Excellence has No Limits

SACHDEVA GLOBAL SCHOOL

CLASS - XIB	BUSIENSS STUDIES	INSURANCE

Name:		Date:	

Meaning

Insurance is a means of providing against loss caused by natural or manmade factors.

It is a contract or agreement under which one party agrees in return for a consideration (called 'premium', which may be monthly, quarterly, half-yearly or annually) to pay an agreed amount of money to another party to make good a loss, damage or injury to something of value.

Under the contract of insurance, the person whose risk is insured is called *insured* and the firm which insures the risk of loss is known as *insurer*.

Fundamental Principle of Insurance

The fundamental principle of insurance is that an individual or a business concern chooses to spend a definite amount of money in place of a possible huge amount involved in an indefinite future loss. Thus, insurance, in essence, is the substitution of a small periodic payment (premium) for a risk of large possible loss. The loss of risk still remains, but the los, when it occurs, is spread over a large number of policyholders exposed to the same risk. The premium paid by them is pooled, out of which the loss sustained by any policyholder is compensated. Thus, in effect, *risks are shared with others*.

Functions of Insurance

1. **Providing certainty :** Insurance provides certainty of payment for the risk of loss. The insurer charges premium for providing the certainty.
2. **Protection :** Insurance provides protection from probable chances of loss. Insurance cannot stop the happening of a risk or event but can compensate for losses.
3. **Risk sharing :** On the happening of a risk event, the loss or damage is shared by all the insured members (by way of premiums).
4. **Assisting in capital formation :** The accumulated funds (*i.e.,* premium payments made by the insured members) are invested in various income generating schemes.

Principles of Insurance

1. **Utmost good faith:** A contract of insurance is a contract of *uberrimae fidei i.e., a contract found on utmost good faith*. Both the insurer and the insured should display good faith towards each other in regard to the contract.
   - The insured must voluntarily make full, accurate disclosure of all facts, material to the risk being proposed.
   - The insurer must make clear all the terms and conditions in the insurance contract.

   Example : Mr. X is a heart patient. But he hides this fact to the LIC while taking a life policy. On his death due to a heart attack, LIC can refuse to pay compensation to his legal representative because a material fact was not disclosed by the insured.

2. **Insurable Interest :** The insured must have an insurable interest in the subject matter of insurance. *Insurable interest means some pecuniary interest in the subject matter of the insurance contract*. The insured must have an interest in the preservation of the thing or life insured, so that he/she will suffer financially on the happening of the event against which he/she is insured. **For example,** a businessman has insurable interest in his stock of goods.

   In order to have insurable interest, it is not necessary that one should be the owner of the property. **For example,** a trustee holding property on behalf of other has an insurable interest in the property.

   Similarly, a person who had advanced money on the security of a factory (mortgage) can take fire insurance policy of that factory though he is not the owner of the factory because he has financial interest in the factory premises.

3. **Indemnity :** All insurance contracts of fire or marine insurance are contracts of indemnity. The insurer undertakes to compensate (in terms of money) the insured for the loss caused to him/her due to damage or destruction of property insured.

   Example : A businessman gets his stock of goods insured for Rs. 4,00,000. If the goods are destroyed by the fire, the insurance company will be liable to pay compensation for the loss caused to the insured. However, maximum compensation shall be Rs. 4,00,000 even if loss is more than this.

   The principle of indemnity is not applicable to life insurance because one cannot estimate the loss due to the death of a person.

4. **Proximate cause (*causa proxima*) :** According to this principle, when the loss is the result of two or more causes, the proximate cause, *i.e.,* the direct, the most dominant

and most effective cause of loss should be taken into consideration. The insurance company is not liable for the remote cause.

Example : In the above example, 'fire' is accepted as the proximate cause of loss. If there had been no fire and goods would have destroyed due to excessive heat, the insurance company would not be liable to pay compensation.

5. **Subrogation :** After the insured is compensated for the loss or damage of the property insured by him/her, the right of ownership of such property passes on the insurer. This is because the insured cannot make any profit by selling the damaged property.

   Example : Mr. Y gets his motor car insured. Some of its parts got damaged in a road accident. He gets the insurance claim and gets the damaged parts replaced with new ones. But the damaged parts will be taken by the insurance company. The insured has no right over the damaged parts since he has already got compensation for the loss.

6. **Contribution :** When more than one insurance policy is taken to cover the same risk, then it is known as '**Double Insurance**'. According to the principle of contribution, if a person has taken more than one insurance policy for the same risk, then all the insurers will contribute the amount of loss in proportion to the amount assured by each of them and compensate him for the actual amount of loss. Separately, the insured cannot claim total loss from each insurer because he has no right to recover more than the full amount of his actual loss.

   If the full amount is recovered from one insurer, the right to obtain further payment from other insurers ceases; and the insurer who has paid claim has the right to call upon other liable insurers to contribute for the loss of payment.

   Example : A businessman gets his factory insured against fire for Rs. 5,00,000 with insurer A and Rs. 3,00,000 with insurer B. Due to fire, a loss of Rs. 1,60,000 occurred. Then, insurers A and B will contribute the loss in the ratio 5 : 3 and will be liable to pay Rs. 1,00,000 $\left(\frac{5}{8} \text{ of } 1,60,000\right)$ and Rs. 60,000 $\left(\frac{3}{8} \text{ of } 1,60,000\right)$ respectively to the businessman.

7. **Mitigation :** According to the principle, the insured must take reasonable steps to minimize the loss or damage to the insured property; otherwise the claim from the insurance company may be lost. **For example,** if goods kept in a store house catch fire and the owner of the goods does not try to save them from fire just because there is an insurance cover, he will loss insurance claim.

Life Insurance

A life insurance policy is basically a protection against the uncertainty of life that is death.

Life Insurance may be defined as a contract in which the insurance company (called *insurer*) undertakes to insure the life of a person (called *assured*) in exchange of a sum of money called *premium* (which may be paid in one lump sum or monthly, quarterly, half yearly or yearly) and promises to pay a certain sum of money either on the death of the assured or on expiry of certain period.

Importance of Life Insurance

1. Life insurance provides protection to the family at premature death on an individual.
2. It gives adequate amount at an ole age when earning capacities are reduced.
3. Life insurance is not only a protection but is a sort of investment because a certain sum is returnable to the assured at the time of death or at the expiry of a certain period.

Main Elements of a Life Insurance Contract

1. The life insurance contract must have all the **essentials of a valid contract :** offer and acceptance, free consent, capacity to enter into a contract, lawful consideration and lawful object.
2. The contract of life insurance is a contract of **utmost good faith**. The assured should be honest and must disclose all material facts about his health to the insurer.
3. In case of life insurance policy, a person has insurable interest in his/her own life, in the life of his/her spouse, or in the lives of his/her children. The assured must have **insurable interest** at the time when the insurance is affected. Insurable interest at the time of maturity is not necessary.
4. Life insurance contract is **not a contract of indemnity.** The life of a human being cannot be compensated and only a specified sum of money is paid. That is why the amount payable in life insurance on the death of the assured is fixed in advance.

Fire Insurance

Fire insurance is a contract whereby the insurer, in consideration of the premium paid, undertakes to make good any loss or damage caused by a fire during a specified period upto the amount specified in the policy.

A claim for loss by fire must satisfy the following **two** conditions:

i. There must be actual loss; and
ii. Fire must be accidental and non-intentional.

Main elements of a fire insurance contract:

1. In fire insurance, the insured must have **insurable interest** in the subject matter of the insurance. Insurable interest must be present both at the time of insurance and at the time of loss.
2. The contract of fire insurance is a contract of **utmost good faith**. The insured should be honest and disclose all facts regarding the nature of property and risks attached to it. The insurance company should also disclose the facts of the policy to the insured.
3. The contract of fire insurance is a contract of **strict indemnity**. In the event of loss, the insured can recover the actual amount of loss or maximum amount of policy, whichever is lower, but not more than that. For example, if a businessman has insured goods for Rs. 2,00,000, the insurer is not liable to pay more than Rs. 2,00,000 if goods worth Rs. 5,00,000 are destroyed by fire.
4. The insurer is liable to compensate only when fire is the **proximate cause of damage or loss.** For example, if overheating without ignition causes damage to goods, it will not be regarded as a fire los and hence insurance claim cannot be recoverable.

Marine Insurance

A marine insurance contract is an agreement wherein the insurer (called *underwriter*) undertakes to compensate the insured (generally the owner of a ship or cargo) for complete or partial loss at sea. A certain sum of money is paid by the insured in consideration for the guarantee/protection he gets.

Marine insurance provides protection against loss by marine perils or perils of the sea, *e.g.,* collision of ship with the rock, or ship attacked by the enemies, risk of theft of goods, etc.

Marine insurance is slightly different from other types of insurance. There are **three** things involved : ship or hull, cargo or goods, and freight.

1. **Ship or hull insurance :** This is an insurance policy for indemnifying the insured for losses caused by damage to the ship.
2. **Cargo insurance :** The cargo while being transported by ship is subject to many risks, *e.g.,* risk of theft, loss of goods. These may be at the port or on voyage. Thus, an insurance policy can be issued to cover against such risks to cargo.
3. **Freight insurance :** Freight insurance is for reimbursing the loss of freight to the insured (shipping company), if the cargo does not reach the destination due to damage or loss in transit because in such a case freight charges are not paid to the insurance company.

Main elements of a marine insurance contract:

1. The contract of marine insurance is a **contract of indemnity**. In the event of loss, the insured can recover only the actual amount of loss from the insurance company. However, in case of 'Hull Policy', the amount insured is fixed at a level above the current market value.
2. The contract of marine insurance is a **contract of utmost good faith**. Both the insured and insurer must disclose everything, which is in their knowledge and can affect the insurance contract.
3. **Insurable interest** must exist at the time of loss but not necessary at the time when the policy was taken. Following persons have insurable interest in marine adventure:
   - Owner of the goods
   - Buyer of the goods
   - Insurer
   - Lender of money on mortgage of ship/cargo in respect of the loan.
   - Master and crew of a ship in respect of their wages.
4. The principle of **causa proxima** will also apply to a marine insurance contract. If a loss is caused by several reasons, then the nearest cause of loss will be considered.

Difference between Life, Fire and Marine Insurance

Basis	Life Insurance	Fire Insurance	Marine Insurance
1. Subject matter	The subject matter of insurance is human life.	The subject matter is any physical property or assets.	The subject matter is a ship cargo or freight.
2. Element	Life insurance has the elements of protection and investment or both.	Fire insurance has only the element of protection and not the element of investment.	Marine insurance has only the element of protection.
3. Insurable Interest	Insurable interest must be present at the time of effecting the policy, but need not be necessary at the time when the claim fall due.	Insurable interest on the subject matter must be present both at the time of effecting the policy as well as when the claim fall due.	Insurable interest must be present at the time when claim falls due or at the time of loss only.
4. Duration	Life insurance policy usually exceeds 1 year	Fire insurance policy usually does not exceed	Marine insurance policy is for one year or period

	and is taken for longer periods ranging from 5 to 30 years or whole life.	year.	of voyage or mixed.
5. Loss Measurement	Loss is not measurable in terms of money.	Loss is measurable in terms of money.	Loss is measurable in terms of money.
6. Indemnity	Life insurance contract is not a contract of indemnity. The life of a human being cannot be compensated and only a specified sum of money is paid. That is why the amount payable in life insurance on the death of the assured is fixed in advance.	The contract of fire insurance is a contract of strict indemnity. In the event of loss, the insured can recover the actual amount of loss or maximum amount of policy, whichever is lower.	The contract of marine insurance is a contract of indemnity. In the event of loss, the insured can recover only the actual amount of loss from the insurance company.
7. Surrender Value	The assured can surrender the policy before its maturity. So, a life insurance policy has a surrender value or paid-up value.	The insured cannot surrender the policy; hence, a fire insurance does not have any surrender value or paid-up value.	The insured cannot surrender the policy, hence, a marine insurance does not have any surrender value or paid-up value.
8. Policy Amount	One can insure for any amount in life insurance.	In fie insurance, the amount of the policy cannot be more than the value of the subject matter.	In marine insurance, the amount of the policy cannot exceed the market value of the ship or cargo.
9. Contingency of Risk	There is an element of certainty. The event *i.e.,* death or maturity of policy is bound to happen.	The event, *i.e.,* destruction by fire may not happen. There is an element of uncertainty and there may be no claim.	The vent, *i.e.,* loss at sea may not occur and there may be no claim. There is an element of uncertainty.
10. Partial loss	It is never a protection against partial loss.	It can be a protection against partial loss.	It can be a protection against partial los.
11. Medical Examination	Medical examination of the assured is necessary.	No medical examination is required.	No medical examination is required.

Health Insurance

Disability resulting from illness or accident may be peril to family because it not only cuts of income but also creates large medical expenses. Health insurance is a safeguard against such medical costs. In India, presently the health insurance exists primarily in the form of Mediclaim policy.

Health insurance provides following types of coverage:

- *Medical expenses:* It covers the expenses of hospitalization/nursing home bills and doctors' services.
- *Disability income:* It replaces the income lost while the insured is unable to work.