

Limitations on Insurers Liability

1. The maximum amount recoverable under any policy is the sum insured, which is mentioned on the policy. The amount is not the agreed value of the property (except in Valued policies) nor is it the amount, which will be paid automatically on occurrence of loss. What will be paid is the actual loss or sum insured whichever is less.

2. Property Insurance is subjected to the Condition of Average. The underlying principle behind this condition is that Insurers are the trustees of a pool of premiums from which they meet the losses of the few who suffer damage, so it is reasonable to conclude that every Insured should bring a proper contribution to the pool by way of premium. Therefore if an insured deliberately or otherwise underinsures his property thus making a lower contribution to the pool, he is not entitled to receive the full benefits. The application of this principle makes the insured his own Insurer to the extent of under-insurance i.e. the pro-rata difference between the Actual Value and the sum insured. The amount of loss will be shared between the Insurer and the insured in the proportion of sum insured and the amount underinsured. The formula applicable for arriving at the amount to be paid by the Insurance Co. is Claim = Loss X (Sum Insured / Market Value) Example Mr. Sudhir Kumar has insured his house

for Rs.5 lacs and suffers a loss of Rs.1 lac due to fire. At the time of loss the surveyor finds that the actual market value of the house is Rs.10 lacs. In this case applying the above formula the claim will be as under:
Loss = 1 lac   sum insured = 5 lacs   Market Value = 10 lacs Therefore, 1 lac X 5 lacs / 10 lacs = 50,000/Claim = Rs 50,000/

4.4 PRINCIPLE OF CAUSA PROXIM

The doctrine of proximate cause is based on the principle of cause and effect, which states that having proved the effect and traced the cause it is not necessary to go any further i.e. cause of cause. The law provided the rule "Cause Proxmia non Remote spectator". The immediate cause and not the remote one should be taken into consideration. Therefore the proximate cause should be the immediate cause. Immediate does not mean the nearest to the loss in point of time but the one most effective or efficient. Thus if there are a number of causes and the proximate cause has to be chosen the choice should be of the most predominant and efficient cause i.e. the cause which effectively caused the result. Proximate cause has been defined as "The active efficient cause that sets in motion a train of events which bring about a result without the intervention of any force started and working actively from a new and independent source". (This definition comes from the ruling given in the case Pawsey v/s Scottish Union and National Insurance Co. (1907). It is important to note that in Insurance Proximate has got nothing to do with time even though the Dictionary defines Proximity as 'The state of being near in time or space' (period or physical) and the Thesaurus given the alternate words as "adjacency of" "closeness", "nearness" "vicinity" etc. But in Insurance Proximate cause is that which is Proximate in efficiency. It is not the latest but the direct, dominant, operative and efficient cause.

The loss of insured property can be caused by more than one cause in succession to another.

The property may be insured against some causes and not against all causes.

In such an instance, the proximate cause or nearest cause of loss is to be found out.

If the proximate cause is the one which is insured against, the insurance company is bound to pay the compensation and vice versa.

Principle of Causa Proxima (a Latin phrase), or in simple English words, the Principle of Proximate (i.e Nearest) Cause, means when a loss is caused by more than one causes, the proximate or the nearest or the closest cause should be taken into consideration to decide the liability of the insurer.

The principle states that to find out whether the insurer is liable for the loss or not, the proximate (closest) and not the remote (farest) must be looked into.

For example: A cargo ship's base was punctured due to rats and so sea water entered and cargo was damaged. Here there are two causes for the damage of the cargo ship - (i) The cargo ship getting punctured beacuse of rats, and (ii) The sea water entering ship through puncture. The risk of sea water is insured but the first cause is not. The nearest cause of damage is sea water which is insured and therefore the insurer must pay the compensation.

However, in case of life insurance, the principle of Causa Proxima does not apply. Whatever may be the reason of death (whether a natural death or an unnatural death) the insurer is liable to pay the amount of insurance.

4.5 PRINCIPLE OF SUBROGATION

It has already been established that the purpose of Indemnity is to ensure that the Insured does not make a profit or gain in any way as a consequence of an accident. He is placed in the same financial position, which he had occupied immediately before the loss occurred. As an off shoot of the above it is also fair that the insurer having indemnified the insured for damage caused by another (A Third Party) should have the right to recover from that party the amount of damages or part of the amount he has paid as indemnity. This right to recover damages usually lies with the bereaved or injured party but the law recognises that if another has already paid the bereaved or injured party then the person who has paid the compensation has the right to recover damages. In case the insured after having received indemnity also recovers losses from another then he shall be in a position of gain which is not correct and this amount recovered from another shall be held in trust for the insurer who have already given indemnity. Subrogation may be defined as the transfer of legal rights of the insured to recover, to the Insurer.

As per this principle after the insured is compensated for the loss due to damage to property insured, then the right of ownership of such property passes to the insurer. This principle is corollary of the principle of indemnity and is applicable to all contracts of indemnity. Subrogation means substituting one creditor for another. Principle of Subrogation is an extension and another corollary of the principle of indemnity. It also applies to all contracts of indemnity. According to the principle of subrogation, when the insured is compensated for the losses due to damage to his insured property, then the ownership right of such property shifts to the insurer. This principle is applicable only when the damaged property has any value after the event causing the damage. The insurer can benefit out of subrogation rights only to the extent of the amount he has paid to the insured as compensation.

For example: Mr. Arvind insures his house for ` 1 million. The house is totally destroyed by the negligence of his neighbour Mr. Mohan. The insurance company shall settle the claim of Mr. Arvind for ` 1 million. At the same time, it can file a law suit against Mr. Mohan for ` 1.2 million, the market value of the house. If insurance company wins the case and collects ` 1.2 million from Mr. Mohan, then the insurance company will retain ` 1 million (which it has already paid to Mr. Arvind) plus other expenses such as court fees. The balance amount, if any will be given to Mr. Arvind, the insured.

4.6 BANK ASSURANCE: MEANING AND BENEFITS

Meaning

Bank-assurance in its simplest form is distribution of insurance products through a banks distribution channel. It is a medium for the cost-effective distribution of insurance and pension products by penetrating diverse markets. There is no clash of interest between banks and insurance companies as bank deposits are for current consumption and they only market insurance services to their customers.

The banking and insurance industry have changed rapidly in the changing and challenging economic environment throughout the world. In the competitive and liberalized environment everyone is trying to do better than others and consequently survival of the fittest has come into effect. Insurance companies are also required to be competitive by way of cost cutting and serving customers in a better way. The time has come for the industry to gradually move from the traditional individual agents towards new distribution channels with a paradigm shift in creating awareness and not just selling products.

The strategy for using the established, entrenched distribution network for one product to market other new products has long existed in the consumer goods sector. The basic premises of this kind of cross selling is the fact that companies keep diversifying their product portfolio using established incumbent networks to promote and distribute new product lines. Banks too have in the recent past adopted this strategy. The answer to this is 'Bank-assurance'.

According to the European School of thought, “Bank-assurance is the amalgamation of the assurance and banking business within a financial environment”

According to the Indian School of thought, it means selling insurance through bank staff, at bank counters, fully exploiting the synergies between banking and insurance, so as to develop and distribute cost effective banking products.

The Life Insurance Marketing and research Association's insurance dictionary defines Bank-assurance as “the provision of life insurance services by banks and building societies.”

The Association of British Insurers defines Bank-assurance as “insurance companies that are subsidiaries to banks and building societies and whose primary market is the customer base of the bank or building society.”

Another definition of Bank-assurance is “the involvement of banks and building societies in the manufacturing, marketing or distribution of insurance products”

According to IRDA, 'Bank-assurance' refers to banks acting as corporate agents for insurers to distribute insurance products.

It takes various forms depending upon the demography, economic and legislative environment of the country. While the demographic climate determines the kind of insurance products, the economic climate will determine the trend in terms of turnover, market share etc., and legislative climate will decide the periphery within which Bank-assurance has to operate.

Benefits

Why Bank-assurance has shown such strong growth in certain markets can be seen as the effect of individual interests feeding into a partnership, and eventually benefiting all parties. It must be to the advantage of each stakeholder in the model (bank, insurance company, consumer and legislator) for the Bank-assurance model to develop successfully. Without these advantages, it is obvious that no collaboration would be possible. Hence, the advantages of Bank-assurance are discussed from the view-point of all the parties concerned- viz. banks, insurers, consumers and legislators.

Benefits to the Insurance Company

Alongwith increasing its customer base through the banks clients, the insurance company is able to reduce its reliance on traditional agents; can develop new financial products and can also obtain financial support from the banks when required (Corneliu, n.d) Further, this alliance also helps in creating brand equity along with cutting down on the cost of acquisition of insurance policies. These benefits have been discussed in detail as under:

1. Through this new distribution network, the insurance company significantly extends its customer base and enjoys access to customers who were previously difficult to reach. This is obviously a fundamental advantage; it is itself enough to convince an insurance company to ally itself with a bank as an insurance company can establish its market presence rapidly.
2. The insurance company has the opportunity to vary its distribution methods, in order to avoid excessive dependence on a single network of the traditional agents.
3. The insurance company often benefits from the trustworthy image and reliability that people are more likely to attribute to banks;
4. The insurance company also benefits from the reduction in distribution costs

relative to the costs inherent in traditional sales representatives, since the sales network is generally the same for banking products and insurance products. This means that products can be sold more cheaply to the consumers.

5. An insurance company can establish itself more quickly in a new market, using a local bank's existing network thereby creating brand equity for itself.

6. Insurance companies can obtain additional capital from banks to improve their solvency and expand business.

Benefits to the Bank

Besides becoming a "one stop shop" for financial needs of the consumers, banks can increase customer retention, reduce risk based capital requirement and secure additional and more stable stream of income. The extra income from Bank-assurance tie-ups can increase profits and productivity of banks, help in hedging credit risks and also create a much needed sales culture in the banks. Even the FICCI survey of 2010 has found that Bank-assurance is the most profitable non-interest income business opportunity for the banks. The bank becomes a sort of "supermarket", a "one-stop shop" for financial services, where all customers' needs – whether financial or insurance-related – can be met. The broadening of its product range makes the bank more attractive and can reinforce customer satisfaction and therefore customer loyalty as services can be tailored according to the requirements of the customers.

2. Bank-assurance is a way of creating a new revenue flow and diversification of business activities of the bank. The commission and fee income from the insurance companies is an additional, secure and more stable stream of income for the banks.

3. It reduces risk based capital requirement of the banks for earning the same level of revenues.

4. The distribution costs can be seen as marginal since, in most cases, it is the bank's existing employees who sell the insurance products. Amongst other things, the one-stop shop model optimizes the use of the network and increases the profitability of the existing branch network.

5. Also, since insurance products tend to be tied up with banking products especially

loans and mortgages, there is hedging of credit risk of the banks to some extent.

Benefits to the Consumer:

1. As mentioned among the advantages for the bank, the consumer enjoys greater access to all financial services from a bank that offers both banking and insurance products;
2. Since the distribution costs are lower than in a traditional distribution network, the consumer can usually get cheaper insurance products than through traditional channels. In addition, premium payment methods are simplified, since premiums are collected directly from bank accounts;

The special relationship between the customer and the bank means that there is a better match between what the customer needs and the solutions provided by the bank.

In a nut shell, we could say that customers' benefit from the opportunity to get simple, often inexpensive insurance products with a premium payment system adapted to their needs (usually monthly installments) and with easy access, since the branch network is usually denser than the network of insurance outlets.

Benefits to the Legislator

The role of the oversight authorities or of the government itself is to make laws to ensure that the risks taken by their country's financial institutions are actively managed and controlled in such a way as to maintain sound national finances. However, events may occur that are outside the control of individual and national managers, which may impact upon the whole financial system. These risks go under the name of "systemic risk".

For financial institutions, Bank-assurance can be a means of limiting such systemic risk because it diversifies the bank's sources of revenue, making its business more stable and thereby safer for its customers too.

On the other hand, certain authorities think that deregulating financial systems to excess can increase a country's systemic risk. This is why, in many countries, banks are still unable to exercise activities outside their core business, in order to avoid additional sources of risk. In addition, certain governments have decided to liberalize the financial system, but progressively, for a more controlled process of deregulation. In other words, supervisory authorities may see Bank-assurance as an advantage or, on the contrary, as a potential risk to a country's financial stability.

4.7 CAUSES OF GROWTH OF BANK-ASSURANCE

The motives behind entering into Bank-assurance also vary. For banks it is a means of product diversification and a source of additional fee income while the insurance companies see Bank-assurance as a tool for increasing their market penetration and premium turnover. These reasons have been clubbed and summarized as under:

Wide Network of branches: Banks can prove to be a vital distribution channel due to their existing wide network of branches all over. This enables the insurance companies to reach out to each and every individual in the country who needs insurance.

Competition: Intense market competition between banks has led to substantial decrease in interest margins of the traditional banking products. Hence, commission and fees from selling insurance products will supplement the bank's earnings.

Customer Database: Customer database with the banks i.e. information on the basic profile of the customer, his financial net worth, spending habits, investment patterns and requirements etc. can prove to be a goldmine for the insurance company. Such information channelized in the right manner can help work out marketing strategies and arrive at result-oriented decisions targeting prospects.

Corporate Clients: Banks can utilize their existing clientele, which includes corporate as well as retail clients to market insurance products. Depending on the relationship with its clients it would become easier to influence the insurance purchase decisions of its clients. Customers too, having banked with a particular bank for a long period repose a sense of trust and faith in the bank.

Rural Penetration: The existing wide network of banks in rural areas can be utilized for selling insurance products. Having been accustomed to the customers' choices, banks are in a better position to understand the needs of the customers and sell tailor made policies.

New Products: In collaboration with the banks, insurance companies can develop new financial products to satisfy diverse consumer needs.

Personalized Service: Since banks have direct contacts with customers, the service area can be tackled easily. Customers, other than their day-to-day financial requirements can also get assistance for premium payment, surrender, transfer of policies and many more.

In the absence of financial planners in India, traditionally the bank managers act as investment advisors to their customers. Due to the proximity, he is in a position to provide solutions based on detailed profile of his customers.

Cross-Selling Products: Banks in their normal course of functions lend finance in the form of loans for cars, or for buying a house to clients. They can combine insurance products and sell as a package. In the current scenario banks can cross sell their products along with the insurance products.

Fee Based Service: Insurance products can be sold as a fee based service. In an age where banks are trying to venture into selling mutual funds and other financial products besides stock Broking etc., selling insurance products could also give an additional boost to the banks income. Also, this income is purely risk free for banks since the bank simply plays the role of an intermediary for sourcing business to insurance companies

4.8 PROCEDURES FOR SETTLEMENT FOR CLAIMS IN FIRE INSURANCE

Fire Insurance Fire is hazardous to human life as well as property. Loss of life by fire is covered under Life insurance and loss of property by fire is covered under fire insurance. Fire causes enormous damage by physically reducing the materials to ashes. A fire insurance policy provides protection strictly against fire. There could be enormous reasons for fire. In practice certain other related perils are also covered by the fire insurance policy. The General Insurance Act (Tariff) recommends the form of the contract in which a fire insurance is to be written. The policy form contains a preamble and operative clause, general exclusions and general conditions. Fire

Insurance comes under tariff class of business. All India Fire Tariff is the revised fire insurance tariff, which came into force on May1, 2001. Now a single policy was introduced to cover all property risks called standard fire and special peril policy in the place of three standard policies i.e. A, B&C. A contract of fire insurance can be defined as a contract under which one party (the insurer) agrees for consideration (premium) to indemnify the other party (The insured) for the financial loss which the latter may suffer due to damage to the property insured by fire during a specified period of time and up to an agreed amount. The document containing the terms and conditions of the contract is known as 'Fire Insurance Policy'. A fire policy contains the name of the parties, description of the insured property, the sum for which the property is insured, amount of premium payable and the period insured against. The premium may be paid either in single installment or by way of installments. The insurer is liable to make good the loss only when loss is caused by actual fire. The phrase 'loss or damage by fire' also includes the loss or damage caused by efforts to extinguish fire.

Scope of cover Standard Fire and special perils policy usually cover loss due to the following perils:

1. Fire: Destruction or damage to the property insured by its own fermentation, natural heating or spontaneous combustion or drying process can not be treated as damage due to fire.

2. Lightning: It may result in fire damage or other type of damage, such as cracks in a building due to a lightning strike.

3. Explosion: An explosion is caused inside a vessel when the pressure within the vessel exceeds the atmospheric pressure acting externally on its surface. This policy, however, does not cover destruction or damage caused to the boilers or other vessels where heat is generated.

4. Storm, cyclone, typhoon, hurricane, tornado, landslide: These are all various types of violent natural disturbances accompanied by thunder or strong winds or heavy rain fall. Loss or damage directly caused by these disturbances are covered excluding those resulting from earthquake, volcanic eruption etc.

5. Bush fire: This covers damage caused by burning of bush and jungles but excluding destruction or damage caused by forest fire 6. Riot, strike, malicious, and terrorism damages: Any loss or physical damage to the property insured directly caused by such activity or by the action of any lawful authorities in suppressing such disturbance is covered.

7. Aircraft damage: Loss, destruction or damage caused by Aircraft, other aerial or space devices and articles dropped there from excluding those caused by pressure waves.

8. Overflowing of water tanks and pipes etc.: Loss or damage to property by water or otherwise on account of bursting or accidental overflowing of water tanks, apparatus and pipes is covered.

9. Add-on Covers: The insurer can issue the standard fire policy with added benefits at the option of the policyholders by charging additional premium. These added benefits are as follows: 1. Architects, Surveyors and Consulting engineer's fees (in excess of 3% claim amount) 2. Debris removal (in excess of 1% of claim amount) 3. Deterioration of stocks in cold storage due to power failure 4. Forest fire 5. Spontaneous combustion 6. Earthquake as per minimum rates and excess applicable as specified in the tariff. 7. Omission to insure additions, alterations or extensions. The following types of losses, however, are not covered by a fire policy: · Loss by theft during and after the occurrence of fire. · Loss caused by burning of property by order of any public authority. · Loss caused by underground fire. · Loss or damage to property occasioned by its own fermentation or spontaneous combustion. · Loss happening by fire which is caused by earthquake, invasion, act of foreign enemy, warlike operations, civil wars, riot etc. In all the above cases the insurer is not liable, unless specifically provided for in the fire insurance policy. The insurer can issue the standard fire policy as per the New Fire Tariff along with added benefits at the option of the policyholders by charging additional premium.

Types of Fire Policies The important fire insurance policies are discussed below: (i) Valued Policy. They are the exception in fire insurance. Under valued policy, the value declared in the policy is the amount the insurer will have to pay to the insured in the event of a total loss irrespective of the actual value of loss. The policy violates the principle of indemnity. The insurer has to pay a specified amount quite independent of the market or actual value of the property at the time of loss. So such a policy is very rarely issued. It may be issued only on artistic work, antiques and similar rare articles whose value cannot be determined easily.

(ii) Specific Policy. Under this policy, the insurer undertakes to make good the loss to the insured upto the amount specified in the policy. Supposing, a building worth Rs.2,00,000 is insured against fire for Rs. 1,00,000. If the damage to the property is Rs.75,000 the insurer will get the full compensation. Even if the loss is Rs.1,00,000 the insurer will get the full amount. But if the loss is more than Rs. 1, 00,000 the insured will get Rs. 1,00,000 only. Hence, the value of property is not relevant in determining the amount of indemnity in case of a specific policy.

(iii) Average Policy. Under a fire insurance policy containing the 'average clause' the insured is liable for such proportion of the loss as the value of the uncovered property bears to the whole property. e.g. if a person gets his house insured for Rs. 4,00,000 though its actual value is Rs. 6,00,000 , if a part of the house is damaged in fire and the insured suffers a loss of Rs. 3,00,000 , the amount of compensation to be paid by the insurer comes out to Rs. 2,00,000 calculated as follows:

Amount of claim= (Insured amount X Actual loss) /Actual value of property (4,00,000 X 3,00,000)/6,00,000 =2,00,000 (iv) Floating policy. A floating policy is used for covering fluctuating stocks of goods held in different lots for one premium. With every transaction of sale or purchase, the quantities of goods kept at different places fluctuate. It is difficult for the owner to take a policy for a specific amount. The best way is to take out a floating policy for all the stocks of goods.

(v) Reinstatement Policy. In such a policy, the insurer has the right to reinstate or replenish the property destroyed instead of paying compensation to the insured in cash. It may be granted on building, machinery, furniture, fixture and fittings only.

(vi) Consequential loss Policy. Sometimes the insured has to suffer a greater financial loss on account of dislocation of business caused by fire .e.g. close down business after fire for repair, to meet fixed expenses such as rent, salaries, taxes and other expenses as usual. Such considerable loss to the insured is not covered by the ordinary fire policy. In order to cover such loss by fire, the 'Consequential Loss Policy' has been introduced. The loss so suffered is separately calculated from the loss actually suffered.

(vii) Comprehensive policy. This policy covers the risks of the fire arising out of any cause that is civil commotion, lightening, riots, thefts, labor disturbances and strikes etc. It is also known as 'all insurance policy'.

(viii) A Blanket policy. This policy is issued to cover all the fixed and current assets of an enterprise by one insurance.

(ix) Declaration policy. In this policy, trader takes out a policy for the maximum value of stock which may be expected to hold during the year. At a fixed date each month, the insured has to make a declaration regarding the actual value of stock at risk on that date. On the basis of such declaration, the average amount of stock at risk in the year is calculated and this amount becomes the sum assured.

(x) Sprinklers leakage policy. It covers the loss arising out of water leakage from sprinklers which are setup to extinguish fire.

Claim Procedure for Fire Insurance

1. In the event of fire the insured must immediately give the insurer a notice about the loss caused by fire. A written claim should be delivered within 15days from the date of loss. The insured is required to furnish all plans, invoices, documents, proofs and other relevant information required by the insurer. If the insured failed to submit these documents within 6 months from the date of loss, the insurer has the right to consider it as no claim.
2. On receipt of the claim the insurer verifies whether the essentials of a valid claim are satisfied or not. e.g. The cause of fire should be an insured peril.
3. The insured completes the form, signs the declaration given in the form as to the truthfulness and accuracy of the information and returns the same.
4. An official employed by the insurer investigates small and simple claims. For large claims, the insurance company employs independent loss surveyor.
5. On the basis of the claim form and the investigation report, the company then

settles the claim.

PROCEDURE TO INSURE THE PROPERTY UNDER FIRE INSURANCE: For insuring any property under the fire insurance policy, the following is the procedure:

1) Filling of proposal form
2) Inspection of the property
3) Payment of premium
4) Issue of Cover note/ Policy document in lieu of acceptance of the proposal.

I) Filling of Proposal Form The fire proposal includes the following information: Description of the property. This would include:

(i) Construction of external walls and roof, number of storeys.
(ii) Occupation of each portion of the building.
(iii) Presence of hazardous goods.
(iv) Process of manufacture.
(v) The sums proposed for insurance.
(vi) The period of insurance.
(vii) History of previous losses.
(viii)Insurance history - whether previously other insurers had declined the risk, etc.

II) Inspection of the property: In case of property of any business organization, whether manufacturing or other type of organization, a risk inspection report is submitted by the insurer's engineers. The engineers submit in their report the nature of risk involved in the factory/ manufacturing unit.

III) Payment of Premium: Based on the proposal form and the inspection report of the engineers, the insurance company will submit the premium rates to the property owner and if these rates are acceptable to him then he should pay the amount to the insurance company. It is also a legal requirement under section 64VB of Insurance Act 1938 that the premium is paid in advance in full to the insurance company.

IV) Issue of Cover note/ Policy document: On receipt of a completed proposal form and / or inspection report, the cover note is issued, pending preparation of the policy document. The cover note is an unstamped document issued to provide evidence of cover till the time the policy is issued. The cover note provides insurance against specified perils on the usual terms and conditions of the company's policy.

The printed policy form provides for a schedule in which the individual details of the contract are typed. The items are similar to those in the Cover Note but with more detailed information.

After issuing the policy document, it is likely that there may be some changes in the nature of property or sum insured may increase or decrease. In this case, these changes can be incorporated by way of endorsements which are issued to record changes such as alteration in risk, increase or decrease of sum insured, etc.

PROCEDURE TO SETTLE THE FIRE INSURANCE CLAIM:

A) If there are any damage or loss arising due to fire then the policy holder should immediately inform the insurance company in writing and with estimated amount of loss.

B) Survey Report: If the amount of loss is small (i.e. up to Rs. 20,000/-), the insurance company may depute an officer to survey the loss and decide on the settlement of the loss on the basis of the claim form and the officer's report. However, in large losses, an independent surveyor duly licensed by the Government is appointed to give a report on the loss. The survey report would generally deal with the following matters:

i. Cause of loss.
ii. Extent of loss.
iii. Under-Insurance, if any.
iv. Details and value of salvage, and how it has been disposed of or proposed to be disposed of.
v. Details of expenses (e.g. fire brigade expenses).
vi. Compliance with policy conditions and warranties.

vii. Details of other insurance policies on the same property, and the apportionment of the loss and expenses among co-insurers.

C) Claim form: The policy holder will submit the claim form with the following information: Name and address of the Insured.

i. Date of loss, time and place from where the fire started.
ii. Cause of fire.
iii. Details of the property damaged such as description, etc.
iv. Value at the time of fire, value of salvage and the amount of loss.
v. Details of other policies on the same property giving the name of the insurer, policy number and sum insured.
vi. Fire Brigade report details.
vii. F.I.R. at the nearest police station regarding third party liability, if any.

D) Settlement of claim: On the basis of the claim form and the survey report, decision is taken about the settlement or otherwise of the loss.

4.9 PROCEDURES FOR SETTLEMENT FOR CLAIMS IN MARINE INSURANCE

Concept Marine Insurance

Marine insurance covers the loss or damage of ships, cargo, terminals, and any transport or cargo by which property is transferred, acquired, or held between the points of origin and final destination. Cargo insurance discussed here is a sub-branch of marine insurance, though Marine also includes Onshore and Offshore exposed property (container terminals, ports, oil platforms, pipelines); Hull; Marine Casualty; and Marine Liability.

The general principles of marine insurance are the same as with other types of insurance in that there are two parties: the assured and assurer (or carrier). The assured or insured agrees to pay a premium and the insurer agrees that, if certain losses or damage occurs to certain interests of the insured, the insurer will indemnify the insured. The similarities pretty much end here. The complex circumstances involved in sea voyages require very specific arrangements for the provision of marine insurance. The fixing of rates and special conditions, for example, requires a vast knowledge of the nature of vessels and cargos and of the conditions of navigation.

The marine policy may cover the risks of a single voyage, or may insure for a certain period of time. Cargo is almost always insured by voyage. Vessels are usually insured for certain duration of time, usually year by the year. Cargo policies may be on a single lot or may be open to cover cargo as shipped by the insured. Hull insurance, or vessel insurance, may cover a ship or a whole fleet.

Typical of marine insurance is the principle that no contract of marine insurance is valid unless the insured has an insurable interest in the subject matter at the time of loss. The term insurable interest has been variously defined. According to the English Marine Insurance Act of 1906, "every person has an insurable interest who is interested in a marine adventure.... a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or damage thereto, or by the detention thereof, or may incur liability in respect thereof".

The nature and scope of marine insurance is determined by reference to s. 6 of the Marine Insurance Act and by the definitions of “marine adventure” and “maritime perils”. A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the insured, in the manner and to the extent agreed in the contract, against losses that are incidental to a marine adventure or an adventure analogous to a marine adventure, including losses arising from a land or air peril incidental to such an adventure if they are provided for in the contract or by usage of the trade; or losses that are incidental to the building, repair or launch of a ship.

"Marine adventure" means any situation where insurable property is exposed to maritime perils, and includes any situation where the earning or acquisition of any freight, commission, profit or other pecuniary benefit, or the security for any advance, loan or disbursement, is endangered by the exposure of insurable property to maritime perils, and any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils. "Maritime perils" means the perils consequent on or incidental to navigation, including perils of the seas, fire, war perils, acts of pirates or thieves, captures, seizures, restraints, detainments of princes and peoples, jettisons, barratry and all other perils of a like kind and, in respect of a marine policy, any peril designated by the policy.

Features of Marine Insurance

1) Offer & Acceptance: It is a prerequisite to any contract. Similarly the goods under marine (transit) insurance will be insured after the offer is accepted by the insurance company. Example: A proposal submitted to the insurance company along with premium on 1/4/2011 but the insurance company accepted the proposal on 15/4/2011. The risk is covered from 15/4/2011 and any loss prior to this date will not be covered under marine insurance.

2) Payment of premium: An owner must ensure that the premium is paid well in advance so that the risk can be covered. If the payment is made through cheque and it is dishonoured then the coverage of risk will not exist. It is as per section 64VB of Insurance Act 1938- Payment of premium in advance.

3) Contract of Indemnity: Marine insurance is contract of indemnity and the insurance company is liable only to the extent of actual loss suffered. If there is no loss there is no liability even if there is operation of insured peril. Example: If the property under marine (transit) insurance is insured for Rs 20 lakhs and during transit it is damaged to the extent of Rs 10 lakhs then the insurance company will not pay more than Rs 10 lakhs.

4) Utmost good faith: The owner of goods to be transported must disclose all the relevant information to the insurance company while insuring their goods. The marine policy shall be voidable at the option of the insurer in the event of misrepresentation, mis-description or non-disclosure of any material information. Example: The nature of goods must be disclosed i.e whether the goods are hazardous in nature or not, as premium rate will be higher for hazardous goods.

5) Insurable Interest: The marine insurance will be valid if the person is having

insurable interest at the time of loss. The insurable interest will depend upon the nature of sales contract. Example: Mr A sends the goods to Mr B on FOB (Free on Board) basis which means the insurance is to be arranged by Mr B. And if any loss arises during transit then Mr B is entitled to get the compensation from the insurance company.

Subject Matter of Marine Insurance

The insured may be the owner of the ship, owner of the cargo or the person interested in freight. In case the ship carrying the cargo sinks, the ship will be lost along with the cargo. The income that the cargo would have generated would also be lost. Based on this we can classify the marine insurance into four categories:

1. Hull Insurance: Hull refers to the ocean going vessels (ships trawlers etc.) as well as its machinery. The hull insurance also covers the construction risk when the vessel is under construction. A vessel is exposed to many dangers or risks at sea during the voyage. An insurance effected to indemnify the insured for such losses is known as Hull insurance.

2. Cargo Insurance: Cargo refers to the goods and commodities carried in the ship from one place to another. The cargo transported by sea is also subject to manifold risks at the port and during the voyage. Cargo insurance covers the shipper of the goods if the goods are damaged or lost. The cargo policy covers the risks associated with the transshipment of goods. The policy can be written to cover a single shipment. If regular shipments are made, an open cargo policy can be used that insures the goods automatically when a shipment is made.

3. Freight Insurance: Freight refers to the fee received for the carriage of goods in the ship. Usually the ship owner and the freight receiver are the same person. Freight can be received in two ways- in advance or after the goods reach the destination. In the former case, freight is secure. In the latter the marine laws say that the freight is payable only when the goods reach the destination port safely. Hence if the ship is destroyed on the way the ship owner will loose the freight along with the ship. That is why, the ship owners purchase freight insurance policy along with the hull policy.

4. Liability Insurance: It is usually written as a separate contract that provides

comprehensive liability insurance for property damage or bodily injury to third parties. It is also known as protection and indemnity insurance which protects the ship owner for damage caused by the ship to docks, cargo, illness or injury to the passengers or crew, and fines and penalties. Types of Marine Policy

There are different types of marine policies known by different names according to the manner of their execution or the risk they cover. They are:

(i) Voyage Policy: Under the policy, the subject matter is insured against risk in respect of a particular voyage from a port of departure to the port of destination, e.g. Mumbai to New York. The risk starts from the departure of ship from the port and it ends on its arrival at the port of destination. This policy covers the subject matter irrespective of the time factor. This policy is not suitable for hull insurance as a ship usually does not operate over a particular route only. The policy is used mostly in case of cargo insurance.

(ii) Time Policy: It is one under which the insurance is affected for a specified period of time, usually not exceeded twelve months. Time policies are generally used in connection with the insurance of ship. Thus if the voyage is not completed with in the specified period, the risk shall be covered until the voyage is completed or till the arrival of the ship at the port of call.

(iii) Mixed Policies: It is one under which insurance contract is entered into for a certain time period and for a certain voyage or voyages, e.g., Kolkata to New York, for a period of one year. Mixed Policies are generally issued to ships operating on particular routes. It is a mixture of voyage and time policies.

(iv) Valued Policies: It is one under which the value of subject matter insured is specified on the face of the policy itself. This kind of policy specifies the settled value of the subject matter that is being provided cover for. The value which is agreed upon is called the insured value. It forms the measure of indemnity in the event of loss. Insured value is not necessarily the actual value. It includes (a) invoice price of goods (b) freight, insurance and other charges (c) ten to fifteen percent margin to cover expected profits.

(v) Unvalued policy: It is the policy under which the value of subject matter insured is not fixed at the time of effecting insurance but has to be ascertained wherever the subject matter is lost or damaged.

(vi) Open policy: An open policy is issued for a period of 12 months and all consignments cleared during the period are covered by the insurer. This form of insurance Policy is suitable for big companies that have regular shipments. It saves them the tedious and expensive process of acquiring an insurance policy for each shipment. The rates are fixed in advance, without taking the total value of the cargo being shipped into consideration. The assured has to declare the nature of each shipment, and the cover is provided to all the shipments. The assured also deposits a premium for the estimated value of the consignment during the policy period.

(vii) Floating Policy: A merchant who is a regular shipper of goods can take out a 'floating policy' to avoid botheration and waste of time involved in taking a new policy for every shipment. This policy stands for the contract of insurance in general terms. It does not include the name of the ship and other details. The other details are required to be furnished through subsequent declarations. Thus, the insured takes a policy for a huge amount and he informs the underwriter as and when he makes shipment of goods. The underwriter goes on recording the entries in the policy. When the sum assured is exhausted, the policy is said to be “fully declared” or “run off”.

(viii) Block Policy: This policy covers other risks also in addition to marine risks. When goods are to be transported by ship to the place of destination, a single policy known as block policy may be taken to cover all risks. E.g. when the goods are dispatched by rail or road transport for shipment, a single policy may cover all the risks from the point of origin to the point of destination.

PROCEDURE OF CLAIM SETTLEMENT

As the risk coverages are different for import/export and inland (with in India) consignments, the procedure of claim settlement is explained separately.

(A) For Import/Export consignments

Claims Documents Claims under marine policies have to be supported by certain documents which vary according to the type of loss as also the circumstances of the claim and the mode of carriage. The documents required for any claim are as under:

a) Intimation to the Insurance company: As soon as the loss is discovered then it is the duty of the policyholder to inform the Insurance company to enable it to assess the loss.

b) Policy: The original policy or certificate of insurance is to be submitted to the company. This document establishes the claimant's title and also serves as an evidence of the subject matter being actually insured.

c) Bill of Lading : Bill of Lading is a document which serves as evidence that the goods were actually shipped. It also gives the particulars of cargo.

d) Invoice: An invoice evidences the terms of sale. It also contains complete description of the goods, prices, etc. The invoice enables the insurers to see that the insured value of the cargo is not unreasonably in excess of its cost, and that there is no gross overvaluation. The original invoice (or a copy thereof) is required in support of claim.

e) Survey Report: Survey report shows the cause and extent of loss, and is absolutely necessary for the settlement of claim. The findings of the surveyors relate to the nature and extent of loss or damage, particulars of the sound values and damaged values, etc. It is normally issued with the remarks “without prejudice,” i.e. without prejudice to the question of liability under the policy.

f) Debit Note: The claimant is expected to send a debit note showing the amount claimed by him in respect of the loss or damage. This is sometimes referred to as a claim bill.

g) Copy of Protest: If the loss or damage to cargo has been caused by a peril of the sea, the master of the vessel usually makes a protest on arrival at destination before a Notary Public. Through this protest, he informs that he is not responsible for the loss or damage. Insurers sometimes require to see the copy of the protest to satisfy themselves about the actual cause of the loss.

h) Letter of Subrogation : This is a legal document (supplied by insurers) which transfers the rights of the claimant against a third party to the insurers. On payment of claim, the insurers may wish to pursue recovery from a carrier or other third party who, in their opinion, is responsible for the loss. The authority to do so is derived from this document. It is required to be duly stamped. Some of the other documents required in support of particular average claims are Ship survey report lost overboard certificate if cargo is lost during loading and unloading operation, short landing certificate etc.

i) Bill of entry: The other important document is bill of entry issued by the customs authorities showing therein the amount of duty paid, the date of arrival of the steamer, etc., account sales showing the proceeds of the sale of the goods if they have been disposed of; repairs or replacements bills in case of damages or breakage; and copies of correspondence exchanged between the carriers and the claimants for compensation in case of liability resting on the carriers.

(B) Inland Transit Claims (Rail / Road)

In regard to claims relating to inland transit, the documents required to be submitted to the insurers in support of the claim are:

(a) Original policy or certificate of insurance duly endorsed.

(b) Invoice, in original, or copy thereof.

(c) Certificate of loss or damage (original) issued by carriers.

(d) If goods are totally lost or not delivered, the original railway receipt and / or non-delivery certificate / consignment note.

(e) Copy of the claim lodged against the railways / road carriers (By Regd. A.D.)

(f) Letter of Subrogation, duly stamped.

(g) Special Power of Attorney duly stamped. (Railway Claims).

(h) Letter of Authority addressed to the railway authorities signed by the consignors in favour of consignees whenever loss is claimed by consignees.

(i) Letter of Authority addressed to the railway authorities signed by the consignors in favour of the insurers

(j) Letter of Undertaking from the claimant in case of nondelivery of consignment.

(k) Claim Bill, after adjusting salvage value proposed.

4.10 SUMMARY

Basically the principle of indemnity and their corollaries and proximate cause has been formulated so that any person does not make profit out of the insurance transaction. The basic purpose of insurance is that the insured is put in same financial position as he was before the loss.

4.11 GLOSSARY

Hull Insurance: Hull refers to the ocean going vessels (ships trawlers etc.) as well as its machinery. The hull insurance also covers the construction risk when the vessel is under construction.

Add-on Covers: The insurer can issue the standard fire policy with added benefits at the option of the policyholders by charging additional premium.

Sprinklers leakage policy: It covers the loss arising out of water leakage from sprinklers which are setup to extinguish fire.

Blanket policy: This policy is issued to cover all the fixed and current assets of an enterprise by one insurance.

4.12 SELF ASSESSMENT QUESTIONS

1. Explain principle of indemnity?

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2. Discuss the concept of bank-assurance.

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3. Discuss the procedures for settlement for claim of fire insurance.

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4. Explain the procedures for settlement for claim of marine insurance.

5. Explain the benefits of bank-assurance.

4.13 SUGGESTED READING

- Ghansham Panda : Principles of Insurance, Kalyani Publishing House, New Delhi
- M.N Mishra & S.B Mishra: Insurance Principles and Practice, S. Chand, New Delhi
- P.K Gupta: Fundaments of Insurance, Himalya Pub., New Delhi
- Rajeda: Principles of Risk Management and Insurance, Pearson Pub., New Delhi
- R.C Gupta & T.C Jain: Insurance and Risk Management, Alpha Pub., New Delhi