Open Vocational Education Programme

Diploma in Insurance Services

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BUSINESS ENVIRONMENT

Designed & Developed
by

Dr. Ajay Garg
Senior Executive Officer
Business & Commerce

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Diploma in Insurance Services

BUSINESS ENVIRONMENT

CONTENTS

Dear Learner,

This programme is specially for all those who are school dropouts and have started small enterprises, want to work in the Insurance sector as a skilled workforce and contribute substantially to the progress of India.

The multi-skill content with hands-on experience of this programme stimulates the intellect by going through concrete operations and then abstracting the concepts. At the same time by giving a variety of skills usable in everyday life, allowing them to form their preferences and know their aptitudes thus enabling them to choose a career. It also improves their self-image and gives them confidence and hope for the future.

The Insurance sector has completed its full circle in the year 2000, i.e. Private sector to Public sector and now back to Private sector. After 44 years, the monopoly of Life Insurance Corporation is no more and after 27 years four Public Sector general Insurance companies lost their monopoly. As on date there are 50 life and general insurance companies and few are queue to get license.

These insurance companies need trained manpower to be present on all India bases. To cater the needs of the insurance industry NIOS has designed a course namely "Diploma in Insurance Services" for the students who have minimum qualification of 12th standard.

In this module the student will be made familiar with the principles of commercial contracts as well as insurance on which the insurance business is transacted.

In this module the student will be made familiar with the activities related to industry and commerce, job opportunities in the insurance sector, various forms of business organization, basic accounting principles as well as principles of management.

We hope that this programme will help you to carve an niche in your career and play an important role in the society.

With best wishes.

Dr. Ajay Garg
Senior Executive Officer
(Business & Commerce)
National Institute of Open Schooling

Dear Learner,

In the fast expanding world of activities, learning new skills has become a necessity. Learning and re-learning has become essential for all. In such an environment, vocational education has assumed great importance. Vocational education, as a stream of education, promotes skill development and training of youth and directs them towards meaningful employment.

In keeping with the needs of the Learners, NIOS conducts Vocational Education Programmes in many areas through distance mode. These programmes include Agriculture, Business & Commerce, Home Science, Engineering & Technology, Computer Science, and Health & Paramedical. The Courses offered in these areas are aimed at providing self employment & wage employment opportunities for NIOS learners.

Diploma in Insurance Services is a One year Diploma course in Insurance Services. This course has been developed with the help of many leading experts of Insurance Sector. The course syllabus is designed keeping in view the requirements of the insurance sector.

This is multi-skilled programme, which will expose you to variety of skills. It includes Business Environment, Principles of Insurance, Life Insurance, General Insurance and Legal framework. This will help in identifying learner's preference for future vocation. We are confident that this course will prove to be beneficial to you.

We wish you all the best in your future career.

Dr. K. P. Wasnik
Director (VE)
National Institute of Open Schooling

Dear Learner,

Welcome to the National Institute of Open Schooling!

By enrolling with this institution, you have become a part of the family of the world's largest Open Schooling System. As a learner of the National Institute of Open Schooling's (NIOS)Vocational Programme, I am confident that you will enjoy studying and will benefit from this very unique School and method of training.

Before you begin reading your lessons and start your training, there are a few words of advice that I would like to share with you. We, at the NIOS, are well aware that you are different from other learners. We realize that there are many of you who may have rich life experiences; you may have prior knowledge about trades and crafts that are part of your family's legacy; you may have a sharp business sense that will make you fine entrepreneur one day. Most importantly, you have the drive and motivation that has made you enroll with this institution, which believes in the spirit of freedom. Yes, we are aware that you have many positive aspects in your personality, which we respect and relate to them.

During the course of your study, NIOS will treat you as the manager of your own learning. This is why your course material has been developed keeping in mind the fact that there is no teacher to teach you. You are your own teacher. Of course, if you have a problem, we have provided for a teacher at your Accredited Vocational Institution (AVI). I would advise you that you should always be in touch with your AVI for collection of study material, examination schedules etc. You should also always attend the Personal Contact Programmes and practical/ Training sessions held at your study centres. These will give you the necessary hands on training that is very essential to master a vocational course.

Studying for a vocational course is different from any other academic course. Here, while the marks obtained in the examination will indicate your grasp on your subject knowledge, your real achievement will be when you are able to apply your vocational skills in the market. I hope that this skill-based learning will help you perform your tasks better .This course of One year duration Diploma Course in Insurance Services developed by leading experts of Insurance sector. It is a multi-skilled programme, which will expose you to a variety of skills in Insurance sector. We hope that you will find it useful. On behalf of NIOS, I wish you the very best for a bright and successful future.

Dr. S. S. Jena
Chairman
National Institute of Open Schooling

ACKNOWLEDGEMENT

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RECENT TRENDS IN INSURANCE SECTOR

1.0 INTRODUCTION

In day to day life every human being is engaged in some activity, it may be related to earn livelihood or household activity. The activity which provides livelihood is known as economic activity. Though there are so many economic activities like manufacturing, trading, banking, transportation and insurance and many more. But in this module we are explaining only the Insurance activity which can be taken by an individual or group of persons to earn their livelihood.

The detail meaning of insurance is being explained in other module but in simple words insurance means transfer of risks of an individual (unexpected and uncertain) i.e Death, old age. Disability, illness or business risks (unexpected and uncertain) i.e fire, earthquake, theft and liability to an insurance company.

The insurance sector is divided in two parts life and general or non-life.

Insurance

↓

Life | Non-life / General

Life insurance deals with only human lives and non-life deals with other than human life. Insurance is divided into two segments i.e. Life and non-life / general and each segment have developed independently therefore it is being discussed separately in the following paragraphs.

In 2000, Indian insurance sector has taken U turn i.e. Privatization (private insurance companies to nationalization (Government Companies) to Privatization/mixed economy (Private/Government companies). Before we discuss how it has happened we would like to enlighten you the past history of insurance in India in brief.

It is said that insurance was practiced in India even in the Vedic times and the sanskrit term "YOGAKSHEMA" in the Rigveda is in reference to a form of insurance practiced by the Aryans 3000 years ago. The code of Manu which prescribes the many practices to be followed by the people for social harmony and development in Ancient India had also dictated that a special charge be made on goods carried from one city to another to ensure their safe carriage to the destination.

1.1 OBJECTIVES

At the end of the lesson you will be able to know

- Why the life & general insurance sector was nationalized
- Why insurance sector was liberalized in 1999
- IRDA action to develop the insurance sector

1.2 LIFE INSURANCE

In 1870 two British life insurance companies entered in India and attempted to do life insurance business on Indian lives. After that many Indian & foreign companies started business in India and by the year 1955 there were 255 insurance companies operating in India and transacting the business to the extent of Rs 200 crores. Due to the following reasons the Government decided to nationalize the life insurance industry w.e.f 1/7/1956.

1. No full guarantee to the Policyholders (who are insured).
2. The concept of trusteeship (confidence) was lacking.
3. Many insurance companies went into liquidation (bankrupt).
4. There was malpractice in the business.
5. Non-Spreading of life insurance.
6. No insurance in rural areas.
7. No group insurance
8. No social security

To overcome the abovementioned problems the life insurance business was nationalized and formed Life Insurance Corporation with following features:

1. The Central Govt. guaranteed the Policyholders through the LIC.
2. Being a Corporation formed under Special Act Passed by the Parliament therefore the public can trust.
3. The LIC cannot be liquidated without the order of the Central Govt.
4. Under the LIC Act, all day-to-day functions of the Corporation and the method of Investment in Govt. Securities were defined. Therefore, the malpractices were eliminated.

After the nationalization the life insurance business has grown substantially in very first year i.e. from Rs 200 crore upto 1956 to Rs 328 crores in 1957 and till privatization in 2000 the business was transacting worth Rs 73436 crores.

1.3 GENERAL INSURANCE

Prior to nationalization of the General Insurance Business in 1972 by enactment of the General Insurance Business Nationalization Act 1972 (GIBNA 1972) there were 55 Indian Companies and 52 non-Indian Companies carrying of the business of General Insurance in India. Before the nationalization the total premium written by these companies was Rs.170 crores as on 1971. At that time the "key Economic indicators" were as follows:

Gross Domestic Product	Rs. 36503 Crores
Per Capita Income	Rs. 675 Crores
Population	541 mns

To understand the why of nationalization in the first place it is sufficient to read the following excerpts from the speech of the then Finance Minister Mr.Y.B.Chavan.

"The primary objective of nationalization of general Insurance was to make it meaningful to the common man, to carry its message to the remotest corner of the country and to give it its rightful place in the economy of the country. When it was in the private sector it was a mere handmaid to trade and industry and served to cater to the interests of a limited clientele. Worse still it functioned in a manner favoring the interests of a few at the expense of, needless to say, the majority. There were allegations of malpractices on a big scale."

"It was the objective of nationalization to remove these malpractices and usher in an era of Insurance run on sound business principles and functioning on healthy and egalitarian lines. The emphasis should be on spreading the message of Insurance as widely as possible and on ensuring that it gives the right weightage to the weaker sections of the society. The principle of competition must have its useful role to play, but not at the expense of unhealthy rivalry."

"General Insurance is a service and proper and efficient service is due to the policyholder as a matter of right. The Corporation exists for the benefit of the policyholder."

"Business must cease to work under purely mercenary motives. Whenever, one feels the need for protection against an unpredictable contingency, a suitable Insurance cover should be available. No excuse should be given that a particular cover is not conventionally given or that other markets of the world do not give it." "Healthy employer-employees relationship is of vital importance to achieve the main objectives of nationalization."

"It will be necessary for the Corporation to review the rating structure in order to ensure that all classes of the policyholder receive a fair deal and the equitable rate of premium."

The Act led to the formation of the General Insurance Corporation (GIC) and the shares of the Indian Insurance Companies and the units of other Insurance Companies operating in India along with the General Insurance business of LIC were transferred to the GIC. The Indian companies became subsidiaries of GIC and the non-Indian Companies were transferred to 4 companies selected as flag companies to operate from 4 zones as under:

1. National Insurance Co. Ltd., with its Head Office at Calcutta.
2. The New India Assurance Co. Ltd. with its Head Office at Mumbai.
3. The Oriental fire & Insurance Co. Ltd., with its Head Office

at New Delhi (from 1974) (now named as The Oriental Insurance Co. Ltd.)

4. United India fire & General Insurance Co. Ltd., with its Head Office at Madras (now named United India Insurance Co. Ltd.)

Notes

The basis of allocation of the 107 companies was the geographical areas of operation i.e. south based companies were allotted to United India, the North based to the Oriental Insurance, the West based to the New India Assurance and East based National Insurance. The 4 flag companies became the subsidiaries of General Insurance Corp. with effect from 1/1/1973.The total business has gone from Rs 1145 crores in 1973 to Rs 9522 crores in 2000.

INTEXT QUESTIONS 1.1

1. Who started the life insurance in India ?
2. How many companies were merged to nationalize the general insurance business?

1.4 REVIEW OF INSURANCE BUSINESS IN INDIA

From above you must have observed that the insurance business has grown manifold after the nationalization of Life Insurance in 1956 and General Insurance in 1972. But the international comparison as per details given below will show that insurance penetration and insurance density in India is at low level as compared to the developing/developed countries.

International Comparison

	Insurance penetration (Premium as GDP)			*Insurance Density (Premium per capita in $)*		
Countries	Total	Non-life	Life	Total	Non-life	Life
USA	8.55	4.32	4.23	2921.1	1474.4	1446.6
UK	13.35	3.05	10.30	3244.3	741.5	2502.8
JAPAN	11.17	2.30	8.87	3908.9	805.50	3103.4
RUSSIA	2.13	1.34	0.78	26.80	17	9.9
France	8.52	2.82	5.70	2080.9	688.60	1392.30
Germany	6.52	3.55	2.96	1675.70	923.50	762.2
INDIA	**1.93**	**0.54**	**1.39**	**8.50**	**2.40**	**6.10**
BRAZIL	2.01	1.66	0.35	68.60	56.70	11.8
MEXICO	1.68	.86	0.82	84.60	43.30	41.30

Notes

KENYA	3.26	2.48	0.78	9.9	7.5	2.4
AUSTRALIA	9.82	3.39	6.43	2037.4	703.8	1333.6
MALAYSIA	3.88	1.72	2.16	140.4	62.3	78.1
NIGERIA	0.95	0.88	0.07	2.6	2.4	0.20

The reasons for low penetration may be that the insurance sector was totally in the hands of the public enterprises. It is observed that the public enterprises in any country can't perform all the economic and business effectively. Even in the socialist country, public enterprises in all the fields can't discharge their full responsibilities. It is also said that complete governmentalization or nationalization will lead towards slavery. Though the Indian economy is a mixed economy (not in Insurance sector till 2000) but the expectation from the public enterprises is too much. In fact, the support and subsidy provided by the Govt. indirectly punishes the taxpayer and the countrymen.

Keeping in view these problems the Indian Govt. started the liberalization process in 1991. Though the liberalization, privatization and globalization (LPG) has taken place in many sector but the insurance sector was liberalized, privatization and globalized in the year 2000.

Liberalization: means abolition of industrial licensing, removal of the limit on industrial investment & a more welcoming approach to foreign investment.

Globalization: means opening of the Indian economy for global cooperation in economic activities. This would involve foreign direct investment in industry and foreign institutional investors investing in the securities market by way of mutual funds etc., removal of quantitative restrictions on imports and reduction of import tariff.

Privatization: means refers to allowing private sector to invest in government companies as well as invest in areas earlier reserved for the public sector. It also implies greater participation of private sector in areas exclusively reserved for public sector.

Before liberalization the Insurance sector was controlled by Controller of Insurance but now the corporate body known as Insurance Regulatory & Development Authority (IRDA) has been formed under IRDA Act 1999 whose main objectives are as follows:

Notes

So far, the IRDA has issued licences to 20 Life Insurance companies and to 15 General Insurance companies including exclusive health insurance company. The private insurers have started their business during the year from 2000 to 2001; and till date there is growth in insurance penetration from 1.93 to 2.40 as well as insurance density from 8.50 to 9.36.

1.5 STEPS TAKEN BY IRDA

IRDA has taken the following steps to develop the Insurance sector in India keeping in view of the following key indicators.

INDIA'S PROFILE

Total Area	3287263 Sq. Kms.
Land Area	2973190 Sq.Kms.
Coastlines	7000 Kms
States	29
UT	6
Districts	463
Population	1.03 (Billion) as on 1/4/ 2001
Urban Population	27%
Population Growth	2.14%
Sex Ratio	927 Females 1000 Males
Density of population	273 persons per KM
Literacy Rate	52.10%
Life Expectancy(Male/ Female)	62/64 years

1.5.1 Policies And Measures To Develop Insurance Market

The Authority has taken a pro-active role in the establishment of a vibrant Insurance market in the country by taking the following steps:

i) The market regulation by prudential norms,

ii) The registration of players who have the necessary financial strength to withstand the demands of a growing and nascent market,

iii) The necessity to have "fit and proper" person in-charge of businesses,

iv) The implementation of a solvency regime that ensures continuous financial stability, and above all,

v) The presence of an adequate number of insurance companies to provide competition and choice to customers all these steps lead to the establishment of a regime committed to an overall development of the market in normal times.

vi) Prescribed rural and social sector norms in respect of Insurance business being underwritten by the companies.

vii) The companies have also been asked to devise insurance policy to specific sector in the economically weak population.

1.5.2 Research and Development Activities Undertaken by the Insurance companies

The insurers have been conducting market research either in-house or through professional agencies

i) to introduce tailor-made products targeted at specific segments of the population so that Insurance can become more meaningful and affordable.

ii) Risk assessment studies are being carried out for measuring accumulation of risk of a particular place at any one point of time.

iii) Consumer awareness campaigns are being encouraged to improve insurance literacy levels by conducting workshops, distributing literature etc.

1.5.3 Protection of Interests of Policyholders

To protect the interests of holders of Insurance policies and to regulate, promote and ensure orderly growth of the Insurance industry the Authority has taken the following steps:

i) a leading consumer activist has been inducted into the Insurance Advisory Committee.

ii) In addition to this member, this committee has drawn representation form the industry, Insurance agents, women's organizations and other interest groups.

iii) While the Government has taken steps to strengthen the Boards of the State-run companies by inducting representatives from consumer organization and policyholder,

iv) the Authority, on it part, was careful to ensure that all the new private companies registered have a director representing consumer interests on their Boards.

v) In addition to this measure all insurers have been advised to streamline their grievance redressal machinery and set benchmarks for efficient and effective service.

vi) All insurance companies are adhering to the Insurance Ombudsman scheme formulated by the Government and complaints against insurance companies are being referred to them by the aggrieved policyholders from time to time.

vii) The Authority is conscious of the fact that the fine print should not take away what the bold print promises and in this regard has come out with the Insurance Advertisement and Disclosure Regulations which ensure that the Insurance companies adhere to fair trade practices and transparent disclosure norms while addressing the policyholders or the prospects.

viii) All Insurance intermediaries, before obtaining a licence, or at the time of renewal of licence, are required to undergo compulsory training to ensure that they can service the policyholders better by being well trained and informed.

ix) Guidelines have been issued to insurers to file their existing and new products with the Authority. In case of new products insurers are required to submit details of

- premium rating,
- policy conditions,
- proposal form,
- claim form,
- underwriting manual and
- the system in vogue to review the rates, terms and conditions in future.
- In addition to this, they are required to furnish certificates from advocates and actuaries that the statements made are true and accurate and are not in violation of any law and
- that the policy wordings are simple and easily understandable to a policyholder.

Notes

1.5.4 Maintenance of Solvency Margins of Insurers

As per provisions of the Insurance Act and the regulations made there under, every life insurer is required

- to maintain an excess of value of his assets over the amount of his liabilities of not less than Rs.50 crores (Rs.100 crores in the case of a reinsurer) or
- a sum equivalent based on a prescribed formula, as determined by regulations not exceeding 5% of the mathematical reserves and a percentage not exceeding 1% of the sum at risk for the policies on which the sum at risk is not negative, whichever is highest.

Similarly, every General insurer is required to maintain a minimum solvency margin of

- Rs.50 crores (Rs.100 crores in the case of a reinsurer) or
- a sum equivalent to 20% of net premium income or a sum equivalent to 30% of net incurred claims whichever is highest, subject to credit for reinsurance in computing net premiums and net incurred claims.

In addition, at the time of registration all the new insurers have been required to maintain a solvency ratio of 1.5 times the normal requirements.

1.5.5 Monitoring of Investments of the Insurers

Investment income is a key determinant in the calculation of premium rates for any insurance company under the various insurance policies/schemes and for declaration of bonus by life insurers. It is a core function of an insurance company, which cannot be outsourced by an insurer.

In the case of general insurance, investment income compensates underwriting losses, if any, of the insurance company, which in turn enables then to keep their premium rates competitive.

Therefore, insurance companies essentially invest these funds judiciously with the combined objectives of liquidity, maximization of yield and safety.

An investment policy has to be submitted to the Authority by an insurer before the start of an accounting year. Since the insurance companies keep the policyholders money in their fiduciary capacity they are also required to maintain a minimum level of solvency to meet the reasonable expectations of the policyholders.

For this, the Authority has mandated the pattern of investment to be followed by the insurance companies. Investments in Government securities, approved investments and infrastructure and the social sectors have been prescribed in the Insurance Act, 1938. (details have been explained in other module)

1.5.6 Health Insurance

All the new insurance companies have been advised that they will carry out health insurance business not as a stand-alone product but as a combined rider with existing life/ non-life policies, and introduce health products in the market. At the moment the health products available is of the standard reimbursement type policy and its variants.

IRDA has recently notified regulations for Licensing of Third Party Administrators (TPA)- Health Services in order to popularize health insurance. Health services rendered by a TPA shall include services in connection with health insurance business. However this shall not include the business of insurance company or the soliciting, directly or through an insurance intermediary including an insurance agent. It is expected that TPAs will bring some sort of regulation regarding standard and quality of treatment, period of treatment and rates.

The Authority is encouraging to business community to come forward to start exclusively health insurance Company. Till date there is only insurer who is exclusively engaged in health insurance business.

1.5.7 Public Complaints

Many customers of insurance companies approach the Authority-both formally and informally for the settlement of their grievances. IRDA follows up for the settlement of these grievances on the complaints on a continuous basis with the insurance companies. Timely attention is given to these complaints and the insurers are advised to settle claims and grievances promptly.

A system of grievance redressal has been built in the Authority supervised by one of its senior officers. This system has proved useful to the Authority – not only to see that complaints get attended to but also to give it an idea of the areas of working of an insurer where have to be improved. The experience gained in this regard is reflecting in the regulations made by the Authority.

1.5.8 Functioning of Ombudsman (a person who decides the complaints of an individual on insurance matters)

The institution of Insurance Ombudsman has great importance and relevance for the protection of interest of policyholders and also to build up their confidence in the system.

This institution has helped to generate and sustain the faith and confidence amongst the consumers in insurers.

The Insurance Council, which is the administrative body has appointed twelve ombudsmen across the country and have provided them with the necessary infrastructure.

The companies are required to honour the awards passed by an Ombudsman within three months.

The awards are binding on the Insurance companies: the customer, however, can resort to in case he decides on the insurance companies; the customer, however, can resort to it case he decides to do so, other methods of grievance settlement.

The Insurance Ombudsman is empowered to receive and consider complaints in respect of personal lines of insurance from any person who has any grievance against an insurer.

The complaint has to be writing, and addressed to the jurisdictional Ombudsman within whose territory a branch or office of the insurer complained against is located. The complaint can relate to any:

a) Grievance against insurer.

b) Partial or total rejection of claims by the insurer.

c) Dispute in regard to premium paid or payable in terms of the policy.

d) Dispute on the legal construction of the policy in so far as such dispute relate to claims.

e) Delay in settlement of claims.

f) Non-issue of any insurance document to customers after receipt of premium.

The limit of an Ombudsman's powers is at present prescribed as Rs.20 lakhs.

The insurance Ombudsman Scheme is complementary to the regulatory functions of IRDA, which has been mandated to take all necessary steps to protect the interest of the policyholders.

The institution of ombudsman has evoked a good deal of public appreciation as is evident from media reports and performance appraisal made by the Authority.

1.5.9 Re-insurer (means insurance of insurance companies)

Reinsurance Business in India is being transacted by General Insurance Corporation. Before the privatization of the Insurance sector the General Insurance Corporation was performing the dual functions i.e. Insurance and Reinsurance. The Insurance business was transacted through its four subsidiaries namely the New India Assurance Co. Ltd., National Insurance Co. Ltd., The Oriental Insurance Co. Ltd., United India Insurance Co. Ltd. After the privatization the functions of GIC has been restricted to reinsurance and civil aviation Insurance. The Insurance Act 1938 has notified under Section 101A that Indian Reinsurer will be General Insurance Corporation and the four subsidiaries have been de-linked from GIC and shall work under the Central Government.

The Reinsurance Programme of every Insurer, carrying on general insurance business, shall be guided by the following objectives viz;

- To maximize retention within the country;
- To develop adequate capacity;
- To secure the best possible protection for the reinsurance costs incurred; and
- To simplify the administration of business.

1.5.10 Customer Service

One of the innovations that some of the insurers have introduced is opening up of "call centers" which are functioning on a 24x7 basis. These centers act not only as enquiry offices for new business to be developed but also function as points of reference and records for claims, which have arisen. It is note worthy to find that some of the new insurers have found it possible to settle claims within 24 to 48 hours.

1.6 SUMMARY

Keeping in view the above mentioned steps taken by the Govt. to develop insurance sector, it is expected that growth of insurance will be as follows:

Presently the private players are making their presence felt only in the urban areas as they have open their offices in the selected cities.

Particulars	Audited 2006-07	Unaudited 2007-08	2014-15(Projected)
		LIFE (first Year Premium)	
LIC	55935	59182	100000
PRIVATE	19471	33806	95000
TOTAL	75406	92988	195000
% Growth		23%	109.70%
		NON-LIFE	
PSU's Includes ECGC & Agriculture Insurance)	17442	18398	40000
Private (includes Health Insurance cos)	8739	11407	30000
Total	26181	29805	70000
% Growth		14%	135%
G. Total	101587	122793	265000
Population	1.04 billion	1.06 billion	1.25 billion

To increase the insurance penetration and density these players have not only to operate in the rural area but also to develop new products to meet the customers needs.

1.7 TERMINAL QUESTIONS

1. Why life insurance sector was nationalized in 1956?
2. Why general insurance sector was nationalized in 1972?

3. What steps have taken by the Authority to protect the policyholder's rights?

4. Discuss the various steps taken by IRDA to develop the insurance sector.

1.8 OBJECTIVE TYPE QUESTIONS

1. Life insurance deals with_______(Human/Animal)

2. In which year ________ the Indian Insurance Sector took U turn. (2000/1999)

Choose the correct option

3. Govt decided to nationalize the life insurance companies in 1956 due to
   a. Lack of confidence
   b. No guarantee to the policyholders
   c. Malpractice in the insurance business
   d. All of the above

4. The name of the Finance Minister at the time of nationalization of general insurance business was __________. (Y.B Chavan, Indira Gandhi)

5. On nationalization of the general insurance business how many govt. companies were formed _____(four/six)

6. LPG in insurance sector means___________ {(Liberalization, Privatization,Globalization)(Liquified Petroleum Gas)}

7. Statement A: Protection of Interest of Policyholders is one of the steps taken by the Govt to develop the insurance sector.

   Statement B: Maintenance of solvency margins of insurers is not a step to develop the insurance sector.

   a. Only A is true b. Only B is true c. Both are true d. Neither of two

8. The main function of Ombudsman is to resolve the complaints of ______(Insurer/policyholders)

9. The financial power of Ombudsman to resolve the complaint is ______(Rs 20 lakhs/Rs 25 lakhs)

10. The reinsurance means______(Insurance of insurer/ insurance of an individual)

Notes

1.9 ANSWERS TO INTEXT QUESTIONS

1.1

1. Two British companies in 1870 started to insure the lives of India.
2. 55 Indian and 52 non-Indian companies were merged in to four companies on regional basis.

1.10 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. Human 2. 2000

3. d 4. Y. B. Chavan

5. Four 6. Liberalization, privatization, globalization

7. a 8. policyholder

9. Rs 20 lakhs 10. Insurance of insurer

(Rs in crores)

Particulars	Audited 2007-08	Audited 2008-09	2014-15 (Projected)
		LIFE	
LIC	149740	157288	253314
PRIVATE	51561	64503	103883
TOTAL	201301	221791	357197
% Growth		10%	37.91%
		NON-LIFE	
PSU's Includes ECGC & Agriculture Insurance)	16832	18031	29039
Private (includes Health Insurance cos)	10992	12321	19843
Total	27824	30352	48882
% Growth		9%	61%
G. Total	229125	252143	406079
Population	1.04 billion	1.06 billion	1.25 billion

2

BUSINESS OPPORTUNITIES IN INSURANCE SECTOR

2.0 INTRODUCTION

Every individual is a personality which is defined by the set of traits which he has acquired through conscious or unconscious exposure to various environment. Identification of these traits & selecting a business opportunity which is in prefect unison with the personality is most crucial job for a person. But in the present scenario the opportunities in the ever growing Insurance sector are available in abundance.

2.1 OBJECTIVES

At the end of this lesson you will come to the various carreer opportunities available in Insurance sector

- Agent/Corporate Agent
- Insurance Brokers
- Surveyors etc.

2.2 IMMEDIATE PAST OF INSURANCE SECTOR

Before the passage of IRDA Bill 1999, there were two nationalized companies in the insurance business (i.e.) Life Insurance Corporation of India and General Insurance Corporation of India. General Insurance Corporation of India has four subsidiaries to carry on general insurance business. They are The New India Assurance Co. Ltd., National Insurance Co. Ltd., United India Insurance Co. Ltd. and The Oriental Insurance Co. Ltd.

These companies together have 6300 offices through out the length and breadth of the country. These companies have 10 lacs indirect employees (agents) and 2 lacs direct employees. These 12 lacs employees conduct insurance business of Rs. 42,000 crores annually and cover just 6% of the insurable population.

2.3 LOOKING AHEAD

Already 25 companies have been granted insurance license by Insurance Regulatory and Development Authority (IRDA). When we look at the profile of these companies and their foreign partners, they are financially very strong, have deep pockets and would deploy highly advanced technology in the field of insurance, which has never been witnessed by the Indian Insurance Consumers, be it IT technology, be it Customer Service, be it innovative Products etc.

It is projected that another 20 will enter the insurance sector in next 10 years. The insurance business is projected to grow to 6 lacs crores as per Confederation of Indian Industry (CII) report. The manpower required to generate insurance business of 6 lac crores is projected to be 40 lacs.

Till date, Insurance companies in India have concentrated their efforts to sell insurance in urban areas mainly. Very little premium comes from the rural areas. Seeing that Insurers prefer easy and cost effective selling and with the apprehension that new players will also follow the same strategy, Insurance Regulatory and Development Authority (IRDA) has made it mandatory for insurance companies to do minimum fixed percentage of total insurance business in Rural area as well. This is to ensure that benefit of privatization of insurance is passed on to the masses in real sense.

Over 70% of population lives in the Rural India and this is the segment, which is yet to be accessed. A number of the new entrants shall be targeting this area and for this they shall be needing a trained and well-motivated workforce to effectively market their products, a challenge for next 3 years. Even in the urban area as the existing companies already have a very strong foothold it will not be easy for the new entrants to make a dent in the business of these companies unless aggressive marketing of their products is done. The real test of course will be their service performance at every stage, as

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worldwide also it is the strength of limited few Insurance companies and weakness of many. It is this benchmark, which will ensure the acceptability of the company by the Public at large.

The traditional mindset of the Indian people does not view Insurance as a very desirable product and it is viewed with suspicion as the general feeling is that Insurance companies collect the premiums but do not pay up when claims arise or if they do pay its only after a lot of harassment. To overcome this mental block is not going to be easy and the new companies will have to go in for innovative marketing methods.

INTEXT QUESTIONS 2.1

1. How business of insurance companies is projected in CII Report?

2. How much manpower is required to do insurance business in next 10 years?

Till date, the selling of Insurance is done by the branch offices of the companies or the Agents who are paid a healthy commission as a percentage of the business they bring to the company. But as on date various distributional channels are being introduced by IRDA as well as in other related areas are introduced where an individual gets an opportunity to start one's career in Insurance sector as discussed below:

2.4 MULTIPLE CAREERS IN INSURANCE SECTOR

2.4.1 Agents/ Insurance Advisers

The present system of selling Insurance through Agents or Insurance Advisors after the forthcoming amendments are through will continue but things are more professional today. IRDA has regulated the procedure for licensing of agents and their minimum qualifications; compulsory training, and passing of an examination conducted by Insurance Institute of India has been made mandatory before a license can be obtained. The license fee has also been increased 15 times. All this will provide a professional touch. The new entrants are going to require Insurance acumen and entrepreneurship skills for selling their products. At present there are approximately 15 lac agents representing the Life and General

Insurance Companies. With the entry of the new players, it is estimated that there will be fresh requirement for 50,000 agents/ Insurance advisers every year. The recruitment procedure is explained in the module "Insurance Legislation"

2.4.2 Corporate Agents

The Corporate Agent is a corporate entity wherein two or more Agents join hands and form legal entity wherein minimum two directors/ partners of a Corporate Agents or the firm should have the qualifications required of an Individual Agent. The capital requirement is Rs 15 lakhs. With this concept many bankers have become Corporate Agents.

2.4.3. Brokers

In America and elsewhere a major amount of Insurance business is conducted through Brokers. A broker is representative of the insured (i.e. customer) rather than of the insurer, but he is like an agent in the sense that he gets paid in the form of commission by the Insurance company with whom he places the business. The broker solicits business from the Insured and then places the business with an appropriate Insurance Company. He can deal with any number of Insurance companies as opposed to the single company that an agent can represent. Brokers also provide pre sale and after sales service to the Insured.

This concept also is an opportunity for those who plan to go on their own and bring business to the new entrants from areas where the companies do not have their own offices or may not want to set up an office due to economics of scale & limited business. The recruitment procedure in explained in module "Insurance Legislation"

2.4.4. Surveyors

Independent qualified professionals from the field of Engineering, medicine and finance can enter this field and provide valuable service to the Insurance companies who do not wish to employ surveyors/ loss assessors directly and prefer to have Independent people who will work for them on case to case basis for a percentage of the claim amount. In America, they are called Claim Adjusters and often they are authorized by the companies to settle the claims upto a certain amount and even make the payment to the insured, so that small claims are settled early and the insured's satisfaction level is kept high.

2.4.5. Risk Managers

This is a highly specialized field. While some big Industrial houses are directly appointing Risk Managers on their rolls others are seeking the services of independent specialist firms/ individuals to advise them in this very important aspect. Risk Managers are mainly engineers, who have in-depth knowledge of safety, hazards, claim minimization and perception of magnitude of risk, which can possibly arise. Technocrats with experience have great opportunities in this specialized field.

2.4.6. Legal Consultants

As in the case of Insurance Consultants the services of legal consultants are availed of by both the Insurer and the Insured and their services are mostly required at the time of claim disputes, during arbitration, Third party claims, Liability claims or when the subject matter has been referred to the courts. It is predicted that growth of legal disputes out of insurance related matters is going to increase exponentially with over 20 new players entering the fray.

2.4.7 Investigators

Independent Individuals or a firm whose services are used on case-to-case basis by the Insurance companies to investigate the genuinity /quantum of claims especially early claims and theft claims. They are specialised people and need to be experts in their field as well as in Insurance. Insurance claim detection agencies, fraud control organisations, and statistical/ grading agencies run by entrepreneurs will take a start in coming times.

2.4.8 Recovery Agents

Their services are used by the Insurance Companies to settle third party claims. Wherein there is a chance of recovery from the third party. The insurers send the recovery agents to talk to the third party and arrive at a justified settlement thus savings on legal costs, which otherwise would have been incurred if the matter had gone to court. At times, the settlements made by the recovery agents are quite favourable.

2.4.9 Medical Professionals

TPA" means a Third Party Administrator who is engaged for a fee or remuneration determined in the Agreement for health services. He is a service provider to the Insured on behalf of insurance company. His work profile includes, to obtain all the requisite documents pertaining to the administration of insurance claim arising out of insurance contract concluded by the insurer with the insured and render necessary assistance and advise to policyholders or claimants or beneficiaries in complying with the requirement for settlement of claims with the insurer, if called for by the agreement;

2.4.10 Actuary

Actuary is most remunerative profession in Insurance sector. In life insurance companies the appointment of Actuary is statutory requirement. Basically he is a Production Manager of an insurance company especially of a Life insurer because he designs the product and its price so that the product is easily saleable in the market. To become an Actuary one has to become a member of ***Actuarial Society of India*** who has prescribed the qualification and examination to be passed by an individual. The minimum qualification is 1st class graduation and who studied Mathematics and Statistics at graduation level. It takes minimum 5-6 years to complete the course.

2.5 SUMMARY

The opportunities are many and will grow with almost 25 new entrants expected to be in this sector. The services of independent entrepreneur or group of professionals joining together is what required today. Only time will tell how many take up the challenge and at what stage. Presently, there is lack of awareness as the Insurance companies, professionals and educational Institutes have a lot to contribute in their own way to promote this cause. IRDA is responsible to promote growth of Insurance under its "Development" Banner. If existing & new Insurance Companies, Associations, Professional bodies, Academicians and dedicated Insurance Institutes do not timely step in to share the load of development of Insurance in India, IRDA as a watchdog will surely make it happen by making it an essential activity to be performed by each one of us.

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2.6 TERMINAL QUESTIONS

1. What are the various opportunities available to sell insurance products?
2. Explain the various career opportunities available in insurance sector.

2.7 ANSWERS TO INTEXT QUESTIONS

2.1

1. Rs 6 lakhs crores in next ten years.
2. About 40 lakhs

3

FORMS OF BUSINESS ORGANISATION

3.0 INTRODUCTION

After identifying the business in any field e.g., Insurance, it is necessary then to have a legal entity to be known in the society. The legal entity can be in any form of a business organization. The various forms of organization are as follows:

1) Sole proprietorship
2) Partnership
3) Co-operative Society
4) Joint stock company (Private and Public)

These are explained in brief as follows:-

3.1 OBJECTIVES

At the end of this lesson you will be able to know

- Various forms of organization
- Its formation & features
- Merits & Demerits

3.2 SOLE PROPRIETORSHIP

3.2.1 Meaning:

The sole proprietorship is a form of business that is owned, managed and controlled by an individual. He has to arrange capital for the business and he alone is responsible for its management. He is therefore, entitled to the profits and has to bear the loss of business, however, he can take the help of his family members and also make use of the services of others such as a manager and other employees.

This type of business organisation is also called single ownership or single proprietorship. If the business primarily consists of trade, the organization is a sole trading organization. Small factories and shops are often found to be sole proprietorship organisations.

It is the simplest and most easily formed business organization. This is because not much legal formality is required to establish it. For instance to start a factory the permission of the local authorities is sufficient. Similarly to start a restaurant, it is only necessary to get the permission of local health authorities. Or again, to run a grocery store, the proprietor has only to follow the rules laid down by local administration.

3.3.2 Features of Sole Proprietorship:

The important features of a sole-proprietary organization include the following:

(i) **Individual Initiative:** One person is the owner in a sole-proprietary form of organisation.

(ii) **Risk Bearing:** The proprietor is the sole beneficiary of profits in this form organisation. If there is a loss he alone has to bear it. Thus the risks of business are borne by the proprietor himself.

(iii) **Management and control:** Management and control of this type of organisation is the responsibility of the sole proprietor. He may, however, employ a manager or other people for the purpose.

(iv) **Minimum government regulations:** The government does not interfere with the working of the sole proprietorship organisation. However, they have to comply with the general laws and rules laid down *by* government.

(v) **Unlimited liability:** The sole proprietor has to bear the losses and is responsible for the liabilities of the business. If the business assets are not sufficient to meet the liabilities, he may also have to sell his personal property for that purpose.

(vi) **Secrecy:** All important decision taken by the owner himself. He keeps all the business secrets only to himself.

3.3.3 Merits Of Sole Proprietorship:

A sole proprietary organisation has the following advantages:

(i) **Easy formation:** A sole proprietorship business is easy to form where no legal formality involved in setting up this type of organization. It is not governed by any specific law. It is simply required that the business activity should be lawful and should comply with the rules and regulations laid down by local authorities.

(ii) **Better Control:** In sole proprietary organisation, all the decisions relating to business operations are taken by one person, which makes functioning of business simple and easy. The sole proprietor can also bring about changes in the size and nature of activity. This gives better control to business.

(iii) **Sole beneficiary of profits:** The sole proprietor is the only person to whom the profits belong. There is a direct relation between effort and reward. This motivates him to work hard and bear the risks of business.

(iv) **Benefits of small-scale operations:** The sole proprietorship is generally organized for small-scale business. This helps the proprietor's family members to be employed in business. At the same time such a business is also entitled to certain concessions from the government. For example, small industrial organisations can get electricity and water supply at concessional rates on a priority basis.

(v) **Inexpensive Management:** The sole proprietor does not appoint any specialists for various functions. He personally supervises various activities and can avoid wastage in the business.

3.3.4 Limitations Of Sole Proprietorship:

A sole proprietor generally suffers from the following limitations:

(i) **Limitation of management skills:** A sole proprietor may not be able to manage the business efficiently as he is not likely to have necessary skills regarding all aspects of the business. This poses difficulties in the growth of business also.

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(ii) **Limitation of Resources**: The sole proprietor of a business is generally at a disadvantage in raising sufficient capital. His own capital may be limited and his personal assets may also be insufficient for raising loans against their security. This reduces the scope of business growth.

(iii) **Unlimited liability:** The sole proprietor is personally liable for all business obligations. For payment of business debts, his personal property can also be used if the business assets are insufficient.

(iv) **Lack of continuity:** A sole proprietary organisation suffers from lack of continuity. If the proprietor is ill this may cause temporary closure of business. And if he dies the business may be permanently closed.

From the above account of the merits and limitations it becomes clear that it is only personal services like repair work, tailoring etc. small factories, retail shops and professional activities which can be set up as sole proprietary organisations. In India, this form of organisation is quite popular and accounts for the largest number of business units.

3.3 PARTNERSHIP

Meaning

Partnership is an association of persons who agree to combine their financial resources and managerial abilities to run a business and share profits in an agreed ratio. Since the resources of a sole proprietor to finance, and his capacity to manage a growing business is limited, he feels the need for a partnership firm. Partnership business, therefore, usually grows out of the need for expansion of business with more capital, better supervision and control, division of work and spreading of risks.

The Indian Partnership Act defines partnership as "Partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all. The persons who have agreed to join in partnership are individually called "Partners" and collectively a 'firm'. A partnership firm can be formed with a minimum of two partners and it can have a maximum of twenty partners.

3.3.1 Features of Partnership:

The features of partnership are as follows:

(i) Existence of an agreement: Partnership is formed on the basis of an agreement between two or more persons to carry on business. It does not arise out of the operation of law as in the case of joint Hindu family business. The terms and conditions of partnership are laid down in a document known as Partnership Deed.

(ii) Engagement in business: A partnership can be formed only on the basis of a business activity. Its business may include any trade, industry or profession. Thus, a partnership can engage in any occupation - production and/or distribution of goods and services with a view to earning profits.

(iii) Sharing of profits and losses: In a partnership firm, partners are entitled to share in the profits and are also to bear the losses, if any.

(iv) Agency relationship: The partnership business may be carried on by all or any of the partners acting for all. Thus, each partner is a principal and so can act in his own right. At the same time he can act on behalf of other partners as their agent. Thus, every partner can bind the firm by his acts.

(v) Unlimited Liability: The liability of partners is unlimited as in the case of sole proprietorship. In case some obligation arises then not only the partnership assets but also the private property of the partners can be taken for the payment of liabilities of the firm.

(vi) Common Management: Every partner has a right to take part in the running of the business. It is not necessary for all partners to participate in the day-to-day activities of the business but they are entitled to participate. Even if partnership business is run by some partners, the consent of all other partners is necessary for taking important decisions.

(vii) Restriction on transferability of share: No partner can transfer his share in partnership to any other person. He may, however, do so with the consent of all other partners.

(viii) Registration: To form a partnership firm, it is not compulsory to register it. However, if the partners so decide, it may be registered with the Registrar of Firms. There are advantages of registration, which are discussed later.

(ix) Duration: The partnership firm continues at the pleasure of the partners. Legally a partnership comes to an end if any partner dies, retires or becomes insolvent. However, if the remaining partners agree to work together under the original firm's name, the firm will not be dissolved and will continue its business after settling the claim of the outgoing partner.

3.3.2 Formation and Registration:

Partnership Deed:

Since partnership rests on an agreement among persons, its formation does not involve any special legal problems. Generally, the partnership agreement is reduced to writing and a Partnership Deed is prepared. Partnership Deed lays down the terms and conditions of partnership and the rights, duties and obligations of partners. The following points are generally covered in the Deed:

(i) The nature of business.

(ii) Name of the firm and the place where its business will be carried on.

(iii) Amount of capital to be contributed by each partner.

(iv) Duties, powers and obligations of all the partners.

(v) Method of preparing accounts and arrangement for audit.

(vi) Whether loans will be accepted from a partner over and above the capital also, if so, at what rate of interest.

(vii) The amount to be allowed as private drawings by each partner and the interest to be charged thereon.

(viii) The ratio in which profits are to be shared.

(ix) Whether a partner can be expelled and, if so, the procedure for the same.

(x) Method for the settlement of disputes.

(xi) Circumstances under which the partnership will stand dissolved, and in case of dissolution, under whose custody the books of accounts will remain.

The Deed has to be stamped and each partner should have a copy of it.

3.3.3 Registration of firm:

Registration of a partnership firm is not compulsory under Indian Partnership Act. In England registration is compulsory. In India, certain privileges which are allowed to those firms, which are registered. But an unregistered firm suffers from certain disabilities. These disabilities make it virtually compulsory for a firm to get registered. A partnership firm may be registered at any time. That is, at the time of formation or at any time during its existence. A partnership firm desiring registration applies lo the Registrar of Firms in prescribed form along with the registration fee. The application should state the following:

(i) Name of the firm.

(ii) The principal place of business of the firm.

(iii) The name of any other place where the firm is to carry on business:

(iv) Date of admission of the partners in the firm.

(v) Names and permanent addresses of the partners.

(vi) Duration of the firm.

The application shall be signed and verified by each partner. Changes in the above particulars have to be communicated to the Registrar. The Certificate of registration is reliable evidence and a conclusive proof of the existence of the firm.

3.3.4 Consequences of Non-Registration:

An unregistered firm suffers from the following serious disabilities:

(i) A partner of an unregistered firm can not file a suit against the firm or any other partner for enforcing his right arising out of the contract;

(ii) An unregistered firm cannot file suit against any third party for the recovery of the claims;

(iii) Such a firm also cannot file a suit against any partner.

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3.3.5 Types of Partnership

According to the nature of agreement among partners, there can be three types of partnership as follows:

(i) Partnership at-will: Such a partnership exists on the will of the partners. That is, it can be brought to an end whenever any partner gives notice of his intention to do so.

(ii) Particular partnership: A particular partnership is formed for undertaking a particular venture. It comes to an end automatically with completion of the venture.

(iii) Partnership for a fixed duration: Such partnership is for a fixed period of time say 2 years, 5 years or any other duration.

3.3.6 Types of Partners

The various types of partner found in partnership firms are as follows:

(i) Active Partners: Partners who take active part in the conduct of day-to-day business of the firm are called active partners. These partners carry on business on behalf of the other partners.

(ii) Sleeping or dormant partners: Sleeping or dormant partners are those who do not take active part in the management of the business. Such partners only contribute capital in the firm and are bound by the activities of other partners. However, they share in the profits and losses of the business.

(iii) Others: Active and sleeping partners are, as a matter of fact, the full-fledged partners i.e. they share in profits and losses of the business and are liable for its dues. However, there are other types of partners also who may be associated with partnership directly or indirectly. They are not full-fledged partners, such partners may include the following:

(a) Nominal Partners: Nominal partners are those who do not have interest in the business but lend their name to the firm. They do not make any capital contribution, and are not entitled to take part in management, but are liable, like other partners, to third parties. Such partners generally have a pecuniary interest (like a share in the profits) in lending their name to a firm. However in certain cases they may not have any pecuniary interest in doing so. For example, a reputed industrialist may, without any profit motive lend his name to a firm run by his family members.

(b) Partners by holding out: If a person by his words or conduct holds out to another that he is a partner, he will be prevented from denying that he is not a partner. The person who thus becomes liable to third parties to pay the debts of the firm is known as a partner by holding out.

3.3.7 Minor admitted into the benefits of partnership

A minor is a person who has not attained the age of 18 years. Since a minor is not capable of entering into a valid agreement, he cannot become partner of a firm. He may, however, be admitted to the benefits of an existing partnership.

It is clear from the preceding discussion that partners can be of three categories:

(i) Those who share in the profits and losses of the business and assume liability of the business debts (like active partners, dormant partners and nominal partners).

(ii) Those who share in profits only (like minor partners) and

(iii) Those who assume liability without sharing in the profits of the business (like partners by holding out).

3.4.8 Merits of Partnership

A partnership form of organisation offers the following advantages:

(i) Ease in formation: A partnership is very easy to form. All that is required is an agreement among the partners. Even the expenses to be incurred for registration are-not much.

(ii) Pooling of financial resources: A partnership commands more financial resources compared to sole proprietorship. This helps in expanding business and earning more profits. As and when a firm requires more money, more partners can be admitted.

(iii) Pooling of managerial stalls: A partnership facilitates pooling of managerial skills of all its partners. This leads to greater efficiency in business operations. For instance, in a big partnership firm, one partner can handle production function, another partner can look after all marketing activity, still another can attend to legal and personnel problems, and so on.

(iv) Balanced business decisions: In a partnership firm, decisions are taken unanimously after considering all the major aspects of a problem. This ensures not only balanced business decisions but also removes difficulties in the smooth implementation of those decisions.

(v) Sharing of risks: Unlike sole proprietary organisation, the risks of partnership business are shared by partners on a predetermined basis. This encourages partners to undertake risky but profitable business activities.

3.3.9 Limitations of Partnership

A partnership form of organisation suffers from the following major limitations:

(i) Uncertainty of existence: The existence of a partnership firm is very uncertain. The retirement, death, bankruptcy or lunacy of any partner can put an end to the partnership. Further, the partnership business can come to a close if any partner demands it.

(ii) Risks of implied authority: It is true that like the sole proprietor each partner has unlimited liability. But his liability may arise not only from his own acts but also from the acts and mistakes of co-partners over whom he has no control. This discourages many persons with money and ability, to join a partnership firm as partner.

(iii) Risks of disharmony: In partnership, since decisions are taken unanimously, it is essential that all partners reconcile their views for the common good of the organisation. But there may arise situations when some partners may adopt rigid attitudes and make it impossible to arrive at a commonly agreed decision. Lack of harmony may paralyse the business and cause conflict and mutual bickering.

(iv) Difficulty in withdrawal from the firm: Investment in a partnership can be easily made but cannot be easily

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withdrawn. This is so because the withdrawal of a partner's share requires the consent of all other partners.

(v) **Lack of institutional confidence:** A partnership business does not enjoy much confidence of banks and financial institutions. It is because the nature of its activities is not disclosed at public and the agreement among partners is not regulated by any law. As a result large financial resources cannot be raised by partnership and growth of business cannot be ensured.

(vi) **Difficulties of expansion:** It is difficult for a partnership firm to undertake modernization of expansion of its operations. This is because of its inability to raise adequate funds for the purpose. Limited membership (restricted to 20) and their limited personal resources do not permit large amounts of capital to be raised by the partners. Therefore, large-scale business cannot generally be organised by partnerships.

It is quite obvious from the discussions that the partnership form of organisation is excellent when the size of business is medium, i.e. neither too small not too large, and when the partners can work in full co-operation with one another,

INTEXT QUESTIONS 3.1

1. Whether the liability of sole proprietorship is limited or unlimited?
2. How many minimum members are required to form partnership firm?
3. Is it compulsory to register the partnership firm?

3.4 CO-OPERATIVE ORGANISATION

3.4.1 Meaning:

A co-operative form of business organization is different from other forms of organization. It is a voluntary association of persons for mutual benefit and its aims are accomplished through self help and collective effort. The main principle underlying a cooperative organization is mutual help, i.e., each for one and all for each. A minimum of 10 persons are required to form a co-operative society. To be called a co-operative society it must be registered with the Registrar of Co-operative Societies under the Co-operative Societies Act. The capital of a co-operative Society is raised from its members by way of share capital. It can also obtain additional resources by way of loans from the State and Central Co-operative Banks.

A Co-operative society has much in common with partnership, yet there are differences between the two types of organisation. In partnership, mutual benefit is restricted to partners only, but in a co-operative society it extends to its members as also the public. For example in a consumer co-operative store or a co-operative credit society, the benefits are available to the members as well as the general public. Besides, partnership requires the existence of some business activity whereas a co-operative may be formed whenever individuals have common needs, which are difficult to fulfill single-handed. Also, registration is optional in the case of partnership but it is compulsory for a co-operative society.

3.4.2 Type of Co-operative Societies

Co-operative societies may be classified into different categories according to the nature of activities performed by them. The main types of co-operative societies are:

1. Consumers' co-operative societies.
2. Producers' co-operative societies.
3. Co-operative marketing societies.
4. Co-operative credit societies.
5. Co-operative farming societies.
6. Co-operative housing societies.

1. **Consumers' co-operative societies:** Consumer' co-operatives are organised by consumers to eliminate middlemen and to establish direct relations with the manufacturers or wholesalers. These societies are formed by consumers to ensure a steady supply of goods and services of high quality at reasonable prices. It purchases goods either from the manufacturers or wholesalers for sale at reasonable prices. The profit if any , is distributed among members as dividend in the ratio of capital contributed and also bonus in proportion to the purchases made by them.

2. **Producers' co-operative societies**: Producers' co-operative are formed to help the members in procuring inputs for production of goods or services. These societies generally provide raw material, tools and equipment and other common facilities to its members. This helps them to concentrate their attention on production of goods. The society provides inputs to the members and takes over their output for sale to outsiders. The basis for distribution of bonus is the goods delivered for sale by each member.

3. **Co-operative marketing societies:** Co-operative marketing societies are voluntary associations of small producers, who find it difficult to individually sell their products at a profit. The main purpose of such a society is to ensure a steady and favourable market for the output of its members. The output is pooled together and sold at the best price. The sale proceeds are distributed in proportion to the contribution of the members to the pool. Marketing co-operatives eliminate middlemen and ensure honest trading practices in weighing, measuring and accounting.

4. **Co-operative credit societies:** Such societies are formed to provide financial help in the form of loans to members. The funds of these societies consist of share capital contributed by the members and the deposits made by them and outsiders. The funds are used in giving loans to needy members on easy terms. Thus, the members are protected from the exploitation of moneylenders, who charge very high rates of interest. Another important purpose of credit co-operatives is to encourage the habit of thrift among their members.

5. **Co-operative farming societies**: In co-operative farming societies, small farmers join together and pool their resources for cultivating their land collectively. Their objective is to achieve economies of large scale farming and maximising agricultural output. Such societies are particularly important in the case of countries like India, where agriculture suffers from excessive sub-division and fragmentation of land. Co-operative farming makes it possible for members to use modem tools and equipments, good seeds, fertilizer and irrigation facilities in order to achieve higher production.

6. **Co-operative housing societies:** They are formed to provide residential accommodation to the members. They undertake the purchase and development of land and/or construction of houses/flats on the land. Some housing co-operatives provide their members with necessary loans at low rates of interest to build houses. These societies are gaining popularity in big cities.

3.4.3 Characteristics of Co-operative Organisation

The following are the main characteristics of cooperative societies:

(i) **Voluntary association:** In co-operatives, the membership is voluntary. Anybody having a common interest is free to join a co-operative society. The member can also leave the society anytime after giving proper notice.

(ii) **Equal voting rights:** In a co-operative society, the principle of one-man one vote is adopted. A member has only one vote irrespective of the number of share(s) held by him. Thus, a co-operative society is run on democratic principles.

(iii) **Separate legal entity:** A co-operative society is required to be registered under the Co-operative Societies Act. Registration provides it a separate legal entity. Its existence is quite different from its members. The death, insolvency or lunacy of a member does not affect its existence. It can sue and be sued in its own name. It can make agreements as well as purchase and sell properly in its own name.

(iv) **Service motive:** A co-operative society is based on the service motive of its members. It's main objective is to provide service to the members and not to maximize profits. Earning profit is the most important objective of other forms of business organisation. It is not so in the case of co-operatives.

(v) **Distribution of surplus:** Out of the profits of the co-operative, members are paid dividend and bonus. The bonus is given according to the volume of business transacted by each member with the co-operative society. For example, in a consumer co-operative society, bonus is paid in proportion to the purchases made by members during a year. In producers' co-operative the valued goods delivered for sale form the basis of distributing bonus.

3.4.4 Merits of Co-operative Organisations

The co-operative form of organisation offers the following advantages:

(i) Easy to form: A co-operative society is voluntary association and may be formed with a minimum of ten adult members. Its registration is very simple and can be done without much legal formalities.

(ii) Open membership: Membership in a Co-operative organisation is open to all having a common interest . A person can become a member at any time he likes and can leave the society by returning his shares without affecting its continuity.

(iii) Democratic management : A co-operative society is managed in a democratic manner. It is based on princiiple of one man one vote. All members have equal rights and can have a voice in its management.

(iv) Limited liability: The liability of the members of a co-operative society is limted to the extent of capital contributed by them. They don't have to bear personal liability for the debts of the society.

(v) Stability: A co-operative society has a separate legal existence. It is not affected by the death, insolvency, lunacy or permanent incapacity of any of its members. It has a fairly stable life and continues to exist for a long period.

(vi) Economical operations: The operation of co-operative society is quite economical due to elimination of middlemen and the voulantarily services provided by its members.

(vii) Government patronage: Government gives all kind of help to co-operatives, such as loans at lower rates of interest and relief in taxation.

(viii) Other benefits: Certain non-economic benefits are also derived by members through cooperatives. Credit co-operatives, for instance, promote habits of thrift and producers' co-operative encourage joint activity among members.

3.4.5 Limitations of Co-operative Organisations

As against the above-mentioned advantages of cooperatives the following limitations and drawbacks of this form of organisation must also be noted:

(i) **Limited capital:** Co-operatives are usually at a disadvantage in raising capital because of the low rate of return on capital invested by members.

(ii) **Inefficient management:** The management of a co-operative society is generally inefficient because the managing committee consists of part-time and inexperienced people. Qualified managers are not attracted towards a co-operative on account of its limited capacity to pay adequate remuneration.

(iii) **Absence of motivation:** A co-operative society is formed for mutual benefit and the interest of individual members are not fully satisfied. There is no direct link between effort and reward. Hence members are not inclined to put in their best efforts in a co-operative society.

(iv) **Differences and factionalism among members:** Once the initial enthusiasm about the co-operative ideal is exhausted, differences and group conflicts arise among members. Then it becomes very difficult to get full co-operation of the members. The selfish motives of members begin to dominate and service motive is some times forgotten. But the society continues because it functions in the interest of members.

(v) **Rigid rules and regulations:** Excessive government regulation and control over Co-operatives affect their functioning. For example, a Co-operative society is required to get its accounts audited by the auditors of the co-operative department and submit its accounts regularly to the Registrar. These regulations and control may adversely affect the flexibility of operations and the efficiency of management in a co-operative society.

INTEXT QUESTION 3.2

1. What is the main aim of co-operative society?

2. What are the voting rights of the members in a co-operative society?

Notes

3.5 COMPANY

The company form of organisation is considered to be most suitable for organising business activities on a large scale as it does not suffer from the limitations of capital and management of other forms of organisation. The sole proprietorship, partnership and Co-operative organisation are not capable of undertaking large scale activity due to lack of adequate capital and limited managerial abilities. In a company organisation those problems can be easily overcome. It has the advantage of attracting huge capital from the public due to the limited liability of members. With adequate capital it can also employ trained and experienced managers to run the business activities efficiently.

3.5.1 Meaning

A company is defined as a voluntary association of persons having separate legal existence, perpetual succession and a common seal. As per the definition, there must be a group of persons who voluntarily agree to form a company. Once formed the company becomes a separate legal entity with a distinct name of its own. Its existence is not affected by change of members. It must have a seal to be imprinted on documents whenever required. The capital of a company consists of transferable shares, and members have limited liability.

3.5.2 Features of a Company

The following are the chief characteristics of the company form of organisation:

(i) **Registered body:** A company comes into existence only after its registration. For that purpose, necessary legal formalities have to be completed as prescribed under the Companies Act.

(ii) **Distinct legal entity:** A company is regarded as a legal entity separate from its members. Thus a company can carry on business in its own name, enter into contracts, sue, and be sued.

(iii) **Artificial person:** A company is the creation of law and has a distinct entity. It is therefore, regarded as an artificial person. The business is run in the name of the company. But because it is an artificial person, its functions are performed by the elected representatives of members, known as directors.

(iv) Perpetual succession: A company has continuous existence independent of its members. Death, insolvency, or change of members has no effect on the life of a company. The common saying in this regard is that members may come, members may go, but the company goes on forever. The life of the company can come to an end only through the prescribed legal procedure.

(v) Common seal: Since a company is an artificial person, it has no physical existence. The activities of the company are carried through a group of natural persons elected by its members (called directors). Every company must therefore, have a common seal with its name engraved on it. Anyone acting on behalf of the company must use the common seal to bind the company.

(vi) Limited liability: The liability of the members of a company is limited. It is limited to the extent of capital agreed to be contributed. Beyond that amount, the members cannot be personally held liable for payment of the company's debts.

(vii) Transferability of shares: The capital of a company is divided into parts called shares. Normally the shares of a company are freely transferable by its members. However, transferability is restricted in the case of private company.

3.5.3 Merits of Company

The most important advantages of a company organisation may be stated as follows:

(i) Collection of huge financial resources: The biggest advantage of a company organisation is that it has the ability to collect large amounts of funds. This is because a company can raise capital by issuing shares to a large number of persons. Shares of small value can be subscribed even by people with small savings. In addition, company can also raise loans from the public as well as different lending institutions. Availability of necessary funds makes it possible for a company to undertake business activities on a large scale.

(ii) Limited liability: Another advantage of the company form of organisation is the limited liability of members. With the liability of members limited to the value of their shares, company is able to attract many people to invest in its shares. It is thus in a position to undertake business ventures involving risks.

(iii) **Free transferability of shares:** A company permits its members to transfer their shares. Free transferability of shares provides liquidity of the member's investment. Thus, if a member needs cash he can sell his shares. Or, he can use the same amount to buy shares of another more profitable company. It enables profitable companies also to attract funds away from the less profitable ones.

(iv) **Durability and stability:** A company is the only form of organisation which enjoys continuous existence and stability. The funds invested in a company by shareholders are not withdrawal until it is wound up. Also any change in the company's membership does not affect its life. As a result of this, a company can undertake projects of long duration and attract people to invest in the business of the company.

(v) **Growth and expansion:** With the large resources at its command a company can organize business on a large scale. Once the business is started on a large scale it gives the company strength to grow and expand. This is because of high profits, which accrue from the economies of large-scale organisation and production.

(vi) **Efficient management:** Since a company undertakes large-scale activities, it requires the services of expert professional managers. Competent managers can be easily hired by a company because it commands large financial resources. Thus, efficient management is ensured in a company organisation.

(vii) **Public confidence:** A company enjoys great confidence and trust of the general people. Companies have to disclose the results of their activities and financial position in the annual reports. The reports are available to the public. It is on the basis of the annual reports and other information that investment is made in companies.

(viii) **Social benefits:** Apart from the benefits mentioned above, a company organisation also offers the following social benefits:

Notes

(a) **Democratisation of management:** In the company form of organisation, management of business is entrusted to the elected representative of shareholders, that is the directors. As a result of democratic management the business of company is run in the best interest of the majority shareholders.

(b) **Dispersal of ownership:** Since a large number of persons are associated with a company as members, its ownership is widely held. Thus the benefits of the company's operations are distributed among a large section of people.

(c) **Assumption of social responsibilities:** Large companies often undertake and contribute to social welfare activities by making donations to schools and colleges, developing rural areas, running health-care institutions, and so on.

3.5.4 Limitations of Company Organisation

A company organisation suffers from the following limitations:

(i) **Lengthy and expensive legal procedure:** The registration of a company is a long-drawn process. A number of documents are to be prepared and filled . For preparing documents experts are to be hired who charge heavy fees. Besides, registration fees have also to be paid to the Registrar of Companies.

(ii) **Excessive government regulations:** A company is subject to government regulations at every stage of its working. A company has to file regular returns and statements of its activities with the Registrar. There is a penalty for non-compliance of the legal requirements. Filing returns and reports involving considerable time and money is the responsibility of a company. All this reduces flexibility in operations.

(iii) **Lack of incentive:** The company is not managed by shareholders but by directors and other paid officials. Officials do not have investment in the company and also do not bear the risks. As such, they may not be as much motivated to safeguard the interests of the company as the shareholders.

(iv) **Delay in decision-making and action:** In large companies, decision making and its implementation happen to be a time consuming process. This is obviously because individual managers are unable to take decisions on their own.They may have to consult others which may take a lot of time. Similarly, after decisions are taken, they have to be communicated to people working at various levels of the organisation. It also delays the implementation of already delayed decisions.

(v) **Conflict of interest:** A company is generally characterised by a large organisation with many groups operating in it. So long as the interests of these groups do not clash with each other they work for the good of the organisation. But sometimes, individual and group interests become difficult to reconcile. For instance, the sales manager may be interested in the quality of products to satisfy customers and increase sales, but the production manager may be more concerned with maximum production without regard to the product quality. In such a situation, the business is bound to suffer in course of time unless there is a reconciliation of the conflicting view points of the two managers.

(vi) **Oligarchic management:** The company management may seem to be fully democratic, but in actual practice, it is the worst form of oligarchy i.e. control by a small group of persons. People who are once elected as directors of a company adopt various means to get themselves re-elected over and again. Such individuals often exploit the company for personal interests instead of working in the interest of shareholders.

(vii) **Speculation:** In speculation, profit is fought to be made by manipulating prices of shares without actually holding shares. A company organisation provides scope for speculation in shares by the directors. Because directors have knowledge of all information about the functioning of Company, they can use it to their personal advantage. For example, directors may sell or buy shares knowing that prices will decline or go up because of low or high profits. As a result of this, innocent shareholders may suffer loss.

(viii) Growth of monopolistic tendencies: A company because of its large size has the tendency to grow into a monopoly so as to eliminate competetion , controll the market and charge unreasonable prices to maximise profits. .

(ix) Influencing government decisions: Big companies are generally in a position to influence government officials to make decision in their favour. This is because such companies have large financial resources and are in a position to bribe even high officials.

From the preceding discussion it is clear that the company form of organisation is best suited to those lines of business activity which are to be organised on a large scale, require heavy investment of capital with limited liability of members. That is why enterprises producing steel, automobiles, computers and high technology products are generally organised as companies.

3.6 Limited Liability Partnership (LLP)

Meaning

LLP, a legal form available world-wide is now introduced in India and is governed by the Limited Liability Partnership Act 2008, with effect from April 1, 2009..

LLP combines the advantages of ease of running a Partnership and separate legal entity status and limited liability aspect of a Company.

3.6.1 Main features of a LLP

I. LLP is a separate legal entity separate from its partners, can own assets in its name, sue and be sued.

II. Unlike corporate shareholders, the partners have the right to manage the business directly

III. One partner is not responsible or liable for another partner's misconduct or negligence.

IV. Minimum of 2 partners and no maximum.

V. Should be 'for profit' business.

VI. Perpetual succession.

VII. The rights and duties of partners in LLP, will be governed by the agreement between partners and the partners have the flexibility to devise the agreement as per their choice. The duties and obligations of Designated Partners shall be as provided in the law.

VIII. Liability of the partners is limited to the extent of his contribution in the LLP. No exposure of personal assets of the partner, except in cases of fraud.

IX. LLP shall maintain annual accounts. However, audit of the accounts is required only if the contribution exceeds Rs. 25 lakhs or annual turnover exceeds Rs.40 lakhs.

3.6.2 Merits

a. Lower cost of formation.

b. Lesser compliance requirements.

c. Easy to manage and run.

d. Easy to wind-up and dissolve.

e. No requirement of minimum capital contributions.

f. Partners are not liable for the acts of the other partners.

g. No minimum alternate tax (as of date).

3.6.3 Demerits

a. LLP cannot raise money from the public.

b. Financial Institution may not lend the large amount the LLP.

3.6.4 Process for incorporating a LLP

The Registrar of Companies (ROC) is the authority having jurisdiction over the incorporation.

a. Decide on the Partners and the Designated Partners.

b. Obtain Designated Partner Identification Number (DPIN) and a digital signature certificate.

c. Decide on the name of the LLP and check whether it is available.

d. Draft the LLP agreement

e. File the LLP Agreement, incorporation documents and obtain the Certificate of Incorporation.

3.6.5 Distinction of Company, partnership firm and LLP

Features	Company	Partnership firm	LLP
Registration	Compulsory registration required with the ROC. Certificate of Incorporation is conclusive evidence.	Not compulsory. Unregistered Partnership Firm will not have the ability to sue.	Compulsory registration required with the ROC
Name	Name of a public company to end with the word "limited" and a private company with the words "private limited"	No guidelines.	Name to end with "LLP"" Limited Liability Partnership"
Capital contribution	Private company should have a minimum paid up capital of Rs. 1 lakh and Rs.5 lakhs for a public company	Not specified	Not specified
Legal entity status	Is a separate legal entity	Not a separate legal entity	Is a separate legal entity
Liability	Limited to the extent of unpaid capital.	Unlimited, can extend to the personal assets of the partners	Limited to the extent of the contribution to the LLP.
No. of shareholders / Partners	Minimum of 2. In a private company, maximum of 50 shareholders	2- 20 partners Minimum of	2. No maximum.
Foreign Nationals as shareholder / Partner	Foreign nationals can be shareholders.	Foreign nationals cannot form partnership firm.	Foreign nationals can be partners.

Taxability	The income is taxed at 30% + surcharge+cess	The income is taxed at 30% + surcharge+cess	Not yet notified.
Meetings	Quarterly Board of Directors meeting, annual shareholding meeting is mandatory	Not required	Not required.
Annual Return	Annual Accounts and Annual Return to be filed with ROC	No returns to be filed with the Registrar of Firms	Annual statement of accounts and solvency & Annual Return has to be filed with ROC

3.6 SUMMARY

CHOICE OF FORM OF ORGANISATION

Having discussed the characteristics, merits, limitations of the various form of organisation (sole proprietorship, partnership, co-operative and company organisation) we may consider how to select most suitable form of organisation for a business venture. Choice of a suitable form of organisation is important because the success and growth of a business depends a great deal on it. The form of organisation determines availability of finance, risk associated with business, division of profit, owners' control, Stability and durability of business, and so on. Since business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kind of business. The selection of a suitable form of organisation is generally made after careful consideration of the following factors:

(i) Scale of operations-manufacturing, trading, service;

(ii) Scale of operations-volume of business (small, medium, large) and the market area served (local, national, international);

(iii) Financial requirements for starting and expanding business;

(iv) Degree of direct control desired by owners;

(v) Degree of risk and liability;

(vi) Division of profit;

(vii) Flexibility of operations;

(viii) Stability of business;

(ix) Legal procedure.

It needs to be emphasized that these factors are inter-related and influence each other. For instance, the financial requirements of a business depend upon the nature of business as well as the scale of operations. The establishment of an industrial enterprise on a large scale would need greater outlay of the capital, than a small enterprise for the same purpose. Similarly, the degree of risk and liability will depend both on the amount invested and the nature of demand for the products of the enterprise. Thus, for a small enterprise (say, a workshop or a grocery shop) the risk will be limited and so will be the owner's liability, even if his personal assets may be used to discharge business debts. Control and sharing of profit are interconnected and both are related to the risk and liability. If the risk and liability are not heavy, the entrepreneur would not like to give up control and share profits with others.

3.7 TERMINAL QUESTIONS

1. Explain the features of partnership.
2. Distinguish between Private & Public company.
3. Write short note on
   a) Co-operative organization
   b) Sole proprietorship

3.8 OBJECTIVE TYPE QUESTIONS

1. There are ____forms of business organization.(four/five)
2. Choose the correct option
   a. Limited liability of the partners in Limited liability Partnership
   b. Shareholders have limited liability
   c. Singe proprietor has unlimited liability.
   d. All the above

Notes

3. Statement A: A Partnership deed is basic document in partnership

   Statement B: LPP should be registered with the Registrar of Companies.

   a. Only A is true b. Only B is true c. Both are true d. Neither of two

4. Choose the wrong option

   a. Maximum partners can be 20 in the partnership firm.

   b. Maximum partners can be unlimited in LLP

   c. Maximum shareholders are unlimited in private company

   d. Sole proprietorship cannot have the partner.

5. Choose the correct option

   Statement A: Cooperative organization is a voluntary association.

   Statement B: Every member has the equal rights in the Cooperative organization.

   a. Only A is true b. Only B is true c. Both are true d. Neither of two

6. Choose the correct option

   Statement A: Partnership has legal entity.

   Statement B: LPP has no legal entity.

   a. Only A is true b. Only B is true c. Both are true d. Neither of two

7. Choose the correct option

   Statement A: There should be minimum Directors 2 in private company.

   Statement B: There should be maximum 20 directors in a partnership firm.

   a. Only A is true b. Only B is true c. Both are true d. Neither of two

8. Choose the correct option

   a. Shares in a company are transferrable.

Notes

b. Shares in LPP are transferable.

c. Share can be returned to the society

d. All the above

9. Choose the correct option

Statement A: The service is the motive of the cooperative societies.

Statement B: LPP is also formed to serve society.

a. Only A is true b. Only B is true c. Both are true d. Neither of two

10. Choose the wrong option

a. Minimum 2 and maximum 50 shareholders in private limited company

b. Minimum 2 and maximum unlimited shareholders in public limited company

c. Minimum 2 and maximum unlimited partners in LPP

d. None of them

3.9 ANSWERS TO INTEXT QUESTIONS

3.1

1. The liability of sole proprietor ship firm is unlimited.
2. Minimum two persons are required to form a partnership firm.
3. No, it is not compulsory but there are certain advantages to get a firm registered.

3.2

1. The main aim is to serve the members.
2. Each member has one vote irrespective of the shares held by him.

3.10 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. five	2. d	3. c	4. c	5. c
6. d	7. a	8. d	9. a	10. d

4

PRINCIPLES OF MANAGEMENT

4.0 INTRODUCTION

In earlier chapters you have studied how the insurance sector is developing in Indian economy and in the present scenario insurance sector is one of the promising sectors to provide employment opportunity. Once you have opted your career in insurance sector and select any form of organization to do the insurance business, as discussed in the previous chapter and to run any organization one should have the knowledge of principles of management. In the following paragraphs the principles of management is being explained.

Before discussing the principles of management it is to explain that all industrial or business activities can be classified as follows:

1. Technical activities consisting of production or manufacture
2. Commercial activities consisting of buying, selling and exchange
3. Financial activities concerning search for optimum use of capital
4. Security activities concerning protection of property and persons
5. Accounting activities concerning with maintenance of accounts including statistics
6. Managerial activities consisting of planning, organizing, commanding, co-ordaining and controlling

Notes

Although industrial or business organizations differ from one another in nature, size or complexities of operation yet all these six activities are common in all enterprises. The first five activities are quite well known therefore we are discussing only the sixth i.e managerial activities. We will explain these principles applicable in any insurance company.

4.1 OBJECTIVES

At the end of this lesson you will be able

- To know the principles of management
- How to apply these principles in insurance organization

4.2 MANAGERIAL ACTIVITIES /PRINCIPLES OF MANAGEMENT

The management activities are known as principles of management which are as follows:

- Forecasting and Planning,
- Organizing,
- Commanding,
- Co-ordaining and
- Controlling

A) Forecasting and Planning

Planning means looking ahead or to foresee. To foresee means, “both to assess the future and make provision for it. To plan means to foresee and provide means for future. The process of planning includes:

1. **The identification of organizational goals**. The aim of any insurance company is to insure life or property of the human being. The goal is to insure maximum number of person or the property so that the risk can be spread on number of persons.

2. **The line of action to be followed**. Once aim is set to insurer human being or property then the next step is how to insure human beings or property. The action will be to create a Marketing Department for a company.

3. **The various stages through which the action would pass**: To sell the insurance product only marketing

department at one place i.e head office cannot achieve the results therefore various offices at different location to be set up to sell the insurance products.

4. **The method to be used to achieve the desired goals**: The next issue comes how to sell the insurance products. Weather it should be through Agents or Corporate Agent or Broker. Accordingly the action of the insurance company will start to recruit the manpower.

B) Organizing

To organize means building up the dual structure, material and human of the organization. To organize means to provide the organization with everything useful to its functioning raw material, tools, capital and personnel. An insurance company may not require the raw material but it requires other material i.e. tool (computers), capital and personnel. A sound organization should have the following to achieve the good relationship between material and human.

ü **A single competent and energetic guiding authority**: There should be a single person to be overall in-charge of the organization who will report to the Board of directors. Like Chief Executing Officer (CEO) or Managing Director is appointed in all organization whether it is insurance or other type of organization. Irrespective of the size of the organization.

ü **Efficient selection of personnel:** Any organization is run by the human beings therefore it is always endeavor of the CEO /Managing Director to recruit the manpower weather technical or finance or marketing the person should be intelligent and efficient. It saves the cost because the efficient people understand the working of the organization and take the decisions quickly. In an insurance industry the trained manpower is required because the insurance polices ate technical in nature and requires lot of skill to make the understand to the customer

ü **Clear definition of duties at all levels:** The duties of each employee should be defined to get the better results form the employees. If duties are not defined then the employees will be confused what to do or not to do. In an insurance company the target should be given to the marketing personnel to insure so many lives or property and being a marketing function, it should not be assigned to Finance Deptt. Moreover there will be many employees in the department the target should be given to the Head of the Deptt and then he will assign the targets to his juniors at different locations.

- **Initiative and responsibility:** The management should ensure that employees take initiative to complete the job assigned to them. The employees should be held responsible for not doing the things. In an insurance company the marketing team should be very strong to sell the insurance products. The team should take initiative to meet the number of persons to get the insurance business. The team should not wait for the instruction of their superiors to meet the customers.

- **Minimum paper work:** In the computer era the paper work can be reduced and the employees of the organization should maximum use the computers to save paper work. In insurance the marketing team should send the daily performance report through email which will reduce the paper work.

- **Reward & efficiency**: The good performers should be awarded cash or non cash award which boost the moral and efficiency of the employees.

- **Unit of command:** Every employee should report to one superior not to more than otherwise the performance and controlling of the employees will be very difficult.

- **Clear and precise decision making:** Any decision taken by any employee should not be ambiguous i.e double meaning because it creates confusion.

- **Proper control**

- **Disincentives for faults and error:** for any fault of any employee or non performer should be penalized otherwise it will affect the working of the performers.

- **Supremacy of general interest in relation to individual etc:** Any individual interest should not be clash with the organization interest. The organization interest should be protected.

C) Commanding

It means setting the business going to get the desired optimum results from the subordinates. The managers must posses the requisites personal qualities and knowledge to command effectively. The managers must

ü have a thorough knowledge of his personnel

ü have capacity to spot the right and competent workers so as to eliminate the incompetent

ü set a good example i.e leadership

ü conduct periodic assessment or audit of performance

ü be well versed in agreement binding the business and its employees

ü have lively and constant touch with subordinates

ü aim at making unity, energy imitative and loyalty prevail among personnel

D) Co-ordinating

It means the process developed by a manger to secure an orderly pattern of group effort among his personnel through unity of action to pursue the common goals. The coordination should be with in the resources available in the organization.

E) Controlling

The controlling means to ensure that everything is done in accordance with the established rules and instruction given to the workmen. The purpose of control is to point out weaknesses and errors in order to rectify them and prevent their recurrence. The effective control must be

i) prompt,

ii) followed with sanctions and

iii) include measure to prevent recurrence of variances a or error

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INTEXT QUESTIONS 4.1

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1. What are the common activities of any organization?
2. What do you mean by Planning?

Notes

4.3 ADVANTAGE OF PRINCIPLES OF MANAGEMENT:

i) **To increase Management efficiency:** The principles of management have been developed from experiences of various professional people. These principles provide guidelines as to how mangers should function in different situations which in turn increase their efficiency.

ii) **To develop the Science of Management:** The principles of management make use of scientific methods for observation. They have helped to develop the science of management. In absence of principles of management it would be not have been possible to develop the organized body of knowledge by management practitioners, thinker and philosophers.

iii) **To train mangers:** Management of principles is also needed to train managers. In the absence of principles the training of mangers depends upon trial and error methods. Formalized methods of acquiring training are possible only when there exists a systemized body of specialized knowledge, techniques or principles.

iv) **To co-ordinate material and human resources:** The principles of management help to coordinate the material and human resources in order to achieve the desired goals or common objectives. Without principles of management there would be a lot of wastage of resources. The principles of management make optimum utilization of natural resources possible.

v) **To improve researches:** The principles of management have helped in inverse of knowledge and carrying out of further research in the field of management. These have provided new ideas imagination and visions to the organization.

vi) **To attain social objectives**: Development of management principles have helped to attain the social goals by increasing efficiency in the use of scarce resources providing good quality products and services at the lowest possible costs.

4.4 SUMMARY

As you know management of any business has become very complex these days. Managers are expected to deal with a number of problems in their day to day working. Therefore principles of management are needed in all business organization.

A principle means a fundamental truth on the basis of reasoning a primary element of general law. Every social science has developed its own principles. Some principles have been developed by experts in management. These principles are the results of various problems faced by professional people and then the solution derived by them to meet with those situations

The principles of management are not like the principles of physical sciences. These are general guidelines and they cannot be mechanically applied. The individual factor plays important part in using managerial principles. To control the individuals the forecasting and planning, Organizing, Commanding, Co-ordaining and Controlling is must as an principles of management.

4.5 TERMINAL QUESTIONS

1. "To mange is to forecast, and plan, to organize, to command, to co-ordiante and to control" Discuss.
2. Discuss the principles of management.
3. What are the advantages of Principles of management as applicable to an insurance company?

4.6 OBJECTIVE TYPE QUESTIONS

1. Planning means______ ahead (Looking/controlling)
2. Choose the correct option

   Statement A: Accounting activities concerning with maintenance of accounts including statistics.

   Statement B: Managerial activities consisting of planning, organizing, commanding , coordinating and controlling.

   a. Only A is true b. Only B is true c. Both are true d. Neither of two
3. Choose the correct option

   a. The effective control must be prompt.

b. The effective control must be followed with sanctions.

c. The effective control must include measure to prevent recurrence of variances or error.

d. All of the above

4. The coordination should be within the ________available in the organization. (resources/manpower)

5. The Mangers set a good example of ______(leadership/officer)

4.7 ANSWERS TO INTEXT QUESTIONS

4.1

1. Technical activities, Commercial activities, Financial activities, Security activities, Accounting activities, Managerial activities consisting of planning, organizing, commanding, co-ordaining and controlling.

2. Planning means looking ahead or to foresee. To foresee means “both to assess the future and make provision for it. To plan means to foresee and provide means for future.

4.8 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. looking
2. c
3. d
4. resources
5. Leadership

5

BASIC ACCOUNTING PRINCIPLES

5.0 INTRODUCTION

We have studied economic activities which have been converted into business activities. In business activity a lot of "give & take" exist which is known as transaction. Transaction involves transfer of money or money's worth. Thus exchange of money, goods & services between the parties is known to have resulted in a transaction. It is necessary to record all these transactions very systematically & scientifically so that the financial relationship of a business with other persons may be properly understood, profit & loss and financial position of the business may be worked out at a particular date. The procedure to record all these transactions is known as "Book-keeping".

In other words the book keeping may be defined as an activity concerned with the recording of financial data relating to business operations in an orderly manner. Book keeping is the recording phase of accounting. Accounting is based on an efficient system of book keeping.

Accounting is the analysis & interpretation of book keeping records. It includes not only the maintenance of accounting records but also the preparation of financial & economic information which involves the measurement of transactions & other events relating to entry.

There are various terminology used in the Accounting which are being explained as under: -

1) **Assets:** An asset may be defined as anything of use in the future operations of the enterprise & belonging to

the enterprise. E.g., land, building, machinery, cash etc.

2) **Equity:** In broader sense, the term equity refers to total claims against the enterprise. It is further divided into two categories.

   i. Owner Claim - Capital

   ii. Outsider's Claim – Liability

   Capital: The excess of assets over liabilities of the enterprise. **It is the difference between the total assets & the total liabilities of the enterprise.** e.g.,: if on a particular date the assets of the business amount to Rs. 1.00 lakhs & liabilities to Rs. 30,000 then the capital on that date would be Rs.70,000/-.

   Liability: Amount owed by the enterprise to the outsiders i.e. to all others except the owner. e.g.,: trade creditor, bank overdraft, loan etc.

3) **Revenue:** It is a monetary value of the products or services sold to the customers during the period. It results from sales, services & sources like interest, dividend & commission.

4) **Expense/Cost:** Expenditure incurred by the enterprise to earn revenue is termed as expense or cost. The difference between expense & asset is that the benefit of the former is consumed by the business in the present whereas in the latter case benefit will be available for future activities of the business. e.g., Raw material, consumables & salaries etc.

5) **Drawings:** Money or value of goods belonging to business used by the proprietor for his personal use.

6) **Owner:** The person who invests his money or money's worth & bears the risk of the business.

7) **Sundry Debtors:** A person from whom amounts are due for goods sold or services rendered or in respect of a contractual obligation. It is also known as debtor, trade debtor, accounts receivable.

8) **Sundry Creditors:** It is an amount owed by the enterprise on account of goods purchased or services rendered or in respect of contractual obligations. e.g., trade creditor, accounts payable.

Notes

5.1 OBJECTIVES

At the end of this lesson you will be able

- To maintain the books of accounts
- To prepare the annual accounts

5.2 ACCOUNTING CYCLE

After taking decisions such as selecting a business, selecting the form of organisation of business, making decision about the amount of capital to be invested, selectingsuitable site, acquiring equipment & supplies, selecting staff, getting customers & selling the goods etc. a business man finally resorts to record keeping.

For all types of business organisations, transactions such as purchases, sales, manufacturing & selling expenses, collection from customers & payments to suppliers do take place. These business transactions are recorded in a set of ruled books such as journal, ledger, cash book etc. Unless these transactions are recorded properly he will not be in a position to know where exactly he stands.

The following is the complete cycle of Accounting

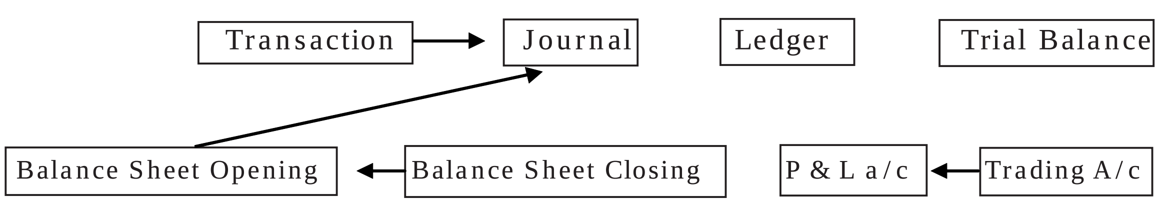
a) The opening balances of accounts from the balance sheet & day to day business transaction of the accounting year are first recorded in a book known as **journal.**

b) Periodically these transactions are transferred to concerned accounts known as **ledger** accounts.

c) At the end of every accounting year these accounts are balanced & the **trial balance** is prepared.

d) Then the final accounts such as **trading & profit & loss** accounts are prepared.

e) Finally, a **balance sheet** is made which gives the financial position of the business at the end of the period.



5.3 ACCOUNTING ASSUMPTIONS

In the modern world no business can afford to remain secretive because various parties such as creditors, employees, Government, investors & public are interested to know about the affairs of the business. The affairs of the business can be studied mainly by consulting final accounts and the balance sheet of the particular business. Final accounts & the balance sheet are the end products of book keeping. Because of the importance of these statements it became necessary for the accountants to develop some principles, concepts and conventions which may be regarded as fundamentals of accounting. The need for generally accepted accounting principles arises from two reasons:

1) to be logical & consistent in recording the transaction

2) to conform to the established practices & procedures

The International Accounting Standards Committee (IASC) as well as the Institute of Chartered Accountants of India (ICAI) treat (vide IAS-I & AS-I) the following as the fundamental assumptions:

1. **Going Concern:** In the ordinary course accounting assumes that the business will continue to exist & carry on its operations for an indefinite period in the future. The entity is assumed to remain in operation sufficiently long to carry out its objects and plans. The values attached to the assets will be on the basis of its current worth. The assumption is that the fixed assets are not intended for re-sale. Therefore, it may be contended that a balance sheet which is prepared on the basis of record of facts on historical costs cannot show the true or real worth of the concern at a particular date. The underlying principle there is that the earning power and not the cost is the basis for valuing a continuing business. The business is to continue indefinitely and the financial and accounting policies are followed to maintain the continuity of the business unit.

2. **Consistency:** There should be uniformity in accounting processes and policies from one period to another. Material changes, if any, should be disclosed even though there is improvement in technique. Only when the accounting procedures are adhered to consistently from year to year

the results disclosed in the financial statements will be uniform and comparable.

3. **Accrual:** Accounting attempts to recognize non-cash events and circumstances as they occur. Accrual is concerned with expected future cash receipts and payments. It is the accounting process of recognizing assets, liabilities or income amounts expected to be received or paid in future. Common examples of accruals include purchases and sales of goods or services on credit, interest, rent (unpaid), wages and salaries, taxes. Thus, we make record of all expenses and incomes relating to the accounting period whether actual cash has been disbursed or received or not.

   In order to keep a complete record of the entire transactions of any business it is necessary to keep the following accounts:

a) **Assets Accounts:** These accounts relate to tangible and intangible assets. e.g., Land a/c, building a/c, cash a/c, goodwill, patents etc.

b) **Liabilities Accounts:** These accounts relate to the financial obligations of an enterprise towards outsiders. e.g., trade creditors, outstanding expenses, bank overdraft, long-term loans.

c) **Capital Accounts:** These accounts relate to the owners of an enterprise. e.g., Capital a/c, drawing a/c.

d) **Revenue Accounts:** These accounts relate to the amount charged for goods sold or services rendered or permitting others to use enterprise's resources yielding interest, royalty or dividend. e.g., Sales a/c, discount received a/c, dividend received a/c, interest received a/c.

e) **Expenses Account:** These accounts relate to the amount spent or lost in the process of earning revenue. e.g., Purchases a/c, discount allowed a/c, royalty paid a/c, interest payable a/c, loss by fire a/c.

5.4 SYSTEMS OF RECORDING

There are three methods of recording of entries which are explained as under:

Single Entry System: This system ignores the two fold aspect of each transaction as considered in double entry system.

Under single entry system, merely personal aspects of transaction i.e. personal accounts are recorded. This method takes no note of the impersonal aspects of the transactions other than cash. It offers no check on the accuracy of the posting and no safeguard against fraud and because it does not provide any check over the recording of cash transactions , it is called as "imperfect accounting".

Double entry system: The double entry system was first evolved by Luca Pacioli, who was a Franciscan Monk of Italy. With the passage of time, the system has gone through lot of developmental stages. It is the only method fulfilling all the objectives of systematic accounting. It recognizes the two fold aspect of every business transaction.

Indian (Deshi Nama) system: This is the Indian system. It differs from region to region; community to community and from business to business. Under this system books are written in regional languages such as Muriya, Sarafi etc. Books are called "Bahis". It is older than double entry system and is complete in itself.

5.5 BASIS OF ACCOUNTING SYSTEM

Cash or receipt basis is the method of recording transactions under which revenues and costs and assets and liabilities are reflected in accounts in the period in which actual receipts or actual payments are made. "Receipts and payments account" in case of clubs, societies, hospitals etc., is the example of cash basis of accounting.

Accrual or mercantile basis is the method of recording transactions by which revenues, costs, assets and liabilities are reflected in accounts in the period in which they accrue. This basis includes considerations relating to outstanding; prepaid, accrued due and received in advance.

Hybrid or mixed basis is the combination of both the basis i.e. cash as well as mercantile basis. Income is recorded on cash basis but expenses are recorded on mercantile basis.

5.6 CLASSIFICATION OF ACCOUNTS

The classification of accounts and rules of debit and credit based on such classification are given below:

Classification of accounts

ACCOUNTS

- Personal
- Impersonal
  - Real
  - Nominal

Personal Accounts:

Accounts recording transactions relating to individuals or firms or company are known as personal accounts. Personal accounts may further be classified as:

(i) **Natural Person's personal accounts:** The accounts recording transactions relating to individual human beings e.g., Anand's a/c, Ramesh's a/c, Pankaj a/c are classified as natural persons' personal accounts.

(ii) **Artificial Persons' Personal accounts:** The accounts recording transactions relating to limited companies, bank, firm, institution, club, etc., Delhi Cloth Mill; M/s Sahoo & Sahoo; Hans Raj College; Gymkhana Club are classified as artificial persons' personal accounts.

(iii) **Representative Personal Accounts:** The accounts recording transactions relating to the expenses and incomes are classified as nominal accounts. But in certain cases (due to the matching concept of accounting) the amount, on a particular date, is payable to the individuals or recoverable from individuals. Such amount (i) relates to the particular head of expenditure or income and (ii) represent persons to whom it is payable or from whom it is recoverable. Such accounts are classified as representative personal accounts e.g., "wages outstanding account", pre-paid Insurance account, etc.

Real Accounts: The accounts recording transactions relating to tangible things (which can be touched, purchased and sold) such as goods, cash, building, machinery etc., are classified as tangible real accounts.

Whereas the accounts recording transactions relating to intangible things (which do not have physical shape) such as goodwill, patents and copy rights, trade marks etc., are classified as intangible real accounts.

Nominal Accounts: The accounts recording transactions relating to the losses, gains, expenses and incomes e.g. Rent, salaries, wages, commission, interest, bad debts etc., are classified as nominal accounts.

Rules of debit and credit (classification based)

1.	Personal accounts	:	Debit the receiver Credit the giver (supplier)
2.	Real accounts	:	Debit what comes in Credit what goes out
3.	Nominal accounts	:	Debit expenses and losses Credit incomes and gains

Let us consider the following example to illustrate how the rules of debit and credit are applied in practice:

Illustration 1.

	Rs.
1. Mr. A commenced business with cash	70,000
2. Purchased goods on credit from Mr. B	14,000
3. Paid wages	500
4. Paid to Mr. B	10,000
5. Purchased furniture	1,000
6. Goods stolen by the Store-keeper	200
7. Received commission	100

(a) S. No.	(b) Explanation	(c) Account Involved	(d) Equation based analysis		(e) Classification based analysis		
			Group	Effect	Rule I	Group	Effect
1.	Business commenced with cash Rs.70,000	Cash & Capital	Assets Personal	Increase Increase	1 3	Real Personal	Comes in Giver
2.	Purchased goods on credit from Rs. 14,000	Goods & Mr. B	Assets Liability	Increase Increase	1 2	Real Personal	Comes in Giver
3.	Paid wages Rs. 500	Wages & Cash	Expenses Asset	Increase Decrease	4 1	Nominal Personal	Expenses go out
4.	Paid to Mr. B Rs.10,000	Mr. B & Cash	Liability Asset	Decrease Decrease	2 1	Personal Real	Receiver Goes out
5.	Purchased furniture for cash Rs.1,000	Furniture & Cash	Assets Assets	Increase Decrease	1 1	Real Real	Comes in Goes out
6.	Goods stolen by store-keeper Rs.200	Loss of Goods & Goods	Loss Asset	Increase Decrease	4 1	Nominal Real	Loss Goes out
7.	Received commission Rs.100	Cash & Commis-sion	Assets Income	Increase Increase	1 5	Real Nominal	Comes in Income

5.7 JOURNAL

Journal is a book which lists accounting transactions of a business other than cash, before posting them to ledgers. The journal is currently only used to a limited extent to cover item outside the scope of other accounting books. Let us understand the mechanism of recording business transaction in a journal.

Example:

Business transactions of Mr.A for the month of Jan.1997.

1st January, 1997	A started business with cash	Rs.20,000/-
3rd January, 1997	Goods purchased for cash	Rs.6,000/-
5th January, 1997	Goods purchased from S	Rs.4,000/-
7th January,1997	Goods sold for cash	Rs.2,000/-
10th January, 1997	Goods sold to B	Rs.6,000/-
12th January, 1997	Cash paid to S	Rs.2,000/-

17th January, 1997	Cash received from B	Rs.4,000/-
23rd January, 1997	Paid wages	Rs.100/-
25th January, 1997	Furniture purchased from R	Rs.400/-
28th January, 1997	Paid for interest	Rs.200/-
31st January, 1997	Paid salaries	Rs.200/-

Notes

Journal Entries

Date	*Particulars Ledger Folio*	*Dr. Amount (Rs.)*	*Cr. Amount (Rs.)*
1997	Cash A/c Dr.	20,000/-	
Jan. 1	To Capital A/c		20,000-
	(Being cash introduced by A)		
Jan.3	Purchase A/c Dr.	6,000/-	
	To Cash A/c		6,000/-
	(Being cash purchases)		
Jan.5	Purchase A.c Dr.	4,000/-	
	To S's A/c		4,000/-
	(Being credit purchase from S)		
Jan.7	Cash A/c Dr.	2,000/-	
	To sales A/c		2,000/-
	(Being cash sales)		
Jan.10	B's A/c Dr.	6,000/-	
	To Sales A/c		6,000/-
	(Being the amount of credit sales)		
Jan.12	S's A/c Dr.	2,000/-	
	To Cash A/c		2,000/-
	(Being the amount of credit sales)		
Jan.17	Cash A/c Dr.	4,000/-	
	To B's A/c		4,000/-
	(Being receipt of cash from B)		
Jan.23	Wages A/c Dr.	100/-	
	To Cash A/c		100/-
	(Being payment of wages in cash)		
Jan.25	Furniture A/c Dr.	400/-	
	To R's A/c		400/-
	(Being purchase of furniture on credit from R)		
Jan.28	Interest A/c Dr.	200/-	
	To Cash A/c		200/-
	(Being payment of interest by cash)		
Jan.31	Salaries A/c Dr.	200/-	
	To Cash a/c		200/-
	(Being payment of salaries by cash)		

5.8 CASH BOOK

All business dealings ultimately resolve themselves into cash transactions, therefore, recording of cash transactions in a separate book becomes necessary. To keep record of all receipts and payments of money in business, cash book is maintained. Cash book with regard to the nature of business and the manner in which the cash is dealt with. Money receipts are entered on debit side and payments are shown on the credit side.

There are three distinct types of Cash Book, and each business could get its cash book ruled in a manner as would suit its own requirements. Thus the Cash Book may be ruled so as to possess.

- Cash and Discount columns only on both sides or
- Cash, Bank and Discount columns on both sides or
- Bank and Discount columns only on both sides.

5.9 PRINCIPAL BOOK: LEDGER

A ledger is a group of accounts. Most of us have probably seen a bound book with the word 'ledger' printed on the cover. All the accounts of a small business/industry could be entered in a ledger in concerned accounts in a summarised and classified form.

From the journal a trader cannot know his total cash, purchases, amount spent under each head of expense and amount earned under each head of income. The journal will not tell him what he owes to his creditors and what his customers owe to him. Such classified information can be got only by opening ledger accounts for every kind of transaction.

Every ledger has two sides namely debit and credit. Left hand side is debit and right hand side is credit. Each side of the ledger has columns on date, particulars, journal folio and amount- In the particulars column of the debit side the name of the account from which benefit is received is recorded and on the credit side, the name of the account to which benefit is given is recorded. The words 'To' and 'By' are affixed to the name of the amount entered on debit and credit sides respectively.

If a business is not able to accommodate all its accounts in

Notes

one ledger it can have more than one ledgers. Business may have an 'accounts receivable ledger' an 'accounts payable ledger' and a 'general ledger' each containing the group of accounts suggested by the title. The ledger is not necessarily a bound book, it may consist of a set of loose leaf pages, a set of punched cards, or if computerised a set of impulses on a magnetic tape. No matter what its form may be, the essential character of the account and the rules for making entries to it remain exactly the same.

(i) Ledger Posting:

Transferring the entries from the journal or a subsidiary book to the ledger is known as posting. Posting the ledger from journal is easy as the transactions in the journal are already classified into debit and credit. However, the following points must be noted while posting the ledger.

– For the same person or expense only one account should be opened.

– Cash and credit sales should be posted to Sales Account and cash and credit purchases to Purchase Account.

– The word Debit as Dr. and Credit as Cr. should not be omitted.

– Date and folio columns should not be left blank.

(ii) Balancing of Ledger Accounts :

At periodic intervals, the debit and credit sides of individual ledger accounts are totalled and balance of each account indicated. If the total of the debit side of any account is more than the credit side, there will be a debit balance and, if the credit side is more than the debit side there will be credit balance.

With the help of the illustration which we took for recording journal entries, let us see how the ledger postings and balancing will be done.

Based on the illustration the following accounts need to be opened in ledger.

Dr. Capital A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
	To balance c/d		20,000/-		By Cash		20,000/-
			20,000/-				20,000/-
				Feb.1	By balance b/f		20,000/-

Dr. Cash A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997	To capital		20,000	1997	By purchase		6,000
Jan.1	To sales		2,000	Jan.3	By S		2,000
Jan.7	To B		4,000	Jan.12	By wages		100
Jan.17				Jan.23	By interest		200
				Jan.28	By salaries		200
				Jan.31	By bal. c/d		200
				Jan.31			17,500
			26,000				26,000
Feb1	To bal. b/f		17,500				

Dr. Purchase A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.3	To cash		6,000	Jan 31	By balance c/d		10,000
Jan.5	To S		4,000				10,000
			10,000				
Feb.1	To bal. b/f		10,000				

Dr. Sales A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.31	To balance		8,000	Jan.7	By cash		2,000
			8,000	Jan.10	By B		6,000
							8,000
				Feb.1	By bal. b/f		8,000

Dr. S's A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.12	To cash		2,000	Jan.5	By Purchase		4,000
Jan.31	To bal. c/d		2,000				
			4,000				4,000
				Feb.1	By bal. b/f		2,000

Dr. B's A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.10	To sales		6,000	Jan.17	By cash		4,000
				Jan.31	By bal. c/d		2,000
			6,000				6,000
Feb.1	To bal. b/f		2,000				

Dr. Wages A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.23	To cash		100	Jan.31	By bal. c/d		100
			100				100
Feb.1	To bal. b/f		100				

Dr. Furniture A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.25	To R		400	Jan.31	By bal. c/d		400
			400				400
Feb.1	To bal. b/f		400				

Dr. Interest A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.28	To Cash		200	Jan.31	By bal. c/d		200
			200				200
Feb.1	To bal. b/f		200				

Dr. R's A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.31	To bal. c/d		400	Jan.25	By furniture		400
			400				400
				Feb.1	By bal. b/f		400

Dr. Salaries A/c Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1997				1997			
Jan.31	To Cash		200	Jan.31	By bal. c/d		200
			200				200
Feb.1	To bal. b/f		200				

Notes

5.10 FINAL ACCOUNTS

The final accounts of a business consists of :

(i) Manufacturing Account

(ii) Trading Account

(iii) Profit and Loss Account

(iv) Balance Sheet.

Before we look into the process of preparing final accounts we must understand the meaning and importance of Trial Balance.

The Trial Balance

The trial balance is simply a list of names of the accounts, and the balances in each account as at a given moment of time, with debit balances in one column and credit balances in another column. The preparation of trial balance serves two principal purposes (i) it shows whether the equality of debits and credits has been maintained and (ii) it provides a convenient transcript of the ledger record as a basis for making adjustments and closing entries for preparation of final accounts.

When the total debits equal total credits, it does not mean that there has been no error in recording the transactions. Entries may have been omitted entirely; they may have been posted to the wrong accounts; off-setting errors may have been made; or the transactions may have been analysed incorrectly. For example when a debit for purchase of a truck is made incorrectly to an expense account, rather than correctly to a fixed assets account, the total of the trial balance is not affected. Nevertheless, errors that result in unequal debits and credits are common, and the existence of such errors is revealed when a trial balance does not balance, that is when the debit column does not add to the same total as the credit column.

A trial balance may be prepared at any time. A pre-adjustment trial balance is one prepared after the original entries for the period have been posted, but prior to the adjusting and closing process. A post closing trial balance is prepared after the closing process.

(i) Manufacturing Account :

When a concern is engaged in both production and selling activities it will have to open a manufacturing account in the general ledger. The manufacturing account is prepared in the following manner.

Manufacturing Account of M/s ____________ for the period from _________ to _________ .

Dr. Cr.

Particulars		Amount Rs.	Particulars	Amount Rs.
To Opening stock of materials		———	By Closing stock of work in progress	———
To Opening stock of work in progress		———		
To Purchases	———		By Cost of manufacturing (B/F)	
Less Purchases returns	———	———		———
To Carriage inward		———		
To Manufacturing wages		———		
To Factory rent		———		
To Power		———		
To Fuel		———		
To Coal		———		
To Water		———		
To Factory insurance		———		
		———		———

Manufacturing Account is balanced by adding debit side and finding the excess of debit over credit. The excess of debit over credit will indicate the cost of manufacturing of the finished goods. This balancing figure will be inserted in the credit side of the Manufacturing Account preceded by the word 'By cost of manufacturing' during the period transferred to Trading Account and the same figure will also be written on the debit side of a 'Trading Account' to be opened in General Ledger. In the Trading Account this figure will be preceded by the word 'To cost of production transferred from the Manufacturing Account'. Thus Manufacturing Account is closed and the cost of production of finished goods during the period is transferred to the Trading Account. The debit balance of (a) opening stock of finished goods, (b) purchase less returns, (c) nominal accounts representing cost incurred in connection with purchase of materials/goods, like carriage inward on such purchase etc. will then be cleared by crediting these accounts and debiting the Trading Account.

(ii) Trading Account

When a concern is engaged in trading activities only, there will be no Manufacturing Account. The Trading Account on its debit side will show certain entries regarding opening stock (of saleable goods), purchase less returns and expenses relating to purchase viz. freight, duty, carriage inward etc.

The credit balance of sales account (less the debit balance of sales return accounts) will then be transferred to Trading Account by debiting the former account and crediting the latter account.

The excess of credit total of trading account over the debit total is called the gross profit. This amount is computed and an entry is passed by debiting this amount to Trading Account (preceded by the word 'To Gross Profit transferred to Profit and Loss Account') and crediting the Profit and Loss Account (preceded by the word 'By Gross Profit, brought over from Trading Account'). The Trading Account .thus indicates the gross result from selling of the goods.

(iii) Profit and Loss Account

At this stage Profit and Loss Account stands credited with gross profit. The Profit and Loss Account also stands adjusted with some of the adjustment entries like bad debts, depreciation, insurance, rent etc. All the debit and credit balances lying in different nominal accounts are then transferred to Profit and Loss Account. The debit balances are closed by entering the respective word 'By Profit and Loss Account'. The respective amounts are also entered on the debit side of the Profit and Loss Account preceded by the words To .... The credit balance of nominal accounts are similarly closed by passing debit entries to the respective nominal accounts preceded by the word 'To Profit and Loss Account'. In the credit side of the "Profit and Loss Account" the corresponding credit entries are inserted preceded by the word 'By ....'.

Thus, the Profit and Loss Account on its credit shows Gross

Notes

Profit and items of miscellaneous incomes and on its debit shows Gross Loss and expenses incidental to carrying of the business and arising in course of running the business. The excess of credit side over the debit side is known as net profit and the excess of debit side over the credit side is known as net loss. The net profit or net loss is transferred to Capital Accounts) in case of proprietary or partnership business and to an account called Profit and Loss Appropriation Account in case of corporate business.

Proforma of Profit & Loss Account

Profit and Loss Account of M/s .... for the year ending ....

Dr. Cr.

Particulars	*Amount Rs.*	*Particulars*	*Amount Rs.*
To Trading A/c (Gross Loss)		By Trading A/c (Gross Profit)	
To Travelling exp.A/c		By Commission (Received)	
To Salaries & Wages A/c		By Interest A/c (Received)	
To Audit Fee A/c		By Discount A/c (Received)	
To printing charges A/c		By Rent A/c (Received)	
To Office establishment A/c		By Net Loss (trans-	
To Discount Paid A/c		ferred to Capital A/c	
To Advertisement A/c		or Profit & Loss	
To Insurance A/c		Appropriation A/c)	
To Carriage outward A/c			
To Dock dues outward A/c			
To Depreciation A/c			
To Bad debts A/c			
To Repair a/c			
To Office lighting A/c			
To Postage, Telegram A/c			
To Interest Paid			
To Legal charges A/c			
To Stationary A/c			
To Trade expenses A/c			
To Bank charges A/c			
Rates and taxes A/c			

To Brokerage A/c

To Sundry expenses A/c

To Rent A/c

To Duty on exported goods A/c

To Net Profit (transferred
to Capital A/c or Profit
& Loss Appropriation A/c)

(iv) The Balance Sheet

A balance sheet shows the financial position of an organisation as on a specified moment of time; in fact it is sometimes called a statement of financial position. It is therefore a status report, rather than a flow report.

After Trial Balance is prepared; adjustments entries passed, and revenue accounts drawn up, all the nominal accounts will stand closed. The accounts still remaining open in the general ledger will represent either personal accounts or real accounts. The balance remaining after the preparations of Trading and Profit and Loss Account in the Trial Balance represents either assets or liabilities existing on the date of the closing of the accounts. When they are arranged in a proper manner, the resultant statement is called 'Balance Sheet'. The balance sheet is a statement of position and strictly speaking not a part of double entry system of book keeping. No transfer of ledger accounts balances is therefore necessary. Only the relevant particulars are extracted from the general ledger. The balance sheet is prepared on a certain date and not for a period. Therefore, it is true only on the date of its preparation and not on any other day. Secondly, the total of liabilities including capital must be equal to total of assets, otherwise it means that the double entry system of book keeping has not been followed properly in respect of all the transactions.

A balance sheet represents the assets of the business, whether fixed or current or fictitious, on the right hand side and liabilities, whether owned or borrowed, on the left hand side. The balance sheet of an organisation can be prepared in the following format :

Notes

Proforma of Balance Sheet

Balance Sheet of M/s ....

as on ....

Liabilities	*Amount Rs.*	*Assests*	*Amount Rs.*
Capital —		Land	
+ Fresh Capital —		Building	
+ Profit —		(—) Less Depreciation	—
- Losses __		Plant & Machinery	
- Drawings __	____	(—) Less Dep.	—
Term Loan	—	Office Furniture	
Bank Over Draft	—	(—) Less Dep.	—
Creditors	—	Stock in Trade	
Bills Payables	—	Sundry Debtors	
Outstanding	—	(—) Less Reserve for	
Other Liabilities	—	Doubtful Debtors	—
		Bills Receivables	
		Prepaid Expenses	—
		Investments	—
		Cash at Bank	—
		Cash in Hand	—
Total	———	Total	———

5.11 APPLICATION OF COMPUTERS AND INFORMATION TECHNOLOGY TO ACCOUNTING AND FINANCIAL MANAGEMENT

Business Accounting and Financial Management are crucial management functions in every enterprise. Whether you manage a small department, a major division, big company, small company or your micro enterprise, you work with numbers every day. Numbers are the language of business and industrial enterprises. Use of computers in general and electronic spread sheet in particular can economically and effectively replace traditional tools of accounting like ledger pager, stubby pencils, worn-out erasers, desktop calculators etc. Use of computer and spread sheet in today's complex business can take you ahead in speed, accuracy and capability.

Computer application in accounting and financial management can help you in transaction recording, financial planning, analysis, and forecasting. Best of all, it gives you a method of examining the implications of endless "What if ?" situations - the tough alternatives you face in running your business profitably. Computer software developing companies have developed a large number of accounting and financial management softwares.

A brief account of some of the important soft wares available in India is given below. The basic function of these softwares is to enter the transactions and the rest of things i.e posting , balance calculation is done by these software. These software can prepare the trail balance, cash book, balance sheet and profit and loss account.

1. Tally
2. Easy
3. Visipak
4. Fact
5. Fast
6. Ex 3.0

5.12 SUMMARY OF ACCOUNTING PROCESS

(i) The first and the most important part of the accounting process is the analysis of transactions, i.e. the process of deciding which account or accounts should be debited, which should be credited, and in what amounts, in order to reflect events in the accounting records. This requires judgement.

(ii) Next comes the purely mechanical step of journalising original entries, that is, recording the result of the analysis.

(iii) Next to journalising is ledger posting. Posting is the process of recording transactions in the ledger accounts, exactly as specified by the journal entries. This is another purely mechanical step.

(iv) At the end of the accounting period Judgement is involved in deciding on the adjusting entries, and these are journalised and posted in the same way as original entries.

(v) The closing entries are journalised and posted. This is also a purely mechanical step.

(vi) Finally, the financial statements are required to be prepared. This requires judgement and knowledge. The accuracy of financial statements will depend upon the quality of judgement made as suggested in steps (i) and (ii)

5.13 TERMINAL QUESTIONS

1. Discuss the principles of accounting.

2. Pass the journal entries for the following transactions in the Books of Mr S.K.Jain

   a) He Sold old furniture for Rs 5000/-

   b) He received insurance commission of Rs 50000/-

   c) Rent paid by cheque Rs 2000/-

   d) He incurred traveling expenses of Rs 3900/-

3. Discuss the various financial statements prepared by any insurance broker.

5.14 OBJECTIVE TYPE QUESTIONS

1. Choose the correct option

   a. Accounting system is either on cash or receipt basis.

   b. Accounting system is either accrual or mercantile basis.

   c. Accounting system is either hybrid or mixed basis.

   d. All of the above

2. Statement A: Real accounts are maintained for tangible things

   Statement B: Real accounts are also maintained for intangible things.

   a. Only A is true   b. Only B is true

   c. Both are true   d. Neither of two

3. The final accounts of a business consists of

   a. Trading account b. Profit & loss Account

   c. Balance Sheet d. All of the above

4. Statement A: Balance sheet is summary of the financial position as on date.

   Statement B: Profit and loss account shows profit or loss for the year.

   a. Only A is true b. Only B is true

   c. Both are true d. Neither of two

5. Choose the correct options:

   a. Single entry system is a system of recording of transactions.

   b. Double entry system is a system of recording of transactions.

   c. Indian (desi nama) system is a system of recording of transactions

   d. All of the above

5.15 ANSWERS TO INTEXT QUESTIONS

5.1

1. Technical activities, Commercial activities, Financial activities, Security activities, Accounting activities, Managerial activities consisting of planning, organizing, commanding, co-ordaining and controlling.

2. Planning means looking ahead or to foresee. To foresee means “both to assess the future and make provision for it. To plan means to foresee and provide means for future.

5.16 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1.d 2. c 3. d 4. c 5. d

6

COMMUNICATION

6.0 INTRODUCTION

Communication is very important function to manage any organization whether it is small or large. In other words, nothing happens in management until communication takes place.

The word communication has been derived from Latin ward "communis" which means common. Thus communication means sharing of ideas is common. It can be defined as exchange of facts, ideas, opinions or emotions between two or more persons to create a common ground of understanding.

Communication is the process of passing information & message from one person to another. It involves atleast two persons i.e. a sender & a receiver. The sender develops & transmits a message to the receiver. The purpose is to achieve common understanding between the sender & the receiver.

The basic unit of communication in an organisation is the link between manager & subordinator. Managers communicate to their subordinates & receive messages from them. To be effective as a manager, you need to be an effective communicator.

6.1 OBJECTIVES

At the end of this lesson you will be able

- To know the communication process to be followed in any organization
- How informal communication is more important than the formal communication

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6.2 COMMUNICATION FUNCTION IN ORGANISATIONS

The communication function as the means by which the activities in the organisation are coordinated to achieve the organisational goals. It is also the means by the which behaviour is modified, change is effected, information is made productive & goals are achieved. Whether it is with a business enterprise, a family, educational institution or trade exhibition, the transfer of information from individual to another is absolutely essential.

There are two main types of communication in every organisation – formal & informal communication.

6.2.1 Formal Communication

Formal communication refers to official communication which takes place through a chain of commands. It flows in formally established channels & is concerned with work related matters. Members of the enterprise and expected to communication with one another strictly as per channels laid down in the structure.

The formal communication may be divided into three categories which are given as follows:

a) Downward Communication:

Under this system, the flow of communication from the top management downward to be operating level. It may also be called a communication from a superior to a subordinate. It follows the line of authority from the top to the bottom of the organisation hierarchy. Downward communication consists of plans & policies, orders and instructions, procedures & rules etc.

b) Upward Communication:

It means the flow of information from the lower levels of the organisation to the higher level of authority. It passes from subordinate to superior as that from worker to foreman, foreman to manager. From manager to general manager & so on. This communication includes opinions, ideas, suggestions, complaints, grievances, appeals, reports etc.

It is very important as it serves as the feedback on the effectiveness of downward communication. Management is able

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to know how well its policies, plans & objectives are followed by those working at lower levels of the organisation. It keeps the management informed about the progress of the work & difficulties faced in performance. On the basis of upward communication, the management revises its plans & policies & makes further planning.

c) Horizontal Communication:

The transmission of information and understanding between people on the same level of organisation hierarchy is called the horizontal communication. This type of communication is also known as lateral or sideward or crosswise communication. Usually, it pertains to inter departmental managers working at the same level of organisation or among subordinates working under one boss. Horizontal communication speeds up information and promotes mutual understanding. It enables the managers working at the same level to exchange information and co-ordinate their activities without referring all matters to the higher level of management.

The horizontal communication is generally of an informal nature. Whenever a departmental head requires some information from another departmental head, he tends to contact him directly. However, this type of communication can be oral or written.

6.2.2 Informal Communication

There is also a great deal of informal communication in an organisation. This communication flows through informal channels and may or may not be work related. Informal communication cuts through the formal organisational structure. Most of us are familiar with the term 'grapevine' used to describe a network of informal communication. Grapevines are present in all organisations. In fact, in large organisations, there are many grapevines moving up, down and across departments.

Grapevines flourish because communication is a natural human tendency. People who know each other in the organisation talk together informally. One thing they have in common is the organisation they work for, so they talk about the happenings in the organisation.

Grapevines carry two types of information : work related and people related. Employees want to know what is going on in the organisation. When they are not kept informed through formal channels, they seek information from the grapevine. Likewise, they are curious about the people they work with. Grapevine carry the type of personnel information not generally communicated through formal channels.

Employees get to know plans, promotions, punishments, etc, much before they are formally announced. Informality however, reduces uniformity of communication and sometimes false or distorted news is circulated.

Some employees consider the grapevine their main source of information. It is fast- they get information quickly and more information is given than is normally included in formal downward communications, which are often written and may originate from some one they do not know personally.

Manager often become frustrated with grapevines, particularly when they carry incorrect information. But grapevines exist; managers cannot stop them. Managers can, however, increase the accuracy of the grapevine by feeding it correct information. And they can try to reduce the relevance placed on grapevines by making certain that formal communication is complete and timely.

INTEXT QUESTIONS 6.1

1. Discuss Types of formal communication.
2. Whether informal communication is good for any organization?

6.3 IMPORTANCE OF COMMUNICATION

Communication is an indispensable part of the process of management. The success of an enterprise depends upon the effective of communication. Every manager must communicate in order to get things done through others. A good communication system offers the following benefits :

1. **Basis of Decision-Making and Planning.** Communication is essential for decision-making and planning. It enables the management to secure information without which it may be possible to take any decision. The quality of managerial decisions depends upon the quality of communication. Further, the decisions and plans of the

management need to be communicated to the subordinates. Without effective communication, it may not be possible to issue instructions and orders. Effective communication helps in proper implementation of plans and policies of the management.

2. **Smooth and Efficient Working:** Communication makes possible the smooth and efficient working of an enterprise. It is only through communication that the management changes and regulates the actions of the subordinates in the desired direction.

3. **Facilitates Co-ordination:** Management is the art of getting things done through others and this objective of management cannot be achieved unless there is unity of purpose and harmony of effort. Communication through exchange of ideas and information helps to bring about unity of action in the pursuit of common purpose. It binds the people together and facilitates co-ordination.

4. **Increases Managerial Efficiency:** Effective communication increases managerial efficiency. It is rightly said that nothing happens in management until communication takes place. The efficiency of a manager depends upon his ability to communicate effectively with the members of his organisation. It is only through communication that management conveys its goals and desires, issues instructions and orders, allocates jobs and responsibility and evaluates performance of subordinates.

5. **Sound Industrial Relations:** Effective communication creates mutual understanding and trust among the members of the organisation. It promotes co-operation between the employer and the employees. Without communication, there cannot be sound industrial relations and industrial peace. It is only through communication that workers can put in their grievances, problems and suggestions to the management.

6. **Helps in Establishing Effective Leadership:** Communication is the basis of effective leadership. There cannot be any leadership action without the effective communication between the leader and the led. Communication is absolutely necessary for maintaining man to man relationship in leadership. It brings the

manager (leader) and the subordinates (led) in close contact with each other and helps in establishing effective leadership.

7. **Motivation and Morale:** Communication is the means by which the behaviour of the subordinates is modified and change is effected in their actions. Through communication workers are motivated to achieve the goals of the enterprise and their morale is boosted. Although motivation comes from within yet the manager can also motivate people by effective communication, e.g., proper drafting of message, proper timing of communication and the way of communication, etc.

8. **Effective Control:** Communication acts as a tool of effective control. The plans have to be communicated to the subordinates, the actual performance has to be measured and communicated to the top management and a corrective action has to be taken or communicated so as to achieve the desired goals. All this may not be possible without an efficient system of communication.

9. **Job Satisfaction:** Effective communication creates job satisfaction among employees as it increased mutual trust and confidence between management and the employees. The gap between management and the employees is reduced through the efficient means of communication and a sense of belongingness is created among employees. They work with zeal and enthusiasm.

10. **Democratic Management:** Communication is also essential for democratic management. It helps to achieve workers' participation in management by involving workers in the process of decision-making. In the absence of an efficient system of communication, there cannot be any delegation an decentralization of authority.

11. **Public Relations:** In the present business world, every business enterprise has to create and maintain a good corporate image in the society. It is only through communication that management can present a good corporate image to the outside world. Effective communication helps management in maintaining good relations with workers, customers, suppliers, shareholders, government and community at large.

6.4 PURPOSE OF COMMUNICATION

In its broadest sense, the purpose of communication in an enterprise is to effect change to influence action towards achieving the goals of the enterprise. Communication is essential for the internal functioning of the enterprises, because it integrates the managerial functions. Especially, communication is needed to:

— establish and disseminate goals of an enterprise,

— develop plans for their achievements,

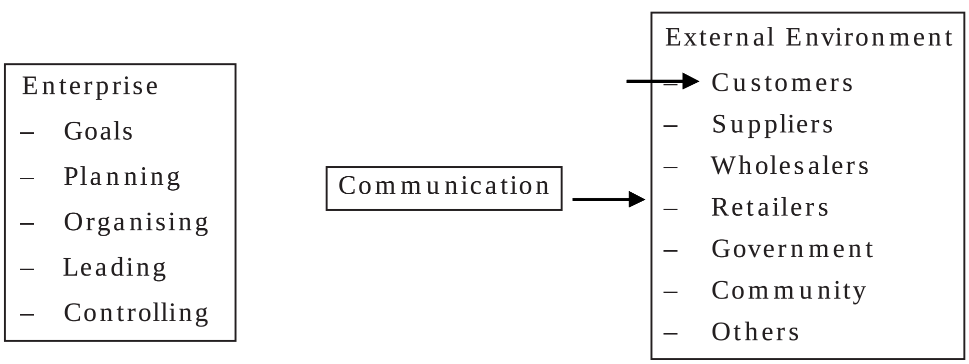
— select, develop and appraise members of the organisation,

— lead, direct, motivate and create a climate in which people want to contribute,

— control performance,

— develop rapport with various agencies and organisations concerned with the business enterprise.

The Management Process



The Purpose and Functions of Communication

The above figure graphically shows not only that communication facilitates the managerial functions but also help an enterprise to relate to its external environment. It is through information exchange that managers become aware of the needs of customers, the availability of suppliers, the claim of stockholders, the regulations of governments, and the concerns of a community. It is through communication that any organisation becomes an open system interacting with its environment.

Notes

6.5 COMMUNICATION PROCESS

Communication process involves sender, transmission of message through a selected channel, receiver and the feedback. The specific steps in communication process are described below :

(a) The Sender of the Message :

Communication begins with the sender, who has a thought or an idea which is then encoded in a way that can be understood by both the sender and the receiver. While it is usual to think of encoding a message into the English language, there are many other ways of encoding, such as translating the thought into computer language.

(b) Channel for Transmission of Message :

The information is transmitted over a channel that links the sender with the receiver. The message may be oral or written, and it may be transmitted through a memorandum, a computer, the telephone, the telegram or television. Television of course, also facilitates the transmission of gestures and visual clues. At all times two or more channels are used. In a telephonic conversation, for instance, two people may reach a basic agreement that they later confirm by a letter. Since many choices are available, each with advantages and disadvantages, the proper selection of the channel is vital for effective communication.

(c) The Receiver of the Message :

The receiver has to be ready for the message so that it can be decoded into the idea. A person thinking about an exciting cricket match may pay insufficient attention to what is being said about an inventory report, thus increasing the probability of a communication breakdown. The next process is the decoding, in which the receiver converts the message into thoughts. Accurate communication can occur only when both the sender and the receiver attach the same or atleast similar meanings to the symbols that compose the message. Thus, it is obvious that a message encoded into German requires a receiver who understands German. Less obvious, and frequently overlooked, is the fact that a message in

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technical or professional jargons requires a recipient who understands such language. So communication is not complete unless it is understood. Understanding is in the mind of both the sender and the receiver. Persons with closed minds will normally not completely understand messages, especially if the information is contrary to their value system.

(d) The Feedback :

To ensure that the message has reached the intended receiver correctly, the communicator has to get feedback from the receiver about the message. Feedback ensures that the process of communication has intact taken place. The feedback provides learning opportunities to the sender and the receiver because it mirrors the consequences of the behaviour. In addition, if the behaviour has been found to be incongruous with the message it opens avenues to make corrections wherever necessary. Without feedback it would be difficult to ascertain whether communication has been received as indicated or not.

In organisational settings feedback is essential. Each employee needs to know where he stands vis-a-vis the organisational expectations, so that he can adjust his behaviour. Similarly, all organisations need some feedback from employees on their policies and practices in order to make improvements whenever necessary.

All organisations have mechanisms to seek and receive feedbacks because the overall viability depends to a large extent on the sharing of information. However, it is often noticed that the efforts of a management to plan and establish reliable and formalized systems of feedback are often defeated because of the widespread tendency of people to establish informal channels and also because of various sources of distortions. Since most of the feedback in organisations is work related, the system should be improved and made more effective.

The following observations are useful pointers :

To avoid unpleasantness some managers and supervisors provide only positive feedback. Whenever an employee does something commendable, a useful positive acknowledgement is made. Actually, both positive and

Notes

negative feedback should be provided. It is equally necessary to tell the employee that he is not doing something correct.

Feedback should be focussed on the specific action rather than on the individual. Comments relating to behaviour are accepted more easily than those relating to an individual's personalities, attitudes, feelings, etc.

Feedback can be valuable if it refers to the description of behaviour. It makes sense to say 'improve your skills' or 'make fewer mistakes' to an erring employee rather, than 'your work is absolutely incorrect'.

Feedback which is provided 'here and now' is more meaningful than delayed feedback. If an employee has done something inappropriate it is necessary to tell him immediately rather than wait for an opportune moment. By then he might have forgotten the event.

Efficiency and satisfaction in an organisation can be improved by providing feedback as a way of sharing information rather than insisting on the right way of doing things. Sharing means that the employers and employees together study the problems, evaluate various alternatives, and choose the best. This conveys the message to the employee that his opinion is valued and he can contribute meaningfully in achieving organisational goals, Feedback plays an important role in the communication process. It requires skill and willingness on the part of the managers and entrepreneurs to involve employees in decisions and share the necessary information with them. As the organisation grow in size, people may not be able to keep in touch with each other and with the organisation's activities and plans. Hence, there is a constant need to evolve mechanisms to communicate with employees, so that they feel part of the organisation.

(e) Noise and Filters in Communication :

Unfortunately communication is affected by noise, which is anything- whether in the sender, the transmission, or the receiver- that hinders communication. Communication suffers from distortion, something intended, sometimes unconscious and it seldom reaches the intended receiver in the form it originated. Distortion in communication takes place because of both environment and human factors.

In factory situation the roar of machines makes it difficult for both sender and receivers to transmit. They either shout or resort to some form of body communication rather than verbal. Gestures, use of various parts of the body, facial expression, etc, are some of the mechanisms that serve the purpose of communication in case of high environmental noise.

However, the most important are human factors. Assumptions, values, past experiences, stereotypes and predisposition influence both the transmission and reception of the messages. Thus the filters and messages passing through them get distorted.

6.6 BARRIERS & BREAKDOWNS IN COMMUNICATION

The managers frequently cite communication breakdowns as one of their most important problems. However, communication problems are often symptoms of more deeply rooted problems. For example, poor planning may be cause of uncertainty about the direction of the firm, Similarly, a poorly designed organisation structure may not clearly communicate organisational relationships. Vague performance standards may leave people uncertain about what is expected of them. Thus the perceptive manager will look for the causes of communication problems instead of just dealing with the symptoms. Barriers can exist in the sender, in the transmission of the message, in the receiver, or in the feedback. Specific communication barriers are discussed below :

(i) **Lack of Planning:** Good communication seldom happens by chance. Too often people start talking and writing without first thinking, planning and stating the purpose of the message. Giving the reasons for a directive, selecting the most appropriate channel, and choosing proper timing can greatly improve understanding and reduce resistance to change.

(ii) **Unclarified Assumptions:** Often overlooked, yet very important, are the uncommunicated assumptions that underlie messages. A customer may send a note stating that he will visit a vendor's plant. Then he may assume that the vendor will meet him at the airport, reserve a hotel room, arrange for transportation, and set up a full-scale review of the programme at the plant. But the vendor may assume that the customer is coming to town mainly to attend a wedding and will make a routine call at the plant. These unclarified assumptions in both instances may result in confusion and the loss of goodwill.

(iii) **Poorly Expressed Message:** No matter how clear the idea in the mind of the sender of communication, it may still be marked by poorly chosen words, omissions, lack of coherence, poor organisation of ideas, awkward sentence structure, unnecessary jargons and a failure to clarify the implications of the message. This lack of clarity and precision, which can be costly, can be avoided through greater care in encoding the message.

(iv) **Loss of Transmission and Poor Retention:** In a series of transmissions from one person to next, the message becomes less and less accurate. Poor retention of information is another serious problem. Thus the necessity of repeating the message and using more than one channel is rather obvious. The loss may also be due to long distance, distracting noises and similar interferences.

(v) **Poor Listening and Premature Evaluation:** There are many talkers but few listeners. Everyone probably has observed people entering a discussion with comments that have no relation to the topic. One reason may be that these persons are pondering over their own problems - such as preserving their own egos or making a good impression on other group members instead of listening to the conversation. Listening demands full attention and self-discipline. It also requires that the listener avoid premature evaluation of what another person has to say. A common tendency is to judge to approve or disapprove what is being said- rather than trying to understand the speakers frame of reference. Yet listening without making hasty judgements can make the whole enterprise more effective and efficient. For example, sympathetic listening can result in better labour management relations and greater understanding among managers. Specially sales personnel may better understand the problems of production people, and the credit manager may realize that an over-restrict credit policy may lead to a disproportionate loss in sales. In short, listening with empathy can reduce some of the daily frustrations in organised lies and result in better communication.

(vi) Semantic Distortion: Semantic is the science of the meaning of words and symbols. Another barrier to effective communication is semantic distortion, which can be deliberate or accidental. An advertisement that states 'we sell for less' is deliberately ambiguous; it raises the question - less than what? Words may evoke different responses. To some people the 'Government' may mean interference or deficit spending; to others, the same word may mean help, equalization, and justice.

(vii) Distrust, Threat and Fear: Distrust, threat and fear undermine communication. In a climate containing these factors, any message will be viewed with skepticism. Distrust can be the result of inconsistent behaviour by the superior, or it can be due to past experiences in which the subordinate was punished for honestly reporting unfavourable, but true, information to the boss. Similarly, in the light of threats - whether real or imagined - people tend to tighten up, become defensive, and distort information. What is needed is a climate of trust, which facilitates open and honest, communication. Other personal barriers may arise from the judgements, emotions and social values of people. They cause psychological distance between the people, which may prevent communication. Our emotions, for example, act as filters in nearly all our communications. We see or hear what we are emotionally tuned to see or hear. Thus communication can not be separated from the personality itself.

(viii) Insufficient Period for adjustment to Change: The purpose of communication is to effect change that may seriously concern employees: shifts in the time, place, type and order of work or shifts in group arrangements or skills to be used. Some communications point to the need for further training, career adjustment, or status arrangements. Change affects people in different ways, and it may take time to think through the full meaning of a message. Consequently, for maximum efficiency, it is important not to force change before people can adjust to its implications.

(ix) Information Overload: One might think that more and unrestricted information flow would help people overcome communication problems. But unrestricted flow may result in too much information. People respond to information overload in various ways. First, they may disregard certain information. A person getting too much mail may ignore letters that should be answered. Second, if they are overwhelmed with too much information, people make errors in processing it. For example, they may leave out the word 'not' in a message, which reverses the intended meaning. Third, people may delay processing information either permanently or with the intention of catching up in the future. Fourth, people may filter information. Finally, people respond to information overload by simply escaping from the task of communication. Efforts should be made to reduce the information overload at each level.

6.7 IMPROVING COMMUNICATION

Although many problems make effective communication difficult the picture is not entirely bleak. As an entrepreneur/ manager, you can improve your communication effectiveness. Whether communication is effective it can be evaluated by the intended results.

Guidelines for Improving Communication

Senders of the messages must clarify in their minds what they want to communicate. This means that the purpose of the message and making a plan to achieve the intended end. Clarity is very essential in any communication.

Effective communication requires that encoding and decoding be done with symbols that are familiar to the sender and the receiver of the message. Thus managers should avoid unnecessary jargons, which is intelligible to the experts in their particular field. Common problems in written communications are that writers omit the conclusion or bury it in the report, are too wordy, and use poor grammar, ineffective sentence structure and incorrect spellings. Yet a few guidelines may do much to improve written communication:

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Writing style should fit the situation and the effect the writer wants to achieve. The forceful style should be used when the writer has power. The tone should be polite, but firm.

The planning of the communication should not be done in a vacuum. Instead, other people should be consulted and encouraged to participate to collect the facts, analyse the message, and select the appropriate media.

Make certain that your message is complete. If you do not supply all of the necessary information people make assumptions about the missing information. This can result in incorrect meaning.

Select the proper time to communicate. Messages received too early or too late decrease communication effectiveness. People are most receptive when there is a need for information. If information is received too late, it may be of no value.

Another aspect of timing concerns the volume of communication. At times we suffer from communication overload : we miss some of the information transmitted to us. You need to be careful not to add to communication overload, rather select a better time to communicate.

Encourage upward communication. Feedback is one of the most important steps in the communication process. Without feedback you cannot be certain the receiver has actually understood what you have communicated. Managers need to be particularly conscious of the importance of checking subordinates' reactions to communications. In face-to-face communication, direct feedback is possible.

Upward communication is necessary to get employees ideas, opinions, and suggestions. Such communication does not occur automatically; it must be encouraged. We need to develop good relationship with our employees, one that is characterised by openness and trust. Once this relationship is established, employees will feel more free to communicate, to respond to our communication, and to make suggestions on their own.

There is a saying that the tone makes the music. Similarly, in communication the tone of the voice, the choice of language, and the congruency between what is said and how it is said influence the reactions of the receiver of the message. An autocratic manager ordering subordinate supervisors to practice participative management will create a credibility gap that will be difficult to overcome. People believe in actions more than they do in words. Actions speak louder than words in the long run. The amount of difference between what one says and what one does is that person's communication credibility gap. When a person's credibility gap is large, poor human relations are likely to follow, such as losing confidence in that person.

The function of communication is more than transmitting information. It also deals with emotions that are very important in interpersonal relationships between superiors, subordinates and colleagues in an organisation. Furthermore, communication is vital for creating an environment in which people are motivated to work towards the goals of the enterprise while they achieve their personal aims.

6.8 SUMMARY

Communication is very important in every organization whether it profitable or non profitable organization. Effective communication is the responsibility not only of the sender but also of the receiver of the information. We need to be a good listener. We need to listen actively with both our ears and our eyes open, hearing what others are saying and understanding their non-verbal communication.

6.9 TERMINAL QUESTIONS

1. Distinguish between formal & informal communication.
2. Discuss the importance of communication in an organization.
3. Explain the communication process.

6.10 OBJECTIVE TYPE QUESTIONS

1. Find Odd man out

   a. Upward communication

Notes

b. Down ward communication

c. Horizontal Communication

d. Vertical Communication

2. Choose the correct Option

Statement A: Formal Communication is the only way to improve the organization.

Statement B: Informal communication is also part of the communication system.

a. both b. neither

c. Statement A d. Statement B

3. Communication process

a. involves sender

b. transmission of message through a selected channel,

c. receiver and the feedback

d. All the above

4. Choose the correct Option

Statement A: Communication is always within the organization only.

Statement B: Communication is always within the organization as well as with the external agencies.

a. both b. neither

c. Statement B d. Statement A

5. Choose the best way of communication

a. Verbal

b. writing

c. Email

d. a& b

Notes

6.10 ANSWERS TO INTEXT QUESTIONS

6.1

1. Three types of formal communication

   i) Down ward   ii) Horizontal   iii) Upward

2. No organization can work without informal communication.

6.10 ANSWER TO OBJECTIVE TYPE QUESTIONS

1. d   2. d   3. d   4. c   5. d

7

INFORMATION TECHNOLOGY (IT) APPLICATIONS IN INSURANCE

7.0 INTRODUCTION

In the present scenario everyone is using computer one way or the other and whenever you go to the market for shopping in any departmental store there you will find billing is computerized. The most common item now a days is a Mobile phone which uses the information technology to send the data or store the data like phone numbers or the messages. In the latest mobile sets songs can also be stored and the mobile phone instrument can be used as computer. The innovation in the computer field is taking at very high pace. Under this chapter we will not teach the working of the computer or any language. We are going to explain how the computer can be useful in the insurance sector.

7.1 OBJECTIVES

At the end of this lesson you will be able to know:

- About Information Technology
- How is it used in Insurance sector i.e Life Insurer as well as General insurer

7.2 MEANING OF INFORMATION TECHNOLOGY

The devices and techniques used to store, process, manage transit and communicate information, encompass various technologies such as computing, microelectronics and telecommunication is known as Information Technology.

There is revolution in the Information Technology after the advent of computers starting with first Generation Computers to the latest Pentium microprocessor based Personal computer. It has been further revolutionized with the development of software packages for specific area from stand alone personal Computers to Local Area Network and ~Wide Area Network~ and Main Frame computers. These computers can be used by many users simultaneously known as Multi-user environment.

You know very well that the volume of transaction is very large in any insurance organization. The data and information are to be stored for a Longer period because insurance contracts are long term especially life Insurance contracts. The Insurance organizations have the network all over. the countries even in foreign countries. Moreover, the transactions are of repetitive nature therefore, it has become necessary to seek the help of machines to process the data.

Initially, the Insurance companies used adrena machines and punch card equipment for creating, storing and processing data. But these machines were severely limited in their capacity. These were mechanical machines or Electra mechanical machines therefore, their speed, capacity and flexibility was much limited, But even the computers had some limitations initially, But these difficulties have been overcome with the help of the recent developments in tele-communication, which are used to aid computer technology.

7.3 INSURANCE RELATED APPLICATIONS

7.3.1 Life Insurance Applications

(a) Life Administration Module:

- **Policy Servicing of existing policies**: The existing policyholders may require various services after taking the insurance policy For eg: Change of Nominee, Change of address, of change in mode of payment, assignment of the policy, Claims payment etc. These changes or payment can be made very easily through computers.

Notes

ü **New Business:** As and when the new business is acquired the initial data of a policyholder is quite large and as stated above the data is to be maintained for longer period therefore storage of data in computer is useful

ü **Renewal notice/Billing:** Renewal notices to be sent for the payment of the premium and with a no. of policyholders are very large and the renewal is on different dates. The computer generates the renewal notice at very high speed and does it automatically. The inter-mediatory bills are generated very fast and quickly

ü **Loans:** The Policyholders do take loans and the insurer has to maintain the records as the insurer has to recover the loan from the policyholder along with the interest. The recovery of loan may be regular or recovery at the time of payment of claim

(b) **Statistics and MIS Claims**: As the data in computer can be stored for longer period the data may be useful for the insurer to prepare the type of policies are sold in the market and type of claim arisen in the particular region. These types of data will be useful for management to take any decision.

(c) **Archiving of historical data and imaging Systems**: As the past data is available with life insurer therefore they can design the new products and price them accordingly.

7.3.2 General Insurance Applications

a) Front Office System

¸ Policy Management and underwriting system

¸ Co-insurance

¸ Reinsurance

¸ Claims Management System

¸ Financial' Accounts and Audit

¸ Statistics and MIS

b) Reinsurance System .

¸ Inward insurance

- Outward Insurance
- Reinsurance Account
- MIS.

c) **Risk Management System**

7.3.3 Other Applications

a) **Investment**

- Term Loan . ..
- Money market .
- Investment Accounts .
- Market Operations

(b) **Personnel System**.

- Payroll system
- Performance Appraisals
- Attendance and leave system
- PF .

(C) **Office Services**

- Purchases
- Inventory
- Tours and Travels etc
- Corporate Accounting System General Insurance Applications

Let us discuss about Front Office System In the General Insurance Industry. These applications can be written in any language and they may differ from Office to Office of The different Insurance Companies. The software namely GENESIS~ is being used by General Insurance Companies.

On-line Front Office System is the first step towards computerization of any insurance Company and a well-designed system at the front offices has following advantages to the company.

- To carry out business transactions efficiently
- Easy to handle growing volume of business and variety of business

(No. of documents processed, Variety of policies issued, Volume of business)

- Efficient customer services
- Reduction in office expenses
- MIS for the Branch Managers .

A good Front Office System should allow Insurer, Underwriters, and agents to manage the day to day operations of the office. The system should be capable of administering all stages of policy development from questions to new business, through adjustments by way of endorsements and renewals of policies. Coinsurance, Claims re-insurance and all accounting functions. The main components of the Front office System are given below:

- Policy Management including Underwriting (Policy acceptance and printing and customer services)
- co-insurance
- Re-insurance.
- Claims.
- Statistics & MIS
- Accounts

7.4 POLICY MANAGEMENT INCLUDING UNDERWRITING

Policy Management has provisions for policy acceptance, client interaction window and policy printing. They should be able to store policies and the system should allow immediate access to a client portfolio. The policy management system generally has provisions for dealing directly through a broker or an agent or branch office. Generally in a good *Policy* Management system The Policy" is able to handle multiple and mixed risks even if these risks are located at multiple locations. Policy management system has following additional features:

- User configured screens
- Provision for questions
- Policy production (including printing)
- Renewals

Notes

- Endorsements
- Coinsurance

The front office system should have the facility to handle Co-insurance policies. The provisions should be such that underwriter simply states whether the insurer is acting as lead insurer or follower. They should then automatically pass the retained premium to the relevant reinsurance. Claims payment should activate co-insurer recoveries wherever necessary.

Reinsurance: The Front Office system generally has facility to handle all types of proportional reinsurance including Surplus and Quota Share Treaties: The system should be capable of setting up treaty layers by class of business with exposure levels varied according to the EML (estimated maximum ion). The system generally has the provision to incorporate proportional reinsurance ceding automatically into any claim payments or recoveries. The reinsurance module automatically produces reinsurance Bordeaux for each cedant.

Claims

The Front Office System includes an integrated claims system to record, progress and monitor claims, experience by Policy Clients brokers, Branch and risk covered. Some of the features of a claims module are given below

- Movement history or duration of claim
- Analysis of claims with user defined screens .
- Automatic recovery from reinsurers
- Incurred but not Reported (IBNR) causation and catastrophe recording and exception reporting
- Other routine enquiries.

Generally the claims system provides all the facilities required to manage reserves, payments. recovery, accounting, claims history recording, statistics, various kinds of ratios, and ‘run off. The claims system also provides claims experience information at the time of renewals and monitors motor claims in order to accurately manage ‘no claims’ bonus.

Notes

Accounting

Front Office System allows accounting for all transactions, which occur in the operating office. The accounting is generally integrated to policy management system and should automatically produce debit/credit notes, renewals notices, cover notes, reminders, statements, Bordeaux, remittance advices etc. The system should be able to handle taxes~ duties, reporting requirements as well as automatic calculation of midterm adjustments:

Statistics & MIS

The statistics module should allow production of comprehensive statistical, analytical and management information, Reports should be in any different formats and should include detailed audits, performance reports for management, should have provisions for exception reports for underwriting purposes and cumulative reports for statutory returns.

7.5 LIFE INSURANCE APPLICATIONS

7.5.1 The Operational Offices

The Operational Office is engaged in procuring of new business and servicing of policies, Hence it has to maintain three types of data in respect of the policies being serviced by it.

7.5.2 Billing

Records containing policy number, name and address, installment premium etc. for printing receipts and notices.

7.5.3 Premium

Records containing policy number, name and address, agency code number, installment premium, commission etc. For preparing commission bills.

7.5.4 Valuation

Master Records containing necessary information for assessing the liability under a policy at any point of time and providing necessary statistical information to management.

When, under a policy, some alterations in policy conditions are effected and the installment premium consequently gets

Notes

altered! all the three files or the Policy Servicing Database have to be corrected. During mid fifties it was difficult as the only way of correcting a punched card was to punch a new card, reproducing the unaltered information from the old card and punching only the altered information. There was always chance of errors creeping into the systems.

In order to avoid errors creeping into the system, the Insurance Industry was therefore continuously on the look out for a system wherein the particulars pertaining to a policy can be maintained on a single record. So when the electronic computers were introduced, the Insurance lndustry was in the safeguard of its users, Since the length of a record on magnetic media can be fairly large almost all the information pertaining to a policy could be contained in single record This eliminated the problem of inter-file consistency and also simplified the process of making any alterations.

After liberalization of insurance sector there are 29 insurers of life and general insurance and apart from Public sector undertaking all are using independent computer software keeping in their marketing strategy. The private players are controlling centrally therefore their module is quite different from the PSU's who are in the field for the more than 50 year. We are discussing in brief the module followed by Life Insurance Corporation (LIC) for the Front End Application for the branches:

1. NEW BUSINESSMODULE (N B Module).
2. CASH COUNTER MODULE .
3. POLICY SERVICING MODULE.
4. CLAIM MODULE.

1. NB Module:

The NB Module takes care of premium calculation, adherence to policy terms and conditions such as minimum or maximum age at entry maximum age at maturity, policy term, sum assured, mode of payment of premium etc. The program checks the validity of individual entry and does consistency checks ag. date of birth and age, data of commencement age, term, and date of maturity, plan, mode of payment etc as expected in the policy conditions end underwriting rules, The Arithmetical part of the Underwriting process, as referred to above, having been taken care of in the Module, the underwriter is free to concentrate on other areas such as Medical Report, Moral Hazard Report. Special Report etc, thereby enhancing the quality of Underwriting Standards. Many jobs manually done previously, such as proposal review slip typing, writing of proposal register and completion advice, outstanding deposit schedule etc has been taken over by the Computer.

2. CASH Module:

The cash module mainly caters to the needs of the cashier and some of the function of the Accounts Department. The premium receipts, policy and proposal deposit receipts, 555, Loan and interest receipts, and Miscellaneous receipts are printed through the use of the Computers. The receipts are generated on-line and there is no need to generate Special Premium receipts (as was the practice earlier). There is no need to keep the preprinted renewal premium receipts. The Renewal Premium history file is updated, This eliminates the ledger posting (i.e. posting of the collection of the premium in the individual ledger, which is a laborious, time consuming job). The cash book, cash and cheques collection list policy deposit schedules etc could now be printed under the CASH MODULE, thereby eliminating the manual preparation of the cash books and Outstanding Policy Deposit schedule.

3. Policy Service Module:

This module enables recording of the Change of Address, furnishing Revival and Surrender Value quotations, Requested File Maintenance (RFM) actions, displaying Policy Deposit position, displaying premium history refunding policy deposits etc.

4. Claim Module:

This module mechanizes all the jobs related with claims that are currently done manually starting from printing discharge voucher, data sheet to the final printing of various MIS statement.

Notes

7.5 SUMMARY

As we have studied above how the IT is playing important role in insurance sector and not only this, the developments in telecommunication, have enabled networking of various computer systems. The computers have been interlinked same office through Local Area Network (LAN). As the company has many offices all over the country and to facilitate the customers, in network called Metro Area Network (MAN) is installed. Through this networking all the branches located in large cities have been interlinked. It is generally done through a central computer, which keeps the data of all the branches. This system has enabled the data for policies to be available at any branch terminal for any policy irrespective of the branch where the policy is underwritten. In this way policyholder is enable to make the payment of premium in any branch to get the receipt immediately.

As the technology is developing very fast the crime rate IT is also increasing and to protect the public interest the Govt. has implemented Indian Information Technology Act 2000 to avoid any crime in IT sector.

7.6 TERMINAL QUESTIONS

1. Explain the importance of IT in life insurance sector.

2. How many IT modules are being used in General Insurance Sector?

3. Is networking helpful in insurance sector?

7.7 OBJECTIVE TYPE QUESTIONS

1. Information Technology is used for ____(Life insurance / General Insurance/Both)

2. Choose odd man out

   a. Personal Computers

   b. Local Area Network

   c. Wide Area Network

   d. Internet

3. Whether Reinsurer can use the computer in its business? Yes / No

4. Choose the correct option

   Statement A: Computers are more useful in life insurance as the life insurance contracts are for longer period.

   Statement B: Computers are not useful in general insurance as the general insurance contracts are for one year only.

   a. both   b. Statement A   c. Statement B   d. Neither

5. Computers are not used in any general insurance office

   a. To play games

   b. To feed the data

   c. To process the claims

   d. To record the investments

7.8 ANSWER TO OBJECTIVE TYPE QUESTIONS

1. Both   2. a   3. yes   4. d   5. a

Open Vocational Education Programme

Diploma in Insurance Services

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PRINCIPLES OF INSURANCE

Designed & Developed
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Diploma in Insurance Services

PRINCIPLES OF INSURANCE

CONTENTS

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Before you begin reading your lessons and start your training, there are a few words of advice that I would like to share with you. We, at the NIOS, are well aware that you are different from other learners. We realize that there are many of you who may have rich life experiences; you may have prior knowledge about trades and crafts that are part of your family's legacy; you may have a sharp business sense that will make you fine entrepreneur one day. Most importantly, you have the drive and motivation that has made you enroll with this institution, which believes in the spirit of freedom. Yes, we are aware that you have many positive aspects in your personality, which we respect and relate to them.

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Studying for a vocational course is different from any other academic course. Here, while the marks obtained in the examination will indicate your grasp on your subject knowledge, your real achievement will be when you are able to apply your vocational skills in the market. I hope that this skill-based learning will help you perform your tasks better .This course of One year duration Diploma Course in Insurance Services developed by leading experts of Insurance sector. It is a multi-skilled programme, which will expose you to a variety of skills in Insurance sector. We hope that you will find it useful. On behalf of NIOS, I wish you the very best for a bright and successful future.

Dr. S. S. Jena
Chairman
National Institute of Open Schooling

Dear Learner,

In the fast expanding world of activities, learning new skills has become a necessity. Learning and re-learning has become essential for all. In such an environment, vocational education has assumed great importance. Vocational education, as a stream of education, promotes skill development and training of youth and directs them towards meaningful employment.

In keeping with the needs of the Learners, NIOS conducts Vocational Education Programmes in many areas through distance mode. These programmes include Agriculture, Business & Commerce, Home Science, Engineering & Technology, Computer Science, and Health & Paramedical. The Courses offered in these areas are aimed at providing self employment & wage employment opportunities for NIOS learners.

Diploma in Insurance Services is a One year Diploma course in Insurance Services. This course has been developed with the help of many leading experts of Insurance Sector. The course syllabus is designed keeping in view the requirements of the insurance sector.

This is multi-skilled programme, which will expose you to variety of skills. It includes Business Environment, Principles of Insurance, Life Insurance, General Insurance and Legal framework. This will help in identifying learner's preference for future vocation. We are confident that this course will prove to be beneficial to you.

We wish you all the best in your future career.

Dr. K. P. Wasnik
Director (VE)
National Institute of Open Schooling

Dear Learner,

This programme is specially for all those who are school dropouts and have started small enterprises, want to work in the Insurance sector as a skilled workforce and contribute substantially to the progress of India.

The multi-skill content with hands-on experience of this programme stimulates the intellect by going through concrete operations and then abstracting the concepts. At the same time by giving a variety of skills usable in everyday life, allowing them to form their preferences and know their aptitudes thus enabling them to choose a career. It also improves their self-image and gives them confidence and hope for the future.

The Insurance sector has completed its full circle in the year 2000, i.e. Private sector to Public sector and now back to Private sector. After 44 years, the monopoly of Life Insurance Corporation is no more and after 27 years four Public Sector general Insurance companies lost their monopoly. As on date there are 50 life and general insurance companies and few are queue to get license.

These insurance companies need trained manpower to be present on all India basis. To cater the needs of the insurance industry NIOS has designed a course namely "Diploma in Insurance Services" for the students who have minimum qualification of 12th standard.

In this module the student will be made familiar with the principles of commercial contracts as well as insurance on which the insurance business is transacted.

As the insurance sector in divided in to two segments i.e. Life and non life therefore the principles are explained separately to avoid any confusion to the students.

We hope that this programme will help you to carve an niche in your career and play an important role in the society.

With best wishes.

Dr. Ajay Garg
Senior Executive Officer
(Business & Commerce)
National Institute of Open Schooling

ACKNOWLEDGEMENT

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RISK & INSURANCE

1.0 INTRODUCTION

Risk is a part and parcel of our daily lives. Risks are all around us whether we are aware of them or not. We may be familiar with some of the risks and then there are others, which may have escaped our attention. There are risks, which we have learned to live with such as "Will I live to see this year through" and than there are risks, which do not cross the mind like "The possibility of house or property getting damaged by an earthquake or lightening".

For example: Whenever you go out of your house the parents are worried that the possibility of accident on roads. Risk of accident is involved.

As & when you go to attend marriage of your relative out of town along with your family members and you lock your house and your parents always feel risk of theft.

1.1 OBJECTIVES

At the end of this lesson you will be able to know

- Risks in life
- How it can be avoided ?

1.2 WHAT IS RISK?

Risk has been defined as the **possibility of occurrence of an unfavourable deviation from the expected** i.e. what you want to happen does not happen or vice versa what you do not want to happen, happens. When such unexpected events occur there is invariably a sense of loss, which may or may not be measurable in terms of money. When your vehicle gets unexpectedly stolen there is a monitory loss but if your Favourite pet dies unexpectedly you feel a great loss but this loss is not measurable. Since an unfavourable deviation from the expected always results in loss, we can also define risk as the **possibility of occurrence of loss.**

Our expectations are mostly positive. We expect our car to be exactly where it was parked in the same condition as when we left it and are unpleasantly surprised if we find it is not there or that it has been damaged when we return. Once we realize that our expectations are less than certain and that actual events may differ from what we expected, **uncertainty** creeps into the mind and **uncertainty is something, which most people are not comfortable with.**

The knowledge of risk and its potential to cause loss creates uncertainty and gives rise to a feeling of **insecurity** which leads to **worry** amongst people and once they are worried enough they will give the problem some thought and try to find a solution, and this is where **Insurance** comes in.

A man is aware that he may die unexpectedly and is worried that in case such an event does happen his family will have to face a lot of hardship and so to mitigate his worry he goes in for life Insurance. Another person may be aware that there is a possibility of his vehicle meeting with an accident and is worried that he may not be in a position to afford its replacement or repair therefore he opts for Motor Insurance. **Insurance provides a means for reducing the adverse impact of unexpected losses** and lessen the worry factor letting a person breathe more easy.

Worry, insecurity and uncertainty are all very negative factors, which adversely affect the output or performance of individuals or even business houses.

A worker who is insecure in his job and is worried by this insecurity will be less productive than his counterpart who is secure. Worry not only leads to reduced production resulting in higher cost but it can also be the cause of accidents as worried workers are more likely to be careless than those who are concentrating on their duties.

Even Business houses when they are uncertain about the future may not be willing to invest more.

Thus we see that Risk with its resultants uncertainty, insecurity and worry definitely have an economic and a psychological cost.

1.3 SOURCES OF RISK

Risk as we have seen is all about losses. In the absence of possibility of loss there would be no risk thus it is important to know about the factors, which cause or contribute towards the occurrence of loss or extent of loss. There are two such factors and these are **“Perils”** and **“Hazards”.**

PERILS

Perils cause the deviation in events from those that we expect. They are the immediate cause of loss. Their very existence ensures that we are surrounded by risk for example flood, death, sickness, theft, terrorism etc. and these are discussed below.

1. Natural Perils:

Our very existence on the planet earth ensures that we live with risk as the almighty in all his wisdom has although gifted nature with many sources of energy unbalance or disturbances beyond limits take the form of risk called perils, which can lead to unexpected losses. There are unexpected natural phenomena, which year in and year out cause untold misery, loss of life and property. The most recent example in the Indian context being the Gujarat Earthquake on Jan 26th 2001, which caused widespread devastation. Nearly 20,000 lives were lost, numerous villages and localities were razed to the ground and lakh were rendered homeless. There is no stopping the fury of nature and the havoc that it plays with mankind. Volcanic eruptions, fire due to lightning, landslides, cyclones, hurricanes, storms, floods, the vagaries of weather, unseasonal rainfall and prolonged dry spells, hailstorms are some other examples of natural risks that can cause losses. These perils are also called **Act of God perils,** and there is little that mankind can do to stop them, he can only learn to live with them and devise means to lessen the negative impact.

A global survey of losses for the year 2006 conducted by Sigma estimated the insured losses due to natural calamities at 14.8 billion dollars and out of this 12.6 billion dollars was on account of floods alone (while looking at these figures we have to bear in mind that these are only for insured losses, the actual figure may be actually much more).

40% of the lives lost during the year in catastrophes were on account of natural disasters with a major contribution being the lives lost due to floods in India & Bangladesh in and Southern Africa in February'2000 and Tsunami in 2005-06.

2. Man Made Perils:

Then there are the manmade perils, which cause loss, these are an outcome of our society and are the violent actions and unethical practices of people, which result in deviation from the expected. There are many of these but only a few are being discussed to illustrate their significance.

(a) **Theft: -** Page – 3 of your daily newspaper provides a fair idea about this rampant malady in our society. The entire page is full of incidents of thefts of motorcycles, daylight robberies and burglaries loss to human life by accident, terrorism, enmity, adulteration murder etc. The figure for the exact extent of losses due to such incidents is not available for India but a study done by the FBI in USA way back in 1974 estimated that such losses in material terms alone exceeded $3 billion that year. Not only outsiders but insiders also steal. Employees steal tools, equipments and goods from their employers worth millions every year.

(b) **Riots, Strikes and Malicious Damage: -** These are perils, which every property owner faces. During Riots miscreants damage, Public and Private property, loot stores, inflict injury or death to innocent people and the police personnel and bring business to a standstill causing untold damage. Similarly strikes sometimes turn violent resulting in damage to life and property. Strikes also result in loss of production causing huge monetary losses, which may even result in bankruptcy. Vandals target unoccupied houses when the proprietors are on vacation and damage the property, in some cases setting it on fire. Cars parked in the street are also often vandalized.

(c) **Accidents: -** Accidents are caused by people and they cause injury to themselves or to others and also damage to property. Automobile accidents alone contribute the maximum share of losses due to this peril. As per WHO study each year "Road Traffics" take the lives of 1.2 million men, women & children around the world and seriously injure millions more. In addition to automobile accidents, accidents due to carelessness of humans result in huge losses to property and life. A carelessly dropped cigarette can lead to fire resulting in heavy losses to property and even life. Thousands of workers lose their lives and limbs every year in industrial accidents caused by human error or carelessness.

In one of the reports by Sigma for the year 2006 puts the global figure of man made insured losses at 5 billion dollars with 50% being attributed to Industrial fires. 11700 people lost their lives and out of these 65% were killed in transport related disasters (which appreciating the extent of losses. We must remember that Sigmas report is only a study of major disasters and only 350 events during the year have been evaluated / studied. The figures therefore just give an idea whereas the ground reality may be even more alarming).

3. Economic Perils:

The third category of Perils or cause of Risk is economic in nature and the examples of this type of Risk are Depression, Inflation, Local fluctuations and the instability of Industrial firms.

Depression in the market leads to low production levels and an increase in unemployment. Low production results in reduced profits or losses for business houses whereas unemployment stops the income of individuals causing mental and physical suffering.

When Inflation is there in the economy the buying power of money declines and the real value of savings and income is reduced. People whose livelihood is based on fixed income such as pensioners (Retired persons) during such periods are the hardest hit and may find it impossible to make both ends meet.

This fluctuation in the general economy can cause unfavourable deviation from the expectations and create risks for both Industries firms as well as individuals.

Sometimes it so happens that even though the general economic condition in the country is stable there are some areas, which may experience recession. These are known as local fluctuations and can effect the Individuals or the business houses in the same manner as the general fluctuation in economy i.e. Depression & Inflation. When particular area is effected the value of investments made in the area declines and jobs are also lost.

At time it is the individual firms which are to blame. The owners lose part or whole of their investment and workers lose their jobs. There are many towns and communities, which are dependent on one single Industry for their well being and when this Industry fails or decides to shift operation the entire town or community is exposed to risk.

Hazards

While perils are the direct cause of loss **hazards are the underlying factors, which increase the probability of occurrence of loss.** There are conditions, which are more hazardous than others e.g., working, as an electrician is a more hazardous occupation than that of a banker as it is more susceptible to accidents. Owning a property on the banks of Ganga is more hazardous than a property in Chandigarh as it is exposed to the risk of damage due to floods. Similarly dealing in textiles is more hazardous than dealing in hardware as the risk of loss due to fire is greater. There are three kinds of hazards:

(i) Physical (ii) Moral (iii) Morale

(i) Physical Hazard: These are hazards, which are related to the physical aspects of the property, which may influence the chances that the property may be damaged or which may increase or decrease the losses incurred due to a particular risk.

The location of a building affects its vulnerability to losses due to fire, floods, earthquakes etc. A residential building close to a unit manufacturing crackers will be more susceptible to losses than a building located in a purely residential area.

Construction of a building also affects the extent of loss. A building or the use to which it is being put is another example of a physical hazard. The same building will be in greater danger of loss by fire if it was used for storing petroleum products than if it was being used as an office or a departmental store.

(ii) Moral Hazard: Moral hazard also affects the probability of loss occurring and the risk is increased. A dishonest person may set his own house or property on fire to avail the Insurance benefit. An unscrupulous trader may arrange for a robbery in his own store to get the benefits. Whenever persons of doubtful integrity buy an Insurance policy the risk increases because loss becomes a certainty.

(iii) Morale Hazard: This is not to be confused with moral hazard, which involves dishonesty but morale hazard is an attitude of lack of concern about the outcome of his actions. An example of this is a person who is careless about stubbing out cigarettes and just throws them around not in the least bothered that his action may cause fire. Bad house keeping is another example of a morale hazard as this also increases the chances of loss occurring.

INTEXT QUESTIONS 1.1

1. Define risk.
2. What are the different types of perils?
3. Distinguish between Moral and Morale hazard.

1.4 TYPES OF RISKS

Risks can be classified into two categories **Pure Risks** and **Speculative Risks.**

To illustrate the difference between the two types of risk let us take the example of a property owner. When a person purchases a property, he is exposed to the risk of damage or loss to his property due to fire. In the event of a fire occurring he will suffer a loss and there is no possibility of him gaining anything if a fire occurs. Simultaneously the value of his property may increase or decrease due to various factors. The areas where the property is located may develop into a prime locality and the value of his property will increase or alternatively the area may not develop but instead becomes uninhabitable because of pollution and the value of his property may decrease. Thus by purchasing the property he exposes himself to the risks of either gaining or losing.

In the first case there was only the chance of a loss occurring this is known as **pure risks** whereas in the second there is a chance of either gain or loss this is known as **speculative risk**. Thus we see that in the same instance i.e. the purchasing of a property the owner exposes himself to both Pure and speculative risk.

Pure risks are those where in case of any unexpected happening the result is only loss whereas in **speculative risks** an unexpected occurrence can possibly result in gain or loss.

When a person gambles or he buys shares there is a chance that he may lose or win or that the share prices may go up and he gains or the share market crashes and he loses. These are **speculative risks**. Risks as we have mentioned earlier is the possibility of loss but when there is also a chance of gain then these risks are called speculative risks.

It is said that the profit that a businessman earns is his reward for bearing a speculative risk. No businessman willingly exposes himself to pure risk because in pure risk there is no gain. It is a universal fact that if one has to live in this risk prone world, one has to expose himself to the pure risks. Pure risks are a part of the environment and are all pervading.

Pure risks which every individual families, firms and other organisations are exposed to can be broadly classified as follows:

(i) **Personal Risk:** Since all losses are ultimately borne by the people it can be said that all risks are personal but there are some losses such as loss of income, mental or physical suffering etc. which have a direct impact on people. Therefore the risk of premature death, sickness, disability, unemployment and even dependent old age are put in this category of Personal risk.

(ii) **Property Risk:** The possibility of loss to an asset such as damage to a building due to fire or damage to a vehicle in an accident or theft of vehicle. These sort of risks fill in the category of Property Risk.

(iii) **Liability Risk:** This is the risk of becoming legally bound to compensate or to pay for damage to the person or property of others.

1.5 WHO FACES RISK ?

Risks as we have seen are inevitably a part of our lives and every individual or business/ Industrial house is exposed to the possibility of loss. The risks faced by the individual or family and the Industry are common but they differ in nature and the extent of loss.

It will be simpler if we discuss the risks faced by the Individual or family separately from the risks faced by the Business houses/ Industries.

1. Family Risks

The term family for all practical purposes henceforth includes an individual who may be living with the family or separately.

(i) Personal Risks

Death: When a person dies the income that he earns with his efforts stops. When death will strike is uncertain and the risk is there at any age. In addition to the loss of income when the head of family dies the family is subjected to expenses on last illness, funeral expenses and settlement of estate not to mention the mental and social burden which cannot be measured in monetary terms but is without doubt very high.

Disability

This may not be as serious as death but it has definite impact on the income. Expenses will increase due to medical care for the disabled family member. Poor health as a result of an accident or illness is one of the most important risks which a family has to face.

Retirement

A person may survive pre-mature death or disability but he still faces loss of income to maintain a reasonable standard of living during retired lifetime.

Unemployment

This risk is also an important one for every family. The current industrial & economic scenario is not very conducive for employment and a lot of companies industrial houses are downsizing, cutting down on the labour force. Voluntary Retirement Scheme and Retrenchment are the order of the day.

(ii) Property Risk

All families in addition to the risk of loss of income or increased expenses also face the risk of loss to property. Loss to property results not only in reduction of Assets but also in loss of income. Examples of property risk are innumerable but to illustrate the extent and nature some are being mentioned here. Homes may be destroyed by fire, floods and storms; cars may be damaged in an accident, burnt, be lost, stolen or destroyed; Savings may be lost in stock market crashes or failure of banks.

(iii) Liability Risk

An individual because of his negligence may become responsible for injury to the person or damage to the property of others for which he has to pay compensation and expose the family to such a risk. With a greater awareness amongst the common man the liability risks is ever increasing and the courts in their judgements appreciating the value of human life and right are awarding huge amounts as compensation for which any individual or family can be beyond imagination and intolerable.

2. Business Risks

As we have already said, businesses also face the same risks as the family but in a different manner and the magnitude is bigger.

(i) **Personal Risks :** The death or disability of an employee who is instrumental in the successful running of the business enterprise can result in loss of business and profits. If a partner in a partnership concern dies, the partnership is dissolved and the surviving partners can suffer loss of Income. In the case of disability of a key employee or partner the firm may be burdened with his medical expenses and may be obliged to continue paying his salary. Firms also to have face the risk of the death or injury to their employees and the burden, which has been transferred to them by law or by contract. The workmen compensation Act 1923 is an example whereby the financial burden resulting from disablement or deaths of an employee is placed upon the employer.

(ii) **Property Risk :** Business houses suffer direct and indirect losses due to property risk. Direct losses can be as a result of various perils much the same as for the family such as destruction of building, machinery and stocks in fire or due to other perils such as storms and flood. In addition dishonest employees may steal from the firm not only material goods but also ideas causing great loss. In this competitive era business houses spend a lot of money on research and development of new concepts but if these are stolen and handed over to other firms in the same field the returns expected from these investments are lost causing great loss. Equipment and property may be damaged or destroyed by rioters or employees on strike. Strike also cause loss of production.

These direct losses may only be a part of the total loss because apart from direct losses due to property damage the business houses also have to bear the indirect loss incurred due to stoppage of operations, disruption in production (Loss of profits) that they may have to face.

(iii) Liability Risk : As in the case of family business, firms also are liable to others for bodily injury or property damage but the exposure is greater than the family as the firm is responsible for the acts of a large number of employees as also the products or services that it deals in.

1.6 HANDLING RISKS

Now that we know that risks are a part of our daily lives we must know how to handle them. Risk management will be discussed in detail under "Practice of General Insurance" and here we shall only make a passing reference to this important aspect.

Some of the methods used to handle risks are Risk Avoidance, Loss Prevention and Reduction, Risk Retention and Risk Transfer. For convenience sake these are briefly being dealt with separately but in practice two or more are used in combination.

1. Risk Avoidance:

The simplest way to deal with risk is to avoid it together. If a factory is to be located on the banks of a river, which is prone to floods every year then it may be decided to shift the site to a safer location. Some people avoid the risk of death or injury in an aeroplane crash by traveling by surface transport only. Organisation like the Armed forces and even some corporate houses restrict the number of their officers traveling in a single aircraft or vehicle together to avoid the risk of all of them dieing in an accident. Though this is the simplest way it is not always practicable.

2. Loss Prevention and Reduction:

Possible loss due to risks may be eliminated or minimized by Loss Prevention and Reduction measures. Some measures such as strict enforcement of "No Smoking" regulations may eliminate fire losses whereas measures such as installation of sprinkler systems and other appliances may reduce the extent of loss due to fire.

Good manufacturing units spend a lot on safety devices and measures and enforce strict rules of conduct within their premises to eliminate or reduce the occurrence of accidents thus minimise their losses & expense incurred on treatment and compensation to employees.

Segregation of hazardous processes from others in a manufacturing unit and isolation of hazardous goods such as petroleum products from non-hazardous goods in a storage facility are some examples of the method of loss Prevention and Reduction.

3. Risk Retention:

It may be consciously decided to retain some risks. Small losses, which may occur frequently may be absorbed by the firm as normal operating expenses such as minor damage or loss of goods in transit.

A financially sound firm may **create an Insurance fund** to which regular payments are credited and from which losses are paid as and when they occur.

This method is used to take care of the domiciliary medical expenses of employees by some large companies having a big workforce.

Some individuals retain the risk of contracting cancer due to smoking not knowing that smoking causes cancer and other even though knowing of it rationalize and pretend that the risk does not exist by saying. "It won't happen to me".

4. Transfer of Risk:

Risk transfer occurs when the activity that creates the risks is transferred to another. For example if a particular process of manufacture is hazardous the firm may decide to get it outsourced i.e. get the job done from a specialized sub-contractor outside so that the associated risks are transferred.

Similarly when a person hires an equipment the owner may insert a condition in the contract that any damage to the equipment shall be the responsibility of the hirer. Lease and rental agreements are an example of this method of handling risk. A rental agreement carries the clause that the equipment shall be returned to the owner in good condition, ordinary wear & tear accepted. Guarantees are also a form of risks transfer where the buyer transfers the risk of purchasing a defective new item back to the manufacture. Most consumer goods coming in the market now are sold with the guarantee that in case of any manufacturing defect or non-performance the equipment will be replaced/ repaired by the manufacturer. Earlier it was not so and the buyer used to purchase the materials at his own risk and in case of defect had to bear the loss.

There are innumerable ways to transferring the risks and these are only a few illustrations but **the most important method of Risk transfer is Insurance.**

The general guidelines for handling risk are given in the table below:

Types of risk	Suitable Method
Low Frequency and low severity	Retention of Risk
High Frequency and Low severity	Loss control
High Frequency and high Severity	Risk avoidance
Low Frequency and high severity	Risk transfer (Insurance)

1.7 SUMMARY

Risk, which is the possibility of an unfavourable deviation from expectation, causes uncertainty to a person who is both exposed to it and aware of his exposure In many instances uncertainty is unpleasant if not unbearable and reaction to it creates a deterrent to economic activity. Perils causes deviations from expectations and hazards increase the likelihood of such occurrences. Hazards may be physical, moral or morale. The sources of perils and hazards are social, physical and economic. Risk is a common characteristics of the environment for individuals, families and firms. All are exposed to personal risk, property risk and liability risk.

1.8 TERMINAL QUESTIONS

1. What are various sources of risk?
2. Distinguish between Pure Risks & Speculative risks.
3. Explain various risk assumption.

1.9 OBJECTIVE TYPE QUESTIONS

1. Risk is _______________ of occurrence of loss. (Possibility/ impossibility)
2. Earthquake is ______ perils. (natural/ manmade)
3. Inflation is _______ perils.(economic/natural)
4. There are ______types of hazards(two/three)
5. Pure Risks are ____.(Insurable/non-insurable)

Choose the correct options

6. Statement A: Risk can be avoided.

   Statement B: Risk can be transferred.

   a. Both statements are correct
   b. Both statements are wrong
   c. Statement A is correct
   d. Statement B is correct

7. Statement A: Pure risks are insurable.

   Statement B: Speculative risks are not insurable.

   a. Both statements are correct
   b. Both statements are wrong
   c. Statement A is correct
   d. Statement B is correct

Notes

8. a. An individual does not face risks
   b. A business organization only faces the risks
   c. Both an Individual and business organization face the risks.
   d. Animals also faces the risk and can be insured.

9. Statement A: Business risks consist of personal, property and liability risks

   Statement B: Family risks consist of personal , property and liability risks.
   a. Both statements are correct
   b. Both statements are wrong
   c. Only statement A is correct
   d. Only statement B is correct

10. Statement A: Morale hazard means lack of concerns.

    Statement B: Moral hazard means dishonesty.
    a. Both statements are correct
    b. Both statements are wrong
    c. Statement A is correct
    d. Statement B is correct

1.10 ANSWERS TO INTEXT QUESTIONS

1.1

1. Risk is the possibility of occurrence of an unfavourable deviation from the expected that is occurrence of undesirable contingency.
2. i) Natural Perils, ii) Manmade perils-Theft, Riots, strikes and malicious damage, accidents iii) Economic Perils
3. Moral hazard means dishonesty of the person and Morale hazard carelessness of a person

1.11 ANSWER TO OBJECTIVE TYPE QUESTIONS

1.9

1. Possibility
2. Natural

3. Economic
4. Three
5. Insurable
6. a
7. a
8. c
9. a
10. a

2

INTRODUCTION TO INSURANCE

2.0 INTRODUCTION

In the preceding chapter the nature and significance of risk and method of handling risks has been explained. As we have seen the possibility of loss creates uncertainty, which has undesirable economic and psychological effect. When we speak of methods of handling risks we are talking about efforts to reduce uncertainty. While no approach to risk problems is used to exclusions of all others the single most important an widely used alternatively for most families & business is insurance.

2.1 OBJECTIVES

At the end of this lesson you will be able to know

- The concept of insurance
- How insurance works
- Need of insurance
- How the insurance helps the economic development of the country

2.2 NATURE OF INSURANCE:

There are three schools of thought, which have defined the nature of Insurance as follows:

1) **Insurance in terms of the relationship between the insured & the insurer – transfer device:**

   According to this school, Insurance may be defined as the transfer of pure risk from the insured to the insurer.

The insured is the person or firm or company confronted by risk and the insurer is a person or firm or company, which specializes in the assumption of risk. The primary business of the insurer is risk assumption for a fee.

2) Technical:

This school of thought defines Insurance in terms of techniques or mechanics it involves. According to Prof Mehr & Cammack, Insurance is a device for reducing risk by combining a sufficient number of exposure units to make their individual losses collectively predictable. The predictable loss is then shared proportionately by all units in the combination. Therefore, it implies both that uncertainty is reduced & losses are shared. Further, it is said that a device will be deemed Insurance if

(i) it implies the law of large numbers so that the requirement of future funds to cover losses are predictable with reasonable accuracy.

(ii) it provides some definite method for raising these funds by levies against the units covered by the scheme.

In short, the essential features of Insurance are the manner in which losses are predicted & shared.

3) Combination:

According to the third school of thought, Prof. Willet defines **Insurance as a social device for making accumulations to meet uncertain losses of capital, which is carried out through the transfer of risks of many individuals to one person or to a group of persons.** Wherever there is accumulation for uncertain losses, or wherever there is transfer of risk, there is one element of Insurance, only when these are joined with the combination of risk in a group is the Insurance complete. Another way to state this is to say that "Insurance is a transfer of risk with the added features of (i) combination of risks (ii) an estimate of future losses".

Although each of the authors have defined Insurance differently but they are all thinking about virtually the same thing when they use the term Insurance. If we sum up all schools of thought then the Insurance can be well defined as follows:-

Notes

"Insurance is a social device which combines the risks of individuals into a group, using funds contributed by members of the group to pay for losses."

The essence of the Insurance scheme is that it is a

1) Social science
2) Accumulation of funds
3) It involves a group of risks
4) Transfer of risk to the whole group

2.3 BACKGROUND

Insurance as security is need of all human beings. No animal, no plant nor mountains and oceans want any security, like man does. Man is afraid of uncertainty, fears and death. Although a reality, one day each one will die; early or later, timely or untimely is the question, which has no answer. He is afraid of risk & losses in future. He is ever in search of security & certainty. In early history man lived in-groups and communities to be secure.

At the earlier stage, whenever an earning member would die due to disease or death, the other members of the social group (or family or clan) would contribute to bail the survivors in the family out of financial difficulties. This contribution was in the shape of food- clothing and shelter. Even today we donate money, food, clothing and other materials of life to rehabilitate the family whose breadwinner has left for his heavenly abode, unfortunately, suddenly, sadly. (Also people, friends, relatives even today contribute towards marriage, education, healthcare expenses or mishap).

Later, as commercial considerations grew stronger and stronger; nucleus family growth became a common practice these contributions and sharing started becoming individualistic and took the shape of 'premium'. The 'assurances' which were earlier by will and practice became a commodity (though intangible). Thus the concept of Insurance grew. Any person who would not contribute, or would contribute less according to his paying capacity was denied reciprocal help or promise of help, or was given help in proportion to his contribution which he had been contributing as a faithful obedient member of the society.

In earlier days, in India, on an unexpected death of breadwinner in any family, the villagers or neighbourhood would collect funds to help the survive in the family and such practice continues even now. Today also, when after death – "Bhog" or "Kirya"s takes place, relatives give money to the survivors though this may not be adequate collection to meet expenses of remaining part of life when there is no breadwinner. **Insurance is on similar pattern.**

2.4 PURPOSE OF INSURANCE

Every human being has fear in his mind. The fear whether he will be able to meet the basic needs of the life i.e. Food, Clothing and Housing (Roti, Kapda and Makkan). He has fear not only for himself but also for his dependents. The source of income to meet his basic needs may be through service or business. If he is able to meet his basic needs then he acquires the assets i.e. vehicles, property or jewellery etc. Then he gets additional fear of saving the assets from destruction. (The assets may be destroyed through accident, fire or earthquake etc. and the income may be cut off due to certainty i.e. old age and death or uncertainty i.e. accident, illness or disability.)

As you know, the old age and death is certain for every human being while the accident, illness, disability and destruction of assets may be by random. The number of accidents will take place but with whom is uncertain. Therefore, to overcome this problem, **the Insurance plays a very important role.**

The principal source of income of an individual comes from the compensation for work performed by him. If this source of income gets cut off then: -

Family will make social and economic adjustments like:

Ã Wife may take employment at the cost of home making responsibilities

Ã Children may have to go for work at the cost of education.

Ã Family members might have to accept charity from relatives, friends etc. at the cost of their independence and self-respect.

Ã Family standard of living might have to be reduced to a level below the essentials for health and happiness.

Notes

The basic threats which all of us may encounter to varied extent and which result in cut off of income or sudden increase in - uncalled for expenses (beyond our means or higher than our earnings) i.e. dislocates the human life, are: -

- ILLNESS (malnutrition, environment, chronic) – uncertain
- ACCIDENT – (uncertain)
- Disability – Permanent or Temporary (uncertain)
- OLD AGE – (certain)
- DEATH – (certain)

LIFE INSURANCE is an arrangement through which a person can plan for the continuation of income when uncertainties and certainties (i.e.) illness or Accident and death or old age disrupt or destroy his ability to earn his livelihood.

Therefore the Insurance is

1. The business of insurance is related to protection of human life, human created assets, human disability and business liabilities possessed by human beings which have a definite value, and
2. Assets and human life generate benefit and income for the owner and his/her family members, and
3. Loss of assets / human life for any reason stops the benefits and income to the owner and family members respectively, and
4. Results in falling of living standards in the family, quality of life and future growth of the associated family members, and
5. Insurance is a mechanism that helps to reduce such adverse consequences through pooling, spreading and sharing of risk.

Thus life insurance business is complimentary to the Government efforts in social management.

INTEXT QUESTIONS 2.1

1. Define nature of Insurance s per third school of thought.
2. Most common example of insurance.

2.5 NEED OF INSURANCE

(a) To provide Security and Safety

The Life Insurance provides security against premature death and payment in old age to lead the comfortable life. Similarly in general Insurance, the property can be insured against any contingency i.e. fire, earthquake etc.

(b) To provide Peace of Mind

The uncertainty due to fire, accident, death, illness, disability in the human life, it is beyond the control of the human beings. By way of Insurance, he may be compensated financially but not emotionally. The financial compensation provides not only peace of mind but also motivates to work more and more.

(c) To Eliminate Dependency

On the death of the breadwinner, the consequences need not be explained. Similar to the destruction of property and goods the family would suffer a lot. It could lead to reduction in the standard of living or begging from relatives, friends or neighbours. The economic independence of the family is reduced. The Insurance is the only way to assist and provider them adequate at the time of sufferings.

(d) To Encourage Savings

Life Insurance provides protection and investment while general Insurance provides only protection to the human life and property respectively. Life Insurance provides systematic saving because once the policy is taken then the premium is to be regularly paid otherwise the amount will be forfeited.

(e) To fulfill the needs of a person

a) Family needs

b) Old age needs

c) Re-adjustment needs

d) Special needs: Education, Marriage, health

e) The clean up needs: After death, ritual ceremonies, payment of wealth tax and income taxes are certain requirements, which decreases the amount of funds of the family members.

Notes

(f) To Reduce the Business Losses:

In business the huge amount is invested in the properties i.e. Building and Plant and Machinery. These properties may be destroyed due to any negligence, if it is not insured no body would like to invest a huge amount in the business and industry. The Insurance reduced the uncertainty of business losses due to fire or accidents etc.

(g) To Identify the Key man:

Key man is a particular man whose capital, expertise, energy and dutifulness make him the most valuable asset in the business and whose absence well reduce the income of the employer tremendously and upto that time when such employee is not substituted. The death or disability of such valuable lives will prove a more serious loss than that fire or any hazard. The potential loss to be suffered and the compensation to the dependents of such employee require an adequate provision, which is met by purchasing an adequate life policies.

(h) To Enhance the Limit:

The business can obtain loan but pledging the policy as collateral for the loan. The insured persons are getting more loan due to certainty of payment at their death.

(i) Welfare of Employees:

The welfare of the employees is the responsibility of the employer. The employer is supposed to look after the welfare of the employees. The provisions are being made for death, disability and old age. Though these can be insured through individual life Insurance but an individual may not be insurable due to illness and age. But the group policy will cover his Insurance and the premium is very low in group Insurance. The expenditure paid on account of premium will be allowable expenditure.

2.6 HOW INSURANCE WORKS

Theory of probability: It says an event may happen. Say 10 % in a year. For example, in a particular city having a population of 1 lakh on an average-200 people die in accident, 800 people get injured and disabled, another 2000 die natural death, & 7000 die of disease.

This data as per statistic is certain.

Then what is uncertain?

Uncertainty is as to who will die or get disabled during day to day high risk prone fast life.

Although, number is known, but name, age, time, place and extent is not known. If it is known that 200 persons are prone to accidental death in a year, it is not known which 200 individuals?

Due to this certainty, that 10,000 people will die in an accident, or get injured and disabled or die natural death or die of disease; All 1 lakh people will fear accident, possibility of injury or death and its consequences to varying degree as per their age, behaviour, nature of work, environment hazards and many other factors. Grown ups and breadwinners may fear more and dependents may fear less.

If in a city of 1 lakh houses & shops, there are about 1000 thefts every year, though some particular 1000 people are affected by the theft, all others (may be more than 90,000) will fear theft, and will like some solution to this problem.

Human life is a unique income generating asset. When other assets depreciate with age, it appreciates. Creator of all these assets is a human being, whose efforts have gone a long way in owning them.

Before Assurance or Insurance companies came, there were social arrangements in India which almost played similar role but to an limited extent as we have already given the examples in the beginning of this chapter which explains how **"Many would contribute to mitigate losses of a few".**

This method of sharing losses of a few by many is the basis or core philosophy of insurance.

Insurance companies started from individual effort i.e. an individual or group of individuals pooled funds in a partnership or company and started offering a definite payment (called claim) in every case of death or disablement of the participating individuals, against a small amount received (called premium).

Notes

For example look at the following numerical: -

Suppose in a year,

Total **Deaths feared**	Total and **Disabilities**	Total Persons **Who wanted to insure**
200 lakh	800	Entitled for claim and agreed to contribute: -Rs.1 (say)

Death payment, say = Rs.1 lakh

Disability payment, say = Rs.50,000/-

Death claims amount for the year = Rs. 2,00,00,000/- (200 X 1 lakh) – (a)

Disability amount for the year = Rs. 4,00,00,000/- (800 X 50,000) – (b)

Total outgo (expected) (a + b) = Rs. 6,00,00,000/- (6 crores)

Therefore, minimum contribution which 1 lakh persons should have made to meet the claims 6 crores / 1 Lakh = Rs. 600 per year

Thus with a small amount of Rs. 600/- each 1 lakh people feel assured for payment of Rs. 1 lakh each in case of death, and Rs. 50,000/- in case of disablement.

And if that individual had to provide for himself, by himself then the entire Rs.1 lakh or Rs.50,000/- would have to be arranged by the unfortunate person himself-

Thus losses are spread in the insurance system.

But is this small sum of Rs-600/- really the premium?

Answer to this question is - No & Not the least.

We will have to **add all costs & expenses of management** (which go on decreasing in proportion of large-ness of the number of people contributing or buying the insurance policy). **(Let us assume it to be say Rs. X)**

Then, add provision of profit to the entrepreneur, share holders since everybody opens his shop for profits, for gains, and not as a charitable house, (or else the shop will close). **(Let it be say Rs. Y)**

Further, there has to be the provision of **a standing fund (reserve), to off-set large natural calamities** (floods, earthquakes, volcanic eruptions, or large-scale accidents like

Concorde Aeroplane crashing or Sahara air bus going into flames or disasters like Gujarat Earthquake or loss to life, property and business in 11th Septmeber'2001 terrorist attack – Manhattan or Pentagon). **(Let it be say Rs. Z)**

Then the total premium comes to [Rs.600+X+Y+Z]

This is a very rough and crude example of arriving at cost of an Insurance product. Experts called actuaries specialize in design and right pricing of Insurance products.

2.7 INSURANCE AS A SOCIAL SECURITY TOOL

- United Nations Declaration of Human Rights 1948 provides: -" Every one has a right to adequate standard of living for health and well being of himself and his family, including food, clothing, housing, medical care, necessary social services and the right to security in the event of unemployment, sickness, disability, widowhood, or other lack of livelihood in circumstances beyond his control."
- Under a socialistic system the responsibility of full security would be placed upon the state to find resources for providing social security. In the capitalistic left to the individuals. The society provides instruments which can be used in securing this aim. Insurance is one of aim. In capitalistic society too there is a tendency to provide some social security by the state under some schemes where members are required to contribute.
- In India, Article 41 of our Constitution requires the State (with in limits of its economic capacity and development) to make effective provision for securing the right to work, to education and to provide public assistance in case of unemployment, old age, sickness and disablement.
- Part of the obligations under Article 41 are met by the State through the mechanism of Life Insurance.
- Where breadwinner of family dies, family's income stops to that extent, affecting the economic condition. Life Insurance provides such alternate arrangement as we have discussed above.Otherwise another family would have been pushed into the lower strata of society. The lower strata creates a cost on society. Poor people cost the nation by way of subsidies etc.

- Life insurance helps in restoration of the adverse economic condition so caused.
- Some of the legislation passed by the Govt. of India to protect the rights and to provide benefits to the common man as a part of its efforts to provide social security to its dominions is discussed in brief below:

(a) Workman Compensation Act 1923:

This perhaps was the earliest act to be enacted for the benefits of the workers. Before this Act was passed workers who met with accidents while performing their duty not only lost their limbs or lives but also were denied any medical aid and more often than not were simply removed from the job and lost their livelihood placing them and their families in great difficulty. By passing this act the liability of employer was fixed and he is now required by law to pay compensation to victims of accidents while on duty. The amount of compensation has been fixed in accordance with the extent of injury, disability and linked to the workers salary and age on the date of accident.

(b) Employee State Insurance Act 1948:

The purpose behind this legislation was to provide medical aid to workers and their families working in industries located in certain notified areas. Under this act a part of the salary a small amount (at present 1.75%) is deducted from the workman's salary and some part is contributed by the Employer (at present 4.75%) and the same is deposited with the Employee State Insurance corp. With the funds thus collected and with more contributions from the state and Central Govt., Dispensaries and Hospitals have been set up all over the country where the worker members and their families are provided health care free of cost. Under this scheme regular periodic payment are made to workers if they are unable to attend duty due to illness and there is provision for payment of pension in the case of permanent partial disability or death.

(c) Motor Vehicle Act 1988:

The Motor Vehicle Act was amended in 1988 to make Third Party Liability Insurance compulsory thus no uninsured vehicle is allowed to ply the roads or in any public place in India. The need of this enactment was felt due to the growing number of vehicles and the increasing number of accidents causing injury and death of the people involved in the accident and not being able to get relief from the owner/ driver of the vehicle because of long protracted legal battle involved, which many victims could not afford. The Act now provides that irrespective of the fact that the fault was of the driver/ owner or not (No-fault) the victim of an accident will be entitled to a payment of Rs. 50,000/- in case of death and Rs. 25,000/- in the case of grievous bodily injury. Motor Accident Claim Tribunals (MACT) have been set up by the State Government to provide speedy redressal of Third Party claims. Damage to property of Third party is also covered and the limit is Rs.6,000/-.

Motor Vehicle Act also provides for the creation of a "Solatium Fund" to cater to the victims of Hit and Run cases. The fund is created by the contribution from Insurance companies, state and central Government and the victims of Hit & Run cases are entitled to receive Rs.25,000/- in case of death and Rs.12,500/- in the case of grievous bodily injury.

(d) Public Liability Act 1991:

The Bhopal Gas tragedy of 1984, which resulted in many deaths and caused untold suffering to lakhs of people prompted the enactment of this legislation. To recap the incident, poisonous gas escaped from the manufacturing plant of Union Carbide leading to one of the worst industrial disasters of recent times. The victims even now; 17 years later are yet to get adequate relief and continue to suffer.

The public liability act now makes it compulsory for all individuals, companies, industries involved in handling of hazardous substances to insure against any untoward happening so that immediate succor is made available to the victims from the Insurance companies.

Other than passing legislations to improve social security the Government also initiated certain schemes under which Insurance is provided to the economically and socially backward people and workers of the unorganized sector at highly subsidized rates. Some of the schemes introduced by the Govt. of India are -

(e) (PASSS) Personal Accident Social Security Scheme:

Introduced in 1985 for the benefit of Poor families i.e. (whose income does not exceed Rs. 7,200 per year). The scheme provided for a payment of Rs.3,000/- in the event of death due to an accident of any person in the age group of 18 to 60 who is the earning member of the poor family. The premium is borne by the Central Government and the expenses for implementation of the scheme by the state Government.

(f) (NAIS) National Agricultural Insurance Scheme or the (RKBY) Rashtriya Krishi Bima Yojna introduced in 1999 with the objective of providing Insurance coverage and financial support to farmers in the event of failure of crops as a result of calamities, pests and diseases. The premium is low and 50% subsidy in premium is allowed to small & marginal farmers which are shared by the Central and State Government.

(g) Hut Insurance Scheme:

Introduced in 1988, for the benefit of very poor families (i.e. those whose annual income does not exceed Rs.4,800/-p.a.). The scheme provides that in case of destruction of Hut due to fire, compensation of Rs.1,000/- for hut & Rs.500/- for belongings shall be paid. The premium is borne by the Central Government.

In addition, to the above schemes the Government has also introduced insurances at subsidized rates for farmers (cattle Insurance), for women (Raj Rajeshwari Mahila Kalyan Yojna), for the girl child (Bhagyashree child welfare policy) and Gramin Personal Accident policy etc. for the benefits of the common people. These shall be discussed later on in the course (under GIC Products) but all this goes to show how through legislations or through Govt. sponsored schemes the Insurance sector acts as a tool for implementation of social security measures.

2.8 ROLE OF INSURANCE IN ECONOMIC DEVELOPMENT

In addition to contributing to the economy by preserving human life values and assets and protecting loss, Insurance also aids in economic development. To grow economy, the Govt. needs capital to finance infrastructure i.e. Roads, bridges, industrial farm communication and Railways lines which requires the huge investment. Individual or Govt. is unable to provide such funds. As the life Insurance contracts are long term contacts. Therefore, insurer by investing funds that flow to them from their many policyholders have become the principal source of capital for the economy.

- Investments are essential ingredients for economic development of any nation. Investments by Insurance companies are in social sector, infrastructure development and government security, papers and bonds.
- Life insurance plays a major role in mobilization of pubic savings.(Rs. 75,000 crores/ year)
- Savings out of life insurance fund are utilized in investments for growth. (infrastructure bonds, Housing, Railway, equity market etc.)
- Looking to non-life side business, industry and trade would be seriously handicapped in the absence of insurance cover relating to losses due to fire, earthquake, flood, storm - natural calamities, act of God etc.)
- Wide-spread of Insurance brings in indirectly the following advantages
    - Better living standards
    - Higher productivity
    - Improved Law and Order
    - Higher GDP
    - Healthy Generation
    - Discourages bad habits and practices causing damage to human life
    - Higher mortality
    - Happy society
    - Enhanced self-esteem
    - Creative Minds
    - Entrepreneurship qualities
    - Social upliftment of the society as a whole

INTEXT QUESTIONS 2.2

1. What are the components of the Premium?
2. Explain the provisions of Article of 41 of Indian Constitution.

2.9 HISTORY OF LIFE INSURANCE

Life insurance is an organised economic activity came into force in different countries at different stages of history.

Records show that first policy providing temporary life assurance cover for a period of 12 months was issued on 18th June 1583 AD in London on the life of William Gybbons and the policy was procured by Richard Martin. The policy was Underwritten by 16 individuals for £383-6s-8d with a premium of £30-13s-4d @ 8%. The insured died on 25th May 1584 i.e. within one year of taking the policy. The underwriters disputed the claim taking the plea that the party had lived for more than 12 lunar months (month of 28 days). However the claim was finally paid after the matter was taken to the court, which ruled in favour of the insured.

The "Amicable Society" started granting fluctuating sum on death since 1705 and a fixed sum since 1757.

With gathering of mortality tables (death rate per 1000 at each age up to the age of 100 years), Life Insurance activity became some what scientific. "Equitable society" was founded in 1762 and worked on a scientific basis.

Insurance In India

It is said that Insurance was practiced in India even in the vedic times and the Sanskrit term "Yogakshema" in the Rigveda is in reference to a form of Insurance practiced by the Aryans 3000 years ago. The code of Manu which prescribes the many practices to be followed by the people for social harmony and development in Ancient India had also dictated that a special charge be made on goods carried from one city to another to ensure their safe carriage to the destination.

By 1885 there were more than 50 British and other foreign agencies having their offices in India. The success of the Managing Agents encouraged the growth of many Insurance

Notes

offices largely with foreign capital many of which were short lived.

In India Two British Companies - the European and the Albert entered in 1870 and attempted writing business on Indian lives. The first Indian Life assurance Society was formed in the same year called "Bombay Mutual Assurance Society Ltd."

It was followed by "Oriental Life Assurance Society Ltd." in 1874, "Bharat" in 1896 and "Empire of India" in 1897.

The New India, Vulcan, Jupiter, British India General and the Universal. These five were composite and dealing both in life and general Insurance.

The Swadeshi Movement of 1905 and Mahatma Gandhis' call to Indians to give their business only to Indian Companies gave a boost to these new companies and they consolidated their position. More Indian companies entered the Life Insurance sector namely Hindustan Co-operative, United India, Bombay Life, National and Laxmi. But the going was not easy as they had little experience in the field of Insurance and they had to compete with 150 foreign offices including some of the largest Insurance groups in the world.

Insurance in Modern India

Government started exercising control on Insurance business by passing "Insurance Act" in 1912. This Act was comprehensively amended and passed as New Act in 1938 for controlling Investment of funds, expenditure and Management. The Office of Controller was established. Again, this Act was amended in 1950.

By 1955, 170 Insurance offices and 80 P.F. Societies registered companies were doing Life Insurance business in India. In view of surge in malpractices in Life Insurance business, due to the illiteracy level being high and lack in will for penetration / spread of Life Insurance business, it was nationalised by Government of India and LIC Act was passed in June'1956, and this Act came into force from 1.9.1956.

Similarly the general insurance (which deals with non-life business i.e insurance of property) also nationalized in 1972 after merging of 55 Indian and 52 non Indian companies were nationalized by forming four general insurance companies.

The Govt. Of India, while liberalizing the Indian economy, also felt the liberalization of insurance sector because of lower penetration of insurance as compared to Indian population and its size and other developing countries. Initially the Govt. formed a Malhotra committee in 1993 to study whether the insurance sector should be opened for private players. The committee recommended to Liberalized, Privatized And Globalize (LPG) the insurance sector. In 1999, the Authority known as Insurance Regulatory & Development Authority through IRDA Act 1999 was formed.

After 44 years and 27 years of monopoly of life and general insurance respectively was broken.

Liberalisation of Insurance industry will undoubtedly benefit Indian economy, the Govt., Industry, Employee, Consumer & Society in the following manner:

Benefits to Economy

- Rapid investment
- Improve Quality to Life (New risk covers)
- Competition will bring Consumer Friendly Products
- Large Scale Mobilisation of Funds
- Insurance & Reinsurance Facilities to Major Projects
- Export Projects covered at Home

Benefits to Government

- Long Term Funds for Infrastructure
- Long Term Debt Market Instruments Available
- Increased Employment Opportunities & Compensation
- Reduced Financial Burden of
- - Rural, Social & Backward Classes
- Contributions in Calamities (Sharing of Social Responsibilities)

Benefits to Industry

- Transfer of Technical Expertise
- Innovative Products and Pricing Options

- Improved Prospects for National Cos.
- Domestic Industry will Utilize Technology and Service Customer with Loyalty
- Market Driven Economy will Benefit Customer the most.

Benefits to Consumer

- Superior Quality at Lower Prices
- Wider Choice of Products
- World Class Service to the Consumer
- Increased Penetration of Insurance

Benefits to Employee

- Human Resource Development
- Exposure to 'State of the Art Practices"
- Greater Job Opportunities
- Higher Remuneration
- Professional Management Practices

Benefits to Society

Insurance Companies Act as Guardians in number of Ways: -

- Risk cover for Large Industry, Trade & Property are offered in Compliance to Law
- Environmental Risks get Reduced
- Hit – and – Run Compensations
- Crop Insurance for Covering Risk of Nature – Poor Rainfall etc.
- Socio Responsibilities Burden shared
  - Education
  - Medical
  - Health
  - Accident

2.11 LIFE INSURANCE INVESTMENT

In fact Life Insurance companies are getting the savings of an individual for longer period therefore, the Govt. has prescribed the norms how the Insurance companies can invest their funds. The norms are as follows:

Every insurer carrying on the business of life-insurance shall invest and at all times keep invested in the following manner:

1. 25% in Govt. securities
2. Not less than 50% in Govt. security or approved securities (including(1) above)
3. a) Not less than 15% in Infrastructure and Social Sector

   b) Not exceeding 35% in others capital market Investment in "other than approved Investments" can in no case exceed 15% of the fund

From the above, it will be observed that the Govt. has asked the Insurance to channel the funds to State and Central Govt. Infrastructure sectors social sector and rural sector and capital market. (For details refer the Investments regulations issued By the Insurance Regulatory Development Authority)

Benefits to Govt.

(a) Long term funds and debt instruments are available to develop the economy.

(b) Infrastructure funds are available to create roads, bridges, communication housing etc. It reduces the burden of the Govt.

(c) Investment in Rural and Social sector reduces the responsibility of the Govt. as a result of which the financial burden of the Govt. reduces.

(d) Capital market: If the insurer is investing the fund in the capital market then industry can enhance their production capacity which will have the multiplier effect on the growth of the economy.

2.12 SUMMARY

Insurance has become the necessity tool for our life. It not only provides security but also saving for future. At younger age the necessity may not be felt but as the man grows old it starts feeling the responsibility towards his family. The insurance also helps the economic development of the country as Government gets the huge funds at nominal rate of interest for longer period. Moreover, if the people are taking care for themselves about their present and future needs then Government will spend their funds in more productive manner.

2.13 TERMINAL QUESTIONS:

1. Insurance is a need of life. Explain
2. What is mechanism of the insurance?
3. How the insurance helps in the economic development of the country?

2.14 ANSWERS TO INTEXT QUESTIONS

2.1

1. Insurance as a social device for making accumulations to meet uncertain losses of capital which is carried out through the transfer of risks of many individuals t one person or to a group of persons.
2. Kirya ceremony in any family on death of breadwinner.

2.2

1. Claim amount plus expenses of management plus profit of company plus provisions for contingencies.
2. Govt of India (within limits of its economic capacity and development) to make effective provisions for securing the right to work, to education, to provide public assistance in case of unemployment, old age, sickness and disablement.

2.15 OBJECTIVE TYPE QUESTIONS

1. Choose the correct Option
   a. Old age is only certain in life.
   b. Old age and death are certain in life.
   c. An accident is certain in life.
   d. An Illness is certain in life.
2. Life insurance business was nationalized in India in ____(1956/1947)
3. Life insurance companies are investing funds as per norms prescribed by the IRDA (True/False)
4. Insurance is a social security tool. (True/False)

Notes

5. Insurance works on law of probability (True/False)

6. Statement A: Insurance is relevant only if there is possible economic loss

   Statement B: An event which will certainly happen cannot be insured.

   a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two

7. Statement A: Insurance provides sense of security.

   Statement B: Insurance ensures that no loss will take place.

   a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two

8. Statement A: Insurance reduces social costs.

   Statement B: Insurance is an instruments of social security.

   a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two

2.16 ANSWERS TO OBJECTIVE TYPE QUESTIONS

2.15

1. b	2. 1956
3. True	4. True
5. True	6. c
7. a	8. c

3

ESSENTIALS OF INSURANCE CONTRACT

3.0 INTRODUCTION

The fundamental principle of Insurance is mathematical; its application is financial; and its interpretation is legal. For the layman to understand the Insurance principle he should be an actuary (who design and price the insurance products); to understand its application to financial problems, he need not be a financial; and to understand its legal concepts, he need not be a lawyer. The subject of Insurance covers a vast array of topics. This and the following chapters are concerned with these topics.

Insurance may be defined as a contract between two parties whereby one party called insurer undertakes in exchange for a fixed sum called premium to pay the other party called insured a fixed amount of money after happening of a certain event.

Insurance policy is a legal contract & its formation is subject to the fulfillment of the requisites of a contract defined under Indian Contract Act 1872.

According to the Act **"A Contract may be defined as an agreement between two or more parties to do or to abstain from doing an act, with an intention to create a legally binding relationship."**

Since Insurance is a contract, certain sections of Indian Contract Act are applicable.

3.1 OBJECTIVES

At the end of this lesson you will be able to know;

- Features of commercial contract
- Principles of contracts for insurance

3.2 ESSENTIALS OF COMMERCIAL CONTRACT

A. Elements of General Contract

1. Offer & Acceptance
2. Consideration
3. Legal capacity to contract or competency
4. Consensus "ad idem"
5. Legality of object

B. Elements of Special Contract relating to Insurance

1. Life Insurance
   a. Utmost Good Faith (Uberrima Fides)
   b. Insurable Interest
2. General Insurance
   a. Utmost Good Faith (Uberrima Fides)
   b. Insurable Interest
   c. Indemnity
   d. Subrogation
   e. Proximate Cause

The essentials of any Insurance Contract are discussed as under with reference to the life Insurance only.

1. Offer & Acceptance:

In Life Insurance an offer can be made either by the Insurance company or the applicant (proposer) & the acceptance will follow. e.g., subsequently

(a) An offer made by the Insurance company to proposer that the premium amount will be Rs.100/- per annum for the Insurance amount of Rs.1000/-. It is for the proposer to accept the offer or not.

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(b) An advertisement in the newspaper about the availability of different life Insurance policies is an invitation for an offer. If a proposer makes an application then it will be offer from the applicant and the Insurance company may or may not accept it.

(c) An offer may be considered accepted either when the Insurance company issues the policy or the first premium is paid by the applicant.

As stated above in example **(a)** if the applicant pays the first premium of Rs.100/- to the Insurance company then the contract is completed as both the parties have accepted the offer.

Similarly, if the company issues the policy in above stated example **(b)** then the offer is accepted by the Insurance company & the contract is completed. In fact, in life Insurance contract the effective date of the policy is very important; when the premium is paid with the application but no conditional receipt is issued the contract is not in force until the policy is delivered to the applicant. The payment of the premium with the application constitutes the offer and the delivery of policy is its acceptance.

Further, if the premium is paid with the application & conditional receipt is issued, the effective date of the contract depends upon the provisions of the conditional receipt. There are three types of conditions as follows:

(a) The condition may be that the Insurance becomes effective as of the date of the application or medical examination whichever is later. A claim arising after this date will be paid even if the application papers have not reached the competent / Approving Authority, provided of course, that the facts on the application & the results of the medical examination are such that the company would have accepted the application had the applicant lived.

(b) The second type of conditional receipt used by a company is the **approval form**, which provides coverage beginning with the date the application is approved by the company. This form does not offer the insured protection for the period from the date of the application until it is approved by the company.

(c) A third type of receipt is the **unconditional binding receipt**. According to this receipt the company binds the Insurance from the date of the application until the policy is issued or the application is rejected. The companies using this type of receipt place a time limit usually from 30 to 60 days. This binding receipt is beneficial to the prospects because he becomes insured from the time the application is filed. This form of receipt is not widely used.

The offer or proposal and its acceptance may be verbal or in writing but in Insurance contracts these are in writing. In General Insurance the Insured offers to purchase an insurance from the Insurer and this offer is in the form of a proposal form and the Insurer after studying the proposal can either reject the proposal or accept it. In case he accepts he issues a cover note or a letter of acceptance. In the latter event the acceptance letter becomes a counter offer or proposal, which is accepted on payment of premium by the insured.

2. Consideration:

There is no validity of a contract if there is no consideration, which is the act or promise offered by one party and accepted by the other as the price of his promise. In Insurance contracts the consideration is the premium that the Insured pays to the Insurer as the price of the promise that the Insurer has made that he shall indemnify the insured. Hence premium payment is the consideration on part of the insured and the promise to Indemnify is the consideration on part of the Insurer.

INTEXT QUESTIONS 3.1

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1. When is the insurance contract considered to be completed?

2. What is consideration in any insurance contract?

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3. Legal Capacity to Contract or Competency:

For an agreement to be binding on all parties, the parties involved must have the legal capacity to enter into a contract.

With respect to the insurer, if the company is formed as per laws of the country & empowered to solicit insurance then the insurer is capable of entering into an agreement.

With respect to the insured, the person should be of legal age i.e. 18 years and of sound mind.

If a contract is made with an underage the application may be held unenforceable if the minor decides to repudiate it at a later date. In Insurance contract the insurer is bound by the contract as long as the underage wishes to continue it. If the minor repudiates his contract, the law will allow him a refund of all premium paid.

Insanity or mental incompetence precludes the making of a valid Insurance contract.

4. Consensus "ad idem" (Same mind):

The understanding between the insurer & insured person should be of same thinking or mind. The reasons for taking the Insurance policy should be understandable to both the parties.

Both parties to the contract should be of the same mind and there must be consent arising out of common intention. Both parties should be clear about what the other is saying. The Insurer should know what the insured wants and the insured should know what the insurer is offering and both should be agreed on this. For example, if an Insured seeking a fire policy is issued a burglary policy there is no consent arising out of common intention.

5. Legality of Object:

To be a valid, a contract must be for a legal purpose & not contrary to public policy. Insurance is legal business therefore it cannot be illegal on the part of the insurer. An individual can take the life Insurance of his own life or his/her family members. If an individual takes a policy on the life of an unknown person it will not be a valid contract as it will amount to gambling.

Another example is that the contract will not be legal if it has anything to do with stolen property or if it is in respect of any unlawful activity. Hence Insurance of stolen goods or the Insurance of smuggling operation shall not stand scrutiny in the court of law and such contracts will be void.

3.3 SUMMARY

In addition to the above features which are common to commercial contracts as well as contracts of Insurance, Insurance contracts are subject to certain special principles evolved under common law in UK and are followed by the Indian courts. These principles are known as the **fundamental principles of the law of Insurance** and these are discussed in the following chapters.

3.4 TERMINAL QUESTIONS:

1. Explain the various features of any commercial contract.

3.5 OBJECTIVE TYPE QUESTIONS

1. Choose the correct option
   a. In an insurance contract an insurer makes an offer and the prospect accepts it.
   b. In an insurance contract a prospect makes an offer and an insurer accepts it.
   c. In an insurance contract an offer and acceptance is not a requirement.
   d. In an insurance contract no principles of contact are applicable.
2. The consideration for the insurer under an insurance contract is a______(premium / sum insured)
3. The consideration for an insured under an insurance contract is a_________________(compensation / premium).
4. Choose the correct options

   Statement A: The minor can enter in to an insurance contract.

   Statement B: The person with unsound mind cannot enter into an insurance contract.

   a. Both statements are correct
   b. Both statements are wrong
   c. Statement A is correct
   d. Statement B is correct

5. Choose the correct options

   Statement A: Insurance is lawful business.

   Statement B: The insurance is not a gambling.

   a. Both statements are correct

   b. Both statements are wrong

   c. Statement A is correct

   d. Statement B is correct

3.6 ANSWERS TO INTEXT QUESTIONS

3.1

1. On accepting the proposal by the insurance company the insurance contract is completed.
2. Premium paid by the person to the insurance company and any compensation paid by the insurance company.

3.7 ANSWERS TO OBJECTIVE TYPE QUESTIONS

3.5

1. b
2. premium
3. compensation
4. d
5. a

4

PRINCIPLES OF LIFE INSURANCE

4.0 INTRODUCTION

In the previous chapter, we have discussed essentials of Insurance contact. But in this chapter, we explained one of the important type of Insurance i.e. Life Insurance. If somebody suffer economic hardship and dies, at that time Dependent Survivors needs life Insurance. Life Insurance is a way to replace the loss of Income that occurs when the earning member of family dies. It is a contract between insured phases and the company that is providing the Insurance. If insured pus on dies while the contract is in force, the insurance company pays a specified sum of money to the person on persons you name as beneficiaries.

4.1 OBJECTIVES

At the end of this lesson you will be able to know:

- Various principles applicable to life insurance contract.
- In case any of these principle is missing the insurance contract will become void.

4.2 UTMOST GOOD FAITH

The commercial contracts are normally subject to the principle of “Caveat Emptor” i.e. let the buyer beware. In most of these contracts each party to the contract can examine the item or services which is the subject matter of contract. For eg. If you go to the market to buy vegetables then you have to be careful yourselves about quality while buying the vegetables and after buying you cannot question the vendor.

Each party believes in the statement of the other party. So long as there is no attempt to mislead & the answers are given truthfully, the question of avoiding the contract would not arise.

In the Insurance contract the product sold is intangible. It cannot be seen or felt. Most of the facts relating to health, habits, personal history and family history are known to one party only, the proposer. The insurer can know most of these facts only if the proposer decides to disclose these facts. It is true that the underwriter can have the assistance of medical report for life Insurance proposal. Sometimes, these aspects are not detected by the medical examination. e.g., a person suffering from high B.P. or diabetes can manage to hide these facts from the examining doctor. The history of past serious sickness, operations and injuries can be suppressed. These aspects may affect the life expectancy of the proposer. Hence, these constitute material information from the underwriter's point of view. Non-disclosure of such facts would put the insurer as well as the community of policyholders at a disadvantage.

It is for these reasons that the law imposes a greater duty on the parties to an Insurance contract than in case of other commercial contracts. This duty is one of utmost good faith **(uberrima fides)**. It is the duty of the assured to make a full disclosure to the underwriter without being asked. In a contract of Insurance, there is an implied condition that each party must disclose every material fact known to him. This type of contract is called uberrima fides i.e. contract of utmost good faith.

Hence utmost good faith can be defined as a positive duty to disclose accurately & fully all facts material to the risk being proposed whether requested or not.

The material fact is the material, which would influence the judgement of a prudent insurer in fixing the premium or determining whether he will cover the risk.

Therefore, facts regarding age, height, weight, previous medical history, smoking/ drinking habits, operations, details of earlier Insurances and hazardous occupation must be disclosed.

There are certain circumstances, which need not be disclosed e.g.:

(a) Facts which every one is supposed to know in general

(b) Facts of common knowledge

(c) Facts which lessen the risk

(d) Facts which could be reasonably discovered by reference to previous policies records of which are available with the insurer

In Insurance contract, the level of good faith above the level of what is in the usual commercial transaction is required. Therefore, Insurance contracts are based on the principles of warranty, representation and concealment. We must understand the nature of warranty, representation and concealment.

4.3 WARRANTY:

A warranty in Insurance is a statement or condition which is incorporated in the contract relating to risk, which the applicant presents as true & upon which it is presumed that the insurer relied in issuing the contract.

In fact, Marine Insurance developed the doctrine of warranty because the marine underwriter was rarely called upon or got a chance to inspect the ship as it might be lying thousands of miles away at ports or in voyage. Therefore, he had to depend entirely upon the word of the person seeking the Insurance. Hence, all information in the application for the Insurance was warranted to be absolutely exact and true. **If it turned out to be untrue, the Insurance was voidable whether the misstatement was intentional or unintentional, material to the loss or immaterial.**

INTEXT QUESTION 4.1

1. If a person is suffering from Cancer/heart disease whether it is duty of person to inform to the insurance company.

4.4 INSURABLE INTEREST

The Insurance Act 1938 doesn't define the insurable interest but it has been defined as follows by Mac-Gillivray

"Where the assured is so situated that the happening of the event on which the Insurance money is to become payable would as a proximity cause, involve the assured in the loss or diminution of any right recognised by law or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability."

The object of Insurance should be lawful for this purpose, the person proposing for Insurance must have interest in the continued life of the insured & would suffer pecuniary loss if the insured dies. If there is no insurable interest, the contract becomes wagering (gambling) contract. All wagering contracts are illegal & therefore null & void.

Own Life Policy

So long as the Insurance is on one's own life, the "Insurance Interest" presents no difficulty. A person has insurable interest in his own life to an unlimited extent. The absence of a limit in this case is reasonable. When a person insures his life he obtains protection against loss to his estate; for in the event of his untimely death the estate would not benefit by the future accumulation he hopes to make during the normal span of life. It is not easy to compute with any degree of certainty what the future earnings of a person would be. Hence no limit may be fixed in respect of life Insurance he may effect.

Where, however, insurer rejects a proposal for an amount of assurance, which is disproportionate to the means of the proposer, it is not normally for lack of Insurable interest but on considerations of "moral hazard". Indeed it may also be presumed in a case where a person proposes for a policy for a large amount, which he may not be able to maintain having regard to his income, that it will be financed by some other person and that there is no insurable interest.

INTEXT QUESTION 4.2

1. Whether can you take life insurance policy of Mr Amitabh Bachan?

4.5 INSURANCE ON THE LIFE OF SPOUSE

As a wife is normally supported by her husband, she can validly effect an insurance on her life for adequate amount. The service and help rendered by the wife used to be thought of as the basis of insurable interest which supports any policy which a man takes on the life of his wife. In Griffiths v. Elemming the

Notes

Court of Appeal in England stated that it was difficult to uphold such interest on the basis of pecuniary interest but thought that such interest could be presumed on broader grounds.

Parent and Child

Following the practice in U.K. in India also a parent is not considered to have insurable interest in the life of the child. The same is the case with a child in respect of his parent's life. Whether this position requires to be reviewed now appears to be engaging the attention of people here.

A Hindu is under a legal obligation to maintain his parents. Even as per traditional law Sec.20 of the Hindu Adoption and Maintenance Act has given statutory form to the legal obligation. The parents have, therefore, a right to maintenance subject to their being aged or infirm. An order for maintenance of parents may also be passed under Sec. 125 of the Code of Criminal Procedure, 1973. It may be stated, therefore, that a parent has pecuniary interest in the life of the child, and an assurance effected on that basis cannot be hit by Sec.30 of the Contract Act as a wagering contract.

However, it may be noted that the pecuniary interest is not a present interest unless the parent is unable to maintain himself or herself at the time when the Insurance is effected. It may therefore, be argued that a parent cannot have insurable interest in the life of the child until the right to maintenance arises; but when a person is not able to maintain oneself how can he be expected to have the means to insure the life of his children?

As a matter of fact in India, even today a child is a potential breadwinner for the parents in their old age. The present affluent circumstances of a parent do not alter that situation. Under the traditional law a right to maintenance could be claimed only against the sons; the statute has now extended the obligation to the daughters as well.

Having regard to the social and economic set up of the people in the country a review of the question seems to be appropriate.

On the life of other relations

In the case of other relations, insurable interest cannot be presumed from the mere existence of their relationship. Moral obligations or duties are not sufficient to sustain an insurable interest.

In every other case, the insurable interest must be a pecuniary interest and must be founded on a right or obligation capable of being enforced by Courts of law.

The following are illustrations of such cases of insurable interest:

(a) **Employer – Employee:** An employer has insurable interest in the life of his employee, and the employee in the life of the employer;

An employer can create insurable interest in the lives of his employees by undertaking to provide monetary benefit to the family or estate of the employees in the event of death. Group Insurances effected by companies on the lives of their employees are on the basis of such insurable interest.

(b) **Creditor – debtor:** A creditor has insurable interest in the life of his debtor upto the amount of the debt;

This is not a satisfactory basis; for in the event of death of the debtor after the debt has been repaid, the creditor would still be entitled to the policy moneys and thus can be in a position to gain by the death of the debtor once the loan is repaid. The better arrangement would be for the debtor to take out a policy for the required amount and mortgage the policy to the creditor. The creditor then cannot take benefits under the policy in excess of his dues.

(c) **Partner:** A partner has insurable interest in the life of his co-partner to the extent of the capital to be brought in by the latter.

(d) **Surety and principal debtor-Co-surety:** A surety has insurable interest in the life of his co-surety to the extent of the proportion of his debt and also in the life of his principal debtor.

Effect on Contract when Insurable interest is not present:

Where, therefore, the proposal is on the life of another, unless the proposer has insurable interest in the life to be assured, the contract shall be void. Lack of insurable interest is a defence, which the insurer may plead in resisting a claim. There may be also cases where Insurance on one's own life is surreptitiously financed and held by another for his benefit, which if detected by the insurer, may be declared void.

As a life Insurance contract is not one of indemnity, the existence of insurable interest and the amount thereof will have to be considered at the time of effecting the contract since lack of such interest would render the contract void. If insurable interest existed at the inception of the policy, the contract would be enforceable though such interest might cease later.

4.5 SUMMARY:

Insurance contracts are influenced by number of legal principles i.e. commercial as well as insurance. As the insurer does not any thing about the proposer therefore, the duty of disclosing the material facts has been imposed on the proposer. The decision of the insurer will depend upon the material facts disclosed by the proposer. The insurable interest should also be present at the time of taking the policy. No one can take the policy in the name of third party with which the proposer is not having any legal relationship and financial loss in case of any mishap with the proposer.

4.6 TERMINAL QUESTIONS:

1. It is the duty of the assured to make a full disclosure to the underwriter without being asked. Discuss.

2. Is it essential that insurable interest should be present in every insurance contract? If yes, explain.

4.5 OBJECTIVE TYPE QUESTIONS

1. Choose the correct Option

   Statement A: Commercial contracts are subject to the principle of "Caveat Emptor"

   Statement B: Insurance contracts are also subject to the principle of "Caveat Emptor"

   a. Both statements are correct

   b. Both statements are wrong

   c. Statement A is correct

   d. Statement B is correct

2. Insurable interest means

   Statement A: Legal right to insure.

   Statement B: Have suffered financial loss.

   a. Both statements are correct

   b. Both statements are wrong

   c. Statement A is correct

   d. Statement B is correct

3. One of the fundamental principles of life insurance is

   a. There is an insurer & policyholder

   b. Utmost good faith

   c. Insurable interest

   d. Both b & c

4. Facts which need to be disclosed.

   a. Facts of common knowledge

   b. Facts which lessen the risks

   c. Facts which every one is supposed to know in general

   d. Family History

5. Non disclosure/Misrepresentation/Concealment of _________ information makes contract voidable. (Material/Immaterial)

   True/False

6. A person has insurable interest in his own life.

7. Parents have insurable interest in the life of child.

8. A creditor has unlimited insurable interest in the life of debtor

9. An employer has an insurable interest in the life of his employees to the extent of the value of his services

10. The duty of disclosure of material facts arises in life insurance:

    a. only during the proposal stage

Notes

b. Only during the policy period if there is a change in risk

c. Only at the time of renewal

d. All of the above

4.6 ANSWERS TO INTEXT QUESTIONS

4.1

1. Yes the person should disclose to the insurance company as per the principle of utmost good faith otherwise at the time claim the insurance can refuse to make the payment.

4.2

1. No you can not take such policy because you have neither legal relationship nor you will loose financially in case of any mis-happening with Mr Bachan life.

4.7 ANSWERS TO OBJECTIVE TYPE QUESTIONS

4.5

1. c	2. a
3. d	4. d
5. material	6. True
7. False	8. false
9. true	10. d

5

FUNDAMENTALS / PRINCIPLES OF GENERAL INSURANCE

5.0 INTRODUCTION

After studying, the life insurance and its importance, the over aspect of insurance other than 'Life Insurance' would is General Insurance. In this chapter, we cover various aspect of General Insurance such as Principles of utmost Good faiths material fact Principle of Insurable Insures and Principle of Indemnity.

General Insurance comprises of insurance of property against fire, burglary etc, personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. Suitable general Insurance covers are necessary for every family. It is important to protect one's property, which one might have acquired from one's hard earned income. Losses created to catastrophes such as the tsunami, earthquakes, cyclones etc. have left many homeless and penniless. Such losses can be devastating but insurance could help mitigate them. Property can be covered, so also the people against Personal Accident. A Health Insurance policy can provide financial relief to a person undergoing medical treatment whether due to a disease or an injury.

5.1 OBJECTIVES

At the end of this lesson you will be able to know:

- Various additional principles applicable to life insurance contract
- In case any of these principles are missing the insurance contract will become void

5.2 PRINCIPLES OF UTMOST GOOD FAITH

Both the parties to a commercial contract are by law required to observe good faith. Let us say that you go to a shop to buy an electrical appliance. You simply will not enter, pay and pick up any sample piece but will check two, three or even more pieces. You may be even ask the shopkeeper to give a demonstration to ensure that it is in working condition and also ask several questions to satisfy yourself about what you are buying. Then when you go home you find it does not work or is not what you were looking for exactly so you decide to return the item but the shopkeeper may well refuse to take it back saying that before purchasing you had satisfied yourself; and he is possibly right. The common law principle "Caveat Emptor" or let the buyer beware is applicable to commercial contracts and the buyer must satisfy himself that the contract is good because he has no legal redress later on if he has made a bad bargain. The seller cannot misrepresent the item he has sold or deceive the buyer by giving wrong or misleading information but he is under no obligation to disclose all the information to the buyer and only selective information in reply to the buyers queries is required to be given. But in Insurance contracts the principles of "Uberrima fides" i.e. of Utmost Good Faith is observed and simple good faith is not enough. Why this difference in Insurance contracts?

Firstly, in Insurance contracts the seller is the insurer and he has no knowledge about the property to be insured. The proposer on the other hand knows or is supposed to know everything about the property. The condition is reverse of ordinary commercial contracts and the seller is entirely dependent upon the buyer to provide the information about the property and hence the need for Utmost Good Faith on the part of the proposer.

It may be said here that the insurer has the option of getting the subject matter of Insurance examined before covering the risk. This is true that he can conduct an examination in the case of a property being insured for fire risk or of getting a medical examination done in the case of a health policy. But even then there will be facts which only the insured can know e.g., the history of Insurance of the property whether it has been refused earlier for Insurance by another company or whether it is also already insured with another company and the previous claim experience. Similarly a medical examination

Notes

may not reveal the previous history i.e. details of past illness, accidents etc. Therefore Insurance contracts insist on the practice of Utmost Good Faith on the part of the Insured.

Secondly, Insurance is an intangible product. It cannot be seen or felt. It is simply a promise on the part of Insurer to make good the loss incurred by the Insured if and when it occurs.

Thus the Insurer is also obliged to practice Utmost Good Faith in his dealings with the Insured. He cannot and should not make false promises during negotiations.

He should not withhold information from the Insured such as the discounts available for good features e.g., fire extinguishing Appliances discount in fire policies or that Earthquake risk is not covered under the standard fire policy but can be covered on payment of additional premium.

In the recent Earthquake disaster in Gujarat a number of Insured failed to get any relief from Insurance Companies as Earthquake risk was not covered.

Utmost Good Faith can be defined as "A positive duty to voluntarily disclose, accurately and fully all facts material to the risk being proposed whether requested for or not".

In Insurance contracts Utmost Good Faith means that "each party to the proposed contract is legally obliged to disclose to the other all information which can influence the others decision to enter the contract".

The following can be inferred from the above two definitions:

(1) Each party is required to tell the other, the truth, the whole truth and nothing but the truth.

(2) Unlike normal contract such an obligation is not limited to any questions asked and

(3) Failure to reveal information even if not asked for gives the aggrieved party the right to regard the contract as void.

How is this duty of Utmost Good Faith to be practiced? And what are the facts that the proposer has to disclose? The answer to both the question is simply the proposer must disclose to the insurer all material facts in respect of the subject matter of Insurance.

Notes

5.3 WHAT IS A MATERIAL FACT?

Material fact is every circumstance or information, which would influence the judgement of a prudent insurer in assessing the risk.

Or

Those circumstances which influence the insurer decision to accept or refuse the risk or which effect the fixing of the premium or the terms and conditions of the contract must be disclosed.

5.4 FACTS, WHICH MUST BE DISCLOSED

i. Facts, which show that a risk represents a greater exposure than would be expected from its nature e.g., the fact that a part of the building is being used for storage of inflammable materials.

ii. External factors that make the risk greater than normal e.g. the building is located next to a warehouse storing explosive material.

iii. Facts, which would make the amount of loss greater than that normally expected e.g. there is no segregation of hazardous goods from non-hazardous goods in the storage facility.

iv. History of Insurance (a) Details of previous losses and claims (b) if any other Insurance Company has earlier declined to insure the property and the special condition imposed by the other insurers; if any.

v. The existence of other insurances

vi. Full facts relating to the description of the subject matter of Insurance

Some examples of Material facts are

(a) **In Fire Insurance:** The construction of the building, the nature of its use i.e. whether it is of concrete or Kucha having thatched roofing and whether it is being used for residential purposes or as a godown, whether fire fighting equipment is available or not.

(b) **In Motor Insurance:** The type of vehicle, the purpose of its use, its age (Model), Cubic capacity and the fact that the driver has a consistently bad driving record.

(c) **In Marine Insurance:** Type of packing, mode of carriage, name of carrier, nature of goods, the route.

(d) **In Personal Accident Insurance:** Age, height, weight, occupation, previous medical history if it is likely to increase the choice of an accident, Bad habits such as drinking etc.

(e) **Burglary Insurance:** Nature of stock, value of stock, type of security precautions taken.

As mentioned this is not an exhaustive list but only a few examples.

Details of previous losses is a material fact which is relevant to all policies.

5.5 FACTS, WHICH NEED NOT BE DISCLOSED

a. **Facts of Law:** Every one is deemed to know the law. Overloading of goods carrying vehicles is legally banned. The transporter can not take excuse that he was not aware of this provision.

b. **Facts which lessen the Risk:** The existence of a good fire fighting system in the building.

c. **Facts of Common Knowledge:** The insurer is expected to know the areas of strife and areas susceptible to riots and of the process followed in a particular trade or Industry.

d. **Facts which could be reasonably discovered:** For e.g. the previous history of claims which the Insurer is supposed to have in his record.

e. **Facts which the insurers representative fails to notice:** In burglary and fire Insurance it is often the practice of Insurance companies to depute surveyors to inspect the premises and in case the surveyor fails to notice hazardous features and provided the details are not withheld by the Insured or concealed by him them the Insured cannot be penalized.

f. **Facts covered by policy condition:** Warranties applied to Insurance polices i.e. there is a warranty that a watchman be deployed during night hours then this circumstance need not be disclosed.

Duration of Duty of Disclosure

The duty of disclosure remains in force through out the entire negotiation stage and till the contract is finalized. Once the contract is finalized than the contract is subject to ordinary simple good faith.

However when an alteration is to be made in an existing contract then this duty of full disclosure recovers in respect of the proposed alteration.

The duty of disclosure also revives at the time of renewal of contract since legally renewal is regarded as a fresh contract.

For example: a landlord at the time of proposal has disclosed that the building is rented out and is being used as an office. If during the continuation of the policy the tenants vacate the building and the landlord subsequently rents it out to a person using it as a godown then he is required to disclose this fact to the Insurer as this is a change in material facts and effects the risks.

(***Note:*** Please note that in long term Insurance Business the Insurer is obliged to accept the renewal premium if the Insured wishes to continue the contract and there is no duty of disclosure operating at the time of renewal. Normally Insurer arranges inspection on each renewal.)

5.6 BREACHES OF UTMOST GOOD FAITH

Breaches of Utmost Good Faith occur in either of 2 ways.

(1) **Misrepresentation,** which again may be either innocent or intentional. If intentional then they are fraudulent

(2) **Non-Disclosure,** which may be innocent or fraudulent. If fraudulent then it is called concealment.

It is important to distinguish between the two: Misrepresentation and Non-Disclosure

Breach of
Utmost Good Faith

Misrepresentation — Non-Disclosure

Misrepresentation: Innocent; Intentional (Fraudulent)

Non-Disclosure: Innocent; Intentional (Concealment)

Misrepresentation :

Innocent :

This occurs when a person states a fact in the belief or expectation that it is right but it turns out to be wrong. While taking out a Marine Insurance Policy the owner states that the ship will leave on a specific date but in fact the ship leaves on a different date.

Intentional : Deliberate misrepresentation arises when the proposer intentionally distorts the known information to defraud the insurer. The selfish objective is somehow to enter the contract or to get a reduction in the premium e.g., If an applicant for motor Insurance stated that no one under 18 would drive the vehicle when in fact his 17 years old son drives frequently. Such a misrepresentation would be material as it would effect the decision of the insurer.

Non-Disclosure

Innocent : This arises when a person is not aware of the facts or when even though being aware of fact does not appreciate its significance e.g.

A proposer at the time of effecting the contract has undetected cancer therefore does not disclose it or

A proposer had suffered from Rheumatic fever in his childhood but he does not disclose this not knowing that people who have this are susceptible to heart diseases at a later age.

Deliberate : This is done with a deliberate intention to defraud the insurer entering into a contract, which he would not have done had he been aware of that fact.

A proposer for fire Insurance hides the fact knowingly by not disclosing that he has an outhouse next to his building, which is used as a store for highly inflammable material.

How To Deal With Breaches

How breaches are dealt with depends upon whether the breaches are

(1) Innocent

(2) Deliberate

(3) Material to the risk

(4) Immaterial to the risk

When Breach of Utmost Good Faith occurs the aggrieved party gets the right to avoid the contract. The contract does not become automatically void and it must decide on the course to be taken. The options available are on case-to-case basis like: -

1) The contract becomes void from the very beginning if deliberate misrepresentation or non-disclosure is resorted to with the intention of misleading the insurer to enter into a contract.

2) To consider the contract void, the bereaved party, must notify the offending party that breach has been noticed and as per the conditions of the contract he is no longer governed with the terms of the contract agreed upon in covering the risk. In case the breach is discovered at the time of claim he will refuse to honour his promise and will not pay the claim. This again occurs when there has been a deliberate breach.

3) When the breach is innocent but it is material to the fact then the insurer may impose a penalty in the form of additional Premium.

4) Where the breach is found to be innocent and is not

material the insurer can choose to ignore the breach or waive off the breach.

5.7 PRINCIPLE OF INSURABLE INTEREST

One of the essential ingredients of an Insurance contract is that the insured must have an insurable interest in the subject matter of the contract. Insurance without insurable interest would be a mere wager and as such unenforceable in the eyes of law.

The subject matter of the Insurance contract may be a property, or an event that may create a liability but it is not the property or the potential liability which is insured but it is the pecuniary interest of the insured in that property or liability which is insured.

The concept is the basis of the doctrine of insurable interest and was cleared in the case of Castellain v/s Priston in 1883 as follows.

“What is it that is insured in a fire policy? Not the bricks and materials used in building the house but the interest of the Insured in the subject matter of Insurance.”

The subject matter of the contract is the name given to the financial interest, which a person has in the subject matter and it is this interest, which is insured.

Insurable Interest is defined as

“The legal right to insure arising out of a financial relationship recognized under the law between the insured and the subject matter of Insurance”.

There are four essential components of Insurable Interests

1) There must be some property, right, interest, life, limb or potential liability capable of being insured.
2) Any of these above i.e. property, right, interest etc. must be the subject matter of Insurance.
3) The insured must stand in a formal or legal relationship with the subject matter of the Insurance. Whereby he benefits from its safety, well-being or freedom from liability and would be adversely affected by its loss, damage existence of liability.

4) The relationship between the insured and the subject matter must be recognized by law.

5.8 HOW IS INSURABLE INTEREST CREATED

There are a number of ways by which Insurable Interest arises or is restricted.

(a) By Common Law: Cases where the essential elements are automatically present can be described as Insurable Interest having arisen by common law. Ownership of a building, car etc, gives the owner the right to insure the property.

(b) By Contract: In some cases a person will agree to be liable for something which he would not be ordinarily for. A lease deed for a house for example may make the tenant responsible for the repair and maintenance of the building. Such a contract places the tenant in a legally recognized relationship with the house or the potential liability and this gives him the insurable interest.

(c) By Statute: Sometimes an Act of the Parliament may create an insurable interest by granting some benefit or imposing a duty and at times removing a liability may restrict the Insurable Interest.

Insurable Interest is applicable in the Insurance of property, life and liability.

In case of property Insurance, insurable interest arises out of ownership where the owner is the insured but it can arise due to other situations & financial interests which gives a person who is not an owner, insurable interest in the property and some of the situations are listed below.

(i) Mortgagee and Mortgagers:

The practice of Mortgage is common in the area of house & vehicle purchase. The mortgagee is the lender normally a bank or a financial institution, and the mortgager is the purchaser. Both have an insurable interest; The mortgager because he is the owner and the mortgagee as a creditor with insurable interest limited to the extent of the loan.

(ii) Bailee:

Bailee is person legally holding the goods of another, may be for payment or other reason. Motors garages and watch repairers have a responsibility to take care of the items in their custody and this gives them an insurable interest even though he is not owner.

(iii) Trustees:

They are legally responsible for the property under their charge and it is this responsibility which gives rise to insurable interest.

(iv) Part Ownership:

Even though a person may have only part interest in a property he can insure the entire property. He shall be treated as a trustee or the co-owners; and in the event of a claim he will hold the money received by him in excess of his financial interest in trust for the others.

(v) Agents:

When the principal has an insurable interest then his agent can insure the property.

(vi) Husband & Wife:

Each has unlimited interest in each others life and hence they have an insurable interest in each others property.

These parties can insure each others lives as they stand to lose in the event of death of any of them.

(vii) Creditor:

Similarly a creditor may lose financially if a debtor dies before paying the loan so the creditor gets an Insurable Interest in the life of the debtor to the extent of the loan amount.

(viii) Liability:

In Liability Insurance a person has insurable interest to the extent of any potential liability which may be incurred due to damages and other costs. It is not possible to foretell how much liability or how often a person may incur liability and in what form or shape it arises. In this way Insurable Interest in Liability Insurance is different than

Insurable Interest in life & property - where it is possible to predetermine the extent of Insurable Interest.

Therefore in liability assurance the insured is asked to choose the amount of sum insured as the maximum figure that he estimates is ever likely to be required to settle the liability claims.

5.9 WHEN SHOULD INSURABLE INTEREST EXIST

(i) **In Life Insurance** Insurable Interest must exist at the time of inception of Insurance and it is not required at the time of claim

(ii) **In Marine Insurance** Insurable Interest must exist at the time of loss / claim and it is not required at the time of inception.

(iii) **In Property and other Insurance** Insurable Interest must exist at the time of inception as well as at the time of loss/ claims.

Other Salient Features of Insurable Interest

(i) **Insurable Interest of Insurers** Once the Insurers have accepted the liability they derive an insurable interest, which arises from that liability thus they are free to insure a part or whole of the risk with another insurer. This is done by reinsurance.

(ii) **Legally Enforceable** The Insurable Interest must be legally enforceable. The mere expectation that one may acquire insurable interest in the future is not sufficient to create insurable interest.

(iii) **Possession** Lawful possession of property together with its responsibility creates an insurable interest

(iv) **Criminal Acts** A person cannot avail benefits from Insurance to cover penalties because of a criminal act but Insurance to take care of civil consequences arising out of his criminal act can be done. This is applicable in the case of motor Insurance where a driver found guilty of an offence which is involved in an accident receives the claim for damage to his own car and also liability incurred due to damage to another's property but he shall not be insured for the amount of penalty that was imposed for his offense.

Notes

(v) Financial Value Insurable interest must be capable of financial evaluation. In the case of property and liability incurred it is easily evaluated but in life it is difficult to put a value on the life of a person or his spouse and this depends on the amount of premium the individual can bear. However in cases where lives of others is involved a value on life can be placed i.e. creditor can put a value on the life of debtor restricted to the extent of the loan.

Employers have an insurable interest in the lives of their employees because if the employee dies there will be cost on training of the replacement and in the case of death of a key employee there may be loss of income as well. The amount of insurable interest cannot be exactly determined but it should be reasonable and proportionally related with salary of an employee; contribution level of a key personal or equity contribution in case of partners.

Assignment of policies is possible but normally not without the permission of the Insurer because it can mean a change in the underwriting consideration as the new policyholder may not have the same insurable interest.

Fire and other Misc. policies are not freely assignable as the Insurer at the time of underwriting has satisfied himself about the Insureds attitude or treatment of the subject matter and its loss causing capability. This would however change in the case of an assignee and it is reasonable to give the insurer a chance to consider the credentials of the new proposer. **When the Insurer gives his consent to the assignment of the policy a new contract is in fact being entered into and this is called NOVATION.**

Marine cargo policies are however freely assignable without the knowledge or the consent of the Insurer the reason being that the ownership of the goods insured frequently change when the goods are still in transit and it is necessary that the benefit of the policy passes to the new owner.

In some cases only the proceeds of the policy are assigned. There is normally no objection to such assignments as the assured is still a party to the contract with the insurer and he has to continue to comply with all the terms and conditions of the policy with the only difference being that in event of a claim the insurer is directed to pay the amount to the Assignee.

Insurers protect themselves by taking a receipt from the person receiving the amount discharging the Insurer from any further liability. This condition arises often in motor claims when bills of repair are directly paid to the garage and not the owner of the vehicle. In these cases the garage owners obtain a letter of satisfaction from the owner and submit his bills to the Insurer directly for payment.

INTEXT QUESTION 5.1

1. Can you insure you house under residential building where you are storing fire works item without disclosing it to insurance company?

2. Can you take insurance policy of Red Fort situated at Delhi?

5.10 PRINCIPLE OF INDEMNITY

Indemnity according to the Cambridge International Dictionary is "Protection against possible damage or loss" and the Collins Thesaurus suggests the words "Guarantee", "Protection", "Security", "Compensation", "Restitution" and "Re-imbursement" amongst others as suitable substitute for the word "Indemnity". The words protection, security, compensation etc. are all suited to the subject of Insurance but the dictionary meaning or the alternate words suggested do not convey the exact meaning of Indemnity as applicable in Insurance Contracts.

In Insurance the word indemnity is defined as **"financial compensation sufficient to place the insured in the same financial position after a loss as he enjoyed immediately before the loss occurred."**

Indemnity thus prevents the insured from recovering more than the amount of his pecuniary loss. It is undesirable that an insured should make a profit out of an event like a fire or a motor accident because if he was able to make a profit there might well be more fires and more vehicle accidents.

As in the case of Insurable Interest, the principle of indemnity also relies heavily on the financial evaluation of the loss but in the case of life and disablement it is not possible to be precise in terms of money.

Notes

An Insurance may be for less than a complete indemnity but it may not be for more than it. To illustrate let us take the example of a person who insures his car for Rs.4 lacs and it meets with an accident and is a total loss. It is not certain that he will get Rs.4 lacs. He may have over valued the car or may be the prices of cars have fallen since the policy was taken. The Insurer will only pay an amount equal to the value of the car at the time of loss. If he finds that a car of the same make and model is available in the market for Rs.3 lac then he is not liable to pay more than this sum and payment of Rs.3 lacs will indemnify the Insured.

Similarly in the case of partial loss if some part of the car needs to be replaced the Insurer will not pay the full value of the new part. He shall assess how much the old part had run and after deduction of a proportionate sum he shall pay the balance amount. An insured is not entitled to new for old as otherwise he would be making a profit from the accident.

However there are two modern types of policy where there is a deviation from the application of this principle.

One is the agreed value policy where the insurer agrees at the outset that they will accept the value of the insured property stated in the policy (sum insured) as the true value and will indemnify the insured to this extent in case of total loss. Such policies are obtained on valuable pieces of Art, Curious, Jewellery, Antiques, Vintage cars etc.

The other type of policy where the principle of strict indemnity is not applied is the Reinstatement policy issued in Fire Insurance. Here the Insured is required to insure the property for its current replacement value and the Insurer agrees that in the event of a total loss he shall replace the damaged property with a new one or shall pay for the replacement in full.

Other than these there are Life and Personal Accident policies where no financial evaluation can be made. All other Insurance policies are subjected to the principle of strict Indemnity. In most policy documents the word indemnity may not be used but the courts will follows this principle in case of any dispute coming before them.

5.10.1 HOW IS INDEMNITY PROVIDED?

The Insurers normally provide indemnity in the following manner and the choice is entirely of the insurer

1) Cash Payment
2) Repairs
3) Replacement
4) Reinstatement

1. Cash Payment

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

2. Repair

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

3. Replacement

This method of Indemnity is normally not preferred by Insurance companies and is mostly used in glass Insurance where the insurers get the glass replaced by firms with whom they have arrangements and because of the volume of business they get considerable discounts. In some cases of Jewellery loss, this system is used specially when there is no agreement on the true value of the lost item.

4. Reinstatement

This method of Indemnity applies to Property Insurance where an insurer undertakes to restore the building or the machinery damaged substantially to the same condition as before the loss. Sometimes the policy specifically gives the right to the insurer to pay money instead of restoration of building or machinery.

Reinstatement as a method of Indemnity is rarely used because of its inherent difficulties e.g., if the property after restoration fails to meet the specifications of the original in any material way or performance level then the Insurer will be liable to pay damages. Secondly, the expenditure involved in restoration may be much more than the sum Insured as once they have agreed to reinstate they have to do so irrespective of the cost.

Limitations on Insurers Liability

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

2. Property Insurance is subjected to the **Condition of Average.** The underlying principle behind this condition is that Insurers are the trustees of a pool of premiums from which they meet the losses of the few who suffer damage, so it is reasonable to conclude that every Insured should bring a proper contribution to the pool by way of premium. Therefore if an insured deliberately or otherwise underinsures his property thus making a lower contribution to the pool, he is not entitled to receive the full benefits.

The application of this principle makes the insured his own Insurer to the extent of under-insurance i.e. the pro-rata difference between the Actual Value and the sum insured. The amount of loss will be shared between the Insurer and the insured in the proportion of sum insured and the amount underinsured. The formula applicable for arriving at the amount to be paid by the Insurance Co. is

Claim = Loss X (Sum Insured / Market Value)

Example

Mr. Sudhir Kumar has insured his house for Rs.5 lacs and suffers a loss of Rs.1 lac due to fire. At the time of loss the surveyor finds that the actual market value of the house is Rs.10 lacs. In this case applying the above formula the claim will be as under:

Loss = 1 lac   sum insured = 5 lacs   Market Value = 10 lacs

Therefore, 1 lac X 5 lacs / 10 lacs = 50,000/-

Claim = Rs 50,000/-

5.11 COROLLARIES OF INDEMNITY

There are two corollaries to the principle of Indemnity and these are Subrogation and Contribution.

1. Subrogation

It has already been established that the purpose of Indemnity is to ensure that the Insured does not make a profit or gain in any way as a consequence of an accident. He is placed in the same financial position, which he had occupied immediately before the loss occurred.

As an off shoot of the above it is also fair that the insurer having indemnified the insured for damage caused by another (A Third Party) should have the right to recover from that party the amount of damages or part of the amount he has paid as indemnity.

This right to recover damages usually lies with the bereaved or injured party but the law recognises that if another has already paid the bereaved or injured party then the person who has paid the compensation has the right to recover damages.

In case the insured after having received indemnity also recovers losses from another then he shall be in a position of gain which is not correct and this amount recovered from another shall be held in trust for the insurer who have already given indemnity. Subrogation may be defined as **the transfer of legal rights of the insured to recover, to the Insurer.**

CASE STUDY -

Why Subrogation is called a corollary of Indemnity and not treated as a separate basic Principle of Insurance can be traced to the judgement given in the case of Casletlan V Preston (1883) in U.K.

"That doctrine (Subrogation) does not arise upon any terms of the contract of Insurance, it is only the other proposition, which has been adopted for the purpose of carrying out the fundamental rule i.e. indemnity. Which I (Judge) have mentioned "it is a doctrine in favour of the underwriters or insurers, in order to prevent the insured from recovering more than a full indemnity; it has been adopted solely for that reason."

Subrogation does not apply to life and personal accidents as these are not contracts of Indemnity. In case death of a person is caused by the negligence of another than the legal heirs of the deceased can initiate proceedings to recover from the guilty party in addition to the policy proceeds.

If the insured is not allowed to make profit the insurer is also not allowed to make a profit and he can only recover to the extent he has indemnified the Insured.

Subrogation – How?

Subrogation can arise in 4 ways

(i) Tort

(ii) Contract

(iii) Statute

(iv) Subject matter of Insurance

(i) Tort: When an insured has suffered a loss due to a negligent act of another then the Insurer having indemnified the loss is entitled to recover the amount of indemnity paid from the wrongdoer.

The Insured has a right in Tort to recover the damages from the individuals involved. The Insurers assume these rights and take action in the name of the insured and take his permission before starting legal proceedings.

Another reason for seeking permission of the insured is that the Insured may be having another claim which was not insured arising from the same incident which he may wish to include because the law allows one to sue a person only once for any single event.

(ii) Contract: This can arise when a person has a contractual right to compensation regardless of a fault then the Insurer will assume the benefits of this right.

(iii) Statute: Where the Act or Law permits, the insurer can recover the damages from Government agencies like the

Risk (Damage) Act 1886 (UK) gives the right to insurers to recover damages from the District Police Authorities in respect of the property damaged in Riots which has been indemnified by them.

(iv) Subject Matter of Insurance: When the Insured has been indemnified and the property treated as lost he cannot claim salvage as this would give him more than indemnity. Therefore when Insurers sell the salvage as in the case of damaged cars it can be said that they are exercising their right of subrogation.

Subrogation – When?

According to common law the right of subrogation arises once the Insurers have admitted the claim and paid it. This can create problems for the Insurers as delay in taking action could at times hamper their chance of recovering the damages from the wrongdoer or it could be adversely effected due to any action taken by the Insured. To safeguard their rights and to ensure that they are in control of the situation from the beginning Insurers place a condition in the policy giving themselves subrogation rights before the claim is paid. The limitation is that they cannot recover from the third party unless they have indemnified the insured but this express condition allows the insurer to hold the third party liable pending indemnity being granted.

Many individuals having received indemnity from the Insurer lose interest in pursuing the recovery rights they may have. Subrogation ensures that the negligent do not get away scot free because there is Insurance. The rights which subrogation gives to the Insurers are the rights of the Insured and it places certain obligations on the Insured to assist the Insurers in enforcing their claims and not to do anything which would harm the Insurers chances to recover losses.

2. Contribution

Contribution is the second corollary of Indemnity.

An individual may have more than one policy on the same property and in case there was a loss and he were to claim from all the Insurers then he would be obviously making a profit out of the loss which is against the principle of Indemnity. To prevent such a situation the principle of contribution has been evolved under common law.

Notes

Contribution may be defined as the "**right of Insurers who have paid a loss to recover a proportionate amount from other Insurers who are also liable for the same loss".** The common law allows the insured to recover his full loss within the sum insured from any of the insurers.

Condition of Contribution will only arise if all the following conditions are met:

1) Two or more policies of Indemnity should exist
2) The policies must cover a common interest
3) The policies must cover a common peril which is the cause of loss
4) The policies must cover a common subject matter
5) The policies must be in operation at the time of loss

It is not necessary that the policies be identical to one another. What is important is that there should be an overlap between policies, i.e. the subject matter should be common and the peril causing loss should be common & covered by both.

As said earlier common law gives the right to the insured to recover the loss from any one insurer who will than have to effect proportionate recoveries from other insurers, who were also liable to pay the loss. To avoid this the Insurers modify the common law condition of contribution by inserting a clause in the policy that in the event of a loss they shall be liable to pay only their "Rate-able proportion" of the loss. It means that they will pay only their share and if the Insured wants full indemnity he should lodge a claim with the other Insurers also.

Rateable Proportion

The accepted way to interpret the term Rate-able Proportion is exhibited. First being that the Insurers should pay in the proportion to the sum insured for example

Sum Insured Policy A	=	10,000/-
Sum Insured Policy B	=	20,000/-
Sum Insured Policy C	=	30,000/-
Total	=	60,000/-

In case of a claim of Rs.6000/- the three insurers would be liable to pay in the proportion 1:2:3 i.e. 'A' pays Rs.1000/- 'B' pays Rs.2000/- and 'C' pays Rs.3000/-.

However, the draw back of this simplistic method is that the terms and conditions of the policies may be different and it would not be prudent to ignore these terms and conditions. For example, the condition of average may apply to one or more policies or there may be an excess clause in one policy which may effect their share of contribution to the loss. It would therefore be correct to assess the loss as per the terms and conditions of the individual policy and pay the claims accordingly. If by following this method the total sum of the liability of the Insurers is more than the claim amount then the Insurers shall pay in proportion to the amount of liability of each.

5.12 PROXIMATE CAUSE

There are three types of perils related to a claim under an Insurance policy

(1) **Insured Perils:** These are the perils mentioned in the policy as being insured e.g. Fire, lightening, storm etc. in the case of a fire policy

(2) **Excepted Perils:** These are the perils mentioned in the policy as being excepted perils **or excluded perils** e.g. Riot strike, flood etc. which may have been excluded and discount in premium availed.

(3) **Uninsured Perils:** Those not mentioned in the policy at all either in Insured or excepted perils e.g. snow, smoke or water as perils may not be mentioned in the policy.

Insurers are liable to pay claims arising out of losses caused by Insured Perils and not those losses caused by excepted or Uninsured perils.

Example: If stocks are burnt then the cause of loss is fire which is an Insured Peril under a fire policy and claim is payable. If the stocks are stolen the loss would not be payable as Burglary is not an Insured peril covered in fire policy Burglary policy is needed to take care of 'theft'.

It is therefore important to identify the cause of loss and to see if it is an Insured peril or not before admitting a claim.

Need to Identify Proximate Cause

If the loss is brought about by only one event then there is no problem in settlement of liability but more often than not the loss is a result of two or more causes acting together or in tandem i.e. one after another. In such cases it is necessary to choose the most important, most effective and the most powerful cause which has brought about the loss. This cause is termed the Proximate Cause and all other causes being considered as "remote". The proximate cause has to be an insured peril for the claim to be payable.

The following illustration may help in distinguishing between the proximate cause and the remote cause.

I. "A person was injured in an accident and was unable to walk and while lying on the ground he contracted a cold which developed into pneumonia and died as result of this. The court ruled that the proximate cause of death was the accident and Pneumonia (which was not covered) was a remote cause and hence claim was payable under the Personal Accident Policy."

II. "A person injured in an accident was taken to a hospital where he contracted an infection and died as a result of this infection. Here the court ruled that infection was the proximate cause of death and the accident was a remote cause and hence no claim was payable under the Personal Accident Policy.

The Meaning of Proximate Cause

The doctrine of proximate cause is based on the principle of cause and effect, which states that having proved the effect and traced the cause it is not necessary to go any further i.e. cause of cause. The law provided the rule "Cause Proxmia non Remote spectator". The **immediate cause and not the remote one** should be taken into consideration.

Therefore the **proximate cause should be the immediate cause. Immediate does not mean the nearest to the loss in point of time but the one most effective or efficient.** Thus if there are a number of causes and the proximate cause has to be chosen the choice should be of **the most predominant and efficient cause i.e. the cause which effectively caused the result.**

Proximate cause has been defined as **"The active efficient cause that sets in motion a train of events which bring about a result without the intervention of any force started and working actively from a new and independent source".** (This definition comes from the ruling given in the case Pawsey v/s Scottish Union and National Insurance Co. (1907).

It is important to note that in **Insurance Proximate has got nothing to do with time even** though the Dictionary defines Proximity as 'The state of being near in time or space' (period or physical) and the Thesaurus given the alternate words as "adjacency of" "closeness", "nearness" "vicinity" etc. **But in Insurance Proximate cause is that which is Proximate in efficiency. It is not the latest but the direct, dominant, operative and efficient cause.**

Losses can occur in the following manners:

i. Loss due to a single cause.

ii. A series or chain of events one following and resulting from the other causing the loss

iii. A series or chain of events which is broken by a new event independently from a different source causing the loss – Broken sequence and

iv. A contribution of two or more events occurring simultaneously and resulting in loss

1) In the case of a single cause being the cause of loss then if that peril is covered the claim is payable and if not covered claim is not payable.

2) Loss due to a series or chain of events. This can be illustrated by the following example event.

a) A driver of a car meets with an accident

b) As a result of the accident he suffers from concussion (shock)

c) Because of the concussion he strayed around not aware where he was going

d) While straying he fell into a stream

e) He died of drowning in the stream

It is clear that the above is a chain of events one leading to the other. The proximate cause would be accident (covered under PA Policy) which resulted in concussion (Disease – not covered) and hence the claim would be payable.

Irrespective of the fact that subsequent causes are covered or not if it is established that the event starting the chain is a covered peril then claim is payable.

However if reverse were the case and the chain was started by an excepted or excluded peril then the claim would not be payable.

For e.g. A person suffers a stroke and falls down the steps resulting in his death. He will not be entitled to any claim under his personal accident policy as the chain was started by a stroke which is an excepted peril.

3. In case of the Broken sequence or Interrupted chain of events if the chain of events is started by an Insured peril but interrupted by an excepted or excluded peril then the claim is paid after deducting the damage caused by the excluded peril. For example, the burglars enter the house and leave the gas stove on leading to a fire and the house is damaged in the fire. The "burglary Insurance" will only pay for the loss due to theft but exclude loss due to fire, which is accepted peril under the burglary policy.

   In case the sequence of events started by an excluded peril is broken by an Insured peril, as a new and independent cause then there is a valid claim for even the damage caused by exempted peril. The burglars enter the house and after carrying out thefts put the house on fire. The fire policy will pay for the damages due to theft as well (which is an excluded peril).

4. In the case of loss due to concurrent causes or two or more causes occurring simultaneously then all the causes will have to be Insured perils only then the claim would be payable but even if one of the causes is an excluded peril the claim will not be payable.

Example: A house collapses due to an earthquake, which results in fire. Under the fire policy earthquake is not a covered risk, hence the claim will not be payable.

To really understand the complexities of Proximate cause and its proper identification one must go through the case studies and a few are being given hereunder.

Notes

Case Studies:

Example I

An army officer insured under a personal accident policy, which excluded accident directly or indirectly due to war during war time went to the railway line to inspect the sentries. While on the visit he was hit by a train and he died as a result of the accident. It was ruled that the policy did not cover as he was there on the line because of the war and the policy did not cover accident due to war.

Example II

A surveyor on surveying a factory damaged in a fire came to the conclusion after detailed investigation that the fire was caused by negligence as well as defective design and both these causes worked together to cause the damage. While the Insurance policy covered negligence it did not cover Defective Design and hence claim was denied.

Example III

In an incident where stocks of potatoes kept in a cold storage got damaged due to leakage of ammonia gas. The stock was insured against contamination / Deterioration / putrefaction due to rise in temperature in the refrigeration chamber caused by any loss or damage due to an accident. The Insurance company did not pay the claim saying that the leakage of gas was not accidental and hence the risk was not covered. The aggrieved approached the consumer forum which held that the leakage of gas was not foreseen or premeditated or anticipated and loosening of the nuts and bolts of the flanges. The consequential escape of gas was within the meaning of the word accident and hence ordered the Insurance Co. to pay the claim.

5.13 SUMMARY

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

5.14 TERMINAL QUESTIONS

1. Explain the relationship between the doctrine of indemnity and the principle of insurable interest.

2. How does the principle of subrogation suplement the doctrine of indemnity?

3. Explain the presence of insurable interest in various general insurance contracts.

5.15 OBJECTIVE TYPE QUESTIONS

1. When there is a fraudulent non disclosure of material facts the insurance contracts becomes:

   a. voidable b. illegal

   c. unenforceable d. Void

2. The legal right to insure means

   a. Competence to enter into contract

   b. Insurable interest

   c. Utmost good faith

   d. Consideration

3. The principle of indemnity is applied in practice through

   a. Franchise deduction b. Deduction & depreciation

   c. Extra premium d. Excess clause deduction

4. Methods of providing indemnity are

   a. cash payment b. repair

   c. Replacement d. All

5. Statement A: The proposer need not to disclose facts which considers as not material

   Statement B: Facts which are common knowledge which the insurer is expected to need not be disclosed.

   a. Only A is true b. Only B is true

   c. Both are true d. Neither of two

6. Which of the following principles of law prevents an insured from making a profit out of his loss

    a. Insurable interest b. Caveat emptor

    c. Utmost good faith d. Indemnity

7. Statement A: The existence of other insurance must be disclosed.

    Statement B: Facts of law need not be disclosed.

    a. Only A is true b. Only B is true

    c. Both are true d. Neither of two

8. Insurable interest can be created

    a. by common law b. by statute

    c. by contract d. all of the above

5.16 ANSWERS TO INTEXT QUESTION

5.1

1. No you cannot insure your house under residential building because you are storing fire hazard material and if any claim arises then no claim will be payable.

2. No, you are not the owner of Red Fort.

    a. Only A is true b. Only B is true

    c. Both are true d. Neither of two

3. Insurers are liable to pay claims arising out of losses caused by

    a. insured perils b. uninsured perils

    c. excluded perils d. All

5.17 ANSWERS TO OBJECTIVE TYPE QUESTION

5.15

1. d 2. b

3 b 4. d

5. b 6. d

7. a 8. d

6

PECULIARITIES OF INSURANCE CONTRACTS

6.0 INTRODUCTION

So far you have studies that the Insurance contract is a contract of indemnity. The contract of Insurance is a contract in which an insurer, in consideration of a premium agrees with an insured either to indemnify him against loss caused by a risk insured against or to pay him an agreed sum of money on the happening of specified events.

The Insurance contract is unique in the sense that in addition to the contract meeting the six common conditions of commercial contracts, it is also subject to 4 special features i.e. Utmost Good Faith, Insurable Interest, Indemnity and its two corollaries, subrogation & contribution and proximate cause. The four condition which we studied in detail in the previous chapters (it is to be remembered that in life Insurance contract the special conditions of indemnity and proximate cause are not applicable). But people have misconception about the insurance which have been discussed in this chapter.

6.1 OBJECTIVES

At the end of this lesson you will be able to know:

- How the insurance is different form gambling
- What are other features of the insurance contract?
- How the dispute arises in the insurance contract

Notes

6.3 INSURANCE AND GAMBLING

Some people at times say that Insurance is a gamble, a wager or a bet where the Insured pays a small amount (Premium) to the Insurer company and the Insurer in turn offers to pay a large sum (claim) in case a particular event happens otherwise he keeps the premium. While on the surface it may appear that this is no different then a person placing a small bet on a horse with the chance of getting 10-20 times his money back if that particular horse wins. While it is true that both Insurance and gambling involve money changing hands on the basis of chance events, it is important to understand the difference between the two.

The very act of placing a bet puts a person at risk of losing money. If he had not placed the bet there would be no risk and he would not care less which horse won or not. In Insurance, whether he insures or not, the risk is there and he is exposed to the possibility of a fire damaging his house. Gambling creates the risk whereas Insurance transfers an existing risk from one party to another.

The other differences between Insurance and gambling are

(1) In Insurance, Insurable Interest is a pre-requisite whereas in gambling the interest is limited to the amount to be won or lost.

(2) The Insured is immune from loss and his identity is known before the event whereas in Gambling the loser cannot be identified before the event.

(3) Full disclosure (Utmost Good Faith) is required from both parties to an assurance contract whereas this is not necessary in a gambling contract.

(4) Insurance contract is enforceable at law whereas there is no legal recourse for any of the two parties in a gambling contract.

INTEXT QUESTION 6.1

1. Is insurance contract gambling?

2. Do you agree that the insurance & maintenance contracts are same?

Notes

6.4 OTHER FEATURES OF AN INSURANCE CONTRACT

(a) Aleatory

Insurance contracts are said to be aleatory i.e. the values given up by the parties are unequal. The insurer may pay a large claim in return for a small amount (premium) or he may not pay at all. In either case the change of values are not equal. It is not true to say that an insured will not get anything if there is no claim but what he does receive is freedom from worry whether he sustain a loss or not. The peace of mind and freedom from worry are of far greater worth than the amount of petty premium paid.

(b) Conditional:

The Insurer is not obligated to perform if the conditions set forth in the contract are not met. The Insured does not promise to meet the conditions but he cannot force the Insurer to perform unless he does so. An example of this is the condition in an insurance policy regarding notification of claims that the Insurer be informed of a loss within a stipulated time period. The Insured is not compelled to do so but the Insurer can refuse to keep his promise if the Insured does not comply with this condition. Because of this conditional nature of an Insurance contract the Insured must be fully aware of the conditions of the policy if he is to receive its protection.

(c) Unilateral:

Only the Insurer makes a promise to do something, the insured on the other hand after payment of premium does not make any promises, though he must comply with the conditions if he wants the insurer to perform. He does not promise to meet the conditions, therefore Insurance contracts are said to be unilateral as in contrast to bi-lateral contracts in which both parties make enforceable promises and either party can force the other to perform or pay damages for not performing.

(d) Personal:

Insurance contracts are personal meaning thereby that it is the loss to person and not to the property itself that is insured. You may say your car is insured but actually its you who is insured against financial loss caused by something happening to your car. That is why when a car is sold the Insurance does not automatically pass on to the new owner. It may be assigned but only with the consent of the Insurer because it is the people who are insured and they effect the hazard and Insurer are concerned as much about the person as with the property which may be subject matter of Insurance.

(e) Adhesion:

The Insurance contracts are contracts of Adhesion. Most commercial contracts are formulated after bargaining between the parties to the contract but Insurance contracts are created by the insurers alone and they are presented to the insured and he can take them as they are or leave them. This fact influence the way courts handle disputes regarding contracts of Insurance. The rule is that if there is an ambiguous clause then it will be interpreted in favour of the Insured on the assumption that since the Insurer has worded the contract he should know what he wants to say and write it down clearly.

This is one reason why Insurance contracts are complicated. Failure to state the specifications of what is covered and what is not and that too in a clear manner can prove to be costly for an Insurance company because if there is a difference of opinion the Insurer will be the victim of court interpretation.

6.5 SUMMARY

We have discussed various features of insurance contracts but it does not mean that the disputes will not arise if these features are present. Disputes may be of two categories.

The first is whether a contract exists or not. Was there a contract? Was it in existence at the time of loss?; and these questions concern whether or not the essential condition of a contract have been met i.e. Was the purpose legal?; Was there an offer and acceptance?; Was there a consideration?; Were the parties competent?; Whether conditions of Utmost Good Faith and Insurable interest were complied with or not?.

The second general area of dispute is whether the claim is payable or not and the amount of claim, and these disputes arise from the questions. Was the risk covered?; Has there been any breach of warranty?; Have the conditions to the policy been complied with?; Was the Sum Insured adequate?; Should the conditions of average apply or not?; Whether entire loss was due to cover risk?; etc.

6.6 TERMINAL QUESTIONS

1. What is the difference between a service contract and a contract of insurance?

2. What are other features of insurance contract?

6.7 ANSWERS TO INTEXT QUESTIONS

6.1

1. Gambling creates the risk whereas Insurance transfers an existing risk from one party to another.

2. No, we do not agree with given statement as Maintenance contract is against the expense of the inevitable whereas Insurance contracts are against the expense of the accidental and there is an element of chance, which is a basic requirement of Insurance contracts.

Open Vocational Education Programme

Diploma in Insurance Services

3

PRACTICE OF LIFE INSURANCE

Designed & Developed
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Diploma in Insurance Services

PRACTICE OF LIFE INSURANCE

CONTENTS

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Studying for a vocational course is different from any other academic course. Here, while the marks obtained in the examination will indicate your grasp on your subject knowledge, your real achievement will be when you are able to apply your vocational skills in the market. I hope that this skill-based learning will help you perform your tasks better .This course of One year duration Diploma Course in Insurance Services developed by leading experts of Insurance sector. It is a multi-skilled programme, which will expose you to a variety of skills in Insurance sector. We hope that you will find it useful. On behalf of NIOS, I wish you the very best for a bright and successful future.

Dr. S. S. Jena
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Dear Learner,

In the fast expanding world of activities, learning new skills has become a necessity. Learning and re-learning has become essential for all. In such an environment, vocational education has assumed great importance. Vocational education, as a stream of education, promotes skill development and training of youth and directs them towards meaningful employment.

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We wish you all the best in your future career.

Dr. K. P. Wasnik
Director (VE)
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Dear Learner,

This programme is specially for all those who are school dropouts and have started small enterprises, want to work in the Insurance sector as a skilled workforce and contribute substantially to the progress of India.

The multi-skill content with hands-on experience of this programme stimulates the intellect by going through concrete operations and then abstracting the concepts. At the same time by giving a variety of skills usable in everyday life, allowing them to form their preferences and know their aptitudes thus enabling them to choose a career. It also improves their self-image and gives them confidence and hope for the future.

The Insurance sector has completed its full circle in the year 2000, i.e. Private sector to Public sector and now back to Private sector. After 44 years, the monopoly of Life Insurance Corporation is no more and after 27 years four Public Sector general Insurance companies lost their monopoly. As on date there are 50 life and general insurance companies and few are queue to get license.

These insurance companies need trained manpower to be present on all India basis. To cater the needs of the insurance industry NIOS has designed a course namely "Diploma in Insurance Services" for the students who have minimum qualification of 12th standard.

I*n this module the student will be made familiar with life insurance segment.*

It is very vast subject but the chapters of this module are limited to various life insurance products with their features, advantage and disadvantage. The method of calculating the premium amount for different products vis-a vis the various benefits which can accrue to the life insurance products.

We hope that this programme will help you to carve an niche in your career and play an important role in the society.

With best wishes.

Dr. Ajay Garg
Senior Executive Officer
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2

INSURANCE DOCUMENTS

2.0 INTRODUCTION

Documents are necessary to evidence the existence of a contract. In life insurance several documents are in vogue. The documents stand as a proof of the contract between the insurer and the insured. The major documents in vogue in life insurance are premium receipt, insurance policy, endorsements etc.

2.1 OBJECTIVE

After going through this lesson you will be able to

- Recall the various documents used in life insurance
- Learn the utility of each document.

2.2 NEED FOR INSURANCE DOCUMENTATION

Life insurance is a legally enforceable contract between two parties both of whom are legally qualified to contract. It is therefore, necessary that the terms and conditions of the agreement must be suitably documented in a manner that would make it clear that both parties to the contract are Ad-idem i.e., of the same mind. Ad-Idem means that both the parties understand the same thing in the same sense or are of the same mind on the same subject. There must be consensus or Ad-Idem between the parties to the contract.

This is possible provided all the terms and conditions, rights and duties - privileges and obligations are properly documented in terms which can be clearly interpreted in a court of law. Between two human beings sometime silence means an

Notes

acceptance. But as the insurer is a legal personality entitled to contract verbal discussion between parties to the contract is not possible and hence there is a need for documentation.

Insurance is also a contract of utmost good faith and enforced only in the distant future. It is therefore necessary that the declarations made by both the parties should be put in black and white for future reference. Any suppression, willful and material shall make the contract void. The insured, therefore, has a duty to declare all that he knows about himself, his health, his financial status in answering questions contained in the proposal form and other ancillary documents which may be required by the insurer.

We shall discuss in this chapter the various kinds of documents which become necessary at three stages of a policy –

(1) at the stage of proposal, which if accepted result into a policy,

(2) during the duration of the policy where several alterations may become necessary

(3) at the end of the policy contract when insurer pays the final claim.

2.2.1 Documents needed at the stage of the proposal

2.2.2 Proposal form is the basic format which is filled in by the proposer who wants to take an insurance policy. It can be defined as **the application for insurance.**

A proposal form has three portions

(1) The first gives **details about the proposer**, his name, address, occupation, the details about the type of insurance that he wants to take and the name of the nominee to whom the money is payable in case the policyholder does not survive to take the maturity amount.

(2) The second portion relates to the **details of the insurance policy** that the proposer already possesses, the present health conditions and the personal history of his health, any sickness or accident he might have had.

This is a detailed questionnaire and the proposer is expected to reply to each question truthfully and honestly. A female proposer has to reply to certain additional questions specific to her gender.

Notes

(3) The last portion of the proposal form relates to the **declaration.** Through this declaration, the proposer

(i) affirms the veracity of the statements made in the proposal form in replying to the question

(ii) affirms that he/she has not suppressed, misrepresented or concealed any fact which may be material to the risk

(iii) agrees that this declaration along with the proposal form shall form the basis of the contract and if any information is found to be false the contract will be null and void thus reinforcing the principle of "Uberimma Fides" (Utmost good faith).

(iv) further agrees to take the insurance on the terms and conditions decided by the insurer.

The proposer further agrees to keep the insurer informed of any changes in the position relating to his health or his occupation between now and the issuance of the first premium receipt.

It is thus clear that after the insurer has issued the first premium receipt, the contract is said to have concluded and thereafter the insurer has no right to change the terms of the contract.

However, the insurer has a right to offer any term and condition before the final acceptance of the insurance. For example, in case of a female proposer, the insurer may not agree to accept the risk of the childbirth. In case of certain hazardous occupation like commercial pilots, the insurer may like to exclude the risk to life due to such occupation.

In case of certain deformity, the risk of accident can be excluded. These exclusions of risks are not normal terms of the policy contract and therefore have to elicit consent of the proposer. In case of a substandard health, the insurer may like to accept a reduced risk during the first one or two years of the insurance. The consent of the insured is a must for such limitations to be imposed.

All such special conditions or riders are mentioned in the policy either by an endorsement or attachment to the document. If the insurer has taken a Convertible Whole Life Plan which is to be converted to an endowment plan after 5 years, the necessary condition is endorsed on the policy.

The terms and conditions as mentioned in the policy along with such endorsements as made at the back of the policy govern the insurance contract and are open to be interpreted by a court. However it may be noted that agents confidential report and the medical examination (confidential) report are not part of the contract for insurance.

INTEXT QUESTIONS 2.1

1. What are the different stages where documentation is required?
2 Define Proposal Form.

There are certain other documents which may be required at the proposal stage.

2.2.3 Age proof

Age is an important factor in deciding the quantum of premium against a policy. The document proving the age, i.e. age proof must be reliable and the insured has to undertake as to its truthfulness. An insurer accepts these documents as standard age proof -

1) Certified extract from municipal records, recorded at the time of birth.
2) Certificate of baptism or extract from Family Bible
3) Extract from school or college records.
4) Extract from service register in case of employees - Government or semi government or such other reputed institutions which insist on conclusive evidence of age at the time of recruitment.
5) Identity card issued by Defence department.
6) Marriage certificates issued by Roman Catholic Church.
7) Domicile certificate.
8) Passport.

Non-standard age proofs are those which are comparatively less reliable and therefore the insurer accepts them with a pinch of salt. In other words the insurer takes certain precautions before accepting such age proofs as final.

For example, such age proofs are examined by a senior officer and not accepted as a matter of routine. Another safeguard is to offer a reduced term of policy so that the policy matures at a comparatively early age. The maximum age of maturity may be fixed at a lower age. The insurer even may charge an extra premium to compensate for the possible understatement of age in such age proof.

Such non–standard age proofs are (1) Horoscope, (2) service records of employers other than those mentioned above (3) ESI card, (4) Marriage Certificate in case of a Muslim proposer., 5) Elders Declaration, 6) Self Declaration, 7) Driving Licence, 8) Certificate issued by village panchayat, 9) Electoral role, 10) Ration card.

Age proof is insisted upon for completion of propsoal if the declared age of the proposer is less than 20 or more than 50 or if the sum proposed is quite high, say above one lakh.

2.2.4 Proof of income

This document may become necessary whenever the sum proposed is very high. Normally a sum proposed which is seven to eight times of the declared income is acceptable for insurance. But proposals do come to the insurer when the known source of income of the proposer is much less compared to the amount of insurance desired. A service holder normally does not face this problem as his sources of income are verifiable.

In case of business people, the assessed income is at times much less compared to what is a desirable income for the amount of insurance desired. In such cases the insurer at times calls for assessed income tax returns, or Chartered Accountant's certificate etc. Such precautions are necessary to eliminate the possibility of moral hazard.

2.3 DOCUMENTS NEEDED DURING THE CONTINUANCE OF THE POLICY:

2.3.1 First Premium Receipts and Renewal Premium Receipts

The First Premium Receipt (FPR) is the **confirmation of insurance**. This document is important as it gives the date of assumption of the risk but its value is nil once the policy document has been issued.

2.3.2 Policy Contract

Policy document is a detailed document and it is the **Evidence of the insurance contract** which mentions all the terms and conditions of the insurance. The insured buys not the policy contract, but the right to the sum of money and its future delivery. The insurer on its part promises to pay a sum of money, provided of course the insured keeps its part of promise of paying the installments of premium as scheduled.

The pre-amble to the insurance contract makes the above statement clear and states that this policy is issued subject to the conditions and privileges printed on the back of the policy. The endorsements placed on the policy shall also be part of the policy and it also makes a reference to the proposal form saying that that the statements given in the proposal form are the basis of the contract.

The schedule which is printed on the policy document identifies the office which has issued the policy. It states the name of the policyholder, the date of commencement of the policy, an identification number of the policy called policy number. This number is extremely useful for making any reference to the insurer relating to this policy. This shall avoid needless delay.

Beneficiary's name is also mentioned along with address.

It is necessary to check that it is correct and any mistake should be immediately pointed out for correction. A mistake in the address may misdirect the premium notices and any other future correspondence. It also states the name of the nominee and the date upto which premium has to be paid. The schedule goes on to mention, the type of policy, on the happening of which, the sum assured is payable and to whom it is payable. It of course also mentions when and how long the premium is to be paid.

The policy document is signed by an official of the insurer and dated and stamped as per the provision of the Stamp Act to make it a completely legally enforceable document.

2.3.3 Renewal Premium Receipts

Though it is the duty of the insured to pay the renewal premium on the due date the insurer sends a renewal premium notice to the insured out of courtesy and on receiving the


Notes

premium issues a renewal premium receipt **(RPR)** which is an important document and has to be preserved as it is the only documentary proof that the due payment has been made.

2.3.4 Endorsements

Life insurance policy being a long term contract, it is quite likely that the conditions may so change over the time that an alteration or change in the policy conditions may be required. The insurers normally permit such changes which are in the interest of the policyholders and also simultaneously do not adversely affect the insurer's interest.

It has to be noted however, that the insurer is not authorized to make any change in the conditions of the policy during its continuance except such which has been agreed to in the beginning of the policy. An insurance policy, in this sense is called an unilateral contract.

All such alterations as are discussed hereafter are effected by endorsements on the policy document.

The following alterations are not permitted.

(1) Alterations during the first year,

(2) Alteration from one class of assurance to another where the premium scale is reduced.

(3) Alteration to another plan which is more risk oriented.

(4) Increase in sum assured in the same policy.

The following alterations are allowed

1) Limiting the premium paying period, but date of maturity remaining unaltered;

2) Change in the mode of payment of premium e.g. Half-yearly to yearly or half-yearly to quarterly;

3) Alteration due to age admission, if required, has to be compulsorily done;

4) Alteration or correction in the name of the assured/nominee;

5) Bringing the policy under salary savings scheme;

6) Replacing a limiting clause by an extra premium. For example the first pregnancy clause can be replaced by an one time extra premium of Rs.5/- per thousand;

Notes

7) An extra premium imposed for specific impairment or occupational reasons can be removed or reduced. For example, an extra premium imposed for hernia or hydrocele can be removed after surgical operation. Similarly, an occupational extra premium can be removed, if there is change in occupation to a less hazardous one. However an occupational extra premium cannot be imposed, after the policy has been issued, even if the policyholder takes up a more hazardous job.

All such alterations are effected by an endorsement on the back of the policy or by a separate memo which becomes a part of the policy.

2.3.5 Duplicate policy :

A policy document is a valuable document and can be used for mortgage etc. Loss of policy document does not absolve the insurer from the liability of payment of policy proceeds when the claim arises. The claim can be settled on the claimants, furnishing an indemnity bond jointly with one surety.

If a policy is irrevocably lost, a duplicate policy can be issued, after following a certain procedure. The insurer satisfies itself of the circumstances leading to loss. Being so satisfied the insurer insists upon an advertisement in a news paper, production of an indemnity bond and payment of policy preparation charges and there after a duplicate policy is issued. The duplicate policy is stamped "Duplicate Policy".

2.3.6 Nomination:

Generally nomination is made at the time of taking a policy. In case it is not done, it is possible to make nomination subsequently by an endorsement on the policy. It is also possible to change a nomination subsequently by an endorsement. After marriage, such change in nomination is normally required.

2.3.7 Assignment

An assignment of a policy in favour of another person or institution can be effected by an endorsement on the policy. Re-assignment can also be done by a subsequent endorsement on the same policy.

Notes

As a nomination is automatically cancelled due to an assignment, after re-assignment, it is necessary to make a fresh nomination.

2.3.8 Renewal Notice

Keeping the policy in force is in the interest of the policyholder and also of the insurer. The insured loses the valuable protection that the life assurance policy ensures. The insurer loses because without the renewal premium coming, the heavy expenses which it incurs in the beginning of a policy cannot be compensated. Every insurer will, therefore, take all possible actions to reduce policy-lapses and if lapsed, to get the policy revived.

An insurer therefore sends out regular premium notices even though it is not a legal requirement.

1) Premium notice is usually sent before the due date of the premium. An insurer is not legally obliged to send a premium notice. It is a matter of courtesy and greatly helps the life assured for timely payment of premium.

2) Premium default notice : This notice is sent within 3 months after the due date reminding the policyholder to pay the premium to prevent the policy-lapses.

3) Issue of Final lapse notice : If the premium is not paid within six months of the due date, and the policy is allowed to lapse, this notice is issued to the policyholder requesting him to revive the policy to restore the full insurance cover.

4) Intimation to agent : Agent being vitally concerned with the continuance of a policy, he is also suitably informed every time so that he can contact the policyholder for payment of the premium.

INTEXT QUESTIONS 1.2

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1. What is FPR?

2. What is endorsement?

3. When can a duplicate policy be issued?.

2.4 SUMMARY

Life insurance being a legally enforceable contract, needs to be documented with details of the rights and obligations of the parties to the contract. Proposal form duly filled in and signed by the proposer is the first document which forms the basis of the contract.

Every time, the insured pays the premium, he receives a premium receipt. The premium needs to be paid in time, non-payment of premium leads to policy-lapses. Re-instatement of the cover is called revival of the policy.

If the policy is not revived, the policy can become a paid up policy for a reduced sum assured under certain conditions.

The policy document mentions in detail all the rights and obligations of the policyholder. The agent is advised to explain the various provisions of the policy to the policyholder.

The wordings in the policy document are of technical nature and hence the need for explaining. If there are certain endorsements on the policy, that need to be explained too.

It needs to be explained that the policy is a valuable document and needs to be kept in safe custody and in the knowledge of the close relatives.

2.5 TERMINAL QUESTIONS

1. Which document evidences the contract of insurance?
2. Which document records any changes in life insurance contract?
3. Discuss the contents of Proposal Form
4. Which are the standard age proofs?
5. Why income documents are required to take a policy?
6. What alterations are not allowed in the policy?
7 Discuss the provisions of sending renewal notices.
8 Which are non-standard age proofs?

2.6 OBJECTIVE TYPE QUESTIONS

1. Which one of the following statements is correct?
   a. The policy is the basis of the insurance contract.
   b. The proposal is the basis of the insurance contract.
   c. Both (a) and (b) statements are correct.

d. Both (a) and (b) statements are wrong.

2. Which one of the following statements is correct?

   a. The proposal must be written by the proposer himself/herself.

   b. The proposal can be written by the Agent.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statements are wrong.

3. Which one of the following statements is correct?

   a. The information in the proposal form is used for underwriting.

   b. Wrong information in the proposal form can nullify the insurance contract.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statements are wrong.

4. Which of the following are confidential and will not be given to the proposer?

   a. The medical report.

   b. The agent's confidential report to the insurer.

   c. The medical referee's advice.

   d. All the above.

5. Which one of the following statements is correct?

   a. FPR is the evidence of the insurance contract.

   b. The medical report is the basis of the insurance contract.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statements are wrong.

6. Which one of the following statements is correct?

   a. The FPR is proof of commencement of risk.

   b. Risk does not commence till the policy is signed.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statements are wrong.

7. If a policyholder applies for cancellation of policy soon after he receives the FPR

Notes

a. The full premium will be refunded.
b. The full premium after some small deduction will be refunded.
c. The policy will be treated as lapsed from the next premium due date.
d. He will be debarred from taking any further insurance policies.

8. Which one of the following statements is correct?
   a. FPR is cash receipt.
   b. Renewal Premium cannot be paid without the renewal notice.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.

9. Which one of the following statements is correct?
   a. IRDA has prescribed proposal forms for all insurers.
   b. Renewal premium cannot be paid without the renewal notice.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.

10. Which one of the following statements is correct?
    a. If policy document is lost the insurance contract becomes void.
    b. The family history appears in the personal statement.
    c. Both (a) and (b) statements are correct.
    d. Both (a) and (b) statements are wrong.

2.7 ANSWERS TO INTEXT QUESTIONS

2.1

1. At the time of taking the policy, For any endorsement and at the time of claim
2. Proposal form means where all the particulars of an individual are provided to the insurance company to underwrite the policy.

2.2

1. The First Premium Receipt (FPR) is the confirmation of insurance
2. Endorsement means any alteration in the policy.
3. Insurer insists upon an advertisement in a news paper, production of an indemnity bond and payment of policy preparation charges and there after a duplicate policy is issued.

2.8 ANSWERS OBJECTIVE TYPE QUESTIONS

1. b	2. d
3. c	4. d
5. d	6. b
7. b	8. a
9. d	10. b

Glossary

Proposal form is the basic format which is filled in by the proposer who wants to take an insurance policy.

First Premium Receipt is the confirmation of a concluded insurance contract.

Policy document is the evidence of the insurance contract and is a detailed document which mentions all the terms and conditions of the insurance

Duplicate Policy If a policy is irrevocably lost, a duplicate policy can be issued, after following a certain procedure. The insurer satisfies itself of the circumstances leading to loss. Being so satisfied the insurer insists upon an advertisement in a news paper, production of an indemnity bond and payment of policy preparation charges and there after a duplicate policy is issued. The duplicate policy is stamped “Duplicate Policy”.

Assignment - An assignment of a policy in favour of another person or institution can be effected by an endorsement on the policy. Re-assignment can also be done by a subsequent endorsement on the same policy.

3

LIFE INSURANCE UNDERWRITING

3.0 INTRODUCTION

Life Insurance Underwriting is the process of accepting the proposal of the customer based on the guidelines formulated by the insurance company. The insurance companies codify a set of procedures which must be followed before accepting any new business. When a new proposal comes to the insurance company its underwriting department scrutinizes the proposal whether or not it fulfills the criteria laid down by the company. If they find any lacunae they ask the agent to get it corrected. It is not that one can get whatever cover one wants. The issue of policy depends on income of the insured and whether he has the capacity to pay the premium over the years. Once the underwriters are satisfied that all the conditions have been fulfilled they go ahead to accept the premium and issue the policy. **Underwriting can be defined as the decision making process during which the company decides whether to insure or not and if yes at what rate**.

3.1 OBJECTIVE

After going through this lesson you will be able to

- Recall the various underwriting procedures
- Remember the points to be considered while examining a proposal

3.2 LIFE INSURANCE IN OPERATION - FROM PROPOSAL TO POLICY

Since life insurance is a financial contract, and a long-term contract and that a contract which may come to be executed when one of the parties to the contract may not exist and may be called upto a court of law in case of dispute in future, it is essential that all the terms and conditions of the contract must be clearly understood and put in writing legibly.

Looking at the importance of the contract combined with the raised expectation of a benefit which is still in the womb of a promise, unstinted trust should be created in the mind of the insured so that he remains confident of its benefit and continues to perform his part of the duty during the continuance of the contract.

The proposal form, as prescribed by the insurer for the type of insurance that the prospect has agreed to buy, must be appropriately selected. The proposer, must go through the proposal column by column, appreciate the meaning and importance of each information sought and fill it up legibly and completely.

Hyphens and obliques, dittos and blanks should be avoided as they are likely to be misunderstood or can be misused. An incomplete proposal leads to further queries and in the process a lot of valuable time and effort is wasted.

While different insurance companies will have different formats for the proposal form the points on which information is sought, are substantially the same.

Wherever medical report is required, the medical examiner is required to endorse the answers to the questions relating to personal history and personal health as stated in this form. If no medical report is required, the life proposed has to give additional information about his physical measurements as required.

However, most insurers insist upon medical reports only in cases where either the sum assured is very high, or the life proposed is beyond certain age limit or the plan of insurance carries a lot of risk element. We shall discuss these points later on in this chapter. However it is sufficient to state here that a medical report has to be given by a company approved medical examiner.

Medical examination has to be conducted at a well-equipped clinic. A lady life has to be examined by a lady doctor only. The medical examiner should not be related to the life proposed

Notes

and the report should be submitted confidentially to the insurer who pays for the medical examination. However, if the prospect decides ultimately not to go ahead with the completion of the proposal, he bears the cost of the medical examination and the initial deposit is refunded less this cost.

Every insurance company has its own policy as to the need for the medical report and therefore company rules must be consulted before taking the life proposed to the doctor.

The insurer may also ask for special reports like X-ray, ECG, Blood Sugar Test etc. after examining the proposal. There are also standard rules for obtaining these reports depending upon age at entry, sum under consideration or personal history of illness etc. These circumstances are provided in the company manual.

The cost of these special reports is initially paid by the prospect but it is reimbursable by the insurer, after the proposal is completed. The rates of payment for these reports are fixed by the insurers in advance and these reports are confidential and are the property of the insurer irrespective of who ultimately pays for those reports.

A host of other documents are required depending upon special need. While the prospect has the obligation to disclose all information about himself relating to his health, habit and occupation, the agent has the responsibility of being circumspect, see the overall posture of the prospect, to note any obvious physical deformity, appearance and physical environment of his residence or work place to know about his financial standing.

The amount of Insurance should commensurate with the income. Too much of insurance may mean a propensity to die early either due to an undisclosed disease or suicide, due to financial problem or family circumstances. Technically this is called moral hazards, which can be uncovered by diligent enquiries made about the prospect by the agent.

Personal statement regarding health declaration- This statement is required at the time of revival of a policy either with or without a medical report depending upon the duration of policy-lapses and physical condition of the life assured. However if there is a delay in completing the proposal say 3 months to one year, the insurer may ask for a statement in the prescribed form.

Notes

Queries regarding occupation - This statement gives a complete picture regarding the extent of hazard, if the life to be assured is engaged in any hazardous occupation like electrical industry or mining or chemical industry etc.

If a policy is to be taken under Married Women's Property Act 1874, to secure the policy money against all other claimants to the estate, prescribed forms are used depending upon the number of beneficiaries and trustees.

For the revival of a children's policy, a separate health declaration is required. Special statements are required, if the proposal has to be financed by a HUF for the benefit of one of its members. If the insurance is to be taken on the life of a key functionary in a company - what is called Keymans' policy, a separate questionnaire is to be filled in by an authorised person of the company.

INTEXT QUESTIONS 3.1

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1. Define Underwriting.
2. When is a health declaration made?
3. When are medical tests needed to be done?

3.3 CLASSIFICATION OF RISKS

The Life Insurance underwriting involves classification of risks affecting the policyholders. The factors that affect risk on the life of an individual is known as hazard. The hazard may be classified as

1) Physical
2) Occupational
3) Moral

3.2.1 Physical hazard

The physical hazard that affects a human life are as follows:-

a) **Age** - The probability of death increases as the age increases. So the premium also increases with the age.

b) **Sex** - The female lives have different underwriting consideration due to various factors such as employment, child birth etc.

c) **Built** - The built of person indicates whether a person is healthy or not. The height, weight and chest measurements helps to find out whether the person is suffering from any ailment or not. Height and weight must be given after taking actual measurement. This gives an idea of the body built. In fact, most insurers publish a chart of desirable height and weight which even medical practitioners follow. This is a product of medico-actuarial study. While writing the height and weight, do not quote from the build-chart. Write the actual measurement only.

d) **Physical Condition** - The Physical condition of the person helps to decide about the premium.

e) **Physical Impairments** - Blindness, deafness and other conditions which are not illness or degenerative are hazards affecting the probabilities of death.

f) **Personal History** - Personal history of illness affects the prognosis. Some diseases leave their mark and may relapse or weaken the resistance. Hence a detailed information regarding present and past illness relating to different body systems is called for. Let it be noted that any affirmative answer regarding any past or present disease does not mean decline of a life cover or extra premium. Most of the common diseases are either ignored or the insurers may advise for a waiting period of 3 to 6 months.

But correct answer must be given so that the insurance cover remains indisputable and security, which is the object of insurance, is guaranteed. Mention the exact disease and the duration if the answer is in the affirmative. Give details of the treatment received. Bodily deformity or previous accident are also important information. Alcohol, drugs are bad for health and habit forming. This is a risk which an insurer would like to avoid unless it is of casual nature. Some insurers treat non-smokers as better than standard lives.

g) **Insurance history** - The next question relates to the insurance history of the proposer. If at any time earlier, any proposal for revival has been declined or considered with certain conditions like extra premium, the underwriters would like to know the reason thereof in order to eliminate the possibility of concealment of any material fact relating to personal history.

h) **Family History** - Family history is another important source of information for the insurer to have a prognosis about the prospect's life. Prognosis as opposed to diagnosis, is a long term estimation about the longevity of the prospect. The children of parents who live to a very ripe old age are supposed to live long.

Diabetes, blood pressure, insanity etc are some of the problems which run in a family. Family members sometimes get infected if some close relatives suffer from infective diseases like tuberculosis. Aids of course is a dread which all insurers would like to avoid. A correct information as far as possible about the family history should be given. Of course, what is not known cannot be declared.

3.2.2 Occupational hazard

We have already explained else where that the nature of occupation has an impact on the life style of the insured. A hazardous occupation calls for special treatment by the insurer either by charging an extra premium or excluding the risk of death due to such hazard. The insurer normally lists out occupations on the basis of the hazard and mentions the special treatment expected.

There is a social angle to this problem of occupational hazard. People working in mines, on electricity poles, or insanitary condition like stone crushers or road cleaning are normally the socially disadvantaged people doing a great service to society. While facing the hazard of their occupation, should they be penalised by paying a higher premium or exclusion of the risk?

Name and address of the present employer is useful for contact and also to appreciate his social standing. Similarly information regarding education, annual income, sources of income and whether the prospect is an income tax payee indicate his social and financial status.

Whenever the proposer is employed in armed forces, his physical health is assured to be excellent. There is a provision for regular medical examination and the army people are categorised on grounds of health. The army personnel can insure without any medical examination for a very high sum assured, a benefit which is not available to the general public.

Notes

3.2.3 Moral hazard

As we have said earlier too much insurance may lead to moral hazard. Insurer, therefore, would like to know how much insurance he is having or going to have. Therefore insurance policies taken through separate proposals or revival of a lapsed policy are important information for undertaking life risk.

3.2.4 Previous Insurance policies

A detailed list of all previous policies has to be provided along with their present status so that the underwriter is able to know the total life cover that this proposer has taken and proposes to take. No insurer would like that anybody should take a fresh insurance immediately after surrendering the previous policy.

As we have explained elsewhere this is bad for all concerned. IRDA has also provided in the agents regulation that no agent shall advise a prospect to take a fresh insurance, if the previous policy has been terminated within a period of six months. Concealment of this fact may affect the validity of the insurance policy.

3.4 FEMALE LIFE

Certain special questions are asked to female proposals relating to pregnancy, and previous history of miscarriages if any. These questions are health related and therefore correct information is relevant to the insurer. Pregnancy is considered an extra risk and particularly first pregnancy. Underwriter takes extra care to cover this risk.

Information relating to husband are important to know about the financial standing of the family vis-a-vis his total insurance. It is true that in case of an insurance proposal on a male life, such questions about wife are not called for. Probably it is a vestige of our social conditions which are extremely important for an insurer.

If husband is insurable and not sufficiently insured, the underwriter would like to know why the wife is proposing for a sum which is higher than that of her husband. It is particularly important if wife has no independent income. Of course if the wife is educated and has her own source of income, inadequate insurance of husband is not very material.

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3.5 PROPOSAL FORM

That this form has to be filled in with utmost care needs no emphasis for this form is the basis of life insurance contract. All the answers must be given completely and legibly and no ambiguity is to be left. All answers should be preferably given in block letters for clarity's sake. The complete address with pin code must be written. If the present address is different from the permanent address, both should be mentioned. Insurance being a long-term contract, one never knows the position say 20 or 30 years hence. A paid up policy is likely to be forgotten.

Sometimes the family members are not aware of the insurance being taken by the breadwinner, who may become victim of a sudden accident. Instances are not unknown when the insurance company traces the life assured through his permanent address which may be in a rural area, where some relatives are staying.

Occupation must be clearly stated so that the nature of the job performed becomes clear. Business, engineer, operator, service etc. are too vague terms to indicate the hazards involved. Of course whenever, special hazard is involved in the occupation, requisite form must be filled in. Any concealment or non-disclosure in this area may lead to the insurance contract being declared void.

3.6 AGE PROOF

Date of birth is important, for premium rate is age dependent. A proposal signed by a minor is invalid. In case of a minor, the risk starts only on attainment of a certain age. Amount of annuity instalment is based upon age and is not much concerned with health. In case premium waiver benefit is desired on a proposal of minor life, proposer's life risk is taken and therefore age proof is a must.

Hence it is advisable that an acceptable and genuine proof of age should accompany the proposal for life insurance. Sometimes proposal is acceptable under certain conditions with an undertaking to submit the age proof at a later date. But such situations should be avoided as non-compliance of the undertaking may lead to various avoidable complications in case of unexpected death of the life assured. Generally school certificate and passport are considered acceptable proofs of age.

3.7 SELECTION OF PLAN AND TERM

The plan should be carefully selected taking into consideration the special need of the life to be insured. A plan well selected generates lot of goodwill for the company which means a lot more business, a lot more income.

Term of course means the period of the plan after which it matures for payment. Here again the need of the proposer alone is to be considered. Term also determines the rate of commission to the agent, but this is of no consideration while canvassing insurance plan and term.

3.8 OBJECTS OF INSURANCE

Objects of insurance can be family provision or old age provision etc. Irrespective of what is stated here, the payment of claim money is decided by the nature of the plan of insurance purchased. There are plans specially designed to provide for the marriage of the female child, maintenance of a handicapped child, a child's insurance to give him the benefits of lower premium etc. Therefore the object stated must match the plan selected.

An endowment plan benefits the family in case of early death of the insured, when the claim money is paid in a lump sum. In case of maturity also, the money is paid in lump sum. However, it is also possible to opt for instalment payment of the lump sum money, in the shape of a pension if option is so exercised in good time, say one year in advance. It is called "settlement option".

A danger inherent in lump sum settlements is though it is most flexible in the hands of the receiver, that the money may be mismanaged, poorly invested or spent foolishly. The surviving beneficiaries of the family need a guaranteed income rather than cash. Of course it is possible to purchase an annuity policy with the cash amount available, even if no such advance arrangement has been made.

3.9 SUM PROPOSED

This is the amount insured and is paid as claim money either on death or maturity along with bonus or guaranteed addition etc. as per the conditions of the policy. As stated earlier, life insurance is not a contract of indemnity and therefore, the claim amount is not related to the financial status of the life assured. It is therefore, advised, while deciding the sum proposed, a proper estimate on lines of Human Life Value theory should be made.

In case, the prospect finds it difficult to pay the required premium for a certain sum assured, which is proper, the agent can select a plan, which permits high sum assured with a low premium like a convertible whole life policy. Alternatively he may keep in continuous contact with the life insured to sell him additional insurance, whenever, his financial situation improves.

In any case, everybody needs a review of his insurance cover from time to time at least for two reasons - One - the income goes up along with the liability in course of time. Two-the continuous inflation in the market, reduces the money value of the insurance over time and therefore additional insurance has to be purchased, at least every five years, to maintain the value of sum assured, at the original rate planned for.

For example, the sum assured of one lakh taken today may find it worth only if compared in terms of its purchasing power ten years from now. The problem is, that as people pay more for goods and services and as their income and wages rise, they often do not increase the life insurance protection to compensate for the other changes. An agent would do well to appreciate this for continuous business.

3.10 ACCIDENT BENEFIT

This part refers to the double accident and permanent disability benefit and for this a small extra premium is charged. We will discuss this benefit a little later. But first let it be known that there is a normal provision for disability benefit allowed in all policies for free and the benefit relates to the waiving of all future premium after the total permanent disability has been caused due to an accident as defined hereafter within stipulated period of the accident and provided the policy is in force.

The Double Accident and Permanent Disability benefit has two parts - one relating to death due to accident and second permanent disability suffered due to such accident.

The benefit payable on the death of the life assured is an additional sum equal to the sum assured, provided the policy was in force at the time of accident and the bodily injury has

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been sustained directly due to an accident caused by an outward, violent and visible means and the death has been caused solely, directly and independent of all other intervening causes, within the stipulated period, due to the bodily injury.

Thus the above definition of accident excludes self injury, attempted suicide, insanity, immorality or when the life assured is under the influence of any liquor, drug etc. The injury suffered by a person while flying in any capacity other than as a passenger without any duty on board is also excluded. So also injury caused during riots, civil commotion, war, mountaineering etc. or while the life assured is committing any breach of law or while in the employment of the armed forces or navigation.

As a general rule, whenever an extra premium is charged due to the hazardous nature of occupation this benefit is excluded, in case the death or disability occurs due to such occupation. So also life assured with physical impairment. The children, male or female are not granted such benefit. Normally an exclusion clause is inserted in the policy document in all such cases.

The permanent disability benefit is the payment of a sum equal to the sum assured, in monthly instalments spread over a period of years. However, if the policy becomes a claim either due to death or maturity, before the expiry of specified years, the balance instalments are paid with the claim.

The second benefit in case of permanent disability in the way of waiving the payment of future premium to the extent of a sum assured specified.

To be eligible for the aforesaid benefit the disability must be the consequence of an accident as defined above and must be total and permanent. In other words the disability must completely disable the life assured from following any occupation or profession in order to earn his livelihood. The insurer must be informed about the happening of this disability with such proof as required and the insurer has a right to examine the disabled person through a medical examiner. However any wrong payment on this count is recoverable by the insurer.

3.11 MODE OF PAYMENT OF PREMIUM

This is an important aspect of selling life insurance because the immediate sacrifice of cost burden to the policyholder can be regulated by selecting carefully the mode of instalment payment. In the prospectus, the insurer prints only annual premiums and if the mode of payment is chosen yearly, a rebate in premium is allowed.

In case the mode selected is half-yearly lesser rebate is allowed. Quarterly rate is exactly one fourth of the published annual rate. Monthly instalments invite 5 % extra. The reason is the higher administrative cost to account for more frequent payments.

Many prospects may find it difficult to pay annual premium in one go. Resistance to sale becomes less, if payment amount can be divided in a number of instalments. However, there is a danger of forgetting such frequent payment causing policy to lapse. It is in the interest of the agent and of the policyholder to ensure that the policy does not lapse due to non-payment of premium.

Modes of payment like payment by bank on a scheduled date or loan from P.F. A/C are other alternatives. For those who are in secured jobs with reputed companies including government, payment of premium through salary savings scheme is possible. In such a case the insurer and the employer enter into an agreement whereby the employer agrees to deduct the premium from the salary of the insured employee who accordingly authorises the employer for the deduction and the employer remits a consolidated amount with a demand note to the insurer.

However this mode of premium payment is not free of its complications. The employer as a third party is involved in payment of premium and thereby keeping the policy in force. If for some reason which may be anything from non-payment of salary to negligence or misappropriation or financial problem of the employer the instalment of premium does not reach the insurer and the claim arises there is a real problem leading to misery and litigation.

In Salary Savings Scheme for keeping the policy in force utmost vigilance on the part of the agent and policyholder is the price to be paid for. From time to time, it has to be assured that

premium is being deducted from salary regularly and it is sent to the insurer with clear identification of each policyholder with policy number and salary number.

Every employer is given a Paying Authority Code at the time of entering into the contract. Similarly each employee has a salary roll number or a badge number by which he is identified by his employer and the department must have a code number for immediate identification. At the time of the proposal a special form in the form of a letter addressed to the employer is signed by the insured employee authorising the employer to deduct the premium from his salary and remitting to the insurer every month.

He undertakes not to revoke this authority to the employer. This authority should be irrevocable just to ensure that insurance premium must get paid regularly without any interruption, which may mean lapse of risk. This scheme has the great advantage of being uninfluenced by the temptation to spend the money if the money comes in hand.

3.12 DECLARATIONS

At the end of the proposal, the proposer makes three declarations which make the answers in the proposal the basis of the insurance contract:

1. The proposer guarantees as to the truthfulness of the information so far it is within his knowledge. Thus the foundation of the basic principle of "utmost good faith'' is laid and the breach of it makes the contract void.

2. The proposer authorises the doctor to divulge all information known to him about the health and habit to the insurer whenever necessary. Thus a doctor giving such information to the insurer at any time, either at the time of proposal or at the time of claim, cannot be held guilty of divulging any confidential information.

3. The third declaration relates to a period between the date of signing the proposal and acceptance of the risk by the insurer. This is a period during which the underwriter has not yet seen the proposal and has, therefore, not undertaken any risk. Any unfavourable incident during this period shall, therefore, materially affect the decision.

The proposal is to be signed in the presence of a witness because that is the legal requirement to enter into a contract. Normally agent should sign as a witness as that is the proper way. If the proposer has signed in a language other than the one in which the questions have been asked in the proposal form, he must declare that he has understood the questions and has answered in his own language.

The person who has explained the questions must also endorse for having done so. However, if the proposer is illiterate and puts his thumb impression, similar declaration is required both by the proposer and the person who has explained the questions. Under no circumstance, the agent should write the answers in the proposal form in his own hand. It is prohibited in the Agents Regulation, 2000.

Section 41 of the Insurance Act states that offer or acceptance of any rebate other than what is permitted in the company prospectus is an offence. However we hope, this provision of law becomes really effective.

Whenever the proposer has to be medically examined by an authorised doctor, the doctor signs the proposal as a proof of having read the proposal form duly filled in. The life proposed signs to establish his identity. The proposal form duly filled in is the basis of contract and no amount of care taken to fill it up is too much. It is rightly compared with the rituals which a couple goes through at the time of marriage. An elaborate ritual is necessary to realise the importance of the relationship. Insurance, establishes a lifetime relationship.

INTEXT QUESTIONS 3.2

1. When is a declaration made?
2. Types of accident benefit.
3. Modes of payment of premium.

3.13 ADVANCE PAYMENT OF PREMIUM

The Sec. 64VB of the Insurance Act 1938 reads as follows : -

1. No insurer shall assume any risk in India in respect of any insurance business on which premium is not ordinarily payable outside India unless and until the premium payable is received by him or is guaranteed to

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be paid by such person in such manner and within such time as may be prescribed or unless and until deposit of such amount as may be prescribed, is made in advance in the prescribed manner.

2. For the purpose of this section, in the case of risks for which premium can be ascertained in advance, the risk may be assumed not earlier than the date on which the premium has been paid in cash or by cheque to the insurer.

   Explanation - where the premium is tendered by postal money order or cheque sent by post, the risk may be assumed on the date on which the money order is booked or the cheque is posted, as the case may be.

3. Any refund of premium which may become due to an insured on account of cancellation of a policy or alteration in its terms and conditions or otherwise shall be paid by the insurer directly to the insured by a crossed order cheque or by postal money order and a proper receipt shall be obtained by the insurer from the insured, and such refund shall in no case be credited to the account of the agent.

4. Where an insurance agent collects a premium on a policy of insurance on behalf of an insurer, he shall deposit with or despatch by post to, the insurer, the premium so collected in full without deduction of his commission within 24 hours of the collection excluding bank and postal holidays.

Life insurance is a contract legally enforceable. No contract is complete without the consideration money and premium is the consideration money against which the insurer promises to fulfill its obligation. As at the beginning of the insurance contract, the insurer incurs certain expenses such as medical test and other administrative expenses, it is necessary that some advance deposit should be made along with the submission of the the proposal form. Life Insurance Corporation of India has fixed certain minimum deposit depending upon the amount of sum assured and the agent is made responsible for its collection.

Normally any insurer expects that the advance deposit should be equal to the first premium subject to a certain minimum.

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If the proposal is accepted, this deposit is adjusted towards the first premium. If the proposer is not willing to complete the proposal for any reason like the policy is rated, i.e., an extra premium is charged, the insurer normally returns the balance amount of this initial deposit after deducting the minimum amount spent towards medical expenses, to the insured and such refund shall in no case be credited to the account of the agent.

Here however, the most important fact is that non-completion of proposal and return of the deposit to the proposer means total futility of the agents' effort. When we buy anything, we pay for it. That is the normal procedure and it is so with life insurance. The agent while canvassing the proposal must make it a point to collect the total first premium after convincing him that the premium is the necessary price to be paid for the benefit of insurance.

The agent being the first underwriter should be able to know whether the insurer will accept the risk at normal rate or with an extra loading. If the insurer is charging an extra premium, it must be for valid reasons and the proposer should be willing to bear this extra expense.

The most compelling reason for getting cash with the application is the matter of putting the insurance in force. A proposal which is acceptable to the insurer and is accompanied with full first premium carries the protection from the date of application. This is a vital consideration for the insured and the beneficiary, since the applicant has no guarantee that he or she shall survive long enough to see the policy issued.

There are too many cases on record where the applicant has died between the date of application and the issue of policy. Even though the advance deposit does mention that this payment does not amount to insurance cover, most insurance companies, would pay the claim, if no other requirements are due from the applicant and the proposer has died after completing all formalities leading to the completion of the proposal.

3.14 SUMMARY

The proposal form is the first document filled in and signed by the proposer with all relevant information. The insurer considers these information and accepts the risk, with suitable conditions. The proposer replies to all the questions honestly and truthfully lest the claim when it arises is not paid. These information relate to his own personal health and family history. Age proof is important. He must nominate somebody to receive the claim when he is no more.

Accident benefit is a rider which is available on payment of a small extra premium. While accepting proposal of insurance from a female life who is not self-earning, the insurer is more circumspect. Agents' confidential report helps the insurer to select a good life for insurance.

Advance payment of premium is a must for the insurer to even consider an insurance proposal. The agent plays important role from the time of canvassing a proposal to the date of payment of claim whenever it arises.

3.15 TERMINAL QUESTIONS

1. Classify the various kinds of risk.
2. What special considerations are required in case of female lives?
3. What are the contents of proposal form?
4. Why object of insurance is necessary?
5. Discuss the various modes of payment of premium.
6. Why premium needs to be piad in advance?
7. Why signing of declaration by proposer is important?

3.16 OBJECTIVE TYPE QUESTIONS

1. What is proposal?
   a. A request for an insurance cover.
   b. An offer to enter into a contract.
   c. Both a request and an offer to enter an insurance contract.
   d. None of the above.
2. Moral hazard may be suspected in cases where
   a. The life to be insured is old.
   b. The insurance is for a very large sum insured.
   c. In the both the cases.
   d. None of the above cases.

3. Under the system of non–medical underwriting
   a. There is no restriction on age.
   b. There is no restriction on sum assured.
   c. Only some towns are covered.
   d. There is restriction on both the Sum assured & age.
4. Which one of the following statements is correct?
   a. An underwriter charges extra premium for physical hazards.
   b. An underwriter charges extra premium for moral hazards.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.
5. Which one of the following statements is correct?
   a. The underwriter assesses the risk.
   b. No policy can be issued without underwriter decision.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.
6. Which one of the following statements is correct?
   a. Underwriting is done only when there is a medical examination.
   b. Medical examination is necessary before a policy can be issued.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.
7. Which one of the following statements is correct?
   a. Underwriters are more cautions while considering cases on female lives.
   b. Underwriting are more cautions while considering cases of educated women.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.

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8. Which one of the following statements is correct?
   a. Working women are treated at par with men.
   b. Educated women are treated at par with men.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.
9. Financial underwriting is done to evaluate
   a. The probability of the policy lapsing in future.
   b. The possibility of moral hazard.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.
10. Which one of the following statements is correct?
   a. Underwriting standards are changing.
   b. The underwriting standards of all insurers are the same.
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.

3.17 ANSWERS TO INTEXT QUESTIONS

3.1

1. Underwriting is the process of accepting the proposal of the customer based on the guidelines formulated by the insurance company.
2. This statement is required at the time of revival of a policy either with or without a medical report depending upon the duration of lapsation and physical condition of the life assured.
3. The medical test is required when either the age of prosper or sum insured is high.

3.2

1. At the end of the proposal form the insured makes declaration.

2. Double Accident and Permanent Disability benefit

3. Yearly, Half-yearly, Quarterly and Monthly (Salary Saving Scheme)

Notes

3.18 ANSWERS TO OBJECTIVE QUESTIONS

1. c
2. c
3. d
4. a
5. c
6. d
7. a
8. c
9. b
10. a

4

PREMIUM AND BONUS

4.0 INTRODUCTION

A insurance policy needs to be bought. This comes at a price which is known as premium. Premium is the consideration for covering of the risk of the insured. The insured agrees to pay premium for a particular period based on the sum insured chosen and in return the insurer agrees to pay the sum insured along with bonus accrued under the policy either on death of the policyholder or on maturity of the policy.

Premium needs to be paid in advance and regularly to keep the policy in force. The Insurers share their profit with the insured by giving bonus under the policies. The amount of bonus is given along with the final maturity amount.

4.1 OBJECTIVE

After going through this lesson you will be able to

- Learn the meaning of consideration
- Recall the methods of computation of premium
- Understand the meaning of bonus

4.2 INSURANCE PREMIUM

Premium is the consideration money that a policyholder has to pay in lieu of the benefit that the insurer promises to confer on the happening of the scheduled eventuality. Insurance is a contract and the policyholder /insured and the insurer are the two parties to the contract. Both parties have rights and obligations. Premium forms the obligation on the part of the insured.

4.1.1 Modes of payment of premium

The premium can be paid at one time, when it is called a single premium. It can also be paid in instalments i.e. yearly, half–yearly, quarterly or monthly. Single premiums are rare except in pension plans. Tabular premiums are given in yearly mode. Half–yearly, quarterly and monthly mode instalment is obtained by dividing the tabular premium by 2 or 4 or 12. However before going for this division, one has to allow for certain rebates which are allowed at different rates for different modes under different plans. Insurers allow some rebate on the premium for yearly and half–yearly mode. However this rebate varies from plan to plan.

The instalment premium for quarterly mode is exactly one fourth of the tabular premium. However for monthly mode, an extra addition of 5% to the tabular premium is made before dividing the tabular premium by 12. Premium can also be paid through salary savings scheme which is in fact a monthly mode but for this, no extra is charged.

Premium is always payable in advance. The rebate for yearly and half-yearly mode is given because the insurer earns interest on the advance payment and also because the administrative expenses are reduced because of lesser frequency of issuing renewal premium notices and receipts and maintaining the record.

Similarly rebate is also permitted for large sum assured and these rebates differ from plan to plan.

4.1.2 Important elements in computation of Premium

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

1. Mortality

The mortality tables are prepared by the insurers on the basis of their experience over a number of years. Though the rate of mortality increases with the increase in age, all insurers charge a level premium which remains constant over the entire duration of the policy term. It is the actuarial science which provides the method to assess such increasing risk and convert it into a level premium.

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This prediction or estimation of mortality is true for a very large group of insured people and not for any individual insured. Thus the small premium charged from the total group is used to pay a big sum assured to the unfortunate few who die early. It is also called pooling of resources. Insurance is also known to be a co–operative action.

2. Expenses of management

Any insurer has to incur expenses for conducting the insurance business. These expenses are not of constant nature. They keep on increasing due to inflationary market conditions. Huge expenses are incurred for procurement of new business, for payment of commission to the agent and other incidental expenses like preparation of policy document etc.

Expense is also incurred for servicing of the policies, e.g. collection of renewal premium, valuation to determine bonus payable, payment of Survival Benefit and Death claim and Maturity Benefit etc.

3. Expected yield on investment :

As the above two elements go to increase the premium rate, the expected yield on investment of the collected endowment component of premium goes to reduce the premium rate. However, as the future yield cannot be determined exactly, it is necessary for a prudent insurer to keep a reserve to take care of unexpected fall in the rate of yield.

4.1.3 Risk, Net/Pure Premium

4.1.4 Risk Premium

The pure premium needed to cover the expected risks but with no allowance for expenses, commission or contingencies is to be made. Thus the cost to meet the risk of death for one year at a particular age is known as risk premium. The risk premium is based on the probabilities of death at various ages.

4.1.5 Net Premium or Pure Premium

A net premium is the premium calculated on the basis of the valuation assumptions to provide the contractual benefits at outset. Its calculation only allows explicitly for interest and mortality. Thus the net premium covers the risk factor as well as interest earned on investment of fund by the insurers.Net premium is always less than the risk premium.

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4.1.6. Loading

As explained before the administrative expenses of the insurer have to be borne out of the premium received from the insured. The amount added to the pure premium to cover the administrative expenses is known as loading. When these expenses are added to the net/pure premium it becomes the **gross premium/office premium** which is actually charged from the customer.

4.1.7 Level Premium

Premium keeps on increasing as the age increases and this is the natural premium paying system but it is impractical because the insurer cannot ask the insured to pay extra premium every year and moreover in the latter years the cost of insurance would become unaffordable resulting in lapse of policies. In view of this insurers charge a level premium and the cost is distributed evenly over the period during which premiums are paid. The premium remains the same, and is more than the actual cost of protection in the earlier years of the policy and less than the actual cost in the latter years. The excess paid in the early years builds up the reserve.

4.1.8 Actuarial Valuation

As discussed before premium is calculated based on some assumptions. The experience in future may not be exactly as assessed. So the process of checking the validity of assumptions from time to time is known as actuarial valuation. The main objects of conducting the valuations being:-

Future projections to be made on the basis of past experience

ü Determine the long term consequences.

ü The analysis should always be as thorough as the information allows and not based on superficial appearances.

ü Using Mathematical modeling for handling the interactions of probability and investment return.

ü ¨Further experience should be fed back to aid the subsequent development of the model and the assumptions.

ü In India the Insurance Act requires actuarial valuations to be done every year.

4.1.9 Calculation of Age

The rate table as published by Insurers gives the rate of premium per thousand sum assured, for different ages nearer birthday. The tabular premium is also different for different premium payment terms. In case of whole life policies, as the premium has to be paid for the whole life, the premium is mentioned only for various ages nearer birthday.

Age nearer birthday means that if the actual age is upto 21 years 5 months 29 days the age for the purpose of calculation of premium is to be treated as 21 years only. However if the age is 21 years 6 months or more it is to be taken as 22 years. In other words if the age is 21 years 11 months and 29 days the age is taken as 22 years.

The method for calculation of age is explained by an example:

	Day	Month	Year
Date of calculation	21.	08.	2000
Date of birth	02.	01.	1964
	19.	07.	36

Age is 36 years 7 months and 19 days. Therefore the age last birthday is 36, the age nearer birthday is 37 and the age next birthday is also 37.

Another example:

	Day	Month	Year
Date of calculation	02.	03.	2000
Date of birth	19	09	1964
	13	05	35

Age is 35 years 5 months and 13 days. Therefore the age last birthday is 35, the age nearer birthday is 35 and the age next birthday is 36.

4.1.10 Calculation of premium

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

This can be explained with an example:

Age nearer birthday	-	30 years
Plan of assurance	-	Endowment with profit
Term of assurance	-	20 years
Sum assured	-	Rs. 5,000
Mode of payment of premium	-	Half–yearly.

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

Tabular premium	Rs.53.19
Rebate for Half-yearly mode	Rs.0.79
	Rs.52.40
Adjustment for S.A. 5000	Nil
Balance	Rs.52.40

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

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

If the mode of payment in the above example would have been yearly, we would have reduced Rs.53.19 by 3% i.e. Rs.1.60. Had the mode been quarterly, we would not need any adjustment. Similarly if the mode of payment would have been monthly, we would have increased the tabular premium of Rs.53.19 by 5%.

Similarly if the sum assured would have been Rs. 25000, we would reduce Rs.52.40 by Rs.1/- before multiplying it with the sum assured, i.e. Rs. 25 only and not Rs. 25,000 as the tabular premium is for a sum assured of Rs. 1,000. Similarly if the sum assured would be Rs. 50,000 or more, we would reduce Rs. 52.40 by Rs.2/- before multiplying it by the sum assured, as explained above.

The underwriting decision is always not as simple as is shown in the above example. The underwriting decision may impose many riders, because of which the premium gets increased. These riders may be

(1) due to the extra benefits wanted by the proposer e.g. accident benefit, premium waiver benefit etc.

(2) due to extra risk perceived by the underwriter on the basis of health, occupation or even for reasons of sex.

Let us explain the effect of these riders on the premium by an illustration -

Plan of assurance -	Endowment assurance with profit
Term of assurance	20 years
Mode	Half-yearly
Age nearer birthday	45 years
Sum assured –	Rs. 20,000

Double Accident benefit – Yes @ Rs 1/= per 1,000

Calculation : - Tabular premium for age 45,

Term 20 yrs is Rs.52.19

Adjustment for Hly. Mode @ 1.5% 0.78

Balance Rs. 51.41

Less adjustment for S.A. Rs. 20,000/- Nil

Rs. 51.41

Annual premium for Rs. 20,000 SA i.e. (Rs. 51.41 x 20)

Rs. 1028.20

Add extra for Double accident benefit

which is Rs.1/- per thousand for Rs. 20,000 Rs. 20.00

Annual premium for Rs. 20,000

with DAB Rs. 1,048.20

Half-yearly instalment premium Rs. 524.10

Rounded upto the nearest rupee Rs. 524.00

The rates of extra premium for the extra benefits like double accident benefit or premium waiver benefit are given in the manual or prospectus issued by the insurer. The extra for premium waiver benefit depends upon the age of the proposer and is to be waived in case of the death of the proposer either due to disease or accident. This is normally applied to an insurance proposal on the life of a child. Extra premium on account of health and occupation is decided by the underwriter and is mentioned in the underwriting decision.

These extra premiums are charged in order to take care of the extra mortality expected in this group of life on account of substandard health or hazardous occupation. Imposing a lien - constant or decreasing for a limited period of one year or six month is another way to deal with the perceived problem of extra mortality. During the lien period, the liability of the insurer is reduced.

In case of joint life plan, there are two lives with two different ages. In order to calculate premium, we need a mean age. There is a table provided in the manual to find the mean age, depending upon the difference in the two ages.

Sex extra is generally levied for those ladies who have not yet undergone a full time delivery and who are not expected to go to a qualified doctor at the time of delivery. Once this extra is paid, this risk of child birth is accepted. However such extra is not levied where the lady in question is educated and belongs to a well to do family and is therefore expected to have the delivery with the help of a qualified lady doctor.

Persons who are physically handicapped, such as blind by one eye, disabled due to polio etc. are denied the benefit of double accident benefit even if it is asked for.

However over the years, insurers have softened their stand, while considering proposals on the life of such physically and socially disadvantaged persons. This may not be an acceptable position strictly on medico actuarial considerations, but social considerations also have their impact. Since the sum assured in such cases is very small, these small deviations from strict actuarial consideration are acceptable.

4.1.11 Computation of extra premium

Mortality as explained above relates to the death rate of a very large group of people of different ages over a long period of time. These people are usually selected people, who are also called standard lives. A separate mortality study is done for people who are rated substandard. In other words these rated people suffer from some disease or other physical deformity because of which the expected mortality rate for these people would be higher than what is expected of standard lives.

This special study by actuarial method thus leads to an estimation of extra premium which shall adequately take care of the extra mortality in this substandard group. In view of such study, extra premium is imposed on people suffering from diabetes or blood pressure etc. It is true that in view of the progress made in the medical science, these diseases are gradually not considered as dreadful as they used to be. Most insurers, therefore, keep on updating their experience relating to mortality of different groups and revise the rates of extra premium also.

4.1.12 Rider premiums

There are also extra premiums, for conferring extra benefits, to the insured. For example, a prospect wants to get double the sum assured, in case of a death due to accident. This benefit is allowed by charging an extra premium.

The insurers usually charge extra premium for riders attached to the policy. One can opt to take death benefit five or even ten times of the basic sum assured and may pay for such extra term rider benefit.

Suppose a Life Insurance Company is providing the following riders

ü Term Cover

ü Accident Death Benefit

The extra premium for Term cover rider is Rs.400 and the Accident benefit is Rs.300. The premium under the policy is Rs. Rs. 2,050. So the premium payable by the insured will be Rs. Rs. 2,050 + Rs. 300 + Rs. 400 = Rs. 2,750.

Thus the rider premiums are payable separately under the policy.

4.3 PREMIUM CALCULATION FOR ULIP POLICIES

In case of ULIP policies the premium is generally fixed in the multiples of say Rs.500 or Rs.1,000 with some minimum amount say Rs. 5,000 or Rs. 10,000. In case of ULIP policies premium may be paid as a single premium or as regular premium over a period of years.

The premium that insurers collect is subject to the deduction of following charges:-

1. **Mortality Charges -** This is the charge for insuring the life of policyholder. The charge depends upon the sum assured you have chosen.

2. **Fund Management Charges** – This is a fee charged for managing your investments

3. **Administration Charges -** This is the charge for handling paper work and other miscellaneous back office expenses.

4. **Switching Charges** – Charges for switching fund option.

5. **Riders Charges -** These are additional benefits which one can opt for, for a charge. Riders are not free. The charges increase based on the riders choosen.

6. **Surrender Charges -** This is the charge to surrender and close the policy prior to its maturity.

7. Premium Allocation Charge : **This is the charge deducted from each and every premium paid towards agent commission and other marketing and initial expenses.**

The charges are generally higher in the first year and get reduced over the term of the policy.

Now suppose a insurance company fixs Rs.10,000 as premium for a policy. From this premium deduction and allocation of units may be as follows:-

Sum Assured : Rs.50,000 – Regular Premium Policy for 5 years

Premium: Rs. 10,000

Charges Deducted :	
Mortality charges	Rs.180
Fund Management Charges:	Rs.750
Administration Charges:	Rs.1000
Riders Charges:	Rs. 500
Premium Allocation Charges:	Rs.2000
Total Charges	Rs.4430

Now the company deducts the charges of Rs. 4430 from the premium of Rs. 10,000 which comes to Rs.5570. The balance amount is used to purchase units of the fund which the policyholder chooses. Now say the policyholder wants to invest in growth Fund whose NAV is Rs.18.21 on a particular date.

The company will allocate 305.87 units to the policyholder (5570/18.21). This unit value will fluctuate and will depend on the performance of the stock market.

Notes

Usually since the payout for agents commission is higher in first year the allocation in units is less. It gradually increases. Say in next year the premium allocation charges are only Rs.250 then total cost comes to Rs.2680. The remaining Rs.7320 will be used to purchase the units for the policyholder.

INTEXT QUESTIONS 4.1

1. Define Level Premium, Office Premium, Net Premium, Rider Premium

4.2 BONUS

A bonus is usually an addition to the contractual benefits under a with-profit life assurance contract. It arises either because of explicit loading in the premiums or because a company's actual experience has been better than what it had assumed in pricing the contract.

All policies are not entitled to bonus, only with–profit–policies are entitled to bonus which is added to the sum assured every year. The rate of bonus addition depends upon the profit that the insurance company makes. For the benefit of participating in bonus the insurers resort to bonus loading which can be quite a substantial amount of the total premium.

The Insurance Act, 1938 stipulates that 90% of the surplus declared after the actuarial valuation has to be distributed amongst the with–profit policyholders.

4.2.1. Reversionary Bonus

Bonus added to the benefit of a with–profit policyholder throughout the life of the policy. The benefit is not guaranteed in advance, but once added to the benefit, it is guaranteed. A reversionary bonus is one which will increase benefits payable in the future. Regular bonus are normally reversionary. Insurers also sometimes declare special reversionary bonus.

4.2.2. Interim Bonus

Bonus is normally declared on a valuation date say for 31.3.2007 the valuation may be declared sometimes in October 2007. In case of policies which result into claim after 31.3.2007 but before the declaration of the bonus would not get the benefit of the bonus. Hence to resolve such situation companies declare interim bonus for policies which become claims during two valuation dates.

As any premium rate decided today, remains constant for the entire duration of the policy which can be upto 50 years or more, the insurer normally takes a very conservative outlook and provides for substantial reserves to take care of any adverse deviation from the originally assumed standard.

Terminal Bonus- This is a one time bonus declared by some companies for policies which have run for 15 years or more. In simpler words it can be said it is a loyalty bonus.

Bonus under ULIP Policies.

In case of Unit Linked Plans the policyholders get the fund accumulated in their account. The NAV of the fund multiplied by the number of units, the policyholder has, is known as Fund Value. In ULIP policies, the policyholders are not entitled to bonus. As in endowment policies these kind of policies are not entitled to bonus. However, the company may pay the policyholder a loyalty bonus at the end of the policy.

INTEXT QUESTIONS 4.2

1. Define Interim Bonus.
2. Define Reversionary Bonus.

4.3 SUMMARY

Premium is a consideration money for the benefit of a lump sum payment by the insurer on the happening of a specified event. The amount of premium is dependent upon age of the prospect, the policy conditions, the term etc. Premium is calculated separately in each case when a proposal is submitted. For extra benefits, extra premium is charged.

The basic premium is, however, decided on the basis of three factors - mortality, expenses and yield on investment. While mortality and expenses increase the premium, investment yield reduces the premium.

All life insurance companies charge level premium i.e. the same premium through out the duration of policy. This practice leads to the generation of some surplus in the initial period of the policy. Hence a portion of this surplus can be paid to a policyholder if he wants to surrender the policy before the maturity date.

4.4 OBJECTIVE TYPE QUESTIONS

1. Which one of the following statement is correct?
   a. The premium under a life insurance policy may be paid monthly
   b. The premium under a life insurance policy may be paid annually
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong

2. Which one of the following statement is correct?
   a. The sum of all the premium paid will be more than the Sum Assured.
   b. The sum of all the premium paid will be less than the Sum Assured.
   c. Both (a) and (b) statements are wrong.
   d. Both (a) and (b) statements are correct.

3. Which one of the following statement is correct?
   a. The annual premium is equal to the SA divided by the term of the policy
   b. The annual premium increases as the term of the policy increases
   c. Both (a) and (b) statements are correct.
   d. Both (a) and (b) statements are wrong.

4. Premium depends upon?
   a. Age of the person to be insured.
   b. Family history of the person to be insured.
   c. Medical history of the person to be insured.
   d. All of the above.

5. Which one of the following statement is correct?
   a. The premium collected in the early years is less than what is required.
   b. The premium collected in the early years is more than what is required.

c. The premium collected in early years is exactly what is required.

d. All the above statements are correct.

6. The net premium will be

a. Less than the risk premium.

b. More than the risk premium.

c. Calculated by adding expenses to the risk premium.

d. More than the pure premium.

7. When interest rates fall, the tabular premium rates are likely to

a. Increase.

b. Decrease.

c. Remain the same.

8. The premium is loaded because of

a. Interest likely to be earned.

b. Likely expenses.

c. Likely claims.

d. Age of the insured person.

9. The policyholder is concerned with the

a. Office premium.

b. Pure premium.

c. Net premium.

d. Risk premium.

10. The reason for charging level premiums is

a. Risk increases as age increases.

b. It is convenient to the policyholder.

c. It is convenient to the insurer.

d. All the above reasons.

4.5 ANSWERS TO INTEXT QUESTIONS

4.1

1. Level premium means the same amount of premium is paid during term of the policy. It does not change with increase of expenses every year.
2. Office premium means the management expenses plus pure premium.
3. Net Premium means the risk premium.
4. Rider premium means additional premium to cover the extra risk.

4.2

1. Interim bonus means the bonus declared by the company between two valuation dates.
2. Reversionary Bonus means that the bonus will accrue but will be paid on the maturity or death of the policyholder.

4.6 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1.	c	2.	c
3.	d	4.	d
5.	c	6.	a
7.	a	8.	b
9.	a	10.	d

5

POLICY CONDITIONS

5.0 INTRODUCTION

Life Insurance is a contract between two parties i.e. insurer and the insured. This contract is governed by certain rules and regulations which is must for an enforceable contract. In this lesson we shall discuss the various policy conditions that apply to contracts of life insurance. Policy conditions must be strictly adhered to. Here both parties must follow the principle of utmost good faith. The policy conditions apply at the time of taking the policy, continues during the duration of the cover and ends with the final settlement of claim under the policy. If the policy conditions are not followed either at the time of taking the policy or some material fact is not disclosed or some information is suppressed at the time of making a claim the insurance company may not honour the claim under the policy.

5.1 OBJECTIVE

After going through this lesson you will be able to

- To learn the various conditions applicable to life insurance contract
- Recall the procedures to be followed to adhere to the conditions.
- Understand the regulation in vogue.

5.2 POLICY CONDITIONS

5.1.1 Age proof and dating back

Age is the basis for determining premium. Lower age means less premium and higher age means higher premium.

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Therefore, the proposer must submit reliable proof of age to the insurer at the time of the proposal itself. Normally the following age proofs are considered reliable :-

1. School & transfer certificate or its certified extract.
2. Certified extract from municipal record.
3. Certificate of Baptism or extract from family bible.
4. Extract from service of Govt. quasi-government or reputed public limited companies where age is recorded on the basis of some standard age proof.
5. Passport.
6. Identity Card of defence personnel.
7. Marriage certificate in case of Roman Catholics.

Extracts of the original certificate has to be signed by the proposer himself. As a general rule, in the plans where the risk element is high, standard proof is insisted upon and so also for children's insurance where without age proof, proposal cannot be completed.

5.1.2 Sub-standard age proofs

Substandard age proofs are service records where age is recorded by declaration, ESI cards, marriage certificate of Muslims, elder's declaration, self declaration etc. which are scarcely accepted and if and when accepted, the insurer restricts the plan and/or term, sum assured and may charge an extra premium to compensate for any probable understatement of age.

5.1.3 Dating back

The commencement of a policy can be dated back within the financial year to give the benefit of lower age. In dating back , the insurer has nothing to lose, for no risk can extend backwards, dating back of children deferred assurance sometimes becomes necessary so that the child attains majority on the date of vesting, i.e., when the child owns the policy. If the policy is dated back within 3 months, no interest is charged. So also dating back to lean months like April and May are allowed interest free. But in the plans which promise to pay high rate of guaranteed addition, interest may be charged on date backing at a high rate. However these details depend upon each insurer and they may devise their own set of rules in this regard.

Sometimes proposals are accepted with an undertaking to submit proof of age at a later date.

5.3 DAYS OF GRACE

Premium is required to be paid on the due date but insurer allows a period of grace and if the payment is made within this period it will be considered as having been paid on the due date.

The days of grace are one month but not less than 30 days in all modes of payment except monthly where the days of grace are reduced to 15 days. During the days of grace, the policy remains in force and the claim is payable if the death occurs even if the due premium has not yet been paid. If the premium is not paid during the days of grace the policy lapses.

This grace period constitutes a privilege to the policyholder. The grace period may be allowed depending upon the discretion of the insurer.

5.4 REVIVAL OF DISCONTINUED OR LAPSED POLICIES

A policy lapses in the event of non-payment of the premium by the insured. Usually a lapsed policy can be revived within a period of 5 years. The amount of arrear premium along with the compounded interest over a period of 5 years becomes so exorbitant that it becomes financially preferable to go for a new policy instead of reviving the old policy.

If the period lapsed is within six months, the policy can be revived by payment of arrear premium with interest only.

After a period of six months, but within 5 years, the policy can be revived by payment of arrear premium with due interest with such other evidence of health and habits as required by the insurer.

The revival conditions may differ depending upon the policies of the insurers.

5.5 REVIVALS

A life insurance policy is a long term contract. The insured is obliged to continue to pay the instalment of premium on the due date to keep the policy in force. There is a grace period for each mode of payment, say of 30 days for all modes except monthly mode where the grace period is reduced to 15 days.

If the due premium is not paid on the due date or even during the grace period, the policy is said to have lapsed. Lapse of a policy means cessation of coverage. However it is possible to revive the policy with total coverage within a certain period.

Revival of a policy means reviewing the policy *de novo* by the insurer. Every insurer will have its own rules in respect of revival of policy.

Revival is a renovation of a policy half-way. Supposing a policy is for 20 years and it has lapsed say after paying 10 years of premium, it is understandable that half the sum assured has already been paid for. Revival of this policy effectively means reviving the risk of only of balance 50% of the sum assured. This revived sum assured is always less than original sum assured and higher by the paid up sum assured. The paid up sum assured is arrived at by dividing the original sum assured by the term of the policy and multiplying it by the period for which the premium stands paid. Say the term of a policy is 20 years, the sum assured, Rs. 10,000 and 10 years premium have been paid, the paid up value is Rs. 10,000 x 10/20 = Rs. 5,000. Thus the sum assured to be revived is Rs. 5,000.

This sum to be revived is important, because being less than the original sum assured, the requirements for medical report etc. may be much less than what was required while taking the original policy. It is also true that age has increased in the meantime and, therefore, some requirements may be still needed.

To cite an example of procedure of revival of policies we shall discuss hereunder the schemes for revival offered by LIC taking into consideration the financial situation of the policyholders :

(1) Ordinary Revival Scheme

The arrear premiums are paid with interest along with other medical requirements, if any.

(2) Special Revival Scheme

It is meant for those policyholders who cannot pay all the

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arrear premiums, but are interested to revive the policy. In this scheme, the date of commencement of the policy is shifted to the date of revival. A necessary condition for this revival is that the policy should not have lapsed for more than two years and it must not have acquired a paid up value.

However, as the date of commencement is advanced, it means a higher age and, therefore, the instalment premium is changed accordingly. The term normally remains the same and the maturity date shifts unless the maturity age goes beyond what is permissible under the plan. In that case, the term is reduced to keep the maturity age within the limit. This privilege of special revival can be allowed only once during the duration of the policy.

The procedure for revival is very simple. The insurer makes all the changes in the policy document by an endorsement. The policyholder however has to pay at least one instalment of premium to cover the risk upto next due date.

(3) Revival by paying arrear premium in instalment :-

This scheme is useful for those who cannot pay arrear premiums in one lump sum and who do not satisfy the basic condition of special revival scheme. For example the policy might have already acquired a paid up value. It is very much like ordinary revival scheme except that in this case, the arrear premium with interest is paid in instalments along with the current premium say-within two years. After having paid the increased premium for the stipulated period the instalment shall be reinstated to its original amount.

(4) Revival with loan Scheme

As is clear from the name this scheme involves two steps -one reviving the policy, two granting a loan. Loan is calculated assuming that the premium has been paid upto the date of revival and thereafter this amount is adjusted towards the arrear premium. However, if this loan amount falls short of the required arrear premium with interest, the balance is payable by the policyholder. Thus while the policy gets revived, it gets loaded with a loan which needs to be repaid with interest or else this is deductible from the claim as and when it arises.

(5) Survival cum Revival :-

As it is known from its name, if the policyholder has taken a money back policy and it has lapsed, LIC would revive the policy from the money which was due to the policyholder as survival benefit.

INTEXT QUESTIONS 5.1

1. What is Revival.?

2. Till what period policy can be revived?

5.6 NON-FORFEITURE REGULATION

If the premium has been paid for a minimum period of 3 years and subsequent premium is not paid, the policy does not become totally void. It becomes paid up to a reduced sum assured. This reduction in sum assured is in proportion to the actual period for which premium has been paid compared to the total period for which the premium was payable.

Some insurance companies have a system called automatic premium loan option. If this option is accepted the policy does not get automatically paid up on stoppage of payment of premium. The policy is kept in force by an automatic withdrawal of premium money out of the surrender value of the policy and the outstanding premium gets paid as long the surrender value lasts. As this withdrawal is treated as a loan with interest, in course of time, the loan and interest totally exhausts the present value of the policy and the policy value becomes zero. However this policy can be revived in the meantime.

Another option used by companies to exercise the non–forfeiture clause is the extended term insurance where a term insurance policy is issued against a single payment equivalent to the surrender value for the initial sum insured.

5.7 HAZARDOUS OCCUPATION

As to occupation it is worth noting that though insurer charges extra premium, if the proposer is engaged in hazardous occupation and removes such extra premium, if such occupation is given up, it does not charge any extra premium to such policyholders who after having taken the insurance takes up a hazardous job. In fact, no policyholder is required to keep the insurer informed of the change in occupation during the continuance of any insurance policy.

Notes

INTEXT QUESTIONS 5.2

1. What are the ideal age proofs?
2. What do you mean by substandard age proof?
3. What is the usual grace period?

5.8 NOMINATION AND ASSIGNMENT

Nomination

Transfer of property through nomination without the hassle of any other transfer deed, is an important special privilege given to the policyholder under Sec.39 of the Insurance Act. The owner of the policy, when taking an insurance on his life, can nominate a beneficiary to whom the claim amount is payable by the insurer in case the insured is no more. Payment to the nominee as named in the proposal and incorporated in the policy document is a sufficient and valid discharge for the insurer.

It is true that nominee should be a close relative who has an insurable interest in the insured person. In other words, he should stand to gain in his existence and harmed by his death. If a nominee is a person other than a close relative with insurable interest, the insurer may ask for clarification and may refuse to accept the risk, as the moral hazard is suspected in such a case. Of course, it is possible to nominate a charitable institution of one's liking.

Besides the relation between a husband and a wife, insurable interest is not presumed to exist, unless specifically explained. Thus while nomination is a special privilege, it needs to be exercised wisely. Nomination can be changed during the duration of the policy by a specific endorsement on the policy document. It generally becomes necessary if the life insured is not married while taking the policy and, therefore, may nominate his/her parents. After marriage nomination can be changed in favour of the spouse by making a special application.

It shall be clear that in case insurance policy is taken on the life of another person, say a child, nomination is not required immediately, for the proposers can claim the money on the death of the minor life assured. However, after the child attains

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majority, he owns the policy and therefore, he has a right to make a nomination.

When life insurance is taken under Married Women's Property Act 1874 no nomination is required. However in the special addendum, the name of the beneficiary along with the name of the Trustees is mentioned. Similarly in a joint life plan a nominee is not required, as the survivor is entitled to the policy money.

The nominee should be a major, because he alone can give a valid discharge to the insurer on receiving the claim money. If, however, the nominee is a minor, an appointee, who must be a major and a close confident, should be appointed to receive the money on behalf of the child and he should hold this money in trust for the benefit of the ultimate beneficiary. Signature of the appointee is obtained in the proposal form as a proof of his consent.

We shall discuss assignment here and also discuss how assignment is different from nomination.

Life insurance is a property and like any other property it can be transferred, mortgaged or dealt with in any other manner. Assignment is a method by which the owner can transfer the ownership of the property to anybody else for valuable consideration or natural love and affection. Sec 38 of the Insurance Act 1938 provides the rule and conditions for assignment of an insurance policy.

A policy can be transferred by an endorsement on the policy or by a separate deed. A written notice should be given to the insurer about the assignment so that the insurer is aware of the assignment and makes the payment to the assignee as and when any payment becomes due. In the absence of such a notice, the insurer can not be held responsible if it has made the payment to the insured or his nominee. However, if at any time before the actual payment, the fact of assignment comes to the notice of the insurer, he cannot ignore the assignment.

Assignment is a complete transfer of ownership of the policy to the assignee who now acquires the right to dispose off the policy in any manner he likes including surrendering the policy. The assignee must be a major and must not be disqualified by law. There must be a consideration for assignment, e.g., taking a loan. Assignment for love and affection is also considered valid. Assignment should not be against law, e.g. against foreign exchange regulations. Assignment must be in writing, properly signed and witnessed.

Assignment can be conditional with the condition that the policy ownership shall revert to the assured, in case he survives till maturity. A policy can be assigned to a charitable institution and such assignment can be either absolute or conditional.

Assignment once done cannot be cancelled by the assignor. The position can be retrieved only by a re–assignment by the assignee on the policy or on a stamped paper.

Thus nomination and assignments are two simple methods provided by the Insurance Act to deal with the property i.e. Life insurance policy, without going through the hassles of succession certificate and other formalities through court of law.

Let us now consider the points that differentiate a nomination from an assignment.

Nomination

1) Nomination can be done at the time of the proposal
2) Nomination can be done only by an endorsement on the policy — not by a separate deed.
3) Life assured alone can nominate.
4) Nomination does not take away the ownership and therefore, life assured can change the nomination any time he likes.
5) Nomination does not need a consideration.
6) Nomination need not be witnessed.
7) Nomination has to be notified to the insurer so that the nominee's interest is protected.
8) Nominee has no right to the policy money so long the life assured is alive.
9) On the death of the nominee, nomination becomes invalid.
10) A nominee merely receives the money on behalf of the beneficiaries. He does not own it.
11) The creditor can get the policy attached.

12) Nomination is automatically cancelled by a subsequent assignment.

Assignment

1) Assignment is not possible at the time of proposal, as he has not yet acquired any property which can be transferred.
2) Assignment is possible both by endorsement or a separate deed.
3) Assignment is possible by the owner who can be an assignee also.
4) Assignment cannot be cancelled without the assignees consent.
5) Assignment has to be for a consideration unless it is for love and affection.
6) Assignment must be witnessed.
7) Notice of assignment is required so that the latter assignee gets a priority over the earlier assignee.
8) The assignee is the owner of the policy and can give a valid discharge to the insurer even if the assured is alive.
9) On the death of the assignee, his successors inherit the right to the policy.
10) The assignee is the owner of the property which is the insurance policy.
11) A creditor of the life assured has no right to an assigned policy.
12) An assignee can further assign the policy.

5.9 PROHIBITION OF REBATE

Section 41 of the Insurance Act, 1938 states:

1) No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take out or renew or continue an insurance in respect of any kind of risk relating to lives or property in India, any rebate of the whole or part of the commission payable or any rebate of the premium shown on the policy, nor shall any person taking out or renewing or continuing a policy accept any rebate, except such rebate as may be allowed in accordance with the published prospectuses or tables of the insurer.

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2) Any person making default in complying with the provisions of this section shall be punishable with a fine which may extend to five hundred rupees.

Section 45 of the Insurance Act: No policy of life insurance effected before the commencement of this Act shall after the expiry of two years from the date of commencement of this Act and no policy of life insurance effected after the coming into force of this Act shall after the expiry of two years from the date on which it was effected, be called in question by an insurer on the ground that a statement made in the proposal for insurance or in any report of a medical officer, or referee, or friend of the insured, or in any other document leading to the issue of the policy, was inaccurate or false, unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that it was fraudulently made by the policyholder and that the policyholder knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose.

5.10 PAID UP VALUE & SURRENDER VALUE

When a policyholder due to any reason stops payment of future premium during the term of the policy he certainly loses the cover of life risk for the future. But what happens to the money he has already paid?

Paid up Value

If the premium has been paid for 3 full years, this money as per the terms and conditions of the policy does not get forfeited. The policy is said to get automatically "paid up". **Paid up** is a technical expression of a position where the money paid is not forfeited. This is the amount which is to be paid on the maturity of the policy or earlier death of the policyholder. This amount is a reduced sum assured exactly in proportion to the term for which premium is paid compared to the term for which premium was payable.

Say for example this policy was for a sum assured of Rupees one lakh for a term of 20 years. If the premium payment has been stopped after payment of 10 years' of premium the paid up value is equal to Rs. 1 lakh x 10 : 20 = Rs. 50,000. If the premium is paid for 5 years, the paid up value is Rs. 1 lakh x 5 : 20 = Rs. 25,000. This money along with the accrued bonus

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is payable only on maturity or death, if earlier. If it is with-profit policy, the bonus which has already accrued during the period when the policy was in force remains attached to it and is paid along with the paid- up value. However a policy is not entitled to any bonus after it gets paid up.

Now if the policyholder wants to get out of the contract altogether and wants the refund of the total money, he is not clearly entitled to the total money. A lot of it has already been used to pay the death claim to the people who have died in the meantime. The initial expense incurred by the insurer was quite heavy and while computing the premium, the provision for expense was spread over the entire period of the policy.

All these have to be recovered out of the deposited premium. The bonus declared is payable only on death or maturity and is technically called 'Reversionary Bonus'. Therefore, only the present value of this bonus is now payable.

Surrender Value

The value which is now payable on cancellation of the policy contract is called the Surrender Value. This is much less than the paid up value for the reasons as explained above.

The surrender value is payable provided the policy has acquired a paid up value and the policy acquires a paid up value only if a minimum of three years premium has been paid. This limit of three years has been kept because the initial huge expenses incurred for the procurement of policy and after paying for the deaths, do not leave much to be paid, before three years.

Guaranteed surrender value

The Insurance Act, 1938 provides for a guaranteed surrender value. The guaranteed surrender value has been defined as follows - If the policy premium has been paid for three years, the minimum surrender value allowable under this policy is equal to 30 percent of the total amount of premium paid excluding the premium for the first year and also additional premium for accident benefit etc. The cash value of any existing vested bonus addition will also be allowed.

Though this is the guaranteed amount payable as surrender value as per the Insurance Act 1938 what is actually paid is the special surrender value which is arrived at by multiplying the paid up value by the surrender value factor. The surrender value factor is a schedule of factors or ratios, which is dependent upon the duration of the period elapsed between the date of commencement and the date of payment of surrender value. The larger the period elapsed, larger is the factor. This factor is multiplied with the paid up value amount to arrive at the special surrender value factor.

The special surrender value is more than the guaranteed surrender value.

5.11 COMPUTATION OF PAID-UP VALUE & SURRENDER VALUE

We will explain this with an example :

Sum assured	-	Rs.75,000/-
Plan	-	Endowment with–profits
Term	-	15 years
Date of commencement	-	28.11.1978
Mode	-	Yearly
Due date of last premium paid	-	28.11.84

Date of calculation of surrender value - 1.10.84.

Calculation :

Term of the policy - ‘x’	=	15 years
Sum assured	=	Rs.75000
Number of premiums paid - ‘t’	=	28.11.1984 28.11.1978 0.0. 6 years and add 1 advance premium
Total number of premiums paid	=	7

Paid up value $= \frac{Rs. 75,000 \times 7}{15} = Rs. 35,000$

Vested bonus against the policy for the six years on the sum assured of Rs. 75,000 is equal to Rs.11,160/-.

Thus the total paid up value is Rs.35000 + Rs.11160 = Rs.46160/-

This paid up value is payable only on maturity or death of the policyholder, if earlier.

The special surrender value	
is wanted on	1.10.1984
Therefore the duration	
which has lapsed on	01.10.1984
	(-) 28.11.1978
	<u>03.10.2005</u>

The surrender value factor as per the special surrender value chart published for duration 5 year and term 15 years is 58%.

Therefore the surrender value

$$= \frac{Rs. 46{,}160 \times 50}{100} = \text{Rs.}26772.80$$

Thus irrespective of the amount of premium paid by the policyholder, the paid up value is decided by the duration for which premium has been paid compared to the term for which premium was payable. And the surrender value factor is determined by the duration which has lapsed from the date of commencement to the date on which the surrender value payment is demanded compared to the original term of the policy taken by him.

5.12 LOAN UNDER POLICY

Loan is a privilege which is allowed provided it is mentioned in the policy conditions. Generally loan is permissible in all savings oriented polices like endowment plans. But in such plans, where survival benefit is paid during the duration of the policy benefit of loan payment is not permitted as the reserve is depleted due to these payments. That is why in money back plans, loan benefit is not permitted.

Loan amount is generally 90% of the surrender value. This percentage increases gradually during the last 3 years of the policy duration. In case the policy has been paid up, only 85% of the surrender value is available for loan.

Now consider the position where a policy had been made paid up i.e. no more premium is being paid. Now the policyholder has taken a loan against this paid up policy or the policy has been made paid up subsequent to the taking of the loan. Loan carries the obligation to pay interest at a certain rate. It is,

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therefore, quite likely that this loan amount due to the addition of interest amount which is not being paid over a period of time shall overtake the admissible surrender value particularly because no more premium is being paid against this policy.

Under such a condition, the policy is surrendered to loan. The policyholder has been granted a loan and he is neither paying the premium nor the interest against the loan. The liability against loan has become more than the surrender value. The insurer therefore, takes what is called “fore closure action”. Before taking a fore—closure action, the policyholder is notified to the effect that if he does not pay the outstanding interest on or before a specific date, the policy would be written off and the surrender value of the policy shall be adjusted against the loan and the outstanding interest and the balance, if any, shall be paid. However, if the policyholder pays the outstanding interest, the fore closure action can be avoided.

5.13 CLAIM CONCESSION

In death cases where the policyholders expire after continuously paying premium for 3 years the insurance company makes payment of full sum assured, subject to the deduction of unpaid premiums with interest till the date of death and unpaid premiums falling due before the next anniversary of the policy within a period of six months or one year from the date of the first unpaid premium.

For example Mr Santosh took a life insurance policy for Rs.1 lakh on 1.1.2005. After making payment for 3 years he died on 4.3.2008. His premium was due in February. Here Insurance company makes him the payment of Rs. 98500 after deducting the premium amount due from Mr Santosh. The premium was Rs. 1500.

INTEXT QUESTIONS 5.3

1. What is a paid up policy?

2. Define Surrender Value.

5.14 SUMMARY

Age is the basis for determining premium. Lower age means less premium and higher age means higher premium, everything else, like table being the same. Therefore, the proposer must submit reliable proof of age to the insurer at the time of the proposal itself.

The days of grace are are one month but not less than 30 days in all modes of payment except monthly where the days of grace are reduced to 15 days. During the days of grace, the policy remains in force and the claim is payable if the death occurs and the due premium has not yet been paid

Revival is a need whenever the policy has lapsed for non-payment of premium. The process of revival is kept easy subject to necessary caution.

Assignment is a procedure to transfer the ownership of the policy, which is a property, to another for a consideration. It is free of normal hassles usual to transfer of property.

The value which is now payable in cancellation of the policy contract is called the Surrender Value.

Loan can be taken against some life insurance Policies. Policyholder may make the interest payment to the insurer and if he wishes the loan and interest gets deducted from the final benefit payable to him.

5.15 TERMINAL QUESTIONS

1. List the various documents accepted as valid age proofs.
2. What is the procedure of dating back of policies?
3. What are the rules regarding revival of a policy?
4. What is the difference between Nomination and Assignment?
5. Differentiate between paid up and surrender value.
6. What is the procedure for taking loan under a policy?

5.16 OBJECTIVE TYPE QUESTIONS

1. Which one of the following statement is correct?
   a. Age is material information and may affect the terms of underwriting.
   b. If age is found to be different, the only effect is on the premium rate.
   c. Both the above statements are correct.

d. Both the above statement are wrong.

2. Age is material for underwriting because it affects?

a. The amount of premium.

b. The decision to call for medical examinations and tests.

c. The plan that can be offered.

d. All the three factors above.

3. Which one of the following statement is correct?

a. Age is important for the underwriting to consider the need for medical tests.

b. Age is material to decide on the plan that can be offered.

c. Both (a) and (b) statements are wrong.

d. Both (a) and (b) statements are correct.

4. Which one of the following statement is correct?

a. In the case of SSS policies, the grace period is one month.

b. If the due date is 27^{th} February the grace period ends on 26^{th} March.

c. Both (a) and (b) statements are correct.

d. Both (a) and (b) statements are wrong.

5. The premium was due on 15^{th} July and 16^{th} August is a Sunday?

a. The grace period will end on 14^{th} August (Friday).

b. The grace period will end on 15^{th} August (Saturday).

c. The grace period will end on 17^{th} August (Monday).

d. The grace period will end as per the discretion of the insurer.

6. The monthly premium was due on 24^{th} February in a leap year (Tuesday).

a. The grace period will end on 9^{th} March (Tuesday).

b. The grace period will end on 10^{th} March (Wednesday).

c. The grace period will end on 11^{th} March (Thursday).

d. The grace period will end on 24^{th} March (Wednesday).

7. Which one of the following statement is correct?

   a. If death occurs in grace period, the premium due is waived.

   b. The date of payment of premium is the date on which the cheque is cleared.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statement are wrong.

8. Which one of the following statement is correct?

   a. Premium have to be paid by cash or cheque.

   b. Premium can be paid electronically.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statements are wrong.

9. Which one of the following statement is correct?

   a. A premium paid within the grace period is payment made on the due date.

   b. A policy is not considered to have lapsed during the days of grace.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statements are wrong.

10. Which one of the following statement is correct?

   a. When a policy lapses, the policyholder loses everything.

   b. When a policy lapses, some benefits are protected.

   c. Both (a) and (b) statements are correct.

   d. Both (a) and (b) statements are wrong.

5.17 ANSWERS TO INTEXT QUESTIONS

5.1

1. Revival means the renew of lapse policy which has been lapsed due to non-payment of premium.
2. With in 5 years the policy can be revived.

5.2

1. Ideal age proof means the proof which is acceptable by the insurer.

2. Substandard age proofs are service records where age is recorded by declaration, ESI cards, marriage certificate of Muslims, elder's declaration, self declaration etc which are scarcely accepted and if and when accepted, the insurer restricts the plan and/or term, sum assured and may charge an extra premium to compensate for any probable understatement of age.

3. It depends upon the mode of payment and varies from 15 days to 30 days

5.3

1. **Paid up** is a technical expression of a position where the money paid under the policy is not forfeited.

2. The immediate payment of paid up value is known as surrender value.

5.18 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1.	a	2.	a
3.	d	4.	d
5.	c	6.	b
7.	d	8.	c
9.	c.	10.	b

6

GROUP INSURANCE

6.0 INTRODUCTION

The life insurance policy can be issued to individual as well as to groups. We have already discussed the various plans available for individuals in lesson 1 under life insurance products. Group insurance follows certain norms for issue of policies to a similar group of people. Under group insurance policy a large number of people are covered under a single policy. These types of policies are generally taken by companies for their employees or clubs for their members and so on.

6.1 OBJECTIVES

After going through this lesson you will be able to

- Understand the meaning of Group Insurance
- Recall the types of Group Insurance Policies
- List out the special features of each policy

6.2 GROUP INSURANCE VS. INDIVIDUAL INSURANCE

Individual insurance is a contract between the individual and the insurance company, called the insurer. The decision to insure is voluntary and the terms on which the insurance age cover is granted, depend upon the appraisal of risk in respect of the individual by the insurer.

Group insurance, on the other hand, is one contract covering a group of lives. The terms of the contract of insurance cover depend upon the characteristics of the group as a whole.

A master policy is issued as evidence of contract between the insurance company and another legal entity, which may be

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an employer, trustees, or an association. The master policy defines the group of lives to be covered, benefit it confers, the amount of contribution to be paid and other conditions and privileges of the participating group members.

It is a group selection process and not a selection of individual life. It is recognized that every group will contain some proportion of substandard lives but group underwriting assumes that the insurer is able to reasonably assess the overall risk from the general nature of the group. The group is supposed to be homogeneous and contain sufficient numbers so that the number of claims by death can be reasonably estimated on the basis of the average.

The amount of cover is determined on the basis of a formula and is not decided by individuals forming the groups. Insurance on the lives of all members upto a limit called “Free Cover limit” is granted on the basis of simple rules of insurability. ‘Simple rules of insurability’ means not being absent from duty on ground of sickness on the date of effecting insurance. Free cover limit does not mean free of insurance premium. It is free to the extent that no evidence of health is called for.

As a result of mass administration and simple underwriting practice it becomes a low cost insurance cover for a group. However, the premium rates are adjusted periodically on the basis of experience. This is called “Experience Rating”. For medium and big sized groups, sharing of profits on the basis of actual experience is a normal feature. If surplus is generated over a period of years after taking into account the premium collected and the benefit conferred, the rate of premium can be reduced in the future years. If on the other hand it results in continuous loss, the premium is rated up.

6.3 CHARACTERISTICS OF A ‘GROUP’: -

(i) It should be homogeneous by nature of occupation. Therefore members of a social club, a political party or religious establishment cannot constitute a group for insurance purpose.

(ii) Insurance must be incidental i.e, the group must not be formed mainly for the purpose of obtaining insurance.

(iii) The group must have a single central administrative machinery to act on behalf of all members.

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(iv) The group should be such that there is a steady stream of new entrants from year to year, so that the group is not stagnant and is not likely to lapse as a result of depletion of members. This requirement also ensures that over a period of time, the average age of the group does not become so high as to render it completely uninsurable.

(v) Another important requirement is that a large proportion of the eligible members of the group should join the group scheme. This would insure that no adverse selection is exercised against the insurance company and the proportion of impaired lives is not unduly high.

(vi) A minimum size of the group is generally prescribed.

6.4 DIFFERENT TYPES OF GROUPS:

6.4.1 Employer-Employee Group :-

In this case the employer takes out the master policy for the benefit of its employees and a trust is formed normally to administer the scheme. At times the employer takes such group insurance to meet the statutory need. The examples are Employee's Gratuity Benefits, Employees Deposit Linked Insurance Schemes.

The scheme can be contributory or non-contributory or jointly contributed by the employer and employees. In the scheme, where the employees do not contribute and the employer bears the total cost, all eligible employees must join the scheme. If however, the scheme is contributory i.e. either employees alone or jointly with the employer finance the scheme, a high level of participation of the eligible employees at commencement and compulsory participation of all new employees, thereafter, is essential.

6.4.2 Creditor - Debtor group :-

The master policy is taken out by the creditors to cover the outstanding amount of loans granted to the debtors. In case of the death of a debtor, the claim amount would be applied towards repayment of loan outstanding in his / her name. Here the creditor may be an employer, an organization giving housing loans, a cooperative credit society, a credit card company etc.

6.4.3 Professional group :-

These may be association of professionals like doctors, lawyers, accountants, engineers, journalists, pilots, insurance agents etc.

6.4.4 Other groups :-

There may be other forms of groups which may be considered eligible for group insurance, i.e. cooperative societies, welfare funds, members of resident society, bank depositors etc. The group should have a reliable identity and should have been formed for some purpose other than group insurance.

Now a days, many nodal agencies, such as central and state government departments and welfare organizations are being allowed to take group insurance schemes covering some specific groups of weaker sections of the society. Examples of such schemes are the Landless Agricultural Labourers Group Insurance Scheme (LALGI) implemented through the state governments, IRDP Loaner's Group Insurance Scheme implemented through District Rural Development Agencies (DRDAs), milk producers group Insurance scheme, implemented through milk cooperatives etc.

INTEXT QUESTIONS 6.1

1. Define a Group.
2. List Different types of group.

6.5 GROUP GRATUITY SCHEME

Provision of the Gratuity Act, 1972, as amended from time to time

The provisions of Gratuity Act, 1972 makes it obligatory on the part of the Employer employing ten or more persons to pay gratuity to an employee on the termination of his employment after he has rendered continuous service for not less than five years @ 15/26 days wages for every completed year of service or part thereof over 6 months subject to maximum of Rs.3,50,000/- :

a) On his superannuation
b) On his retirement or resignation or

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c) On his death or disablement due to accident or disease (completion of 5 years however is not necessary in case of death or disablement)

6.5.1 Need for funding gratuity liability

The gratuity whether payable in terms of the Gratuity Act or as per the service rules of the employer if he offers better benefits, is an increasing liability not only on account of increase in number of years of service put in by the employee but also on account of increase in salary and amendments to the statute. As such business acumen and sound accounting principles desire that the liability should be funded in the year in which it arises, by setting aside adequate funds under an approved Trust Fund. The Group Gratuity Scheme being marketed by Insurers has been approved under Part C of the fourth Schedule of the Income Tax Act, 1961, to assist the employer to fund the gratuity liability with the following distinct advantages:

6.5.2 Benefits to the employer

(i) Tax Benefits: 100% payments made to insurer are treated as management expenses under section 36 (ii) (v) of the Income Tax Act, 1961. Further the yield available on the contribution is not taxable under section 10 (25) (iv) of the Income Tax Act, 1961.

(ii) Statutory liability is booked year to year thus reflecting the true picture of the Profit and Loss of the Organisation.

(iii) Gratuity payment can be made without affecting the business finances.

(iv) High yield depending on the size of the fund.

(v) The Actuarial valuation to assess the gratuity liability is made free of cost.

6.5.3 Benefits to the employees

(i) Gratuity payments are secured.

(ii) In case of death of an employee, insurer pays enhanced gratuity, i.e. a gratuity an employee would have earned on his retirement based on his last drawn salary.

6.6 GROUP SUPERANNUATION SCHEME

Progressive entrepreneurs have come to acknowledge that key

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men who are pillars of any organisation, have vast avenues open to them, particularly in todays context of liberalised Indian economy. In order to retain his keymen and to attract better talent, the employer offers competitive remuneration and perks, and value additions in the form of Insurers Group Superannuation Schemes.

6.6.1 Need for superannuation scheme

To provide regular income to an employee after retirement. With continuous improvement in longevity the economic problem of old age is now as serious as the calamity of premature death. Retirement benefits received in lump sum are frittered away and not invested prudently, as a result the post retirement life without financial security and regular income may become an unbearable burden.

6.6.2 Who pays contribution

Either the employer (upto 27% of wages including contribution to P.F.) or both employer and employee.

6.6.3 Pension Schemes are basically of two types :

(i) Benefit purchase (Defined Benefit) Scheme, where the amount of pension and other benefits are defined in the Rules of the scheme and the contribution required to finance the benefits are determined after actuarial valuation.

(ii) Money purchase (Defined Contribution) Scheme, where the contribution rates or amounts in respect of the members are defined in the Rules of the scheme. Ultimate benefits will depend upon accumulation of the contribution actually made from time to time.

6.6.4 Benefits to the employer

× Retain key personnel.

× Attract better talent for organisational growth.

× Extend tax free perquisites to employees and win their loyalty and boost their morale.

× Employers get 100% tax benefits on contributions to superannuation fund.

× High Return on contribution.

6.6.5 Benefits to the employees:

- Regular income after retirement with a variety of options to suit individual need.
- Tax free compulsory savings.
- Tax rebate under section 80C if contribution made by employee.

6.6.6 Pension options to suit individual need

- Pension payable for guaranteed period 5, 10 or 15 years and there after for life.
- Pension payable for life (with or without return of capital).
- Joint Life Pension (with or without return of capital).

6.6.7. Other option

- Commutation of Pension (1/3 if entitled to Gratuity, 1/2 otherwise)
- On leaving service, immediate pension if eligible as per policy rules.
- Deferred pension if desired.
- Transfer of Equitable interest as per rules

6.6.8 Subsidiary benefits (Optional)

CATEGORY/ DESIGNATION	MAXIMUM INSURANCE COVER		
GROUP SIZE	**25-99**	**100-499**	**500+above**
A Sr.Executives	1,75,000	2,50,000	3,50,000
B Middle Management	1,25,000	2,00,000	2,50,000
C Clerical/Supervisor	80,000	1,25,000	1,75,000
D Sub Staff	40,000	60,000	80,000

Risk cover Group Insurance Scheme in conjunction with Superannuation Scheme can be offered if group size is 10 or more. The insurance cover relates to 2 months salary for each year of future service subject to a maximum of upto Rs.3 Lacs depending on the size of the Group.

6.7 GROUP SAVINGS LINKED INSURANCE SCHEME

The Central and State Governments had formulated an insurance-cum-savings scheme nomenclature. Group Insurance Scheme for the benefit of Central & State Government employees. However the employees of Public Sector, Quasi Govt. Undertakings, Universities, autonomous bodies such as Municipalities, Zilla Parishads etc. were not covered under the Govt. Scheme.

The Life Insurance Corporation of India designed the Group Saving Linked Insurance Scheme for the above sectors as detailed below:-

6.7.1 Objectives of the scheme

- To provide low cost-life insurance.
- Inculcate saving habits so that nominal amount compulsorily set aside during the service period grows into a sizeable fund of savings and accrued interest compounding yearly, which on retirement acts as a cushion for financial security.
- In the event of untimely death during service period, the insurance amount with accumulated saving assist the bereaved family to tide over the financial crisis.

6.7.2 Insurance cover

Depends on designation and size of group as under:

6.7.3 Premium

It is decided on the basis of group size and the occupation of the group.Premium has two components i.e. Risk Premium and Savings Premium.Risk Premium is utilized to offer life cover and the Savings Premium is accumulated in members account.

6.7.4 Tax benefit

Total monthly contribution entitled to Income Tax rebate under Section 80C.

Receipts of saving accumulation/insurance amount are tax free.

6.7.5 Benefits

In case of resignation/retirement: The accumulated savings with interest @ 11% compounding yearly will be paid.

In case of unfortunate death during the service: The insurance amount together with accumulated savings and interest will be paid to the beneficiary.

6.7.7. Other conditions:

Membership: 75% of total staff strength or minimum 25 whichever is more.

Insurability condition : Not absent from duty on grounds of medical/ sick leave at the time of introduction of the scheme.

Payment of premium: Monthly contribution to be deducted from salary and remitted by the employer.

6.7.8 Accident benefit:

Double accident benefit can be allowed to the extent of the SA for an extra premium @Rs.0.75 per thousand SA per annum. Double Accident cover under all group schemes taken together should not exceed Rs.1.5 Lacs.

6.8 GROUP INSURANCE SCHEME IN LIEU OF EDLI

All employers to whom the Employees' Provident Fund and Misc. Provision Act 1952 applies have a statutory liability to provide Life Insurance benefit to all their employees by subscribing to Employees Deposit Linked Insurance (EDLI) Scheme. Under the scheme as amended with effect from 24th June,2000 the insurance benefit is equal to the average balance to the credit of the deceased employee in the Provident Fund during the last 12 months, provided that where such balance exceeds Rs.35,000, insurance cover would be equal to Rs.35,000 plus 25% of the amount in excess of Rs.35,000 subject to a maximum of Rs.60,000. Thus if the length of service is not adequate and/ or the salary is low the average balance may be substantially low and the benefit to the employee's family is either inadequate or non-existent.

The contribution @ 0.51% of each employee's salary is payable by the Employer to the Provident Fund Authorities.

6.8.1 Comparison of EDLI scheme of P.F. with group insurance scheme of LIC

In EDLI Scheme of P.F. each employee is covered for an amount equivalent to average balance in P.F. account during the preceding 12 months and the maximum cover of Rs.35,000/- is given if average balance in P.F. A/c is Rs.65,000/- or more.

In Group Insurance Scheme of LIC, each employee is insured for a minimum sum assured of Rs.11,000/- to Rs.37,000/- depending upon the current salary and service put in from day one irrespective of the balance in P.F. account.

6.8.2 Cost of premium

The cost is always more in EDLI Scheme of P.F. because it is linked to the wage bill and any increase in wage bill will lead to increase in premium. Cost borne by the employer may not be useful to the employees due to meagre balance in their P.F. account.

Under LIC's Group Insurance Scheme, the cost is always less since it is not linked with wage bill, but depends on age of the employees covered under the scheme, and the insurance cover.

6.8.3 Double Accident Benefit

There is no provision for any Double Accident Benefit under the EDLI Scheme of P.F. Department. Whereas under LIC's Group Insurance Scheme Double Accident Benefit can be availed by paying additional premium of 0.75 paise per thousand sum assured. In this case double the sum assured will be paid in case of accidental death.

6.8.4 Claim settlement

Under LIC's Group Insurance Scheme the claim settlement is simple and prompt and is settled on the strength of death certificate duly forwarded by the employer confirming the death but this is not so in P.F. Scheme, since the payment depends on the reconciliation of all the accounts of the members and hence the delay.

6.9 GROUP INSURANCE SCHEME

Group Insurance Schemes are generally term insurance schemes renewable every year and are offered to homogenous and identifiable groups at a very low cost. Progressive employers use it as tool to retain experienced and trained staff and executives in their employment thus reducing the turn over. Group Insurance Scheme provides tax benefits both to the employer and the employees.

The object of various Group Insurance Schemes is to provide for a fixed sum assured on death of a member covered under the scheme and is offered under One Year Renewable Term Assurance Plan.

6.9.1 Premium chargeable:

Group (Term) Insurance Scheme is at present offered under One Year Renewable Group Term Assurance Plan (OYRGTA). Every year on Annual Renewal date the premium is charged depending upon the changes in size and age distribution of the age group.

6.9.2 Different Schemes:

Group (term) Insurance Scheme has a number of varieties . The Scheme may provide for a uniform cover to all members of the group or graded covers for different categories of members, cover for all amounts of outstanding housing loans or vehicle advances, or some other benefits (e.g., life cover to supplement pension or PF benefits in case of death). The schemes may have add-ons like Double Accident Benefit, Critical Illness Benefit, Disability Benefit etc.

6.9.3 General features of various Group Insurance Schemes:

1. **Premium:** The premium under such scheme may be wholly paid by the employer or the Nodal Agency. However, the scheme may be contributory i.e. the members may also contribute.

2. **Double Accident Benefit:** Double Accident Benefit, i.e. payment of double the sum assured on death due to accident (without permanent disability benefit), may be allowed under Group Insurance Schemes for an extra premium.

3. **Eligibility :** For Group Insurance Scheme in lieu of EDLIS the insurability condition is that the employee should be a member of the Provident Fund Scheme of the employer. For other GI Schemes of employer-employee groups the insurability condition is that the member should not be absent on ground of sickness on the entry date. For all non-employer-employee Group Schemes the basic insurability condition is that the member should be in good health on the date of entry.

When a claim arises, the particulars of the respective member are to be intimated together with the claim form and death certificate.

6.10 GROUP LEAVE ENCASHMENT SCHEME

The Council of the Institute of Chartered Accountants of India have issued Accounting Standard (AS-15) relating to the Accounting for Retirement Benefits in the Financial Statements of the Companies. It has thus, become necessary for the companies to ascertain their various types of accrued liabilities on an appropriate basis and provide for the same in the books by debiting to the Profit & Loss Account each year.

The said scheme of the Life Insurance Corporation of India has been designed to assist the employers to meet with the provisions of these Accounting Standards. The salient features of the scheme are as under:

1) The funding will be done under the Cash Accumulation Plan i.e. a Running Account shall be maintained in respect of the scheme. All contributions (excluding Term Insurance Premium) shall be credited to this account and all claims settled (except insurance cover) shall be debited to the Running Account. Interest shall be credited as at 31st March every year at a rate to be declared by LIC under the Cash Accumulation Plan.

2) A Group Insurance cover of a flat Sum Assured subject to a minimum of Rs.5000/- and maximum of Rs.25,000/- per employee will be provided.

3) Claims in respect of Leave Encashment shall be settled as per the Rules of the Scheme on the exit of the employees. Where such exit is due to death of the employee, an additional amount of insurance cover shall also be paid to the nominee of the employee.

6.11 GROUP MORTGAGE REDEMPTION ASSURANCE SCHEME

'Group Mortgage Redemption Assurance Scheme', is a Group Insurance Scheme for the borrowers of housing/vehicle loans from financial institutions where loan is recovered under EMI. Under the scheme, the premium is payable in a single installment covering a decreasing life cover. Insurance cover every year will be almost equal to the loan outstanding at the anniversary date of each borrower.

Under the scheme, the premium depends upon:

1. Age (nearer Birthday) at entry of the member into the scheme.
2. Outstanding loan amount at entry date.
3. Term of loan.
4. Schedule of repayment.
5. Rate of interest with which the loan was availed.

Any borrower may become member of this scheme. The minimum term of assurance is 3 years. Existing borrowers can join the scheme with certain conditions within 6 months of the commencement of scheme.

In case of death of the member during the coverage period, life cover on the anniversary date preceding the date of death is payable. The claim proceeds are used to square off the outstanding loan.

6.12 SUMMARY

Group insurance is a contract of insurance with a company, or association covering a group of people who are engaged in the similar occupations. The group should be such that there would be continuous flow of new members while old members would retire. Individual members do not have to sign any papers and the benefit would be available uniformly to the entire group.

There could be a variety of group schemes, some relating to the legal requirements and some voluntary. The Group Gratuity Scheme is one such scheme in which the legal liability of gratuity to ones employees can be insured by the employer with the insurer. Similarly superannuation liability of any employer can be met by ensuring it through a Group Superannuation Scheme. Group Savings Linked Insurance Scheme is intended to provide low cost life insurance and inculcate a habit of savings in the employees and provide insurance benefit to the family in case of untimely death.

Thus, Group insurance can be designed to meet a variety of needs of a group indeed of an individual. The benefits paid through group insurance enjoy the Income Tax benefit similar to the individual insurance schemes.

6.13 TERMINAL QUESTIONS

1. What are the characterstics of a group?
2. Elucidate different types of groups
3. Differentiate between individual and group insurance.
4. Discuss the features of Group Gratuity Scheme
5. Discuss the features of Group Superannuation Scheme
6. Discuss the features of Group Savings Linked Insurance Scheme.

6.14 OBJECTIVE TYPE QUESTIONS

1. State which one of the following statement is correct.

   a. In group insurance, a single policy is issued covering many persons.

   b. A master policy covers servants of a master.

   c. Both the statements above are correct.

   d. Both the statement above are wrong.

2. State which one of the following statement is correct.

   a. In group insurance, there is only one proposal to insure many.

   b. In group insurance, there is only one policy covering many.

   c. Both the statements above are correct.

   d. Both the statement above are wrong.

3. State which one of the following statement is correct.

   a. In group insurance, the proposal is made by the employer.

   b. In group insurance, proposals are made by each of the insured.

   c. Both the statements above are correct.

   d. Both the statement above are wrong.

4. State which one of the following statement is correct.
   a. Group insurance covers a large number of persons in the policy.
   b. Group insurance is relatively cheaper than individual insurances.
   c. Both the statements above are correct.
   d. Both the statement above are wrong.
5. State which one of the following statement is correct.
   a. A bank can take out a group policy for its account holders.
   b. A finance company can take out a group policy for those taking loans from it.
   c. Both the statements above are correct.
   d. Both the statement above are wrong.
6. State which one of the following statement is correct.
   a. The amount of cover in a group policy is chosen by individual members.
   b. The amount in a group of cover for each member is fixed by the terms of the policy.
   c. Both the statements above are correct.
   d. Both the statement above are wrong.
7. State which one of the following statement is correct.
   a. A master policy is issued in a group insurance policy.
   b. Each member in a group policy pays the premium directly to the insurer.
   c. Both the statements above are correct.
   d. Both the statement above are wrong.
8. Which of the following is true for a group policy.
   a. Copies of the master policy are given to all members by the insurer.

b. The group has to be formed exclusively for the purpose of insurance.

c. Entry into the scheme and exit out of it, is at the option of the members.

d. The amount of the cover is determined by the scheme.

9. State which one of the following statement is correct.

a. A trade union can take out a group insurance policy for its members.

b. The cover for an employee can be equal to his age multiplied by a fixed number.

c. Both the statements above are correct.

d. Both the statement above are wrong.

10. State which one of the following statement is correct.

a. A group insurance contract is between the insurer and the insured persons.

b. The extent of insurance cover is chosen by each individual member.

c. Both the statements above are correct.

d. Both the statement above are wrong.

6.15 ANSWERS TO INTEXT QUESTIONS

6.1

1. Group insurance is a contract covering a group of lives.
2. Employer-employee group ,Creditor - Debtor groups, Professional groups.

6.16 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1.	a	2.	c
3.	a	4.	c
5.	c	6.	b
7.	b	8.	d
9.	c	10.	d

7

CLAIMS AND SETTLEMENT

7.0 INTRODUCTION

The Insurance Policy is taken by the consumers to compensate them in the event of happening of an unforeseen event. It is a hedge against unavoidable circumstances. In general insurance the loss is payable only on happening of some specific event. If the insured does not suffer any loss no claim is paid to him. The premium is charged on yearly basis and no accumulation takes place. However the scenario is different in case of life insurance. If the insured dies during the policy period he gets the sum assured along with the bonus accrued under the policy if any. If the insured survives the policy period he gets the maturity amount accrued under the policy. In this lesson we shall learn the various aspects in settlement of life insurance claim.

7.1 OBJECTIVES

After going through this lesson you will be able to

- Learn the various categories of claim
- Enlist the documents required in settlement of claim
- Recall the process of claim settlement
- Remember the guidelines issued by IRDA in respect of claim settlement

7.2 CLAIM SETTLEMENT

Payment of claim is the ultimate objective of life insurance and the policyholder has waited for it for a quite long time and in some cases for the entire life time literally for the payment. It is the final obligation of the insurer in terms of the insurance contract, as the policyholder has already carried out his obligation of paying the premium regularly as per the conditions mentioned in the schedule of the policy document. The policy document also mentions in the schedule the event or events on the happening of which the insurer shall be paying a predetermined amount of money (S.A.).

There may be three types of claim in life insurance policies–

1. Survival Benefit Claim
2. Maturity Benfit Claim
3. Death Benefit Claim

We shall discuss hereunder the details of each category of claims.

7.2.1 Survival Benefit :

Survival benefit is not payable under all types of plans. It is payable in endowment or money back plans after a lapse of a fixed period say 4 or 5 years, provided firstly the policy is in force and secondly the policyholder is alive.

As the insurer sends out premium notices to the policyholder for payment of due premium, so it sends out intimation also to the policyholder if and when a survival benefit falls due. The letter of intimation of survival benefit carries with it a discharge voucher mentioning the amount payable.

The policyholder has merely to return the discharge voucher duly signed along with the policy document. The policy document is necessary for endorsement to the effect that the survival benefit which was due has been paid.

The survival benefit can take different forms under different types of policies.

7.2.2 Maturity Claim

It is a final payment under the policy as per the terms of the contract. Any insurer is under obligation to pay the amount on the due date. Therefore the intimation of maturity claim and discharge voucher are sent in advance with the instruction to return it immediately.

If the life assured dies after the maturity date, but before receiving the claim, there arises a typical problem as to who is

Notes

entitled to receive the money. As the policyholder was surviving till the date of maturity, the nominee is not entitled to receive the claim.

The policy under such conditions is treated as a death claim where the policy does not have a nomination. The insurer in such a case shall ask for a will or a succession certificate, before it can get a valid discharge for payment of this maturity claim.

In case the policy has been taken under Married Women's Property Act, the payment of maturity claim has to be made to the appointed trustees, as the policyholder has relinquished his right to all the benefits under the policy. It is for this relinquishment of right that the policy money enjoys a privileged status of being beyond the bounds of creditors etc.

If the maturity claim is demanded within one year, before the maturity it is called a discounted maturity claim. This amount is much less than the maturity claim.

7.2.3 Death Claim

If the life assured dies during the term of the policy, the death claim arises. If the death has taken place within the first two years of the commencement of the policy, it is called an early death claim and if the death has taken after 2 years, it is called a non early death claim.

INTEXT QUESTIONS 7.1

1. When the maturity claim is payable?
2. When the death claim is payable?

7.3 CLAIM DOCUMENTS & FORMS AND SETTLEMENT PROCEDURE

We will discuss in this section the insurance documents necessary at the time of the final payment. The final payment may relate to the maturity or death claim payment.

7.3.1 The documents required for payment of maturity claim :

(i) Age proof, if age is not admitted.

(ii) Original policy document for cancellation.

(iii) In case assignment is executed on a separate paper, that document has to be surrendered.

(iv) Discharge form duly executed.

(v) Indemnity bond in case the policy document is lost or destroyed, duly executed by the policyholder and a surety of sound financial standing.

7.3.2 The documents required for payment of a death claim.

(i) An intimation of death by the nominee or a near relative.

(ii) Proof of age if not already admitted.

(iii) Proof of death.

(iv) Doctor's certificate who attended the deceased during his last illness.

(v) Identity certificate from a reputable person who saw the body of the deceased life assured.

(vi) Certificate of cremation or burial from a reputable person who attended the funeral.

(vii) An employer certificate if any, of the deceased.

If the policy has been assigned validly or if there is a valid nomination in the policy document, no further proof of title to the policy money is necessary. In other cases, the satisfactory evidence of title to the estate of the deceased is required from competent court of law. e.g.

(i) A probate of the will, if a will has been executed by the deceased life assured.

(ii) A succession certificate if no will has been left.

(iii) A certificate from the Administrator General, if the total amount of the estate left does not exceed Rs. 2,000/-.

In case there is a rival claim court's prohibitory order may be required to prevent the insurer from making the payment to the nominee as mentioned in the policy document.

7.3.3 In case the life assured has disappeared

Under Indian Evidence Act, 1872, Section 108, a person who has disappeared is presumed to be dead only if he has not been heard of for 7 years by those who would naturally have heard of him, if he had been alive.

Notes

The claimant has to produce the decree of the court to the effect that the assured should be presumed to be dead.

The legal heirs are required to keep on paying the premium payment till such court order is received failing which the policy will be treated as a paid up policy.

7.3.4 In case the premature death claim

In case of a premature death claim, i.e. a death within two years of the commencement of the policy, the insurer asks from claimant documents in order to eliminate the possibility of any suppression of a material fact at the time of submitting the proposal.

(i) Hospital treatment details where the assured was hospitalised.

(ii) Certified copies of postmortem report

(iii) The police investigation report if death is due to an accident or unnatural cause.

INTEXT QUESTIONS 7.2

---

1. What is the meaning of age not admitted?
2. What is succession certificate?

7.4. PROCEDURE OF CLAIM SETTLEMENT

7.4.1 Maturity Benefit

If the policyholder lives through the duration of the policy and becomes eligible to get the maturity value it is called the settlement of a maturity claim. As the policyholder is alive, the nomination is of no significance. Age is normally admitted at the stage of the proposal. If it has not been admitted for some reason, it is necessary to submit the age proof before the payment of the maturity value.

Much before the date of maturity the insurer sends the claim discharge voucher which has to be returned duly signed and witnessed along with the policy document for payment of the maturity value.

7.4.2 Death Claim

In case of the death of the policyholder at anytime during the duration of the policy, the claim amount becomes payable to the nominee mentioned in the policy document. The nominee or the nearest relative shall send an intimation of death of the policyholder to the insurer stating therein the fact of death, the date of death, cause of death and the place of death along with the policy number.

Insurer deals with the death claim differently on the basis of the duration or the policy. If the policyholder has died within two years of the commencement of the policy, i.e., acceptance of risk which may be different from the date of commencement if the policy has been dated back it is treated as "early or premature claim" and if the death has occured after 2 yrs of the commencement, it is treated as normal death claim.

In a normal death claim, that is if the life assured has died after two years of the commencement of risk, the insurer, on being intimated about the death of the policyholder, calls for the age proof, if not earlier admitted, the original policy document and proof of death. The proof of death can be a certificate from the municipal authorities under which cremation has taken place, or other local body like death registry. The claimant generally is required to fill in a form giving certain routine information about his title to the policy money and the information relating to death, which is normally called a claimant's statement.

7.4.3 Premature claim

It is a premature claim if the death has occurred within two years from the commencement of the policy or the date of last revival, or medical examination. The insurer takes certain precautions before making payment under such a premature claim.

It wants to satisfy itself that it is a genuine case i.e., the correct policyholder has died and that the cause of death does not go back to a date prior to the commencement of the policy. The duration of last illness is of vital importance to eliminate any fraudulent intention. Last medical attendants' certificate, hospital report, burial certificate, employees' leave record, if he was an employee in a reputed firm etc, are the different records examined and normally a senior officer is deputed by the insurer to make on the spot investigation, through neighbours, colleagues or doctor of the locality.

Notes

As the revival of the policy is a *de novo* contract of insurance, the insurer would like to verify whether the statement contained in the declaration of good health given at the time of revival is correct. If such a statement is proved fraudulent relating to a material fact, the claim, may be rejected. Life insurance is a contract of utmost good faith and good faith has to be observed, not only at the time of the proposal, but also at the time of the revival of the policy whenever it is done.

In case there is a rival claimant to the insurance money, the insurer can get a valid discharge by paying to the nominee. The rival claimant can approach a court of law which may order to stop the payment till the case is finally disposed of.

However if there is no nomination under the policy, the insurer shall await a valid title through either a will or a probate as a letter of administration or a succession certificate. It may take quite sometime to get such certificate from the court and in the meantime the family may suffer. A good agent therefore shall ensure that there is a valid nomination or assignment.

If there is an assignment, the policy money is paid to the assignee. If there is a reassignment of the policy, it is necessary that a fresh nomination is done, as assignment invalidates the existing nomination. However, if there is a nomination in favour of the insurer for taking any loan, the nomination is said to be unaffected subject to the claim of the insurer.

If the premature death has been due to an accident, it is necessary to get a police inquiry report in lieu of the attending physician certificate. Suicide, if it has taken place within one year of the beginning of the risk, exempts the insurer from the liability of the payment of the claim. The propensity to commit suicide is a moral hazard and is not expected to continue beyond one year.

If the policyholder disappears and he has not been heard of for 7 years by those who would naturally have heard of him, if he had been alive, he is presumed dead as per Sec 108 of the Indian–Evidence Act, 1872. However, it is necessary to keep the policy in force during this period by payment of the due premiums on the due dates.

7.4.4 Claim concession

Normally, a death claim becomes payable so long as the policy is kept in force by payment of due premium. In other words if the payment of premium is stopped and the grace period expires and if the death occurs thereafter the policy is treated as lapsed or paid up depending upon whether the premium has been paid for less than 3 yrs or 3yrs & more. Under a lapsed policy no claim is payable. In case of a paid up policy, only the paid up value is payable.

However, some companies provide certain concessions with regard to the claim payment, if the policy has run for 3 yrs or more:

1. If the premiums under a policy have been paid for a minimum period of three full years, and the life assured has died within 6 months from the date of the first unpaid premium insurer pays the full sum assured instead of the paid up value and only the unpaid premiums for the policy year are deducted from the claim amount.

2. This concession is extended to a period of twelve months and the full sum assured is paid if the life assured dies within one year from the due date of the first unpaid premium, provided the premiums have been paid for a minimum period of 5 years subject to deduction of the unpaid premiums for the policy year.

7.4.5 Ex Gratia claim

When a policy has not acquired paid up value and claim concession rules are not applicable, nothing is payable in case of death. However some insurers relax the rules in favour of the claimant.

If the premiums have been paid for more than 2 years and

(a) the death occurs within three months from the first unpaid premium, full sum assured with bonus, if any, is payable ;

(b) if the death occurs after 3 months, but within 6 months, half the sum assured is paid ;

(c) if the death occurs within one year from first unpaid premium, notional paid up value is paid.

Under the first condition, the unpaid premium with interest for the policy year of death will be deducted from the claim and no deduction is made in the other two conditions.

Notes

7.5 CLAIM SETTLEMENT OPTIONS

Most claims are paid in single lump sum. In case of a small sum assured, this lump sum payment may become necessary for immediate needs. (However, where the sum assured is large the amount if paid in instalments would be a valuable aid to the family maintenance). It is surprising that adequate attention is not paid to this aspect of the settlement options either by the claimant, or by the agent or the insurer.

The settlement options as available are not competitive in interest rates and therefore most claimants probably would not opt for it. Lump sum payments are most likely to be spent much faster leaving the family without the benefit of security. The family in the absence of the breadwinner may not have the foresight and the ability to look to the safety of the capital, rate of return, liquidity and ease of management of money. Many insurance companies world over are facilitating the management of the claim by offering a lot of options to the claimant.

Life insurance can be described as the creation of capital and annuities as a method of distribution of capital. Life insurance companies therefore, can convert this capital into annuity payments as per the needs of the claimant.

An agent would do well to advise the widow in this regard and help her to purchase a suitable annuity policy with this claim amount so that the family can look after itself smoothly for quite sometime. Annuities of various types are available, as has been discussed in the chapter on "Life Insurance Products".

Lump sum payment, let it be remembered, does not offer protection against the creditors of the beneficiary, while the payment through annuity payment does. For beneficiaries, inexperienced in the art of money management receiving guaranteed payments in instalment may be more desirable.

INTEXT QUESTIONS 7.3

1. What is a premature claim?
2. What is an Ex Gratia Claim?
3. Is an insurance company bound to pay Ex gratia Claims?


Notes

7.6 IRDA REGULATION ON POLICYHOLDERS PROTECTION

The Insurance Regulatory and Development Authority has issued the Protection of Policyholders' Interests Regulations, 2002. This regulation states the matters to be stated in the life insurance policy for the protection of policyholders interests. It also lays down the procedure to be adopted towards the settlement of claim under a life insurance policy.

7.6.1. Claims procedure in respect of a life insurance policy

(i) A life insurance policy shall state the primary documents which are normally required to be submitted by a claimant in support of a claim.

(ii) A life insurance company, upon receiving a claim, shall process the claim without delay. Any queries or requirement of additional documents, to the extent possible, shall be raised all at once and not in a piece-meal manner, within a period of 15 days of the receipt of the claim.

(iii) A claim under a life policy shall be paid or be disputed giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers and clarifications required. However, where the circumstances of a claim warrant an investigation in the opinion of the insurance company, it shall initiate and complete such investigation at the earliest. Where in the opinion of the insurance company the circumstances of a claim warrant an investigation, it shall initiate and complete such investigation at the earliest, in any case not later than 6 months from the time of lodging the claim.

(iv) Subject to the provisions of Section 47 of the Act, where a claim is ready for payment but the payment cannot be made due to any reasons of a proper identification of the payee, the life insurer shall hold the amount for the benefit of the payee and such an amount shall earn interest at the rate applicable to a savings bank account with a scheduled bank (effective from 30 days following the submission of all papers and information).

(v) Where there is a delay on the part of the insurer in processing a claim for a reason other than the one covered by sub-regulation (4), the life insurance company shall pay interest on the claim amount at a rate which is 2%

above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

Notes

7.7 SUMMARY

Claim payment relates to the payments made by the insurer to the policyholder or his nominee on happening of the event as mentioned in the schedule of the policy document. In money back plans, survival benefit is paid from time to time to the policyholder. This amount is tax free and comes handy to meet planned events.

The maturity claim is a payment at the end of the term of the policy and is the happiest occasion for the policyholder, for he receives the entire money with certain additions after years of paying the premium.

A death claim payment is the real fulfillment of the purpose of life insurance, for no other instrument of savings can perform this miracle.

The procedure for payment of the survival benefit or maturity claim is rather simple. In case of death claim also the procedure is hassle free unless there is any fraud involved. No life insurance company can afford to create problems for payment of death claim, except at its own peril. A good agent comes to the aid of the widow on such an occasion.

7.8 TERMINAL QUESTIONS

1. List the various types of claims that can be made under life insurance.
2. What are the documents required for settlement of death claim?
3. What are the documents required for settlement of maturity claims?
4. What are the provisions framed for settlement of claims under IRDA Policyholders' Protection Regulations?
5. What is need of giving ex-gratia claims?
6. When are claim concessions offered?
7. What are the claim settlement options available to the insurers?

7.9 OBJECTIVE TYPE QUESTIONS

1. What is meant by a claim under an insurance policy?
   a. Any demand made by the policyholder on the insurer.
   b. A demand to fulfill the policyholder's obligations.
   c. A demand to fulfill the insurer's obligations.
   d. All the three above.

2. Which one of the following statement is correct?
   a. A request for a loan is considered as a claim.
   b. A request for surrender of the policy is considered a claim.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.

3. Which one of the following statement is correct?
   a. A claim will be paid as soon as the death of the insured is confirmed.
   b. An insurer makes enquiries to establish that death took place.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.

4. Which one of the following statement is correct?
   a. A death claim within two years of commencement is treated as an early claim.
   b. A death claim within two years of revival is treated as an early claim.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.

5. Which one of the following statement is correct?
   a. The insurer waits for a demand before taking action in maturity claim cases.
   b. The insurer takes action in a death claim case after a demand is made on it.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.

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6. Which one of the following statement is correct?
   a. Maturity claims are paid to policyholders.
   b. Maturity claims are paid to assignees.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.
7. Which one of the following statement is correct?
   a. The death claim is settled in favour of the nominee in MWP Act cases.
   b. The death claim is settled in favour of the trustee in MWP Act cases.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.
8. Which one of the following statement is correct?
   a. Maturity proceeds are paid to the nominee, if the policyholder dies earlier.
   b. Maturity proceeds are paid to the heirs, if the policyholder dies earlier.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.
9. Which one of the following statement is correct?
   a. No claim is paid unless the original policy is produced.
   b. Claim can be paid even without the original policy, if it is lost.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.
10. Which one of the following statement is correct?
   a. Claims may be paid on the basis of indemnity, if title is not established.
   b. Claims may be paid on the basis of indemnity, if original policy is lost.
   c. Both the statements above are correct.
   d. Both the statements above are wrong.

7.10 ANSWERS TO INTEXT QUESTIONS

7.1

1. Maturity claim is payable on the maturity of the term of the policy.
2. If the life assured dies during the term of the policy, the death claim arises

7.2

1. Age not admitted means the age proof is not provided at the time of taking the policy.
2. Succession certificate is issued by the Courts where the legal heirs of the deceased are mentioned. .

7.3

1. Premature claim means if the death has occurred within two years from the commencement of the policy or the date of last revival, or medical examination. The insurer takes certain precautions before making payment under such a premature claim.
2. When a policy has not acquired paid up value and claim concession rules are not applicable nothing is payable in case of death. However, some insurers relax the rules in favour of the claimant and the claim paid is known as ex-gratia Claim
3. No the company is not bound to Ex gratia claims.

7.11 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. d	2. d	3. d
4. c	5. b	6. c
7. b	8. b	9. b
10. c		

Open Vocational Education Programme

Diploma in Insurance Services

4

PRACTICE OF GENERAL INSURANCE

Designed & Developed
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Diploma in Insurance Services

PRACTICE OF GENERAL INSURANCE

CONTENTS

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Before you begin reading your lessons and start your training, there are a few words of advice that I would like to share with you. We, at the NIOS, are well aware that you are different from other learners. We realize that there are many of you who may have rich life experiences; you may have prior knowledge about trades and crafts that are part of your family's legacy; you may have a sharp business sense that will make you fine entrepreneur one day. Most importantly, you have the drive and motivation that has made you enroll with this institution, which believes in the spirit of freedom. Yes, we are aware that you have many positive aspects in your personality, which we respect and relate to them.

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Studying for a vocational course is different from any other academic course. Here, while the marks obtained in the examination will indicate your grasp on your subject knowledge, your real achievement will be when you are able to apply your vocational skills in the market. I hope that this skill-based learning will help you perform your tasks better .This course of One year duration Diploma Course in Insurance Services developed by leading experts of Insurance sector. It is a multi-skilled programme, which will expose you to a variety of skills in Insurance sector. We hope that you will find it useful. On behalf of NIOS, I wish you the very best for a bright and successful future.

Dr. S. S. Jena
Chairman
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Dear Learner,

In the fast expanding world of activities, learning new skills has become a necessity. Learning and re-learning has become essential for all. In such an environment, vocational education has assumed great importance. Vocational education, as a stream of education, promotes skill development and training of youth and directs them towards meaningful employment.

In keeping with the needs of the Learners, NIOS conducts Vocational Education Programmes in many areas through distance mode. These programmes include Agriculture, Business & Commerce, Home Science, Engineering & Technology, Computer Science, and Health & Paramedical. The Courses offered in these areas are aimed at providing self employment & wage employment opportunities for NIOS learners.

Diploma in Insurance Services is a One year Diploma course in Insurance Services. This course has been developed with the help of many leading experts of Insurance Sector. The course syllabus is designed keeping in view the requirements of the insurance sector.

This is multi-skilled programme, which will expose you to variety of skills. It includes Business Environment, Principles of Insurance, Life Insurance, General Insurance and Legal framework. This will help in identifying learner's preference for future vocation. We are confident that this course will prove to be beneficial to you.

We wish you all the best in your future career.

Dr. K. P. Wasnik
Director (VE)
National Institute of Open Schooling

Dear Learner,

This programme is specially for all those who are school dropouts and have started small enterprises, want to work in the Insurance sector as a skilled workforce and contribute substantially to the progress of India.

The multi-skill content with hands-on experience of this programme stimulates the intellect by going through concrete operations and then abstracting the concepts. At the same time by giving a variety of skills usable in everyday life, allowing them to form their preferences and know their aptitudes thus enabling them to choose a career. It also improves their self-image and gives them confidence and hope for the future.

The Insurance sector has completed its full circle in the year 2000, i.e. Private sector to Public sector and now back to Private sector. After 44 years, the monopoly of Life Insurance Corporation is no more and after 27 years four Public Sector general Insurance companies lost their monopoly. As on date there are 50 life and general insurance companies and few are queue to get license.

These insurance companies need trained manpower to be present on all India bases. To cater the needs of the insurance industry NIOS has designed a course namely "Diploma in Insurance Services" for the students who have minimum qualification of 12th standard.

In this module the student will be made familiar with non life (general) insurance segment.

There are about 150 products in the general insurance but selected and importance products are being explained under this module. The products which are explained are fire, marine, Motor, Health, Personal Accidental, and rural insurances. There are certain products like liability and Project insurance are explained in brief.

We hope that this programme will help you to carve an niche in your career and play an important role in the society.

With best wishes.

Dr. Ajay Garg
Senior Executive Officer
(Business & Commerce)
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ACKNOWLEDGEMENT

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1

FIRE INSURANCE

1.0 INTRODUCTION

Insurance sector is divided in two parts as under:

Insurance

Life insurance

Non-life or General insurance

In this module we will explain various insurance polices related to non-life /general insurance. Non-life /general insurance means the insurance of various tangible or non-tangible assets other than human life. Even loss of human life or damage to human body due to accidents are covered by general Insurance. Thus, human life relates to life insurance and the belongings i.e. properties of human beings fall under this category.

Though there are various general insurance policies but we will discuss only the following important policies:

1. Fire Insurance
2. Marine Insurance (Transit)
3. Vehicle Insurance
4. Personal Accident Insurance
5. Health Insurance
6. Rural Insurance Policies

The above said policies are being sold only by general insurance companies and cannot be sold by life insurance companies. This restriction is imposed only in India but not in other parts of the world.

In India also, prior to nationalization, general insurance business was conducted by life insurance companies also but after nationalization in 1972, consequent upon passing of the General Insurance Business Nationalisation Act (GIBNA) General Insurance Corporation of India was formed and was conferred the exclusive power to regulate and conduct the business of General Insurance in India.

Since 1973 the GIC and its four subsidiary companies namely New India Assurance Co. Ltd., National Insurance Co. Ltd., Oriental Insurance Co. Ltd., and United India Insurance Co. Ltd. had been the sole players in the field until the passing of the IRDA Act 1999 which allowed the entry of private players.

Over the past few years a few private players have entered the arena. The new players have entered the General Insurance field but are playing cautiously. These are still early days but the field is wide open, the future is bright and the customer is the one who will be benefited the most by the growing competition. We hope to see international level of service and products in the country soon and a multiple choice to select from.

At the end of this lesson, you will be able to:

ü Explain the meaning of fire insurance

ü Buy the fire insurance

ü Settle the claim under fire insurance

ü Know the practice of fire insurance in India.

ü Know what is not covered under fire insurance

In the following pages, we shall be discussing the Fire Insurance.

1.1 HISTORY OF FIRE INSURANCE

The development of fire Insurance can be traced back to 1601 A.D. when the Poor Relief Act was passed in England. Vide this act, letters called “briefs” were read from the church asking for collections from the public to help those who suffered losses from fire. There was a great fire in London–a historical disaster–

in which within span of three days from 2nd to 5th Sept.'1666, 80% of the city was destroyed which sowed the seeds of fire Insurance as we know it now.

Notes

First, only buildings were insured and the first fire office was established by a builder Nicholas Barbon in 1680. In 1708, Charles Povey founded the Traders Exchange for insuring movable goods, merchandise and stocks against loss or damage and this was the first to insure both the building and its contents.

1.2 MEANING OF FIRE INSURANCE

The term fire in a fire insurance is interpreted in the literal and popular sense. There is fire when something burns. In other words fire means visible flames or actual ignition. Simmering/ smoldering is not considered fire in Fire Insurance. Fire produces heat and light but either of them alone is not fire. Lightening is not a fire but if it ignites something, the damage may be due to fire.

Under section 2(6A) Insurance Act 1938, the fire insurance business is defined as follows: "Fire insurance business means the business of effecting, otherwise than independently to some other class of business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies".

Example: The following are the items which can be burnt/ damaged through fire:

- Buildings
- Electrical installation in buildings
- Contents of buildings such as machinery, plant and equipments, accessories, etc.
- Goods (raw materials, in–process, semi–finished, finished, packing materials, etc.) in factories, godowns etc..
- Goods in the open
- Furniture, fixture and fittings
- Pipelines (including contents) located inside or outside the compound, etc.

The owner of abovementioned properties can insure against fire damage through fire insurance policy which provides

Notes

financial protection for property against loss or damage by fire.

1.3 FEATURES OF FIRE INSURANCE:

(Dear learner, most of the features to be discussed in the following paragraphs of Fire Insurance you must have studied under Principles of General Insurance in other module)

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

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

3) **Contract of Indemnity:** Fire insurance is a contract of indemnity and the insurance company is liable only to the extent of actual loss suffered. If there is no loss, there is no liability even if there is fire. Example: If the property is insured for Rs 20 lakhs under fire insurance and it is damaged by fire to the extent of Rs. 10 lakhs, then the insurance company will not pay more than Rs. 10 lakhs.

4) **Utmost Good Faith:** The property owner must disclose all the relevant information to the insurance company while insuring their property. The fire policy shall be voidable in the event of misrepresentation, mis-description or non-disclosure of any material information. Example: The use of building must be disclosed i.e whether the building is used for residential use or manufacturing use, as in both the cases the premium rate will vary.

5) **Insurable Interest:** The fire insurance will be valid only if the person who is insuring the property is owner or having insurable interest in that property. Such interest must exist at the time when loss occurs. It is well known that

Notes

insurable interest exists not only with the ownership but also as a tenant or bailee or financier. Banks can also have the insurable interest. Example: Mr. A is the owner of the building. He insured that building and later on sold the building to Mr. B and the fire took place in the building. Mr. B will not get the compensation from the insurance company because he has not taken the insurance policy being a owner of the property. After selling to Mr. B, Mr. A has no insurable interest in the property.

6) **Contribution:** If a person insured his property with two insurance companies, then in case of fire loss both the insurance companies will pay the loss to the owner proportionately. Example: A property worth Rs. 50 lakhs was insured with two Insurance companies A and B. In case of loss, both insurance companies will contribute equally.

7) **Period of fire Insurance:** The period of insurance is to be defined in the policy. Generally the period of fire insurance will not exceed by one year. The period can be less than one year but not more than one year except for the residential houses which can be insured for the period exceeding one year also.

8) **Deliberate Act:** If a property is damaged or loss occurs due to fire because of deliberate act of the owner, then that damage or loss will not be covered under the policy.

9) **Claims:** To get the compensation under fire insurance the owner must inform the insurance company immediately so that the insurance company can take necessary steps to determine the loss.

INTEXT QUESTIONS 1.1

1. What is utmost good faith?

2. What is period of insurance?

Notes

1.4 PROCEDURE TO INSURE THE PROPERTY UNDER FIRE INSURANCE:

For insuring any property under the fire insurance policy, the following is the procedure:

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

I) Filling of Proposal Form

The fire proposal includes the following information :

Description of the property. This would include:

I) (i) Construction of external walls and roof, number of storeys.

(ii) Occupation of each portion of the building.

(iii) Presence of hazardous goods.

(iv) Process of manufacture.

(v) The sums proposed for insurance.

(vi) The period of insurance.

(vii) History of previous losses.

(viii) Insurance history - whether previously other insurers had declined the risk, etc.

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

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

Act 1938 that the premium is paid in advance in full to the insurance company.

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

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

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

1.5 PROCEDURE TO SETTLE THE FIRE INSURANCE CLAIM:

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

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

The survey report would generally deal with the following matters:

(i) Cause of loss.

(ii) Extent of loss.

(iii) Under-Insurance, if any.

(iv) Details and value of salvage, and how it has been disposed of or proposed to be disposed of.

(v) Details of expenses (e.g. fire brigade expenses).

(vi) Compliance with policy conditions and warranties.

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

C) **Claim form**: The policy holder will submit the claim form with the following information :

(i) Name and address of the Insured.

(ii) Date of loss, time and place from where the fire started.

(iii) Cause of fire.

(iv) Details of the property damaged such as description, etc.

(v) Value at the time of fire, value of salvage and the amount of loss.

(vi) Details of other policies on the same property giving the name of the insurer, policy number and sum insured.

(vii) Fire Brigade report details.

(viii) F.I.R. at the nearest police station regarding third party liability, if any.

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

1.6 PRACTICE OF FIRE INSURANCE IN INDIA

In India, under fire insurance policy, in addition to fire, other perils are also included and the policy is known as **“Standard Fire and Allied Perils Policy”.**

The perils specified in the fire policy are:

A. **Fire**: It has been explained as above.

B. **Lightning:** Any lightning due to cloud burst may damage the property and the same will be covered under the fire policy.

C. **Explosion / Implosion:** Sudden change in the temperature in any plant & machinery or exposure to atmospheric pressure may result into loss and the same will be covered under fire policy.

D. **Aircraft Damage:** Any damage to the property due to any droppings by aircraft or by itself will also be covered under the fire policy.

E. **Riot, Strike and Malicious Damage (RSMD):** Any damage to the property due to public or strike by employees or malicious damage (intentional damage) by any person will be covered under this policy.

F. **Storm, Cyclone, Typhoon, Tempest, Hurricane, Tornado, Flood and Inundation (STFI):** The property damage due to any of these storms and flood will also be covered under this policy. The meaning of these perils lies in different intensity of the storms. Flood not only means the leakage of water through river but also accumulation of water due to heavy rains in the premises.

G. **Impact Damage:** Damage to the property due to impact by any Rail / Road vehicle or animal by direct contact, but not belonging to or owned by the Insured or any occupier of the premises or their employees while acting in the course of their employment.

H. **Subsidence and Landslide including Rock Slide**

Destruction or damage caused by Subsidence of part of the site on which the property stands or Land slide / Rock slide.

I. **Bursting and/or overflowing of Water Tanks, Apparatus and Pipes:** If due to bursting or overflowing of water from the water tanks installed in the premises of the policyholder any damage or loss to the property of the policyholder is caused, it will be covered under this policy.

J. **Missile Testing Operations:** Any loss or damage due to missile testing by the Govt. or otherwise will be covered under this policy.

K. **Leakage from Automatic Sprinkler Installations :** In most of the organizations as a fire protection measure, automatic sprinkler system is installed. If due to non–usage of the sprinkler system or otherwise it starts leaking and damages the property, then it will be covered under the fire insurance policy.

L. **Bush Fire:** It means fire spread from the bushes (small fire) but will not include forest fire.

IN TEXT QUESTIONS 1.2

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1. What are allied perils in Fire insurance policy?

1.7 THE FIRE INSURANCE DOES NOT COVER THE FOLLOWING RISKS KNOWN AS GENERAL EXCLUSIONS

(i) In every claim minimum deduction say Rs 5000/- or Rs 10000/- will be made while settling the claim under this policy. It is to avoid small losses.

(ii) Loss, destruction or damage caused by war, and kindred perils.

(iii) Loss, destruction or damage directly or indirectly caused to the insured property by nuclear peril.

(iv) Loss, destruction or damage caused to the insured property by pollution or contamination.

(v) 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).

(vi) Loss of earnings, loss by delay, loss of market or other consequential or indirect loss or damage of any kind or disruption whatsoever.

(vii) Earthquake: It is not covered under the fire policy but by paying additional premium, the earthquake can be covered.

1.8 SPECIAL POLICIES

a) Floater Policy

This policy is issued only for the stocks, not for plant &

machineries. Sometime the stock is kept at various locations and it is very difficult to provide the value of stock at each location. Therefore to cover the risks of stocks at various locations under one sum insured an additional premium can be paid. Example: A person is having two godowns at Delhi and the value of stock is Rs 50 lakhs and he is not having the value at each location then he can insure the stock under floating policy by paying an additional premium.

b) Declaration Policies

This type of policy is useful where there is frequent fluctuations in stocks / stock values and to avoid the under insurance (insurance of lower value) of the stock, Declaration Policy(ies) can be granted subject to the following conditions:

(a) The minimum sum insured shall be Rs. l crore.

(b) Monthly declarations based on the average of the highest value at risk on each day or highest value on any day of the month shall be submitted by the Insured latest by the last day of the succeeding month. If declarations are not received within the specified period, the full sum insured under the policy shall be deemed to have been declared.

(c) Reduction in sum insured shall not be allowed under any circumstances.

(d) Refund of premium on adjustment based on the declarations / cancellations shall not exceed 50% of the total premium.

(e) The basis of value for declaration shall be the Market Value unless otherwise agreed to between insurer and insured.

(f) It is not permissible to issue declaration policy in respect of

i) Insurance required for a short period

ii) Stocks under going process

iii) Stocks at Railway sidings

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Example:

Sum insured	:	Rs. 1,00,00,000/- (1 crore)
Rate	:	Rs. 1.00 per mille
Premium	:	Rs. 10,000/-

Monthly Declarations

January	Rs. 58,00,000/-
February	Rs. 56,00,000/-
March	Rs. 46,00,000/-
April	Rs. 30,00,000/-
May	Rs. 30,00,000/-
June	Rs. 30,00,000/-
July	Rs. 30,00,000/-
August	Rs. 40,00,000/-
September	Rs. 40,00,000/-
October	Rs. 40,00,000/-
November	Rs. 40,00,000/-
December	Rs. 40,00,000/-
Total Declarations	Rs. 4,80,00,000/-
Average sum insured/ month	Rs. 40,00,000/-
Premium received in Advance	Rs. 10,000/-
Premium on average sum insured (say)	Rs. 4,000/-
Excess premium paid	Rs. 6,000/-

According to rule, refund cannot exceed 50% (i.e.) Rs. 5000/- and not Rs. 6000/-.

c) Floater Declaration Policy

It is combination of the above mentioned policies i.e. stock lying at different locations and the value of stock fluctuating.

1.9 ADDITIONAL TERMS & CONDITIONS

a) Reinstatement Value

This is the fire policy with the reinstatement value clause attached to it. The clause provides that in the event of loss, the amount payable is the cost of reinstating property of the same kind or type, by new property (i.e.) "New for Old".

This basis of settlement differs from the basis under the fire policy where the losses are settled on the basis of market value i.e. making deductions for depreciation, etc.

Under reinstatement value policy, it is possible to cover the depreciated value of the building or machinery. The cost of replacement of the damaged property is ascertained by new property of the same kind. If due to technical improvements the new machinery is better than the damaged machinery e.g. output is increased with less consumption of power, the insured is obliged to bear a part of the cost of the new machinery to ensure that he does not derive any undue benefits. Thus, the principle of indemnity is still observed.

The reinstatement value clause incorporates the following special provisions:

(a) Reinstatement must be carried out by the insured and completed within 12 months after the destruction or damage, or within such extended time as may be allowed by insurers, failing which the loss will be settled on the normal indemnity basis i.e. according to the Fire Policy.

(b) Until reinstatement is carried out, the liability under the policy remains on the normal indemnity basis. i.e. market value basis.

(c) Pro-rata Average is applied by comparing the sum insured with the cost of reinstatement of the entire property insured as on date of reinstatement.

(d) The reinstatement basis of settlement will not apply

    (i) If the insured fails to intimate to the insurer within 6 months or any extended time his intention to replace the damaged property.

    (ii) If the insured is unable or unwilling to replace the damaged property. In such cases the loss will be settled on the normal basis of indemnity.

(e) The work of reinstatement may be carried out upon another site and in any manner required by the insured provided the liability under the policy is not thereby increased.

Notes

These insurances are granted to insureds whose bonafides are satisfactory and, are generally issued only in respect of building, plant *and* machinery in a comparatively new condition.

These insurances are not granted on stocks.

b) Local Authorities Clause

Reinstatement Value Policy may be extended to cover such additional cost of reinstatement of the destroyed or damaged property as may be incurred solely by reason of the necessity to comply with the Building or other Regulations under any Act of Parliament or bye-laws of any Municipal or Local Authority.

c) Agreed Bank Clause

All policies in which a Bank has a partial interest are to be made out in the name of the Bank and Owner or Mortgagor and the Agreed Bank Clause incorporated in the policy.

The salient features of the clause are :

(a) The claim is payable to the bank whose receipt shall be a complete discharge and binding on all parties insured.

(b) Any notice under the policy is sufficient if given by or to the bank.

(c) Any settlement, compromise etc. in relation to dispute if made with the bank shall be valid and binding on all parties insured.

(d) Any alteration or increase in risk does not invalidate the insurance, provided the bank notifies the same as soon as it comes to its knowledge and pays additional premium.

1.10 SUMMARY

The fire policy does not cover only the loss/damage of fire but also due to other perils like lightening, storms, strike, aircraft damage etc. Therefore the fire policy in India, is known as Standard Fire and Special Perils Policy. Though these risks are covered yet exceptions are always there. For the growth of the Indian economy every business organization should insure its assets.

If the value of stocks is fluctuating substantially during the year then the same should be insured under declaration fire insurance policy. To protect the interest of the financial institutes the agreed bank clause may be included.

In India, the fire insurance premium contributes 30% to 40% of every insurance company.

1.11 TERMINAL QUESTIONS

1) Explain the features of the fire insurance policy.
2) Discuss the fire insurance policy in India.
3) Explain the various types of fire insurance policies.
4) Write short notes on
   a. Reinstatement Value
   b. Agreed Bank Clause
   c. Local Authorities Clause

1.12 OBJECTIVE TYPE QUESTION

1. Under which of the following conditions the fire policy will cease
   a. Changes in trade or manufacture activities
   b. Unoccupancy of the building for more than 30 days
   c. Transfer of insurable interest unless by will or operation of law
   d. All of the above.
2. In case of a Fire Declaration Policy, if Sum Insured – Rs.1 crore, Rate of premium – Rs.1 per mille, and Average of Monthly Declarations – Rs.60 lakh, calculate Provisional Premium and Refund of Premium.
   a. Rs.9,000, Rs.5,000 b. Rs.10,000, Rs.4,000
   c. Rs.7,000, Rs.7,000 d. Rs.8,000, Rs.6,000
3. The Standard Fire and Special Perils Policy covers works of art for an amount ‘not’ exceeding Rs. _________.
   a. 20,000 b. 10,000
   c. 5,000 d. 15,000

4. For insuring full protection of a factory the declaration of SI should be on the following basis.

   a. Block wise separate amounts on (i) Building (ii) Machinery (iii) Stocks and Stocks in process (iv) Furniture & other contents.

   b. Block wise separate amounts on (i) Building (ii) Machinery (iii) Stocks

   c. Total amount for all above as SI

   d. None of the above.

5. Which of the following perils can be an add-on cover under the Fire policy at extra premium?

   a. Spontaneous combustion   b. Flood

   b. Impact Damage   d. Explosion

6. Under Fire Declaration policy, the basis of monthly declarations is

   A. A: Average of the highest value on each day of the month.

   B. B: Highest value on any day of the month

   C. C: Value on the last day of the month.

   a. B and C   b. A and B

   c. A, B and C   d. A and C

7. Calculate the net premium, if

   i. Sum insured : Rs. 500 lakh

   ii. Rate of premium : Rs. 2 per mille. Terrorism Rate Rs 0.30 per milli

   iii. Discount : 80%

   a. Rs. 35000/-   b. Rs. 23,000/-

   c. Rs 1.5 lakhs   d. None

8. Which of the following Statements is true?

¸ **Statement A : Short period rates are charged when the period of insurance is less than 12 months**

¸ **Statement B : Short period rates are charged when the policy is cancelled by the insured**

a. Only Statement A
b. Only Statement B
c. Both Statements
d. Neither of the Statement.

9. In case of Fire and Accident Insurance, Insurable interest must exist
   a. At the time of loss only
   b. At inception of insurance only
   c. Both at inception of insurance and at the time of loss
   d. No insurable interest is required

10. Floater Policy can be given under which situations.
    a) Where sum insured exceeds 2 crores
    b) Where goods are placed at different godowns at different Locations
    c) Where goods are placed at different godowns at different locations in the same compound
    d) Sum insured cannot be ascertained at all locations.

    i) a & b are correct
    ii) a, b & c are correct
    iii) a, b, c & d are correct
    iv) None is correct

1.13 ANSWERS TO IN TEXT QUESTIONS

1. Lightning, Explosion / Implosion, Aircraft Damage Riot, Strike and Malicious Damage, Impact Damage, Subsidence and Landslide including Rock slide, Bursting and / or overflowing of Water Tanks, Apparatus and Pipes, Missile Testing Operations, Leakage from Automatic Sprinkler Installations, Bush Fire.

1.14 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. d	2. b	3. b	4. a
5. a	6. b	7. a	8. c
9. c	10 . i		

2

MARINE INSURANCE

2.0 INTRODUCTION

This is the oldest branch of Insurance and is closely linked to the practice of Bottomry which has been referred to in the ancient records of Babylonians and the code of Hammurabi way back in B.C.2250. Manufacturers of goods advanced their material to traders who gave them receipts for the materials and a rate of interest was agreed upon. If the trader was robbed during the journey, he would be freed from the debt but if he came back, he would pay both the value of the materials and the interest.

The first known Marine Insurance agreement was executed in Genoa on 13/10/1347 and marine Insurance was legally regulated in 1369 there.

Marine Insurance

Cargo Hull

2.1 OBJECTIVES

- Know the meaning of Marine insurance
- Buy the Marine insurance
- Settle the claim under Marine Insurance
- Know the inland transit/overseas transit.
- Know what is not covered under Marine insurance

2.2 MEANING OF MARINE INSURANCE

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against transit losses, that is to say losses incidental to transit.

A contract of marine insurance may by its express terms or by usage of trade be extended so as to protect the insured against losses on inland waters or any land risk which may be incidental to any sea voyage.

In simple words the marine insurance includes

A. Cargo insurance which provides insurance cover in respect of loss of or damage to goods during transit by rail, road, sea or air.

   Thus cargo insurance concerns the following :

   (i) export and import shipments by ocean-going vessels of all types,

   (ii) coastal shipments by steamers, sailing vessels, mechanized boats, etc.,

   (iii) shipments by inland vessels or country craft, and

   (iv) Consignments by rail, road, or air and articles sent by post.

B. Hull insurance which is concerned with the insurance of ships (hull, machinery, etc.). This is a highly technical subject and is not dealt in this module.

2.3 FEATURES OF MARINE INSURANCE

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

2) **Payment of premium:** An owner must ensure that the premium is paid well in advance so that the risk can be covered. If the payment is made through cheque and it is

dishonored then the coverage of risk will not exist. It is as per section 64VB of Insurance Act 1938- Payment of premium in advance.(Details under insurance legislation Module).

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

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

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

   Example: Mr A sends the goods to Mr B on CIF (Cost, Insurance and Freight) basis which means the insurance is to be arranged by Mr A. And if any loss arises during transit then Mr A is entitled to get the compensation from the insurance company.

6) **Contribution:** If a person insures his goods with two insurance companies, then in case of marine loss both the insurance companies will pay the loss to the owner proportionately. Example; Goods worth Rs. 50 lakhs were insured for marine insurance with Insurance company A and B. In case of loss, both the insurance companies will contribute equally.

7) **Period of marine Insurance:** The period of insurance in the policy is for the normal time taken for a particular transit. Generally the period of open marine insurance will not exceed one year. It can also be issued for the single transit and for specific period but not for more than a year.

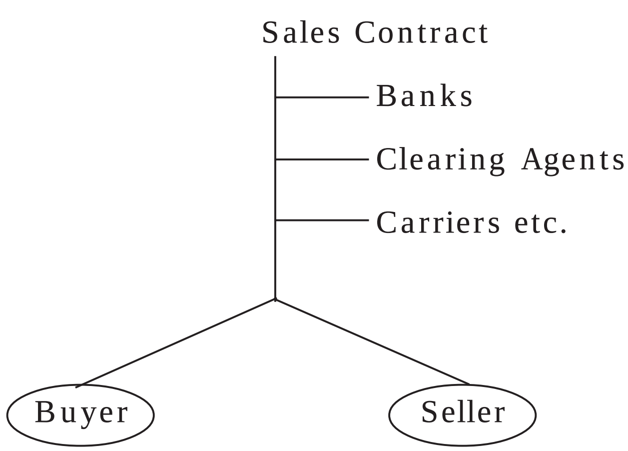
8) **Deliberate Act:** If goods are damaged or loss occurs during transit because of deliberate act of an owner then that damage or loss will not be covered under the policy.

9) **Claims:** To get the compensation under marine insurance the owner must inform the insurance company immediately so that the insurance company can take necessary steps to determine the loss.

2.4 OPERATION OF MARINE INSURANCE

Marine insurance plays an important role in domestic trade as well as in international trade. Most contracts of sale require that the goods must be covered, either by the seller or the buyer, against loss or damage.

Who is responsible for affecting insurance on the goods, which are the subject of sale? It depends on the terms of the sale contract. A contract of sale involves mainly a seller and a buyer, apart from other associated parties like carriers, banks, clearing agents, etc.



The principal types of sale contracts, so far as Marine insurance is directly concerned, are as follows:

Type of contract	Responsibility for insurance
Free on Board (F.O.B. Contract)	The seller is responsible till the goods are placed on board the steamer. The buyer is responsible thereafter. He can get the insurance done wherever he likes.
Free on Rail (F.O.R. Contract)	The provisions are the same as in above. This is mainly relevant to internal transactions.
Cost and Freight (C&F Contract)	Here also, the buyer's responsibility normally attaches once the goods are placed on board. He has to take care of the insurance from that point onwards.
Cost, Insurance & Freight (C.I.F. Contract)	In this case, the seller is responsible for arranging the insurance upto destination. He includes the premium charge as part of the cost of goods in the sale invoice.

Practice in International trade

The normal practice in export /import trade is for the exporter to ask the importer to open a letter of credit with a bank in favour of the exporter. As and when the goods are ready for shipment by the exporter, he hands over the documents of title to the bank and gets the bill of exchange drawn by him on the importer, discounted with the bank. In this process, the goods which are the subject of the sale are considered by the bank as physical security against the monies advanced by it to the exporter. A further security by way of an insurance policy is also required by the bank to protect its interests in the event of the goods suffering loss or damage in transit, in which case the importer may not make the payment. The terms and conditions of insurance are specified in the letter of credit.

For export/import policies, the-Institute Cargo Clauses (I.C.C.) are used. These clauses are drafted by the Institute of London Underwriters (ILU) and are used by insurance companies in a majority of countries including India.

INTEXT QUESTIONS 2.1

1. Who will get claim amount in case of marine insurance?
2. If sale contract is FOB, who should insure the goods?

2.5 PROCEDURE TO INSURE UNDER MARINE INSURANCE

A) Submission of form

B) Quotation from the Insurance Company

C) Payment of Premium

D) Issue of cover note/Policy

A) Submission of form

a) The form will have the following information:

a) Name of the shipper or consignor (the insured).

b) **Full description of goods to be insured:** The nature of the commodity to be insured is important for rating and underwriting. Different types of commodities are susceptible for different types of damage during transit- sugar, cement, etc are easily damaged by sea water; cotton is liable to catch fire; liquid cargoes are susceptible to the risk of leakage and crockery, glassware to breakage; electronic items are exposed to the risk of theft, and so on.

c) **Method and type of packing**: The possibility of loss or damage depends on this factor. Generally, goods are packed in bales or bags, cases or bundles, crates, drums or barrels, loose packing, paper or cardboard cartons, or in bulk etc.

d) **Voyage and Mode of Transit**: Information will be required on the following points :

i. the name of the place from where transit will commence and the name of the place where it is to terminate.

ii. mode of conveyance to be used in transporting goods, (i.e.) whether by rail, lorry, air, etc., or a combination of two or more of these. The name of the vessel is to be given when an overseas voyage is involved. In land transit by rail, lorry or air, the number of the consignment note and the date thereof should be furnished. The postal receipt number and date thereof is required in case of goods sent by registered post.

iii. If a voyage is likely to involve a trans-shipment it enhances the risk. This fact should be informed while seeking insurance. Trans-shipment means the change of carrier during the voyage.

e) **Risk Cover required**: The risks against which insurance cover is required should be stated. The details of risks are discussed subsequently in this chapter.

B) Quotation by insurance company

Based on the information provided as above the insurance company will quote the premium rate. In nutshell, the rates of premium depends upon :

(a) Nature of commodity.

(b) Method of packing.

(c) The Vessel.

(d) Type of insurance policy.

C) Payment of premium:

On accepting the premium rates, the concerned person will make the payment to the insurance company. The payment can be made on the consignment basis.

D) Issue of cover note /Policy document:

i) Cover Note

A cover note is a document granting cover provisionally pending the issue of a regular policy. It happens frequently that all the details required for the purpose of issuing a policy are not available. For instance, the name of the steamer, the number and date of the railway receipt, the number of packages involved in transit, etc., may not be known.

Notes

ii) Marine Policy

This is a document which is an evidence of the contract of marine insurance. It contains the individual details such as name of the insured, details of goods etc. These have been identified earlier. The policy makes specific reference to the risks covered. A policy covering a single shipment or consignment is known as specific policy.

iii) Open Policy

An open policy is also known as 'floating policy'. It is worded in general terms and is issued to take care of all "shipments" coming within its scope. It is issued for a substantial amount to cover shipments or sending during a particular period of time. Declarations are made under the open policy and these go to reduce the sum insured.

Open policies are normally issued for a year. If they are fully declared before that time, a fresh policy may be issued, or an endorsement placed on the original policy for the additional amount. On the other hand, if the policy has run its normal period and is cancelled, a proportionate premium on the unutilised balance is refunded to the insured if full premium had been earlier collected.

On receipt of each declaration, a separate certificate of insurance is issued. An open policy is a stamped document, and, therefore, certificates of insurance issued thereunder need not be stamped.

Open policies are generally issued to cover inland consignments.

There are certain advantages of an open policy compared to specific policies. These are:

(a) Automatic and continuous insurance protection.

(b) Clerical labour is considerably reduced.

(c) Some saving in stamp duty. This may be substantial, particularly in the case of inland sendings.

iv) Open Cover

An open cover is particularly useful for large export and import firms-making numerous regular shipments who would otherwise find it very inconvenient to obtain insurance cover separately for each and every shipment.

Notes

It is also possible that through an oversight on the part of the insured a particular shipment may remain uncovered and should a loss arises in respect of such shipment, it would fall on the insured themselves to be borne by them. In order to overcome such a disadvantage, a permanent form of insurance protection by means of an open cover is taken by big firms having regular shipments.

An open cover describes the cargo, voyage and cover in general terms and takes care automatically of all shipments which fall within its scope. It is usually issued for a period of 12 months and is renewable annually. It is subject to cancellation on either side, i.e., the insurer or the insured, by giving due notice.

Since no stamps are affixed to the open cover, specific policies or certificates of insurance are issued against declaration and they are required to be stamped according to the Stamp Act.

There is no limit to the total number or value of shipments that can be declared under the open cover.

The following are the important features of an open policy/ open cover.

(a) Limit per bottom or per conveyance

The limit per bottom means that the value of a single shipment declared under the open cover should not exceed the stipulated amount.

(b) Basis of Valuation

The 'Basis' normally adopted is the prime cost of the goods, freight and other charges incidental to shipment, cost of insurance, plus 10% to cover profits, (the percentage to cover profits may be sometimes higher by prior agreement with the clients).

(c) Location Clause

While the limit per bottom mentioned under (a) above is helpful in restricting the commitment of insurers on any one vessel, it may happen in actual practice that a number of different shipments falling under the scope of the open cover may accumulate at the port of shipment. The location clause limits the liability of the insurers at any one time or place before shipment.

Notes

Generally, this is the same limit as the limit per bottom or conveyance specified in the cover, but sometimes it may be agreed at an amount, say, upto 200% thereof.

(d) Rate

A schedule of agreed rates is attached to each open cover.

(e) Terms

There may be different terms applying to different commodities covered under the open cover, and they are clearly stipulated.

(f) Declaration Clause

The insured is made responsible to declare each and every shipment coming within the scope of the open cover. An unscrupulous insured may omit a few declarations to save premium, specially when he knows that shipment has arrived safely. Hence the clause.

(g) Cancellation Clause

This clause provides for cancellation of the contract with a certain period of notice, e.g., a month's notice on either side. In case of War & S.R.C.C. risks, the period of notice is much shorter.

Distinction between "Open policy" and "Open cover"

The open policy differs from an open cover in certain important respects. They are :

(a) The open policy is a stamped document and is, therefore, legally enforceable in itself, whereas an open cover is unstamped and has no legal validity unless backed by a stamped policy/certificate of insurance.

(b) An open policy is issued for a fixed sum insured, whereas there is no such limit of amount under any open cover. As and when shipments are made under the open policy, they have to be declared to the insurers and the sum insured under the open policy reduces by the amount of such declarations. When the total of the declarations amounts to the sum insured under the open policy, the open policy stands exhausted and has to be replaced by a fresh one.

h) Certificate of Insurance

A certificate of insurance is issued to satisfy the requirements of the insured or the banks in respect of each declaration made under an open cover and / or open policy. The certificate, which is substituted for specific policy, is a simple document containing particulars of the shipment or sending. The number of open contract under which it is issued is mentioned, and occasionally, terms and conditions of the original cover are also mentioned. Certificates need not be stamped when the original policy has been duly stamped.

Types of Marine Insurance

a) Special Declaration Policy

This is a form of floating policy issued to clients whose annual estimated dispatches (i.e. turnover) by rail / road / inland waterways exceed Rs 2 crores.

Declaration of dispatches shall be made at periodical intervals and premium is adjusted on expiry of the policy based on the total declared amount.

When the policy is issued sum insured should be based on previous year's turnover or in case of fresh proposals, on a fair estimate of annual dispatches.

A discount in the rates of premium based on turnover amount (e.g. exceeding Rs.5 crores etc.) on a slab basis and loss ratio is applicable.

b) Special Storage Risks Insurance

This insurance is granted in conjunction with an open policy or a special declaration policy.

The purpose of this policy is to cover goods lying at the Railway premises or carrier's godowns after termination of transit cover under open or special declaration policies but pending clearance by the consignees. The cover terminates when delivery is taken by the consignee or payment is received by the consignor, whichever is earlier.

c) Annual Policy

This policy, issued for 12 months, covers goods belonging to the insured, which are not under contract of sale, and

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which are in transit by rail / road from specified depots / processing units to other specified depots / processing units.

d) "Duty" Insurance

Cargo imported into India is subject to payment of Customs Duty, as per the Customs Act. This duty can be included in the value of the cargo insured under a Marine Cargo Policy, or a separate policy can be issued in which case the Duty Insurance Clause is incorporated in the policy. Warranty provides that the claim under the Duty Policy would be payable only if the claim under the cargo policy is payable.

e) "Increased Value" Insurance

Insurance may be 'goods at destination port' on the date of landing if it is higher than the CIF and Duty value of the cargo.

2.6 PROCEDURE OF CLAIM SETTLEMENT:

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

2.6.1 For Import/Export consignments

Claims Documents

Claims under marine policies have to be supported by certain documents which vary according to the type of loss as also the circumstances of the claim and the mode of carriage.

The documents required for any claim are as under:

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

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

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

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

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

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

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

h) **Letter of Subrogation :** This is a legal document (supplied by insurers) which transfers the rights of the claimant against a third party to the insurers.

On payment of claim, the insurers may wish to pursue recovery from a carrier or other third party who, in their opinion, is responsible for the loss. The authority to do so is derived from this document. It is required to be duly stamped.

Some of the other documents required in support of particular average claims are Ship survey report lost over-board certificate if cargo is lost during loading and unloading operation, short landing certificate etc.

i) **Bill of entry:** The other important document is bill of entry issued by the customs authorities showing therein the amount of duty paid, the date of arrival of the steamer, etc., account sales showing the proceeds of the sale of

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the goods if they have been disposed of; repairs or replacements bills in case of damages or breakage; and copies of correspondence exchanged between the carriers and the claimants for compensation in case of liability resting on the carriers.

2.6.2 Inland Transit Claims (Rail / Road)

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

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

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

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

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

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

(f) Letter of Subrogation, duly stamped.

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

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

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

(j) Letter of Undertaking from the claimant in case of non-delivery of consignment.

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

2.7 RISK COVERAGE

For export/import policies, the-Institute Cargo Clauses (I.C.C.) are used. These clauses are drafted by the Institute of London Underwriters (ILU) and are used by insurance companies in a majority of countries including India.

Exclusions

All three sets of clauses contain general exclusions. The important exclusions are:

Notes

i. Loss caused by willful misconduct of the insured.

ii. Ordinary leakage, ordinary loss in weight or volume or ordinary wear and tear. These are normal 'trade' losses which are inevitable and not accidental in nature.

iii. Loss caused by 'inherent vice' or nature of the subject matter. For example, perishable commodities like fruits, vegetables, etc. may deteriorate without any ' accidental cause'. This is known as 'inherent vice'.

iv. Loss caused by delay, even though the delay be caused by an insured risk.

v. Deliberate damage by the wrongful act of any person. This is called 'malicious damage' and can be covered at extra premium, under (B) and (C) clauses. Under 'A' clause, the risk is automatically covered.

vi. Loss arising from insolvency or financial default of owners, operators, etc. of the vessel. Many ship owners, especially tramp vessel owners, fail to perform the voyage due to financial troubles with consequent loss or damage to cargo. This is not an accidental loss. The insured has to be cautious in selecting the vessel for shipment.

vii. Loss or damage due to inadequate packing.

viii. War and kindred perils. These can be covered on payment of extra premium.

ix. Strikes, riots, lock-out, civil commotions and terrorism (SRCC) can be covered on payment of extra premium.

B) Inland Consignments.

Exclusions

All three sets of clauses have the same exclusions as are found in ICC Clauses.

2.8 MISCELLANEOUS

a) Duration of Cover-Import/export

Cargo policies are issued for specified voyage or transit whatever the time taken. It is necessary to be clear as to when exactly risk commences and terminates under a voyage policy.

The duration of cover is defined in the Transit Clause (popularly known as Warehouse to Warehouse Clause or WW clause) of the 1CC.

The cover commences from the time the goods leave the warehouse at the place named in the policy, continues during the ordinary course of transit and terminates either

a) On delivery to the consignees' or other final warehouse at the destination named.

b) On delivery to any intermediate warehouse used by the insured for purposes of storage or distribution or

c) On the expiry of 60 days after discharge from the vessel at the final port of discharge whichever shall first occur.

(**Note** : The time limit of 60 days is prescribed to ensure early clearance of goods by the consignee. Insurers extend the time limit, at extra premium, in genuine circumstances causing delay in clearance.)

b) Duration of Cover-Inland consignments

Insurance attaches with the loading of each bale/ package into the wagon/truck for commencement of transit and continues during ordinary course of transit, including customary trans shipments and ceases immediately on unloading of each bale/package –

(a) at destination railway station for rail transits

(b) at destination named in the policy in respect of road transits.

Note: Under both clauses the risk attaches from the time the goods leave the warehouse and / or the store at the place named in the policy for the commencement of transit and continues, during the ordinary course of transit, including customary transshipment, if any,

(i) until delivery to the final warehouse at the destination named in the policy, or in respect of transits by Rail only or Rail and Road, until expiry of 7 days after arrival of the railway wagon at the final destination railway station, or

(ii) in respect of transits by Road only, until expiry of 7 days after arrival of the vehicle at the destination town named in the policy, whichever first occur.

Notes

c) Total Loss

Goods may be totally lost by the operation of the marine peril. The measure of indemnity in the event of total loss of the goods is the full insured value. The insurers are entitled to take over the salvage, if any.

An actual total loss takes place where the subject matter is entirely destroyed or damaged to such an extent that it is no longer a thing of the kind insured.

As against actual total loss, a constructive total loss, which is a commercial total loss, takes place where the subject matter insured is abandoned on account of the actual total loss being inevitable, or where the expenditure to be incurred for repairs or recovery would exceed the value of the subject-matter after the repairs or recovery.

d) Particular Average

These are partial losses caused by marine perils. The particular average losses occur when there is a total loss of part of the goods covered, e.g., a consignment may consist of 100 packages of which 5 packages may be lost completely. Another way in which particular average loss occurs is when there is damage to the goods. Where whole or any part of the goods insured is delivered damaged at destination, the percentage of depreciation is ascertained by a surveyor appointed for the purpose, by comparing on the one hand the gross sound market value and, on the other, the gross damaged market value on arrival of the goods at destination.

e) General Average

General Average is a loss caused by a general average act. An act is referred to as general average act when an extraordinary sacrifice or expenditure is made to save the entire ship. Such an act should be voluntary, and the expenditure reasonable. It should be undertaken with the sole idea of preserving the property imperiled in an adventure. Whenever there is a general average, the party on whom it falls, gets a rateable contribution known as general average contribution from the other parties, who are interested in the adventure and who have benefited by the voluntary sacrifice or expenditure.

The following are the examples of a general average loss:

(a) Cargo jettisoned in an effort to refloat the vessel

(b) Tugs employed to tow the vessel to safety

As mentioned earlier, general average is shared proportionately by all the interests at risk at the time of the general average act, i.e. ship, cargo and freight.

In the event of a general average act, the ship owner declares "general average". He has a lien on the goods for the general average contribution. Therefore, before the goods are released at destination, the ship owner insists on the consignees to execute a bond. In addition to the general average bond, the consignees may have to pay a general average deposit in cash, or present a guarantee given by a bank or an insurance company.

Thus, there are two types of losses resulting from a general average act : sacrifice and expenditure. These losses are payable under the marine policy provided an insured peril was the cause of the general average act. Cargo which is sacrificed is a loss payable under the cargo policy. Similarly, contributions to be made by owners of 'cargo' saved are also paid as a loss under their cargo policies.

The adjustment of general average is done by specialists known as G.A. adjusters.

f) Salvage Loss

When the goods insured are damaged during transit, and the nature of the goods is such that they would deteriorate further and would be worthless by the time the vessel arrives at destination, it would be a prudent and sensible way of dealing with the situation by disposing off the same at an intermediate port for the best price obtained. The term 'salvage loss' refers to the amount payable which is the difference between the insured value and the net proceeds of the sale. This is a practical method of settlement.

g) Sue and Labour Charges

Insurers expect that the insured should at all times act as if he was uninsured and take such steps as a prudent person would normally take. In view of this, if there be any expenses incurred by the insured or his agents to minimize the loss or damage payable under the policy, the same are reimbursed by insurers.

Examples of such charges known as Sue and Labour charges are landing, warehousing, reconditioning, re-forwarding and similar charges.

h) Extra Charges

Under this expression come survey fees, settling agents fees, etc. They are payable if the claim is admitted. Whenever a marine survey is arranged, the fees are paid by the claimant initially and are reimbursed when the claim is paid.

i) Recovery from Carriers

As stated earlier, in many marine claims, there are possibilities of recovery from the carriers, i.e., road carriers, railways, steamer companies, etc. After payment of claim, the insurers are subrogated the rights and remedies available to the insured against the carriers or third parties responsible for the loss.

INTEXT QUESTIONS 2.2

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1. Mention the types of coverage's available for the export consignments.

2. Explain whether recoveries can be made from Carriers.

2.9 SUMMARY

Marine insurance deals with goods when these are being moved from one place to another by approved mode of transportation. The goods can be moved within the country and outside the country. The risks are involved in any type of transportation and to cover these risks marine (transit) insurance is developed. The risk coverage depends upon the nature of goods and packing and to cover the risks the price is to be paid which is known as premium. The consignment can be single or multiple and accordingly the marine insurance policy i.e single transit or open cover or open policy is issued by the insurance company. The risk coverage is defined by Institute of London Underwriters under the various clause ICC (A), (B), (C) and the same is acceptable to all throughout

Notes

the world. Similarly the clauses for inland transit have been defined as ITC (A),(B), (C).

2.10 TERMINAL QUESTIONS

1) Define the marine insurance and explain its features.

2) Explain the procedure to be followed to cover the risk for transporting the goods from Delhi to USA.

3) Discuss the procedure for making any marine insurance claim.

2.11 OBJECTIVE TYPE QUESTIONS

1. INCO Term commonly applied internationally does not include the following terms for type of contract

   a. F .O.B.

   b. C & F

   c. I.C.C.

   d. C.I.F

2. A document authorized by the buyer for the seller to draw on buyer's bank, the amount stated on completion of conditions as stated in letter of credit:

   a. Bill of Lading

   b. Bill of exchange

   c. Export Invoice

   d. Marine Cargo Insurance Policy

3. In case any accident occurs, the cause in known as

   a. Risk

   b. Peril

   c. Damage

   d. None of the above

4. In Marine Insurance Policy Insurable interest must exist at the time of

a. Taking policy

b. At the time of claim

c. Both at time of Policy & claim

d. May not have insurable interest

5. Ordinary Leakage as per ICC means

a. Leakage from accident Tin

b. Evaporation of Liquids in atmosphere

c. Leakage from defective Tin

d. None of the above

6. Which of the following statements is true?

Statement A: Insurer pays Rs.9,000 for total loss of a case of textiles during transit insured for Rs.10,000 but having a C.I.F. value of Rs.9,000 only.

Statement B: Insurer pays Rs.2,000 in respect of a cargo insurance claim of Rs.2,000 under a marine cargo policy subject to a franchise of Rs.1,000.

a. Only Statement A

b. Only Statement B

c. Both the Statements

d. Neither of the Statements

7. Which of the following risks covered under Institute Cargo Clauses (B) are not covered under Institute Cargo Clauses (C)

Statement A: Discharge of cargo at port of distress

Statement B: Earthquake, volcanic eruption, lightning.

a. Statement A only

b. Statement B only

c. Both statements

d. Neither of the Statements

8. Under Institute Cargo Clauses (Air), insurance terminates on expiry of ———days after unloading of cargo from aircraft at final place of discharge.

   a. 60 days

   b. 30 days

   c. 7 days

   d. 14 days

9. Which of the following statements is true?

   Statement A: Cargo policy is assigned by blank endorsement, that is, mere signature of policyholder without specifying the assignee. Notice to insurer is not necessary.

   Statement B: Hull policies include a clause requiring that assignment shall be by specific endorsement.

   a. Statement A only

   b. Statement B only

   c. Both the Statements

   d. Neither of the Statements

10 . Which of the following statements is true under an F.O.B. contract of sale?

   Statement A: Seller is responsible till goods are placed on board the carrying vessel.

   Statement B: Buyer's responsibility attaches once the goods are placed on board the vessel.

   a. Only Statement A

   b. Only Statement B

   c. Both the Statements

   d. Neither of the Statements

Notes

2.12 ANSWERS TO INTEXT QUESTIONS

2.1

1. A person who is having insurable interest at the time of loss.
2. The seller is responsible to take the insurance.

2.2

1. There are three types i.e ICC (A),or (B) or (C)
2. Yes, the recoveries can be made by the insurer from the carriers.

2.13 ANSWER TO OBJECTIVE TYPE QUESTIONS

1. c,	2. b,	3. b,	4. b,
5. b,	6. c,	7. b,	8. a,
9. c,	10.c		

3

MOTOR INSURANCE

3.0 INTRODUCTION

This is the class of Insurance through which a majority of the people recognize general Insurance and that too because it is compulsory for all motorized vehicles to have an Insurance policy against third party liability before they can come on road.

Though this class of Insurance is the major source of premium earnings for the Insurance companies it is also the class which is showing the biggest losses.

3.1 OBJECTIVES

At the end of this lesson, you will be able to:

- Know the meaning of Motor insurance
- Buy the Motor insurance
- Settle the claim under Motor insurance/Third Party
- Know what is not covered under Motor insurance

For purpose of insurance, motor vehicles are classified into three broad categories:

(a) Private cars

(b) Motor cycles and motor scooters

(c) Commercial vehicles, further classified into

  (I) Goods carrying vehicles

  (II) Passenger carrying vehicles e.g.

   - Motorized rickshaws
   - Taxis
   - Buses

(III) Miscellaneous Vehicles, e.g.

- Hearses (funeral van)
- Ambulances
- Cinema Film Recording & Publicity vans
- Mobile dispensaries etc.

3.2 TYPES OF POLICIES

CAR/VAN

MC/SCOOTER

BUS/ TRUCK
HEAVY VEHICLE

Pvt. Commercial

Private

Private Commercial

Two
Wheeler

Three
Wheeler

TYPES OF CLAIMS

VEHICLE

ACCIDENT

Theft

Accident

Collision

With Other Vehicle

Other External Object

Fire etc.

Own Damage

Third Party

Total Loss

Cash loss

Repair

Death Bodily

injury

Property damage

Motor Vehicles Act, 1988

It is necessary to have knowledge of Motor Vehicles Act passed in 1939 and amended in 1988.

In the old days, many of the pedestrians who were knocked down by motor vehicles and who were killed or injured, did not get any compensation because the motorists did not have the resources to pay the compensation and were also not insured. In order to safeguard the interests of pedestrians, therefore, the Motor Vehicles Act, 1939, introduced compulsory insurance.

The insurance of motor vehicles against damage is not made compulsory, but the insurance of third party liability arising out of the use of motor vehicles in public places is made compulsory. No motor vehicle can ply in a public place without such insurance.

The liabilities which require compulsory insurance are as follows:

(a) any liability incurred by the insured in respect of death or bodily injury of any person including owner of the goods or his authorised representative carried in the carriage.

(b) liability incurred in respect of damage to any property of a third party;

(c) liability incurred in respect of death or bodily injury of any passenger of a public service vehicle;

(d) liability arising under Workmen's Compensation Act, 1923 in respect of death or bodily injury of: (i) paid driver of the vehicle; (ii)conductor, or ticket examiner (Public service vehicles); (iii) workers, carried in a goods vehicle;

(e) liability in respect of death or bodily injury of passengers who are carried for hire or reward or by reason of or in pursuance of contract of employment.

The policy of insurance should cover the liability incurred in respect of any one accident as follows:

(a) In respect of death of or bodily injury to any person, the amount of liability incurred is without limit i.e. unlimited.

(b) In respect of damage to any property of third party : A limit of Rs.6,000/-.

The liability in respect of death of or bodily injury to any passenger of a public service vehicle in a public place, the amount of liability incurred is unlimited.

Section 140 of the Motor Vehicles Act 1988, provides for liability of the owner of the Motor Vehicle to pay compensation in certain cases, on the principle of "no fault". The amount of compensation, so payable, is, Rs.50,000/- for death, and Rs.25,000/- for permanent disablement of any person resulting from an accident arising out of the use of the motor vehicle.

(Note: The principle of "no fault" means the claimant need not prove negligence on the part of the motorist. Liability is automatic.)

Certificate of Insurance

The Motor Vehicles Act provides that the policy of insurance shall be of no effect unless and until a certificate of insurance in the form prescribed under the Rules of the Act is issued.

The only evidence of the existence of a valid insurance as required by the Motor Vehicles Act acceptable to the police authorities and R.T.O, is a certificate of insurance issued by the insurers. The points covered under a certificate of insurance differ according to the type of vehicle insured.

3.3 TYPES OF POLICIES

For all classes of vehicles, there are two types of Policy Forms:-

Policy Forms

Form A

To cover Act Liability

Form B

To cover own damage + Act Liability

Form "A" : to cover Act Liability.

Notes

Form "B" : to cover Own Damage Losses and Act Liability. The policy can also be extended to cover additional liabilities as provided in the Tariff.

Form "A" is called "Standard Form for "A" Policy for Act Liability". This form applies uniformly to all classes of vehicles, whether Private Cars, Commercial Vehicles, Motor Cycles or Motor Scooters, with suitable amendments in "Limitations as to Use".

Form "B", which provides wider cover as indicated above, varies with the class of vehicle covered. There are therefore Form "B" Policies for Private Cars, Commercial Vehicles, Motor Cycles / Scooters, etc.

Policy Form B

This policy provides the so-called 'comprehensive' cover and the structure of the policy form is the same for all vehicles, (with some differences which are pointed out, wherever applicable)

Section I : Loss or Damage (or "Own Damage"). The risks covered are :

a) Fire, explosion, self-ignition or lightning.

b) Burglary, house breaking or theft.

c) Riot and strike.

d) Earthquake (fire and shock damage)

e) Flood, typhoon, hurricane, storm, tempest, inundation, cyclone, hailstorm, frost.

f) Accidental external means.

g) Malicious act.

h) Terrorist activity.

i) Transit by road, rail, inland waterway, lift, elevator or air.

j) Landslide /rockslide.

Exclusions

i. consequential loss

ii. depreciation

iii. wear and tear; and

iv. mechanical or electrical breakdowns, failures or breakages

v. Damage to tyres unless the vehicle is damaged at the same time. (Then, 50% of cost of replacement payable). For commercial vehicles, see Compulsory Excess Clause dealt with later

vi. Loss when the vehicle is driven under the influence of intoxicating liquor or drugs

(**Notes:** 1. In the motor cycle and commercial vehicle policy there are additional exclusions :

(1) Loss of or damage to accessories by burglary, housebreaking or theft unless the vehicle is stolen at the same time.

(2) In commercial vehicle policy, there is a further exclusion: Damage caused by overloading or strain of the vehicle.

Towing Charges

If the motor car is disabled as a result of damage covered by the policy, the insurers bear a reasonable cost of protecting the car and removing it to the nearest repairers, as also the reasonable cost of re-delivery to the insured. The amount so borne by the insurers is limited to maximum of Rs.2,500/- in respect of any one accident.

(**Note:** For motor cycles the limit is Rs.300/-, for cars Rs.1500/- and for commercial vehicles Rs.2500/-).

Repairs

Ordinarily repairs arising out of damage covered by the policy can be carried out only after they are authorized by the insurers. However, the insured is allowed to carry out the repairs without authorization from the insurers, provided that:

(a) the estimated cost of such repair does not exceed Rs-500/- (Rs.150/- for motor cycles).

(b) the insurers are furnished forthwith with a detailed estimate of the cost; and

(c) the insured gives the insurers every assistance to ensure that such repair is necessary and that the charge is reasonable.

Compulsory Excess

This applies to all vehicles. The insured has to bear a part of the claim amount in respect of each accident.

Further loss / damage to lamps, tyres, mudguards and / or bonnet side parts, bumpers and / or paintwork is not payable except in the case of a total loss of vehicle.

Section II Liability to Third Parties

The insurers indemnify the insured against all sums which he may become legally liable to any person including occupants carried in the motor car (provided that they are not carried for hire or reward) by reason of death or bodily injuries caused to such third parties or by reason of damage to the property of third parties caused by or arising out of the use of the motor car. The insured's liability for damage to property of third parties is limited to Rs.6000/-; whilst liability for death of or bodily injury to third party is unlimited.

The legal costs and expenses incurred by such third parties are reimbursed in addition. The legal costs and expenses incurred by the insured are also reimbursed provided that they were incurred with the insurer's written consent.

The insurers are liable for the death of or bodily injury arising out of and in the course of employment, but only to the extent necessary to meet the requirements of the Motor Vehicles Act. The damage to property is not paid for, if the damaged property belonged to the insured or was held in trust by him or was in the custody or control of the insured.

(**Note:** This section is, more or less, the same for all vehicles, subject to some variations for motor cycles and commercial vehicles)

Section III

This appears in commercial vehicle policies only.

This section provides cover while the vehicle is towing one disabled mechanically - propelled vehicle. It provides that whilst the insured vehicle is being used for the purpose of towing any one disabled mechanically - propelled vehicle

(a) the cover provided by the policy remains operative, and

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(b) under Section II of the policy, indemnity will also be provided for the liability in connection with such towed vehicle. This however is subject to the following two provisios:

i. The towed vehicle should not be towed for hire or reward and

ii. No cover is available under the policy for the damage to the towed vehicle or the property conveyed thereby.

General Exclusions (applicable to all sections)

These provide that the insurer shall not be liable in respect of:

(a) any accident outside the geographical area specified in the policy, that is, India. The limit can be extended to cover Bangladesh, Bhutan, Nepal, Pakistan, Sri Lanka & Maldives on payment of extra premium.

(b) contractual liability.

(c) any accident when the vehicle is used not in accordance with the Limitations (Use Clause)

(d) any accident when the vehicle is driven without an effective driving licence (Driver's Clause).

(e) war, etc and nuclear risks.

Conditions

Apart from the usual conditions such as notice of loss, cancellation of policy, arbitration, etc. there are two conditions which are specific to motor policies.

– The insured is required to safeguard the vehicle from loss or damage and maintain it in efficient condition. In the event of an accident, the insured shall take precautions to prevent further damage. If the vehicle is driven before repairs any further damage is at insured's risk.

– The insurer has the option to repair or replace the vehicle or parts or pay in cash the amount of damage or loss. The insurer's liability cannot exceed the insured's estimated value of the vehicle (specified in the policy) or the value of the vehicle at the time of loss whichever is less.

Rating/ Proposal Form

The proposal form elicits all information necessary for rating and underwriting. Some examples of rating are given:

Private Cars/ Scooters/ Motorcycles

Rates are based upon the cubic capacity as given by manufacturers, Insured’s Declared Value (IDV), the Zone of operation and age of the vehicle.

The cubic capacity of the vehicle indicates the power of the engine. Separate rates apply for cars upto 1000 cc, fònm 1000 cc – 1500 cc and ab_ve 1500 cc and scooters/motorcycles upto 150cc,150-350cc & above 350cc.

Similarly there are different rates for vehicles in the age groups upto 5 yrs.; 5 yrs. to 10 yrs. and above 10 yrs.

There are two Zones of operation, Zone A and Zone B, as follows:

Zone A : Ahmedabad, Bangalore, Chennai, Hyderabad, Kolkata, Mumbai, N.Delhi & Pune

Zone B : Rest of India.

Note: The rates for Zone A are higher than those for Zone B.

Commercial Vehicles

The rating depends upon the Zone of operation, passenger carrying capacity/ gross vehicle weight, Insureds Declared Value (IDV) and age of the vehicle.

There are three Zones for commercial vehicles.

1. Zone A	Chennai, New Delhi, Kolkatta and Mumbai
2. Zone B	All other state capital
3. Zone C	Rest of India

Personal Accident Cover

There is provision for Compulsory Personal Accident Cover for Owner-Driver of cars and commercial vehicles of Rs.2.0 lacs and Rs.1 lac for owner driver of scooters / motorcycles. It covers Death, PTD and PPD only.

Extra benefits

All Vehicles

(a) The Third Party premium includes cover for third party property damage in excess of the required coverage of liability of Rs.6,000/- as per the M.V.Act. In case the insured wants to get only the liability as per act covered (i.e. Rs.6,000/-) then discount in T.P. premium is allowed.

(b) Wider legal liability to persons e.g. paid drivers etc. employed in operation and / or maintenance of the vehicle i.e. under W.C. Act and at common law.

(c) Personal Accident cover for unnamed passengers as per the registered carrying capacity of the vehicle upto a max. of Rs.2 lac/ person on payment of extra premium.

Private Cars

(a) Extra fittings like radios, tape-recorders, air conditioners etc. (Also applicable to commercial vehicles)

(b) Reliability Trials and Rallies in India (Also applicable to motor cycles).

Discounts (some examples)

(a) Voluntary excess under Own Damage Section -(Applicable to all vehicles).

(b) Membership of recognised Automobile Association (Private cars & motor cycles).

(c) Deletion of Riot, Strike, etc.. Earthquake, Flood. (All vehicles).

(d) Special discount for Anti-Theft device approved by AAI (2.5% on O.D. premium max. of Rs.500).

(e) Special discount of 25% on O.D. premium for vintage cars

No Claim Bonus

A discount in the premium is allowed at renewal if there is no claim during the policy year for all vehicles.

1st Year	20%	3rd Year	35%	5th Year	50%
2nd Year	25%	4th Year	45%		

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Underwriting

There are several factors which are important for underwriting such as type of vehicle e.g. imported cars, sports cars, use of the vehicle, geographical area etc. But the most important is the age of the vehicle.

Generally, the approach of insurers is as follows :

	Comp. Cover	Comp. Subject to Inspection	Comp. Subject Inspection + Excess	Act Cover Only
Pvt. Car	10 Yrs.	10 – 15 Yrs.	——	Over 15 Yrs.
Taxis	3 Yrs.	3 – 5 Yrs.	5 – 7 Yrs.	Over 7 Yrs.
Public Carriers	5 Yrs.	5 – 6 Yrs.	6 – 7 Yrs.	Over 7 Yrs.

INTEXT QUESTIONS 3.1

1. How many sections are in commercial vehicles insurance policy?
2. In how many zones is India divided for the commercial vehicles?

3.4 CLAIMS (OWN DAMAGE)

On receipt of notice of loss, the policy records are checked to see that the policy is in force and that it covers the vehicle involved. The loss is entered in the Claims Register and a claim form is issued to the insured for completion and return.

The insured is required to submit a detailed estimate of repairs from any repairer of his choice. Generally, these repairs are acceptable to the insurers but they at times ask the insured to obtain repair estimate from another repairer, if they have reason to believe that the competence, moral hazard or business integrity of the repairer first chosen is not satisfactory.

Assessment

Independent automobile surveyors with engineering background are assigned the task of assessing the cause and extent of loss. They are supplied with a copy of the policy, the claim form and the repairer's estimate. They inspect the damaged vehicle, discuss the cost of repair or replacement with the repairer, negotiate as per the indemnity, and submit their survey report.

In respect of minor damage claims, independent surveyors are not always appointed. The insurer's own officials or their own automobile engineers inspect the vehicle and submit a report.

Settlement

The survey report is examined and settlement is effected in accordance with the recommendations contained therein. The usual practice is to authorise the repairs directly with the repairer to whom a letter is issued to that effect. In this letter the repairers are also instructed to collect direct from the insured the amount of the excess, depreciation, salvage, etc. If applicable to the claim, before delivering the repaired vehicle to him. The repairers are also instructed to keep aside the salvage of damaged parts, if there are any, for being collected by the salvage buyer nominated by the Insurers.

Or else, if the repairers are willing to retain the salvage, its value, as indicated by the surveyor, is deducted from the claim bill.

On receipt of their final bill of repairs after completion of repairs and a satisfaction note or voucher from the insured that the vehicle has been repaired to his satisfaction, the payment to the repairer is effected.

Sometimes, the repairer is paid directly by the insured in which case the latter is reimbursed on submission of a receipted bill from the repairers.

In either case, discharge voucher or receipt is obtained. The Claims Register and the policy and renewal records are marked that the claim is paid indicating the amount of claim and the amount of salvage, if any.

Claims Documents

Apart from claim form and Survey report the other documents required for processing the claim are:

(1) Driving Licence

(2) Registration Certificate Book

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(3) Fitness Certificate (Commercial Vehicles)

(4) Permit (Commercial Vehicles)

(5) Police Report (Taxis, commercial Vehicle need F.I.R. / spot survey if loss is heavy or T.P. loss occurs)

(6) Final Bill from repairers

(7) Satisfaction Note from the insured

(8) Receipted bill from the repairer, if paid by insured.

(9) Discharge voucher (full and final payment)

Total Loss Claims

Whenever a surveyor finds that a vehicle is either beyond repairs or the repairs are not an economic proposition, he negotiates with the insured to assess the loss on a **Total Loss basis -** for a reasonable sum representing the market value of the vehicle immediately prior to the loss.

If the **market value** is more than the insured value, the settlement will be brought about for the insured value. The Insured will be paid in cash and the Insurers will take over the salvage of the damaged vehicle which will thereafter be disposed of for their own benefit calling tenders through advertisements in newspapers.

However, before the actual payment is made to the Insured, the Insurer will collect from him the Registration and Taxation books, ignition keys and blank TO. and T.T.0. forms duly signed by the insured, so that the salvage is usually not encouraged, unless insured desires, so as to avoid the hastle of salvage disposal.

Theft Claims

Total losses can also arise due to the theft of the vehicle and its remaining untraced by the police authorities till the end. These losses will have to be supported by a copy of the First Information Report (FIR) lodged with the Police authorities immediately after the theft has been detected.

The police authorities register the complaint allotting it a number of the entry made in the Station Diary. This number which is usually known as SDE No. or C.R. No. (Crime Register) has to be quoted by the Insured in the claim intimation to the Insurers.

The police keep the investigations going until the vehicle is traced and delivered to its owner. However, if they do not succeed in recovering the vehicle after a period of, say 1-2 months, they file away the case certifying that the case is classified as true but undetected. This police certificate referred as "Non-Traceable" certificate is essential before a total loss following theft is settled by the insurers.

The documents to be submitted by the Insured will be the same as those described above. If the **R.C. Book** and **Taxation Certificate** are **also stolen** along **with the vehicle.** It will be necessary for the insured to obtain duplicate ones from the Registering Authority and thereafter deposit them with the Insurers.

The **only additional documents** will be addressed by the **Insured to the R.T.O.** informing about the loss of the vehicle due to theft and filing a Non User Form so that he is not made liable to pay the taxes.

Some insurers also obtain from the insured a special type of a Discharge on a stamped paper whereby the Insured undertakes to refund the claim amount if the vehicle is subsequently traced and delivered to him by the police. He also undertakes in the Discharge Form to pay any taxes which may be outstanding against the stolen vehicle. The ignition keys R.C.Books etc. are preserved by the Insurer in their custody so that these are made readily available if the vehicle is traced at a later date.

It is always prudent to inform the concerned Registering Authority by a Registered A/D letter that a total loss claim is being processed for payment in respect of the stolen vehicle and to request them not to transfer the ownership of the vehicle to any one. This will prevent the thief from disposing of the stolen vehicle.

3.5 THIRD PARTY CLAIMS

Section 165 of the Motor Vehicles Act 1988, empowers the State Governments to set up Motor Accident Claims Tribunals (MACT) for adjudicating upon third party claims.

When a tribunal has been set up for an area, no civil court has any jurisdiction to entertain any claim falling under the tribunal's jurisdiction.

The aggrieved party has to move the tribunal within a period of six months from the date of accident.

While making the award, the tribunal has to specify the amount payable by the insurer.

The procedure for third party claims is briefly described as follows:

On receipt of notice of claim from the insured, or the third party or from the MACT, the matter is entrusted to an advocate.

Full information relating to the accident is obtained from the insured. The various documents are collected and these include

– Driving Licence

– Police report

– Details of driver's prosecution, if any

– Death certificate, coroner's (PM report) report, if any (fatal claims).

– Medical Certificate (bodily injury claims)

– Details of age, income and number of dependants etc.

A written statement is then filed on the facts of the case with the MACT by the advocate. Eventually, if the award is made by the MACT, the amount is paid to the third party against proper receipt.

INTEXT QUESTIONS 3.2

1. Who assesses the Claim of the Motor vehicle in case of accident?
2. Who sets up the MACT and why?

Compromise Settlements

Where theòd is clear liability under the policy, claims are negotiated with the third party to accept a compromise settlement, which if accepted by the third party, is registered with the MACT and its consent obtained. The cheque is deposited with MACT for disbursement to the rightful beneficiaries.

Lok Adalats

Pending cases with the MACT where the liability under the policy is not in doubt are placed before the Lok Adalat or Lok Nyayalaya, for a voluntary and amicable settlement between the parties. A copy of decision in the prescribed memo and the cheque is deposited with MACT. Lok Adalat sessions are organized regularly by the insurance companies in liaison with the Legal Aid Board of each State and MACT to effect amicable settlement of third party claims.

No Fault Liability

These claims can be made by depositing the appropriate amount with the MACT after obtaining death certificate, medical certificate and police report.

3.6 SUMMARY

It is very important class of insurance as no vehicle can run on the roads without having the insurance especially third party. Any claim on account of damage of the vehicle will be paid by the insurance company subject to the assessment of loss by the independent Surveyor.

Third party claim is settled by the court and the government has laid down the procedure to settle these cases.

3.7 TERMINAL QUESTIONS

a. Discuss the procedure to insure the vehicle for own damage as well as third party insurance.

b. How the third party claim is settled?

c. Explain No Claim Bonus in vehicle insurance.

d. Write short notes on

- Theft Claims
- Lok Adalats
- Types of policies

3.8 OBJECTIVE TYPE QUESTIONS

1. The validity of a Motor Cover Note may be extended for a maximum period of _________.

a. two months b. one month

c. three months d. fortnight

2. **Which of the following Statement is true?**

   Statement A: Voluntary 'excess' under own damage section is applicable to all vehicles.

   Statement B: Compulsory 'excess' is applicable only to commercial vehicles.

   a. Both Statements b. Neither of the Statements

   c. Only Statement A d. Only Statement B

3. **Which of the following premium rating factors does not apply to motor cycles and scooters (own damage cover)?**

   a. Geographical area of operation

   b. cubic capacity

   c. Insured's estimated value

   d. Purchase price

4. **Choose correct Statement**

   Statement A: Third Party Liability premium of the State transport vehicles are part of TP Pool

   Statement B: Third Party Liability premium of the private vehicles are not part of TP Pool

   a. Both Statements b. Neither of the Statements

   c. Only Statement A d. Only Statement B

5. **Sec.163 (a) of the MV Act deals with the following:**

   a. No Fault Liability

   b. Structured compensation

   c. Defences available to Insurance Company

   d. Appeal to High Court

6. **Private Car policy does not cover the following use:**

   a. Used for social purpose

   b. Reliability test

c. Used for domestic pleasure purpose

d. Carrying samples belonging to insured

7. **Own damage is covered under which Section of the Package Policy?**

a. Section II	b. Section III
c. Section I	d. None of these

8. **Compulsory deductible is applicable to:**

a. Commercial Vehicle only

b. Private cars

c. Miscellaneous vehicles

d. All the above

9. **In case of double insurance with different insurers, which of the policies would be cancelled?**

a. At the option of the insured

b. At the option of insurer

c. Any one policy

d. Policy commencing later

10. **Geographical Zone for the purpose of rating is based upon:**

a. Area of operation of the vehicle

b. Area of the insurance company

c. Location of R T O concerned

d. At the option of insured/ insurers

3.8 ANSWERS TO INTEXT QUESTIONS

3.1

1. There are 3 sections.

2. There are Zones i.e Metros, State Capitals and other cities.

3.2

1. The Approved Loss Assessor and Survey.

2. State Govt for speedy settlement of third party claims

3.8 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. a	2. a	3.c	4. d
5. b	6. b	7. c	8. d
9. d	10 . c		

Notes

4

PERSONAL ACCIDENT INSURANCE

4.0 INTRODUCTION

4.1 OBJECTIVES

At the end of this lesson, you will be able to:

- Know the meaning of Personal Accident insurance
- Buy the Personal Accident insurance
- Settle the claim under Personal Accident insurance
- Types of Personal Accident polices
- Know what is not covered under fire insurance

4.2 MEANING OF PERSONAL ACCIDENT INSURANCE

The purpose of personal accident insurance is to pay fixed compensation for death or disablement resulting from accidental bodily injury.

The personal accident insurance policy provides that, if at any time during the currency of this policy, the insured (person who has taken the policy) shall sustain any **bodily injury** resulting **solely and directly accident** caused by **external violent and visible means**, then the insurance company shall pay to the insured or his legal personal representative(s), as the case may be, the sum or sums set, forth, in the policy, if resulting in specified contingencies such as death, **permanent disablement** etc.

To under stand the meaning of definitions, we should under stand the bold words mention in the para above.

a) **Bodily injury:** Any disease due to accident is known as bodily injury but does not include any disease due to natural cause. Mental shock or grief does not amount to accident unless and until some physical injury is caused. In current scenario it is noticed that due to grief some disablement i.e paralysis is taking place and the same is covered under this policy.

b) **Solely & Directly:** The bodily injury shall have been caused solely and directly by an accident and the bodily injury must directly and independent of any other cause result in death or disablement.

For eg: 1) A person is thrown from his horse while hunting and so injured that he cannot walk and he lies on the wet ground until he is pick up. He thus catches chill which turns pneumonia and dies. Though he dies because of pneumonia but the actual cause is an accident and it covered under personal accident insurance policy.

2) If a person breaks a leg in an accident and taken to hospital where he contracts an infectious disease from another patient which result in to death and the same is not covered under the personal accident insurance policy.

c) **Accident**: An accident is an event which is wholly unexpected not intended or designed. For eg: Snake biting, Drowning suicide and unprovoked murder are covered under this policy.

d) **External, violent and visible means**: The cause of accident i.e. the means must be within the definitions as a whole but the result may not be external. In other words the means or cause of accident must be within the definitions but the result or effect need not be external or visible so long as it is bodily injury e.g. injury may be internal i.e. inside the body but the result must be death or disablement.

e) **Disablement :** When a person is prevented by an accidental bodily injury from engaging in any occupation or business he is said to be disabled and his ability to attend to any occupation or business is call disablement.

4.3 FEATURES OF PERSONAL ACCIDENT

1) **Offer & Acceptance**; It is a prerequisite of any contract. Similarly the person will be insured under personal

accident insurance policy after the offer is accepted by the insurance company. Example: A proposal submitted to the insurance company along with premium on 1/1/2011 but the insurance company accepted the proposal on 15/1/2011. The risk is covered from 15/1/2011 and any loss prior to this date will not be covered under fire insurance.

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

3) **Contract of Indemnity:** This principle is not applicable to personal accident policy. This is so because life is invaluable and no amount of money can compensate the death or disablement of a human being. When polices are issued to employer to reimburse under service conditions the amounts of compensation paid by them to their employees or their dependents on the disablement or the death of their employees i:e the insured are indemnified with the exact amount of compensation paid by them.

4) **Utmost good faith:** The person must disclose all the relevant information to the insurance than company while insuring himself because none other him knows about his health and other relevant particulars. Any change in profession or occupation during the policy should also be informed to the insurance company. e.g. A person is working in the office in administrative job and took the personal accident policy but later on he becomes pilot then he should inform o the insurance company otherwise the insurance company can refuse the claim in case it arises.

5) **Insurable Interest:** A person is having an unlimited interest in his own life and as such this feature is valid in this policy. Similarly the wife has unlimited interest in the life of husband and vice versa. The employer has the insurable interest in the life his employees.

6) **Contribution:** As the principle of indemnity is not applicable to this policy therefore the principle of

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contribution will also not apply. The person will get sum insured of all personal insurance policies irrespective of number of polices.

7) **Period of Insurance:** The period of insurance is to be defined in the policy which varies form one year to five years. Some times this policy is issued for specific rail/road/sea journey.

8) The cover under this policy is for 24 hours and on a worldwide basis. Even if the insured person dies in foreign country due to accident the compensation will be paid in India in Indian rupees up to the sum insured.

9) **Claims:** To get the compensation under personal accident insurance the legal heirs should inform to the insurance company about the death of the insured and incase of disability the person himself can inform the insurance company.

4.4 COVERAGE'S /COMPENSATION

a) Death: If a person dies due to an accident the risk is covered under the personal accident policy. His legal heirs are entitled to get the sum insured. e.g. If the sum insured is Rs 1.00 lakhs and in case of death his legal heirs will get Rs 1.00 lakhs as compensation.

b) Disability: Disability can be classified further as follows:

- Permanent Total Disability(PTD)
- Permanent Partial Disability(PPD)
- Temporary Total Disability (TTD)

Permanent Total Disability: As the name indicates the disablement is of permanent and irrecoverable nature and is absolutely total and the insured is unable to engage in the gainful employment. Under this disability the compensation is equal to the sum insured. Example of PTD:

- Loss of sight of both eyes
- Loss by physical separation of two entire hands or entire feet
- Loss of one hand and one foot

- Person in comma for longer period will also be treated as PTD
- Paralysis

Permanent Partial Disability: The disability is not total but partial. e.g. Loss of toe or a finger. The compensation will be based on the percentage of the disability and it will defined in the policy and if it not defined then as per doctor certificate the compensation is paid.

Temporary total disablement: As the name implies this is a disablement which is total but for a temporary period only. The temporary may be days, weeks, months or even years. The payment is on weekly basis.

c) **Carriage of dead body:** The expenses incurred for a carriage of dead body of insured due to accident to place of residence are reimbursed. The reimbursement is some percentage of the sum insured say 2% of sum insured but maximum Rs 2500/-. This amount will be over & above the sum insured.

f) **Education amount for children:** Incase of death or permanent disablement of the insured person the insurance company also pays the education for two children if the age is below 25 years of those children.

g) **Modification of the house:** In case of the permanent disablement of a insured person, he has to modify his house for his free movement the expenditure of such modification will be reimbursed by the insurance company up to certain limit of the sum insured.

4.5 EXCLUSIONS (NOT COVERED UNDER PERSONAL ACCIDENT INSURANCE POLICY)

No compensation is payable in respect of death, injury or disablement of the insured

(i) From intentional self-injury, suicide or attempted suicide.

(ii) Whilst under the influence of intoxicating liquor or drug

(iii) Whilst engaging in Aviation or Ballooning whilst mounting into, dismounting from or traveling in any balloon or aircraft other than as passenger (fare paying or otherwise)

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in any duly licensed standard type of aircraft anywhere in the world

(iv) Directly or indirectly caused by venereal diseases or insanity

(v) Arising or resulting from the insured committing any breach of law with criminal intent.

(vi) From service in the armed forces

(vii) Resulting directly or indirectly from child birth or pregnancy.

4.6 PROCEDURE FOR INSURING UNDER PERSONAL ACCIDENT INSURANCE POLICY:

a) Submission of proposal form

b) Assessment of the proposal form and premium rate to be quoted

c) Payment of the premium

d) Issue of policy document

a) **Submission of proposal form-**. The person who is interested to insure himself under this policy will submit the information in the prescribed proposal form as follows:

   i. Personal details i.e., age, height and weight, full description of occupation and average monthly income.

   ii. Physical condition

   iii. Habits and pastimes

   iv. Other or previous insurances

   v. Previous accidents or illness

   vi. Selection of benefits and sum insured

   vii. Declaration

b) Assessment of the proposal form and premium rate to be quoted

While the assessing the proposal form the sum insured is selected by the insured but insurers exercise some control. The sum insured is compared with the average monthly income of the insured. The age of a person should be between 5 year to 70 years.

Rating In personal accident insurance, the rating factor used is the occupation. Generally speaking exposure to personal accidents at home, on the street etc. is the same for all persons, But the risks associated with occupation vary according to the nature of work performed. For example, an office manager is less exposed to risk at work than a civil engineer working at a site where a building is constructed.

It is not practicable to fix a rate for each profession or occupation. Hence, occupations are classified into groups, each group reflecting, more or less, similar risk exposure.

Risk Group I: (Lowest Premium rate)

Accountants, Doctors, Lawyers, Architects, Consulting Engineers, Teachers, Bankers, Persons engaged in administration functions. Persons primarily engaged in occupations of similar hazards.

Risk Group II: (Higher Premium rate)

Builders, Contractors and Engineers engaged in superintending functions only, Veterinary 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 Sportsmen, Woodworking Machinists and Persons engaged in occupations of similar hazards.

Risk Group III : (Highest Premium Rate)

Persons working in underground mines, explosives, magazines, workers involved in electrical installation with high tension supply. Jockeys, 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.

c) **Payment of the premium:** Based on the above risk category the person will pay the premium to insurance company to insure himself.

d) **Issue of Policy Document:** Based on the proposal form and the premium amount is received the policy document is issued which contains the following information

i) Name of the person and address

ii) Age

iii) Occupation

iv) Sum insured

v) Nominee

vi) Policy Conditions

a) Written notice of claims with full particulars.

In case of death written notice must, unless reasonable cause is shown, be so given before internment or cremation, and in any case, within one calendar month after the death

b) In the event of loss of sight or amputation of limbs, written notice thereof must be given within one calendar month after such loss of sight or amputation.

c) Proof of claim satisfactory to the Company shall be furnished.

d) Any doctor on behalf of the company shall be allowed to examine the person of the Insured on the occasion of any alleged injury or disablement and as may reasonably be required.

e) A post mortem examination report, if necessary, be furnished within the space of fourteen days after demand in writing.

f) In the event of loss of sight the Insured shall undergo at the Insured's expense such operation or treatment as the company may reasonably deem desirable.

g) No sum payable under this policy shall carry interest.

h) No claim is payable if the claim is fraudulent or supported by fraudulent statement.

i) The insured shall give immediate notice to the company of any change in his business or occupation. The insured shall on tendering any premium of the renewal of this policy give notice in writing to the company of any disease, physical defect or infirmity with which he has become affected since the payment of last preceding premium.

j) The policy is cancelable by either party. Pro-rata refund of premium is made if cancelled by insurers and short period refund of premium, subject to no claim under the policy, if cancelled by the insured.

k) The Company shall not be bound to take notice or be affected by any notice of any trust, charge, lien, assignment or other dealing with or relating to this policy but the receipt of the Insured or his legal personal representatives shall in all cases be an effective discharge to the Company.

l) The Company treats the insured as the absolute owner of the policy. Receipt of the insured or his legal personal representatives that is, those with a Succession Certificate etc. granted by a court of law will be an effective discharge to the Company.

m) Differences regarding amount of loss (not question of liability) are to be referred to arbitration. The award of arbitration is a precedent to suit in Court of Law.

n) If the insurers disclaim liability the insured has to file a suit in a Court of Law within 12 months from the date of such disclaimer.

o) The insurer is not liable for

   (a) Compensation under more than one of causes (death or disability)

   (b) Once a claim is settled under one of the causes the policy becomes inoperative. No further claim can be admitted under the policy.

   (c) Payment of weekly compensation (until the total amount shall have been ascertained and agreed).Although, the benefit is known as weekly compensation the payment is generally made in one lump sum after the quantum of liability is agreed. It is felt that periodical part payments may encourage a claimant to deliberately prolong the disablement. In genuine hardship cases however 'on account' payment is made which is then adjusted against the final payment due.

Notes

Miscellaneous features

i) Family Package Cover

(a)	Earning Member and Spouse, if earning. for each.	100% of the Capital Sum (Persons Insured) Insured
(b)	Spouse (if not earning member) whichever is lower	50% of the Capital Sum Insured or Rs. 1 lakh.
(c)	Children (between the age of 5 years and 25 years) whichever is lower per child.	25% of the Capital Sum and Insured or Rs. 50000/-

(i) For children the cover is limited to Death and Permanent Disablement (total or partial)

(ii) Premium payable for husband and wife will be on the total sum insured for husband and wife.

(iii) A discount of 5% is granted on the gross premium.

ii) Extensions

A personal accident policy can be extended by endorsement, on payment of extra premium to cover medical expenses incurred by the insured in connection with the accidental bodily injury, subject to specified limits.

4.7 CLAIM PROCEDURE

a) **Intimation:** Immediately the intimation to be sent to the insurance company in writing mentioning the nature of loss and the policy number.

b) **Claim form**: The claim form is designed to elicit information, among other things, on the following :

- Personal details such as age, occupation, etc.
- Details of accident, nature of injuries, etc.
- Name and address of the attending doctor.
- Medical certificate of the attending doctor (sometimes this is issued as a separate form).
- Details of other insurances to apply contribution, if applicable and to check whether they had been disclosed in the proposal form.

c) **Documents:** The following documents are sent along with the claim form

- **Medical Certificate :** to obtain medical opinion on the cause or extent of incapacity or progress towards recovery.
- **Medical examiner's Report -** To corroborate medical certificate in doubtful cases, or if other causes are in operation.
- **Receipt / Discharge form** :- to acknowledge the money and to confirm the finality of the settlement.
- **Death Certificate -** To give the date and cause of death. Post mortem reports where a post-mortem has been done.
- **Probate or letters of administration -** the legal document to prove the title of an executor or an administrator (i.e. if no assignment is made)

For disablement claims the documents, inter-alia, required are

- Medical Certificate, diagnostic reports etc.
- Prescription, bills and receipts.
- Leave of absence certificate from the employer.
- Medical fitness certificate.

INTEXT QUESTIONS 4.1

1. Up to what age the Personal Accident Insurance Policy can be issued.
2. Can contract of indemnity be applied to Personal Accident Insurance Policy?

4.8 GROUP PERSONAL ACCIDENT POLICY

In the above paras we have studied about eh individual personal accident insurance policy but the said policy can be issued where there is some common relationship among the persons to be insured and a central point for the administration of the insurance scheme. Accordingly, these policies can be granted only to groups clearly following under any one of the following categories:

- Employer - employee relationship including dependants of the employee.
- Pre identified segments / groups where the premium is to be paid by the State / Central Governments.
- Members of a registered co-operative society.
- Members of Registered Service Clubs.
- Holders of credit card of Banks / Diners / Master / Visa
- Holders of Deposit Certificates issued by Banks / NBFC's
- Shareholders of Banks / Public Limited Companies.

Salient Features of Group Policy

The coverage is the same as under individual P.A. policy except that

a. cumulative bonus and education grant do not apply. However, medical expenses and war risks extensions are available.

b. The sum insured is fixed separately for each insured person.

c. Rates of premium applicable to named employees as per the classification of risks. Where it is not possible to obtain details of occupation for each insured person, insurers use their discretion in applying the rates.

d. If P.A. cover is required only for the restricted hours of duty (and not for all the 24 hours of the day), a reduced premium equivalent to 75% of the appropriate premium is charged. The cover applies to accident to employees arising out of and in the course of employment only. If cover is required only for the restricted hours, when the employee is not at work and / or not on official duty, the reduced premium of 50% of the appropriate premium is charged.

e. It is possible to exclude the Death benefit, subject to following conditions;

   (i) A group life policy covering Death benefit for the same group of persons is in existence.

   (ii) Group P.A. Policy covers a group of 100 persons or more

Notes

4.9 SUMMARY

The personal accident insurance policy is issued to cover the risk of accidents by external means resulting in the death or bodily injury. The bodily injury may result in to the permanent total disability or partial disability or temporary total disability. This policy can be issued to an individual or in group. The premium rates depend upon the person engaged in activities to earn his livelihood. The sum insured will depend upon the income of the person.

4.10 TERMINAL QUESTIONS

1) Explain the features of Personal Accident Insurance policy.

2) Discuss the claim procedure to be flowed to get the claim in case of death of an insured person.

3) Write short notes on

   i) Permanent total disability ii) Group Personal Accident iii) Procedure to taking the Personal accident insurance policy

4.11 OBJECTIVE TYPE QUESTIONS

1. **Special feature of normal PA policy**

   a. Cover is for office hours & on a world wide basis

   b. Cover is for 24 hours & within India only

   c. Cover is for office hours & within India only

   d. Cover is for 24 hours & on a world wide basis

2. **Which of the following contingencies is‘not’ covered under personal accident policy?**

   a. Permanent total disablement

   b. Temporary total disablement

   c. Permanent partial disablement

   d. Temporary partial disablement

3. **Under Personal Accident Policy, weekly benefits are paid subject to a maximum period of**

   a. 100 b. 52

   c. 104 d. 75

4. **Which of the following Statements are true?**

   Statement A: Once a claim for permanent total disablement is paid, the personal accident policy becomes inoperative.

   Statement B: Weekly compensation is paid only when the total amount is arrived at and agreed

   a. Both Statements

   b. Neither of the Statements

   c. Only Statement A

   d. Only Statement B

5. **Claim under P.A. policy cover is not payable if the death is occasion by**

   a. Murder b. Drowning

   c. Snake bite d. Suicide

6. **The Principle of Contribution does not apply to the following policy**

   a. Standard Fire Policy b. Machinery Breakdown

   c. Personal Accident d. Burglary Policy

7. **On duty PA policy covers**

   a. Accident in course of employment

   b. Accident while coming to workplace

   c. Accident while returning to house from workplace

   d. Accident occurring during holidaying

8. **A owner of two wheeler is covered under motor package policy. He has a separate PA cover also. A dies in a accident**

   a. Death Claim to the legal heir in a PA policy only is payable

   b. Death claim in the PA cover in the two-wheeler policy only is payable

c. Both the claims under both the policies are payable

d. Claim under none of the policy is payable

9. Which of the following differentiates GPA policy from individual PA POLICY?

a. Death b. Disablement

c. Medical expenses d. Cumulative bonus

10. Which of the following benefits can be granted only on payment of extra premium under PA POLICY?

a. Medical expenses b. Loss of limb

c. Carriage of dead body d. Education fund

4.12 ANSWERS TO INTEXT QUESTIONS

4.1

1. Up to the age 70 years the Personal Accident Insurance Policy can be issued.
2. No it is not applicable.

4.13 ANSWER TO OBJECTIVE TYPE QUESTIONS

1. d	2. d	3.c	4. a
5. d	6. c	7. a	8. c
9. d	10. a		

5

HEALTH INSURANCE

5.0 INTRODUCTION

With the increasing cost of health services and medical bills which a common man can not afford, this class of insurance has a growing market. It is estimated that a family spends an average of 10% of its monthly income on health care. In India where there is no Social Insurance for the public the individual has to take care of himself and his family. A prolonged illness or disability can spell havoc for the family budget and upset all the planning. While the importance of Health Insurance cannot be denied, it is unfortunate that so far in India the Health Insurance policy is being purchased by families and individuals who can afford to pay the medical bills. But the Govt. of India is putting all its efforts to encourage people to buy health insurance and specialized insurance companies are promoted which are exclusively dealing in health insurance. The life insurance companies are also permitted to issue the health insurance policy.

5.1 OBJECTIVES

At the end of this lesson, you will be able to:

- Know the meaning of Personal Accident Insurance.
- Know the meaning of Health Insurance.
- To understand buying methods of Health Insurance Policy.
- Settle the claim under Health Insurance.
- Know the practise of Health Insurance in India.
- Know what is not covered under Health Insurance policy.

Note: Dear students do not get panic while reading this chapter because medical terminology being used here may be quite difficult for you. But we have no other option rather than to use these terminologies as per the need of this policy.

5.2 FEATURES/COVERAGES OF HEALTH INSURANCE POLICY

Any health insurance policy should cover the following the expenses:

1) The policy should provide for reimbursement of hospitalisation / domiciliary hospitalisation expenses for illness/disease suffered or accidental injury sustained during the policy period.

   Hospital/Nursing Home: It means any institution in India established for indoor care and treatment of sickness and injuries, which

- Has been registered either as a hospital or nursing home with the local authorities and is under the supervision of a registered and qualified medical practitioner.
- Should comply with the minimum criteria as under:
  a) It should be equipped with atleast 15 in-patient beds.
  b) Fully equipped operation theatre of its own where the surgical operations are carried out.
  c) Availbility of fully qualified nursing staff round the clock. Fully qualified doctor(s) should be in charge round the clock.

The term **Hospital / Nursing Home** shall not include an establishment which is a place of rest, a place for the aged, a place for drug addicts or place for alcoholics, a hotel or a similar place.

Domiciliary Hospitalisation Benefit means medical treatment for a period exceeding three days for such illness / injury which in the normal course would require treatment at the hospital / nursing home but actually taken whilst confined at home in India under any of the following circumstances namely:-

(i) The condition of the patient is such that he / she cannot be removed to the hospital / nursing home or

(ii) The patient cannot be removed to hospital / nursing home due to lack of accommodation therein.

2) The policy should pay during the period of insurance maximum up to the sum insured for expenses incurred under the following heads:

   (a) Room, Boarding Expenses in the Hospital / Nursing Home

   (b) Nursing Expenses

   (c) Surgeon, Anesthetist, Medical Practitioner, Consultants. Specialist fees

   (d) Anesthesia, Blood, Oxygen, Operation Theatre Charges, Surgical Appliances, Medicines and Drugs, Diagnostic Materials, and X-Ray, Dialysis, Chemotherapy, Radiotherapy, Cost of Pacemaker, Artificial Limbs and Cost of organs and similar expenses

3) Reimbursement is allowed only when treatment is taken in a hospital or nursing home which satisfies the criteria specified in the policy.

4) Expenses on hospitalisation for minimum period of 24 hours are admissible. However, this time limit is not applied to specific treatment i.e. Dialysis, Chemotherapy, Radiotherapy, Eye Surgery, Dental Surgery, Lithography (Kidney stone removal), D&C, Tonsillectomy taken in the hospital / nursing home and the insured is discharged on the same day ; the treatment will be considered to be taken under hospitalisation benefit.

5) Relevant medical expenses incurred prior to up to certain period, say 30 days and after hospitalization up to certain period, say 60 days, are treated as part of the claim.

6) Any one illness means continuous period of illness and it includes relapse within 105 days from the day of last consultation with the Hospital/Nursing Home where treatment may have been taken. Occurrence of same illness after a lapse of 105 days will be considered as fresh illness for the purpose of this policy.

7) The policy does not cover some disease i.e Asthma, Bronchitis,Chronic Nephritis Diarrhea and all type of Dysenteries including Gastroenteritis, Diabetes Mellitus

Notes

and Insipid us, Epilepsy, Hypertension, Influenza, Cough and cold, All psychiatric or Psychosomatic Disorders Pyrexia of unknown origin for less than 10 days, Tonsillitis and upper respiratory Tract infection including Laryngitis and Pharyngitis, Arthritis, Gout and Rheumatism

5.3 EXCLUSIONS THAT THE HEALTH INSURANCE POLICY DOES NOT COVER

a) All diseases / injuries which are pre-existing when the cover incepts for the first time.

b) Any disease other than those stated in clause (c) below, contracted by the insured person during the first 30 days from the commencement date of the policy. This exclusion shall not, however, apply if in the opinion of Panel of Medical Practitioners constituted by the company for the purpose, the insured person could not have known of the existence of the disease or any symptoms or complaints thereof at the time of making the proposal for insurance to the company. This condition shall not however apply in case of the insured person have been covered under this scheme or group insurance scheme with any of the Indian Insurance Companies for a continuous period of preceding 12 months without any break.

c) During the first or more years of the operation of the policy the expenses on treatment of diseases such as Cataract, Benign Prostates Hypertrophy, Hysterectomy for Menorrhagia or Fibromyoma, Hernia, Hydrocele, Congenital Internal Disease, Fistula in anus. Piles, Sinusitis and related disorders. If these diseases are pre-existing at the time of proposal they will not be covered even during subsequent period of renewal.

d) Circumcision unless necessary for treatment of a disease not excluded hereunder or as may be necessitated due to an accident, vaccination or inoculation or change of life or cosmetic or aesthetic treatment of any description, plastic surgery other than as may be necessitated due to an accident or as a part of any illness.

e) Cost of spectacles and contact lenses, hearing aids. (These may be termed as normal maintenance expenses.)

f) Dental treatment or surgery of any kind unless requiring hospitalisation.

g) Convalescence, general debility, run down condition or rest cure, congenital external disease, or defects or anomalies, sterility, venereal disease, intentional self injury and use of intoxicating drugs / alcohol.

h) Various conditions commonly referred to as AIDS.

i) Charges incurred at hospital or nursing home primarily for diagnostic. X-Ray or laboratory examinations or other diagnostic studies not consistent with the positive existence or presence of any ailment, sickness or injury for which confinement is required at a Hospital / Nursing Home or at Home under Domiciliary Hospitalisation as defined.

j) Expenses on vitamins and tonics unless forming part of treatment.

k) Treatment arising from childbirth including Caesarean section (can be deleted, if maternity benefit is covered).

l) Voluntary medical termination of pregnancy (abortion) during the first 12 weeks from the date of conception.

m) Naturopathy treatment.

5.4 PROCEDURE TO BE FOLLOWED FOR BUYING HEALTH INSURANCE POLICY:

1) **Filling of proposal form**: The proposal form will contain the personal information of the person like name, address, age, occupation, sum insured etc. and two photographs of an individual is to be enclosed.

2) **Declaration of good health/medical questionnaire**: A person should give a declaration of his good health. In case of adverse health then he should submit the certificate from the doctor.

3) **Medical examination report**: It is required from the doctor, who is having the qualification of MD, if the age of person is more than 45 years. It is must even if the person is possessing good health.

4) **Payment**: The premium is paid through cheque to get the tax benefit under Income Tax Act, 1961.

5) **Issue of Policy documents** : The policy document is issued once above mentioned information/documents submitted.

6) **Issue of Photo Card by Third Party Administrator (TPA)**: After issuing the policy documents, the TPA will issue the photo identity card for each person which will help to get the treatment in the hospital on cashless basis. TPA are licensed by the IRDA who will settle the health insurance claims on behalf of the insurance companies. TPAs have empanelled various hospitals on all India basis who will provide the health treatment on cashless basis meaning thereby, that the policyholder will not pay any amount to the hospital and the hospital will get the payment directly from the TPA up to the sum insured of a person. If some insured is not sufficient to meet the bill of the hospital then the excess amount will be paid by the policyholder.

5.5 MISCELLANEOUS CONDITIONS / BENEFITS

a) **Age Limit**: This insurance is available to persons between the age of 5 years to 80 years. Children between the age of 3 months to 5 years can be covered provided one or both parents are covered concurrently.

b) **Family Discount**: This discount of 10% in the total premium is allowed to a family comprising the insured and any one or more of the following:

   i) Spouse

   ii) Dependent children (i.e. legitimate or legally adopted)

   iii) Dependent parents

c) **Cumulative Bonus**: The sum insured is increased by certain percentage, say 5% for each claim from the year of insurance subject to a maximum accumulation of 10 years. In the event of a claim, the increased percentage will be reduced to a certain percentage, say the double of the bonus rate by 10% of the sum insured at the next renewal but the basic sum insured will remain the same. Some companies do not allow this cumulative bonus but instead of this allow a discount in the premium on the next renewal if no claim is reported during the currency of the previous policy.

d) **Cost of Health Checkup**: The insured shall be entitled to reimbursement of medical check up, generally once in every four underwriting years, subject to no claim preferred during this period. The cost shall not exceed

1% of the average sum insured during the block of four years.

e) **Extension of Cover**: The health cover is available for Indian Territories but it can be extended to Nepal and Bhutan with prior permission.

5.6 CLAIM SETTLEMENT PROCEDURE

If any claim arises in health insurance policy, the same can be settled in any of the following ways:

1. Reimbursement of expenses.
2. Cashless facility for planned hospitalization
3. Cashless facility for emergency hospitalization

1. **Reimbursement of expenses**: If a policyholder falls sick and hospitalized in non-empanelled hospital then he should follow the following procedure:

   - Intimation to the insurer/ Third Party Administrator (TPA) along with the name of the person who has fallen sick
   - Policy number
   - Name of the hospital
   - Name of the doctor

   The above information should be sent within 7 days of the hospitalization.

   Within 30 days final claim form should be furnished along with the following documents:

   - Hospital receipts/ original bills.
   - Cash memos.
   - Various reports and tests.
   - Hospital admission and discharge slip.
   - Case history.
   - Any other documents desired by TPA or hospital.

   Note: Kindly ensure that insured person has been admitted to a hospital/nursing home as defined in the policy.

2. Cashless facility for planned hospitalization:

- The expected expenses to be incurred should be sent to TPA through the agreed list of network hospital
- Policy no. & card number should be shown to the hospital
- On confirmation from the TPA the treatment can be taken in that hospital.
- If expenses increase during the treatment then the hospital will sent revised estimate to the TPA for their approval.
- For any post hospitalization treatment the original bills/cash memos can be sent to the TPA after completing the treatment for the reimbursement.

3. Cashless facility for emergent hospitalization

- A card issued by the insurer should be shown to the hospital.
- The expected expenses may sent to the TPA for their approval.
- For any post hospitalization treatment the original bills/cash memo can be sent to the TPA after completing the treatment for the reimbursement.

Important: Kindly ensure that the Identity-Card is easily available with the policyholder.

INTEXT QUESTIONS 5.1

1. Who settles the Health Insurance Claim?
2. What is the meaning of 'family' for health insurance?

5.7 TYPES OF HEALTH INSURANCE POLICY

a) **Floater Health Insurance Policy**: It means that a single sum insured will be available for all family members. For example, a family consists of self, spouse and two children purchases health insurance of Rs 1.00 lakh. Under the floater policy, any family member can avail the medical claim of Rs 1.00 lakh. The coverage and other terms & conditions are the same as are explained above in para 5.1 to 5.3. The premium will be applicable to the highest aged member of the family.

b) **Critical Illness Insurance Policy:** Critical illness insurance or critical illness cover is an insurance product, where the insurer is contracted to typically make a lump sum cash payment if the policyholder is diagnosed with one of the critical illnesses listed in the insurance policy.

The policy may also be structured to pay out regular income and the payment may also be on the policyholder undergoing a surgical procedure, for example, having a heart bypass operation.

The contract terms contain specific rules that define when a diagnosis of a critical illness is considered valid. It may state that the diagnosis need be made by a physician who specializes in that illness or condition, or it may name specific tests, e.g. EKG changes of a myocardial infarction, that confirm the diagnosis.

c) **Group Health Insurance Policy**: The Group Health Insurance Policy is available to any Group / Association / Institution / Corporate body of more provided it has a central administration point and subject to a minimum number of persons to be covered. The group policy is issued in the name of the Group / Association / Institution / Corporate Body (called insured) with a schedule of names of the members including his/her eligible family members (called insured persons) forming part of the policy.

The details of insured person is required to furnish a complete list of Insured Persons in the prescribed format according to sum insured.

Any additions and deletions during the currency of the policy should be intimated to the company in the same format. However, such additions and deletions will be incorporated in the policy from the first day of the following month subject to pro-rata premium adjustment.

No change of sum insured for any insured person will be permitted during the currency of the policy.

No refund of premium is allowed for deletion of insured person if he or she has recovered a claim under the policy.

The coverage under the policy is the same as under Individual Mediclaim Policy with the following differences:-

Notes

a) Cumulative bonus and Health Check up expense are not payable.

b) Group discount in the premium is available

c) Renewal premium is subject to claims made during the previous policy .

d) Maternity benefit extension is available at extra premium. Option for maternity benefits has to be exercised at the inception of the policy period and no refund is allowable in case of insured cancellation of this option during currency of the policy. A waiting period of 9 months is applicable for payment of any claim relating to normal delivery or caesarean section or abdominal operation for extra uterine pregnancy. The waiting period may be relaxed only in case of delivery , miscarriage, or abortion induced by accident or other medical emergency. Claim in respect of delivery for only first two children will be considered in respect of any one insured person. Those insured persons who already have two or more living children will not be eligible for this benefit. Expenses incurred in connection with voluntary medical termination of pregnancy during the first 12 weeks from the date of conception are not covered.

d) **Overseas Medical Policy:**

This policy was originally introduced in 1984 to provide for payment of medical expenses in respect of illness suffered or accident sustained by Indian residents during their overseas trips for official or holiday purpose.

The insurance scheme, since 1984 has been modified from time to time to provide for additional benefits such as in-flight personal accident, loss of passport etc. In 1991, Employment and Study Policy was introduced. This policy is meant for Indian citizens temporarily working or studying abroad.

Eligibility:

(a) Indian Residents undertaking bonafide trips abroad for:

(i) Business and official purposes.

(ii) Holiday purpose

(iii) Accompanying spouse and children of the person who is going abroad will be treated as going under holiday travel.

(iv) Foreign Nationals working in India for Indian employers of Multi-National Organisation getting their salary in Indian Rupees, covering their official visits abroad provided they are undertaken on behalf of their employers.

Age Limit:

(a) For adults upto 70 years

(b) Cover beyond 70 years is permissible at extra premium.

(c) Children between the age of 6 months to 5 years are covered by excluding certain specific children diseases.

Period of Insurance

The Insurance is valid from the first day of insurance and expires on the last day of the number of days specified in the policy schedule or on return to India whichever is earlier.

Extension of the period of insurance is automatic for the period not exceeding 7 days, and without extra charge, if necessitated by delay of public transport services beyond the control of the insured person.

COVERAGE Section A - Personal Accident

This insurance will pay upto the limit as shown in the Schedule if the insured person sustains accidental bodily injury and such bodily injury within 12 months of the date of the injury is the sole and direct cause of death or loss of eye(s) or limb(s). Not more than US $ 2,000 is payable in respect of death if the insured person's age is under 16.

Section B - Medical Expenses and Repatriation

This insurance will pay up to the limit shown in the Schedule in total for the insured person in respect of covered medical related expenses, incurred outside the Republic of India by the insured person suffering bodily injury, sickness, disease or death during the period of insurance.

Covered Expenses:

(a) Expenses for physician services, hospital and medical services and local emergency medical transportation.

(b) Upto US $ 225 per occurrence, in case of dental services for the immediate relief of dental pain only. However, dental care necessary as a result of a covered accident shall be subject to the limit of cover and deductible.

(c) Expenses for physician ordered for emergency medical evacuation, including medically appropriate transportation and necessary medical care enroute, to the nearest hospital when the insured person is critically ill or injured and no suitable local care is available.

(d) Expenses for medical evacuation, including transportation and medical care enroute to a hospital in India or the insured person's normal place of residence in India when deemed medically advisable by the Medical Advisors and the attending physician.

(e) If the insured person dies outside India, the expenses for preparing the air transportation of the remains for repatriation to India or up to an equivalent amount for a local burial or cremation in the country where the death occurred.

Specific Conditions

a) No claim will be paid in respect of

   (i) expenses for treatment which could reasonably be delayed until the Insured Person's return to the Republic of India. The question of what can or what cannot be reasonably delayed will be decided jointly by the treating physician and the Medical Advisors.

   (ii) cosmetic surgery unless necessary as a result of a covered accident.

   (iii) routine physical examination or any other examination where there is no objective indication of impairment of normal health.

b) The insurance will not cover pregnancy of the Insured Person including resulting childbirth, miscarriage abortion or complication of any of these.

c) **Restricted Cover**: In the event that the proposer is unable to present himself or herself for medical examination where called for by the Insurance Company, the limit of indemnity under this insurance is reduced to US $ 10,000 in respect of and limited to the expenses for physician services, hospital physician and medical services and local emergency transportation. Such limit applies to medical expenses incurred through illness or disease only.

Section C - Loss of checked baggage

This insurance will pay up to the limit of cover shown in the Schedule of the policy in the event of the Insured Person suffering a total loss of baggage that has been checked by an International Airline for an International flight.

Section D - Delay of checked baggage

This insurance will pay up to the limit of cover shown in the schedule for the necessary emergency purchase of replacement items in the event that the Insured Person suffers a delay of more than 12 hours from the scheduled arrival time at the destination for delivery of baggage that has been checked by an International Airline for an International outbound flight from India.

Section E - Loss of passport

This insurance will pay upto the limit of cover shown in the schedule for the reimbursement of actual expenses necessarily and reasonably incurred by the Insured Person in connection with obtaining a duplicate or fresh passport.

No claim will be paid that is less than the deductible stated in the schedule. The deductible shall apply to each insured event and shall be borne by the Insured Person.

Section F - Personal Liability

This insurance will pay up to the limit of cover shown in the schedule if the Insured Person in his or her private capacity becomes legally liable to pay for accidental bodily injury to Third Parties or accidental damage to Third Party Property, arising from an incident during the covered trip.

General Exclusions: (All Sections) No claim will be paid:

a) In respect of a medical condition that was known by the insured person to exist and/or he had been treated for the condition in the one year immediately preceding the effective date of the policy

b) Where the insured person:

   (i) is traveling against the advice of a physician

   (ii) is on waiting list for specified medical treatment; or

   (iii) is traveling for the purpose of obtaining medical treatment; or

   (iv) has received a terminal prognosis for a medical condition.

c) Suicide, attempted suicide, venereal disease or abuse of drugs or alcoholic drinks.

d) In respect of medical services obtained within India.

e) Arising from the insured taking part in Naval, Military or Air Force operations.

f) Arising from aviation except where the insured flies as a passenger in an aircraft properly licensed to carry passengers.

g) Arising from participation in professional sports events or other hazardous sports.

h) Where there is another insurance covering the same interest e.g. health insurance, any occupational benefit plan, national health insurance scheme or public assistance programmes, except in excess of the benefit under such plan, insurance or scheme.

e) Corporate Frequent Travelers

This is an annual policy granted to officials of companies registered under the Companies Act, who are regularly traveling abroad.

The salient features of the endorsement are :

a) The insurance is valid in respect of trips undertaken during the 12 months following the date of purchase as stated in the schedule - subject to the duration of any one trip not exceeding 30 /45 days.

b) In the event that the insured person is travelling outside India on the last day of insurance the cover shall extend to include duration of trip until his return to India within 30 days of the expiry date.

c) No cover is available for persons over the age of 70.

d) i) A person up to 60 years of age need not undergo medical check-up. However, a person over 60 years of age but within 70 years of age must undergo at the inception of the annual cover a full medical checkup including Blood / Urine Strip Test and E.C.G.

ii) The cover granted is always subject to the insured person advising the Insurance Company any material change in his health condition. Policy to be issued to individuals only.

f) Employment and Study Policy

The policy is designed for Indian citizens temporarily posted abroad in a sedentary non-manual work or students pursuing studies or engaging in research activities abroad.

The salient features of the Scheme are:

– **Age limit**: 18 to 60 years

– **Limit of Liability** : U.S. $ 75,000/- any one insured person and in all any one period of insurance.

Premium : The premium for the policies issued to the executives of corporate clients for employment purposes will be paid in foreign currency and the premium for students going abroad for higher studies will be paid in Indian Rupees.

The premium varies according to the age group 18-40 and 41-60 and the type of plan. The same rate applies to accompanying spouse but a lower rate is charged for child under 18 years. For students premium varies according to the type of plan.

The benefits are divided into 2 sections :

Section I:

Sub—Section A:

Medical Expenses incurred in respect of disease / injury contracted / sustained during the policy period limited to maximum liability

(I) under the policy

(II) 52 weeks after the onset of injury / sickness

(III) 12 weeks after the expiration date of the insurance

Sub—Section B :

If the insured person is evacuated to India the insurers will pay medical expenses in India, as provided under Sub-section A above in addition but within the overall limit of US $ 75,000.

Sub—Section C:

Repatriation and Alternative Expenses ; In the event of the death of an insured person, the insurers will pay the actual expenses for preparation and transportation to India of the remains of the insured person or funeral expenses incurred in the country of posting, not exceeding US $ 8,000 in total.

Sub–Section D:

Medical Emergency Reunion Expenses upto US $ 5,000/-in all when as a result of a covered injury or covered sickness insured person is hospitalized and it is agreed by all parties that the insured person shall be medically evacuated to India as soon as possible, insurer will pay upon the recommendation and prior approval of the claims administrator the following expenses incurred in respect of travel by the mother or father or guardian or spouse.

a) The cost of an Economy Air Ticket for one person from India to the airport serving the area where the Insured Person is hospitalized and returned to India.

b) Reasonable travel and accommodation expenses incurred in relation to Emergency Reunion.

Section II

Contingency Insurance - (Applicable to sponsored students only)

In the event that it is mutually agreed that the insured person is unable to continue completion of his studies in the country of study (the details of which are declared in the proposal form) due to covered injury or covered sickness first occurring in the country of study resulting in (a) Death or (b) Loss of entire sight of either or both eyes, or (c) Permanent total disablement and is medically evacuated under section I (B) above or a valid claim is payable under section I(C), this insurance will pay by way of recompense a benefit to the nominated sponsor who has provided financial support to the insured person as regard the insured period of study overseas and is declared in the proposal form at a rate of US $ 750 capital sum for each month of study completed during the period of insurance.

In case the insured cannot continue to complete his course of studies due to mental, nervous or emotional disorder, this benefit is limited to 25% of the amount due. But if the educationalist running the insured person course consider that because his performance on and his attitude to the studies were unsatisfactory, he is unable to complete his course of study no benefit would be payable.

Notes

INTEXT QUESTIONS 5.2

1. What is meaning of Floater Health Insurance Policy?
2. How many sections are in Overseas Medical Policy?

5.8 SUMMARY

Health insurance requires attention of all members of society due to factors like

- Medical inflation,
- Increasing life expectancy,
- Increasing load of lifestyle diseases and
- Uncertainties in individual employability and earnings

Living long and dying young are both creating new tensions in the society. We are not having proper health social security system in India and every household is spending major part of its earning on medical expenses. If we, all members of the society (who can afford health insurance) decide to buy health insurance at earliest eligible age, consciously or unconsciously, then a proper health social security system will prevail in the country.

5.9 TERMINAL QUESTIONS

1) Define the features of the Health Insurance Policy.
2) Explain the exclusions of the Health Insurance Policy.
3) Discuss the features of the Overseas Medical Policy.
4) Explain the features of Personal Accident Insurance policy.
5) Discuss the claim procedure to be followed to get the claim in case of death of an insured person.

6) Write short notes on

i) Permanent total disability ii) Group Personal Accident iii) Procedure to taking the personal accident insurance policy

5.10 OBJECTIVE TYPE QUESTIONS

1. **Which of the following criteria may not be complied with in the definition of hospital/nursing home, if it is not registered**

   a. Fully equipped OT

   b. At least 10/15 in-patients beds

   c. Tie up with TPA

   d. Fully qualified nursing staff

2. **The Standard Medi-claim Policy excludes any disease (other than diseases excluded during the first two years of operation) for how many days from commencement of policy.**

   a. 30 b. 45

   c. 15 d. 60

3. **Which of the following is excluded in the Standard Medi–Claim Policy**

   a. Simple Tooth Extraction b. Cataract Operations

   b. Hysterectomy d. All the above

4. **Select the appropriate options**

   1) Domiciliary Hospitalization benefit is covered under a Individual Medi-claim policy

   2) Cost of health check up is covered and Individual Medi–claim Policy

   a. Both statements are false

   b. Both statements are true

   c. Statement 1 true but statement 2 is false

   d. Statement 1 is false but statement 2 is true

Notes

5. **Which of the following is covered under Medi–claim Insurance Policy?**

   a. Dental treatment b. Cost of Spectacles

   c. Cost of Pacemaker d. Cosmetic Surgery

6. **Income tax benefit under Section 80(D) of Income Tax Act is admissible**

   a. If premium is paid in cash

   b. If premium is paid by cheque

   c. (a) and (b)

   d. None of the above

7. **Claims are settled under the Overseas Mediclaim Policy**

   a. By the Policy Issuing Office

   b. Overseas Claim Settlement Agent

   c. Insured pays to the hospital and seek reimbursement

   d. Lloyds of London

8. **Universal Health Insurance Policy for BPL families is issued by**

   a. Private and PSU Insurers b. PSU Insurers only

   c. Central Government d. State Government

9. **In respect of Medi Claim Policy, TPA denote**

   a. Third Party Availability for claims

   b. Third Party Administrator

   c. To Pay Afterwards

   d. None of the above

10. **Medical Benefit under UHIS is restricted to**

    a. Rs. 30,000/- per family

    b. Rs. 30,000/- per member

    c. Rs.50,000/- per family

    d. Rs.12,500/- per member

5.11 ANSWERS TO INTEXT QUESTIONS

5.1

1. Either Insurance Company or through Third party Administrator (TPA)
2. Self, Spouse, depended children and depended parents

5.2

1. A single sum insured floats among the all family members.
2. There are six sections in the policy.

5.12 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1.c	2. a	3. a	4.a
5 c .	6. b	7. b	8. a
9. b	10. c		

6

RURAL INSURANCE

6.0 INTRODUCTION

Under the provisions of sections 32–B and 32–C of the Insurance Act, 1938, insurance companies are obliged to provide such percentages of business as may be specified by the IRDA, for persons in the rural sector or social sector, workers in the unorganised or informal sector, for economically vulnerable or backward classes of the society and other categories of persons, as may be specified by the IRDA.

The IRDA has, in pursuance of the provisions of the above two sections of the Insurance Act, issued the (Obligations of Insurers to Rural or Social Sectors) Regulations, 2000, which lays down that every insurer transacting general insurance business, shall underwrite business in the rural sector, to the extent of at least 2% of total gross premium in the first financial year, at least 3% of gross premium in the second financial year and 5% of the gross premium in the third and further financial years. The obligations include insurance for crops.

The Rural sector has been defined as any place which, as per the last census, has a population of not more than 5000, density of population of not more than 400 per square kilometer, and at least 75% of the male working population engaged in agriculture.

The Government of India has launched various programmes for the benefit of small farmers, marginal farmers, agricultural laborers, etc. Since 1980, all these programmes have been integrated into Integrated Rural Development Programme (IRDP) which is funded by the Central and State governments on 50:50 basis. The objective of the programme is to provide, to the target group of rural families, a package of assistance comprising of income generating assets, working capital, etc. through subsidy, institutional credit, etc.

Special insurance schemes are framed to protect the beneficiaries of IRDP projects. Under these policies, the rates of premium are lower and claims procedure is simplified. Whenever, the word 'scheme' is used hereafter, it refers to these special policies.

Insurers will evolve appropriate strategies and plans to meet these obligations.

6.1 OBJECTIVES

At the end of this lesson, you will be able to:

- Know the various rural insurance policies.
- Know the coverage under various rural insurance schemes.
- Settle the claim.

Know what is not covered under various rural insurance policies

6.2 RURAL POLICIES

Rural policies comprise the insurance of:

1. various livestock, e.g., cattle, sheep, goat, etc.
2. sub-animals e.g., silkworm and honeybee.
3. plantation and horticultural crops, e.g. rubber, grapes, etc.
4. property e.g., agricultural pumpsets, etc.
5. persons e.g., gramin accident.

6.3 CATTLE INSURANCE

The word 'Cattle' for the purpose of the market agreement refers to the following animals, whether indigenous, exotic or cross *bred*, within the age limit indicated.

Milch Cows : 2 years to 10 years

Milch Buffaloes : 3 years to 12 years

Stud bulls (Cow / Buffalo species) : 3 years to 8 Years

Bullocks (Castrated bulls and Castrated male buffaloes) : 3 years to 12 Years

6.3.1 Coverage

Cattle policy prescribed by the agreement provides indemnity for death due to

(a) Accident (inclusive of fire, lightning, flood, inundation, storm, hurricane, earthquake, cyclone, tornado, tempest and famine)

(b) Diseases *contracted* or occurring during the period of this policy.

(c) Surgical operations

(d) Riot and strike

The policy can also be extended to cover Permanent Total Disability (PTD)on payment of extra premium :

(a) Permanent Total Disability which, in the case of Milch Cattle, results in permanent and total incapacity to conceive or yield milk.

(b) PTD which, in the case of Stud Bulls, results in permanent incapacity for breeding purpose.

(c) PTD in the case of which Bullocks, Calves / Heifers and Castrated male buffaloes, results in permanent and total incapacity for the purpose of use mentioned in the proposal form.

6.3.2 Exclusions

i. Malicious or wilful injury or neglect, overloading, unskillful treatment or use of animal for purpose other than stated in the policy without the consent of the Company in writing.

ii. Accidents occurring and/or disease contracted prior to commencement of risk.

iii. Intentional slaughter of the animal except in cases where destruction is necessary to terminate incurable suffering on human consideration on the basis of certificate issued by qualified Veterinarian or in cases where destruction is resorted to by the order of lawfully constituted authority.

iv. Theft and clandestine sale of the insured animal.

v. Pleuro–pneumonia in respect of cattle in Lakimpur and Sibasagar Districs of Assam.

vi. Transport by air and sea.

6.3.3 Special conditions provide as follows :

a. The company is not liable to pay the claim if death is due to disease occurring within 15 days from the commencement of risk.

b. Claim is not entertained unless the ear tags are surrendered to the Company. If the ear tags are lost the insured is responsible for notifying the Company and getting the animal retagged.

c. In addition to other details, i.e animal's number or mark. species / breed, sex, colour and distinguishing mark, age, height, purpose for which used and sum insured.

6.3.4 Claim Procedure

Non Scheme Animals

In the event of death of an animal immediate intimation should be sent to the insurers and the following requirements should be furnished :

i. Duly–completed claim form

ii. Death Certificate obtained from qualified Veterinarian on Company's form.

iii. Postmortem examination report if required by the Company

iv. Ear Tag applied to the animal should be surrendered. The Companies follow the principle of "No Tag - No Claim". Generally claim is not be paid if tag is not submitted. However, in cases of genuine hardship, the higher competent authority may consider the claim if the identity of the animal is established.

v. The value of the animal should be established properly keeping in view age, etc.

Scheme Animals

Intimation of loss / death of animal should be given to the Company or Financing Bank immediately, within 7 days. Claimant has to furnish the following requirements within 30 days:

(a) Duly–completed and signed claim form along with ear tag.

(b) Certification of death from Veterinary surgeon or a Certificate jointly by any two of the following:

   (i) Sarpanch of the Village

   (ii) President or any other Officer of Co-op. Credit Society.

   (iii) Official of the Milk Collection Centre, or others specified.

   Subject to their declaration that they have seen the carcass and ear tag intact in the ear mentioning number thereof.

(a) Post mortem report, if conducted.

6.3.5 Sum Insured

The market value of cattle varies from breed to breed, from area to area and from time to time. The sum insured is based on market value as recommended by a Veterinarian. Indemnity is based on sum insured or market value whichever is less. In case of scheme animals, the policy is issued as agreed value policy and claims are settled for 100% of sum insured.

6.3.6 Premium

The premium rates are lower for scheme animals than for non-scheme animals. This applies to indigenous / cross-bred animals. Higher rates are charged for exotic animals. Group discounts and long-term discounts are available. There is provision for percentage increase in renewal premium for adverse claims experience.

6.3 SHEEP AND GOAT INSURANCE

The policy provides indemnity (sum insured or market value, whichever is less) against death of sheep and goats due to

– Accident (including fire, lightning, flood, cyclone, famine, strike, riot and civil commotion) or

– Disease

– Occurring or contracted during the period of insurance.

The exclusions are more or less the same as under the cattle insurance policy. These relate to wilful neglect, intentional slaughter, theft, etc.

However, the following exclusion is specific to this policy:

– Death due to Enterotoxaemia, Sheep Pox, Reinderpest, Anthrax, Foot and Mouth disease, Haemorrhagic Septicaemia, Blackquarter.

These diseases are covered only if the animal is successfully innoculated and the Veterinary Certificate is supplied to the company.

The conditions are the same as under cattle insurance policy.

The market agreement applies to all indigenous, cross–bred and exotic sheep and goats in the age group of 6 months to 6 years (4 months to 7 years in the case of 'scheme' animals)

The market value of sheep and goats varies from breed to breed, area to area and time to time. The Veterinarian's recommendation is a guide for acceptance of risk and settlement of claim. No salvage value is deducted from claims.

The premium rates are separately applied for:

(a) Indigeneous animals

(b) Cross–*bred* animals

(c) Exotic animals

Animals should be identified by metal ear tagging and / or tattooing method. Natural marks should be noted in the proposal and Veterinary certificate.

Group discount is available depending upon the number of animals covered (minimum 101 to 500 animals).

The salient features of insurance for other animals which fall under separate market agreements are outlined in the table below:

	Animals	**Sum insured**	**Indemnity**	**Rate**
A.	Draught horses, ponies, mares, mules. yaks - used for cart work, farm work etc. (Age limit 2 to 8 years) (**Note:** Long term Master Policy for 3,4 or 5 years with 25% discount)	100% of market value	Death - 80% of S.I. P.T.D. - 75% "	4% 1% extra

B.	Camels male and female (Age limit 3 to 12 years)	Bank finance schemes Max - Rs. 3000 Individual cases - Market Value	Death - 80% of S.I. or Market value whichever is less	4 % to 6%
			P.T.D. - 75% of S.I.	PTD- 1% extra

Notes

The agreement prescribes rules for identification, claims procedure etc. as in cattle and sheep and goat insurance.

6.4 POULTRY INSURANCE

'Poultry' for the purpose of the market agreement refers to (a) layers (b) broilers and (c) parent stock (exotic and cross-bred only).

The agreement prescribes age limits and minimum number of birds to be insured.

The policy provides indemnity against death of birds due to accident (including fire, lightning, flood, cyclone / storm / tempest/earthquake, strike, riot, act of terrorism) or disease contracted or occurring during the period of insurance.

Some examples of exclusions are:

(a) Transit by any mode of transport.

(b) Improper management (including over crowding).

(c) Loss / death due to natural mortality, non–specified or unknown diseases or reasons.

(d) Theft and clandestine sale of birds

(e) Intentional slaughter of the birds except in cases where destruction is necessary to terminate incurable suffering on human consideration and to protect remaining healthy flock to reduce additional losses on the basis of certificate issued by qualified Vet. Surgeon or in cases where destruction is resorted to by order of lawfully constituted authority, under intimation to Insurance Company.

The sum insured has to be fixed as per the valuation chart for layers and broilers. For parent stock birds the valuation chart has to be fixed in consultation with the Hatchery owners.

Premium rates vary for a) broilers b) layers and c) parent stock and according to a) IRDP scheme and b) non-IRDP scheme.

The agreement prescribes 'no-claim' discount and discount for good features some examples of which are:

(i) Farms having resident / own Veterinary officer or farms managed by Veterinary doctors.

(ii) Farms having good dead bird disposal system, i.e. farms with incinerator.

(iii) Farms with standard layout such as good distance between sheds etc.

Underwriting Considerations

(a) All birds in the farm should be insured

(b) The minimum number of birds prescribed should be maintained and all the birds are covered on flock basis and hence no identification is necessary.

(c) Farms should have veterinary facility of their own or on consultancy basis.

Claims

Claims are admissible only if the mortality due to insured-peril in the flock exceeds the 'excess' limit prescribed. For example, for broilers 5% of the population in each batch is the 'excess' limit.

Daily mortality details should be submitted on weekly basis, failing which reports will be treated as 'nil' for that week. In the case of alarming death / out break of epidemic nature, notice within 12 hours should be given and all birds segregated and produced for inspection. Also, the insured should arrange emergency sale of live birds in the presence of Company's representative. This is for the purpose of averting or minimising the loss.

The claim documents required are

a) Claim form.

b) Vet. P.M. Report for sample birds

c) Daily record of mortality, feeding etc.

d) Purchase invoices for the birds.

e) Any other proof as may be required e.g., photographs, medical bills etc.

INTEXT QUESTIONS 6.1

1. What is the minimum age for insurance for the milch cows?

2. What is the meaning of 'Poultry' under Poultry insurance?

6.5 AQUA CULTURE (SHRIMP / PRAWN) INSURANCE

The insurance scheme under the agreement is applicable to licensed farms, in accordance with the Government notification, growing Brackish–Water shrimp / Fresh–water prawns by adopting extensive / modified extensive / semi intensive system only.

The insurance covers only total loss or destruction of shrimp/ prawns and is available as under:

Section I: Basic Cover

Only Total Loss of the Shrimp / Prawns due to the following:

(a) Summer Kill

(b) Pollution (from external source only).

(c) Poisoning.

(d) Riot and Strike.

(e) Malicious acts of Third Parties

(f) Earthquake.

(g) Explosion/Implosion.

(h) Storm, Tempest, Cyclone, Typhoon, Hurricane, Tornado, Flood, Inundation, Volcanic eruption and / or Other convulsions of nature.

(i) Aircraft and other aerial devices or articles dropped therefrom, impact with any road vehicle, horses and cattle.

(j) Terrorism Section II: Comprehensive Cover

Covering all perils as listed in basic policy and death due to disease excepting diseases caused by bad management and/ or which are due to nutritional deficiencies.

Some examples of exclusions are :

– Malicious or wilful injury, poisoning, negligence, error or omission by the insured or his family members or employees.

Notes

- Improper and incompetent management and rough handling.
- Infidelity of any person, burglary, poaching and theft.
- Transit by any means.
- Flood and inundation due to the action of normal tides.
- The agreement provides for a formula for fixing the sum insured. Policy period is for four and half months (culture period).

Claims

The insured shall, upon the occurrence of any event giving rise to or likely to give rise to a claim under this policy, give immediate notice within 24 hours to the Company, and shall, within fourteen (14) days thereafter, furnish to the company fully the completed claim form, and death certificate with details certified by an official of the Department of Fisheries / MPEDA or any marine biologist, etc.

All dead shrimp / prawns should be produced before the representative of the Company.

Various insurance schemes for which there are no market agreements are now outlined. The coverage, rates of premium, underwriting practice, etc. may vary among the companies. The notes which follow are designed to provide an idea of the general approach adopted.

Insurance policies are available to cover the following animals:

Elephants used for commercial / religious purposes in the age group 5 to 60 years. Sum insured should exclude the value of tusk. The rate is 4.5% for temple elephants and 5% for other *animals*. In the event of claims, 80% of the market value is paid.

Pigs (indigenous / cross bred / exotic, in the age group of 6 months to 3 years. Sum insured varies according to age of the animal. The limit of liability for a claim is 80% of the sum insured. The rate is 5% on peak value during the rearing stage.

Rabbits - All breeds in the age group of 1 day to 4 years. The sum is 100% of market value and the rate is 7%, Claim payment is at 70% of the sum insured or market value, whichever is less.

Notes

Zoo and Circus animals and birds. (All or none basis). Sum insured is based on valuation done by curator and health certificate by Veterinary doctor. The coverage is as per cattle / poultry policy. The rate of premium is as follows :

Zoo - 5 % sum insured

Circus - 7.5% of sum insured

The common features of the insurance schemes are :

a) Coverage is against accident or disease. The exclusions are generally the same as under the cattle policy but there may be additional exclusions relevant to the specific animal covered.

b) Basis of sum insured is the Veterinarian Certificate.

c) Appropriate identification marks on the animal are to be incorporated in the policy.

d) Claims procedure is generally the same as under cattle policy or poultry policy, as applicable.

6.6 SERICULTURE (SILK WORM) INSURANCE

The insurance scheme is applicable to Univoltine, Bivoltine and Multivoltine breed of silkworms fed on mulberry leaves only.

Indemnity is in respect of total loss or destruction of the cocoons, following the death of the silkworm due to accident or disease during the period of insurance.

Some of the important exclusions are :

a) Diseases contracted prior to or within 5 days from the date of commencement of risk.

b) Loss due to natural mortalities and / or normal trade loss.

c) Loss due to improper management and / or rough handling.

d) Theft or clandestine sale.

The policy may be extended at extra premium, to cover loss of cocoons due to accident during transit from the insured's farm to the cocoon market.

The crop period varies from 3 weeks to 5 weeks, that is from the stage of plantation of eggs to the final stage, i.e. harvesting of cocoons. Thus, the policy may be issued for 12 months or the duration of the crop period, as is required.

The value of cocoons at each stage till the harvest period, is to be certified by the Sericulture Department of the State Government. In view of the variation in the value of cocoons, the policy is not issued with fixed sum insured. The sum insured therefore, is equivalent to the cost of inputs only. A certificate from the Sericulture Department regarding the cause of loss and the value of cocoons at the time of loss is the basis for the settlement of claim.

The important terms of the policy are:

- Measures to be taken for prevention of disease and pest attacks.
- The eggs should be healthy.
- Cocoons should not be sold in any place other than the notified market.
- The insurance cover ceases once the cocoons leave the rearing premises.
- A technical report-cum-certificate of the Government Sericulture Department approving the method adopted by the sericulturist and identifying the areas where Silk worms are reared.
- Only disease–free supply of layings for rearing, obtained from licensed seed suppliers or the Government Sericulture Department, are insurable.

6.7 HONEY BEE INSURANCE

The insurance applies to hives and / or bee colony belonging to the cooperative society. The cover is in respect of all accidental loss or damage to the hive and/or bee colony. Theft risk can be covered on payment of additional premium.

The important exclusions are:

- Neglect or improper management and / or rough handling.
- Natural mortality.
- Any destruction as required by any order of Government / municipal authority.

Value for (a) cost of hive and (b) cost of bee colony will be taken as insured value. An agreed valuation based on the figures provided by the State Khadi and Village Board or Khadi and Village Industries Commission is accepted.

The respective boxes should be identified with the company code and number. Assessment of loss is based on the certificate given by an authorised officer of the concerned Government Department. The liability under the policy is 80% of the assessed amount, the insured bearing the balance 20%.

6.8 HORTICULTURE / PLANTATION INSURANCE SCHEME

The Scheme applies to the following:

a) Horticulture crops :

- Grape
- Citrus (Orange, Lime, Sweet lime)
- Chikoo (Sapota)
- Pomegranate
- Banana
- Mushroom
- Papaya
- Coconut

(**Note:** The subject matter covered is fruits)

b) Plantation:

- Rubber, Eucalyptus, Poplar, Teakwood
- Oil Palm
- Betelvine

c) Sugarcane

d) Tea

e) Floriculture

f) Polyhouse / Glass House

g) Nursery

h) Tissue culture

(**Note :** The subject matter covered is trees)

The Insured

The insured is the individual farmer whether owner or tenant.

However, a policy may be issued in the name of a registered body of farmers formed for the purpose of procurement of input, marketing of produce etc. Particulars of each member must be recorded in a schedule to the policy, so that claims can be settled on individual basis.

The Salient Features of the Policy

Coverage

Damage to the Horticulture / Plantation crop described in the schedule by

1) Fire, including forest fire and bush fire.
2) Lightning
3) Terrorism
4) Riot and strike
5) Storm, hailstorm, cyclone
6) Flood and inundation

Exclusions

Some examples are:

1) Loss by theft.
2) Earthquake.
3) Drought conditions.
4) Cold waves & heat waves.
5) Natural mortality of plants.
6) Delay in the onset of monsoon.

Further, the insurance does not cover loss or damage to

– Fertilisers, manures, etc., stored in the insured's field.
– Crop after ripening / harvesting is done or whilst in storage or transit.

Period of Insurance

Crop duration (one season) or twelve months whichever is shorter.

Sum Insured

The sum insured shall be based on the cost of cultivation on *Input Cost or Cost of Raising / Development of trees*, depending on the crop which is insured.

'The cost of inputs is defined in the policy to meet the recurring expenses incurred to raise the crop and some examples are:

– Pruning, deweeding, planting / seeding.
– Soil tillage
– Fertilizers and insecticides
– Maintenance of soil structure
– Watering plants
– Use of synthetic hormones
– Plant protection
– Labour charges for the above

The total cost of inputs per acre / hectare is stated in the policy.

Note : Separate sum insured is fixed for the following property, if covered under the policy

– Structure supporting the plants / crops.
– Irrigation system.
– Agricultural *equipments*.

Settlement of Claims

The policy includes a specific crop–wise clause which provides a percentage scale of costs of inputs corresponding to various stages of cultivation.

The amount of claim payable is in respect of cost of inputs and is determined with reference to this scale and subject to the following:

Franchise: No claim is payable, if the amount of the assessed claim does not exceed 10% of the total sum insured per acre or Rs. 1,000/- per affected acre, whichever is lower.

Excess: The insured shall bear first 20% of the claim as determined above, that is, only 80% of such claim shall be payable.

Deductions. Losses due to any or all of the excluded perils and / or improper maintenance shall be quantified and deducted to arrive at the loss payable.

Rates of Premium

Some indications of rates are provided for general information only.

	Crops	% on Sum insured
1.	Horticulture crops	5.00
2.	Plantations	1.25
3.	Floiculture, Poly–House, Glass House	0.50
4.	Betelvine	10.00
5.	Plant supporting structures	0.25

6.8 AGRICULTURAL PUMP SET POLICY

The insurance is granted on *Centrifugal Pump* sets (electrical and diesel) upto 25 H.P. capacity of approved makes used for agricultural purposes only.

The cover is in respect of unforeseen and sudden physical damage to pump sets (including starters) by

a) Fire, lightning.

b) Riot, strike, malicious damage, terrorism.

c) Mechanical, electrical breakdown.

d) Burglary (by violent forcible entry and provided the pump set is kept in a locked enclosure).

Flood risk can be granted on a selective basis at extra premium.

Some important exclusions are :

a) Cost of dismantling, to and from transport to workshop and cost of erection.

b) Faults existing at the time of commencement of policy and known to the insured

c) Damage for which the manufacturer or supplier is responsible.

The sum insured should represent 100% of new replacement value.

The rates of premium vary according to type of set, i.e. electric or diesel / oil and horse power.

There is excess applicable to machinery—breakdown claims only and the amount of the excess varies according to the type of set and horse power.

There are discounts for group policies, long term policies and for 'no claim'.

6.9 FAILED–WELL INSURANCE

The insurance applies to dug wells, bore wells or dug-cum-bore wells used for developing ground water and financed by Cooperative / Commercial banks and sponsored by National Bank for Agriculture and Rural Development (NABARD).

The policy indemnifies the insured to the extent of cost of all civil construction, less the cost of pumping equipment, and its accessories, or the sum insured, whichever is less, if the well fails to yield specified quantity or water.

The proposal form countersigned by the bank has to be accompanied by:

a) Site plan of place of land on which well is to be dug. (site selection has to be done by a qualified hydrologist / geophysicist)

b) Permission of the local municipal authority.

A group policy may be issued to the bank covering a number of farmers provided the required details are supplied for each well.

Failure of well is determined with reference to prescribed parameters and certified by the District / Block Certifying Agency constituted by the State Government.

6.9.1 Lift Irrigation Insurance

The lift irrigation system comprises : Intake well, Delivery chambers. Jack well. Pump house. Water storage tank, Pipeline cables, Switch gears, Starters and Electric motors of capacity from 3 H.P. to 200 H.P.

Coverage

The policy provides indemnity against unforeseen and sudden physical loss and / or damage by:

a) Fire

b) Riot, strike and malicious Damage

c) Storm, flood etc.

d) Earthquake

e) Landslide

f) Theft

g) Bursting of pipelines

h) Mechanical and / or Electrical breakdown.

There is an excess of Rs. 1000/- on each and every claim. For machinery breakdown the excess is 1 % of the value of the machinery or Rs. 1000/- whichever is higher.

The sum insured shall be equal to the cost of replacement of insured property by new property, of the same kind and capacity, subject to terms and conditions laid down in the policy.

6.11 CYCLE RICKSHAW POLICY

The policy provides similar cover as under a pedal–cycle policy. Accidental damage is subject to excess of Rs.25/-.

It includes legal liability for death or injury of passengers with a limit of Rs. 500/- each for 2 passengers and damage to their goods of Rs. 500/-.

6.12 ANIMAL–DRIVEN CART INSURANCE

The cover is provided under three sections.

a. Loss or damage to cart or tonga by accidental, external means, fire, lightning, storm, flood, burglary, theft, riot, strike, malicious act., terrorism and when in transit by rail, road or inland waterways.

b. Death or permanent total disablement of the insured animal arising during and out of an accident to the cart/ tonga.

   The animals used for driving / pulling are:

   – Male buffaloes, bullocks, bulls

   – Horse/Mule

   – Donkey

   – Camel

2. Third party liability upto Rs. 5,000/- per accident and Rs. 10000/- for all accidents in a year
3. Personal accident cover (as per Gramin Policy) to the driver, whether owner or otherwise.

Notes

Sum insured should be 100% of the market value of the cart / tonga and animal to be declared separately. The policy is subject to excess of Rs. 100/-(cart) and Rs. 200/- (tonga) for each claim. In case of damage to rubber tyres, the liability is limited to 50% and in case of total loss to 75%.

INTEXT QUESTIONS 6.2

1. What type of elephants are insured?
2. Which animals are insured under Animal Driven Cart Insurance?

6.13 GRAMIN PERSONAL ACCIDENT INSURANCE

The Sum insured is fixed at Rs.10.000 for death, loss of two eyes/two limbs and permanent total disablement and Rs.5,000/- for loss of one eye or one limb.

The premium is fixed at Rs.5/- per policy. Group discounts and long term discounts are available.

Age limits for acceptance are : minimum 10 years and maximum 70 years.

A policy-cum-proposal form has been devised and the claims procedure simplified. Death claims are settled expeditiously through the provision of nomination. Post-mortem report is not insisted upon where clear evidence of accident is available.

6.14 HUT INSURANCE

This insurance is under market agreement. Dwelling huts in rural areas, constructed with financial aid from Banks / Cooperatives / Government institutions, are covered against the risk of fire, earthquake, inundation, storm, impact damage, riot, strike and malicious damage for a maximum sum insured of Rs. 6000/- (agreed value policy) comprising Rs. 5000/-for structure and Rs. 1000/- for contents.

Maximum 200 huts, situated in one contiguous area are covered. Larger size is considered and rated separately. Huts have to be identified by description and number allotted.

The rate is Rs. 3/- per mile. Group discounts are available.

Hut Insurance (Group)

The group cover is given to the State Governments only in respect of huts in rural / semi-rural areas of the state, provided all huts are covered.

The risks covered are: Fire, lightning, explosion, riot, strike, malicious damage, impact by rail / road vehicle or animals, storm, cyclone, flood and inundation, earthquake subsidence, landslide, rockslide, and terrorism.

The sum insured should not be more than Rs. 5,000/-. The rate of premium is Rs. 3/- per mile with provision for lower rates for number of huts ranging from 15,000/- to Rs. 1 crore and over Rs. 1 crore on a slab basis.

The total aggregate claim shall be limited to

a) Rs. 2 crores per event

b) Rs. 10 crores in any one year during the currency of the policy

The business is shared with the state government on 50% co-insurance basis. Ordinary claims are processed by claim enquiry–cum settlement officers.

Major claims, e.g. flood and fire are surveyed and assessed by a Task Force constituted by the insurer.

6.15 FARMERS' PACKAGE INSURANCE

It provides multiple covers under one policy

The details of cover are as follows :

		Risks	Sum Insured
a)	Dwelling hut / house and content	Fire, lightning, natural perils, impact damage, riot, strike, malicious damage	Rs.5000/- (Dwelling) Rs.1000/- (Contents)
b)	Cattle (Indigenous)	Death (accident / disease) Permanent Total Disablement, Breeding / Calving risk	2 cattle heads @ Rs. 2,000/- each

Notes

c)	Agricultural Pumpset (up to 5 HP)	Fire, theft, machinery breakdown	100% of market value
d)	Bullock Cart	Death / Permanent disability of animal due to accident, Damage to cart (accident), Third party liability, Personal Accident to cart driver	Rs.2,000/- (2 bullocks) Rs.1,000/- (Cart)
e)	Gramin Personal Accident (Insured and Spouse)	Death / Permanent Total Disablement	Rs.6,000/- each

INTEXT QUESTIONS 6.1

1) How can cattles be insured?

2) Explain the Farmers' Package Insurance.

3) Discuss the Agricultural Pump Set Policy.

6.17 OBJECTIVE TYPE QUESTIONS

1. Which of the following risks is excluded under cattle policy?

   a. Theft of animal   b. Earthquake

   c. Flood   d. Cyclone

2. Which of the following limits affect the claim amount payable under Horticulture/Plantation policy

   A. Franchise   B. Excess

   a. Both   b, Neither

   c . A   d. B

3. Poultry Insurance is not underwritten for birds under the following categories

   a. Broiler   b. Layers

   c. Hatchery unit   d. One day old chicks

4. Under Honey Bee Insurance the liabilities for loss is —— % of the loss assessed amount and the insured bearing the balance of the loss.

Notes

a. 80 b. 60

c. 70 d. 90

5. Which of the following risks are covered under Horticulture/Plantation Insurance Policy?

a. Draught Conditions b. Forest Fire

c. Delay in onset d. Cold waves and heat waves

6. Crop Insurance is based on

a. Total input value b. Sale value

c. Value inclusive of land d. None of the above

7. Freshwater Prawn Insurance does not cover

a. Pollution b. Poisoning

c. Riots & strike d. Partial Loss

8. Poultry Insurance does not cover

a. Layers b. Broilers

c. Hatcheries d Tandoori

9. A milch cow is covered under Cattle Insurance up to the age of

a. 8 years b. 10 years

c. 12 years d. 14 years

10. Sum insured in Fisheries Insurance is arrived on the basis of

a. Only the cost of seeds b. Only the cost of input

c. Only the cost of import of seeds d. None

6.18 ANSWERS TO INTEXT QUESTIONS

6.1

1. Minimum age is two years.

2. 'Poultry' for the purpose of the market agreement refers to a) layers b) broilers and c) parent stock (exotic and cross-bred only).

6.2

1. The elephants used for charitable and commercial purpose are insured.

2. Male buffaloes, bullocks, bulls, horse/mule, donkey, camel.

6.19 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. a	2. a	3. c	4. a
5. b	6. a	7. d	8. d
9. a	10. b		

7

LIABILITY INSURANCE & DOCUMENTS IN GENERAL INSURANCE

7.0 INTRODUCTION

In previous chapters we have explained various products of general insurance and they fall under the category of Property Insurance. It means the insurance of physical goods which are fixed at one place or moving by road or sea or air or rail. In some situation, by any act, wilfully or unwilling, of an individual or organization, a third party is affected by death or bodily injury or property damage. The affected party may claim the damage from such person. Such person may insure himself for such acts through Liability Insurance.

7.1 OBJECTIVES

At the end of this lesson, you will be able to:

- Explain the meaning of Liability Insurance
- Identify types of Liability Insurance
- Enumerate the various documents required under insurance

The dictionary meaning of liability means "responsibility". Legal liability means the liability which can be enforced in the court of law and the same can be insured.

The legal liability can fall under two heads:

1) Criminal Liability 2) Civil Liability

1) **Criminal Liability** : is enforced by the State Government and punishable under the law in the form of fine or imprisonment or both

2) **Civil Liability:** occurs when an action is taken by one party against another party resulting in the damage of the property or death or bodily injury of the aggrieved party and the compensation is payable under the law of the land.

The most common example is that of a person who is driving a vehicle and hits some body on the road resulting in death or bodily injury. The aggrieved party may claim compensation from the vehicle owner who may not be financially sound to pay the compensation amount. Liability insurance is available.

The other historical example is that of the Bhopal Gas Tragedy of 1984, one of the greatest environmental disasters. Lethal gas escaped from the Union Carbide plant, affecting lakhs of residents of the surroundings areas. Many died or were left permanently disabled this prompted the Government to pass the Public Liability Insurance Act, 1991 which imposes a no fault liability on anyone who handles hazardous substances to pay compensation to the victims of an accidental occurrence.

Besides the compulsory insurance, the growing awareness of the public and the high compensation being awarded by the courts has made this class of insurance a necessity for professionals and businessman who may become liable to pay for damages.

7.1 VARIOUS TYPES OF LIABILITY INSURANCE

1. **Compulsory Public Liability Policy:** For those industries which are using hazardous material in their manufacturing process.

2. **Public Liability Policy (Industrial / Non-Industrial Risks):**

   ü **Industrial Risks** are manufacturing premises including godowns, warehouses etc., forming part thereof,

   ü **Non-Industrial Risks are** Hotels, Motels, Club houses. Restaurants, Boarding and Lodging houses. Flight kitchens, Cinema Hails, Auditoriums, Theatres, Public Halls, Pandals and Open air theatres.

3. **Product Liability:** If the use of a product causes death or bodily injury or property damage then the manufacturer is liable to pay compensation. Product liability insurance

is available to cover that risk. This is useful for manufacturer of food products and for the auto industry.

4. **Professional Indemnities** : Professional indemnities are designed to provide insurance protection to professionals such as doctors, solicitors, chartered accountants, architects etc. against their legal liability to pay damages arising out of negligence in the performance of their professional duties.

DOCUMENTS IN GENERAL INSURANCE

7.2 Introduction:

Insurance is an intangible product. In other words, you cannot see it or feel it or touch it. It is a simply, wherein, a piece of paper, the insurance company is promising to indemnify the losses in case of mis-happening. As the general insurance contract is for one year, therefore it is necessary to have proper documentation. In this chapter we have tried to explain the nature of the various documents which are required from the time of taking the insurance to the settlement of the claim. The documents are:

a. Prospectus

b. Proposal Form

c. Cover Note

d. Policy Document

e. Endorsement

f. Renewal Notice

g. Claim Form

h. Survey Report

Let us explain these documents one by one:

a. Prospectus:

Every insurance company issues the prospectus wherein the profile of the company and the features of the products are explained. After going through the company profile and the product feature the person may decide whether to buy the product of a particular company or not. It is like the school or college prospectus which parents buy before admitting the child in the particular school or college.

b. Proposal Form

As in every contract, offer and acceptance are important parts of an insurance contract.

In insurance the **proposal form is an offer or application made to the Insurance Company for purchase of Insurance cover.** The applicant or prospect is required to complete the printed proposal form supplied by the insurer.

The proposal forms are designed in such a manner and the questions framed as to elicit all material facts. The questions may vary according to the class of insurance. A brief description of the Insurance cover and its benefits is usually given on the reverse of the proposal form.

In some classes of insurance such as Marine Cargo Insurance, proposal forms are not used and only a questionnaire is required to be completed and submitted to the Insurance Company. Similarly in Fire Insurance of industrial risks where pre-risk inspection is arranged before accepting the risk, the proposal form is not used.

The use of proposal form is compulsory in the case of Accident Insurance, Health Insurance and other simple risks and they incorporate a declaration from the proposer declaring that the facts stated in the proposal form are true and nothing material has been concealed to the best of his knowledge.

Some questions common to all proposal forms are:

(1) **Proposer's name in full**

(2) **Proposer's address**

(3) **Proposer's profession/ occupation/ business**

(4) **Previous and Present Insurance**: The proposer is required to state whether he was insured previously or if he has a current policy with another insurer. He must declare the name of the other insurers and whether cover has been declined by another insurer or if any special conditions have been imposed or additional premium charged at the time of renewal, etc.

(5) **Claim Experience**: The proposer is to disclose full details of losses whether insured or not, and the details of claim payments received. The details regarding own damage and damage to third party are to be given separately.

(6) **Sum Insured**: This is the maximum liability of the insurer under the policy.

(7) Signatures, date and agent's recommendation.

The special questions will vary as per the needs of the particular insurance. Some examples are given below:

1. **In Fire Insurance:** Questions will relate to the type of construction, location and occupancy, whether separate or adjoining other buildings. In case of manufacturing units, details of process and the type of power used, etc.
2. **In Motor Insurance:** Cubic capacity, age of vehicle, area of operation, carrying capacity, purpose for which used and details of driving offences.
3. **In Personal Accident:** Questions regarding age, occupation, height, weight or any physical shortcoming
4. **In Marine Cargo:** Though there is no proposal form, the questionnaire will seek the following information :

full description of goods, type of packing, mode of transit, cover required, name of steamer, sum to be insured and past claim experience.

c. Cover Note:

A cover note is a temporary document issued as confirmation of the insurance contract in advance of the policy as it may take some time for the policy to be issued. Till the policy is ready the cover note is the proof that the insurance cover is in force.

The cover note contains brief details of the Insurance cover and is valid for 15 days extendable to a maximum of 60 days. Once the policy is issued the validity of the cover note ceases. In certain cases, instead of a cover note, the insurers issue only a letter confirming the cover.

The cover note is an unstamped document but it provides the same insurance as the policy and the wording of the cover note clearly states that it is subject to the terms and conditions of the policy. Specific clauses, i.e. Agreed Bank Clause or Declaration Clause, etc. are also incorporated in the cover note if required.

A typical cover note will contain the following details:

1. Name and addresses of the insured
2. Sum insured
3. Period of insurance
4. Risk covered
5. Rate of premium or provisional rate if the actual rate is not known
6. Description of the subject matter of insurance. In case of cars the details will include make, model, CC, seating capacity etc. and in Fire Insurance the particulars of the building, i.e. whether it is Kutcha and the nature of activity carried on in the premises.
7. Serial no., date of issue, time of issue

d. Policy Forms

The policy form is a **stamped document, which provides evidence of an Insurance contract.** The insurance policy is required to be stamped in accordance with the provisions of the Indian Stamp Act, 1899.

The policy document is typically divided into the following parts:

In Fire and Accident Insurance, the policy form used is on a scheduled basis, i.e., all individual details relating to a particular Insurance are grouped together in a schedule. The scheduled type of policy may be divided into certain distinct sections, viz.:

(i) The Heading: Giving the insurers name and address of registered office.

(ii) The Preamble or Recital Clause: This section introduces or recites the parties to the contract i.e., the insurer and the insured. If the insurance is based upon a proposal form the preamble makes a reference to this. This clause also refers to the premium as having been paid or agreed to be paid by the insured as consideration. (It is to be noted however, that in accordance with the provisions of the Insurance Act, 1938, as amended, no risk can be assumed by an insurer unless the premium has been paid in full in advance.

(iii) Operative or Insuring Clause: This clause sets out the essence of the contract. It specifies the perils insured

Notes

under the policy and the circumstances in which the insurer will become responsible to make a payment or its equivalent to the insured. The perils which are specifically excluded from the insurance are mentioned in this clause in some forms.

If the Operative Clause is divided into various sections, as in the case of comprehensive private car insurance, there may be exceptions in each section followed by the general exceptions applicable to the whole policy. This clause also provides that the insurer, undertaking to pay the loss or damage, is subject to the terms, exceptions and conditions contained in or endorsed on the policy. A reference is also made to the sum insured or other limits of liability.

(iv) Schedule: This section contains all the typewritten information applicable to the particular contract. In Fire Insurance, for example, the schedule provides for the following data:

Insured and Address

Policy No.

Date of Issue

Agency

Risk Covered   Rate   Premium

Period of Insurance

Property Insured

(v) Attestation or signature clause: This clause provides for the signature on the policy. The policy is signed by the authorized official of the insurer.

(vi) Conditions: All fire and accident policies contain conditions which are printed on the policy. These are called express conditions, which are necessary to regulate the contract.

Conditions

Conditions enumerate the duties of the parties to the contract and in some cases define the terms used in the contract. As insurance contracts are conditional contracts, it is essential for the insured to be aware of the conditions. He cannot expect the insurer to fulfill its part if he does not fulfill the required conditions. If he fails to do so he may find that he has released the insurer from his obligations. Conditions printed in the policy are called express conditions. Without the express condition the insurance contract would only be subject to the implied conditions, i.e. Utmost good faith, Insurable Interest, Indemnity and Proximate Cause.

The express conditions serve a number of purposes while some deal with the practice of insurance e.g., the condition relating to cancellation of the policy or the condition requiring the insured to notify the insurer in time about a loss. Other conditions repeat the legal principles to emphasis their importance. As example of this is the obligation on the part of the insured to disclose all material facts before the conclusion of the contract. Still other conditions may modify the basic principles; e.g., transfer of legal rights, to recover from another party, to the insurer, even before the claim is paid, though under law, subrogation arises only after payment of loss.

The express and implied conditions can be categorized as:

(a) **Conditions precedent,** e.g. disclosure of all material facts before the conclusion of the contract. A breach of the condition can enable the insurer to avoid his liability under the policy from its very beginning.

(b) **Conditions subsequent,** e.g. notification of any change in the risk during the currency of the policy. A breach of these conditions entitles the insurer to avoid the liability under the policy after it has come into force.

(c) **Conditions precedent to liability,** e.g. notice of loss within the prescribed time limits. The breach of this condition can prevent the insured from claim benefits.

The policy form also contains a clause reading as follows:

"The policy and schedule shall be read together and any word or expression to which a specific meaning has been attached in any part of this policy or of the schedule shall bear the same meaning wherever it may be."

This clause ensures that the words 'Insured', 'Property Insured' and 'Period of Insurance' etc., if occurring anywhere in the policy will have the same meaning and relates to the details given in the schedule.

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e. Endorsements:

Normally policies are issued in a standard form by the insurers. However if it is intended to modify the terms and conditions at the time of issuing the policy, this modification is done by setting out the alterations in a memorandum which is attached to the standard policy form. Such a memorandum is called an **endorsement.**

Endorsement are also used for recording changes in the policy, during its currency, and some of the endorsements commonly required relate to:

1. Change in sum insured (increase/ decrease)
2. Change of insurable interest due to sale, mortgage or hypothecation
3. Change in nominee
4. Inclusion of additional perils to be covered
5. Change of risk, e.g., change in occupancy of the building in Fire Insurance
6. Transfer of property to another location
7. Cancellation of insurance
8. Change in name or address etc.

Some examples of endorsements are given below:

Cancellation:

"At the request of the insured the insurance by this policy is hereby declared to be cancelled from _________. The insurance having been in force for a period over _______ months no refund is due to the insured.

f. Extension of cover to include extra peril:

At the request of the insured it is hereby agreed to include the risk of _______ under the above policy. In consideration thereof an additional premium is charged to the assured as under: -

g. Renewal Notice:

In General Insurance the cover is granted normally for one year and in Fire Insurance the preamble states that the indemnity under the policy applies "during the period of insurance mentioned in the schedule or to any subsequent period in respect of which the insured shall have paid, and the insurers shall have accepted, the premium required for the renewal of the policy."

Though the insurer is not legally bound to remind the insured that his policy is due to expire on a particular date, yet, out of courtesy and as a part of good business practice, insurers send a renewal notice one month in advance of the date of expiry advising the insured to renew the policy.

The notice includes all relevant details of the policy and the premium payable and also includes a note advising the insured that if there is any change in the risk he should inform the insurer about such changes. The insured's attention is also drawn to the statutory provision that no risk can be assumed unless the premium is paid in advance.

h. Claim Form:

Claim forms are issued to the insured when he notifies a loss under a policy. Claim forms vary according to different classes of insurance but are generally designed to elicit complete information regarding the loss, i.e., circumstance of loss, date and time of loss, cause of loss and extent of loss etc.

Motor claim forms provide for a rough sketch of the accident, Burglary claim forms contain questions regarding notification to the police; Fire Insurance claim forms have questions regarding value of property at time of loss, details of other policies covering the same subject matter and whether any third party was responsible for the loss. This information is required for application of the Principles of pro-rata average, contribution and subrogation as Property Insurance is a contract of indemnity.

The issue of a claim form does not constitute an admission of liability on the part of the insurer and this is made clear by the insurer by using the words, "Without Prejudice" on every claim form. Even the subsequent correspondence regarding the claim carry these words to make it clear that even though the claim is being processed

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Notes

the question of liability is left open. Claim forms are not used in Marine Cargo Insurance except in respect of inland transit claims.

i) **Survey Report:**

This report is submitted by duly–licensed surveyors who are appointed by the insurers to investigate the loss when notice of loss and claim form is received. The report provides independent evidence of the cause and extent of loss and other information to the insurers for processing and settling of claims.

7.3 SUMMARY

Apart from the insurance of property, the Liability Insurance is also must in this society. Every person is supposed to act in a prudent manner so that by his act, willingly or unwilling does not affect other persons by way of bodily injury or death or property damage. It is compulsory under various statutes and while other are optional but a person cannot escape from his liability in case of loss to a third party.

Proper documentation is a must for any insurance policy because any wrong information may lead to repudiation of the claim. One must be very careful while providing the information to the insurance company and also go through the policy document as it may contain some information which may contradict the information given in the proposal form.

INTEXT QUESTIONS 7.1

1. What is the meaning of Liability?
2. What constitutes the evidence of the insurance?

7.4 TERMINAL QUESTIONS

1. Discuss the importance of Liability Insurance.
2. Explain the contents of the policy documents.
3. Write down the contents to be mentioned in the proposal form of a Fire Insurance policy.
4. Write short notes on
   a. Endorsement

Notes

b. Claim form

c. Survey report

7.5 OBJECTIVE TYPE QUESTIONS

1. Which of the following is an evidence of insurance contract ?

   a. Policy document b. Prospectus

   c. Payment of premium d. Acceptance of proposal

2. Which one is true?

   Statement A: Endorsements are issued during the policy period to record alteration

   Statement B: Endorsements are issued as part of the policy at the time of issue

   a. Both b. Neither

   c. Statement A d Statement B

3. Which one is true?

   Statement A: Liability Insurance deals with the liability towards a third party.

   Statement B: Property Insurance deals with assets of the third party.

   a. Both b. Neither

   c. Statement A d Statement B

4. Which one is true?

   Statement A: Proposal form is required for all types of general insurance.

   Statement B: Proposal form is not required for Marine Insurance .

   a. Both b. Neither

   c. Statement A d. Statement B

5. Choose the wrong option

   a. Professionals like Doctors, and CAs can be insured under Professional Indemnity Insurance.

Notes

b. Manufacturing industry can be insured for civil liabilities.

c. Individual can be insured for third party liability insurance.

d. Criminal Liability of an individual can be insured.

7.6 ANSWERS TO INTEXT QUESTIONS

1. The dictionary meaning of liability means “responsibility” and legal liability means the liability which can be enforced in the court of law and the same can be insured.

2. The stamped policy document.

7.7 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. a	2. a	3. c
4. d	5. d	

Open Vocational Education Programme

Diploma in Insurance Services

5

LEGAL FRAMEWORK

Designed & Developed
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Diploma in Insurance Services

LEGAL FRAMEWORK

CONTENTS

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Before you begin reading your lessons and start your training, there are a few words of advice that I would like to share with you. We, at the NIOS, are well aware that you are different from other learners. We realize that there are many of you who may have rich life experiences; you may have prior knowledge about trades and crafts that are part of your family's legacy; you may have a sharp business sense that will make you fine entrepreneur one day. Most importantly, you have the drive and motivation that has made you enroll with this institution, which believes in the spirit of freedom. Yes, we are aware that you have many positive aspects in your personality, which we respect and relate to them.

During the course of your study, NIOS will treat you as the manager of your own learning. This is why your course material has been developed keeping in mind the fact that there is no teacher to teach you. You are your own teacher. Of course, if you have a problem, we have provided for a teacher at your Accredited Vocational Institution (AVI). I would advise you that you should always be in touch with your AVI for collection of study material, examination schedules etc. You should also always attend the Personal Contact Programmes and practical/ Training sessions held at your study centres. These will give you the necessary hands on training that is very essential to master a vocational course.

Studying for a vocational course is different from any other academic course. Here, while the marks obtained in the examination will indicate your grasp on your subject knowledge, your real achievement will be when you are able to apply your vocational skills in the market. I hope that this skill-based learning will help you perform your tasks better .This course of One year duration Diploma Course in Insurance Services developed by leading experts of Insurance sector. It is a multi-skilled programme, which will expose you to a variety of skills in Insurance sector. We hope that you will find it useful. On behalf of NIOS, I wish you the very best for a bright and successful future.

Dr. S. S. Jena
Chairman
National Institute of Open Schooling

Dear Learner,

In the fast expanding world of activities, learning new skills has become a necessity. Learning and re-learning has become essential for all. In such an environment, vocational education has assumed great importance. Vocational education, as a stream of education, promotes skill development and training of youth and directs them towards meaningful employment.

In keeping with the needs of the Learners, NIOS conducts Vocational Education Programmes in many areas through distance mode. These programmes include Agriculture, Business & Commerce, Home Science, Engineering & Technology, Computer Science, and Health & Paramedical. The Courses offered in these areas are aimed at providing self employment & wage employment opportunities for NIOS learners.

Diploma in Insurance Services is a One year Diploma course in Insurance Services. This course has been developed with the help of many leading experts of Insurance Sector. The course syllabus is designed keeping in view the requirements of the insurance sector.

This is multi-skilled programme, which will expose you to variety of skills. It includes Business Environment, Principles of Insurance, Life Insurance, General Insurance and Legal framework. This will help in identifying learner's preference for future vocation. We are confident that this course will prove to be beneficial to you.

We wish you all the best in your future career.

Dr. K. P. Wasnik
Director (VE)
National Institute of Open Schooling

Dear Learner,

This programme is specially for all those who are school dropouts and have started small enterprises, want to work in the Insurance sector as a skilled workforce and contribute substantially to the progress of India.

The multi-skill content with hands-on experience of this programme stimulates the intellect by going through concrete operations and then abstracting the concepts. At the same time by giving a variety of skills usable in everyday life, allowing them to form their preferences and know their aptitudes thus enabling them to choose a career. It also improves their self-image and gives them confidence and hope for the future.

The Insurance sector has completed its full circle in the year 2000, i.e. Private sector to Public sector and now back to Private sector. After 44 years, the monopoly of Life Insurance Corporation is no more and after 27 years four Public Sector general Insurance companies lost their monopoly. As on date there are 50 life and general insurance companies and few are queue to get license.

These insurance companies need trained manpower to be present on all India bases. To cater the needs of the insurance industry NIOS has designed a course namely "Diploma in Insurance Services" for the students who have minimum qualification of 12th standard.

The course syllabus is designed keeping in view of the requirements of the insurance sector.

In this module the student will be made familiar with the activities related to industry and commerce, job opportunities in the insurance sector, various forms of business organization, basic accounting principles as well as principles of management.

We hope that this programme will help you to carve an niche in your career and play an important role in the society.

With best wishes.

Dr. Ajay Garg
Senior Executive Officer
(Business & Commerce)
National Institute of Open Schooling

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1

INSURANCE REGULATORY & DEVELOPMENT AUTHORITY ACT

1.0 INTRODUCTION

In other modules of this course you have studied the meaning of insurance and its importance and how it plays a very important role in economic development of the country. By now you must be well versed that in insurance business, there is a contract between individuals or group or businessmen and insurance companies. The duration of these contracts varies from one year to thirty years or more and volume of such contracts are also very large.

As you know the insurance contract is of promises or assurances by the insurance companies to compensate the insured in case of mishappening but nothing is tangible. When the product is intangible (which can not be seen or touch) and volume of such contracts is huge then the disputes do arise in any industry. To settle these disputes the Government of any country appoints regulator and also enforces the law which controls the industry.

1.1 OBJECTIVES

In this module we will study various Acts which are directly related to insurance business and some acts which indirectly deal with the insurance business. In the following para we have referred about two Acts LIC Act 1956 and GIBN Act 1972 but we will not explain these acts as they have lost their importance due to changed scenario in respect of the Insurance sector in the country. We will be covering the following Acts in this module:

- Insurance Regulatory & Development Authority Act 1999.
- Insurance Act 1938.
- Consumer Protection Act 1986.
- Insurance Ombudsman.
- Marine Insurance Act 1963.
- Carriage of Goods by sea Act 1925.
- Bill of Lading Act 1855.
- Motor Vehicle Act 1988.
- Inland Steam Vessels Act 1977.
- Public Liability Act 1991.
- Workman's Compensation Act 1923.

For the benefit of those of you who are studying various Acts for the first time, we would like to mention that Acts lay down the rules and regulations framed by the Government in respect of specific activities. These rules & regulations are explained in sections which have been serially numbered and are called "Section 1 or 2 or 30 and so on".

At the end of this lesson, you will be able to:

- Know about the Controlling and regulating Authority for Insurance sector in India.
- Define how many members constitute the Authority.
- Enumerate procedure of their appointment.
- Enlist the Duties, Power and functions of Authority.

1.2 HISTORY

In India also, Government started exercising control on Insurance business by passing two acts in the year 1912 namely

- Provident Insurance Societies Act V of 1912 and
- Indian Life Insurance Companies Act VI of 1912.

These acts were later comprehensively amended and a new Act namely Insurance Act 1938 came into existence for controlling

- Investment of funds,

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- Expenditure and
- Management of the insurance companies

The Office of Controller was established to implement this act.

Again, this Act was amended in 1950 as per the need of the hour. But in view of growing malpractices in Life Insurance business and also due to the illiteracy level being high and lack of will for spread of Life Insurance business, it was nationalized by Government of India.

LIC Act was passed in June; 1956, and this Act came into force from 1st Sept.1956. Similarly general insurance business was nationalized Act came into force w.e.f 1st April 1973 through General Insurance Business Nationalization Act 1972 (GIBNAct 1972). To implement these acts the Government made some minor changes in the Insurance Act 1938.

In early 90's, with the world market forces playing with full strength; growing literacy level; better regulatory systems and need for fast growth in this sector, the need of the hour was to go with the world and throw open Life & General Insurance Sector to private entrepreneurs once again so that there is no monopoly and the customer/ consumer/ buyer gets more choices than one type of Insurance product.

To study the liberalization process in Insurance sector in India, Malhotra Committee was formed under the Chairmanship of Late Shri R.N. Malhotra. The Malhotra committee submitted its report in 1994 which recommended that private companies be allowed to operate in India. The Government accepted the Committee's recommendation and Insurance Regulatory Authority (IRA) was set up in 1996 to show the path for privatization of insurance Industry. The main aim was the development of Insurance covering all strata of society (to not only rich but poor, folks from rural, tribal, unorganized sector, social sector, disabled community, daily wagers, women at large, etc.) gained importance through concerns put forth by political leaders, trade unionists, social organisations, co-operatives and policy makers; which amended the name IRA to IRDA (Insurance Regulatory & Development Authority). Again some amendments were made in the Insurance Act 1938 for smooth functioning of IRDA.

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1.3 INSURANCE REGULATORY DEVELPMENT AUTHORITY ACT (IRDA) 1999

This Act was passed by Parliament in Dec.1999 & it received presidential assent in Jan.2000. The aim of the Authority is **"to protect the interest of holders of Insurance policies to regulate, promote and ensure orderly growth of Insurance industry & for matters connected therewith or incidental thereto."**

Under this Act, an authority called IRDA is established which replaces Controller of Insurance under Insurance Act 1938.

1.3.1 Definitions

Like any other Act, various terms have been defined as follows under section 2: -

a) "Appointed Day" means the date on which the Authority is established.

b) "Authority" means the Insurance Regulatory and Development Authority.

c) "Chairperson" means the chairperson of the Authority.

d) "Fund" means the Insurance Regulatory and Development Authority Fund.

e) "Interim Insurance Regulatory Authority" means the Insurance Regulatory Authority set up by the Central Government.

f) "Intermediary or Insurance intermediary" includes Insurance brokers, reinsurance brokers, insurance consultants, surveyors and loss assessors.

g) "Member" means a whole time or a part time member of the Authority and includes the Chairperson.

h) "Notification" means a notification published in the Official Gazette.

i) "Prescribed" means prescribed by rules made under this Act.

j) "Regulations" means the regulations made by the Authority.

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1.3.2 Features of Authority

- Corporate body by the aforesaid name which means it will act as group of persons, called members, who will work jointly not as an individual person like Controller of Insurance.
- Having perpetual succession which means any member may resign or die but the Authority will work.
- A common seal with power to enter into a contract by affixing a stamp on the documents.
- Sue or be sued means the Authority can file a case against any person or organization and vice versa.

1.3.3 Composition of Authority

The Authority shall consist of nine persons as per details given below:.

- Chairperson.
- Not more than 5 whole time members.
- Not more than 4 part time members.

These persons shall be appointed by the Central Govt. from amongst persons of ability, integrity & standing who have knowledge or experience in life Insurance, general Insurance, actuarial science, finance, economics, law accountancy, administration or other discipline which would in the opinion of the Central Govt. be useful to the Authority. (Section 4)

1.3.4 Tenure (Section 5)

- The Chairman tenure will be for 5 years and eligible for reappointment till he attains the age of 65 years.
- The appointment of members will be for 5 years and eligible for reappointment but not exceeding the age 62 years.

1.3.5 Removal of Members (Section 6)

The Central Government can remove any member of the Authority if he :-

a) Is declared bankrupt

b) Has become physically or mentally incapable of acting as a member

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c) Has been awarded punishment by any Court.

d) Has acquired such financial or other interest which affect his function as a member.

e) Has so abused his position as to render his continuation in office detrimental to the public interest.

But no member can be removed form the office unless & until the reasonable opportunity of being heard is given to such member in the matter.

1.3.6 Salary & Allowances (Section 7)

The Chairperson and full time members' shall receive the salary & allowance as prescribed by the Government.

1.3.7 Bar on future employment (Section 8)

The Chairperson and the whole time members cannot accept any appointment without Govt. approval within 2 years from the date on which he ceases or retires from the office.

INTEXT QUESTIONS 1.1

1. List the Composition of Authority.
2. The Authority shall consist of nine persons i.e. Chairperson, not more than 5 whole time members and not more than 4 part time members.
3. Mention the maximum age of the Chairperson of IRDA.
   a. Maximum age of Chairperson of IRDA is 65 years.

1.3.8 Superintendence & Direction (Section 9)

The Chairperson shall have overall control & provide direction in respect of all administrative matters of the Authority. He will chair the meeting as and when he is present in the meeting.

1.3.9 Meeting of Authority (Section 10)

The meeting of the Authority will be held at the time and place as decided by the Chairperson as per regulation made under this act. If the Chairperson is unable to attend the meeting then the members will choose the Chairperson from amongst the present members.

All the issues to be discussed in the meeting shall be decided by a majority of votes by the present and voting. In case of equal voting the decision of Chairperson of that meeting will be final.

1.3.10 Invalidation of proceedings of Authority (Section 11)

The proceedings of Authority will not become invalidate (not valid in the eyes of law) due to following reasons:-

- Defects in the formation of the Authority.
- Defect in appointment of any Member.

1.3.11 Officers & Employees of Authority (Section 12)

The Authority may appoint officers and employees as it considers necessary for the efficient discharge of its functions. The terms & conditions of such officers shall be governed as per the regulations made under this Act.

1.3.12 Transfer of Assets, Liabilities etc (Section 13)

As stated above that initially the Authority was formed under the name “Insurance Regulatory Authority (IRA)” and later on the name was changed to “Insurance Regulatory & Development Authority.”(IRDA) Therefore the assets and liabilities of IRA will be transferred to IRDA on the date of establishment of the Authority.

1.3.13 Duties, Powers & Functions of Authority (Section 14)

Duties: The Authority shall have the duty to regulate, promote and ensure orderly growth of the Insurance business and re-insurance business subject to the provisions of any other provisions of the act.

Powers & Functions to:-

(a) Issue to the applicant (Insurance company or Insurance Agent or Surveyors or Insurance Brokers or Third Party Administrators) a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;

(b) Protection of the interests of the policyholders in matters concerning assigning of policy, nomination by policyholders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;

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(c) Specifying requisite qualifications, code of conduct and practical training for insurance brokers , agents, surveyors, Third Party Administrator ;

(d) Specifying the code of conduct for surveyors and loss assessors (Who assess the loss of policyholder in case of General Insurance);

(e) Promoting efficiency in the conduct of insurance business;

(f) Promoting and regulating professional organisations connected with the insurance and re-insurance business;

(g) Levying fees and other charges on insurance companies, Agents, Insurance Brokers, Surveyors and Third party Administrator;

(h) Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the Insurance business;

(i) Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (w.e.f., 1/1/2007 TAC has ceased to function).

(j) Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

(k) Regulating investment of funds by insurance companies;

(l) Regulating maintenance of margin of solvency i.e., having sufficient funds to pay insurance claim amount;

(m) To settle the disputes between insurers and intermediaries or insurance intermediaries;

(n) Supervising the functioning of the Tariff Advisory Committee;

(o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause(f);

(p) Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

(q) Exercising such other powers as may be prescribed.

Notes

1.3.14 Grants from the Central Government (Section 15)

The Government after approval from the Parliament may grant funds to discharge their duties as per this Act.

1.3.15 Constitution of Funds (Section 16)

(1) There shall be a fund to be called "The Insurance Regulatory and Development Authority Fund" and there shall be credited there to:—

   a. all Government grants, fees and charges received by the Authority;

   b. all sums received by the Authority from such other source as may be decided upon by the Central Government;

   c. the percentage of prescribed premium income received from the insurer/insurance intermediaries.

(2) The Fund shall be applied for meeting:—

   a. the salaries, allowances and other remuneration of the members, officers and other employees of the Authority:

   b. the other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

1.3.16 Accounts and Audit (Section 17)

(1) The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.

(2) The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.

(3) The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the of the accounts of the Authority shall have the same rights, privileges and authority in connection with

such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in the particular shall have the right to demand the production of books of account, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.

(4) The accounts of the Authority as certified by the Comptroller and Auditor General of India or any other person appointed by him in this behalf together with the audit-report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

1.3.18 Establishment of Insurance Advisory Committee (Section 25)

(1) The Authority may, by notification, establish with effect from such date as it may specify in such notification, a Committee to be known as the Insurance Advisory Committee.

(2) The Insurance Advisory Committee shall consist of not more than twenty-five members excluding ex-officio members to represent the interests of commerce, industry, transport, agriculture, consumer fora, surveyors, agents, intermediaries, organisations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector.

(3) The Chairperson and the members of the Authority shall be the ex-officio Chairperson and ex officio members of the Insurance Advisory Committee.

(4) The objects of the Insurance Advisory Committee shall be to advise the Authority on matters related to insurance.

(5) The Insurance Advisory Committee may advise the Authority on such other matters as may be prescribed.

1.3.19 Miscellaneous Provisions

- The Central Government can issue the direction to the Authority on policy matters not on administrative and technical matters and the Authority is bound to follow such direction.

- The Central Government can supersede any act of the Authority.

- The Chairperson, Members and employees of Authority shall be deemed to be public servant while performing the duties as per the provision of this Act.
- The Authority can delegate its powers to Chairperson or members or officers and employees of the Authority as per regulation made under this act.
- The Authority has the power to make rules related to salary & allowances and other terms & conditions to be applicable to its Chairperson, members, employees or officers.
- The Authority has power to make regulations to be followed at its meetings
- The rule & regulation made by the Authority shall be placed before the Parliament.
- Any rule or regulations made under this act will bar the applicability of other laws of the land.
- The Authority has the powers to make amendment in Insurance Act 1938, LIC Act 1956 & GIBN Act 1972.

1.4 SUMMARY

The main aim to form IRDA is to create a regulator which will regulate and develop the insurance sector in the country and control all individuals or organizations who are directly or indirectly involved with the insurance sector. The Authority has the powers to issue regulations related to insurers, insurance intermediaries, surveyors, third party administrators for their registration, renewal of their license and review their workings for smooth functioning of insurance sector. The Authority also protects the interest of the policyholders for whom the insurers are issuing the policies. With this the Authority does not become supreme as it is accountable to the Central Government.

1.5 TERMINAL QUESTIONS

1. Explain the power & functions of the Authority.
2. What is the composition of the Authority and its tenure?
3. Define Insurance intermediary, appointed day and member.

1.6 OBJECTIVE TYPE QUESTIONS

1. IRDA was formed in _______(1999/2001)
2. Total members of IRDA are _____(9/10)
3. The retirement age of member is ___(62/65)
4. Choose the correct option

   IRDA does not specify requisite qualifications, code of conduct and practical training for

   a) insurance brokers.

   b) agents & surveyors.

   c) Third Party Administrator.

   d) Insurer.
5. ______can supersede the IRDA (Central Govt/Supreme Court)

1.7 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. 1999
2. 9
3. 62
4. d
5. Central Govt.

Notes

2

REGULATIONS ISSUED BY IRDA

2.0 INTRODUCTION

Till 1999 the insurance sector was controlled by Controller of Insurance as per the provisions of Insurance Act 1938 but after formation of the IRDA it is felt by the Authority that the most of the provisions of this Act were irrelevant in the present scenario of the country. Therefore the Authority issued various regulations, as deemed fit, to develop the insurance sector in the country.

Therefore, we shall be discussing the following important regulations in this following chapters :–

Procedure of :–

- Granting of license to companies to start insurance business.
- Approval of insurance product.
- Appointment of different insurance intermediary.
- Investing the insurance premium.
- Accounting & audit.
- Miscellaneous important provisions of Insurance Act.

These regulations were not issued in the above sequence but we have followed this logic - firstly the insurance company will come into existence, secondly the insurance product will be design and developed, thirdly the manpower is required to sell the product, fourthly the premium received by the insurance companies is to be invested, fifthly the accounts are to be maintained and lastly, various provisions.

2.1 OBJECTIVES

At the end of this lesson you will be able to know:-

- The procedure of getting the license of insurance from IRDA.
- The procedure to get approval of insurance product from IRDA.
- The procedure to appoint an insurance inter-mediatory.

Before we start explaining the first regulations, we shall discuss various terms defined in Insurance Act 1938

2.2 DEFINITIONS

1 “Actuary” means an actuary possessing such qualifications as may be prescribed;

2 “Authority” means the Insurance Regulatory & Development Authority established under the Insurance Regulatory and Development Authority Act, 1999.

3 “Policy-holder” includes a person to whom the whole of the interest of the policy-holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is defeasible or is for the time being subject to any conditions;

4 “Approved Securities” means –

i. Government securities and other securities charged on the revenue of the Central Government or of the Government of a State or guaranteed fully as regards principal and interest by the Central Government or the Government of any State;

ii. Debentures or other securities for money issued under the authority of any Central Act or Act of a State Legislature by or on behalf of a port trust or municipal corporation or city improvement trust in any presidency-town;

iii. Shares of a corporation established by law and guaranteed fully by the Central Government or the Government of a State as to the repayment of the principal and the payment of dividend;

iv. Securities issued or guaranteed fully as regards principal and interest by the Government of any Part B State and specified as approved securities for the purposes of this Act by the Central Government by notification in the Official Gazette;

5. “Auditor” means a person qualified under the Chartered Accountants Act, 1949 to act as an auditor of companies;

6. “Certified” in relation to any copy or translation of a document required to be furnished by or on behalf of an insurer certified by a principal officer of such insurer to be a true copy or a correct translation, as the case may be;

7. “Court” means the principal Civil Court of original jurisdiction in a district, and includes the High Court in exercise of its ordinary original civil jurisdiction;

8. “Fire Insurance Business” means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies.

9. “General Insurance Business” means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.

10. “Government Security” means a Government security as defined in the Public Debt Act,

11. “Indian Insurance Company” means any insurer being a company:—

(a) which is formed and registered under the Companies Act, 1956 (1 of 1956);

(b) in which the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed twenty-six per cent paid-up equity capital of such Indian insurance company;

(c) whose sole purpose is to carry on life insurance business or general Insurance business or re-insurance business.

12. "Insurance Agent" means an Insurance agent duly licensed and who receives or agrees to receive payment by way of commission or other remuneration in Consideration of his soliciting or procuring Insurance business including business Relating to the continuance, renewal or revival of policies of Insurance;

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

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

    (b) the granting of annuities upon human life.

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

14. "Marine Insurance Business" means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares, merchandise and property of whatever description insured for any transit by land or water, or both, and whether or not including warehouse risks or similar risks in addition or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine Insurance policies;

15. "Miscellaneous Insurance Business" means the business of effecting contracts of insurance which is not principally or wholly of any kind or kinds included in fire, marine insurance business.

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2.3 PROCEDURE OF GRANTING OF LICENSE TO COMPANIES TO START INSURANCE BUSINESS

No person can carry on Insurance business unless & until he has obtained a certificate from the Authority for a particular class of Insurance business. For e.g. A person can start life Insurance, marine Insurance, fire Insurance, health Insurance etc. But a life Insurance business cannot be combined with other type of Insurance business. Those who are already in Insurance Business like General Insurance Corp., National Insurance, New India Assurance, Oriental Insurance & United India Insurance have to obtain a fresh certificate within 3 months from the date of commencement of this Act or before such date as fixed by the Govt.

Even those insurers for whom the registration was not necessary before the commencement of this Act will require the registration certificate.

To get the registration certificate the following procedure is to be followed:

Every application in the prescribed form (IRDA/R1) for registration shall be made with the following enclosures:—

1. A certified copy of Memorandum and Articles of association if the applicant is a company.
2. The name, address & the occupation of the directors of the company.
3. A statement of the class of insurance business proposed to be carried on.
4. A statement indicating the sources that will contribute the share capital.

On receiving the above documents IRDA will verify the contents and may ask for additional information if any. The Authority may ask the Principal Officer to appear to their office for any information or clarification.

If the Authority is satisfied with the information and documents provide with the application form (IRDA/R1), the Authority may ask for an additional application in the prescribed form (IRDA/R2) which should be accompanied with then following documents:—

1. Every Insurance shall deposit in cash or in approved securities or partially in cash or partially in approved securities as per details given below: -

   (i) In case of Life Insurance business, a sum equivalent to 1% of his total gross premium written in India in any financial year commencing after the 31st day of March 2000 not exceeding rupees ten crores (Rs.10 crores).

   (ii) In the case of General Insurance business a sum equivalent to 3% of his total gross premium written in India in any financial year commencing after 31/3/2000 not exceeding rupees ten crores (Rs.10 crores).

   (iii) In case of reinsurance business, a sum of rupees twenty crores (Rs.20 crores).

   (iv) If the business is to be done in marine Insurance only & relates exclusively to country craft or its cargo or both the amount to be deposited Rs.1,00,000/- (Rs.1 lakh) only.

   (v) A certificate from the Reserve Bank of India showing the amount deposited.

2. A declaration verified by an affidavit from the “Principal Officer” that the equity capital of the company has been complied with.

   The paid up equity excluding preliminary expenses and registration charges should be Rs.100 crores for life or General Insurance business and Rs.200 crores for the Reinsurance business.

   If any insurer is carrying on business of insurance already then within 6 months from the commencement of the Act the paid up capital should be as per prescribed limits in the Act.

3. A certified copy of the published prospects and of the standard policy forms of the insurer.

4. Statement of assured rate, advantages, terms & conditions to be offered in connection with Insurance policies.

5. In the case of the business the certificate from the actuary that such rates are workable & sound.

6. In the case of marine accident & miscellaneous Insurance

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business other than workmen's compensation & motor car Insurance the available forms, prospects and statements to be submitted.

7. The receipt of deposit of Rs. 50,000/- for each class of business.

8. If there is any foreign partner, a certified copy of Memorandum of understanding between Indian promoter and Foreign promoter including details of support comfort letters exchanged between the parties.

9. Any other document as desired by the Authority after scrutiny the application.

2A) If on the receipt of an application for registration and the authority is satisfied that

a) The financial condition & the general character of management of the applicant are sound.

b) The volume of business likely to be available to & the capital structure & earning prospects of the applicant will be adequate.

c) The interest of the general public will be served if the certificate of registration is granted to the applicant then the certificate of registration is granted.

Refusal of Registration

- If the Authority refuses the registration the reason of such decision will be intimated to the applicant.
- The Applicant whose application has been rejected can file an appeal before the Central Govt. within 30 days from the date on which a copy of the decision is received.
- The decision of the Govt. shall be final and shall not be questioned before any court.

Cancellation of Registration

The Authority has the right to cancel the certificate of registration either wholly or in so far as it relates to a particular class of Insurance business if the any of the conditions specified for registration is not complied with.

Renewal of Registration

Every year the registration is to be renewed and the application is to be made to the Authority before 31st Dec. of the preceding years with the prescribed fees i.e.,

(i) 1/4th of 1% of premium received or Rs. 5 crores whichever is less.

(ii) It should not be less than Rs. 50,000 in each class of business.

(iii) For reinsurer companies 1/4th of 1% will be considered of total premium in respect of facultative reinsurance accepted in India.

(iv) Fees to be paid in Reserve Bank of India.

INTEXT QUESTIONS 2.1

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1. Mention the fees to be paid by any life insurer on registration and on renewal.
2. Mention the minimum capital requirement for any Insurer.

2.4 REGULATION FOR PRODUCT APPROVAL

No Insurance Company can sell any insurance product unless & until the product is approved by the Authority. The procedure to get the approval from the Authority is as follows:—

Life Insurance Products

The life Insurance products are classified as:—

1) Linked Business.

2) Non-Linked Business.

3) Non-life/General Insurance Business.

An insurer who wishes to introduce a new product or to make changes to any existing product or to withdraw an existing product shall submit the application in the prescribed proforma to IRDA with full details and reasons to make changes in any existing product or to withdraw an existing product.

The insurer shall not commence selling the product in respect of which additional information has been sought by the Authority until the Authority confirms in writing. If no such information is sought by the Authority, the insurer can commence selling the product in the market.

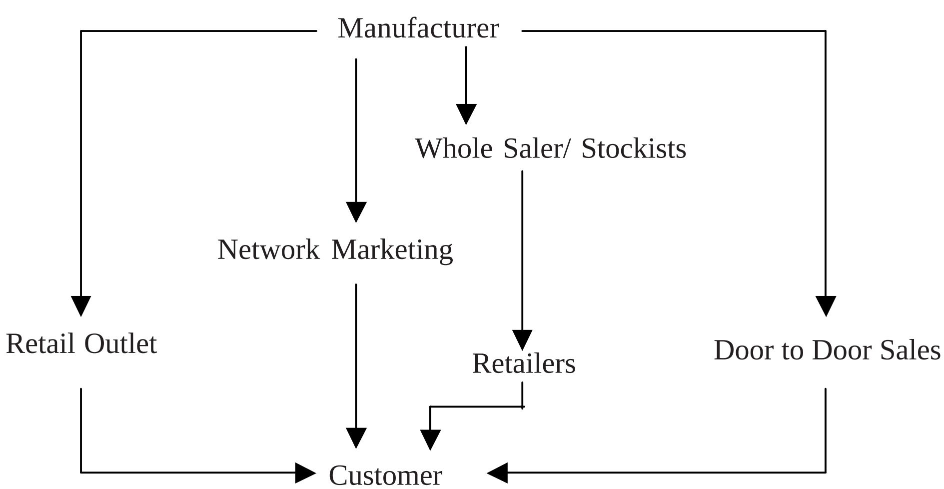
Period of Approval

Within 15 days (earlier 30 days) of the receipt of the application the Authority may seek additional information with regard to the product, and the insurer shall not commence selling the product in respect of which additional information has been sought by the Authority, until the Authority confirms in writing having noted such information. If no such information is sought by the Authority, the insurer can commence selling the product in the market, as set out in the application after the expiry of the said 15 days (earlier 30 days) period. This procedure is known as "File & use."

2.5 DISTRIBUTION CHANNELS

Distribution refers to the arrangement by which the product, after manufacture is moved till it reaches the customers, the objective is to ensure that the product is available to the customer when he wants to buy it.

Generally for the tangible products the distribution channels is as follows:



Wholesaler/ Stockists: The Wholesaler will buy the goods from the manufacturer in large quantities and hold the stock and distribute them to retailers as per their requirements.

Retailers: The retailer is one of the last distribution channel, who is selling the product to the customer.

Retail outlet: Sometimes the manufacturer open a retail outlet in each part of country to have a direct access with customer. For e.g.; BATA showroom for shoes, Titan for wrist watches.

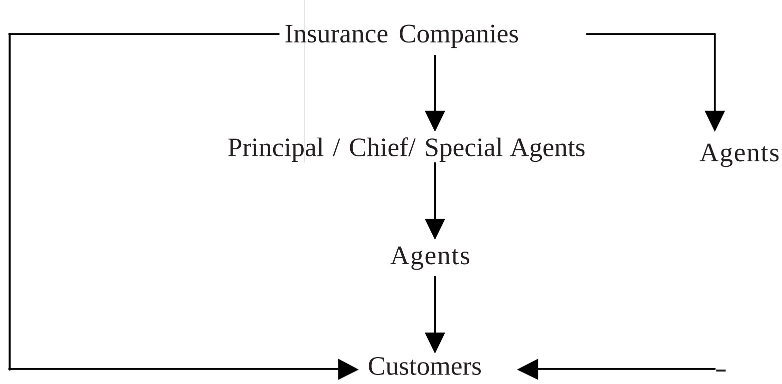
Door to Door Sales: Under this system, the sale is made directly to the customer through the salesman who is visiting at residence of the customer prospects.

For e.g.; Eureka Forbes Products – Water filter, Vacuum Cleaner, Tupperware, Avon Cosmetic.

Network Marketing: This concept of marketing started few years back under which the manufacturer is selling the product to an individual and forms a chain to provide more benefit to the customers. For e.g. **Amway**

If we look at the distribution channel of an Insurance Company, it may be different because the insurance is a intangible product. The distribution channels before nationalization were as follows:

Before Nationalization



The distribution channel of insurance sector is regulated by the Insurance Act 1938.

Principle Agent/ Chief/ Special Agents:

These Agents were appointed under Section 42A, 42B and 42C of the Insurance Act 1938. But the appointment of these agents was stopped w.e.f. 1/4/1950 therefore the explanation of these provisions is not given.

After Nationalization

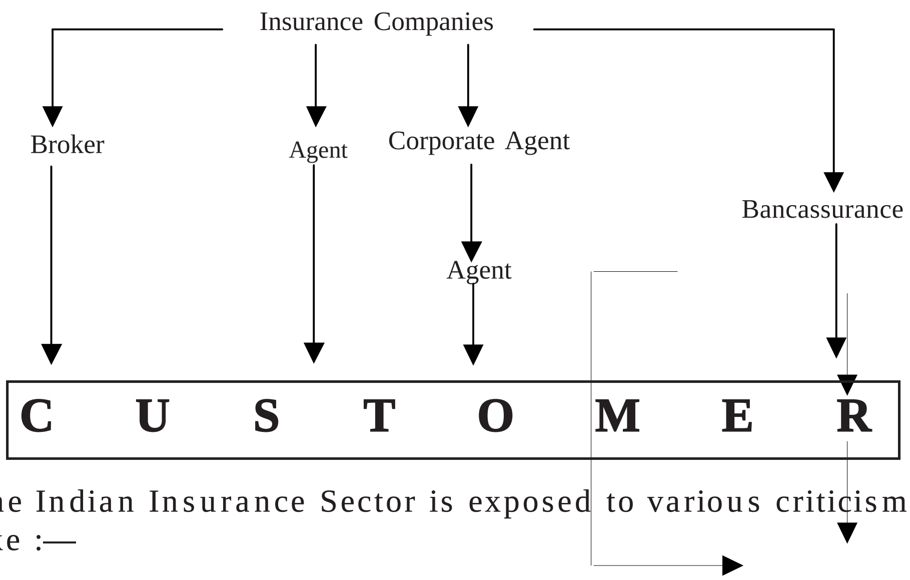
Insurance Companies

Agent

Customers

The Insurance product is being sold either through an agent or directly by the company.

After Privatization of 2000



The Indian Insurance Sector is exposed to various criticisms like :—

- **Relating to service level**
- **Speed of claim settlement**
- **Efficiency**
- **Value for money**
- **Standards of technical competency in staff**

In fact the customer expectations are

Tangible :—

- **Choice**
- **Better cost**
- **Better products**
- **Better administration**

Infact the customer expectation are Intangible:—

- **They want to be treated like individuals**
- **They want attention of their problems**
- **They want to be understood**
- **They expect an ethical approach to business**

In fact the customer wants to be recognized as being a valuable and integral part of Insurance business. Insurance companies need innovation and expertise to respond.

The Indian Insurance sector has a vast potential considering the country's large population, a growing and affluent middle class, large household saving and increased trade volume. Therefore Insurance Companies will have to identify the thrust areas i.e. individual or business issues must be involved in marketing services i.e. trained manpower and designing the marketing strategy in the changing scenario that understand the customer needs, identification of features the consumer is looking for in the insurance service and the price the customer is willing to pay for the service. To protect the interest of customers IRDA has set regulations to appoint various distribution channels and in the following paragraphs the regulations related to Agents/Corporate Agent/ Insurance broker are explained:

2.5.1 Agent:

An agent can work for any one life insurance and one general insurance company and the appointment of an agent will be as per regulation prescribed by IRDA as explained below:

Issue of License:

IRDA or an officer authorized by it in this behalf will issue a license. These Regulations specify:

– Authorizes designated persons, being officers of Insurers to issue such license for three years

– The license may be to act as an

  - Agent for the "Life Insurer" or
  - Agent for the "General Insurer" or
  - Agent as a "Composite Insurance Agent" means Agent for life insurance as well as general insurance.

- Fee for the license (Rs. 250/-)
- The manner of making an application etc.

Qualification

A person must:—

1. Be at least 18 years of age.
2. Have passed 12th standard or equivalent examination if he is to be appointed in a place with population of 5,000 and more or 10th standard otherwise.
3. Have undergone practical training in an approved Institute, in life or general insurance as the case may be for 50 hrs. (on renewal for 25 hours) spread over 3 to 4 weeks for either of the licenses, and 75 hours spread over 6 to 8 weeks for composite license There are relaxations in the hours of Training for some Professionals, like CA's, MBA, Associates/Fellows.
4. Have passed the examination conducted by Insurance Institute of India or any other examination body recognized by the authority. He will have to qualify 2 hrs. written test by obtaining 50 marks out of 100 marks.
5. The fees for each license is prescribed as Rs. 250/-. If the application for renewal is late but made before expiry of the license than Rs. 100/- will be charged extra. In case license has expired already then application for renewal will normally be turned down but if hardship is proved then license may be renewed.

Disqualification

A person would be debarred from obtaining a license if he is found to be:—

1. A minor.
2. Of unsound mind declared by court of competent jurisdiction.
3. Guilty of criminal breach of trust, misappropriation, cheating, forgery or abetment or attempt to commit any such offence.

Code of Conduct

(1) Every person holding a license, shall adhere to the code of conduct as specified like identify himself and the

Notes

insurance company of whom he is an insurance agent, Disclose his license to the prospect on demand, disseminate the requisite information in respect of insurance products offered for sale by his insurer, disclose the scales of commission in respect of the insurance product offered for sale, if asked by the prospect, indicate the premium to be charged by the insurer for the insurance product offered for sale, about proposal form etc

(2) No insurance agent shall, like solicit or procure insurance business without holding a valid license; induce the prospect to omit any material information in the proposal form; induce the prospect to submit wrong information in the proposal form or documents submitted to the insurer for acceptance of the proposal; behave in a discourteous manner with the prospect; interfere with any proposal introduced by any other insurance agent; offer different rates, advantages, terms and conditions other than those offered by his insurer; etc.

Cancellation of License

The designated person may cancel a license of an insurance agent, if the insurance agent suffers, at any time during the currency of the license, from any of the disqualification as stated above and recover from him the license and the identity card issued earlier. Even on non performance of minimum business expectation by the Insurer the agency can be terminated.

2.5.2 Corporate Agent:

The provisions of appointment of an agent are applicable for the Corporate Agent subject to the additional provisions as explained below:

1. Corporate Agent can be only firm or company.
2. Insurer may decide on case to case basis for having share capital of Rs 15 lakhs.
3. A person known as Principal Officer should be qualified as Associate of Insurance Institute of India Mumbai (AIII) and if a corporate in existence then with in 3 years from the date of renewal the principal office should acquire the said qualifications.

INTEXT QUESTIONS 2.2

1. Minimum qualification to be insurance Agent.
2. How much Share capital is required to become a Corporate Agent?

2.5.3 Brokers

An insurance broker is a new distribution channel introduced in 2002 by IRDA. The insurance broker is professional & expert organization who deals with all insurance companies and area of operation is on all India bases.

The Brokers are categorized under three types:—

(a) Direct broker; It means the broker can deal in life and general insurance business.

(b) Reinsurance broker; It means the broker can deal with reinsurance business.

(c) Composite broker; It means the broker can deal with reinsurance and life & general insurance business.

Requirements of Capital:—

Any applicant seeking to become an insurance broker should satisfy the following conditions:

a) It shall have a minimum amount of capital as mentioned below:

Category	Minimum amount (Rupees)
Direct broker	fifty lakhs
Reinsurance broker	two hundred lakhs
Composite broker	two hundred and fifty lakhs

b) The capital in the case of a company limited by shares and a cooperative society shall be in the form of equity shares.

c) The capital in the case of other applicants shall be brought in cash.

d) The applicant shall exclusively carry on the business of an insurance broker as licensed under these regulations.

e) No part of the capital of an applicant shall be held by a non-Indian interest beyond 26% at any time.

f) Principal Officer: In any insurance broking firm a person called Principal Officer will be responsible for insurance business and day to day function of the broking firm. To become the principal officer he should fulfill the following criteria:

- The Principal officer should have minimum qualification of graduation or as prescribed by IRDA
- The principal officer of the applicant has received at least one hundred hours/fifty hours of theoretical and practical training from an institution recognised by the Authority from time to time.
- Has passed an examination, at the end of the period of training conducted by the National Insurance Academy, Pune or any other examining body recognised by the Authority.

Validity of licence:— A licence once issued shall be valid for a period of three years from the date of its issue, unless the same is suspended or cancelled by IRDA.

Fees:—

Category	**Amount**
Direct Broker	Rs 20,000/- at the time of license and every year 0.5% of brokerage earned minimum Rs 25,000/- & maximum Rs 1,00,000/-
Reinsurance Broker	Rs 40,000/- at the time of license and every year 0.5% of brokerage earned minimum Rs 75,000/- & maximum Rs 3,00,000/-
Composite Broker	Rs 50,000/- at the time of licenses and every year 0.5% of brokerage earned minimum Rs 1,25,000/- & maximum Rs 5,00,000/-

Professional indemnity insurance :— Every insurance broker shall take out and maintain and continue to maintain a professional indemnity insurance cover throughout the validity of the period of the licence. The amount of indemnity should be three times of the brokerage earned during last year or Rs 50.00 lakhs which ever is higher.

2.6 SUMMARY

Though the insurance sector is liberalized in the year 2000 but keeping in view of the nature of product i.e intangible IRDA has full control over the insurance companies/ product approval/Distribution Channels. To start insurance business in India one has to get registered with IRDA and invest minimum Rs 100 crores for life Insurance/general insurance and Rs 200 crores for reinsurance business. Life insurance business cannot be merged with general insurance business therefore two different companies have to be formed for starting both insurance businesses. Apart from the capital requirements a lengthy procedure is to be followed to get a license to start the insurance business. After registration an insurance company needs a product to sell in the market. Again the product should be approved by IRDA and the procedure is simple “file & use”, which means the product features are to be submitted in the prescribed form and market after 15 days if no objection is raised by IRDA.

Being intangible product the trained manpower is required to sell the insurance product. These products can be sold through Agents, Corporate Agents or Broker who are licensed by IRDA. These individuals/Directors will have minimum qualifications and undergo training of 100 hours in IRDA approved institutes and pass the examination conducted by Insurance Institute of India/National Insurance Academy. It is not permitted to sell the insurance product by the persons not qualified as mentioned above. The difference among the different distributions channels is that the Agents and Corporate Agents can sell the product of one insurance company while an insurance broker can sell the product of all the insurance companies. An insurance broker can work on all India basis while an Agent/Corporate Agent can work in particular city and attached with one particular office of the insurer.

2.7 TERMINAL QUESTIONS

(a) Explain the procedure to obtain a license of an insurance Broker.

(b) Discuss the code of conduct of an agent.

(c) Distinguish between an Agent and an Insurance Broker.

2.8 OBJECTIVE TYPE QUESTIONS

Choose the correct option

1. Who can sell the insurance product other than Insurer ?

   a. Any person

   b. A person who is licensed by IRDA

   c. A person who is authorized by Insurer.

   d. A person who is authorized by Govt.

2. Choose the correct option

   Statement A: The share capital of any Insurance company is Rs 100 crores.

   Statement B: The Share capital of Direct Broker is Rs 100 lakhs.

   a. Statement A b. Statement B c. Both d. None

3. Choose the correct option

   Statement A: To become an Insurance Agent in rural area minimum qualification is 12th passed.

   Statement B: To become an Insurance Broker in rural area minimum qualification is 10th passed.

   a. Statement A b. Statement B c. Both d. None

4. Choose the correct option

   Statement A: Insurer can sell any product.

   Statement B: Insurer can sell any product with the approval of IRDA.

   a. Statement A b. Statement B c. Both d. None

5. Choose the correct option

   Statement A: A Principal Officer is must for all distribution channel of insurance product.

   Statement B: A Principal Officer is required only for Insurers.

   a. Statement A b. Statement B c. Both d. None

2.9 ANSWERS TO INTEXT QUESTIONS

2.1

1. Rs 10 crores at the time of registration and 0.25% of premium received or Rs 5 crores which ever is less at the time of renewal of registration.
2. Rs 100 crores.

2.2

1. Have passed 12^{th} standard or equivalent examination and 10^{th} standard to become Insurance Agent in Rural area.
2. Rs 15 lakhs.

2.10 ANSWERS TO OBJECTIVE TYPE QUESTIONS

2.8

1. b
2. a
3. d
4. b
5. none

3

INVESTMENTS, ACCOUNTS & MISC PROVISIONS

3.0 INTRODUCTION

After selling the insurance products either directly by insurer or through insurance inter-mediatory the insurer gets the amount by way of premium which every Insurance company will invest its funds (collection of premium) as per “THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (INVESTMENT AMENDMENT) REGULATIONS, 2001. The different investment pattern has been defined for life, general, and re-insurer in the said regulations and the same is explained in the following paragraphs.

In addition to the investment the insurer has to maintain the accounts properly as the insurer is to pay the amount at the time of claim in case of general insurance and on maturity or death of the insured the amount is to be paid to the insured or their nominee as the case may be. The procedure of accounting the premium and their investment is prescribed in the regulation defined by IRDA in INSURANCE REGULATORY & DEVELOPMENT AUTHORITY (PREPARATION OF FINANCIAL STATEMENTS & AUDITOR’S REPORT OF INSURANCE COMPANIES) REGULATIONS 2000.

3.1 OBJECTIVES

At the end of this chapter you will know:—

- How the premium amount is invested by Insurer
- How the accounts are being maintained by Insurer

- Investment in Rural and social sector.
- Penalty for non compliance of provision of the Act.

Notes

3.2 INVESTMENTS

3.2.1 Life Insurance Company:

The life insurance company business has been divided in two parts as follows:—

- **Life Insurance Business**
- **Pension & General Annuity Business**
- **Unit Linked Insurance Business**

The investment pattern of controlled funds of **Life Insurance Business** is as follows:

Investment in Govt. securities	Not less than 25%
Investment in Govt. security or approved securities	Not less than 50% including above security
Infrastructure and Social Sector	Not less than 15%
Investments in approved investments and other than approved investments	Not exceeding 35% and not exceeding 15% in other than approved investments

The investment pattern of **Pension and General Annuity Business**:

Investment in Govt. securities	Not less than 20%
Investment in Govt. security or approved securities	Not less than 40% including above security
Investments in approved investments and as per exposure norms	Not exceeding 60%

Unit Linked Life Insurance Business:

Every insurer shall invest and at all times keep invested his segregated fund of unit linked life Insurance business as per pattern of investment offered to and approved by the policyholders. Unit Linked policies may only be offered where the units are linked to categories of assets which are both marketable and easily realizable. However the total investment in other than approved category of investments shall at no time exceed 25% of the fund.

3.2.2 General Insurance Company

The investment pattern of total assets general insurance company is as follows:

Investment in Govt. securities	Not less than 20%
Investment in State Govt security and other guaranteed securities	Not less than 30% including above security
Housing and Loans to State Government for Housing and Fire Fighting equipment, being not less than, (Subscription to/ purchase of Bonds/ debentures issued by HUDCO, National Housing Bank or House building institutions duly accredited by National Housing Banks, for house building activities, duly guaranteed by Government or carrying current rating of not less than 'AA' by independent, reputed and recognized rating agencies would also qualify for compliance of this regulation.)	Not exceeding 5%
Infrastructure and Social Sector	Not less than 10%
Investments in approved investments and non approved investments	Not exceeding 55% and not more than 25% in non approved investments

3.2.3 Reinsurance Business

Every reinsurer carrying on reinsurance business in India shall invest and at all times keep invested his total assets in the same manner as set out above, until such time separate regulations in this behalf are made by the Authority.

Approved Securities & Investments:

The meaning of approved securities and investments has been defined under section 27(A) and 27 (B) of Insurance Act 1938. The list is lengthy but the main is aim that the insurance company should invest the funds which are very safe & sound as the fund is public money and the insurer is to pay back the sum insured in case of maturity or if claim arises.

Infrastructure

Infrastructure facility means

(i) A road, highway, bridge, airport, port, Railways including BOLT, road transport system, a water supply project, irrigation project, industrial parks, water treatment system, solid waste management system, sanitation and sewerage system;

(ii) Generation or distribution or transmission of power;

(iii) Telecommunication;

(iv) Project for housing;

(v) Any other public facility of a similar nature as may be notified by the Authority in this behalf in the Official Gazaette;

Obligation of Rural and Social Sector:—

Rural Sector:—

(i) Five percent in the first financial year;

(i) Seven percent in the second financial year;

(ii) Ten percent in the third financial year;

(iii) Twelve percent in the fourth financial year;

(iv) Fifteen percent in the fifth financial year;

Social Sector:—

(i) Five thousand lives in the first financial year;

(ii) Seven thousand five hundred lives in the second financial year;

(ii) Ten thousand lives in the third financial year;

(iii) Fifteen thousand lives in the fourth financial year;

(iv) Twenty thousand lives in the fifth financial year;

3.3 PROCEDURE OF INVESTMENTS

- Every insurer shall constitute an Investment Committee which shall consist of a minimum two non-executive directors of the Insurer, the Principal Officer, Chiefs of Finance and Investment division, and wherever appointed actuary is employed, the Appointed Actuary.

- The decision taken by the Investment Committee shall be properly recorded and be open to inspection by the officers of the Authority.
- Every insurer shall draw up annually an Investment Policy and place the same before its Board of Directors for its approval.
- The investment policy as approved by the Board will be implemented by the investment committee, which shall keep the Board informed periodically about is activities.
- The Board shall review its investment policy and its implementation on an half-yearly basis or at such short intervals to protect the policyholder's interest.
- The details of the Investment Policy or its review as periodically decided by the Board shall be submitted to the Authority within 30 days of its decision thereto. The Authority may call for further information from time to time from the insurer as it deems necessary and in the interest of policyholders issue such directions to the insurers as it thinks fit.

INTEXT QUESTIONS 3.1

1. List the investment pattern of life insurer.
2. List the Obligations of Rural & Social Sector.

3.4 ACCOUNTS

Under Section 4 of the Insurance Act 1938, the IRDA has framed the rules & regulations known as **Insurance Regulatory & Development Authority (Preparation of Financial Statements & Auditor's Report of Insurance Companies) Regulations 2000.**

Life Insurance and General Insurance Business shall prepare the financial statements :—

a) Balance Sheet.

b) Revenue Account [Policyholders' Account], life insurance.

c) Revenue Account [Fire, Marine and Miscellaneous], General Insurance.

d) Receipts and Payments Account [Cash Flow statement] and,

e) Profit and Loss Account [Shareholders' Account].

The abovementioned shall be prepared as per the Accounting Standards prescribed by Institute of Chartered Accountants of India.

3.5 MISCELLANEOUS PROVISION

3.5.1 Insurance Business in Rural or Social Sector:—

Every insurer shall undertake such percentages of life Insurance business and general Insurance business in the rural or social sector, as stated above.

3.5.2 Obligations of Insurer in Respect of Rural or Unorganized Sector / Backward Classes

Every insurer shall discharge the obligations specified - persons residing in the rural sector, workers in the unorganized or informal sector or for economically vulnerable or backward classes of the society and other categories of persons as stated above.

3.5.3 Assignment and Transfer of Insurance Policies (38)

A transfer or assignment of a policy of life Insurance, whether with or without consideration, may be made only by an endorsement upon the policy itself or by a separate instrument, signed in either case by the transferor or by the assignor or his duly authorized agent and attested by at least one witness, specifically setting forth the fact of transfer or assignment.

The transfer or assignment shall be complete and effectual upon the execution of such endorsement or instrument duly attested but except where the transfer or assignment is in favor of the insurer shall not be operative as against an insurer and shall not confer upon the transferee or assignee, or his legal representative, any right to sue for the amount of such policy or the moneys secured thereby until a notice in writing of the transfer or assignment and either the said endorsement or instrument itself or a copy thereof certified to be correct by both transferor and transferee or their duly authorized agents have been delivered to the insurer.

3.5.4 Nomination by Policyholder (39)

1. The holder of a policy of life Insurance on his own life, may, when affecting the policy or at any time before the policy matures for payment, nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death.

2. Any such nomination in order to be effectual shall, unless it is incorporated in the text of the policy itself, be made by an endorsement on the policy communicated to the insurer and registered by him in the records relating to the policy and any such nomination may at any time before the policy matures for payment be cancelled or changed by an endorsement or a further endorsement or a will, as the case may be, but unless notice in writing of any such cancellation or change has been delivered to the insurer, the insurer shall not be liable for any payment under the policy made bona fide by him to a nominee mentioned in the text of the policy or registered in records of the insurer.

3. The insurer shall furnish to the policyholder a written acknowledgement of having registered a nomination or a cancellation or change thereof, and may charge a fee not exceeding one rupee for registering such cancellation or change.

4. A transfer or assignment of a policy made in accordance with section 38 shall automatically cancel a nomination.

5. Where the policy matures for payment during the lifetime of the person whose life is insured or where the nominee or, if there are more than one nominees, all the nominees die before the policy matures for payment, the amount secured by the policy shall be payable to the policyholder or his heirs or legal representatives or the holder of succession certificate, as the case may be.

6. Where the nominee or if there are more than one nominees, a nominee or nominees survive the person whose life is insured, the amount secured by the policy shall be payable to such survivor or survivors.

3.5.5 Limitation of Expenses of Management in Life Insurance Business – (Section 40B)

Every insurer transacting life Insurance business in India shall furnish to the Authority statements in the prescribed form duly certified by an actuary on the basis of premium currently used by him in regard to new business in respect of mortality, rate of interest, expenses & bonus loading.

No insurer shall spend as expenses of management exceeding the prescribed limits in any calendar year.

The expenses of management include commission payments of all kinds and any amount of expenses capitalized. In case of an insurer having his principal place of business outside India, a proper share of head office expenses which shall not be less than such percentage as may be prescribed of the total premiums (less reinsurances) received during that year in respect of life Insurance business transacted by him in India. But it does not include in the case of an insurer having his principal place of business in India any share of head office expenses in respect of life Insurance business transacted by him outside India.

If in any year the expenses of management exceeds the prescribed limits then it will be contravention of the provision if the excess amount so spent is within such limits as may be fixed in respect of the year by the Authority after consultation with the executive committee of life Insurance council by which the actual expenses incurred may exceed the expenses permissible.

Every statement shall be signed by the chairman and two directors of the company, the principal officer and auditor's certification and duly certifying that all expenses of management in respect of life Insurance business transacted by the insurer in India have been debited in the revenue account as expenses.

If the insurer is carrying on any other class of Insurance business in addition to life Insurance business an auditor's certificate certifying that all charges incurred in respect of his life Insurance business and in respect of his business other than life Insurance business have been fully debited in the respective revenue accounts.

3.5.6 Limitation of Expenses of Management in General Insurance Business (40C)

No insurer shall in respect of any class of general Insurance business transacted by him in India spend in any calendar year as expenses of management including commission or remuneration for procuring limits and in prescribing any such limits regard shall be had to the size & age of the insurer. If an insurer has spent as such expenses in any year an amount in excess of the amount permissible and the same shall not be contravention of the provision of this section, if the excess amount is within the limit as may be fixed in respect of the year by the Authority after consultation with Executive Committee of the General Insurance council which the actual expenses incurred may exceed the expenses permissible.

Every insurer shall incorporate in the revenue account a certificate signed by the Chairman and two directors & by the principal officer and an auditor certifying that all expenses of management have been fully debited in the revenue account as expenses.

3.5.7 Prohibition of Rebates (41)

No person shall allow rebate on any Insurance policy (life as well as general) to induce any person to take the Insurance policy. The rebate may be allowed in accordance with the published prospectuses or tables of the insurer. If any Insurance agent takes the Insurance policy for himself then it will not be considered as rebate of commission.

3.5.8 Penalty to be Imposed for Non-compliance of the Various Important Provisions of the Act.

Section 102. If any person, who is required under this Act, or rules or regulations made there under:—

(a) To furnish any document, statement, account, return or report to the Authority, fails to furnish the same.

(b) To comply with the directions, fails to comply with such directions.

(c) To maintain solvency margin, fails to maintain such solvency margin.

Notes

(d) To comply with the directions on the insurance treaties, fails to comply with such directions on the insurance treaties, he shall be liable to a penalty not exceeding five lakh rupees for each such failure and punishable with fine.

Section 103:— If a person makes a statement, or furnishes any document, statement, account, return or report which is false and which he either knows or believes to be false or does not believe to be true:—

(a) He shall be liable to a penalty not exceeding five lakh rupees for each such failure.

(b) He shall be punishable with imprisonment which may extend to three years or with fine for each such failure.

3.5.9 Penalty for False Statement in Document of Investment

Section 104:— If a person fails to comply with the provisions of section 27(investment) or section 27A (investment of Life Insurer) or section 27B (investment of General Insurer) or section 27C (prohibition of investment) or section 27D (Manner of investment), he shall be liable to penalty not exceeding five lakh rupees for each such failure.

3.5.10 Wrongfully Obtaining or Withholding Property.

Section 105:— If any director, managing director, manager or other officer or employees of an insurer wrongfully obtains possession of any property or wrongfully applies to any purpose of the Act, he shall be liable to a penalty not exceeding two lakh rupees for each such failure.

3.5.11 Offences by Companies

Section 105A

(1) Where any offence under this Act has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Notes

(2) Where any offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

3.5.11 Penalty for Failure to Comply with Section 32B (Insurance Business in Rural or Social sector).

Section 105B:— If an insurer fails to comply with the provisions of section 32B, he shall be liable to a penalty not exceeding five lakh rupees for each such failure and shall be punishable with imprisonment which may extend to three years or with fine for each such failure.

3.5.12 Penalty for Failure to Comply with Section 32C (Obligation of Insurer in respect of rural or unorganized sector):—

105C:— If an insurer fails to comply with the provisions of section 32C, he shall be liable to a penalty not exceeding twenty-five lakh rupees for each such failure and in the case of subsequent and continuing failure, the registration granted to such insurer under section 3 shall be cancelled by the Authority.

3.5.13 No Risk to be Assumed Unless Premium is Received in Advance Section 64VB:—

No insurer shall assume the risk in India unless & until the premium payable is received by him in advance.

In case the premium is tendered by postal money orders or cheques sent by post the risk may be assumed on the date on which the money order is booked or the cheques is posted as the case may be.

Where an Insurance agent collects a premium on a policy of Insurance on behalf of an insurer, he shall deposit with or dispatch by post to the insurer within 24 hours of the collection excluding bank & postal delays.

The agent is not to deduct his commission from the premium amount.

Declaration of Interim Bonus (112)

The insurer who is carrying a business of life Insurance shall be at liberty to declare an interim bonus or bonus to policyholders whose policies mature for payment by reason of death or otherwise.

Surrender Value 113

If any life Insurance policy in which the premium have been paid in full for atleast three consecutive years will acquire guaranteed surrender value. The bonus will also be in addition to the guaranteed surrender value.

INTEXT QUESTIONS 3.2

1. List the Accounting Statements to be prepared by any general insurer.
2. Meaning of 64 VB.

3.5 SUMMARY

In this chapter we have explained various important activities of an insurance company whether it is doing the business of life or general or re-insurer. The utilization of premium amount received by insurance companies are very important as this amount belongs to the public (policyholders) to whom the amount is to be paid back as and when claim arises or on maturity. Therefore the insurer will invest such funds to earn maximum return with safety as per the norms prescribed by IRDA so that the public funds are not misused and lost by the insurer so that the insurer does not have any funds to pay the claim or maturity amount.

Similarly the accounts of any insurer are being maintained as the guidelines framed by IRDA related to preparation of financial statements of any insurer. It is to ensure that the public gets true and fair picture of workings of any insurer.

3.6 TERMINAL QUESTION

1. Mention the investment pattern of Life Insurance Company.

Notes

2. Distinguish between assignment and nomination.
3. List the provisions of rural and social sector.

3.7 OBJECTIVE TYPE QUESTIONS

1. One of the following Accounting Statements does not form part of Specified Financial Statements comprising under regulation called IRDA (Preparation of Financial Statements and Auditors Report of Insurance Companies) Regulations 2000. Identity that statement.

   (a) Balance Sheet.

   (b) Revenue Accounts.

   (c) Profit and Loss Account.

   (d) Fund-Flow Statement.

2. Choose the Correct Option

   Statement A: Life insurer will invest not less than 25% in Central Government Securities.

   Statement B: Life insurer will invest not less than 50% in Central & State Government Securities.

   a. Statement A b. Statement B c. Both d. None

3. Choose the Correct Option

   Statement A: General insurer will invest not less than 20% in Central Government Securities.

   Statement B: General insurer will invest not less than 30% in Central & State Government Securities.

   a. Statement A b. Statement B c. Both d. None

4. Choose the Correct Option

   Statement A: It is not obligatory for Life insurer to invest in rural sector.

   Statement B: It is obligatory for General Insurer to invest in rural sector.

   a. Statement A b. Statement B c. Both d. None

5. Choose the Correct Option

   Statement A: Nomination is must in all Life insurance products.

Notes

Statement B: Nomination is not compulsory in all Life insurance products.

a. Statement A b. Statement B c. Both d. None

6. Choose the Correct Option.

Statement A: It is a legal requirement to pay the premium in advance in Life insurance only.

Statement B: It is a legal requirement to pay the premium in advance in general Insurance only.

a. Statement A b. Statement B c. Both d. None

7. The life insurance premium should be paid for minimum _____ years.

a. 3 b. 4 c. 5 d. 1

8. Choose the Correct Option

Statement A: IRDA can put limit on the management expenses of the Life insurer only.

Statement B: IRDA can put limit on the management expenses of the General insurer only.

a. Statement A b. Statement B c. Both d. None

9. Choose the Correct Option

Statement A: IRDA can impose fine on insurer if obligation of Rural and Social sector is not fulfilled.

Statement B: IRDA can impose fine on insurer for non compliance of submission of documents.

a. Statement A b. Statement B c. Both d. None

10. Infrastructure facility means

(a) A road, highway, bridge, airport, port, Railways including BOLT, road transport system, a water supply project, irrigation project, industrial parks, water treatment system, solid waste management system, sanitation and sewerage system.

(b) Generation or distribution or transmission of power.

(c) Telecommunication.

(d) All above

3.8 ANSWERS TO INTEXT QUESTIONS

3.1

1. Life Insurance and General Insurance Business shall prepare the financial statements
   a) Balance Sheet.
   b) Revenue Account [Policyholders' Account], life insurance.
   c) Revenue Account [Fire, Marine and Miscellaneous], General insurance.
   d) Receipts and Payments Account [Cash Flow statement] and
   e) Profit and Loss Account [Shareholders' Account].

2. No insurer shall assume the risk in India unless & until the premium payable is received by him in advance.

   In case the premium is tendered by postal money orders or cheques sent by post the risk may be assumed on the date on which the money order is booked or the cheques is posted as the case may be.

   Where an Insurance agent collects a premium on a policy of Insurance on behalf of an insurer, he shall deposit with or dispatch by post to the insurer within 24 hours of the collection excluding bank & postal delays.

   The agent is not to deduct his commission from the premium amount.

3.2

1. Fire, Marine and Miscellaneous accounts.
2. The premium received by the insurance company in advance and the risk will start once the premium received by the insurance company.

3.9 ANSWER TO OBJECTIVE TYPE QUESTIONS

1. d	2. c	3 . c	4. b
5. a	6. d	7. a	8. d
9. c	10. d		

4

RIGHTS & REMEDIES AVAILABLE TO CONSUMERS

4.0 INTRODUCTION

Man is a social & rational animal. He has throughout his evolution tried to improve upon everything, he has laid his hands upon, anything which he has thought & about everything which he has invented or discovered. This special faculty which has been blessed on man & which inspires a person to channelize all his energies to reach a destination of perfection in life is the power to think. One cannot survive alone. Interaction is must. There is interaction between two individuals, between families, between societies, between nations and so on & so forth. Education, trade and commerce, all are focuses of human interaction. But the indispensable interaction between the entities, if one may think of minutely keeping in view the commercialization of every sphere of life is the interaction between the seller & the buyer, the giver & the recipient, the skilled ones & the beneficiaries, the trader & the consumer. In fact, every body is a consumer because one may sell something but at the same time has to buy also. Insurance activity is also one of the intangible products i.e which can not be seen or touched. In fact it is only a promise on piece of paper which no consumer/buyer reads unless & until any dispute arises in fulfilling the promises by the insurers. The government/IRDA has protected the interest of the consumers/policyholders through various laws which have been explained in this chapter.

Notes

4.1 OBJECTIVES

After this chapter you will be able to know various remedies for the Policyholders under the following acts

- Protection of Policyholders Interest.
- Consumer Protection Act 1986.
- Insurance Ombudsman.

4.2 PROTECTION OF POLICYHOLDERS' INTERESTS

Under the provisions of Protection of Policyholder's Interest the procedure is defined for the insurance companies to be followed at the time of issue of policies and the documents required at the time of claim and how the disputes are to be resolved.

4.2.1 Procedure before the sale of product:—

A prospectus of any insurance product shall clearly state the scope of benefits, the extent of insurance cover and in an explicit manner explain the warranties, exceptions and conditions of the insurance cover and, in case of life insurance, whether the product is participating (with-profits) or non-participating (without-profits). The allowable rider or riders on the product shall be clearly spelt out with regard to their scope of benefits, and in no case, the premium relatable to all the riders put together shall exceed 30% of the premium of the main product.

4.2.2 Proposal for insurance:—

Except in cases of a marine insurance cover, where current market practices do not insist on a written proposal form, in all cases, a proposal for grant of a cover, either for life business or for general business, must be evidenced by a written document. It is the duty of an insurer to furnish to the insured free of charge, within 30 days of the acceptance of a proposal, a copy of the proposal form.

The proposal forms and documents used in the grant of cover may, depending upon the circumstances of each case, be made available in languages recognised under the Constitution of India.

Notes

4.2.3 Grievance redressal procedure

Every insurer shall have in place proper procedures and effective mechanism to address complaints and grievances of policyholders efficiently and with speed and the same along-with the information in respect of Insurance Ombudsman shall be communicated to the policyholder along-with the policy document and as may be found necessary.

4.2.4 Claims procedure in respect of a life insurance policy

A life insurance policy shall state the primary documents which are normally required to be submitted by a claimant in support of a claim.

A life insurance company, upon receiving a claim, shall process the claim without delay. Any queries or requirement of additional documents, to the extent possible, shall be raised all at once and not in a piece-meal manner, within a period of 15 days of the receipt of the claim.

A claim under a life policy shall be paid or be disputed giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers and clarifications required. However, where the circumstances of a claim warrant an investigation in the opinion of the insurance company, it shall initiate and complete such investigation at the earliest. Where in the opinion of the insurance company the circumstances of a claim warrant an investigation, it shall initiate and complete such investigation at the earliest, in any case not later than 6 months from the time of lodging the claim.

If a claim is ready for payment but the payment cannot be made due to any reasons of a proper identification of the payee, the life insurer shall hold the amount for the benefit of the payee and such an amount shall earn interest at the rate applicable to a savings bank account with a scheduled bank (effective from 30 days following the submission of all papers and information).

Where there is a delay on the part of the insurer in processing a claim for a reason other than the above, the life insurance company shall pay interest on the claim amount at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

4.2.5 Claim procedure in respect of a general insurance policy

An insured or the claimant shall give notice to the insurer of any loss arising under contract of insurance at the earliest or within such extended time as may be allowed by the insurer. On receipt of such a communication, a general insurer shall respond immediately and give clear indication to the insured on the procedures that he should follow. In cases where a surveyor has to be appointed for assessing a loss claim, it shall be so done within 72 hours of the receipt of intimation from the insured.

Where the insured is unable to furnish all the particulars required by the surveyor or where the surveyor does not receive the full cooperation of the insured, the insurer or the surveyor as the case may be, shall inform in writing the insured about the delay that may result in the assessment of the claim. The surveyor shall be subjected to the code of conduct laid down by the Authority while assessing the loss, and shall communicate his findings to the insurer within 30 days of his appointment with a copy of the report being furnished to the insured, if he so desires. Where, in special circumstances of the case, either due to its special and complicated nature, the surveyor shall under intimation to the insured, seek an extension from the insurer for submission of his report. In no case shall a surveyor take more than six months from the date of his appointment to furnish his report.

If an insurer, on the receipt of a survey report, finds that it is incomplete in any respect, he shall require the surveyor under intimation to the insured, to furnish an additional report on certain specific issues as may be required by the insurer. Such a request may be made by the insurer within 15 days of the receipt of the original survey report.

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

On receipt of the survey report or the additional survey report, as the case may be, an insurer shall within a period of 30 days offer a settlement of the claim to the insured. If the insurer, for any reasons to be recorded in writing and communicated to the insured, decides to reject a claim under the policy, it shall do so within a period of 30 days from the receipt of the survey report or the additional survey report, as the case may be.

Notes

Upon acceptance of an offer of settlement by the insured, the payment of the amount due shall be made within 7 days from the date of acceptance of the offer by the insured. In the cases of delay in the payment, the insurer shall be liable to pay interest at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is received by it.

General

Any breach of the obligations cast on an insurer or insurance agent or insurance intermediary in terms of these regulations may enable the Authority to initiate action against each or all of them, jointly or severally, under the Act and/or the Insurance Regulatory and Development Authority Act, 1999.

INTEXT QUESTIONS 4.1

---

1. What penalties are imposed on Insurer on delaying the payment of claim?
2. Mention the procedure to be followed by Insurer to sell their product.

4.3 CONSUMER PROTECTION ACT 1986

As every one is a consumer therefore, the legislative has enacted the Consumer Protection Act 1986, which was made more powerful by the Consumer Protection (Amendment) Act 1993 to arm each & every consumer or consumer associations with rights to seek speedy & cheap remedies in such manner which is proving to be very popular & effective as well, leaving behind a trail of rulings & findings where under so many of us have benefited.

The statute has been enacted to provide for better protection of the interests of consumers and for that purpose to make provisions for the establishment of consumer councils and other authorities for the settlement of consumer's disputes and for matters connected therewith.

Let us discuss the various provisions of the Act in brief to explain the basics of Consumer Protection Act 1986.

4.3.1 General

1. This is Act applies to all the goods and services.
2. It covers private, public and cooperative sectors.

4.3.2 Rights of the consumers

The Act seeks to promote and protect the rights of the consumers such as: -

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

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

(iii) The right to be heard and assured that consumer's interests will receive due consideration at appropriate forums.

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

(v) The right to consumer education.

4.3.3 Who is a consumer for the purpose of services?

a) One who hires any services for a consideration, which has been paid or promised or partly paid or partly promised or under any system of deferred payments.

b) It includes any beneficiary of such service other than the one who actually hires the service for consideration and such services are availed with the approval of such person.

4.3.4 What constitutes a defect or deficiency?

A defect or deficiency is a

- Fault.
- Imperfection.
- Shortcoming.
- Inadequacy.
- Quality.
- Nature.

Notes

- manner of performance which is required to be.
- maintained by or under any law.
- in pursuance of a contract.
- undertaking in relation to that service.

4.3.5 The main objective of the Act is:—

- To provide simple, speedy and inexpensive redressal to the consumer's grievances.
- To provide this, a **three-tier quasi-judicial** machinery at the national, state and district level has been envisaged under the Act.
- National Consumer Disputes Redressal Commission (National Commission).
- State Consumer Disputes Redressal Commission (State Commission).
- District Consumer Disputes Redressal Forum (District Forum).

4.3.6 Who can file a complaint?

1. Consumer.
2. Any voluntary organisation representing consumers registered under Companies Act/Societies Act.
3. Central Government.
4. State Government or Union Territory.

A group of consumers having common dispute.

4.3.7 Where to file a complaint?

1. If the cost of goods or services and compensation asked for does not exceed Rs.20 lakhs then the complaint can be filed in the District Forum which has been notified by the government for the District **where the cause of action has arisen or where party resides.**
2. If the cost of goods or services and compensation asked for is more than Rs. 20 lakhs but less than 1 Crore, the complaint can be filed before State Commission.

3. If the cost of goods or services and compensation asked for exceeds Rs. 1 Crore, the complaint can be filed before the National Commission.

4.3.8 Appeals:

If a person is not satisfied with the decision of the district forum, he can file an appeal with the state commission and in case of not being satisfied with the decision of state commission; appeal can be filed before the national commission. Appeals against the decision of the national commission can be filed in the Supreme Court.

4.3.9 Relief available to consumers:

Depending on the nature of relief sought for by the consumer and facts, the redressal forum may give order for one or more of the following relief:-

1. Removal of defects from the goods.
2. Replacement of goods.
3. Refund of consideration paid.
4. Award of compensation for the loss or injury suffered.

4.3.10 Limitations:

Complaint is to be filed within 2 years from the date on which cause of action has arisen. Time-barred complaints shall not be entertained by Forums.

INTEXT QUESTIONS 4.2

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1. Whether an individual can file complaint in the Consumer Courts on account of repudiation of the claim?

2. Where to file a complaint if the disputable amount is more than Rs 20 lakhs?

4.4 OMBUDSMAN SCHEME

Introduction to the Scheme:—

(i) Central Government framed rules known as Redressal of Public Grievances Rule 1998, in exercise of the powers vested in it under section 114(1) of Insurance Act, 1938.

(ii) These rules are in respect of the Ombudsman Scheme to resolve all complaints relating to claims against insurers.

(iii) Complaints are to be resolved in cost effective, efficient and impartial manner.

(iv) The Scheme has been notified in the Gazette of India on 11.11.98.

4.4.1 The Ombudsman may receive and consider complaints of individuals relating to:

(i) Any partial or total repudiation of claim by an insurer.

(ii) Any dispute in regard to premium paid or payable in terms of the policy.

(iii) Any dispute in regard to the legal construction of the policies in so far as such disputes relate to the claims.

(iv) Delay in settlement of claims.

(v) Non-issue of an insurance document to customers after receipt of premium.

(vi) The Ombudsman shall act as counselor and mediator in matters which are within his terms of reference and, if requested to do so in writing by mutual agreement by the insured person and insurance company.

(vii) The Ombudsman's decision whether the complaint is fit and proper for being considered by it or not shall be final.

4.4.2 When can a complaint be made to the Ombudsman?

(i) If the insurer has rejected a written representation of the complainant.

(ii) The complainant had not received any reply within one month after the insurer received his representation.

(iii) The complainant is not satisfied with the reply given to him by the insurer.

(iv) The complaint is made not later than 1 year after the insurer had rejected the representation or sent his final reply on the representation of the Complainant.

(v) The complaint is not on the same subject matter, for which any proceedings "before any court, or Consumer Forum, or arbitrator" is pending or were so earlier.

4.4.3 Recommendations:

When a complaint is settled through mediation of the Ombudsman.

(i) He makes a 'recommendation' which he considers fair in the circumstances of the case.

(ii) Copies of the 'recommendation' shall be sent to the complainant and the insurance company.

(iii) Such 'recommendation' shall be made not later than one month from the date of the receipt of the complaint.

(iv) If a complainant accepts the recommendations of the Ombudsman, he will communicate his acceptance within 15 days of receipt of the recommendation.

(v) Acceptance letter to the Ombudsman should clearly state that the settlement reached is acceptable to him in totality in full and final settlement of his claim.

(vi) Thereafter, the Ombudsman will send a copy of the recommendation along with complainant's acceptance letter to the insurance company.

(vii) The insurer shall comply with the terms and conditions of the recommendation immediately but not later than 15 days of the receipt of such recommendations.

(viii) Finally, the insurer shall inform the Ombudsman about its compliance.

4.4.4 Awards

Where complaint is not settled through mediation of the Ombudsman

(i) He shall pass an Award.

(ii) Which he considers fair in the facts of the case.

(iii) Award shall be in writing.

(iv) It shall state the amount awarded to the complainant.

(v) Ombudsman shall not award any compensation in excess of the loss suffered by the complainant or 20 lakh, whichever is less.

(vi) Award shall be passed within a period of three months from the date of receipt of the complaint.

(vii) Copies of the award shall be sent to the insurer and the complainant.

(viii) Complainant shall furnish to the insurer within one month, a letter of acceptance that award is in full and final settlement of his claim.

(ix) Insurer shall comply with the award within 15 days from the receipt of the acceptance letter and intimate compliance to the Ombudsman.

4.4.5 Consequences of non-acceptance of award:

If the complainant does not intimate acceptance within one month from the date of receipt of the award, the insurance company may not implement the award.

4.4.6 Ex-gratia payment

If the Ombudsman deems fit, he may award an Ex-gratia payment.

The decision of the ombudsman is binding on the insurers, but the consumer if he feels aggrieved by the decision can approach the civil courts for relief.

INTEXT QUESTIONS 4.3

---

1. What are the consequences of non acceptance of award?
2. When the Scheme of Ombudsman was implemented?

4.5 SUMMARY

As and when any business activity increases the disputed do arise and to resolve the disputes at the earliest the Govt has framed the Consumer protection Act 1936, and IRDA has issued regulations to protect the interest of Policyholders. Any dispute related to insurance activity can be resolved though Insurance ombudsman or filing a complaint at IRDA. If a person is not satisfied with the decision of any of such legal organization then the policyholder can file an appeal in the Courts.

4.6 TERMINAL QUESTIONS

---

1. What are the rights of consumer under Consumer protection Act 1986?

Notes

2. List the remedies available to the policyholders under Protection of Policyholder rights.

3. What action will be taken by Ombudsman if a policyholder is not satisfied with the decision of the Ombudsman?

4.7 OBJECTIVE TYPE QUESTIONS

1. The limit of dispute can be referred to the District Consumer Court _______(up to Rs 20 lakhs/ up to Rs 25 lakhs).

2. The limit of dispute can be referred to the State Consumer Court _______(Rs 100 lakhs/Rs 50 lakhs).

3. The limit of dispute can be referred to the District Consumer Court _______(More than Rs 100 lakhs/Rs 250 lakhs).

4. The limit of dispute can be referred to the Insurance Ombudsman ________ (Rs 20 lakhs/Rs 10 lakhs).

5. Consumer Protection Act is applicable to

   a. Goods

   b. Service

   c. Goods & Services

   d. None

4.8 ANSWRES TO INTEXT QUESTIONS

4.1

1. In the cases of delay in the payment, the insurer shall be liable to pay interest at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

2. A prospectus in which the details of the products is explained will be provided to the customers.

4.2

1. Yes an individual can file an complaint on the basis of deficiency of the service.

2. State Consumer Court.

Notes

4.3

1. If the complainant does not intimate acceptance within one month from the date of receipt of the award, the insurance company may not implement the award.

2. In Nov 1998

4.9 ANSWRES TO OBJECTIVE TYPE QUESTIONS

1. 20 lakhs

2. 100 lakhs

3. More than 100 lakhs

4. 20 Lakhs

5. C

5

PUBLIC LIABILITY INSURANCE ACT 1991, AND WORKMEN COMPENSATION ACT 1923 AND MOTOR VEHICLE ACT 1988

5.0 INTRODUCTION

In this chapter we will discuss various Acts where an employee or third party will get compensation because of no fault of his / her. For eg. A vehicle driver hits pedestrian on road with out his fault then the owner of vehicle is responsible to payment the compensation to the nominee of the deceased. But an individual may not be financial strong to pay the compensation therefore the law was enacted to insure all the vehicles so that affected person gets the compensation from insurer. Similarly the owner of any industry may have to pay compensation to the general public because of no fault but they are affected because of the industry.

5.1 OBJECTIVES

At the end of this lesson, you will be able to

- How the compensation can be claimed from the industrialist because of general public is affected.
- How the industrialist can cover their risk through insurance.
- How the vehicle owner can protect himself to pay the compensation.

Notes

5.2 PUBLIC LIABILITY ACT 1991

5.2.1 Introduction

The workers who are handling hazardous substances and likely to fall victims of accidents. The employees used to escape their liability on the grounds of assumed risk or contributory negligence brought legislation to protect the workers for their safety in hazardous occupation. One of the ways to protect workers is through providing Insurance to them. The employer has also to share the burden in this.

Very often, the majority of the people affected are from the economically weaker sections & suffer great hardships because of delayed relief & compensation. While workers and employees of hazardous installations are protected under separate laws, members of the public are not assured of any relief except through long legal processes. Industrial units seldom have the willingness to readily compensate the victims of accidents & the only remedy now available for the victims is to go through prolonged litigation in the court of law.

It is, therefore, essential to provide for Mandatory Public Liability Insurance for installations handling hazardous substances to provide minimum relief to the victims. Such Insurance, apart from safe guarding the interests of the victims of accidents would also provide cover & enable the industry to discharge its liability to settle large claims arising out of major accidents. If the objective of providing immediate relief is to be achieved, the mandatory public liability Insurance should be on the principle of “no fault” liability as it is limited to only relief on a limited scale. However, availability of immediate relief would not prevent the victims to go to courts for claiming higher compensation.

An Act to provide for public liability insurance for the purpose of providing immediate relief to the persons effected by accident occurring while handling any hazardous substance and for matters connected therewith or incidental thereto, was introduced in 1991. The Act gives relief on the principle of “No Fault”.

Where death or injury to any person (other than a workman) or damage to any property has resulted from an accident, the owner shall be liable to give following relief for such death, injury or damage.

(i) Reimbursement of medical expenses incurred upto a maximum of Rs. 12,500 in each case.

(ii) For fatal accidents the relief will be Rs. 25,000 per person in addition to reimbursement of medical expenses, if any incurred on the victim up to a maximum of Rs. 12,500.

(iii) 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 authorised physician. The relief for total permanent disability will be Rs. 25.000.

(iv) For loss of wages due to temporary partial disability, which reduces the earning capacity of the victim, there will be a fixed monthly relief not exceeding Rs. 1,000/-per month up to a maximum of 3 months provided the victim has been hospitalised for a period exceeding 3 days and is above 16 years of age.

(v) Upto Rs. 6,000 depending on the actual damage, for any damage to private property.

INTEXT QUESTIONS 5.1

1. Mention the compensation payable under permanent disability.

2. Mention the medical expenses payable.

5.3 WORKMEN'S COMPENSATION ACT 1923

5.3.1 Introduction

The Workmen's Compensation Act 1923 came into force w.e.f. 1/7/1924. The object of this Act is to make provision for the payment of compensation to a workman only i.e. to the concerned employee himself in case of his surviving the injury in question and to his dependents in the case of death.

The growing complexity of industry in the country, with the increasing use of machinery & consequent danger to workmen, along with the comparative poverty of the workmen themselves renders it advisable that they should be protected from hardship out of accidents. A legislation of this kind helps to reduce the number of accidents in a manner that cannot be achieved by official inspection and to mitigate the effect of accidents by provision for suitable medical treatment, thereby making industry more attractive to labour & increasing its efficiency.

The Act provides for cheaper & quicker disposal of disputes relating to compensation through tribunals than was possible under the civil law.

Section 2 (1) & (4) of the Act defines the amount of compensation to be paid in the case of death, permanent total disablement and Permanent partial disablement due to an injury while on duty or due to disease contracted which is peculiar to that environment also called "occupational disease".

The following is the amount payable in different cases:—

(a) On death an amount equal to 50% of the monthly wages last drawn by the deceased workman multiplied by the relevant factor or Rs.80,000/- whichever is more.

(b) Where permanent total disablement occurs an amount equal to 60% of the monthly wages last drawn by the injured workman multiplied by the relevant factor or Rs.90,000/- whichever is more.

(The relevant factor mentioned in (a) & (b) above is based on the age of the employee and is given in the act. For e.g. at age 16 the factor is 228.54; at age 30 it is 207.98; at age 50 it is 153.90. For the purpose of arriving at the compensation the act has fixed the maximum monthly wages of Rs.4,000/- p.m. and in case his salary is more than Rs.4,000/- p.m. he shall be deemed to be getting a wage of Rs.4,000/- p.m. only).

(c) In case of permanent partial disablement the amount payable will be a percentage of the amount payable due to permanent total disability and the percentage is specified in the act. Some examples are:

Amputation through shoulder joint	-	90%
Loss of thumb	-	30%
Loss of four fingers of one hand	-	50%
Loss of middle finger (whole)	-	12%
Loss of Ring or little finger (whole)	-	7%

(d) In case of temporary total or partial disablement a half monthly payment of the sum equivalent to 25% of the monthly wages of the workman.

In addition to the above in case of death of an employee, a sum of Rs.2,500/- is required to be deposited by the employer with the commissioner for payment to the eldest surviving dependant of the workman towards funeral expenses.

Some examples of occupational disease are:

1. Hearing impairment caused by noise.
2. Lung cancer caused by asbestos.
3. Lung disease caused by cotton, flex, hemp etc.
4. Skin disease caused by physical, chemical or biological agents.

5.4 THE MOTOR VEHICLE ACT 1988

5.4.1 Introduction:

The first law relating to Motor Vehicles was the Indian Motor Vehicle Act 1914, which stayed in operation till the year 1939. During this long period there was a vast change in the transport scenario and the need was felt to comprehensively renew the old law as the developments rendered the working of the old Act of 1939 inconvenient and it was not in tune with the change in time and the new Act of 1988 was enacted.

The Motor Vehicle Act was amended in 1988 to make Third Party Liability Insurance compulsory thus no uninsured vehicle is allowed to play on the roads or in any public place in India. The need of this enactment was felt due to the growing number of vehicles and the increasing number of accidents causing injury and death of the people involved in the accident and not being able to get relief from the owner/ driver of the vehicle because of long protracted legal battle involved, which many victims could not afford. (Section 146)

The Act now provides that irrespective of the fact that the fault was of the driver/ owner or not (No-fault) the victim of an accident will be entitled to a payment of Rs. 50,000/- in case of death and Rs. 25,000/- in the case of grievous bodily injury.

Motor Accident Claim Tribunals (MACT) have been set up by the State Government to provide speedy redressal of Third

Party claims. Damage to property of Third party is also covered and the limit is Rs.6,000/-.(Section 140 of Motor Vehicle Act).

In addition to the above claim the affected party can claim more compensation on account of death or permanent disability under any other law of the country. (Section 141 & 142).

Motor Vehicle Act also provides for the creation of a "Solatium Fund" to cater to the victims of Hit and Run cases. The fund is created by the contribution from Insurance companies, state and central Government and the victims of Hit & Run cases are entitled to receive Rs.25,000/- in case of death and Rs.12,500/- in the case of grievous bodily injury. (Section 161)

Section 147 defines the requirement of an Insurance policy and the limits of its liability. It also makes the issue of certificate of Insurance compulsory, as well as the limitation of a cover note.

Section 163A makes special provisions for payment of compensation on a structured formula basis by the insured or the insurer as the case may be. The structure formula is based on the age of the deceased or injured person, his earning capacity and his/her dependents.

INTEXT QUESTIONS 5.2

1. What is relevant factor under WC Act 1923?
2. Why is MACT set up?

5.5 SUMMARY

To protect an individual on account of any accidents because of no fault then he is entitled for the compensation under Public liability Act or Motor Vehicle Act and if he/she happens to be an employee in any industry then he/she is entitled for the compensation under Workman's Compensation Act. Under these Acts the amount or formula is defined so that every individual is compensated properly or sufficiently, not arbitrarily. In-spite of these acts there are many disputes in respect of compensation as the affected parties demand more compensation because of his/her earning capacity and age etc. In Indian Courts most of the cases are related for Motor Vehicle Act. To settle these cases speedily the Govt has set up Tribunal i.e. Motor Accidents Claim Tribunal(MACT) in each State.

5.6 TERMINAL QUESTIONS

1. Mention the compensation amount payable under Public Liability Act 1991.
2. Write short note on Workman's Compensation Act 1923 or Motor Vehicle Act 1988.

5.7 OBJECTIVE TYPE QUESTIONS

1. Death Benefit under Public Liability Act 1991

   a. Rs 25,000/- b. Rs 50,000/-

   c. Rs 1,00,000/- d. Rs 12,500/-

2. Public Liability Act 1991 is applicable to ________(All Industries/ hazardous industries).
3. No benefit is available in case of bodily injury under Public Liability Act 1991. (wrong/correct)
4. Workmen's Compensation Act is applicable to _________. (manufacturing/ service industry)
5. If a workman dies due to accident, the minimum Compensation is payable under Workman's Compensation Act is _______ (Rs 80,000/-/ Rs 90,000/-).
6. **Under Motor Vehicle Act, 1988 Third Party claims can be adjudicated by:**

   a. Insurable Ombudsman b. Motor Accident Claims Tribunal

   c. Lok Adalat d. Lok Nyayalaya

7. **Compensation for death U/S 140 of the Motor Vehicle Act is:**

   a. Rs.25,000 b. Rs.12,500

   c. Rs.50,000 d. Unlimited

8. **Third Party death liability in Private Car is unlimited. The liability in case of Motor Vehicle is:**

   a. Rs.5 lakh b. Rs.1 lakh

   c. Unlimited d. None of the above

9. **Compulsory insurance of motor vehicle is provided for the first time under:**

a. Motor Vehicle Act, 1988.

b. Motor Vehicle Act, 1939.

c. Insurance Act, 1938.

d. Road Transport Authority Act

10. **The compensation for death U/S 161 of the Motor Vehicle Act is:**

a. Rs.50,000 b. Rs.25,000

c. Motor vehicle act Rs.12,500 d. Unlimited

5.8 ANSWERS TO INTEXT QUESTIONS

5.1

1. Rs 25000/-
2. Rs 12500/-

5.2

1. Age of the employee at the time of accident.
2. For speedy redressal of the settlement of claim.

5.9 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1.	a	2.	hazardous industry
3.	wrong	4.	Manufacturing
5.	Rs 80000/-	6.	b
7.	c	8.	c
9.	a	10.	b

6

LAWS RELATED TO MARINE INSURANCE AND INCOME TAX PROVISIONS RELATED TO INSURANCE

6.0 INTRODUCTION

The Marine Insurance Act, 1963 codifies the law relating to Marine Insurance. With a few exceptions this Act closely follows the UK Marine Insurance Act, 1906. Under his Act various definitions of principles of insurance and terminology have been defined which we have explained in the other module under Chapter "Marine Insurance". Kindly read those clauses & terminology carefully. In addition to the Marine Insurance Act, 1963 the following laws governs the practice of marine Insurance contracts. A good working knowledge of these laws is necessary for underwriters to pursue rights of recovery from carriers or bailees under subrogation proceedings.

6.1 OBJECTIVES

At the end of this lesson, you will be able to:

- Know the related laws to marine insurance.
- How the Transporter is responsible for the loss of goods during transit.
- Income tax provisions related to Life Insurer, General Insurer, Business organization and Individuals.

6.2 MARINE INSURANCE ACT, 1963

6.2.1 The Carriage of Goods by Sea Act, 1925

This Act defines the minimum rights, liabilities and immunities of a ship-owner in respect of loss or damage to cargo carried. Broadly, speaking, the Act deals with three aspects of a ship owner's liabilities towards cargo owners. They are:

a) The circumstances when the ship owner is deemed to be liable for loss or damage to cargo.

b) The circumstances 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.

c) The limits of liability of a **ship owner** for loss of or damage to cargo calculated in monetary terms per package or unit of cargo.

6.2.2 The Merchant Shipping Act, 1958

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

6.2.3 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 documents required in connection with settlement of Marine Cargo claims.

6.3 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 Post Trust Authorities.

6.3.1 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. The Act defines the liability of the air carriers for death of or injury to passengers and for loss of or damage to registered luggage and cargo. The

Act 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.

6.3.2 Multi- Modal Transportation Act, 1993

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

6.4 THE CARRIERS ACT 1865

With the growth of industries movement of goods and property became an integral part of the society. The carriers role for the movement of goods became very important. In the beginning individual carriers came into existence and later many companies were formed. Tramways and Indian Railway Companies were formed under the enactments and their role as common carriers was of prime importance. While operating as common carriers loss or damage to the goods and property being carried were occasioned by the negligence or criminal acts of themselves, their servants or agents. It became necessary to make common carriers liable for the loss or damage so caused. To enable common carriers to limit their liability for loss of, or damage to, property delivered to them to be carried and also to declare their liability for loss of, or damage to, such property occasioned by the negligence or criminal acts of themselves, their servants or agents a Bill was introduced in the legislature.

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

Under the Act the Common Carrier includes any association or body of persons, whether incorporated or not, other than the Govt. carrying on business of transporting property from one place to another by land or inland navigation for all persons & for some consideration or reward.

The person does not include a Govt., Postal Deptt., the Indian Airlines etc. It includes an association or a body of persons which may be a co-operative society, a partnership firm or any other public or private company.

Under section 3 of the Act

"Carriers are not to be liable for loss of certain goods as given in the schedule above one hundred rupees in value.

Schedule

Gold and silver coin, Gold and silver in a manufactured or un-manufactured state, Precious stones and pearls. Jewellery, Time-pieces of any description, Bills and Hundis,

Currency notes of the Central Government, or notes of any Bank, or securities for payment of money, English or Foreign. Stamps and stamped paper, Maps, prints and works of art etc etc.

INTEXT QUESTIONS 6.1

1. What is represented by the Bill of lading?
2. What is multi modal transportation?

6.5 INDIAN INCOME TAX ACT 1961

6.5.1 Terminology

To understand the Income Tax Act one has to understood the various terms which are used frequently.

Income: Any earning by way of salary, profit or loss or rental income or interest income or profit or loss on sale of any capital assets or lottery, prizes is considered as income under Income Tax Act.

Assessee: An assessee is a person whose income is being assessed. For e.g., Mr. 'A' is a govt. employee or in job; his salary is an income, therefore - Mr. A will be considered as assessee.

Financial Year: The financial year is of 12 months starting from 1st April & ending to 31st March of the succeeding year.

Previous Year: The financial year in which the income is earned is known as the previous year.

Assessment Year: It is the succeeding year of the previous year and the year in which the income is assessed.

For e.g., Mr. A is in service and earning Rs.10,000 p.m. from 1/1/1999.

Financial Year: 1/4/98 to 31/3/99

Previous Years are: 1/4/98 to 31/3/99; 1/4/99 to 31/3/2000 & 1/4/00 to 31/3/2001

Assessment Year: (1/4/99 to 31/3/2000) will assess the income earned during the previous year 1/4/98 to 31/3/99.

Assessment year (1/4/00 to 31/3/2001) will assess the income earned during the previous year 1/4/99 to 31/3/2000.

6.5.2 Income Heads

Under section 14 of the Income Tax Act all incomes for the purpose of charge of Income Tax & Computation of total income have been classified under the following five heads of Income.

1)	Salaries	Section 15-17
2)	Income from House Property	Section 22 to 27
3)	Profits & gains of Business & Profession	Section 28 to 44
4)	Capital gains	Section 45 to 55
5)	Income from other sources	Section 56 to 59

Income, which falls within one head cannot be assigned to or taxed under another head. Further, income computed under each distinct head is not separately chargeable to tax. Income tax is only one tax levied on the aggregate of income classified and chargeable under the different heads.

The brief explanation of these heads are as under: -

1. Salary

Salary received and due during the previous year is chargeable to tax. However, if any salary has been included in the total income for any previous year on the basis of receipt it shall not be included again on the total income when it becomes due. Similarly, when any salary due (arrear) is not included in the total income it shall be included in the total income when it is received. The advance salary is included in the total income but not a loan taken by an employee from the employer.

Salary due means what is legally due or where a legally enforceable right has vested in the employee against the employer.

2. Income From House Property

The buildings include residential buildings let out for business or profession or for storage or warehouse or auditoriums for entertainment programmes. Cinema Halls, building let out for office, dance halls, music halls etc. But it does not include temporary hutments in the vacant land & any rental income there from will be assessed under the head "Income from other Sources". The location of building is immaterial. It may be located in India or abroad. If a company is incorporated with the object of promoting & developing a building for market place, the income of the company is not assessable under the head "Income from Business & Profession" but it is assessable under the head "Income from House Property". In case, the business carried on by the assessee has been stopped & the business premises have been based out the rental income is assessable as income from property.

3. Profit & Gains of Business or Profession Business [Sec.2(13)]

Business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. For practical purposes, business means the purchase and sale or manufacture of a commodity with a view to make profit. Business includes banking, transport business or any other adventure. In this connection it is not necessary that there should be a series of transactions in a business and that it should be carried on permanently. Neither repetition nor continuity of similar transactions is necessary. Profit of an isolated transaction is also taxable under this head provided that it is a venture in the nature of business or trade. A transaction may be a single one and in that sense isolated but it must comprise some activity in the nature of operations, which are ordinarily followed in respect of trade. In this connection intention of purchase is very important. One may purchase an article for one's own use and without any intention to sell it and the mere fact that he subsequently sells it at a profit will not make the transaction of purchase and sale an adventure in the nature of trade. If, however, at the date of the purchase and sale an adventure in the nature of trade. If,

Notes

however, at the date of the purchase the object of the purchase was not to bring the article in his own use but to sell it at a profit, there can hardly be any doubt that in that case the transaction would be a venture in nature of trade. Where a persons purchased, land and resold as building sites after plotting out within two years of purchase, it was held that the transaction was in the nature of trade and assessable as business income.

Profession includes vocation [Sec.2(36)]

Profession means those activities for earning livelihood which require intellectual skill or manual skill, e.g., the work of a lawyer, doctor, auditor, engineer and so on, are in the nature of profession. Vocation means activities which are performed in order to earn livelihood, e.g., brokerage, Insurance agency, music, dancing, etc. As the rules for the assessment of business, profession or vocation are the same, there is no importance of making any distinction between them from the income tax point of view.

4. Income from Capital Gains

Any profits & gains arising from the transfer of a capital assets effected in the previous year shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place.

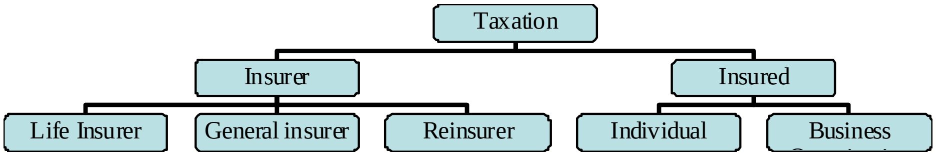
5. Income from other resources

This is a residuary head of income and all such income profits & gains which are not chargeable to income tax under any of the first four heads.

6.5.3 Taxation Provisions for Insurers, Insured

Like every commercial contract, there are two or more persons are involved in the insurance contracts. The persons involved in these contracts are called Insurer (The seller) and the Insured (Buyer). As the obligations are of these persons are different, therefore the provisions of income tax are also different which are explained as under:—

The Tax provisions in the Insurance sector can be discussed under the following heads:



Notes

1. Insurer

a) Life Insurer:

As per the Insurance Act 1938 amended up to date in India, only companies registered under Indian Companies Act 1956 can start the Insurance business. As the companies are also conducting the commercial transaction business therefore these should also be considered at par with the other commercial organization under the head "Income from Business and Profession" but Income Tax Act considers Life insurer differently because the income generated by them is from contribution made by the general public for the risk coverage and saving. If the same is taxed at the rate applicable then it is taxed on the saving of an individual.

Hence section 44 (A) of the Act deals the taxation provisions related to life insurer and explained as under:

If the person who carries on or at any time in the previous year carried on life insurance business the profit & gains of such person from that business shall be computed separately from his profit and gains from any other business and further adjusted the surplus or deficit by the Actuarial valuation.

The Actuarial valuation means the liability of the life insurance company to be paid to the policyholders either on death or on maturity including bonus.

For eg: If a Life Insurance Company has earned Rs. 10 crores from life insurance and other activities then the profit say Rs. 3 crores from other activities and actuarial liability say Rs. 5 crores then the income form business will be as follows:—

	Rs. in crores
Total Income of Life Insurance Company	10.00
Less income form other activities	3.00
Income of life insurance business	7.00
Less Actuarial valuation	5.00
Taxable income of Life insurance company	2.00

The life insurance company will pay tax @ 12.5% on Rs. 2.00 crores under section 115B of Income Tax Act and normal rate (30% as on date) on income from other activities

b) General Insurer and Reinsurer:

in the case of these organizations the profit and gains are computed as in the case of other organization except that the reserve for unexpired risks may be allowed. Reserve for unexpired risks means provision of claims has been made on the general insurance polices who has not expired but claim may arise in future or the next financial year. The normal income tax rate will be applicable to these two insurers.

2. Insured

a) Individual:—

The following benefits are available to an individual who invest his income in insurance:—

i) Payment of life insurance premium: The payment of premium up to Rs 1.00 lakhs can be reduced from the taxable income of an individual. Premium may be life insurance or Annuity plan.

ii) Payment of Health insurance; The payment of premium on health insurance can be reduced from the taxable income of an individual up to Rs 15000/- (Rs 20000/- if any family member is senior citizen).

b) Business Organization:—

Any business organization incurring any expenditure by way of insurance premium is allowed as expenditure. In other words the income will be reduced by the expenses incurred on insurance for Plant & Machinery, Building, stock etc. Even if the insurance premium is paid for welfare of the employees are allowable expenditure.

INTEXT QUESTIONS 6.2

1. Define Income under Income Tax Act 1961.
2. Define Previous year under Income Tax 1961.

6.6 SUMMARY

As material is insured under marine insurance and the goods

are sent through various modes of transportation like rail/road/sea/air and transporter is acting as a bailee and he is supposed to transport the goods in safe and sound condition. In case of loss he can not be made liable for the total loss and his liability will be limited under various acts.

In Income Tax Act the special consideration has been given to both life insurer and insured to popularize insurance. The income of life insurer is taxed at lower rate but the income of general insurer or Reinsurer at normal rate. The premium paid by the insured also gets the benefits by reducing his income as a result his tax liability also reduces.

6.7 TERMINAL QUESTIONS

1) How actuarial valuation is related with income tax treatment for insurer?

2) List the deduction allowed to business entity and an individual.

3) Discus the Carrier Act.

4) Write short note on

   a. The Carriage of Goods by Sea Act, 1925.

   b. The Merchant Shipping Act, 1958.

   c. Various Income heads under IT Act.

6.8 OBJECTIVE TYPE QUESTIONS

1. Under Indian Income Tax Act 1961 the Income can classified under ______heads(5/6).

2. Previous year and financial year can be same. (Correct/incorrect).

3. Income Tax Rate for life insurance business is ________ ________(12.5%/ 30%).

4. The maximum limit for health insurance premium is __________ (Rs. 15,000/-, Rs. 25,000/-).

5. Income Tax Rate for General insurance business is _______________(12.5%/ 30%).

Notes

6.9 ANSWERS TO INTEXT QUESTIONS

6.9.1

1. 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.
2. Multi-modal transportation means transportation of goods under more than one mode of transport i.e. rail, road and sea.

6.9.2

1. Any earning by way of salary, profit or loss or rental income or interest income or profit or loss on sale of any capital assets or lottery, prizes is considered as income under Income Tax Act.
2. The financial year in which the income is earned is known as the previous year.

6.10 ANSWERS TO OBJECTIVE TYPE QUESTIONS

1. 5
2. Correct
3. 12.5%
4. Rs 15,000/-
5. 30%