

FUNDAMENTALS OF INSURANCE

Meaning of Insurance

Insurance is a contract in which one party (the insurer) agrees to compensate another party (the insured) for financial loss arising due to the occurrence of an uncertain future event, in return for a consideration called **premium**.

In simple words, insurance is a **mechanism of risk transfer**, where the risk of loss is shifted from an individual to an insurance company.

Definition of Insurance

Some popular definitions are:

- **“Insurance is a contract by which one party undertakes to indemnify another against loss arising from certain specified risks.”**
- **According to Magee:** “Insurance is a plan by which large numbers of people associate themselves and transfer risks to the shoulders of all.”

Nature of Insurance

The main characteristics or nature of insurance are:

1. **Contractual Relationship** – Insurance is a legal contract between insurer and insured.
2. **Risk Transfer** – Risk is transferred from insured to insurer.
3. **Payment of Premium** – Premium is the consideration paid by insured.
4. **Uncertain Event** – Loss must arise from an uncertain future event.
5. **Compensation, not Profit** – Insurance compensates losses; it does not allow profit.
6. **Pooling of Risks** – Risks of many insured persons are pooled together.

Need and Importance of Insurance

Insurance plays a very important role in modern life.

(a) Protection against Financial Loss

Insurance provides financial security against risks like death, accident, fire, theft, or illness.

(b) Risk Management

It helps individuals and businesses manage risks efficiently.

(c) Encourages Savings

Life insurance policies promote long-term savings.

(d) Economic Stability

Insurance companies mobilize funds and invest them in development projects.

(e) Peace of Mind

It reduces anxiety and provides mental satisfaction.

Principles of Insurance

Insurance contracts are governed by certain fundamental principles:

1. **Principle of Utmost Good Faith** – Both parties must disclose all material facts.
2. **Principle of Insurable Interest** – Insured must have financial interest in the subject matter.
3. **Principle of Indemnity** – Compensation is limited to actual loss.
4. **Principle of Subrogation** – Insurer gets the rights after paying the claim.
5. **Principle of Contribution** – Loss is shared if more than one policy exists.
6. **Principle of Proximate Cause** – Loss must be caused by an insured risk.

Types of Insurance

1. Life Insurance

Provides protection against the risk of death and also acts as a savings tool.

Examples:

- Term insurance
- Endowment policy
- Whole life policy

2. General Insurance

Covers non-life risks.

Examples:

- Fire insurance
- Marine insurance
- Motor insurance
- Health insurance

3. Social Insurance

Provided by the government for social welfare.

Examples:

- Employees' State Insurance (ESI)
- Provident Fund
- Pension schemes

Meaning of Life Insurance

Life insurance is a contract under which the insurer promises to pay a specified sum of money to the insured or nominee on the **death of the insured** or on the **maturity of the policy**, in consideration of a **premium** paid periodically.

Life insurance provides:

- **Risk coverage** against death
- **Savings and investment benefits**
- **Financial security** to dependents

2. Definition of Life Insurance

- **According to Section 2(11) of the Insurance Act, 1938:**
“Life insurance business means the business of effecting contracts of insurance upon human life.”

3. Nature of Life Insurance

1. **Contract of Assurance** – Payment is certain (death or maturity).
2. **Long-term Contract** – Policies usually run for many years.
3. **Based on Human Life** – Subject matter is human life.
4. **Requires Insurable Interest** – Must exist at the time of contract.

5. **Premium-based** – Regular payment of premium is compulsory.
6. **Not a Contract of Indemnity** – Value of life cannot be measured in money.

Types of Life Insurance Policies

1. Term Insurance

- Pure risk coverage
- No maturity benefit
- Low premium

2. Whole Life Policy

- Coverage for entire life
- Premium paid for limited years
- Sum assured paid on death

3. Endowment Policy

- Combines insurance and savings
- Payment on death or maturity

4. Money Back Policy

- Periodic payments during policy term
- Balance paid at maturity or death

5. ULIPs (Unit Linked Insurance Plans)

- Insurance + investment
- Market-linked returns

6. Pension / Annuity Plans

Fire Insurance

Meaning:

Covers loss or damage to property caused by fire and related perils.

Risks Covered:

- Fire

- Lightning
- Explosion
- Riot and strike
- Natural calamities (if included)

The Life Insurance Corporation of India (LIC) is the largest life insurance company in India. It plays a vital role in providing life insurance protection, encouraging savings, and supporting economic development.

Objectives of LIC

- To provide financial security to policyholders
- To spread life insurance widely, especially in rural areas
- To mobilize public savings
- To invest funds in nation-building activities
- To ensure economical and efficient insurance service

Functions of LIC

(a) Insurance Functions

- Issuing life insurance policies
- Providing risk coverage and maturity benefits
- Settling claims promptly

(b) Investment Functions

- Investing policyholders' funds in government securities
- Supporting infrastructure and development projects

(c) Social Functions

- Providing insurance to weaker sections
- Supporting social security schemes

Organization Structure of LIC

LIC has a **well-defined organizational structure**:

- **Central Office** – Mumbai
- **Zonal Offices**

- **Divisional Offices**
- **Branch Offices**

This wide network helps LIC reach customers across India.