Module 2
Insurance And Risk

Introduction

In one form or another, we all own insurance. Whether it's auto, medical, liability, disability or life, insurance serves as an excellent risk-management and wealth-preservation tool. Having the right kind of insurance is a critical component of any good financial plan. While most of us own insurance, many of us don't understand what it is or how it works. In this tutorial, we'll review the basics of insurance and how it works, then take you through the main types of insurance out there.

What Is Insurance?

Insurance is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the premium.

Insurance allows individuals, businesses and other entities to protect themselves against significant potential losses and financial hardship at a reasonably affordable rate. We say

"significant" because if the potential loss is small, then it doesn't make sense to pay a premium to protect against the loss. After all, you would not pay a monthly premium to protect against a $50 loss because this would not be considered a financial hardship for most.

Insurance is appropriate when you want to protect against a significant monetary loss. Take life insurance as an example. If you are the primary breadwinner in your home, the loss of income that your family would experience as a result of our premature death is considered a significant loss and hardship that you should protect them against. It would be very difficult for your family to replace your income, so the monthly premiums ensure that if you die, your income will be replaced by the insured amount. The same principle applies to many other forms of insurance. If the potential loss will have a detrimental effect on the person or entity, insurance makes sense.

Insurable risk

Business insurance is designed to protect your IT company against *insurable risk*, or the likelihood of a loss. But it's

important to understand that even the most comprehensive insurance policies don't cover every type of risk.

What is an insurable risk?

Insurable risks are risking that insurance companies will cover. These include a wide range of losses, including those from fire, theft, or lawsuits.

When you buy commercial insurance, you pay premiums to your insurance company. In return, the company agrees to pay you in the event you suffer a covered loss.

By pooling premiums from many policyholders at once, insurers are able to pay the claims of the few who do suffer losses, while providing protection to everyone else in the pool in case they need it.

Types Of Insurance Policies In India

In life, unplanned expenses are a bitter truth. Even when you think that you are financially secure, a sudden or unforeseen expenditure can significantly hamper this security.

Depending on the extent of the emergency, such instances may also leave you debt-ridden.

While you cannot plan ahead for contingencies arising from such incidents, insurance policies offer a semblance of support to minimise financial liability from unforeseen occurrences.

There is a wide range of insurance policies, each aimed at safeguarding certain aspects of your health or assets.

Broadly, there are 8 types of insurance, namely:

- Life Insurance
- Motor insurance
- Health insurance
- Travel insurance
- Property insurance
- Mobile insurance
- Cycle insurance
- Bite-size insurance

Simply knowing the various insurance policies does not help. Instead, you must know how each of these plans work.

Without adequate knowledge about each of them, you may not be able to protect your finances, as well as the financial well-being of your family members.

1. Life Insurance

Life Insurance refers to a policy or cover whereby the policyholder can ensure financial freedom for his/her family members after death. Suppose you are the sole earning member in your family, supporting your spouse and children. In such an event, your death would financially devastate the whole family. Life insurance policies ensure that such a thing does not happen by providing financial assistance to your family in the event of your passing.

Types of Life Insurance Policies

There are primarily seven different types of insurance policies when it comes to life insurance. These are:

- **Term Plan** - The death benefit from a term plan is only available for a specified period, for instance, 40 years from the date of policy purchase.
- **Endowment Plan** - Endowment plans are life insurance policies where a portion of your premiums go

toward the death benefit, while the remaining is invested by the insurance provider. Maturity benefits, death benefit and periodic bonuses are some types of assistance from endowment policies.

- **Unit Linked Insurance Plans or ULIPs** - Similar to endowment plans, a part of your insurance premiums go toward mutual fund investments, while the remaining goes toward the death benefit.
- **Whole Life Insurance** - As the name suggests, such policies offer life cover for the whole life of an individual, instead of a specified term. Some insurers may restrict the whole life insurance tenure to 100 years.
- **Child's Plan** - Investment cum insurance policy, which provides financial aid for your children throughout their lives. The death benefit is available as a lump-sum payment after the death of parents.
- **Money-Back** - Such policies pay a certain percentage of the plan's sum assured after regular intervals. This is known as survival benefit.
- **Retirement Plan** - Also known as pension plans, these policies are a fusion of investment and insurance. A portion of the premiums goes toward creating a retirement corpus for the policyholder. This is available

as a lump-sum or monthly payment after the policyholder retires.

Benefits of Life Insurance

If you possess a life insurance plan, you can enjoy the following advantages from the policy.

- **Tax Benefits** - If you pay life insurance premiums, you are eligible for tax benefits in India, under Section 80(C) and 10(10D) of the Income Tax Act. Thus, you can save a substantial sum of money as taxes by opting for a life insurance plan.
- **Encourages Saving Habit** - Since you need to pay policy premiums, buying such an insurance policy promotes the habit of saving money.
- **Secures Family's Financial Future** - The policy ensures your family's financial independence is maintained even after your demise.
- **Helps Plan Your Retirement** - Certain life insurance policies also act as investment options. For instance, pension plans offer a lump-sum payout as soon as you retire, helping you to fund your retirement.

2. Motor Insurance

Motor insurance refers to policies that offer financial assistance in the event of accidents involving your car or bike. Motor insurance can be availed for three categories of motorised vehicles, including:

- **Car Insurance** - Personally owned four-wheeler vehicles are covered under such a policy.
- **Two-wheeler Insurance** - Personally owned two-wheeler vehicles, including bikes and scooters, are covered under these plans.
- **Commercial Vehicle Insurance** - If you own a vehicle that is used commercially, you need to avail insurance for the same. These policies ensure that your business automobiles stay in the best of shapes, reducing losses significantly.

Types of Motor Insurance Policies

Based on the extent of cover or protection offered, motor insurance policies are of three types, namely:

- **Third-Party Liability** - This is the most basic type of motor insurance cover in India. It is the minimum mandatory requirement for all motorised vehicle owners, as per the Motor Vehicles Act of 1988. Due to the limited financial assistance, premiums for such policies also tend to be low. These insurance plans only

pay the financial liability to the third-party affected in the said mishap, ensuring that you do not face legal hassle due to the accident. They, however, do not offer any financial assistance to repair the policyholder's vehicle after accidents.

- **Comprehensive Cover** - Compared to the third-party liability option, comprehensive insurance plans offer better protection and security. Apart from covering third party liabilities, these plans also cover the expenses incurred for repairing the damages to the policyholder's own vehicle due to an accident. Additionally, comprehensive plans also offer a payout in case your vehicle sustains damage due to fire, man-made and natural calamities, riots and others such instances. Lastly, you can recover your bike's cost if it gets stolen, when you have a comprehensive cover in place. One can also opt for several add-ons with their comprehensive motor insurance policy that can make it better-rounded. Some of these add-ons include zero depreciation cover, engine and gear-box protection cover, consumable cover, breakdown assistance, etc.
- **Own Damage Cover** - This is a specialised form of motor insurance, which insurance companies offer to consumers. Further, you are eligible to avail such a plan

only if you purchased the two-wheeler or car after September 2018. The vehicle must be brand new and not a second-hand one. You should also remember that you can avail this standalone own damage cover only if you already have a third party liability motor insurance policy in place. With own damage cover, you basically receive the same benefits as a comprehensive policy without the third-party liability portion of the policy.

Benefits of Motor Insurance Policies

Cars and bikes are increasingly more expensive with each passing day. At such a time, staying without proper insurance can lead to severe monetary losses for the owner. Listed below are some advantages of purchasing such a plan.

- **Prevents Legal Hassle** - Helps you avoid any traffic fines and other legalities that you would otherwise need to bear.
- **Meets All Third-Party Liability** - If you injure a person or damage someone's property during a vehicular accident, the insurance policy helps you meet the monetary losses, effectively.
- **Financial Assistance to Repair Your own Vehicle** - After accidents, you need to spend considerable sums on repairing your own vehicle.

Insurance plans limit such out of pocket expenses, allowing you to undertake repairs immediately.

- **Theft/loss cover** - If your vehicle is stolen, your insurance policy will help you reclaim a portion of the car/bike's on-road price. You can expect similar assistance if your vehicle is damaged beyond repair due to accidents.

3. Health Insurance

Health insurance refers to a type of general insurance, which provides financial assistance to policyholders when they are admitted to hospitals for treatment. Additionally, some plans also cover the cost of treatment undertaken at home, prior to a hospitalisation or after discharge from the same.

With the rising medical inflation in India, buying health insurance has become a necessity. However, before proceeding with your purchase, consider the various types of health insurance plans available in India.

Types of Health Insurance policies

There are eight main types of health insurance policies available in India. They are:

- **Individual Health Insurance** - These are healthcare plans that offer medical cover to just one policyholder.
- **Family Floater Insurance** - These policies allow you to avail health insurance for your entire family without needing to buy separate plans for each member. Generally, husband, wife and two of their children are allowed health cover under one such family floater policy.
- **Critical Illness Cover** - These are specialised health plans that provide extensive financial assistance when the policyholder is diagnosed with specific, chronic illnesses. These plans provide a lump-sum payout after such a diagnosis, unlike typical health insurance policies.
- **Senior Citizen Health Insurance** - As the name suggests, these policies specifically cater to individuals aged 60 years and beyond.
- **Group Health Insurance** - Such policies are generally offered to employees of an organisation or company. They are designed in such a way that older beneficiaries can be removed, and fresh beneficiaries can be added, as per the company's employee retention capability.

- **Maternity Health Insurance** - These policies cover medical expenses during pre-natal, post-natal and delivery stages. It covers both the mother as well as her newborn.
- **Personal Accident Insurance** - These medical insurance policies only cover financial liability from injuries, disability or death arising due to accidents.
- **Preventive Healthcare Plan** - Such policies cover the cost of treatment concerned with preventing a severe disease or condition.

Benefits of Health Insurance

After assessing the various kinds of health insurance available, you must be wondering why availing such a plan is essential for you and your loved ones. Look at the reasons listed below to understand why.

- **Medical Cover** - The primary benefit of such insurance is that it offers financial coverage against medical expenditure.
- **Cashless Claim** - If you seek treatment at one of the hospitals that have tie-ups with your insurance provider, you can avail cashless claim benefit. This feature ensures that all medical bills are directly settled between your insurer and hospital.
- **Tax Benefits** - Those who pay health insurance premiums can enjoy income tax benefits. Under Section 80D of the Income Tax Act one can avail a tax benefit of up to Rs.1 Lakh on the premium payment of their health insurance policies.

4. Travel Insurance

When talking about the different types of insurance policies, one must not forget to learn more about travel insurance

plans. Such policies ensure the financial safety of a traveller during a trip. Therefore, when compared to other insurance policies, travel insurance is a short-term cover.

Depending on the provider you choose, travel insurance may offer financial aid at various times, such as during loss of baggage, trip cancellation and much more. Here is a look at some of the different types of travel insurance plans available in the country:

- **Domestic Travel Insurance** - This is the kind of travel insurance policy that safeguards your finances during travels within India. However, if you plan to step outside the country for a vacation, such a policy would not offer any aid.
- **International Travel Insurance** - If you are stepping out of the country, ensure you pick an international travel insurance plan. It allows you to cover the unforeseen expenses that can arise during your trip like medical emergencies, baggage loss, loss of passport, etc.
- **Home Holiday Insurance** - When you are travelling with family, your home remains unguarded and unprotected. Chances of burglary are always significant, which may lead to significant losses. Thankfully, with home holiday insurance plans, which are often included

within travel policies, you are financially protected from such events as well.

Benefits of Travel Insurance

The following aspects are covered under travel insurance plans:

- **Cover Flight Delay** - Flight delays or cancellations can lead to significant losses for the passenger. If you buy travel insurance, you can claim such financial losses from the insurer.
- **Baggage Loss/Delay** - Travel insurance lets you claim monetary assistance if there is a delay or you happen to lose your luggage during the trip. With this amount, you can purchase some of the necessary items.
- **Reclaim Lost Travel Documents** - Visa and passport are essential documents during an international trip. Opting for international travel insurance ensures that you have the necessary financial backing to reapply for interim or replacement documents as and when necessary.
- **Trip Cancellation Cover** - A sudden death in the family or a medical emergency may play spoilsport with your travel arrangements. Thankfully, international travel insurance plans support trip cancellations in such

events. You can claim financial assistance to pay penalties and cancellation charges for flights, hotels, etc.

5. Property Insurance

Any building or immovable structure can be insured through property insurance plans. This can be either your residence or commercial space. If any damage befalls such a property, you can claim financial assistance from the insurance provider. Keep in mind that such a plan also financially safeguards the content inside the property.

Types of Property Insurance in India

Here are some types of property insurance policies available in India:

- **Home Insurance** - With such a policy, you remain free from all financial liabilities that may arise from damage to your home or contents inside due to fires, burglaries, storms, earthquakes, explosions and other events.
- **Shop Insurance** - If you own a shop, which acts as a source of income for you, it is integral to protect yourself from financial liability arising from the same. Whether the liability occurs due to natural calamities or due to

accidents, with these plans, you can immediately undertake repairs to the shop.

- **Office Insurance** - Another type of property insurance policy, office insurance ensures that the office building and all the equipment inside are significantly protected in the event of unforeseen events. Generally, office spaces include expensive equipment, such as computers, servers and much more. Thus, availing these plans is essential.
- **Building Insurance** - If you own a complete building, opting for home insurance may not be sufficient. Instead, you can purchase building insurance to cover the entire premises.

Benefits of Property Insurance

If you still think that property cover is not one of the types of insurance plans you need to avail, take a look at some of the advantages from the same.

- **Protection against Fires** - While the insurance policy cannot prevent fires, it can prevent financial liabilities from such an event.
- **Burglaries** - If your property exists in an area prone to theft and burglaries, such a policy is vital to ensure financial security.

- **Floods** - In certain parts of India, floods are common. These floods can ravage your property leading to substantial losses. Property insurance also protects against such events.
- **Natural Calamities** - The plan also offers financial aid against damage arising from earthquakes, storms and more.

Rebuilding or renovation of a property is immensely expensive. Thus, property insurance policies are the best option to ensure long-term financial health.

6. Mobile Insurance

Owing to the rising price of mobile phones and their several applications today, it has become imperative to insure the device. Mobile insurance allows you to reclaim money that you spend on repairing your phone in the event of accidental damage.

Further, you can also claim the same in case of phone theft, making it easier to replace the handset with a new phone.

Benefits of Mobile Insurance

Mobile insurance policies are extremely beneficial, especially for those who own a premium smartphone.

- **Comprehensive protection for new devices** - The value of phones tend to decline with time. Thus, when the handset is new, phone insurance can help safeguard its significant value.
- **Coverage against Damage to Screen** - If you accidentally damage the smartphone screen, which is one of the most important parts of such devices, your insurance plan will pay for the repair expenses.
- **Theft or Robbery of Smartphone** - Nothing is worse than buying your dream smartphone and losing it due to theft or burglary. Well, phone insurance will help you afford a replacement handset if such an unfortunate thing happens.

Some insurers may not allow you to buy insurance for the smartphone after a month or two passes from the purchase of the handset.

7. Cycle Insurance

Bicycles are valuable properties in India as some people rely on these vehicles for their daily commute. A cycle insurance

policy ensures that you have access to necessary funds should your bicycle undergo accidental damage or theft. It saves your out of pocket expenses, while also ensuring immediate repairs to the vehicle.

Benefits of Cycle Insurance

The advantages of availing such an insurance policy are:

- **Worldwide Coverage** - Depending on the insurance provider, cycle insurance policies provide financial assistance regardless of where your bicycle undergoes damage. Even if you meet with a cycling accident in a different country, such a plan will offer aid.
- **Protection against Fires and Riots** - If your bicycle sustains damage due to accidental fires and/or rioting, insurance policies will provide the necessary financial assistance to repair or undo the damage.
- **Accidental Death Benefit** - If you pass away due to bicycle accidents, the insurance policy for the cycle would offer a lump-sum payout to your surviving family members.

Regardless of your cycle's price, opting for insurance can reduce your financial liabilities significantly.

8. Bite-Size Insurance

Bite-sized insurance policies refer to sachet insurance plans that minimise your financial liability for a very limited tenure, generally up to a year.

These insurance plans allow you to protect your finances against specific damage or threats.

For instance, particular bite-sized insurance may offer accidental cover of Rs. 1 Lakh for a year. You can choose this policy when you think you might be particularly susceptible to accidental injuries.

Another example is insurance cover for specific diseases. For instance, if your area is prone to water-borne diseases, such as cholera, you can pick a policy that covers cholera treatment and all associated costs for a 1-year period.

Benefits of Bite-sized Insurance

The primary benefit of bite-size insurance policies is that it allows you to avail financial protection at very limited prices.

The premiums are so low that it hardly makes any impact on your overall monthly expenditures. In comparison, the sum insured is significant.

Economic and Social Benefit Of Insurance

1. **Security and Safety**: It gives a sense of security and safety to the businessman. It enables him to receive compensation against actual loss. He can concentrate on his business with a secure feeling that in case of losses arising from insurable risk, his losses will be compensated.

2. **Distribution of risk**: Risk in insurance is spread over a number of people rather being concentrated on a single individual.

3. **Normal expected profit**: An insured trader can enjoy normal margin of profit all the time. He is protected from unexpected losses because of insurance.

4. **Easy to get loans**: A trader can get bank loans easily if his stock or property is insured, as insurance provides a sense of security to the lenders.

5. **Advantages of Specialization**: Businessmen can concentrate on their business activities without spending more time on safeguarding their property. The insurance companies, on the other hand, can provide specialized insurance services.

6. **Development of Social Sectors**: Insurance funds are available for economic development particularly for the development of social sectors. Especially for a developing country like India, insurance funds are an important source for investing in infrastructure projects (roads, power, water supply, telecom etc).

7. **Social cooperation**: The burden of loss is shouldered by so many persons. Thus, insurance provides a form of social cooperation.

Insurance Regulatory & Development Authority

A. Organizational Structure of IRDAI:

Composition of IRDAI:

As per Sec. 4 of IRDAI Act, 1999, the composition of the Authority is:

a) Chairman;

b) Five whole-time members;

c) Four part-time members,

(appointed by the Government of India)

IRDAI's Head Office is at Hyderabad

All the major activities of IRDAI including ensuring financial stability of insurers and monitoring market conduct of various regulated entities is carried out from the Head Office.

IRDAI's Regional Offices are at New Delhi & Mumbai

The Regional Office, New Delhi focuses on spreading consumer awareness and handling of Insurance grievances besides providing required support for inspection of Insurance companies and other regulated entities located in

the Northern Region. This office is functionally responsible for licensing of Surveyors and Loss Assessors. Regional Office at Mumbai handles similar activities, as in Regional Office Delhi, pertaining to Western Region.

B. Insurance Regulatory Framework:

1. Insurance Regulatory and Development Authority of India (IRDAI), is a statutory body formed under an Act of Parliament, i.e., Insurance Regulatory and Development Authority Act, 1999 (IRDAI Act 1999) for overall supervision and development of the Insurance sector in India.

2. 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.

3. The Insurance Act, 1938 is the principal Act governing the Insurance sector in India. It provides the powers to IRDAI to frame regulations which lay down the regulatory framework for supervision of the entities operating in the sector. Further,

there are certain other Acts which govern specific lines of Insurance business and functions such as Marine Insurance Act, 1963 and Public Liability Insurance Act, 1991.

4. IRDAI adopted a Mission for itself which is as follows:

- To protect the interest of and secure fair treatment to policyholders;
- To bring about speedy and orderly growth of the Insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
- To ensure speedy settlement of genuine claims, to prevent Insurance frauds and other malpractices and put in place effective grievance redressal machinery;
- To promote fairness, transparency and orderly conduct in financial markets dealing with Insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;

- To take action where such standards are inadequate or ineffectively enforced;
- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

5. Entities regulated by IRDAI:

a. Life Insurance Companies - Both public and private sector Companies

b. General Insurance Companies - Both public and private sector Companies. Among them, there are some standalone Health Insurance Companies which offer health Insurance policies.

c. Re-Insurance Companies

d. Agency Channel

e. Intermediaries which include the following:

- Corporate Agents
- Brokers
- Third Party Administrators
- Surveyors and Loss Assessors.

6. Regulation making process:

- Section 26 (1) of IRDAI Act, 1999 and 114A of Insurance Act, 1938 vests power in the Authority to frame regulations, by notification.
- Section 25 of IRDAI Act, 1999 lays down for establishment of Insurance Advisory Committee consisting of not more than twenty five members excluding the ex-officio members. The Chairperson and the members of the Authority shall be the ex-officio members of the Insurance Advisory Committee.
- The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to making of regulations under Section 26.
- Accordingly, the draft regulations are first placed in the meeting of Insurance Advisory Committee and after obtaining the comments/recommendations of IAC, the draft regulations are placed before the Authority for its approval.
- Every Regulation approved by the Authority is notified in the Gazette of India.
- Every Regulation so made is submitted to the Ministry for placing the same before the Parliament.

7. The Authority has issued regulations and circulars on various aspects of operations of the Insurance companies and other entities covering:

- Protection of policyholders' interest
- Procedures for registration of insurers or licensing of intermediaries, agents, surveyors and Third Party Administrators.
- Fit and proper assessment of the promoters and the management
- Clearance /filing of products before being introduced in the market
- Preparation of accounts and submission of accounts returns to the Authority.
- Actuarial valuation of the liabilities of life Insurance business and forms for filing of the actuarial report;
- Provisioning for liabilities in case of non-life Insurance companies
- Manner of investment of funds and periodic reports on investments
- Maintenance of solvency
- Market conduct issues

Essentials Of Insurance Contracts

The valid contract, according to Section 10 of the Indian Contract Act 1872, must have the following essentialities;

1. Agreement (offer and acceptance),
2. Legal consideration,
3. Competent to make a contract,
4. Free consent,
5. Legal object.

1. Offer and Acceptance

The offer for entering into the contract may come from the insured.

The insurer may also propose to make the contract. Whether the offer is from the side of an insurer or the side of the insured, the main fact is acceptance. Any act that precedes it is the offer or a counter-offer. All that preceded the offerer counter-offer is an invitation to offer.

In insurance, the publication of the prospectus, the canvassing of the agents are invitations to offer.

When the prospect (the potential policy-holder) proposes to enter the contract, it is an offer and if there is any alteration in the offer that would be a counter-offer.

If this alteration or change (counter-offer) ill-accepted by the proposer, it would be acceptable.

In the absence of a counter-offer, the acceptance of the offer will be an acceptance by the insurer. At the moment, the notice of acceptance is given to another party; it would be a valid acceptance.

2. Legal Consideration

The promisor to pay a fixed sum at a given contingency is the insurer who must have some return or his promise. It need not be money only, but it must be valuable.

It may be summed, right, interest, profit or benefit Premium being the valuable consideration must be given for starting the insurance contract.

The amount of premium is not important to begin the contract. The fact is that without payment of premium, the insurance contract cannot start.

3. Competent to make the contract

Every person is competent to contract;

1. Who is off' is an age of majority according to the law,
2. Who is of sound mind, and
3. Who is not disqualified from contracting by any law to which he is subject?

A minor is not competent to contract. A contract by a minor is void excepting contracts for necessaries. A minor cannot sign a contract.

A person is said to be of sound mind to make a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests.

A person who is usually of unsound mind, but, occasionally of sound mind may .make a contract when he is of sound mind. Alien energy, an undischarged insolvent and criminals cannot

agree. A contract made by an incompetent party/parties will be void.

4. Free Consent

Parties entering into the contract should enter into it by their free consent.

The consent will be free when it is not caused by—
(1)coercion,
(2)undue influence,
(3) fraud, or
(4) misrepresentation, or
(5) mistake.

When there is no free consent except fraud, the contract becomes voidable at the option of the party whose consent was so caused. In the case of fraud, the contract would be void.

The proposal for free consent must sign a declaration to this effect, the person explaining the subject matter of the proposal to the proposer must also accordingly make a written declaration or the proposal.

5. Legal Object

To make a valid contract, the object of the agreement should be lawful. An object that is,
(i) not forbidden by law or
(ii) is not immoral, or
(iii) opposed to public policy, or
(iv) which does not defeat the provisions of any law, is lawful.

In the proposal from the object of insurance is asked which should be legal and the object should not be concealed. If the object of insurance, like the consideration, is found to be unlawful, the policy is void.

Principles of Insurance

The concept of insurance is risk distribution among a group of people. Hence, cooperation becomes the basic principle of insurance.

To ensure the proper functioning of an insurance contract, the insurer and the insured have to uphold the 7 principles of Insurances mentioned below:

1. Utmost Good Faith
2. Proximate Cause
3. Insurable Interest
4. Indemnity
5. Subrogation
6. Contribution
7. Loss Minimization

Let us understand each principle of insurance with an example.

Principle of Utmost Good Faith

The fundamental principle is that both the parties in an insurance contract should act in good faith towards each other, i.e. they must provide clear and concise information related to the terms and conditions of the contract.

The Insured should provide all the information related to the subject matter, and the insurer must give precise details regarding the contract.

Example – Jacob took a health insurance policy. At the time of taking insurance, he was a smoker and failed to disclose this fact. Later, he got cancer. In such a situation, the Insurance company will not be liable to bear the financial burden as Jacob concealed important facts.

Principle of Proximate Cause

This is also called the principle of 'Causa Proxima' or the nearest 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. If it is not a cause the property is insured against, then no payment will be made by the insurance company.

Example –

The wall of the building damaged due to fire, fell down due to storm before it could be repaired and damaged an adjoining building. The owner of the adjoining building claimed the loss under the fire policy. In this case, the fire was a remote cause, and the storm was the proximate cause; hence the claim is not payable under the fire policy.

Principle of Insurable interest

This principle says that the individual (insured) must have an insurable interest in 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.

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.

To claim the amount of insurance, the insured must be the owner of the subject matter both at the time of entering the contract and at the time of the accident.

Principle of 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. The purpose of the indemnity principle is to set back the insured at the same financial position as he was before the loss occurred. Principle of indemnity is observed strictly for property insurance and not applicable for the life insurance contract.

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.

Principle of 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.

Subrogation gives the right to the insurance company to claim the amount of loss from the third-party responsible for the same.

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.

Principle of Contribution

Contribution principle applies when the insured takes more than one insurance policy for the same subject matter. It states the same thing as in the principle of indemnity, i.e. the insured cannot make a profit by claiming the loss of one subject matter from different policies or companies.

Example – A property worth Rs. 5 Lakhs is insured with Company A for Rs. 3 lakhs and with company B for Rs.1 lakhs. The owner in case of damage to the property for 3 lakhs can claim the full amount from Company A but then he cannot claim any amount from Company B. Now, Company A can claim the proportional amount reimbursed value from Company B.

Principle of Loss Minimisation

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.

Example – If a fire breaks out in your factory, you should take reasonable steps to put out the fire. You cannot just stand back and allow the fire to burn down the factory because you know that the insurance company will compensate for it.