UNIT-1: INTRODUCTION: NATURE, IMPORTANCE AND TYPES OF BUSINESS – INSURANCE MARKETS AND FUNCTIONS – INSURANCE INDUSTRY – PRICING OF INSURANCE

Q1. Define Insurance? Explain the nature of Insurance?

Ans: In the words of Justice Tindall, "Insurance is a contract in which a sum of money is paid to the assured as consideration of insurer's incurring the risk of paying a large sum upon a given contingency.

Insurance follows important characteristics – These are follows

1) SHARING OF RISK

Insurance is a co-operative device to share the burden of risk, which may fall on happening of some unforeseen events, such as the death of head of family or on happening of marine perils or loss of by fire.

2) CO-OPERATIVE DEVICE

Insurance is a co-operative form of distributing a certain risk over a group of persons who are exposed to it (Ghosh & Agarwal). A large number of persons share the losses arising from a particular risk.

3) LARGE NUMBER OF INSURED PERSONS

The success of insurance business depends on the large number of persons insured against similar risk. This will enable the insurer to spread the losses of risk among large number of persons, thus keeping the premium rate at the minimum.

4) EVALUATION OF RISK

For the purpose of ascertaining the insurance premium, the volume of risk is evaluated, which forms the basis of insurance contract.

5) AMOUNT OF PAYMENT

The amount of payment in indemnity insurance depends on the nature of losses occurred, subject to a maximum of the sum insured. In life insurance, however, a fixed amount is paid on the happening of some uncertain event or on the maturity of the policy.

6) PAYMENT OF HAPPENING OF SPECIFIED EVENT

On happening of specified event, the insurance company is bound to make payment to the insured. Happening of specified event is certain in life insurance, but in the case of fire, marine of accidental insurance, it is not necessary. In such cases, the insurer is not liable for payment of indemnity.

7) TRANSFER OF RISK

Insurance is a plan in which the insured transfers his risk on the insurer. This may be the reason that may Erson observes, that insurance is a device to transfer some economic losses would have been borne by the insured themselves.

8) SPEADING OF RISK

Insurance is a plan which spread the risk & losses of few people among a large number of people. John Magee writes, "Insurance is a plan by which large number of people associates themselves and transfers to the shoulders of all, risk attached to individuals".

9) PROTECTION AGAINST RISKS

Insurance provides protection against risk involved in life, materials and property. It is a device to avoid or reduce risks.

10) INSURANCE IS NOT CHARITY

Charity pays without consideration but in the case of insurance, premium is paid by the insured to the insurer in consideration of future payment.

11) INSURANCE IS NOT A GAMBLING

Insurance is not a gambling. Gambling is illegal, which gives gain to one party and loss to other. Insurance is a valid contact to indemnity against losses. Moreover, insurable interest is present in insurance contracts it has the element of investment also.

12) A CONTRACT

Insurance is a legal contract between the insurer and insured under which the insurer promises to compensate the insured financially within the scope of insurance policy, the insured promises to pay a fixed rate of premium to the insurer.

13) SOCIAL DEVICE

Insurance is a plan of social welfare and protection of interest of the people. Rieged and Miller observe "Insurance is of social nature".

14) BASED UPON CERTAIN PRINCIPLE

Insurance is a contract based upon certain fundamental principles of insurance, which includes utmost good faith, insurable interest, contribution, indemnity, cause proxima, subrogation etc, which are operating in the various fields of insurance.

15) REGULATION UNDER THE LAW

The government of every country enacts the law governing insurance business so as to regulate, and control its activities for the interest of the people. In India General Insurance Act 1972 and the Life Insurance Act 1956 are the major enactment in this direction.

16) WIDE SCOPE

The scope insurance is much wider and extensive various types of policies have been developed in the country against risk of fire, marine, accident, theft, burglary, life, etc.

17) INSTITUTIONAL SETUP

After nationalisation, the insurance business in the country is operation under statutory organization setup. In India, the General Insurance Companies and the Life Insurance Corporation and subsidiary companies of General Insurance Corporation are operating the various fields of insurance.

18) INSURANCE FOR PURE RISK ONLY

Pure risks give only losses to the insured, and no profits. Examples of pure risks are accident, misfortune, death, fire, injury, etc., which are all the sided risks and the ultimate results in loss. Insurance Companies issue policies against pure risk only, not against speculative risks. Speculative risk has chances of profit of losses.

19) BASED ON MUTUAL GOODWILL

Insurance is a contract based on good faith between the parties. Therefore, both the parties are bound to disclose the important facts affecting to the contract before each other. Utmost good faith is one of the important principles of insurance.

Q2. Explain the importance of Insurance?

As the industrial revolution comes with cutthroat competition, the chances of uncertainty are also increasing day by day. Insurance plays significant role for not only an individual or for not only an individual or for a family but it has spread over the entire nervous system of the nation.

According to the famous philosopher J. Royce, Insurance Principles comes to be more and more used and useful in modern affairs. Not only does is serve the ends of individuals, it tends more and more both to pervade and transform our modern social order. It brings into now synthesis, not merely pure and applied sciences, but private and public interests, individual prudence and a large regard for. The general welfare theft and charity.

One famous author named "Dinsdale" also explains the importance of insurance as under. "No one in modern world can afford to be without insurance".

Q3. Explain the functions of Insurance?

Insurance becomes very useful in today's life. It plays significant role in this competitive era. One should know the functions of insurance According to Sir William Beveridge the functions of insurance can be divided into three categories.

1) **Primary Functions**
2) **Secondary Functions**
3) **Indirect Functions**

1. PRIMARY FUNCTION

(A) TO PROVIDE PROTECTIONS

The most important function of insurance is to provide protection against risk of loss. It is one check the reality of the misfortune happening, and pays the cost of damages of losses.

(B) TO PROVIDE CERTANITY

We know future is totally uncertain. Any misfortune happening may occur at any stage of life. The amount of loss and time of losses both are uncertain. No doubt better planning and administration can reduce the chances of happening these types of accidents but it requires lots of attention towards strengths and weaknesses, special knowledge of the field after all these precautions, the uncertainty remains steady. Insurance provides certainly towards the losses. The policy holders pay the premium to by certainty.

(C) DISTRIBUTION OF RISK

It is a co-operative effort where the risk is distributed among the group of people. Thus, no one have to bear the losses occurred due to uncertainty.

2. SECONDARY FUNCTION

(A) HELPS IN ECONOMIC PROGRESS -

Insurance plays an important role in economic progress. It gives fully certainty to the industrialists towards the risks. The entrepreneurs can more concentrate on innovative and profitable techniques of the production. They should not require thinking over the risks. The industrialists can establish new industries in environment. Thus, industries have got development in economic and commerce of the nation.

(B) IN PREVENTS LOSSES

Insurance plays vital role in preventing the losses. The amount of premium is minimized by using such appliances like the fire extinguisher. If one uses interior machinery which may be caused for misfortune, the amount of premium will be high. Thus, indirectly, insurance provides help to minimize the chances of risks. It will be useful for the agencies which are directly related with the same function like,

a) Loss prevention association of India.
b) The salvage crops of loss prevention association of India.
c) Survey and inspection of risks, etc.

3. INDIRECT FUNCTION

(A) A FORCED SAVINGS

Life Insurance is also a method of savings in India. Income Tax Act gives relief in payment of income tax because government wants to habituate general public to save money. It encourages the habit of thrift and savings among the people. Thus, it becomes compulsory savings to people of nation.

(B) POMOTE FOREIGN TRADE

It is compulsory to take marine insurance policy in foreign trade in India. Foreigners can't issue the foreign trade bill unless the cargo is fully insured. Thus foreign trade is totally depends upon the insurance sector of the nation. It gives relief to entrepreneurs from the uncertainty of foreign trade.

(C) OTHERS

Insurance provides certainties towards risks in entrepreneurship. It gives confidence in general public. It is one of the important source of investment which develops the trade and commerce of the nation.

Q4. Explain the advantages of Insurance?

1. INVESTMENT OF FUNDS

In the course of their business, insurance by the way of premiums collect vast sums. Especially in life business much of it can be invested profitably over long periods. This benefits the nation as a whole because insurers are required by law to invest the major portion in government securities and other approved investment, out of which nation-building activities are undertaken.

2. REDUCTION OF COST INSURANCE

Income earned by investment of accumulated funds further increases the fund and goes to reduce the cost of insurance for otherwise the premiums would have to be higher to next extent.

3. EFFECT ON PRICES

Manufacturers pass on the consumer, the cost of insurance along with other production cost. Still it is beneficial to the consumers because without insurance the cost would have been much more.

4. INVISIBLE EXPORT

Providing insurance service overseas is our invisible export, like export of material goods and the profit brought in is contribution to the favorable balance of trade.

5. REDUCING COST OF SOCIAL SERVICES

No victim or heirs of a deceased victim of motor accidents now a days goes without compensation from insurance funds built out of compulsory insurance of motor vehicles and this is no small benefit social relief.

Q5. Explain the limitations of Insurance?

In spite of number of advantages of insurance, it has certain limitations. On account of such limitations, the benefits of insurance could not be availed in full. These limitations are

1. All the risks cannot be insured. Only pure risks can be insured and speculative risks are not insurable.
2. Insurable interest (financial interest) en the subject matter of insurance either at the time of insurance or at the time of loss, or at both the times must be present, in the absence of which the contract of insurance becomes void.
3. In case the loss arises from the happening of the event cannot be valued in terms of money, such risks are not insurable.
4. Insurance against the risk of a single individual or a small group of persons are not advisable, since it is not practicable due to higher cost involved.
5. Another important limitation is that the premium rates are higher in our country & as such, certain category of people cannot avail the advantage of insurance. The main reason for the higher rate of premiums is the higher operating cost.
6. It becomes difficult to control moral hazards in insurance. There are certain people who mystifies the insurance plans for their self-interest by claiming false claims from insurance companies.
7. Insurance is not a profitable investment. Its main object is to provide security against risks; insurance business cannot be a source to acquire profits.

Certain specified risks can be insured with co-operation of the government only; such as, unemployment insurance, insolvency of banks, food insurance, etc.

Q6. Explain the basic principles of Insurance?

The mechanism of insurance involves a contractual agreement in which the insurer agrees to provide financial protection against a specified set of risk for a price called the premium.

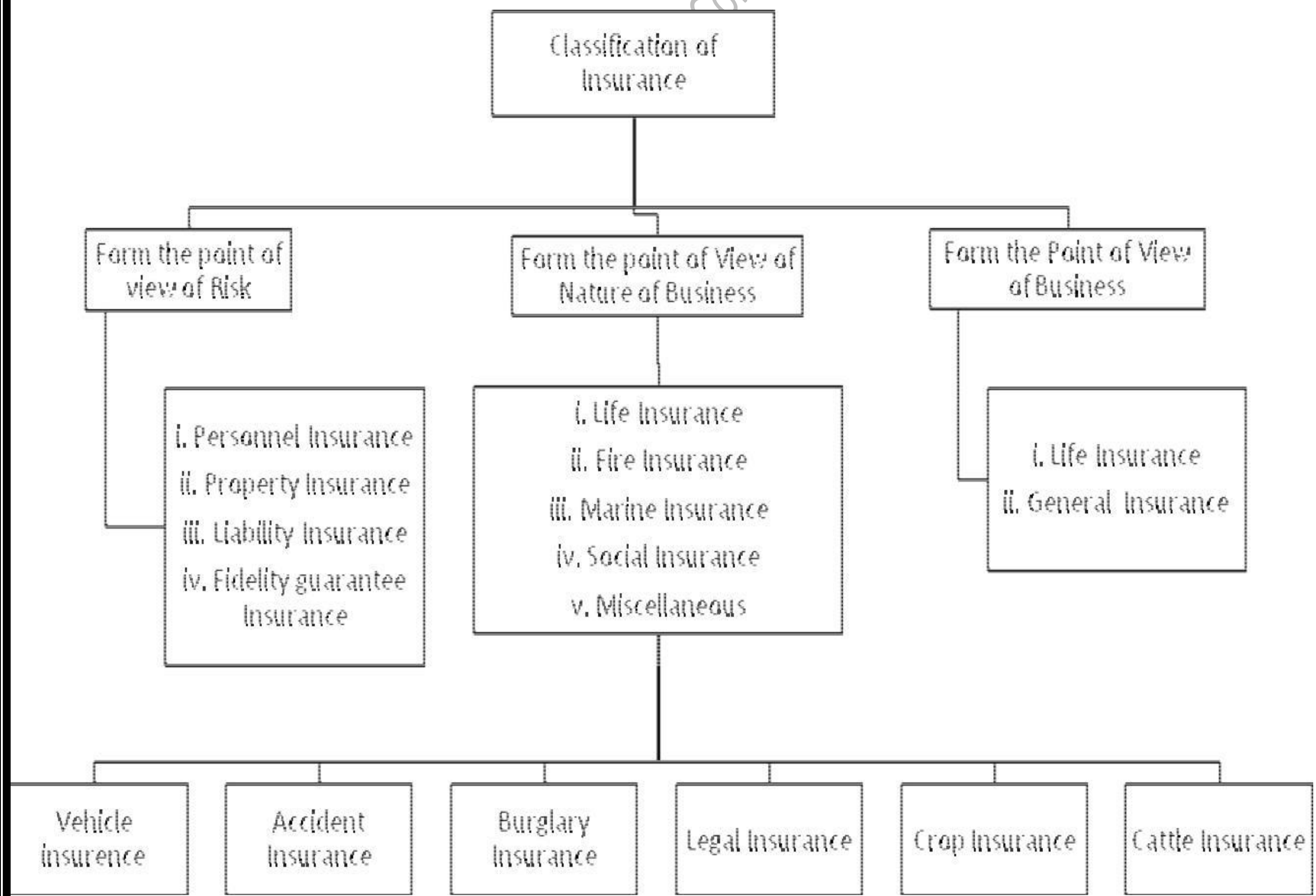
It is hence essentially an intangible product. The insurance customer cannot see or feel the product he or she is buying. And though the policy document does give the comfort that the coverage is on; generally no real service is delivered until a claim occurs.

In normal commercial transactions, the legal maxim “Caveat Emptor” Latin for “Let the buyer Beware”/operates. This means that the buyer takes the risk regarding the quality or condition of the property purchased. This in turn, implies that the buyer has the opportunity to examine the product before purchase since, in view of what is stated in the preceding paragraph, the insurance customer has no such opportunity, insurance transactions need be governed by special principles in order to protect the interests of the contracting parties, particularly the customer.

It is in view of this that the contracts are governed by certain special basic legal principles. These make insurance contracts very unique and different from other kinds of commercial contracts. The basic principles are

1. **Insurable Interest**
   The legal right to insure – it is a must for an insurance contract to have validity. This principle is also relevant to both life and general insurance.
2. **The principle of indemnity**
   It determines the extent of insurer's liability in the case of loss. The need for determining the liability is however, largely applicable to general insurance alone.
3. **The principle of contribution**
   The corollary of the indemnity – principle exclusively applicable to general insurance. It tells us how the liability is to be met when the insured has taken insurance with more than one insurer.
4. **The principle of subrogation**
   Another corollary of the indemnity principle and again exclusively applicable to general insurance refers to the rights that an insurer has paid him an indemnity.
5. **The Principle of Utmost Good Faith**
   The duty of insured and the insurer to disclose all relevant facts. This is relevant to both life and general insurance.
6. **The Principle of Proximate Cause**
   The rule that determines how to proceed with processing a claim lodged by an insured, when a loss could apparently be traced to more than one event, some of which are not covered by the insurance contract.

Q7. Explain various types' Insurance businesses?



Q8. How insurance is priced (risk pricing)?

Insurance is designed to reimburse your financial costs if you are affected by an unexpected event such as damage to or loss to your property. Examples of events that can be insured against include:

- your home being flooded
- your car being stolen
- you being unable to work due to ill health

When you buy a policy to cover you against a risk, insurers use risk pricing to work out how likely it is that you will make a claim and the likely size of that claim to calculate your premiums (payments).

When insurers use risk pricing to set your premium, they consider the different risk characteristics that might affect your policy. These characteristics help insurers charge a fair price that reflects the risk of each customer making a claim, to make sure you pay a premium that is in the interests of the fair treatment of all customers. Insurers can use risk pricing characteristics including:

- your age
- your health
- whether you smoke
- how safely you drive
- the likelihood of property flooding
- where you live
- gender
- race
- religion or belief

There are also certain risk pricing characteristics that insurers do not use, such as results from a predictive genetic test, other than the predictive genetic test.

TERMINOLOGIES USED IN INSURANCE

Different terms are used in the theory and practice of important among them are given below.

1. **INSURED:**
   The party or the individual who seeks protection against a specified task and entitled to receive payment from the insurer in the event of happening of stated event is known as insured. An insured is normally in insurance policy holder.

2. **INSURER:**
   The party who promises to pay indemnity the insured on the happening of contingency is known as insurer. The insurer is an insurance company.

3. **BENEFICIARIES**
   The person or the party to whom the policy proceeds will be paid in the event of the death or happening of any contingency is called beneficiary.

4. **CONTRACT**
   An agreement binding at law between to or more parties is called contract.

5. **PREMIUM**

The amount which is paid to the insurer by the insured in consideration to insurance contract is known as premium. It may be paid on monthly, quarterly, half-yearly, yearly or as agreed upon it is the price for an insurance policy.

6. INSURED SUM

The sum for which the risk is insured is called the insured sum, or the policy money or the face value of the policy. This is the maximum liability of the insurer towards the insured.

7. EXCEPTION

A peril specifically excluded from the scope of a policy is called exception.

8. PERIL

A peril is an event that cause a personal or property loss by fire, windstorm, explosion, collision premature death, sickness, floods, dishonesty

9. UNDERWRITER

An insurer an official in an insurance company whose main responsibility is to accept risks.

10. HAZARD

Hazard is a condition that may create, increase or decrease the chances of loss from a given peril.

11. EXPOSURE

An exposure is a measure of physical extent of the risk. An individual who owns a business house may be subjected to economic loss and individual loss because of his business and personal exposure.

12. CHANCE OF LOSS

It is the probable number of times in any given number of that loss will occur. The highest chance of loss is 100 percent that means the loss is certain. When the chance of loss is zero, the degree of risk is also zero.

13. ACCIDENT

An unlooked for mishap or an untoward event which is not expected or designed.

14. CASE LAW

The law which is found in the decision of law courts.

15. COMMON LAW

The law based on usage, custom and legal decisions as distinct from statue Law.

16. CONDITION

A provision inserted in a policy to define extends or reserve rights and responsibilities.

17. COVER NOTE

An unstamped document issued by or on behalf of insurers as evidence of insurance pending issue of policy.

18. DAMAGES

Monetary compensation award at law for a civil wrong or breach of contract.

19. INDEMNITY

Compensation for actual loss suffered is call indemnity.

20. REINSURANCE

Reinsurance is a method where by the original insurer transfers all or part of risk he has assumed to another company or companies with the object of reducing his own commitment to an reducing his own commitment to an amount that he can bear for his own account commensurate with his financial resources in the event of loss. It was originally confined to offers and acceptances on individual risk known as facultative reinsurance transactions.

21. NO CLAIM BONUS

The bonus is getting under the policy, if the claim is not reported during the policy period and after that the time renewal (in time) then as per the policy term no claim bonus is avail for the vehicle insurance policy and the rate of bonus is different in different general insurance companies, and the maximum rate should be up to 50% as per the norms.

IMPORTANT ASPECTS OF INSURANCE BUSSINESS

1. ACTUARY

An ACTUARY is a person who has passed specialized examinations conducted by the Actuarial Society of India or the Institute of Actuaries, London. Actuaries are technical experts who have received specialist training in the mathematics of insurance. Their job is to ensure that the insurance products provided by the company are mathematically sound. They undertake various activities like calculation of mortality rates, estimating expenses to be incurred by the insurance company in administrating various policies, and determining the rate of return that will be earned by the company on its investments. Based on the above, they decide on the premiums to be charged on various policies. As is obvious from the above, a good actuary has to be a good economist, a good statistician as well as a good security analyst. Every insurance company requires good actuaries to continuously study its operations and advise the management on the appropriateness of their policies.

2. UNDERWRITING

An UNDERWRITER scrutinizes, analyzes and takes the decisions on the proposals received for insurance. While analyzing the risks arising from the insurance applications, the underwriters ensure that the company issues the maximum possible policies while keeping the risk of loss within acceptable limits. Any applications that pose reasonable risks are accepted and those posing lower or higher than average risks are accepted at lower or higher rates" of premium than normal. Any applications posing unreasonable risks are declined. The job of accepting or declining the proposals of insurance received by a company and deciding on the premium at which to accept the proposals is done by the underwriting department.

3. POLICY OWNER SERVICES

The employees in this area are the ones who issue the actual policy “documents. They also ensure customer satisfaction by attending to various requirements arising during the duration of a contract like nominations, assignments, alterations, etc. These employees are basically responsible for maintenance of policy records, proressim1, customer requests and informing policy-owners about any material changes that affect their policies.

4. CLAIM ADMINISTRATION

The employees in this area are responsible for the actual settlement of claims. They analyze the claims received against .various policies. After thoroughly studying the claims, they decide whether the claim is valid. They calculate the benefit amounts for settlement of all valid claims. Any claims that are found invalid are rejected.

5. MARKETING

The marketing department studies consumer behavior needs and wants. On the basis of these studies, they give suggestions for new products which can satisfy those needs. The marketing executives also develop marketing plans, design promotional material for the different products, market the products to the customers and provide them services. The marketing department's role starts even before the inception of a product and carries on well after the product has been sold to the customer.

6. INVESTMENT

The employees in this area manage the company's assets and investments. They study the financial markets in order to give recommendations on the best avenues of investments so that the company can maximize its returns.

7. ACCOUNTING

As in any other organization, the accountants in an insurance company keep records of the income and expenses. They keep track of the income from premiums and investments as also the expenses for running the office, agents' commission, claim payments, etc. They prepare the reports and statements which show the financial position of the company. The policy holders, shareholders, and insurance regulators can get to know the financial status of the insurance company from these reports.

8. INFORMATION SYSTEM

The employees looking after this area provide their services to all the departments of an insurance company. They design and maintain computer systems so that any required information can be easily retrieved at any time. They also develop and test new systems and procedures for the company, install them and ensure that they operate efficiently and effectively.

9. LEGAL AND COMPLIANCE

The employees in this department play an important role in ensuring that the company is complying with all the regulations and laws in the country. They develop the policy forms, contracts for agents, etc., in line with the existing rules and regulations and also advise the staff and management on any legal issues. In case there is any dispute arising out of a claim, the attorneys from the legal department defend the company's position.

These, then, are the different activities carried out by the various departments in an insurance company. An equally important activity which has not been covered above is the distribution of the different products of the insurance companies. This distribution is carried out by various components of the distribution channel.

10. DISTRIBUTION CHANNELS

These are routes by which the product prepared by the producer reaches the ultimate consumer. Thus, the distance between the producer and the consumer is bridged by the distribution channel.

In the case of insurance companies, the distribution system is a network of individuals and organizations that are involved in making the insurance products available to the customers. They form a link between the insurance company and the buyers of insurance products.

The various components of the distribution channel in an insurance company are

1. AGENTS

An insurance agent is an agent licensed under section 42 of the Insurance Act, 1938. He/she receives payment by way of commission for procuring insurance business. He/she is also responsible for business relating to the continuance, renewal or revival of policies of insurance. An agent could also be a corporate agent i.e. a company or firm could also be an agent.

The primary function of an agent is to procure business for the insurance company. However, the agent can only procure business for the particular insurance company which he/she represents, and for no other company.

Once the insurance contract has been put into force, the agent has to ensure continuance of the policy through regular payment of renewal premiums. In case of a claim, the agent should help the insured in proper settlement of claims.

2. INSURANCE BROKERS

An individual or firm, whose lull-time occupation is the placement of insurance business with insurance companies, is known as an insurance broker. The broker receives brokerage as a percentage of the premium from the insurer.

The main difference between an agent and a broker is that there are no restrictions on the procurement of business by a broker for various different insurance companies, while the agent can only procure business for that particular company which he represents. Insurance brokers give advice to the insured without charging them.

3. INSURANCE CONSULTANTS

Insurance consultants are usually specialists who give advice to consumers who wish to buy insurance products. However, unlike the brokers, they get paid by the insured for this advice.

4. BANKING OUTLETS

These days, there has been a trend of using outlets of banks for distribution of insurance products. The logic behind this is that, as both banks and insurance companies target the same segments of population, using the bank outlets for distribution of insurance products, it can help in saving overheads as well as infrastructure costs. The concept of banc assurance has gained importance in the banking sector which is good for the insurance sector.