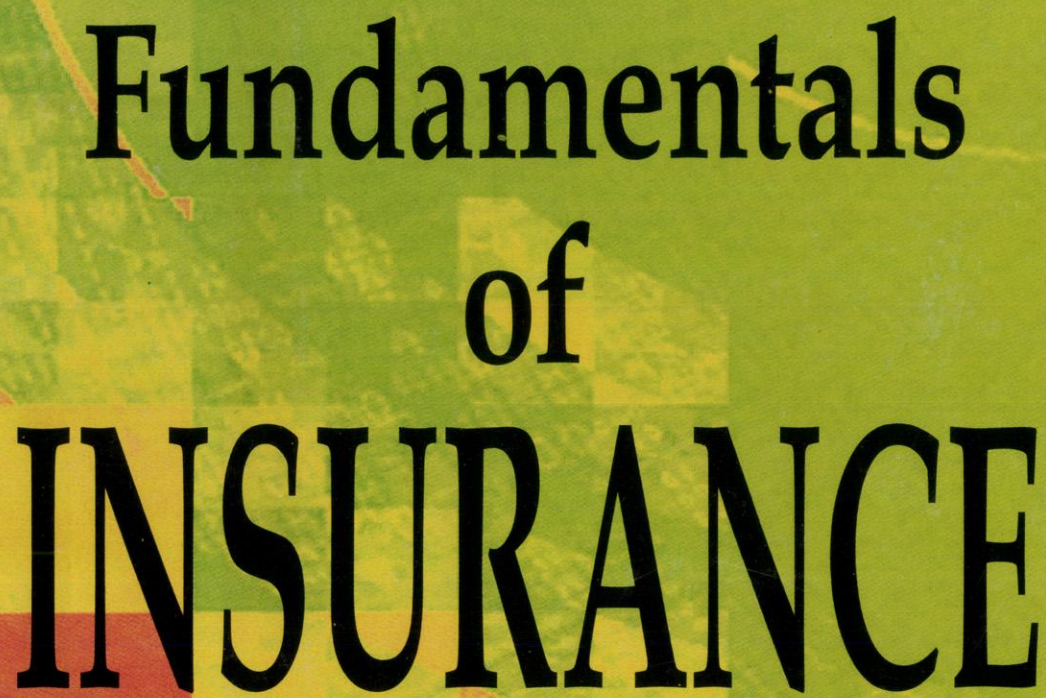

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Himalaya Publishing House

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Sacred Memory of my Father

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UNIT 1

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CHAPTER 1

RISK MANAGEMENT AND CONTROL

Human beings are considered the most intelligent creatures on this earth. The thinking power available to human beings is enormous and this has led human beings to define their style of living and distinguish between good and bad situations. The criteria for deciding whether the situation is good or bad depend upon *individual's perception*. However, one thing is sure–*that human beings always prefer and strive for happy situations and wants to avoid the adverse ones.* Actually, the zeal to be happy always has given birth to the jargon **risk!**

1.1 The Concept of Risk

People express risk in different ways. To some, it is the chance or possibility of loss, to others, its may be uncertain situations or deviations or what statisticians call dispersions from the expectations. Different authors on the subject have defined risk differently. However, in most of the terminology the term risk includes exposure to adverse situations. The indeterminateness of outcome is one of the basic criteria to define a risk situation. Also, when the outcome is indeterminate, there is a possibility that some of them may be adverse and therefore need special emphasis. Let us have a look at the popular definitions of risk.

According to the Dictionary, risk refers to the possibility that something unpleasant or dangerous might happen.[1]

"Risk is a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for."[2]

"At its most general level, risk is used to describe any situation where there is uncertainty about what outcome will occur. Life is obviously risky."[3]

The degree of risk refers to the likelihood of occurrence of an event. It is a measure of accuracy with which the outcome of a chance event can be predicted.

In most of the risky situations, two elements are commonly found:

1. The outcome is uncertain *i.e.* there is a possibility that one or other(s) may occur. Therefore, logically, there are at least two possible outcomes for a given situation.
2. Out of the possible outcomes, one is unfavourable or not liked by the individual or the analyst.

1.2 Risk vs. Uncertainty

Uncertainty is often confused with the risk. Uncertainty refers to a situation where the outcome is not certain or unknown. Uncertainty refers to a state of mind characterised by doubt, based on the lack of knowledge about what will or what will not happen in the future.[4]

---

[1] *Macmillan English Dictionary*, Macmillan Publishers Ltd. 2002, p. 1227.

[2] Emmett J. Vaughan, *Risk Management*, John Wiley & Sons, Inc., 1997, p. 8.

[3] S.E. Harrington and G.R. Niehaus, *Risk Management and Insurance*, McGraw-Hill, 1999, p. 3.

[4] Vaughan, *op. cit.*, p. 7.

Uncertainty can be perceived as opposite of certainty where you are assure of outcome or what will happen. Accordingly, some weights or probabilities can be assigned into risky situations but uncertainty, the psychological reaction to the absence of knowledge lacks this privilege.

Decision under uncertain situations is very difficult for the decision-maker. It all depends upon the skill, judgement and, of course luck.

Uncertainty being a perceptual phenomenon implies different degrees to different person. Assume a situation where an individual has to appear for the first in the newly introduced insurance examination.

(*a*) an individual student undergone training in insurance.

(*b*) an individual with training or experience in insurance.

A's perception towards uncertainty (of performance in examination) is different from that of B. Nonetheless, in both situations, the outcome that is the questions which will be asked in the examination are different.

1.2.1 Loss and chance of loss

A risk refers to a situation where there is the possibility of a loss. What is a loss?

Loss has been defined in many ways. *Loss in accounting sense means that portion of the expired cost for which no compensating value has been received.*[5]

Loss refers to the Act or instance of losing the detriment or a disadvantage resulting from losing.[6]

Loss means being without something previously possessed.[7]

The chance of loss refers to a fraction or the relative frequency of loss. The chance of loss in insurance sense is the probability of loss.

For example, assume there are 10,000 factories in the insurance pool, which may be affected due to earthquake, and on the basis of past experience, 5 have been affected, then the probability of loss is 0.0005.

The whole game of insurance business is based on the probability of loss. If the insurer estimates correctly, he wins else loses or is forced to close the business.

From the insurer's perspective, it is the probability of loss that accentuates the need for insurances. The probabilities of losses may be ex-post or ex-ante. In practice, the ex-ante probabilities are widely used for undertaking risk in insurance business.

The chance or probabilities of loss estimation requires accounting for causes of losses popularly characterised as *perils* and *hazards.*

1.2.2 Perils

A peril refers to the cause of loss or the contingency that may cause a loss.[8] In literary sense, it means the serious and immediate danger.[9] Perils refer to the immediate causes of loss. Perils may

[5] M.N. Arora, Cost Accounting, Vikas Publishing House, 200, p. 122.

[6] Oxford Advance Learner's Dictionary, Oxford University Press, 1984, p. 504.

[7] *M.S. Dorfman,* Introduction to Risk Management and Insurance, *Prentice Hall, 2002,* pp. 4-5.

[8] Dorfman, *op. cit.*, p. 5.

[9] Oxford Advance Learner's Dictionary, *op. cit.*, p. 622.

be general or specific *e.g.* fire may affect assets like building, automobile, machinery, equipment and also, humans. Collusion may cause damage to the automobile resulting in a financial loss.

1.2.3 Hazards

Hazards are the conditions that increase the severity of loss or the conditions affecting perils. These are the conditions that create or increase the severity of losses. Economic slow down is a peril that may cause a loss to the business, but it is also a hazard that may cause a heart attack or mental shock to the proprietor of the business. Hazards can be classified as follows :

(1) **Physical Hazards**–Property Conditions–consists of those physical properties that increase the chance of loss from the various perils. *E.g.* stocking crackers in a packed commercial complex increases the peril of fire.

(2) **Intangible Hazards**–Attitudes and Culture–Intangible hazards are more or less psychological in nature. These can be further classified as follows :

(a) *Moral Hazard*–Fraud–These refer to the increase in the possibility or severity of loss emanating from the intention to deceive or cheat. For example–putting fire to a factory running in losses. With an intention to make benefit out of exaggerated claims, deliberately indulging into automobile collusion or damaging it or tendency on part of the doctor to go for unnecessary checks when they are not required, since the insurance company will reimburse the loss.

(b) *Morale Hazard*–Indifference–It is the attitude of indifference to take care of the property on the premise that the loss will be indemnified by the insurance company. So, it is the carelessness or indifference to a loss because of the existence of insurance contract. For example–smoking in an oil refinery, careless driving etc.

(c) *Societal Hazards*–Legal and Cultural–these refer to the increase in the frequency and severity of loss arising from legal doctrines or societal customs and structure. For example, the construction or the possibility of demolition of buildings in unauthorised colonies.

1.3 Types of Risks

Financial and Non-Financial Risks

Financial risk involves the simultaneous existence of three important elements in a risky situation–(*a*) that someone is adversely affected by the happening of an event, (*b*) the assets or income is likely to be exposed to a financial loss from the occurrence of the event and (*c*) the peril can cause the loss. When the possibility of a financial loss does not exist, the situation can be referred to as *non-financial* in nature. Financial risks are more *particular* in nature.

Individual and Group Risks

A risk is said to be a *group* risk or *fundamental* risk if it affects the economy or its participants on a macro basis. These are impersonal in origin and consequence. They affect most of the social segments or the entire population. These risk factors may be socio-economic or political or natural calamities *e.g.* earthquakes, floods, wars, unemployment or situations like 11th September attack on U.S. etc.

Individual/particular risks are confined to individual identities or small groups. Thefts, robbery, fire etc. are risks that are particular in nature. Some of these risks are insurable. The methods of

handling fundamental and particular risks differ by their very nature *e.g.* Social insurance programmes may be undertaken by the government to handle fundamental risks. Similarly, an individual to prevent against the adverse consequences of fire may buy fire insurance policy.

Pure and Speculative Risks

Pure risk situations are those where there is a possibility of loss or no loss. There is no gain to the individual or the organisation. For example, a car can meet with an accident or it may not meet with an accident. If an insurance policy is bought for the purpose, then if accident does not occur, there is no gain to the insured. Contrarily, if the accident occurs, the insurance company will indemnify the loss.

Speculative risks are those where there is possibility of gain as well as loss. The element of gain is inherent or structured in such a situation. For example–if you invest in a stock market, you may either gain or lose on stocks.

The distinguishing characteristics of the pure and speculative risks are :

(*a*) Pure risks are generally insurable while the speculative ones are not.

(*b*) The conceptual framework of the risk pooling can be applied to pure risks, while in most of the cases of speculative risks where it is not possible. However, there may be some situation where the law of mathematical expectation might be useful.

(*c*) Speculative risk carry some inherent advantages to the economy or the society at large while pure risks like uninsured catastrophes may be highly damaging.

Static and Dynamic Risks

Dynamic risks are those resulting from the changes in the economy or the environment. These risk factors mainly refer to the macro economic variables like inflation, income and output levels, and technology changes. Dynamic risks emanate from the economic environment and therefore, these are difficult to anticipate and quantify. Contrary to this, static risks are more or less predictable and are not affected by the economic conditions. The possibility of loss in a business or unemployment after undergoing a professional qualification, loss due to act of others etc. are static and accordingly suitable for insurance.

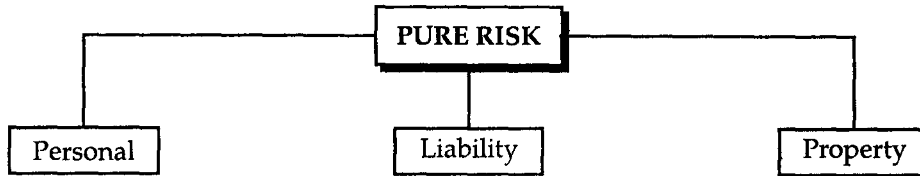
Quantifiable and Non-quantifiable Risks

The risk which can be measured like financial risks are known to be quantifiable while the situations which may result in repercussions like tension or loss of peace are called as non-quantifiable.

1.4 Classifying Pure Risks

Since pure risks are generally *insurable*, the discussion on risk is skewed towards pure risks only. On the presumption that insurable pure risks being *static*, they can be classified as follows :

Exhibit 1-A



Personal Risks

These are the risks that directly affect the individual's capability to earn income. Personal risks can be classified into the following types :

(*a*) *Premature death*–death of the bread earner with unfulfilled or unprovided financial obligations.

(*b*) *Old age*–it refers to the risk of not having sufficient income at the age of retirement or the age becoming so that there is a possibility that the individual may not be able to earn the livelihood.

(*c*) *Sickness or disability*–the risk of poor heath or disability of a person to earn the means of survival. *E.g.* the possibility of damage of limbs of a driver due to an accident.

(*d*) *Unemployment*–the risk of unemployment due to socio-economic factors resulting in financial insecurity.

Property Risks

These are the risks to the persons in possession of the property being damaged or lost. The immovables like land and building being damaged due to flood, earthquake or fire–the movables like appliances and personal assets being destroyed due to fire or stolen. The losses may be direct or indirect/consequential. A direct loss implies the visible financial loss to the property due to mishappenings. Whereas, the indirect ones are the losses arising from the occurrence of an incident resulting in direct/physical damages or loss. The loss to crops due to flood is a direct loss–the destruction of the growing power is a consequential one.

Liability Risks

These are the risks arising out of the intentional or unintentional injury to the persons or damages to their properties through negligence or carelessness. Liability risks generally arise from the law. *e.g.* liability of the employer under the workmen's compensation law or other labour laws in India.

In addition to the above categories, risks may also arise *due to the failure of others.* For example, the financial loss arising from the non-performance or standard performance in a contract–in engineering/construction contracts.

1.5 Losses and Methods of Handling Pure Risk

The various methods of handling pure risk depend upon the nature of losses. The losses from pure risk in an organisation may be categorised as follows :

Exhibit 1-B

Direct Losses	*Indirect Losses*
• Damage to Assets	• Loss of Normal Profit (net cash flow)
• Injury/Illness to Employees	• Continuing and Extra Operating Expense
• Liability Claims and Defense Costs	• Higher Cost of Funds
	• Foregone Investment
	• Bankruptcy Costs
	• (legal fees)

Although the various techniques of risk management have been discussed at length in the following chapter, the following discussion will give you a brief idea of how the risk can be handled :

- *Avoidance*–avoid the risk or the circumstances which may lead to losses. For example–not to visit border areas at the time of war tensions. Avoid manufacturing and marketing a product of which patent/copyright is doubtful.
- *Loss Control*
  - *Loss Prevention*–Reduce Loss Frequency–for example not to smoke in a factory producing inflammable products, getting training before driving etc.
  - *Loss Reduction*–Lower Loss Severity–deployment of fire fighting equipment, first aid boxes etc.
- *Retention*–to retain in *full* or part of the risk. A risk is said to be actively retained if the individual is fully aware of the risk and its implications and prefers to retain it. On the contrary, it is said to be passive, if the individual is ignorant of the risk or there is carelessness on part of the exposed.
- *Transfer*–to transfer the risk to another individual or organisation either by :
  - *Contractual Agreements*–insurance, derivatives, diversification strategies etc.
  - *Corporatising*–converting the sole proprietor/partnership business into a company from an organisation. It is well known that in case of a proprietor firm, the proprietor is individually liable in an unlimited sense and in case of partnership firm, the partners are jointly and severally liable which is also in the nature of unlimited liability. However, in case of companies the liability of the shareholders is generally limited to the extent of capital contributed by them.

1.6 Risk Management Process

The role of risk management

The future is largely unknown. Most business decision-making takes place on the basic of expectations about the future. Making a decision on the basis of assumptions, expectations, estimates and forecasts of future events involvės taking risks. Risk has been described as the *"sugar and salt of life"*. This implies that risk can have an upside as well downside. People take risk in order to achieve some goal they would otherwise not have reached without taking that risk. On the other hand, risk can mean that some danger or loss may be involved in carrying out an activity and therefore, care has to be taken to avoid that loss. This is where Risk Management is important, in that it can be used to protect against loss or danger arising from a risky activity.

Definition

Risk management is an integrated process of delineating specific areas or risk, developing a comprehensive plan, integrating the plan, and conducting ongoing evaluation.

The Process

The risk management process involves the following logical steps.

1. Defining the objectives of the risk management exercise
2. Identifying the risk exposures
3. Evaluating the exposures
4. Critical analysis of risk management alternatives and selecting one of them
5. Implementation and review.

The job of risk management can, therefore, be broken down into three elements, which follow each other in a logical sequence :

A. Risk analysis

B. Risk control

C. Risk financing

Because the conditions under which firms operate change, the risk management process has a necessity to be dynamic. All three elements of the process have therefore to be continuing reassessment and monitoring of the results.

All Risk Manger's believe that *"prevention is better than cure"*. It is better not to have suffered a loss than to suffer and collect under an insurance policy. Insurance does not compensate for all losses; for example, time spent dealing with the claim loss of client base and reputation. There is also a growing body of evidence to suggest that a significant proportion of firms never fully recover from the effects of a major loss and have to be wound-up within a short time even if fully insured.

A. Risk Analysis

The first step in the process is to analyse the risk to which an organisation may be exposed. Risk analysis has to prime elements–the identification of risk and its evaluation.

Risk Identification

Risk Identification requires knowledge of the organisation, the market in which it operates, the legal, social, economic, political, and climatic environment in which it does it's business, it's financial strengths and weakness, its vulnerability to unplanned losses, the manufacturing processes, and the management systems and business mechanism by which it operates. Any failure at this stage to identify risk may cause a major loss for the organisation. Risk identification provides the foundation for risk management. The various methods of risk identification are :

- Checklist Method
- Financial Statement Method

- Flowchart Method
- On-site Inspections
- Interactions with Others
- Contract Analysis
- Statistical Records of Losses

Risk Evaluation

Risk Evaluation breaks down into two parts, the assessment of :

- the probability of loss occurring, and
- its severity

The probability analysis tells us the various possibilities of the perceived scenarios for a given set of circumstances. The severity refers to the direct and indirect measurable impact of the scenarios being analysed.

B. Risk Control

Risk control covers all those measures aimed at avoiding, eliminating or reducing the chances of loss-producing events occurring, or limiting the severity of the losses that do happen. Here, one is seeking to change the conditions that bring about loss-producing events or increase their severity. Though some measures call for little more than common sense, often considerable technical knowledge is required, for which the risk manager will need to turn to experts in the particular field.

Risk can be controlled either by avoidance or by controlling losses. Avoidance implies that either a certain loss exposure is not acquired or an existing one is abandoned.

Loss control can be exercised in two ways.

(*a*) One way is to enhance and monitor the level of precautions taken to minimise the losses due to exposures.

(*b*) Another is to control and minimise the risk operations, internal risk control techniques include diversification and/or investments in getting information of loss exposures so as to control them.

The internal risk control measures generally employed are (a) diversification and (b) investment in information. The operational measures fro risk control in an organisation includes–(a) increased precautions and (b) reduced level of activity.

C. Risk Financing

When the risk exposure for an organisation exceeds the maximum limit that the organisation can bear, it becomes necessary to either transfer or reduce risk. However, there is cost involved in both of these exercises. If the method adopted is insurance, the consequential impact on taxes and profits also becomes important. Risk Financing, therefore, refers *to the manner in which the risk control measures that have been implemented shall be financed.*

It has to be recognised that in the long run an organisation will have to pay for its own losses. The primary objective of risk financing is *to spread more evenly over time cost of risk in order to reduce the financial strain* and possible insolvency which random concurrency of large losses may cause. The secondary objective is *to minimise risk costs.*

Essentially an organisation can finance its risk cost in three ways :

- Losses may be charged as they occur to current operating costs; or
- Ex-ante provision may be made for losses, either through the purchase of insurance or by building up a contingency found to which losses can be charged; or
- When losses occur they may be financed with loans, which are repaid over the next few months or years.

1.7 Risk Financing Techniques

Risk financing includes the following alternatives :

1.7.1 Risk Retention

Risk retention implies that the losses arising due to a risk exposure shall be *retained* or *assumed* by the party or the organisation. Risk retention is generally a deliberate decision for business organisations inherited with the following characteristics :

(*a*) The consequential losses are small;

(*b*) Losses are shown as operating expenses or can be funded with retained profits.

Of the various techniques of risk retention, self-insurance and captive insurance and the popular ones.

Self-Insurance

Self-insurance is one of the forms of planned retention by which the part or full of the exposure arising due to a risk factor is retained by the firm. Self-insurance programmes differ from the other programmes in the sense of the formal arrangements made. It acts as an alternative to buying insurance in the market or when a part of the claim is not insured in the commercial market. It may be done by keeping aside funds to meet insurable losses. The main reason for self insurance is that the organisation believes it has large funds to finance losses and the opportunity cost of transfer is less than the cost of insurance.

Benefits of Self-insurance

(*a*) *Saves transaction costs*–it helps to save cost in the form of amount payable to insurer for overheads and profits, commissions and taxes and the social loading (arising from the statutory requirements) inherent in the premium.

(*b*) *Accuracy of predictions*–the risk managers in the organisation think that they are better judges of the adverse exposures and can estimate better than the insurers.

(*c*) *Investment of funds*–since insurance companies invest large chunk of funds in various securities and the returns arising therefrom is not reflected in the rates charged by the insurers, the cost reduction becomes obvious for the insured.

(*d*) *Minimisation of disputes*–self-managed funds enhances satisfaction to the insured and reduces the conflicts in claims settlement. Also, there is a direct incentive to reduce and control the risk of loss.

Captive Insurance

Captive insurance companies represent a special case of risk retention. *A captive insurance company* is an entity created and controlled by a parent, whose main purpose is to provide insurance to its corporate owner. The ideology behind this method is that the parent company may save in terms of overhead costs and profits which would otherwise be charged by the insurance company. Also, the insured companies claim premiums as expenses, which may lead to advantages in terms of differential cash flows. These captives may either be pure *captives or group captives.*

A pure captive is an insurance company established by the parent (generally into non-insurance business) organisation to provide insurance cover to itself or its subsidiary or affiliated organisations.

Group captives are those formed by a group of companies for providing insurance cover to control their respective and collective risks. In U.S. terminology these are also known as "trade association insurance companies."

Motives Behind Captives

(*a*) *Optimised loss prevention benefits*–The benefits enduring from loss prevention are available directly to the insured.

(*b*) *Economies of scale*–Groups with several subsidiaries can enjoy the benefit of perfectly tailored insurance products made available to cover risks.

(*c*) *Non-availability of insurance*–Captives provide to cover risk exposures for which covers are otherwise not available in the market.

(*d*) *Stability of earnings*–The captives reduce the chances of adverse impact of sudden fluctuations in profits on the firm.

(*e*) *Cost and tax advantages*–Obviously, as said earlier, captives reduce cost of risk financing and provide gains in the regime of differential taxes.

1.7.2 Risk Transfer

Risk transfer implies that the exposed party transfers whole or part of the losses consequential to risk exposure to another party for a cost. The insurance contracts fundamentally involve risk transfers. Apart from the insurance device, there are certain other techniques by which the risk may be transferred.

(*a*) *Insurance*–Insurance is a contractual transfer of risk. The insurance company agrees to indemnify the losses arising out an occurrence pre-determined and charges some cost for this act, called as premium. The insurance method of risk transfer is most appropriate when the severity of losses is very high.[10] Since the important constraint. *i.e.* the cost of transfer prevails, the suitability of this method depends upon the *size* of the organisation and *affordability.*

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[10] *Dorfman, op. cit.*, p. 58.

(*b*) *Non-insurance transfers*–Out of the various methods of non-insurance risk transfers, the most common are :

(*i*) Hold-harmless agreements or indemnity agreements are the contractual relationships specifying that all losses shall be borne by the designated party *e.g.* a landlord contracting that all losses shall be borne by the tenant. These agreements by themselves do not reduce original risk.[11] The form and jurisdiction of hold harmless agreements varies from contract to contract.

(*ii*) Incorporation is another method by which, for example, the sole proprietorship firm or partnership firm can convert themselves into companies and reduce the liability on them. To quote, the liability of a proprietorship firm is unlimited compared to that of a company limited by shares–the liability of the members is limited to the extent of capital contributed by them.

(*iii*) Hedging can be used to transfer speculative risk. The popular of the instruments used in hedging are derivative contracts.

(*iv*) Diversification across business or geographic locations justified or coupled with synergies or economies of scale can also significantly reduce risk in aggregate.

1.8 Risk Management Objectives

Risk management objectives differ from individual to individual and organisation-to-organisation. However, as a concept these can be segregated into two :

(*a*) *Before occurrence of losses*–these can be of following types :

- Reduction in worry and fear
- Economical ways of handing risk
- Overcome legal obligations

(*b*) *After occurrence of losses* :

- Survival
- Congruence with mission and objectives
- Optimising social effects

1.9 Risk Management Information Systems (RMIS)

"Risk management information systems are software tools designed to assist risk managers in their functions. Traditional RMIS software emphasizes claim management, safety monitoring, and financing losses. Other tools available in a RMIS are management of insurance policies, exposure data and insurance certificates.

An enterprisewide RMIS system can help managers with a wide array of functions. At the outset, once connected to an organization's existing information systems, the RMIS gathers information from all these various systems into one database. There, the data can be analyzed from various angles to get different perspectives on the risks the organization faces.

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[11] J.S. Trieshman *et. al.*, Risk Management and Insurance, South-Western College Publishing, 2001, pp. 84-85.

With this rich database and analysis tool, various custom reports can be produced not just for a risk manager, but also for managers throughout the organization, giving them a detailed look at their exposures.

Initially, in the late 1960s and early 1970s, risk management information technology was limited to systems utilizing mainframe computers that allowed insurers to print out summaries of claim losses as a courtesy to their larger policyholders. These primitive loss run were often months behind real time, contained numerous errors, and were difficult to read. Moreover, they contained little useful information, the only exception being the total incurred loss figures for any particular claim.

RMIS can be used for the following :

1. Reporting

Creation of reports that summarize loss payments and estimates of future losses. Accounting and finance departments use these reports in preparing the organization's financial statements.

2. Examination of Causes of Accidents

By identifying the reasons for accidents, risk managers can determine where safety and loss prevention expenditures would be most helpful. A large number of employees or customers slipping and falling in a certain area may warrant a review of cleanup procedures or a study of the costs for installing special carpet.

3. Review of Claims Adjustment Process

Risk managers use RMIS to evaluate the performance of claims adjusters by comparing actual results to standards. Typical evaluation areas are promptness of initial contact, case settlement time, amount paid for type of injury, and accuracy of the adjuster's case value estimate.

The emergence of internet as a critical tool for business communication and services has rapidly impacted RMIS, as many vendors have "Web-Enabled" new and existing products to take advantage of the Internet's broad availability and low end user maintenance costs. The internet has also permitted older legacy systems to remain viable in the marketplace because end-users work with a newer, standard interface even though processing may be occurring on a mainframe or other older computer system.

Software products have also been introduced to serve special application needs, such as catastrophe simulation software to assist in examining the effects of disasters on a group of exposed properties, and hazardous material tracking programmes to record the uses and locations of potentially hazardous items.

1.9.1 Risk Manager Tasks and Responsibilities

Risk manager is a person who performs the risk management function in an organisation by whatever name called. He is responsible for overall risk management activities including risk control and financing. They are also sometimes responsible for employee benefit plans. The responsibilities of risk manager vary with the organisation size.

In most of the professional organisations, RMIS are computerised, in such cases risk manager has to force relatively new problems.

- data impurity
- lacks of service
- software incompatibility
- mapping errors (when changing vendors)
- poor system documentation
- obsolescence
- bugs
- hardware incompatibility
- system inflexibility
- proprietary problems (only the creator knows how the system is put together)

The possible remedies are :

- solid assessment of needs
- comprehensive and clear specifications
- good contract negotiation
- reference checks, including on-site inspection
- financial check (especially important if relying solely on the vendor for support)
- source code (the actual programming code for the system, especially useful should the vendor go out of business)
- standard software configuration, such as DOS or Windows
- internal access to systems expert
- solid vendor account team

1.9.2 Some RMIS Vendors

Independent, claims administration-oriented RMIS vendors

- CARE System Corp.
- GenSource Corp. (formerly CIC).
- Nichols Engineering (formerly Conway).

These three vendors offer solid property/causality claims administration software for large self-insureds and TPAs on a global basis.

Broker and TPA-based RMIS Vendors

- Crawford RSG.
- Envision/Near North Risk Technologies Inc.
- J&H Marsh & McLennan Inc.'s STARS
- Sedgwick Information Systems

Insurer/TPA-based Vendors

- IG.
- Chubb.
- CIGNA (ESIS Inc.)
- RISKTRAC Inc. (Liberty Mutual Group).

1.10 Organisation of Risk Management Department

The organisation structure of a large risk management department in a corporate form or organisation may be as follows :

- In *small organisations*, the risk management job is confined to the president or the owner. In medium type organisations, the risk-handling job is entrusted to the chief financial officer or someone at middle level management position.
- In *large business organisation*, the risk management department is headed by a top official generally director, who is also a member of the board of directors. He is duly supported by an analyst, generally a professional who is entrusted with all risk research responsibilities. Below the chain are middle level managers designated by the respective risk management methods. viz., prevention and loss control, insurance etc.

1.11 Risk Management vs. Insurance Management

Risk management is a broader management activity concerned with the analysis and control of the various risks in an organisation from a strategic perspective. Insurance management has a narrow perspective limited to the effective management of insurance covers in a given organization. For a non-insurance organization, insurance management would therefore be construed as a sub-activity of the risk management function. The direct objective of risk management function is to maximise value for the stakeholders. Insurance management, by its nature, is confined to the management of the selected pure risk while, risk management takes a wholistic view of the organization, consider all risks whether pure or speculative, and attempts to integrate the various managerial functions and spreads across various departments in an organization. Insurance management emanates from the risk management function.

Key Terms

- Captives
- Diversification
- Dynamic Risk
- Event
- Hazard
- Insurance Management
- Loss
- Peril
- Risk
- Risk Analysis
- Risk Control
- Risk Management
- Risk Retention
- Static Risk

Suggested Readings

- Emmett Vaughan and Therese Vaughan, *Essentials of Risk Management and Insurance,* John Wiley and Sons Inc. 2002.
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- Kenneth A. Froot, *The Financing of Catastrophic Risk,* The University of Chicago Press, 1999.
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- Margot Naylor, *The Truth about Life,* George Allen and Unwin Ltd., London, 1971.
- Mark S. Dorfman, *Fundamentals of Insurance,* Prentice-Hall, 2002.
- Robert I. Mehr, *Fundamentals of Insurance,* Irwin, 1986.
- Scott E. Harrington and Gregory R, Niehaus, *Insurance and Risk Management,* IRWIN/McGraw-Hill, 1999.

Questions for Review

1. Define risk. List some ways in which risk creates an economic burden for society.
2. Differentiate between the following type of risk :
   (*a*) Pure versus Speculative
   (*b*) Static versus Dynamic
   (*c*) Subjective versus Objective
3. Give an example of a risk that is both pure and static.
4. An insurable loss is :
   (*a*) An event that has not been predicted.
   (*b*) An exposure that cannot be easily measured before the event has occurred.
   (*c*) An unexpected reduction of economic value.
   (*d*) Being without something one has previously possessed.
5. Differentiate between a peril and a hazard and give an example of each.
6. For each of the following hazards, state the peril to which the hazard relates.
   (*a*) A drunken driver of a truck
   (*b*) A person with damaged kidneys
   (*c*) A house with poor quality of electricity cable fittings.
   (*d*) An unlocked car in no-parking area.
7. "Pure Risks are always insurable." Comment.
8. A risk manager stated, "If a risk is to be properly controlled, it must be perceived, and it must be appreciated in terms of probable frequency and possible severity." The writers went on to give two examples as follows :

(*a*) A company brings together in two airplane flights nearly all of its dealers and distributors from a certain country.

(*b*) Another company makes a special contract with the government of a foreign country to set up a factory in that country. Special machinery is to be sent by ship and customs duty is to be waived if the machinery arrives by a certain date.

For each of these situations, indicate the potential loss exposure for the company.

9. What data would be most helpful to include in a risk management information system designed particularly for an automobile manufacturers? How might the RMIS requirement for such a firm differ from those of an amusement theme park? Explain.
10. List and explain three desirable risk management goals likely to be found in risk management and control process. Distinguish between risk management and insurance management.
11. What are the steps in developing a risk management plan? Why is the order of the steps important? Which step is the most difficult to accomplish.
12. Define a captive insurer and explain why captive insurers are formed.
13. Explain the basic factor that a risk manager must consider if commercial insurance is used in a risk management programme? List and explain the three main categories of loss control activities.

CHAPTER 2

INSURANCE BASICS

2.1 Insurance Defined

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

In Financial Sense

Insurance is a social device in which a group of individuals (insureds) transfer risk to another party (insurer) in order to combine loss experience, which permits statistical prediction of losses and provides for payment of losses from funds contributed (premiums) by all members who transferred risk.

In Legal Sense

A contract of insurance is a contract by which one party in consideration of the price paid to him proportionate to the risk provides security to the other party that he shall not suffer loss, damage or prejudice by the happening of certain specified events. Insurance is meant to protect the insured against uncertain events, which may cause disadvantage to him. Life insurance however is a distinctive type of insurance where there is certainty of the payment of a specified amount either on the death of the insured or on the maturity of the policy whichever is earlier.[1]

2.2 Costs and Benefits of Insurance

The purpose of insurance mode of risk transfer is to provide economic protection against the losses that may be incurred but to chance events such as–(*a*) death, (*b*) disability, (*c*) economic losses. One party (the insurer) for a set amount of money (premium) agrees to pay the other party (insured or beneficiary), a sum of money (benefit) upon the occurrence of an event, which may or may not occur. Insurance provides economic protection against losses that may be incurred due to chance events that may or may not occur during the effective time of the contract called a policy. The insurance of business organisations is essential in the sense that adverse events, if not guarded, may affect–the business itself, the business owner or owner's personal property and may also threaten the continued operation of the business and threaten the owner's financial well-being. The fundamental advantages of insurance contracts are :

(*a*) It involves transfer of risk from the individual to the group, and

(*b*) There is a sharing (pooling) of losses on some equitable basis such that fortuitous losses will be indemnified (paid).

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[1] *Insurance Laws & Practice*, Vidhi Publications, 2002, p. 21.

More specifically, the cost and benefits of insurance are :

Benefits

- Reimbursement for losses
- Reduction in tension and fear
- Avenue for investment–life insurance investment officer attractive return.
- Prevention of losses
- Credit multiplication

Costs

- Cost of Business operations–Social wastage of resources
- Fraudulent and exaggerated claims–Malicious and undesirable transfer of wealth.

2.3 Elements of an Insurable Risk

For a pure risk to be insurable, it should possess the following characteristics.

Large Numbers of Exposure Units

The theory of insurance is based on law of large numbers. Therefore the prime necessity for a rise to be insurable is that there must be a sufficiently large number of homogenous exposures in order that losses are reasonable predictable. Also, the probabilistic estimates used by the insurance company, by logic, assume large number of units in a distribution and insurance products are priced accordingly.

Define and Measurable (Calculable) Loss

The losses are fairly predictable and can be measured in money terms. Loss of peace of mind, tension etc. or loss of life cannot be indemnified.

Determinable Probability Distribution

The probability distribution of the happening of adverse event is determinable. This condition is necessary to establish the free premium according to the theory of equivalence. If there is not determinable distribution, there is no question of issuing a cover by an insurance company.

Random (Fortuitous) Loss

The adverse event may or may not occur in future and once which the insurance company has not control. Naturally, if the event is non-random or the loss has occurred in the past, there is no question of insurance.

Also, it is important to note that randomness is ensured by underwriters who guard against adverse selection–the tendency of the poorer than average insured to seek or continue insurance coverage.

Non-catastrophic Loss

The losses should be non-catastrophic. Not all the units in a homogenous group will be subject to an adverse event. Recall that if all the units meet losses, the company will be ruined only few out of a large group will be exposed.

Premium should be Economically Feasible

Since, the insurance pool is structured to be sufficiently large, the price charged by the insurer for buying the risk is generally low. It should be sufficient to cause the rich for the insurer as well as viable for the insured.

2.3.1 Insurance Versus Gambling

If gambling events were insurable, the gambler would be put in the enviable position of being unable to lose because if it is head, he wins else if fails, he collects the money from insurance company. Since, the insurance premium must include the charge for the losses and the expenses of operating the insurance pool, the resulting premium must be more than the mathematically fair value of the potential loss. Moreover, the gambler presumably enjoys the risk of gambling and therefore would be unlikely to pay the premium needed for transferring the risk being enjoyed. Law prohibits the use of insurance for gambling purposes because fraud and murder would increase thus making a social device prohibitively expensive and therefore making the system fail. In summary, the gambling can be distinguished from an insurance contract in the following ways :

(*a*) Gambling creates risk while insurance transfers an existing risk.

(*b*) Gambling deals with speculative risk–there might be gains or losses, while Insurance deals with pure risk.

2.3.2 Insurance Versus Wager

Insurance contracts are often confused with wagering contracts. The main points of difference between the two are :

(*a*) Insurance contracts are legal ones; enforceable at court of law while wagering contracts are void contracts.

(*b*) Parties to an insurance contract are identifiable at the inception of the contract but in wagers, the parties to suffer losses are identified after the occurrence of the event.

(*c*) Insurance contracts are contracts of indemnity; wagers are winning or lose contracts.

(*d*) At the inception of the insurance contracts the parties have to disclose fully all material facts, however wager does not requires such disclosure.

(*e*) Insurance contracts have social objective viz. to provide a cover against the ill effects of unforeseen events. However, wagers create additional risk and have harmful effects on society.

However, insurance contracts are conditional contracts in the sense that the performance of the contract depends upon the happening of the contracted event.

2.4 Principles of Insurance

Indemnity

The principle of indemnity implies that *on the happening of an event insured against, the Insured will be placed by the insurer in the same pecuniary (monetary) position that he/she occupied immediately before the event. Indemnity means that the insured person is placed, financially, in the same position, as he was before the loss.*

The non-life insurance covers viz. Property and Liability are basically contracts of indemnity. However, the indemnity must not be construed as an instrument to profit. The indemnity goes along with two checks :

(*a*) to prevent the insured from benefiting under the contract

(*b*) to reduce the impact of moral hazards

The exceptions to the application of indemnity are found in Personal Accident Policies, Agreed Value policies in Marine Insurance and valuables and reinstatement policies like in Engineering policies. These are also contracts of indemnity but by a special application of the principle, the measure of indemnity is decided at the time of entering into the contract itself in the event of a claim the insured must :

- prove that he/she has sustained a monetary loss
- prove the extent and value of his/her loss
- prove the extent and value of his/her loss
- transfer any rights which he/she may have for recovery from another source to the Insurer, if he/she has been fully indemnified.

Example

In a valued (marine) policy, if there is damage/loss to the cargo, the claim is limited to the value expressed in the policy cover irrespective of the actual value of the cargo lost or damaged. The settlement of the loss will be subject to (*a*) Sum insured and (*b*) Average (*c*) Excess/Deductible.[2]

It is important to note that the contract of life insurance is not as such insurance, but it is in the nature of assurance. This is logical in the sense that life can not be indemnified, instead if a person dies, then under the contract of life insurance the sum assured will be paid by the insured.

Utmost Good Faith

Under the contract of insurance, the insured is duty bound to disclose all material facts relating to the risk to be covered.

Utmost good faith is a positive duty voluntarily to disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not.

A material fact is a fact, which would influence the mind of a prudent underwriter in deciding whether to accept a risk for insurance and on what terms. Both the parties to a contract are expected to observe good faith. However, the good faith assumes utmost importance when Material Facts are concerned and therefore utmost good faith should be observed on matters relating to Material facts. Examples of material facts in various classes of insurance are :

[2] For better understanding of these terms please refer to the glossary of insurance terms.

(1) *Motor* : Details of any young drivers

(2) *Household* : Details of any commercial use of private dwelling house

(3) *Commercial* : Previous losses/hazards

(4) *Life* : Details of Heart Diseases

Duty of disclosure applies to both the *Proposer* and the *Insurer*. Duty of disclosure operates at : inception–until the date cover is confirmed by the Insurers renewal–up to the renewal date mid term alterations–until the Insurers confirm cover in respect of the alterations.

Breach of utmost good faith is essentially a violation of "Consensus ad idem", a prerequisite for a valid contract. The breach may relate to (*a*) misrepresentation or (*b*) non-representation. Intentional misrepresentation may be termed as fraudulent and the intentional non-disclosure may be termed as concealment of facts. When misrepresentation or non-representation is unintentional, it may be termed as breach of general duty. The utmost good faith is vital from an insurer's perspective. It is important for the insurer to decide about :

(*a*) Acceptance or rejection of a proposal

(*b*) Pricing of the insurance cover

(*c*) Contribution to indemnity

(*d*) Powers of subrogation under the contract

(*e*) Imposition of conditions and warranties

Subrogation

Subrogation in general, means the legal right of one person, having indemnified the other in a contractual obligation to do so, to stand in the place of another and avail of all the rights and remedies of the another, whether enforced or not.

It entitles the Insurer who has granted an indemnity to receive after payment of a loss the advantage of every right of the Insured. Subrogation condition is a corollary to the principle of Indemnity. A loss may occur accidentally or by the action or negligence of third party (not workmen). The property owners have a right to proceed against the offending third party to recover the loss/damage and also under their insurance policy but not under both. If the insured opts to recover the loss under the insurance policy which is faster and does not involve litigation, he will surrender his rights against the third parties in favour of the insurers signing a 'Letter of subrogation' on an appropriate stamp paper.

An exception to this are life insurance policies wherein insured/beneficiaries can claim under an insurance policy and also proceed against the offending third party.

The insurer must exercise the right of recovery in the name of the Insured (prevents the Insured from obtaining more than one indemnity)

Example

The Insurer of an importer of electrical goods receives a claim in respect of a faulty toaster. The Insurer pays the claim but takes over the insured's rights to claim back against the manufacturer. The insurance company can proceed with this claim in the Insured's name.

Subrogation rights only apply where there is a legal liability under the policy *i.e.*, where policy cover existed and the claims are paid. However, the policy conditions customarily provide for such subrogation rights before the claim payment. However, recovery from third parties can be made only if claim is paid.

Contribution

Contribution condition is a corollary to the Principle of indemnity. If an insured obtains more than one policy covering the same risk, he cannot recover the same loss from more than one source so that more than 'Indemnity' does not benefit him. Although the Insured may affect more than one policy to cover the same property or interest, he/she cannot recover in total more than a full indemnity. Contribution condition checks that each policy pays only a rateable portion under each separate policy. Application of contribution principle can arise only when the policies :

- Cover the same peril
- Cover the same subject matter
- Are effected by or on behalf of the same Insured

Example

An insured loses his/her watch on holidays. He/She has holiday insurance and All Risks Cover on his/her household policy. The cost of the claim should be shared under both policies

Example

If an insured has taken three policies from insurers X, Y and Z for Rs. 5,00,000, Rs. 5,00,000 and Rs. 2,00,000 respectively, an the loss to the property due to the operation of the insured peril is Rs. 1,20,000, then the ratio of contribution will be 5 :5 :2 Hence the claim payable by X, Y and Z will be Rs. 50,000, Rs. 50,000 and Rs. 20,000 respectively.

In the same example if the value of the property at the time of loss was Rs. 15,00,000 then the indemnity in respect of X, Y and Z shall be reduced proportionately by the factor {Sum Insured/ Actual Value}. Such cases shall be deemed to be cases of under insurance and the under cover shall be construed to *self insured* by the insured. Hence, the losses shall be borne by the parties X, Y, Z and insured as Rs. 16,667, Rs. 16,667,Rs. 6,667 and Rs. 10,000 respectively.

Insurable Interest

The Insured must have an insurable interest in the subject matter of insurance, *i.e.*, he/she must benefit by its safety or be prejudiced by its loss.

It is the legal right to insure arising out of financial relationship recognised under law, between the insured and the subject matter of insurance.

Insurance contracts without insurable interests have no sanction of the law as they amount to speculation The owner of a property has absolute insurance interest When a person insures a property, what is insured therein, is his interest in that property. By this principle, insurance interest exists to other parties like lessor, lessee, financiers, etc., but their interest is limited to the extent of their financial commitment only. The insurable interest must exist both at the time of the proposal and at the time of claims. However, in the case of marine insurance contracts, which

are assignable without the consent of the insurers, insurable interest must exist at the time of loss only (Marine insurance contracts are governed by Marine Insurance Act of 1963). Insurable Interest may be created either by :

Obligation to Insure

(*a*) By Statute

(*b*) By Contract

(*c*) By Custom

Option to Insure

(*a*) Owners

(*b*) Mortgagors

(*c*) Lessors

(*d*) Trustees

(*e*) Tenants

Example

Everybody would have an insurable interest in their own personal possessions *e.g.* car, watch. An employee would have no insurable interest in their desk at work but the employer has. A husband has insurable interest in his wife.

Proximate Cause

It is defined as the active efficient cause that sets into 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. Therefore there must be an efficient cause, which brings about a loss with no other intervening cause, which breaks the chain of events. A loss could be due to a cause of causes. In the chain reaction, it is the dominant cause, which would be the proximate cause to be considered for the purpose of a claim. It is always the duty of the insured to prove that the loss arose out of the insured peril, which is proximate.

Example

Firemen remove undamaged stock from a burning building to avoid its involvement in the fire. It is stacked in the open yard and subsequently damaged by rain. Was the proximate cause of the damage the fire or the rain? If the rain damage occurred before the Insured had an opportunity to protect it then the proximate cause of the damage would be the fire. However, if the stock were left unprotected for an unreasonably long period, the rain would be a new and independent cause of damage.

If there are more than one cause operating together and one of the cause is excepted peril, the claim shall not be payable under the policy. However, if the results of the operation of an insured peril can be separated from the excluded peril, the claim shall be payable in respect of insured peril.

Example

During the war period, a bomb was dropped on a factory, which caused fire to the factory. The proximate cause of loss in this case is enemy action and not fire.

Arbitration

When liability under the policy is admitted but the quantum is disputed, the insured cannot rush to a Court of law without first referring the dispute to Arbitration as per 'Indian Arbitration and reconciliation Act–1996'. In keeping with the provisions of the Act, the insured may appoint an arbitrator to be followed by appointment of another arbitrator by the insurers They can also appoint a single arbitrator, to represent both of them. If the two separate arbitrators cannot reach an agreement, both the arbitrators can appoint a third arbitrator called umpire. The award of the Arbitrators is binding on both the parties to the dispute and cannot be challenged unless a point of law is involved. The jurisdiction of Arbitration proceedings is within Indian territory. However, when foreign funding is involved, the financiers who are also joined in the policy as co-insured, may insist upon conducting the Arbitration proceedings in their own country. In such a case, the insurers may agree to modify the arbitration condition suitably.

2.5 Insurance Contracts

2.5.1 Functions of an insurance contract

The formulation of every contract depends upon the parties and subject matter of contract. The insurance contract performs the following functions :

(1) to define the risk that is to be transferred

(2) to state the conditions under which the contract applies and

(3) to explain the procedure for settling losses.

2.5.2 Nature of Contract

An insurance contract as four principle attributes :

(*a*) *Entirety*–all the terms and conditions are to be found in the policy document. If the terms and conditions are oral or not stated explicitly they are difficult for parties to prove.

(*b*) *Personal*–the contact follows the person, the insured, rather than property.

(*c*) *Unilateral*–After the insured pays the premiums the performance is obligatory on one party, *i.e.* the insurer.

(*d*) *Aleatory*–performance is conditioned upon an event that may or may not happen

2.5.3 Elements of Insurance Contract

The four basic elements to every insurance contract are :

(*a*) **Application :** An application is required for every contract of insurance. In the application, which is an offer to enter into a contract, the prospective insured sets forth the facts and figures required by the insurance carrier's underwriting department. The application may be brief and oral, or of any length and in written form. In life insurance, the application itself becomes a part of the contract.

(*b*) **Binders :** A binder is a memorandum specifying some of the details of the property or liability policy to be issued by the company. It is memorandum of insurance issued pending delivery of the formal policy. The binder may be oral or written and may be given either by an agent or a company. A broker, not being an agent of an insurance company, cannot issue binders. The binder is usually a temporary document and ordinarily would remain in force no more than ten days. For example, in automobile insurance a car buyer wants immediate coverage. By binding the insurance company to the risk, the agent need not wait for the insurance to become effective.

Binders are not used in life insurance. Given the long-term nature of the contract and the insurer's inability to cancel a life insurance policy, the life insurer requires an opportunity to examine the application (and possible the applicant) before being bound to a lifetime contract. However, in place of binders the life insurance agent can provide the applicant with a receipt (assuming the first premium installment is paid) that will provide varying insurance benefits depending on the nature of the receipt.

(*c*) **Policy Forms :** Policy forms are formal written contract of insurance that sets forth all of the terms of the agreement. The policy had two parts :

- *Heading :* It is the declaration page and identifies the risk by specifying the name of the issued, the address location of the risk, period covered by the policy, description of the subject being insured, the amount of insurance the amount of the premium, and any warranties of representations made by the insured.
- ***Body :*** It is the contract itself containing the various clauses pertaining to agreements exclusion and condition.
- *Back :* It specifies the rights of the insured and the duties of the insurer. The condition, and stipulations define the rights and duties of the parties aside from injury agreement.

  Standardization of policy forms is an ongoing process, and most insurance contracts have uniform language for the greater part of their terms. Such standardisation makes possible economies of operation, statistical uniformity, and better communication between the insured, his agent, and the insurance company. Where language has been standardised, determination of the meaning of the words and phrases by the courts reduces the chance a misunderstanding.
- *Endorsement :* An endorsement is a form that is used to modify the policy contract Endorsements may extend or restrict coverage, permit transfers of interest in property, transfer coverage, transfer coverage from one place to another, increases or decreases limits of coverage, provide for assignment of policies or changes in beneficiary designations, provide for changes in settlement options elected, or in any other legal manner permit amendments to the contract. Endorsements are usually done by party forms or by embossing through rubber stamps of the desired alteration.

2.5.4 Maxims Applicable to Insurance Contracts

The following maxims are elemental to insurance contracts and their interpretation.

(*a*) *Uberrimac fiddi*–Utmost good faith

(*b*) *Spes successions*–hope of succession–direct and not hope of insurable interest

(*c*) *Cause proxima*–the proximate and immediate cause of loss is important

(*d*) *Pari Delicto*–parties to be equally blamed–in case of illegal policies, the premium cannot be recovered/returned.

(*e*) *Salus Populist supermen* by the regard for pubic interest and welfare is the highest in law.

(*f*) *Rao ipsa loquitor*–the thing speaks for itself for example in case of accidents, the circumstances of the case and not more occurrence of the events has to be seen.

2.6 Kinds of Insurance

The commonly known categories of various insurance covers are–

NON-LIFE INSURANCE

Property

Personal and business property insurance that covers risks against fire, marine, theft and burglary. The types of insurance under this category are :

- Home Insurance/Domestic cover
- Business insurance
- Commercial Insurance

Liability

This protects the insured against injury or damage claims made by a third party. The types of insurance under this category are :

- Motor insurance
- Workmen Compensation
- Liability Insurance
- Aviation Insurance
- Project and Engineering Insurance

Health

In case of an illness or injury suffered by the insured or his/her dependents, health insurance covers their medical expenses incurred. The types of insurance under this category are :

- Hospital Insurance
- Medical cover

LIFE INSURANCE

Life Insurance products can be broadly divided into various categories, which include money back, pension, endowment and specialised plans. The popular life products are :

- Money Back
- Pension

- Women, Girl child and Couple
- Endowment
- Whole Life
- Child Insurance

The various types of life and non-life covers are discussed in detail in Unit 3-5.

Key Terms

- Contribution
- Gambling
- Indemnity
- Insurable Interest
- Insurable Risk
- Pooling
- Proximate Cause
- Subrogation
- Utmost Good Faith
- Wagering Contracts

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Questions for Review

1. Define insurance. Briefly explain the costs and benefits of insurance.
2. List the various classes of life and non-life insurance covers available in India.
3. Write short notes on principles of Subrogation and Contribution.
4. Distinguish between assurance and insurance in view of principle of indemnity.
5. Distinguish between insurance and wagering contracts.
6. Define proximate cause. Discuss the application of proximate cause to insurance contracts.
7. Describe the proximate cause in the following situations :

(*a*) A motorcycle driven at a high slipped due to rain water on the road and damaged. (Speed/Rain Water)

(*b*) During violence in a political party meeting, some articles of furniture were stolen. (Theft/Violence)

(*c*) During an earthquake, a school building caught fire and was destroyed. (Fire/Earthquake)

UNIT 2

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CHAPTER 3

RATING OF INSURANCE PRODUCTS

Pricing of Insurance products is mysterious to most of the people. It is different from the pricing of tangible where one can figure out the cost of inputs. Also, in other services, the cost of providing them can be estimated with some judgement. Insurance is the business of buying risk. Therefore, most people think in terms of what they paid for buying a risk cover and what they paid for the cover. When an insurers sells a policy, it has no way of knowing what will be the realised cost of the policy because it depends upon whether or not the policy buyer has losses and, if so, how many and how large they are. Of course, this is the reason that different people are charged different prices for policies providing the same kinds and amounts of insurance.

3.1 Theory of Rating

The bread and butter of the insurance industry are based on the probability and statistics. Actually speaking, the insurance game is a game of probability. One, who correctly estimates wins, otherwise loses. The Insurance actuaries constantly face a trade off when determining the premium to charge for coverage : the premium must be high enough to cover expected losses and expenses, but low enough to remain competitive with premiums charged by other insurers. Actuaries apply statistical analysis to determine expected loss levels and expected deviations from these loss levels. Through the application of the law of large numbers, insurers reduce their risk of adverse outcomes.

Rating or Pricing of insurance products is typical in the sense that in insurance transactions, the sales price (i.e. the insurance premium) is collected before stipulated services, namely claim payments, are duly provided.

"Two corollary are usually drawn : (a) insurance pricing is rather a delicate actuarial exercise; and thus (b) technical reserves must be built up to represent the liabilities towards policyholders to ensure that the inherent promises to them do not become failed promises. These reserves are then invested on financial markets and placed under the supervision of the relevant regulatory authority. This is precisely why insurance firms are usually viewed as fulfilling an important financial intermediary function."[1]

"A fundamental principle of insurance pricing is that if insurers are to sell coverage willingly, they must receive premiums that

(1) are sufficient to fund their expected claim costs and administrative costs and

(2) *provide an expected profit to compensate for the cost of obtaining the capital necessary to support the sale of coverage."*

The premium level that is just sufficient to fund the insurer's expected cost and provide insurance company owners with a fair return on their invested capital is known as the fair premium.

Actuaries generally calculate the base premium on the basis of expected claims distribution using principle of equivalence (P = ps) such that

$$P = E(S) + k + R$$

[1] Briyo and Varenne, Insurance from Underwriting to derivatives, John Wiley & Sons Ltd., 2001, p. 6.

[2] Harrington and Miehaus, Insurance and Risk Management, McGraw Hill, p. 115.

Where E(S) represents the mathematical expectation of claims, k denotes ongoing company running costs, while R is a risk premium which allows for coverage of unforeseen deviations in the claims amount to be paid, but still provides the company with "normal" profits i.e. this standard pricing mechanism relies upon the so-called "law of large numbers. Within a large, diversified and homogeneous underwriting portfolio, the claims burden should converge towards its expected value.

3.1.1 Probability and its Use in Insurance

The probability of an event refers to the chances of its occurrence of the total set of possible occurrences. For a given pool of automobile covers sold by an insurance company, it is important to find out for the underwriter, what is the chance of occurrence of an automobile accident? If he correctly estimates the probability, the correct cost of bearing the risk i.e. the premium will be charged from the clients, otherwise, if adverse happens the claims may *ruin* the company.

A *probability distribution* or a *theoretical frequency distribution* is the distribution of all possible outcomes of a random variable (A random variable is a variable whose outcome is uncertain). For example, suppose a coin is tossed, either there can be head or a tail. The coin was tossed 50 times and the following observations *cumulatively* were noted for 10, 20, 30, 40 and 50 experiments :

No. of Experiments	10	20	30	40	50
Heads	4	9	13	18	24
Tails	6	11	17	22	26
Probability of a head	40%	45%	43.33%	45%	48%

We all know that if we increase the number of trials such that it approaches infinity (?), the probability of getting a head will be 50%. The logical conclusion which flows from this illustration is that by increasing the number of experiments for a given random variable, *the probability of the occurrence for a given outcome can be accurately estimated and used for decision making.* Risk management decisions need to be made prior to knowing what the actual (realised) outcomes of key variables will be. A manager does not know beforehand which outcomes of random variable affecting the firm's profits will occur. Nevertheless, he or she must make decisions. Once the outcomes are observed, it usual is easy to say what would have been the best decision. However, we cannot evaluate decisions from this perspective, which is why probability distribution is so important. Probability distribution tells us all the possible outcomes and the possible outcomes and the probability of those outcomes. Information about probability distribution is needed to make a good risk management decision.

Probability Distributions

Probability distributions can either be discrete or continuous. A discrete distribution can take limited values, which can be listed, however a continuous can take any value within a given range. In insurance we use the three popular variable distributions- the Binomial, the Normal and the Poisson. In each of these distributions, it is assumed that events occur in a random fashion, meaning that the probability that any one event will occur is equal to the probability that any other event will occur. It is also assumed that events are independent of each other, in other words, when one event occurs; the probability that a second event will occur is not changed.

Poisson distribution is best to be used when the probability of occurrence of an event is small and the population size is very large. Now let us take an example to illustrate the use of probability. Assume that for a given life insurance group of 5 members, the premium charged is Rs. 3,000 and

the coverage (sum assured) is Rs. 90,000. If one of those five persons is likely to die in a given period, we are interested in finding whether there will be profit or loss to the insurance company.

Total Premiums collected = Rs. 3000 × 5

= Rs. 15000

Expected value of losses = 90,000 × 0.20

= Rs. 18,000

Since Expected values of losses > total premiums collected, the pricing of insurance product was improper.

3.1.2 Dual Application of Law of Large Numbers

It implies from the above discussion that a large sample will improve our estimates of the underlying probability. Even in the case of priori probabilities where the probability is known, it must be applied to large number of trials if we expect actual results to approximate in true probability. Therefore, in the case of empirical probabilities, the requirements of a large number has dual application :

- To estimate the underlying probability accurately, the insurance company must have a sufficiently large sample, the more accurate will be the estimate of the probability.
- Once the estimate of the probability has been made, it must be applied to a sufficiently large number of exposure units to permit the underlying probability to work itself out.

In this sense, to the insurance company, the law of large numbers means that the larger the number of cases examined in the sampling process, the better the chance of that actual experience will approximate a good estimate of the probability.

In making predictions on the basis of historical data, the insurance company assumes that things will happen in the future as they have happened in the past. But it may not be true. It is likely that the probability involved is constantly changing. Since the insurance company bases its rates on the expectation of future losses, it must be concerned with the extent to which actual experience is likely to deviate from the predicted results. For the insurance risk is measured by potential deviation of actual from predicted results.

It should be noted that although probability theory plays an important role in the operation of insurance, insurance does not always depend on probabilities and predictions. It is only when insurance is to be operated on an advance premium basis, with the participants paying their share of losses in advance, the probability theory and predictions become important.

Insurance is about spreading the risks. From the perspective of an insurance company, represents the probability of compensation pay outs being greater than the premium revenue, resulting in a net loss to the company. In general, the insurers risk is reduced if there are many individuals or business taking up insurance. A large pool of policyholders would reduce the administration cost of processing a policy. A large pool would also reduce average insurance premiums because the revenue required to meet the claims is spread over a large number of policyholders. The general assumption is that claims do not increase proportionately with the number of policyholders.

Therefore it is the probability that must be correctly estimated otherwise, the insurance company may default or go into liquidation.

3.1.3 Pooling in Insurance

Pooling of risks is the underlying feature of insurance. Insurance companies try to make a group or pool of homogenous exposures with a view to reduce the losses arising from that exposure. It is most advantageous when the losses are uncorrelated. When the group agrees to bear the losses in some proportion, the burden on a given member is reduced. This has the effect of loss distribution for the group flatter and flatter. The application of large numbers and pooling suggests that normal curve becomes flatter any flatter when the members are added to a group–logically, because of reduction in the variance and likely concentration towards mean (m).

3.1.4 Rate-making Constituents

From a managerial perspective, the major components of premium can be described as follows :

Pure Premium

It is the most important component of the insurance premiums. Based on actuarial calculations, it includes the amount needed to cover expected losses and loss adjustment expenses.

Operating Expenses

Operating Expenses include the sales commission and other marketing costs, taxes, and the cost of handling claims. The size of this component of premium varies from one line to another, largely dependent upon the extent and variety of policyholder services that the insurer provides.

Margin and Other Incomes

It includes an allowance for (*a*) contingencies, and (*b*) underwriting gain or profit. Contingency funds are needed to meet unexpected increase in the number or size of benefit payments and underwriting gains are needed to provide funds for financing growth and expansion.

3.1.5 Rating Terminology

- Insurance prices are called as *Premiums*. Premiums are based on rates and rates are based on per unit of exposure.
- The term *rate* is used synonymous with premium in the insurance business. It is the price per unit of insurance.
- *Exposure units are* quantitative units used in insurance pricing.
- *Loading* refers to the amount that must be added to the pure premium for other expenses, profit and margin for contingencies.

Kind of Insurance	*Exposure Unit*
Automobile	Automobile insured (IDV)
Fire	Rs. per 100
Liability (Products)	Rs. per 1,000
Worker's Compensation	Rs. per 100
Life	Rs. per 1,000

3.1.6 Rating Objectives

Pricing of insurance products is a critical issue. The underwriting/actuarial department in the insurance company is highly conservative and tries to fix the prices *all-inclusive*. On the contrary, in a competitive environment, it becomes a problem to sell the product at mathematical prices and they are forced to offer incentives thereby reducing realised prices. The non-life insurance business in India is substantially regulated. Tariff Advisory Committee (TAC) constituted under the Insurance Act 1938, controls and regulates the rates, advantages, terms and conditions that may be offered by insurers in respect of General Insurance Business relating to Fire, Marine (Hull), Motor, Engineering and Workmen Compensation. All other products are non-tariff. These rates are also called as statutory standards. In addition to these regulations the pricing of insurance products must achieve the following general objectives :

(*a*) *Adequacy* : The rate must be adequate to generate the premium income the insurer needs to pay its claims and expenses. In addition, the insurers' income must be adequate to assure fair rate of return to the investors of funds. Also, they are sufficient to finance continuing growth and expansion.

(*b*) *Reasonableness* : The rates must not be so excessive that allows insurance companies to earn abnormal gains. There is no recipe for reasonableness, but what the insurance company can justify to the potential buyers in a free market condition is considered as reasonable.

(*c*) *Fairness* : The rates must not be "unfairly discriminatory". The insurance rates must be fair and must discriminate among the buyers fairly. Since the rates must vary with classifications as principle, they must not create unrest among the group of buyers. In other words, the rates must not be same for hetro-groups and must not be different for homo-groups.

(*d*) *Simplicity, Consistency and Flexibility* : The rating system must be simple to understand and inexpensive to use. The rate must not change frequently under circumstances warrant (responsiveness to changes in the number of expected claims and losses). Also, the pricing mechanism should encourage the reduction of losses.

3.2 Types of Rating

Insurance rating assesses the cost of the insurance product. Depending upon the type of rating, the price to the buyer may be–(*a*) entirely different from the one paid by another, (*b*) same as that paid by other customers or (*c*) similar to that paid by others, but more or less than the amount for one reason or another. There are basically three recognised rate-making methods :

- Judgement rating
- Class rating
- Merit rating
- Schedule rating
- Experience rating
- Retrospective rating

Judgement Rating

It is used when the risk proposed to be bought is so unusual that little or no statistical information about similar risk is available. Each exposure is individually evaluated, and the rate is deter-

mined largely by the underwriter's judgement. Such cases are not unusual to the insurers when the loss exposures are so diverse that a class rate cannot be calculated, or when credible loss statistics are not available. When the judgement rating is used, each premium is unique and is based on the opinion of the person making it. It is widely used in ocean marine insurance and in some lines of inland marine insurance.

Class Rating

Class rates are the most common rate in insurance business. Insured risks are classified on the basis of one or several important features and all that belong to the same class are subject to the same rate per unit of exposure. The rate charged reflects the claims experience for the class as a whole. It is based on the assumption that future losses to insured will be determined largely by the same set of factors. This type of rating is also termed as manual rating because the various classifications and the respective rates are in the form of printing manuals.

Life insurance is one of the line where class rates are used viz. rates based on age, gender, healthiness, smoking and drinking habits etc. Class rating is also used for homeowners insurance, automobile insurance, workers compensation and health insurance. The twin considerations in class rating are :

How many different classifications and rates should there be?

How many characteristics of the covered risks should class rating take into account?

These two go together because the number of classifications depend upon the number of rating factors that are considered; the more the factors, the more the classifications.

The class rate may be determined by dividing the amount of incurred losses and loss adjustment expenses by the number of exposure units. Incurred losses include all losses paid during the accounting period, plus amounts held as reserves for the future payment of losses that have already occurred during the same period. Loss adjustment expenses are the expenses incurred by the company in adjusting losses during the same accounting period.

Another technique could be to compare the actual loss ratio with the expected loss ratio, and the rate is adjusted accordingly. The actual loss ratio is the ratio of incurred losses and loss adjustment expenses to earned premiums. The expected loss ratio is the percentage of the premiums that is expected to be used to pay losses.

When rates are based on just a few factors, many other characteristics of each exposure are ignored. Number of rating classes is dilemma for the rate-maker. The greater the number of classes, the more the factors that can be taken into account and therefore the more similar risks in any given class will be. On the other hand, increasing the number of classes reduces the number of insured in each one. Law of large number tell that the greater the number of exposures in each class, the more reliable the prediction of future losses will be. Hence, there are reasons for having so many classes and also for having a few. Increasing the number of classes causes the risks in each class to be more nearly alike, but reducing the number of classes causes the rates to be based on a larger body of data and to be more reliable.

Merit Rating

Merit rating is a modification of the class rating. It modifies the class rate of a particular class insured based on individual loss experience. It is based on the assumption that the loss experience of a particular insured will differ substantially from the loss experience of the other insured.

In doing so, it reflects the extent to which a specific risk differs from the others in the same class. The various types of merit-rating plans are :

Schedule rating

Under this plan, each exposure is individually rated. In calculation of schedule rates the first step is to examine the risk (the person or object insured) in order to identify the features that are likely to cause losses or to prevent them. Then the risk is compared with the average or standard risk of its type. Finally deductions are made from the standard rate, for this risk's desirable features and additions are made for its undesirable features, the resultant rate is rate that is tailored made to reflect the characteristics of risk for which it is used. The scheduled rating system (for a building) takes into account the following major factors :

- Occupancy
- Construction
- Location
- Protection
- Maintenance

The various additions to and subtractions from the basic rate are based upon the judgement of the person who develop the overall scheduled rating system and important feature of this system is that it identifies the factors entering into an insurer's rate.

Experience rating

This type of rating modifies the class rate on the basis of claim experience of a particular exposure. The actual losses for a period generally of two or three years are compared with the average risks in the same class. The rate is reduced if the risk has a better record than the average, it is increased if the record is worst than average. Experience rating is used only for large risks *viz.* large enough to have many losses each year reflecting a trend. Hence, this type of rating is generally limited to larger firms that generate a sufficiently high volume of premiums and more credible experience.

Retrospective rating

Contrary to experience rating retrospective rating modifies the insurance cost on the basis of current experience. This is generally done by making a provision in the policy contract that final rates will be determined *retrospectively*. Generally a range indication maximum and minimum is specified and the final premium is determined after the policy expires and depends upon the amount of losses incurred during the year. If the losses are very small the insured will pay the minimum premium otherwise if they are very large the insured will be charged the maximum premium. Usually the premium lies between maximum and minimum premium. Retrospective rating increases the insured's incentive to control losses, because the pay-off in premium savings can be substantial. It is generally applied to large liability and workers compensation policies.

3.2.1 Life Insurance vs. Non-life Insurance Pricing

Pricing of life Insurance products is simpler and life insurance rates are more stable and precise. In life insurance, the main factors used for determining the premium rates are : (*a*) Mortality,

(*b*) expenses and (*c*) interest. The insurers from time to time including the IRDA Annual Reports also publish the mortality statistics. In non-life insurance the insurers make estimates of the claims cost based on past experience, which are subject to review from time to time. The factors considered when pricing general insurance products are : (*a*) Claims cost, (*b*) business acquisition cost, (*c*) management expenses, (*d*) margin for fluctuations in claims experience and (e) a reasonable profit. Accordingly, the life insurance and non-life insurance pricing can be distinguished as follows :

3.2.2 Rate Making Entities

The individual insurers or professional rate making organisations may determine insurance rates. However, actuaries are generally involved in the rate-making process.

Professional Rate-making Organisations

Professional rate making organisations are the specialists that perform the rating work for the insurance companies. The reason for existence of such organisations is that many companies do not have the sufficient data of their own. By working together and pooling their premium and loss data, they can develop a more reliable rating information. Co-operative rate-making is also suitable for smaller companies.

Actuaries

Actuaries are the specialists in the mathematics of insurance, who carry out the prime responsibility of the rate-making process either working in companies or otherwise. They make financial sense of the future by applying mathematical models to problems of insurance and finance. Actuaries are experts who perform actuarial analysis of insurance rates, rating procedures, rating plans, and schedules of insurance companies. These are professionals who are experienced in reviewing and analysing insurance operations, reserves and underwriting procedures and provide technical assistance regarding actuarial matters to policy examiners and other technical staff. They perform the following functions :

(*a*) Developing new forms of insurance to meet the changing needs of consumers.

(*b*) Determining the reserves needed to meet the future obligations.

(*c*) Analysing the expenses and earnings and providing database for distribution of surpluses.

(*d*) Conducting research studies on claims experiences, projecting future claims and earnings.

(*e*) Communicating with the company officials, agents, policyholders, and regulatory authorities about company policies and practices.

Key Terms

- Acturies
- Class Rating
- Experience Rating
- Exposure Unit
- Judgement Rating
- Margin
- Operating Expenses
- Pure Premium
- Rate-making Organisations
- Retrospective Rating

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Questions for Review

1. "Insurance is a dual application of law of large numbers." Discuss.
2. Define Pooling. Briefly explain the advantages of pooling to insurance institutions.
3. Briefly explain the major determinants of insurance pricing. Do you think that their respective weightages vary from organisation to organisation?
4. What is rating? Briefly explain the various classes of rating.
5. "In order for insurance rates to be fair, they must discriminate fairly among the various policyholders." Explain.
6. What general comparisons can be made between life insurance pricing and non-life insurance pricing?

CHAPTER 4

LEGAL AND ECONOMIC ENVIRONMENT OF INSURANCE BUSINESS

Insurance is a federal subject in India. Two statutes primarily regulate the insurance business– (*a*) Insurance Act 1938 and (*b*) Insurance and Regulatory Development Authority Act, 1999. The Insurance business is classified into four classes–(1) Life Insurance, (2) Fire, (3) Marine and (4) Miscellaneous insurance. Life Insurers transact life insurance business and General Insurers transact the rest. Apart from this, GIC and its subsidiaries are regulated by General Insurance Business (Nationalization) Act, 1972 and LIC of India being regulated by The Life Insurance Corporation Act, 1956.

4.1 Need for Regulation

The regulator of insurance business in India is IRDA constituted by the IRDA Act, 1999. Regulation of Insurance business provides the insurance market with direction, management control and correction. Insurance, generally, all over the world is widely regulated. This is because of the following reasons :

(*a*) *Widespread severe impact of insurer solvency*. Since solvency ensures that insurance transactions are certain ad predictable, promotion and maintenance of insurer solvency are at the heart of all regulatory activity. Insureds are generally incapable of self-protection and if the insurance company becomes insolvent, the results may be disastrous. Insurance generally mobilise savings, and therefore they bear a kind of fiduciary relationship as that of a banker and customer, and therefore, it requires public regulation.

(*b*) *Unequal knowledge and bargaining power of the buyers and seller*–insurance contacts are complex and the insurance itself is an intangible product.

(*c*) *Insurance pricing* is–typical and unique and requires estimation before the costs are fully known.

(*d*) *Social welfare*–insurance by definition is a sound device and optimally should be made available to public at large without discrimination.

4.2 Legal Framework of Insurance Business

Insurance is made available to the public through the medium of contracts that detail the rights and duties of the parties to the insurance agreement. These contracts may range from implied or oral agreements, as in the binders given by fire and casualty insurance agents, to formal written contracts issued by companies. Most of the insurance contracts are expressed in writing even when an oral binder initiates the transaction.

Insurance contracts are complicated because of the technical nature of the subject matter, the statutory requirement that certain language be employed, and the need to avoid terms that may be construed as ambiguous. However, the need for legal clarity may lead to a contract that is beyond the comprehension of the typical insurance consumer. Furthermore, the technical nature

of many contracts often distracts from the mutual understanding of its terms by the parties to the contract.

Insurance contract can broadly be classified into two categories (a) life and (b) non-life insurance. The subject matter of life insurance is life of the assured. In a life policy the life is covered for a certain amount which is payable on the maturity of the policy or on the death of policyholder which is earlier. The amount is payable on death to the nominee/legal heir of the deceased.

Non-life insurance can again be categorised according to the uncertainties and events covered by the respective policies. Some examples of non-life insurance policies are householders insurance and fire insurance. Personal accident insurance is linked to human life hence would not strictly fall in the category of non-life insurance though the characteristic of uncertainty which attracts to non life insurance is manifested even in personal accident and medical insurance policies respectively.

The first law governing contracts of insurance is the Indian Contract Act, 1872. However, there many issues not covered by the said Act. This may relate to torts, consumer rights, transfer of property, agency issues etc.

4.2.1 Torts and Crimes

Torts

A tort is a private wrong. It occurs whenever someone acts or fails to act in such a manner that an individual's peace of mind or right are jeopardized. It refers to any individual's action that effectively deprives another of his right to security of person, reputation, or property. Technically, each tort is defined in terms of specific statutory or common law requirements, and these vary substantially in different jurisdictions. Negligence, assault, battery, libel, slander, trespass, fraud, and false imprisonment are examples of torts. Torts differ from crimes in that the latter are public wrongs. A crime is any act that the legislature determines to be punishable by law. The same act may include all of the elements of a particular tort and a particular crime, in which case there exists a public remedy in the form of punishment prescribed by law and a private remedy that is often in the form of monetary damages.

Torts are important in insurance because they are a major source of loss covered by liability insurance. The automobile insurance policy is essential because it provides for payment of judgments awarded by the courts in negligence cases as well as the costs of litigation or claims settlement. The comprehensive personal liability insurance policy covers losses arising from negligent conduct unrelated to the care, custody, or control of the automobile or to business pursuits. The comprehensive general liability insurance policy covers losses occurring as a direct result of negligence in many business situations.

Crimes

Some crimes that are recognized by statute are specific to insurance, while others are relevant to insurance law because they are crimes committed to obtain funds illegally from insurance companies. A few examples of crimes are :

(*a*) Rebating–passing of commission/incentives by agents to prospective insureds to purchase on insurance policy.

(*b*) Twisting–inducing an individual to terminate are life insurance policy in order to buy another to the disadvantage of the insured.

(*c*) Filing of false claims–attempt to collect money from an insurance company when there is no loss or the padding or inflation of claims by procuring excessive and fraudulent estimates of damages.

(*d*) Unlicensed insurance activity–Unlicensed person engaging in any insurance transaction that requires licensing (guilty of a misdemeanor).

(*e*) Defamation–publication of material that might tend to lessen public confidence in the institution of insurance.

(*f*) Asson–felonious burning of property of another to defraud an insurance company.

(*g*) Homicide–when the beneficiary of a life insurance policy swindles the insured for the purpose of obtaining the proceeds of the policy or other wise.

(*h*) Breach of trust–agents using or mingling the client's insurance premiums with their own funds.

(*i*) Unfair discrimination–charging of different rates by a single insurance company to similar risk class.

(*j*) Conspiracy–dishonest agent conspires with his client to defraud the insurance company by misrepresentation, by filing false claims or falsifying documents.

4.2.2 Indian Contract Act, 1872

Insurance contracts are agreements between insurance companies and insured for the purpose of transferring from insured to the insurer a part of the risk of loss arising out of contingent event. Therefore all the provisions of Indian Contract Act, 1872, in general are applicable to insurance contracts. Under Section 10 of the Indian Contract Act, following conditions are necessary to form a valid contract :

(*a*) Agreement between two parties

(*b*) Lawful object

(*c*) Capacity to contract

(*d*) Legal purpose

(*e*) Consideration

(*f*) Possibility of performance etc.

4.2.3 Insurance Act, 1938

This Act was passed in 1938 and was brought into force from 1st July 1939. Afterwards, the Acy has been amended a number of times including those in 1950 and 1968. Important Provisions in the Act relate to :

(A) Conduct of Insurance Business (Part–II)

(1) Registration and licensing of insurance

(2) Accounts and Audit

(3) Licensing of agents and serveyors

(4) Submitting of returns

(5) Investment norms

(6) Amalgamation and tranfer of insurance business

(7) Authority's control over management.

(B) Insurance Association of India Councils of the Association and Committees thereof (Part IIA)

(C) Tariff Advisory Committees and control of tariff rates (Part IIB)

(D) Solvency Margin, Advance Payment of premium and restrictions on the opening of a new place of business (Part IIC)

(E) Provident Societies (Part III) Registration, working, Investment norms, liquidation etc.

(F) Mutual insurance companies and co-operative life insurance societies (Part IV) Working capital norms, loans, membership, deposits etc.

(G) Reinsurance (Part IVA)

(H) Penalties (Part V).

Section 2c of the Act prohibits persons to carry on insurance business until he is -

(*a*) A public company.

(*b*) A registered society under

(*c*) A body corporate incorporated under the law of any country outside India not being in the nature of a private company. However, the central government is empowered to exempt any insurer or any person for the purpose of carrying on the business of granting superannuation allowances and annuities as per Section 2(11(c) or for the purpose of carrying general insurance business. Exempted insurer after the promulgation of IRDA Act, 1999 only Indian Insurance company can carry insurance business.

Licensing conditions

Only Indian Insurance companies to be granted licenses : Under the Act, it is mandatory that only an Indian insurance company can carry on an insurance business in India. An Indian insurance company is a company registered under the Companies Act 1956 where the aggregate foreign equity shareholding does not exceed 26 per cent and whose sole purpose is to carry on a life, general or reinsurance business.

Two-stage licensing process

Stage 1–Requisition for Registration

An application has to be made to the Authority with all the prescribed disclosure norms. Some of the important items cover :

1. Promoter's back-ground, financial strength, share-holders' agreement and reasons for entering the sector.
2. Director's back-ground.

3. Capital structure, initial and future.
4. Financial projections for 5 years.
5. Scenario Building and Sensitivity analyses.
6. Rural and social sector strategy.

There is no provision for appeal in the event of a second rejection. A revised application is permissible by the applicant company only after 2 years with an additional condition that this will be with a new set of promoters or for a different class of insurance business.

Stage 2–Application for Registration

After the requisition is granted by the Authority, the applicant is required to make an application for registration. Information to be disclosed includes :

- Proof of paid-up capital of Rs. 100 crore.
- Proof of deposit.
- Marketing and distribution information. This should include information on Market Research. Product information, Distribution Strategy and Details, Sales promotion, Customer service.
- *Operations* : Information should cover underwriting, information technology, Internal controls, Personnel.
- *Investment* : Information on investment Philosophy, Strategy and ground level arrangements.
- *Reinsurance* : Information on Approach and Terms.
- *Expenditure* : This should include a description of the manner in which the expenses of administration have been estimated. These expenses will have to be distinguished between first year and renewal, fixed and variable. The proposed expenses as a percent of premium at levels of operational offices, supervisory offices and head office.

Licensing Criteria

Some of the important parameters include :

- Promoter and directors' background
- Promoter financial strength
- Volume of business and earning prospects
- Rural and social sector focus
- Product profit
- Capital structure
- Actuarial and professional expertise
- Infrastructure
- Public interest

Other Licensing Issues

An appeal can be made to the Central Government against the decision of Authority, which shall be final. The applicant company can submit a new application only after two years with the additional condition that it has to be with a new set of promoters or for a different class of insurance business. The Authority will grant more licenses to applicants for life and health insurance than general insurance. Licenses expire on the 31st day of March each year and have to be renewed each year.

Capital Requirement and Foreign Stake

Minimum paid-up equity capital required for a life insurance is Rs. 100 crore and for a reinsurer Rs. 200 crore. The capital contributed can only be in the form of equity shares as preference shares cannot be issued. The incumbent, LIC, would be required to increase its equity share capital from the existing Rs. 5 crore to Rs. 100 crore within a period of six months from the date of commencement of the IRDA Act. Also, the four GIC subsidiaries would have to increase the equity share capital to Rs. 100 crore from Rs. 40 crore are resent. The GIC will not be required to bring in additional capital since its present capital base is Rs. 215 crore.

Accounts and Returns

An insurer is required to keep a separate account of all receipts and payments in respect of each class of insurance viz., Fire, Marine and miscellaneous Insurance. Every insurer is required to prepare, at the expiration of each financial year, in the prescribed forms,

(*a*) a balance sheet

(*b*) a profit and loss account

(*c*) a revenue account for each class of insurance business

These accounts are required to be audited annually by an auditor and printed and four copies to be furnished as returns to the IRDA within 6 months from the close of the financial year. Every Insurer is required to furnish to the authority a certified copy of the minutes of the proceedings of every General Meeting, within 30 days from the holding of the meeting. The Insurance Rules framed under the Act provide that the following items of information shall be maintained in respect of each class of business :

- A record of cover notes specifying the identification number, name of party, dates of commencement and expiry, type of cover granted, the amount of premium and cross- reference to the policy.
- A record of policies, which should be serially numbered, listing all policies issued, entered in chronological order, stating the number of policy, date of commencement and expiry of risk, name/s of the insured, premium received, cross reference to the relevant bank Guarantee or deposit and the nature of risk granted, cross reference to any cover-note issued prior to the issue to the policy and cross-reference to any endorsement passed subsequent to the issue of the policy.
- A record of premiums showing, according to chronological order or receipt of premiums, date of receipt, the amount, and name of party from whom received and with cross- reference to policy number.

- A record of endorsements mentioning the policy number to which attached, dates of commencement and expiry of the endorsement, the type of endorsement and the additional premium charged or refund due and cross reference to the premium register.
- A record of bank guarantees and deposits giving particulars of the party, amount and conditions of guarantee or deposits and cross-reference to the relevant policy or policies.
- A record of claims intimate mentioning name of claimant, giving reference to policy number, date of intimation of claim, interest covered, nature and cause of the loss or damage, provisional estimate of loss, amount at which settled, date of settlement of claim, recoveries from salvage or otherwise and whether surveyed. Two separate records, one relating to claims intimated and the other relating to claims paid, may be maintained if there is adequate cross referring of information between them and if the information required under this clause is readily available from them taken together.

The rules framed under the Insurance Act, 1938 also provide that the following items of information shall be maintained for the business of the insurer as a whole.

(*i*) A register of agents.

(*ii*) A record of business procured by each agent and the amount of commission paid thereon.

(*iii*) Records of employees including field workers.

(*iv*) Cash book and disbursement book.

(*v*) A record of investments and assets.

(*vi*) Records of insurance companies with which common and facultative reinsurance arrangements of reinsurance treaties are entered into .

(*vii*) Record of facultative reinsurance ceded and accepted.

Further, the Rules provide that receipts for payments received shall be maintained in a systematic manner and documents used for assuming risk are serially numbered and field accordingly. The documents relating to claims settled, including copies of any survey of loss assessment reports, shall be maintained as follows :

(*i*) in respect of every loss or damage on which a claim of less than Rs. 5,000 has been made, for a period of three years :

(*ii*) in respect of every loss or damage on which a claim of Rs. 5,000 or more but less than rupees Rs. 20,000 has been made, for a period of five years :

(*iii*) in respect of every loss or damage on which a claim of Rs. 20,000 or more but less than rupees one lakh has been made, for a period of seven years :

(*iv*) in respect of every loss or damage on which a claim of rupees one lakh or more has been made, for a period of twelve years;

such period being counted from the date on which the claim is settled.

Investments

Every insurer is required to invest his assets only in those investments approved under the provisions. Returns in the prescribed form are to be submitted to the Authority showing as at 31st March of the preceding year, the investments made out of assets.

Limitation on Expenses of Management

The Act prescribes maximum limits of expenses of management including commission that may be incurred by the insurer. The percentages are prescribed in relation to the total gross direct business written by the insurer in India. These provisions do not apply to the General Insurance Corporation of India.

Prohibition of Rebates

No person shall allow or offer to allow as an inducement to any person to take out insurance any rebate of the whole or part of commission payable or any rebate of the premium shown in the policy. Any person making default in complying with these provisions shall be punishable with fine which may extend to five hundred rupees.

Powers of Investigation

The Central Government may at any time, by order in writing, direct the Authority or any other person specified in the order, to investigate the affairs of any insurer and report to the Central Government.

Advance Payment of Premium

No insurer shall assume any risk unless and until the premium is received in advance or is guaranteed to be paid or a deposit is made in advance in the prescribed manner. This rule of advance payment of premium may be relaxed in circumstances specified in the rules framed under the Act.

Licensing of Surveyor or Loss Assessor

A surveyor or a loss assessor must hold a valid licence, which is subject to renewal after a period of 5 years. Before admitting a claim exceeding Rs. 20,000 a general insurance company needs to obtain a report on the loss that has occurred from the surveyor or loss assessor.

Penalties

The Act has laid down penalties for contravention of the following provisions :

- Failure to maintain solvency margins.
- Failure to comply with investment norms.
- Failure to carry out rural and social sector obligations.
- Making a false statement or furnishing a false document.
- Failure to comply with the directions of the Authority.
- Failure to furnish documents, statements and returns required by the Act.

4.2.4 Tariff Advisory Committee

The Tariff Advisory Committee (TAC) established under the Act is empowered to control and regulate the rates, terms, etc. that may be offered by insurers in respect of any risk or of any category of risks. It is provided that in fixing, amending or modifying such rates etc. the Committee

shall try to ensure as far as possible that there is no unfair discrimination between risks of essentially the same hazard and also that consideration is given to past and prospective loss experience. Every insurer is required to make payment to the TAC of the prescribed annual fees.

List of Existing Tariff Business Controlled by TAC

Fire	:	All India Fire Tariff, Petrochemical Tariff, Industrial All Risks Tariff, Consequential Loss (fire) Tariff
Marine	:	Marine Hull Tariff, Fishing Vessels Tariff, Tea Tariff
Engineering	:	Contractor's All Risk Tariff (CAR), Contractors Plant and Machinery Tariff (CPM), Electronic Equipments Insurance Tariff (EEI), Machinery Breakdown Tariff (MB), Civil Engineering Completed Risks Tariff (CECR), Storage cum Erection Tariff (SCE), Loss of Profit, Boiler and Pressure Vessels Tariff, Deterioration of Stocks (Potato) Tariff etc.
Motor	:	All India Motor Tariff
Miscellaneous	:	Workmen Compensation Tariff

4.2.5 The Indian Stamp Act, 1899

The Indian Stamp Act requires that a policy of insurance be stamped in accordance with the schedule of rate prescribed.

4.2.6 The Consumer Protection Act, 1986

The Act applies to all goods and services unless specifically exempted by Central Government. The provisions of the Act are compensatory in nature.

It enshrines the following rights of the consumers :

(*i*) The right to be protected against the marketing of goods which are hazardous of life and property;

(*ii*) The right to be informed about the quality, quantity, potency, purity, standard and price of goods so as to protect the consumer against unfair trade practices;

(*iii*) The right to be heard and to be assured that consumers interest will receive due consideration at appropriate forum;

(*iv*) The right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers;

(*v*) The right to consumer education.

Under Section 2(e) of the Act, the insurance is recognised as services. Chapter 32 of the Act elaborates various consumer rights.

4.2.7 Arbitration and Conciliation Act, 1996

Arbitration means the reference of a matter in dispute to the judgment of a person selected by the parties to the dispute. Arbitration thus is a private process of resolution of disputes and it is commonly resorted to because it is less formal, less expensive and less time consuming than

proceedings in a court of law. An arbitration condition is incorporated in a majority of "Non-marine general insurance policies." The salient features of the condition are :

- Differences in regard to the quantum of loss to be paid under the policy (Liability being otherwise admitted) shall be referred to arbitration.
- No difference shall be referable to arbitration if the company has dispute or not accepted liability under the policy.
- A sole arbitrator may be agreed to by the parties in writing; if not agreed, each party can approach an arbitrator after receipt of written notice of the other party.
- If either party shall refuse or fails to appoint arbitrator the other party can appoint a sole arbitrator.
- Any disagreement between the two arbitrators shall be referred to an umpire.
- Umpire shall be appointed by the arbitrators in writing before entering in the agreement.
- Umpire shall sit with the arbitrators and preside at their meetings.

The main objectives of the Act, *inter alia,* are :

(*i*) To comprehensively cover international and commercial arbitration and conciliation as also domestic arbitration and conciliation;

(*ii*) To make provision for an arbitral procedure which is fair, efficient and capable of meeting the needs of the specific arbitration;

(*iii*) To provide that the arbitral tribunal gives reasons for its arbitral award;

(*iv*) To minimise the supervisory role of courts in the arbitral process;

(*v*) To permit an arbitral tribunal to use mediation, conciliation or other procedures during the arbitral proceedings to encourage settlement of disputes;

(*vi*) To provide that every final arbitral award is enforced in the same manner as if it were a decree of the court.

4.3 Other Laws Applicable to General Insurance Business

Apart from the legal enactment discussed in the previous section, following laws are also applicable to general insurance business in India.

4.3.1 Motor Vehicles Act, 1988

Motor Vehicles Act, 1988 provides for compulsory insurance of motor vehicles. The Act provides that no motor vehicle can be used in a public place unless there is in force in relation to vehicle a policy issued by an authorised insurer. This policy covers the insured person's liability in the event of death, bodily injury of certain persons or damage to property of third persons.

Section 140 (1) of the Motor Vehicles Act, 1988 provides as follows :

"Where the death or permanent disablement of any person has resulted from an accident arising out of the use of a motor vehicle, the owner of the vehicle shall, or, as the case may be, the owners of the vehicle shall, jointly and severally, be liable to pay compensation in respect of such death or disablement in accordance with the provisions of this section".

Section 140(3) further provides that the claimants shall not be required to plead and establish that the death or permanent disablement, in respect of which the claim has been made was due to wrongful act, neglect or default of the owner or owners, of the vehicle or vehicles concerned or any other person. The compensation payable is restricted to Rs. 50,000 in case of death and Rs. 25,000 in the case of permanent disablement.

Even if the victim has contributed fully or partially to the happening of the accident, such negligence is not to be taken into account defect the liability of the motorist or to reduce the amount of damages.

The compensation awarded under the Act does not prevent the claimant to proceed for claim/ damages under any other law inforce. However, the compensation awarded under any other law shall be reduced by the amount of compensation awarded under this Act.

Section 163 provides that the Central Government may establish a fund known as the Solarium Fund to be utilised for paying compensation in respect of death or grievous hurt the person resulting from Hit and Run motor accidents.

It is provided that grievous hurt shall have the same meaning as the Indian Penal Code. According to Section 320 of the Indian Penal Code the following kinds of hurt are designated as grievous :

(*i*) Emasculation;

(*ii*) Permanent privation of the vision of either eye;

(*iii*) Permanent privation of the hearing of either ear;

(*iv*) Privation of any member or joint;

(*v*) Destruction or permanent impairing of the powers of any member or joint;

(*vi*) Permanent disfiguration of the head or face;

(*vii*) Fractüre or dislocation of a bone or tooth;

(*viii*) Any hurt which endangers life on which causes the sufferer to be during the space of twenty days in severe bodily pain or unable or follow his ordinary pursuits.

The compensation payable for death claims is fixed at Rs. 25,000 and in respect of 'grievous hurt' Rs. 12,500. The payment of compensation for Hit and Run accidents is subject to the condition that if any compensation is awarded for such death or grievous hurt under any other provisions of the Motor Vehicles Act or any other law, the amount paid under Hit and Run accident has to be deducted from such compensation. The Solatium Fund consists of contributions from the General insurance Industry. The Central Government, and the state Governments decided by the Central Government.

The Central Government is also authorised by the Act to make a scheme to provide for the administration of the Solatium Fund. The Act was amended in 1994 to introduce a new concept of "Payment of Compensation on Structured Formula Basis," that is payment of fixed compensation to victims of fatal injuries in motor vehicle accidents, based on their age and income.

4.3.2 The Inland Steam Vessels Act, 1917 and the Amended Act, 1977

The Act provides that the provisions of Chapter VII of the Motors Vehicles Act, 1955 regarding insurance of mechanically propelled vessels against third party risks are applicable to steam vessels. The Act maker it compulsory for the owners of operators of inland vessels to insure

against legal liability of death, bodily injury or damage caused to the property of third persons and passengers.

4.3.3 Marine Insurance Act, 1963

Marine Insurance Act, 1963 (based on Marine Insurance Act 1906) codifies the law relating the conduct of marine insurance business in India. The provisions of the Act *inter-alia* includes provisions relating to basic insurance principles (Indemnification, insurable interest, utmost goodfaith, subrogation and contribution, valuation, losses, warranties, return of premiums etc.

4.3.4 The Carriage of Goods by Sea Act, 1925

The Act defines the minimum rights, liabilities and immunities of a shipowner on loss or damage to cargo. The act deals with three aspects of a shipowners liabilities towards cargo owner :

(*i*) the circumstances when the shipowner is deemed to be liable for loss or damage to cargo unless he proves otherwise;

(*ii*) the circumstance when the shipowner is exempted from liability, i.e., when loss or damage is caused by events outside his control, *e.g.*, perils of the seas;

(*iii*) the limits of liability of a shipowner for loss of or damage to cargo calculated in monetary terms per package or unit of cargo.

4.3.5 The Merchant Shipping Act, 1958

This Act also provides a certain protection to shipowners. For example, the liability of a shipowner can be limited to certain maximum sum for certain losses, provided the incident giving rise to such claim has arisen without the actual fault or privy of the shipowner. These claims may relate to loss of life, personal injury or loss of or damage to property on land or water. The Act also confers the obligation on the shipowner to send his ship to sea in a seaworthy and safe condition.

4.3.6 The Bill of Lading Act, 1855

This Act defines the character of the Bill of Lading as an evidence of the contract of carriage of goods between the shipowner and the shipper, as an acknowledgement of the receipt of the goods on board the vessel and, as a document of title. The bill of lading is one of the various documents required in connection with settlement of marine cargo claims.

4.3.7 The Indian Ports (Major Ports) Act, 1963

This Act defines the liability of Port Trust Authorities for loss of or damage to goods whilst in their custody and prescribes time limits for filing monetary claim on, or suit against, the Port Trust Authorities.

4.3.8 The Indian Railways Act, 1890

The Indian Railways Act, passed in 1890 was amended in 1961 and the amendment came into force from 1st January, 1962. The Act deals with various aspects of Railway Administration. However, Chapter VII is relevant to Marine Insurance practice as it deals with the responsibility of Railway Administration as carriers.

This Chapter makes provision, *inter alia,* for the following :

(*a*) rights and liabilities of railways as carriers of goods :

(*b*) procedure for notification of claims for compensation for losses.

The Railways Claims Tribunal Act, 1987 provides for formation of tribunals to deal with claims for cargo loss, personal injuries, excess freight, etc. and prescribes procedures thereunder.

4.3.9 The Carriers Act, 1865

The Act defines the rights and liabilities of truck owners or operators who carry goods for public hire in respect of loss or damage to goods carried by them. It also prescribes the time limit within which notice of loss or damage must be filed with the road carriers.

4.3.10 The Indian Post Office Act, 1898

This Act defines the liability of the Government for loss, misdelivery, delay of or damage to any postal articles in course of transmission by post.

4.3.11 The Carriage by Air Act, 1972

This Act gives effect to the provisions of the Warsaw Convention, 1929 and the Hague Protocol, 1955 relating to international carriage of passengers and goods by air. It defines the liability of the air carrier for death of or injury to passengers and loss of or damage to registered luggage and cargo. It also prescribes the maximum limits of liability for death, injury, damage etc. and also prescribes the time limits within which claims have to be filed on the air carrier. The provisions of the Act also apply with some changes, to domestic carriage, that is, carriage within India.

4.3.12 Multi Modal Transportation Act, 1993

The Act provides for registration of multi-modal transport operators engaged in transportation of goods under more than one mode of transport, i.e., by rail/road and sea. It prescribes limits of liability of the operator, contents of documents to be issued by them, notice of loss, etc.

4.3.13 Workmen's Compensation Act, 1923

The Act provides for the payment by employers to their workmen of compensation for injury by accident, arising out of and in the course of employment. The object of this legislation has been stated as follows–The growing complexity of industry in this country, with the increasing use of machinery and consequent danger to workmen, along with the comparative poverty of the workmen themselves render it advisable that they should be protected as far as possible, from hardship out of accidents. It provides certain benefits to employees in case of accidents during employment, sickness, maternity etc.

4.3.14 Employees State Insurance Act, 1948

The Employees' State Insurance Act, 1948, has been described as an Act "to provide for certain benefits to employees in cases of sickness, maternity and employment injury and to make provision for certain other matters in relation thereof 'Under the Act, the Employees' State Insurance Corporation has been set up to administer the Insurance Scheme. The Scheme is applicable to

industrial employees as defined in the Act. The Act operated in certain industrial areas as notified by the Government from time to time. It is intended that the Act will be eventually extended to all industrial areas in the country. Under the scheme a fund is maintained consisting of contributions from the employees, employers and the Government.

From this fund the following expenses are met :

(*i*) Sickness benefit, maternity benefit, disablement benefit, dependants' benefit (death) and medical treatment

(*ii*) Establishment and maintenance of hospital, dispensaries, etc. for the benefit of the insured persons and their families.

(*iii*) Administration of the Scheme.

4.4 Registration and Licensing of Insurance

Companies in India is governed by IRDA (Registration of Indian Insurance companies) Regulation 2000, The important provisions contained in these stipulation are :

- Any applicant desiring to carry on the insurance business in India has to make application to the authority.
- Separate to application has to be made for (a) life insurance business consisting of linked business, non-linked business or both and (b) general insurance business including health insurance business
- The paid up capital of the insurer shall not have more than 26% shares in the form of foreign equity.
- While evaluating the application the authority will consider the track record of promoters, the extent of obligation to promote life and general insurance products in priority sectors, nature of product, planned infrastructure of the applicant company level of actual and other professional expertise, organisation structure etc.
- If the authority is satisfied with the criterion like insurance obligations, Volume of business available to, capital structure earning prospects, serving of public interest and fulfilment of the provisions contained in various sections of the Act, it may register and grant him a certificate
- Within 12 months from the date of registration, the insurer has to commence business and extended period if any.
- The capital requirements are minimum paid up capital of Rs. 100 crores for life and general insurance and Rs. 200 crores for non-insurance business.

Regulations framed under insurance regulatory and development authority act, 1999 and the insurance (Amendment) Act, 2002

1. Insurance Regulatory and Development Authority (Actuarial Report and Abstract) Regulations, 2000.
2. Insurance Regulatory and Development Authority (Obligation of insure of Rural or Social Sectors) Regulation, 2000.

3. Insurance Regulatory and Development Authority (Insurance Advertisements and Disclosure) Regulations, 2000.
4. Insurance Regulatory and Development Authority (Licensing of Insurance Agents) Regulations, 2000.
5. Insurance Regulatory and Development Authority (General Insurance–Reinsurance) Regulations, 2000.
6. Insurance Regulatory and Development Authority (Appointed Actuary) Regulations, 2000.
7. Insurance Regulatory and Development Authority (Assets, Liabilities and Solvency Margin of Insurers) Regulations, 2000.
8. Insurance Regulatory and Development Authority (Meetings) Regulations, 2000.
9. Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000.
10. Insurance Advisory Committee (Meetings) Regulations, 2000.
11. Insurance Regulatory and Development Authority (Investment) Regulations, 2000.
12. Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002.
13. Insurance Regulatory and Development Authority (Licensing, Professional Requirements and Code of Conduct) Regulations, 2000.
14. Insurance Regulatory and Development Authority (Conditions of Service of Officers and Other Employees) Regulations, 2000.
15. Insurance Regulatory and Development Authority (Life Insurance–Reinsurance) Regulations, 2000.
16. Insurance Regulatory and Development Authority (Investment) (Amendment) Regulations, 2001.
17. Insurance Regulatory and Development Authority (Third Party Administrators–Health Services) Regulations, 2001.
18. Insurance Regulatory and Development Authority (Re-insurance Advisory Committee) Regulations, 2001.
19. Insurance Regulatory and Development Authority (Protection of Policy Holders' Interest) Regulations, 2002.
20. Insurance Regulatory and Development Authority (Investment) (Amendment) Regulations, 2002.
21. Insurance Regulatory and Development Authority (Assets, Liabilities and Solvency Margin of Insurers) (Amendment) Regulations, 2002.
22. Insurance Regulatory and Development Authority (Licensing of Corporate Agents) Regulations, 2002.
23. Insurance Regulatory and Development Authority (Licensing of Insurance Agents) (Amendment) Regulations, 2002.

24. Insurance Regulatory and Development Authority (Insurance Bookers) Regulations, 2002.
25. Insurance Regulatory and Development Authority (Manner of Payment of Premium) Regulations, 2002.
26. Insurance Regulatory and Development Authority (Obligations of Insurers to Rural or Social Sectors)(Amendment) Regulations, 2002.
27. Insurance Regulatory and Development Authority (Protection of Policyholders Interest) (Amendment) Regulations, 2002.

Key Terms

- Crime
- IRDA
- Licensing
- Registration
- Tariff Advisory Committee
- Tort

Suggested Readings

- Anoop K. Kaushal and S.K. Mohanty, *Insurance Law Manual*, Universal Law Publishing Co. Pvt. Ltd. 2002.
- J.E. Grieder and W.T. Breadles, *Law and the Life Insurance Contract*, Richard D. Irwin, 1968.
- Kenneth S. Abraham, *Distributing Risk–Insurance, Legal Theory and Public Policy*, Yate University Press, 1986.
- *Practice of General Insurance*, Insurance Institute of India, Mumbai, 2000.

Questions for Review

1. Briefly summarise the various legal provisions applicable to insurance business in India.
2. Write short notes on :
   (*a*) Licensing of insurance companies
   (*b*) Elements of insurance contracts
   (*c*) Maxims applicable to insurance contracts.
3. "Insurance business is partially regulated in India." Do you agree? Give reasons for your answer.
4. Apart from the general laws applicable to each class of insurance business, there are certain laws applicable to the conduct of general insurance business in India. Discuss.

CHAPTER 5

UNDERWRITING PROCESS AND METHODS

Underwriting as an art began in the United Kingdom since Victorian times. Where upon a group of sailors/traders began the practice to insure against the perils involved in a sea voyage, it included the insuring of the goods in transit against known perils such as piracy, weather perils and goods getting destroyed in the voyage against the payment of a pre-agreed sum by the trader(s). The practice evolved with the times and the insurance model took shape. In the early days of marine insurance, the details of a ship or cargo to be insured were described on a slip. This slip was taken to Lloyd's and the person, who was to carry the risk read the details, then signed the slip under the details of the risk. In this way, the person carrying the risk became known as the *underwriter*. The genesis of the insurance business also evolved from the United Kingdom and the first insurers were the Lloyd's industries.

5.1 Underwriting Defined

Underwriting is the prices of selecting and classifying exposures. It is directly related to rate-making or the pricing function of an insurer, because computed rates contemplate some composition of loss-producing characteristics to which they will be applied.

Underwriting is the insurance function that is responsible for assessing and classifying the degree of risk a proposed insured or group represents and making a decision concerning coverage of that risk.[1]

Underwriting includes all the activities necessary to select risks offered to the insurer in such a manner that general company objectives are fulfilled.

The person responsible for evaluation and acceptance/rejection of risks and computation of premium is called as the *underwriter*. Accordingly, the decision made by the underwriter concerning risk classification and rating is called as the *underwriting* decision. Underwriting decisions are crucial for insurers since they can make or mar an insurance company. Good underwriting helps the insurance companies in many ways. It make them financially stronger and helps secure competitive advantage. This is obvious in the sense that if risks are assessed properly, pricing will be effective and therefore the company can well compete and build up reputation.

In life insurance business, underwriting is performed by home or regional office personnel, who scrutinize applications for coverage and make decisions as to whether they will be accepted, and by agents, who produce the applications initially in the field, but these decisions may be subject to post underwriting at a higher level because the contracts are cancellable on due notice to the insured. In life insurance, agents seldom have authority to make binding underwriting decisions. In all fields of insurance, however, agency personnel usually do considerable screening of risks before submitting them to home office underwriters.

5.1.1 The Trade-off

The underwriting exercise is a trade-off between the business and survival. If the insurance company sets high standards for risk which can be undertaken, the company may loose market and consequentially, the potential premium income which can be threat to survival. If the insur-

[1] P.K. Gupta, *Insurance and Risk Management*, Himalaya Publishing House, 2004, p. 354.

ance company charges too much of premium in a fashion that is become excessive, the company will loose competitive advantage. Also, if the company undertakes risk with a loose assessment in a zeal to get business, it may be dangerous because the possibility of claims may increase substantially. Hence and therefore, a proper balance is to be maintained between business and good business.

5.1.2 The Conflict

The conflict between production and underwriting are common to insurance companies. The underwriting department may have turned down business that has been previously sold by an agent, an apparent conflict of interest arises between these two areas. The problem is similar to that which exists between credit and sales in other firms, with a good sale ruined because credit is not approved. Neither the agent nor the underwriter will profit long by underwriting that is too strict or too loose. The former will choke off acceptable business and may create unnecessary expenses in cancelling business already bound by the agent, whereas the latter invites such substantial losses that the company may be forced to withdraw entirely from a given line, to the detriment of the agent.

5.1.3 Twin Guiding Principles

The two main principles of underwriting are *Adverse Selection* and *Persistency*. The underwriter must always guard himself against the adverse selection of risks. There is tendency on part of the potential insureds, those who are more likely to be affected by the happening of the adverse event, to go for insurance cover compared to ones who are well off. For example–*Ceteris Paribus*, a healthy person is less likely to go for an insurance cover than the one who becomes frequently ill. Accordingly, the potential business for the insurers would represent these class. Therefore, the underwriter should carefully appraise the inherent risk in such cases and fix the premium so as to avoid likely significant losses.

In addition, the underwriter must not offer products which the consumers cannot afford. Also the premium fixed for the insureds must be consistent enough to support the cash flow model of the insurers. The continuous renewal of policies is must to business retention. The underwriter should carefully examine the paying capacity of the potential customer before offering a product, if large number of policies are surrendered or lapsed, the company will be ruined.

5.2 The Objectives and Principles of Underwriting

The primary objective of underwriting is to see that the applicant accepted will not have a loss experience that is very different from that assumed when the rates were formulated. To this end, certain standards of selection relating to physical and moral hazards are set up when rates are calculated, and the underwriter must see that these standards are observed when a risk is accepted. For *e.g.*, a company may decide that it will accept no fire exposures situated in areas where there is no fire department protection or will accept no one for life insurance who has had cancer within the previous five years.

When reviewing an application for property insurance for a piece of property, such as a farm, that is located where there is no fire department protection or when reviewing an application for life insurance in which the individual had cancer four and half years ago, the underwriter asks the question, "Can I make an exception for this application, or must I reject it because it does not come within the technical limitations of my instructions?" In answering this question, the underwriter visualises what would happen to the company's loss experience if a very large number of

identical risks were accepted. If the aggregate experience would be very unfavourable, the underwriter will probably reject the application.

The objectives of underwriting can be therefore expressed as follows :

1. *Product Equitable to Customer*–The underwriter should fairly assess the risk in a proposal and fix the premium justifiable to the consumer.
2. *Deliverable to the Customer*–Consumers are the final authority for buying the products. If the marketers are not able to sell so that the product becomes undeliverable, the onus is on the underwriters to carry an introspection of the various factors that caused differences between the consumers and company's expectations.
3. *Financially Feasible to the Insurance Company*–The insurers are not in the business of charity. The underwriting benefit must be reflected by the financial statements. Although, the underwriters are not directly involved in the pricing of insurance products, yet their contribution is as vital as that of actuaries, because they operationalise the business of risk.

Most of the insurance companies formulate underwriting policy which provides the framework for underwriting decisions. It is also called as the *underwriting philosophy*. The underwriting policy specifies the line of insurance that will be written as well as prohibited exposures, the amount of coverage to be permitted on various types of exposure, the area of the country in which each line will be written, and similar restrictions. Generally, the individual who applies the underwriting rules and guidelines, called the desk underwriter, do not involve in forming the company underwriting.

The underwriting philosophy also describes in general terms how the underwriter will use reinsurance for its risk management.[2] The underwriting philosophy can be translated into *underwriting guidelines* which specify the general standards that specify which applicants are to be assigned to the risk established for each insurance product.

In life insurance, the underwriter is assisted by medical reports from the physicians that examined the applicant, by information from the agent, by an independent report (called inspection report) on the applicant prepared by an outside agency created for that purpose, and by advice from the company's own medical advisor. In property-liability insurance (as well as life insurance), the underwriter has the services of reinsurance facilities and credit departments to report on the financial standing of applicants and also can review loss histories of applicant.

5.3 Underwriting in Life Insurance

Life insurance underwriting is mainly concerned with mortality. Mortality risk for an insurer is that the insured will die prior to the stipulated life. An impairment in any respect of a proposed insured's personal health, medical history, health habits, family history, occupation, or other activities that could increase that person's expected mortality risk.[3]

While underwriting risk of an individual in life insurance, following factors are generally considered by life insurance companies :

(*a*) Age,

(*b*) Sex,

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[1] *Ibid.*

[1] *Ibid.*

(*c*) Height and weight,

(*d*) Health history (and often family health history–parents and siblings),

(*e*) The purpose of the insurance (such as for estate planning, or business or for family protection),

(*f*) Marital status and number of children,

(*g*) The amount of insurance the applicant already has, and any additional insurance s/he proposes to buy,

(*h*) Occupation (some are hazardous, and increase the rise of death),

(*i*) Income (to help determine suitability),

(*g*) Smoking or tobacco use this is an important factor, as smokers have shorter lives),

(*h*) Alcohol (excessive drinking seriously hurts life expectancy),

(*i*) Certain hobbies (*e.g.*, race car driving, hang-gliding, piloting non-commercial aircraft), and

(*j*) Foreign travel (certain foreign travel is risky).

Similarly in case of group insurance the following factors are considered :

(*a*) Proposed Coverage–which includes assessment of eligibility, level of benefits which can be offered, administration of the group and the mode of payment to intermediaries.

(*b*) Cause of existence of the relevant group–classified on the basis of the nature of job, specific agendas etc.

(*c*) Size of the group–large groups are always better than small groups for obvious reasons.

(*d*) Nature of Group's business-based on nature of industry, cement plants and coal mines workers are more prone to respiratory/kidney problems.

(*e*) Geographical location of the group.

(*f*) Stability of the group.

(*g*) Attributes of group members–sex, age and work profile.

(*h*) Level of participation–contribution by members or else, no contribution by members.

(*i*) Persistency and prior experiences.

In case of renewals, the most important factor is the claims experience. Underwriters place the potential insureds in the appropriate risk class (based on various criterion) generally classified as follows :

(*a*) *Preferred Class* : where the happening of an adverse event or the possibility of claims is the least, i.e., the inherent risk is lesser than average risk.

(*b*) *Standard Class*–where the risk exposed is at par with the average risk. Most of the insured belong to this class.

(*c*) *Sub-standard Class*–where the anticipated risk is higher than the average risk. Insurance companies typically establish this risk class for proposed insureds that have permanent medical impairments or conditions, are recovering from serious illnesses or accidents, or have occupations or avocations that significantly increase their degree of risk.

The Underwriting Process

The underwriting of life assurance is in quite a different category from other forms of personal insurances. This is because the underwriter assesses the risk at inception only. The company is then guaranteeing cover for sometimes, up to 30 years, or even throughout life. Life assurance underwriting involves looking at medical, occupational and avocation factors as well as the individual's lifestyle. In particular, the extra risk posed by AIDS has led to an increased number of questions on proposal forms, or on a separate questionnaire, about lifestyle, which are designed to identify if the proposer is likely to be in a high risk group for AIDS or HIV.

The underwriting process for life assurance involves–(1) performing field underwriting, (2) reviewing the application in the office, (3) gathering additional information, if required and (4) taking and underwriting decision. Additional information is often required by the underwriter in order to reach a decision. This can be in the form of detailed questionnaires, a report from the proposer's own doctor (Medical Attendant's Report), an examination by an independent doctor (Medical Examiner's Report) and/or specific tests.

Following steps are generally followed by underwriters :

1. Receiving Proposals/Applications

The application for insurance is the source of insurability information that the life insurance company's underwriter will evaluate first. These are generally collected by the field personnel, the agents. There are two basic parts to a typical life insurance application : (1) General Information, and (2) Medical Information.

The General Information section of an application asks general questions, including name, age, address, birth date, sex, income, marital status and occupation. In addition, details about the requested insurance coverage such as type of policy, amount of insurance, name and relationship of the beneficiary, other insurance that the client owns, and additional insurance applications pending as on date. The Medical Information section of an application focuses on insured's health and asks a number of questions about health history, history of his/her family's as well. The medical section of the application is fairly extensive and must be fully completed. In addition to this, information may also gathered through a medical examination, depending on age and the face amount of coverage.

2. The Medical Report

The average medical examination (which is generally at no cost to the applicant except in case of revivals) may be conducted. Depending on the medical questions are answered, an insurance company may ask the medical doctor(s) of the client for more detail on any conditions in question. This gathering of information is practically a standardized method used with all domestic insurance companies. Life Insurance Companies generally have several sources of information about medical and financial history to assist them in the underwriting process. These include personal medical records and doctor, the Medical Information Bureau, Special Questionnaires, Inspection Reports and even Credit Records.

3. Underwriting Review

Once all of the information has been gathered, an individual from the insurance company (called an underwriter) evaluates the data. At this evaluation, the underwriter is seeking to classify the risk presented to the company. In addition, the underwriter will determine the premium for the

policy based on the primary and secondary factors influencing the premium, and the premium rates the company's actuaries have set for your risk profile. As a consumer, here is the hard part to understand in getting a policy : insurance companies have different underwriting guidelines. This is why the least expensive policies are the most stringent on their guidelines. Throughout every step of the underwriting process, the life insurance agent normally provides with details, keeps abreast of where the insured stand in the process and guide and answer to the questions. Ultimately, making the underwriting process less intimidating and more manageable.

If the proposed insured presents a risk more than the risk which the insurance company is willing to cover, the application will be declined by the underwriter.

4. Policy Writing

In life insurance the policy is usually written in a special department whose main task is to issue written contracts in accordance with instructions from the underwriting department and, because most policies are long term in nature, to keep a register of them for future reference. Insurance companies generally use automated systems which generate the computerised client record, records of payment of premium and they do verify that all the requirements of underwriting have been met.

5.4 Underwriting in Non-life Insurance

The underwriting of commercial, business insurances is a much more complicated and involved task. Commercial insurances range from small shops and factories to large multinational corporations, with operations in many countries throughout the world. The degree of complexity of the underwriting required would obviously vary with the sheer size of the risk, but certain basic principles are fundamental.

The essence of the task is that the underwriter has to evaluate the hazard associated with the risk, which is being proposed. In small cases he may be able to do this from reading a proposal form and corresponding with the sponsor. It may be that a local inspector is asked to call and see the shop or factory for himself. In large cases this is simply impossible. Detail of the risk could not be confined to a proposal form since there is just too much information to condense, no matter how large the form may be. The insurance companies may take the help of brokers in these cases. The broker in these cases will be in a position to prepare the case for the underwriter. This may mean site inspections by the broker and the preparation of plans and reports on the relevant aspects of the risk. This documentation, which may be extremely extensive, is then passed to the underwriter and negotiation can commence on the terms, conditions, cover and price.

Several sources of information are available to the underwriter regarding the hazards of a commercial applicant for property and liability insurance :

(*a*) *Application Containing the Insurers Statements* : The basic source of underwriting information is the application, which varies for each line of insurance and for each type of coverage. The broader and more liberal the contract, usually more detailed information is required. The questions on the application are designed to give the underwriter the information needed to decide whether to accept the exposure, reject it or ask for additional information.

(*b*) *Information from the Agent or Broker* : In some line of non-life insurance, the agent may exercise his underwriting authority. For commercial insurances, the profit-sharing contracts are also entered with the agents, whereby the agent derives a special incentive if the business brought by him has resulted in a profit to the company.

(*c*) *Prior Experiences* : The past history of claims is also a source of information. In case of existing clients where the claims experience has been unfavourable, the insurance company penalises i.e. loads premium for new businesses or renewals of the existing ones.

(*d*) *Inspection* : Surveys are also conducted by the company's specialists/consultants to find out the accuracy of information as contained in the proposal form.

Underwriting Practices

Underwriting of non-life insurance in India is generally carried out by a department called as "new-business department." Most of the underwriting work is performed at Branch and Divisional office level, of course, in accordance with the underwriting policy and rules framed by the head office of the insurance company. The underwriting guidelines cover the following[4] :

(*a*) acceptance of normal risks irrespective of sum issued

(*b*) acceptance of normal risks upto specified sum insured

(*c*) acceptance of normal classes of business with prior approval of the controlling office (the controlling office may be head office/regional office).

(*d*) acceptance of risks with prior approval for the controlling office

(*e*) acceptance of risks subject to underwriting safeguards

(*f*) procedural matters.

The risks in fire, marine and motor insurance have generally high levels of limits of acceptance. However, in some classes of insurances, the limits are fairly low. Some of these are[5] :

(*i*) All risk insurance on jewellery etc.

(*ii*) Baggage insurance

(*iii*) Personal Accident Insurance

(*iv*) Special Contingency Insurance

For higher limits in these cases, the approval of controlling office is essential.

In case of fire insurance, only standard fire and special-perils policy with the permitted "Add-on" covers if any, can be issued premiums and specified by Tariff Advisory Committee.

- Unless otherwise specifically provided for Policy (ies) covering Buildings and/or contents shall show blockwise separate amount on (i) Building (ii) Machinery and Accessories (iii) Stock and Stock-in-process (iv) Furniture and other contents.
- It is permissible to exclude Storm, Tempest, Flood and Inundation group of perils and or Riot, Strike, Malicious and Terrorism Damage perils at inception of the Policy by deleting the relevant perils from the Policy. The deletion should apply for the entire policy in one complex/compound/location covering the entire interest of the insured under one or more policy (ies) without any option for the selection. Reduction in premium rates for such deletion (s) may be allowed as shown under the relevant sections of the Tariff. When these perils are deleted from the scope of the policy, the general exclusions shall include these perils.

[4] Practice of General Insurance, Insurance Institute of India, p. 156.

[5] Practice of General Insurance, *op. cit.*, p. 156-157.

- Any risk, which has not been provided for by TAC is referred to the Committee for rating. Provisional rate of Rs. 2.50 per mile is charged in such cases for covering the risks under Standard Fire and Special Perils Policy. No discounts and/or agency commission is be allowed on this rate. For add-on covers, additional rates provided in Section VIII is to be charged.
- Rates shown under the tariffs are minimum rates. Insurers may charge rates higher than those given under the tariff.
- The risks above the normal kind of risks are normally declined by the insurance companies. Otherwise, they are accepted by changing a higher premium and imposing restrictive conditions, clauses and warranties. For example, risks in ammunition, explosive, fireworks, celluloid, match factories etc. In a fire policy, special perils can be accepted subject to the inspection of risk. Similarly, for consequential loss policy, the audit of accounts is a must.
- In case of marine insurance, the declined risks may be billion, currency over specified limits, quit in secondhand drums against leakage's, second hand machinery against breakage etc. The age of the cargo carrying vessel is an important factor in marine insurance underwriting.
- In motor insurance, acceptance of comprehensive risk is subject to the specified year of the manufacture/assembly of the vehicle. An underwriter before acceptance of risk may conduct an inspection of the vehicle. Similarly, military disposal vehicles can be covered by Act only, risks comprehensive insurance on imported cars is allowed subject to incorporation of an excess clause.[6]

Key Terms

- Adverse Selection
- Claims Experience
- Comprehensive Risks
- Persistency
- Underwriting Philosophy

Suggested Readings

- Genes store, *Insurer Company, Operations,* LOMA 2000.
- *Practice of General Insurance,* IC 11, Insurance Institute of India, Mumbai, 1999.
- Vaughan & Vaughan, *Essentials of Risk Management and Insurance,* John Wiley & Sons, 2002.

Questions for Review

1. Define underwriting. Briefly explain the trade-off and conflict in underwriting business.
2. Explain the process of underwriting in life and non-life insurance business.
3. Comment on the various underwriting practices in India.
4. Briefly explain the various principles of underwriting.

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[6] Practice of General Insurance, Insurance Institute of India, p. 159.

CHAPTER 6

REINSURANCE

Although to many, reinsurance is a relatively unknown aspect of the insurance industry, its roots can be traced as far back as the late 14th century. From that time forward, reinsurance evolved into the business as it operates today. While the early focus of reinsurance was in the marine and fire insurance lines, it has expanded during the last century to encompass virtually every aspect of the modern insurance market. Reinsurance is a device whereby the insurance company may reduce its risk by transferring a portion to one or more insurance companies. Reinsurance is a special, highly technical, competitive industry whose existence makes possible a more effective institution of risk.

6.1 Reinsurance Defined

Reinsurance is a transaction in which one insurer agrees, for a premium, to indemnify another insurer against all or part of the loss that insurer may sustain under its policy or policies of insurance. The company purchasing reinsurance is known as the ceding insurer; the company selling reinsurance is known as the assuming insurer, or, more simply, the reinsurer. Reinsurance can also be described as the "insurance of insurance companies".

Reinsurance provides reimbursement to the ceding insurer for losses covered by the reinsurance agreement. It enhances the fundamental objective of insurance–to spread the risk so that no single entity finds itself saddled with a financial burden beyond its ability to pay. Reinsurance can be acquired either directly from a reinsurer or through a broker or reinsurance intermediary.

6.2 Objectives of Reinsurance

Insurers purchase reinsurance for essentially four reasons : (1) to limit liability on specific risks; (2) to stabilise loss experience; (3) to protect against catastrophes; and (4) to increase capacity. Different types of reinsurance contracts are available in the market commensurate with the ceding company's goals.

Limiting Liability

By providing a mechanism in which companies limit loss exposure to levels commensurate with net assets, reinsurance allows insurance companies to offer coverage limits considerably higher than they could otherwise provide. This function of reinsurance is crucial because it allows all companies, large and small, to offer coverage limits to meet their policyholders' needs. In this manner, reinsurance provides an avenue for small-to-medium size companies to compete with industry giants. In calculating an appropriate level of reinsurance, a company takes into account the amount of its available surplus and determines its retention based on the amount of loss it can absorb financially. Surplus, sometimes referred to as policyholders' surplus, is the amount by which the assets of an insurer exceed its liabilities.

A company's retention may range from a few lakh rupees to thousands of crores. The reinsurer indemnifies the loss exposure above the retention, up to the policy limits of the reinsurance contract. Reinsurance helps to stabilise loss experience on individual risks, as well as on accumulated losses under many policies occurring during a specified period.

Stabilisation

Insurers often seek to reduce the wide swings in profit and loss margins inherent to the insurance business. These fluctuations result, in part, from the unique nature of insurance, which involves

pricing a product whose actual cost will not be known until sometime in the future. Through reinsurance, insurers can reduce these fluctuations in loss experience, thus stabilising the company's overall operating results.

Catastrophe Protection

Reinsurance provides protection against catastrophic loss in much the same way it helps stabilise an insurer's loss experience. Insurers use reinsurance to protect against catastrophes in two ways. The first is to protect against catastrophic loss resulting from a single event, such as the total fire loss of a large manufacturing plant. However, insurers also seek reinsurance to protect against the aggregation of many smaller claims, which could result from a single event affecting many policyholders simultaneously, such as an earthquake or a major hurricane. Financially, the insurer is able to pay losses individually, but when the losses are aggregated, the total may be more than the insurer wishes to retain.

Through the careful use of reinsurance, the disruptive effects catastrophes have on an insurer's loss experience can be reduced dramatically. The decisions a company makes when purchasing catastrophe coverage (*e.g.*, size of retention and coverage limits) are unique to each individual company and vary widely depending on the type and size of the company purchasing the reinsurance and the risk to be reinsured.

Increased Capacity

Capacity measures the rupee amount of risk an insurer can assume based on its surplus and the nature of the business written. When an insurance company issues a policy, the expenses associated with issuing that policy–taxes, agent commissions, administrative expenses–are charged immediately against the company's income, resulting in a decrease in surplus, while the premium collected must be set aside in an unearned premium reserve to be recognised as income over a period of time. While this accounting procedure allows for strong solvency regulation, it ultimately leads to decreased capacity because the more business an insurance company writes, the more expenses that must be paid from surplus, thus reducing the company's ability to write additional business.

Companies experiencing rapid expansion are particularly susceptible to the timing problem between expenses (which must be debited immediately) and income (which must be credited over time) generated by new business. By reinsuring a portion of the business it writes, an insurance company reduces the problem of decreased surplus. Through reinsurance, the company shares a portion of its underwriting expenses with its reinsurer and reduces the drain on surplus.

Reinsurance also permits the ceding company to expand capacity by permitting the ceding company to take credit for reinsurance on the annual accounting statement it files with state regulators.

If the reinsurer satisfies certain regulatory requirements intended to assure the security of the reinsurance arrangement, the ceding company may count as asset reinsurance payments owed to it on claims it has paid, thus expanding its surplus. The ceding company can also reduce liabilities and loss reserves attributable to the business ceded to the reinsurer.

In addition, the ceding company often receives a ceding commission from the reinsurer as reimbursement for expenses, such as agent commissions and overhead, associated with acquiring the business being reinsured. The ceding commission is added directly to the ceding company's surplus, thus increasing it further.

Another type of reinsurance transaction, which may affect surplus, is known as *loss portfolio transfer*. In such an arrangement, one insurer cedes to another insurer its reserves for incurred but

unpaid losses and loss adjustment expenses. Typically, these reserves are associated with a particular class or line of business, such as medical malpractices. The ceding insurer transfers cash to the assuming insurer equal to the assuming insurer's estimate of the present value of these liabilities, plus an amount the reinsurer may require to carry the additional risks involved in the transfer.

In addition, reinsurers often provide insurers with a variety of other services. Some reinsurers provide guidance to insurers in underwriting, claims reserving and handling investments and even general management. These services are particularly important to smaller companies or companies interested in entering new lines of insurance.

In any discussion of reinsurance, limitations of the business must be considered along with the advantages. First and foremost, reinsurance does not change the inherent nature of a risk being insured. Thus, it does not make a bad risk insurable or an exposure more predictable or desirable. While it may limit an insurance company's exposure to a risk, the total risk exposure is not altered through the use of reinsurance.

6.3 Role of the Reinsurers

Reinsurance is governed by the same principles as for insurance. But instead of covering property or casualty risks directly, the reinsurer insures insurance companies. Reinsurance spans the diversity of situations specific to each type of insurance and is consequently more complex and much broader in range, since it covers the whole world. An insurance company issues contracts called *policies*. The insurance company is the direct or primary insurer of an individual or a business. The policy is written in its name, making it liable for all claims arising under the policy. The insured deals exclusively with the insurance company. But the insurance company spreads its risks arising under the policy by transferring all or part of those risks to one or more reinsurance companies.[1]

In the event of a claim, the insurance company must pay to the insured the full amount of compensation due under the policy. It is then up to the insurance company to recoup the sums corresponding to the risk transferred from its reinsurers. At the beginning of each year, the insurance company takes out contracts with one or more reinsurance companies to cover it for policies issued to its customers for the year in question. Reinsurers in turn usually cede a share of the risk they accept to other reinsurers known as retrocessionnaires; this system is roughly equivalent to bank syndicates. To put it differently, the reinsurer performs three essential services, together with a number of additional services.

First, reinsurance enables direct writing companies to even out their results when major, exceptional, losses occur : a hurricane or an earthquake for instance can seriously affect the accounts of an insurance company. Reinsurance considerably reduces this type of potential imbalance.

Second, insurance companies use reinsurance to increase the maximum amount they are able to cover as primary insurer for any given potential loss or loss category; in other words, their available capacity is increased. As a result, insurance companies can write more risks, or larger risks, without becoming over-extended.

Third, reinsurance also provides insurers with the large amounts of cash needed in the event of a major loss, enabling them to manage their assets safely and profitably.

In addition to the above services the reinsurance companies also provide the following advisory services to their ceding companies :

Formulating the Reinsurance Program

The types of reinsurance cover selected can considerably influence the profitability and solvency of an insurance company.

[1] www.bimaguru.com

Support Services

This range from training of technical and administrative personnel to practical assistance in organisation, accounting and data processing, risk inspection and co-operation in claims settlement.

Specialised Services

In certain highly specialised areas such as major public works' projects or death term life insurance policies written on substandard patients, reinsurers are more familiar with the relevant statistic and rates applicable, and they have the permanent capacity available to cover cedants' exposures.

Capital Base

In most of the developing/ developed countries laws have been enacted on the minimum ratio of capital to retained premiums needed to transact business. This ratio is referred to as the solvency margin. It means that a dynamic but narrow capital base insurance company must rely heavily on reinsurance in order to grow; reinsurance can in some instances play a more direct role in financing insurance companies. In life insurance, for example, considerable outlays are required to build up marketing outlets and other facilities needed when new types of policies are first issued. Reinsurers are often called on as partners to help finance this type of investment; in turn they are entitled to share in the return on the investment.

Reinsurers are often a source of hard currency for ceding companies in weak currency countries. Many developing nations reinsure imported equipment and machinery in order to secure the hard currency needed for repairs or replacements in the event of damage or destruction.

6.4 Techniques of Reinsurance

The two main types of reinsurance agreements are *proportional* and *excess of loss.* A reinsurance contract written on a proportional basis simply prorates all premium, losses and expenses between the insurer and the reinsurer on a pre-arranged basis. The proportional approach is used extensively in property reinsurance. Excess of loss contracts require the primary insurer to keep all losses up to a predetermined retention and the reinsurer to reimburse the company for any losses above that retention, up to the limits of the reinsurance contract. In simplest terms, retention is analogous to the deductible a policyholder may have on a personal insurance policy, such as an automobile or homeowner's policy.

The reinsurance coverages can be broadly classified into two–*treaties* and *facultatives.*

6.4.1 Reinsurance Treaties

Reinsurance treaties are a form of comprehensive coverage bought by ceding companies, either directly or through a reinsurance broker, to protect all or a share of their portfolios for a given class of business. All policies covering risks insured under a treaty are automatically reinsured; in other words the reinsurer cannot decline a risk coming under the treaty. Treaties may be either proportional or non-proportional.

Non-proportional Treaty

In this type of treaty, reinsurance cover begins once the amount of the claim exceeds a predetermined amount. Let us imagine a reinsurance treaty for Rs. 400 crores in excess of Rs. 100 crores; this is what reinsurers call a Rs. 500 crores cover with a deductible of Rs. 100 crores. If a loss occurs and its total cost is less than the Rs. 100 crores, only the primary insurer is concerned. If, however, the cost of the claim is in excess of the Rs. 100 crores, the direct-writing company pays

its share equal to Rs. 100 crores and the reinsurance company the remainder, up to Rs. 400 crores. The reinsurance premium for this type of business is computed on the basis of the amounts insured under each individual policy the treaty covers, referred to as *portfolio exposure*, and other factors such as previous loss statistics.

Proportional Treaty

In this type of treaty, the reinsurer and ceding company share the premium and losses proportionally. If an insurance company for example takes out a proportional cover for 40% of its portfolio and if the claims amount to a total of Rs. 100 crores, the insurer pays 60%, or Rs. 60 crores and the reinsurer the remaining 40%, or Rs. 40 crores. The reinsurer will have received 40% of the original premium the ceding company charged its insureds, and will pay a percentage of the premiums representing a fraction of the ceding company's expenses incurred in acquiring and managing the business. This is known as the *commission* or acquisition expense.

In most cases, reinsurance companies only accept a share of a treaty. Each year, insurance companies provide their reinsurers with information on intended policies concerning maximum exposures, estimated premium income, classes of business, marketing strategies etc. Before the start of the year, they finalise treaty conditions with the lead reinsurer exclusions, commissions, and so forth. They then invite other reinsurers to accept a share in their treaties, depending on the program announced and terms negotiated.

6.4.2 Facultatives

Facultative insurance is an optional case by case method that is used when the ceding company receives application for insurance that exceeds its retention limit.[3] Facultative treaties are inter company agreements for optional or voluntary reinsurance transactions. Facultative covers are written on an individual risk basis when a primary company insures risks for amounts in excess of its treaty capacity or risks not covered by its treaties. The lead reinsurer assesses each risk individually and, in consultation with the insurance company, sets the rates and terms of the primary cover. Facultatives serve essentially to cover major industrial and civil engineering risks and, for much smaller amounts, insurers' exposure to liability claims. The reinsurer retains the right to accept or reject any business offered by the insurance company.

6.5 Reinsurance Arrangements

Quota Share Reinsurance

In this type of arrangement, the reinsurer receives a quota share of both the exposures and the premiums *less* agreed costs incurred by the ceding company in writing the business.

Pro-rata Reinsurance

It states that the reinsurer will assume all risk upto some specific policy and will cede a portion of the risk above the retention limit.

Excess-of-loss Reinsurance

It specifies the extent of reinsurance in terms of losses rather than in terms of liability. Under such a treaty, the ceding company would pay all claims upto a specified amount per event or per period. Any losses over the agreed amount would be paid in full or part as agreed by the reinsurer. This is different from quota and pro-rata arrangements in the sense that agreement does not refer to any specific policy but covers all of the insurer's business. This type of arrangement is in the nature of catastrophe coverage.

Loss Ratio Reinsurance

It provides for reimbursement by the reinsurer when a specific loss ratio is exceeded. The loss ratio is generally the ratio of losses incurred to premiums earned. The loss ratio is generally fixed in such a fashion that it is over the normal one and, at such a level that the insurer could not bear without sustaining severe damages to its financial condition. Therefore, this arrangement is also a kind of catastrophe coverage.

6.6 The Reinsurance Contract

Based on its business needs, an insurer negotiates with a reinsurer, directly or through a broker, to determine the terms, conditions and costs of a reinsurance contract. Under a reinsurance contract, an insurer is indemnified for losses occurring on its insurance policies and covered by the reinsurance contract. There are no standard reinsurance contracts although two basic types, treaty and facultative, are used and adapted to meet individual insurers' requirements.

Underwriting treaty reinsurance differs greatly from that of facultative reinsurance. Reinsurance treaties automatically cover all risks written by the insured that fall within their terms unless they specifically exclude exposures. While treaty reinsurance does not require review of individual risks by the reinsurer, it demands a careful review of the underwriting philosophy, practice and historical experience of the ceding insurer, as well as a thoughtful evaluation of the company's attitude toward claims management and engineering control and management's general background, expertise and planned objectives.

Facultative reinsurance contracts cover individual underlying policies and are written on an individual basis. Stated simply, facultative reinsurance covers a specific risk. Both facultative and treaty contracts may be written on a proportional or an excess of loss basis, or a combination of both.

A facultative agreement covers a specific risk of the ceding insurer. A reinsurer and ceding insurer agree on facultative terms and conditions in each individual contract. In contrast, a reinsurance treaty is a broad agreement covering some portion of a particular class or classes of business (*e.g.*, an insurer's entire workers' compensation or property book of business). Historically, treaties remain in force for long periods of time and are renewed on a fairly automatic basis unless either party wishes to negotiate a change in terms.

Facultative reinsurance requires substantial personnel and technical resources for underwriting individual risks. Often, facultative business presents significant potential for loss, thus a reinsurer must have the necessary staff knowledge to underwrite each exposure accurately.

Facultative reinsurance contracts are also used to supplement treaty arrangements when treaties contain specific exclusions, such as exposures involving long haul trucking or munitions manufacturing. Insurers may fill coverage voids created by reinsurance treaty exclusions by negotiating a separate facultative reinsurance contract for a particular policy or group of policies.

Certain classes of risks anticipated to develop significant losses may adversely affect an insurer's treaty experience. Although not excluded from a treaty, these risks may be placed facultatively. For example, a primary insurer that may not ordinarily provide commercial automobile coverage might agree, as a service to its insured, to write such a policy as an accommodation. The company may then seek facultative reinsurance to protect its loss experience under treaty agreements. The reinsurer providing an insurer's treaty coverage may not necessarily provide its facultative reinsurance.

Reinsurers also purchase their own reinsurance protection, called *retrocessions*, in the same forms and for the same reasons as ceding insurers. By protecting reinsurers from catastrophic losses, as

well as an accumulation of smaller losses, retrocessions stabilise reinsurer results, thus serving the same risk-spreading objectives as the initial reinsurance transaction.

Reinsurance relationships range from the simple to the complex. An insurer may enter into a single reinsurance treaty to cover certain loss exposures or may purchase numerous treaties until the desired level of reinsurance protection is achieved. This process, known as layering, uses two or more reinsurance agreements to obtain desired level of coverage. At the time a claim comes due, the reinsurers respond in a predetermined sequence, as necessary, to cover the loss. Layering of reinsurance coverage is no different in principle than the layering of excess and umbrella coverage by a policyholder, or the purchase of specific risk coverage through a rider on an insurance policy. It is simply a means of securing the type and amount of insurance or reinsurance protection desired by a purchaser.

Certain fundamental principles underlie all reinsurance contracts, regardless of how simple or complex the reinsurance transaction. First, the only parties to a reinsurance contract are a reinsured company and its reinsurer. All contractual rights and obligations run only between these two companies. Second, the proceeds collectible under the reinsurance contract are an asset of the ceding company. Finally, as a contract of indemnification, the reinsurance is payable only after the reinsured company has paid losses due under its own insurance or reinsurance agreements, unless there is an insolvency clause, which allows the receiver of an insolvent insurer to collect on reinsurance contracts.

6.7 Reinsurance in Indian Perspective

After the nationalisation of insurance business, the GIC was made responsible for reinsurance protection. 20% of the small risks and medium risks in a fire portfolio are currently ceded to GIC. 25% of the listed risks are also ceded subject to a maximum of Rs. 50 crores, In market place, 30% of each risk is ceded to pool and retroceded back which is fully retained by the companies, subject to a monetary limit of Rs. 750 crores Probable Maximum Loss (PML). The net retention of GIC is Rs. 125 crores (maximum) and Rs. 15 crores (Absolute). The apex insurance regulatory body IRDA has issued two sets of separate regulations for general insurance and life insurance business.

Key Terms

- Catastrophe
- Facultatives
- Reinsurance
- Treaty

Suggested Readings

- Irving Pfeffer and David, R. Klock, *Perspectives on Insurance,* Prentice-Hall, Englewood Cliffs, 1974.
- *Insurance Chronicle*–various issues, ICFAI Press, Hyderabad.

Questions for Review

1. Define Reinsurance. Briefly explain the various objectives of reinsurance.
2. "Reinsurance is a well thought well structured expense for insurance company? Explain.
3. Distinguish between Facultative and Treaties.

UNIT 3

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CHAPTER 7

LIFE INSURANCE

Life Insurance is a contract for payment of a sum of money to the person assured, or failing him/her, to the person entitled to receive the same, on the happening of the event insured by the contract.

Section 2 (*ii*) of the Insurance Act 1938 defines life insurance business as "the business of effecting contract upon life. It includes :

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

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

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

Usually the insurance contract provides for the payment of an amount on the date of maturity or at specified dates at periodic intervals or at unfortunate death if it occurs earlier. Obviously, there is a price to be paid for this benefit. Among other things, the contract also provides for the payment of premiums by the assured. Life Insurance is universally acknowledged as a tool to eliminate risk, substitute certainty or uncertainty and ensure timely aid of the family in the unfortunate event of the death of the breadwinner. It is sometimes called as the civilised world's partial solution to the problems caused by death. In a nutshell, life insurance helps in two ways: premature death, which leaves dependent families to fend for itself and old age without visible means of support.

7.1 Nature of Life Insurance/Assurance

1. The peculiar nature of Life Assurance is that the contracted event (cause) is bound to happen and the insurer has to perform the contract.
2. Life insurance convers death due to natural causes as well as due to accidents.
3. Life insurance contract is a long term contract having all essential features of a valid contract.
4. Life insurance is contract of assurance and not indemnity *viz.* life can not be indemnified. Therefore, subrogation and contribution does not apply to life insurance.
5. A warranty in a life insurance policy is not collateral but basi to the contract.
6. Life insurance is a kind of investment to the assured where he gets the compounded value of premiums upon survival.

7.2 Advantages of Life Insurance

Superior to any Other Savings Plan

Unlike any other savings plan, a life insurance policy affords full protection against risk of death. In the event of death of a policyholder, the insurance company makes available the full sum

assured to the policyholders' near and dear ones In comparison, any other savings plan would amount to the total savings accumulated till date. If the death occurs prematurely, such savings can be much lesser than the sum assured. Evidently, the potential financial loss to the family of the policyholder is sizable.

Encourages and Forces Thrift

A savings deposit can easily be withdrawn. The payment of life insurance premiums, however, is considered sacrosanct and is viewed with the same seriousness as the payment of interest on a mortgage. Thus, a life insurance policy in effect brings about compulsory savings.

Easy Settlement and Protection Against Creditors

A life insurance policy is the only financial instrument the proceeds of which can be protected against the claims of a creditor of the assured by effecting a valid assignment of the policy.

Administering the Legacy for Beneficiaries

Speculative or unwises expenses can quickly cause the proceeds to be squandered. Several policies have foreseen this possibility and provide for payments over a period of years or in a combination of installments and lumpsum amounts.

Ready Marketability and Suitability for Quick Borrowing

A life insurance policy can, after a certain time period (generally three years), be surrendered for a cash value. The policy is also acceptable as a security for a commercial loan, for example, a student loan. It is particularly advisable for housing loans when an acceptable LIC policy may also cause the lending institution to give loan at lower interest rates.

Disability Benefits

Death is not the only hazard that is insured; many policies also include disability benefits. Typically, these provide for waiver of future premiums and payment of monthly installments spread over certain time period.

Accidental Death Benefits

Many policies can also provide for an extra sum to be paid (typically equal to the sum assured) if death occurs as a result of accident.

Tax Benefits

Under the Indian Income Tax Act, 15% of the premium paid is allowed as a rebate from the total income tax liability, Also 100% of the premium paid is deductible as an expenditure from business income. When these benefits are factored in, it is found that most policies offer returns that are comparable/or even better than other saving modes such as PPF, NSC *etc*. Moreover, the cost of insurance is a very negligible.

7.3 Life Insurance Contract and Policy Provisions

Life insurance policy is an evidence of insurance contract. The life policy contains the following details :

(*a*) **'Heading'** contains the name and address of the Insurer. This also indicate the jurisdiction in cases of legal disputes and also the address where any notices can be served by the Insured against the company.

(*b*) **'Preamble'** states the inention of the parties to the contract in brief and general terms. It introduces both the parties. The receipt of the proposal and declaration as well as the first premium from the proposer are acknowledged. The statement and declarations contained in the proposal and personal statement are stated to be the basis of the agreement.

(*c*) **'Operative Clause'** mentions the mutual responsibilities and obligations of both the parties as follows :

a. In consideration of payment of the first premium and subsequent premiums as an when they fall due (the payment of premiums is made a conditionprecedent for performance of the contract by the insurer).

b. The insurer agrees to pay the benefits secured under the policy including bonus in respect of participating policies.

c. On receipt of proof satisfactory to the company.

(*i*) The happening of event on which the benefits are payable,

(*ii*) The title of the person claiming payment.

(*iii*) Age of the life assured, if not already admitted.

(*d*) **'Proviso'** contains two stipulations : (*a*) the conditions and privileges printed on hte back of the policy shall be deemed to be a part of the Policy and (*b*) every endorsement placed evidencing alterations etc., shall be deemed to be part of the policy.

(*e*) **'Schedule'** contains details of the partiacular contract. The details can be classified as follows:

a. **Identifying the policyholder :** policy number, date of commencement, date of proposal, name and address of the proposer and life assured.

b. **Scope of Cover :** plan and term of insurance, sum assured, date of maturity, events on the happening of which the benefits become payable, any additional benefits like accident benefit.

c. **To whom the sum assured is payable :** specific information and also Name of nominee.

d. **Premium :** the installment premium, due dates, mode of payment of premium, period during which premiums are payable, dates on last premium.

e. **Age :** age of the life assured and whether the same has been admitted.

f. Space for any special provisions.

(*f*) **'Attestation'** the policy should be stamped and then signed by an authorized official of the company.

(*g*) **'Conditions and Privileges'** these are usually printed on the back of the Policy Document and can be classified into three groups :

(*a*) **Conditions :** These explain the nature of the contract : like proof of age here mention is made that premium is calculated on the basis of age and if age has already not been

admitted and subsequently proved to be higher than stated, the company reserves to modify any terms of the contract.

- **Forteiture in certain events :** Three events under which the benefits secured under the policy can be forfeited *viz.*, (1) non-payment or premiums subject to non-forfeiture privilege (2) in the event of any condition being contravened and (3) in case there has been untrue or incorrect statements regarding material facts subject to section 45 of insurance contract.
- **Suicide :** This condition stipulates that in the event of death due to suicide within one year from the commencement of risk, the policy shall be void.
- **Other restrictive clauses :** Certain clauses like extra premiums charged for temporary periods, Lien clause, excluding certain risks like accident and disability benefits to physically handicapped persons, pregnancy clauses, etc.,
- **Assignment and Nomination :** This condition merely stipulates that notice of assignment or nomination should be submitted for registration with the insurance company and in registering the notice, the company does not accept any responsibility or express any opinion as to its validity or legal effect.

(*b*) **Privileges :** Certain previlleges are allowed under the policy. For example in payment of Premiums–days of grace allowed, (both in the event of death and when the policy is in force during the days of grace,) full sum assured will be paid subject to deduction of overdue premiums. This privilege also stipulates that in the event of death when the policy is in full force for the full sum assured, the unpaid premium, if any, due before the next policy anniversary will be deducted from the claim amount.

Revival of discontinued policies : A policy lapses if the premium due is not paid before the expiry of the days of grace. Subsequently, the policy can be revived subject to certain conditions, which may bary from company to company. These conditions for revival of a lapsed policy are stated in this privilege.

Non-forfeiture regulations : As per Insurance Act, 1938 a life insurance policy whereunder premiums have been paid for a continuous period of three years connot wholly lapse byt will have to acquire some value. This privilege is referred to as 'Non-forfeiture' regulation. The method of calculation of such value will have to be incorporated in the policy.

Other Policy Provisions

Apart from the various condition and priviledges mentioned above, the provision are made in the provision by way of clauses. Some of these are stated below :

(*a*) **Ownership Clause :** till the owner' is alive, he has all contracted right under the policy.

(*b*) **Entirety Clause :** the policy documents and ansurances form the entire part of the contract.

(*c*) **Reinstatement Revival Clause :** which empower the policy holder to reinstate (revive) of premium but object to some conditions.

(*d*) **Policy loan Clause :** which allows the insured to take a cash loan on the policy subject to condition.

(*e*) **Dividend Clause :** which allows the insurer to pay dividend on participating poliers.

(*f*) **Waiver of premium :** where the insured becomes totally disabled (permanent partial/total disablement). Also called as disability benefit.

(*g*) **Accident benefit :** Which allows the insuer to pay benefit over and above the normal benefit (in case of death/disablement) occurring due to aceident.

(*h*) **Guaranteed Surrende Value Clause :** which shows the cash value receivable if the policy is surrendered. It may also indicate the former for calculation.

7.4 Classification Selection and Treatment Objects

Method of Risk Classification

The two methods commonly empolyed int he classification of risks are :

(*a*) ***Judgement Method :*** The underwriter studies all the features of the life to be insured and on the basis of analysis of various factors takes a decision. Under this method the company depend upon the combined judgement of those in the medical, actuarial, and other areas who are qualified for this work to make underwriting decisions. The judgement method of rating functions effectively when there is only one unfavorable factor to consider whether the decisions to be made is simply whether to accept the proposed insured at standard rates or to reject him or her entirely. However, situations where multiple factors are involved or a proper substandard classification is needed, then this method can not be efficiently applied.[1]

(*b*) ***Numerical rating :*** In this method, a large number of factors, which influence mortality, are taken in account. For various factors, debits (additions) or credits (subtractions) are made to the scores. The numerical ratings vary from company to company–75 to 500. Illustratively, as rating increases, the quality of risk diminishes. A rating in the range of 75-125 is generally considered as standard and *over and above 125 as sub standard*. An underwriter has to take into account the nature and combined effects of extra risks *e.g.* impairments jointly causing additional extra risks. In these cases some additions are made to the arrived rates calculated independently.[2]

Treatment of Sub-Standard Life Insurance Risks

The three broad classifications of sub standard risks are :

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

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

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

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[1] Kenneth Black, Jr. and Harold D. Skipper, Pearson Education, 2003, p. 668.

[2] Arithmelical Addition of Extra Specific Morlalies is called as Lindquist's Rule.

The popular methods of treating sub standard risk are :

(a) ***Increase in premium :*** Increase in normal premium (multiple table extra) is the most common method adopted by the insurance companies for treatment of sub-standed risks. Under its method premiums canbe treated as follows :

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

(ii) a special mortality table is developed for each sub-standard classification that reflects the experience of each and a set of gross premium is computed for the clasification.[4]

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

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

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

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

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

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

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

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

7.5 Calculation of Premium

In calculating premium the following variable are considered :

(i) Term and Plan

(ii) Riders

(iii) Extras

(iv) Sum Assured

(v) Mode of payment

The rates of premium are quoted per thousand for various age groups. The table rates are then multiplied by the sum assured to arrive at a base premium. Then to the base premium, the addition or dedications are made. Consider the following example :

Sum proposed	Rs. 50,0000
Cover	Money Back Policy
Age (near birthday)	30

[3] S.L. Kawe, *Principles of Life Insurance*, Himalaya Publising, 2004, p. 46.

[4] Kenonete Black *et. al.*, *op. cit.*, p. 672.

Term	35 years
Table Rates	Rs. 27.00 per thousand
Adjustment Rate for high SI	+ Rs. 1.60 per thousand
Double Accident Benefit (DAB)	1%
Mode of payment	Semi-Annual

Calculation

Tabular Premium	
(Rs. 5,00,000 × 27/1000)	13,500
Adjussult Benefit for large SI	
(Rs. 5,00,000 × 1.60/1000)	800
Annual Premium	14,300
DAB Extra (1%)	1430
Total Price	15,730
Semi Annual Premium (15730/2)	**Rs. 7865**

7.6 Types of Policies

The two basic elements in a life insurance cover are (*a*) death cover and (*b*) risk cover. The insurance plans that provide only the death covers *i.e.* the benefits are paid on the death of the insured person are called as *Term Assurance Plans,* else, the plans under which the benefits are paid on the survival of the insured within a specified period are called as *pure endowment plans.* All insurance covers are a mix of these basic elemantary plans.

Classification based on time

(*a*) *Whole life* : Whole term, Limited term, Convertible

(*b*) *Term plans* : Limited, Convertible, Renewable

Classification based on investment objectives

(*a*) *Endowment plans* : Pure, Joint, Double, Anticipated

(*b*) *Participating plans* : Moneyback policies

Clasification based on premium payment

1. Single premium policies
2. Level premium policies

Classification based on claim payment

(*a*) Fixed sum policies

(*b*) Annuity policies

Classifiction based on number of persons assured

(*a*) Single life

(*b*) Multiple life

(*c*) Last survivorship policy

In addition to above, there may be various categories of policies depends upon the riders attached or a specific purpose of the cover *e.g.* children education policy, malliage policy *etc.*

Let us now concentrate on the generic covers available in India.

Whole Life Policies

In whole life policies, the insurance cover extends to whole life of the assured and premium are paid till death. LIC, now a days settles the payment of sum assured and accured bounsers, if the assured attains the age of 80. Even the premiums are low, there policies are not very popular. Alternativaly, limited payment plans are considered better, where the insured pays premium till certain age and afterwards the cover continues till death under the sum assured with accrued bonuses are paid.

In a convertible whole life plan, if the assured does not excercise the option of conversion into endowment plan in the stipulated intial years, the cover gets automatically converted into whole life plan.

Endowment Policies

Unlike whole life, an endowment life insurance policy is designed primarily to provide a living benefit and only secondarily to provide life insurance. Therefore, it is more of an investment than a whole life policy. Endowment life insurance pays the face value of the policy either at the insured certain age or after a number of years of premium payment.

Endowment life insurance is a method of accumulating capital for a specific purpose and protecting the savings program. Many inverstors use endowment life insurance to fund anticipated financial needs, such as college education or retirement.

Premium for an endowment life policy is much higher than those for a whole life policy.

Endowment policies are of various types of which a few are described as follows :

(*a*) *Pure Endowment :* Where the sum assured is payable to policeholders either on survival or death within the endowment period.

(*b*) *Joint Endowment :* Where the policy covers the risk on two or more lives under the single policy.

(*c*) *Marriage Endowment :* Where the policy is designed to meet the marriage financing needs of the family member of the policy holder.

Similarly, we have covers like education, children deferred endowment, double cover, triple cover, anticipated endowment policies *etc.*

Participating Policies

In participanting policies, the profit of the insurer operation are distributed to the policy holders in the form of bonuses declared of the every valuation. Both whole life and endowment policies can be made participating in profits at the option of the policyholder. These also called as with-profit policies.

Money Back Policies

It is an endowment policy for which a part of the sum assured is paid to policyholder in the form of survival benefits, at fixed intervals, before the maturity date. The risk cover on the **life** continues for the full sum assured even after payment of survival benefits and bonus is also calculated on the full sum assured. If the policyholder survives till the end of the policy term, the survical benefits are deducted from the maturity value.

These policies are for a fixed tenure, usually up to 25 years and the policyholder pays a fixed premium periodically during the paying period.

Pension Policies

These are the policies that provide benefits to the insured only upon retirement. If the insured dies during the terms of the policy, his nominee would receive the benefits either as a lump sum or as a persion evey mouth. The premiums are paid over a specified period. In general, most of the persion plans pay 25% of the cash value of the policy as in mediate income and the remaining value is invested in an investment fund that pays out a sums at a stipulated interval.

Annuity Policies

Annuity is acontract that provides an income for a specified period of time.

Annuity schemes are those wherein policyholders regular contributions over a period of time (or a one-time contribution) accumulate to form a corpus with the insuer. The corpus is used to yield a regular income that is paid to policyholders until death starting from the desired retirement age. Some annuity schemes have the option to pay the survivors a lump sum amount upon the death of insured in addition to the regular income while the insured is alive.

For example : Jeevan Dhara and Jeevan Akshay plans currently offer a guaranteed return of 12.5% and 10% respectively in addition to life cover.

Life insurance contracts in simple form are different from the annuity contracts in the sense that the insuer pays in the even of the death of insured in a life insurance contract, while in an annuity contract the insuser stops paying upon the death of the innured.

Annuities are of the following types :

- **Immediate :** An immediate annuity provides income for a guaranteed period of time. Payments begin within one year of purchase. Income payments can either be for life, for a specified number of years or a combination of both.
- **Deferred :** In the case of a deferred annuity, the payments to the annuitant start after a certain deferment period. A deferred annuity is made with either a single purchase payment (Single Premium Deferred Annuity) or several purchase payments over time (Flexible Premium Deferred Annuity). A deferred annuity can be converted into a stream of income at any time after 12 months.
- **Fixed :** A fixed annuity assures minimum rate of return.
- **Variable :** A variable annuity offers a variety of investment fund account portfolios, including growth-oriented portfolios that can help you keep up with inflation. variable annuity values and income payments may vary based on the underlying performance of the selected portfolio.

Benefits of Annuities

- Helps accumulate long term savings.
- Helps maximize income in retirement
- Provides lifetime of regular income source
- Tax benefits u/s 88 of the Income Tax Act, 1961
- Benefits the beneficiary on the death of the annuitant.

However there is a cost involved if the insured wants to get out of the annuity before a certain specified time.

Options in Annuity

Single life annuity : The annuitant receives income payments for the rest of his/her life.

Single life with period certain : The annuitant receives income for the rest of his or her life. If the annuitant dies before receiving a specific number of payment (period certain), the beneficiary will receive income for the remainder of the period; thus, a minimum number of payments are guaranteed.

Joint and survivor : The annuitant and the designated joint annuitant will receive income for the rest of their lives. Upon the death of the annuitant, payments would continue to the joint annuitant at a percentage of the original lèvel as selected by the annuitant at the time the income option was chosen.

Joint and survivor with period certain : The annuitant and the desgnated joint annuitant will receive income for the rest of their lives. If the annuitant and his or her joint annuitant die before a specific number of payments, the beneficiary will receive income for the remainder of the period certain.

7.7 Life Insurance Agency

Agents for the core of life insurance distibution system in India Agents are essential for soliciting business because of the following reasons :

(*a*) Clarification of an idea to the proposer

(*b*) Assignment of needs of the potential insured

(*c*) Personalised Guidance to the potential insured

(*d*) Assesment of risk for the insurer

Who are Agents?

Agents in a legal sense means a person who is employed to perform and act on half of others (principal) for a price called as commission. Agents in life insurance context means the person holding a valid licence from IRDA issued in accordance with the IRDA Regulations.

Minimum conditions to be fulfilled to become an agent (As per IRDA Regulations)

Qualifications

Qualifications of the Applicant : The applicant shall possess the minimum qualification of a pass in 12th Standard or equivalent examination conducted by any recognised Board/Institution, where the applicant resides in a place with a population of five thousand or more as per the last vrndud, snf s psdd in 10th Standard or equivalent examination from a recognised Board/Institution if the applicant resides in any other place.

Practical Training : (1) The applicant shall have completed from an approved institution, at least, one hundred hours' practical training in life or general insurance business, as the case may be, which may be spread over three to four weeks, where such applicant is seeking licence for the first time to act as insurance agent.

Provided that the applicant shall have completed from an approved institution, at least, one hundred fify hours' practical training in life and general insurance business, which may be spread over six to eight weeks, where such applicant is seeking licence for the first time to act as a composite insurance agent.

2. Where the applicant, referred to under sub-regulation (1), is :

(*i*) an Associate/Fellow of the Insurance Institute of India, Mumbai;

(*ii*) an Associate/Fellow of the Institute of Chartered Accountants of India, New Delhi;

(*iii*) an Associate/Fellow of the Institute of Costs and Works Accountants of India, Calcutta;

(*iv*) an Associate/Fellow of the Institute of Company Secretaries of India, New Delhi;

(*v*) an Associate/Fellow of the Actuarial Society of India, Mumbai;

(*vi*) a Master of Business Administration of any Institution/University recognised by any State Government or the Central Government; or

(*vii*) possessing any professional qualification in marketing from any Institution/University recognised by any State Government or the Central Government :

he shall have completed, at least, fifty hours' practical training from an approved institution.

Provided that such applicant shall have completed from an approved institution, at least, seventy hours' practical training in life and general insurance business, where such applicant is seeking licence for the first time to act as a composite insurance agent.

3. An applicant, who has been granted a licence after the commencement of these regulations, before seeking renewal of licence to act as an insurance agent, shall have completed, at least twenty-five hours' practical training in life or general insurance business, as the case may be, from an approved institution.

Provided that such applicant before seeking renewal of licence to act as a composite insurance agent shall have completed from an approved institution, at least, fifty hours' practical training in life and general insurance business.

Examination : The Applicant shall have passed the pre-recruitment examination in life or general insurance business, or both, as the case may be, conducted by the Insurance Institute of India, Mumbai, or any other examination body.

Fees Payable : (1) The fees payable to the Authority for issue or renewal of licence to act as insurance agent or a composite insurance agent shall be rupees two hundred and fifty.

(2) The additional fees payable to the Authority, under the circumstances mentioned in sub-section.

(3) of Section 42 of the Act, shall be rupees one hundred.

Code of Conduct : (1) Every person holding a licence, shall adhere to the code of conduct specified below :

(*i*) Every insurance agent shall :

(*a*) identify himself and the insurance campany of whom he is an insurance agent;

(*b*) disclose his licence to the prospect on demand;

(*c*) disseminate the requisite information in respect of insurance products offered for sale by his insurer and take into account the needs of the prospect while recommending a specific insurance plan;

(*d*) disclose the scales of commission in respect of the insurance product affered for sale, if asked by the prospect;

(*e*) indicate the premium to be charged by the insurer for the insurance product affered for sale;

(*f*) explain to the praspect the nature of information required in the propasal form by the insurer, and also the importance of disclosure of material information in the purchase of an insurance contract;

(*g*) bring to the notice of the insurer any adverse habits or income inconsistency of the prospect, in the form of a report (called "Insurance Agent's Confidential Repart") along with every proposal submitted to the insurer, and any material fact that may adversely affect the underwriting decision of the insurer as regards acceptance of the proposal, by making all reasonable enquiries about the prospect;

(*h*) inform promptly the prospect about the acceptance or rejection of the proposal by the insurer;

(*i*) obtain the requisite documents at the time of filling the proposal form with the insurer; and other documents subsequently asked for by the insurer for completion of the proposal;

(*j*) render necessary assistance to the policyholders or claimants or beneficiaries in complying with the requirements for settlement of claims by the insurer;

(*k*) advise every individual policyholder to effect nomination or assignment or change of address or exercise of options, as the case may be, and offer necessary assistance in this behalf, wherever necessary;

(*ii*) No insurance agent shall :

(*a*) solicit or procure insurance business without holding a valid licence;

(*b*) induce the prospect to omit any material information in the proposal form;

(*c*) induce the propoect to submit wrong information in the proposal form or documents submitted to the insurer for acceptance of the proposal;

(*d*) behave in a discourteous manner with the prospect;

(e) interfere with any proposal introduced by any other insurance agent;

(f) offer different rates, advantages, terms and conditions other than those offered by his insurer;

(g) demand or receive a share of proceeds from the beneficiary under an insurance contract;

(h) force a policyholder to terminate the existing policy and to effect a new proposal from him within three years from the date of such termination;

(i) have, in case of a corporate agent, a portfolio of insurance business under which the premium is in excess of fifty percent of total premium procured, in any year, from one person (who is not an individual) or one organisation or one group of organisation;

(j) apply for fresh licence to act as an insurance aent, if his licence was earlier cancelled by the designated person, and a period of five years has not elapsed from the date of such cancellation;

(k) become or remain a director of any insurance company;

(iii) Every insurance agent shall, with a view to conserve the insurance business already procured through him, make every attempt to ensure remittance of the premiums by the policyholders within the stipulated time, by giving notice to the policyholder orally and in writing.

Remuneration and Termination

The agents can be remunerated either on rolls (*i.e.*, salary basis) or on commission basis or may be combination of both. The payment of remuneration varies prom company to company and policy to policy. Agents in India are required to bring business for a mimum stipulated period and minimum covers specified in order to be entittled for continuous payment of commision till the policies engaged are in force. Agents of LIC are also entitled to insurance for specified term and gratuity benefits. Term insurance is linked to average annual commission (revival) earned in the three agency years preceeding his deaths.[5]

The agency can be terminated if :

1. the agent is disqualified as per Section 42 (4) of the IRDA Act 1999 (Regulation 9);
2. the agent becomes incompetent to contract as per the provisions of Indian Contract Act, 1972;
3. offers rebate of the whole or part of the commission (Section 41 of the Insurance Act, 1938);
4. fails to fulfill the requirements of minimum business as per agency contract;
5. licence is cancelled or not renewed.

7.8 Policy Servicing and Provisioning

7.8.1 Basic Procedure for Issuing a Life Insurance Policy

Insurance is a contract and therefore, the process of life insurance starts with the proposal made by the prospective insured (called as the proposer) in a standard application form issued by insurance companies generally made available by agents. Once the policy has been selected, the proposer has to provide information about income, age and health. If there is a need for medical

[5] *Practice of Life Insurance*, Insurance Institute of India, Mumbai, p. 15.

examination, the report of the medical examiner is sent to the insurance company confidentially. The agent or the development officer generally does a first level underwriting and a report thereon is sent to the company. This report provides information about the financial position and need and adequacy of insurance for the proposer. It also contains the information gathered by the agent/development officer from his personal sources or inquiries made on the basis of the information furnished by the proposer. Thereafter, the documents are scrutinised from various angles particulary age, financial condition and health status.

Age Proof

Scrutiny of age is an important concern for the life insurer because old age people have high probability of dying than the younger ones and premium is calculated on the basis of age groups. Accuracy in age computation resolves hardship both to the insurer and the potential insured in the sense that the correct age avoids the company being affected by lesser premiums or undersired risk bought or risk not bought because of fear. From the insured's perspective, it helps in charging of fair premiums and insurance availability. The proofs of age, which are generally considered are as under :

- Certified extract from municipal or other records made at the time of birth.
- Certificate of Baptism or certified extract from family Bible if it contains age or date of birth.
- Certified extract from School or College if age or date of birth is stated therein.
- Certified extract from Service Register in case of Govt. employees and employees of Quasi Govt. institutions including Public Limited Companies and
- Passport issued by the Passport Authorities in India.

Alternative Age Proofs, which are also accepted in the industry, are :

- Marriage certificate in the case of Roman Catholics issued by Roman Catholic Church.
- Certified extracts from the Service Registers of commercial Institutions or Industrial Undertakings provided it is specifically mentioned in such extracts that conclusive evidence of age was produced at the time of recruitment of the employee.
- Certificate of Birth granted by Syedna v. Molana Badruddin Sahib of Baroda.
- Identity Cards issued by Defence Department.
- A true copy of the University Certificate or of Matriculation/Higher Secondary Education, S.S.L. Certificate issued by a Board set up by a State/Central Government.
- Non-standard age proofs like Horoscope, Service Record where age is not verified at the time of entry, E.S.I.S. Card, Marriage Certificate in case of Muslim Proposer, Elder's Declaration, Selfdeclaration and Certificate by Village Panchayats are accepted subject to certain rules.

Medical Examination

Generally, at some levels and in case of endowment policies, whole life policies, the medical examination is not asked for. However, if the amount of insurance is very high or the age is high or the first level examination has some adverse remarks, then the insurance company may refer the proposal for a thorough examination. Cases of pregnant women, or women with history of

miscarriages or abortion are declined. Some times the medical examination may be waived, like in rural areas, where the facilities are not available.

After the above examinations and obtaining special reports, if required, the underwriter may accept or reject the case. Else, he is empowered to modify the sum assured, premium to be charged and manner thereof, impose conditions or provide exclusions in the policy.

In case of untrue or incorrect statement contained in the proposal, personal statement, declaration and connected documents or any material information withheld, subject to the provision of Section 45 of the Insurance Act 1938, wherever applicable, the policy shall be declared void and all claims to any benefits in virtue thereof shall cease.

After the policy is issued, the policyholder in a number of cases finds the terms not suitable to him and desires to change them. LIC allows certain types of alterations during the lifetime of the policy. However, no alteration is permitted within one year of the commencement of the policy with some exceptions. The following alterations are allowed :

- Alteration in class or term
- Reduction in the sum assured
- Alteration in the mode of payment of premiums
- Alteration in the date of commencement of the policy
- Splitting up of a single policy into two or more policies
- Removal of an extra premium
- Alteration from without profit plan to with profit plan
- Alternation in name
- Correction in policies
- Settlement option of payment of sum assured by instalments
- Grant of accident benefit
- Grant of premium waiver benefit under CDA policies
- Alteration in currency and place of payment of policy monies.

A fee for the change or alteration in the policy is charged by the company called as the quotation fee and no additional fee is charged for giving effect to the alteration.

7.8.2 Issue of Duplicate Policy

A duplicate policy confers on its owner the same rights and privileges as the original policy. The following are the requirements for issuing a duplicate policy :

1. Insertion of an advertisement at the policyholder's cost in one English daily newspaper having wide circulation in the State where the loss is reported to have occurred. A copy of the Newspaper in which the advertisement appeared should be sent to the servicing office one month after its appearance. If no objection has been lodged with LIC regarding the policy in question, a duplicate policy will be issued after complying further requirements, *i.e.*, Indemnity Bond and payment of charges for preparing duplicate policy and stamp fee.

2. However, the requirement of advertisement and Indemnity Bond may be dispensed with or modified in certain circumstances as given below :
   - loss of policy by theft
   - destruction of policy by fire
   - loss of policy while in custody of an office of government
   - mutilated or damaged policy
   - policy in torn and a part of it is missing
   - policy partially destroyed by white ants.

The need to have a duplicate policy also arises at the time of receiving Maturity Amount or Death Claim, to obtain Surrender Value/Loan and to obtain a Duplicate Policy in other cases.

7.8.3 Nomination

Nomination is the process of identifying a person to receive the policy money in the event of the deth of the Policyholder. Nomination can be done at the inception of the Policy by providing details of nominee in the proposal form. However, if the nomination is not given at the beginning, the policyholder can give it at a later date. This nomination has to be effected by giving notice in a prescribed form to the insurer and getting it endorsed on Policy Bond. Change of Nomination can be done by the Policyholder any time during the term of the Policy and any number of times. For this, the policyholder has to give a notice in a prescribed form to the insurer and get it endorsed at the back of the Policy.

Further, Nomination can be removed any time by the Policyholder without giving prior notice to the Nominee. Nomination can be done only by a policyholder, who is a major, and on a policy on his own life. Under Nomination, the Nominee gets only the right to receive the policy money in the event of the death of the Policyholder. Nomination does not pass on the property in the Policy. If Nominee dies when the Policyholder is still surviving then the nomination would be ineffective. Nomination has no effect if the Policyholder is surviving. If Nominee dies after the death of the policyholder but before receiving policy money, then also Nomination becomes ineffective and only the Legal Heirs of the Policyholder can claim money. In the case of Children's Policies, Nomination is not done until the Child becomes a major. Nomination is governed by Section 39 of Insurance Act 1938.

The nominee is statutorily recognised as a payee who can give a valid discharge to the Corporation for the payment of policy monies. Nomination will be incorporated in the text of the policy at the time of its issue. After the policy is prepared and issued and if no Nomination has been incorporated the assured can ordinarily affect the nomination only by an endorsement on the policy itself. A nomination made in this manner is required to be notified to the Corporation and registered by it in its records. A nomination is not required to be stamped. Any chage or cancellation of nomination should be given in writing only by the Life Assured. Nomination under Joint Life Policy can only be a joint nomination. Nomination in favour of a stranger cannot be made as there is no insurable interest and moral hazard may be involved.

Nomination in favour of wife and children as a class is not valid. Specific names of the existing wife and children should be mentioned. Where nomination is made in favour of sucessive nominees, *i.e.*, nominee "A" failing him to nominee "B" failing whom nominee "C", the nomination in favour of one individual in the order mentioned will be considered. Where the nominee is a

minor, an appointee has to be appointed to receive the monies in the event of the assured's death during the minority of the nominee. No nomination can be made under a policy financed from HUF funds. In the case of first endorsement of nomination the date of registration of nomination will be the date of receipt of the policy by the servicing office and in case of any other nomination or cancellation or change thereof, the date of receipt of the policy and/or of notice whichever is later, will be the date of registration.

7.8.4 Assignment

Assignment is a means whereby the beneficial interest, right and title under a Policy gets transferred from Assignor to Assignee. 'Assignor' is the Policyholder who transfers the title, and 'Assignee' is the person who derives the title from the Assignor. Assignment can be made only after acquiring the Policy. Assignment can be done only for consideration–for money or money's worth or goods, moral and meritorious consideration, like Love and Affection. Assignment can be made by mere endorsement on the Policy or by a separate duly stamped Deed. Assignment can be done by the Proposer, Policyholder or the Absolute Assignee. Assignor must be a major, and must have an absolute right over the Policy. Assignment must be in writing and the Assignor's signature along with a Withness is a must. Notice of Assignment should be submitted to the insurer. There are two types of assignments :

1. *Conditional Assignment* whereby the assignor and the assignee may agree that on the happening of a specified event which does not depend on the will of the assignor, the assignment will be suspended or revoked wholly or in part. Conditional Assignment is usually effected for consideration of natural Love and Affection.
2. *Absolute Assignment* whereby all the rights, title and interest which the assignor has in the policy passes on to the assignee without reversion to the assignor or his estate in any event. Absolute Assignmewnt is usually effected for valuable consideration.

On Assigning the Policy, the Assignor loses his right over the Policy and the Assignee gets the right and becomes the owner of the Policy. The Assignee can further re-assign the Policy and he also has a right to sue under the Policy. A valid assignment once made cannot be cancelled. It can be done only by another valid assignment. In all the cases, Assignment automatically cancels an earlier Nomination. However, when the Policy is assigned to the insurer say for loan, Nomination gets affected and it does not get cancelled. Under Conditional Assignment, if the conditional Assignee dies, the benefit under the Policy goes back to the Life Assured if surviving. Otherwise, the benefit goes to Policyholder's Nominee. Under Absolute Assignment, if the Absolute Assignee dies, the benefits under the Policy go to the Legal Heirs of the Assignee. Assignment is governed by Section 38 of Insurance Act, 1938.

An assignment has an effect of directly transferring the rights of the transferor in respect of the property transferred. Immediately on execution of an assignment of the Policy of life assurance the assignor forgoes all his rights, title and interest in the Policy to the assignee. The premium/ loan interest notices etc. in such cases will be sent to the assignee. In case the assignment is made in favour of public bodies, institutions, trust etc., premium notices/receipt will be addressed to the official who has been designated by the institutions as a person to receive such notice.

An assignment of a life insurance policy once validly executed, cannot be cancelled or rendered in effectual by the assignor. Scoring of such assignments or super scribing words like 'cancelled' on such assignment does not annul the assignment. And the only way to cancel such assignment would be to get it re-assigned by the assignee in favour of the assignor.

Re-assignment

An assignee may during the currency of the policy re-assign the interest in the policy to the previous assignor, such reassignment will have the effect of cancelling the assignment and the interest title of the policy revert to the previous assignor.

7.8.5 Revivals

If the premium under a policy is not paid within the days of grace, the policy lapses. Revival is a fresh contract wherein the insurer can impose fresh terms and conditions. In case of LIC, a lapsed policy can be revived within 5 years from the date of first unpaid premium. A policy can be revived under the following types of revival :

1. Ordinary Revival

The distinctions between nomination and assignment are as follows :

Nomination	*Assignment*
(*i*) (*a*) Nomination can be effected before a policy is issued by mentioning the nominee's name, age relationship and address in the proposal from, or by a letter giving these details.	(*i*) (*a*) A policy canot be assigned before it is issued as the life assured does not acquire the property which he can assign until after the policy is actually issued.
(*b*) Nomination can be made after the policy has been issued by an endorsement on the policy document. Nomination, however, cannot be done by a deed.	(*b*) A policy can be assigned after it has been issued by an endorsement on the policy, or by a deed which must be stamped.
(*ii*) Only the holder of a policy on his own life, *i.e.* the life assured, can make a nomination.	(*ii*) The absolute owner of the policy–either the proposer of the absolute assignee–or by the person having requisite authority from such owners can make an assignment.
(*iii*) Nomination can be effected wherever Insurance Act, 1938 applies, *i.e.* in India or where similar enactments apply, *viz.*, in Pakistan and Sri Lanka.	(*iii*) An assignment can be executed anywhere in the world according to the law of that country.
(*iv*) The assured retains full control and can deal with the policy without the consent of the nominee.	(*iv*) The assured loses control over the policy as vested interest is created in favour of the assignee whose consent in all matters relating the policy is necessary. The absolute assignee is the owner of the policy and can deal with it.
(*v*) A nomination need not be supported by a consideration.	(*v*) An assignment in favour of a third party must necessarily be supported by a consideration, but not among blood relations.
(*vi*) A nomination may or may not be witnessed.	(*vi*) An assignment must be witnesed, otherwise it will be invalid.
(*vii*) Notice is required to safeguard the nominee's interest.	(*vii*) Notice is required to enable the assignee to acquire priority over an earlier assignee.
(*viia*) Nomination is generally in favour of relatives.	(*viia*) Assignment can be in favour of anybody.
(*viii*) A nominee has no right to sue under the policy, as long as the life assured is alive.	(*viii*) Assignee has the right to sue under the policy.

Nomination	Assignment
(*ix*) Nomination can be cancelled by the life assured during the currency of the policy by cancellation of the nomination, by a change of nomination, or by an assignment.	(*ix*) An assignment cannot be cancelled by the assignor. Rather, the assignee alone can reassign the policy.
(*x*) Where the nominee is a minor, only the appointment of an appointee by the life assured is required.	(*x*) When assignee is a minor, a guardian has to be appointed by the father of the assignee, or any other authorised person.
(*xi*) The appointment can be incorporated in the wording of the nomination.	(*xi*) The appointment cannot be incorporated in the wording of the assignment.
(*xii*) No vested interest is created in favour of nominee	(*xii*) Vested interest is created in favour of assignee.
(*xiii*) A nominee has only the right to collect the policy monies upon the death of the life assured and when paid by L.I.C. A nominee may or may not be the legal heir to the money.	(*xiii*) On receipt of the notice of the policy holder's death, L.I.C. is obliged to recognise the assignee as the person legally entitled to receive the policy monies.
(*xiv*) The nomination becomes ineffective in case the nominee dies.	(*xiv*) If a conditional assignee dies, the right under the policy reverts to the life assured, depending upon the terms of assignment. If an absolute assignee dies the right devolves upon his/her heirs.
(*xv*) If the nominee dies after the life assured but before settlement of the chaim, the policy monies would be payable to the heirs of the life assured.	(*xv*) If the assignee–whether absolute or conditional-dies after the life assured but before settlement, the policy monies would be payable to the heirs of the assignee.

Source : Keyfeatures of life insurance policies sify=com.htm.

If a revival of the policy is effected within 6 months from the due of first unpaid premium, no personal statement regarding health is required and the policy is revived on collection of delayed premium plus interest. The rate of interest to be charged for such delayed premium will depend on the date of commencement of the policy.

2. *Revival on Non-medical Basis*

For revival of the policy on non-medical basis, the amount to be revived should not exceed the prescribed limit for non-medical assurance taken by the life assured.

3. *Revival on Medical Basis*

If a policy connot be revived under ordinary revival or revival on non-medical basis it can be revived with medical requirements. The medical requirements will depends upon the amount to be revived.

4. *The Other Schemes for Revival are :*

- Special Revival Scheme
- Revival by instalment
- Loan-cum-revival
- Survival Benefit-cum-revival

7.8.6 Policy Loans

Most of the insurance companies give privilege to the policyholder to obtain loans on certain policies subject to certain rules. The policyholder has to apply for a loan in a prescribed form and submit the Policy Bond along with the form duly completed. The loan amount is calculated depending on the Surrender Value (SV) that the policy would have acquired, and approximately 85% of the Surrender Value are given as loan. Loans can also be perceived as riders offered by some private insurance companies. Rate of interest charged on loans taken on insurance policies veries from company to company and from time to time. A policyholder can repay the loan amount either in part of in full, any time during the term of the Policy. For LIC, the minimum repayment should be Rs. 50 and thereafter in multiples of Rs. 10. If the loan amount is not repaid during the term of the Policy or early claim, the amount of loan plus interest, if any, will be deducted from the claim money payable and the balance amount will be paid to the claimant. In case of LIC, if the interest is not paid regularly every half year, then the interest is calculated on compound interest basis. If the premiums are not paid regularly, that is, if the policy is not kept in force, there is a possibility that the loan amount along with accured interest exceeds the surrender value. At that stage, foreclosure action is taken on the policy.

Generally, plans for Children or special plans like Jeevan Griha and Deferred Annuity/Pension Plans as well as Money Back Plans etc. are not eligible for loans. The requirement for granting a loan are as under :

(*a*) Application for loan with an endorsement of terms and conditions of the loan is being placed on the policy.

(*b*) Policy to be assigned absolutely in favour of the Corporation.

(*c*) A receipt for the loan amount.

In case of LIC, the maximum loan amount available under the policy is 90% of hte Surrender Value of the policy (85% in case of paid up policies) including cash value of bonus. The minimum period for which a loan can be granted is six months from the date of its payment. If repayment of loan is desired within this period the interest for the minimum period of six months will have to be paid. In case the policy becomes a claim either by maturity or death within six months from the date of loan, interest will be charged only upto the date of maturity/death.

7.8.7 Surrender Value

Surrender Value is the cash value payable by insurnace on voluntary termination of the policy contract at the desire of Policyholder, but before the expiry term. A policy can be surrendered, provided, it is kept in force for at least three years (in case of LIC). The mode of calculating Surrender Value differs from company to company, but in most cases it is limited to the amount of premiums paid at the time of surrender. It also depends upon the duration elapsed and the total duration under the policy as on the date of surrender.

Calculation of Surrender Value

The calculation of surrender value involves the following steps :

(*a*) Calculate duration elapsed under the policy. This duration will be equal to data of calculation of surrender value less date of commencement to be rounded off to the nearer half year.

(*b*) Calculate the paid up value, inclusive of vested bonus under with profit plans.

(*c*) Ascertain from the tables the appropriate surrender value factor per Rs. 100/-paid-up value, corresponding to plan, duration elapsed and orginal term.

(*d*) Surrender Value = Paid-up × Surrender value Factor/100.

Note : If this figure is less than the guaranteed surrender value, latter is payable.

Example

Sum Assured	= Rs. 1,00,000
Plans and Term-Endowment (with profits)	= 20 years
Mode of payment	= Semi-annual
Date of commencement	= 01.01.85
Due date of last premium paid	= 01.03.97
Date of calculation of surrender value	= 1.3.1997
Number of years premium paid	= 01.01.97–01.01.85 = 12 years.
Term of the policy	= 20 years
Paid up value	= 12/20 × 1,00,000 = Rs. 60,000 (A)
Vested bonus	= Rs. 77,000 (B)
Paid-up value including vested Bonus	= A + B = Rs. 1,37,000

7.9 Settlement of Claims

The life insurance claims can be classified in two categories (*a*) Death claims (*b*) Maturity claims. Settlement procedure of each of these is discussed below :

7.9.1 Death Claims

If the insured dies before the expiry of the term of the policy, it is called as death claim. The death of the life assured has to be intimated in writing to the insurer. It may be done by the nominee, assignee, a relative of the life assured, the employer, agent or development officer. Partculars like policy number, name of the life assured, the date of death, the cause of death and the relationship of the informant to the decreased are to be mentioned. The intimation must satisfy two conditions : (*a*) It must be from a concerned person and (*b*) must establish beyond doubt, the identity of the deceased person as the life assured under the policy.

Sometimes, the office need not wait till the intimation of the claim is received. Obituary columns, the concerned agent or newspaper reports in case of accidents or air crashes may give information and the claim action can be initiated. However, care has to be taken to ensure that identity of the deceased is established.

The facts required to the submitted by the claimant are : (*a*) Date of death (*b*) Reason and Place of Death and (*c*) Full details of policies held by the Life assured should also be submitted. Death claims are categorised as Non-Early Death claims and Early Claims. The procedure for processing these claims is different.

(A) **Non-early Death Claims** refer to death of the Life assured occurring after 3 years from the date of commencement of policy or Date of last revival/reinstatement. If the policy is in force till death by regular payment of premiums, full sum assured is payable along with bonus (if it is with a profit policy). The requirements for the settlement of the death claim are :

- Policy Document
- Death Certificate from the appropriate authority
- Legal evidence of Title, if the claimant is not an assignee/nominee

- Abridged Claim Form
- Discharge Form duly signed
- Assignment/Reassignment deed, if any
- Age proof, if age is not already admitted

Once these documents are received and if they are found in order, claim is settled and payment is made to the person entitled to.

(B) **Early claims** refer to the death of life assured occurring within 3 years from commencement of policy. The following forms are to be submitted duly completed :

- Statement from the medical attendants who last treated the deceased Life assured.
- Certificate of treatment issued by the hospital authorities where the deceased was treated last.
- Certificate by the employer if the deceased was an employee.
- Certificate of burial/cremation signed by a person who attended the funeral of the deceased.

Where death takes place due to accident, the death has to be reported to the police and a FIR (First Information Report), police inquest report, and post-mortem report (if conducted only) are to be submitted. Wherever death takes place within 2 years from Date of commencement an enquiry is conducted to determine the genuineness of claim. On the basis of these, the decisions to settle accidental benefits are taken. Under MWPA policy the proceeds of the policy wil be paid to the trustees. If there is no trustee, the official trustee will step in. But if the beneficiaries are major and competent to contract, payment can be made directly to them without the intervention of trustees. The assured need not sign the discharge voucher.

- In case of absolute assignment, the payment will be made to the assignee. If the assignment is conditional, payment can be made to the assured himself, after satisfying repayment of loan that may be the reason for assignments.
- If the policy is irretrievable lost, advertisement of the loss of the policy is a necessary precaution. Payment can be made on the basis of an indemnity executed by the policyholder together with a surety of means. It is not necessary to issue a duplicate policy.
- The death claim amount is payable to the nominee or the assignee as the case may be. If the life assured has died without making an assignment or nomintion, legal evidence of title (proof of ownership) such as succession certificate or letters of administration or probate of a will where a will exists, would be requried.
- The insurer may waive strict evidence of title, if the amount involved is small, there is no other estate left by the deceased and there is no dispute among he survivors about the policy moneys.
- If the intimation claim is received after 3 years from the death, the same is time barred. The claimant has to be informed accordingly. However, if the death had occurred with 3 years of the policy's commencement of revival, simultaneous investigation should be conducted to find out the bonafides of the claim, without the knowledge of the claimant. However, if more than three years have elapsed, since the date of risk, the claimant has to be informed that the claim is barred by limitation. But simultaneusly claim froms can be issued without prejudice to see if any ex-gratia payment can be made.

- If the death has occurred within 2 years of the date of the policy (that is the date of FPR) the possibility of suppression of evidence cannot be ruled out. Hence, it is necessary to investigate such cases. The reasons for intimating a claim late may be deliberate attempt to tamper with evidence.
- Death can take place suddenly *e.g.* due to cardiac arrest, downing, burns, air crash, suicide, and murder or at the hand of justice. In case of an air crash, a certificate from 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 would be needed. In case of sudden heart failures, doctor's certificate will not be forthcoming.
- In case of defence personnel, a certificate from the commanding officer of the Uniut is to be obtained. If a court of enquiry is ordered its findings should be obtained.

7.9.2 Maturity Claims

Maturity claims are payable as per the terms of the policy. These policies are generally endowment polices including money back policies. The amount payable at the time of maturity includes sum assured and bonuses/incentives. The insurer normally sends advance intimations to the insured. The insurer has to satisfy that :

- The life assured is the holder of the policy and his identity is proved.
- The age stands admitted.
- The premiums are all paid.
- The original policy is handed in together with a completed discharge voucher before making payment.

The insurance company is expected to make payment on the maturity date. Post-dated cheques are normally set in advance.

Documents Required

In the case of maturity claims, the insurer will call for the following documents, well before the date of maturity.

- Policy document, if it is not available, it may have been deposited elsewhere as a security for a loan. If policyholder loses the policy, the claim can be settled on the strength of an indemnity bond from the policyholder and a reliable surety of sound financial means. For small amounts, a letter of indeminity may suffice. In case of very small amounts, say Rs. 1,000/- or less, even this can be dispensed with.
- Age proof, if the age is not already admitted.
- Deed of assignment if any.
- Discharge form issued by the office.

If the claim does not determine the policy finally, as in the case of periodical survival payments, the policy document will be returned to the policy holder after due endorsements.

Settlement

Settlement procedure in a maturity claim is simple. After receipt of the completed and stamped

discharge voucher from the person entitled to the policy money, along with the policy documents, claim amount will be paid by account payee or crossed and order cheque. In case of survival benefit claims, that is whose sum assured is retuned by instalments, suitable endorsements will be made on the policy document and in policy records, before returning the policy document to the policy holders. If the discharge from is lost in transit, a duplicate discharge form can be issued.

- Where the assured or the person to sign the discharge is known to be mentally deranged, a certificate from a court of law under the Indian Lunacy Act appointing a persons to act as a guardian to manage the properties of the lunatic should be called. If the person has recovered from the mental disorder, a certificate form the Psychiatic Hospital to that effect would be necessary.
- If the assured has been adjudged insolvent by court of law before the policy has matured for payment and if a notice is received from the official assignee of the court along with a certified copy of the court's order declaring assured as insolvent and also on order appointing official assignee as the assignee of the insolvent's estate, the official assignee should be informed about the date of maturity and other details. If the assignee claims the money, the payment has to be made to him under advice to the life assured. If the judicial authority has sold the policy in a court action, the purchaser, who produces certificate of sale, will be entitled to the policy moneys.
- If a prohibitory order of a court of law or a notice from income-tax officer under Section 226 (3) of the Income Tax Act is subsisting, the assured should be asked to have a proper withdrawal order served on the insurer. Otherwise, the insurer will act according to the notice.
- If the life assured is reported to have died before the maturity date, the claim has to be treated as death claim and processed accordingly. But if the assured is reported to have died after the date of maturity but before the receipt is discharged, the claim is to be treated as a maturity claim and paid to the legal heirs. Death certificate and evidence of title would be necessary.
- Under the Evidence Act, a person who has disappeared is presumed to be dead only if he has not been heard of for seven years. In such cases a decree of presumption of death from a court of law would be needed. The premiums must be paid until presumption of death is made, otherwise, the payment would be made after the court decree is obtained, as per the status of the policy as on the date when the premiums stopped.
- Payments of claim amount to claimants who are non-resisdents of India are governed by the Foreign Exchange Control Regulations.
- If a policy is financed through HUF funds, the policy belongs to HUF and as such the policy moneys would be payable to the Karta of HUF only.

  However, the insurer sometimes provides certain relaxation in settlements of the claims. Legally no claim is acceptable in respect of a lapsed policy or death of the Life assured occurring within 3 years from the date of commencement of the policy. However, some concessions are available and payment of claims are made :

- If the Life assured had paid at least 3 years' premiums and thereafter if premiums have not been paid, the nominees get proportionate paid up value.
- In the event of the death of the Life assured within 3 years and the policy is under the lapsed position, nothing is payable.

If minimum 2 years premiums are paid and if death of Life assured occurs within 3 months from the date of first unpaid premium, then full sum assured along with bonus is payable subject to recovery of the premium already fallen due and the premium that falls during the policy anniversary.

Between 3 to 6 months from fully unpaid premium, only 59% of basic sum assured is payable. No bonus is paid and no arrears of premium are received. If death occurs between 6 months to 1 year, from fully unpaid premium only notional paid up value is given.

Double Accident Benefit is provided as an inject to the life insurance cover. For this purpose an extra premium of Rs. 1/- per Rs. 1000/- S.A. is charged. For claiming the benefits under the Accident Benefit the claimant has to produce the proof to the satisfaction of the corporation that the accident is defined as per the policy conditions. Normally for claiming this benefit documents like FIR, Post-morten Report are insisted upon.

Disability Benefit Claims consist of waiver of future premiums under the policy and extended disability benefit consisting in addition of a monthly benefit payment as per policy conditions. The essential condition for claiming this benefit is that the disability is total and permanent so as to preclude him from earning any wage/compensation or profit as a result of the accident.

The LIC has also set-up Claims' Review Committees which in cases of repudiation, give opportunity to the claimant to make representation for consideration by the Review committees at the Zonal Office and the Central Office. As a result of such reviews, depending on the merits of each case appropriate sanctions are made.

The Grievance Redressal Machinery has been further exapanded with the appointment of Insurance Ombudsman at different centres. At present there are 12 centres operating all over the country. Complaints regarding claims, any dispute regarding premiuums, legal construction of the policy in relation to claim and non-issue of insurance document comes under the purview of Ombudsman's consideration.

7.10 Life Insurance Demand and Outlook

Life insurance sector has started acquiring new shapes with newer innovations in the post liberatlisation era. Big brands like Birla, Tata, ICICI, HDFC etc. have tied up with foreign partners. The life insurance has been the baby of LIC of India, primarily because of its monopoly till privatisation. Even though the growth has been impressive over years, yet the penetration is pretty low. Let us have a look at the life insurance average index. The number of policies sold is very low [Exhibit 7A] *viz.*, 13.2 per 100 persons compared to the Asian counterparts like Malaysia and Japan where it is 37.0 and 201.4 respectively.

The life insurance premium as a percentage of GDP is very low and which is expected in improve in coming years indicating a vast potential for the players.

Country	*Life Premium as % of GDP*
South Korea	8.0
UK	6.5
USA	5.2
India	1.3

Source : indiainfoline.com

The expected demand as per research studies show a vast potential to the extend of 650 million estimated by 2005 [Exhibit 7B]. The key reasons for this optimism can be described on two accounts :

From the View Point of Investment

1. The life insurance sector has demonstrated in the past, its commitment to provide a steady and secured return compared to other forms of investments.
2. The life insurance premium offer tax incentives which have been continuing since long. However, Kelkar Committee recommendations have posed a threat. Yet these have not been implemented.
3. The life investments have proved least risk options compared to stock markets where investors in one form or other have burned hands including the UTI fiasco.

Exhibit 7A

LIFE INSURANCE COVERAGE

Individual live Insurance Coverage Index, 1999

Country	*(No. of policies per 100 persons)*
Indonesia	3.2
Philippines	6.1
India	13.2
Thailand	15.0
Malaysia	37.0
Hong Kong	71.2
South Korea	72.0
Taiwan	76.7
Singapore	114.5
Japan	201.4

Source : Chartered Financial Analyst, May 1999.

Exhibit 7B

LIFE INSURANCE STATISTICS

Indian Population	1 Billion
GDP as on 2000 (Rs. bn)	20000 Billion
Gross domestic savings as a % of GDP	23%
NCAER estimate of insurable population	240
Estimated market by 2005	650 Million

Source : Indianfoline.com

From Social Angle

1. The change in life style and attitudes, shift to nuclear family system have urged the need for insurance.

2. The increasing literacy rate has resulted in chanelling of financial resource from savings to financial assets.
3. The life insurance convers can be used as collateral security for obtaining loans which positively affected the demand for life products.
4. The young population ratio is the highest in India which is likely to drive the demand for insurance.

From Macro-economic Angle

1. The average annual percentage growth of GDP is approximately 5% (exhibit 7C).
2. The infant norfality rate is improving *viz.*, 61.467 deaths/1000 live births compared to past (exhibit 7C)
3. The middle class is expanding and its per capita income is growing.
4. The percentage of financial assets in household savings is growing *viz.*, in 2000-01 it was 11% of the total household savings of 20.9%.

In addition to above, the private players and, also, LIC are coming out with new and innovative products whiach are likely to attract the potential customers.

Exhibit 7C

ECONOMIC AND SOCIAL INDICATORS

Population in millions, 2002	1045
Surface Area in 1000 Sq. kms.	3288
People per Sq. Km.	312
GNP in $ Billions 2002	320
Rank in the world by GNP	11
Average Annual Growth of NDP (%)	6.8
Average Annual % Growth of GDP	5
Public Expenditure on health % of GNP (1998)	0.6
Public Expenditure on Education % of GNP	3.2
Infant mortality per 1000 live births	61.467 deaths/ 1000 live births (2002)

Source : Census Statistics

DEMOGRAPHIC TRENDS AND PROJECTIONS-I**

	1996	*2001*	*2006*	*2011*
Total Population (Million)	934.22	1012.39	1094.13	1178.89
Urban Population (%)	27.23	28.77	30.35	31.99
Sex Ratio (Males per 100 Females)	107.9	107.2	106.6	106

DEMOGRAPHIC TRENDS AND PROJECTIONS-II**

	1996-2001	*2001-2006*	*2006-2011*
Growth Rate of Population (% pa)	1.62	1.57	1.5
Expectation of Life at Birth (Male/Years)	62.36	63.87	62.65
Expected of Life at Birth (Female/Years)	65.27	66.91	67.67

***Source* : Census Statistics.

Key Terms

- ❖ Assignment
- ❖ Lapse
- ❖ Nomination
- ❖ Revival
- ❖ Sum Assured
- ❖ Technical Account
- ❖ Insured Coverage Index
- ❖ Life Fund
- ❖ Premium
- ❖ Shareholder's Account
- ❖ Surrender Value

Suggested Readings

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Questions for Review

1. Briefly comment on the life insurance demand and out look in India context.
2. How risks are classified in life insurance? What are the various methods of treatment of sub-standard risks?
3. Write short notes on :
    1. Termination of agency
    2. Conditions and priviledges in life contract

4. Distinguish between :
   (*a*) Nomination and Assignment.
   (*b*) Maturity and Death Claim.
   (*c*) Money Back Policy and Endowment Policy.
5. Can a life insurance policy one issued be altered? If yes, how and one what basis?
6. Enumerate the conditions under which a claim may be paid within 3 years from the issue of policy.
7. Define surrender Value. Calculate the paid up value and surrender value of a policy on 01/03/2003 as per details below :

SA	Rs. 5,00,000
Plan and term	14-20
Mode of reminpayment	Annual
D.O.C.	10.08.90
F.U.P.	8/03

8. Calculate the amount payable from the following information :

Sum Assured	Rs. 5,00,000
Plan	75-20
Rider	Double Accident Benefit
Death of Assured due to accident	28/07/98
Date of commencement	01/08/86
Survival benefits paid	Rs. 1,00,000 (5th year) Rs. 1,00,000 (10th year)

9. Compute the premium for the following cases.

(*a*)	SA	Rs. 1,00,000
	Type	Endowment Policy with Profits
	Mode of Premium payment	Half yearly
	Adjustment factor for large SI and half yearly mode	Rs. 1.5 per thousand
	Tabular premium rate	Rs. 36.70 per thousand
	Accident Extra	1%
	Health Extra	0.5%
(*b*)	Type of cover	Whole Life
	SA	Rs. 60,000
	Proposer Age	45 years
	Period of cover	25 years
	DAB and EPDB	1%
	Table rate	Rs. 49.00 per thousand
	Adjustment factor for large SI	Rs. 1.50 per thousand
	Mode of Premium	Quarterly

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UNIT 4

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CHAPTER 8

FIRE INSURANCE

Fire insurance business in India is governed by the All India Fire Tariff, 2001 that lays down the terms of coverage, the premium rates and the conditions of the Fire Policy. Fire insurance policy is suitable for the owner of property, one who holds property in trust or in commission; individuals/financial institutions who have financial interest in the property. All immovable and movable property located at a particular premises such as buildings, plant and machinery, furniture, fixtures, fittings and other contents, stocks and stock in process along with goods held in trust or in commission including stocks at suppliers/customer's premises, machinery temporarily removed from the premises for repairs can be insured.

Fire insurance is a profitable business to the insurance companies in India. The growth rate in the fire insurance premiums in the last 6-7 years has been impressive till 1999-2000. The premiums were growing at the rate of 12.5% approximately. However, this growth came to a halt in the F.Y. 2000-01 when premiums declined by the equivalent rate. The net claims ratio reached a peak for almost all the insurance companies in the F.Y. 2000-01. Afterwards the fire insurance business has grown considerably especially due to the sudden burst of expansions in the industrial and housing sectors. It is estimated that while the Indian fire insurance premiums (rates) will go down compared to present where they are among the highest in the world, the growth is likely to be high in the near future.

8.1 Fire Insurance Contracts

Section 2(6A) of Insurance Act, 1938 defines "Fire insurance business" as "the business of effecting, otherwise than incidentally, to some other class of insurance business, contracts of insurance against loss by incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies."

The contract of fire insurance is similar to other contracts and comes into being when a person seeking insurance protection enters into a contract with the insurer to indemnify him against the loss of property by or incidental to fire and or lighting, explosion etc.[1] There is no statutory enactment for regulation of fire business in India akin to Marine insurance which is governed by the Indian Marine Insurance Act, 1963.

Features of a Fire Insurance Contract

(*a*) *It is personal in nature* : It does not ensure the safety of the insured property. Its purpose is to see that the insured does not suffer loss by reason of his interest in the insured property. So it is personal in nature in the sense that it involves the payment of money if the loss occurs.

(*b*) *Cause of fire is immaterial* : The insurer irrespective of the cause of fire will reimburse the loss due to fire. The doctrine of cause proxima applied unless there is a suspicion of fraud or wilful act or otherwise falling outside the scope of the contract.

(*c*) *Indivisibility* : The fire insurance contract covers the fire losses in whole and generally indivisible unless specifically provided by the contract.

[1] Insurance Law & Practice, Taxmann, 2001, p. 197.

Application of Insurance Principles to Fire Insurance

Insurable Interest

Ownership is a conclusive evidence of an insurable interest. Where the property is charged or mortgaged to a financier as security, the financier acquires insurable interest. The insurable interest in fire insurance must exist at the time of cover, continue throughout its currency and should exist at the time of loss. In case the subject matter of insurance is transferred, the policy does not transfer automatically, it must be agreed by the insurer and endorsed on the policy document.

Indemnity

The indemnity for loss or damage suffered is the reinstatement or the market value. In case of property, market value or the reinstatement value is used. However, stocks are valued on the basis of market value. The sum insured should always represent the true value of the property.

Utmost Good faith

The insured is bound to disclose all material facts to the insurer, which have a bearing on the contract. If the subject matter of insurance is materially altered, the insured should give notice the insurer immediately. The guiding principle states that the insured should assume as if uninsured all times and accordingly is bound to take care of the insured property always.

Subrogation and Contribution

The insurers are entitled to subrogation rights when they have indemnified the losses to the insured and can proceed to recover the losses from third parties. In case the property has been insured from more than one insurer, the rateable proportion shall apply in the event of claims.

8.2 Fire Insurance Coverages

8.2.1 Standard Fire Policy

The fire insurance policy has been nomenclatured Section II of the All India Fire Tariff as Standard Fire and Special Perils Policy. The standard risks covered, add-on covers, exclusions, conditions as prescribed by the tariff are described as follows[2] :

Standard Risks

Fire

Destruction or damage to the property insured by its own fermentation, natural heating or spontaneous combustion or its undergoing any heating or drying process cannot be treated as damage due to fire. For *e.g.*, paints or chemicals in a factory undergoing heat treatment and consequently damaged by fire is not covered. Further, bring of property insured by order of any Public Authority is excluded from the scope of cover.

Lightning

Lightning may result in fire damage or other types of damage, such as a roof broken by a falling chimney struck by lightning or cracks in a building due to a lightning strike. Both fire and other types of damages caused by lightning are covered by the policy.

[2] www.timesofmoney.com

Explosion/Implosion

Explosion is defined as a sudden, violent burst with a loud report. An explosion is caused inside a vessel when the pressure within the vessel exceeds the atmospheric pressure acting externally on its surface. An explosion may cause fire damage or concussion damage. An implosion means bursting inward or collapses. This takes place when the external pressure exceeds the internal pressure. This policy, however, does not cover destruction or damage caused to the boilers (other than domestic boilers), economisers or other vessels in which steam is generated and machinery or apparatus subject to centrifugal force by its own explosion/implosion. These risks can be covered in a Boiler and Pressure Plant Insurance Policy, which is specially designed to handle these risks.

Aircraft Damage

The loss or damage to the property (by fire or otherwise) directly caused by aircraft and other aerial devices and/or articles dropped there from is covered. However, destruction or damage resulting from pressure waves caused by aircraft travelling at supersonic speed is excluded from the scope of the policy.

Riot, Strike, Malicious and Terrorism Damage

The act of any person taking part along with others in any disturbance of public peace (other than war, invasion, mutiny, civil commotion etc.) is construed to be a riot, strike or a terrorist activity. 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 or minimising its consequences is covered. Further the wilful act of any striker or locked out worker, in connection with a strike or a lock out, or the action of any lawful authority in suppressing such act, resulting in visible physical damage by external means, is also covered. Malicious act would mean an act with malicious intent but excluding omission of any kind by any person, resulting in visible physical damage to the insured property, whether or not the act is committed in the course of disturbance of public peace or not. Burglary, housebreaking, theft or larceny does not constitute a malicious act for the purpose of this cover. Total or partial cessation of work or the retarding or interruption or cessation of any process or operations; or, permanent dispossession resulting from confiscation, commandeering, requisition or destruction by order of the Government or any lawfully constituted authority; or permanent or temporary dispossession of any building or plant or unit or machinery resulting from the unlawful occupation by any person of the same or prevention of access to the same, are not covered.

Storm, Cyclone, Typhoon, Tempest, Hurricane, Tornado, Flood and Inundation

Storm, Cyclone, Typhoon, Tempest, Tornado and Hurricane are all various types of violent natural disturbances that are accompanied by thunder or strong winds or heavy rainfall. Flood or Inundation occurs when the water rises to an abnormal level. Flood or inundation should not only be understood in the common sense of the terms, *i.e.,* flood in river or lakes, but also accumulation of water due to choked drains would be deemed to be flood.

Impact Damage

Impact by any Rail/Road vehicle or animal by direct contact with the insured property is covered. However, such vehicles or animals should not belong to or owned by the insured or any occupier of the premises or their employees while acting in the course of their employment.

Subsidence and Landslide Including Rockslide

Destruction or damage caused by Subsidence of part of the site on which the property stands or Landslide/Rockslide is covered. While Subsidence means sinking of land or building to a lower level, Landslide means sliding down of land usually on a hill. However, normal cracking, settlement or bedding down of new structures; settlement or movement of made up ground; coastal or river erosion; defective design or workmanship or use of defective materials; and demolition, construction, structural alterations or repair of any property or ground-works or excavations, are not covered.

Bursting and/or Overflowing of Water Tanks, Apparatus and Pipes

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

Missile Testing Operations

Destruction or damage due to impact or otherwise from trajectory/projectiles in connection with missile testing operations by the Insured or anyone else, is covered.

Leakage from Automatic Sprinkler Installations

Damage caused by water accidentally discharged or leaked out from automatic sprinkler installations in the insured's premises is covered. However, such destruction or damage caused by repairs or alterations to the buildings or premises; repairs removal or extension of the sprinkler installation; and defects in construction known to the insured, are not covered.

Bush Fire

This covers damage caused by burning, whether accidental or otherwise, of bush and jungles and the clearing of lands by fire, but excluding destruction or damage caused by Forest Fire.

The policy may be extended to cover earth quake, fire and shock; deterioration of stock in the cold storages following power failure as a result of insured peril, additional expenditure involved in removal of debris, architect, consulting engineers' fee over and above the amount covered by the policy, forest fire, spontaneous combustion and impact damage due to own vehicles. In case of a partial loss, Insurance Company shall effect payment for repairs and replacement. In case of policy with reinstatement value clause, cost of reinstatement will be paid on completion of reinstatement subject to overall limit of the sum insured. Insurance company may at its option, also repair or replace the affected property instead of paying for the cost of restoration.

Exclusions

This policy does not cover :

1. 5 per cent of each and every claim resulting from lighting/ storm/tempest/flood/inundation/subsidence and landslide including rockslide covered under the policy.
2. Loss destruction or damage caused by war, invasion, act of foreign enemy hostilities or warlike operations (whether war is declared or not), civil war, mutiny, civil commotion assuming the proportions of or amounting to a popular rising, military rising, rebellion, revolution, insurrection or military or usurped power.

3. Loss, destruction or damage directly or indirectly caused to the property insured by :
   - Ionising radiations or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel.
   - The radioactive toxic, explosives or other hazardous properties of any explosive nuclear assembly or nuclear component thereof.
4. Loss, destruction or damage caused to the insured property by pollution or contamination excluding :
   - Pollution or contamination which itself results from a peril hereby insured against.
   - Any peril hereby insured against which itself results from pollution or contamination.
5. Loss, destruction or damage directly to solution or unset precious stones curios, works of art for an amount exceeding Rs. 10,000, manuscripts plans, drawings, securities, obligations or documents of any kind stamps, coins or paper money, cheques, books of accounts or other business books, computer systems, records, explosives unless otherwise expressly stated in the policy.
6. Loss, destruction or damage to the stocks in cold storage premises caused by change of temperature.
7. Loss, destruction or damage to any electrical and/or electronic machine, apparatus, fixture or fitting (excluding fans and electrical wiring in dwellings) arising from or occasioned by over-running, excessive pressure, short circuiting, arcing, self-heating, or leakage of electricity, from whatever cause (lightning included).
8. Expenses necessarily incurred on : (*i*) Architect's surveyor's and consulting engineer's fees and (*ii*) Debris removal by the insured following a loss, destruction or damage to the property insured by an insured peril in excess of 3 per cent and 1 per cent of the claim amount, respectively.
9. Loss of earnings, loss by delay, loss of market or other consequential or indirect loss or damage or any kind or description whatsoever.

The clauses covered above are subject to the normal general conditions of the insurance company.

Add-on Covers

The insurers 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. These added benefits or add-on covers are as follows :

- Architect's, surveyor's and consulting engineer's fees (in excess of 3 per cent claim amount).
- Debris removal (in excess of 1 per cent of claim amount).
- Deterioration of stocks in cold storage premises due to power failure following damage due to an insured peril.
- Forest fire.
- Impact damage due to insured's own vehicles, forklifts and the like and articles dropped therefrom.
- Spontaneous combustion.

- Omission to insure additions, alterations or extensions.
- Earthquake (fire and shock) as per minimum rates and excess applicable as specified in the Tariff.

In respect of the above add-on covers. The insurance company will compulsorily deduct 5 per cent of each claim before paying the claim proceeds to the insured.

The standard policies exclude certain perils from the scope of cover. The main reasons for the exclusions are :

(*i*) To restrict the cover to normal coverage required by the typical or average insured. Personal Accident Policy which provides for the agreed benefits to be paid under certain specified Contingencies, does not cover medical expenses, which can be included on payment of an additional premium. Similarly, Workmen Compensation Policy indemnifies the insured against his liability at law to his direct employees, and provides for the Insureds legal liability to employees of sub-contractor to be included by payment of premium at a tariff rate on the wages payable to workmen of sub-contractor. Similarly, policy can be extended to cover medical expenses, and the diseases specified in Part III of the Schedule C on payment of an additional premium.

(*ii*) To exclude loss which are of an extra-ordinary or catastrophic nature, *e.g.*, the earthquake peril for locations involving storage of materials, and industrial/manufacturing risks. In view of concentration of material, property involving huge sum insured, perils of earthquake, and/or flood etc. Could cause losses which might assume proportion of a catastrophe. While for residences, offices, shops and for Tiny Sector, etc., these perils (of earthquake and flood, etc.) are offered as in-built perils, as for these risks, perils of earthquake and flood may not cause catastrophic losses.

(*iii*) To precisely define and clarify the scope of cover. For example, to prevent disputes in the event of a loss which is akin to fire but is not within the meaning of the policy, spontaneous combustion is excluded under fire policy.

(*iv*) To exclude risks which may be accepted after obtaining more underwriting information or arranging inspection, *e.g.* flood risk in fire insurance, pollution cover under public liability policy, and cover for exports under Products Liability Policy.

(*v*) To exclude losses which are convertible under other policies. This eliminates duplication of coverage. For example, the general public liability policy excludes liability arising out of the use of Motor Vehicle, because a Motor Third Party Policy is available. Similarly, Plate Glass Policy does not cover loss of or damage by fire, which can be covered separately under a Fire Insurance Policy.

(*vi*) To exclude risks which cause losses of high degree of frequency, *e.g.* the risks of larceny under Burglary (Business Premises) Policy, and shortages, which are discovered at periodic stock taking.

(*vii*) To exclude loss which are caused intentionally, *e.g.*, suicide under personal accident policies.

(*viii*) To exclude losses, which are inevitable, *e.g.* wear and tear and depreciation under motor policies and 'inherent vice' under marine cargo policies.

(*ix*) To exclude losses which are commercially uninsurable *e.g.* war and nuclear risks.

(*x*) The standard policies may also exclude certain classes of property from the coverage. For example, the fire policy excludes certain classes of property, *e.g.* documents, coins, paper

money, books of account, unless expressly stated in the policy. The intention is to ascertain the existence of such property and, if necessary to include certain classes of property in the coverage subject to special terms and conditions. Similarly curios, works of art, paintings can be covered after obtaining valuation report, from the Director of Museum and stamps collection can be covered on production of valuation certificate from Philatelic Society.

8.2.2 Standard Policy Coverages

The tariff Advisory Committee has prescribed three types of fire coverages *viz.*, Policy A, Policy B and Policy C.

Policy A

Fire Policy A covers the following perils–(*i*) fire, (*ii*) lightning, (*iii*) explosion/implosion, (*iv*) impact damage, (*v*) aircraft damage, (*vi*) riot, strike and malicious and terrorist damage, (*vii*) storm, cyclone, tempest, hurricane, tornado, flood and inundation, (*viii*) earthquake, (*ix*) subsidence and landslide (including rockslide).

Only Policy A can be issued to cover artisans workshops, bio-gas plants, village and cottage industries, tiny sector or small scale industries.

Policy B

Fire Policy B covers the perils–(*i*) fire, (*ii*) lightning, (*iii*) explosion/implosion, (*iv*) impact damage (*v*) aircraft damage, (*vi*) riot, strike and malicious and terrorist damage. (The cover is similar to Policy C).

The tariff permits exclusion of riot, strike and malicious and terrorist damage perils, with specified reduction in the premium rate under the policy.

Policy C

Fire Policy (Policy 'C') is issued to cover industrial/manufacturing risks and storage risk and covers–(*i*) fire, (*ii*) lightning (*iii*) explosion/implosion, (*iv*) impact damage, (*v*) riot, strike and malicious and terrorist damage.

The riot, strike and malicious and terrorist damage perils can be excluded on specific request with an agreed reduction in the premium rate.

The fire policy C may be extended to cover special perils on payment of extra premium. These special perils are :

(*a*) Spontaneous combustion

(*b*) Earthquake (shock and fire)

(*c*) Storm tempest, flood and inundation

(*d*) Subsidence and landslide

(*e*) Accident Leakage or contamination of oil

(*f*) Spoilage of stock/machinery due to interruption of process of manufacture by insured perils

(*g*) Deterioration of stocks due to power failure following damage to premises of Public Power Stations

(*h*) Bursting/overflowing of water tanks, apparatus and pipes

(*i*) Sprinkler leakage

(*j*) Bush or forest fire

(*k*) Subterranean fire

(*l*) Missile testing operations cover.

Fire Policy A and B (Simple Risks) : Fire Policy A and B are issued in respect of dwellings, offices, hotels and shops, educational institutions, etc.

8.2.3 Special Coverages

Apart from standard coverages, fire, policy may also be issued to meet the specific requirements of clients. Some of these are :

(*a*) Reinstatement Value Polices

(*b*) Stock Policies

(*c*) Consequential Loss Policies

These are detailed in the following sections.

8.3 Reinstatement Value Policies

In this policy, attaching the Reinstatement Value Clause of the fire policy modifies the basis of settlement of claims. Under the latter policy, losses are settled on the basis of market value of the property on the date of fire. This value, which takes into account depreciation, wear and tear, etc. will not be found adequate by the insured who desires to replace the property by a new one of the same kind, type of capacity. *This policy is issued in respect of building, plant, machinery, furniture & fixtures, fittings etc.*

Under the policy, the insurers pay, not the depreciated value (*i.e.* market value) but *the cost of replacement of the damaged property by new property of the same kind*. The advantages are obvious–during inflationary periods the new reinstatement value is far higher than the depreciated value. The sum insured is required to reflect the new replacement value and not the market value as under the normal fire policy. The reinstatement value clause of the policy places liability on the insured to complete the reinstatement work within 12 months of the loss/damage. Else, the claim will be settled on the basis of normal indemnity (market value). Also of the cost of reinstatement > Sum Insured, the rateable proportion applies.

8.4 Policies for Stocks

There are three types of policies for stocks.

8.4.1 Floater Policies

Stocks at various locations can be covered under one sum insured by floater policies, since these policies take care of frequent changes in sum insured at various locations.

These policies may be issued to cover stocks in one amount situated in a more than one specified building situated (1) within the limits of one city/town/village, (2) more than one city/village/town but upto 50 locations, (3) for more than 50 locations in various cities/towns/villages. The Floating policies are not issued in respect of immovable property nor are they issued to Transport Contractors and Cleaning and Forwarding Agents.

Floating policies for risks situated within the limits of one city/town/village may be issued by charging 25% loading over and above the highest rate applicable to any one risk. 50% loading over and above the highest rate applicable to any one risk is charged under Policies covering upto 50 locations in more than one city town/village.

The maximum sum insured at any one location should not be more than 10% of the total sum insured. It is essential that the insured should have a good internal audit and accounting procedure under which total amount of risk and locations can, if required, be established. The condition of average is applied to the limit of sum insured at each location, and also to the total sum insured under the policy.

A policy issued to cover in one amount, more than 50 locations in various cities/towns/villages is subject to the undernoted regulations :

Total sum insured in respect of all locations should not be less than Rs. 3 crores.

The maximum sum insured at any one location should not be more than 10% of the total sum insured.

The address of the locations should be declared to the company, at the inception, and changes advised as and when they occur. However, when locations cannot be identified or change is very frequent, the requirement of specifying address of locations is relaxed, but the number of unspecified locations should not exceed 10% the total number of locations, or 20 locations whichever is lower.

The insured should have a good internal audit and accounting procedure to establish total amount at risk and locations at a particular time.

The pro-rata conditions of average is applied to the limit of sum insured at each location and also to the total sum insured under the policy.

8.4.2 Declaration Policies

Declaration policies are useful to businesses, which face frequent fluctuations in stock quantity or value. Insurance companies can issue these policies subject to the following conditions.

- The minimum sum insured is Rs. 1 crore.
- Monthly declarations based on the average of the highest value at risk on each day or highest value on any day of the month are to be submitted by the insured to the insurer.
- Reduction in sum insured is not allowed under the policy.
- The insured cannot claim refund of premium on adjustment based on the declarations in excess of 50 per cent of the total premiums.
- The basis of value for declaration shall be the market value prior to the loss or as otherwise agreed to between the insurance company and the insured.

Exclusions

Declaration policies cannot be issued in respect of insurance required for a short period stocks undergoing process and stocks at railway sidings. Also, these policies are not sanctioned to (a) Transport contractors and Forwarding and clearing agents (b) in respect of stock-in-process (c) insurances for short period.

Advantages

(1) The premium is limited to the actual amount of risk irrespective of the sum insured.

(2) The liability of the insurer is concurrent under the policy.

(3) Provision for adjustment of premium is an incentive to the insured to effect cover for the maximum amount.

Example

Assume that the sum insured is Rs. 1,00,00,000 and the rate per mille is Re. 1.20. The insured is liable to pay a provisional premium of Rs. 12,000. Now, if the aggregate of monthly declarations comes out to be Rs. 13,20,00,000. The average monthly declaration value will be Rs. 1,10,00,000 (Rs. 13,20,00,000/12). Accordingly, the premium on the policy will be Rs. 13,200 (Rs. 1,10,00,000 × 1.20). The additional premium to be borne by the insured will be Rs. 1,200.

8.4.3 Floater Declaration Policies

These policies combine the features of the floater and declaration policies. All rules relating to Floater Policies and Declaration Policies shall apply here except :

- The minimum premium retention of the insurance company shall be 80 per cent of the annual premium.
- Minimum sum insured is Rs. 2 crore.

8.5 Consequential Loss Policies

Coverage and Suitability : This policy is suitable for business establishments and corporate for whom business interruption would mean heavy monetary loss in view of huge fixed costs. Fire consequential loss policy provides cover for expenses and increased cost of working as a result of business interruption following a loss covered by the fire policy. Insurance cover can be taken for the maximum period of the anticipated interruption in the event of loss. In addition, the supplier's and the customer's premises on which the business is dependent, cost of auditors fee (required to submit the monetary claim) can also be insured.

Because of the business interruption following a loss, there may be a reduction in turnover and this may affect the anticipated gross profit. Fixed costs are to be incurred immaterial of the production activity. Consequential loss policy covers reduction in gross profit due to business interruption. The additional expenditure necessarily incurred for avoiding or reducing the fall in turnover during the interruption period is covered under this policy. Also, there are overhead expenses of running the business such as salaries, wages, taxes, interest etc. which continue to be incurred inspite of the interruption of the production.

Premium : Premium chargeable depends on the type of industry/business, the anticipated gross profit, indemnity period chosen and additional covers required. Refund of premium (not exceed-

ing 50%) can be claimed based on the actual gross profit figures as per the audited balance sheet after the expiry of the policy.

Basic fire policy to cover the assets at the business premises is a prerequisite. For claiming benefits under this policy the *loss* should first be admitted under the fire policy. Amount of gross profit required to be insured, the indemnity period, details of the business premises to be covered and additional covers required shall be provided in the proposal form.

Advantage

In case of major fire loss, the business operations get interrupted resulting in reduced turnover and eventually in loss of profits. It is a well known fact that fixed or standing charges have to be incurred immaterial whether there has been any production or not. All these are not covered by the normal fire policy. It is here that the consequential loss policy comes into force. Thus, for overall protection to the business and its profitability, consequential policy is necessary in addition to the fire insurance policy.

8.6 Rate Fixation in Fire Insurance

The rate of fire insurance is prescribed by All India Fire Tariff. Insurers may charge rate higher than the tariff rates. The computation of rate is done in the following manner :

(*a*) Base rates are arrived for the class of property

(*b*) Reduction in rates is allowed for deletion of STF1 and/or RSMTD perils, if opted not to be included

(*c*) Extra tariff is added for Hazardous Assets

(*d*) Discount is allowed for claims experience

(*e*) Further discount is allowed for betterment of risks

The rates of insurance generally depend upon the nature of physical hazards, classification of risks, loss experience and nature of risks. Following considerations are taken into account while fixing premiums :

- Premium rating depends on the type of occupancy-whether industrial or otherwise.
- All property located in an industrial complex will be charged on rate depending on the product(s) made.
- Facilities outside industrial complexes will be rated depending on the nature of occupancy at individual location.
- Storage areas will be rated based on the hazardous nature of goods held.
- Additional premium is charged to include "Add on" covers.
- Discount in premium is given based on past claims history and fire protection facilities provided at the premises.
- The insured can also opt out riot, strike, malicious and terrorism damage covers and flood group and perils for reduction in premium.

The risks are classified as simple risks, Industrial/Manufacturing risks, Utilities, Storage risks, Tank farms/Gasholders Risks (Section III–VII of the tariff).

8.6 Fire Insurance Documents

Proposal Form

The proposal form contains the following information :

- Details of the proposer–location details, nature and location of risk, nature of business, financial performance, claims history, existing insurances etc.
- Type of coverage–inclusions and exclusions opted for
- Details of subject matter of insurance
- Sum Insured–computation basis and basis of indemnity.
- Insured Declaration/Authentication
- Risk inspection report
- *Cover note*
- A cover note is issued pending issue of policy. It contains the following information :
  - Proposer details
  - Sum Insured
  - Details of risk covered
  - Details of premium
  - Date of issue and validity
  - Date of commencement and expiry of cover
  - Authentication
  - Warranties and clauses

Policy Document

The fire policy must follow the format prescribed by the tariff. It contains the all the information as contained in the cover note as mentioned above. In addition, it contains the endorsement and alterations made to the policy.

8.7 Settlement of Claims

In the event of claim, the insured is required to give a notice of loss to the insurers and submit proofs and particulars of loss. The onus of proof that the loss occurred due to the insured peril is of the insured. The insurers are also duty bound to minimise the losses and to take all reasonable steps to minimise losses. The following steps are generally followed when the fire insurance claim is processed :

1. *Verification*–that the policy was in force, the loss reported is the subject matter of insurance and the loss occurred due to the operation of insured peril.
2. *Allotment of claim number*–the claim is entered in the claims register and a number is allotted which inter alia contains the estimate of loss and the surveyors deputed for the purpose.
3. *Issue of claim form*–a claim form is issued to the insured for due completion and submission to the insured.

4. *Appointment of surveyors*–the surveyors are appointed to estimate the amount of loss, investigate the cause of loss and actually enquire as to the genuineness of the claim.
5. *Preliminary report*–the surveyors submit the brief (first) report to the insured.
6. *Final report*–based on facts and response to the preliminary report the surveyor to the insurer submits a detailed report of the loss.
7. *Adjustment*–the claim is adjusted for premium due etc. and the discharge voucher is submitted by the insured to the insurer.
8. *Payment of claims*–after receipt of discharge vouchers and other documents, the claim is paid to the insured and the entries are made in the claims register.

Key Terms

- Add-on-cover
- Consequential Loss
- Declaration Policies
- Floater Policies
- Reinstatement Value Policies

Suggested Readings

- *Fire and Consequential Loss Insurance,* IC 57, Insurance Institute of India, Mumbai 2001.
- *IRDA Annual Report 2001-02.*
- *Insurance Law Manual,* Taxmann, 2001.
- *All India Fire Tariff prescribed by Tariff Advisory Committee.*

Questions for Review

1. Define fire insurance. Explain the important features of a standard fire policy.
2. Write short notes on :
   (*a*) Fire Extinguishing Appliance Discount
   (*b*) Dual Basis of Wages Insurance
   (*c*) Debris Removal Clause.
3. Briefly explain the various underwriting considerations in fire insurance business.
4. Discuss the importance of "depreciation factor" in fire insurance loss assessment.
5. Explain how basis rate are arrived at under the Consequential Loss (Fire) cover?
6. Distinguish between :
   (*a*) Standard Fire Policy and Reinstatement Value Policy
   (*b*) Floater and Declaration Policies
   (*c*) Originating Factors vs. Contributory Factors.

CHAPTER 9

MARINE INSURANCE

Insurance on the risks of transportation of goods is one of the oldest and most vital forms of insurance. The value of goods shipped by business firms each year cost millions of rupees. These goods are exposed to damage or loss from numerous transportation perils. The goods can be protected by ocean marine and inland marine contracts. Ocean marine insurance provides protection for goods transported over water. All types of ocean going vessels and their cargo can be insured by ocean marine contracts, the legal liability of ship owners and cargo owners can also be insured. Inland marine insurance provides protection for goods shipped on land. It includes insurance on imports and exports, domestic shipments, and means of transportation such as bridges and tunnels. In addition, inland marine insurance can be used to insure fine art, jewellery, fur and other properties.

9.1 Marine Insurance Contract

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured in a manner and to the extent thereby agreed, against marine losses, that is, the losses incidental to marine adventure. Marine insurance cover gives financial protection from total loss or partial damage of sea going ships and cargoes. In return for the payment of a premium, the underwriter of a marine risk or 'line' insures the ship owner, ship–charterer or merchant, for part or the whole value of a ship or cargo. Freight charges paid in advance may be insured by the ship-owner. Each type of marine insurance requires an assessment of the nature, size are value of the risk and the underwriter calculate his premium according to the quality of the ship or cargo and the destination and route of the voyage at risk. Marine insurance contracts are amongst the least charging and most familiar of all types of risk business. *There is a marine adventure when any insurable property is exposed to marine perils.* Marine perils also known as perils of the seas, means the perils consequent on, or incidental to, the navigation of the sea or the perils of the seas, such as fire, war perils, pirates, rovers, thieves, captures, Jettisons, barratry and any other perils which are either of the like, kind or may be designed by the policy.

9.2 Insurance Principles Applied to Marine Business

Utmost Good Faith

The insured to bound to disclose all material facts to the insurer before the contract is entered into.

Example

If an equipment is transported and insurance cover was obtained as such implying as is a new one and actually the equipment is one which has been renovated, the insurer may cancel the contract as it was a concealment of fact.

However, if there is certain information, which reduces the exposure, to the insurer or which the insurer is bound to have known or waived *suo moto,* the contract is valid.

Insurable interest

The insured may not have insurable interest at the time of contract, but he must have a reasonable expectation of acquiring it and it must exist at the time of loss. As per the provisions of the

Marine Insurance Act, 1963, every person has an insurable interest who is interested in a maritime adventure". The insurable interest may be :

(*a*) *Defeasible*–which is brought to an end by during the tenure of the voyage by occurrence of an event other than maritime perils. For example–cessation of insurable interest of the seller upon the transfer of title to the buyer.

(*b*) *Contingent*–which attaches during the tenure of the voyage on the happening of the contingent event. For example when the goods are sold on FOB terms to the buyer, when the goods are loaded on the vessel, the seller interest terminates, but if the goods are returned by the buyer, the interest again attaches for the seller.

Indemnity

The indemnity for the insurance contract is "in manner and to the extent thereby agreed". The indemnity depends on the contact. In case of valued policies, the measure of indemnity is the agreed value. However, in case of unvalued policies, unless provided, the indemnity has to be calculated as per the provisions of the Section 18 of the Marine Insurance Act, 1963.

Subrogation

The insurer on the payment of claims for losses which may be partial or total, is subrogated to all the rights and remedies of the assured in respect of the subject matter insured. A letter of subrogation is generally taken from the insureds when claims are paid, in situations where the recovery is possible from third parties.

Contribution

When for the same subject matter of marine insurance, there are more than one policy such that sums insured exceed the indemnity allowed by the act, the assured shall be deemed to be cover insured and rateable proportion shall apply to such cases.

Warranties

Warranties, common to marine insurance contracts are the promises by the insured that something shall be done or shall be done or a certain state of affairs exist or do not exist. The logical reason for imposing warranties by the insurers is to safeguard their interest from hazards and they can avoid liability in case of breach.

9.3 Types of Marine Insurance[1]

The two broad categories of marine insurance are–ocean marine insurance and inland marine insurance.

9.3.1 Ocean Marine Insurance

Ocean marine insurance is one of the forms of transportation insurance. The ocean marine contracts are incredibly complex, reflecting basic marine law, trade customs, and court interpretations of the various policy provisions. Ocean marine insurance can be divided into four basic classes to reflect the various insurable interests :

[1] Marine Insurance, Insurance Institute of India, pp. 1-12.

Hull Insurance covers physical damage to the ship or vessel. It is similar to collision insurance that covers physical damage to a automobile caused by collision. Hull insurance is always written with a deductible. In addition, it contains a collision liability clause that covers the owner's legal liability if the ship collides with another vessel or damages its cargo. However, the running down clause does not cover legal liability on that vessel arising out of injury or death to other persons, damage to piers and docks, and personal injury and death of crew members.

Cargo Insurance covers the shipper of the goods if the goods are damaged or lost. 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. The shipper is required to report periodically the number of shipments that are made. The open-cargo policy has no expiration date and remains in force until it is cancelled.

Protection and Indemnity (P&I) Insurance is usually written as a separate contract that provides comprehensive liability insurance for property damage or bodily injury to third parties. P&I insurance protects the ship owner for damage caused by the ship to piers, docks and harbour installations, damage to the ship's cargo, illness or injury to the passengers or crew, and fines and penalties.

Freight Insurance indemnifies the ship owner for the loss of earnings if the goods are damaged or lost and are not delivered.

Ocean marine insurance has certain fundamental concepts :

Covered Perils : an ocean marine policy provides broad coverage for certain specified perils, including perils of the sea, such as damage or loss from bad weather, high waves, collision, sinking, and stranding. Other covered perils include loss from fire, enemies, pirates, thieves, jettison (throwing goods overboard to save the ship), barratry (fraud by the master or crew at the expense of the ship or cargo owners), and similar perils. Ocean marine insurance can also be written on an "all-risks" basis. All unexpected and fortuitous losses are covered except those losses specifically excluded. Common exclusions are losses due to delay, war, inherent vice (tendency of certain types of property to decompose), and strikes, riots, or civil commotion.

Particular Average : in marine insurance the word average refers to a partial loss. A particular average is a loss that falls entirely on a particular interest, as contrasted with a general average, a loss that falls on all parties to the voyage. Under the free of particular average clause (FPA), partial losses are not covered unless the loss is caused by certain perils, such as stranding, sinking, burning or collision of the vessel. The FPA clause can be written with franchise deductible, where the franchise amount is stated as a percentage of the insured property. Thus, an FPA clause of 3% means that a covered loss under 3% falls entirely on the insured; if the loss is 3% or more, the insurer pays the loss in full.

General Average : a general average is a loss incurred for the common good and consequently is shared by all parties to the venture. Each party must pay its share of the loss based on the proportion that its interest bears to the total value in the venture. Four conditions must be satisfied to have a general average loss :

- *Necessary* : the sacrifice is necessary to protect all interests in the venture–ship, cargo, and freight.
- *Voluntary* : the sacrifice must be voluntary.
- *Successful* : the effort must be successful. At least part of the value must be saved.

- *Free from Fault* : any party that claims a general average contribution from other interests in the voyage must be free from fault with respect to the risk that threatens the venture.

Sue and Labour : under this the insured is required to do everything possible to save and preserve the goods in case of loss. The insured who fails to do this has violated a policy condition, hence loses the rights of recovery.

Abandonment : in ocean marine insurance, two types of total losses are recognized : actual and constructive. Actual total loss occurs when the property is completely destroyed. Constructive total loss occurs when, even though the ship or other subject matter of insurance is not totally destroyed, it would cost more to restore it than it is worth. The ship may be abandoned to the insurer and the insured collects the full amount of the policy. The salvage then belongs to the insurer, who is usually in a better position to dispose of it than the insured because the insurer deals with salvage companies all over the world and is experienced in such matters.

Warehouse to Warehouse : under the terms of the warehouse to warehouse clause, such protection as is afforded under the insuring agreement extends from the time the goods leave the warehouse of the shipper, even if it is located far inland, until they reach the warehouse of the consignee.

Coinsurance : although an ocean marine policy does not contain a specific coinsurance clause, losses are settled as if there is a 100 percent coinsurance clause. An ocean marine policy is a valued contract, by which the face amount is paid if a total loss occurs. If the insurance carried does not equal the full value of the goods at the time of loss, the insured must share in the loss.

Warranties : there are two types of warranties in marine insurance : express and implied. Express warranties are written into the contract and become a condition of the coverage relating to potential causes of an insured event. And can be of the type free of capture and seizure warranty (FC&S), strike, riot and civil commotion (SR&CC), delay warranty and trading warranty. Implied warranties are not written into the policy but become a part of it by custom. Breach of warranty in marine insurance voids the coverage, even if the breach is immaterial to the risk. It can be of types of seaworthiness, deviation and legality.

9.3.2 Inland Marine Insurance

Inland marine insurance grew out of ocean marine insurance. Ocean marine insurance first covered property from the point of embarkation to the place where the goods landed. As commerce and trade developed, the goods had to be shipped over land as well. Inland marine insurance developed in the 1920s to cover property being transported over land, means of transportation such as bridges and tunnels, and property of a mobile nature.

Commercial property that can be insured by inland marine contracts can be conveniently classified into five categories :

- Domestic Goods in Transit.
- *Property Held by Bailees* : bailees are legally liable for damage to customer's property only if they or their employees are negligent.
- *Mobile Equipment and Property* : inland marine property floaters can be used to cover property that is frequently moved from one location to another.
- *Property of Certain Dealers* : certain "block" policies are used to insure dealers. Most policies provide coverage on an "all-risks" basis.

- *Means of Transportation and Communication* : this refers to property at a fixed location that is used in transportation or communication.

For purposes of regulation, inland marine contracts are classified into two categories; *filed forms* and *nonfiled forms*. With filed forms, the policy forms and rates are filed with the state insurance department. Filed forms are typically used in situations where there are a large number of potential insureds and the loss exposures are reasonably homogenous. In contrast, non-filed forms refer to policy forms and rates that are not filed with the state insurance department. Nonfiled forms are used in situations where the insured has specialized or unique needs, the number of potential insureds is relatively small, and the loss exposures are diverse.

9.4 Marine Insurance in India

There is evidence that marine insurance was practised in India some three thousand years ago. In earlier days travellers by sea and land were exposed to risk of losing their vessels and merchandise because of piracy on the open seas. Moreland has maintained that the practice of insurance was quite common during the rule of Akbar to Aurangzeb, but the nature and coverage of insurance in this period is not well known. It was the British insurers who introduced general insurance in India, in its modern form. The Britishers opened general insurance in India around the year 1700. The first company, known as the Sun Insurance Office Ltd. was set up in Calcutta in the year 1710. This followed by several insurance companies of different parts of the world, in the field of marine insurance. In 1972, the government of India nationalized the general insurance business by forming GIC.

9.5 Marine Insurance Policies[2]

Marine insurance policies cover risks associated with transhipments of goods like :

1. Transit of heavy goods such as rail engines by shipping vessels or
2. Consignment of diamonds sent by post or
3. Movement of household goods by rail/road/air.
4. Risks vary with the type of business transacted whether it is by importers, exporters or trading house.
5. Some form of life and transit risks is still undertaken by Indian Posts & Telegraphs Dept.

Salient Features

- The striking features of Marine Insurance policies is that they are issued on 'agreed value basis'.
- The values agreed may include all expenses incurred or to be incurred and some amount of profit margins as well. As such the valuation of the consignment is important and it should be based on supporting evidence.

The contracts can be supply of goods on :

1. Ex-factory/godown/warehouse basis

[2] www.insuremagic.com

2. F.O.B. basis (free on board-values arrived at, may include sale price, packing and incidentals, insurance and freight for local transit until goods are placed on the ocean going vessel)
3. F.O.R. (values until placed on railway wagon as in the case of FOB)
4. C & F (cost and freight values as in CIF, except the insurance costs)

C.I.F. (cost insurance and freight would be sale price and incidental charges, insurance charges from warehouse to warehouse basis or any other point of delivery and all freight charges).

Types of Policies

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

Voyage Policy

The voyage policy is issued to cover up a specific transit from a particular point to another. The cover ceases upon the carrier reaching the town of destination. In all the policies, the scope of cover can be :

(*i*) Basic cover : Basic cover is described in ICC-C clause.

(*ii*) Wider cover : wider cover is described by ICC-B.

(*iii*) All Risks cover. All risks cover by ICC-A.

(*iv*) All risks cover does not pay all losses.

(*v*) All risks cover can be extended against "Delay start up" or 'Consequential Loss due to Marine delays' or 'Advance loss of profits' risks.

(*vi*) While the basic policy document contains general conditions, the scope of cover and exceptions and special exclusions are attached by separate clauses known as Institute Cargo Clauses (ICC).

Extensions of Voyage Policy

(*i*) FOB risks cover : The road/rail transit risks can be extended until the goods are placed on board of the ocean going vessel, which may involve country craft/lighter risks also.

(*ii*) Sellers'contingency risks : FOB cover can further be extended against 'Sellers contingency risks'.

(*iii*) Warehouse to warehouse basis : the policy covers all risks right from the moment the goods are dispatched from the supplier's warehouse till they reach the buyers' warehouse.

Annual Policy

If a business involves regular dispatch of goods throughout the year, and the quantity can be reasonably estimated in advance, an annual policy can be obtained on the basis of estimated annual dispatches. Premiums collected in advance will be adjusted at the end of the year. In case of annual policies, the previous year's turn over and the estimated increase during the current year is the basis for fixing sum insured for annual policy.

Declaration Policy

An alternative to annual policy is declaration policy. A policy can be obtained for any specific amount so that every dispatch to be insured for transit risks can be declared as agreed to and accounted until the sum insured is exhausted. The policy can be extended for a further sum. In case of declaration policies, one has to take a policy equivalent to 3 months estimated dispatches, which can be extended any number of times. All the dispatches should be declared without exception as per terms agreed to.

Special Declaration

If sum insured selected is more than Rs.2 crores, a special declaration policy can be obtained for which volume discount in premium is allowed. The annual dispatches should be reasonably estimated and the policy taken. However, the sum can be extended for a couple of times in extraordinary cases of genuine reasons. In case of special declaration policies, the minimum sum insured should be Rs.2 crores and the policies should be for sums equivalent to estimated annual dispatches. The declarations can be made at an agreed period (even after a loss). As the entire premium has to be paid in advance, volume discounts are offered.

Open Cover

It is a memorandum of agreement by which the insured will set out the terms of cover and rates of premium for one-year transaction of Marine dispatches. The open cover is not a Policy and it is not negotiable. A Certificate of insurance is issued for each declaration duly stamped for appropriate value and the Certificate will be negotiable.

Duty Policy

A deviation in Marine Insurance is to issue custom duty payable for imports by the same Marine Policy though there may not be any transit risks involved. In case of CIF contracts, the exporter to the extent of CIF values would have arranged the Insurance only. Custom Duty payable, if any, would be the responsibility of the importers and they can separately obtain Custom Duty policy on 'stand alone basis'.

Another special feature of custom duty policy is that it is a pure indemnity policy and the insured is paid the exact amount of loss of custom duty as a result of loss or damage to the consignment. The policy should be obtained before the vessel reaches the port of destination. Duty policy can be obtained much after dispatch of goods but before the vessel reaches the port of discharge.

Increased Value Policy

Increased value if goods imported are damaged in transit and such goods can be procured locally at prices higher than the CIF + custom duty, the increased value policy covers such difference in value. This is purely an indemnity policy and for the benefit of the insured only and cannot be assigned to others. The policy should be obtained before the overseas vessel reaches the port of destination.

Marine Delays (Marine LOP)

In case of new project where equipment has to be procured indigenously or by imports, any loss or damage to the equipment during transit may involve ordering of fresh equipment which leads

to delay in completion of the project, commencement of production and thereby loss of profits. The Financial institutions who are interested in timely completion of the project for their debt servicing, would like this risk covered by an Insurance contract and the Marine (cargo) insurance policy can be extended against what are known as 'consequential loss due to Marine delays' or simply–Delay start up.

Marine Policy as a Part of Builders Risk (Marine cum Erection)

In case of Marine cum Erection Insurance policy, Marine risks are followed by storage risks, erection and testing. In the standard Marine (cargo) policy, the cover ceases after the goods are delivered at the site of erection. In a project site, it is not possible to examine any internal damage to the consignment and such losses don't surface till the time of erection. If any damage were found at the time of erection attributable to Transit risks, the marine policy and erection policy bear 50% each of the cost of damage. This is possible only if both Marine policy and erection policy is taken from the same insurers.

9.5.1 Nature of Marine Policies

- Marine policies, except increased policies, are freely assignable. Marine policy document is a fundamental requirement for discounting invoices with local bankers without waiting for the importer to receive the overseas shipments and pay the invoices.
- Even for sale contract on FOB basis when the insurable interest ceases (the goods are placed overboard by the seller) by a notional extension of principle of insurable interest, the risk can be covered by 'Sellers Contingency Policy'.
- Consignments sold without the support of a 'letter of credit' can also be insured for importer default to pay by "Export Credit Guarantee Corporation of India".

But for the Marine insurance policies, the trade, industry and commerce would not have developed to the present levels of turnovers anywhere in the world. A manufacturer can export their produce with confidence as their dispatches have the support of Marine insurance policies, and they can also discount their bills with local Bankers without waiting for the bills being paid by the overseas importers after they receive the goods which may take months by ocean transit. Marine Insurance Policy is one of the important documents besides Invoice and Bill of Lading.

While there is no Tariff rate of premium and the insurers can charge any rate depending upon the nature of goods, the mode of trans-shipment, type of package, the voyage route and the past claims experience. However extended covers like SRCC and War risks (for overseas cargo) risks are governed by special regulations and the premiums collected will be credited to the Central Government.

Shipping vessels are listed according to their age, draught weight and their classification by G.I.C. for approval. Full details of every shipping vessel built anywhere in the world would be available in 'Lloyds Register' (issued by Lloyds of London). Minimum standards are fixed. Any vessel falling short of these standards will attract loading of premium. Service Tax and Stamp duty is always collected from the insured separately along with premiums.

Except in the case of increased value policies, no formal proposal form eliciting insurance history, claims history or matters relating to physical or moral hazards, which are common in all other policies, is called for. However simple details of the property in transit, type of packing, mode of transport and values are to be provided in Marine Questionnaire form. The reason being that

all Marine Insurance policies (cargo) are easily assignable to any one and one should have insurable interest at the time of a claim and not necessarily at the time of insurance. The policy is assigned by simply endorsing the policy on its reverse.

Open cover is a memorandum of agreement between the two parties and it is not negotiable. Increased value policy is obtained to take care of market fluctuation of prices and it can be obtained much after dispatch of goods but before the vessel reaches the port of discharge. A completed proposal form is required in this case.

9.6 Marine Cargo Losses and Frauds

The various causes of marine losses are : (*a*) Theft Pilferage and non-delivery, (*b*) Handling and Stowage damage, (*c*) Loss from water damage and (*d*) Marine perils. However, maritime frauds are very common. These are categorised as follows :

(*a*) Scuttling of ships–deliberate sinking of ships.

(*b*) Documentary Frauds–the manipulation of shipping frauds, use of forge documents.

(*c*) Chartering of vessels–fraudulent chartering companies.

(*d*) Cargo thefts–deviation of ships from standard routes, "paper shipping companies".

Apart from various measures taken by the concerned parties, following should be taken into care to reduce the frequency of frauds :

(*a*) Vessels approved by GIC (entered in IRS) should be used

(*b*) Exercise of reasonable care and diligence wile dealing with unknown parties or parties new in the business.

(*c*) Payments should be affected by confirmed IRLC.

(*d*) The agents involved in the whole process should be reliable.

(*e*) Reputed charterer should be hired.

9.7 Settlement of Claims

Marine insurance claims are of two broad types–marine hull and marine cargo. Both are dealt separately in the following sections.

9.7.1 Marine Hull

9.7.1.1 Types of Marine Hull Claims

Marine Hulls are divided into three groups viz. :

(*a*) Oceangoing vessels and other vessels rated exclusively by the Tariff Advisory Committee.

(*b*) Vessels insured under Builder's Risk Policies, Ship Repairer's Liability Policies, Ship Breaking Policies and the Charterer's Liability Policies.

(*c*) All the vessels and/or operations of which rates have been provided in Marine Hull Manual under specific Tariffs or otherwise and all other vessels/operations not covered by (*a*) and (*b*) above.

The types of hull claims are :

- Total Loss/Constructive Total Loss;
- Particular Average/Particular charges *i.e.*, Partial Losses/Expenses;
- Salvage and Salvage Charges–either Salvage Awards or Salvage under contract;
- General Average;
- Collision liability;
- Liability and Non-liability Claims (such as wreck removal) falling under the P & l section for the policy where such cover is granted;
- Sue & Labour charges;
- Personal Accident Claims for crew covered under Sailing/Fishing vessels Tariffs.

Following claims are generally considered for reference to professional Average Adjusters :

(1) All claims falling under Category 1.1 "A" unless the claim involved is straightforward and also for a nominal amount.

(2) (*a*) GA or GA/PA claims on vessels under Category 1.1 "C".

(*b*) Collision Liability claims requiring cross Liability adjustment in respect of risk falling under Category 1.1 "B" and "C".

9.7.1.2 Procedures of claims settlement

Following considerations are important while deciding on *Oceangoing vessels* :-

(*a*) nature and quantum of claims likely to arise under this category;

(*b*) likelihood of occurrence of loss in distant foreign waters;

(*c*) involvement of laws and practices of foreign jurisdictions, and

(*d*) involvement of foreign professional and/or firms like surveyors, repair yards, adjusters, solicitors, arbitrator, courts, etc.

The current system of processing these claims in accordance with the international practices and these practices are likely to continue except in so far as the provisions of the Indian Statutes are concerned.

Sundry Hulls (including Sailing vessels, Fishing vessels, Inland vessels etc.).

Following procedure is generally adopted for claim settlement :

- A Licensed Surveyor is appointed in all cases of Partial Losses/Expenses. Also licensed Surveyor are appointed in case of TL/CTL only where the vessel or its wreck, of reasonable value is available for inspection or making reasonable attempt to salvage.
- On receipt of loss intimation a letter is written "on *without prejudice basis* to the insured advising about the appointment of Surveyor and/or investigator requesting the insured to render full co-operation to the Surveyor/Investigator appointed and to return the claim form duly completed and signed.
- Notice of Abandonment of the vessel/wreck in writing is a prerequisite for a constructive Total Loss Claim. Practically speaking, insurers decline *prima facie* acceptance of the Notice

of Abandonment. However, insurer's refusal to accept abandonment does not legally prejudice the insured's claim for a CTL once the Notice of Abandonment has been issued by the insured and received by the insurer. Notwithstanding this the insurer generally refuse acceptance of abandonment of the wreck till the probable liabilities attaching to the wreck (Port and other dues, statutory requirement of wreck removal in case of vessel sunk in navigate channel; etc.) are reasonably estimated as considered.

- Total loss claim is settled on the basis of the statements and documents, as also the investigator/s Surveyor's report as the case may be if the circumstances are found to be reasonably acceptable. As per the Marine Insurance Act, following acceptance of a claim for total loss of a vessel, the insurers become entitled to the wreck or the proceeds thereof, if any. However, before enforcing such entitlement, the insurers ascertain whether or not any liability, statutory or otherwise, is reasonably likely to attach to such wreck or proceeds thereof.
- Since Marine Hull Policy is issued for a composite sum insured, representing the aggregate values of Hull and Machinery and showing Hull or Machinery values separately in the policy being prohibited, no claim for total or Constructive Total Loss is considered for settlement on the basis of and on account of either Hull or Machinery value alone.
- In case of partial loss, surveyors are duty bound to achieve assessment net of salvage, if any because it is difficult and very often not economical for the underwriters to get involved in salvage take-over and disposal. However, where this is not possible, arrangements are made to take over the salvage from the insured before the settlement of the claim and disposed accordingly.
- Claims occurring in foreign waters are generally dealt with in the same manner as in the case of Ocean-going vessels.

Documents Required

The documents required for the settlement of Sundry Hull claims are :

(1) A final survey Report *inter-alia* incorporating the following :

  (*a*) Name of the registered owner of the vessel.

  (*b*) Identity of the vessel including registration details. License particulars including validity thereof wherever applicable.

  (*c*) The details of loss suffered.

  (*d*) The Surveyor's observation on the alleged circumstances of the loss.

  (*e*) The reasonable probability of the alleged circumstances giving rise to the losses noticed and/or claimed.

  (*f*) Quantification of repairs/replacement cost, Salvage, Sue and labour etc. Where applicable.

  (*g*) Cause of loss as per the Perils Clause of the Policy and the deposit to be collected by the steamer.

In lieu of cash deposit, steamer companies often accept unlimited guarantee of the Insurance Company covering the goods.

Documents for General Average Claims

1. Original Policy or certificate of insurance duly endorsed.
2. Bill of Lading (signed copy)
3. Invoice (original or signed copy)
4. A copy of Notice declaring General Average by the Shipowner/Agent.
5. General Average Deposit Receipt (GADR) on the original Lloyds form duly endorsed.

(GADR indicates the name of the steamer, details of the casualty, the Bill of Lading no., the provisional net arrived value of the goods, description of the goods, the name of the GA Adjusters, the amount of the deposit by the consignees etc.)

General Average Guarantee and Counter Guarantee

As an alternative to cash deposit ship owners are willing to accept a Guarantee from a bank or if the goods are insured from the insurers. Insurers grant this Guarantee on the behalf of the insured in terms of which they agree to pay the General Average Contribution. In such cases, a Counter Guarantee is obtained from the insured. The Counter Guarantee is required because the General Average adjustment may be based on a contributory value of the cargo which may be higher than its insured value.

Letter of Transfer

This letter is signed by the consignees whereby they :

(*i*) surrender their rights in respect of the deposit paid to ship owners by the insurers;

(*ii*) agree to transfer the deposit amount to the credit of the insurers;

(*iii*) authorize the insurers to receive from the ship owners the difference between the amount of general average as adjusted and the amount of the deposit;

(*iv*) undertake to refund to the insurers any sum deducted by the ship owners from the deposit which may not be recoverable under the insurance policy; and

(*v*) undertake to repay to the insurers, if the contributory value exceeds the insured value the proportion of general average applying to such value.

If it is reported that the General Average Act has included sacrifice of cargo, then the consignee clear the damaged cargo only after the General Average Survey is conducted by the ship's Surveyors.

9.7.2 Consignments by Rail/Road

In the case of sea/air/multi-modal transport/postal claims, the insured has to furnish evidence of : (1) insurance, (2) transit, (3) value and (4) loss. The following documents are required to be submitted to insurers in support of claims under rail/road transit policies :

General Documents

1. Original policy or certificate of insurance duly endorsed.
2. Invoice (original or copy)/packing list/weight specification.

3. Independent Surveyor's Report, if any.
4. Letter of Subrogation (if recovery is possible).

Other Documents Depending on the Nature of Claim

1. Original Railway Receipt (Non-delivery cases)
2. Copy of the Railway Receipt (damage claim)
3. Original Consignment Note (Non-delivery cases–Road transit claims)
4. A copy of the Consignment Note (Damage claim–Road transit claims)
5. 'Non-delivery' or 'Partial delivery' certificate from the Railways/Road Transport Operators.
6. Open Delivery/Assessment Delivery Certificate (Rail/Road)
7. Certified copy of the Remarks in the Railway Delivery Book (Damage claims).
8. Certified copy of the remarks in the delivery Challan (Road Transit Claims).
9. Copy of (*a*) Notice of claim lodged on the carriers (Rail/Road) (*b*) Acknowledgement (*c*) Subsequent correspondence with the carriers.
10. Special Power of Attorney (Rail Transit Claims).
11. Letter of Authority (Rail Transit Claims).

9.7.3 Marine Cargo

Documents generally required for settlement of various types of cargo claims are as under :

General

(*a*) Original insurance policy/declaration under the open policy duly endorsed by the insured. A letter of indemnity may be furnished if the original is lost.

(*b*) Original or a signed copy of sale invoice along with packing list wherever is available.

(*c*) Signed copy of Bill of Lading (in case of sea voyage)/Air Consignment Note (for air cargo/ MTD/CTD (For multi-modal transport)/postal receipt for sending by post.

(*d*) Triplicate or exchange control copy of Bill of entry (to facilitate verification of the date of filing to ascertain whether there has been any delay and also to check duty payment details).

(*e*) In case of General Average. G.A. Guarantee and Counter Guarantee of original Cash Deposit Receipt with the Letter of Transfer as the case may be. Reference be made to the separate para on G.A.

(*f*) Letter of Subrogation duly stamped and executed (only where recovery from carriers/other third parties is possible).

(*g*) Special Power of Attorney (wherever recovery from Railway/other carriers is involved. In other cases as required).

In case of short landing/non-delivery of complete consignment

Full set of original Bill of Lading/Air Consignment Note/Postal Receipt, etc. as applicable endorsed in favour of insurers. The original contract of affreightment should be endorsed by the carrier confirming shortlanding/non-delivery of the entire consignment by them or with a separate shortlanding/non-delivery certificate. An undertaking to be obtained from the claimant that he would take delivery of the cargo, it traced, under an insurance survey.

In Case of Partial Non-delivery/Short Landing

Non-delivery and/or landed but missing certificate from the sea-air/CTO/carrier/postal authority/Port Trust, as applicable.

In Case of Partial Loss or Damage

(*a*) Assessment report by sea/air/CTO carrier/postal authority

(*b*) Survey Report of independent surveyor (if survey has not been waived)

(*c*) Claim form/claim bill.

In case of a consignee's claim to be settled in India for export shipment, Banker's Certificate confirming non-receipt of export proceeds in India in an appointed manner.

Non-delivery (short landing or landed but missing)

Specific Documentation : The claimant should be requested to apply for Either shortlanding certificate or landed but missing certificate from the port authorities or the Steamer Company within the period allowed under statute/Port rules. When the short landing or landed but missing certificate is obtained, the claimant should be asked to send notice to the carrier or the Port Authorities, as the same may be for the value of lost cargo (CIF value and/or duty and/or profit) and obtain their acknowledgement claim on the carrier or the port authorities should be accompanied by :

(*i*) Original of shortlanding or landed but missing certificate

(*ii*) Copy of bill of lading

(*iii*) Copy of Invoice.

Individuals or agencies specialized in the work of tracing missing cargo should be engaged to trace the missing cargo of high values. Where such certificates are not forthcoming in time, notice to carries and port authorities etc., must be served by the claimant within the statutory time limits for the value of cargo not received.

Total and/or Constructive Total Loss

Where total and/or constructive total loss of the cargo has been caused whilst in the custody of the steamer company or port authorities :

(*i*) Copy of valued claim on the carrier/port authorities (as the case may be) and acknowledgement thereof.

(*ii*) Notice of abandonment in case of C.T.L. to customs authorities.

(*iii*) Open assessment/delivery certificate/ship survey report.

Particular Average–Partial Loss *i.e.*, Theft, Pilferage, Shortage and Other Damages (in cases where loss or damage is reported before clearance from the dock) :

(*i*) Steamer/port survey report.

(*ii*) Customs examination certificate before clearance of consignment from docks.

(*iii*) Independent survey report.

As regards claim for the shortage from externally sound cases, it is essential to ask claimants to refer the matter to their suppliers about the policy of short packaging at their end. Only on receipt of confirmation from the suppliers about correct packing as per invoice further processing of claims on merits should be done. Surveyors should be asked to examine whether there was sufficient empty space in the case to hold the missing items or whether the missing items were replaced by some foreign materials by comparing the weight of consignment stated in the invoice/packing list with the package received at the destination in order to determine skilful pilferage in transit. It may also be checked as to whether the missing items had been extracted by Customs for examination or other purposes.

Claim under Duty and Increased Value Insurance Policy

In the case of certified shortlanding no duty is payable. Claims other than shortlanding have to be scrutinized with due regard to the basis of duty insurance and may be authorized for payment for the actual value of the loss including the actual customs duty paid but to exceeding the proportionate insured value on duty.

As regards Increased Value Insurance, the claim would be payable for proportionate increased value insured under the policy as per the Increased Value Insurance Clause.

As provided in the duty insurance clause a claim under "duty"/"increased value" policy is admissible only if the loss is admissible in terms of the cover granted under the same policy covering the same consignment. This provision however need not apply to cases where the CIF is insured overseas, due to contractual obligation. Further, if a marine claim is within the ambit of the policy conditions but declined by the insurers for other reasons like non-compliance of Section 64 VB of the Insurance Act this will not affect the admissibility of the duty claim. Therefore the claimant is required to furnish to the company proof of the liability for loss under the Marine Policy as per terms and conditions of the policy.

The other documents required are :

(*i*) Original Duty Insurance Policy duly endorsed

(*ii*) Copy of Bill of Lading

(*iii*) Bill of Entry

(*iv*) Survey Report

(*v*) Copies of correspondence exchanged with customs/carriers relating to the claim lodged with them.

General Average

In the event of the Steamer Company declaring General Average, the steamer Agents to make cash will call upon the consignees Deposit before delivery of the consignment at destination. The

consignees should be asked not to comply with this, without prior written concurrence of the dealing office. The concurrence can be given after ensuring that Lloyd's form of bond or similarly worded form is used.

(*i*) Copy of Certificate of Registration and License, if any, issued by the concerned authorities;

(*ii*) Original of the Certificate/Letter of the Cancellation of registration of vessel in respect to Total Loss claims.

(*iii*) Weather Report for the relevant place, date and time from the competent authority in case adverse Weather Warranty is involved.

(*iv*) Affidavits and/or statements by the owner, Tindal and all members of the crew separately of the insured vessel and/or rescuing vessel, if any made to any authority such as Police, Magistrate, Notary Public, Port Office, Indian Consulate etc.

(*v*) Marine Casualty Form issued by Mercantile Marine Department where applicable.

N.B. : Marine Casualty form is available only if any member of the crew including Tindal has survived the casualty. If all the crew members including the Tindal employed in the particular adventure die due to the casualty or are missing beyond trace, the Marine Casualty Form is not issued by Mercantile Marine Department as no statement from any of the crew regarding the casualty can be recorded by the Department. However, in such cases, the Mercantile Marine Department issues a certificate confirming that the casualty has been reported to them.

(*vi*) Police Report for claims within the territorial waters and for SRCC claims.

(*vii*) The loss should be reported to the Port Authorities if occurring within the port area.

(*viii*) In view of the localized and small scale operation, 'Salvage Charges covered under the Fishing Vessels Policy is to be seen differently from that under Ocean-going vessels Policy inasmuch as neither the Lloyd's Open Form for salvage agreement nor any international professional salvor is ever likely to be involved in salving such vessels. Therefore, in most of the cases the salvage services rendered to fishing vessels will be contracted salvage and for the purpose of eliminating unnecessary complications, it is advisable to treat such salvage charges as Sue and Labour costs for all practical purposes. It is however, to be ascertained that the amounts claimed for such costs are both actually incurred judiciously and reasonably incurred as also incurred to avoid or minimize a loss that would otherwise be admissible under the policy.

(*ix*) In the event of a Total and/or constructive Total Loss claim being considered for admission, the original insurance policy duly discharged by the insured is to be collected. However, where the original policy is reported to be lost an appropriate Letter of indemnity in lieu thereof should be obtained from the insured.

(*x*) In the event of a claim for partial Loss/Expenses, Salvage, Salvage Charges or Sue and Labour Charges, original repair bills, cash memos and similar documents duly verified and certified by the Surveyor as also Salver's/diver's Report where applicable, are to be furnished. Claims for Sue and Labour charges may have to be considered for settlement over and above the TL/CTL claim settlement. For these also original bills/cash memos in support of expenses incurred are required.

(*xi*) For the claims other than TL/CTL, the applicable deductible should be first deducted from the total claim amount as provided for in the clauses attached to and forming part of the policy.

In addition to the above, the following documents have to be collected for sailing vessel claims.

(*i*) Certificate of Inspection

(*ii*) Free Board Certificate before commencement of the voyager,

(*iii*) Cargo Manifest

(*iv*) Load Line Certificate

(*v*) Port Clearance Certificate.

In case of Fishing Vessels, wherever the provisions of the Merchant Shipping (Amendment) Act 1983 Part XVA, Section 435A to X are applicable, the Surveyors should be directed to report on the compliance thereof.

Fixed Jetties and Pontoons

Since these are fixed structures and are included in the Hull Department more as an extension of the principles of Hull Insurance than for any other reason, in the event of losses it is advisable to process such claims as 'Engineering claims and proceed accordingly.

However, since some losses may be found to be appropriate to be dealt with in accordance with the practices of Hull Department like in the event of fixed Pontoon getting un-moorred accidentally going adrift and ultimately sustaining damage or getting standard/grounded, such claims should be processes in line with practices of the Hull Department.

ANNEXURE–9A[3]

RBI Guidelines on Marine Insurance

Introduction

Persons, firms, companies, etc. resident in India are not permitted to take general insurance of any kind with insurance companies in foreign countries without prior approval of Reserve Bank of India. Besides, permission of Government of India under General Insurance Business (Nationalisation) Act, 1972, is also required in such cases. Proposals for direct insurance outside India should be submitted to Reserve Bank explaining reasons for seeking such insurance cover and producing a certificate issued by GIC or any of its subsidiaries to the effect that the proposed insurance cover cannot be obtained from them.

Marine Insurance on Exports

GIC has been permitted to accept premiums in rupees from exporters against export of goods from India on production of certificate from them to the effect that -

(*a*) the insurance charges on the shipment in question have to be borne by exporter in terms of the contract with overseas buyer and that he is not making the payment on behalf of any non-resident; or

[3] www.rbi.org.

(*b*) the exporter is defraying the insurance charges on the shipment in question on account of overseas buyer of the goods and that he undertakes to add the amount on the invoice and recover the payment so made from the buyer in an approved manner.

While handling shipping documents against exports contracted on f.o.b., c.& f. or any other terms under which liability on account of marine insurance on the shipment rests with overseas buyers but exporters have taken the insurance cover on non-resident party's account, authorised dealers should verify that the actual premium has been added on the invoice for being recovered from buyers.

Note : *Certain countries operate restrictions requiring importers in their countries to obtain marine insurance cover from local insurers, settlement under which in favour of exporters in India may not be permissible in the event of cargo getting lost before reaching the port of destination due to Exchange Control regulations governing remittances against imports into those countries. Exporters may in such cases avail of contingency marine insurance policies from GIC and its subsidiaries in order to protect their interests till the goods are paid for. Claims on such policies will be payable only to exporter in India and such policies will not be assignable to overseas buyer or any other party. In such cases, the insurance premium paid to GIC will not be recoverable from overseas buyers.*

Protection Against Transit Risks under f.o.b., c.& f., etc. Contracts for Exports

Sometimes in case of exports contracted on f.o.b., c.& f., etc. terms, exporters ship cargo without verifying that the goods have been adequately insured against transit risks by overseas buyers. Unless the cargo is insured for the entire duration of transit and insurance is available for protection of exporter until ownership in the goods passes to buyer, the exporter will be liable to suffer financial losses apart from loss of foreign exchange caused by damage/loss to the goods, except where the export is covered by an irrevocable letter of credit opened by the buyer. It is, therefore, necessary for the exporter to verify even before goods are shipped out of India, that they are insured against all risks of loss or damage during the entire course of transit and that such insurance is available to him by virtue of incorporation of sellers' interest clause in the policy. In cases where exporter is not assured that his interests are protected fully through insurance, he may also avail of contingency insurance cover from Indian insurers on the analogy of the provisions in the Note under paragraph 15A.2.

Marine Insurance on Imports

GIC has been permitted to accept premiums in rupees from importers against import of goods into India on production of a certificate from them to the effect that -

(*a*) the insurance charges on the shipment in question have to be borne by importer in terms of the contract with the overseas seller, and

(*b*) where the import is covered under an Import Licence, he undertakes to ensure that the amount of insurance premium paid will be endorsed on the import licence in due course.

Claims Against Marine Insurance Policies Covering Exports

(*i*) GIC and its subsidiaries have been permitted to settle claims against marine insurance policies covering exports from India out of foreign currency balances held by them, provided they are satisfied that ownership of the goods lost, damaged, etc. vests in such claimant that the latter is not making the claim merely as an agent of the real owner of the goods in India. In cases where the funds held by the insurers abroad are inadequate, claims will

have to be settled by remittances from India. Authorised dealers may permit such remittances without reference to Reserve Bank, on application from insurers on form A.2 together with documents listed in paragraph A.7 of Memorandum GIM after verifying that the statement of claim has been duly completed and signed by an authorised official of the insurer and that the remittance is *prima facie* in order. Where any document is not produced in original, an explanation for the insurer's inability to do so should be obtained. In all cases, the statement of claim (form GIM1) should be enclosed to form A.2 and submitted to Reserve Bank with appropriate. The other documents may be returned to the applicant insurer after marking them.

(*ii*) GIC and its subsidiaries may sometimes make arrangements with overseas claims-settling agents for facilitating speedy settlement of claims relating to exports from India. In such cases, authorised dealers may on receipt of requests from GIC/its subsidiaries, open revolving letters of credit in favour of established claims-settling agents abroad providing payment against production of documentary evidence viz. statement of claim, survey report or other documentary evidence of loss/damage, original policy or certificate of insurance, etc.

(*iii*) Reimbursement of claims under the credit may be made by authorised dealers on verification of the required documents.

Where GIC and its subsidiaries have settled claims against marine insurance policies covering exports from India in favour of Indian exporters, authorised dealers may allow remittance of claims by Indian exporters to overseas buyers on production of documentary evidence in support of the claim, provided export proceeds have been realised in full by the exporter. A declaration from the Indian exporter that the overseas buyer has not been compensated in any other manner for the loss of/damage to goods exported from India in respect of which claim has been settled by GIC or its subsidiary, should also be obtained.

Claims Against Marine Insurance Policies Covering Imports into India and Merchanting Trade

Remittances against claims under marine insurance policies covering imports into India may be allowed by authorised dealers on verification of the certificates regarding ownership of the goods etc. as laid down in paragraphs A.8 and A.9 of Memorandum GIM. Authorised dealers should specifically confirm on form A.2 that the necessary documentary evidence has been verified and conditions laid down in paragraphs A.8 and A.9 of Memorandum GIM are fulfilled.

Premium for Extension of Insurance Cover on Imports

Sometimes, importers may not retire documents received under letters of credit promptly and goods may meanwhile arrive at the Indian port and remain unprotected in the docks. In cases where marine insurance has been taken abroad and normal period has expired, authorised dealers have been granted permission to have the insurance cover extended and to remit the insurance premium.

Risk Insurance on Marine Hulls

GIC is operating a scheme of comprehensive insurance on Indian marine hulls covering all risks against war and other allied risks arising out of civil commotion, political or labour disturbances, etc. Shipowners should, therefore, normally obtain such insurance cover only in India.

Key Terms

- ❖ Annual Policy
- ❖ Cargo Insurance
- ❖ Constructive Total Loss
- ❖ General Average
- ❖ Hull Insurance
- ❖ Maritime Frauds
- ❖ Particular Average
- ❖ Voyage Policy

Suggested Readings

- *IRDA Annual Report 2001-02.*
- *Marine Insurance,* IC67, Insurance Institute of India, Mumbai.
- Barry Supple, *A History of British Insurance,* Cambridge University Press, 1970.
- *The ET Knowledge Series,* Insurance, 2001-02.

Questions for Review

1. Trace the history of marine insurance. Is marine insurance a profitable business in India? If so, why?
2. Briefly explain the various types of marine insurance covers available in India.
3. Distinguish between :
   (*a*) Open Cover and Open Policy
   (*b*) General Average and Particular Average
   (*c*) Total Loss and Constructive Total Loss
4. Briefly explain the various types of marine losses and maritime frauds and methods to prevent them.
5. List the documents required for settlement of :
   (*a*) Cargo claims
   (*b*) Hull claims

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UNIT 5

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CHAPTER 10

PROPERTY AND LIABILITY INSURANCE

Property Insurance

Property insurance indemnifies the insured for physical damage to, or destruction of, personal or commercial property resulting from the occurrence of specified perils. Losses covered under the property covers include both the cost of replacing or repairing the destroyed or damaged property and the indirect or consequential losses. A rising standard of living and the mechanization of industry have increased the number of personal and commercial exposures to property damage.

Property can be classified simply as : (*a*) personal and (*b*) commercial.

Personal Property Coverages

1. Motor Insurance (for loss due to accidents arising from use of automobiles)
2. Burglary Insurance (for thefts etc.)
3. Homeowners Insurance (specialised covers)

Commercial Property Coverages

1. Fire Insurance (Fire risks)
2. Marine Insurance (Transportation risks)
3. Fidelity Insurance (Dishonesty related risks)
4. Businessowners Insurance (Comprehensive covers)
5. Consequential Loss Insurance (Loss of Income)

The above mentioned covers are respectively discussed in various chapters of Unit 4 and Unit 5.

Liability Insurance

Liability insurance indemnifies the insured for losses arising from his liability for damages to the property or person of others. The insurer agrees to pay damages to third party claimants who have valid claims against the insured. Liability may arise from intentional interference with the rights of an other negligence, or as a matter of law.

Intentional interference includes deliberate destruction of property, tresspass, vandalism and malicious mischief. It also includes assault, batter, defamation and false imprisonment. Absolute liability may be imposed regardless of fault *e.g.* losses associated with use of hazardous substances. The negligent use of property may result in a tort action against the property owner.

This chapter exclusively focusses on various liability covers available in India.

Liability Insurance Covers

Liability insurance covers provide indemnity to the insured in respect of financial consequences arising out of liability under the civil law. The civil liability arises either due to the operation of :

(*a*) Law of torts

(*b*) Specific Statutory Enactments

10.1 Tort Liabilities

A legal wrong is a violation of a person's legal rights, or a failure to perform a legal duty owed to a certain person or to the society as a whole. These wrongs may either be crimes (against the society), breach of contracts or torts. A tort is a civil wrong for which the law allows a remedy in the form of pecuniary damages. Tort may be of following types :

(*a*) *Intentional Torts*–frauds, infringement of rights, assault, trespas etc.

(*b*) *Strict Liability*–absolute liability in respect of loss or injury due to use of hazardous substances, occupational injury to employees etc.

(*c*) *Negligence*–failure to perform duties

Some of the specific tort liability covers are discussed below :

10.1.1 Product Liability

This insurance is intended to provide an indemnity to the insured (upto the limit of liability) in the event of a claim being brought against him. This may be caused by anything harmful or defective in the products sold or supplied by the insured in connection with the business specified. The insurer in addition reimburses all costs and expenses incurred with its written consent defending such a claim for compensation. The insurance does not cover the cost of removing, replacing or repairing defective products or loss of use thereof.

Liability for injury or damage caused by a defective product may arise due to the operation of Sale of Goods Act or Consumer Protection Act. The product liability policy seeks to indemnify the insured against his legal liability to pay compensation (including claimants costs, fees and expenses) in respect of injury damage or pollution for third parties for claims arising out of accidents due to any defects in the products specified in the policy during the period of the insurance and first made against the insured during the policy period. For the purpose of determining the indemnity granted :

1. Injury shall mean death, bodily injury, illness or disease of or to any person
2. Damage shall mean actual and/or physical damage to the atmosphere or of any water, land or other tangible property
3. Pollution shall mean pollution or contamination of the atmosphere or of any water, land or other tangible property
4. Product shall mean any tangible property after it has left the custody or control of the Insured which has been designed, specified, formulated, manufactured, constructed, installed, sold, supplied, distributed, treated, serviced, altered or repaired by on behalf of the Insured
5. Accident shall mean a fortuitous event or circumstance which is sudden, unexpected and unintentional including resultant continuous, intermittent or repeated exposures arising out of the same fortuitous event or circumstances

The product policy is on 'Claims made' basis. This means that the accident giving rise to the claim shall occur during the period of insurance and further that the claim shall be first made against

the insured during the policy period. The retroactive date is the date of commencement of the first 'Claims made' product liability policy. This date remains unaltered as long as the policy has been renewed without break and there has been no substantial material change in the risk. The policy does not cover :

Special Exclusions

1. The policy excludes liability for costs in the repair, reconditioning, modification or replacement of any part of any product which is or is alleged to be defective.
2. For cost arising out of the recall of any product or part thereof.
3. Arising out of any product which is intended for incorporation into the structure, machinery or control of any aircraft.
4. Arising out of deliberate, willful or intentional non-compliance of any statutory provision.
5. Arising out of pure financial loss such as loss of goodwill, loss of market, etc.
6. Arising out of fines, penalties, punitive and exemplary damages.
7. For injury and/or damage occurring prior to the Retroactive date shown in the schedule.
8. Arising out of deliberate, conscious or intentional disregard of the insured's technical or administrative management of the need to take all reasonable steps to prevent claims.
9. For injury to any person under a contract of employment or apprenticeship with insured where such injury arises out of the execution of such contract.
10. Arising out of contractual liability which would not have existed in the absence of the specific contract.
11. Arising out of any product guarantee.
12. Arising out of claims for failure of the goods or products to fulfill the purpose for which they were intended

In addition, War and Nuclear Perils are specifically excluded. The policy does pays for loss or damage due to

1. War and war like perils
2. Wear and tear, depreciation, consequential loss
3. Nuclear group of perils
4. Gross and wilful negligence of Insured
5. Violation of policy conditions
6. Loss/damage/liability where Insured's family or Insured's employee are involved as principal/accessory
7. Intentional act/self injury/influence of drug/intoxicant.

10.1.2 Directors' and Officers' Liability Insurance

In a recent spate of litigation, a number of adverse court verdicts regarding the liability of directors and officers of companies to a third party were passed where the directors and officers

were held personally liable for payment of compensation to the third party. Ordinarily, the directors and officers are bound by duty towards the company itself, shareholders, employees, creditors, customers, competitors, members of the public, government and other regulatory bodies. Any breach or non-performance in the duties can result in claims against the companies and/or its directors of the company by reason of any wrongful act in their respective capacity. The Directors' and Officers' Liability Insurance policy has been designed specifically to meet any financial liabilities imposed upon them.

This policy provides cover for directors and officers of a company to reduce the impact of potential litigation owing to :

1. Failure of supervision.
2. Inaccuracy in statements of financial accounts.
3. Lack of judgement and good faith.
4. Mismanagement of funds.
5. Mis-statements in prospectuses.
6. Allotment of shares.
7. Unauthorised loans or investments.
8. Failure to obtain competitive bids.
9. Imprudent expansion resulting in a loss.
10. Using inside information.
11. Unwarranted dividend payment, salaries or compensation.
12. Misleading statements filed with the stock exchange.
13. Misrepresentation in acquisition agreement for the purchase of another company.
14. Wrongful dismissal of an employee.

Risks covered

This policy covers all claims made in event of :

1. Mergers, takeovers and divestment.
2. Liquidation.
3. Changes in control of shareholding.
4. Share issues.
5. Shareholder claims.
6. Misdeeds of co-directors.
7. Trustee accountability and responsibility.
8. Customs and excise allegations.
9. Administrative liabilities.
10. Termination of employment.

11. Disposal of old firm/entry of new owners.
12. Miscellaneous litigation.

Compensation Offered

The extent of indemnity being severely restricted by the Companies' Act will reimburse the extent of legal costs expended only if the Director/Officer successfully defends the act taken against him. Also, coverage is available on a 'claims made' basis and applies only to claims made against the Board of Directors during the policy period, irrespective of when the wrongful act occurred.

The cover applies to :

1. Liabilities arising from any claim made against Directors and/or Officers of the company by reason of any wrongful act in their respective capacity.
2. Liabilities against the company where it is required to indemnify the Directors/Officers pursuant to common or statutory law provisions or Memorandum and Articles of Association.
3. The company and its subsidiaries that are under the common control of the Directors/ Officers.

Exclusions

1. The policy does not pay for the losses arising from any claim.
2. Prior and pending litigation and claims submitted under previous policies. Bodily injury, sickness, disease, emotional distress, death, damage or destruction of tangible property including loss.
3. Insured v/s Insured. *viz.* Directors suing each other.
4. Illegal personal profit and remuneration.
5. Deliberate, dishonest or fraudulent acts.
6. Pollution and/or contamination.
7. Insider trading.
8. Outside directorship (can be covered with specific information).

10.1.3 Employer's Liability

Workmen Compensation Act, 1923 and the common law impose liability of an employer for employment injury (including death) of any of his employees who is a 'workman' as defined under the Act. Section 3 of the Act provides that the employer is liable for compensation if personal injury is caused to workmen by accident arising out of and in the course of employment. Also if the workman contacts any disease, specified in the Act as an occupational disease, the illness is deemed to be injury by accident arising out of and in the course of employment.

Coverage of the Policy under the WC Act, 1923

1. Indemnity to insured against his liability as an 'employer' to accidental injuries (including fatal) sustained by the 'workman' whilst at work.

2. On extra premium-medical, surgical, and hospital expenses including the cost of transport to hospital for accidental employment injuries
3. Liability in respect of diseases mentioned in Part C/schedule III of WC Act, on additional premium; which arise out of and in the course of employment

The rates of insurance are prescribed by the tariff which is in two forms :

Table A–Indemnity against the legal liability for accident to employees under :

(*a*) Workmen Compensation Act, 1923

(*b*) Fatal Accident Act, 1855

(*c*) Common Law

Table B–indemnity cover for legal liability arising under :

(*a*) Fatal Accident Act, 1855

(*b*) Common Law

Compensation

Subject to the provisions of WC Act the amount of compensation/reimbursable is as follows :

1. Where employment injury results in death, then 40%-50% of the monthly wages of the deceased multiplied by the relevant factor or Rs. 20,000/- which ever is more.
2. Permanent Total Disablement 50%-60% of the monthly wages of the injured disabled (PTD) workman multiplied by relevant factor or Rs. 24,000/- which ever is more.
3. Permanent Partial Disablement–(*a*) For an injury specified in Part II of disablement (PPD) schedule. The percentage of loss of earning capacity caused applied to the compensation payable for permanent total disablement (*b*) For an injury not specified in schedule–the percentage of permanent loss of earning capacity as assessed by qualified Medical Practitioners applied to the compensation payable for permanent total disablement.
4. Where more than one injury caused by same accident it shall be aggregate but in any case not to exceed the amount payable for permanent total disablement
5. Temporary disablement–A half monthly payment equivalent to 25% (total or partial) of monthly wages of the workman to be paid in accordance with the provisions of Sub section (2) of the WC Act.
6. Actual medical expenses incurred in connection with on-duty accident ranging from Rs. 80/- to 2400/- per case as per the option given at the inception of the policy by the insured and extra premium paid.
7. Legal costs and expenses incurred with the Company's consent.

Exclusions

1. Any injury which does not result in fatality or partial disablement for period exceeding 3 days.
2. First 3 days of disablement where the total disablement is less than 28 days.

3. For any non-fatal injury caused by any accident which is directly attributable to :
   (*a*) Influence of drinks or drugs
   (*b*) Willful disobedience of an order for securing safety of the workman
   (*c*) Willful removal or disregard of safety guard device.
4. War group and nuclear group of perils.
5. Liability to employees of contractors of the insured (unless specifically declared).
6. Employee who is not a "workman" as per WC act.
7. Liability of insured assumed under an agreement.
8. For occupational diseases mentioned in part "C" of schedule III of WC Act, unless cover is extended on extra premium.
9. Increase due to any change in statute provisions after policy had incepted under more than one statute/one forum for the same injury.

10.1.3 Professional Indemnity policies

The Professional Indemnity Insurance Policy is available for all doctors, medical establishments, contractors, engineers, architects, interior decorators, chartered accountants, financial accountants, management consultants, lawyers, advocates, solicitors and counsel

Jurisdiction applicable under the Professional Indemnity policy will be within Indian Courts.

Under this cover, the policyholder will be covered for any professional act or omission occurring during the period of insurance provided the policy is renewed without interruption and is in force at the time of claim. Any claims arising out of act or omission of policyholder have to be made in writing during the policy period. The retroactive date of the policy is the period commencing from the date and hour mentioned in the policy and expiring at midnight on the expiry date mentioned in the policy. If the policyholder notifies any event or circumstance as a claim during the period of policy and if insurance company accepts it, then the insurer will deal with the claim. The **"Extended Claim Reporting Clause"** allows the policyholder a time limit up to 90 days from cancellation or non-renewal of policy to notify claims which had taken place during the period of insurance. And the only condition is that another policy does not exist.

10.2 Specific Statutory Liabilities

Public Liability Insurance

The Public Liability Insurance Act, 1991 imposes "no fault" liability in respect of use of hazardous substances as specified by the Act. The object of this Act is to provide through insurance immediate relief to persons affected due to "accident" while "handling" "hazardous substance" by the owners on "no fault liability basis". This has also been brought under Tariff. The definition of "Owner" is so comprehensive as to cover any person who owns or has control over any hazardous substance at the time of accident. This includes any Firm or its partners. Association or its members, Company or its Directors and all other persons associated and responsible to that Company in the conduct of their business. The various terms like "Accident", "Hazardous substances" as defined in Section 2 of the Act are given below.

"Accident" means an accident involving a fortuitous, sudden or unintentional occurrence while handling any hazardous substance resulting in continuous, intermittent or repeated exposure to death of, or injury to any person or damage to any property but does not include an accident by reason only of war or radioactivity.

"Handling" in relation to any hazardous substance, means the manufacture, processing, treatment, package, storage, transportation by vehicle, use, collection, destruction, conversion, offering for sale, transfer or the like of such hazardous substance.

"Hazardous Substance" means any substance or preparation which is defined as hazardous substance under the Environment (Protection) Act, 1986 and exceeding such quantity as may be specified by notification by the Central Government.

"Hazardous Substance" means any substance or preparation which, by reason of its chemical properties or handling is liable to cause harm to human beings, other living creatures, plants, micro-organism, property or the environment (as per the Environment (Protection) Act, 1986).

Maximum Liability

Any one accident : Minimum equal to Paid up Capital upto a maximum of Rs. 5 crores.

Any one year : Three times of 'Any one accident' limit subject to a maximum of Rs. 15 crores.

In case of claim/s exceeding the above statutory limit/s, it is to be met by the Environmental Relief Fund to be set up under Section 7A of the Act and managed by the Authority appointed by the Central Government.

The liability beyond the total of the insurance and the Relief/Fund is to be borne by the "Owner". Every owner, in addition to premium, has to pay to the insurer and equivalent amount to be credited to the said fund. However, the central government has powers to exempt any establishment from compulsory insurance, if a fund has been established and maintained for an amount not less than Rs. 5.0 crores or equal to the paid up capital of the establishment, in any nationalized bank for meeting liability under the act.

Schedule of Compensation

1. Reimbursement of medical expenses incurred upto a maximum of Rs. 12,500/- in each case.
2. For a fatal accident the relief will be Rs. 25,000/- per person in addition to reimbursement of medical expenses, if any incurred on the victim upto a maximum of Rs. 12,500/-.
3. For permanent total or permanent partial disability or other injury or sickness, the relief will be :
    a. Reimbursement of medical expenses incurred, if any, upto a maximum of Rs. 12,500/- in each case and,
    b. Cash relief on the basis of percentage of disablement as certified by an authorized physician. The relief for total permanent disability will be Rs. 25,000/-.
4. For loss of wages due to temporary partial disability which reduce the earning capacity of the victim, there will be a fixed monthly relief not exceeding Rs. 1,000/- per month upto a maximum of 3 months provided the victim has been hospitalized for a period exceeding 3 days and above 16 years of age.

5. In respect of damage to private property, upto Rs. 6,000/- per claim.
6. Apart from Public liability insurance Act policy, policies are also available to cover the legal liability of the insured against third parties for claims arising due to industrial accidents. Two different types of policies are available to cover accidents in industries like factories etc. and non industries like hotels, schools, exhibitions and storage tanks etc.

Claim Procedure

1. The Insured has to give written notice to the company as soon as possible of any claim made against him (or any specific event or circumstance that may give rise to a claim being made against the Insured) which forms the subject of indemnity under the policy and shall give all such additional information as the company may require.
2. Every claim, writ, summons or process and all documents relating to the event shall be forwarded to the Company immediately after they are received by the Insured, alongwith the claim form duly filled up.
3. No admission, offer, promise or payment shall be made or given by or on behalf of the insured without the written consent of the company.
4. The insured will have the right to take over and conduct in the name of the Insured in defense of any claim in case of voluntary public liability policies.
5. In the event of liability rising under the policy or payment of a claim under the policy, the limit of indemnity per anyone year under the policy shall get reduced to the extent of quantum of liability to be paid or actual payment of such claim.
6. No claim is payable under the policy unless the cause of action arises in India and the liability to pay claim is established against the Insured in an Indian Court. It is also to be understood that only Indian Law shall be applicable in such action.

10.2.2 Other Laws

The other statues associated with the public liability insurance are :

1. Water (Prevention and Control of Pollution) Act, 1974.
2. Air (Prevention and Control of Pollution) Act, 1981.
3. The Environment (Protection) Act, 1986.
4. The Factories Act, 1948.
5. Motor Vehicles Act, 1989 and its ammendments.
6. Consumer Protection Act, 1986.

Key Terms

- Employer's Liability
- Liability Insurance
- Product Liability
- Professional Indemnity
- Property Insurance
- Public Liability Insurance Act, 1991
- Workmen Compensation Act, 1923

Suggested Readings

- G.E. Rejda, *Principles of Insurance and Risk Management*, Pearson Education, 2002.
- *Liability and Engineering Insurance*, Insurance Institute of India, Mumbai, 2000.
- Irving Pfeffer and David Klock, *Perspectives on Insurance*, Prentice Hall, 1974.

Questions for Review

1. Briefly explain the provisions of Public Liability insurance Act, 1991 with respect to compulsory insurance and the schedule of compensation.
2. Write short notes on :
   (*a*) Professional Indemnity Policies
   (*b*) Product Liability Policies
3. Outline the cover available in the policy under the Workmen Compensation Act, 1923.
4. Briefly explain the property and liability insurances giving suitable examples.

CHAPTER 11

RURAL INSURANCE

11.1 Need and Potential of Rural Insurance

The insurance sector has been mostly confined to cities. However, in the rural areas where human life and income-generating rural assets need more protection, there is tremendous scope for developing insurance business. The rural sector so far has been grossly neglected since last 50 years from the privileges of insurance cover, though a silent economic revolution can be seen now in the villages.

With the opening of the insurance sector to the private sector and foreign companies, the time has come when the government should pay serious attention to covering the rural areas. While it is true that access to insurance cover depends on the literacy/awareness levels and assured income, well-planned and organised efforts by committed private sector companies can yield rich dividends from the rural areas. This is because :

(1) A large number of rural districts have witnessed significant growth and prosperity;

(2) Access to reliable and authentic data and information has improved considerably, which can enable quick and correct decision-making;

(3) There are specific functionaries and agencies in the rural areas, which can help, explore and exploit insurance business in the untapped rural market.

Rural Banking as a Catalyst

"With a decline in the public investment in agriculture, the rural banking system has been encouraging the farm development through provision of credit facilities for production of crops including horticulture, plantation, forestry; purchase of farm equipment; livestock and fish farming; irrigation facilities and installation of diesel engines etc. Bank credit is also provided for establishing village/cottage industries, stocking/supplying farm inputs and cattle-feed, and business and trade purposes. From 1969-70 to 1999-2000, up to Rs 3.1 crore has been provided to the farm sector."[1]

"With enhanced incomes, and further supplemented by bank credit, the rural population is acquiring consumer durables, constructing houses, purchasing vehicles, computers, and so on.

All these assets need to be protected from damage/loss, natural or man-made. Thus, the rural areas offer enormous opportunities for committed private insurance companies in both life and non-life insurance schemes."

The efforts by the private insurance players, of course, backed by business, can have direct positive impact on rural development and the economic growth. Insurance in the farm sector can supplement the advances of science and technology.

Both the conventional players, LIC and GIC have been providing some insurance cover in rural areas. But, they are insufficient to meet the exact requirements of the rurals. There is an immense need of creating awareness among people. The rural customers often contend that the claim lodgement and settlement procedure is time-consuming and cumbersome. "Cattle insurance under the government-sponsored Integrated Rural Development Programme and crop insurance have not met with the expected results."

[1] Mr. A.R. Patel Web article on Rural Insurance.

"Besides, the village profile available with each of the branches of nationalised/public sector banks contain exhaustive data on the population, cultivating households, categories of farmers, classification of workers, livestock, cropping pattern, farm equipment and machinery and so on.

There are more than 1,75,000 rural credit outlets in addition to the offices of the District Rural Development Agency, the District Industries Centre, and the District Development Manager of nationalised banks and Lead District Manager of the Lead Bank. All these institutions and agencies can offer considerable information to insurance companies."

Modus Operandi

Those willing to enter into rural insurance or improvise must do the following :

- Design tailored products.
- Establish efficient methods of premium collection and claims settlements.
- Create awareness for the need of insurance products.
- Educated unemployed youths of the villages can be trained and become valuable assets for the companies. While insurance companies are eager to build their business in the urban areas, there is a hitherto untapped potential for business in the rural areas, which can be exploited.
- The Centre and the State governments must encourage private and foreign insurance companies to enter the rural areas, and provide protection to rural assets from damage and loss due to natural and man-made calamities. For this purpose, reasonable and need-based concessions/relief in taxation and subsidies, required infrastructural facilities and administrative support must be extended, at least for ten years. The government may consider appointing an Expert Committee on Rural Insurance to work out the modalities for private and foreign companies interested in entering the rural areas.

(The paragraphs in quotes mentioned in this section are the views of Mr. A.R. Patel–a Mumbai-based rural credit specialist.)

11.2 Legal Framework

The Insurance Regulatory and Development Authority Act, 1999 (para 19; First schedule) has amended the Section 32B and 32C of the Insurance Act, 1938 as under :

Section 32B

Every insurer shall, after the commencement of Insurance Regulatory and Development Authority Act, 1999, undertake such percentages of life insurance business and general insurance business in the rural and social sector, as may be specified, in the *Official Gazette* by the authority, in this behalf.

Section 32C

Every insurer shall, after the commencement of Insurance Regulatory and Development Authority Act, 1999, discharge the obligations specified under Section 32B to provide life insurance or general insurance policies to those residing in the rural sector, workers in the unorganised sector or informal sector or economically vulnerable or backward classes of the society and other

categories of persons as may be specified by the regulations made by the authority and such insurance policies shall include insurance for crops.

The IRDA Regulations 2000 makes it compulsory for the insurers, existing and new to promote the rural insurance (Annexure 11A). The regulations prescribe for undertaking benchmark percentages for insurances in the rural insurance sector for the players.

The *rural sector* has been defined as a place which, as per the latest census, the population is not more than 5,000, the density of population is not more than 400 per sq. km. and at least 75% of the male working population is engaged in agriculture.

The regulations provide that those who are proposing to carry on the life insurance business in the year 2000 or later, are required by these regulations to write in the rural sector, at least 5% of the total policies written directly in the first financial year, 7% in the second financial year and so on. In case of non-life insurance, 2% of the total gross premium income written direct in that year, 3% in the second year and so on. Also, the authority may revise the obligation once in 5 years.

11.3 Various Rural Insurance Policies

Aqua Culture Insurance

This policy is meant for licensed farms or farms provided in accordance with the Government Notification for growing brackish water shrimp/fresh water prawns by adopting extensive/ modified extensive/semi-intensive systems. The Policy grants cover under two sections :

Section I : Basic cover, which covers only losses due to natural calamities.

Section II : Comprehensive cover granting cover for disease also. Policy is usually given for a period of 4½ months. The basic cover provides compensation for total loss of shrimp/prawns due to :

Summer kill, pollution from external source, poisoning, riot, strike and malicious acts of third parties, terrorism, explosion/implosion, air craft and aerial devices or articles dropped therefrom, impact damage, earthquake, storm, tempest, cyclone, flood and inundation, volcanic eruption and other convulsions of nature. Comprehensive cover in addition to basic cover encompasses death due to diseases except those caused by bad management and nutritional deficiencies.

In the event of a fortuitous event resulting in a loss, the basis of loss settlement is the sum insured, which is fixed as follows :

Sum Insured = Number of seeds released X expected survival rate (%) X expected average body weight in grams X input cost per Kg. For losses upto 4th fortnight stage, maximum liability shall be restricted to 80% of the input cost only. From 5th fortnight onwards claims are admitted as a percentage of biomass. Deductions towards salvage are made. Where the percentage of loss at any stage equals or exceeds 80% of the total shrimps/prawns insured, it will be treated as total loss.

Premium : Premium rates have been fixed as follows :

Zones	*Section-I (Basic)*	*Section-II (Comprehensive)*
(*a*) For highly cyclone prone zones	3%	7½%
(*b*) Others	2%	6%

Requirements : The farm should obtain statutory licence for setting up and conducting aquaculture operations in the area as per Government legislation. The ponds should be prepared as per prescribed, recommended and established standards. The seed should be healthy, of good quality, selected as per prescribed norms and obtained from well-known source. The seed should be of high quality and procured from reputed firms. Holiday period as recommended by MPEDA or such Government agency should be observed. All matters concerning farming practices, norms, stipulations; guidelines recommended by competent Government agency, fisheries department research institutes, fisheries college etc. should be complied with.

Cattle Insurance

This policy is suitable for the farmer–who owns the cattle and the banks/financial institutions which have financed the purchase of cattle under IDP/DRDA/DPAP schemes. "Cattle" refers to Cows and Buffaloes, Stud Bulls, Bullocks, He Buffaloes, Calves and Heifers. The Policy is usually given for a period of 12 months or for a long term of 3 to 5 years as per term of loan. The policy covers loss due to death, accident, illness or disease of the animal. A qualified veterinary officer's certificate is necessary for accepting the proposal and also for fixing the value of the cattle which forms the basis for loss settlement. The policy also covers transit of cattle from the place of purchase to stable located within 80 Km. For transit above the stipulated distance, additional premium @1% is charged.

The policy pays for the market value of the animal prior to the accident or the sum insured whichever is less. A veterinary surgeon's certificate will be necessary to claim the amount in the case of death of the cattle. Premium is charged on the market value of the cattle at the following rates.

S.No.		*Type of Animal for Death Cover*	*Rate of Premium Additional Rate for permanent total disability and from yielding milk*
1.	Animals financed under Government Scheme	2.25%	0.85%
2.	Non scheme Animals	4.00%	1.00%
3.	Exotic Animals	6.00%	1.00%

Minimum Premium of Rs. 50/- per policy is chargeable. Discounts are allowed in the case where full advance premium is paid under long-term policies and group policies. However premium is loaded in case of adverse claim ratio.

Veterinary examination and tagging of the animals is necessary for granting insurance cover. Natural identification marks and colour should be clearly noted in the proposal form along with the veterinarian's report.

Indian economy is based on agriculture and about 75% of the population still depend on agriculture, dairy farming and agro-based small-scale industry. Sound agricultural base can only lead to economic stability. Hence, farmers have to be adequately protected against the various hazards. It is for this reason GIC has introduced various rural insurance schemes not only to offer financial protection to rural masses but also to fulfil the social objective of their upliftment. Chief among such schemes is the cattle insurance policy whereby the livelihood of the farmer is protected against accidental causes. Thus, this cover attains utmost importance amongst rural insurance policies.

Failed Well Insurance

Wells financed by Co-operative societies, financial institutions, banks, Government sponsored schemes can be covered under this policy against the risk of low or no yield provided the selection of site is made on scientific principles and methods. The well sites located in areas mapped by state geological departments having potential for borewells for yields upto 1000 gallons per hour are covered by this policy. Yield will be tested by pumping intermittently for 6 hours by a 2HP/3HP submersible pump. If the yield is below 500 gallons, the well shall be deemed to be a total failure. If the yield is between 500 to 1000 GPH, policy pays for the proportion the actual yield bears to assured yield.

Following types of wells are covered under this policy :

- Shallow tube wells
- Filter point wells
- Dry wells
- Bore wells
- Dug cum bore wells

Benefits

Drilling cost at Rs. 160 per metre upto a depth of 80-90 metres is payable subject to a limit of Rs. 15,000 per borewell. The following costs are included. Transportation of equipment upto Rs. 350/-; Yield testing charges upto Rs. 500/-; Spot investigation charges upto Rs. 250; Labour charges for fixing casing pipe; cleaning and dewatering charges.

However, the following are excluded :

- Expenses incurred but not specifically covered.
- Natural calamities, riot and strike, quality of water, structural failure cessation of work, wilful act and negligence, defective design and material, bad workman-ship, war and allied perils. Policy is subject to an excess of 17.5% of claim amount.

Rate of premium is 17.5% of sum insured. The proposal must be accompanied by site selection report obtained from qualified geo-hydrologist approved by the insurers. The test is to be based on geophysical methods only, such as electrical relativity logging, vertical sounding etc., taking into account at least 250 m between two wells. The permission from local Municipal authority for digging the well and signature of bank wherever applicable shall be obtained. Open wells shall have a minimum diameter of 10 ft and depth of 30 ft. Borewells shall have a diameter of 6 inches and installed upto hard rock zone and properly sealed. Wells should be rested for 24 hours before testing. It is not rare that despite the scientific exploration, yield in the wells may not match the guaranteed yield. It is in such a situation, this insurance comes to the rescue of the well owner. Thus, this cover is recommended.

Farmers' Package Insurance

This policy is suitable for the farmers who wish to cover all their property and assets under a single package policy. The Policy can be issued either to individual farmers or a group. Personal effects, household goods, village/cottage industrial units belonging to the farmer are covered under this insurance. This Policy has 14 Sections offering coverage as follows :

Section 1 : Covers the residential building of the farmer including contents and farm produce kept in the building from fire and allied perils.

Section 2 : Covers the loss or damage to stock of farm produce from fire and allied perils. Stocks in go down and in open are covered.

Section 3 : Covers all the contents in the premises against burglary, house-breaking and terrorist acts.

Section 4 : Covers loss or damage to TV/VCP/VCR of the insured due to fire/burglary/theft, electrical or mechanical breakdown of accidental external means.

Section 5 : The policy covers loss or damage to pedal cycle by accident, burglary, house-breaking, or fire.

Section 6 : Covers the insured and his family against personal accident and death due to accidental reasons.

Section 7 : Provides fire cover to artisans, tiny sector units, village and cottage industries.

Section 8 : Cover death of animals due to diseases or accident including fire/lightning/famine.

Section 9 : Covers agricultural pump set upto 10 HP capacity from the risks of fire/theft/burglary and breakdown risks.

Section 10 : Covers over 500 poultry birds in the farm located within the insured premises due to any accident.

Section 11 : Covers fraud committed by any salaried employee of the insured in the premises.

Section 12 : Covers accompanied baggage lost or damaged during travel anywhere in India.

Section 13 : Covers animal drawn vehicle from risks of damage to the vehicle, personal accident, third party liability from accidental causes. The policy also covers the life of the driver.

Section 14 : Covers loss or damage to agricultural tractors and its accessories due to accidental reasons. Unnamed passengers (upto 6) travelling on such tractors are covered.

Policy offers compensation as per limits of liability/as per sum insured set against each section. Rates of premium are fixed for individual sections. If more than 4 sections are covered, upto 15% discount is available. When more than 6 sections are covered, upto 20% discount is allowed.

Fish Insurance

This policy is devised for fresh water fish rearers to cover stock of fry/fingerlings/fish/breeders of breeds like Rohu, Katla, Mrigal, Common Carp, Silver Carp or any other recognised breeds. The policy covers total loss to the fish due to accident or disease during the period of insurance. The cover includes loss due to pollution, poisoning, malicious act by third parties, riot and strike. Partial loss of any kind is not covered. Flood and allied risks are covered as an extension on payment of extra premium. The policy can also be extended to cover the fish rearing pond, bunds, sluices etc. against fire and natural calamities on payment of additional premium. Policy is issued for the rearing period subject to a maximum period of 12 months from the date of stocking.

Since the value of fish increases due to growth and inputs, settlement of any loss will be effected as per the scheduled valuation fixed on fortnightly basis (the table of valuation will be attached to the policy). The value depends on the cost of fry/fingerlings, cost of input and other incidental expenses. Insurance has to be effected on the sum insured of final stage of rearing period (Peak value). Premium will be charged @ 2.4% on the peak value. Flood perils are covered by charging 1% extra in non-flood prone areas and 2% in case of flood prone areas. Fish rearing ponds can be covered @ 0.5% of the value of ponds in non-flood prone area and 1% in flood prone areas. The proposal form should be duly completed and certified by the Government fishery official. If the pond is subsidised by Bank/FFDA, a copy of the techno-economic feasibility report is to be provided for deciding the sum insured/peak value/input cost for the items stated in the declaration sheet. Specimen copies of daily fish culture records are to be submitted. For flood cover to bunds, a certificate from Government fishery extension officer regarding construction and viability of bunds is to be provided.

Even though the fish farming is lucrative, offers high yields and profits, the experience during the recent years has been especially bad both for the farmers as well as the insurance companies. Insurance companies therefore adopt strict underwriting practices and compliance of warranties to minimise losses and also extend their technical assistance, which explains why it makes good sense in taking this insurance.

Floriculture Insurance

Growers of commercial flowering plants such as rose, crysanthemum and jasmine having adequate agricultural expertise in the subject may take out this policy. This policy covers only plants whilst growing in the farm/green house/poly-house against total loss or damage due to

- Fire including forest fire and bush fire
- Lightning
- Acts of terrorism, riot and strike
- Storm, hailstorm, cyclone, flood and inundation
- Earthquake
- Impact damage by rail/road/air vehicles and animals.

Policy may be extended to cover risks of loss due to drought, pests, and diseases specific to flowering plants. The Policy covers the input costs incurred till the time of loss. These are the recurring expenses incurred to raise/maintain the plants such as soil preparation, fertiliser, manure, cost of plants/seeds/saplings, cost of planting/sowing and Pruning, pesticides, insecticides, irrigation, labour charges and other costs specifically covered. Claims exceeding 50% of the total sum insured per hectare or Rs. 1,000/- whichever is less only shall be admitted. Each and every claim is subject to an excess of 20%. Premium is charged on the sum insured opted as follows :

Risk Cover	*Rate*
Basic cover	1.25%- 2.5%
Under glass house/Green House in open field	
Additional Cover (Pests/diseases & drought)	0.75%-1.5%

At the time of taking out insurance, the plants should be at least one month old after plantation/ transplantation i.e., the plants should be well established in the soil. Insurance cover will be granted subject to pre-acceptance inspection by insurers and feasibility report from State Agricultural Directorate/Expert's opinion being received

Floriculture requires constant supervision and maintenance. Despite all the precautions, the plants are exposed to risks from pests and unknown diseases or action of natural calamities. It is for this reason, coverage of the plantation under this policy is strongly recommended.

Lift Irrigation/Sprinkler Insurance

This policy is suitable for the agriculturist using the lift irrigation or sprinkler installation for cultivation. This policy covers loss or damage to intake well, delivery chambers, jackwell, pump-house, water storage tank, pipe lines, cables, starters and motors of the lift irrigation system or sprinkler installation arising out of

- Fire and allied perils
- Flood, earthquake and land slide
- Accidental damage to machinery and pipe line
- Bursting of pipe lines
- Theft

On the occurrence of a loss, claims will be paid for the cost of restoration to the extent of sum insured set against each item. An excess of 1% the machinery value subject to a minimum of Rs. 1000/- per claim is applicable. Theft claims are paid on receipt of non-traceable certificate from the police.

A rate of 1% on the cost of the entire system is applicable for insurance under this policy. The sum insured shall be the new replacement cost including freight, customs duty and erection costs. Terrorist risk can be included in the cover at an extra premium. Duly filled in proposal giving the details of the machinery and their individual replacement costs should be submitted.

Loss due to breakdown, theft or accidental reasons to the machinery not only is a loss in itself, but also has consequential effect that the crop is affected. It is necessary that the system is repaired/reinstated to mitigate the losses. This policy comes to aid in such situations and is therefore recommended.

Plantation/Horticulture Insurance

Suitability : This policy is suitable for individual farmer-owner or tenant engaged in cultivation of horticultural trees or plantations or an association/organised and registered body of farmers engaged in cultivation of specified crops. Also bodies procuring inputs, processing/marketing of the produce can take this policy.

Salient Features : Horticultural trees/orchards such as citrus fruits (Orange, Lime, Sweet Lime), Grapes, Chikoo, Pomegranate, Banana and Plantations such as Rubber, Eucalyptus, Poplar, Sugarcane, Betelvine, Cardamom, Sweet Chilli, Oil Palm, Teakwood, Strawberry, Tea, Apple and Coconut can be covered by this policy. The Policy covers loss or damage due to fire (including forest and bush fire), lightning, storm, hail storm, cyclone and other such natural calamities/acts of terrorist to fruits in respect of horticultural crops.

Tree in Case of Plantations

Additional Covers : Unseasonal rains and frost in case of grape vines and tea, loss or damage by wild animals in case of sugarcane, banana; drought and disease in case of banana, flood and inundation in case of teak plantations; disease and pests in case of tea plantations and betelvine are the additional covers available.

Benefits : Claims are paid to the extent of 80% of the assessed loss subject to the overall limit of the sum insured. Sum insured shall be based on the cost of cultivation i.e. input cost or cost of raising/development of trees. Only such claims exceeding 10% of sum insured per acre or minimum of Rs. 1000/- shall be admitted. Input costs on account of loss or damage to the horticultural crop/plantations are covered. Loss of yield is not covered.

Premium : Premium shall be charged for different crops as follows :

	Type of Crop	*Rate*
1.	Horticultural Crops	5.0%
	*Citrus fruits, Chikoo, Pomegranate, Banana, Grapes	
2.	Plantations	1.25%
	*Rubber, Eucalyptus, Poplar, Teak wood, Tea, Mango	
3.	Sugarcane	1.25%
4.	Betelvine	6.0%
5.	Sweet Chilli (Capsicum)	4.4%
6.	Coconut	
	3 months to 3 years	0.60
	4 years to 7 years	0.50
	8 years and upto 50 years	1.50%

Requirements : Inter cropping may be done only if it does not interfere with normal growth and health of the trees. No smoking or cooking shall be allowed in the open fields and within 30 m of the property insured. Dry vegetation & leaves should be removed periodically.

Recommendations : Plantations are exposed to a variety of perils ranging from pests to forest fires. It bccomes very difficult for the farmer to come out of the effects of loss in the absence of comprehensive insurance cover. It is for this reason, this insurance policy is devised which is very popular and hence recommended.

Poultry Insurance

Suitability : This policy is suitable for the poultry farmers, the beneficiaries of schemes sponsored by DRDA, DPAP, IRDP and financial institutions providing assistance to poultry units.

Salient Features : This comprehensive policy is issued to cover poultry consisting of Broiler chicks/ Layer chickens/Cocks & hens in the poultry farms. A minimum number of 100 broilers/500 layers or 200 birds per batch in the hatchery can be covered under the policy.

The policy provides compensation for loss to birds dead due to accident (including fire, lightning, flood, cyclone, earthquake, riot, strike, and terrorist act); diseases contacted or occurring during the period of insurance.

Benefits : Policy provides compensation when the mortality rate of the birds exceeds the following limits.

Bird	*Age*	*Mortality Rate*
Broilers	1 day to 6 Weeks	More than 5% of the batch size
Layers	1 day to 8 weeks	More than 5% of the batch size
	9th week to 20th week	More than 3% of numbers at beginning of 9th week
	21st week to 72nd week	More than 1% of numbers at the beginning of 21st week.

In the event of death of birds 80% of the bird value or as decided by the veterinary surgeon whichever is less is paid. There is an additional deductible of 20% in case of Gumbore disease.

Premium : Premium rates depend on the age of the bird; whether or not they are financed under IRDP scheme as follows :

Bird	*Age* *For IRDP scheme*	*Premium* *Non IRDP scheme*	*Rate*
Broilers	1 day to 8 weeks	0.25% per bird/batch	1.5% (6.0% p.a.)
	1 day to 6 weeks	1.00% per bird p.a.	1.2% (4.8% p.a.)
Layers	1 day to 20 weeks	–	3.2%
	21 weeks to 72 weeks	–	3.5%
	1 day to 72 weeks	0.8% per bird	5.5%
Parent stock (hatchery)	–	–	5.0%

Requirements : A Certificate from a qualified veterinarian is required. In case of layer farms having more than 5000 birds, insurance company 's veterinary officer or panel doctor shall carry out inspection. All the birds in the farm should be insured. Standard practices of poultry rearing, record keeping shall have to be practised.

Out break of epidemics/natural calamities such as cyclone result in widespread loss to the poultry affecting the financial position of the poultry owner. The policy comes handy in such a situation and benefits the farmer.

ANNEXURE 11-A

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

New Delhi, the 14th July, 2000

(Obligations of Insurers to Rural and Social Sectors) Regulations, 2000

In exercise of the powers conferred by Section 32C read with Section 32B of the Insurance Act, 1938, (4 of 1938), the Authority, in consultation with the Insurance Advisory Committee, hereby makes the following regulations, namely :

1. Short Title and Commencement

   (1) These regulations may be called the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural or Social Sectors) Regulations, 2000.

   (2) They shall come into force from the date of their publication in the *Official Gazette*.

2. Definitions

   1. In these regulations, unless the context otherwise requires–

(*a*) "*Act*" means the Insurance Act, 1938 (4 of 1938);

(*b*) "*Authority*" means the Insurance Regulatory and Development Authority established under the provisions of Section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999);

(*c*) "*Rural sector*" shall mean any place as per the latest census which has–(*i*) a population of not more than five thousand; (*ii*) a density of population of not more than four hundred per square kilometre; and (*iii*) at least seventy five per cent of the male working population is engaged in agriculture;

(*d*) "*Social sector*" includes unorganised sector, informal sector, economically vulnerable or backward classes and other categories of persons, both in rural and urban areas;

(*e*) "*Unorganised sector*" includes self-employed workers such as agricultural labourers, bidi workers, brick kiln workers, carpenters, cobblers, construction workers, fishermen, hamals, handicraft artisans, handloom and khadi workers, lady tailors, leather and tannery workers, papad makers, powerloom workers, physically handicapped self-employed persons, primary milk producers, rickshaw pullers, safai karmacharis, salt growers, seri culture workers, sugarcane cutters, tendu leaf collectors, toddy tappers, vegetable vendors, washerwomen, working women in hills, or such other categories of persons.,

(*f*) "*Economically vulnerable or backward classes*" means persons who live below the poverty line;

(*g*) "*Other categories of persons*" includes persons with disability as defined in the Persons with Disabilities (Equal Opportunities, Protection of Rights, and Full Participation) Act, 1995 and who may not be gainfully employed; and also includes guardians who need insurance to protect spastic persons or persons with disability;

(*h*) All words and expressions used herein and not defined herein but defined in the Insurance Act, 1938 (4 of 1938), or in the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), shall have the meanings respectively assigned to them in those Acts.

3. Obligations

Every insurer, who begins to carry on insurance business after the commencement of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), shall, for the purposes of Sections 32B and 32C of the Act, ensure that he undertakes the following obligations, during the first five financial years, pertaining to the persons in–

(*a*) **Rural sector,** (*i*) in respect of *a life insurer*–(I) five per cent in the first financial year; (II) seven per cent in the second financial year; (III) ten per cent in the third financial year; (IV) twelve per cent in the fourth financial year; (V) fifteen per cent in the fifth year; of total policies written direct in that year; (*ii*) in respect of *a general insurer*,–(I) two per cent in the first financial year; (II) three per cent in the second financial year; (III) five per cent thereafter, of total gross premium income written direct in that year.

(*b*) **Social sector,** in respect of all insurers,–(I) five thousand lives in the first financial year; (II) seven thousand five hundred lives in the second financial year; (III) ten thousand lives in the third financial year; (IV) fifteen thousand lives in the fourth financial year; (V) twenty thousand lives in the fifth year;

Provided that in the first financial year, where the period of operation is less than twelve months, proportionate percentage or number of lives, as the case may be, shall be undertaken. Provided further that, in case of a general insurer, the obligations specified shall include insurance for crops. Provided further that the Authority may normally, once in every five years, prescribe or revise the obligations as specified in Regulation 3.

4. Obligations of Existing Insurers

(1) The obligations of existing insurers as on the date of commencement of IRDA Act shall be decided by the Authority after consultation with them and the quantum of insurance business to be done shall not be less than what has been recorded by them for the accounting year ended 31st March, 2000.

(2) The Authority shall review such quantum of insurance business periodically and give directions to the insurers for achieving the specified targets.

Key Terms

- Acqua Culture Insurance
- Cattle Insurance
- Failed Well Insurance
- Farmer's Package Insurance
- Floriculture Insurance
- Horticulture Insurance
- Lift Insurance
- Poultry Insurance
- Rural Banking
- Rural Insurance Covers

Suggested Readings

- N.K. Rustagi, *Crop Insurance in India–An Analysis*, B.R. Publishing Corporation, 1988.
- K.N. Rao, *Crop Insurance : Past, Present and Future, An Article published in Vision,* Journal published by MDI, Gurgaon, July-Dec. 2002.
- Syed M. Ahsan, *Agricultural Insurance : A New Policy for Developing Countries,* Gower Publishing Co. Ltd., 1985.
- Strategies for Rural Markets, Anabil Bhattacharya, *Insurance Time,* Kolkata, October 2002.
- *Miscellaneous Insurance,* Insurance Institute of India, Mumbai, IC78, 2002.

Questions for Review

1. Briefly explain the various rural insurance covers available in India.
2 List the IRDA provisions on obligations of insurers to rural and social sectors.

CHAPTER 12

PROJECT AND ENGINEERING INSURANCE

Every project leader within the corporate sector knows that nothing but an unqualified success of a project can ensure the repayment of costs involved or loans availed. In case of any delays or failure of a project, liquid funds will have to be made available to replace the costs incurred as well as repay the loans taken. Ever since India has been ushered into the era of liberalization, privatization and globalization, Project insurance has emerged as the need of the hour. The demand for Project insurance is increasing with major emphasis placed on infrastructure projects, besides other large projects.

At times, tried and tested risk management tactics have proved themselves effective in stemming the risks. But now, every Risk Manager would rather look for a new technique that could reflect the changing times. Everyone is looking for a modern and up-to-the mark risk management strategy. Since the industrial scenario is changing so quickly, Risk Managers in India have been forced to steel themselves for a challenging albeit an interesting assignment that should ensue within this new millennium by

- Adapting to the 'Global Scenario' and 'Modern Technology'
- Providing the latest Risk Management tactics as well as sustained Risk
- Management support for the development of industry within the Indian sub-continent.

Although new technology results in optimization of productivity and production, it also creates new and unheard-of risks. Introducing new technology is similar to developing a new sub-culture in engineering, erection, construction, commissioning and innovation in handling and transport of materials. Since automation also intensifies the chances of risks occurring due to human error, the repercussions are bound to be costly. Since Risk Management means efficiently managing the risks, it should be oriented towards the prevention rather than the cure, itself.

Risks Associated with New Projects

Risks, which might have a significant impact on the construction or operation of a project, can be grouped as :

1. *Commercial Risks* : Related to potential problems during construction resulting in delays and escalation of costs.
2. *Operational Risks* : Poor performance that translates in failure in generating adequate cash to pay the lending financial institutions.
3. *Risks of Disparity* : Difference between supply and markets resulting in the inability to produce assured capacity.
4. *General Risks* : Vendor's inability to utilize power generated.
5. *Political Risks* : Most likely to affect non-Indian investors as they are mere spectators to the ongoing bureaucratic scenario.

Basically, Risk Management is aimed at analyzing risks, controlling and financing them. Ideally, the Risk Manager must review the efficiency of the risk management decisions taken and also make appropriate changes that ensure proper handling of risks.

12.1 Project Insurance

All Risk Project Insurance Policy : Project Insurance is an all-inclusive insurance cover for any damage to project material whilst in transit, risks of damage on site and while being erected or commissioned under an "All Risks Project Insurance Policy." This policy has been designed after bearing in mind the various risks associated with erection of a factory right from the shipment of the first consignment, the subsequent storage, civil construction, erection of plant and machinery, commissioning and trials until the end of the trial period when commercial production commences. Any damages or injury to the third party is covered under this policy. This policy is more commonly known as *Marine-cum-Erection* policy.

Marine-cum-Erection Insurance : Although people tend to think that there are major differences between Project insurance and Marine-cum-Erection insurance, they are essentially the one and the same since the scope of cover is strikingly similar in both. This is also an "All Risks Insurance" which provides cover against the *loss* or damage to the consignments during transit or damage during storage, handling, erection, testing and commissioning stages. This policy also covers Third Party Liability due to indemnifiable accidents at project site. The cover commences right from the moment goods leave the manufacturer's/supplier's premises (warehouse) in a foreign country and remains in force during voyage to any Indian port and thereafter during inland transit to the site of erection; during storage at site; during shifting of goods for the purpose of erection and continues to be in force until completion of erection, testing and commissioning.

Escalation

In order to take care of increase in value due to escalation in the basic project cost, duties appreciation in Foreign Currency and fluctuation in the Exchange Rate, the escalation provision may be availed at the inception of the policy. The maximum permissible limit is 50 per cent escalation and premium is charged on half the escalation amount.

Basic Insurance Cover

This insurance cover under Project Insurance Policy comprises of two parts.

1. The first is coverage for transit to take care of the interest during the transit from the various suppliers' warehouses to the site of erection.

2. The second is the storage-cum-erection coverage to take care of the interest during storage, erection, testing and commissioning.

The transit risks covered are "All Risks" plus war, strike, riot and civil commotion for imports and strike, riot and civil commotion for inland transit.

For the erection portion, the risks covered are any accident, fire, riot and strike, lightning, malicious damage, storm, tempest, flood and inundation, earthquake, act of God perils, tearing apart due to centrifugal forces, short-circuiting, faults in erection, lack of skill and carelessness, and theft and burglary of property stored at the site of erection. It also covers damages to equipment during the commissioning and testing, till handed over to the principals.

Additional Covers

The risks of one project differ from another. In order to meet the particular requirements of the project concerned, care should be taken to check on which additional coverage/s out of those listed below is/are required and action taken thereon.

- Dismantling Cover
- Express Delivery
- Third Party Liability Cover
- Testing of Second-hand Machinery
- Deletion of 60 days Clause in Ocean Policy
- Cross Liability Cover
- Maintenance Period
- Terrorism Cover
- Additional Transits
- Clearance and Removal of Debris
- Additional Customs Duty.

Storage Risks at Fabricators' Premises/Workshop

In short, the cover is against all risks of physical loss or damage arising out of operation of any one or more of the following perils :

- *Location Risks :* Fire, Lightning, Theft and Burglary.
- *Handling Risks :* Impact from falling objects, Collision, failure of Cranes or Tackles.
- *Operational Risks :* Failure of safety devices, Leakage of Electricity, Insulation failures, Short-circuit, Tearing apart on Account of centrifugal forces. Explosion.
- *Human Risks :* Carelessness, Negligence, Faults in erections, Malicious Element, Damage, Strikes and Riots, Terrorism
- *Acts of God :* Earthquake, Storm, Tempest, Hurricane, Flood.
- Subsidence : Landslide, Rockslide.

Insurance policies that are required after completion of project are :

- Fire insurance
- Machinery Breakdown Insurance
- Advance loss of Profit
- Public Liability Insurance

12.2 Engineering Insurance

Apart from various covers available for projects before and after implementation, specific covers are also available for various items of plant and machinery and equipments. Some of these are discussed as below :

(*a*) Boiler Insurance

(*b*) Erection Insurance

(*c*) Storage-cum-Erection

(*d*) Marine-cum-Erection

(*e*) Loss of Profits (Machinery) Insurance

(*f*) Contractors all risk policy

(*g*) Machinery Breakdown insurance.

Civil Engineering Completed Risks Insurance Policy

This cover is provided to owners and operators of civil engineering structures can have comprehensive insurance protection against loss or damage after the construction work has been completed and the facilities are taken over. This policy is suitable for completed works such as runways, railway lines, bridges, flyovers, jetties, tunnels, dams, canals, harbours, dry docks, water pipe lines, irrigation systems, reservoirs, etc. The policy offers cover against loss or damage due to :

1. Fire
2. Lightning
3. Explosion/implosion
4. Riot, strike & malicious damage
5. Impact by any rail, road or water borne vehicle or animal
6. Storm, cyclone, typhoon, tempest, hurricane, tornado, flood & inundation, wave action
7. Subsidence, landslide and rockslide
8. Earthquake, fire and shock, tsunami
9. Frost, avalanche, ice

Extra Covers

Further hazards depending on the location and type of risk can be included like bush fire, volcanic action, blasting operations, cover for removal of debris following a loss at additional premium.

In case of damages which can be repaired, the policy provides for payment of costs necessary to restore the items to their condition immediately before the occurrence of the damage. In case of total loss, the actual value of the items immediately before the occurrence of the loss is payable to the extent the costs are included in the sums insured. Since the policy is on indemnity basis, only incurred costs are payable. Loss assessment is subject to adjustments for under insurance, salvage and policy excess. Premium is charged for the type of civil works covered, the earthquake zone in which the property is located, the additional covers required and the past claims experience. The insured has to file a proposal form giving full description of the civil works proposed to be insured, the geographical conditions, exposure to the risks, maintenance details and the values for which insurance is required need to be submitted. The documents generally required for processing engineering claims are as under :

(*a*) Copy of the policy complete with terms, conditions and warranties.

(*b*) Claim form duly completed by the insured.

(*c*) Survey report should include -

(*i*) Clear indication of the cause of loss

(*ii*) Extent of damage and loss

(*iii*) Establishment of liability

(*iv*) Assessment of loss occurrence of riot is in the public knowledge, production

(*v*) Confirmation of compliance of policy terms, conditions and warranties.

(*vi*) Admissibility of the claim.

(*d*) Photographs (if necessary)

(*e*) Police report, and (if necessary)

(*f*) Fire Brigade report (if necessary)

The steps involved in the loss adjustment are as under :

Gross loss assessed

(*a*) Less : depreciation, if any,

(*b*) Less : Salvage

(*c*) Less : Under Insurance

(*d*) Less : Excess

(*e*) Net Claim Payable

Note : Items (*e*) and (*f*) may be waived if the survey report is clear and does not cause any doubt on the occurrence as well as the extent of loss. Where occurrence of riot is in the public knowledge, production of Final Police Investigation Report and Fire Brigade report may be waived.

In case of the theft losses it is necessary to collect a copy of the first information report or proof of complaint lodged by the insured with the police, such as Registered A/D letter. Final Investigation Report may be waived depending upon the merits of the case.

All Risks Insurance

This policy is designed to protect the interest of civil contractors and Firms involved in construction activity against the damage or destruction of various civil engineering projects undertaken by them. The policy is suitable for all types of civil engineering construction works ranging from small buildings to massive dams as they are susceptible to damage by a variety of external and internal causes during the course of construction. This is a comprehensive policy designed to cover all risks associated with civil works right from the time of commencement of works at site till the contract works are taken over or put into use. The policy covers :

1. Fire/lightning.
2. Accidental damage during construction like dropping or falling, defective workmanship and material, lack of skill,.negligence, malicious act and human error.

3. Act of God perils such as flood and inundation, earthquake.
4. Collapse, collusion, impact.
5. Theft and burglary, malicious and terrorist damage.

Policy may be extended to cover air freight, additional customs duty, express freight, over time wages, expenses for clearance an removal of debris, damage to surrounding property, third party liability, escalation in costs, contractor's plant and machinery at the construction site, defects in construction which surface during maintenance period for which the contractor is liable under the terms of agreement with the principal. Claims are payable at the prevailing market rates for restoration of affected property to the condition immediately before the occurrence of damage. Cost of any improvement and modifications will not be admitted. The amount of loss payable is subject to under insurance if any, and the policy excess. Premium chargeable depends on the nature of the project, the project cost, the project period, geographic location and the period of testing. Discount in premium is allowed for large projects with sum insured more than 100 crores, the higher deductibles opted and for the fire protection available at the site. Premium may be paid in installments where the project period exceeds 1 year. In case of early completion of the project also, refund of premium may be claimed for the balance period of insurance.

Contractor's Plant And Machinery Insurance Policy

This policy is suitable for contractors involved in construction business for covering all kinds of construction equipment like compressors, heavy duty cranes, boring machines, bulldozers, pipe jacking, and hauling equipment, papers, excavators, loaders, road rollers, tunnel boring machines etc. can be covered under this policy. The policy offers cover against loss or damage due to sudden unforeseen eventualities such as :

1. Fire, lightning, explosion/implosion/aircraft damage, riot strike, malicious and terrorist damage, earthquake, subsidence, landslide, rockslide, storm, tempest, hurricane, typhoon, tornado, flood and inundation as are covered by the fire policy.
2. Burglary & theft
3. Damages while at work due to faulty handling, dropping or falling, collision and impact.

The policy can be extended to cover the additional risks of third party property damage and injuries; loss or damage to surrounding property, expenses incurred on overtime, express freight, air freight, additional customs duty, clearance of debris following a loss for additional premium. In the event of a loss, costs necessarily incurred for restoration or repairs of the damaged equipment including transportation costs to and fro repair shop, customs duties, taxes etc. to the extent included in the sum insured are paid. Policy also covers transit risk of the equipment within the project site. However, damages to exchangeable parts, electrical or mechanical breakdown, and accidents resulting from over load or similar tests are excluded. The policy is subject to excess as stated in the policy. Rate of premium depends on the type of equipment and the location at which it operates. Premium is charged on the reinstatement cost of the equipment. The potential insured has to submit a proposal form giving details of contractor's plant and machinery item wise, the individual values proposed for insurance and the geographical location of the project site where the equipment shall be used. In case additional covers are required they should be specifically mentioned.

At the time of claim settlement the validity of the policy at the time of occurrence and identification of damaged equipment/item is verified. The surveyor generally confirms the accidental

damage to the equipment. For items fabricated by the contractor and replacement values not available, the surveyor assesses the loss on the basis of actual costs incurred by the insured.

Deterioration of Stock Insurance

Breakdown and cold storage machinery may cause rise in temperature of cold storage chambers leading to Deterioration of stock. This policy covers such losses to the stocks in cold storage. The policy is suitable for the owner of the cold storage (individual or a cooperative society) or those who take the cold storage on lease or hire for storage of perishable commodities. This policy covers loss or damage to the stocks in cold storage following breakdown of the cold storage plant. The deterioration of the stocks can be due to :

1. Rise in temperature
2. Sudden and unforeseen escape of refrigerants into the cold storage rooms.

However, the following causes are not covered :

1. Shrinkage, inherent defects or diseases, natural putrefaction, etc.
2. Improper storage, damage to packing material, insufficient air circulation
3. Any wilful act or gross negligence of insured or his representatives
4. Loss due to overloading of plant
5. Fire perils including riot, strike, malicious and terrorism damages, war perils
6. Loss arising out of failure of any part requiring periodical renewal; wear and tear parts
7. Operation of fuses and similar devices

Policy can be extended to cover damage to stocks resulting from failure of public electric supply. In the event of a loss, the market value of the commodities lost and reasonable expenses incurred to avoid or minimize such loss or damage, say for transferring the goods from one cold storage to the other are paid. In case of a total loss, claim is paid subject to the overall limit of sum insured under the policy. The sum insured should represent the maximum value of stocks in the cold storage at any given time. Certificates issued by Government authorities that the stocks are unfit for consumption should be provided in support of the claim made. Premium depends on the nature and value of goods stored, the age and condition of the refrigeration plant, stand by/ repair and/or replacement facilities, nature of refrigerant, alternative storage facilities available, past claims experience and similar other factors. Proposal form should be submitted duly filled giving the nature of commodities stored, details of the refrigeration plant, stand by/maintenance and repair facilities available. The refrigeration plant should be covered under machinery breakdown insurance policy. Following loss minimization measures are insisted by the surveyors while settlement claims :

(*i*) No fresh stock should be loaded in the cold storage chambers.

(*ii*) Cold storage doors should be sealed to maintain temperature and avoid temperature rise.

(*iii*) If possible, the insured should be requested of shift stocks to some other running cold storage premises preferably in cool evening/night period or by refrigerated vans.

(*iv*) The insured should be requested to carry out repairs to the refrigerator plant most expeditiously.

(*v*) If there is no possibility of completing the repairs immediately, the insured should be advised to unload stocks from cold chamber for disposal in the local market as quickly as possible, and at the best available price in association with the surveyor/local authorities.

Erection All Risks Insurance

This policy is suitable for the principal or contractors of a project being erected as the project is exposed to various external risks during the construction period and damage to plant and machinery and the supporting structures due to accidents cause financial loss apart from delay in implementation of the project. Interest of all the sub-contractors may be covered by one policy for operational flexibility. This is a comprehensive insurance policy designed to cover any sort of contingency right from the moment the materials are unloaded at the project site and continues during the entire project period until the project is tested, commissioned and handed over. The policy covers the following perils :

1. *Location risks* : Fire, lightning, theft and burglary.
2. *Handling risks* : Impact from falling objects, collision, failure of chains or tackles.
3. *Operational risks* : Failure of safety devices, leakage of electricity, failure of insulation, short circuit, explosion, etc.
4. *Risks of human element* : Negligence, carelessness, faults in erection, malicious damage, riots and strikes.
5. *Act of God* : Storm, tempest, hurricane, flood, inundation, landslide, rockslide, and earthquake.
6. *Extra covers* : Cover for contractors plant and equipment, third party liability, surrounding property, removal of debris, escalation, express freight, overtime charges, additional customs duty are provided at suitable additional premium.

Claims are payable at the prevailing market rates for restoration of affected property to the condition immediately before the occurrence of damage. Cost of any improvement and modifications will not be admitted. The amount of loss payable is subject to under insurance if any, and the policy excess. Premium chargeable depends on the nature of the project, the project cost, the project period, geographic location, the period of testing. Discount in premium is allowed for large projects with S.I more than 100 crore, the higher deductibles opted and for the fire protection available at the site. Premium may be paid in installments where the project period exceeds 1 year.

Industrial All Risks Insurance

This coverage is provided to all major industrial units (other than petrochemical risks) having over all sum insured of Rs. 100 crores and above in one or more locations in India are eligible to take Industrial All Risks Insurance Policy. The policy offers cover against damage due to all perils covered by :

A. Fire and special perils policy.

B. Burglary insurance policy.

C. Machinery Breakdown/Boiler explosion/Electronic equipment Insurance.

D. Business Interruption due to fire and special perils policy.

Losses due to the following are excluded :

1. Faulty material/workmanship/defective design and material.
2. Inherent vice, defects, deteriorations, and normal wear and tear.
3. Collapse or cracking of buildings.
4. Pollution, contamination, shrinkage, rust, corrosion, scratching, & temperature changes
5. Larceny, fraud, dishonesty, inventory losses, shortage on delivery
6. Wilful act, negligence; wars and nuclear risks.

Machinery loss of profit cover is optional. Debris removal, escalation and other covers available as extensions to fire policy can be covered for additional premium. The policy offers widest range of cover compared to that provided by individual operational policies. Under insurance to the extent of 15% is ignored. Sine the insurance is on reinstatement value basis; all expenses for restoration of the damaged property will be covered to the full extent. The policy is however, subject to an excess of 5% of claim amount with a lower limit of 5 lakhs and upper limit of Rs. 50 lakhs. Premium rates for the policy are based on

1. The cover opted
2. Claims experience
3. Deductibles opted
4. Risk assessment report of the engineer (for MLOP)

Machinery Insurance Policy

This policy is suitable for every industry which operates on machines and for whom breakdown of plant and machinery is of serious consequence. Monetary costs involved for restoration of machine to its original state are covered by the machinery (breakdown) insurance policy. The policy offers cover against loss or damage to the plant and machinery due to sudden and unforeseen reasons whilst the machinery is at work or at rest caused by :

1. Faulty material, design, construction or erection.
2. Vibration, mal-adjustment, mal-alignment
3. Defective lubrication, loosening of parts, stress, molecular fatigue, heating, centrifugal force, explosion/implosion.
4. Electrical faults and failures.
5. Failure of connected machinery or protective devices.
6. Lack of skill/carelessness of the operators
7. Falling, impact, collision and the like
8. Obstruction or entry of foreign bodies into the machine

Additional expenses required to repair & restore the damaged machinery like overtime, express freight, surrounding property, third party liability, additional customs duty, air freight can be covered on payment of necessary additional premium.

In case of partial loss, all expenses necessary for restoration of the affected machinery will be paid to the extent insured in the policy. Claims will be paid in full provided the machine is adequately insured. Depreciation is not applied except for parts with limited life or which are subject to wear and tear. Excess at 1% of sum insured shall be deducted from all claims. Where the repair cost exceeds the cost of the machine, loss will be dealt on 'total loss basis ' *i.e* claim will be settled for the depreciated cost of the machine as on the date of loss. Premium is charged on the reinstatement value of individual machinery. The machine as a whole should be insured. Premium rates depend on the type of machine; the industry in which it is used and its value. Discounts are offered based on factors such as stand-by facilities, spares available and claims experience provided the value of all machinery at a particular location exceeds Rs. 10 crores. While settling claims, the test reports of the damaged parts if deemed necessary by the surveyor and/or suggested by the insurers is to be submitted to the insurer/surveyor. The claim payable may include costs of dismantling transportation to the repairer's shop, repairs and re-transportation and re-erection and other incidental expenses. If damaged equipment being sent out is covered under a Marine Transit Policy, the cost of such insurance may also be reimbursed. If repeated losses are reported on the same equipment, the underwriting office can take the help of an outside expert to ascertain the precise cause of repeated losses and suggest measures for avoidance/minimization of re-occurrence of breakdown/loss. The exclusion of damage to Belts, Ropes, Chains, Rubber Tyres, Dyes, Moulds, etc. is to be considered. As to the oil and other operation media in the transformer and equipment, these may be reimbursed when specifically covered under the policy.

The losses under the other extensions like additional custom duty, air freight, express freight, etc., are to be assessed separately and the underwriting office should confirm the availability of additional sum insured specifically for such items of expenditure while recommending the claim for settlement. If the assessment involves additional expenses for repair/replacement, the surveyor should confirm that the expenses are reasonable.

Loss of Profits Policy

This policy is suitable for industries where interruptions or delays as a result of machinery breakdown or boiler explosion result in huge consequential losses. Where the time lag between the breakdown or loss and the restoration is large, this policy compensates for the loss of profits during the intervening period.

The policy offers cover against consequential losses following loss or damage to the property insured under machinery breakdown and/or boiler and pressure plant insurance. This policy covers actual financial losses suffered by the insured due to business interruption arising from :

1. Reduction in turnover and
2. Increase in cost of working

The standard policy thus insures the loss of gross profits in the business following accident to the machinery, boiler and pressure plant, as a result of material damage loss covered under the corresponding machinery breakdown and boiler explosion policies. The losses as a result of reduced turnover because of the machinery damaged and the additional expenditure necessarily incurred for avoiding or reducing the fall in turnover for the interruption period are compensated under this policy. However, the policy is subject to a time excess of 7 days (14 days in case of petrochemical risks) which means that interruptions for periods less than or equal to these periods are not covered. Premium rates depend on the critical nature of the machinery covered by the breakdown or explosion policies; their relative importance and contribution to final output; the repairs, maintenance and stand by facilities available and the indemnity period opted.

Key Terms

- Deterioration of Stocks
- Errection Risks
- Industrial Risks
- Machinery All Risks
- Project Risks

Suggested Readings

- Engineering Insurance, IC77, *Insurance Institute of India,* Mumbai, 1999.
- Miscellaneous Insurance, IC78, *Insurance Institute of India,* Mumbai, 1999.
- Barry D. Smith *et. al., Property and Liability Insurance Principles,* Insurance Institute of America, 1994.

Questions for Review

1. Briefly explain the need for project insurance and the various covers available in India.
2. Write short notes on :
   (*a*) Deterioration of Stocks Insurance
   (*b*) Contractor's Plant and Machinery Insurance

CHAPTER 13

SOCIAL INSURANCE

Social Insurance through various programs provides a safety net against the financial insecurity that can result from premature death, unemployment, poor health, job related disabilities and old age. These programs are especially vulnerable to individuals and families with limited incomes. However in India social insurance concept is in its premature stage, due to vast cultural, economic, social diversities.

13.1 What is Social Insurance?

The government on a compulsory basis generally provides social insurance. It is not easy to precisely define social insurance because the government can use the power and resources to apply the insurance method or modification of it in a variety of ways. In the developed countries like U.S. there has been a tendency to look first to the private insurance industry for the coverage of risk that society deem important. When such risks have not been handled adequately by private insurance, social insurance programme comes into picture.

13.2 Characteristics and Need for Social Insurance

The main characteristics of social insurance are :

- Social insurance is based on the law, rather than on contract. Cost and benefit are established by and can be changed by government.
- Hence coverage is compulsory for all persons to whom the law applies. They cannot choose to decline to participate, nor can they select the coverage or the amount of the benefits.
- The objective is to provide some minimum level of economic security for the large portion of the population. The basic ideology is to provide an economic system that stresses free enterprise and individual initiative, people should not rely entirely upon government programs.
- The focus of social insurance is to provide maximum benefits to the lower income groups. Unless lower income groups are subsidised to high income groups, the payments of the former will not be large enough to furnish the minimum level of protection that are desired.
- Social insurance usually covers only those who are or who have been employed. Most social insurance plans are concerned for interruption of income (by death, unemployment or retirement) earned through employment.

13.3 Legal Framework for Social Insurance

The Insurance Regulatory and Development Authority Act, 1999 (para 19; First schedule) has amended the Sections 32B and 32C of the Insurance Act, 1938 as under :

Section 32B

Every insurer shall, after the commencement of Insurance Regulatory and Development Authority Act, 1999, undertake such percentages of life insurance business and general insurance business in the rural and social sector, as may be specified, in the Official Gazette by the authority, in this behalf.

Section 32C

Every insurer shall, after the commencement of Insurance Regulatory and Development Authority Act, 1999, discharge the obligations specified under Section 32B to provide life insurance or general insurance policies to those residing in the rural sector, workers in the unorganised sector or informal sector or economically vulnerable or backward classes of the society and other categories of persons as may be specified by the regulations made by the authority and such insurance policies shall include insurance for crops.

The IRDA Regulations 2000 makes it compulsory for the insurers, existing and new to promote the social insurance.[1] Similar to the requirement for the rural sector, the regulations also prescribe for undertaking benchmark percentages for insurances in the social insurance sector for the players.

The *social sector* is defined as including the unorganised sector, the informal sector, the economically vulnerable or backward classes and other categories of persons, both in rural and urban areas.

In case of social sector the requirement is compulsory underwriting of 5000 lives in the first financial year, 7,500 in the second year and so on. Also, the authority may revise the obligation once in 5 years.

13.4 Social Insurance in India

Social insurance is the baby of the social security systems prevailing in that country. Social security is the security cover which society furnishes through appropriate organisation against risks to which its members are exposed. The basic idea is to use social means to prevent deprivation and vulnerability to deprivation.

In the literature on development issues, it has often been assumed explicitly or implicitly that developing countries are too poor to be able to *afford* social security systems. Public participation in social security systems can take wide variety of forms and it is very much possible even for poor countries to achieve considerable success on this front. This is not to say that economic growth and social security are not linked. However at the same time, simple economic growth alone cannot ensure improvements in living standards of people. Social intervention is necessary for improving quality of life at the micro level.

Studies carried out by UNICEF and World Bank also provide considerable evidence that it has been the direct public support rather than the average income of the population that has been the driving force behind the success of social security schemes worldwide. In fact, the countries with good primary social systems are those which have adopted the path of support-led security (as against growth-led security) and have *not waited* to grow rich before resorting to large scale public support to guarantee certain basic capabilities. Notable examples include China, Chile, Cuba, Jamaica and Kuwait.

Need for a Social Security System in India

A large chunk of Indian population lives under object poverty. They barelyt manage to earn enough to eat. It is our social obligation to provide our underprivileged brethren with an adequate safety cover.

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[1] Annexure 11-A

Only a very small percentage of the working population is employed by the organised sector, which provides benefits like the state pension. A vast majority is either self employed or employed in the rural and unorganised sector. As a result, they are deprived of social benefits such as retirement benefits and disability or death compensation. Similarly, health-care although subsidised is thinly and haphazardly spread. State support for the unemployed and disabled is negligible.

Social changes taking place in the country are also resulting into increased need for a social security system. The Joint Family System, which prevailed in India for long is losing its flavour. This system provide a natural safety cover to the members of a family. However, its break-up into nuclear families meanst hat the death or disability of the bread-earner leaves his dependants completely exposed.

A comprehensive social security system includes social insurance, health insurance, disability compensation, unemployment compensation, old-age pension schemes, etc. In India, social security systems are an emerging concept and there is no strong base to start with. Given the constraints on funds and infrastructure availability, social insurance is the only scheme that can be launched at present. Further, opening up of the insurance sector has created increased awareness about insurance and also provides a sustainable revenue model to carry out the task of social insurance.

India–A Special Case

India is a special case compared to many other countries for the implementation of social insurance schemes. A support-led social security system is one that requires active state intervention. The main source of funds provided by the state comes from the taxes it collects. Unfortunately, India has a tiny tax-paying base. Further, social insurance is not a constitutional right of the citizens in India. The cause can again be traced to the fragile economic situation of the country that does not permit any kind of comprehensive social insurance schemes.

Social Insurance Schemes of GIC

GIC has launched certain social insurance covers like Krishi Bima Yojana, Personal Accident social security scheme, hut insurance scheme. However, the experience has been that most of these are failure in the sense these schemes failed to achieve the objectives for which these were floated. Similar is the case of LIC.

Social Insurance Schemes of LIC

Life Insurance Corporation of India (LIC) has taken the initiative and launched several social insurance schemes. Some of the schemes launched by LIC in the past are : Landless Agricultural Labourers Scheme, Group Insurance Scheme for beneficiaries of the Integrated Rural Development Program, Rural Group Life Insurance Schemes and the Krishi Shramic Samajik Suraksha Yojana (2001). Most of the social insurance schemes launched could not achieve their desired objective as a large chunk of the population covered under these schemes were not even aware of them. In August 2000, LIC launched the Janashree Bima Yojana as a single scheme to replace the older social insurance schemes. The objective of this scheme is to provide life insurance protection to the rural and urban poor living below the poverty line and marginally above the poverty line. This is a group insurance scheme and the minimum size of the group is 25. The annual premium is Rs. 200 per member per annum. The member/nodal agency/state government pays half the premium and the remaining half is borne out of the Social Security Fund.

There are 40 occupational groups, which can be covered under Janashree Bima Yojana. They range from beedi workers and handloom tailors to construction workers and safai karamacharis.

Creation of a Separate Body for Social Insurance

The Central Government of India created the Social Security Fund in 1988. LIC was given the responsibility for managing the fund. However, performance data for the past five years on the social insurance front is not encouraging.

Exhibit 13-A

Description	*1996-97*	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Existing lives	44,86,884	47,57,476	47,72,082	46,23,797	46,62,281
New Lives	4,48,143	2,62,456	1,28,158	3,26,190	74,610
Total	49,35,027	50,19,941	49,00,240	49,49,987	47,36,891

The number of new lives covered in the last one year is less than the number of people born in India in one day. Providing social insurance to all is a mammoth task and requires a set-up fully dedicated to this task. On the front of social insurance, various recommendations have been made by researchers extracts of which are follows :

- Cost minimisation is a basic requirement on which any social security system is built. Instead of all the insurance companies complying with the social requirement (as imposed by IRDA) individually, it has been proposed that a common pool of funds be generated and channelled towards the same objective. This will prevent duplication of work and thereby reduce administrative and implementation costs.
- At the same time, with the entry of private insurance players in the country, it is all the more difficult for LIC to do justice to both–its commercial insurance business and meeting social obligations. The need for a separate body dedicated to social insurance is therefore obvious.
- The biggest concern in implementation of social schemes are being able to reach the target population and cost effectiveness. Therefore only group insurance can be introduced in such schemes. It is a time-tested fact that Government bodies have not been able to make inroads among the masses in a cost-effective manner. Further, given that India has a very narrow tax base and low tax revenue, work based and community-based social insurance systems should be encouraged.
- Decentralisation *i.e.* participation of local in administration and implementation of such schemes is essential. Therefore, it is necessary to have a nodal agency that can interact with people on behalf of the insurer and with the insurer on behalf of the group. The *introduction of a nodal agency* would also reduce the administrative overheads of the insurer thereby reducing overall cost. There are several advantages of the use of a nodal agency for implementation of social life insurance schemes.

  (*a*) Local level participation and ownership ensures that implementation would suit local requirements and hence there are higher chances of success.

  (*b*) This structure combines advantages of centralised policy making with localised implementation.

  (*c*) It effectively bypasses poor functioning of the public sector hierarchy.

However these recommendations pertain only to the delegated authority and not devolved authority. The insurer will collect the premium directly from the nodal agency and the nodal agency will do the collection in parts or at one time from the group members.

Registered bodies like co-operatives, unions (such as taxi union etc.), associations (such as fishermen associations), self help groups and registered NGOs etc. are ideally suited to act as nodal agencies.

Co-operative

As per statistics of the National Co-operative Union of India, there are 1.4 lakh primary agricultural co-operatives and 3.6 crore people whereas the non-credit co-operatives cover 6.4 crore people. In the present scenario, co-operatives fit very well to act as the nodal agency and offer immense potential for reaching out to the masses of India.

Associations

Associations are widely spread across the country in different occupational groups and hence provide a platform to tap the people associated with such associations.

Self Help Groups

Self Help Group is a concept utilised by NABARD to develop the habit of thrift saving among very poor people who are devoid of any sort of financial system. At present, their main function is to collect money in small instalments from members at regular intervals and form a common pool. It also provides credit to its members, when required. These groups are linked to the local bank either directly or through NGOs. Through NGOs, government bodies and banks, vast number of self-help Groups have been established in the recent years. Fuelled by enthusiasm at all stakeholder levels, it has expanded rapidly throughout India, including marginal and tribal areas. In light of the above facts, Self Help Groups can also be used as nodal agencies.

Critical Success Factors in Selection of Nodal Agencies

- *High level of mutual trust*

  People should have faith in the nodal agency, especially when targeted people are less educated and are from the low-income group.

- *Monetary transactions*

  The existence of monetary transaction is the single most critical operational factor for success. In the case where existing interactions between the individuals and the nodal agency involves monetary transactions, it becomes much easier to collect money efficiently and on time.

- *Frequency of interaction of nodal agency with the group*

  High frequency of interaction adds to mutual understanding between the individuals and the nodal agency.

- *Organisational structure of the nodal agency*

  The organisation structure of the nodal agency should be conducive to the implementation of social insurance schemes. The structure should ensure simplicity of the process for the

individuals covered. The nodal agency's structure should also ensure the transparency of its operations. This would help in inspiring trust among the people.

- *Interests of the nodal agency*

  From the nodal agency's perspective, the implementation of any such scheme should be in line with its objectives. It has been observed that in case of most co-operatives, the primary intention was to help its members. However, some NGOs were looking for monetary incentives to cover their costs.

20.5 Unemployment Insurance

Unemployment Insurance is designed to provide short term protection for regularly employed persons who lose their jobs and who are willing and able to work. Unemployment insurance has several basic objectives :

- Provide cash income during involuntary unemployment.
- Help unemployed workers find jobs
- Encourage employers to stabilize employment
- Help stabilize economy.

Unemployment insurance is a popular concept in developed countries like U.S. where they have well defined laws and regulations. However, in India it will take a long time to come.

Key Terms

- ❖ Social Insurance Schemes
- ❖ Unemployment Insurance
- ❖ Self-help Groups
- ❖ Nodal Agency

Suggested Readings

- Irving Pfeffer and David R. Klock, *Perspectives on Insurance*, Prentice-Hall, Englewood Cliffs, 1974.
- IRDA Annual Reports.
- Mark D. Dorfman, *Fundamentals of Insurance*, Prentice-Hall, 2002.

Questions for Review

1. Define social insurance and state its main features. List the various provisions of IRDA Regulation on social insurance.
2. Critically evaluate the state of social insurance scheme in India what steps can be taken to make them more effective?

CHAPTER 14

MOTOR INSURANCE

Motor Insurance originated in U.K. where the first motor insurance policy was introduced into England in 1894 to cover third party liabilities. And in 1899 the policy was extended to cover the accidental damage similar to what is known as comprehensive policy. In India the Motor Vehicles Act was passed in 1939 and in 1946 the third party insurance was introduced compulsorily.

The need for compulsory motor insurance is obvious. There has been a phenomenal rise in the motor accidents in the last 4-5 years. Much of these are attributable to a sudden spurt in the number of vehicles. Every vehicle before being driven on roads has to be compulsorily insured. The automobile insurance policy represents a combined coverage of the vehicles including accessories, loss or damage to his property or life and the third party coverage.

14.1 Overview of the Losses due to Automobile Ownership and Usage

The major sources of loss exposure arising from the automobile accidents are :[1]

- Legal liability for harm caused to others as a result of negligence
- Bodily injury
- Property damages and or theft of vehicles

Risk managers realise that insurance should be considered within the context of all available risk management tools. There are several ways to lower losses from automobile accidents :

(1) reduce the frequency and severity of accidents, (2) restrict payments, and (3) redistribute expenses and losses.[2]

Loss Control and Prevention

The loss to the automobile insurance service providers is mainly in the form of claims arising from accidents. Accidents can be minimised by providing better infrastructure in terms of roads, limit on speed and other sophisticated traffic control measures. Also, automobile manufacturers must be encouraged to continuously pursue enhancement of the safety measures in the vehicles.

Globally speaking, there has been a demand for smaller, light-weight vehicles, which has resulted in increased severity of accidents and consequential losses.

Restriction on Claims

Putting restrictions on the insured's claims in the sense the fraudulent claims can be easily detected and effectively reduce the cost to the insurers. Another way is to incentivise the good clients by way of attractive rates and discounts.

Redistribution of Losses and Expenses

The auto liability claims, which frequently arise from driver's negligence, can be tackled through redistributions. In such a mechanism, first the guilty party is to be determined and then the guilty

[1] Harrington & Neihaus, *Risk Management and Insurance*, McGraw–Hill, 1999, p. 533.

[2] J.S. Triechmann, S.G. Gistavson and R.E. Hoyt, *Risk Management and Insurance*, South-Western College Publishing, 2001, pp. 270-272.

party pays to the suffered party the amount of loss. Such processes are generally channelled through the judicial system.

Automobile Coverages[3]

The coverage for automobiles differs in countries. However, in most of the developed countries following types of coverage are available :

Automobile Liability Insurance

Automobile Liability Insurance protects the insured against the loss arising from legal liability when his or her automobile injures someone or damages another's property.

Medical Payments Coverage

Automobile Medical Payments coverage reimburses the insured and members of the insider's family for medical expenses that result from automobile accidents. The protection also applies to other occupants of the insured's automobile.

Physical Damages Insurance

Automobile Physical Damage Coverage insures against the loss of the policyholder's own automobile. The coverage is written under the two insuring agreements (also called as Comprehensive coverage) and Collusion–which indemnifies for collusion losses. Physical damage coverage applies to the insured auto regardless of the default. If the other driver is at fault, the insured that carry collusion coverage has the option of proceeding against the other driver or collecting under his or under policy coverage. In India, the GIC offers two types of policy coverage. Form A policy cover is legally compulsory under the Motor Vehicles Act, while Form B policy is optional, known as comprehensive cover. Both of these are discussed in section 14.3 of this chapter.

14.2 Need for Automobile Insurance[4]

In Indian conditions, the vehicles are subject to many hazards like potholes, open manholes, puddles, untarred roads, traffic management system, poor pedestrian management, absence of footpaths for pedestrians, jaywalkers, increasing number of accidents etc. which accentuate the need for automobile insurance. Some of these hazards are discussed below :

Footpaths

As footpaths are encroached by hawkers, pedestrians have a tough time dodging between vehicles to reach the other end of the road. Large potholes and manholes are a common sight and during the monsoon the situation can get only worse causing untold damage to your vehicle.

Drunken Driving

Drunken driving is another very common feature. Be it a car, a two-wheeler, or even a truck, drunken driving is one of the major reasons for increase in accidents. Though drunken driving is a punishable offence the penalty has hardly proved to be a deterrent.

[3] Vaughan and Vaughan, *Essentials of Risk and Insurance Management and Insurance*, John Wiley and Sons. Inc., 2001, pp. 435-436.

[4] www. Insuremagic.com/Auto Insurancebasics–Need for Automobile Insurance.htm

Reckless Driving

Besides, rash driving by youngsters is another of the dangerous realities that you should consider. Majority of the youngsters drive recklessly caring little for the law, causing serious accidents resulting in loss of life or limb.

Theft

Cases of stolen cars are on the rise. Experts in stealing cars are well aware of the loopholes that can be exploited and accordingly have also been successful in manipulating with the chasis number of vehicles in order that they are not traced.

Fire

Other than these there is also a danger of fire or theft of vehicle. Therefore, vehicle insurance under such unsafe conditions is a must not only to cover risks towards the owner and the vehicle but also to cover the financial liability that may arise from an accident in which the other party is injured. The cost of repairs that you would have to pay to the other party in case of an accident may be exorbitant. Besides if the accident involves hospitalisation too, the expenses can go through the roof. It would be a great burden if all these costs are borne by the individual. The insurance company can indemnify against such losses and the financial liability arising thereof.

Should Auto Insurance be made Compulsory?

If the auto insurance is not made compulsory, there is a strong possibility that some may not buy these voluntarily. This is because most of them think that the cost of accidents or losses will fall on others or they underestimate the risk of loss. "Economic arguments for compulsory insurance laws in these people to consider more of the costs of their actions when deciding whether to drive, what kind of car to buy, how safely to drive, and so on."[5]

The economic rationale for insurance may be that it affects people's decision to drive. Some people are likely to forgive driving if the insurance is made compulsory since it acts as a financial disincentive. Another could be that it encourages people to drive safely, which may reduce cost of risk. Those who criticise compulsory auto insurance plead that it results in lowering the disposable income or it results in a shift of income from lower group to the higher group. Also, the success of the compulsory law depends on its enforcement and way it is perceived by the insureds. In India, most of the insurance companies are facing huge losses due to false/heavy claims, the insurance being used for dubious advantages.

14.3 Types of Motor Insurance Policies

The All India Motor Tariff governs motor insurance business in India. According to the Tariff, all classes of vehicles use two types of Policy Forms. They are Form A and Form B. Form A, or what is commonly known as Act Policy, covers Act Liability, which is a compulsory requirement of the Motor Vehicles Act. No vehicle can be used without this minimum insurance cover. Use without such insurance is a penal offence. The following liabilities can be covered in this policy :

- Unlimited liability towards Third Party bodily injury;
- Liability towards Third Party Property Damage to the extent of Rs. 6000/- only;

[5] Harrington & Neihaus, *op. cit.*, pp. 553-554.

- Unlimited liability towards bodily injury of passengers of the vehicle;
- Liability towards employees of the owner of the vehicle while travelling in or using it, against bodily injury, to the extent required under the Workmen's Compensation Act.

Form B, or what is commonly known as Comprehensive Policy, is an optional cover, which takes care of the following additional losses and liabilities :

- Loss or damage to the vehicle and its accessories and extra fittings, protection and removal costs, and towing disabled vehicles (only for commercial vehicles).
- Liability towards Third Party Property Damage, in excess of Rs. 6000/-.
- Liability towards employees under Common Law and Fatal Accidents Act, over and above the liability under Workmen's Compensation Act.
- Personal Accident Benefits for the owner, passengers and employees.

The above losses or liabilities can be separately covered in conjunction with the liabilities covered under the Act Policy, by taking a Comprehensive Policy paying an additional premium.

14.3.1 Form A Policy

As per the provisions of Motor Vehicles Act, all the vehicles plying in the Territorial Limits of India must possess an ACT POLICY at all times. The violation is punishable with fine etc., as per Motor Vehicle Act (as prevalent at the time of detection). As described earlier, this policy covers:

(1) Third Party Property Damage/Bodily Injury (Fatal or Non-fatal) when Insured vehicle is used in a public place,

(2) Insured's legal liability, as per Motor Vehicle Act, arising out of accident caused by or arising out of the use of the vehicle anywhere in India, and

(3) Such liability as above in respect of injury (fatal or non-fatal) to any third party and damage to any third parties' property.

The owners of the vehicle having insurable interest in it undertake this policy. The period of the cover is generally a period of 12 months from the date of inception. However, Short period covers are also available at higher rates. Subject to limit of liability laid down in the Motor Vehicle Act, the policy pays the insured's legal liability for death/disability for third party, loss or damage to third party property. Also, the liability for claimant's cost is also met (Maximum Rs. 6,000/-) unless additional premium for opting unlimited cover is paid. In addition, all costs and expenses incurred with insurer's written consent are paid.

In case of death of the Insured/Person entitled to compensation for a liability incurred under this policy, his legal heirs will be indemnified as in the case of the Insured, subject to the limitations of use of the vehicle provided that the Driver was holding a valid and effective driving license.

Third Party (A person other than Insured and the Insurer) who is injured/dies due to an accident with the Insured Vehicle, the amount of compensation adjudged by the Motor Accident Claims Tribunal is made good by the insurers and is payable to the legal heir of the deceased or the injured. The amount of compensation is unlimited/has no preset limit.

All costs and expenses are incurred by the insured with Insurer's written consent. The compensation payable to Third Party for damage to its property (movable or fixed) is restricted to Rs. 6000/- {Rupees Six Thousand Only}, irrespective of the amount adjudged by the Motor

Accident Claims Tribunal/Court. This compensation limit can be increased to Unlimited by paying of an additional Premium at the time of taking insurance. All costs and expenses incurred by Insured with Insurer's written consent.

Claims arising out of and in the course of employment of a person in the employment of the Insured are compensated to the extent of Rs. 20,000 when an Employee (other than paid driver) is in the driving seat.

When vehicle is used outside the geographical area, when used contrary to limitation as to use, driven by a person other than the driver as stated in the clauses mentioned in the policy of insurance.

14.3.2 Form B Policy[6]

Form B is an optional cover, which offers some specific advantages. Although the Act Policy Form A is identical for different classes of vehicles, the comprehensive policy cover differs for various classes of vehicles. For private cars and motorcycles, there are two Sections in the Comprehensive Policy. Additionally, Section III is provided for commercial vehicles.

SECTION I

It concerns loss or damage to the vehicle and covers the risks like :

- Fire, Explosion, Self-ignition and Lightning
- Burglary, Housebreaking and Theft
- Riot, Strike, Malicious and Terrorism Damage
- Earthquake
- Flood, Typhoon, Hurricane, Storm, Tempest, Inundation, Cyclone, Hailstorm
- Accidental External Means
- Transit by road, rail, inland waterway, lift, elevator or air.

For motorcycles and commercial vehicles, the risk of frost damage is also covered. From the above coverage, for all classes of vehicles, the risks of riot, strike, malicious and terrorism damage, earthquake and flood and storm; can be opted out of with a consequent discount in premium. In addition to these, cover is also available for 'Protection and Removal Costs' and 'Authorisation of Repairs'. If a motor vehicle is disabled as a result of loss or damage due to the perils mentioned above, the insurance company bears the reasonable cost of protection and removal to the nearest repairer and the cost of redelivery to the owner/insured subject to a maximum limit, in respect of any one accident. The limits for various class of vehicles are as follows :

Motor Cycles/Scooters :	Rs. 300
Private Car & Taxis	Rs. 1,500
Other Commercial Vehicles	Rs. 2,500

The owner/insured is also allowed to authorise repair expenses upto Rs. 500/- per accident.

[6] www. Insuremagic.com/Auto Insurancebasics—Risk covered by a Comprehensive Policy.htm.

SECTION II

It covers the liabilities towards third parties, *i.e.*, liabilities of bodily injuries and property damage.

SECTION III

It is applicable to commercial vehicles. It covers the vehicle while it is being used for the purpose of [Towing Disabled Vehicles.' This section covers Third Party Liabilities that the insured vehicle or the one being towed for reward/remuneration. Further, the insurance company is also not liable for damages to the towed vehicle or any property being conveyed thereby.

Benefits of Comprehensive Policy Cover–An Illustration

Mr. Tom has an Act Only policy covering his private car. He employs a paid driver. While driving the vehicle, after dropping Mr. Tom at his office, the vehicle collides with a truck and the driver dies on the spot. Being an old car, Mr. Tom had nothing much to lose and that is why he had not taken a Comprehensive Policy. However, the family of the driver lost their breadwinner.

As an employer, Mr. Tom is liable to compensate for the driver, since he was driving the vehicle in course of employment. The Motor Vehicles Act, 1988 makes it compulsory to insure liabilities under Workmen's Compensation Act.

Accordingly, the legal heir of the deceased driver filed an application to the Labour Commissioner and an Award of Rs. 1,50,000 was passed against the employer. Mr. Tom, equipped with an Act Policy, approached the insurance company. who in turn satisfied the Award. The legal heir of the driver received the compensation from the Labour Court soon after and everyone was happy.

The liability for compensation as per the Workmen's Compensation Act, depends on the wages of the employee and his age, and represents mainly the loss of earnings. However, other losses representing mental pain and agony for the family, loss of consortium, future expenses on dependents and loss of prospective earnings are not accommodated in this compensation.

The legal heir of the driver, in the instant case then approached the Motor Accident Claims Tribunal, demanding a compensation of Rs. 1,00,000 towards these losses. The Tribunal passed an award of Rs. 50,000, found reasonable as per provisions of Common Law and Fatal Accidents Act. Mr. Tom had an Act Policy, which did not cover this liability, and he was saddled with the responsibility of satisfying the Court Order. You can imagine the financial burden he had to bear. Had he taken a Comprehensive Policy, covering his driver by payment of a small premium, he would not have to face this difficulty. The insurance company would have paid this additional amount of compensation too. It is, therefore, always beneficial and advisable to take a comprehensive policy covering these liabilities.

Exclusions to the Comprehensive Insurance Cover

This insurance does not cover loss or damage caused due to :

(*a*) Driver being under intoxication

(*b*) Vehicle being driven by a person not holding an effective, valid licence.

It also does not cover :

(*a*) Damage to tyres (unless the vehicle is also damaged).

(*b*) Wear and tear, mechanical breakdown.

Calculation of Premiums

In the case of Comprehensive Insurance Cover, for the purpose of premium, vehicles are categorized as follows :

Private Car

This is used for personal purposes. The premium is computed on the following basis :

- Geographical area of use and cubic capacity
- Value of the vehicle.

Accessories are to be specified separately under electrical and non-electrical items.

Two-wheeler

It is used for personal purposes only. Premium is calculated on cubic capacity and value of vehicle. Accessories are to be specified. Theft of accessories is not covered, unless the vehicle is stolen at the same time.

Commercial Vehicle

This is a vehicle used for hire and is classified as follows :

Goods-carrying commercial vehicle : In this case premium is calculated on carrying capacity–gross vehicle weight and value of the vehicle. Accessories extra, as specified.

Passenger-carrying commercial vehicle : In this case premium is calculated on carrying capacity of the vehicle–number of passengers and value of the vehicle. Accessories extra, as specified.

14.3.3 Auto Policy in United States

The personal auto policy, famous in the U.S. includes four main types of coverage :[7]

(*a*) "third party" liability coverage for liability to third parties harmed by negligence of an insured person;

(*b*) "first party" medical payments coverage for the insured, or in states with no-fault or related laws, personal injury protection coverage for the insured's medical expenses and loss of income;

(*c*) uninsured and under insured motorists coverage for losses caused to an insured by drivers without liability insurance and drivers with comparatively low liability insurance limits; and

(*d*) coverage for physical damage to or theft of insured autos.

The auto liability coverage in the personal auto policy provides broad coverage for liability for bodily injury and property damage to other parties arising out of the use of an automobile by an insured person. As is customary with the liability insurance, the insurer also agrees to defend the insured and bear the defence costs and is responsible for negotiating and setting the claims.

[7] Harrington & Neihaus, *Risk Management and Insurance*, McGraw-Hill, 1999, p. 534.

Personal auto liability coverage may be sold with a "single limit" that specifies the maximum amount that the insurer will pay for all damages from a single accident.

Under the first-party auto medical payments coverage, the auto owner can receive payment for medical expenses arising out of an accident. Coverage is for the medical expenses for the named insured and family members hurt in any auto and other persons that are hurt while occupying a covered auto. Coverage limits under such policies are comparatively low.

In U.S. with no-fault or related laws, the personal auto policy includes personal injury protection coverage for the named insured, family members, and parties hurt while occupying a covered auto instead of medical payment coverage.[8]

14.4 Factors Considered for Premium Rating

Automobile insurance pricing has always been a matter of controversies to the consumers, service providers and the regulators. Auto claims have increased significantly in India since last 10 years. Auto insurance rates charged to different customers reflect differences in the discounted expected costs of providing coverage. In order to classify different persons into homogeneous groups with respect to expected claim costs, insurers generally use rate classification system that include (1) driver classes that reflect the characteristics of individual insureds, and (2) territorial rating to reflect expected differences in claim costs for people that live in different geographical areas (holding individual characteristics constant). Of course, physical damage rates also depend upon the value and type of vehicle. Liability insurance rates sometimes also depend on the type of vehicle, given evidence that certain vehicles are more likely to be involved in at-fault accidents. The major factors considered in establishing driver classes and the use of territorial rating factors are :[9]

Driver Classes

The parameters are Age, Gender, and Marital Status, Use of automobile, driving education and driving record. The insureds in younger age group, the males, the married ones and new and inexperienced drivers have on average high accidental claims. The loading on the premium increases by the numbers and amount of accident claims.

Territorial Rating

Large cities have higher average claim costs followed by suburban areas, smaller cities, and small towns or rural areas. In India, the geographical areas have been classified into Group A and Group B.

Motor/Automobile Insurance business in India is governed by the All India Motor Tariff, which lays down the premium rates, terms and conditions. The main factors taken into consideration for rating in India are vehicle classifications on several parameters, the geographical area of operations and experiences.

Vehicle Classification

Vehicles are generally classified on the basis of its technical specifications, its value or use.

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[8] *Ibid.*, p. 537.

[9] *Ibid.*, p. 545.

Technical Specifications ("The Type")

The typology of a vehicle is more or less based on its cubic capacity or gross vehicle weight and its carrying capacity. Heavier vehicles are more exposed to accidents since the resultant damages they incur are more. Similarly, vehicles with higher carrying capacity expose more passengers to risk. Therefore heavier vehicles attract higher premium rate. In private cars, taxis and motorcycles, the factor is the cubic capacity. The more the cubic capacity, the higher the premium rate. Whereas in goods-carrying commercial vehicles and passenger-carrying commercial vehicles, the criteria are gross vehicle weight and passenger carrying capacity respectively.

The Value of the Vehicle

The premium rate is applied on the value of the vehicle to arrive at the premium payable. It is the owner/insured who has to select a correct value of the vehicle and declare the same for insurance. This value is known as the Insured's Estimated Value (IEV) in motor insurance and represents the sum insured.

Normally, this value is arrived at by considering the age of the vehicle and its present purchase price. A Maruti 800 was purchased in 1998 for Rs. 1,80,000/- Considering the conventional 10% depreciation each year and the present purchase price of a similar vehicle at Rs. 2,00,000/- the IEV for year 2000 is Rs. 1,80,000 less 20% of Rs. 2,00,000 = Rs. 40,000.00

IEV = Rs. 1,40,000.00

However, this is not sufficient for deriving the correct IEV of the vehicle in terms of motor insurance. In motor insurance, the basis for payment of claims is the market value of the vehicle at the place and time of loss. This market value may be understood as, the price that the vehicle would fetch in the second-hand market. For certain vehicles, there is a good demand in the second-hand market. Maruti is one of them. The 1998 model mentioned above may fetch a price of say, Rs. 1,50,000. In such situations, the correct IEV for the Maruti of 1998 model should be Rs. 1,50,000.

Now take the case of a Premier Padmini car of 1998 model. The purchase price in 1998 was say, Rs. 1,80,000/- The depreciated value in year 2000 works out to Rs. 1,40,000. But, the second-hand value would be at most Rs. 30,000, since it has virtually no demand in the market.

In this case, the correct IEV should be Rs. 30,000/- only. It is not worthwhile to insure your vehicle at a higher value since that will increase the premium payable but, in case of total loss, only the market value would be payable.

In motor insurance, the IEV is the limit of liability per accident and not for the entire period of insurance. In cases of partial loss or losses, which may be made good by repairs, there is no limit to the number of accidents in any period of insurance. Suppose the Premier Padmini car, as described above, claims for two accidents in the year 2000, the first for an amount of Rs. 20,000/- and the second for Rs. 15,000/- under its insurance policy with IEV of Rs. 30,000/-. Both these claims can be recovered from the insurance company, since their respective values are within the limit of IEV, irrespective of the fact that the insured in this process recovers more amount during the period of insurance than he was insured for.

However, if the vehicle is totally lost or damaged and cannot be repaired, the insured would be paid the market value or IEV, whichever is less. It is very important to select a correct IEV for insurance. There is a tendency of motor vehicle owners to declare a lower value for insurance to reduce the premium expenditure. Although, insurance companies check the IEV for its sufficiency

before accepting the insurance, this is not a correct practice as the insured is exposed to a greater loss in case the vehicle is totally lost or damaged.

The Use of the Vehicle

Risk exposure varies in relation to the use the vehicle is put to. Private cars are lesser exposed than taxis, as the latter is used extensively for maximum revenue. Taxi's therefore attract a higher premium rate. Similarly, goods carrying vehicles, which are used as private carriers and transport, only their owners' goods attract a lower premium, than those used as public carriers for transporting goods for hire.

The Geographical Area of Operation

The area of operation of a vehicle also has a direct bearing on the premium rate. This is so because, certain areas of operation are more congested with high densities of population and road traffic than others and poses higher exposure to accidents. For this purpose, the tariff differentiates two zones in India, i.e., Zone A and Zone B, for private cars and taxis. Zone A represents the Chennai region and Mumbai region (excluding Mumbai city) and Zone B represents the Kolkata region, Delhi region and Mumbai city. In Zone B, the densities of population and road traffic are more and hence attract a higher premium rate.

Such differential rating does not apply to commercial vehicles such as trucks and buses, as these vehicles normally travel throughout India for their operation. However, a discount is allowed on the premium for commercial vehicles used as contract carriage, school buses, public and private buses used for carrying passengers/workers and operate within a radius of 50 kilometres from the city limits.

Details of States under Zone A & Zone B

	Zone A	*Zone B*
Andhra Pradesh	Andaman & Nicobar Islands	Mumbai City
Goa, Daman, Diu	Arunachal Pradesh	Nagaland
Gujarat	Assam	Orissa
Karnataka	Bihar	Punjab
Kerala	Delhi	Rajasthan
Madhya Pradesh	Haryana	Sikkim
Maharashtra	Himachal Pradesh	Tripura
(Excluding Mumbai City)	Lakshadweep Islands	Uttar Pradesh
Pondicherry	Manipur	West Bengal
Tamil Nadu	Mizoram	

The Claims Experience

Unfavourable claims experience is obviously a bad risk. The tariff has adopted a system called the "No Claim discount", to give discounts for good claims experience and a loading for bad experience. The claim experience of expiring year's policy is the basis for allowing discount or charging a loading.

14.5 Motor Insurance Claims

14.5.1 Own Damage Claims

Documents

Following Documents generally required for settlement of motor claims. However depending on the merits of the case, a particular document may not be necessary or an alternate document could be used to serve the purpose of the Insurer.

(*a*) *Claim form* required to be completed.

(*b*) *Registration Certificate* : the details usually verified from the RC can instead be obtained from purchase details of the vehicle if the circumstances so warrant.

(*c*) *Driving License* : as per policy condition the driver is required to hold an effective driving license both in terms of the period validity and the class of vehicle that is being driven at the time of the accident. The MV Act provides for a grace period of 30 days after expiry of a license during which period the license may be accepted as effective, provided the holder has not been qualified from holding a license. For loss sustained by parked vehicles, driving license may not be relevant.

(*d*) *Load Challan/Trip Sheet :* to verify that the load carried was within the permissible limits and the trip sheet giving details of number of passengers carried in the vehicle.

(*e*) *Fitness Certificate* : the fitness certificate indicates the roadworthiness of a commercial vehicle.

(*f*) *Report to Police* : a copy of the FIR and Panchanama is required wherever third parties are involved in an accident.

(*g*) *Survey Report :* surveyor ascertains the damage, assess the quantum of payable claim, verify vehicular documents and confirm that the loss/damage being claimed for is in conformity with the narration of the accident. Wherever replacement of parts is allowed surveyors physically verify serial numbers as appearing on major parts, which carry such numbers.

Procedure

- In order to proceed for claim, the insured immediately informs the insurer.
- The policy documents are verified to ensure that the policy is force and the loss is entered in the claims register and the claim form is issue to the insured to be completed and returned.
- The insurer, immediately on receipt of intimation of loss, either in writing or over telephone, a surveyor is appointed based on the estimate of repairs. The surveyors are supplied with the copy of the claim form, copy of policy and the repairer's estimate.
- In case of major accidents, the insured would be asked to arrange for photographs of the vehicle at the spot of the accident, showing all the external damages and the number plate of the vehicle. The photo expenses are to be reimbursed upto Rs. 500. Alternatively, the insured may inform the nearest office of the insurer to arrange for such photographs.
- The survey report is examined and settlement is done based on surveyor's recommendations.

- ❑ If reinspection after repair is considered necessary it may be conducted by the same surveyor who has assessed the loss.
- ❑ Conventionally, the payment is made to the repairer directly.
- ❑ If for any reason, to be specified, the driving license cannot be produced, the claim may be considered only on non-standard basis. However for settlement of such claims the authority should be vested only with the Managers and above in the RO. Where the driving license is not endorsed for tourist taxis, since, different practices prevail in different states, it is necessary to check the local practice. The claim is to be treated as standard or non-standard on the basis of the practice prevailing in the state where the accident occurs and this will be decided by a Manager and above in the RO.
- ❑ The repairers are bound to keep aside the value of salvage and if the salvage is desired to be retained, the value is deducted from the claim bill.

Partial Loss Claims

A. Submission of bills/cash can be dispensed with for claims upto Rs. 50,000 in respect of private cars and two wheelers only, subject to

   (*a*) The survey report correctly indicating the cost of parts allowed for replacement

   (*b*) Claims being settled on the basis of a report of reinspection after repairs by the surveyor certifying that the repairs and replacements have been carried out as per assessment. For other classes of vehicles bills/cash memos have to be obtained and verified.

B. If surveyor confirms replacement of the engine and chassis if allowed for replacement and indicates the new numbers, claims may be settled whilst simultaneously advising the insured that

   (*a*) As per the provision of the Motor Vehicles Act, the new numbers have to be incorporated in the RC book.

   (*b*) Insurance company be informed about the incorporation of the new numbers in the RC book for endorsing on the policy document to facilitate settlement of future claims.

   (*a*) Where the vehicle is totally damaged or when the net cost of repairs is almost close to the market value of the IEV the claim could be considered to be a total loss. Such total loss claims should be encouraged on net of salvage basis i.e., salvage being retained by the insured and an appropriate amount towards salvage value as determined by the surveyor in consultation with the company be deducted from the total loss amount.

   (*b*) However, if the insured to retain the salvage, arrangements should be made for the safe custody of the damaged vehicle to prevent further loss or damage. The RTO should be informed by Registered AD post. An inventory on the major parts should be taken before taking possession of the vehicle. Immediate steps thereafter should also be taken for its disposal as per company's guidelines for disposal of salvage.

14.5.2 Theft Claims

1. *Partial Loss due to Theft* : Theft of parts/accessories from a vehicle should be reported to the police immediately by the insured. If parts are found missing or changed after recovery of stolen vehicle this be recorded in panchanama/recovery memo. Final police investigation

report will also be required. However, if the competent authority is satisfied about the genuineness of the loss, final investigation report may be waived provided the insured sends a registered AD letter to the SP/ACP requesting that the insurer should be informed of any recovery.

2. *Total Loss due to Theft* : Unless claims settling authority is fully satisfied, investigation of the theft to be arranged by an investigator who may be appointed with specific terms of reference.
3. The following documents should be collected from the insured in addition to a certified copy of the FIR, for considering "on account" payment of the admissible claim after expiry of 90 days from the date of loss.
   (*a*) Surrender of the Registration Book and the Tax Book to the insurer duly transferred in the name of the insurers. The RTO is to be informed about the theft of the vehicle and this should be entered in Tax Book so that further tax will not accrue.
   (*b*) Letter of indemnity and subrogation.
   (*c*) Ignition keys of the vehicle.
   (*d*) Certificate of insurance and the original insurance policy, if not stolen with the vehicle.
   (*e*) Specially worded discharge voucher.
4. The balance payment may be released on receipt of the Final Police Investigation Report or on expiry of a suitable waiting period from the date of the "on account" payment, after obtaining the discharge voucher in full and final settlement of the claim.
5. The Police and the Registration authorities and the NCRB should be notified in writing about disposal of the claim on "total loss" basis following theft of the vehicle. They should be requested to advise the company if the vehicle is recovered subsequently. Immediately after receipt of advise from the Police regarding recovery of the vehicle, necessary steps for taking possession of the vehicle from the Police custody should be taken and, if necessary, an advocate should be appointed for filing recovery application in the court.
6. Municipal Authorities, where applicable and the RTO should be advised by registered Letter with Acknowledgement. Due to record 'non use' of the vehicle on account of theft and about the cancellation of the Insurance Certificate.
7. If the vehicle is recovered subsequently, the insured will have the option to repay the claim amount already paid and retain the recovered vehicle. If the vehicle is found damaged, the insured will be indemnified against loss of damage. The insured should be advised to obtain recovery memo from the Police and to get the vehicle surveyed at the Police Station before taking delivery, as mentioned under partial loss theft claims.
8. In cases of criminal breach of trust each case should be dealt with an individual basis depending upon facts of each case and subject to legal opinion.

14.5.3 Third Party Bodily Injury Claims : Fatal and Non-fatal

1. *Intimation of Claim* : Intimation about an accident resulting into third party claim is received through various sources :
   (*a*) Insured directly or by mention in passing whilst lodging own damage claim

(*b*) Claimant

(*c*) MACT/Courts by notice

(*d*) Through accident report from police in Form 54 prescribed under Central Motor Vehicles Rules, 1989.

2. *Investigation* : Investigation about the accident to collect the relevant data to quantify reasonable and just compensation as per the specified formats in respect of all third party claims is mandatory. The companies should ensure that this investigation helps the insurance company in finalizing out of court settlement at the earliest.

3. *Appointment of Advocate* : On receipt of notice from the MACT a competent advocate from the panel may be appointed if necessary. The following relevant documents and information should be given to him/her immediately to enable him/her to draft written statement (w/s) on behalf of the Company and ensure that the proper defense is taken where necessary and no frivolous statements are made.

4. *Policy Copy* : Duly certified true copy of the complete policy with the relevant clauses and endorsements as actually attached with the original issued covering the vehicle at the material time of accident.

5. *Driving Licence* : In case it has been observed that driver was not duly licensed the necessary information should be given to the advocate. Though under Section 149(2) of the MV Act, 1988, Insurance Company has no liability if the driver is not duly licensed, the onus to prove that the driver was not holding a license rests on insurance company and this obligation is required to be discharged fully to the satisfaction of the court.

6. *Compliance Policy Conditions* : If a breach of a specific policy condition has been observed it should be brought to the notice of the Advocate to enable proper defense if possible.

7. (*a*) Written statement on behalf of the insurance company incorporating all defenses available as enumerated under Section 149 of MV Act should be promptly filed.

   (*b*) Wherever necessary when there is collusion between the insured and the claimants or when the insured fails to defend the claim, the company's advocate must be instructed to obtain the MACT's permission under Section 170 of the MV Act to Defend the claim on merits.

8. *Payment of No Fault Liability Claims* : If liability under affected policy is established after taking into consideration the foregoing defenses, company should take immediate steps to deposit No Faulty Liability amount as per Section 140 of the MV Act, 1988.

9. *Payment of Fault Liability Claims* : Companies may initiate action to settle such claims either through

   (*a*) Jald Rahat Yojna

   (*b*) Lok Adalats

   (*c*) Direct negotiation with the claimant through DICC & RICC.

10. *Jald Rahat Yojna* : Section 152 of MV Act, 1988 authorizes insurance company to settle motor third party non-fatal bodily injury claims where claimant is an adult without claimants taking recourse to MACTs. Industry has already launched the Scheme since 1991.

Guidelines for Placing Claims in Lok Adalats

- Maximum participation and disposal of large number of claims in Lok Adalats sessions should be ensured.
- Companies should place the claims normally falling within the following parameters before lok adalat :
  - (*a*) where occurrence of the accident is within the policy period.
  - (*b*) where estimated liability is not expected to be exceeding Rs. 5,00,000 per application for compensation.
  - (*c*) where no substantial point of law is involved.
  - (*d*) where no defences are available under Section 149 of the MV Act, 1988, such as driver not holding effective driving license and breach of policy condition relating to limitations as to use.
  - (*e*) where policy record shows that the driver was holding effective driving license.
  - (*f*) where despite concerted efforts on the part of the insurance companies. They are not in a position to prove conclusively to the satisfaction of the court that a person drove the vehicle not duly licensed.
  - (*g*) since there is a provision of automatic transfer of insurance in pursuance of Section 157 of MV Act, 1988 the companies cannot take defense of non-transfer of insurance of the vehicle on their books.
  - (*h*) where more than one vehicle insured with different insurance companies is involved in an accident resulting into a third party claim, companies should agree for settlement on 50-50 basis to apportion the liability between them.
- Companies should not accept conditional settlement such as subject to verification of certain documents, production of documents etc.
- On having reached the agreement for compromise settlement concerned MACT issues a Consent Order specifying *inter alia* the period during which the agreed amount should be deposited. On receipt of such order, companies must deposit the amount as agreed to with the MACT within 30 days from the date of award as per schedule.
- In the event of lok adalat for pending appeals before High Courts is organized, such claims where quantum of compensation is in dispute may be considered.
- Appeals which are filed to decide a point of law should not be considered for placing before lok adalat.
- Applications for compensation filed by the paid employees may also be placed before lok adalat, whether wider legal liability is covered or not.

Key Terms

- Bodily Injury
- Comprehensive Policy
- Legal Liability
- Maturity Claim
- Act only Policy
- Premium Rating

Suggested Readings

- Harrington & Niehaus, *Risk Management and Insurance,* McGraw-Hill, 1999.
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- *Insurance Law Manual,* Taxmann, 2001.
- *Motor Insurance,* IC 72, Insurance Institute of India, Mumbai, 2003.

Questions for Review

1. Is automobile insurance compulsory in India? What types of insurance covers are available for automobiles?
2. Write short notes on :
   (*a*) No claim discount.
   (*b*) Factors considered for premium rating.
   (*c*) Insured Declared Value
3. Briefly explain the various documents required for settlement of own damage and third party documents.
4. Explain the major point of differences between the procedure for settlement of third party claims and own damage claims.

CHAPTER 15

MISCELLANEOUS INSURANCE

15.1 Burglary Insurance

Burglary insurance covers indemnity against losses or damage due to burglary and is available to commercial establishments, factories, private premises, godowns etc. The various types of burglary covers available are :

(1) Burglary (Business Premises Policy)

(2) Burglary (Private Residences) Policy

(3) Burglary All Risks Policy

(4) Money-in-transit insurance

(5) Baggage Insurance Policy

The basic burglary insurance policy covers

1. Property contained in a business premises, stocks owned, held in trust/commission and for which one is responsible.
2. Premises itself against damage (which one has to make good).
3. Cash, valuables, securities kept in a locked safe or cash box in locked steel cupboard can be specifically covered.

The cover can be obtained by any individual whose property is exposed to risk of burglary; one which is liable for goods in trust/commission; one who is liable to make good damage to premises. The burglary cover provides indemnity in respect of property lost/damaged by burglary/house breaking and damage to premises caused by burglars during burglary or attempts at burglary. The cover can be extended to include riot and terrorism. The claim under the policy is restricted to actual loss/damage to the insured property caused by burglary/house breaking, subject to the limit of sum insured. If sum insured is not adequate, policy pays only proportionate loss. Policy does not pay for loss/damage

4. To goods in trust/commission, jewellery, curios, title deeds, business books–unless specifically insured
5. Due to shop lifting, acts involving insured/his family members/employee
6. Recoverable under Fire/Plate glass insurance policy
7. Due to war perils, Riot & Strike, Acts of God, Nuclear perils
8. By abstraction from a safe using a key or duplicate key, unless it is obtained by violence or threat

The following documents are required while processing such claims under the policy :

(*i*) Duly completed claim form.

(*ii*) Final investigation report from the police.

(*iii*) Survey report.

(*iv*) Photographs.

In case of small losses the dealing office arranges for settlement of claim on the basis of completed claim form, First Information Report registered with the police provided the office is satisfied about the genuineness of the claim. It is considered preferable to appoint an investigator with surveyor's license and knowledge of accounts as assessment of losses involves checking books of accounts. Waiver of Final Investigation Report of the police is sometimes considered at the discretion of the Competent Authority so long as the investigator cum surveyor's report does not raise any doubt regarding the cause and quantum of loss. Subrogation/indemnity letter from the Insured is a must.

15.2 Money Insurance

1. "Money" carried by authorised messengers of the insured while in transit from the time it is taken out till received at the destination—points of origin and destination being specified before-hand.
2. Undisbursed money retained in a burglar-resistant and safe against burglary-risks.
3. Cash carried by, insured/proprietor/partner/director and also one firm carrying the cash of another firm in the same premises is also insurable.
4. Cash retained overnight by the employees in their residences in locked steel cupboard when on collection duty, up to 48 hours from the time of collection.

   Any industrial, manufacturing or business concern who periodically draw large sums of money for their day-to day transactions, payment of salaries, one time payments like arrears of pay, bonus etc.

   Loss by robbery, theft, hold-up or any fortuitous cause when the cash is in transit. When cash is retained over-night, it is covered only against burglary, house-breaking and theft risks.

   Money or money's worth actually lost, up to the "limit per carrying" specified in the policy.
5. Shortage due to error or omission.
6. Riot, strike, terrorism, war and Nuclear group of perils.
7. Money entrusted to any person other than the insured or an authorised employee (except due to the employee's fraud or dishonesty discovered within 48 hrs).
8. Legal liability. consequential loss, theft from an unsecured vehicle.
9. Money entrusted to a carrier.
10. Loss due to any act in which the insured is involved as principal or accessory.

15.3 Jewellers' Block Insurance

The policy contains four separate sections covering separate possessions.

Section I

This section covers loss or damage to property at business premises or other specified premises where property is deposited by fire, theft, riot, strike etc.

Section II

This section covers property carried/conveyed outside the specified premises for the business purpose by any cause other than the specified exclusions under the policy.

Section III

This section covers loss or damage to property whilst in transit with in India by

1. Insured Post
2. Air Freight

Section IV

This section covers loss or damage to office furniture, fixtures in the premises covered and safes at specified residence by fire and allied perils, house breaking, theft, riot, strike.

The risks are classified as 3 classes :

Class I–Having 24 hours watchman for the premises employed by the insured in all listed premises.

Class II–Common watchman for the building or night watchman employed.

Class III–All others.

Rating

Section I

Sum Insured	*Ratio for*		
	Class I	*Class II*	*Class III*
Upto Rs. 25 lakhs	0.25%	0.35%	0.50%
Upto Rs. 50 lakhs for over Rs. 25 lakhs	0.20%	0.30%	0.45%
Above Rs. 50 lakhs and upto Rs. 75 lakhs for the sum over Rs. 50 lakhs	0.175%	0.275%	0.425%
Over Rs. 75 lakhs (on the sum excess of Rs. 75 lakhs)	0.15%	0.25%	0.40%

Section II

On the first part of the aggregate of the individual

limits under Section II upto 50% of Section I Sum Insured	0.30%
On the next 25% of Section I Sum Insured	0.40%
On the next 25% of Section I Sum Insured	0.50%

Section III

1% on the aggregate Sum Insured under this section.

Section IV

0.10% on the Sum Insured

Discounts may be allowed in the premium rate for the following :

1. Physical features discount- In case the shop has additional security arrangements, like close circuit TV, electronic alarms etc., then a discount of 5% for each additional feature restricted to a maximum of 10% may be allowed subject to an inspection report of premises by an officer of the company being kept along with the Underwriting papers.
2. Good claims experience discount may be allowed when
    1. Policy is in force for a minimum period of three consecutive years
    2. If average claims experience is less than 50% for the last three years, 5% discount may be allowed
    3. Less than 30%,10% discount may be allowed

Exclusions

4. Loss or damage during cleaning, repairing, restoring
5. Property missing at stock taking
6. Articles in public exhibition
7. Depreciation, wear, tear etc.
8. Window display after close of business hours
9. Earth quake, Flood, cyclone etc.

15.4 Baggage Insurance

Baggage cover is available to the people who travel frequently. The cover provides indemnity in respect of Loss or damage to accompanied baggage by accident or mishappenings or from vehicle (car) provided that it has total locking system. Rate of premium is 0.75% of the Sum Insured. The exclusions are :

1. Cover is for accompanied baggage only. Unaccompanied baggage to be covered under transit policy
2. Loss within the municipal limits of the place where the insured resides permanently is not covered
3. Loss or damage to securities and other negotiable instruments is not covered
4. Loose articles such as walking sticks umbrellas fans, sun shades or deck chairs are not covered
5. Loss of or damage to valuables like jewellery and ornaments or precious stones etc. are excluded

15.5 Personal Accident Insurance

Personal accident cover provides indemnity to the insured in respect of any bodily injury resulting solely and directly from accident caused by violent and visible means, as agreed in the policy. Any individual or group of individuals (through employer, association, and institution etc.) aged between 12 and 70. Subject to medical examination at 70, a person can be covered up to 80. When an accidental injury being the sole and direct cause results (during the period of insurance) in :

Event	*Claims Paid*
Death	100% of Sum Insured
Permanent Total Disablement	100% of Sum Insured
Loss of two limbs/Two eyes or one limb and one eye	100% of Sum Insured
Loss of one limb or one eye	50% of Sum Insured
Permanent Partial Disablement	Varying% of Sum Insured as per policy
Temporary Total Disablement	1% of Capital Sum Insured per week, Subject to a maximum of Rs 3000 per week, for a maximum period of 100 weeks

On payment of extra premium, medical expenses incurred up to 25% of claim or 10% of Sum Insured can be covered. Policy also pays for education fund for dependant children (2) of deceased insured and expenses of carriage of dead body of insured from accident site (as per details in policy)

Attractive cumulative bonus at the time of renewal, by way of increasing the Sum Insured by 5% for each completed claim free year of insurance (maximum of 50% CSI) without collecting extra premium as per policy.

Classification of Risks

Group I

Doctors, Accountants, Lawyers, Architects, Consulting Engineers, Teachers, Bankers, Persons engaged in administration functions, persons primarily engaged in occupation of similar hazards.

Group II

Builders, Contractors and Engineers in superintending functions only, Veterniary Doctors, Paid drivers of motor cars and light motor vehicles and persons engaged in occupation of similar hazards and not engaged in manual labour. All persons engaged in manual labour (Except those falling under Group III), Cash Carrying Employees, Garage and Motor Mechanics, Machine Operators, Drivers of trucks or lorries and other heavy vehicles, Professional Athletes, and sportsman, Woodworking Machinists and persons engaged in occupation of similar hazards.

Group III

Persons working in underground mines, explosives, magazines, workers involved in electrical installation with high tension supply, Circus Personnel, Persons engaged in activities like racing on wheels or horseback, big game hunting, mountaineering, winter sports, skiing, ice hockey, ballooning, hang gliding, river rafting, polo and persons engaged in occupations/activities of similar hazard.

Exclusions

1. Compensation under more than one clause for same period of disability not exceeding capital sum insured
2. Any payment after admission of a claim for 50%/100% of Capital Sum Insured
3. Any claim in the same period of insurance exceeding the Capital Sum Insured

4. Suicide, attempt there at, VD, criminal breach of law, accidental death/injury under influence of liquor/drugs
5. Pregnancy related claim
6. War and nuclear perils

15.6 Banker's Indemnity Insurance

This policy is provided to Banks, NBFC's and other institutions who deal with operations involving money. The policy covers risks associated with :

1. *Premises*–By fire, riot & strike, burglary or house breaking or hold up resulting in loss to money/securities at the premises.
2. *Transit*–Lost, stolen, mislaid, misappropriated or made away either due to negligence or fraud of employees of the insured whilst in transit.
3. *Forgery*–Loss by bogus, fictitious or forged or raised cheque/drafts/FDRs or forged endorsements.
4. *Dishonesty*–Loss to money and/or operations by dishonesty.
5. *Hypothecated Goods*–By fraud and/or dishonesty or criminal act of the insured's employees.
6. *Registered Postal Sendings*–Loss by robbery, theft or by other courses to the parcels insured with the post office.
7. *Appraisers*–Infidelity or criminal acts by appraisers on the approved list.
8. *Janata Agents*–Infidelity or criminal acts by Janata Agents/chhoti Bachat Yojana Agents/ Pygmy Collectors.

The indemnity provided under this policy in respect of direct losses shall not exceed the sums insured set against each cover. Excess is applicable except for fire and burglary claims. By charging appropriate premium, the sum insured under the policy is maintained constant so as to have full cover even after a claim. The insured is required to lodge a complaint with the police and take all practical steps to recover the property lost/apprehend the guilty person/take departmental action in the event of a loss. All material evidence should be made available to the insurers. The major requirements for obtaining this cover are :

1. All jewellery/ornaments shall be valued and recorded in the register of the bank at the time of pledging.
2. The insured is required to exercise reasonable care to safeguard the property insured.
3. Installation of alarm systems and security arrangements are mandatory.
4. Escort with fire arms is required during transit of cash upto Rs. 10 lakhs and two guards where value exceeds Rs. 10 lakhs.

15.7 Aviation Insurance

Aircraft Comprehensive Insurance Policy

The Policy covers (*a*) Loss of damage to the aircraft. (*b*) Legal liability to the third party and passengers. (*c*) Legal liability for freight, mail etc. carried. (*d*) Personal accident risk to the pilots, crew and ground staff. (*e*) Loss of professional licence of pilots and other crew members.

Air Line Insurance (Hull and Liability)

The hull policy covers loss and accidental damage (including emergency landings) to air and ground risks; the liability policy covers the airline against legal action from third parties or customers in respect of death, injury or physical damage to property. Most airlines have 'manuscript' wordings devised by the brokers, insurers and purchasers to reflect individual needs, circumstances and preferences. Hull claims are quickly determined and settled. Liability losses are usually complex, as accidents often result from a combination of factors. Often liability will be split with other parties, such as airports and, particularly, manufacturers.

Airline Insurance (Hull War)

These policies provide cover to airlines for loss of, or damage to, their property (aircraft and spares). The risks covered are excluded from hull all risks policies, and arise from war or war related activities including :

- War, invasion, hostilities, civil war, rebellion, attempted coups etc.
- Strikes, riots, civil commotion or labour disturbances
- Sabotage
- Hijacking (attempted or actual) or seizure of control (including pilot suicide)
- Acts of political or terrorist purposes
- Confiscation, naturalisation, detention etc. for the use of any government or public authority.

Product Liability

Product liability covers an insured's legal liability to third parties for injury and loss or damage arising out of the defective design or manufacture of an aircraft product. It encompasses all types of aircraft products, for example airframes, engines, seats and minor components.

General Aviation

General aviation is the insurance of "all aircraft other than commercial and military aircraft, and commercial aircraft capable of carrying less than 40 passengers". Different insurers use different definitions. Often planes that can carry between 40 and 60 passengers may be included in either this book or the airline book, depending on the insurer's reinsurance program.

Miscellaneous Covers

There are a number of other types of aviation cover available. Long term policies (of up to 3years) are common for each of these types of covers.

Aviation Insurance can be purchased in two ways : (1) from a "direct writing" company where the insured contacts the company direct; or (2) through an independent insurance agent who represents several companies. The Indian aviation insurance business is worth around $20 million. In India, the major chunk of this business is owned by GIC. However hardly 2 per cent of the same is retained by it since the premium is large, various complexities are involved and as the risk is huge and it will have to be reinsured. On a global basis, the loss ratio in general aviation insurance has exceeded 1.1 to as much as 1.25 or more for the last several years. The key reasons that the insurance companies have been losing money in aviation business are :

1. The cost of repairs is increasing fastly
2. The number of insured accidents is up
3. The value of the aircraft is soaring

To keep insurance costs under control in the current difficult environment, aircraft and aviation business owners have to think on the following aspects :

- Self-insurance
- Matching equipment to needs
- Optimise maintenance cots
- Promote revenues
- Promote personal aviation
- Focus on safety

15.8 Other Urban Non-Traditional Insurance

Besides the major insurance categories discussed earlier, theh following covers are also available :

- Horse Insurance
- Cycle Risk Shaw Insurance
- Pedal Cycles Insurance
- Plate Glass Insurance
- Household Appliances Insurance
- Shopkeepers' Policy (Composite)
- Carriers Legal Liability
- LPG Dealers
- Office Umbrella
- Special Contigency
- Electronic Equipment Policy
- Gun Insurance
- Baggage Insurance

Key Terms

- Aviation Insurance
- Baggaged Insurance
- Burglary Insurance
- Capital Accident Insurance
- Personal Accident Insurance
- Permanent Total Disablement

Suggested Readings

- Engineering Insurance, IC 77, Insurance Institute of India, Mumbai, 1999.
- Miscellaneous Insurance, IC 78, Insurance Institute of India, Mumbai, 1991.
- Barry D. Smith *et. al.*, Property and Liability Insurance Principles, Insurance Institute of America, 1994.

Questions for Review

1. "Aviation insurance is a high risk business." Do you agree? Substantiate your answer with suitable arguments.
2. Briefly explain the procedure for loss settlement in burglary insurance.
3. Write short notes on :
   (*a*) Classification of risks in Jweller's Block Insurance.
   (*b*) Table of Benefits in Personal Accident Insurance.
   (*c*) Banker's Indemnity Insurance.

CHAPTER 16

INSURANCE BUSINESS NATIONALISATION & REGULATION

16.1 Historical Framework of Insurance

16.1.1 Global Perspective

Insurance in the Pre-Greek Period

The history of western civilisation focuses on Babylon (500 B.C.) as the centre of early economy linking China, India and Persia with Phoenicia, Egypt and Aromania. The principal imports of Babylonia included gold, silver, copper, tin precious and semiprecious stones, ivory, woods such as ebony and oil, essences, wine and slaves. During trade routes, Bandits, pirates, fire storms and death were common occurrings. The loss chances were very high and the Babylon Merchants who extended credit on such vulnerable collateral as cargo in transit charged risk premiums above the interest charges on capital. The borrower usually pledged all of his property and his family in order to secure the loan. If the misfortune befell him, the borrower lost everything and he and his family might be sold into slavery.

Under the pressures of high risk, trade declined, and by 2250 B.C. there was little commercial activity along the trade routes of the Near East. The *Code of Hammurabi,* which formalized the concepts of *civic responsibility, bottomry,* and *respondentia,* improved trade conditions and established doctrines that were to play significant roles in the evolution of insurance. *Bottomry* and *respondentia* loans were maritime contracts on vessels (bottoms) or on cargoes (*res*). There were three basic elements in such agreements : (1) a loan on the vessel, cargo, or freight, (2) an interest rate on the loan, and (3) a risk premium for the chance of loss of the venture and the consequent cancellation of the debt. Under the provisions of a bottomry bond, the borrower was freed of his obligation on the event that the collateral was lost through no wilful act of his own. Modern credit life and disability insurance is used in the same manner as the bottomry loan. In the event of death or total disability of the borrower the debt is cancelled. The insurance premium, which is separate from the interest on the loan, corresponds to the risk premium of ancient times.

Ancient Greece Period

The Greek era of modern history witnessed (750 B.C.), the two most significant developments of early times, brought to a high degree of refinement (a) well-establishment of bottomry contract (b) concept of averages evolved. Risk premiums were differentially charged based on various factors, mostly contemporary in the manner the insurance rates are set. The first insurance exchange is believed to have been established in Athens in this early period similar to the later developed at Lloyd's of London.

Insurance in Roman Empire

The Greek tradition in insurance was conveyed to the Romans, who adopted the practices of bottomry and its related contracts. The laws of warranty and general average were further refined. The Romans even had an insurance exchange, although it is not believed to have been formalized as was the one in Athens. The major contribution of the Romans to the insurance heritage was the organized burial society, a rudimentary form of life and health insurance.

Burial societies, known as *Eranoi* and *Thiasoi*, existed in Greece for the purpose of providing prepaid bunals for members, but the Romans provided more elaborate burial and benevolent services through their *collegia*. Authorized by special Senate decree, the *collegia* were the true counterparts of the fraternal insurance organisations of modern times. Members prepare their contributions, a fund was maintained, and benefits were paid in terms of decent burial and last expenses incurred by the family of the deceased member.

The annuity concept appeals to have been comprehended by the Romans, because they apparently solved the problem of valuation.

The *collegia* represented the distinctive contribution of the Romans to the history of insurance. By formal organisation, the promise of definite benefits, and the collection of regular prepaid assessments, they are direct antecedents of the guilds of the Middle Ages and of fraternal insurance in modern times. While there is little evidence of actuarial skill, adequacy of dues collections must surely have been a criterion of membership fee setting.

Dark Ages

The decay and disintegration of Roman Expire in the fifth century A.D. bought in its wake an era of negligible international commerce and the development of small isolated self sufficient, and self contained communities. The *collegia* of Rome evolved into the guilds of the Middle Ages. The early Anglo-Saxon Guild was a family association loosely knit for the purpose of providing mutual aid. When a youth attained the age of fourteen years, the Norman conquerors of England required him to find sureties to guarantee his keeping the peace. To meet this contingency, the early guilds were formed. In time, the guilds enlarged their functions to include benefits to craftsmen, artisans, and professional persons. The full-fledged development led to religious, economic, political, and defensive organizations. About the eighth century, trade guilds in Flanders and West Germany offered mutual protection against loss arising from fire damage to livestock and against other misfortune. Insurance became an instrumentality of a commercial society, and until the revival of trade in Europe and Asia, thee can be found few examples. Of the existence of insurance institution in the modern sense.

Revival of International Commerce

Bottomry agreements were common in Venice, Geneva, Florence, Naples, Tarentum, and Bari before the year A.D. 1000, as evidenced by the Amalfitan Sea Codes. Marine insurance made progress during the twelfth through fourteenth centuries and there appears to have been a Chamber of Assurance at Bruges, about 1310, at which merchants could insure their goods upon payment of a stipulated percentage. The antecedents of fire insurance are found in the custom, recorded as early as 1240 in the village of Verambacht which held that a person whose house burned down was to be indemnified without delay by the whole village. By 1227, outside merchants wishing to sell their wares at local fairs could be insured against loss by fire or theft for a duty of four deniers. By 1400, Europe's trade pattern was well-developed, considering the relatively low state of transportation technology. Small ships hugging the coastlines of Europe, caravans of small wagons travelling overland, and countless peddlers carrying their inventories on their backs supplied a network that moved goods in high demand to and from all parts of the civilized world. Bottomry bonds were used extensively throughout the renaissance of commerce, and insurance was a basic consideration in all shipping along major routes. A cargo of armor shipped from Hamburg to London in 1560 was insured by the Hanse underwriters at a rate of 6 per cent. This rate is similar to contemporary levels.

Insurance Business in 1600

Toward the end of the Elizabeth reign, the insurance business in England was a flourishing trade with well established centers of activity, respected contracts, competitive rates, and an adequate market for most of the needs of the time. Insurance was conducted by sole proprietors on an individual basis, but it was customary for the insured to obtain joint participation of as many underwriters as were required to provide full coverage. Afterwards, the insurance market developed very fast with a variety of product offering witnessing huge competition throughout the globe.

16.1.2 Indian Perspective

The Insurance Sector in India dates back to 1818 when the first insurance company was established–the Oriental Life Insurance Company at Calcutta. This was followed in quick succession with the establishment of Bombay Life Assurance Company (1823) and Madras Equitable Life Assurance Society (1829). In the general insurance business Triton Insurance Company (1850) was the first to be established. Prior to 1871, Indians were charged about 15 percent more premium as compared to Europeans. Bombay Mutual Life Assurance Society (1871) was the first company not to differentiate between Indians and Europeans in the matter of fixation of premiums. The first attempt at regulation of the insurance business in India was through the Indian Life Assurance Companies Act in 1912. This was later broad-based and the Insurance Act came into existence from the year 1928 onwards. The Insurance Act was subsequently reviewed and a comprehensive legislation was enacted called the Insurance Act, 1938. The nationalization of life insurance business took place in 1956 when 245 Indian and foreign insurance and provident societies were first amalgamated and then nationalized. The Life Insurance Corporation of India (LIC) came into existence and has since enjoyed a monopoly over the life insurance business in India. The milestones in the Insurance sector 1912 onwards can be summarised as under. The life insurance sector witnessed the following development.

1912 : The Indian Life Assurance Companies Act enacted as the first statute to regulate the life insurance business.

1928 : The Indian Insurance Companies Act enacted to enable the government to collect statistical information about both life and non-life insurance businesses.

1938 : Earlier legislation consolidated and amended to by the Insurance Act with the objective of protecting the interests of the insuring public.

1956 : 245 Indian and foreign insurers and provident societies taken over by the central government and nationalised. LIC formed by an Act of Parliament, viz. LIC Act, 1956, with a capital contribution of Rs. 5 crore from the Government of India.

The General insurance business in India, on the other hand, can trace its roots to the Triton Insurance Company Ltd., the first general insurance company established in the year 1850 in Calcutta by the British. Some of the important milestones in the general insurance business in India are :

1907 : The Indian Mercantile Insurance Ltd. set up, the first company to transact all classes of general insurance business.

1957 : General Insurance Council, a wing of the Insurance Association of India, frames a code of conduct for ensuring fair conduct and sound business practices.

1968 : The Insurance Act amended to regulate investments and set minimum solvency margins and the Tariff Advisory Committee set up.

1972 : The General Insurance Business (Nationalisation) Act, 1972 nationalised the general insurance business in India with effect from 1st January 1973. 107 insurers amalgamated and grouped into four companies viz., the National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd. and the United India Insurance Company Ltd. GIC incorporated as a company.

16.1.3 Insurance Sector Reforms

In 1993, Malhotra Committee, headed by former Finance Secretary and RBI Governor, R.N. Malhotra was formed to evaluate the Indian Insurance Industry and recommend its future direction. The committee was set up with an objective of complementing the reforms in the Indian Financial sector. The reforms were aimed at "creating a more efficient and competitive financial system suitable for the requirements of the economy keeping in mind the structural changes currently underway and recognising that insurance is an important part of the overall financial system where it was necessary to address the need for similar reforms."

Malhotra Committee–Purpose and Recommendations

Purpose

(*a*) To suggest the structure of the insurance industry, to assess its strengths and weaknesses of insurance companies in terms of the objectives of creating an efficient and viable insurance industry, which will have a wide reach of insurance services, a variety of insurance products with a high quality of services to the public and servicing as an effective instrument for mobilization of financial resources for development.

(*b*) To make recommendations for changing structure of insurance industry, for changing general policy frame work etc.

(*c*) To take specific suggestions regarding LIC and GIC with a view to improve functioning of LIC and GIC.

(*d*) To make recommendations on regulation and supervision of the insurance sector in India.

(*e*) To make recommendations on role and functioning of surveyors, intermediaries like agents etc. in the insurance sector.

(*f*) To make recommendations on any other matter which are relevant for development of the insurance industry in India.

Recommendations

In 1994, the committee submitted the report and gave the following recommendations now in the point form :

Structure

- Government stake in the insurance Companies to be brought down to 50%.
- Government should take over the holdings of GIC and its subsidiaries so that these subsidiaries can act as independent corporations.
- All the insurance companies should be given greater freedom to operate.

Competition

- Private Companies with a minimum paid up capital of Rs. 1 billion should be allowed to enter the industry.
- No Company should deal in both Life and General Insurance through a single entity.
- Foreign companies may be allowed to enter the industry in collaboration with the domestic companies.
- Postal Life Insurance should be allowed to operate in the rural market.
- Only one State Level Life Insurance Company should be allowed to operate in each state.
- The Insurance Act should be changed.
- An Insurance Regulatory body should be set up.
- Controller of Insurance (Currently a part from the Finance Ministry) should be made independent.

Investments

- Mandatory Investments of LIC Life Fund in government securities to be reduced from 75% to 50%.
- GIC and its subsidiaries are not to hold more than 5% in any company (There current holdings to be brought down to this level over a period of time).

Customer Service

- LIC should pay interest on delays in payments beyond 30 days.
- Insurance companies must be encouraged to set up unit linked pension plans.
- Computerization of operations and updating of technology to be carried out in the insurance industry.

Overall, the committee strongly felt that in order to improve the customer services and increase the coverage of the insurance industry should be opened up to competition. But at the same time, the committee felt the need to exercise caution as any failure on the part of new players could ruin the public confidence in the industry.

16.2 Insurance Act 1938—Major Provisions

Prohibition on conduct of insurance business

Section 2c of the Act prohibits persons to carry on insurance business until he is :

(*a*) A public company.

(*b*) A registered society under.

(*c*) A body corporate incorporated under the law of any country outside India not being in the nature of a private company. However, the central government is empowered to exempt any insurer or any person for the purpose of carrying on the business of granting superannuation allowances and annuities as per Section 2(11(c) or for the purpose of carrying

general insurance business. Exempted insurer after the promulgation of IRDA Act, 1999 only Indian Insurance company can carry insurance business.

Licensing Conditions

Only Indian Insurance companies to be granted licenses : Under the Act, it is mandatory that only an Indian insurance company can carry on an insurance business in India. An Indian insurance company is a company registered under the Companies Act 1956 where the aggregate foreign equity shareholding does not exceed 26 per cent and whose sole purpose is to carry on a life, general or reinsurance business.

Two-stage licensing process

Stage 1–Requisition for Registration

An application has to be made to the Authority with all the prescribed disclosure norms. Some of the important items cover :

1. Promoter's back-ground, financial strength, share-holders' agreement and reasons for entering the sector.
2. Director's back-ground.
3. Capital structure, initial and future.
4. Financial projections for 5 years.
5. Scenario Building and Sensitivity analyses.
6. Rural and social sector strategy.

There is no provision for appeal in the event of a second rejection. A revised application is permissible by the applicant company only after 2 years with an additional condition that this will be with a new set of promoters or for a different class of insurance business.

Stage 2–Application for Registration

After the requisition is granted by the Authority, the applicant is required to make an application for registration. Information to be disclosed includes :

- Proof of paid-up capital of Rs. 100 crore.
- Proof of deposit.
- Marketing and distribution information. This should include information on Market Research. Product information, Distribution Strategy and Details, Sales promotion, Customer service.
- *Operations :* Information should cover underwriting, information technology, Internal controls, Personnel.
- *Investment :* Information on investment Philosophy, Strategy and ground level arrangements.
- *Reinsurance :* Information on Approach and Terms.
- *Expenditure :* This should include a description of the manner in which the expenses of administration have been estimated. These expenses will have to be distinguished between

first year and renewal, fixed and variable. The proposed expenses as a percent of premium at levels of operational offices, supervisory offices and head office.

Licensing Criteria

Some of the important parameters include :

- Promoter and directors' background
- Promoter financial strength
- Volume of business and earning prospects
- Rural and social sector focus
- Product profit
- Capital structure
- Actuarial and professional expertise
- Infrastructure
- Public interest

Other Licensing Issues

An appeal can be made to the Central Government against the decision of Authority, which shall be final. The applicant company can submit a new application only after two years with the additional condition that it has to be with a new set of promoters or for a different class of insurance business. The Authority will grant more licenses to applicants for life and health insurance than general insurance. Licenses expire on the 31st day of March each year and have to be renewed each year.

Capital Requirement and Foreign Stake

Minimum paid-up equity capital required for a life insurance is Rs. 100 crore and for a reinsurer Rs. 200 crore. The capital contributed can only be in the form of equity shares as preference shares cannot be issued. The incumbent, LIC, would be required to increase its equity share capital from the existing Rs. 5 crore to Rs. 100 crore within a period of six months from the date of commencement of the IRDA Act. Also, the four GIC subsidiaries would have to increase the equity share capital to Rs. 100 crore from Rs. 40 crore are resent. The GIC will not be required to bring in additional capital since its present capital base is Rs. 215 crore.

Accounts and Returns

An insurer is required to keep a separate account of all receipts and payments in respect of each class of insurance viz., Fire, Marine and miscellaneous Insurance. Every insurer is required to prepare, at the expiration of each financial year, in the prescribed forms,

(*a*) a balance sheet

(*b*) a profit and loss account

(*c*) a revenue account for each class of insurance business

These accounts are required to be audited annually by an auditor and printed and four copies to be furnished as returns to the IRDA within 6 months from the close of the financial year. Every Insurer is required to furnish to the authority a certified copy of the minutes of the proceedings of every General Meeting, within 30 days from the holding of the meeting. The Insurance Rules framed under the Act provide that the following items of information shall be maintained in respect of each class of business :

- A record of cover notes specifying the identification number, name of party, dates of commencement and expiry, type of cover granted, the amount of premium and cross- reference to the policy.
- A record of policies, which should be serially numbered, listing all policies issued, entered in chronological order, stating the number of policy, date of commencement and expiry of risk, name/s of the insured, premium received, cross reference to the relevant bank Guarantee or deposit and the nature of risk granted, cross reference to any cover-note issued prior to the issue to the policy and cross-reference to any endorsement passed subsequent to the issue of the policy.
- A record of premiums showing, according to chronological order or receipt of premiums, date of receipt, the amount, and name of party from whom received and with cross- reference to policy number.
- A record of endorsements mentioning the policy number to which attached, dates of commencement and expiry of the endorsement, the type of endorsement and the additional premium charged or refund due and cross reference to the premium register.
- A record of bank guarantees and deposits giving particulars of the party, amount and conditions of guarantee or deposits and cross-reference to the relevant policy or policies.
- A record of claims intimate mentioning name of claimant, giving reference to policy number, date of intimation of claim, interest covered, nature and cause of the loss or damage, provisional estimate of loss, amount at which settled, date of settlement of claim, recoveries from salvage or otherwise and whether surveyed. Two separate records, one relating to claims intimated and the other relating to claims paid, may be maintained if there is adequate cross referring of information between them and if the information required under this clause is readily available from them taken together.

The rules framed under the Insurance Act, 1938 also provide that the following items of information shall be maintained for the business of the insurer as a whole.

(*i*) A register of agents.

(*ii*) A record of business procured by each agent and the amount of commission paid thereon.

(*iii*) Records of employees including field workers.

(*iv*) Cash book and disbursement book.

(*v*) A record of investments and assets.

(*vi*) Records of insurance companies with which common and facultative reinsurance arrangements of reinsurance treaties are entered into.

(*vii*) Record of facultative reinsurance ceded and accepted.

Further, the Rules provide that receipts for payments received shall be maintained in a systematic manner and documents used for assuming risk are serially numbered and field accordingly. The

documents relating to claims settled, including copies of any survey of loss assessment reports, shall be maintained as follows :

(*i*) in respect of every loss or damage on which a claim of less than Rs. 5,000 has been made, for a period of three years :

(*ii*) in respect of every loss or damage on which a claim of Rs. 5,000 or more but less than rupees Rs. 20,000 has been made, for a period of five years :

(*iii*) in respect of every loss or damage on which a claim of Rs. 20,000 or more but less than rupees one lakh has been made, for a period of seven years :

(*iv*) in respect of every loss or damage on which a claim of rupees one lakh or more has been made, for a period of twelve years;

such period being counted from the date on which the claim is settled.

Investments

Every insurer is required to invest his assets only in those investments approved under the provisions. Returns in the prescribed form are to be submitted to the Authority showing as at 31st March of the preceding year, the investments made out of assets.

Limitation on Expenses of Management

The Act prescribes maximum limits of expenses of management including commission that may be incurred by the insurer. The percentages are prescribed in relation to the total gross direct business written by the insurer in India. These provisions do not apply to the General Insurance Corporation of India.

Prohibition of Rebates

No person shall allow or offer to allow as an inducement to any person to take out insurance any rebate of the whole or part of commission payable or any rebate of the premium shown in the policy. Any person making default in complying with these provisions shall be punishable with fine which may extend to five hundred rupees.

Powers of Investigation

The Central Government may at any time, by order in writing, direct the Authority or any other person specified in the order, to investigate the affairs of any insurer and report to the Central Government.

Advance Payment of Premium

No insurer shall assume any risk unless and until the premium is received in advance or is guaranteed to be paid or a deposit is made in advance in the prescribed manner. This rule of advance payment of premium may be relaxed in circumstances specified in the rules framed under the Act.

Licensing of Surveyor or Loss Assessor

A surveyor or a loss assessor must hold a valid licence, which is subject to renewal after a period of 5 years. Before admitting a claim exceeding Rs. 20,000 a general insurance company needs to obtain a report on the loss that has occurred from the surveyor or loss assessor.

Penalties

The Act has laid down penalties for contravention of the following provisions :

- Failure to maintain solvency margins.
- Failure to comply with investment norms.
- Failure to carry out rural and social sector obligations.
- Making a false statement or furnishing a false document.
- Failure to comply with the directions of the Authority.
- Failure to furnish documents, statements and returns required by the Act.

Key Terms

- Bottomary Contracts
- Inflation
- Insurance Density
- Liberalisation
- Malhotra Committee
- Fiscal Policy
- IRDA Act, 1999
- Insurance Reforms
- Macroeconomic Issues
- Respondentia

Suggested Readings

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- *IRDA Annual Report*, 2001-02.
- Spencer L. Kimbell and Herbert S. Demenberg, *Insurance, Government and Social Policy : Studies in Insurance Regulation*, the S.S. Haubner Foundation for Insurance Education, 1969.
- Irving Pfeffer and David R. Klock, *Perspective on Insurance*, Prentice-Hall, Englewood Cliffs, 1994.

Questions for Review

1. Trace the history of Indian Insurance industry for the period 1818-1999. What are your comments on the present state of Insurance Market.
2. Write short notes on :
   (1) Insurance Sector Reforms
   (2) Insurance Player in India
   (3) Macro-economic aspects of insurance.
3. "From a global perspective insurance has emerged as a business risk management device to a highly sophisticated risk transfer mechanism for both individuals and corporations." Discuss.