UNIT -1

INSURANCE

MEANING

Insurance means the act of securing the payment of a sum of money in the event of loss or damage to property, life, a person etc., by regular payment of premiums.

Insurance is a means of protection from financial loss. It is a form of risk management, primarily used to hedge against the risk of a contingent or uncertain loss.

Insurance is a method of spreading over a large number of persons, a possible financial risk too serious to be conveniently sustained by an individual. The aim of all types of insurances is to protect the owner from a variety of risks which he anticipates.

A contract of insurance is a contract whereby one person called the ‘insurer’, undertakes in return for the agreed consideration called the ‘premium’ to pay to another person, called the ‘insured’ a sum of money or its equivalent on the happening of a specified event.

SCOPE

i. **Provide protection** - The primary function of insurance is to offer protection against future risk, accidents and uncertainty. Insurance is actually a shield against economic loss, by sharing the risk with others

ii. **Collective risk** - Insurance is a device to contribute to the financial loss of a few among many. Insurance is a mean by which little losses are shared among larger number of people. All the insured share the premiums towards a fund and out of which the persons exposed to a particular risk are paid.

iii. **Evaluation of risk** - Insurance concludes the probable volume of risk by evaluating various factors that give rise to risk. Risk is the origin for determining the premium rate also.

iv. **Provide assurance** - Insurance is a device, which helps to modify from uncertainty to certainty. Insurance is a mechanism whereby uncertain risks may be made more certain.

v. **Avoidance of losses** - Insurance alarms individuals and businessmen to adopt suitable device to prevent unfortunate consequences of risk by observing safety instructions; installation of automatic sparkler or alarm systems, etc. prevention of losses causes smaller payment to the assured by the insurer and this will encourage for more savings by way of premium. The condensed rate of premiums motivates for more business and better protection to the insured.

vi. **Small capital to cover larger risks** - Insurance relieves the businessmen from security investments, by paying small amount of premium against superior risks and uncertainty.

vii. **Encourage towards the development of larger** industries - Insurance provides development opportunity to those larger industries having additional risks in their setting up. Even the financial institutions may be prepared to give credit to ailing industrial units which have insured their assets including plant and machinery.

viii. **Way of savings and investment** - Insurance serves as savings and investment, insurance is a compulsory way of savings and it limits the unnecessary expenses by the insured. For the reason of availing income-tax exemptions also people invest in insurance.

ix. **Source of earning foreign exchange** - Insurance is a worldwide business. The country can earn foreign exchange by way of issue of marine insurance policies and various other ways.

x. **Risk-Free trade** - Insurance promotes exports insurance, which makes the foreign trade risk-free with the assistance of different types of policies under marine insurance cover.

PRINCIPLES

1. **Existence of risk**: It is vital to every contract of insurance that the subject matter should be exposed to the contingency of loss or risk. Risk involves the happening of an uncertain event adverse to the interest of the assured. In marine insurance the ship or cargo is exposed to the loss by perils of the sea. In fire insurance the risk is in the destruction of property by fire45. In life insurance, the risk is in the death of the assured, though a certainty, but uncertain as to the time of its happening. In an abstract sense, risk may be defined as the chance of loss. It can either be an uncertainty as to the outcome of some event or events, or loss as the result of at least one possible outcome. In any case, the promise of the insurer is to save the assured against the uncertain consequences.

2. **Principle of indemnity**: Insurance is essentially a contract of indemnity. All the claims of the assured will be adjusted only with reference to the actual loss sustained by him. Thus, it is implied in every contract of insurance that the assured in case of a loss against which the policy has the actual loss, is to prevent fraud on the part of the assured. It checks the temptation to gain by unfair means and the willful causing of loss. However, the factual

basis for the application of the principle of indemnity is not the prevention of crime or consideration of public policy but it derives from the inherent nature of the bargain.

3. **Insurable interest** – the insured typically must directly suffer from the loss. Insurable interest must exist whether property insurance or insurance on a person is involved. The concept requires that the insured have a "stake" in the loss or damage to the life or property insured. What that "stake" is will be determined by the kind of insurance involved and the nature of the property ownership or relationship between the persons. The requirement of an insurable interest is what distinguishes insurance from gambling.

4. **Utmost good faith** – the insured and the insurer are bound by a good faith bond of honesty and fairness. Material facts must be disclosed.

5. **Contribution** – insurers which have similar obligations to the insured contribute in the indemnification, according to some method.

6. **Subrogation** – the insurance company acquires legal rights to pursue recoveries on behalf of the insured; for example, the insurer may sue those liable for the insured's loss. The Insurers can waive their subrogation rights by using the special clauses.

7. **Causa proxima, or proximate cause** – the cause of loss (the peril) must be covered under the insuring agreement of the policy, and the dominant cause must not be excluded

8. **Mitigation** – In case of any loss or casualty, the asset owner must attempt to keep loss to a minimum, as if the asset was not insured.