NCFM

NSE's CERTIFICATION IN FINANCIAL MARKETS

Insurance Module

NATIONAL STOCK EXCHANGE OF INDIA LIMITED

Test Details:

Sr. No.	Name of Module	Fees (Rs.)	Test Duration (in minutes)	No. of Questions	Maximum Marks	Pass Marks (%)	Certificate Validity
1	Financial Markets: A Beginners' Module *	1500	120	60	100	50	5
2	Mutual Funds : A Beginners' Module	1500	120	60	100	50	5
3	Currency Derivatives: A Beginner's Module	1500	120	60	100	50	5
4	Equity Derivatives: A Beginner's Module	1500	120	60	100	50	5
5	Interest Rate Derivatives: A Beginner's Module	1500	120	60	100	50	5
6	Commercial Banking in India: A Beginner's Module	1500	120	60	100	50	5
7	Securities Market (Basic) Module	1500	105	60	100	60	5
8	Capital Market (Dealers) Module *	1500	105	60	100	50	5
9	Derivatives Market (Dealers) Module *	1500	120	60	100	60	3
10	FIMMDA-NSE Debt Market (Basic) Module	1500	120	60	100	60	5
11	Investment Analysis and Portfolio Management Module	1500	120	60	100	60	5
12	Fundamental Analysis Module	1500	120	60	100	60	5
13	Banking Sector Module	1500	120	60	100	60	5
14	Insurance Module	1500	120	60	100	60	5
15	Macroeconomics for Financial Markets Module	1500	120	60	100	60	5
16	NISM-Series-I: Currency Derivatives Certification Examination	1000	120	60	100	60	3
17	NISM-Series-II-A: Registrars to an Issue and Share Transfer Agents – Corporate Certification Examination	1000	120	100	100	50	3
18	NISM-Series-II-B: Registrars to an Issue and Share Transfer Agents – Mutual Fund Certification Examination	1000	120	100	100	50	3
19	NISM-Series-IV: Interest Rate Derivatives Certification Examination	1000	120	100	100	60	3
20	NISM-Series-V-A: Mutual Fund Distributors Certification Examination *	1000	120	100	100	50	3
21	NISM-Series-VI: Depository Operations Certification Examination	1000	120	100	100	60	3
22	NISM Series VII: Securities Operations and Risk Management Certification Examination	1000	120	100	100	50	3
23	Certified Personal Financial Advisor (CPFA) Examination	4000	120	80	100	60	3
24	NSDL–Depository Operations Module	1500	75	60	100	60 #	5
25	Commodities Market Module	1800	120	60	100	50	3
26	Surveillance in Stock Exchanges Module	1500	120	50	100	60	5
27	Corporate Governance Module	1500	90	100	100	60	5
28	Compliance Officers (Brokers) Module	1500	120	60	100	60	5
29	Compliance Officers (Corporates) Module	1500	120	60	100	60	5
30	Information Security Auditors Module (Part-1)	2250	120	90	100	60	2
	Information Security Auditors Module (Part-2)	2250	120	90	100	60	
31	Options Trading Strategies Module	1500	120	60	100	60	5
32	FPSB India Exam 1 to 4**	2000 per exam	120	75	140	60	NA
33	Examination 5/Advanced Financial Planning **	5000	240	30	100	50	NA
34	Equity Research Module ##	1500	120	65	100	55	2
35	Issue Management Module ##	1500	120	80	100	55	2
36	Market Risk Module ##	1500	120	50	100	55	2
37	Financial Modeling Module ###	1000	150	50	75	50	NA

* Candidates have the option to take the tests in English, Gujarati or Hindi languages.

\# Candidates securing 80% or more marks in NSDL-Depository Operations Module ONLY will be certified as 'Trainers'.

** Following are the modules of Financial Planning Standards Board India (Certified Financial Planner Certification)

- FPSB India Exam 1 to 4 i.e. (i) Risk Analysis & Insurance Planning (ii) Retirement Planning & Employee Benefits (iii) Investment Planning and (iv) Tax Planning & Estate Planning
- Examination 5/Advanced Financial Planning

\## Modules of Finitiatives Learning India Pvt. Ltd. (FLIP)

\### Module of IMS Proschool

The curriculum for each of the modules (except Modules of Financial Planning Standards Board India, Finitiatives Learning India Pvt. Ltd. and IMS Proschool) is available on our website: www.nseindia.com > Education > Certifications.

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Note: Candidates are advised to refer to NSE's website: www.nseindia.com, click on 'Education' link and then go to 'Updates & Announcements' link, regarding revisions/updations in NCFM modules or launch of new modules, if any.

This book has been developed for NSE by Mrs. Subhashini Prakash, Prime Career Mentors Pvt. Ltd.

Chapter 1: Introduction to Insurance

1.1 Definition of Insurance

Insurance has been defined in many ways; Willet defines insurance "as the social device for making accumulations to meet uncertain losses of capital which is carried out through the transfer of risks of many individuals to one person or to a group of persons".

Dr. Pfeffer defined Insurance as a device for the reduction of the uncertainty of one party called the insured, through the transfer of particular risks to another party called the insurer, who offers, a restoration at least in part of economic losses suffered by the insured.

Another definition of insurance is "a promise of compensation for specific potential future losses in exchange for a periodic payment". Insurance is designed to protect the financial well-being of an individual, company or other entity in the case of unexpected loss. Some forms of insurance are required by law, while others are optional. Agreeing to the terms of an insurance policy creates a contract between the insured and the insurer. In exchange for payments from the insured (called premiums), the insurer agrees to pay the policy holder a sum of money upon the occurrence of a specific event. In most cases, the policy holder pays part of the loss (called the deductible) and the insurer pays the rest. Examples include car insurance, health insurance, disability insurance, life insurance, etc.

Insurance therefore is a contract between two parties whereby one party agrees to undertake the risk of another in exchange for consideration known as premium and promises to pay a fixed sum of money to the other party on happening of an uncertain event (death) or after the expiry of a certain period (in case of life insurance) or to indemnify the other party on happening of an uncertain event (in case of general insurance).

The party bearing the risk is known as the 'insurer' or 'assurer' and the party whose risk is covered is known as the 'insured' or 'assured'.

1.2 How Insurance Works

The underlying concept behind insurance is sharing of risks by pooling of funds. Groups of people sharing similar risk come together and make contribution towards a pool and the money so collected is used towards compensating for any losses suffered by members of the pool. When the pool is managed by the individuals it is called mutual insurance and when it is managed by a company it is called life/general insurance.

1.2.1 We will understand the concept with an example:

<table>
<tr><th>Example 1
(What happens if 2 houses are burnt?)</th><th>Example 2
(What happens if 25 persons dies?)</th></tr>
<tr><td>Assumptions
Houses in a village = 500
Value of 1 House = Rs.1,00,000
Houses burning in a year = 2
Total annual loss due to fire
= Rs. 2,00,000/-
Contribution of each house owner
= Rs. 500/-</td><td>Assumptions
Number of Persons = 5000
Age and Physical condition = 60 years and Healthy
Number of persons dying in a yr
= 25
Economic value of loss suffered by family of each dying person
= Rs. 2,00,000/-
Total annual loss due to deaths
= Rs. 50,00,000/-
Contribution per person
= Rs. 1,200/-</td></tr>
<tr><td>UNDERLYING ASSUMPTION
All 500 house owners are exposed to a common risk, i.e. fire</td><td>UNDERLYING ASSUMPTION
All 5000 persons are exposed to common risk, i.e. death</td></tr>
<tr><td>PROCEDURE
All owners contribute Rs. 500/- each as premium to the pool of funds
↓
Total value of the fund = Rs. 2,50,000 (i.e. 500 houses * Rs. 500)
↓
2 houses get burnt during the year
↓
Insurance company pays Rs. 1,00,000/- out of the pool to 2 house owners whose house got burnt</td><td>PROCEDURE
Everybody contributes Rs. 1200/- each as premium to the pool of funds
↓
Total value of the fund = Rs. 60,00,000 (i.e. 5000 persons * Rs. 1,200)
↓
25 persons die in a year on an average
↓
Insurance company pays Rs. 2,00,000/- out of the pool to the family members of each of the 25 persons dying in a year</td></tr>
<tr><td>EFFECT OF INSURANCE
Risk of 2 house owners is spread over 500 house owners in the village, thus reducing the burden on any one of the owners</td><td>EFFECT OF INSURANCE
Risk of 25 persons is spread over 5000 people</td></tr>
</table>

1.3 We can see from above that two concepts emerge out of this

- Criteria for insurable Risk
- Underwriting

1.3.1 Can Insurance insure all kinds of risks?

For a risk to be considered for insurance, the following criteria should be satisfied.

1. Law of large numbers: " Mathematical premise stating that the greater the number of exposures (1) the more accurate the prediction; (2) the less the deviation of the actual losses from the expected losses (X - x approaches zero); and (3) the greater the credibility of the prediction (credibility approaches one). This law forms the basis for the statistical expectation of loss upon which premium rates for insurance policies are calculated".

Insurance is based on probabilities of loss occurrence. The insurers estimate the premium payable based on the relevant statistics and probabilities. For the actual outcome of loss exposure to be reflective of the statistics, there must be a large number of homogenous units. The larger the number of homogenous (similar) exposure units the more likely the loss experience will conform to the probability statistics.

2. The loss must be accidental or fortuitous: For a risk to be insurable, it should be accidental or of fortuitous nature because insurance is based on chance. We cannot insure an event which is bound to happen. There should be an element of uncertainty. For e.g. in fire insurance, the property is insured against the perils of fire, flood etc. on the assumption that loss may or may not happen. If we are sure there is bound to be floods in the next 15 days and take insurance, the policy will not be valid. However, in life insurance though death is certain, this principle is still applicable as we are not sure when death would actually arise, some may die at 20 some at 60 and so on.

i) Here we need to distinguish between Speculative risk and Pure risk:

Speculative risks are not insurable. The difference between pure risk and speculative risk is that in speculative risk there is a possibility of loss or profit. These risks are willingly taken by people with an aim to make profit. The typical example is a day trader in the stock market who buys shares in the morning hoping that the price will go up before the market closes and he can sell the shares at a profit. However, the share prices may come down in which case the day trader incurs a loss.

Pure risks are those risks in which there is only a possibility of loss or no loss, there is no probability of making profits. Pure risks are categorized into Personal, Property and Liability or legal risks. Personal risks affect people directly such as illness, death, injury etc. Property risk affects property such as building, machinery, car etc. Legal risks or Liability risks involves, as the name suggest, the risk of being sued due to negligence or causing injury to another person or loss/damage to property of another person.

Pure risk is insurable, because the law of large numbers can be applied to forecast future losses and thus insurance companies can calculate what premium to charge based on expected losses. On the other hand, speculative risks have more varied conditions that make estimating future losses difficult or impossible. Also, speculative risk will generally involve a greater frequency of loss than a pure risk.

ii) Risk can also be classified as to whether it affects many people or only a single individual. **Fundamental risk** is a risk, such as an earthquake or terrorism, that can affect many people at once. Economic risks, such as unemployment, are also fundamental risks because they affect many people. **Particular risk** is a risk that affects particular individuals, such as robbery or vandalism. Insurance companies generally insure some fundamental risks, such as hurricane or wind damage and most particular risks.

In the case of fundamental risks that are insured, insurance companies help to reduce the risk of great financial loss by limiting coverage in a specific geographic area and by the use of reinsurance, which is the purchase of insurance by insurer from another insurer called reinsurer.

Fundamental risks are risks that affect many members of society, but fundamental risks can also affect organizations. For instance, enterprise risk is the set of all risks that affects a business enterprise. Speculative risks that can affect an organization are usually subdivided into strategic risk, operational risk, and financial risk.

Strategic risk results from goal-oriented behavior. A business may want to try to improve efficiency by buying new equipment or trying a new technique, but may result in more losses than gains. **Operational risks** arise from the operation of the enterprise, such as the risk of injury to employees or the risk that customers data can be leaked to the public because of insufficient security. **Financial risk** is the risk that an investment will result in losses. Because most enterprise risk is speculative risk and because the enterprise itself can do much to lower its own risk, many companies are learning to manage their risk by creating departments and hiring people with the express purpose of reducing enterprise risks—also called as **enterprise risk management**. Many larger firms may have a chief risk officer (CRO) with the primary responsibility of reducing risk throughout the enterprise.

iii) Peril and Hazard

Peril is an immediate, specific event, causing a loss and giving rise to risk. An accident or illness is a peril. If a house burns down, then fire is the peril.

A **hazard** is a condition that gives rise to a peril. Smoking is a physical hazard that increases the likelihood of a house fire and illness.

Three types of hazards :

- **i)** **Physical hazards** are characteristics of the individual that increase or reduce the chance of peril. Examples are body structure (height related to weight), blood pressure, sugar levels, cholesterol levels etc.

- **ii)** **Moral Hazards** are habits or activities that increase risk, such as drug or alcohol use. These have social as well as personal effects.

- **iii)** **Morale Hazards** are individual activities that arise from a state of mind, such as the casual indifference toward one's body as exhibited by individuals with hazardous hobbies, such as ski-diving or flying ultra-light aircraft.

3. Loss must be definite and measurable: The insurer should be able to measure the loss in financial terms and there should be no ambiguity as to whether loss has occurred or not. That is, there should not be any doubt on whether the payment is due under the policy or not. For example, under health insurance, the cost of medical treatment is obtained by way of hospital and medical bills and enables the insurer to check on the extent of loss suffered by the insured.

4. The loss must not be catastrophic: Catastrophic losses refers to devastating losses arising out of a single event such as an earthquake. While insurance companies do cover catastrophic losses, they may agree to cover these losses for the insured, not as a standalone loss but combined along with other types of losses and provided the catastrophic losses are such that their occurrence would be rare. Most of the insurance companies protect themselves against catastrophic losses by taking out sufficient reinsurance. We have discussed above the criteria which should exist for a risk to be insurable. Another important aspect of insurance is related to underwriting.

1.3.2 Underwriting:

In insurance parlance the term underwriting refers to the insurer's decision as to whether to :

- a) Accept a risk
- b) Rate, terms and condition subject to which the risk is to be accepted.

For an insurer to be able to underwrite, he has to evaluate the risk as well as the exposure. Based on the evaluation, it decides on the extent of coverage to be granted, the premium to be charged in consideration of transfer of risk. If the nature of risk does not fit in with the underwriting philosophy of the company, the insurer (underwriter) may decide to decline acceptance of the risk.

While underwriting a risk, various factors are taken into account; for example, while granting motor insurance, the past driving record of the insured, age of the insured, type of vehicle etc. are of great relevance. Similarly, while underwriting health insurance, the past health history of the assured, nature of pre-existing diseases, family history of chronic ailment are taken into account.

The underwriters, based on information gathered, past experience on similar lines as well as using the underwriting guidelines of the company may decide :

i) To accept the risk

ii) To accept the risk subject to special terms and conditions

iii) To reject the risk

1.4 Insurance Act, 1938

This Act came into force on 1st July 1939 and is applicable to the whole of India, except Jammu and Kashmir. This law is applicable to all the insurance companies and other entities participating in the insurance industry in India .

The purpose of enactment of this law is:

1. To supervise all the organisations operating in insurance business in India. This is ensured by making registration compulsory.
2. To increase deposit of insurance companies to ensure that they are adequately financed and conform to minimum capital requirements.
3. Full disclosure of information is enforced to ensure soundness and transparency in management.
4. Submission of accounts and inspection of insurance companies by authorities.
5. Guidelines are laid for investment of funds by insurance companies.
6. Regulations to govern the assignment and transfer of life insurance policies besides including the possibility of making nominations.

The Insurance Act, 1938 was amended in 1950, again in 1956 when life insurance business was nationalized and again in 1972 when general insurance was nationalised.

1.5 Insurance Regulatory and Development Authority (IRDA)

IRDA is the regulator of the insurance industry in India and was constituted by an Act of Parliament in 1997. It has the following mission:

To protect the interests of the policy holders. To regulate, promote and ensure orderly growth of the insurance industry.

It is constituted by a 10 member team consisting of :

Chairman

Five whole time members

Four part time members

1.5.1 Duties, Powers and Functions of IRDA

Section 14 of the IRDA Act, 1999 lays down the duties, powers and functions of IRDA which are :

1. issuance of certificate of registration, renewal, modification, withdraw, suspend or cancel such registration;
2. Protection of the policyholders interest;
3. Laying down qualifications, training and code of conduct for intermediaries;
4. Laying down code of conduct for Surveyors;
5. Promote efficiency in the conduct of insurance business;
6. Promoting and regulating professional organisations connected with the insurance and re-insurance business;
7. Levying fees and other charges for carrying out the purposes of this Act;
8. Calling for information, conduct of inspection, audit of all organizations associated with the insurance business;
9. Control of the rates, terms etc. offered by general insurers in respect of business not controlled by Tariff Advisory Committee (TAC);
10. Specifying the manner in which accounts should be maintained by insurers and intermediaries;
11. Regulation of investment of funds by insurers ;
12. Regulation of maintenance of solvency margins;
13. Act as a dispute settlement authority between insurers and intermediaries;
14. Supervise TAC;
15. Specify the percentage of premium income to be utilised for promoting organizations mentioned in clause 6 ;
16. Specify the rural sector obligation of insurers;
17. Exercise any other powers as prescribed.

1.6 Insurance Advertisements and Disclosure Regulations, 2000

This regulation has been formulated with a view to prevent mis-selling and misleading information about the insurance products being sent to the potential clients. Some important points to be kept in mind are:

Every advertisement for insurance shall:

1. State clearly and unequivocally that insurance is the subject matter of solicitation;

2. State the full registered name of the insurer/ intermediary/ insurance agent;
3. Every insurance company shall be required to prominently disclose in the advertisement, the full particulars of the insurance company and not merely any trade name or monogram or logo;
4. Every insurer or intermediary or insurance agent shall have a compliance officer, whose name and official position in the organisation shall be communicated to the IRDA and he shall be responsible to oversee the advertising programme;
5. Every advertisement by an insurance agent that affects an insurer must be approved by the insurer in writing prior to its issue. It shall be the responsibility of the insurer while granting such approval to ensure that all advertisements that pertain to the company or its products or performance comply with these regulations and are not deceptive or misleading.
6. Every insurer or intermediary shall follow recognised standards of professional conduct as prescribed by the Advertisement Standards Council of India (ASCI) and discharge its functions in the interest of the policyholders.

1.7 Protection of Policy holders Interest Regulations, 2002

With a view to protect the end consumer, IRDA has laid down regulations which cover the following:

1.7.1 Matters to be stated in life insurance policy

1. A life insurance policy shall clearly state:
   i. the name of the plan governing the policy, its terms and conditions;
   ii. whether it is participating in profits or not;
   iii. the basis of participation in profits such as cash bonus, deferred bonus, simple or compound reversionary bonus;
   iv. the benefits payable and the contingencies upon which these are payable and the other terms and conditions of the insurance contract;
   v. the details of the riders attached to the main policy;
   vi. the date of commencement of risk and the date of maturity or date(s) on which the benefits are payable;
   vii. the premiums payable, periodicity of payment, grace period allowed for payment of the premium, the date for the last installment of premium, the implication of discontinuing the payment of an instalment(s) of premium and also the provisions of a guaranteed surrender value;
   viii. the age at entry and whether the same has been admitted;

ix. the policy requirements for (a) conversion of the policy into paid up policy (b) surrender (c) non-forfeiture and (d) revival of lapsed policies;

x. contingencies excluded from the scope of the cover, both in respect of the main policy and the riders;

xi. the provisions for nomination, assignment and loans on security of the policy and a statement that the rate of interest payable on such loan amount shall be as prescribed by the insurer at the time of taking the loan;

xii. any special clauses or conditions, such as, first pregnancy clause, suicide clause etc.;

xiii. the address of the insurer to which all communications in respect of the policy shall be sent;

xiv. the documents that are normally required to be submitted by a claimant in support of a claim under the policy.

2. While forwarding the policy to the insured, the insurer shall inform through the letter forwarding the policy, that the insured has a period of 15 days from the date of receipt of the policy document to review the terms and conditions of the policy and where the insured disagrees to any of those terms or conditions, he has the option to return the policy stating the reasons for his objection, whereby he shall be entitled to a refund of the premium paid, subject only to a deduction of a proportionate risk premium for the period on cover (15 days) and the expenses incurred by the insurer on medical examination of the proposer and stamp duty charges.

3. In respect of a unit linked policy, in addition to the deductions given under (2) above, the insurer shall also be entitled to repurchase the unit at the price of the units on the date of cancellation.

4. In respect of a cover, where premium charged is dependent on age, the insurer shall ensure that the age is verified, as far as possible, before issuance of the policy document. In case where age has not been admitted by the time the policy is issued, the insurer shall make efforts to obtain proof of age and admit the same as soon as possible.

1.7.2 Matters to be stated in general insurance policy

1. A general insurance policy shall clearly state:

   i. the name(s) and address(es) of the insured and of any bank(s) or any other person having financial interest in the subject matter of insurance;

   ii. full description of the property or interest insured;

   iii. the location or locations of the property or interest insured under the policy and where appropriate, with respective insured values;

iv. period of insurance;

v. sums insured;

vi. perils covered and not covered;

vii. any franchise or deductible applicable;

viii. premium payable and where the premium is provisional subject to adjustment, the basis of adjustment of premium be stated;

ix. policy terms, conditions and warranties;

x. action to be taken by the insured upon occurrence of a contingency likely to give rise to a claim under the policy;

xi. the obligations of the insured in relation to the subject matter of insurance upon occurrence of an event giving rise to a claim and the rights of the insurer in the circumstances;

xii. any special conditions attached to the policy;

xiii. provision for cancellation of the policy on grounds of mis-representation, fraud, non-disclosure of material facts or non-cooperation of the insured;

xiv. the address of the insurer to which all communications in respect of the insurance contract should be sent;

xv. the details of the riders attached to the main policy;

xvi. proforma of any communication the insurer may seek from the policyholders to service the policy.

2. Every insurer shall inform and keep informed periodically the insured on the requirements to be fulfilled by the insured regarding lodging of a claim arising in terms of the policy and the procedures to be followed by him to enable the insurer to settle a claim early.

1.7.3 Claims procedure in respect of a life insurance policy

1. A life insurance policy shall state the primary documents which are normally required to be submitted by a claimant in support of a claim.

2. A life insurance company, upon receiving a claim, shall process the claim without delay. Any queries or requirement of additional documents, to the extent possible, shall be raised all at once and not in a piece-meal manner, within a period of 15 days of the receipt of the claim.

3. A claim under a life policy shall be paid or be disputed giving all the relevant reasons, within 30 days from the date of receipt of all relevant papers and clarifications required.

However, where the circumstances of a claim warrant an investigation in the opinion of the insurance company, it shall initiate and complete such investigation at the earliest. Where in the opinion of the insurance company the circumstances of a claim warrants an investigation, it shall initiate and complete such investigation at the earliest, in any case not later than 6 months from the time of lodging the claim.

4. Subject to the provisions of section 47 of the Act, where a claim is ready for payment but the payment cannot be made due to any reasons of a proper identification of the payee, the life insurer shall hold the amount for the benefit of the payee and such an amount shall earn interest at the rate applicable to a savings bank account with a scheduled bank (effective from 30 days following the submission of all papers and information).

5. Where there is a delay on the part of the insurer in processing a claim for a reason other than the one covered by sub-regulation (4), the life insurance company shall pay interest on the claim amount at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

1.7.4 Claim procedure in respect of a general insurance policy

1. An insured or the claimant shall give notice to the insurer of any loss arising under contract of insurance at the earliest or within such extended time as may be allowed by the insurer. On receipt of such a communication, a general insurer shall respond immediately and give clear indication to the insured on the procedures that he should follow. In cases where a surveyor has to be appointed for assessing a loss/ claim, it shall be so done within 72 hours of the receipt of intimation from the insured.

2. Where the insured is unable to furnish all the particulars required by the surveyor or where the surveyor does not receive the full cooperation of the insured, the insurer or the surveyor as the case may be, shall inform in writing the insured about the delay that may result in the assessment of the claim. The surveyor shall be subjected to the code of conduct laid down by the IRDA while assessing the loss and shall communicate his findings to the insurer within 30 days of his appointment with a copy of the report being furnished to the insured, if he so desires. In certain circumstances either due to special or complicated nature of the case, the surveyor may, under intimation to the insured, seek an extension from the insurer for submission of his report. In no case shall a surveyor take more than six months from the date of his appointment to furnish his report.

3. If an insurer, on the receipt of a survey report, finds that it is incomplete in any respect, he shall require the surveyor under intimation to the insured, to furnish an additional report on certain specific issues as may be required by the insurer. Such a request may be made by the insurer within 15 days of the receipt of the original survey report. Provided that the facility

of calling for an additional report by the insurer shall not be resorted to more than once in the case of a claim.

4. The surveyor on receipt of this communication shall furnish an additional report within three weeks of the date of receipt of communication from the insurer.

5. On receipt of the survey report or the additional survey report, as the case may be, an insurer shall within a period of 30 days offer a settlement of the claim to the insured. If the insurer, for any reasons to be recorded in writing and communicated to the insured, decides to reject a claim under the policy, it shall do so within a period of 30 days from the receipt of the survey report or the additional survey report, as the case may be.

6. Upon acceptance of an offer of settlement as stated in sub-regulation (5) by the insured, the payment of the amount due shall be made within 7 days from the date of acceptance of the offer by the insured. In the cases of delay in the payment, the insurer shall be liable to pay interest at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

1.7.5 Policyholders' Servicing

1. An insurer carrying on life or general business, as the case may be, shall at all times, respond within 10 days of the receipt of any communication from its policyholders in all matters, such as:

    1. recording change of address;
    2. noting a new nomination or change of nomination under a policy;
    3. noting an assignment on the policy;
    4. providing information on the current status of a policy indicating matters, such as, accrued bonus, surrender value and entitlement to a loan;
    5. processing papers and disbursal of a loan on security of policy;
    6. issuance of duplicate policy;
    7. issuance of an endorsement under the policy; noting a change of interest or sum assured or perils insured, financial interest of a bank and other interests; and
    8. guidance on the procedure for registering a claim and early settlement

1.8 Third Party Administrators (TPA) - Health Insurance

TPAs are licensed by IRDA and are engaged for a fee or remuneration for the provision of health services. Health services means all the services rendered by a TPA as per the terms of agreement entered into with an insurance company in connection with health insurance business, however the services rendered will not include either insurance business or soliciting of insurance business either directly or through an intermediary. They are normally contracted by a health insurer to administer services, including claims administration, premium collection, enrollment and other administrative activities.

The license to act as TPA is granted by IRDA only to companies which have a share capital and are registered under Companies Act, 1956. As per the memorandum of the company, the primary objective should be to carry on business in India as TPA in the health services and they are not permitted to transact any other business. The minimum capital prescribed is Rs. 1,00,00,000 .

As per the act at least one of the directors should be a qualified medical doctor registered with Medical Council of India. The Chief Executive Officer (CEO) of the company has to under go training as prescribed by the IRDA.

The TPA can enter into agreement with more than one insurance company and the insurance companies can also deal with more than one TPA.

1.8.1 Code of conduct for TPA

The code of conduct for TPA has been prescribed by the Act.

TPA licensed under these regulations shall as far as possible act in the best professional manner.

In particular and without prejudice to the generality of the provisions contained above, it shall be the duty of every TPA, its Chief Administrative Officer or Chief Executive Officer and its employees or representatives to :-

1. establish its or his or their identity to the public and the insured/policyholder and that of the insurance company with which it has entered into an agreement.
2. disclose its licence to the insured/policyholder/prospect.
3. disclose the details of the services it is authorised to render in respect of health insurance products under an agreement with an insurance company;
4. bring to the notice of the insurance company with whom it has an agreement, any adverse report or inconsistencies or any material fact that is relevant for the insurance company’s business;
5. obtain all the requisite documents pertaining to the examination of an insurance claim arising out of insurance contract concluded by the insurance company with the insured/policyholder;
6. render necessary assistance specified under the agreement and advice to policyholders or claimants or beneficiaries in complying with the requirements for settlement of claims with the insurance company;

7. conduct itself /himself in a courteous and professional manner;

8. refrain from acting in a manner, which may influence directly or indirectly insured/ policyholder of a particular insurance company to shift the insurance portfolio from the existing insurance company to another insurance company;

9. refrain from trading on information and the records of its business;

10. maintain the confidentiality of the data collected by it in the course of its agreement;

11. refrain from resorting to advertisements of its business or the services carried out by it on behalf of a particular insurance company, without the prior written approval by the insurance company;

12. refrain from inducing an insured/policyholder to omit any material information, or submit wrong information;

13. refrain from demanding or receiving a share of the proceeds or indemnity from the claimant under an insurance contract;

14. follow the guidelines/directions that may be issued down by the IRDA from time to time.

Chapter 2 : Fundamentals of Risk Management

2.1. Definition of Risk

Risk is a condition whereby there is a possibility of loss occurring. In insurance the subject matter insured is called the Risk.

There are two main components in definition of risk:

i) **Uncertainty:** Uncertainty refers to a situation where an event may or may not happen. For eg. a building may or may not have a fire accident.

ii) **Undesired consequences:** Undesired consequences refers to the negative results that may arise out of an event, such as a fire accident which may result in damage to a property as well as result in consequential loss of business due to stoppage of work.

Risk is distinguished from peril and hazard.

Peril is a cause of loss, eg. fire.

Hazard is a condition that may create or increase the chance of a loss arising from a given peril.

Physical hazard refers to the hazards / features associated with a risk, such as storage of cotton near chemicals in a factory (chemicals increase chances of igniting the cotton).

Moral hazard refers to the moral risk of the insured. For instance if the insured has a history of making fictitious claim in the past, insurers would not like to insure him.

2.1.1 Subjective Risk and Acceptable Risk

Subjective risk is the extent to which a person feels threatened by a particular risk. Uncertainty of an event, as seen by an individual, varies from person to person based on the quality of data available of past events.

Acceptable risk is the level of subjective risk which an individual or company feels comfortable in facing and the size of loss that could be absorbed. Acceptable risk will always be influenced by financial considerations.

2.2 Classification of Risks

i. Pure Risks and Speculative Risks

Pure risks are those which present the possibility of a loss or no loss but not a profit. The person who buys a car immediately faces the possibility that something may happen which could damage or destroy the car. The possible outcomes are loss or no loss.

Speculative risks may produce a profit or loss. Most typical example is day trading, i.e. buying a share expecting to make profit which may not be the case always.

It is possible a risk may be both pure and speculative, e.g. loss of property by fire is a pure risk for owner. But speculative for the insurer who underwrites large number of risks hoping to achieve an overall profit on his portfolio.

ii. Dynamic and Static Risk

Dynamic risks are those resulting from changes in the economy, changes in price level, consumer tastes, income and output, technology and may cause financial loss to members of the society.

Static risk involves those losses that would occur even if there were no changes in the economy. These losses arise from causes other than changes in economy – eg. fire, flood.

iii. Fundamental and Particular Risks

Fundamental risks are those which affect the whole or significant part of the society - wars, major natural calamities etc.

Particular risks involve losses that arise out of individual events and affect an individual or a single firm and arise from factors over which he or it may exert some control.

2.3 Definition of Risk Management

Most definitions stress two points:

i. Risk management is concerned primarily with pure risk and

ii. Managing pure risks

Risk manager's job is:

i. Identification of the problem.

ii. Evaluation / measurement of its potential effects.

iii. Identification and analysis of possible solutions.

iv. Adoption of-the most appropriate solution.

v. Monitoring the results.

2.4 Stages of Risk Management - Two Stages

i. Risk identification - until a risk is identified as a threat, it cannot be managed.

ii. Risk measurement / evaluation - is essential to decide on the appropriate method of dealing with the risk.

The process of risk identification and evaluation/ measurement is called Risk Analysis.

2.4.1 Risk Identification

Consists of -

- Risk perception - ability to perceive that there is an exposure to risk.
- Identification of causes which can lead to a loss and its effect.

Whether the risk is actually a threat? How it might be caused? What perils would be involved? What are the likely consequences?

Tools of risk identification :

i. Exposure check list - this is simply a listing of common exposures. It is good to prepare a list of exposures, that is the peril to which the business is exposed to.

ii. Event analysis is a technique for considering likely events which could cause problems and then investigating the causes and effects. This technique uses as its starting point a particular loss producing event such as fire. Use of Hazard Logic Trees which is a method in which the various hazards which can increase the risk and increase the chance of operation of a peril is drawn, so that it is possible to identify the cause of and event which would produce a loss.

iii. Fault Tree Analysis - It highlights situations which may present no risk on themselves but which could endanger the organization if they were to exist together. Eg. if flammable vapours are produced in a chemical factory, this might not be a hazard in itself. However, if it is exposed to electrical spark or ignited cigarettes, the hazard is enhanced.

iv. Hazards and Operability Studies - this technique is used at the planning stage of process plants in order to identify and eliminate potential causes of failure. It consists of posing of the repeated question "what would happen if ...." at every stage.

v. Dow Index - Dow Chemicals in the USA developed a system for identification and evaluation of fire and explosion hazard potential based on the study of many plant accidents. The technique is to:

    - List all materials in the operation
    - Identify the dominant substance in terms of quality and hazard
    - Quantify the hazards according to heats of combustion, decomposition or reaction
    - Apply DOW rating factors.

    For eg. in a factory manufacturing chemicals, as a first step, all the materials used in the plant are listed, once the listing is done, the chemicals which are most hazardous are identified. The next step is to evaluate each chemical in terms of its various attributes to understand the risks to which it is most susceptible to. Once these are done, the rating which has been developed by DOW is applied. In this way the risk is identified and classified.

vi. Safety Audit – fire plus explosion safety, accident precaution, products safety, statistical analysis of experience, contingency plan, final report with recommendation and time bound implementations. To be done internally or by an outsider consultant.

vii. Flow charts - A flow chart of the entire process is drawn and risks the process is exposed to is identified.

viii. Site visits - standard of maintenance and housekeeping which have a bearing on exposure to losses arising out of fire, explosion etc. are analysed.

2.4.2 Risk measurement / evaluation

Once the risks are identified, the risk manager must evaluate them. Evaluation implies some ranking in terms of importance. In the case of loss exposures, two facts must be considered:

1. possible frequency or probability of loss
2. possible severity of loss

Measuring probability is difficult due to –

- Risks facing a company are not of a kind where the number of possible outcomes are known for certain.
- Therefore, statistical probability cannot be exactly calculated.
- What can be done is to calculate a probability of future occurrences based on information about the past.
- The probability arrived at will never be more than an estimate.

Two important conclusions :

i. Better the record keeping of past occurrences of a similar kind, better the measurement of a particular risk is likely to be.

ii. Catastrophic events happen so infrequently compared to small losses. The measurement of the probability of such events is likely to be least exact.

While measuring probability, severity must not be ignored as the effect of a risk is most important to risk manager. The most accurate determination of the probability of a fire occurring is of little use if the prediction does not distinguish between a trivial fire and one which destroys the factory.

Measuring Severity

Purpose is to locate a risk in the scale of risks facing an organization.

Risks facing any organization can be categorised as :

Trivial - effects can be borne by organization as part of normal operations.

Minor - effects can be born within a single accounting period.

Major - effects would be too great for the organization to bear in a single accounting period, but which could be acceptable if spread over a period of time.

Catastrophe - effects would destroy the organization.

The divisions between these categories can be expressed in financial terms and there tends to be an inverse ratio between size of a risk and its frequency.

Risk	**Occurence**
Catastrophe	Rare
Major	Infrequent
Minor	Fairly Frequent
Trivial	Frequent

2.4.3 Risk Avoidance

Risk avoidance is the most drastic method of dealing with risks. Whereas other methods are aimed at reducing the potential impact of risks, either by reducing loss probabilities or reducing financial consequences, risk avoidance results in total elimination of exposure to loss due to specific risk. But it is most limited in practical application because it involves abandoning some activity and so losing the benefits that may accompany it. It is a negative rather than a positive approach.

Depending on the type of risk involved risk avoidance can be achieved by :

- Changing the activity which brings about risk.
- Changing materials used in the activity.
- Changing the method by which the activity is done.

Plan for risk avoidance at planning stages - saves expenses, disruption of business etc.

Risk Reduction

Risk avoidance is limited in scope. A more common approach is risk reduction.

Risk reduction may relate either to the probability or severity and may take effect before, during or after a loss.

STAGE	TECHNIQUE	AIM
Pre Loss	Preventive - eliminate cause of loss	Reduce Probability
During Loss	Protection - salvaging to preserve as much as possible of the value of damaged property or ability of injured person	Reduce severity
Post Loss	1. Protecting things or persons exposed to damage or injury. 2. To limit loss to as small a compass as possible.	Reduce severity

All forms of risk and loss reduction will involve the following:

1. Physical Devices
   i) Active devices which continually operate to reduce the probability of a loss producing event occurring - e.g. thermostats on boilers and refrigerating equipment, overload switches on electrical equipment.
   ii) Passive devices like security and fire alarm, sprinklers, automatic fire door etc.
2. Organisational measures - structure and responsibility geared towards risk control goals.
3. Education and training of employees.
4. Management education and training - to create awareness of the risk to which the organization is exposed and of the ways in which they may be controlled.
5. Contingency planning - prepares the organization for 3 phases:
   i) Pre-loss - emphasis on ways of preventing the risk from producing its effects and ensuring that those effects are minimized if loss occurs.
   ii) At the time of loss - main concern is to save life and salvage property and to bring the disaster to end as quickly and as safely as possible, so as to limit its effects.
   iii) Post loss - a recovery plan to be implemented to bring the organization back to its normal pre-loss level of operations as quickly as possible.

2.4.4 Risk Transfer

1. Transfer of the activity that creates the risk.
2. Transfer of financial losses arising from the occurrence of the risk e.g. subcontracting hazardous activities - transfer of liability to contractor etc.

Transfer of liability risks by contract, is by exclusion clause, hold harmless clause or indemnity clause.

This contract for transfer of risks is entered into by the parties to the contract whereby one party is relieved of his responsibility for loss/damage for which he is responsible under common law. For eg. an owner of a building is responsible for any damages to the building and has to incur expense to rectify it. He may enter into a contract with the tenant whereby the tenant takes over the responsibility for damages to the property.

Exclusion clause - clauses that relieves one party of the liabilities that he may otherwise incur towards the other.

Hold Harmless clause - a contract usually written such that one party assumes legal liability on behalf of another party.

Indemnity clause – contract to indemnify one party for losses sustained in lieu of consideration received.

2.4.5 Risk Financing

After risk is identified, measured and treated appropriately, the question of financing the risk arises:

Options

1. Pay for losses as they arise out of operating budgets with no specific financial provision being made.
2. Set up internal contingency fund to meet loss.
3. Borrow to meet cost of losses - from subsidiaries.
4. Risk transfer by insurance.

2.4.6 Risk Retention

Factors influencing risk retention decision:

1. Risk Appetite of the organization - management philosophy, size of company etc.
2. Nature and size of risk
3. External incentives and disincentives - this refers to the incentive which a company derives for retaining risk or disincentive for transferring risk. For eg. some of the rating agencies from Japan do not confer quality rating to a company if the company avails loss of profit insurance. Loss of profit insurance is an insurance where losses in revenue sustained due to stoppage of business due to an insured peril is covered. If such coverage is taken, it implies (as per the rating agencies) that the insured does not have an alternative plan to continue with production and cannot commence operations within a short period of time from an unforeseen event.

2.4.7 Construction of a plan

Once the risk exposure is identified and analysed, the next step is to take a decision on the combination of measures which an enterprise wishes to adopt to minimize or eliminate the risk. This is done by putting up an appropriate risk management plan. The plan should clearly state the various techniques of risk management adopted with regard to various risks. The plan for a shop may state that:

a) The measures for risk reduction such as putting up fire extinguishers, warning boards etc.

b) Risk avoidance measures such as undertaking not to sell crackers, cigarettes etc.

c) Risk transfer measures such as availing Fire, Burglary, Money Insurance

d) Risks retained; such as, since the employees are highly trusted, the insured decides not to avail of fidelity polices

2.4.8 Implementation of a plan

Once the risk management plan is adopted, the next step is to implement it. The plan so adopted should be economical, efficient and should be constantly updated.

2.4.9 Monitoring the Plan

The risk management program does not end with the implementation of a plan. The success of the plan has to be constantly monitored, the outcome should be reviewed. This would enable the risk manager to detect risks which might have escaped his attention earlier and plug holes in the plan to ensure that the optimal program is formulated.

Chapter 3: Insurance Contract, Terminology, Elements and Principles

3.1 Introduction

All insurance purchases involve contracts. In fact, insurance is a distinct branch of contract law. It would be easier to understand insurance, if general knowledge of contract law is available with a person. It is important to understand the term 'contract' as it is used in general and the distinguishing feature of insurance contract.

A 'contract' is an agreement between two or more parties which, if it contains the elements of a valid legal agreement, is enforceable by law or in other words a 'contract' involves exchange of promise and in case of breach the parties to the contract can avail of legal remedy. The law of contract in India is governed by the Indian Contract Act, 1872.

3.2 Contract Terminology

Contracts are legally binding agreements which mean that the parties to the contract have legal recourse in the event of one of the parties not adhering to the terms of the contract. The court can either ask the party to the contract to honour the commitment and perform an act as laid down in the contract or it can instruct the offender to compensate the affected party financially.

Depending on the nature of breach, a contract may either become :

i) Void, or

ii) Voidable

A contract becomes void if the purpose of the contract is illegal for e.g. an insurance policy taken to cover a smuggled item becomes void and cannot be enforced. Similarly, if a person not competent to enter into a contract, such as a person of unsound mind is party to a contract, the contract becomes void ab initio (which means the contract is void from the very beginning of the contract). The courts cannot enforce such a contract as the contract, in strict terms, never existed.

A contract becomes voidable when one of the parties to the contract can exercise the option of breaking the contract when the other party commits a breach of any of the terms of the contract. For instance, in an insurance policy, if the insured changes the nature of business, from that of an office to a shop, then, in the event of a claim, the insurer can refuse to admit a claim and can consider the contract as voidable as the insured has failed to inform them about change in the nature of risk.

3.3 Elements of a Valid Contract

All valid contracts must have the following four elements: offer and acceptance, consideration, capacity and legal purpose.

3.3.1 Offer and Acceptance

In any valid contract, there should be an offer and acceptance. If we take the insurance policy as an example, the insured makes an offer by way of filling up a proposal and the insurer accepts the offer by quoting rates and terms under which he is willing to accept the offer to insure. It is of absolute importance in a contract that both the offer and acceptance should be expressed in terms which are unambiguous and clear.

It is also important that the acceptance should be on the same terms on which the offer is made. For instance, if an insured makes an offer to cover his house in Karol Bagh, Delhi, then the acceptance should be for coverage of the same house and not a different property. If the second party to whom the offer is made wishes to make a counteroffer, he may do so and the contract is valid only when the first party agrees to the terms proposed by the second party. This is called “consensus ad idem”.

The acceptance of an offer should be unconditional. If any conditions are imposed then those conditions have to be agreed to by both the parties for the contract to come into existence.

While it is good for the offer and acceptance to be in writing, both oral and written offer and acceptance are recognised by law.

3.3.2 Consideration

Consideration is the price paid by both the parties for the promise and is a key requirement for a valid contract. The logic for this is that each part to the contract should confer some benefit on the other. In insurance, the consideration on the part of the insured is the money he pays as premium and the insurer makes a promise to indemnify the insured in the event of the happening of the contingency insured against.

3.3.3 Capacity

The third requirement for a valid contract is the capacity of the parties to enter into a contract. The reason being a person entering into the agreement should have the ability to honour the commitment made under the contract. Minors, a person of unsound mind, those in an intoxicated state etc. cannot enter into a legally binding agreement. The purpose is to ensure that people who are not in a fit state should not be taken advantage of.

Similarly the insurer should possess the necessary qualification to enter into a contract. In India only those insurers who have been licensed by IRDA to carry on the business of insurance can issue insurance policies.

3.3.4 Legal Purpose

The purpose of the agreement/contract should be legal. If two parties enter into an agreement the purpose of which is not legal, the same cannot be enforced in a court of law and hence the contract would not be valid. For example, if an insurance policy is issued to cover the results of a race, the contract would become invalid.

3.4 Distinguishing Characteristics of Insurance Contracts

While all the contracts should have the abovementioned four features to be legally binding, an insurance contract has some special characteristics while at the same time adhering to the above mentioned features.

The special features of an insurance contract are :

1. Principle of indemnity
2. Rules of insurable interest
3. Subrogation in insurance
4. Doctrine of utmost good faith
5. Aleatory contract concept

3.4.1 Principle of indemnity

Insurance contracts are generally based on the principle of indemnity. As per this principle, the insured should be in the same financial position after the settlement of claim as he was immediately prior to the loss. The rationale being that the insured should not benefit from an insured loss.

However there are some insurance policies which are an exception to the above rule, such as:

1. Life Insurance

Since the value of human life cannot be assessed, life insurance policies are not strict policies of indemnity. These are more of a benefit policy. However, this does not mean that one can take insurance policy for any value, as this would create a moral hazard. Most of the insurers determine the sum assured based on some benchmark, such as the earning capacity of the assured.

2. Replacement cost insurance

This policy offers new for old and came into vogue during the second world war. Due to high inflation in those days, the claim amount received on market value basis was found to be inadequate to carry on businesses. Such type of policies are issued under Fire and Engineering branch of insurance and they are granted for relatively new property, project insurance etc. In such policies no depreciation is deducted and the claim settlement is made on replacement value of the property on the date of loss.

3. Valued insurance policies

A valued insurance policy is another exception to the rule of indemnity. Valued policies pay the full face value of the policy whenever an insured's loss occurs. The value of the insured property is agreed to before the policy is written. Marine insurance contracts are issued on a valued basis. Under marine insurance, the policies are generally issued for Invoice cost + Freight + Insurance + 10% being margin for profit.

For eg. marine insurance is taken for 100 cartons of readymade garments which has an invoice value of Rs 1,00,000, the freight payable for transporting it is Rs. 2,000, marine insurance payable for covering the transportation risk is Rs. 1,500. Insurance can be taken for Rs. 1,00,000 + Rs. 2,000 + Rs. 1,500 = Rs. 1,03,500 . Additional 10% can be added for the profit which the seller may make on the transaction, as the profit would be lost in case of any loss or damage while the consignment is in transit. Hence, the value for which insurance can be taken is Rs 1,03,500 + 10% (of Rs. 1,03,500) = Rs. 1,13,850. This is the amount that will be paid by the insured to the insurer in case of loss, damage to the cartons.

Claim settlements are also based on the valuation agreed upon.

Similarly while insuring obsolete machinery, antiques, works of art which does not have a regular market, the valuation is agreed prior to the commencement of the policy to avoid disputes in the event of claims.

3.4.2 Insurable Interest

For an insurance contract to be valid, the proposer should have insurable interest in the subject matter of insurance. Insurable interest implies that the proposer should benefit financially by the continued existence of the insured property/life or should be put into financial loss by the loss/damage/death of the subject matter insured.

i) Property Insurance

In all types of property insurance other than marine, the insurable interest should exist at the time of inception of the risk as well as at the time of claim. Marine insurance, by its nature, is taken to cover trade related activities wherein the rights to the goods is passed on from one party another. Hence, insurable interest under marine insurance should exist at the time of claim. The person with insurable interest is the person in whom the ownership of the property vests at the time of loss.

ii) Life Insurance

In life insurance, insurable interest should exist at the time of entering into the contract. Further, in life insurance it is the owner of the policy and not the beneficiary who should possess insurable interest. However, it is quite possible that owner and the beneficiary are the same though it is not mandatory.

3.4.3 Subrogation

Subrogation is the legal substitution of one person in another's place. Subrogation means "stepping into the shoes" of another person. In insurance it implies if the insured has any rights against third parties, the insurer on payment of the claim takes over these rights. This is a corollary to the principle of indemnity and enforcing the principle of subrogation ensures that the principle of indemnity is upheld. In insurance, subrogation gives the insurer the right to collect from a third party, any rights which the insured has against such a third party, after paying the insured's claim(s). A typical case of subrogation arises in automobile insurance claims. Suppose Satish is responsible for the collision of his car with Rahul's car. Rahul may sue Satish for damages or he may collect money from his own automobile insurance. If he chooses to collect money from his own insurance, his insurance company will be subrogated to his right to sue Satish (insurance company replaces Rahul). Rahul cannot collect money for his loss both from his insurer and from Satish.

Subrogation does not exist in life insurance because life insurance is not a contract of indemnity. Thus, if Mr. Rahul Kumar is killed by his neighbor's negligence, Mrs. Kumar may collect whatever damages a court will award for her husband's wrongful death. She may also collect the life insurance proceeds. The life insurer is not subrogated to the liability claim and cannot sue the negligent party.

3.4.4 Utmost good faith (Uberrimae Fidei)

In all legal contracts, it is essential that the parties to the contract exercise good faith. However, in insurance the emphasis is on utmost good faith which should be exercised by the insured. As the insured alone has complete information about the subject of insurance, he should reveal all the facts to the insurer. In case of breach of this condition the contract becomes void abinitio.

3.4.5 Aleatory contract

Aleatory contract is a contract wherein the performance of one or both the parties is based on the occurrence of an event. Such insurance contracts may be a boon to one party but create a major loss for the other, as more in benefits may be paid out than actual premiums received, or vice versa (a large amount is paid by way of claim where as the amount received as premium is very small, or when there is no claim, the entire premium is retained without any outflow to the insured).

3.4.6 Contract of adhesion

The wordings of the insurance policy is written by the insurer and the insured either accepts the contract in full or rejects it but cannot modify it. Because of the one sided nature of the contract, the courts interpret the policy wordings and clauses, in case of any ambiguity, in favour of the insured.

3.4.7 Unilateral contract

Insurance contracts are unilateral in nature as only the insurer can be held accountable in a court of law.

3.5 Common clauses and sections in a insurance contract :

The insurance contract contains the following sections and clauses :

1. Declaration section where in the insured declares that the information provided by him is true to the best of his knowledge.
2. The operative clause which describes the insured and the extent of coverage.
3. Exclusions under the policy.
4. Conditions which need to be fulfilled for the cover to be valid.
5. Riders and endorsements which are not standard part of the policy but can be covered subject to extra premium. The term rider is used in Life policies. A common rider is accidental death also called double indemnity, whereby if death occurs due to an accident, the claim amount payable is double the face value of the policy.

Chapter 4: General Insurance

4.1 Insurance can be broadly classified as:

A) Life Insurance

B) Non- Life Insurance

As the name denotes, Life Insurance deals with insurance of human life and Non – life deals with all insurance other than life.

4.2 Non-Life insurance can be further classified into:

A) Property Insurance

B) Personal Insurance

C) Liability Insurance

In this chapter we will deal with various types of Property Insurances.

4.3 Types of Property Insurance :

A) Fire Insurance

B) Various types of Engineering Insurance

C) Marine Insurance, etc.

4.3.1 Fire Insurance

4.3.1.1 Suitability

Fire insurance policy is suitable for the owner of a property, one who holds property in trust or in commission, individuals/financial institutions who have financial interest in the property. All immovable and movable property located at a particular premises such as buildings, plant and machinery, furniture, fixtures, fittings and other contents, stocks and stock in process along with goods held in trust or in commission including stocks at supplier's/ customer's premises, machinery temporarily removed from the premises for repairs can be insured.

4.3.1.2 Salient Features

Along with the basic coverage against loss or damage by occasional fire, the standard fire and special perils policy provides protection from a host of other perils such as:

1. Lightning
2. Explosion/implosion

3. Aircraft and articles dropped therefrom, i.e. any damage to the insured property caused either due to an aircraft falling on the property or any object dropped from the aircraft damaging the insured's property.
4. Impact damage due to rail/road or animal; other than insured's own vehicle
5. Riots, strike, malicious and terrorism damage
6. Subsidence (motion of a surface as it shifts downward) and landslides (including rockslide)
7. Storm, cyclone, typhoon, tempest, hurricane, tornado, flood and inundation, damage caused by sprinkler leakage, overflow, leakage of water tanks, pipes etc.

4.3.1.3 Extra covers

The policy may be extended to cover earth quake, fire and shock; deterioration of stock in the cold storages following power failure as a result of insured peril, additional expenditure involved in removal of debris, architect / consulting engineers' fee over and above the amount covered by the policy, forest fire, spontaneous combustion and impact damage due to own vehicles.

4.3.1.4 Benefits

In case of a partial loss, the insurance company effects payment for repairs and replacement. In case of policy with reinstatement value clause, cost of reinstatement will be paid on completion of reinstatement subject to overall limit of the sum insured. The insurance company may at its option, also repair or replace the affected property instead of paying for the cost of restoration.

4.3.1.5 Premium

- Premium rating depends on the type of occupancy-whether industrial or otherwise.
- All properties located in an industrial complex will be charged one rate depending on the product(s) made.
- Facilities outside industrial complexes will be rated depending on the nature of occupancy at individual location.
- Storage areas will be rated based on the hazardous nature of goods held.
- Additional premium is charged to include "Add on" covers.
- Discount in premium is given based on past claims history and - fire protection facilities provided at the premises.
- The insured has the option not to avail riot, strike, malicious and terrorism damage cover. Similarly the insured can decide not to take coverage against the risks of flood, storm, typhoon and inundation in which case the insured may be entitled to some discounts.

4.3.2 Various types of Engineering Insurance

4.3.2.1 Machinery insurance policy

Machinery Insurance Policy was developed to grant industry effective insurance cover for plant and machinery and mechanical equipment at work, at rest or during maintenance operations. Normally financial institutions insist on insurance cover against fire, riot and strike and Acts of God perils. With the advancement of technology, the machines used in the industry are becoming increasingly complicated. Now machines are manufactured with increased capacities, higher speeds of operation, reduced energy consumption, reduced maintenance time, reduced life, cheaper substitutes for reducing costs etc.

The machineries are getting more and more sophisticated and delicate. The guarantees given by the manufacturers are very vague. It is very difficult to prove whether a loss was due to manufacturing defect or not.

Since a modern machine replaces a number of small machines, the cost of replacement is high. The cost of repairs of most of the machinery would be rather high due to the expertise required to carry out the repairs as well as frequent changes in technology making the earlier machines redundant or making it difficult to get spare parts etc. A major breakdown in the machinery may have a severe affect and wipe out a large portion of profit for a businessman.

4.3.2.2 Machinery covered under the policy

Under machinery insurance, it is possible to insure practically all stationary and mobile machinery, mechanical and electrical equipments, machineries and apparatus used in industry. Fertilizer plants have many critical types of equipments. The vital equipments such as main compressors, turbine, turbo alternator sets, process and their motors blowers, transformers and boiler feed water pumps, ID fan, FD fan, etc. can be insured.

4.3.2.3 Basis of sum insured

The sum insured to be declared under this policy should be its new replacement value including freight, customs duty if any, handling and erection charges.

4.3.2.4 Deductible / excess under the policy

Every item in this policy is subject to a deductible excess. This is the amount which the insured has to bear in each and every loss or damage that occurs to the item. Over and above this amount only the insurers are liable under this policy. Thus in case of a claim, the insurers deduct this excess from the claim amount and pay the rest of the amount.

4.3.2.5 Basis of claim settlement

The basis of claim settlement is as follows :

1. Partial loss : Cost of replacement of parts in full without depreciation plus the labour charges, cost of dismantling, re-erection, freight to and from repair shop, customs

duty, if any. In case of items with limited life, appropriate depreciation is taken into consideration.

2. Total loss : Total loss is destruction of an asset or property to the extent that nothing of value is left and the item cannot be repaired or rebuilt to its pre-destruction state. In case of total loss the settlement is based on the actual value of item immediately before the occurrence, taking into account appropriate depreciation.

4.3.3 Contractors All Risk Insurance

4.3.3.1 Introduction

Contractor's All Risks (CAR) Insurance is a relatively modern branch of engineering insurance. The basic concept of CAR Insurance is to offer comprehensive and adequate protection against loss or damage in respect of the contract works, as well as for third party claims in respect of property damage or bodily injury arising in connection with the execution of a civil engineering project.

4.3.3.2 Insured

CAR insurance may be availed by :

- the principal
- the contractors engaged in the project, including all subcontractors.

In order to prevent overlaps or gaps in the cover provided, the insured under CAR insurance can be all parties concerned, such as the Principal, the contractor and sub contractor (where applicable) so that the interests of all the parties are protected.

4.3.3.3 Subject matter insured

CAR insurance can be taken out for all buildings and civil engineering projects, such as:

- office buildings, hospitals, schools and theaters
- factories, power plants
- roads and railway facilities, airports
- bridges, dams, tunnels, water supply and drainage systems, canals and harbours etc.

The cover relates to the following:

• Bantras Works :

This denotes the property being erected including preparatory work on the site, such as excavation, grading and leveling work, the execution of' temporary structures like diversion and protective dams etc.

- Temporary Structures and Equipments :

This includes workers' temporary accommodations, storage sheds, scaffolding, construction utilities for temporary electricity, water supply etc.

- Construction Machinery :

This includes earthmoving equipments cranes and the like as well as site vehicles not licensed for use on public roads, no matter whether such machinery is owned or hired by the contractors. These are to be covered under separate Contrator's Plant and Machinery (CPM) policy.

- Costs at Clearance of Debris :

This term implies the expenses incurred for the removal of debris from the site in the event of a loss indemnifiable under the policy.

- Third Party Liability :

This refers to legal liability arising out of property damage or bodily injury suffered by third parties and occurring in connection with the contract work on or near the building site. However, the cover does not extend to indemnify insured against any claims from the insured's employees or workmen who are connected with the construction project.

- Surrounding Property :

The term implies property located on the site as well as property surrounding the site.

A distinction is made however, between :

Property belonging to or held in care, custody or control of persons named in the policy as the insured (in this case cover is only granted by way of an endorsement) and property belonging to or held in care, custody or control of persons, who may be regarded as third parties for the purposes of the policy, (in this case indemnity is payable according to the principles of third party liability cover of the CAR policy).

4.3.3.4 Scope of cover

CAR insurance provides an 'all risk' cover whereby every hazard is covered which is not specifically excluded. This means that almost any sudden and unforeseen loss or damage occurring during the period of insurance to the property insured on the building site is indemnified. The most important causes of loss indemnification under CAR insurance are:

- Fire, lightning and explosion
- flood, inundation, rain, snow avalanche, wind storm
- earthquake, subsidence, landslide, rockslide
- theft, burglary
- bad workmanship, lack of skill, negligence, malicious act or human error

CAR insurance also covers loss of or damage to building material; on site, while being transported, while in intermediate storage or during assembly or disassembly.

The cover provided for CAR insurance is only subject to a few exclusions which the international insurance markets usually apply. These are normally what are termed as uninsurable risks. These exclusions are named in the policy and essentially comprise:

i. loss or damage due to war or warlike operations, strike, riot, civil commotion, cessation of work, requisition by order of any public authority (it is possible to include the risks of strikes and riot in special cases but such an inclusion is subject to careful prior examination)

ii. loss or damage due to wilful act or wilful negligence of the insured or of his representatives.

iii. loss or damage due to nuclear reaction, nuclear radiation or radioactive contamination

iv. consequential loss of any kind or description whatsoever such as claims from penalty losses due to delay, loss of contract

v. loss or damage due to mechanical and/or electrical breakdown or derangement of construction machinery, plant and equipment

vi. loss or damage due to faulty design

vii. the cost of replacement; repair or rectification of any deficiencies in the contract works (i.e. use of defective or inadequate material). While the cost of rectification of a defective material/work is excluded, if this defective material/workmanship causes any other damage, such losses are payable. For eg. if a part of the building develops cracks and falls down due to defective workmanship, which in turns falls on a machinery and damages the machinery, loss to such machinery is payable though damage to the part of the building which developed cracks is not payable.

4.3.3.5 Period of cover

The cover attaches as from the commencement of Work or after the items entered in the schedule of the policy have been unloaded at the site and terminates when the completed structure or any completed part thereof is taken over or put into service. In addition, it is possible to extend the period of cover to include maintenance period.

4.3.3.6 Calculation of sum insured and premium

a. **Sum insured**

The sum insured must be equal to the amount stated in the building contract, plus the value of any construction material supplied and/or additional work performed by the principal. Any increase in the contract sum must be notified immediately to the insurers in order to avoid under insurance.

Usually, separate sums insured are fixed for:

- construction machinery and construction plant and equipment (the relevant sum insured must be equal to the replacement value applicable when the contract is concluded, including freight, erection costs and customs duties) ;
- existing buildings and clearance of debris (in this connection it is essential that the respective sums insured are adequate)

Third party liability cover is likewise subject to a separate limit of indemnity for any one accident or series of accidents arising out of an event.

b. **Premiums**

The premium rates for CAR insurance is based on the nature of the project and period of contract taking into account peculiarities of each individual project. Basically, the following factors are considered for proper risk assessment:

i. experience and ability of the contractor

ii. conditions on and exposure of the site e.g. the probability of earthquakes, flood, inundation etc.

iii. design features and building material

iv. construction techniques

v. safety factors considered in the construction; time schedule measures provided to ensure safe execution of the project

To be able to arrive at premium rate which are reasonable and commensurate with the risk involved, the insurers must be given an opportunity of checking the building contract, drawings and specifications, construction time schedule as well as other relevant information. The more complete the information given to the insurers, the more accurate the assessment of the risk will be and the more appropriate and fair the premium for the insured.

If it is not possible to complete a project within the policy period, the insurance may be extended, subject to the payment of an additional premium.

4.3.3.7 Indemnification

While the CAR policy undertakes to indemnify the insured against loss or damage specified in the policy, it is customary to make the insured responsible for a small portion of the loss. This is achieved by stipulating a deductible:

- A deductible is stipulated for each CAR insurance. This is the share in each and every loss which the insured has to bear from his own account and which is thus deducted from the amount of indemnity of indemnity. The deductible varies according to the type and size of a building project and the hazards involved in each individual case. The purpose of each deductible is to stimulate the insured's interest in loss prevention and to relieve the insurers as also the insured from dealing with the many minor losses where the administrative expenses incurred would be excessive compared with the indemnity. Usually, separate deductibles are applied for the contract works, the temporary structures for normal losses and losses due to Act of God perils such as flood, storm, earthquake etc. The limit of indemnity over all is the sum insured.

4.3.4 Marine Cargo Insurance

4.4.4.1 Brief History :

Marine insurance is as old as civilization. This system of marine insurance owes its origin and evolution to mankind's fear of future uncertainty and consequent search for security. It began probably in the cities of Northern Italy by the Lombardy merchants around the end of the 12^{th} century. Marine insurance became a full-fledged and specialised activity some centuries later. The humble coffee house of the Lloyds opened by Edward Lloyd around 1680 AD saw the beginning of marine insurance. From these humble beginnings it has now grown into a business of vast proportions.

4.3.4.2 What is marine insurance?

It is a system of financial protection against the happenings of accidental or fortuitous events, such as;

a) During sea transportation' the goods may be lost due to sinking of the vessel.

b) Damaged due to incursion of seawater into the holds of the ship during rough weather.

c) During land transit, the goods may be lost damaged by the derailment of railway wagons or collision of motor goods vehicle.

d) During transit and whilst in storage incidental to transit, the goods may catch fire or may be stolen.

These hazards or causes of loss are referred to as perils or risks in insurance terminology And may result in the following types of losses:

a) Total loss - e.g. an entire shipment is lost due to the sinking of the vessel or due to outbreak of fire

b) Partial loss - cargo is damaged by seawater during heavy weather or cargo is jettisoned (thrown away) to save the marine voyage threatened by heavy weather.

c) Expenses - The insured may incur certain expenses to prevent aggravation of loss or damage - e.g. hides (animal skin before it is converted to leather) / leather slightly damaged by seawater may be - re-conditioned at an intermediate port to reduce the loss or prevent the total loss.

The purpose of marine insurance is to indemnify such losses. The types of losses paid for and the extent of payment depends upon the terms and conditions of the marine insurance policy. Marine insurance covers cargo when it is in transit not only over the sea but also when in transit by air, overland, inland, waterways, costal seas and also when being sent by post (registered or otherwise) etc. In fact anything in transit under a valid contract can be covered under a marine policy.

4.3.4.3 What is the need for marine insurance?

Marine cargo insurance and banking are considered to be the life blood of commerce. Domestic and international trade is financed by the banking system and this financing is dependent on "collateral security" against loss, which is provided by the marine insurance policy. The cargo might constitute the "physical security" for the bank finance, but if the goods are lost or damaged by transportation hazards, this "physical security" is of no use to the banks. Hence, the marine cargo insurance provides the supportive security.

4.3.4.4 Limited liability of the carrier (shipper):

At times shipping and trading circles argue that the carrier's liability can take the place of an insurance policy. The Carriage of Goods by Sea Act, 1925, statutorily determines the carrier's liability and responsibility. Unless it can be proved that the carrier did not perform his duties as provided for in the statute, he cannot be held liable. The undertaking to make good the loss under insurance policy is wider in scope than under the various statutes governing carriers. The per package limitation and provisions relating to excluded articles also act as limitations to recovery of the full value of the goods from the carriers.

4.3.4.5 What are the special features of marine insurance?

a) Marine cargo policies are freely assignable because the interest in the goods passes through various hands till the ultimate consignee takes final delivery. A cargo policy may be assigned either before or after a loss.

   Since the policies are freely assignable the existence of the insurance interest of the claimant should exist at the time of loss. There is no need of insurable interest to exist at the time of taking up the policy. However, the insured should have reasonable expectation of acquiring such interest at a later date.

b) The sum insured indicated in the policy is the value agreed between the insured and the insurer. Hence the policies are on agreed value basis. The value so agreed upon cannot be reopened i.e. the value once agreed upon cannot be changed unless fraud is suspected. In addition to cost, insurance and freight a percentage loading is included to arrive at the agreed value. An element of anticipated profit can also be added to arrive at such an agreed value. The indemnity provided by the policy is of course subject to the actual amount of the loss or damage and is also subject to the overall limit i.e. the sum insured.

c) The duration of cover in a marine policy is subject to the transit clause of the respected cargo clause. This differs from one mode of transit to another (sea, rail, road and air). While the duration of cover in other clauses of insurance is fixed at the time of the issue of the policy itself - in marine insurance it is governed by the nature of transit, time of discharge, time of arrival at destination.

d) The interpretation and applicability of various Statutes, the legislation of various countries, port conditions, customs procedures, and the legal systems in various parts of the world, govern the operation and interpretation of a marine insurance policy.

4.3.4.6 Scope of cover

A marine insurance policy undertakes to indemnify the insured in the event of a loss caused by an insured peril during the currency of the policy. The cargo is exposed to various perils from the time it leaves the supplier's warehouse till received at the final warehouse of the consignee. The policy should offer cover against these various types of losses. The minimum extent of cover is against the total loss or damage of the cargo. This can be caused by fire, sinking, stranding, washing over-board etc. Cargo remaining undelivered is also a loss to the insured. The total loss may be of the entire cargo or a part thereof may be totally lost. The scope of cover afforded under different types of policies is determined by the clauses attached to them.

4.3.5 Features of motor insurance

4.3.5.1 Types of covers

We shall now see how motor insurers meet the insurance requirements of their clients- both compulsory and optional.

Irrespective of the type of vehicle involved, motor insurers usually will grant one of four main types of policy cover, namely:

- Statutory Third Party Liability Only
- Extended Third Party Liability only
- Third party, fire and or theft
- Comprehensive

In many countries the third party liability cover is broken in two parts, viz; third party bodily injury and third party property damage. The conditions of the policies issued may vary in many respects according to the class of vehicle insured.

4.3.5.2 Classification of motor insurance business

For proper and equitable rating of any insurance portfolio the insurable population has to be divided into homogeneous groups, more popularly known as classifications, such that the constituents of each class present more or less the same degree of risk for the insurer. If a group consists of constituents having diverse risk levels, the pricing of insurance for such a group would be very difficult and may expose the insurer to the risk of adverse selection. Motor insurance business is commonly divided as follows:

a) Private cars (not used for carrying passengers for hire or reward)

b) Motor cycles

c) Commercial vehicles (including private cars carrying passengers for hire or reward)

d) Motor trade road risk

e) Motor trade internal risk

- **Private Cars**

This category comprises cars of private type including station wagons used for social, domestic and pleasure purposes and business or professional purposes (excluding the carriage of goods other than samples).

- **Motor Cycles**

Motorcycles with or without sidecars, pedal cycles or mechanically assisted pedal cycles and motor scooters with or without sidecars come under this category.

- **Commercial vehicles**

All vehicles other than Private Cars or Motor Cycles excluding vehicles running on rails come under this category.

- **Motor trade road risk**

Essentially this classification is a sub class of commercial vehicles and the road risks of vehicles belonging to motor traders, before being sold to the ultimate customers, are covered under this class.

- **Motor trade internal risk**

This class covers the risk that the motor trader is exposed to while the vehicles are either brand new or belong to customers and are on premises of the motor traded for servicing or repair.

Besides this broad classification, each class is further divided into sub classes of homogeneous risks. The broad classification will usually be same in most of the countries. However the sub-classifications may vary slightly from country to country.

4.3.5.3 Motor Insurance Coverage

The motor insurance usually covers three kinds of financial losses:

1. Loss or damage to the vehicle
2. Liability to third parties
3. Loss of use of vehicle

Loss of use of vehicle cover is available in most of the developed insurance markets. For eg. due to an accident, the insured vehicle cannot be used for may be a week in which case an alternate vehicle is given by the insurer for the period when his vehicle is under repairs. This cover is currently not available in India.

4.3.5.4 The Perils (please check this once again)

The most common perils covered by motor insurance policies are:

- i. Fire, explosion, self ignition or lightning;
- ii. Burglary, housebreaking or theft;
- iii. Riot and strike;
- iv. Earthquake (fire and shock damage);
- iv. Flood, typhoon, hurricane, storm, tempest, inundation, cyclone, hailstorm, frost;
- vi. Accidental external means (all accidents are covered under this);
- vii. Malicious act;
- viii. Terrorist activity;
- ix. Transit by road, rail, inland-waterway, lift, elevator or air;
- x. Landslide or rockslide.
- xi. Legal liability of the insured to third parties for death, bodily injury or damage to property arising out of the use of the vehicle. The legal cost and expenses incurred by the insurance with the insurers’ consent are also payable.
- xii. Personal accident to owner driver

4.3.5.5 Additional Benefits

Apart from the standard coverage as discussed above some extra benefits are also available:

- i. Wider legal liability to drivers
- ii. Legal liability to employees travelling in the vehicle

iii. Personal accident cover for unnamed passengers of vehicle

iv. Coverage for trailers

v. Coverage for rallies, reliability trials, motor racing etc.

4.3.6 Burglary Insurance

4.3.6.1 Scope

The Burglary policy covers theft of property after forcible violent entry or theft followed by actual violent forcible exit. The policy is issued to cover the stocks, furniture, fixtures, calculators etc. as well as damage to the building caused by burglary. Cash in safe can also be covered provided the cash is kept in burglar proof safe and the burglary happens following violent and forcible methods to obtain the key or in opening the safe. The policy can be extended to cover the risk of riots, strike and terrorism.

4.3.6.2 Exclusions

- Loss or damage caused by the family members or employee of the insured.
- Committed by any person lawfully present in the premises.
- Bills, promissory notes, cheques etc. unless specifically covered.
- War and nuclear perils

4.3.6.3 Conditions

i) Each and every item is separately subject to the condition of average.

If the insured value of the property is less than the value of the property immediately prior to the loss, the insurance company will pay only proportionate amount towards the claim and the balance has to be borne by the insured. Each and every item is separately subject to the condition of average.

For eg.

Insured Items	**Insured value (In Rs.)**	**Value at the time of loss (In Rs.)**	**Loss (In Rs.)**
Stock in process	2,50,000	3,00,000	Nil
Raw material	1,00,000	1,00,000	Nil
Finished Goods	1,50,000	1,00,000	75,000
Total	**5,00,000**	**5,00,000**	**75,000**

In this case even though total value insured is equal to the value at risk on the date of loss, since principle of average is applicable to each item, the claim payable for finished goods would be =75,000*1,00,000/1,50,000= Rs. 50,000.

ii) Notice of loss: Immediate notice of loss should be given to the insurer. Within 7 days of loss, completed information of lost items, their estimate should be submitted.

iii) Prevention and minimization of loss: The insured should act as though he is uninsured and take all steps to prevent and minimize the loss.

iv) The indemnity may be by way of replacement, repair or reinstatement at the option of the insurer. The principle of contribution shall apply which means that if the insured has taken insurance for the same property with more than one insurer, each insurer shall pay proportionate amount towards the claim. For eg. stock of Rs. 3,00,000 is insured both with Insurer A and with insurer B for Rs. 3,00,000 each. Due to burglary, stocks worth Rs. 50,000 is stolen. Both Insurer A and Insurer B would pay Rs. 25,000 towards the loss.

v) Unless notice is given to the insurer and approved by them, any transfer of property other than by will, shall render the policy void.

vi) If liability is admitted, any dispute on quantum shall be referred to arbitration.

4.3.7 Money Insurance

4.3.7.1 Scope

Money in transit covers :

i. wages in transit form bank to the insured's premises.

ii. cash in transit from the insured's premises to post office for purchase of stamps, money order etc.

iii. postal order, money order, postage etc. in transit from post office to the insured's premises.

iv. wages in transit from the insured's main office to branch office.

v. cash other than wages, in transit from the bank to the insured's premises, from the insured's premises to the bank and between offices of the insured.

vi. Cheques, bills of exchange, money order etc. in transit form the insured's premises to the bank.

vii. Cash collected by employees from the time of collection until delivery at the insured's premises or bank. Money retained in safe at the insured's premises upto 48 hours from the time of collection.

4.3.7.2 Extensions

i. Infidelity of the employees – the normal policy does not cover infidelity of employees unless discovered within 48 hours. However, on payment of additional premium, the policy can be extended to cover the act of dishonesty by an employee.

ii. Disbursement risk : the normal policy does not cover loss of money while the wages are being disbursed. However, this risk can be covered by charging additional premium.

iii. Riots, strike : These risks too can be covered on payment of extra premium.

iv. Over 48 hours : Money retained in safe in the insured's premises is ordinarily covered only for 48 hours. This means that if the money is kept in the premises for over 48 hours and not deposited in the bank, the policy will not cover the money in safe beyond 48 hours. Cover in excess of this period can be agreed at an additional premium.

v. In till / counter : Money in counter during the insured's office hours can also be covered at additional premium. The theft should be accompanied by violence by any person other than the employee of the insured.

4.3.7.3 Exclusions

i. Shortages due to errors or omissions.

ii. Loss of cash entrusted to any person other than an employee.

iii. Loss where the insured or employee is involved, unless loss is caused by fraud by a cash carrying employee and discovered within 48 hours.

iv. Losses which are covered by other policies.

v. Loss arising from war and allied war perils.

vi. Losses arising from riot, strike and civil commotion and acts of terrorism.

vii. Loss of cash from the safe by the use of key to the safe unless the key has been obtained by force.

viii. Loss after business hours, unless the money is locked in a safe or strong room.

4.3.7.4 Sum Insured

Under money insurance, two sums are relevant:

i. The maximum amount carried in any one single transit.

ii. The total estimated amount of money in transit during the policy period.

The premium is charged on (ii) above i.e. on the total estimated amount of money in transit during the entire policy period which is considered as provisional premium. On expiry of the policy, the insured has to declare the actual value of money in transit. The premium is then calculated again on this amount. This premium is called the 'earned premium'. The difference between the estimated premium and the earned premium is refunded /charged to the insured. The limit mentioned in (i) above is the maximum liability of the insurer in a single loss.

4.3.7.5 Underwriting considerations

The insurer needs some information based on which he can decide whether he wishes to offer coverage to the inured. The information elicited to underwrite money insurance are:

i. Maximum amount carried in a single transit.

ii. No. of employees carrying cash, the no. of years of service with the company, any history of previous default.

iii. Mode of carrying money, i.e. by bus, taxi etc.

iv. Manner of carrying cash.

v. Whether there are any armed guards accompanying the cash carrying employees.

vi. Nature of location of office, the distance between office and the bank etc.

vii. Distance over which money is carried.

viii. General condition of law and order in the area in which money is being carried.

Chapter 5: Personal and Liability Insurance

5.1 Personal Insurance

Though general insurance does not insure the life of a person, as in the case of life insurance policies, there are certain personal insurance policies which are issued under the non-life section. The major amongst these are the Mediclaim and Personal Accident policies.

5.2 Mediclaim Policies

Mediclaim policy was introduced in India 1981 and later on modified in 1996. These policies offer health insurance and can be issued either as individual policies or as a group policy.

5.2.1 Individual Mediclaim

This policy seeks to reimburse the expenses incurred by the insured for hospitalization/ domiciliary (residence) hospitalisation arising out of an illness/accident.

- **Hospitalisation**

The following expenses are reimbursed under this policy provided the illness /accident is sustained during the policy period:

1. Room and Boarding charges in hospital/nursing home.
2. Nursing expenses.
3. Surgeon, anaesthesia and other specialist doctor fees.
4. Operation theatre, diagnostic materials, blood, pacemaker requirements etc.
5. The treatment should be taken in a nursing home/hospital which is -
    i. registered
    ii. has at least 15 inpatient beds (10 for C class cities)
    iii. has an operation theatre which is fully equipped
    iv. fully qualified nursing staff round the clock.
6. It is a requirement that patient should be admitted for at least 24 hrs. However this is not applicable for dialysis, chemotherapy, dental surgery etc., that is those ailments where the treatment is given and the patient is discharged on the same day.
7. Medical expenses incurred 30 days prior to and 60 days after hospitalization are also paid provided it is incurred for the same ailment for which the patient has been hospitalised.

- **Domiciliary Hospitalisation**

Means treatment given for an ailment, for a period of more than 3 days, which normally needs hospitalization but the treatment has to be given at home because the patient's condition is such that he cannot be physically moved or lack of accommodation in the hospital. However, certain diseases which are chronic in nature such asthma, bronchitis, diabetes, hypertension, arthritis and fever for less than 10 day etc. are not considered for domiciliary hospitalization benefit.

5.2.2 Exclusions

Claims made for the following will not be considered for payment as they are excluded from the scope of the policy:

1. Pre-existing diseases.
2. 30 days exclusion – certain ailments are excluded for the first 30 days from the time of inception of the policy, as it is felt that these could not have been contracted within such a short period and they were probably pre-existing.
3. Some ailments are excluded in the first year of the policy, as again, these are of such a nature that they take time to manifest for eg. cataract, hysterectomy, hernia, piles etc.
4. War and nuclear perils.
5. Circumcision is not paid for unless necessary for treatment of a disease.
6. Spectacle, hearing aids etc.
7. Dental treatment, unless requiring hospitalization.
8. General weakness, venereal diseases (VD), rest cure etc.
9. AIDS
10. Hospitalisation merely for diagnostic purpose.
11. Vitamins, tonics.
12. Treatment related to childbirth. Voluntary abortion.
13. Naturopathy.

5.2.3 Age Limit

Mediclaim policies are issued to those in the age group of 5 to 80 years. However, children can be covered from 3 months to 5 years provided either of the parents have taken a mediclaim policy.

5.2.4 Policy conditions :

Some of the policy conditions which are common and incorporated by most of the insurers are:

i. All notices to the insurance company should be in writing.

ii. Premium to be paid before commencement of the policy.

iii. Claim intimation should be given within 7 days with details about the hospital, illness, doctor etc.

iv. Final claim with bills and required documents should be given to the insurer within 30 days from the date of completion of treatment.

v. All bills in original should be submitted.

vi. Fraudulent claims will not be paid.

vii. Principle of contribution shall apply.

viii. Policy can be cancelled by 30 days notice. If cancelled by insurer, refund is made on prorate basis. If done by insured refund is on short period basis. Most of the general insurance policies are issued for one year. It is not advisable to issue shorter period policies. However, all insurers provide for short period rates which are much higher than annual rates. These rates are mentioned in the policy. Hence, if the insured wishes to cancel the policy midterm the insurer will not refund the entire premium for the balance period. He will retain the premium for the period for which the policy has been in existence on short period rates.

  For eg. let us say the short period rate for a policy of 3 months is 40% and the premium paid is Rs. 10,000. If the insured wishes to cancel the policy after 3 months the refund will be Rs. 10,000 - (40% of Rs. 10,000)= Rs. 6,000/-

  Whereas if the insurer cancels the policy the refund will be on prorate, i.e. on proportionate basis. In the example above, if the insurer cancels the policy, the refund amount would be Rs. 10,000 - (10000 * 3/12) = Rs. 7,500/-

ix. If liability is denied, the insured should file a case within 12 months from the date of denial. If quantum is in dispute it should be referred to arbitration.

5.3 Group Mediclaim policy

Group policy is issued to a homogenous group such as employees of a company, members of credit card etc. For eg. Citibank can take a Group policy for all the credit card holders of Citibank.

The benefits are the same as for an individual policy with some variations, which are;

a) Cumulative bonus and health check up are not allowed.

b) Group discount based on size is allowed.

c) Renewal is subject to bonus/ malus clause

d) Maternity benefit extension is available.

5.3.1 Bonus/Malus

Depending on the claims ratios for the preceding 3 policies, bonus or low claim discount is allowed. Similarly, if the claims ratio is adverse, malus or claim loading is charged.

For eg. for a policy, the sum insured is Rs. 1,00,000 and the claims ratio for the past three years is 120% and the premium paid is Rs. 10,000. If the insurance company wishes to apply malus of say 20%, the renewal premium would be Rs 12,000/-.

Coversely, if the claims ratio is 50% and the insurer gives a low claim discount of 20%, then the renewal premium payable would be Rs. 8,000/-.

5.3.2 Maternity Extension

The policy can be extended to cover expenses incurred towards child birth; this extension is granted by charging 10% loading on the total basic premium. The maximum sum insured allowed is Rs. 50,000 or sum insured under the policy, whichever is lower. The maternity benefit is available only if incurred in a hospital.

- For childbirth the waiting period is 9 months; this can be relaxed in case of a miscarriage.
- The claim is payable only for 2 children; if someone has 2 children already they will not be eligible.
- Voluntary medical termination of pregnancy within 12 weeks is not payable.
- Pre natal and post natal expenses not payable unless hospitalized.

5.4 Personal Accident Insurance (PA)

5.4.1 Coverage

If during the currency of the policy the insured sustains any bodily injury directly and solely from accident caused by external violent means, the insurance company shall pay to the insured or his legal personal representative, the sum indicated in the policy if the accident results in death or disability.

5.4.2 Definition of some of the terms used in PA policy

i. **Bodily injury –** While this excludes any disease from natural causes, however any disease proximately caused by accident is payable. While shock or grief is not covered, disablement arising out of shock is payable.

ii. **Solely and Directly -** This means that the bodily injury should be a direct and sole cause of the accident. An accident may cause a disease, which in turn may result in death. The proximate cause is accident, hence the claim will be paid. For eg. a man is thrown off a horse and is so injured he cannot walk. While lying in bed as a result of the injury, he contacts pneumonia and dies. The proximate cause is the accident and there is no break in the chain of events, hence a claim under PA policy would be considered.

iii. **Accident** – An accident is an unexpected, unintended act. However, sometimes even voluntary acts are considered as accidents. For eg. a man jumping from a burning building sustaining injuries, murder, snakebite, frostbite etc. are also considered as accidents.

iv. **External, violent and visible means** – Cause of accident should be external but injuries can be internal.

v. **Disablement** – Disability refers to the inability of the insured to attend to occupation/ work.

5.4.3 Types of coverage :

i. **Permanent Total Disablement (PTD) –** Disablement is permanent, irrevocable and total. Loss of eye sight, loss of limbs etc. are examples.

ii. **Permanent Partial Disablement (PPD) –** Here the disablement is permanent and partial. For eg. the loss of finger(s). The policy carries a table of compensation for different disabilities which is expressed as a percentage of capital sum inured.

iii. **Temporary Total Disablement (TTD) –** The disability is total but temporary. For instance a fracture in the leg due to which the insured is unable to attend to work.

Benefit chart to give an idea as to the benefits available in a PA policy

Contingency	**Compensation payable**
Death	100% of capital sum insured
Loss of 2 limbs, 2 eyes, one limb and one eye	100% of capital sum insured
Loss of one limb or one eye	50% of capital sum insured
PTD other than above	100% of capital sum insured
PPD	As per table attached to the policy
TTD	Weekly 1% of capital sum insured subject to maximum of Rs. 3,000

Additional Benefits

Nature of benefit	coverage	Amount payable
Carriage of dead body	Expense incurred in carrying dead body to residence	2% of capital sum insured or Rs. 2500, whichever is less
Education Fund	Education benefits to insured's dependent children	If one dependent child, 10% of capital sum insured subject to a maximum of Rs. 5000 If more than one dependent child, 10% of capital sum insured, subject to a maximum of Rs. 10,000

5.4.4 Exclusions under PA policy

Common exclusions :

i. Suicide, intentional self injury.

ii. While under the influence of liquor or drugs.

iii. While engaged in aviation, ballooning etc.

iv. Venereal diseases, Insanity.

v. Breach of law with criminal intent.

vi. Service in armed forces.

vii. Child birth/pregnancy.

viii. War and similar perils.

5.4.5 Policy conditions

The conditions applicable to a personal accident policy are:

1. Claims intimation should be given in writing.
2. In case of death, notice to be given before cremation and in any case, latest, within a month.
3. In case of any permanent total disablement, notice to be given within a month.
4. Proof of claim to be given.
5. In case of any disability, the company can exercise the right to examine the insured.
6. In case of death, post mortem should be done and report submitted within 14 days.

7. The insurer may ask the insured to undergo any operation at insured's expense in case of loss of sight.
8. In case of death/PTD/PPD, the claim shall be settled on submission of policy for cancellation.
9. No interest shall be payable.
10. Claims will not be settled if the claim made is fraudulent

5.5 Liability Insurance

The third type of general insurance is liability insurance, this form of insurance is gaining popularity of late with the society getting more and more litigious. Liability insurance provides indemnity for financial consequences arising from legal liability. The indemnity payable under this insurance covers compensation awarded against the insured, legal costs awarded against the insured and the defence costs. This insurance is concerned with the civil liability and not the criminal liability.

Civil liability arises under :

a) The law of tort - tort in French means wrong. Tort laws deals with wrong doing. If an act of a person caused injury to another person or damages his property, the wrongdoer will be held responsible for the losses caused by such damage/injury.

b) Statutory law – the liability arising under the statutory law. For eg. an employer is responsible to compensate a workman for injuries sustained at work under the Workman's Compensation Act, 1923.

c) Law of contract – Liabilities arising out of breach of a contract.

5.6 Employers Liability Insurance

If an employee, during the course of employment, sustains injury or contacts any disease which can be considered as an occupational disease, the employer is liable under the law to pay compensation as laid down in the Act. In India this type of liability is governed by the Workman's Compensation Act, 1923. The act clearly lays down the compensation for death, permanent and temporary disablement. The amount of compensation payable depends on the age of the employee and the wages drawn at the time of death/injury, the lower the age the higher would be the compensation payable. Similarly, higher the wages drawn higher would be the compensation payable.

5.6.1 Coverage under the policy

- This policy provides coverage against legal liability arising under the -
  i) Workmen's Compensation Act, 1923

ii) The Fatal Accidents Act, 1855

iii) Common law

- Personal injury or disease should have occurred during the course of the policy period.
- Legal expenses incurred by the insured to defend their liability, provided the same is incurred with the consent of the insurer.

5.6.2 Exclusions

The policy will not be liable for claims arising due to -

1) Any disease or injury arising out of nuclear risks.
2) Liability of the insured to its contractor's employees, unless agreed to by payment of extra premium.
3) Contractual liabilities.

5.7 Public Liability Insurance

To indemnify the insured, in respect of all sums which they become legally liable to pay to third parties, as compensation for damages in respect of :

i. Death, personal injury, bodily injury or illness of any person.

ii. Loss of or damage to property as a result of an occurrence happening in the territorial limits (all liability policies specify the territorial limit covered) in connection with and during the course of the business activities or caused by any of its (the insured's) products.

5.7.1 Compulsory Public Liability (Act Policy)

In India, under Public Liability Insurance Act, 1991, certain guidelines have been laid down about the liability of industries dealing in certain types of commodities.

- Under Public Liability Insurance Act 1991, the liability of the enterprise dealing in hazardous substance is defined. If death/injury or damage to property is caused by an accident the owner shall be liable.
- If it is a no fault liability, the claimant need not establish that the death/injury etc. was caused by the default/negligence of the insured.
- The compensation payable is Rs. 25,000 for death and permanent total disablement, a percentage of Rs. 25,000 for partial total disablement as certified by a physician and Rs. 1,000 per month for temporary total disablement. Medical expense upto Rs. 12,500 can be paid and Rs. 6,000 is the maximum limit for property damage.
- The liability of the owner has to be compulsorily insured.

- The sum insured is equal to the paid up capital of the company. If the owner is not a company, the sum assured should be equal to all assets of the undertaking.
- The insurer's liability is restricted to Rs. 5 crores per accident and Rs. 15 crores during the entire policy period.
- An amount equal to premium is collected towards Environment Relief Fund by the insurer and remitted to the goverment.
- If the award for an accident exceeds the limit of insurer, the amount shall be paid from the above fund and the amount in excess of this has to be borne by the insured.
- While this is a compulsory insurance, the Central Goverment may exempt some goverment undertakings from this insurance, provided, a fund for Rs. 5 crores or an amount equal to the paid up capital is maintained is maintained by these government entities.
- Accident is defined as fortuitous, sudden occurrence such as handling any hazardous material resulting in exposure to death or injury.
- Handling means processing, storage, transportation etc. of hazardous substance.
- Hazardous substances are listed and grouped in the Act.
- Owner is refered to a partner in the case of a firm; directors, managers etc. in the case of a company.
- Turnover means the entire gross sales turnover for manufacturing units and total annual receipt for godowns/warehouses. For transport operators it would be annual freight receipts.

The policy has an operative clause which essentially details the following:

The first part of the clause spells out –

a) the parties to the contract
b) business carried out
c) payment of premium
d) contribution to environment relief fund etc.

While the second part states that the insured will be indemnified against statutory liability arising out of handling hazardous substances.

5.7.2 Policy Exclusions:

Liability arising out of -

- Wilful non-compliance with statutory provisions.
- Fines, Penalties.
- Any other legislations other than the Act.

While Act policy provides coverage as per the Public Liability act, the insurer may be legally held liable to pay compensation much in excess of what is covered under the Act Policy, in which case the Public Liability Act Policy would compensate to the extent specified in the operative clause and the balance has to be paid by the insured himself or he should take additional liability policy to cover such legal liability.

5.7.3 Conditions

i. Written notice of claim and of any claims received against the insured should be given to the insurance company.
ii. No liability should be admitted without the written consent of the insurer.
iii. The liability under the policy is invoked for claims made within 5 years from the date of accident.
iv. Written records of annual turnover should be maintained by the insured.
v. Condition of contribution shall be applicable.
vi. Policy can be cancelled by either party by giving 30 days notice. Refund is made on prorata basis if cancelled by the insurer and on short period basis if cancelled by the insured.
vii. If claim is disputed, the insured should file a suit within 12 months.
viii. Fraudulent claims will not be paid as, the principle of utmost good faith for disclosure of material facts, is applicable.
ix. In case of any dispute about the meaning of any word, the definition given by the Act is applicable.

5.8 Professional Indemnity Insurance

This policy provides indemnification to the policyholder against loss incurred only as a result of their negligent act, error or omission in carrying out their business. This policy is also known as Errors and Omissions Insurance as well as malpractice insurance. The liability under this policy primarily arises due to the negligence of the insured in performance of their professional duties.

5.8.1 Coverage

"To indemnify the insured against all sums for which they shall become legally liable to pay as compensation to third parties for bodily injury or for loss or damage to third party property arising out of or from any negligent act, error or omission committed or omitted or alleged to have been done during the course of the conduct or performance of the professional services and duties, including all legal costs and expenses." Professional Indemnity policy is usually availed by Accountants, Doctors, Architects etc.

5.9 Product Liability Insurance :

The liability under this section arises as per the terms of the Sale of Goods Act, 1930 (date of the Act). As per this provision, only those who have purchased the goods can file a claim and secondly the claimant need not prove negligence on the part of the seller. The policy aims at making good the losses incurred by the claimant in terms of -

i. personal injury/death sustained as a result of use of the product.

ii. Loss/damage to property sustained as a result of the use of the product.

5.9.1 Exclusions

i. Mere defect in the product for which the claimant incurs cost for reconditioning, repairing etc. does not fall within the scope of coverage.

ii. Liability arising out of product guarantee.

iii. Liability arising for products which have left the control of the insured prior to retroactive date.

iv. Costs incurred for product recall, unless specifically covered.

5.9.2 Conditions

The conditions applicable to public liability (given earlier) shall apply for product liability, except condition no. viii as this is not applicable for this policy.

Chapter 6: Financial Planning and Life Insurance

6.1 Financial Planning

A financial plan is a process, which helps an individual to achieve his or her financial objectives. It involves careful and well thought out spending, savings and investment planning.

The need for financial planning has become essential more so with economic uncertainty, erratic job situation, longer life span etc. In financial planning, the first and foremost is to set the investment objectives. This could vary from person to person. Some typical objectives are :

- Building a home
- Children's education
- Marriage - own/childrens'
- Retirement provision
- In addition there might be some emergency funding required which could be caused by :
    - Illness
    - Accident
    - Job loss etc.

Financial planning provides security in times of uncertainity. Let us understand in a little more detail the need for financial planning :

6.1.1 Emergency funding:

An emergency fund may be needed for meeting sudden contingencies such as, major illness in the family requiring medical expenses, property losses, loss of job etc. Any prudent individual would set aside an amount to meet such contingencies. This can be achieved through the help of insurance. The amount of the fund required depends upon the level of insurance coverage the individual or household can get, attitude of the individual and the family towards risks etc. Generally the emergency fund is expressed as 'x' number of months of a family's income depending on the financial capacity of the family.

6.1.2 Education Fund:

Unlike the earlier days, the education of children has become prohibitively high in many fields and most of the families aim to set aside a part of their earnings to provide for the higher education of their children. Again insurance products which provide funding for educational purposes are available. The size of fund to be insured for would depend upon the number of children, their educational aspirations etc. Further, the educational institution in which the children plan to go for their higher education also makes a substantial impact on the size of funds required.

6.1.3 Unemployment :

In times of recession, economic downturns etc., there is a possibility of a person being out job and hence every family needs to have some money set aside to take care of possible periods of unemployment. Insurance comes useful in such cases.

6.1.4 Premature Death :

The earning member(s) of the family are worried about the possibility of premature death, which would result in the drop in the standard of living of the family left behind. Hence, one of the key objectives of people while carrying out financial planning is to effectively provide for this contingency.

6.1.5 Property loss :

One of the major objectives of most families is to build a house. The house faces certain threats such as fire, floods etc. If such an event happens and the house had been bought on a loan, not only the loan needs to be repaid but also an additional burden of having to pay rent to live in a rented premises till the house is repaired. This is another contingency any family should take into account while carrying out the financial planning.

6.1.6 Retirement Planning :

Most people would like to ensure that in their post retirement life they can live with the same comforts they are accustomed to during their working life. However, after retirement, the monthly salary a person earns stops while expenses, particularly medical expenses, stays the same or increases.

Most individuals plan for the above contingencies by setting aside a part of their income and investing them in various investment options / insurance products available.

However, one crucial component of financial planning is to take care of uncertainty of life. What would happen if the earning member of the family dies an untimely death? Who would pay for the housing loan, childrens' education, medical expenses etc. Life is uncertain and therefore we have life insurance to take care of this uncertainty.

Life insurance policies are very innovative. Besides taking care of the survivors in the event of the death of the earning member, various options are available by which one can plan for pension, education for the children, marriage of the children etc.

6.2 Ratios as a tool for financial analysis

Ratios can be very effective tools for financial analysis for individuals as well as companies. Discussed below are some of the ratios which can help in providing benchmarks to help in personal financial planning -

i) Basic Liquidity ratio (BLR)

BLR = Liquid assets/monthly expenses.

BLR helps in working out the number of months one can live with the available cash assets should you lose your job or for whatever reason the source of income of a person dries up. While there is no ideal ratio, if it is anywhere between 3 and 6 it means that one has adequate cash to support monthly expenses for a period of 3 to 6 months which could be considered as adequate.

ii) Savings Ratio (SR)

SR = Savings/gross income.

This ratio indicates the percentage of income that is saved. The higher the savings, higher would be the funds available for future financial requirements.

iii) Debt to Asset ratio = Debt (total liabilities)/total assets

This ratio gives a clear picture of how much of the assets have been financed by debt, a very high ratio indicates low networth.

iv) Debt service ratio = Total amount of debt repayment/ annual take home income

This ratio indicates the proportion of income which is used up towards loan repayments. While granting loans, most of the companies take this ratio into account to satisfy themselves that the borrower can service further borrowings.

6.3 Definition of Life Insurance

6.3.1 Life Insurance is a contract between two parties, the insured and the insurer, wherein the insurer agrees to pay a specified sum of money upon the occurrence of insured's death or any other event specified in the policy. The consideration from the insured is that he or she agrees to pay an agreed amount (premium) at specified time periods to the insurer.

6.3.2 Like all contracts, this contract has offer and acceptance. The insured by of completing the proposal form makes an offer and the insurer accepts the offer by way of quoting the terms and conditions. The consideration from the insured's end is payment of premium and from the insurer it is promise to compensate in the event of occurrence of the insured event.

6.3.3 The purpose of the contract is legal and both the parties should be competent to enter into a contract, i.e. the insurer should have the license to carry on the business of insurance and the insured should be of stable mind and not a minor.

6.4 Law of large numbers

The law of large numbers is the foundation of all Insurance and was discovered 300 years ago by a Swiss mathematician, Jacob Bernoulli. When an event based on chance is observed, the larger the number of observations, the more likely the actual result will coincide with the expected result.

This principle also demonstrates that an event with a low probability of occurrence in a small number of trials has a high probability of occurrence in a large number of trials. The actual outcome of a statistical process converges towards the expected value as the number of observation increases.

"When a coin is flipped once, the expected value of the number of heads is equal to one half. Therefore, according to the law of large numbers, the proportion of heads in a large number of coin flips should be roughly one half. In particular, the proportion of heads after *n* flips will surely converge to one half as *n* approaches infinity ".

In insurance premium calculations are done on the basis of the probability of occurrence of an event such as death, fire etc. The costing which is done on the basis of using the probability theory works more accurately when the number of people insured is large and the geographical spread is greater.

6.5 Factors affecting rating under Life insurance

i) In life insurance we take into account the life expectancy or the rate of mortality for the purpose of premium calculation. Insurance is spreading the loss of few to many. It is primarily aimed at sharing the losses. Premium amount is collected from a number of people and claims paid to a few people. For eg. if the policy is issued for Rs. 1,00,000 and a group of 100 are part of the insurance scheme, the amount to be charged from each person would depend upon the estimation of loss ratio. If one out of 100 is expected to die then the premium for each person in the group would be Rs. 1,000 so that an amount of Rs. 1,00,000 can be paid on the death of one person. However, if 2 out 100 are expected to die, then the premium would be Rs. 2,000 to create the pool of Rs. 2,00,000. The estimation of losses is done by way of mortality tables. These tables depict age wise probability of death and survival. Mortality tables are used as a basis for calculating the cost of insurance by all insurance companies.

ii) Actuaries take into account the time value of money i.e. the interest that can be earned on the premium. The assumption in the earlier example was very simplistic. We assumed collecting premium in such a manner that it became equivalent to the value of the claim. In actual practice it is not so because the premium collected from various insured persons is invested in certain forms of investments. Such investments yield returns which helps in subsidizing (reducing) the premium amount.

Some of the factors which should be taken into account while calculating the time value of money is whether the premium is collected in one lumpsum from the insured or is it annual payments. If single premium is received, the returns on it would be higher as the entire amount is available for investment over a longer period of time as against annual premiums. In insurance, a single payment is a lumpsum payment made once during the entire policy period, whereas annual premium refers to premium paid annually.

Similarly, the rate of return on investments is also of great importance. Correct estimation of the rate of return is critical. If erroneously, a higher rate of return on an investment is taken for calculating the premium payable, the insurance company stands to incur losses as it might collect lower premium and pay out higher sums.

iii) The terms and conditions of the policy and the benefits accruing under it are critical. The premium rate to be charged would depend on the type of policy issued. There are many different types of Life insurance policies available in the market. Under some policies, the benefits are payable either on death or on expiry of a fixed period of time, whereas other policies provide for payment of fixed amount of money in periodic intervals. Similarly, there is difference in the mode of payment of premium too. It could be single premium or annual premium. Hence, the premium charged would depend upon the benefits of the policy to a great extend.

iv) In the example given in (i) above no consideration has been given to administrative expenses that would be incurred by the insurer. Any insurance company has to incur lot of costs while administrating the policy. Further, at the inception of the policy high amount of expenses are incurred. However, premium to be charged has to be uniform and can't be high in year one compared to the rest of the policy period.

The insurance companies also have to incur expenses such as rent, electricity, salaries, the insured has to bear these expenses too, hence the pure premium calculated in example given in A above is loaded for all the expenses and the gross premium is arrived at, the insurers charge the gross premium from the insured and not the pure premium.

6.6 Principles of Insurance and Life Insurance

We will see below how the principles of Insurance are applicable for Life Insurance contracts:

6.6.1 Utmost good faith :

When insured decides to insure himself he has access to all the information about the insurance company. However the insurer does not have adequate information about the insured. Hence, it becomes imperative for the proposer to disclose to the insurer all material facts regarding the proposed insurance. This duty is not limited to facts known to him but also to facts which he is expected to know.

Material fact is a fact which affects the decision of a prudent underwriter in deciding the terms of acceptance of the risk as well as whether to accept or reject the risk. If a material fact is not disclosed to the insurer, the contract becomes voidable at the option of the insurer.

6.6.2 Insurable Interest:

The proposer should have insurable interest in the life of the assured. Insurable interest exists when the proposer derives financial benefit from the continuous existence of the assured or suffers financial loss by the death of the assured. Every person has insurable interest in his own life as he can protect his estate from loss of future earnings by insuring his life. Spouse has insurance interest in the life of his wife/ husband.

Others who are said to have insurable interest are

Employer in the name of the employee
Creditor in the name of the debtor
Partner in the life of his partner etc…

6.6.3 Indemnity

As per this principle, the insured should neither be better off nor worse after the claim is settled. This principle requires that the financial loss is measurable. The insured should neither profit nor suffer a loss.

Life insurance is not a strict insurance of indemnity as the value of a human life cannot be calculated, however the insurers are careful while insuring the life of an individual and take into account his earning capacity while deciding on the value for which insurance is granted. The sum assured is fixed in such a way that the proceeds of the policy help the insured's family to maintain the same standard of living.

6.6.4 Subrogation

Subrogation involves transfer of rights of the insured to the insurer who indemnifies the insured on the happening of the loss. This principle is a corollary of the principle of Indemnity and is imposed to ensure that the insured does not profit by insurance. Since the value of life cannot be determined this principle is not applicable for life insurance .

6.6.5 Contribution

This means sharing of losses between multiple insurers for the same risk. This is not possible in Life insurance for the same reason as mentioned for subrogation.

Chapter 7: Types of Life Insurance Policies

7.1 Term Insurance :

As the name implies, these policies are issued for a term or a period of time and if the death of the assured occurs during the term of the policy, the policy pays the sum assured. If the insured lives beyond the period stated in the policy, no payment under the policy is envisaged. The term insurance provides pure death protection and does not have any savings element as some other insurance policies do. The premium under the term policies are lower as the policies are issued for a fixed period. However, this type of policy is not a great option as a saving instrument as the assured does not get any amount from the policy should he survive the policy period i.e. if the policy is issued for a period of 20 years expiring on 31st December 2012 and the insured is still alive on that date, he will not be entitled to receive any money under the policy.

7.2 Types of Term Life Insurance

7.2.1 Yearly renewable term insurance :

This policy is issued for one year period and if the insured dies during the policy period, the insurer settles the claim. This might be issued with a renewable term, for 5 years, 10 years and so on. Instead of a time period, the policies are also issued offering coverage upto a specified age such as 60 years etc. The insurer settles the claim if the assured dies before the specified age.

7.2.2 Level term life insurance :

Under this policy, the premium amount stays the same for a given period of years (10, 15, 20 years etc.). The policy is generally issued for a period of 10, 15, 20, or 30 years. The longer the term, the higher is the annual premium (the premium payable remains the same, however if the policy has been taken for a longer period, say 30 years, the premium rate would be higher (than say a 10 year policy) as the policy covers the insured at a older age when the chances of death are higher). For eg , if a policy is taken for a sum assured of Rs. 10,00,000 at an annual premium of Rs. 25,000 per year for 10 years, the insured continues to pay Rs. 25,000 every year and for the same sum assured if the policy is for 20 years, the premium may be Rs. 40,000 per year.

Most level term policy have a renewal option and allow the insured to renew and extend the period if they so desire. The renewal is not guaranteed. However, as long as the insured is of normal health it is permitted.

7.2.3 Decreasing term life insurance:

This type of contract factors in payment of lesser benefits each year the policy is in force. For eg. should the assured die in the very first year of availing the policy, the beneficiary receives the face value of the policy, say for eg. Rs. 50,00,000. If death occurs in year two, the proceeds would come down (would be less than Rs. 50,00,000) and in year 20 the proceeds may be a mere Rs. 15,00,000. The premium during the years remains constant while the benefit comes down as the probability of death goes up with age.

7.2.4 Increasing term life insurance:

Under this contract, the benefit goes up with passing year and the premium under this policy also goes up every year.

The term life insurance policies are useful as they provide maximum coverage to people whose resources may be limited. The premium for term insurance is lower than Whole Life insurance.

7.3 Whole Life Insurance :

The oldest and the purest form of life assurance is Whole Life insurance. The premium is paid by the assured throughout the life time of the assured and the sum assured is paid to the beneficiary on the death of the assured. This policy satisfies the original intention of life insurance which is to provide security to dependants on the death of the assured, Under this type of policy the beneficiary named in the policy is paid the benefits under the policy on the death of the assured. The payment under the policy is assured and this policy does not have an end date.

As these policies provide for payment only in the event of death, the premium under this policy is lower than other policies. The assured can insure himself or herself for higher amounts (at comparatively low premiums) so that his dependants are well provided for in the event of his or her death.

However, these policies are not very popular as it does not meet the expectations and changing needs of many investors, who look at insurance as an investment option besides being a means to provide for the survivors in the event of the insured’s death. Further, this type of policy requires premium payment to be made indefinitely and the policy holder may find it difficult to continue the premium payment during his old age. This type of policy is ideally suited to take care of estate duty liability. Duties or property tax is payable on the death of the assured by the legal heirs for transfer of property in their name. This duty at times can be very steep. The proceeds of the policy is useful for paying up these taxes.

7.3.1 Limited payment whole life insurance:

Under this policy while the policy continues to provide coverage to the assured till his death, the premium payments are for a fixed period of time. The last premium, depending on the policy, may be paid at the age of 60 years.

It is needless to mention that the amount of premium paid is a function of the duration for which the premium is paid, hence in limited payment policies, the premium payable shall be higher for the same sum assured as compared to Whole Life Insurance.

7.3.2 Types of Whole Life Insurance

1) Single Premium : This policy envisages one single payment of premium regardless of when the death would occur. It involves front ending premium payment i.e. payment of the entire premium in one lumpsum payment at the inception of the cover.

2) Continuous Premium : The insured continues to pay the same premium as long as he or she lives. These are also called level premium whole life insurance. The amount of premium to be paid is calculated taking into account the probability of insured's death and compound interest.

3) Modified whole life insurance : The premium payable is staggered so that the insured pays a lower level of premium in the initial years and much higher amount in the later years as the earning capacity of the insured goes up.

   Whole Life insurance provides permanent protection by way of payment of sum assured on the death of the assured to his family.

7.4 Endowment policy :

The sum assured is payable on the death of the assured or after a fixed period of years whichever occurs first. This type of policy combines the advantage of security or protection for the family in the event of the assured's premature death and /or facilitates retirement by paying out a lumpsum amount at an age agreed upon, should the assured continue to live upto that age. Generally, people try to coincide this with their retirement age of say 60 years.

Endowment policies are popular in India as it combines life assurance with investment option and appeals to the security conscious people. However, the premium under this policy is higher as the insurer has to definitely pay out a claim either to the beneficiary in the event of the death of the assured or to the insured if he lives upto a certain age.

7.4.1 Joint Life Endowment Policy:

This is a variation of the endowment policy and is generally issued to cover the husband and wife together. The sum insured is payable under this policy either on expiry of a stated number of years or on death of one of the assured whichever is earlier. With this payment the policy comes to an end and does not continue to cover the second assured. This policy is jointly taken by a husband and wife.

7.4.2 Double Endowment Policy:

The amount of sum assured, which is paid by the insurer on survival of the insured, is double the amount payable in the event of the insured's death (within policy period). For eg. if under the policy the sum assured payable on death might be Rs. 5,00,000, whereas the amount payable on survival would be Rs. 10,00,000/-.

Under term insurance, the policy proceeds are paid in the event of the death of the insured during the specified term. Whereas, under endowment policy, insured may either avail an endowment policy for a specified period at the end of which, if he or she is alive, collects the proceeds of the policy or alternately, the insured may choose an age at which he or she would like to be paid the policy benefits.

7.5 Children's policies

1. **Fixed Term (Marriage) endowment** : Policy is taken by the parent or guardian and for the purpose of this insurance, they are regarded as the assured. A particular term is selected and on expiry of the term the sum assured is paid to the assured. During this term, premium is paid but payment of premium ceases in case of death of the assured. The sum assured is payable on the death of the assured or on completing the period fixed for insurance whichever should occur first. The logic behind this policy is to create a capital for any major expense such as marriage of the child or higher education of the child.

2. **Educational Annuity Assurance :** It is similar to the above policy except that instead of lump sum payment of the sum assured, the benefit is disbursed in half yearly installments for 5 years. This is ideal for higher education needs as it helps in the payment of semester fees.

These types of policies are taken when parents are aware that after a lapse of say 10 years, the education of the child or marriage of the child has to be provided for.

3. **Children's deferred assurance** :

The purpose is to provide for life assurance to a child. The parents propose the life of the child as assured. As the name suggests the insurance is deferred :

a) The life assurance for the child commences when he or she reaches the age of 18 to 22 (i.e. any age between 18 and 22 can be chosen for the commencement of life assurance) No claims are paid during the deferment period, i.e. the period between commencement of premium payment and the chosen age when the life assurance begins. For eg. if a parent starts a policy for his child when the child is 10 and wishes to commence life assurance from the age of 22, then the deferment period would be 12 years from the time the child is 10 years old till he reaches the age of 22.

b) In case of death of the child before the agreed age when the risk commences, the premium is returned.

c) In case the parent (the premium payer) dies, the premium must be continued to be paid by someone else till the deferred date.

d) Once the child reaches the vesting age, i.e. the age when the life assurance commences, he or she can claim cash option i.e. he can opt to receive the premium amount paid so far under the policy in case the policy is discontinued.

e) On reaching majority i.e. the age of 18, irrespective of the vesting age chosen under the policy, the life assured signs an agreement with the insurer and from that date the contract is between the insurer and the life assured.

f) Health proof is not asked for once the assured attains the vesting age.

7.6 Annuities

Annuity: Annuity is the periodical payment made by the insurer to the assured, in consideration for the capital payment or lumpsum payment received by them. For capital payment received, the insurer agrees to pay the annuitant an agreed amount of money periodically throughout life. The purpose is the opposite of life insurance, where the payment is made on the death of the assured. In the case of annuity the payments are made as long as the annuitant is alive.

There are two phases of an annuity; they are :

1) The accumulation phase is the phase during which the annuitant pays premium to the insurer.

2) The distribution phase / liquidation period is when the insurer makes annuity payment to the annuitant till his death.

7.6.1 Types of Annuity

1) **Immediate Annuity** : This type of annuity should be purchased with a single premium. The benefit payment i.e. the payment made by the insurer to the insured, is made within a short period of taking the policy. The annuitant receives annuity either till his death or for a fixed period of time such as 10 years, 20 years etc. depending on the type of contract entered into. The payment is made as long as the annuitant is alive .

2) **Deferred Annuity** : Under this type of policy, the annuitant starts receiving the

annuity payment after lapse of fixed number of years as agreed upon at the inception of the policy. The premium may be paid either as one lumpsum payment or it could be monthly, quarterly, half yearly or yearly payments during the deferment period (i.e. the period intervening between the commencement of the policy and the commencement of benefit payment by the insurer to the annuitant). In case of the death of the annuitant during the deferment period, the premium will be returned without interest.

3) **Guaranteed Annuity** : The insurer is required to make annuity payments for at least a certain number of years, which is called period certain, irrespective of whether the annuitant is alive or dead. If the annuitant survives this period, the annuity payments then continue until the annuitant's death and if the annuitant dies before the expiry of the period certain, the beneficiary is entitled to collect the remaining payments certain i.e. the amount to which the annuitant would have been eligible had he been alive till period certain. For e.g. a policy commences on 1st January 2005, the period certain is upto 31st December 2010 and the annuitant was to receive Rs. 10,000 every year. However, the annuitant dies on 30th June 2009. The annuitant would have received the payment for 2009 and thereafter his heirs would receive an amount of Rs. 10,000 in 2010 being the amount they are entitled for the year 2010 as the period certain lapses on 31-12-2010.

7.6.2 Method of Premium payment

1) Single premium annuity : The annuity is purchased by remitting a single premium.

2) Annual Premium annuity : When annuity is purchased by payment of annual premiums for a fixed period of time.

7.7 Group Insurance

While most of the individuals avail life insurance policy for the purpose of security as well as for investment purposes, group insurance policies are becoming increasingly popular as many employers are seeking to provide benefits to the employees, by way of taking a life policy in the employer's name. The group has to be homogeneous, i.e. all the members of the group should either be employed by the same employer or should belong to the same association etc. for the group policy to be issued.

A master policy, in the name of the employer or any association which takes the policy, is issued. Unlike individual policies here the risk assessment is done for the group as a whole. It is important that the group should not have been formed for the sole purpose of availing insurance. There should be a steady flow of members into the group to ensure that the risk profile is maintained and the policy does not end up servicing only aging members.

In case of group policies, the premium rates are periodically reviewed based on the claims experience of the group. This is known as experience rating. Most of the policies offer sharing of profits based on actual claims experience. If the overall claims experience of the group over a period of years is favourable, the excess of premium paid over claims and other administrative expenses of the insurer, is shared with the assured by way of bonus etc.

7.7.1 Types of groups

which avail group insurance are :

1) Employer-Employee groups : The employer takes a master policy for all his employees. The premium payment may be made either by the employer fully or it might be shared with the employees in agreed ratios. However, it is insisted that the share of the employer should be atleast 25% and also that all the employees in the company should be insured and there should be no adverse selection against the insurance company. That is, if given as an option to the employees, it is likely that the younger employees may not wish to take life insurance and the company may take the group insurance only for the senior members (in terms of age). This would lead to increase in the average age of the group insured, as life insurance is based on calculation of life expectancy. A group consisting of senior, aged employees, from the point of view of the insurer, is an adverse risk and deemed as an adverse selection against the insurer.

2) Creditor-Debtor Groups : The creditor takes out a master policy is favour of all its debtors. This is most common where a housing loan has been sanctioned. The housing financier may take out a policy in favour of all those who have availed housing loan from the housing financier and the claim amount can be used to repay the balance amount of the housing loan, in the event of the unfortunate death of a debtor.

3) Government schemes : Either the central or state government often take out a group policy for the lives of a section of the people as a welfare measure. For instance some of the state governments take a life policy for fishermen, policemen etc.

7.7.2 Experience Rating :

Experience rating as the name implies means that the rating of premium based on the experience. In individual policy, the premium rates are arrived at based on the age and occupation of the assured and once the premium is stated, there would be no further adjustment made during the policy period.

Whereas, under group policies, the rate for premium are quoted on the basis of the overall experience of the insurer for similar groups. Once the policy has been in force, the insurer may realize that the experience of the group in question is vastly different from the insurer's original assumptions. If the experience of the group is favourable i.e. if the claims ratio are attractive, then the insurer offers a share in the surplus or profit.

However for the concept to work, the size of the group has to be fairly large; the insurers insist on a group size of atleast 200. Experience rating does not mean that after every year the excess of premium over claims is shared with the policy holder, rather the insurer deducts from the gross premium, the amount of claims paid, administrative expenses etc. and out of the amount so arrived at, a percentage of the balance is used for experience rating adjustment. For eg., let us assume the premium received from a group in a year is Rs. 10,00,000. The amount of claims and administrative expenses comes to Rs. 6,00,000. The insurer wishes to distribute 60% of the surplus. Then the amount available for profit sharing is Rs. 2,40,000. This profit is shared with the group either by way of reduction in future premium(s) or enhancement in sum assured or payment of bonus.

In case of negative balance in a year, the amount is carried forward and adjusted against profits made in the later years and till the net balance becomes positive, no adjustment would be made.

Year	Profit/loss under the policy (in Rs.) (A)	Profit /loss brought for adjustment (B)	Adjustment – (B-A)	Profit/loss under the policy available for sharing (in Rs.)
2007	(-) 5,00,000	0	0	0
2008	3,00,000	(-) 5,00,000	(-) 2,00,000	0
2009	5,0,0000	(-) 2,00,000	3,00,000	3,00,000

7.8 Industrial Life Assurance

Industrial Life assurance originated in the United Kingdom. The policy was issued for the benefit of low income workers. The agents collected premium on a weekly basis as the workers were paid weekly wages and the purpose of the insurance was to provide for a burial fund.

These policies are high cost policies for insurance companies mainly because the target clientele was the low income workers whose life expectancy is low and secondly due to high administrative cost involved in collecting premiums from large number of workers. These policies are almost extinct now.

7.9 Life insurance premium and tax benefits

In India, life insurance has been popularized by offering a number of tax incentives. The

Income Tax act provides tax relief for investing in life insurance and investors use this form of investment for tax planning as well.

Any amount that you pay towards life insurance premium for yourself, your spouse or your children can be included under section 80C deduction. Please note that life insurance premium paid by you for your parents (father / mother / both) or your in-laws is not eligible for deduction under section 80C. If you are paying premium for more than one insurance policy, all the premiums can be included. It is not necessary to have the insurance policy from Life Insurance Corporation (LIC) – even insurance bought from private players are eligible.

Deductions allowable from income for payment of life insurance premium :

- **Under Section 80C**

  a. Life insurance premium paid in order to effect or to keep in force an insurance on the life of the assessee (tax payer) or on the life of the spouse or any child of the assessee and in the case of Hindu Undivided Family (HUF), premium paid on the life of any member thereof, provided premium paid is not in excess of 20% of capital sum assured. For eg. if the capital sum assured under the policy is Rs. 5,00,000, the premium paid under the policy should be less than Rs. 1,00,000 for it to be eligible for deduction.

  b. Contribution to deferred annuity plans in order to effect or to keep in force a contract for deferred annuity on his own life or the life of his spouse or any child of such individual, provided such contract does not contain a provision to exercise an option by the insured to receive a cash payment in lieu of the payment of annuity.

- **Under Section 80CCC**

  A deduction is allowed, to an individual assessee, for any amount paid or deposited by him from his taxable income in the annuity plans for receiving pension (from the fund set up under the Pension Scheme).

  NOTE: The premium can be paid upto Rs. 1,00,000 to avail deduction u/s. 80C, 80CCC and 80CCD. However, there is no sectoral cap i.e. the limit of Rs. 1,00,000 can be exhausted by paying premium under any one of the said sections.

- **Under Section 80D**

  Deduction allowable upto Rs.15,000/- if an amount is paid to keep in force an insurance on health of assessee or his family (i.e. spouse and children)

  Additional deduction upto Rs.15,000/- if an amount is paid to keep in force an insurance on health of parents.

  In case of Hindu Undivided Family (HUF), deduction allowable upto Rs.15,000/- if an amount is paid to keep in force an insurance on health of any member of that HUF

Note: If the sum specified in (a) or (b) or (c) is paid to effect or keep in force an insurance on the health of any person specified therein who is a senior citizen, then the deduction available will be upto Rs.20,000/-, provided that such insurance is in accordance with the scheme framed by

a) the General Insurance Corporation of India (GIC) as approved by the Central Government in this behalf or;

b) Any other insurer approved by the Insurance Regulatory and Development Authority.

- **Jeevan Aadhar Plan (Sec.80DD):**

  Deduction from total income upto Rs. 50,000/- allowable on amount deposited with LIC under Jeevan Aadhar Plan for maintenance of an handicapped dependent (Rs.1,00,000/- where handicapped dependent is suffering from severe disability)

Exemption in respect of commutation of pension

- Under Section 10 (10A) (iii) of the Income Tax Act, any payment received by way of commutations of pension (commutation of pension means payment of lump sum amount in lieu of a portion of pension surrendered voluntarily by the pensioner based on duration of period in relation to the age). For eg. if a person retiring at 60 is expected to live upto 80, he may surrender a portion of his pension say Rs 5,000 per month and receive lumpsum amount of perhaps Rs. 8,00,000 which would be equivalent to Rs. 60,000 for 20 years discounted for interest factor out of the Annuity plans is exempt from tax.

Income tax exemption on maturity/death claims proceeds under Section 10 (10D)

- Any sum received from Life insurance policy as maturity proceeds, death benefits is exempt from tax.
- However, the proceeds of the following policies are taxable :

  a) Key man insurance is taxable. (It is a type of policy where key executives of a company are insured by the company as their sudden demise may lead to a management crisis for the company.)

  b) Single premium policies will be taxed as income in the year benefits under the policy are received assuming the premium exceeds 20% of the sum assured.

  c) An insurance policy in respect of which the premium payable for any of the years during the term of the policy exceeds 20 % of the actual capital sum assured. This will not be applicable for any sum received on the death of a person.

Chapter 8: Insurance Intermediaries

8.1 Introduction

Insurance products can be either sold directly by the licensed insurance companies or it can be marketed through intermediaries holding authorised sanction from IRDA. With a view to ensure that the insurance policies are marketed only by licensed agents and brokers, the regulator has laid down stringent regulations for granting of license to the intermediaries. While agents play a key role in marketing insurance products, the role played in life insurance and personal insurance by the agents is far greater than in commercial, property and liability insurance which is by and large availed by corporates.

8.2 Individual agent :

As per the Licensing of Insured Agents Regulations, 2000, the agents are required to hold a license issued by IRDA/ authorised office of the insurance company (usually the corporate office is designated as the authorised office by the insurer). The license once issued is valid for a period of three years and a license fee is applicable. On expiry of three years the license has to be renewed. The applications for renewable should reach the insurance company atleast 30 days prior to the expiry of the license.

To qualify as an agent, the agent should :

1. At least have passed 12^{th} standard where he resides in a place with population of 5000 or more / or should have atleast passed 10^{th} standard when a applicant resides in any other place.
2. Have completed from an approved institution certain number hours of training in life or general insurance business when he is seeking license for the first time to act as an insurance agent.
3. Have completed from an approved institution certain number of hours of training in life and general insurance business when he is seeking license for the first time to act as a composite agent (an agent who works for both life and general insurance business)
4. Should be a major.
5. Should not be of unsound mind.

8.2.1 Corporate agent :

The following entities can apply to become a corporate agent :

i. A firm
ii. Company formed under the Company's Act, 1956

iii. Banking company

iv. Regional Rural Bank (RRBs)

v. Co-operative societies, Co-operative Banks

vi. Panchayat/ Local Authority

vii. NGO as approved by the IRDA

8.2.2 Code of Conduct.

Every person holding a licence, shall adhere to the code of conduct specified below :-

1. Every insurance agent shall :

i. identify himself (through an identity card issued by the insurance company) and the insurance company of whom he is an insurance agent;

ii. disclose his licence to the prospect on demand;

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

iv. disclose the scales of commission in respect of the insurance products offered for sale, if asked by the prospect;

v. indicate the premium to be charged by the insurer for the insurance products offered for sale;

vi. explain to the prospect the nature of information required in the proposal form by the insurer and also the importance of disclosure of material information in the purchase of an insurance contract;

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

viii. inform promptly the prospect about the acceptance or rejection of the proposal by the insurer;

ix. obtain the requisite documents at the time of filing the proposal form with the insurer and other documents subsequently asked for by the insurer for completion of the proposal;

x. render necessary assistance to the policyholders or claimants or beneficiaries in complying with the requirements for settlement of claims by the insurer;

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

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

2. No insurance agent shall :

i. solicit or procure insurance business without holding a valid licence;

ii. induce the prospect to omit any material information in the proposal form;

iii. induce the prospect to submit wrong information in the proposal form or documents submitted to the insurer for acceptance of the proposal;

iv. behave in a discourteous manner with the prospect;

v. interfere with any proposal introduced by any other insurance agent;

vi. offer different rates, advantages, terms and conditions other than those offered by his insurer;

vii. demand or receive a share of proceeds from the beneficiary under an insurance contract;

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

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

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

xi. become or remain a director of any insurance company;

8.3 Broking regulations

IRDA regulations classify brokers into three categories :

i. Direct brokers

ii. Reinsurance Brokers

iii. Composite Brokers

Brokers represent a client while agents represents an insurer. The direct brokers are authorised to represent clients and arrange insurance policies for them in life as well as in general insurance and can place business with any of the insurance companies. Reinsurance brokers represent direct insurers and arrange reinsurance (when an insurance company insures a part of the business underwritten by them with another insurance, it is called reinsurance) with Reinsurance companies. Composite brokers are licensed to place direct as well as reinsurance business with insurers.

The broker can be an individual, partnership firm, company or a society. The principal officer of the broker should possess the minimum qualifications prescribed in the IRDA Act, he has to undergo 100 hours of practical training and pass the exams conducted by the National Insurance Academy (NIA) or any other body recognised by the IRDA.

The brokers have to comply with minimum capital requirements specified by IRDA.

8.3.1 Functions of a direct broker :

The functions of a direct broker includes any one or more of the following:

a. obtaining detailed information of the client's business and risk management philosophy;

b. familiarising himself with the client's business and underwriting information so that this can be explained to an insurer and others;

c. rendering advice on appropriate insurance cover and terms;

d. maintaining detailed knowledge of available insurance markets, as may be applicable;

e. submitting quotation received from insurer/s for consideration of a client;

f. providing requisite underwriting information as required by an insurer in assessing the risk to decide pricing terms and conditions for cover;

g. acting promptly on instructions from a client and providing him written acknowledgements and progress reports;

h. assisting clients in paying premium under section 64VB of Insurance Act, 1938 (4 of 1938);

i. providing services related to insurance consultancy and risk management;

j. assisting in the negotiation of the claims; and

k. maintaining proper records of claims;

8.3.2 Functions of a re-insurance broker:

The functions of a re-insurance broker includes any one or more of the following:

a. familiarising himself with the client's business and risk retention philosophy;

b. maintaining clear records of the insurer's business to assist the reinsurer(s) or others;

c. rendering advice based on technical data on the reinsurance covers available in the international insurance and the reinsurance markets;

d. maintaining a database of available reinsurance markets, including solvency ratings of individual reinsurers;

e. rendering consultancy and risk management services for reinsurance;

f. selecting and recommending a reinsurer or a group of reinsurers;

g. negotiating with a reinsurer on the client's behalf;

h. assisting in case of commutation of reinsurance contracts placed with them;

i. acting promptly on instructions from a client and providing it written acknowledgements and progress reports;

j. collecting and remitting premiums and claims within such time as agreed upon;

k. assisting in the negotiation and settlement of claims;

l. maintaining proper records of claims; and

m. exercising due care and diligence at the time of selection of reinsurers and international insurance brokers having regard to their respective security rating and establishing respective responsibilities at the time of engaging their services.

8.3.3 Functions of composite broker:

A composite broker carries out any one or more of the functions mentioned in 8.3.1 and 8.3.2 above.

8.8.4 Procedure for licensing

The IRDA on being satisfied that the applicant fulfills all the conditions specified for the grant of licence, grants a licence in Form B and sends an intimation thereof to the applicant mentioning the category for which the IRDA has granted the licence. The licence shall be issued subject to the insurance broker adhering to the conditions and the code of conduct as specified by the IRDA from time to time.

8.3.5 Validity of licence

A licence once issued shall be valid for a period of three years from the date of its issue, unless the same is suspended or cancelled pursuant to these regulations.

8.4.6 Renewal of licence

1. An insurance broker may, within thirty days before the expiry of the licence, make an application in Form A to the IRDA for renewal of licence.

Provided however that if the application reaches the IRDA later than that period but before the actual expiry of the current licence, an additional fee of rupees one hundred only shall be payable by the applicant to the IRDA. Provided further that the IRDA may for sufficient reasons offered in writing by the applicant for a delay not covered by the previous proviso, accept an application for renewal after the date of the expiry of the licence on a payment of an additional fee of seven hundred and fifty rupees only by the applicant.

2. An insurance broker before seeking a renewal of licence, shall have completed, atleast twenty five hours of theoretical and practical training, imparted by an institution recognized by the IRDA from time to time.

3. The IRDA, on being satisfied that the applicant fulfills all the conditions specified for a renewal of the licence, shall renew the licence in Form B for a period of three years and send an intimation to that effect to the applicant.

4. An insurance broker licensed under these regulations for a specified category may also apply for the grant of a licence by the IRDA for any other category by fulfilling the requirements of these regulations. However, such application shall be made only after a lapse of one year from the grant of a licence in the first instance.

8.3.7 Remuneration

No insurance broker shall be paid or contracted to be paid by way of remuneration (including royalty or licence fees or administration charges or such other compensation), an amount exceeding:

1. on direct general insurance business -
    - i. on tariff products:
        - a. 10 percent of the premium on that part of the business which is compulsory under any statute or any law in force;
        - b. 12½ percent of the premium on others.
    - ii. on non- tariff products:

      17½ percent of the premium on direct business.
2. on direct life insurance business -
    - i. individual insurance
        - a. 30 percent of first year’s premium
        - b. 5 per cent of each renewal premium
    - ii. annuity
        - a. immediate annuity or a deferred annuity in consideration of a single premium, or where only one premium is payable on the policy, 2 percent of the premium
        - b. deferred annuity in consideration of more than one premium:
    - i. 7½ percent of first year’s premium
    - ii. 2 percent of each renewal premium

3. group insurance and pension schemes:

    i. one year renewable group term insurance, gratuity, superannuation, group savings linked insurance — 7½ percent of risk premium

        Note: Under group insurance schemes there will be no remuneration for the savings component.

    ii. single premium - 2 percent of risk premium

    iii. annual contributions, at new business procurement stage - 5 percent of non risk premium with a ceiling of Rupees three lakhs per scheme.

    iv. single premium new business procurement stage - 0.5 percent with a ceiling of Rupees five lakhs per scheme.

    v. remuneration for subsequent servicing - one year renewable group term assurance - 2 percent of risk premium with a ceiling of rupees 50, 000/- per scheme.

4. on reinsurance business

    i. as per market practices prevalent from time to time.

8.3.8 Professional indemnity insurance —

1. Every insurance broker shall take out and maintain and continue to maintain a professional indemnity insurance cover throughout the validity of the period of the licence granted to him by the IRDA, provided that the IRDA shall in suitable cases allow a newly licensed insurance broker to produce such a guarantee within fifteen months from the date of issue of original licence.

2. The insurance cover must indemnify an insurance broker against —

    ii. any error or omission or negligence on his part or on the part of his employees and directors;

    iii. any loss of money or other property for which the broker is legally liable in consequence of any financial or fraudulent act or omission;

    iv. any loss of documents and costs and expenses incurred in replacing or restoring such documents;

    v. dishonest or fraudulent acts or omissions by brokers' employees or former employees.

3. The indemnity cover —

    i. shall be on a yearly basis for the entire period of licence;

    ii. shall not contain any terms to the effect that payments of claims depend upon the insurance broker having first met the liability;

iii. shall indemnify in respect of all claims made during the period of the insurance regardless of the time at which the event giving rise to the claim may have occurred, provided that an indemnity insurance cover not fully conforming to the above requirements shall be permitted by the IRDA in special cases for reasons to be recorded by it in writing.

4. Limit of indemnity for any one claim and in the aggregate for the year in the case of insurance brokers are as follows :

Category of insurance broker	Limit of indemnity
(i) Direct broker	three times of the remuneration received at the end of every financial year subject to a minimum limit of rupees fifty lakhs.
(ii) Reinsurance broker	three times of the remuneration received at the end of every financial year subject to a minimum limit of rupees two crores and fifty lakhs.
(iii) Composite broker	three times of the remuneration received at the end of every financial year subject to a minimum limit of rupees five crores

5. The un-insured excess in respect of each claim shall not exceed five percent of the capital employed by the insurance broker in the business.

6. The insurance policy shall be obtained from any registered insurer in India who has agreed to —

i. provide the insurance broker with an annual certificate containing the name, address, licence number of the insurance broker, the policy number, the limit of indemnity, the excess (i.e. the balance amount, which as per policy, has to be borne by the insured in the event of a claim) and the name of the insurer, as evidence that the cover meets the requirements of the IRDA;

ii. send a duplicate certificate to the IRDA at the time the certificate is issued to the insurance broker; and

iii. inform the insurer immediately of any case of voidance, non-renewal or cancellation of cover mid-term.

7. Every insurance broker shall—

i. inform immediately the IRDA should any cover be cancelled or voided or if any policy is not renewed;

ii. inform immediately the insurer in writing of any claim made by or against it;

iii. advise immediately the insurer of all circumstances or occurrences that may give rise to a claim under the policy ; and

iv. advise the IRDA as soon as an insurer has notified that it intends to decline indemnity in respect of a claim under the policy.

8.4 Indian Insurance Market

8.4.1 Life Insurance

The first Life Insurance Company which came into existence in India was "The Oriental Life Insurance Company", established in 1818. This was a British company. The first Indian insurance company subsequently came into being in 1871 called the "Bombay Mutual Life Assurance Society".

8.4.2 Nationalisation of Life insurance in India

Life insurance in India was nationalized on January 19, 1956, through the Life Insurance Corporation Act. At the time of nationalisation of life insurance in India, there were 154 domestic insurers, 16 foreign insurers and 75 provident funds operating under the Insurance Act of 1938. All the 245 Indian and foreign insurers and provident societies were taken over by the central government as a result of their nationalisation. Life Insurance Corporation of India (LIC), which is the largest insurance company in India, was formed by an act of Parliament, viz. the LIC Act, 1956. LIC was promoted with a capital of Rs. 5 crore by the Government of India.

8.4.3 Privatisation Of Life insurance in India

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

The IRDA opened up the insurance market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests.

8.4.4 Life Insurance Players

Some licensed life insurers operating in India* :

1. Bajaj Allianz Life Insurance Company Ltd.
2. Birla Sun Life Insurance Co. Ltd.
3. HDFC Standard Life Insurance Co. Ltd.
4. ICICI Prudential Life Insurance Co. Ltd.
5. ING Vysya Life Insurance Company Ltd.
6. Life Insurance Corporation of India
7. Max New York Life Insurance Co. Ltd.
8. Met Life India Insurance Company Ltd.
9. Kotak Mahindra Old Mutual Life Insurance Ltd.
10. SBI Life Insurance Co. Ltd.
11. Tata AIG Life Insurance Company Ltd.
12. Reliance Life Insurance Company Ltd.
13. Aviva Life Insurance Company India Ltd.
14. Sahara India Life Insurance Co, Ltd.
15. Shriram Life Insurance Co, Ltd.
16. Bharti AXA Life Insurance Company Ltd.
17. Future Generali India Life Insurance Company Ltd.
18. IDBI Fortis Life Insurance Company Ltd.,
19. Canara HSBC Oriental Bank of Commerce Life Insurance Company Ltd.
20. AEGON Religare Life Insurance Company Ltd.
21. DLF Pramerica Life Insurance Co. Ltd.
22. Star Union Dai-ichi Life Insurance Co. Ltd.
23. India First Life Insurance Company Ltd.

*Please check IRDA's website for latest details

8.4.5 Non-Life Insurance

"Triton Insurance Company Ltd." (the first general insurance company) was formed in the year 1850 in Kolkata by the British. The first Indian general insurer to commence operations was the “Indian Mercantile Insurance Company” in the year 1907. The New India Assurance Company Ltd. a leading public sector non-life insurance company was incorporated in 1919.

8.4.6 Nationalisation of general insurance In India

In 1972, the non-life insurance business was nationalized and General Insurance Corporation of India (GIC) was formed with four subsidiaries:

- The National Insurance Co. Ltd.
- Oriental Insurance Co. Ltd.
- United India Insurance Co. Ltd.
- New India Assurance Co. Ltd.

All the 107 Indian and Foreign insurers operating at the time of nationalisation were integrated and grouped into the above mentioned four companies and operated as subsidiaries of GIC.

8.4.7 Privitisation of Non-Life Insurance :

The general insurance market was opened for competition in December 2000 and the four public sector companies have been made autonomous and no longer function as a subsidiary of the GIC. They have been de-linked from the parent company and made as independent insurance companies, though they continue to operate as government owned entities. Private sector general insurance companies have also been allowed to open up business in India.

Licensed non-life insurers operating in India* :

1. Bajaj Allianz General Insurance Co. Ltd.
2. ICICI Lombard General Insurance Co. Ltd.
3. IIFFCO Tokio General Insurance Co. Ltd.
4. National Insurance Co.Ltd.
5. The New India Assurance Co. Ltd.
6. The Oriental Insurance Co. Ltd.
7. Reliance General Insurance Co. Ltd.
8. Royal Sundaram Alliance Insurance Co. Ltd
9. Tata AIG General insurance Co. Ltd
10. United India Insurance Co. Ltd.
11. Cholamandalam MS General Insurance Co. Ltd.
12. HDFC ERGO General Insurance Co. Ltd.
13. Export Credit Guarantee Corporation of India Ltd.
14. Agriculture Insurance Co. of India Ltd.

15. Star Health and Allied Insurance Company Ltd.
16. Apollo Munich Health Insurance Company Ltd.
17. Future Generali India Insurance Company Ltd.
18. Universal Sompo General Insurance Co. Ltd.
19. Shriram General Insurance Company Ltd.
20. Bharti AXA General Insurance Company Ltd.
21. Raheja QBE General Insurance Company Ltd.
22. SBI General Insurance Company Ltd.
23. Max Bupa Health Insurance Company Ltd.
24. L&T General Insurance Company Ltd.

*Please check IRDA's website for latest details

(Model test paper for the module is available on the website **www.nseindia.com > 'Education' > 'Prepare for a Testing' link)**

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