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**DEPARTMENT OF MODERN OFFICE MANAGEMENT
LECTURE NOTES
SEMESTER- 2ND**

**PAPER- FUNDAMENTALS OF INSURANCE
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INTRODUCTION TO INSURANCE

MEANING

- Insurance is a contract a legal agreement between two parties, i.e., the individual named insured and the insurance company called insurer.
- In this agreement the insurer promises to help with the losses of the insured on the happening contingency.
- The insured on the other hand pays a premium in return for the promise made by the insurer.

DEFINITION

- **Allen H. Willett** : Insurance is that social device for making accumulations to meet uncertain losses which is carried out through the transfer of the risks of many individuals to one person or to a group of persons.
- **Mowbray and Blan Chard** : Insurance is a social device for eliminating or reducing the cost to society of certain type of risk.
- **Allen Z: Mayerson** : Insurance is a device for the transfer to an insurer certain risks of economic loss that would otherwise come to the insured.

FUNCTIONS OF INSURANCE

A. Primary Functions

1. Provide protection

- The primary purpose of insurance is to provide protection against future risk, accidents and uncertainty.
- Insurance cannot check the happening of the risk, but can certainly provide for the losses of risk.
- Professor Hopkins observes, "Insurance is a protection against economic loss by sharing the risk with others." He further adds "Insurance is the protection against economic loss".

2. Collective Risk Sharing / Distribution of Risk

- Insurance is it wise to share the financial loss.
- It is a cooperative effort where the risk is distributed among the group of people.
- Similarly, Rigel and Miller observe. "Insurance is a device whereby the uncertain risks may be made more certain."

3. Evaluation of risk

- Insurance determines the probable volume of risk by evaluating various factors that give rise to risk.
- Risk is the basis for determining the premium rate also.

4. Ensure certainty

- No one knows what will happen next the future is uncertain.
- Any misfortune happening may occur at any stage of life amount of loss and time of losses both are uncertain.
- Insurance is a device which helps to change from uncertainty to certainty.
- Insurance provides certainty of payment for the uncertain loss.

5. Spreading risks

- Professor Thomas has correctly written that "Insurance is the device for spreading or distributing risks."

B. Secondary Functions

1. Insurance Prevent Losses

- Insurance plays important role in preventing losses, it provides certainty and prevent losses.
- Insurance provides certainties towards risks in entrepreneurship so that entrepreneurs can concentrate on Innovative and profitable techniques of the production.

2. Provides Capital and Help in Economic Progress

- As we know insurance plays important role in human life
- Insurance helps in Economic Progress of Insured. It provides capital and helps in commercial prosperity. It develops the trade and commerce of the nation.

3. Ensure Welfare of Society

- Insurance serves the sociological purpose; Insurance indirectly helps Nation and contributes its progress.
- Insurance provides security and minimizes worries of losses or damage, destruction, and death.
- It develops the trade and commerce of the nation.
- Insurance gives Confidence in the general public.

Other Functions or Indirect functions of Insurance

1. Saving and Investment

- It is one of the important source of investment.

- In India, One more important thing is that in India, Income Tax Act gives relief in payment of income tax.
- It encourages the habit of savings among the people. In India, Life Insurance is also a method of Savings.

2. Risk-Free Trade

- As above mentioned insurance provides certainty and provides protection for future loss or damage.
- It provides Indemnity in the event of unexpected loss or damages or disaster.
- Insurance boosts exports, making foreign trade risk free with the help of the different type of Policy.

3. Medium of Earning Foreign Exchange

- In International Business, any country can earn foreign exchange by way of issue of marine insurance policies.
- There are some other ways also available.
- In India, it is compulsory to take Marine Insurance Policy in foreign trade

FEATURE OF INSURANCE

1. Contract

- Insurance is a contract between the insurance company and the policyholder wherein the policyholder (insured) makes an offer and the insurance company (insurer) accepts his offer.
- The contract of insurance is always made in writing.

2. Consideration

- Like other contracts, there must be lawful consideration in insurance also.
- The consideration is in the form of premium which the insured agrees to pay to the insurer.

3. Protection of financial risks

- Insurance offers protection to those risks which can be measured in terms of money i.e., financial risks.
- As such insurance compensates only financial or monetary loss or risks.

4. Based upon certain principles

- The insurance is based upon certain principles like insurable interest, utmost good faith, indemnity subrogation, causa-proxima, contribution, etc.

5. Regulated by Law

- In almost all the countries in the world, statutory laws are being enacted to regulate the functioning of insurance companies.
- In India too, life insurance and general insurance are regulated by Life Insurance Corporation of India Act 1956, and General Insurance Business (Nationalization) Act 1972, and IRDA Regulations etc.

6. Value of Risk

- Before insuring the subject matter of the insurance contract, the risk is evaluated in order to determine the amount of premium to be charged on the insured.
 - Several methods are being adopted to evaluate the risks involved in the subject matter.
 - If there is an expectation of heavy loss, higher premiums will be charged.
- Hence, the probability of occurrence of loss is calculated at the time insurance.

7. Amount of payment

- The amount to be paid to the policyholders depends upon the value of loss occurred due to the particular risk, provided insurance cover is there up to that amount.
- In life insurance, the assurer has to pay the agreed amount on the happening of an event.
- But in the case of property and general insurance, the amount of loss as well as the occurrence of loss is required to be proved.

8. Insurance is not a charity

- Premium collected from the policyholders under an insurance is the cost of risk so covered.
- Hence it cannot be taken as charity

9. Co – operative Device

- All for one and one for all is the basic for Co – operation.
- The insurance is a system wherein large number of persons, exposed to a similar risk, are covered and the risk is spread over among the large insurable public.

PRINCIPLES OF INSURANCE

1. 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.

2. 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.

3. 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.

4. Principle of Indemnity

- Indemnity means security or compensation against loss or damage.
- 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.

5. Principle of Subrogation

- Subrogation is a principle of substitution and recovery.
- The principle of subrogation enables the insured to claim the amount from the third party responsible for the loss. It allows the insurer to pursue legal methods to recover the amount of loss.

6. 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.

7. Principle of Loss Minimization

- This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimize 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.

IMPORTANCE / ADVANTAGES OF INSURANCE

I. Importance to an Individual

1. The greatest advantage of insurance is to provide security and safety to the assured against uncertainty.
2. The insurance protection gives mental peace to the insured and enables him to eliminate constant about the loss of his possession.
3. It enhances the habit of savings among the people, especially in life insurance.
4. It helps the insured to avoid or minimize loss by making recommendations through various channels of advertisement from the insurers.
5. The insurance policy can be used as a security by the insured for the mortgage of property.
6. Insurance supplies old-age provisions to the life-policy holders.
7. The insured easily gets credit facility for his trade on the insured goods or properties.
8. Life insurance is a means of capitalization of money in the event of death before the maturity of the policy.
9. The insured gets tax benefits in life insurance.
10. Insurance has made it possible to increase the efficiency of the insured in determining what risk should be insured against and what risk he can afford to face himself.

II. Importance to Society

1. The entire economic system is revolving round the insurance for safety against risk.
2. Rapid industrialization is made possible by insurance as its funds are employed in the development of business and industry.
3. The working population feel a sense of security if there is an insurance.
4. The key men insurance provides protection to the industry in case of death of professional executives.
5. Insurance indirectly reduces the cost of manufacturing goods.
6. Life insurance provides social security to a family.

7. The insurance fulfills its social obligations by providing employment opportunities to the general public.
8. Insurance funds are employed for the development of basic human facilities like housing, electricity, water, sanitation, etc.
9. Insurance distributes the loss of few among a large group of society.
10. Insurance has the effect of raising the living standard of the people

LIFE INSURANCE

MEANING

- Life insurance is a contract between the insurer and policy owner.
- Insurer is agreed to pay an amount to the person insured or his nominee either at the date of maturity or a periodic interval or unfortunate death of the policy owner.
- Policy owner has to pay a fixed amount called premium in periodic intervals.
- This can be monthly, quarterly, half yearly or yearly.
- Policy owner is allowed to choose the type of payment and payment cycle.

DEFINITION

- R.S. Sharma : Life insurance is a contract whereby the insurer, in consideration of a premium paid either in lumpsum or in periodical instalments, undertakes to pay an annuity or a certain sum of money either on death of the insured or on the expiry of a certain number of years.
- D.S. Hansell : Life insurance is a contract in which a sum of money is paid by the assured in consideration of insurer's incurring the risk of paying a large sum upon a given contingency.

CLASSIFICATION OF POLICIES

1. ON THE BASIS OF PERIOD OR DURATION

A. Whole-life Policies

- The Whole-life Policy will mature for payment only on the death of the assured or as an exception on the date of his attaining 100 years of age.

❖ Ordinary Whole-life Policy

- Under the Ordinary Whole-life Policy premiums are payable throughout the lifetime of the assured.
- If the policy completes 35 years or the assured attains 80 years of age

Limited Payment Whole-life Policy

- Under the Limited Payment Whole-life Policy the premiums are paid for a limited or selected period (say up to the retirement age of the assured) but the

policy will mature for payment only on the death of the assured.

❖ **Convertible Whole life Policy**

➤ The Convertible Whole-life Policy gives the option of conversion into endowment policy after the expiry of live years of the policy.

❖ **Anticipated Whole life Policy**

➤ The Anticipated Whole-life Policy is a combination of limited whole life and anticipated endowment policies.

B. Endowment Policy

➤ The Endowment Policy is issued for a fixed period and the premium is payable during that period only.

❖ **Ordinary Endowment Policy**

➤ The Ordinary Endowment Policy will mature for payment on the survival of the assured on the date of maturity or on the date of his death within the endowment period.

❖ **Pure Endowment Policy**

➤ The Pure Endowment Policy will mature for payment, only if the insured person survives the endowment period.

❖ **Joint-life Endowment Policy**

➤ The Joint-life Endowment Policy is taken on the lives of two or more persons and will mature for payment on the expiry of the endowment period or on the death of any one of the life assured before the endowment period.

Special Endowment Policy

➤ The Special Endowment Policy is issued to meet the special needs of film artistes and professionals on foreign assignments who have a very short span of earning life.

➤ The income of such persons is high over a limited period and its continuation is uncertain.

C. Term-Insurance Policy

➤ The Term-Insurance Policy is issued for short-term ranging from three months to specified number of years and will mature for payment only on the death of the assured within the term period, but if he survives, nothing is payable.

❖ **Straight Term Policy**

➤ The straight term policy is issued for very short period of years and the premium is generally paid in one installment called the single premium.

➤ The policy money is payable only if death occurs within the term.

❖ **Decreasing (or Diminishing) Term Policy**

➤ The Decreasing Term Policy is issued to the borrowers of money and the amount of the policy payable at the end of each year is automatically reduced and is equal to the outstanding loan which will be paid if the assured dies before the end of the term.

➤ This is also called as 'Mortgage-Redemption Policy'

❖ **Renewal (or Renewable)-Term Policy**

➤ The Renewal-term Policy can be renewed after the expiry of the term without medical examination but at a different rate of premium applicable to the age at the time of renewal.

❖ **Convertible-Term Policy**

➤ Under the Convertible-Term Policy an option is available to the assured to convert it into whole-life or endowment life policy without going in for fresh medical examination.