IC-38

INSURANCE AGENTS
LIFE

ACKNOWLEDGEMENT

This course is based on revised syllabus prepared by Insurance Institute of India, Mumbai

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INSURANCE AGENTS - LIFE
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This course is purely meant for the purpose of study of the subject by student appearing for the examination of Insurance Institute of India & is based on prevailing best industry practices. It is not intended to give interpretation or solution in case of dispute or matters involving legal argument.

This is only an indicative study material. Please note that the questions in the examination shall not be confined to this study material.

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PREFACE

The Institute has developed the course material for Insurance Agents Life Branch in consultation with the industry. The course material is prepared based on the syllabus approved by IRDAI.

The study course, thus, provides basic knowledge of Life, General and Health insurance that enables agents to understand and appreciate their professional career in the right perspective. Needless to say, insurance business operates in a dynamic environment the agents will have to keep abreast of changes in law and practice, through personal study and participation in in-house training given by insurers.

We thank IRDAI for entrusting this work to III. The Institute wishes all those who study this course and pass the examination.

Insurance Institute of India

CONTENTS

SECTION 1

COMMON CHAPTERS

CHAPTER 1

INTRODUCTION TO INSURANCE

Chapter Introduction

This chapter aims to introduce the basics of insurance, trace its evolution and how it works. You will also learn how insurance provides protection against economic losses arising as a result of unforeseen events and serves as an instrument of risk transfer.

Learning Outcomes

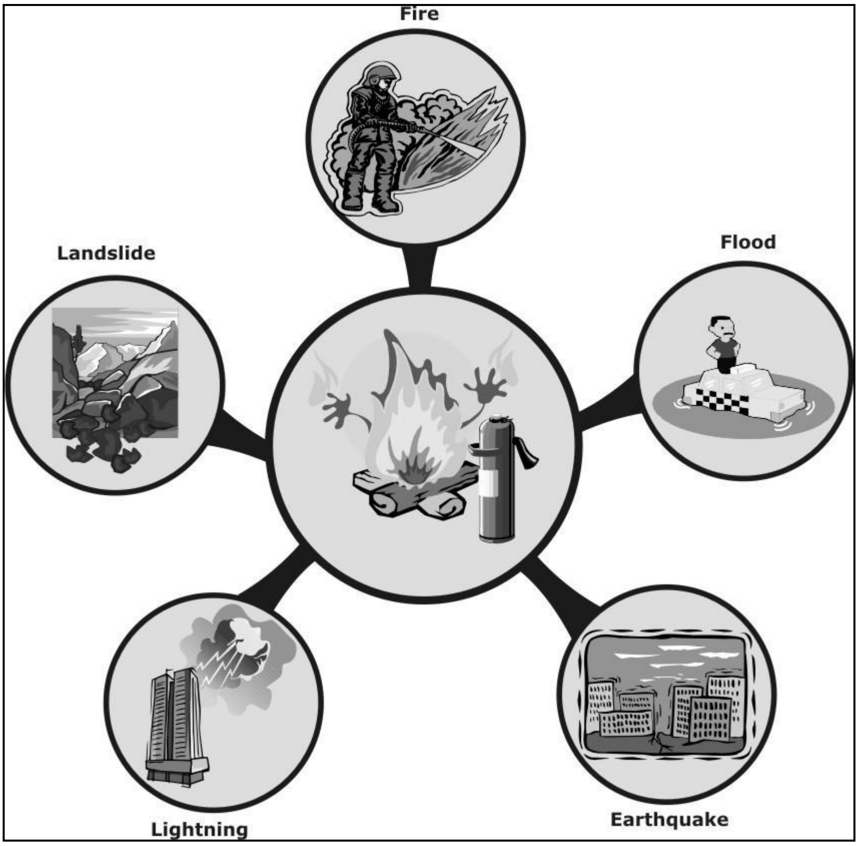
A. Life insurance – History and evolution
B. How insurance works
C. Risk management techniques
D. Insurance as a tool for managing risk
E. Role of insurance in society

A. Life insurance – History and evolution

We live in a world of uncertainty. We hear about:

- ✓ trains colliding;
- ✓ floods destroying entire communities;
- ✓ earthquakes that bring grief;
- ✓ young people dying suddenly pre-maturely

Diagram 1: Events happening around us



Why do these events make us anxious and afraid?

The reason is simple.

i. Firstly these **events are unpredictable.** If we can anticipate and predict an event, we can prepare for it.

ii. Secondly, such unpredictable and untoward events are often a **cause of economic loss and grief**.

A community can come to the aid of individuals who are affected by such events, by having a system of sharing and mutual support.

The idea of insurance took birth thousands of years ago. Yet, the business of insurance, as we know it today, goes back to just two or three centuries.

1. History of insurance

Insurance has been known to exist in some form or other since 3000 BC. Various civilisations, over the years, have practiced the concept of pooling and sharing among themselves, all the losses suffered by some members of the community. Let us take a look at some of the ways in which this concept was applied.

2. Insurance through the ages

Babylonian Traders	The **Babylonian traders** had agreements where they would pay additional sums to lenders, as a price for writing off of their loans, in case a shipment was lost or stolen. These were called 'bottomry loans'. Under these agreements, the loan taken against the security of the ship or its goods had to be repaid only if and when the ship arrived safely, after the voyage, at its destination.
Traders from Bharuch and Surat	Practices similar to Babylonian traders were prevalent among **traders from Bharuch and Surat,** sailing in Indian ships to Sri Lanka, Egypt and Greece.
Greeks	The **Greeks** had started benevolent societies in the late 7th century AD, to take care of the funeral – and families – of members who died. The **Friendly Societies of England** were similarly constituted.
Inhabitants of Rhodes	The **inhabitants of Rhodes** adopted a practice whereby, if some goods were lost due to jettisoning[1] during distress, the owners of goods (even those who lost nothing) would bear the losses in some proportion.
Chinese Traders	**Chinese traders** in ancient days would keep their goods in different boats or ships sailing over the treacherous rivers. They assumed that even if any of the boats suffered such a fate, the loss of goods would be only partial and not total. The loss could be distributed and thereby reduced.

3. Modern concepts of insurance

In India the principle of life insurance was reflected in the institution of the joint-family system in India, which was one of the best forms of life insurance down the ages. Sorrows and losses were shared by various family members in the event of the unfortunate demise of a member, as a result of which each member of the family continued to feel secure.

The break-up of the joint family system and emergence of the nuclear family in the modern era, coupled with the stress of daily life has made it

[1]Jettisoning means throwing away some of the cargo to reduce weight of the ship and restore balance

necessary to evolve alternative systems for security. This highlights the importance of life insurance to an individual.

i. **Lloyds**: The origins of modern commercial insurance business as practiced today can be traced to Lloyd's Coffee House in London. Traders, who used to gather there, would agree to share the losses, to their goods being carried by ships, due to perils of the sea. Such losses used to occur because of maritime perils, such as pirates robbing on the high seas, or bad sea weather spoiling the goods or sinking of the ship due to perils of the sea.
ii. **Amicable Society for a Perpetual Assurance** founded in 1706 in London is considered to be the first life insurance company in the world.

4. History of insurance in India

a) **India**: Modern insurance in India began in early 1800 or thereabouts, with agencies of foreign insurers starting marine insurance business.

The Oriental Life Insurance Co. Ltd	The first life insurance company to be set up in India was an English company
Triton Insurance Co. Ltd.	The first non-life insurer to be established in India
Bombay Mutual Assurance Society Ltd.	The first Indian insurance company. It was formed in 1870 in Mumbai
National Insurance Company Ltd.	The oldest insurance company in India. It was founded in 1906 and it is still in business.

Many other Indian companies were set up subsequently as a result of the Swadeshi movement at the turn of the century.

Important

In 1912, the **Life Insurance Companies Act** and the **Provident Fund Act** were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it compulsory that premium-rate tables and periodical valuation of companies be certified by an actuary. However, the disparity and discrimination between Indian and foreign companies continued.

The **Insurance Act 1938** was the first legislation enacted to regulate the conduct of insurance companies in India. This Act, as amended from time to time continues to be in force. The Controller of Insurance was appointed by the Government under the provisions of the Insurance Act.

b) **Nationalisation of life insurance**: Life insurance business was nationalised on 1st September 1956 and the **Life Insurance Corporation of India (LIC)** was formed. There were 170 companies and 75 provident fund societies doing life insurance business in India at that time. From 1956 to 1999, the LIC held exclusive rights to do life insurance business in India.

c) **Nationalisation of non-life insurance**: With the enactment of General Insurance Business Nationalisation Act (GIBNA) in 1972, the non-life insurance business was also nationalised and the **General Insurance Corporation of India (GIC) and its four subsidiaries** were set up. At that point of time, 106 insurers in India doing non-life insurance business were amalgamated with the formation of four subsidiaries of the GIC of India.

d) **Malhotra Committee and IRDAI**: In 1993, the Malhotra Committee was setup to explore and recommend changes for development of the industry including the reintroduction of an element of competition. The Committee submitted its report in 1994.In 1997 the Insurance Regulatory Authority (IRA) was established. The passing of the Insurance Regulatory& Development Act, 1999(IRDAI) led to the formation of **Insurance Regulatory and Development Authority of India (IRDAI)** in April 2000 as a statutory regulatory body both for life, non-life **and health** insurance industry. **IRDA has been subsequently renamed as IRDAI in 2014.**

Amending the Insurance Act in 2015, certain stipulations have been added governing the definition and formation of insurance companies in India.

An Indian Insurance company includes a company '***in which the aggregate holdings of equity shares by foreign investors, including portfolio investors, do not exceed forty-nine percent*** of ***the paid up equity capital of such Indian insurance company, which is Indian owned and controlled, in such manner as may be prescribed'.***

Amendment to the Insurance Act also stipulates about foreign companies in India, ***A foreign insurance company can engage in reinsurance through a branch established in India. The term "re-insurance" means the 'insurance of part of one insurer's risk by another insurer who accepts the risk for a mutually acceptable premium'***

5. Life insurance industry today

Currently, there are 24 life insurance companies operating in India as detailed hereunder:

a) Life Insurance Corporation (LIC) of India is a public sector company
b) There are 23 life insurance companies in the private sector

Alphabetical List of **23** Life-Assurance Companies, in the Private-Sector, is as follows:

S.No.	Company
1	AEGON Life Insurance Company Limited
2	Aviva Life Insurance Company India Limited
3	Bajaj Allianz Life Insurance Company Limited
4	Bharti AXA Life Insurance Company Limited
5	Birla Sun Life Insurance Company Limited
6	Canara H.S.B.C. Oriental Bank of Commerce Life Insurance Company Limited
7	D.H.F.L. Pramerica Life Insurance Company Limited
8	Edelweiss Tokio Life Insurance Company Limited
9	Exide Life Insurance Company Limited
10	Future Generali India Life Insurance Company Limited
11	H.D.F.C. Standard Life Insurance Company Limited
12	I.C.I.C.I. Prudential Life Insurance Company Limited
13	I.D.B.I. Federal Life Insurance Company Limited
14	IndiaFirst Life Insurance Company Limited
15	Kotak Mahindra Old Mutual Life Insurance Company Limited
16	Max Life Insurance Company Limited
17	P.N.B. Metlife India Insurance Company Limited
18	Reliance Nippon Life Insurance Company Limited
19	Sahara India Life Insurance Company Limited

20	S.B.I. Life Insurance Company Limited
21	Shriram Life Insurance Company Limited
22	Star Union Dai-ichi Life Insurance Company Limited
23	Tata A.I.A. Life Insurance Company Limited

c) The postal department, under the Government of India, also transacts life insurance business via Postal Life Insurance, but is exempt from the purview of the regulator

Test Yourself 1

Which among the following is the regulator for the insurance industry in India?

I. Insurance Authority of India
II. Insurance Regulatory and Development Authority of India
III. Life Insurance Corporation of India
IV. General Insurance Corporation of India

B. How insurance works

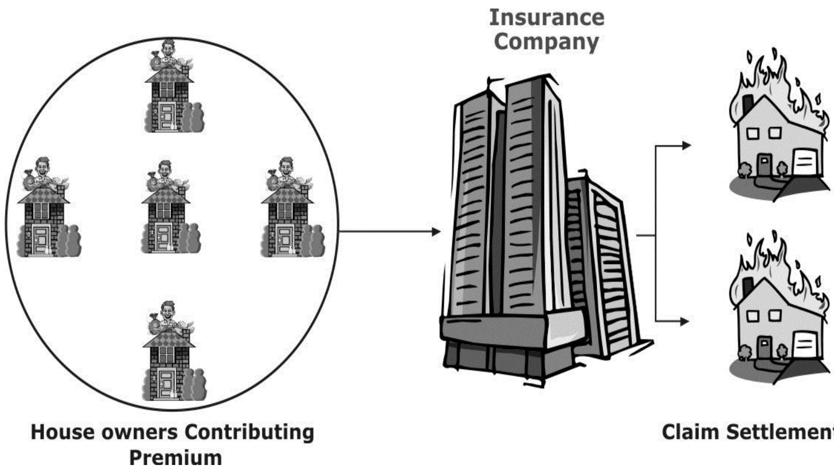
Modern commerce was founded on the principle of ownership of property. When an asset loses value (by loss or destruction) due to a certain event, the owner of the asset suffers an economic loss. However if a common fund is created, which is made up of small contributions from many such owners of similar assets, this amount could be used to compensate the loss suffered by the unfortunate few.

In simple words, the chance of suffering a certain economic loss and its consequence could be transferred from one individual to many through the mechanism of insurance.

Definition

Insurance may thus be considered as a process by which the losses of a few, who are unfortunate to suffer such losses, are shared amongst those exposed to similar uncertain events / situations.

Diagram 2: How insurance works



There is however a catch here.

i. Would people agree to part with their hard earned money, to create such a common fund?

ii. How could they trust that their contributions are actually being used for the desired purpose?

iii. How would they know if they are paying too much or too little?

Obviously someone has to initiate and organise the process and bring members of the community together for this purpose. That 'someone' is known as an 'Insurer' who determines the contribution that each individual must make to the pool and arranges to pay to those who suffer the loss.

The insurer must also win the trust of the individuals and the community.

1. How insurance works

a) Firstly, these must be an asset which has an economic value. The **ASSET**:
   i. May be **physical** (like a car or a building) or
   ii. May be **non-physical** (like name and goodwill) or
   iii. May be **personal** (like one's eyes, limbs and other aspects of one's body)

b) The asset may lose its value if a certain event happens. This chance of loss is called as **risk**. The cause of the risk event is known as **peril**.

c) There is a principle known as **pooling**. This consists of collecting numerous individual contributions (known as premiums) from various persons. These persons have similar assets which are exposed to similar risks.

d) This pool of funds is used to compensate the few who might suffer the losses as caused by a **peril**.

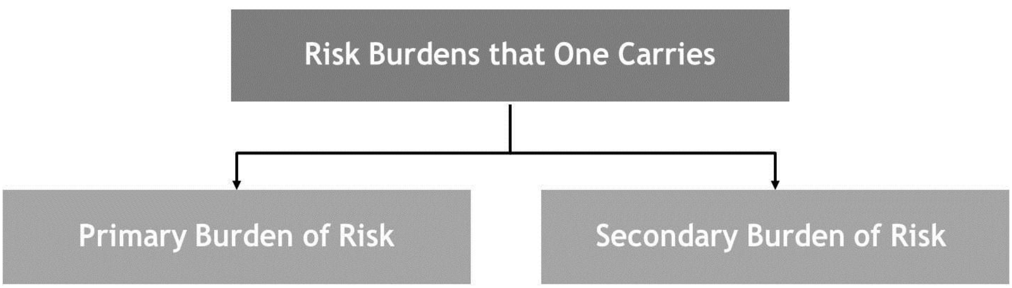
e) This process of pooling funds and compensating the unlucky few is carried out through an institution known as the **insurer.**

f) The insurer enters into an insurance **contract** with each person who seeks to participate in the scheme. Such a participant is known as **insured.**

2. Insurance reduces burdens

Burden of risk refers to the costs, losses and disabilities one has to bear as a result of being exposed to a given loss situation/event.

Diagram 3: Risk burdens that one carries



There are two types of risk burdens that one carries – **primary and secondary**.

a) Primary burden of risk

The **primary burden of risk** consists of losses that are actually suffered by households (and business units), as a result of pure risk events. These losses are often direct and measurable and can be easily compensated for by insurance.

Example

When a factory gets destroyed by fire, the actual value of goods damaged or destroyed can be estimated and the compensation can be paid to the one who suffers such loss.

If an individual undergoes a heart surgery, the medical cost of the same is known and compensated.

In addition there may be some indirect losses.

Example

A fire may interrupt business operations and lead to loss of profits which also can be estimated and the compensation can be paid to the one who suffers such a loss.

b) Secondary burden of risk

Suppose no such event occurs and there is no loss. Does it mean that those who are exposed to the peril carry no burden? The answer is that apart from the primary burden, one also carries a secondary burden of risk.

The **secondary burden of risk** consists of costs and strains that one has to bear merely from the fact that one is exposed to a loss situation. Even if the said event does not occur, these burdens have still to be borne.

Let us understand some of these burdens:

i. Firstly there is **physical and mental strain caused by fear and anxiety.** The anxiety may vary from person to person but it is present and can cause stress and affect a person's wellbeing.

ii. Secondly when one is **uncertain about whether a loss would occur or not**, the prudent thing to do would be to set aside a reserve fund to meet such an eventuality. There is a cost involved in keeping such a fund. For instance, such funds may be held in a liquid form and yield low returns.

By transferring the risk to an insurer, it becomes possible to enjoy peace of mind, invest funds that would otherwise have been set aside as a reserve, and plan one's business more effectively. It is precisely for these reasons that insurance is needed.

Test Yourself 2

Which among the following is a secondary burden of risk?

I. Business interruption cost
II. Goods damaged cost
III. Setting aside reserves as a provision for meeting potential losses in the future
IV. Hospitalisation costs as a result of heart attack

C. Risk management techniques

Another question one may ask is whether insurance is the right solution to all kinds of risk situations. The answer is 'No'.

Insurance is only one of the methods by which individuals may seek to manage their risks. Here they transfer the risks they face to an insurance company. However there are some other methods of dealing with risks, which are explained below:

1. Risk avoidance

Controlling risk by avoiding a loss situation is known as risk avoidance. Thus one may try to avoid any property, person or activity with which an exposure may be associated.

Example

i. One may refuse to bear certain manufacturing risks by contracting out the manufacturing to someone else.

ii. One may not venture outside the house for fear of meeting with an accident or may not travel at all for fear of falling ill when abroad.

But risk avoidance is a negative way to handle risk. Individual and social advancements come from activities that need some risks to be taken. By avoiding such activities, individuals and society would lose the benefits that such risk taking activities can provide.

2. Risk retention

One tries to manage the impact of risk and decides to bear the risk and its effects by oneself. This is known as self-insurance.

Example

A business house may decide, based on experience about its capacity to bear small losses up to a certain limit, to retain the risk with itself.

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3. Risk reduction and control

This is a more practical and relevant approach than risk avoidance. It means taking steps to lower the chance of occurrence of a loss and/or to reduce severity of its impact if such loss should occur.

Important

The measures to reduce chance of occurrence are known as '**Loss Prevention**'. The measures to reduce degree of loss are called '**Loss Reduction**'.

Risk reduction involves reducing the frequency and/or sizes of losses through one or more of:

a) **Education and training**, such as holding regular "fire drills" for employees, or ensuring adequate training of drivers, forklift operators, wearing of helmets and seat belts and so on.

   One example of this can be educating school going children to avoid junk food.

b) **Making Environmental changes**, such as improving "physical" conditions, e.g. better locks on doors, bars or shutters on windows, installing burglar or fire alarms or extinguishers. The State can take measures to curb pollution and noise levels to improve the health status of its people. Regular spraying of Malaria medicine helps in prevention of outbreak of the disease.

c) **Changes made in dangerous or hazardous operations,** while using machinery and equipment or in the performance of other tasks

   For example leading a healthy lifestyle and eating properly at the right time helps in reducing the incidence of falling ill.

d) **Separation**, spreading out various items of property into varied locations rather than concentrating them at one location, is a method to control risks. The idea is, if a mishap were to occur in one location, its impact could be reduced by not keeping everything at that one place.

   For instance one could reduce the loss of inventory by storing it in different warehouses. Even if one of these were to be destroyed, the impact would be reduced considerably.

4. Risk financing

This refers to the provision of funds to meet losses that may occur.

a) **Risk retention through self-financing** involves self-payment for any losses as they occur. In this process the firm assumes and finances its own risk, either through its own or borrowed funds, this is known as **self-insurance**. The firm may also engage in various risk reduction methods to make the loss impact small enough to be retained by the firm.

b) **Risk transfer** is an alternative to risk retention. Risk transfer involves transferring the responsibility for losses to another party. Here the losses that may arise as a result of a fortuitous event (or peril) are transferred to another entity.

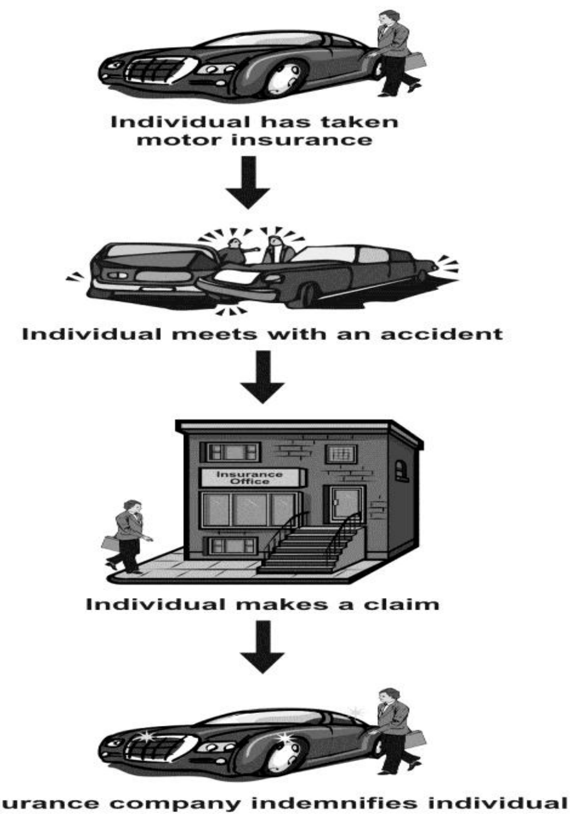
Insurance is one of the major forms of risk transfer, and it permits uncertainty to be replaced by certainty through insurance indemnity.

Insurance vs Assurance

Both insurance and assurance are financial products offered by companies operating commercially. Of late the distinction between the two has increasingly become blurred and the two are taken as somewhat similar. However there are subtle differences between the two as discussed hereunder.

Insurance refers to protection against an event that **might** happen whereas assurance refers to protection against an event that **will** happen. Insurance provides cover against a risk while assurance covers an event that is definite e.g. death, which is certain, only the time of occurrence is uncertain. Assurance policies are associated with life cover.

Diagram 4: How insurance indemnifies the insured



There are other ways to transfer risk. For example when a firm is part of a group, the risk may be transferred to the parent group which would then finance the losses.

Thus, insurance is only one of the methods of risk transfer.

Test Yourself 3

Which among the following is a method of risk transfer?

I. Bank FD
II. Insurance
III. Equity shares
IV. Real estate

D. Insurance as a tool for managing risk

When we speak about a risk, we are not referring to a loss that has actually been suffered but a loss that is likely to occur. It is thus an expected loss. The cost of this expected loss (which is the same as the cost of the risk) is the product of two factors:

i. The **probability** that the peril being insured against may happen, leading to the loss

ii. The **impact** or the amount of loss that may be suffered as a result

The cost of risk would increase in direct proportion with both probability and amount of loss. However, if the amount of loss is very high, and the probability of its occurrence is small, the cost of the risk would be low.

Diagram 5: Considerations before opting for insurance

1. Considerations before opting for Insurance

When deciding whether to insure or not, one needs to weigh the cost of transferring the risk against the cost of bearing the loss, that may arise, oneself. The cost of transferring the risk is the insurance premium – it is given by two factors mentioned in the previous paragraph. The best situations for insurance would be where the probability is very low but the loss impact could be very high. In such instances, the cost of transferring the risk through its insurance (the premium) would be much lower while the cost of bearing it on oneself would be very high.

a) **Don't risk a lot for a little**: A reasonable relationship must be there between the cost of transferring the risk and the value derived.

Example

Would it make sense to insure an ordinary ball pen?

b) **Don't risk more than you can afford to lose**: If the loss that can arise as a result of an event is so large that it can lead to a situation that is near bankruptcy, retention of the risk would not appear to be realistic and appropriate.

Example

What would happen if a large oil refinery were to be destroyed or damaged? Could a company afford to bear the loss?

c) **Consider the likely outcomes of the risk carefully**: It is best to insure those assets for which the probability of occurrence (frequency) of a loss is low but the possible severity (impact), is high.

Example

Could one afford to not insure a space satellite?

Test Yourself 4

Which among the following scenarios warrants insurance?

I. The sole bread winner of a family might die untimely
II. A person may lose his wallet
III. Stock prices may fall drastically
IV. A house may lose value due to natural wear and tear

E. Role of insurance in society

Insurance companies play an important role in a country's economic development. They are contributing in a significant sense to ensuring that the wealth of the country is protected and preserved. Some of their contributions are given below.

a) Their investments benefit the society at large. An insurance company's strength lies in the fact that huge amounts are collected and pooled together in the form of premiums.

b) These funds are collected and held for the benefit of the policyholders. Insurance companies are required to keep this aspect in mind and make all their decisions in dealing with these funds so as to be in ways that benefit the community. This applies also to its investments. That is why successful insurance companies would not be found investing in speculative ventures i.e. stocks and shares.

c) The system of insurance provides numerous direct and indirect benefits to the individual, his family, to industry and commerce and to the community and the nation as a whole. The insured - both individuals and enterprises - are directly benefitted because they are protected from the consequences of the loss that may be caused by an accident or fortuitous event. Insurance, thus, in a sense protects the capital in industry and releases the capital for further expansion and development of business and industry.

d) Insurance removes the fear, worry and anxiety associated with one's future and thus encourages free investment of capital in business enterprises and promotes efficient use of existing resources. Thus insurance encourages commercial and industrial development along with generation of employment opportunities, thereby contributing to a healthy economy and increased national productivity.

e) A bank or financial institution may not advance loans on property unless it is insured against loss or damage by insurable perils. Most of them insist on assigning the policy as collateral security.

f) Before acceptance of a risk, insurers arrange survey and inspection of the property to be insured, by qualified engineers and other experts. They not only assesses the risk for rating purposes but also suggest and recommend to the insured, various improvements in the risk, which will attract lower rates of premium.

g) Insurance ranks with export trade, shipping and banking services as an earner of foreign exchange to the country. Indian insurers operate in more than 30 countries. These operations earn foreign exchange and represent invisible exports.

h) Insurers are closely associated with several agencies and institutions engaged in fire loss prevention, cargo loss prevention, industrial safety and road safety.

Information

Insurance and Social Security

a) It is now recognised that provision of social security is an obligation of the State. Various laws, passed by the State for this purpose involve use of insurance, compulsory or voluntary, as a tool of social security. Central and State Governments contribute premiums under certain social security schemes thus fulfilling their social commitments. The Employees State Insurance Act, 1948 provides for **Employees State Insurance Corporation** to pay for the expenses of sickness, disablement, maternity and death for the benefit of industrial employees and their families, who are insured persons. The scheme operates in certain industrial areas as notified by the Government.

b) Insurers play an important role in social security schemes sponsored by the Government such as
   1. RKBY – Rashtriya Krishi Bima Yojana
   2. RSBY – Rashtriya Swasthya Bima Yojana
   3. PMJBY – Pradhan Mantri Jeevan Jyoti Bima Yojana
   4. PMSBY – Pradhan Mantri Suraksha Bima Yojana

   All these benefit the community in general.

c) All the **rural insurance schemes**, operated on a commercial basis, are designed ultimately to provide social security to the rural families.

d) Apart from this support to Government schemes, the insurance industry itself offers on a commercial basis, insurance covers which have the ultimate objective of social security. Examples are: **Janata Personal Accident, Jan Arogya** etc.

Test Yourself 5

Which of the below insurance scheme is run by an insurer and not sponsored by the Government?

I. Employees State Insurance Corporation
II. Crop Insurance Scheme
III. Jan Arogya
IV. All of the above