INSTITUTE OF ACTUARIAL & QUANTITATIVE STUDIES

Class: FY BSc

Subject : Life Insurance – Principles, Products and Practices

Subject Code: PUSASQF 1.5

Chapter: Fundamental Principles of Life Insurance and Legislation

2. Fundamental Principles of Life Insurance

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Utmost Good faith	Insurable Interest	Indemnity	Proximate Cause	Subrogation	Contribution	Mitigation

2.1 Utmost Good Faith (Uberrimae fidei)

- The insurer must honestly explain everything clearly about the extent of the terms and conditions of the insurer and the insured must also provide a clear and correct for objects or interests of the insured.

- **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. Insurable interest means that the subject matter for which the individual enters the insurance contract must provide some financial gain to the insured and also lead to a financial loss if there is any damage, destruction or loss.

- **For example** - the owner of a vegetable cart has an insurable interest in the cart because he is earning money from it. However, if he sells the cart, he will no longer have an insurable interest in it.

2.3 Indemnity

- This principle says that insurance is done only for the coverage of the loss; hence insured should not make any profit from the insurance contract. In other words, the insured should be compensated the amount equal to the actual loss and not the amount exceeding the loss.

- **For example** - The owner of a commercial building enters an insurance contract to recover the costs for any loss or damage in future. If the building sustains structural damages from fire, then the insurer will indemnify the owner for the costs to repair the building by way of reimbursing the owner for the exact amount spent on repair or by reconstructing the damaged areas using its own authorized contractors.

2.4 Proximate Cause

- This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property. If the proximate cause is the one in which the property is insured, then the company must pay compensation.

- 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

- Subrogation means one party stands in for another. As per this principle, after the insured, i.e. the individual has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property goes to the insurer, i.e. the company.

- **For example** :- If Mr A gets injured in a road accident, due to reckless driving of a third party, the company with which Mr A took the accidental insurance will compensate the loss occurred to Mr A and will also sue the third party to recover the money paid as claim.

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

- This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimise the loss to the insured property. The principle does not allow the owner to be irresponsible or negligent just because the subject matter is insured.

- 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 writing. 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 extend 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

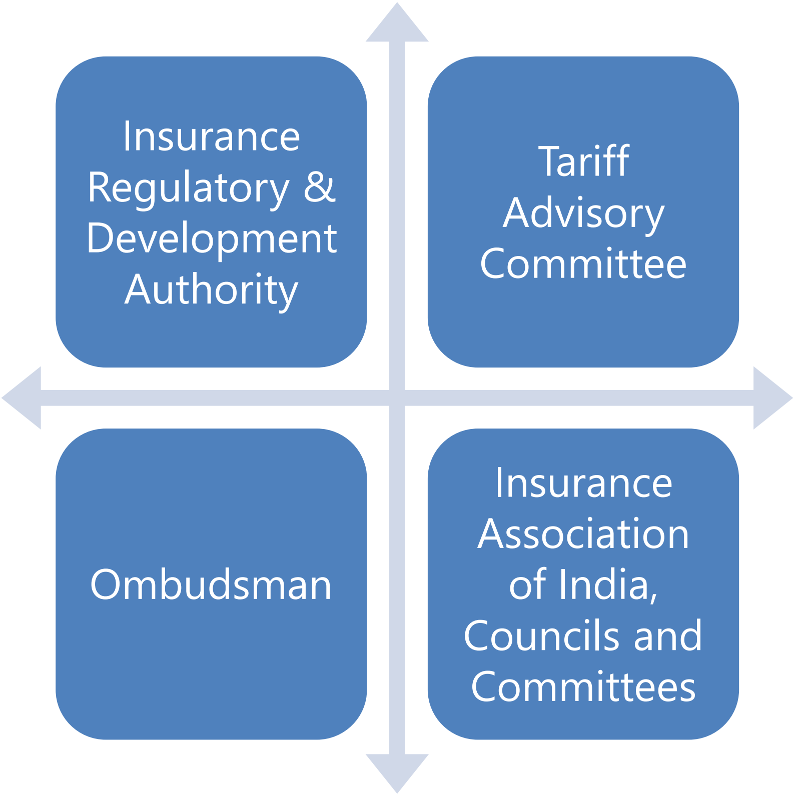
S.No.	Answers	Principle(s) Identified
7.	The insured can claim only rest Rs. 20,000.	Indemnity
8.	No, as he has already been compensated by the company. The insurance company has the right to sue and retain the money.	Subrogation
9.	Because the peril against which the insurance was taken does not match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

3 Regulatory authorities



4 IRDAI

- The **Insurance Regulatory and Development Authority of India** (IRDAI) is a regulatory body under the jurisdiction of Ministry of Finance , Government of India and is tasked with regulating and licensing the insurance and re- insurance industries in India.

- It was constituted by the Insurance Regulatory and Development Authority Act, 1999, an Act of Parliament passed by the Government of India.

- The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938. The key objectives of the IRDAI include promotion of competition so as to enhance customer satisfaction through increased consumer choice and fair premiums, while ensuring the financial security of the Insurance market.

4.1 Functions - IRDAI

- Issuing, renewing, modifying, withdrawing, suspending or cancelling registrations
- Specifying qualifications, the code of conduct and training for intermediaries, agents, surveyors and loss assessors
- Promoting efficiency in the conduct of insurance businesses
- Promoting and regulating professional organizations connected with the insurance and re-insurance industry
- Regulating a margin of solvency
- Adjudicating disputes between insurers and intermediaries or insurance intermediaries
- Supervising the Tariff Advisory Committee
- Specifying the percentage of premium income to finance schemes for promoting and regulating professional organizations
- Specifying the percentage of life and general insurance business undertaken in the rural or social sector
- Specifying the form and the manner in which books of accounts shall be maintained, and statement of accounts shall be rendered by insurers and other insurer intermediaries

5 Tariff Advisory Committee

- The Tariff Advisory Committee ("Advisory Committee") is a body corporate, which controls and regulates the rates, advantages, terms and conditions offered by insurers in the general insurance business. The Advisory Committee has the authority to require any insurer to supply such information or statements necessary for discharge of its functions. Any insurer failing to comply with such provisions shall be deemed to have contravened the provisions of the Insurance Act.

- Every insurer is required to make an annual payment of fees to the Advisory Committee of an amount not exceeding in case of reinsurance business in India, one percent of the total premiums in respect of facultative insurance accepted by him in India; and in case of any other insurance business, one percent of the total gross premium written direct by him in India.

6 Insurance Association of India

All insurers and provident societies incorporated or domiciled in India are members of the Insurance Association of India ("Insurance Association") and all insurers and provident societies incorporated or domiciled elsewhere than in India are associate members of the Insurance Association.

There are two councils of the Insurance Association, namely

1. The Life Insurance Council
2. The General Insurance Council.

6.1 The Life Insurance Council

- Life Insurance Council is a forum that connects the various stakeholders of the sector. It develops and coordinates all discussions between the Government, Regulatory Board and the Public.

- Constituted under Sec.64C of Insurance Act 1938, the Life Insurance Council functions through several sub-committees and includes all life insurance companies in India. In total, there are 24 life insurers who offer a variety of traditional and new innovative products.

- It’s objective is to play a significant and complementary role in transforming India's life insurance industry into a vibrant, trustworthy and profitable service, helping people in their journey to prosperity.

6.1.1 Functions - The Life Insurance Council

- To function as an active forum to aid, advise and assist insurers in maintaining high standards of conduct and service to policyholders.
- Interact with the Government and other bodies on policy matters.
- Actively participate in spreading insurance awareness in India.
- Take steps to develop education and research in insurance.
- Help India enjoy the benefits of global practices.
- The Life Insurance Council, through its Executive Committee, conducts examinations for individuals wishing to qualify themselves as insurance agents.
- It also fixes the limits for actual expenses by which the insurer carrying on life insurance business or any group of insurers can exceed from the prescribed limits under the Insurance Act.

6.2 The General Insurance Council

- The General Insurance Council has been constituted under section 64C of the Insurance Act, 1938 since 2001 by the Insurance Regulatory and Development Authority of India (IRDAI).

- The General Insurance Council is an important link between the Insurance Regulatory and Development Authority of India and the non-Life insurance industry. It also pushes for the Industry’s issues with the Government.

- While the Council plays the role envisaged for it by the Insurance Act, it also facilitates overall growth for the industry in a fair and equitable manner in the interest of all stake holders.

6.2.1 Functions - The General Insurance Council

a) Main Objects

- To aid, advise and assist insurers carrying on general insurance business in the matter of setting up equitable and clear standards of conduct and sound practice and in the matter of rendering efficient service to holders of General Insurance policies.
- To render advice to the Authority in the matter of controlling the expenses of insurers in respect of their General Insurance business in India.
- To bring to the notice of the Authority, the case of any insurer acting in a manner prejudicial to the interests of the holders of general insurance policies.
- To bring about better co-ordination and cohesion in the general insurance industry.
- To promote awareness about the role and benefits from general insurance.

6.2.1 Functions - The General Insurance Council

b) Objects incidental or ancillary to the attainment of the main objects:

- To promote, sponsor and support programmes and activities, and to take action including submitting memoranda, representations and campaigns necessary for maintaining a positive image of the General Insurance industry through media, forums and opinion makers and enhance the level of consumer confidence in the industry.
- To promote and facilitate research and development in all branches and related activities of General Insurance business.
- To evolve and recommend innovative procedures and solutions for legal, technical, managerial or professional activities in the General Insurance business.
- To act as a clearing house for data collection, storage, dissemination and exchange of data, procedures and practices to be adopted in General Insurance business, etc

6.2.1 Functions - The General Insurance Council

- The income and the property of the Council, whensoever derived shall be applied solely for the promotion of the objects set forth herein read with the provisions of the Act. The income / surplus funds of the Council shall not be distributed to the Members under any circumstances. However, the Council may decide not to collect fees for any year under the provisions of Section 64L(2) of the Act.

- Proper and complete accounts shall be kept of all the sums of money received and expended by the Council/Committee and the matters in respect of which such receipts and expenditures takes place, and of property, credit and liabilities of the Council; and, subject to any reasonable restrictions as to the time and manner of inspecting the same that may be imposed in accordance with the regulations of the Council for the time being in force, the accounts shall be open for inspection by Members.

7 Ombudsman

- The Ombudsman are appointed in accordance with the Redressal of Public Grievances Rules, 1998, to resolve all complaints relating to settlement of claims on the part of insurance companies in a cost-effective, efficient and effective manner.

- The Ombudsman are also empowered to receive and consider any partial or total repudiation of claims by an insurer, any dispute in regard to the premium paid in terms of the policy, any dispute on the legal construction of the policies in as much such a dispute relates to claims, delay in settlement of claims and the non-issue of any insurance document to customers after receipt of premium.

- The Ombudsman act as a counsellor and mediator and make recommendations to both parties in the event that the complaint is settled by agreement between both the parties