NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF BUSINESS AND HUMAN RESOURCES

COURSE CODE: ENT 121

COURSE TITLE: PRINCIPLES AND PRACTICE OF INSURANCE

COURSE GUIDE

ENT 121
PRINCIPLES AND PRACTICE OF INSURANCE

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Introduction

ENT 121: Principles and Practice of Insurance is a semester course work of two credits. It will be available to all students, taking the B.Sc programme in the School of Business and Human Resource Management.

The course will involve organizations, mostly the insurance industry.

The Course Guide tells you what ENT 105 is all about, the materials you will be using and how to make use of the materials to ensure adequate success it also contains assignments/questions. There will be tutorial classes but full details of these tutorial classes will be conveyed to you at the appropriate time.

What You Will Learn in this Course

The course contents consist of the nature of insurance, principles and practice of insurance and the need for the practice of insurance. Insurance companies are risk takers. They accept risks transferred to them by individuals, corporate bodies, government and their agencies/corporation.

Re-insurance companies: As individuals purchase insurance from insurance companies, insurance companies also purchase insurance from re-insurance companies.

Course Aims

The aims of this course are to further expose you to the nature and principle and practice of insurance, the contributors to these principles as well as the various approaches to insurance. Due to the importance of authority and communication in the practice of insurance the course is aimed at making you have greater appreciation of these two areas.

The aims will be achieved by:

explaining the nature of insurance identifying
the functions of insurance highlighting the
importance of insurance describing the various
approaches to insurance
explaining the major contributors to the insurance industry
defining risk and insurance, identifying the insurance market and intermediaries and their functions.

Course Objectives

By the end of the course you should be able to:

Explain the nature of insurance
List the functions of insurance
List some classification of risk
Identify the insurance market, and intermediaries and their functions
Mention major categories of general insurance business.
Name all types of life assurance contracts their uses and benefits
Explain the principle of contract as relate to insurance.
Define insurance contract and the rules applying to insurance.

Course Materials

The Course Guide
Study Units
Textbooks
The Assignment File

Study Units

There are 15 units of this course which should be studied carefully.

These units are as follows.

Module 1

Unit 1	Introduction to Insurance
Unit 2	Classes of Non-Life Insurance Business
Unit 3	Classes of Life Insurance
Unit 4	General Principles of Insurance
Unit 5	Principles of Insurance

Module 2

Unit 1	Principles of Utmost Good Cause
Unit 2	The Principle of Proximate Cause
Unit 3	The Principle of Indemnity
Unit 4	The Principle of Subrogation
Unit 5	The Principle of Contribution

Module 3

Unit 11	Insurance Documentation
Unit 12	General Principle of Underwriting and Rating
Unit 13	Renewal and Cancellation
Unit 14	Making a Claim
Unit 15	Risk Management

Each study unit will take at least two hours and it includes the introduction, objectives, main content, exercise, conclusion, summary and reference.

You are expected to study the materials, reflect on them and do the exercises. Some of the exercises will necessitate your visiting some insurance companies.

There are also textbooks, under references/further readings. They are to give you additional information. Practice the self assessment questions for additional practice and greater understanding; by so doing the stated learning objectives will be achieved.

The Assignment File

The major assignment required of you is a Tutor-Marked Assignment. (TMA) which you are expected to complete at the end of each unit and mail to your tutor.

Tutor-Marked Assignment

You are expected to apply what you have leant in the study units. The assignments which are four in number are expected to be turned into your tutor for grading. They constitute 30% of the total score.

Final Examination and Grading

At the end of the course, you will write the final examination. It will attract the remaining 70%.This makes the total final score to be 100%

Summary

ENT 121 (Principle and Practice of Insurance) exposes you further to the nature of insurance principles and the practice of insurance. On the successful completion of the course, you would have been armed with the principles necessary for efficient and effective insurance and entrepreneurial &small business management.

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MODULE 1

Unit 1 Introduction to Insurance
Unit 2 Classes of General Insurance Business
Unit 3 Classes of Life Insurance
Unit 4 General Principles of Insurance
Unit 5 Principles of Insurable Interest

UNIT 1 INTRODUCTION TO INSURANCE

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1.0 INTRODUCTION

This unit will teach the definition of risk, the classification of risk, the definition of insurance, and the market insurance intermediaries. It is important that you grasp this concept before proceeding to the next unit.

2.0 OBJECTIVES

At the end of this unit you should be able to:

- define risk and insurance
- identify the insurance market
- identify the intermediaries of the insurance market and their functions.

3.0 MAIN CONTENT

3.1 Insurance and Risk

3.1.1 What is Risk?

Risk can simply be defined as the unlooked for, unwanted event in the future. Risk is the sugar and salt of life. Risk brings sweetness and bitterness to life. Life is full of risk and any individual, organization or state can be a victim any day. In everyday life, risk comprises the steady toll of fire, accident, theft, explosion and other similar events. The list is lengthy and costly in terms of money and in terms of human pain and suffering.

3.1.2 Classification of Risk

There are several different ways of looking at risk, but we adopt the classifications based on the nature of risk and its insurability.

Pure Risks – These are risks that can result only in loss, such as a plane crash, physical loss or damage to goods by fire or theft or the incurring of legal liability to pay damages by negligently causing bodily injury to someone or damage to the property of others. Pure risks are insurable because they are capable of statistical measurement.

Speculative Risks – Speculative risks may result in either a profit or a loss, which may be either large or small. Examples of speculative risks are: change in fashion, market change, etc. These risks are uninsurable because there is no way of measuring their effect.

Political Risks – These risks are outbreak of wars, trade/currency restrictions, etc.

3.1.3 Life without Risk

Human beings cannot exist without risk. This is applicable to business since, for example, manufacturing activity cannot be stopped just because people will be injured nor can we ban motor vehicles on the road in order to stop accidents. Do we stop the use of electricity or cooking gadgets just because of fire outbreak? Clearly, these options are unreasonable. The world has to continue even in the face of risk and insurance is one of the many methods of doing this.

Therefore, various classes of insurance policies exist to take care of the various risks to which organizations, human beings and governments are subjected to in everyday life.

3.2 What is Insurance?

As a house owner or factory owner, are you ever bothered by the possibility that your house or factory and all your possessions might be burnt to ashes one night or that your car might be damaged beyond repair by another car on the road? Or are you worried that you might inadvertently hurt someone when you are driving to work or just by crossing the road carelessly? Buying insurance is one way by which you can remove some of your worries and gain peace of mind.

Insurance can therefore be defined as an arrangement by which one party (the insurer) promises to pay another party (the insured) a sum of money if something should happen which causes the insured to suffer financial loss. By so doing, the responsibility for paying for such losses is then transferred from the insured to the insurer. In return for accepting the burden of paying for losses when they occur, the insurer charges the insured a price called *premium.*

Consider the example below:

John and Samuel are both house owners. Let us assume that each house is worth two million naira. John a wise man insured his house against possible loss by fire at a premium of ₦5,000, while Samuel's house is uninsured.

The possible financial consequences for their actions are as follows:

Table 1

Insured or Not

Name	**Premium payment**	**Loss if house is destroyed by fire**	**Amount received from insurer in the event of Loss**	**Net Loss in the event of:**	
				Fire	**No Fire**
John	N5000	N2 Million	N2 Million	N5, 000	N5,000
Samuel	NILL	N2 Million	NILL	N2 Million	NILL

By insuring, John has been able to transfer the loss of N2million to his Insurer. His financial position is therefore the same, whether or not his house burns down. Whatever happens all he has to pay is a premium of ₦5,000.

Although Samuel avoids paying ₦5,000, he has to bear the full loss of any fire. Samuel is therefore ₦5,000 better off than John if there is no fire, but N1,995,000 worse off in the event of a fire outbreak.

3.3 The Insurance Market

The major players in the insurance market are:

Insurance companies
Reinsurance companies
Insurance intermediaries
Buyers of insurance products.

Insurance Companies – Insurance companies are risk takers. They accept risks transferred to them by individuals, corporate bodies, government and their agencies/corporations etc. Insurance companies are required to be registered by the National Insurance Commission. The requirements for registration are contained in the Insurance Act 2003.

Re–Insurance Companies – As individuals purchase insurance from insurance companies, insurance companies also purchase insurance from Re–insurance companies. Companies that accept insurance from insurance companies are called re–insurance companies. Re–insurance is therefore a form of insurance whereby an insurance company can transfer to another insurer all or part of its liabilities in respect of claims arising under the contracts of insurance that it writes.

3.4 Insurance Intermediaries

Like any commodity or service, insurance transaction involves intermediaries through which insurance services pass to the insuring public.

There are two main categories of insurance intermediaries. They are insurance brokers and insurance agents.

Insurance Brokers are required to be registered and professionally qualified. The requirements for registration as a broker are contained in the Insurance Act 2003.A broker is an intermediary between the insurer and the insured. The main function of a broker is to act as the agent of the insured (the person taking an insurance policy) in obtaining insurance cover for his risk and as agent of the insurer (insurance company) in collecting premium.

Insurance brokers receive brokerage (commission) from the insurance companies with whom they place business.

Insurance Agents – An agent is a person who acts on behalf of another. Insurance agents act as agents of insurance companies in obtaining businesses from potential policy holders.

The main duty of an agent is to solicit risk and collect premium on behalf of the principal (insurer). An agent receives commission and other remuneration from insurers.

Insurance agents are required to be licensed by the National Insurance Commission. The minimum requirements for licensing insurance agents are contained in the Insurance Act 2003.

There are three classes of insurance agents:

The Full–Time Agent: A full–time agent acts for only one or more insurance companies. Also, the agent might be an independent agent or an employee of an insurance company. The full–time agent devotes all his time towards the selling of insurance products. He is remunerated---in the case of an employee, by monthly allowance plus commission and in the case of an independent agent by commission only on the business produced.

The Part-Time Agent: A part–time agent does other things apart from selling insurance products. He might act for one or more insurance companies. A part–time agent earns commission only on business introduced.

The Staff Agent: The staff agent is an employee of an insurance company. He sells insurance products on behalf of only his employer. In return, he earns a commission on businesses introduced in addition to his monthly salary.

3.5 Buyers of Insurance Products

Buyers of insurance products are:

Individuals – The demand for insurance by individuals depends on their financial position. As a person’s income rises, he can afford to buy the financial security provided by insurance. A rise in a person’s income enables the person to acquire more property such as; a car, a house and household goods, which will in turn create the need for insurance protection.

Business Organizations–The demand for insurance by business buyers is a function of economic development. As an economy grows, more capital - intensive methods of production tend to be employed. This will in turn increase the demand for property insurance for the protection of property and liability insurance to compensate employees, consumers and third parties for injury or damage to property resulting from the activities of business organizations.

Charities, Clubs and other Organizations--This third group of insurance buyers tends to demand for insurance when their activities and income increases. An increase in activities increases the needs for group personal accident for the protection of their members and property insurance for the protection of their assets.

Governments and Government Agencies/Corporations Governments, Federal, State and Local councils are big time buyers of insurance products. The need for insurance by these buyers is mainly to protect governments' assets movable or immovable. In the case of agencies /corporations, the need for insurance protection is obvious due to the fact that some of their activities are hazardous. For instance, can NNPC do without insuring its assets? Can airlines afford not to insure their aircraft? The answer is definitely "no" as no aircraft can be allowed to fly in the air space of another country without insurance protection.

SELF ASSESSMENT EXERCISE

1. What is the definition of risk?
2. Give the definition of insurance.
3. What do you understand by pure risk and speculative risk?
4. Distinguish between an insurance company and a re-insurance company.

4.0 CONCLUSION

We have examined the meaning of risk, classifications of risk and how to manage our exposure to risk. Also, we went further to define insurance and we looked at the insurance market as well as buyers of insurance products.

5.0 SUMMARY

As human beings, we cannot totally avoid or eliminate risk completely from our lives. The world has to continue even in the face of mounting risks of fire outbreak and various forms of accidents. However, we can manage our exposure to risk and insurance is one of the many methods of doing this.

Risk is the unlooked for, unwanted event in the future.

Risk can be classified based on the nature of its insurability as follows:

Pure risks, which are risks that can result only in loss. They are insurable because they are capable of statistical measurement. Speculative risks may result in either a profit or a loss, for example, change in fashion and market fluctuation. They are uninsurable, while political risks are outbreak of war, trade/currency restriction etc.

Insurance is an arrangement by which one party promises to pay another party a sum of money if some thing should happen which causes the insured party to suffer financial loss. The insurance market comprises insurance companies, reinsurance companies, insurance brokers and insurance agents.
Buyers of insurance products include individuals, business organizations, charities/clubs and governments, government agencies/corporations.

6.0 TUTOR-MARKED ASSIGNMENT

1. Insurance products are distributed through intermediaries. Mention the various intermediaries in the insurance market and explain their functions.
2. Mr. Bob bought a three bed room flat for N5,000,000 and paid N11,000 to insure the flat. Mr. Bob's friend Mr. Dag bought the same type of flat in the same estate for the same amount of N5, 000,000. An insurance agent approached him to take an insurance cover for his flat as his friend did, but Mr. Dag refused. Three months later, there was an outbreak of fire and Mr. Dag's flat was destroyed. Explain the financial consequences of Mr. Bob and Mr. Dag's action. Illustrate this with a table.

7.0 REFERENCES/FURTHER READINGS

Assa, S. O. *The Business of Insurance Broking in Print*.

Diacon, G.C.O. & Steele, J. T. (1981). *Introduction to Insurance*. London: (C II,).No. 010

UNIT 2 CLASSES OF GENERAL INSURANCE BUSINESS

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1.0 INTRODUCTION

Most people and most organizations, in every kind of society need some sort of insurance cover. The only exceptions are people without property and dependents. Everyone else has possessions or potential liabilities that need to be protected. Insurance contract represents only one way in which people can guard against misfortune. For example, most primitive societies have developed systems of mutual aid or help so that if one member suffers a financial setback the others club together in order to repair the damage. Such mutual aid probably cannot work unless all members are exposed to roughly the same risks, and will be unfair if some members have a potential for greater and more frequent losses than others. Modern insurance represents a more equitable system.

Insurance developed when primitive societies found themselves unable to support trade and manufacturing activities because of the significantly increased size and/or frequency of losses involved. Marine insurance was developed by the great sea-faring traders, the Phoenicians, around 3000 years ago. The earliest record of an insurance policy relates to a Mediterranean voyage in 1347 A.D. Many of the other types of commercial property insurance date back to the Industrial Revolution, with its growth and of many fracturing enterprises using comparatively expensive buildings and machinery and employing mass-production techniques. Private property insurance did not appear in England until after the Great Fire of London, which in 1666 destroyed a large proportion of London’s buildings.

Nowadays, a wide variety of insurance contracts is available. In Nigeria, the Insurance Act of 2003 classifies insurance business into two main classes of insurance – life insurance and general insurance business.

2.0 OBJECTIVES

At the end of this unit you should be able to:

- mention major categories of general insurance business their scope of cover, their uses and exclusions
- discuss their distinguishing features.

3.0 MAIN CONTENT

3.1 General Insurance Business

Insurance Act, 2003 categorizes general insurance business into 8 groups:

a) Fire insurance business
b) General accident insurance business
c) Motor vehicle insurance business
d) Marine and aviation insurance business
e) Oil and gas insurance business
f) Engineering insurance business
g) Bonds credit guarantee and suretyship insurance business
h) Miscellaneous insurance business.

However, in this unit, we shall be looking at the common classes of general insurance business.

3.1.1 Motor Vehicle Insurance

The first motor car appeared in the United Kingdom in 1894 and by 1898 the Law Accident and Insurance Society Ltd. was providing a limited motor insurance cover. But then, motor insurance was not compulsory and the uncompensated victims of motor accidents suffered much hardship. However, the increased popularity and mass-production of cars after the First World War increased casualty figures and the

Road Traffic Act 1930 in Britain introduced compulsory motor insurance covering liabilities to killed or injured third parties. Nigeria being colonized by the Britain enacted the same Act and it was known as the Motor Insurance (Third Party) Act 1945. Similar compulsory insurance requirements were also introduced in other countries, many of which require damage to third parties' property to be covered as well. In Nigeria, it is only recently through the Insurance Act 2003 that third parties' property damage was made compulsory

The conditions of the Road Traffic Acts apply to all vehicles used on the road including private cars, commercial vehicles, motor cycles and certain "special types" i.e., mobile cranes, fork-lifts, trucks and bull dozers.

Scope of Cover

There are four types of cover in motor insurance:

i. Road Traffic Act Cover

This provides insurance cover for injury or death of third parties (including passengers) arising from the use of a vehicle on the road, but not for damage to their property. It is an offence to use or to permit the use of a motor vehicle on the road unless such cover is in force. There are those who are exempted from the compulsory insurance requirements:

a) Where the owner of the vehicle deposits and keeps deposited a specified amount with the Accountant General of the Supreme Court.
b) Where the vehicle is owned and is driven under the control of a local authority, the police or the armed forces.

In fact the Road Traffic Act cover is no longer issued by insurers in Nigeria because it is not relevant.

ii. Third Party Cover

This provides protection against liabilities to third parties for injury or death and for property damage. It also covers legal costs. In Nigeria the Insurance Act 2003 has made this cover compulsory with a third party damage limit of N1,000,000.

iii. Third Party, Fire and Theft Cover

This covers liabilities to third parties as under third party cover plus damage or loss to the policyholder's own vehicle from fire or theft.

iv. Comprehensive Cover

The comprehensive covers accidental loss or damage to the policyholder's own vehicle in addition to the cover provided by the Third Party, Fire and Theft policy.

3.1.2 Fire and Special Perils Insurance

The devastating effect which a fire can have on a business premises or private building is common knowledge and the necessity for insurance coverage is evident.

As a result, the Insurance Act 2003 makes it compulsory to insure public buildings. Section 65(1), provides that "Every public building shall be insured against hazards of collapse, fire, earthquake, storm and flood". Section 65(2) defines "public buildings" to include "tenement house, hostel, a building occupied by tenants, lodgers, or licensee and any building to which members of the public have ingress and aggress for the purpose of obtaining education or medical services, or for recreation or transacting of business". The nature of the legal liabilities of an owner or occupier of premises is in respect of loss of or suffered by any user of the premises and third parties.

The actual risk of fire occurring on a building varies from building to building, depending on the following factors:

1. The construction materials used in the building
2. The usage of the building
3. The type of materials stored in the building
4. The fire-fighting appliance installed in the building
5. The standard of house keeping etc.

Fire loss or damage is a waste to the economy and the need to restore the loss with minimal delay underscores the need to have fire insurance protection.

The object for fire insurance is to reinstate or replace property damaged or destroyed or to compensate an insured person for such damages so that he is placed in the same financial position after a loss as he occupied immediately before the loss.

Scope of Fire and Special Perils Insurance_

The standard Fire Insurance Policy covers three major perils:

a) Fire (whether resulting from explosion or otherwise) but not occasioned by or happening through:

i. Its own spontaneous fermentation or heating or its undergoing any process involving the application of heat;
ii. Earthquake, subterranean fire, riot, civil commotion, war and kindred risks;

b) Lighting;
c) Explosion not occasioned by or happening through any of the perils specified in (ii) above;

Explosion of boilers used for domestic purposes only;

Explosion in a building not being part of any gas work , of gas used for domestic purposes or used for lighting or heating the building.

Also, the following known as special perils may be added on payment of additional premium, hence the name, Fire and Special Perils:

1. Perils of a chemical nature – explosion, spontaneous combustion;

2. Social (or, more correctly, anti-social) perils – riot, civil commotion, strikers, taking part in labour disturbance or malicious persons acting on behalf of or in connection with any political organization and malicious damage (unconnected with political organization);

3. Perils of nature – storm and tempest, flood, tornado, earthquake, subterranean fire, subsidence

4. Mechanical (or miscellaneous) perils – aircraft or other aerial devices or articles dropped thereof. Busting or overflowing of water tanks, pipes or apparatus. Impact by road vehicles, horses or cattle sprinkler leakage.

Incidental Fire Losses

Sometimes, property is not burned but loss regarded as a fire loss is sustained as a direct consequence of a fire in the following circumstances:

Property damaged by water or other extinguishing agents used for extinguishing purposes;

Damage done by the Fire Brigade in execution of its duties e.g. in gaining access to a fire;

Property blown up to prevent a fire from spreading;

Damage caused by falling walls or parts of a building in which a fire takes place;

Damage by smoke and scorching;

Loss or damage to property removed from a burning building caused by rain, theft or damage during removal provided that the articles are justifiably removal mitigate a loss.

Fire insurance could be effected on the following assets:

1. Building and contents
2. Office, furniture, fixtures and fittings;
3. Plant, machinery, equipment and spare parts;
4. Trade including raw materials, work-in-progress and finished goods etc.

3.1.3 Burglary Insurance

In insurance, burglary or theft is defined as theft involving entry to or exit from the premises by forcible and violent means. This does not include entry to the premises by a key, by a trick or by hiding in the premises whilst open for business (unless the thief subsequently makes his exist by forcible and violet means).

The intention of insurers in a burglary policy is to cover theft of property resulting from the breaking down of the premises.

The object of a Burglary Insurance Policy is to reimburse an insured for losses and damages sustained through burglary and theft.

The word “theft” is usually used for business premises while burglary and house breaking are used for private dwelling houses though all these words virtually have the same meaning.

The bases of Burglary Insurance are:

Fill Value Basis – Under this basis the sum insured on each item is equal to its exact value at risk. In the event of loss, if the sum insured is less than the value at risk, what is known as “Average” will be applied. This means that the insured will bear a ratable proportion of the loss in the event of under-insurance.

First Loss Policy –Under the first loss policy basis the sum insured is deliberately limited to a sum lower than the full value of the property with the insurer’s consent. Losses up to this are normally paid without application of Average in the normal way. It is usually taken by an insured who feels that the loss he may suffer cannot be more than a percentage of the value at risk.

In assessing this type of risk the following factors will be taken into consideration:

> Location of the premises containing the goods – For example a building on Victoria Island (an exclusive area in Lagos, preferred by the elite) is adjusted to be better risk than one in Ajegunle or Mushin or Amukoko (areas also in Lagos, regarded as slums by many people).
>
> Security – The type of security systems employed within and around the building is an important factor.
>
> Nature of goods stored – The degree of attractiveness of the goods stored matters. For example, jewelry and electronics are more susceptible to theft than items such as deep freezers, furniture etc.

3.1.4 Money Insurance

In insurance, the definition of “money” is much wider than most people expected and includes such things as “cash, currency notes, bank notes, bonds, bills of exchange, stamps (not forming part of a stamp collection, trading stamps, luncheon vouchers etc.) in other words, items whose negotiability gives them as currency.

Money is property and is at risk from both fire and theft, it is particularly attractive to thieves having all the attributes that the thief likes, such as – high value, small bulk, easy to transport, easy to dispose of , difficult to trace available in both the fire and theft policies. Money is at risk anywhere and particularly so when in transit.

The scope of cover under the money policy is normally on an “all risks” basis and covers loss of money through theft, fire and other causes not specifically excluded whilst

a) In transit;
b) On the insured’s business premises and safe;
c) On bank night safe;
d) In the custody of specified employees;
e) Damage to safe.

A limit premium is imposed for any transit, and a sum insured applies to money in safe, on the insured’s premises and in custody of employees.

3.1.5 Goods-in -Transit Insurance

Goods-in-Transit is meant to compensate the insured for loss or damage sustained while his goods are in transit .The scope of cover is “ALL RISKS” of loss or damage whilst the goods are in transit on land or water anywhere in Nigeria and also whilst temporarily housed in a locked building during the course of transit.

Cover can be provided under two schemes:

a) Single Transit Basis– Where the policy terminates as soon as each transit is completed.

b) Annual Policy Basis–Under this basis the insured is provided with automatic cover for all his sending for the year. It is renewable yearly.

Under the single transit policy, the limit of carriage is the value of goods at risk and in the case of Annual policy, a limit per carriage is fixed at the inception of the policy.

3.1.6 Marine Insurance

Marine Insurance is the insurance of ships, crew, passengers and cargoes exposed to maritime perils. In the case of cargo, it includes the land transit at each and of the voyage.

People exposed to risks associated with the movement of cargo by sea or air and also those interested in the ownership and control of vessels usually take out marine cargo insurance or marine hull and Machinery insurance cover as necessary.

Insurance polices available in marine insurance are as follows:

a) Cargo Insurance

In Nigeria, Section 67(1) makes it illegal for importers to buy goods on a Cost, insurance and Freight (CIF) basis. The Act requires all imports to be insured in Nigeria Insurance Market.

What risks are insured–Perils covered are contained in the institute's clauses. The principal sets of clauses in the institute cargo clauses consist of the three clauses, the institute cargo clauses A, B and C.

i. Institute Cargo Clauses "C"

The "C" clauses are designed to provide major coverage, that is:

- Fire or explosion losses.
- Vessel or craft being stranded, grounded, sunk or capsized.
- Over turning or derailment of hand conveyance with any external object, other than water.
- Discharge of cargo at port of distress
- Jettison and general average
- General average sacrifice.

ii. Institute Cargo Clauses 'B'

The institute cargo clauses 'B' is suitable for cargo, which is not liable to minor damage, or is of low value. The goods are insured for a limited number of specified perils as listed under clauses 'C' including the following perils:

- Washing over board;
- Entry of sea, lake or river into vessel, craft, hold conveyance container, life-van or place of storage;
- Total loss of any package, lost over board, or dropped during loading or unloading;
- Loss or damage reasonably attributable to earthquake, volcanic eruption or lighting.

iii. Institute Cargo Clauses 'A'

The institute cargo clauses 'A' provides the widest form of cover of the three clauses being against "ALL RISKS" of loss of or damage to the subject matter insured, but shall in no case be deemed to extend to cover loss, damage or expenses proximately caused by or inherent vie or nature of the subject matter.

Similarly, cover is available under the institute cargo clauses (air) for goods sent by air excluding sending by post.

Duration of Cover

Under each of the types of cover stated above the insurance as provided by the respective "conditions" remains operative whilst the consignment is in transit from:

Manufacturer's or exporter's warehouse to the port of loading;
Voyage i.e. port of loading to destination port;
Destination port to warehouse of the importer.

Unless cover is agreed to be otherwise restricted in any way, in which case this must have been agreed prior to the commencement of the insurance.

Sets of conditions/clauses contained duration limit of 60days after completion of discharge over side of the goods insured from the overseas vessel (30 days in the case of air freighted cargo) at the final port of discharge, whichever shall first occur.

If after discharge of the cargo at the final port of discharge, but prior to termination of the insurance, the goods are to be forwarded to a destination other than that to which they are insured under the cover, the insurance whilst remaining subject to termination as mentioned above, shall not extend beyond the commencement of transit to such destination.

The insurance shall further remain in force during delay beyond the control of the assured, such as destination, force discharge, transshipment and during any variation of the adventure arising from the exercise of a liberty granted to ship owners or chatterers under the contract of a frightens.

Generally under the Marine Cargo Insurance, the sea worthiness of the vessel as between the assured and underwriters is admitted and in the event of loss the assured's right of recovery under the insurance shall not be prejudicial by the fact that the loss may have been attributable to the wrongful act or misconduct of the ship owners or their servants, committed without the privities of the assured.

a. General Exclusions

The following specified exclusions are contained in the three sets of clauses:

Willful misconduct of the assured
Ordinary leakage
Ordinary loss in weight or volume
Ordinary wear and tear
Improper packaging
Inherent vice or nature of the subject matter insured
Insolvency or financial default of carriers
Deliberate damage or destruction by the wrongful act of any person (clauses 'B' and 'C' only)
Use of nuclear (and similar) weapons

b. Marine Hull Insurance

Hull insurance refers to the insurance cover on vessels, fishing trawlers, motor boats and other outboard engines. Cover is usually in three parts.

Hull and machinery
Voyage risks
Protection and indemnity (P & I) cover

Cover can be extended to include the following additional risks:

Dropping off and falling overboard of outboard motor
Racing risk, trailer and transit

The insurance company usually requires detailed information about the proposal and the vessel i.e. its engine, use and body.

3.1.7 Workmen's Compensation Insurance

The workmen's compensation insurance protects employers from claims for damage brought against them by the employed for bodily injury or illness arising out of and in the course of employment. The Workmen's Compensation Act of 1987 made employers liable to pay compensation for death or injury suffered by any employee whilst at work. All employees are protected by the Act including part-time and causal workers.

The levels of compensation required by the Act are:

a) In case of injury resulting in death _ _ _ the employee's 42 months earnings;
b) Injury resulting in permanent disability _ _ _ 54 months earnings
c) Injury resulting in temporary total disability – Basic salary/wages as follows:

First 6 months - - - - - - - - - - - - 100% of basic salary
Next 3 months - - - - - - - - - - - - 50% of basic salary
Next 15 months - - - - - - - - - - - 25% of basic salary

d) Medical expenses _ _ Any reasonable expenses incurred within or (with approval) outside Nigeria.

The Act defines earning to include basic salary/wages, food, fuel overtime if regular and other special remuneration including bonus.

In Nigeria, the workmen's compensation insurance provides compensation as stated above except the overseas medical treatment expenses which can be added on payment of additional premium.

3.1.8 Fidelity Guarantee Insurance

Fidelity Guarantee or Suretyship Insurance was devised in the "who held position of responsibility" in commerce, industry or government where people were often required to name someone else who could act as their guarantor. This guarantor undertook to make good any money misappropriated through the dishonest actions of the supposedly responsible person. At that time not every honest man could find a surety, because of the obvious hazards of their provision. Consequently in 1840, the Guarantee Society was formed to provide such guarantee by means of insurance, soon to be followed in 1845 by the British Guarantee Society (of Edinburgh).

Scope of Cover

The modern Fidelity Guarantee Insurance covers an employer against the financial consequences of dishonest acts by employees involving cash or stock discovered during the discovery period. Such losses do not normally come to light until after the employee has left the organization.

Therefore, there is a discovery period allowed in the policy. This period is between 12 to 24 months. Consequently, losses discovered within the stated period after cessation of the employee's service with the organization will be met.

Substantiating Fidelity Guarantee claim requires the use of auditors, therefore, the policy extends to include auditors' cost.

Type of Cover

There are three methods of effecting the Fidelity Guarantee Policy.

1. **Name Basis** – In this case the names of the employees and the amount guaranteed for each person are stated. Premium is charged on the aggregate sum guaranteed.

2. **Position Basis** – This is where the positions or official designations are used instead of names. The premium is also charged on the aggregate sum guaranteed.
3. **Blanket Basis** – Under this method, employees are categorized into various categories or by simply stating "ALL EMPLOYEES" on the organization's payroll. The sum guaranteed per loss is fixed with another limit of guarantee of lost per year.

The premium is based on a percentage of the yearly limit with sometimes a fixed amount per person covered by the policy. Blanket basis is used where the employees' business is well established and conducted on sound lines with at least twenty staff, carefully recruited after proper enquires, remunerated mainly by wages or salary and not by commission and not frequently changed.

3.1.9 Public Liability

In any business there is always the risk that the activities of the employer or his employee will give rise to an action against the employer for damages for personal injury to third parties or for damage to third parties property. The Public Liability Insurance protects the insured against any legal liability incurred for bodily injury to third parties or damage to their property. It is available to both businesses and individuals.

3.1.10 Products Liability

Products Liability Insurance covers the insured against liabilities arising out of any injuries to third parties (or damaged to their property) caused by goods supplied, sold, tested, serviced or repaired by the insured.

3.1.11 Professional Indemnity Insurance

Professional Indemnity Insurance is intended to protect professional people, such as layers, insurance brokers, doctors, accountants, surveyors, consulting engineers or architects against any liabilities incurred as a result of their negligence, advice to clients or carelessness in carrying out their instructions.

However, for a claim to succeed under professional indemnity insurance the claimant must show that the insured failed to exercise the reasonable skill and care that could be expected from a member of his profession.

3.1.12 Engineering Insurance

Engineering Insurance originated in the middle of the 19th century during the Industrial Revolution in Britain. At that time, lack of operational control, inadequate maintenance and design errors resulted in property damage and loss of life from explosion of steam boilers. Consequently, inspection was made compulsory to encourage care and safety in the use of plant and machinery.

The first engineering insurance company developed out of an association of steam users for safety in the use of steam power. The aim was to provide boiler explosion insurance on boilers inspected and to increase profit from inspection services.

However, engineering covers have been extended to cover larger and more complex machinery and equipment.

Types of Engineering Insurance

The common types of engineering insurance policies include:

i) Contractors All Risks
ii) Erection All Risks
iii) Machinery Breakdown
iv) Boiler and Pressure Vessel
v) Electronic Equipment
vi) Plant All Risks

Contractors All Risks (CAR)

This type of insurance can be taken up for all building and civil engineering projects, such as residential and office buildings, hospitals, schools, stadiums, factories, roads/bridges, dams, tunnels, water supply systems, etc.

The purpose is to offer comprehensive and adequate financial protection against loss or damage in respect of:

a) The contract work
b) Construction plant and equipment/machinery
c) Third parties' liabilities for bodily injury or damage to property arising in connection with the execution of the contract.

Scope of Cover

The cover is an "ALL RISKS" against all sudden and unforeseen loss or damage occurring to the property during the period of insurance. Any risk not specifically excluded is covered. Common causes of losses indemnifiable are:

Fire, lighting, explosion Flood,
inundation, earthquake
Theft/burglary, bad workmanship
Lack of skill, negligence, malicious acts or human error.

The period of cover is the construction period plus the maintenance period.

Erection All Risks (EAR)

This is basically the same as CAR but with erection or installation of mechanical or electrician plants. Items usually covered under EAR are:

Generators, steam boilers, compressors, transformers and switch gas, elevators and cranes. Also included are complete production plants such as, power stations, steel works, chemical plants, paper and textile machinery, furnaces or plants producing consumer goods that are being erected. Civil engineering work necessary for the project to be erected may be included but this should not be more than 50% of the total value of the contract.

The scope of cover and period of cover are the same as in contractors "ALL RISKS" (CAR)

Machinery Breakdown Insurance

Machinery Breakdown Insurance covers plant, machinery and mechanical equipment at work, at rest or during maintenance operations. It is a material damage policy which covers accidental breakdown to mechanical, lifting and electrical machinery. It is an accident insurance on machinery.

Scope of cover

The scope of cover is against unforeseen and sudden physical loss of or damage to the insured items. Common causes for loss or damage to machinery are faulty design, human failure, short circuit and other electrical causes and shortage of water in boilers.

Boiler and Pressure Vessel (BP)

This is a combined material damage and third party liability policy that covers;

- Material damage to the insured boiler
- Surrounding property
- Liability to the public for personal injuries or property damage arising out of the explosion of the boiler.

The boiler must of necessity be satisfactorily inspected before cover can be granted.

Items usually covered under Boiler and Pressure Vessel are:

- Steam boilers, economizers, super heaters
- Steam/feed pipes, steam pressure vessels
- Air receivers, auto claves, hot water heating boilers
- Steam ovens and presses, piping and radiators.

Scope of Cover

Basically, the risks of explosion or collapse are the covers available. It is not an "ALL RISKS" policy but a name policy. It covers explosion or collapse of the insured boiler or vessel such as:

- Damage to the insured item itself
- Other property of the insured
- Damage to property belonging to third party for which the insured is liable
- Liability to third party for personal injuries.

Electronic Equipment

Electronic Equipment Insurance is a material damage "ALL RISKS" policy specifically covering all types of electronic equipment such as:

- Computer installations and data media
- Telecommunications, medical, security and process control etc.

It also includes additional cost of working for continuation of operation after loss.

Scope of Cover

It is an "accident" insurance on "ALL RISKS" basis covering losses which arise suddenly and unforeseeable, and materially affects the subject matter insured.

Plant All Risks

Plant All Risks Insurance is designed for contractors' plants and machinery on an annual basis. It covers:

- Construction equipment
- Heavy mobile plant against any loss or damage from any cause whatsoever occurring at work, at rest, during maintenance operations, in transit by road, rail or inland waterways.

Items could be moveable and non-moveable plant which may include – bulldozers, scrappers, cranes, hoists etc.

Scope of Cover

The policy covers the insured construction equipment and plant against unforeseen or accidental damage from a number of risks which include:

- Innocent operation, negligent or malicious acts of employees
- Burglary and theft
- Collision, overturning and derailment
- Forces of nature such as storm, flood, landside, earthquake and volcanic eruption.

SELF ASSESSMENT EXERCISE

1. What are the alternative forms of Motor Vehicle Insurance?
2. Motor Insurance was first made compulsory in Nigeria in what year?
3. What is covered by the Standard Fire Insurance policy?

4. Some incidental fire losses are regarded as fire loss. Mention five such losses.
5. What is full value basis and first loss policy?
6. What is the scope of cover under money insurance policy?
7. What is marine cargo insurance and Marine Hall Insurance?
8. What cover does Public Liability Insurance provide?
9. List the classes of insurance known as Engineering Insurance.

4.0 CONCLUSION

In our business activities or private activities, we are often faced with various kinds of losses, which depend on the nature of the activities. Losses usually faced by man include;

Property losses – Physical property or assets that could be changed, lost or stolen, burn, static assets, such as buildings and machinery and movable assets like vehicles, stock and ships.

Liability losses such as legal liability for incidents involving injury to third parties or damage to their property.

Personnel losses arising from the injury or death of employees.

Pecuniary losses which may result from thefts or frauds perpetrated by employees.

The various insurance covers discussed earlier are used to provide compensation for losses mentioned above.

5.0 SUMMARY

Insurance was developed to support trade and manufacturing activities. Marine insurance was developed by the great sea – faring traders. The enlisted record of an insurance policy relates to Mediterranean voyage in 1347 AD.

The industrial revolution with its growth in manufacturing enterprises created the need for property insurance while private property insurance was included by the Great Fire of London in 1666.

Common classes of insurance nowadays include:

Motor insurance – motor insurance was first made compulsory in Britain in 1930 through an Act known as Road Traffic Act 1930. A similar Act was enacted in Nigeria in 1945 and was known as Motor Insurance (third Party) Act 1945.
The scope of Motor Insurance cover includes:

Road Traffic Act. This is no longer granted in Nigeria. Third party only, Third Party Fire and Theft and Comprehensive.

Fire and Special Peril Insurance

The object of fire insurance is to compensate policy holders against any loss or damage to insured property which is caused directly by fire or lighting.

The basic fire insurance policy covers: Fire, lighting and explosion of domestic boilers, explosion of gas used for domestic purposes or used for lightning or heating the building.

Special perils are, other explosions, spontaneous combustion, storm and typhoon, flood, tornado, earthquake, subterranean fire, subsidence, aircraft or other genial devices or articles dropped there form, bursting or overflowing of water tanks, pipes or apparatus, by road vehicles, horses or cattle, sprinkler leakage riot, strikes and civil commotion.

Burglary

The object of a business policy is to compensate or reimburse an insured for losses and damages sustained through business and theft. Burglary insurance can be on "full value basis or on a "first loss" basis.

Money Insurance

Cover under money policy is normally on an "ALL RISKS" basis and refers to money:

In transit
With the insured's business bankers
In safe and
In the custody of employees.

The object is to pay compensation to the insured for losses not excluded in the policy.

Goods-in-Transit Insurance is meant to compensate the insured for loss or damage sustained while his goods are in transit.

Marine Cargo of Hall Insurance is the insurance of ships, crew, passengers and cargoes exposed to marine perils.

Workmen's compensation insurance policy passes compensation. Resulting from building insure or illness or death of employees arising out of and in the course of employment.

Fidelity Guarantee Insurance covers employers against the financial consequences of dishonest acts by employees involving cash or stock.

Public liability Insurance compensates the insured against legal liability incurred for bodily injury to the third parties or damage to third parties' property, while product liability covers the insured against liabilities arising out of any injuries to third parties or damages to their property as a result of goods supplied, sold, tested, serviced or repaired by the insured.

Engineering Insurance includes the following:

Contractors at risks, erection all risks machinery breakdown, boiler and pressure vessels, electronic equipment and plant all risks insurance.

6.0 TUTOR-MARKED ASSIGNMENT

1. What is Special Perils Insurance? List five such perils.
2. Briefly outline the cover provided by the following:

(a) Comprehensive Motor Insurance
(b) Plant All Risks Insurance
(c) Goods-in-Transit Insurance

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UNIT 3 CLASSES OF LIFE INSURANCE

CONTENTS

1.0 Introduction
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1.0 INTRODUCTION

Until recently, the term “assurance” was used when referring to the life sector of insurance. The terms “life insurance” and “life insured” are now commonly used.
Life insurance or **life assurance** is a contract between the policy owner and the insurer, where the insurer agrees to pay a sum of money upon the occurrence of the insured's death. In return, the policy owner (or policy payor) agrees to pay a stipulated amount called a premium at regular intervals.

As with most insurance polices, life assurance is a contract between the *insurer* and the *policy owner (policyholder)* whereby a benefit is paid to the designated beneficiary (or beneficiaries) if an *insured event* occurs which is *covered* by the policy. To be a life policy the *insured event* must be based upon life (or lives) of the people named in the policy.
Insured events that may be covered include:

a) death,
b) diagnosis of a terminal illness
c) diagnosis of a critical illness
d) disability due to ill health
e) permanent disability
f) accidental death
g) requirement for long term care

There are four basic life assurance contracts. These are stated and explained below.

2.0 OBJECTIVE

At the end of this unit you should be able to name all types of life assurance contracts, their uses and benefits.

3.0 MAIN CONTENT

3.1 Types of Contracts in Life Assurance

3.1.1 Term Assurance

In this type of contract, a fixed term of years is decided upon at the outset. The benefit i.e. sum assured is only payable if death should occur during the chosen term. Nothing is payable if the life assured survives to the end of the term. The premiums for this contract are low because the majority of term assurance contracts do not result in payment.

Uses – Term Assurance policies are used to cover period in a person's life when the consequences of an early death would be particularly serves, for example:

When a young family is growing up
When a house mortgage or other loan is being repaid.
When an income for dependents may be required.

These requirements give rise to variations in the basics for assurance contract; for example, when a loan or mortgage is being repaid a "decreasing term assurance" may be used. In decreasing term assurance, the sum assured payable decreases each year so that it is equal to the amount of loan outstanding at any given time during the term.

Also, a decreasing term assurance may be used when an income is required on the death of a breadwinner.

SELF ASSESSMENT EXERCISE 1

Explain term assurance in an assurance policy.

3.1.2 Whole Life Assurance

There are several types of whole life insurance policies. The six traditional forms: non-participating (aka "non par"), participating, indeterminate premium, economic, limited pay, and single premium. It should be noted that there are as many types of insurance policies as can be written in their contracts while staying within the law's guidelines.

1. Non-Participating Policy

Under this policy, all values related to the policy (death benefits, cash surrender values, premiums) are usually determined at policy issue, for the life of the contract, and usually cannot be altered after issue.

This means that the insurance company assumes all risk of future performance versus the actuaries' estimates. If future claims are underestimated, the insurance company makes up the difference. On the other hand, if the actuaries' estimates on future death claims are high, the insurance company will retain the difference.

2. Participating Policy

In a participating policy (also *par* in the, and known as a *with-profits policy)*, the insurance company shares the excess profits (variously called *dividends* or *refunds* or *bonus*) with the policyholder. In this policy, the greater the success of the company's performance, the greater the dividend. For a mutual life insurance company, participation also implies a degree of ownership of the mutuality.

3. Indeterminate Premium

It is similar to the non-participating policy, except that the premium may vary year to year. However, the premium will never exceed the maximum premium guaranteed in the policy.

4. Economic Policy

It is a blending of participating and term life insurance, wherein a portion of the dividends is used to purchase additional term insurance. This can generally yield a higher death benefit, at a cost to long term cash value. In some policy years the dividends may be below projections, causing the death benefit in those years to decrease.

5. Limited Pay

It is similar to a participating policy, but instead of paying annual premiums for life, they are only due for a certain number of years, such as 20. The policy may also be set up to be fully paid up at a certain age, such as 65 or 80. The policy itself continues for the life of the insured. These policies would typically cost more up front, since the insurance company needs to build up sufficient cash value within the policy during the payment years to fund the policy for the remainder of the insured's life.

6. Single Premium

It is a form of limited pay, where the pay period is a single large payment up front. These policies typically have fees during early policy years should the policyholder cash it in.

7. Interest Sensitive

This type is fairly new, and is also known as either *excess interest* or *current assumption* whole life. The policies are a mixture of traditional whole life and universal life. Instead of using dividends to augment guaranteed cash value accumulation, the interest on the policy's cash value varies with current market conditions. Like whole life, death benefit remains constant for life. Like universal life, the premium payment might vary, but not above the maximum premium guaranteed within the policy.

In a whole life assurance contract, there is no fixed term. Premiums are paid up to the date of death, when the sum assured becomes payable. The premiums charged are higher than for term assurance because claims would definitely be made on the policy.

Whole life assurance is used as a means of obtaining relatively inexpensive cover and to cover the event of early death over lengthy periods.

SELF ASSESSMENT EXERCISE 2

Identify and explain the various types of whole life assurance policy.

3.1.3 Endowment Assurance

An **endowment policy** is a life assurance contract designed to pay a lump sum after a specified term (on its “maturity”) or on earlier death. Typical maturities are ten, fifteen or twenty years up to a certain age limit. Some policies also pay out in the case of critical illness.

Endowment assurance has a fixed term of years decided upon at the outset. The benefit under the policy is payable either on death during the chosen term or at the end of the term if the life assured survives until then.

Endowments can be cashed in early (or “surrendered”) and the holder then receives the surrender value which is determined by the insurance company depending on how long the policy has been running and how much has been paid in to it. During adverse investment conditions, the encashment value or surrender value may be reduced by a “Market Value Adjuster” to allow for the need to cash in units at a time when investment conditions are not ideal. This means that the investor would receive the surrender value less the market value adjuster.

Various types of endowment policy are as outlined and explained below:

1. Traditional With Profits Endowments

There is an amount guaranteed to be paid out called the **sum assured** and this can be increased on the basis of investment performance through the addition of periodic (for example annual) bonuses. Regular bonuses (sometimes referred to as **reversionary bonuses**) are guaranteed at maturity and a further non-guaranteed bonus may be paid at the end known as a **terminal bonus**

2. Unit-linked Endowment

Unit-linked endowments are investments where the premium is invested in units of a unitized insurance fund. Units are encashed to cover the cost of the life assurance. Policyholders can often choose which funds their premiums are invested in and in what proportion. Unit prices are published on a regular basis and the encashment value of the policy is the current value of the units. This is the simplest definition.

3. Full Endowments

A full endowment is a with-profits endowment where the basic sum assured is equal to the death benefit at start of policy and, assuming growth the final payout would be much higher than the sum assured

4. Low Cost Endowment (LCE)

A low cost endowment is a combination of an endowment where an estimated future growth rate will meet a target amount and a decreasing life insurance element to ensure that the target amount will be paid out as a minimum if death occurs (or a critical illness is diagnosed if included).

The main purpose of a low cost endowment has been for endowment mortgages to pay off interest only mortgage at maturity or earlier death in favour of full endowment with the required premium would be much higher.

5. Traded Endowments

Traded endowment policies (TEPs) or second hand endowment policies (SHEPs) are traditional with-profits endowments that have been sold to a new owner part way through their term. The TEP market enables buyers (investors) to buy unwanted endowment policies for more than the surrender value offered by the insurance company. Investors will pay more than the surrender value because the policy has greater value if it is kept in force than if it is terminated early.

When a policy is sold, all beneficial rights on the policy are transferred to the new owner. The new owner takes on responsibility for future premium payments and collects the maturity value when the policy matures or the death benefit when the original life assured dies. Policyholders who sell their policies, no longer benefit from the life cover and should consider whether to take out alternative cover.

The TEP market deals exclusively with traditional with profits policies. The easiest way of determining whether an endowment policy is in this category is to check to see whether it mentions units, indicating it is a unitized with profits or unit linked policy, if bonuses are in sterling and there is no mention of units then it is probably a traditional with profits. The other types of policies - “Unit Linked” and “Unitized With Profits” have a performance factor which is dependent directly on current investment market conditions. These are not tradable as the guarantees on the policy are much lower and there is no gap between the surrender value and the market value.

6. Modified Endowments

Modified endowments were created in response to single-premium life (endowments) being used as tax shelters. They are contracts with fewer than 7-level annual premiums, and are subject to more stringent tax regulations. They are also subject to annuity rules (such as penalties for pre-death proceeds before age 59½). If a life insurance policy is changed and then fits the seven-pay rules, it may then be redefined as a modified endowment.

SELF ASSESSMENT EXERCISE 3

Identify and explain the various types of endowment assurance policy.

3.1.4 Annuities

An annuity is a financial contract written by an insurance company that provides for a series of guaranteed payments, either for a specific period of time or for the lifetime of one or more individuals. Although an annuity is essentially a life insurance product, there are important differences between the two. For example, under the terms of a life insurance policy the insurer will generally make a payment upon the death of the insured. Under the terms of an annuity, however, the insurance company makes its payments during the lifetime of the individual. In addition, unless the annuity contract specifies a beneficiary, most annuity payments cease upon the death of the recipient.

Investors purchase annuities for many reasons, the most common being the tax deferral of earnings and the guarantee of a lifelong annual income. Annuities have become much more attractive investment options for retirement savings in recent years. This has been due in large part to innovation within the industry, as providers have introduced reasonably priced products with greater flexibility, as well as a variety of investment options.

The key benefits of annuities include the following:

- Earnings grow tax-deferred until withdrawal.
- Annuity holders receive a specified amount of annual income during retirement.
- Investors are allowed to switch between investments in their annuity tax-free.
- Investors can contribute as much as they want during the accumulation phase of an annuity.

There are two basic types of annuities: Immediate and Deferred.

Immediate annuities are usually purchased at retirement age, with benefits that begin immediately (within one year of purchase).

Deferred annuities offer benefit payments that begin at some future date. Interest usually accrues on a tax-deferred basis in the interim.

Annuities are also classified as either “Qualified” or “Non-Qualified” based on the type of funds that an investor uses to purchase the annuity contract (or to contribute to it).

Qualified annuities are annuities that an investor funds with either pre-tax funds or tax-deductible contributions.

Non-qualified annuities are those contracts funded with after-tax funds.

Annuities may also be Fixed or Variable.
A fixed annuity is a personal retirement account in which the earnings are based on a fixed rate set by the insurance company. Fixed annuities are susceptible to inflation risk due to the fact that there is no adjustment provided for runaway inflation.

A variable annuity is a personal retirement account in which the investment grows tax-deferred until the investor is ready to withdraw the assets. Unlike an IRA, there are no restrictions on the amount of the annual investment. In addition, variable annuities offer the potential for greater returns and the opportunity for the investor to make his/her own decisions regarding how the assets are invested. Another important feature of the variable annuity is the family protection, or death benefit that often comes along with such contracts. This guarantees that, should the investor die during the accumulation phase of the variable annuity, the account owner's beneficiary will receive at least the amount of the investor's contributions minus withdrawals, or the current market value of the account.

An annuity is designed to provide a regular income or what is known as pension from a fixed date i.e. on retirement until the policyholder dies. Premiums are paid for a number of years before the income payments start. This is known as deterred annuity or one large single premium is paid and the income payments start immediately. This is known as immediate annuity.

The Pension Reform Act 2004 requires retirees to use part of their retirement benefit to purchase immediate annuities from any approved life assurance company. One important thing in annuities polices is that the amount of each payment is guaranteed.

4.0 CONCLUSION

We have explained classes of life insurance policy such as term assurance policy, whole life assurance, endowment assurance and annuities.

5.0 SUMMARY

Life insurance or **life assurance** is a contract between the policy owner and the insurer, where the insurer agrees to pay a sum of money upon the occurrence of the insured's death. In return, the policy owner (or policy payor) agrees to pay a stipulated amount called a premium at regular intervals.

As with most insurance polices, life assurance is a contract between the *insurer* and the *policy owner (policyholder)* whereby a benefit is paid to the designated Beneficiary (or Beneficiaries) if an *insured event* occurs which is *covered* by the policy. To be a life policy the *insured event* must be based upon life (or lives) of the people name in the policy.

Insured events that may be covered include: death, diagnosis of a terminal illness, diagnosis of a critical illness, disability due to ill health, permanent disability, accident and death, among others.

6.0 TUTOR-MARKED ASSIGNMENT

Identify and explain the various types of whole life assurance policy.

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UNIT 4 GENERAL PRINCIPLES OF INSURANCE

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  3.1.7 No Representation or Fraud
4.0 Conclusion
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1.0 INTRODUCTION

An insurance contract is an agreement between an insurance company and the individual effecting the insurance cover. Such an individual is referred to as the insured.

An insurance contract falls under the general heading of simple contracts. Hence, it is a “legally binding agreement” made between two or more parties, by which rights are acquired by one or more to act or forbearances on the part of the other parties.

Generally persons who effect insurance do it either because they are legally required to do so or they cannot accommodate the risks themselves or both.

2.0 OBJECTIVES

At the end of this unit you should be able to:

- explain the principle of contract as it relates to insurance
- define insurance contract and the rules applying to insurance.

3.0 MAIN CONTENT

3.1 The Nature of Insurance Contracts

Insurance contracts must satisfy the requirements of simple contracts.

These requirements are considered below.

3.1.1 Offer and Acceptance

An offer is a communication of the contract terms by one party to another. Acceptance refers to the letter's agreement of those terms.

In motor insurance contract, the offer is made by the proposer when he completes a proposal form. The insurer accepts by issuing a cover note. However, where an insurer, imposes additional terms then the insurer has made a counter offer which is assumed accepted by the proposer on his agreement to pay the premium based on the new terms.

3.1.2 Consideration

Consideration refers to the gain or benefit received by one party in return for a promise or the performance of an act of another. In an insurance contract, the consideration consists on the one hand of the insurer's promises to compensate the insurer for a loss, and on the other hand of the premium payment by the insured, to the insurer. The promise to make good any loss suffered by the insured is the consideration of the insurer. However, while the insured's consideration is available at the beginning of the contract that of the insurer shall be available at some future date.

3.1.3 Legal Capacity of Parties

Certain categories of persons are not qualified to enter into insurance contracts. These include persons of unsound mind and minors. Therefore contracts made by them may be set aside.

3.1.4 Consensus and Idea

This Latin expression means "in complete agreement of mind". With respect to motor insurance, for instance, this implies that both the proposer and the underwriter must be falling about the same or and for a particular scope of cover. Hence, if the proposer aims at using his vehicle for commercial purposes, the underwriter must not assume that the vehicle is to be used for private and social purposes.

3.1.5 Legality

Contracts must not be illegal, that is, they are invalid if they are forbidden by statute or are against what is called public policy.

3.1.6 No Mistakes

There must not be a mistake in making the contract. If one or both of the parties to a contract makes a mistake in the process of making the agreement, the effect of such a mistake depends on the nature of the error. A mistake may make the contract invalid where there is no agreement over the contract.

3.1.7 No Misrepresentation or Fraud

A representation is a factual statement made by one party to the other which is intended and succeeds in persuading the latter to enter into the contract. If such a statement is false it is a misrepresentation. If misrepresentation is fraudulent, the insured party can:

- Carry on with the contract; or
- He can claim damages if he has suffered a loss, and
- He can either refuse to perform the agreement or rescind the contract.

SELF ASSESSMENT EXERCISE

1. What is a contract of insurance?
2. List four of the features essential to make any contract legally enforceable
3. What is a policy document

4.0 CONCLUSION

We have explained the principles of insurance contract, the definition of insurance contract and the rules governing insurance contracts.

5.0 SUMMARY

A contract is an agreement between two or more participants which is legally binding. A legally binding agreement between the buyer (the insured) and the seller of insurance (the insurer is a contractor of insurance).

In a contract of insurance, the insurer and the insured must agree on details such as the price, the effect and nature of cover and so on. These terms are usually set out by the insurer in a document called the policy.

Consideration consists of the insurer's promising to compensate the insured for a loss and the insured paying their premium.

All parties to a contract must have legal capacities to enter into agreement and there must be an agreement of mind.
Also, the contract must not be illegal, it must have no mistakes and no misrepresentation or fraud.

6.0 TUTOR-MARKED ASSIGNMENT

1. Write short notes with examples on the following:

a) Offer and acceptance in insurance contract
b) Consideration in insurance contract.

2. Give the definition of the contract of insurance with examples.
3. "Consensus adIdem", is a Latin expression. Explain the meaning with an example.

7.0 REFERENCES/FURTHER READINGS

Green,M & Trieschmann, J.S. (1978). *Risk and Insurance* (5^{th} ed). South Western Publishing Company.

Carter, D.L. (1973). *Risk Management.* Cambridge London: The Bustunton Press.

UNIT 5 PRINCIPLES OF INSURABLE INTEREST

CONTENTS

1.0 Introduction
2.0 Objectives
30 Main Content
 3.1 Insurable Interest
  3.1.1 Definition
  3.1.2 Subject Matter of the Insurance
  3.1.3 Timing of Insurable Interest
  3.1.4 Examples of Insurable Interest
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

The practice of insurance is guided by six basic principles in addition to the basic contractual requirements discussed in Unit 4.

These basic principles i.e. insurable interest, utmost good faith, proximate cause, indemnity, subrogation and contribution were established and later many of them have been upheld by the courts with the strength of the law behind them, these principles have now become the foundation stones of modern insurance practice .

A person cannot gain an understanding of the practice of insurance without first understanding these basic principles or doctrines.

Therefore, starting from this unit, we shall deal with the principles of insurable interest, utmost good faith, proximate cause, indemnity, subrogation and contribution.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain in detail what insurable interest is
- give examples of insurable interest
- give the timing of insurable interest.

3.0 MAIN CONTENT

3.1 Insurable Interest

The term "Insurable Interest" refers to financial or pecuniary involvement capable of being insured. Hence it eliminates emotional attachment to property. Therefore the owner of a motor car may wish to decorate and fancy it as much as he does his home, but in practical business setting the car should be valued no more than its market value.

3.1.1 Insurable Interest Defined

Insurable interest can be simply defined as the legal right to insure arising out of a financial relationship, recognized at law between the insured and the subject matter of insurance.

A contract of insurance is only valid in law if the insured has an insurable interest, that is, if he or she has a legally recognized financial relationship with the subject matter of the insurance and stands to lose out if that subject matter is damaged.

There are three keys in the definition of insurable interest:

i. A legal relationship: The insurable must be recognized in law and must be based on same legal relationship.

ii. Financial loss: The insured must suffer financially if the property, liability or event involved is damaged from the occurrence of the insured event.

iii. There must be some property, rights, interest, life, limb or potential liability capable of being insured and must be the subject matter of insurance.

3.1.2 Subject Matter of the Insurance

The subject matter of insurance can be any form of property or an event that may result in a loss of a legal right or creation of a legal liability. For example, under a fire and special perils policy. The subject matter can be buildings, machinery/plants, office furniture/fittings and stock-in-trade.

Under a public, it is the insured's legal liability for injuring or damage to property. For life assurance policy, it is the life being assured. In the case of marine insurance it can be the ship, the cargo or the ship owner's legal liability to third parties for injury or damages.

3.1.3 Timing of Insurable Interest

In some types of insurance, insurable interest must exist at the time of purchase of the policy and in others insurable interest need not exist but must exist at the time of loss.

The position is summarized below:

Table 5.1: The Need for an Insurable Interest to Exist

Type of Insurance	At Date of Purchase	At Date of Loss
Life	Yes	No
Land	Yes	Yes
Marine	No	Yes
Other(except goods)	Yes	Yes
Other (goods)	No	Yes

The Marine Insurance Act 1906 Section6 states that the assured must be interested in the subject matter insured at the time of the loss though he need not be interested when the insurance is effected. This follows the customs of maritime trading because cargo may change ownership while in transit.

In life Assurance, insurable interest is required at the inception. The case of Dalby V. The India and London Life Assurance Company (1854) set down the principle that the need only be valued at inception and as there is no requirement for insurable interest at the time of claim.

For other insurances because they are contract of indemnity require the insured to have suffered a loss before there is liability, insurable interest must exist at the time of loss.

The Gaming Act 1845 requires insurable interest at inception, since contracts without it would be wagers. Before this Act, it had been held in property contract that there had to be insurable interest at inception (Sadler's Co. V. Badcock (1743)).

3.1.4 Examples of Insurable Interest

It is not only sufficient for you to be able to define the principle of insurable interest but you must be able to understand its application to the everyday transaction of insurance. Therefore, we will look at the application of the principles of insurable interest to three of the more common forms of insurance i.e. life assurance, property and liability insurances.

i. Life Assurance

There is unlimited insurable interest in one's own life and as such one can effect a policy for any sum assured. However, the cost of policy limits a person's ability to insure his or her own life. Also, spouses have an interest in each other's lives. In this way wives can affect policies on the lives of their husbands and vice versa.

A blood relationship does not automatically provide an insurable interest except in certain limited cases of industrial life insurance not so common nowadays.

A creditor has insurable interest on the life of a debtor but only to the extent of the indebtedness. A surety on the life of his principal, in case the latter should die and leave him liable for his debts.

Partners can insure each other's lives up to the limit of the loss that they would incur if any of them should die.

ii. Non-Life Insurance

The existence of insurance interest is less difficult to demonstrate on non-life insurances, because it normally arises either out of ownership is. property insurance or out of legal liabilities incurred to third parties.

In liability insurance, there is an unlimited insurable interest against potential liability damages to third parties. The interests are determined by precedent and by the courts and no maximum value can be placed on them.

In property insurances, the insured has an insurable interest only to the extent of his legally enforceable financial interest. It has been established in law that the following are allowable interests:

(a) An owner has an interest to the full extent of his ownership. Husbands and wives have a full insurable interest in each other's property.

A part or joint owner has an interest in the full value of the property, not just up to the extent of his ownership.

(b) Executors and trustees have an interest in the property for which they have a legal responsibility.

(c) A bailer can insure up to the value of the goods he holds.
(d) A mortgagee has an interest to the extent of his loan.

SELF ASSESSMENT EXERCISE

1. What is insurable interest?
2. What is the subject matter of the insurance?
3. When does insurable interest exist in life Assurance?
4. When does insurable interest exist in Marine insurance?

4.0 CONCLUSION

Insurable interest is the first principle of insurance. The contract of insurance is only valid when there is an insurable interest. It is therefore necessary for you to understand this principle before proceeding to the other principles.

5.0 SUMMARY

Insurable interest is the legal right to insure out of a financial relationship recognized at law between the insured and the subject matter of insurance. The subject matter of insurance can be property or an event which might result in a loss of a legal right or the creation of a legal liability.

In some classes of insurance, insurable interest must exist at the time of purchase of the insurance and in others insurable interest is not necessary at the inception but must exist at the time of loss.

In Life Assurance, a person has unlimited insurable interest in his or her life. Husband and wife also have insurable interest on each other's life.

In Non-Life Insurance, an owner of a property has insurable interest in that property up to the extent of his legally enforceable financial interest. Also, husbands and wives have a full insurable interest in each other's property.

6.0 TUTOR-MARKED ASSIGNMENT

1. A contract of insurance is only valid in law if the insured has an insurable interest. Give examples of how insurable interest can arise in life assurance, in property insurance and liability insurances.
2. What is the subject matter of insurance?

3. Give examples of

   a) Fire and special perils insurance
   b) Public liability insurance
   c) Marine insurance

7.0 REFERENCES/FURTHER READINGS

Steele, John T. *Elements of Insurance* 101. (C II NIGBUA) *CII Journal.*

MODULE 2

Unit 1 Principles of Utmost Good Faith
Unit 2 Principles of Proximate Cause
Unit 3 Principles of Indemnity
Unit 4 Principles of Subrogation
Unit 5 Principles of Contribution

UNIT 1 PRINCIPLES OF UTMOST GOOD FAITH

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
3.1 Utmost Good Faith
3.1.1 Definition
3.1.2 Material Fact
3.1.3 Facts that must be Disclosed
3.1.4 Facts which need not be Disclosed
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

In most commercial contracts, there is no need for the parties to disclose information not requested. The idea is that people should make the best bargain, while not actually misleading each other. The legal principle governing such contracts is called Caveat Emptor (let the buyer beware)

In common law the principle of caveat emptor is applicable to the sale of goods. Hence a car dealer is not obliged to tell a buyer that the tyres fixed to the new vehicle he wishes to buy are old ones. It is assumed that the buyer should be able to see things for himself or ask questions that will help him discover everything a reasonable person should know about the vehicle before paying for it.

However, insurance contracts do not follow the above stated principles. Insurance contracts are based on the principle of utmost good faith (*uberrimae fidei*). This is because of the peculiar nature of insurance contracts.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- graph the principle of utmost good faith as it applies to insurance contracts
- mention facts that must be disclosed and those which need not be disclosed.

3.0 MAIN CONTENT

3.1 Utmost Good Faith

The doctrine of utmost good faith means that all parties to the contract are legally obliged to disclose all material information. All facts and circumstances that would affect the other's willingness to enter into the contract must be disclosed. The proposals must disclose to insurers all those facts which are material to the risk, likewise, insurers must not withhold information which could lead a prospective insured into a less favorable contract.

3.1.1 Definition

Utmost good faith (*uberrimae fidei*) can be defined as a positive duty to voluntarily disclose, accurately and fully, all facts materials to the risk being proposed, whether asked for them or not.

3.1.2 Material Fact

The Marine Insurance Act 1906 Section 18(2) states that every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk. Insurance contracts are therefore contracts of faith and trust.

In Rozanes v. Bowen (1928), the judge said as the underwriter knows nothing and the man who comes to him to ask him to insure knows everything, it is the duty of the assured to make a full disclosure to the underwriter without being asked, of all the material circumstances.

In commercial law of contract, when there is a misrepresentation, the injured party can avoid the contract only in very specific circumstances.

Most contracts cannot be avoided on grounds that one party was not told something.

However, in insurance contracts different, insurers have the right to avoid a contract if they can prove either that there was misrepresentation of a material fact, that a material was involved; or that there was non-disclosure of a material fact.

3.1.3 Facts that must be Disclosed

Based on the definition of a material fact, a prospective policyholder must reveal anything that would affect the insurer's judgment in deciding whether or not to enter into the contract. The duty of the policyholder to disclose all material facts exists regardless of any questions expressly asked on any proposal form if one is used.

What is material varies from one insurance policy to another. Some facts are material in almost every insurance; for example:

a. Any claims or losses under previous insurance contracts
b. Any refusal of cover by another insurer, even if that cover was a different type of insurance.
c. All facts relating to the character or integrity of the insured, such as previous criminal convictions
d. Full facts relating to and descriptions of the subject matter of the insuranceThe policyholder must disclose all material facts as soon as negotiations for the contract begins and re-emerges at renewal date for those contracts subject to yearly renewal.

3.1.4 Facts which need not be Disclosed

Certain material facts need not be disclosed unless specific enquiry is made. These facts are:

a. Those which lessen the risk. For example, the installation of a sprinkler system to protect against fire
b. Those which the insurer already knows, or is deemed to know.

This applies:

i. To matters of common knowledge
ii. To knowledge of the law
iii. To incomplete information already disclosed in some way or form, into which the insurer should enquire more closely.

c. Those which are not known by the insured.

4.0 CONCLUSION

Insurance contract is based on the principle of good faith. Good faith must be observed by the proposer and insurer. All parties to the contract are legally obliged to disclose all material information. The proposer is in a better position to know everything; it is his or her duty to make a full disclosure to the underwriter without being asked of the material circumstances.

5.0 SUMMARY

Utmost good faith (*uberrima fidei*) means that all parties to the contract of insurance must disclose all material information. Material facts pertaining to the risk being proposed must be voluntarily disclosed, must be accurate and full whether asked for or not.

In insurance contract, proven non-disclosure of material facts by the policyholder can make the insurer avoid the contract.

What is material differs from insured to insured. However some facts are material in almost every kind of insurance. These facts are:

Claims and losses under previous insurance contracts
Previous criminal convictions
Facts relating to and the descriptions of the subject matter of the insurance.

Some facts need not be disclosed. These facts are:

Facts which lessen the risk
Facts of law – everybody is deemed to know the law
Facts which an insurer is deemed to know
Facts about which the insurer has been put on enquiry.

6.0 TUTOR-MARKED ASSIGNMENT

1. Compare the principle of disclosure under commercial contracts with that of insurance contracts.
2. What do you understand by the doctrine of Utmost good faith as it applies to the contract of insurance?
3. In the contract of insurance, material facts must be disclosed. Mentioned facts that must be disclosed and facts that need not be disclosed.
4. When must material facts be disclosed?

7.0 REFERENCES/FURTHER READINGS

Steele, John. T. Elements of Insurance No.101 (CIIN, NIGERIA) *CII Journal.*

UNIT 2 PRINCIPLES OF PROXIMATE CAUSE

CONTENTS

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 3.1 Proximate Cause
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  3.1.2 Train of Events
  3.1.3 Causation
  3.1.4 Examples Proximate Cause
  3.1.5 Remote Causes
  3.1.6 Concurrent Causes
  3.1.7 Nature of the Perils Relevant to Proximate Cause
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

In every insurance contract, the peril against which cover is granted is stated so that the intention of the parties is clearly known.

There are conditions in every contract of insurance. These conditions state that certain causes of loss are excluded or that certain results of an otherwise insured perils are excluded. The reasons being that the additional cover may warrant an additional premium or the peril may be the one which insurers regard as a fundamental risk which are more properly dealt with by the state. Example is war risk or nuclear explosive.

2.0 OBJECTIVES

At the end of this unit you should be ale to:

- define proximate cause
- explain the principle of proximate cause
- apply the principle of proximate cause to certain classes of insurance contracts.

3.0 MAIN CONTENT

3.1 Proximate Cause

3.1.1 Definition

Proximate cause has been defined in the case of Pahsey v. Scottish Union and National (1907) as “the active, efficient cause that set in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new and independent source’’.

The essence of this principle is to ensure that persons who insure against specific risks are compensated for those risks only. For example, a person who insures his vehicle under a third party, fire and theft cover cannot claim for damage should the vehicle be involved in an accident not related to fire. The proximate cause is neither the first cause, nor the last cause but it is the dominant cause. Causation must be understood by every man in the street and by applying common serve standards. For example, explosion is to be understood by its everyday meaning and not as a chemist might view it.

A cause is active and efficient, when it is directly linked between the cause and the result; it must be strong enough that at each stage in the train of events one can logically predict what the next event in the train of events will be, until the result under consideration takes place. If there are several causes operating, the proximate one will be the dominant or the most forceful one operating to bring about the result.

3.1.2 Train of Events

No single event takes place to cause a loss. Something causes the loss making the event to happen and somehow something else causes that cause and so on.

3.1.3 Causation

It is sometimes difficult to determine the efficient cause of a loss.

However, it is fairly obvious what the initial event and the last event were. The difficulty arising in deciding if there is a direct chain of causation between them, or whether some new force has intervened to supersede the initial cause as the event bringing about the ultimate loss.

One way of coming to a decision is to start with the first event in the chain and ask oneself what is logically likely to happen next. If the answer leads one to the second event and this process is respected until one reaches the final event, then the first event is the proximate cause of the last.

If at some stage in the process, there is no obvious connection between one link in the chain and the next, then there is a break in the chain and something else must be the cause of the loss.

Another method is to start at the loss and work backwards along the chain, asking oneself, at each stage, why did this happen? In the unbroken chain, one arrives back at the initial event.

3.1.4 Examples of Proximate Cause

Below are some real life illustrations of proximate cause:

a) A storm blew down the gable wall of a timber building; this falling wall broke electrical wiring. The broken wiring short-circuited and sparked. The sparks caused a fire in the timber building and fire brigade was called. They used water hoses to put out the fire and to cool neighbouring buildings. The water caused damage to the contents of the timber building and to the neighboring buildings.

Using either of the two methods described above, it is clear there is a direct line of causation between the storm, the collapse of the burning damage and the water damage.

b) A dropped match set fire to rage in a garage. The fire developed and overheated acetylene gas cylinders, the cylinders exploded. A wall of the garage was blown out and burning materials were blown onto a neighboring office and the office caught fire. All these losses can be traced back to the dropped match.

c) In Roth v. South Easthope Farmers' Mutual Insurance (1918) a lightning damaged a building and weakened a wall. Shortly afterwards, the wall was blown down by high winds. It was held that lightning was the proximate cause of all the damage.

d) Also, in Gaskarth v. Law Union Insurance Co. (1876), fire damaged a wall and left it weakened. Several days later a gale blew the wall down, it was decided that the fire was not the proximate cause of the wall falling down.

e) This case is similar to a recent happening in Marina, Lagos. Fire burnt down former NIDB building in Marina Lagos. Before the building could be repaired, it suddenly collapsed. The co-insurers agreed that the proximate cause of the collapse was fire and they accepted to pay the claim.

3.1.5 Remote Causes

In examples(c) and (d) the difference is that in (d) it was that the fire was the remote cause whereas we are concerned with the proximate cause.

In example (c) the wind occurred shortly after the lightning damage whereas in (d) several days passed between the fire and the storm.

In a case like this, where damage has occurred but there is no imminent likelihood of further loss, then the original cause becomes weaker as the prime cause as time goes by.

The principle is that, if time is short as in (c), the initial cause is usually held to be the proximate cause. If there is sufficient time but nothing was done as in (d), the original cause will be deemed to be too remote.

3.1.6 Concurrent Causes

In some cases, two causes which are independent of each other may occur at the same time and each contributes to the loss. For example,

a) A fire breaks out during a storm but is not caused by the storm and there is some burning damage and some wind damage.

b) Secondly, a fire could break out during a riot but independently of it. Ultimately, damage is done both by the original fire and by a fire started by rioters.

These types of situations are relatively rare.

3.1.7 Nature of the Perils Relevant to Proximate Cause

The perils relevant to an insurance claim can be classified under three headings:

a. Insured Perils

These are those named in the policy as insured e.g. fire, lightning and (qualified) explosion.

b. Excepted or Excluded Perils

These are perils stated in the policy as excluded, either as causes of insured perils e.g. riot, earthquake, war.

c. Uninsured or other Perils

These are perils not mentioned at all in the policy e.g. storm, smoke and water neither excluded nor mentioned as insured in a fire policy.

4.0 CONCLUSION

Proximate cause is the active, efficient and effective cause that sets in motion a train of events which brings about a result without the intervention of any force started and working actively from a new and independent source.

For a loss to be claimable, the cause or causes of the loss must be the proximate cause. It must not be the remote cause or excepted or excluded perils.

The essence of the principle of proximate cause is to ensure that only risks insured against are compensated for.

5.0 SUMMARY

In insurance contracts, it is necessary to specify perils which are covered and those which are not insured against.

Conditions in contract of insurance states causes of loss that are excluded or certain results of an otherwise insured perils that are excluded.

The most acceptable definition of proximate cause is that stated in the case of Passkey v. Scottish Union and National Insurance (1907) stated above.

It is not possible for one single event to cause a loss. Something usually causes the loss making the event to happen and somehow something else caused that cause and so on.

Causation of loss must be identified no matter how difficult it is. The cause must of cause not be remote to the proximate cause of loss.

6.0 TUTOR-MARKED ASSIGNMENT

1. Give the definition of proximate cause as given in the case Pawley v. Scottish Union and National (1907).
2. Give two examples of proximate cause and one example of remote cause.

7.0 REFERENCES/FURTHER READINGS

Steele, John T. Elements of Insurance 101. (CIIN, Nigeria) *CII, London Journals.*

UNIT 3 PRINCIPLES OF INDEMNITY

CONTENTS

1.0 Introduction
2.0 Objective
3.0 Main Content
3.1 Definition
3.2 The Concept of Indemnity
3.3 Indemnity and Insurable Interest
3.4 Application of Indemnity
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

The principle of indemnity applies to all policies of insurance, except that of life and personal accident insurance on one's own life or that of a spouse, unless it is excluded by express conditions in the contact.

Indemnity and insurable interest are closely linked because the principle of indemnity means that the insured cannot recover any sum exceeding the extent of his or her insurable interest.

2.0 OBJECTIVE

On completion of this unit, you should be able to:

- explain the principle of indemnity and its application to the contract of insurance.

3.0 MAIN CONTENT

3.1 Definition of Indemnity

Indemnity is a mechanism by which insurers provide financial compensation in an attempt to place the insured in the same financial position after the loss as he enjoyed immediately before it: or indemnity can be defined as effect financial compensation sufficient to place the insured in the same financial position after a loss as he enjoyed immediately before it occurred.

The importance indemnity plays in insurance was emphasized in the case *Castellain V. Preston (1883)*. The judge stated that, the very foundation in his opinion, of every rule which has been applied to insurance law is this, that the contract insurance contained in marine or fire polity is a contract of indemnity and of indemnity only and that if a proposition is brought forward which is at variance with, that is to say, which either will prevent the assured from obtaining a full indemnity or which gives the assured more that a full indemnity, that proposition must certainly be wrong.

3.2 The Concept of Indemnity

The principle of indemnity lays down that following a loss, an insurer should attempt to provide financial compensation which would place the insured in the same financial position as he was immediately before the loss.

In the case of Castellain V. Preston *(1883)*, *Lord Justic Brette* said that indemnity is the controlling principle in insurance law. Due to the centrality of indemnity to insurance the opposition of insurance problems has arisen.

There are difficulties in defining the concept, how it is to be applied to the various classes of insurance and how, if at all, it is to be modified to cope with changing needs.

The problem really is deciding how much an insured is to receive when the insured against event occurs. For example, if an insured who bought a machine for ₦1,000,000 five years ago now knows that it would cost ₦1,5000,000 to replace today; how much should he receive if there is a valid claim under his insurance policy?

3.3 Indemnity and Insurance Interest

There is a link between indemnity and insurable interest. This is because the insured interest in the subject matter of insurance is what is insured. If any claims arise, the payment to be made to the insured cannot exceed the extent of his interest. However, there are some cases where the insured receive less than the value of their interest.

Just as in insurable interest, the principle of indemnity relies heavily on financial evaluation of insurance which makes determining the financial valuation difficult. For example, in life assurance and personal accident insurance there is generally unlimited interest and in these cases indemnity is not possible. It is thereby normally said that life and personal accident policies are not contract of indemnity as the value of a person's life or limb cannot be measured by money. There are exceptions to this general rule. For example, where an employer effects a personal accident policy on his staff, the medical expense in relation to the benefits of the policy is subject to the principle of indemnity, because the benefit is subject to reimbursement to the employer for any medical expenses incurred on an insured employee.

3.4 Application of the Principle of Indemnity

Although indemnity is fairly easy to define, it can be very difficult to apply in practice. This is because the application depends on the different classes of insurance or whether losses are total or partial and on the policy holder's circumstances.

As we stated, life and personal accident contracts are not contract of indemnity unless they are on a life of another basis. In liability and pecuniary insurance the measure of indemnity is the value of the court award or out-of–court settlement of pecuniary loss. The expenses of setting the claim, such as legal fees, are usually added.

In property insurance, the application of the principle of indemnity presents problems as can be seen below.

In property insurance, indemnity is provided by claim payment, reinstatement, repair and replacement. The option as to which method is to be employed is normally given to the insurers by the wording of the policy.

However, insurers sometimes agree with the insured's requests for indemnity to be provided by a specific means. While they are willing to assist the insured in this way they would not look favorably on a method which increases their costs.

a. Total Losses

Total losses occur when the subject matter of the contract is totally destroyed. The insured can recover no more and no less than its financial value of the time and place of loss.

In the event of total destruction of buildings and machinery the calculation of indemnity of second–hand value is based on the estimated repair or replacement costs with deductions for wear and tear. A deduction is also made for betterment where, because of technological advances, the modern equivalent is of better quality than the outdated item it replaces.

Where stock is totally destroyed the insurers will examine its purchase price and will add handling costs, although any marketing expenses saved through its destruction must be deducted.

In marine insurance, a total loss sometimes arises even though the ship has not been completely destroyed, for instance where the cost of recovering a ship is greater than its value. This is described as constructive total loss: the vessel is then abandoned to the insurer. The insurer treats it as if it had been totally lost and taking over ownership.

b. **Partial Losses**

Where a partial loss occurs, the insurer is entitled to recover the difference between the second–hand value of the damaged property before the loss and afterwards. This is obviously pertinent to damage to cars and machinery; once they have been damaged their second–hand value is likely to be next to nothing. In such cases, the cost of repair should be used as the basis for indemnity with the usual deductions made for wear and tear betterment.

The best way to illustrate the circumstances is by case laws.

In *Leppard V. Excess,* Mr Leppard was paid £3,000 rather than the cost of repair because there was substantial evidence that he had no intention of rebuilding the damaged cottage. If Mr. Leppard had demonstrated that he wanted to live in the cottage, however, it would have been unfair to have given him less than the cost of repair.

Another case is that of *Reynolds and Anderson V. Phoenit Assurance Co. Ltd and Others* (1978). In this case, the plaintiffs owned a massively constructed old malting which they used for storing grain; this was largely destroyed by fire. The insurers eventually paid over £30,000 for the rebuilding of the malting because Messrs Reynolds and Anderson had demonstrated a genuine need to rebuild. But if they had wisely wished to replace the warehouse facilities, their £30,000 would have been quite sufficient to buy a modern equivalent.

c. **Modification to Indemnity**

Generally the principle of indemnity applies to all non–life insurance unless modified expressly by contract conditions. There are three main instances where such conditions may be used.

i. Modified to deal with situations where no clear measure of indemnity can be agreed.

ii. Modified to allow the insured to receive more than a fair indemnity with the insurer's consent.

iii. Modified to empower the insurer, with the consent of the insured, to provide less than a full indemnity.

SELF ASSESSMENT EXERCISE

1. What is indemnity?
2. What is partial loss?
3. What is total loss?
4. What are the three modifications that can be made to the principle of indemnity?

4.0 CONCLUSION

The principle of indemnity is to allow the insured to be compensated adequately. The intention is to place the insured in the same financial position he was be immediately before the loss.

5.0 SUMMARY

Not all classes of insurance are subject to the principle of indemnity. All non–life insurance policies are subject to the principle except modified. Life assurance policies are not subject to the principle of indemnity with a few exceptions as mentioned.

Indemnity is a financial compensation provided by insurers in an attempt to place the insured in the same pecuniary position after the loss as he enjoyed immediately before the loss.

Indemnity and insurance interest are linked because the insured's interest in the subject matter of insurance is what is insured. The insured cannot claim more than the extent of his interest.

Application of the principle of indemnity depends on the different classes of insurance. It is fairly easy in liability and pecuniary insurances because the measurement of indemnity is the value of the court award or out-of-court settlement or pecuniary loss. However, in property insurance, problems arise as to how to measure damages.

Insurers have the option to make payment by cash, reinstate, repair and replace.

Indemnity might be based on total losses, partial losses and the circumstances of the policymaker. The principle might be expressly modified by the contract conditions so that the insured might receive more than a fair indemnity or less than a full indemnity with the consent of both parties.

6.0 TUTOR-MARKED ASSIGNMENT

1. Define the principle of indemnity with examples.
2. Explain how the principle of indemnity applied to a total settlement under fire insurance insuring a building, machinery and stock.
3. Discuss the link between the principles of indemnity and insurable interest.

7.0 REFERENCES/FURTHER READINGS

Steele, John T. Elements of Insurance 101. (CIIN, Nigeria) *CII, London Journals*.

UNIT 4 PRINCIPLES OF SUBROGATION

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
 3.1 Subrogation Defined
 3.2 Corollary of Indemnity
 3.3 Extent of Subrogation Rights
 3.4 How Subrogation May Arise
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 3.5 Waiver of Subrogation
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

The principle of subrogation is a coronary of the principle of indemnity. Its operation ensures that an insured receives no more than an indemnity. In practical terms, if insurers pay for a total loss any salvage or recovery shall become property of the insurer and not that of the insured.

Hence, as soon as the insurers pay fully for the loss of a motor vehicle, the insured subrogates (that is, passes over) his interest on the car to the insurers.

2.0 OBJECTIVES

On completion of this unit you should be able to:

- to identify the principles of subrogation
- discuss the extent ,the how and when of subrogation.

3.0 MAIN CONTENT

3.1 Subrogation Defined

Subrogation is the right of one person, having indemnified another under a legal obligation to do so, to stand in the place of that other party

and avail himself of all the rights and remedies of that other party whether already enforced or not.
The principle was put forward in 1882 in the case of *Burnand V. Rodocanachi* that, an insurer, having indemnified a person, was entitled to receive back from the insured anything he may receive from any other source.

The important point is that the insured is entitled to indemnity but no more than that. Subrogation allows the insurer to recoup any profit the insured might make from an insured event. It also allows them to pursue any rights or remedies which the insured may possess, always in the name of the insured, which may reduce the loss, Subrogation right does not mean that the insured cannot recover from a source in addition to his own insurers. If the insured succeeds in recovery from another source, such money is not his but is held in trust for his insurer who has already provided an indemnity.

3.2 Corollary of Indemnity

Subrogation applies only to the contract of indemnity, since life and personal accident insurances are not contracts of indemnity, that is nothing to prevent policyholders from receiving compensation from more than one source. For example, if death was caused by the negligence of another person, then the deceased’s representatives may be able to recover from that source in addition to the policy money.

In contract of indemnity, subrogation exists so that indemnity does not fail. The leading case is that of *Castellain V. Preston* (1883). Mr. Preston had contracted to sell his house, but before the sale was completed the house burned down and Preston recovered the loss from his insurers. Preston also managed to obtain the full purchase price upon completion of the sale and had therefore received the value of the house twice over. This was clearly contrary to the principle of indemnity. The insurers sued, that is, they stood in the place of Preston and were able to recover their money.

3.3 Extent of Subrogation Rights

As a result of the link between subrogation and indemnity, an insurer cannot recover more than what he had paid out. This means that insurers must not make any profit for exercising their subrogation rights.

This strengthens the link between subrogation and indemnity: insurers can only subrogate to the extent that they have provided indemnity.

However, where there is under insurance, and the insured has been considered by his own insurer for part of the risk, he is entitled to retain an amount equal to that share of the risk out of any money recovered. If the insurer makes an exgratia payment it is not indemnity and subrogation rights only arise out of the need to support the concept of indemnity.

3.4 How Subrogation May Arise

There are four ways in which subrogation may arise.

a. Subrogation in Tort

The law of tort concerns civil wrongs inflicted on legal neighbors, in areas of nuisance, negligence, trespass and defamation. Subrogation gives insurers the right to sue a third party in the name of the insured for losses he has suffered as a result of such wrongs.

b. Subrogation in Contract

Subrogation rights arise from any rights owed to the insured resulting from contracts formed with other parties. *Castellain V. Preston* illustrated subrogation rights out of a contract of house purchased.

c. Subrogation in Statute

The most common subrogation right in statute arises from the Riot (Damage) Act (1886), where insurers have a right, in their own name, to recover riot damages from the police authority.

d. Salvage

Another source of subrogation right exists where there is valuable debris remaining following a total loss. If insurers have paid a full indemnity they are entitled to salvage the debris.

3.4.1 When the Rights of Subrogation Arise

Under common law, the insurers cannot exercise their subrogation right until they have admitted the insured’s claim and paid it. However, this gives rise to some problems as the insurers would not have complete control from the date of the loss and their eventual position could be prejudiced by delay or other action on the insured’s part.

To ensure their position is not prejudiced, insurers place a condition on the policy giving themselves subrogation rights before the claim is paid.

They cannot however recover from the third party before they actually settled with the insured. This condition allows insurers to hold the third party liable pending indemnity being granted to the insured person.
In marine insurance, alteration to the common law position does not arise. The claim must be paid before the underwriters have subrogation rights.

3.5 Waiver of Subrogation Rights

Subrogation rights may be waived by an insurer if it is convenient for him to do so. This may be done to save administrative costs.

Also, in employer's liability (workmen's compensation) insurances subrogation is waived by insurers if it would involve taking action against an employee in the name of his employer.

Also, the courts can restrain an insurer from taking up subrogation rights if the rights are unjust or inequitable.

SELF ASSESSMENT EXERCISE

1. What is the definition of subrogation?
2. The principle of subrogation is corollary to that of indemnity. Discuss.
3. How can subrogation arise?
4. When does the right of subrogation arise?

4.0 CONCLUSION

Subrogation and indemnity are corollary. The two principles operate to prevent both the insured and insurer from making profit out of an insured loss.

5.0 SUMMARY

Subrogation is the right of one person to stand in the place of another and avail himself of all the rights and remedies of that other party whether already enforced or not.

Subrogation applies only to contract of indemnity. It exists so that the principle of indemnity does not fail.

Insurers can subrogate only to the extent that they have provided indemnity.

Subrogation may arise in tort, in contract in statute and by salvage.

Subrogation rights arise, in the case of common law, when insurers have admitted the insured's claim and paid it. For obvious reasons, insurers have decided to place a condition on the policy that gives them subrogation rights before the claim is paid except in marine insurance where no sum modification is allowed.

Subrogation rights may be waived by an insurer if the administrative costs of recovering from third party are too high. In the case of employer's liability insurers normally waive their subrogation rights and of course, the courts may in certain cases restrain insurers from exercising their subrogation rights.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain with examples

a. The extent of subrogation rights
b. The how of subrogation rights
c. The when of subrogation rights.

2. State the principle laid down by the case, *Castellain V. Preston* (1883).

7.0 REFERENCES/FURTHER READINGS

Steele, John T. Elements of Insurance 101. (CIIN, Nigeria). *CII, London Journals.*

UNIT 5 PRINCIPLES OF CONTRIBUTION

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  3.2 Contribution and a Common Interest
  3.3 The Timing of Contribution
  3.4 Ratable Proportion
  3.5 Avoidance of Contribution Rights
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1.0 INTRODUCTION

A person is at liberty to insure his vehicle with more than one insurance company. However, if he suffers a loss all insurers concerned will "contribute" towards the payment to put him in the position he was just prior to the loss. He will not be allowed to claim separately from each of the insurers as this may lead to his receiving more than the value of his loss.

2.0 OBJECTIVES

On completing this unit you should be able to

- identify and discuss the principle of contribution
- calculate the ratable proportion in contribution.

3.0 MAIN CONTENT

3.1 Contribution Defined

Contribution can be defined as the rights (or the exercise of the rights) of an insurer to call upon other insurers similarly (though not necessarily equally) liable to the same insured to share the cost of an indemnity payment.

The important point here is that if an insurer has paid a full indemnity, it can recoup an equitable proportion from the other insurers of the risk. However, if a full indemnity has not been paid, then the insured will wish to claim from the other(s). The principle of contribution enables the total claim to be shared in a fair manner.

3.2 Contribution and a Common Interest

For two or more insurers to contribute towards a loss, the following conditions must be present:

- There must be some common ground between them.
- The policies must be contracts of indemnity..
- The policies must cover common interests.
- The policies must cover the common perils that caused the loss
- There must be a common subject matter of insurance.
- The policies must have been taken out by or on behalf of the same insured.

Contribution can take place as long as there is some kind of overlap between policies.

There are several cases supporting the conditions stated above. Some of them are considered below.

A Common Interest

The case of *North British and Mercantile V. Liverpool, London & Globe* (1877) popularly known as (the King and Queen Grangries' Case) demonstrated that a common interest in the subject matter of insurance was necessary for contribution. The owners of a deposit of grain had a policy of fire insurance covering the grain, so too had the bailee who was responsible for it. The grain was destroyed by fire, the liability having attributed to the bailee, the bailee's insurers paid the claim, but failed to recover a contribution from the owner's insurers because the insured's interests in the grain were different one being the bailee and the other owner.

A Common Peril

The perils insured by each do not require being identical under each contract, as long as it is the common peril which caused the loss. In the case, *American Surety Co. of New York V. Wrightson* (1910) an insurance covering dishonesty of employees was held to be in contribution with one covering dishonesty of employees and burglary. The dishonesty was the common peril.

A Common Subject Matter

The common subject matter may be some form of property, but may not necessarily be so, as it was in the American Surety case stated above. Similarly it could relate to a legal liability.

3.3 The Timing of Contribution

Contribution is a common law right arising whenever the principle of indemnity operates. It can only operate after an indemnity has been paid. To modify this common law right, a "contribution condition" is included in non – marine policies to allow insurers pay their individual share of any loss. The policyholder must therefore claim against all liable insurers in order to receive a full indemnity.

In marine insurance, the common – law rights still apply.

The policyholder can confine his claim to one of insurers if he so wishes and that insurer must meet the loss to the limit of his liability and at common-law, call for contribution from the others after he has paid.

The contribution condition in most non-marine policies states that the insurer is liable only for his "ratable proportion" of the loss. That is, the insurer is liable for his share only. Therefore, the insured is left to make a claim against other insurers if he wishes to be indemnified. The condition does not make it compulsory for the insured to claim from the other policies, but in practice the insured do so.

3.4 Ratable Proportion

There are two methods of how "ratable proportion" can be calculated.

a. Proportion to the Sums Insured

$$\frac{\text{Suminsuredbyparticularinsurers}}{\text{Total sums insured by all insurers}} \times \frac{\text{Loss}}{1}$$

This is applicable to property which is not subject to average and in which the subject matter of insurance is identical.

Company A insures house building for N10,000,000
Company B insures it for N20,000,000

A loss by fire of N12,000,000 would be apportioned as follows:

Insurer A would pay $\frac{\text{N10,000,000}}{\text{N30,000,000}} \times \underline{\text{N12,000,000}} = \text{N4,000,000}$

Insurer B would pay $\frac{\text{N20,000,000}}{\text{N30,000,000}} \times \underline{\text{N12,000,000}} = \text{N8,000,000}$

Total Payment = N12,000,000

For property subject to average or where an individual loss limit applies within a sum insured, the independent liability method is used.

b. Independent Liability

Independent liability is the amount an insurer would have to pay if he was the only insurer covering the loss.

Formular = $\frac{\text{InsurerAsuminsured}}{\text{Value at Risk}} \times \frac{\text{Loss}}{1}$

Example

Insurer A insured is a property for N 2,000,000
Insurer A insured the same property for N1,000,000
The policy is subject to pro rata average. The actual value at the time of loss was N4,500,000. The loss under consideration is N450,000.

To determine what each insurer would pay if it had been the only one that had the policy in force;--- To find A's independent liability, Average is to be applied to the loss.

$\frac{\text{N2,000,000}}{\text{N450,000,000}} \times \frac{\text{N450,000}}{1} = \text{N200,000}$

Similarly, B's independent liability is

$\frac{\text{N1,000,000}}{\text{N450, 000,000}} \times \frac{\text{N450,000}}{1} = \text{N100,000}$

N300,000

The wording of the average condition makes the insured his own insurer for the amount under insurance, in this case N150,000

Insured bears $\frac{\underline{N1,500,000}}{N450,000,00} \times \frac{\underline{N450,000}}{1} = N150,000$

3.5 Avoidance of Contribution Rights

There are three main ways in which contribution rights can be waived

a. Non – Contribution Clause

Sometimes contribution right is removed by a clause in one or both of the policies as follows:

The policy shall not apply in respect of any claim where the insured is entitled to indemnity under any other insurance. This means that the policy would not contribute if there was another insurance in force. The wording may be modified by adding to the cheque given above the following; except in respect of any excess beyond the amount which would have been payable under such other insurance had this insurance not been effected.

b. More Specific Insurance Clause

Sometimes, an insured may have a policy specifically insuring a property and another policy insuring a wide range of property including the property insured in the first policy.

A non-contribution clause is usually included in the wide – range policy from contributing with the more specific policy unless such insurance is insufficient to pay the whole loss.

c. Specific Market Agreement

This is designed to prevent contribution where it is technically allowable. For example, if an employer's loss is covered under his employer's liability insurance and also under his motor insurance, the loss would be paid by the former.

In law, no contribution can take place between two policies covering different interests, but in practice this dictum is often ignored. For example, one of the rules of the Fire Officers' Committee applies contribution between insurers wherever real property is doubly insured by different people, for instance, two mortgages of the same property. This rule now protects insures from having to pay a loss twice over because of two differing interests.

SELF ASSESSMENT EXERCISE

1. What is contribution right?
2. What conditions must be present before contribution rights can apply?
3. Explain the term “ratable proportion”

4.0 CONCLUSION

Contribution is the right of an insurer to call upon other similarly liable insurers to the same insured to share the cost of an indemnity payment. In common law the insurer has right of contribution. In practice, this common law rule has been modified through policy condition or agreement.

5.0 SUMMARY

The principle of contribution supports the principle of indemnity.

Even if an insured, insures his property with more than one insurer, he cannot get more than full value.

For the principle of contribution to apply, there must be some common ground, it must be a contract of indemnity, must cover common interests and common perils.

Contribution rights can be waived by the insertion of a non-contribution clause in the policies, and by a specific market agreement.

6.0 TUTOR-MARKED ASSIGNMENT

1. What is the difference between subrogation and contribution?
2. What is the common law principle of contribution and what is obtained in practice?
3. Contribution rights are avoidable. What are the ways in which contribution rights are avoided?
4. What was the rule set out in the case known as the “King and Queen Granaries”?

7.0 REFERENCES/FURTHER READINGS

Steele, John T. Elements of Insurance 101. (CIIN, Nigeria). *CIIN, London Journals*.

MODULE 3

Unit 1 Insurance Documentation
Unit 2 General Principles of Underwriting and Rating
Unit 3 Renewal and Cancellation
Unit 4 Making a Claim
Unit 5 Risk Management

UNIT 1 INSURANCE DOCUMENTATION

CONTENTS

1.0 Introduction
2.0 Objectives
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  3.3 Cover Notes
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1.0 INTRODUCTION

If you want to buy some insurance, how do you go about it? Who do you ask? What will the insurer's seller want to know?

First of all, you need to make contact with the people who sell insurance. Next, you have to provide the insurer with enough information to enable him decide whether or not he wants to sell insurance; then you would need to complete a proposal form and the insurer will have to issue various documents setting out t the details of the contact and providing proof that a contract of insurance exists.

In this unit we will look at each stage of this process in turn.

2.0 OBJECTIVES

On completion of this unit, you should be able to:

mention the various forms of documents use in the contract of insurance

discuss them in terms of their need and importance.

3.0 MAIN CONTENT

3.1 From Proposal to Policy

If you want to buy insurance, you must contact the people who sell it. Insurance is sold to the general public in two ways: by salesmen and by intermediaries. At this stage the applicant for insurance cover is known as the proposer and on completion of all the processes a policy form is issued evidencing the proof that a contract of insurance exists.

3.2 Proposal Forms

We have noted that insurance contracts require utmost good faith from both parties. It is therefore essential that each party to the contract discloses all material facts known to him. As a matter of practice there are some general required data which the insurance company shall always be interested in. In order to ease the problem of disclosure for the prospective insured, the insurance company asks some lead questions which would help the prospective insured to remember and disclose material facts.

These lead questions prepared in the form of a questionnaire comprise the proposal form. The proposal form is therefore a document drafted by the insurance company seeking answers to the main material aspects of the risk being proposed.

a. The Need for a Proposal Form

The acceptance of a particular insurance contract is based on the insurer's clear knowledge about the circumstances of the other contracting party. Insurers use the proposal form to elicit relevant information from prospects. This serves two main purposes. Firstly, an honest prospect may not know which fact about him is material and hence may fail to disclose same.

Secondly, it is the best way an insurer can obtain information that will enable him decide whether to accept the particular risk or not.

Almost all the proposal forms contain a declaration that the proposal is the basis of the contract and that the insured warrants the truth of the answers contained therein. The proposal form therefore serves as the basis of the contract of insurance.

A secondary purpose of the proposal form is that it serves as a means of advertising the insurance company and some of its other products.

b. The Use of Proposal Forms

In some classes of insurance, insurers prefer to receive completed proposal forms for reasons already mentioned, but there are circumstances where practice or convenience demands that they are dispensed with.

In marine insurance proposal forms are not usually used, so also is in large fire insurance. In practice broker's slips are used.

In Nigeria each company has its own form for each class of business as such students are advised to obtain a selection of proposal forms form each class of business and to compare their structure and questions.

c. Common Questions

The following are common questions found in most proposal forms regardless of the class of insurance

Proposer's name – This is for the purpose of identification and the nature of physical or moral hazard.

Proposer's address is an important factor in underwriting motor insurance, theft insurance and all risks insurance. This is because different geographical areas present different chances of loss.

The proposer's address is also required for correspondence purposes.

Proposer's occupation – A proposer's occupation shows the degree of exposure. Some occupations present abnormal hazards, e.g mining, belonging to an airline crew, plastic manufacturing textile manufacturing, woodwork.

Previous and present insurance history-- Every proposer is required to disclose his previous and present insurance history whether insurers have imposed special terms or premiums, or have declined the proposer or his risk in the past.

Claims or loss history-- Insurers will wish to know previous losses, whether insured or not.

Particular questions – Apart from the general questions discussed above, there are certain bits of information which are specific to the class of insurance being proposed. Proposal forms for each class of insurance therefore have particular or specific questions relating to the hazards concerned. Examples of the type of information required are given class by class below:

(i) Fire and Special Perils Insurance

Questions as to:

a. Construction and use of buildings and their value
b. Nature and value of contents
c. Nature of processes carried on
d. Extensions of cover required.

(ii) Motor Insurance

a. Details of the vehicle
b. Use of the vehicle
c. Age, experience, claims and accidents of all regular drivers
d. Type of cover required.

(iii) Life and Personal Accident Insurance

a. Age, occupation and medical history of the life to be assured
b. Height, weight and details of hazardous pastimes

(iv) Public Liability Insurance

a. The nature of work carried on
b. Details of dangerous materials used
c. Numbers of employees and their annual wage roll at premises and elsewhere
d. Details of lifting plant and vehicles other than those licensed for road use
e. Limits of liability to be covered.

(v) Workmen's Compensation / Employer's Liability Insurance

a. Numbers and grouping of employees and their annual wageroll per group;
b. Details of dangerous machines, boilers and pressure vessels and lifting apparatus;
c. Details of dangerous substances used;

Declaration

There is usually a declaration to the effect that the proposal is the basis of the contracts, and that the proposer will accept the insurer's usual form of contract. Also, that the proposer warrants the truth of his answers.

Signature

Below the declaration and questions there are places for the proposer's signature and the date.

3.3 Cover Notes

A cover note is a temporary policy of insurance. It is issued as temporary protection, usually for a period of 30 days (in the case of motor insurance) before a permanent certificate is issued.

Cover notes are issued in the following circumstances.

As evidence that an insurance cover is in force before the policy is issued.

To enable the insurer obtain the information necessary for the preparation of the policy

To grant temporary cover until a survey is carried out.

In all the above stated cases, the initial cover could be confirmed by letter but in the case of motor insurance, booklets of cover notes preprinted are used.

Cover notes have the same legal statues as the policy as such if a loss occurs during the period the cover note is in force, the insurers are liable in the terms of their standard policy unless special terms have been agreed on and included in the cover given.

3.4 Certificates of Insurance

A certificate of insurance is required when insurance cover is compulsory by law.
In Nigeria the following classes of insurance are compulsory by law as such certificates are required to be issued as evidence of the company with the relevant status.

(i) Motor Insurance

The Motor Vehicle (Third Party) Insurance Act 1950 requires that where a vehicle is on the public highways, there must be in force a policy of insurance covering the user's liability for third party personal injuries caused by the vehicle or its use. The Act states that the policy is effective unless and until an insurance certificate in the prescribed form is delivered by the insurer to the insured.

The certificate must show:

a. the name of the policy holder
b. the registration number of the vehicle
c. the inception date of the cover of the vehicle
d. the expiry date of the cover
e. the persons or classes of persons entitled to drive
f. the limitation as to the use of the vehicle.

(ii) Marine Cargo Insurance

Section 67(1) of Insurance Act 2003 requires that insurance in respect of goods to be imported into Nigeria must be made with an insurer registered under the Act. Section 67 (3) further requires that every letter of credit or such similar document issued by any bank or other financial institution in Nigeria in respect of such goods shall be on a carriage and freight basis only.

A marine insurance certificate is therefore issued for each consignment as evidence of insurance cover in Nigeria.

3.5 Policy Forms

When a contract has been made between the proposer and the insurer, it is recorded in a document called a "policy". The policy is the evidence of a contract of insurance and in the event of a dispute occurring, it is the policy to which the court's attention will be drawn.

Each insurer has his own standard form of policy wording for each class of insurance but in Nigeria through market agreement the same wordings are used in most classes of insurance.

In Nigeria, schedule policies are used. The scheduled wordings are discussed below:

The Heading – The heading states the name and address of the insurance company.
The Recital or Preamble Clause--All policies start with this clause. It refers the parties to the contract, the proposal form and declaration as the basis of the contract and to the premium.

The Operative Clause--This clause states the extent of the cover and sets out the circumstances in which the insurance will operate.

The operative clause usually starts with the expression, "Now this policy witnesseth…" and this goes on to describe the insurer's undertaking"

Exceptions--The exceptions clause sets out the circumstances under which the insurer will not be liable under the policy. The exceptions are sometimes included immediately after the insured peril and sometimes they are contained in a separate section of the policy.

Conditions--Most policies are subject to conditions which are usually stated in the policy.

The general conditions in most policies except marine insurance include:

- Identification
- Observation
- Notification
- Precautions
- Admission
- Contribution
- Cancellation
- Arbitration

The details of these conditions are found in the policy document. You should endeavour to obtain the document and study the details.

SELF ASSESSMENT EXERCISE

1. What is a proposal form?
2. What is a cover note and certificate of insurance?
3. Define the policy form.
4. What are the details in motor insurance

4.0 CONCLUSION

Documentation in the contract of insurance is important. Some of the documents are used to obtain information from the proposer or insured while others are used as evidence of the contract of insurance either temporarily or permanently.

5.0 SUMMARY

In contract of insurance, various documents are used. The proposal form is the first document a buyer of insurance will be required to complete. The document seeks to obtain necessary information which is material to the risk being proposed.
The cover note is a temporary policy and in motor insurance; it is a temporary certificate. It is issued pending the preparation of the permanent certificate of motor insurance. The cover note has the same legal status as the policy.

The certificate of insurance is required when insurance cover is compulsory. Common classes of insurance requiring certificate of insurance include motor insurance and marine insurance.

The policy document is the evidence of a contract of insurance. It is referred to when there is a dispute. In Nigeria schedule types of policies are used. The wordings for each class of policy are the same by market agreement. The policy document contains the heading, recital or preamble clause, operative clause, conditions and endorsements.

6.0 TUTOR-MARKED ASSISGNMENT

1. What is a certificate of insurance and which classes of insurance does the certificate issue?
2. The proposal form is used to obtain information from a proposer. What are the common questions found in most proposal forms?
3. What is the importance of a proposal form?
4. Schedule policies are used in Nigeria. What are the common wordings of a schedule policy?

7.0 REFERENCES/FURTHER READINGS

Steele, John T. Element of Insurance 101 (CIIN Nigeria). *CII London Journals.*

NFI Insurance Motor Insurance Policy Document and Motor Insurance Proposal Form.

UNIT 2 GENERAL PRINCIPLES OF UNDERWRITING AND RATING

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
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 3.2 The Role of the Underwriter
 3.3 Underwriting Fire Insurance
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1.0 INTRODUCTION

In the preceding unit we discussed the various documents that are used in the contract of insurance. In particular, we said anybody who wants to buy insurance would have to complete a proposal form. The person who assessed the details in the proposal form is called an underwriter and the process is known as underwriting.

2.0 OBJECTIVES

On completion of this unit you should be able to:

- explain the meaning of underwriting
- identify and explain the factors that are considered in underwriting some classes of insurance.

3.0 MAIN CONTENT

3.1 Underwriting Defined

This is the processes by which an insurer evaluates the risk being proposed to decide whether or not to accept it and if so on what terms. A person that plays this role is known as an underwriter.

The underwriter decides the charges, the terms and conditions to be imposed.

3.2 The Role of the Underwriter

Deciding a price – An important part of underwriting is deciding what price to charge for the insurance.

The factor the underwriter usually considers in fixing the price of a risk include claims costs expenses and allowance for profit margin. The profit margin will be influenced by the level of competition in the insurance market.

In order to come to decisions, the underwriter will also assess two aspects of hazards i.e. physical and moral.

Physical hazards are tangible aspects of the subject matter of insurance, which are likely to influence the occurrence or severity of loss.

The underwriter obtains information as to the physical hazards through material facts disclosed in the proposal form or by the surveyor’s report or through the underwriter’s knowledge of the trade, processes etc. built up through his experiences over the years.

Physical hazards can be considered in two ways:

- What are these aspects of the risks that are likely to influence the insured event to take place?
- What are those aspects of the risk that are likely to make it a serious loss rather than a minor one if the event does take place?

Moral hazards are concerned with the attitudes and conduct of people. The conduct of the insured, employers and society at large have influence in assessing moral hazards.

3.3 Underwriting Fire Insurance

The Fire Insurance

Examples of physical features which could start fires are:

- Electrical installations in poor condition or the presence of old wire;
- Heat sources, naked lights, heaters, blow torched smoking near flammable materials;
- Poor storage of materials which are likely to self – ignite or which could react with materials next to them.

Other hazards that may burn once started, more severely than it would otherwise have been are:

Timber walls or thatched roofs
Storage of flammable materials or oils;
Open – plan work area.

However, the following physical features would make the risk a better one.

Brick fire – stop walls, fire proof doors to wall openings,
Segregation and compartmentation of dangerous goods and processes,
Automatic sprinkler protection.

Underwriting Factors

A large number of underwriting factors affect claims experience for buildings but the most important ones in use are in construction. In Nigeria building construction is classified into A, B, and C.

Class A – Walls, floors, and stairways entirely must be made of non – combustible materials.

Class B – External walls and roofs should be constructed of mainly non – combustible materials but wood floors are allowed.

Class C – Walls and external roof surfaces should be substantially constructed of non – combustible materials.

Combustible materials, excepting the building frame work allowed but not exceeding ten percent (10%) of other factors are:

Name – The name of any individual or a company could reveal some moral hazard, which could be good or bad.

Location of the building – Buildings in highly congested areas such as Mushin, Oshodi areas of Lagos will attract higher rates than those in Ikoyi or Ikeja GRA, also in Lagos.

Occupation – Whether or not hazardous processes are carried on.

3.4 Underwriting Theft Insurance

As in fire, construction of buildings places an important role in assessing risk of theft. A building having light weight construction walls or roof such as timber, asbestos, or corrugated iron, or normal window catches and rim latches on doors would present several poor features offering little resistance to a potential intruder. Also, if the contents of a building are attractive to thieves, e.g. jewelry, electronics and clothes, the case would be regarded as being heavy in physical hazards.

On the other hand, a strong building construction, security locks and bolts and intruder alarm systems can greatly improve what would otherwise be a poor physical risk.

3.5 Underwriting Motor Insurance

The use of a vehicle in areas of high traffic density such as Lagos, Port – Harcourt and similar large cities increases the like hood of an accident.

Other factors to be considered are;

Use of vehicle – vehicles used for commercial purposes are more exposed to accidents than those for private use.
Also cars which are costly to repair are regarded as presenting extra hazard.
Drivers under the age of 25 and sports cars are often regarded as poor physical risks.

3.6 Underwriting Liability Insurance

Underwriting factors depend on the type of liability insurance. For public and products liability insurance the major factors are, proposer's trade or business – business like food or drug manufacturing bring the proposer into close contact with the public and as such impose greater risks.

3.7 Underwriting Life and Personal Accident Insurance

In life and personal accident insurance, underwriters classify proposals by age and occupation. These are the major underwriting factors for these insurances.

The various factors that underwriters examine are:

Age – In life insurance, policy holders are classified by age since the likelyhood of death or ill–health generally increases with age.

Occupation – A person's occupation affects his or her chance of suffering accidental injury or ill–health: an electrician or a mechanic is far more likely to be injured at work than a clerk or a manager.

Therefore, underwriting classifies occupations into the following classes:

Class I – No Accident/Health Risk

This includes professional, administrative or clerical workers, such as lawyers, accountants, doctors, teachers or shop assistants.

Class II – Slight Accident/Health Risk

This includes skilled occupations involving a moderate amount of manual work and semi–skilled occupations with little manual content e.g. garage mechanics, plumbers, painters and taxi drivers.

Class III – Appreciable Accident/Health Risk

This includes physically strenuous or manual work that is not unacceptably hazardous e.g. security guards, crane operators, mining engineers etc.

Class IV – Extra – Hazardous Risks

In these occupations, either the risk of injury is particularly great i.e coal – miners, test pilot, jockeys, demolition workers, or the consequences of even a slight injury could be disastrous i.e professional entertainers or sportsmen, concert pianists, or a high degree of moral hazard may be present, in particular a temptation to exaggerate the seriousness of any injury.

Physical Conditions

In life insurance, an underwriter will investigate the proposer's height, and weight and compare these with tables of average weights of people of the same set.

3.8 Premium Rating in None Life Insurance

The basic aim of underwriting is to fit an appropriate price for the risk presented. In fitting the price, an underwriting will try to balance general conflicting forces.

In carrying out his duties therefore, the underwriter ensures that there is equity among policyholders. The premiums must reflect the burden which each policyholder expects to impose on the insurance fund. The premium must be sufficiently large to cover losses and administrative expenses. If the premiums charged are consistently too low, this may force the insurer into insolvency.

Also, every enterprise aims to earn adequate profits, therefore underwriters must set their premiums to produce the required profit level.

All these combined are known as office premium.

A Breakdown of Office Premium

All office premiums have four main components:

A risk premium – This is the portion that the insurer must recover from each policyholder in order to cover the present value of expected claims costs in the period of insurance.

The expenses loading – This the amount which is added to cover the policyholder’s fair contribution to all the insurer’s other costs e.g. commissions, staff salaries, costs of electricity and stationary and capital equipment.

The profit loading – The profit loading is the amount which is added to the premium to cover expected divided payments to the shareholders.

The contingency loading – This the amount which is added to the risk premium to cover the possible variability of claims costs. The contingency loading serves to cushion the insurer to some extent from unexpectedly large claims.

Calculation of the Premium

Rate per centum of the sum insured.

In fire, theft, all risks, consequential loss, life and marine insurances and in fact most types of policy premiums are costed by applying a rate per N100 to the sum insured.

Each company has a rating guide which must necessarily agree with the Insurers Association's rates, i.e. Fire Insurance Rating Guide and Marine Rating Guide published by Nigerian Insurers Association. Rates are reviewed from time to time to reflect current trends and practices.

Rates are determined by claim costs/administrative costs, and loading for profit and contingencies.

Various factors are considered in determining the claim costs depending on the class of insurance under consideration.

In case of fire insurance, the construction of the building is important, other factors include the value of the risk, the use of the building, location of the building and occupation of the insured and so on.

For theft insurance, the same principle for fire risk rating applies; risk factors include construction, occupation, nature of stock, protection devices, values and previous loss record.

Premiums calculation in most classes of insurance are based on a rate per cent to the sum insured or limit of liability. In a few classes of insurance, flat premium rates are used.

SELF ASSESSMENT EXERCISE

1. Define the terms underwriting and underwriter.
2. Define physical and moral hazards.
3. What are underwriting factors in motor insurance?
4. What is a flat premium?

4.0 CONCLUSION

You should be able to clearly define underwriting and explain the factors which are considered in underwriting some classes of insurance.

5.0 SUMMARY

The knowledge you have acquired should enable you answer the following tutor-marked questions.

6.0 TUTOR-MARKED ASSIGNMENT

1. Define the term underwriting factor.
2. Explain the component of office premium.
3. What are the underwriting factors in fire and theft insurance? Explain in detail.
4. What is physical hazard? How does an underwriter obtain information as to the physical hazard on a fire insurance risk presented?

7.0 REFERENCES/FURTHER READINGS

Steel, John T. Element of Insurance 101 (CIIN Nigeria).

Nigeria Fire Insurance Rating Guide 1999 (NIA).

Nigerian Motor Insurance Tariff (NIA).

UNIT 3 RENEWAL AND CANCELLATION

CONTENTS

1.0 Introduction
2.0 Objectives
3.0 Main Content
  3.1 Principles of Renewal and Cancellation
    3.1.1 Renewal Procedures
    3.1.2 Renewal Documents
    3.1.3 Days of Grace
    3.1.4 Renewal Terms
    3.1.5 Cancellation
4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

In most non – life insurance, the contracts last for only a year, but subject to annual renewal, if the insured and insurer so agree to renew. However, in the case of life insurance contracts they last for many years, the insurer is obliged to continue to provide cover for the entire period. So it is not necessary for such a policy to be renewed on a periodic basis.

When a policy is renewed for another year, a legally separate contract is created. Offer, acceptance and all other requirements for the formation of insurance contracts must again be present. This means, the insured must disclose any material facts which have developed or altered since the previous year.

Even within the first year or on renewal, within the period of renewal and even if the premium had been paid, the parties to the contract of insurance may cancel the policy within the provisions contained in the policy.

2.0 OBJECTIVES

On completion of this unit, you should be able to:

- state renewal procedures and cancellation of insurance contracts
- differentiate between the two systems.

3.0 MAIN CONTENT

3.1 Principles of Renewal and Cancellation

3.1.1 Renewal Procedures

There is no compulsion on the insured and insurer to renew annual policies for a further period. However, in the case of life assurance business, the contract is for a specified period of years or until the happening of a certain event even though the premium is paid annually or half – yearly or monthly.

The insurer must accept the renewal premium from the assured. If the assured did not renew i.e pay the premium, the policy will lapse or become "paid–up" or the Premium will be paid out of the surrender value until it is exhausted.

3.1.2 Renewal Documents

Certain documents are used in the process of insurance policy renewal.

Renewal Notice

It is not compulsory for the insurer to a issue renewal notice but insurers usually issue renewal notices approximately two weeks or one month before the expiry date of the current insurance.

A renewal notice is a reminder to the insured that his existing insurance cover is about to expire. The renewal note will show the insured's name, the policy number, type of insurance, the sum insured, the renewal premium and the renewal date. In long–term insurance i.e life assurance, reminders are also sent to the policy holders but they are not renewal notices. They simply remind the policyholders that they must soon pay another premium installment.

There is often a perforated remittance slip attached showing the policy number, the insured's name and type of premium and a request that the insured should detach this and forward it with his remittance.

Also, there is usually a notice on the renewal note to the effect that any changes in the risk since inception or since last renewal must be intimated to the insurers.

Legal Status of the Renewal Notice

There is no legal requirement for the insurer to issue renewal notices. Moreover, the exact legal status of the notice when issued will depend on the wording of the notice.

If the notice is worded as a simple reminder of the existing cover and its expiry date, it has no legal function. It just reminds the insured who wishes to renew to make a new offer to the insurer. On the other hand, if the notice invites the insured to renew his contract, then it is subject to acceptance by the insured for renewal. Whichever wording is used, the effect is the same as any offer. It can be withdrawn before it is accepted by the insured.

3.1.3 Days of Grace

As stated, renewal notices are sent out two weeks or one month before the expiry date of the policy. If the insured intends to renew his insurance cover but fails to do so before it expires, the insurer may continue to provide protection for a period of so – called days of grace, which is usually restricted to a maximum of 15 days.

If the insured pays the premium within this 15–day period the cover continues in full and if a loss has occurred between the renewal date and the date of payment, the insured will be able to recover. However, if the insured intimates by word or action, either before the renewal date or within the days of grace, that he does not intend to renew, the policy will lapse on the renewal date.

There are some policies to which days of grace do not apply. These policies include, short period policies which renewals are not usually issued, they are marine insurance and motor insurance. In marine and motor insurance, it is expected that the premium must be paid on or before the expiry date to obtain full cover.

There is a special position in motor insurance policies. No days of grace are allowed under motor third party insurance; since the back dating of cover is prohibited by the Road Traffic Acts but insurer do provide a 15 day motor insurance certificate on the back of the renewal notice.

This is essentially 15 days free Road Traffic Act cover which operates if the motorist has not insured elsewhere, irrespective of renewal.

Days of grace are available on the own damage part of comprehensive motor policies. Therefore, if the insured pays his renewal premium within 15 days of expiry he obtains a backdated own damage cover plus free third – party insurance with the same overall effect as if the days of grace had applied to both parts of his insurance.

3.1.4 Renewal Terms

In annual contracts, the terms on which the insurers are prepared to renew may be different from those previously applying. This may be because experience may mean that the premium / rate will be increased compared with the previous year. Or that the scope of cover needs alteration or the policy excess needs to be increased.

3.1.5 Cancellation

Even when a valid offer and acceptance have been made and premium paid, the parties to a contract of insurance may still be able to cancel the policy.

There are circumstances in which the insurer may decide to cancel the policy:

There is a condition in contracts that gives the insurer the right to cancel, following due notice given to the insured and the return of part of the premium. Insurers do sometimes take advantage of this clause if the claims experience has been particularly bad. However, existing claims must have been met before cancellation can be effected.

Apart from the above, insurers can only cancel contracts if it can be proved that they are illegal, void or voidable.

Illegal contracts include contracts with enemy aliens, non–existent in Law. The premiums paid should be refunded by insurers.

Void contracts entered into fraudulently and fraudulent misrepresentation are void or non–existent. In this case the policy holder is not entitled to any return of the premium.

Voidable contracts: An insurer can avoid liability if he chooses, if the insured breaches the principle of utmost good faith or the warranty allows the insurer to cancel the contract and the return of premium.

Cancellation by the insured may be made at any time. Return premium may not necessarily be made by the insurer. In non–life insurance, a return of premium depends on the attitude of the insurer and the reasons for cancellation. For example, part of the motor insurance premium may be refunded if the insured sells his car before the expiry of his motor insurance cover.

SELF ASSESSMENT EXERCISE

1. What is renewal notice?
2. What are days of grace?
3. What is return of premium?

4.0 CONCLUSION

Most non–life insurance contracts last for only a year and when the year is over the contract expires and insurance cover cases. Often, both the insurer and the insured renew the annual policy for a further period of one year on existing terms and conditions or on a new basis.

Insurers usually send the insured a renewal notice which is just to remind the insured that the policy will soon expire.

5.0 SUMMARY

In insurance contracts provision for renewal is contained in the policy documents as part of the policy conditions. Insurers usually invite their policyholders to renew their policies before they expire. The invitation is known as a renewal notice. Renewal notices contain details of the existing insurance and a pay–in–slip requesting the insured to use it for payment of the renewal premium due.

A 15–day period of grace is often given to the insured after the expiry of the contract to renew. If the insured pays the premium within the days of grace the policy continues but if not the policy is regarded as having lapsed. Some policies have no days of grace and in the case of motor insurance, special position applies. There is no days of grace for third party insurance cover but days of grace applies to the own damage/loss section of a comprehensive motor insurance policy.

The parties to the contract of insurance may decide to cancel the contract. Insurers have provision in their policy documents for cancellation. This provision must be complied with before cancellation can be effective. Also, there are circumstances in which insurers may cancel their policies.

On the other hand, an insured may decide to cancel his policy at any time. In some cases there will be a return premium and in others no return premium is made.

6.0 TUTOR-MARKED ASSIGNMENT

1. What is a renewal notice and what is the legal position of the renewal notice?
2. In what circumstances may a contract of insurance be terminated?
3. What are days of grace, and in which classes of insurance are they applicable.
4. Just before his comprehensive motor insurance expired, Mr. John received a renewal notice from his insurer. Mr. John did not pay the renewal premium until 15 days when he was involved in an accident. Stated below are claim estimates forwarded by Mr. John to his insurer:

Third part property damage claim	N200,000
Damage to his vehicle	N500,000

What will be the position of Mr. John's insurer in respect of the claim estimate submitted?

7.0 REFERENCES/FURTHER READINGS

Steele, John T. Elements of Insurance 101 (CIIN Nigeria).

UNIT 4 MAKING A CLAIM

CONTENTS

1.0 Introduction
2.0 Objectives
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   3.1 Claims Procedure
   3.2 Notifying the Insurer
   3.3 Proof of Loss
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   3.5 The Cause of Loss
   3.6 The Size of the Claim
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   3.8 Payment by Mistake
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4.0 Conclusion
5.0 Summary
6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

The purpose of insurance is to provide financial compensation in the event of a loss. Therefore, if an insured suffers a loss or an accident and if the loss is covered by his insurance policy he can make a claim against his insurer. Making claim is simply an application by the insured for the payment of monies due under his insurance contract.

2.0 OBJECTIVES

On completion of this unit, you should be able to:

- explain the processes of making insurance claims
- discuss the procedures in handling insurance claims.

3.0 MAIN CONTENT

3.1 Claim Procedure

Before an insurer will pay a claim, certain conditions must be satisfied.

- A loss or insured event must occur. The insured must suffer some financial loss before compensation is paid. This is the case in non –

life insurance. For life insurance, the insured event must have taken place, such as the death or survival of the insured.
The insurer must be notified. Insurers usually request further details and completion of a claim for when they are notified of a loss.

Proof must be provided. The onus is on the insured to show that a loss or event covered by the insurance has occurred. The insured must also prove the extent of such a loss.

3.2 Notifying the Insurer

Most insurance policies require a loss to be notified in writing within a specified number of days from the date of occurrence. This could be seven, fourteen or thirty days. This notification clause must be complied with as non–compliance may give the insurer the right to avoid paying the claim. However, in practice insurers usually consider date notification on each individual merit.

Initial verbal notification may be made as soon as possible followed by a written notification. The insurers usually would send claim forms to the insured immediately they receive notification verbally or in writing.

A claim form is simply a questionnaire asking for details of the insured, details of the loss, or damage or destruction and of the time, place and nature of the loss, name at the time and place of loss. Claims are not usually paid unless and until this formation has been provided.

3.3 Proof of Loss

It is the duty of the insured to prove that a loss has occurred and to demonstrate its size. This may be done by the insured given full particulars of the loss, or documentary proof of the loss. For example, in personal accident insurance, any claim must be accompanied by a medical certificate; a medical examination by the insured’s medical doctor. In motor insurance, a theft loss must be accompanied by a police report, original particulars of the vehicle and purchase receipt. In marine insurance, claims are investigated by an independent surveyor and in fire insurance large claims are investigated by an independent loss adjuster.

Once the insured has demonstrated the loss, if the insurer wishes to take advantage of an exception in the policy it is up to the insurer to prove that the exception holds.

3.4 Claims That Fail

An insured's claim may fail for the following reasons:

- The insurance contract is invalid or had been invalidated
- The loss is excluded
- The claim is contrary to public policy.

3.5 The Cause of Loss

Insurance policies cover losses that are specified. Thus the standard fire policy will not pay claims on buildings which are blown down by high winds or blown up by explosions, but it does cover buildings damaged by fire.

However the causes of loss are more complicated than these losses of related causes, factors or events; or

- A chain of related causes, factors or events; or
- Several causes may occur together;
- Several unrelated causes

The insurer must therefore discover the time, real or proximate cause of loss. Only if the contract covers the proximate cause will the insurer pay the claim. For example, a personal accident policy specifically excludes losses caused by sickness and ill health. If a policy holder has a heart attack while cleaning windows and falls from the ladder, and as a result breaks his neck and dies, the proximate cause of death is the heart attack rather than the fall and a claim will fail. However, if his ladder breaks and the fall brings on a heart attack from which he subsequently dies, a claim would succeed because the proximate cause was accidental.

3.6 The Size of the Claim

The size of a claim depends on whether the contract is one of indemnity or of reinstatement, a valued policy or a contract to pay a specified sum.

Therefore, the size of a claim under a contract of indemnity will be determined by the principles of indemnity. The claim must be sufficient to place the insured in the same financial position after the loss as he was in before the loss. For example, the claim for property insurance is the value of the loss or damage of the property at the time and place of loss. For a large claim a specialist adjuster; engineer or surveyor is used to assess the loss. In liability insurances, the claim payment is settled by the insurer directly with the injured third party, and is meant to reflect compensation for loss of earnings, pain and suffering, disability and legal costs. The payments are equal either to the damages awarded by the courts or to the amount of an out–of–court settlement.

The size of a claim under reinstatement contracts depends on the cost of rebuilding or restoring the damaged property in its original form, less any allowances for betterment.

For a valued policy, the size depends on the value placed on the property and the extent of damage.

3.7 Who Receives the Claim Payment?

Usually the claim is paid directly to the person or company that bought the insurance policy. However, there are certain exceptions such as are identified below:

i. In a liability claim, the claim is paid directly to the injured third party.
ii. Where the policy is assigned, the proceeds from the policy will be made to the assignor.
iii. In life assurance, death claim is paid to the insured's legal representative or to the beneficiaries.
iv. Claims may be paid to another person by order from courts, although this is not common.

3.8 Payment by Mistake

Where an insurer pays a claim which should not have been paid, because no cover was in force for one reason or the other, the insurer is entitled to recover the mistaken claim payment except in certain instances, including that of gratia payments and payments made following a mistake in law or under legal obligation.

3.9 Disputed Claims

In some cases, the insurer and the insured may disagree over the amount of claim payment or over whether a claim should be paid or not. In such cases, settlement should be made by negotiations between a claims official from the insurer and the insured or an independent loss adjuster and the claimant or by reference to the courts, or by taking the dispute to arbitration, for a policy that contains arbitration conditions.

SELF SSESSMENT EXERCISE

1. What is a claim form?
2. What is the proximate cause of loss?
3. What is proof of loss?
4. State the reasons why a claim may fail?

4.0 CONCLUSION

The essence of the insurance contract is that the insurer agrees in return for the premium paid by the insured, to indemnify or compensate him in the event of a loss. Therefore, an insured who suffers genuine loss within the meaning and intention of his policy must be compensated.

Insurers have the duty to ensure that insurance funds are not wasted; only policyholders who have suffered genuine losses are compensated.

5.0 SUMMARY

We have seen that before a claim is paid both the insured and the insurer must follow certain procedures.

On the part of the insured, the loss must be reported promptly and within the required period of notification. Also, the insured must obtain a claims form and complete it with all the necessary supporting documents proving the loss and size of the loss.

Notification may be oral or in writing. The insurer on receipt of notification checks the following:

- Whether the contract is in force
- Whether the loss is covered
- Whether the premium has been paid in advance
- Whether the terms, conditions and provisions of the contract are kept

He will then acknowledge receipt of the loss notification and send the claim form to the insured.

On the receipt of the supporting documents, the insurer decides whether the claim will be handled in house or he would appoint an independent loss adjuster to handle the claim. Small losses are usually handled in house, while large losses are handled by independent loss adjusters.

6.0 TUTOR-MARKED ASSIGNMENT

1. What procedure would an insured follow when he suffers a genuine loss under his personal accident insurance?
2. An insurer will have to take some steps when a loss is reported to him. What are these steps
3. How is claim dispute settled?
4. What happens when payment is made by mistake?

7.0 REFERENCES/FURTHER READINGS

Steele, John T. Elements of Insurance 101 (CIIN Nigeria) *CIIN Journals.*

UNIT 5 RISK MANAGEMENT

CONTENTS

1.0 Introduction
2.0 Objectives
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3.1 The Concept of Risk in Insurance
3.1.1 Definition and Classification of Risk
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3.1.7 The Interrelationship of Risk Analysis, Control and Financing
4.0 Conclusion
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6.0 Tutor-Marked Assignment
7.0 References/Further Readings

1.0 INTRODUCTION

From time immemorial, man has sought ways of controlling risk to which individuals either private or grouped together as commercial and business ventures are exposed.

Until about 20 years ago, the concept of risk management was regarded as a subject and an arm of practical management. It is a multidisciplinary subject which brings together the ideas and techniques drawn from various disciplines, to provide sound conceptual functions and a set of tasks for the analysis and positive control of risks.

It was widely acclaimed that risk management was first introduced in the United States of America in the early fifties as a result of dissatisfaction on the part of the corporate and individual insurance buyers with the inadequate premium discount given by insurance underwriters to compensate for higher risk retention and the loss prevention methods being adopted for their insured risks.

2.0 OBJECTIVES

After studying this unit, you should be able to:

define risk
classify risks
identify risks
evaluate risks
discuss financial/physical control of risks
analyze the interrelationship of risk analysis, risk control and risk financing.

3.0 MAIN CONTENT

3.1 The Concept of Risk in Insurance (Conditions of Certainty, Conditions of Risk and Conditions of Uncertainty)

These conditions relate basically to the state of an investor's knowledge about underlying factors which affect the outcome of his investment decisions. The nature and effects of each condition on investment activities will now be discussed.

Conditions of certainty can be said to prevail where a potential investor has full knowledge of the ultimate outcome of an investment opportunity. This implies:

a. Perfect knowledge, from the outset, of the exact nature and timing of the stream or cash-flow to be expected from an investment opportunity.

b. The expectation that the anticipated outcome would not be subject to chance.

Given that situation, an investor would conceptually have a single-valued expectation of the outcome of an investment opportunity. Since such an outcome would not be subject to chance, benefits expected from the investment ex-ante would synchronize with benefits actually realized ex-post.

Situations of single-valued expectations are rare in the investment world. In practice, one can speak of certainty conditions whenever the number of possible outcomes from an investment activity falls within a very narrow range of possible values. In that case, there would be only a very remote possibility of divergence between expected and realized investment outcomes. Investments in fixed income financial assets can be so categorized, especially where the likelihood of default in the payment of interest or principal is remote.

An investor in government treasury securities can, for instance, calculate with fear. Uncertainty has been described as one of the fundamental facts of life. Many individuals and business enterprises fail to realize the magnitude of risks to which they are exposed every minute of the day. How many people for instance, are aware that the building in which they are can catch fire from many sources anytime and so place them in the danger of being injured or possibly losing some of their property, such as documents? Equally, individuals face the risk of imminent death from numerous causes both known and unknown. Just remember the case of Dele Giwa, a renowned Nigerian journalist who was killed at his breakfast table by a letter bomb on the 19th of October, 1986. When he received the parcel, little did he know he would be gone forever the next minute. That was the risk of death lurking around him.

In business circles, numerous examples of risks facing business entrepreneurs are also legion. A company that owns a business premises where different types of manufactured goods are stored can be burnt down anytime. A bank could be robbed by armed robbers any moment, irrespective of the number of armed policemen mounting guard.

3.1.1 Definition and Classification of Risk

Many writers have defined the word risk in many ways, but for the purpose of this course, risk, according to Robert Imehr and Emerson Cammack is defined as the *"uncertainty of loss"*. That is, risk involves a situation where it is not certain when, where and how a loss or misfortune may occur.

Risk may be classified as:

a. Pure or speculative risk;
b. Fundamental or particular risk.

Pure risk is one that gives rise to a loss or a loss situation. For example, if a car owner drives his car without sustaining an accident or injury to a third party. The owner does not suffer any loss. On the other hand, he may be involved in an accident. In this case, he suffers a loss.

Pure risk may arise from natural disaster. For example, earthquake, fire, thunder and lightening. It may also arise from human behaviour such as car theft, car accident, bank robbery, etc. These kinds of risks are generally insurable, that is, they can be covered by insurance companies.

Speculative risk is one which gives rise to loss or gain or break-even situation. Examples are common in buying and selling of goods and shares, pools betting, gambling of all sorts, trade losses, possibility of a

fall in demand etc. fall in the category of speculative risks. Generally, insurance companies do not insure speculative risks, that is, they are uninsurable.
Fundamental risk is one that arises from the society in which we live or from the physical occurrences beyond man's control. Unemployment, war, changes in fashion, changes in customs and inflation are examples of fundamental risks that arise from the society in which we live. On the other hand, examples of physical occurrences beyond the control of man include earthquake, flood, tidal waves, volcanic gas emission; as the one that occurred at Nyos in Cameroon on 22nd August, 1986. Some fundamental risks are insurance while some are uninsurable.

3.1.2 The Concept and Process of Risk Management

Risk management is a system among various functions of an organization whereby the risks threatening the assets and earnings of the organization can be identified, analysed and controlled in the most efficient and economic manner.

Risk management process takes a broader view of the problems, passed-by risks than does of the insurance. The process starts at a more fundamental level and asks the basic questions as to what risk this organization is exposed to.

It moves on from there to evaluate the likely impact on the organization by looking at both severity and frequency. Having identified the risk and evaluated it, risk management techniques are then applied to decide how this identified risk could best be controlled. This process is shown in the diagram below where we can see a simple representation of the various stages of risk management.

The risk management process

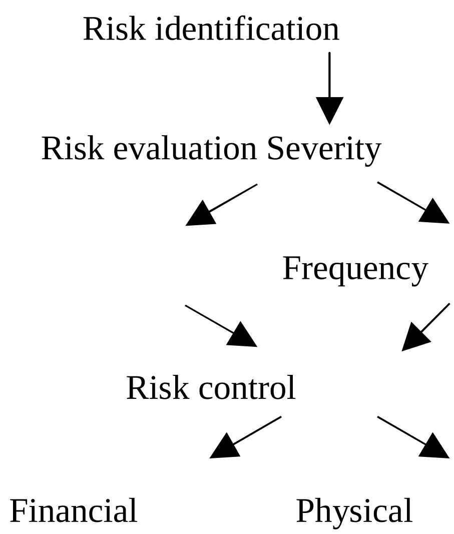


Fig. 1: The risk management process

Retention Transfer Elimination Minimization

It can be seen from this diagram that financial transfer of risk will be the stage in the process involving insurance. Earlier, insurance was defined as a risk transfer mechanism and it is in this capacity that it relates to risk management. Insurance then, is one part of the risk management process.

3.1.3 Risk Identification Techniques

Here, it is essential to carry out some kind of physical inspection. Having done this, one or more of the following may be a helpful aid to identifying risks:

i. Organizational charts;
ii. Flow charts;
iii. Checklist or questionnaire.

An organizational chart will show the basic organizational structure of the plant or of an entire company. It will show the relationship between and among different personnel. For example, it could highlight weaknesses in organizational structure which could cause problems for the risk manager.

The flow chart is particularly useful in companies where the system of manufacture as production involves materials, flowing through a process. It shows the flow of the operation and can highlight problems which would be caused by unforeseen events.

The checklist involves the risk manager asking a number of questions about each stem of plant. These questions normally revolve around the risks to which the plant could be exposed.

3.1.4 Risk Evaluation

Risk evaluation or analysis – The second stage in the risk management process is that of evaluating the impact of risks on the firm. Risks are often evaluated in a qualitative manner, that is, something which benefits from experience and the risk managers falls back on their own experience of similar events or situations in measuring the potential impact of risks. The method here involves statistical work which really begins with the keeping of adequate records.

Risk control is the third and final step in the risk management process as shown in Fig. 1. It should be recognized that this falls into two parts viz: physical and financial. The objective of a risk manager is the economic control of risk. After identifying and evaluating the risk, he can decide how best to respond to it.

3.1.5 Financial Control of Risks

This particular aspect could be divided into two categories, viz: retention and transfer.

Retention

This situation decides to retain the expectation of risks which are predictable and transfer the unpredictable to insurance. So the extent of this retention value the company becomes its own insurance. Also, in the case where the insured retains an excess or deductibles, this means that the insured retains the risk to the tune of this excess or deductibles. Alternatively, a separate fund could be set up to pay for losses or risk which may be fully retained. Such a fund is called self-insurance. Furthermore, new developed risk retention has been the formation of captive insurance companies, where large companies set up a subsidiary company to insure all the risks to which the parent company might be exposed.

Transfer

The second method of financial risk control is the situation in which the company transfers the effect of the loss to some other person or company. The most common form of risk transfer is by way of insurance. This is where the owner of the property is paying to her, the risk transferred to an insurance company. As earlier mentioned, this is only where insurance is concerned in the whole process of risk management.

3.1.6 Physical Control of Risks

Generally, this involves loss prevention which sometimes is referred to as risk reduction. It could be divided into two categories, namely:

(i) Elimination, and
(ii) Minimisation of risk.

Elimination

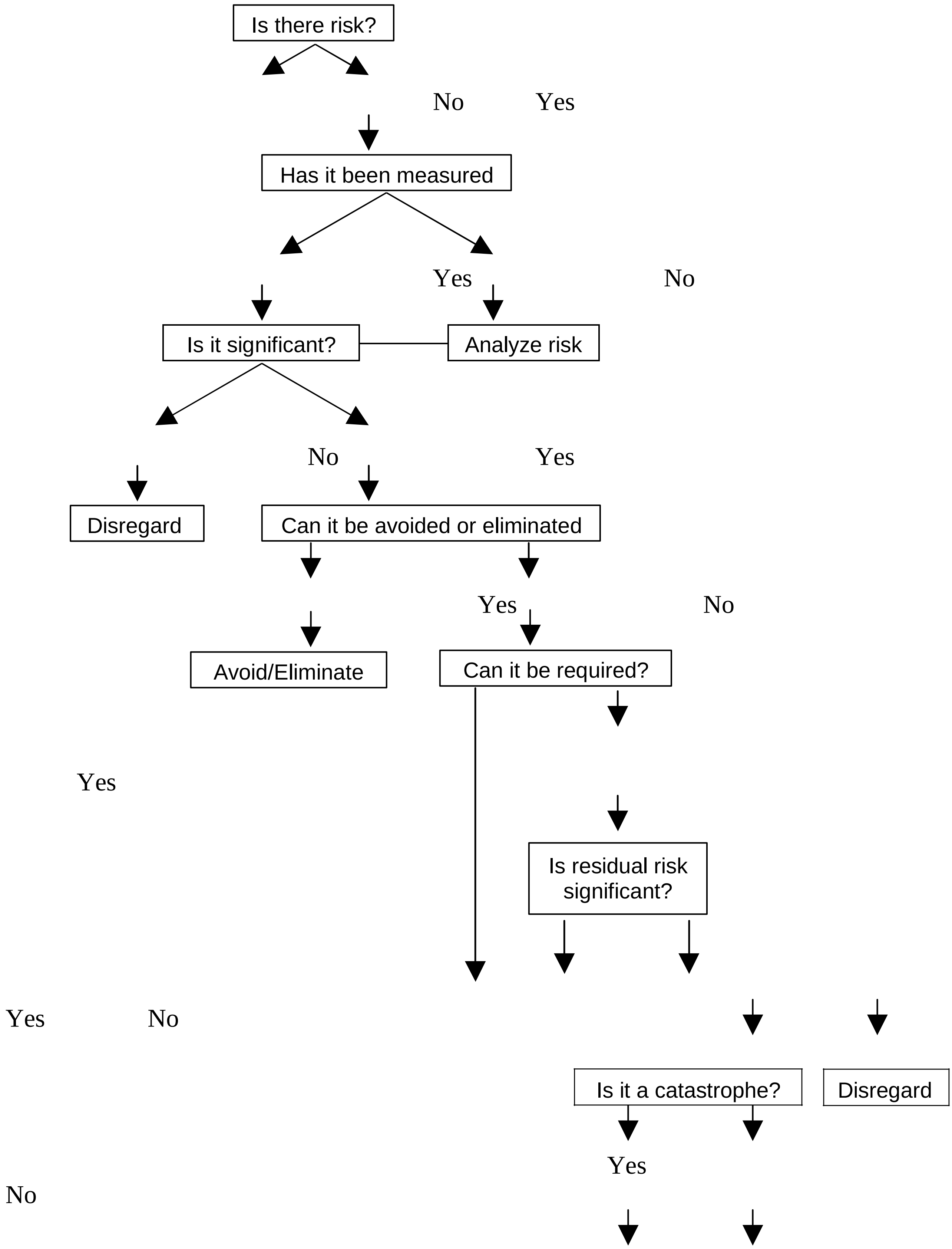
Many people think that the surest way of preventing losses is to eliminate the possibility of occurrence totally. A person who, for instance, is really concerned over the likelihood of a motor accident could sell the car, and so eliminate the risk. For some other domestic or business risks, their elimination will just not be possible.

Minimization

The thoughts on the inability to eliminate risk leads to how best losses can be minimized. This falls into two main divisions:

i. Pre-loss minimization – This involves steps taken before the adverse events occur.
ii. Post-loss minimization – This takes place after the loss has occurred to minimize the severity or extent of loss.

The Interrelationship of Risk Analysis, Control and Financing



Can it be retained?

Fig. 2 The interrelationship of risk analysis, control and financing

SELF ASSESSMENT EXERCISE

1. Explain the concept of risk in insurance.
2. How is risk classified? Discuss.
3. Give five (5) examples each of:

a. measures for reducing loss probabilities
b. techniques of reducing loss severity.

4.0 CONCLUSION

We have seen that no insurer or insured can afford to neglect risk management which has been defined as the process of growth and its effects on the growth process as well as on performance in the insurance market.

It is seen that the services of the intermediary increases the gross premium income of the insurers and consequently, contributes positively to the economy of the country.

This course material is designed to improve the information on which decisions are taken to help reduce risk. An insurer that is considering marketing a new product may seek to reduce uncertainty by conducting a market research, though given the limitation of such research, there can be no guarantee that actual outcome will match the expected results.

In such circumstances, the need for past data, statistical information mainly on claims of insurance are to be charged from the experience gathered so far. This and any other data the insurer uses to charge future premium as a result of the severity and frequency of risk insured against.

5.0 SUMMARY

Risk management plays a significant role in the formulation of decision making in the method of risk financing. Risk financing may include risk transfer, i.e. reinsurance, co-insurance, premium loading etc. It is said that a risk with high loss frequency and severity can better be transferred through catastrophe excess of loss reinsurance. However, through risk evaluation, the insurer is able to classify its portfolio of risk in terms of frequency and severity for effective decision.

6.0 TUTOR-MARKED ASSIGNMENT

1. Discuss the six (6) steps that constitute the logical sequence of every risk management programme.

2. Outline the interrelationship of risk analysis, risk control and risk financing using a suitable diagram.

7.0 REFERENCES/FURTHER READINGS

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