

Class: MSc

Subject : Life Insurance – Principles, Products and Practices

Chapter: Fundamental Principles of Life Insurance

2. Fundamental Principles of Life Insurance

01

Utmost
Good faith

02

Insurable
Interest

03

Indemnity

04

Proximate
Cause

05

Subrogation

06

Contribution

07

Mitigation

2.1 Utmost Good Faith (Uberrimae fidei)

- the insurer and the insured must disclose all material facts before the policy inception.
- **For example** - John took a health insurance policy. At the time of taking policy, he was a smoker and he didn't disclose this fact. He got cancer.

Insurance company won't pay anything as John didn't reveal the important facts.



2.2 Insurable Interest

- Insured must have the insurable interest on the subject matter
- **For example** - a policyholder buying property insurance for their own house but not for their neighbour's house.

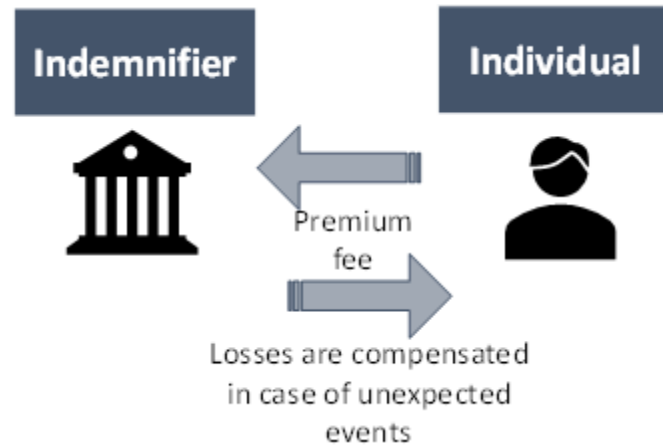
The person does not have an insurable interest in any financial loss arising from damage to their neighbour's house



2.3 Indemnity

- also known as a 'hold harmless' clause as one party agrees to hold the other party harmless.
- **For example** - The owner of this house was indemnified.

This means the insurance company covered the repair costs caused by the lightning damage.



2.4 Proximate Cause

- concerned with how the loss or damage actually occurred
- Example: Driver of "Car A" runs a red light and hits "Car B," which had a green light, causing injury to the driver of Car B. Driver of Car A had a duty to not run the red light, and, assuming no extenuating circumstances that excused running the red light, his actions in doing so directly (and therefore, proximately) caused injuries to the driver of Car B.
- Example: Driver of "Car A" runs a red light, and "Car B" which has a green light, swerves to avoid being hit. The driver of Car B is fuming and nervous, with a racing pulse. Upset, the driver of Car B continues driving, and three blocks later, hits a parked car, injuring himself.

The driver of Car B can try and claim that the actions of the driver of Car A caused him to get hurt when he hit the parked car. And it may well be a remote cause; but it is probably not the proximate cause.



2.5 Subrogation

- After the insured gets the claim money, the insurer steps into the shoes of insured. After making the payment insurance claim, the insurer becomes the owner of subject matter.
- **For example :-** Ram took a insurance policy for his Car. In an accident his car totally damaged. Insurer paid the full policy value to insured.

Now Ram can't sell the scrap remained after the scrap.



By Fritz Ahlfeldt

2.6 Contribution

- In case the insured took more than one insurance policy for same subject matter, he/she can't make profit by making claim for same loss more than once.
- **For example** - Raj has a property worth Rs.5,00,000. He took insurance from Company A worth Rs.3,00,000 and from Company B - Rs.1,00,000. In case of accident, he incurred a loss of Rs.3,00,000 to the property.

Raj can claim Rs. Rs.3,00,000 from A but after that he can't make profit by making a claim from Company B.



2.7 Mitigation

- reducing risk of loss from the occurrence of any undesirable event

Moral hazard - party protected from risk in some way will act differently than if they didn't have that protection.





Identify the principle(s) in each case

1. Karan has taken fire insurance policy for his factory. Due to fire he suffered a loss of Rs. 2 Lakhs and he gets the compensation for the same. The half-burnt goods can be sold for Rs. 30000. Who has the right over it?
2. X enters into contract to build a godown for Y for Rs 50,000. Mr. Y supplies all the material for construction to Mr. X. Can Mr. X insure the material supplied for the period of construction?
3. A factory owner gets his stock of goods insured, but he hides the fact that the electricity board has issued him a statutory warning letter to get his factory's wiring changed. Later, the factory catches fire due to sort circuit of wiring. Can he claim compensation?
4. Shubham has taken a loan from Saurabh against the security of his factory. Can Saurabh take a fire insurance policy of that factory?
5. Rishabh insured his factory for Rs. 5 lakhs against fire. Due to fire, he suffered a loss of Rs. 3 Lakh. How much amount he can recover from the insurance company?
6. Aditya gets his house insured against fire of Rs.10 Lakhs with insurer A and for Rs. 5 lakhs with insurer B. A loss of Rs. 3 lakhs occurred. How much compensation can he claim from A and B?



Identify the principle(s) in each case

7. Ms. Gopal took a fire insurance policy of Rs. 1,00,000 on the property of Rs. 3,00,000. If there is a fire in the premises of the insured causing loss to the extent of Rs. 80,000, he will be compensated with Rs. 80,000. But, if there is a second fire in the premises and the entire property is burnt, how much amount the insured can claim on account of second offer?
8. Mr. Arun's goods in a warehouse were insured against fire with Bharat Insurance Company. The goods were burnt and Arun recovered the full value from the insurance company. Subsequently Arun also sued the warehouse keeper and recovered a sum of Rs. 10 lakhs from him. Can Arun retain this money?
9. Mr. Raymond insures his ship against the Perils of Sea for Rs. 5,00,000. The ship was burnt partially and loss estimates is Rs. 2,00,000. When Raymond asks for claim, the insurance company denies the claim. Why?



Answers

S.No.	Answers	Principle(s) Identified
1.	The insurance company, because he has been fully compensated for the loss.	Subrogation
2.	Yes. Mr. X is likely to gain on the existence of the material and loss by the destruction.	Insurable Interest
3.	No, because he hides the fact tat the electricity board has issued him a statutory warning letter	Utmost Good Faith
4.	Yes, because Shubham has taken a loan from Saurabh against the security of his factory.	Insurable Interest
5.	3 lakhs	Indemnity
6.	He can claim compensation in the ratio 2:1 (10:5) from A and B respectively.	Contribution



Answers

S.No.	Answers	Principle(s) Identified
7.	The insured can claim only rest Rs. 20,000.	Indemnity
8.	No, as he has already been compensated by the company. The insurance company has the right to sue and retain the money.	Subrogation
9.	Because the peril against which the insurance was taken does not match with the actual accident.	Proximate Cause



"Buying **INSURANCE cannot change your life but it prevents your lifestyle from being changed. An illness can wipe an entire family's savings that they have saved for decades by the medical bills.**

You will not turn **BANKRUPT because of buying insurance but **you will cause** your loved ones to turn bankrupt if you don't."**

- Jack Ma