

SUGGESTED ANSWERS

PROFESSIONAL PROGRAMME

**INSURANCE LAW AND PRACTICE
(PP-IL&P/2013)**



**THE INSTITUTE OF
Company Secretaries of India**
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THE INSTITUTE OF COMPANY SECRETARIES OF INDIA

PROFESSIONAL PROGRAMME

INSURANCE LAW AND PRACTICE



PP-IL&P/2013

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CONTENTS

<i>Sl.No.</i>		<i>Page</i>
	TEST PAPER 1/2013	
1.	Answer to Question No. 1	... 1
2.	Answer to Question No. 2	... 2
3.	Answer to Question No. 3	... 6
4.	Answer to Question No. 4	... 7
5.	Answer to Question No. 5	... 8
6.	Answer to Question No. 6	... 11
	TEST PAPER 2/2013	
7.	Answer to Question No. 1	... 14
8.	Answer to Question No. 2	... 15
9.	Answer to Question No. 3	... 17
10.	Answer to Question No. 4	... 17
11.	Answer to Question No. 5	... 18
12.	Answer to Question No. 6	... 21

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(iii)

(iv)

TEST PAPER 3/2013

13. Answer to Question No. 1	...	24
14. Answer to Question No. 2	...	25
15. Answer to Question No. 3	...	27
16. Answer to Question No. 4	...	28
17. Answer to Question No. 5	...	30
18. Answer to Question No. 6	...	31

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The Suggested Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, students are expected to be well versed with the amendments in the Laws/Rules made upto **six** months prior to the date of examination.

PROFESSIONAL PROGRAMME
INSURANCE LAW AND PRACTICE

TEST PAPER 1/2013

Time allowed : 3 hours

Max. Marks : 100

NOTE : Answer Any 5 Questions. All questions carry equal marks

Question No. 1

(a) Briefly explain the following:

(i) Cover note

(ii) Certificate of Insurance

(5 marks)

(b) Enumerate the risks faced by insurance companies as financial intermediaries.

(5 marks)

(c) Mr. Saurabh Jain owns a restaurant, which he had bought three years ago for Rs. 20 lakhs. He had bought fire insurance worth Rs. 16 lakhs (which is the written down value of his insured property). His restaurant caught fire and the amount of loss suffered was worth Rs. 15 lakhs. What is the amount of compensation to be paid by the insurance company ? (10 marks)

Answer to Question No. 1(a)(i)

Cover note

Cover note is the document which is issued immediately after the insurance premium is received to prove that insurance cover is existed. Cover note is valid for 60 days from the date of issue. Cover note is mostly used in motor insurance and transit insurance, particularly for import covers by sea. The cover note in marine insurance would be valid for duration of transit.

Answer to Question No. 1(a)(ii)

Certificate of Insurance

These are usually given in marine transit insurance under open policies and also for motor insurance. In motor insurance they are mandatory as it confirms that there is insurance cover extant for the vehicle plying on public roads. They are less detailed than an Insurance policy and not stamped, but essentially give the same information regarding insurance

Answer to Question No. 1(b)**Risk faced by Insurance Companies as Financial Intermediaries**

There are number of risk faced by an Insurance company as financial intermediaries. Few of them are as given below

- (a) Risk of Mismatch in return and committed payment
- (b) Regulatory Risk
- (c) Risk of Fluctuation in Interest rates
- (d) Risk of Investment handling
- (e) Insurance complaint handling
- (f) Reputation risk due to Mis-selling of insurance policies

Answer to Question No. 1(c)

Written down value of Machinery	Rs. 16 Lakhs
Insurance value	Rs. 16 Lakhs
Loss incurred	Rs. 15 Lakhs

Since the actual amount of loss is less than the insured value so insured value will be paid by insurance company. In this question, the original value of restaurant will not be considered.

Question No. 2

- (a) Write short notes on the following:
 - (i) Insurance ombudsman scheme
 - (ii) How does society benefit from the insurance ? (5 marks each)
- (b) Distinguish between:
 - (i) Life Insurance and General Insurance
 - (ii) Endowment Scheme and Pure Insurance Scheme (5 marks each)

Answer to Question No. 2(a)(i)**Insurance Ombudsman Scheme**

The Insurance Ombudsman scheme was created by Government of India for individual policyholders to have their complaints settled out of the courts system in a cost-effective, efficient and impartial way. There are 12 Insurance Ombudsman in different locations and the policy holders can approach the one having jurisdiction over the location of the insurance company office that he has a complaint against.

Persons eligible to be appointed as Insurance Ombudsmen

Only the following persons shall be eligible to be appointed as Insurance Ombudsmen:

- (a) Persons who served in the capacity of Chairman or Managing Director in Public Sector Insurance Companies

- (b) Persons who have served the Indian Administrative Service or the Indian Revenue Service
- (c) Persons who are retired Judges of the Supreme Court or the High Courts

An Ombudsman shall be appointed by the Governing body from a panel prepared by a Committee comprising of:

- (a) Chairman, IRDA
- (b) Two representatives of Insurance council including one each from Life Insurance business and from General Insurance respectively
- (c) One representative of Central Government

An Ombudsman shall serve for a term of three years and shall be eligible for reappointment. However, an Ombudsman shall not hold office after he or she attains the age of 65.

Powers of Ombudsmen

An Ombudsmen is empower to entertain the following disputes:

- (a) A complaint as specified under Rule 13
- (b) Partial or total repudiation of claims by an insurer
- (c) Dispute with regard to the premium paid or payable in terms of the policy
- (d) Dispute on the legal construction of policies with regard to claims
- (e) Delay in settlement of claims
- (f) Non-issuance of any insurance document to customers after receipt of premium

Answer to Question No. 2(a)(ii)

Benefits of Insurance to Society

People live in society. Society is full of risks and uncertainty Insurance is a social device providing financial compensation to those who suffer from misfortune. Such payment being made form accumulated contribution of all parties participating in the scheme. Insurance provides stability, in the society by necessary arrangement of security against loss form unexpected risks. Society becomes more peaceful and safe by insurance, which provides different benefits and financial security against losses form risks. The major benefits of insurance to society are given below.

1. *Indemnification for Loss:*

All remembers of society are facing different risks. If risks are insured, all losses occurred form unexpected risks are indemnified Indemnification permits individuals and families to be restored to their former financial after to loss occur. As a result, they can maintain their financial security.

2. *Fewer Burdens to Society*

Because insured are restored either in part or in whole after a loss occurs, they

are less likely to apply for public assistance welfare benefits, or to seek financial assistance from relatives and friends. So other members of the society need not help the unlucky member even after suffering from loss. If the individual has not insured the risk, the relatives and friends should support him financially, when he becomes unlucky victim from the risks.

3. *Source of Investment Funds.*

Insurance is a business of collection of fund and payment to insureds suffered from unexpected incidents. Hence, insurance industry accumulates funds as premium from society and become an important source of funds for capital investment. Insurance companies collect premiums in advance of the loss and funds not needed to pay immediate losses can be loaned to business firms. Generally, insurance companies invest such funds typically in shipping centers, hospitals, factories, housing development etc. In this way, insurance industry creates capital fund and promotes economic development of a country.

4. *Less worry and Fear*

Another benefit of insurance to society is that it decreases the worry and fear of members of society regarding the risk of accident and premature death. If family heads have adequate amounts of life insurance, they are less likely to worry about the financial security of their dependents in the event of premature death, Similarly, businessmen who are insured enjoy greater peace of mind because they know are covered if a loss occurs.

5. *Prevention of loss*

when losses occur from risks, the insurer has to indemnify them financially Since loss of insured is transferred from insurer in the insurance policy, the insurance company should bear the risks. it means occurrence of loss from the risks is the loss of the insurer, not of the insured. Hence, the prevention as well as now becomes the interest of the owner of the property as well as the insurance company. That is why; insurance companies are actively involved in numerous programs about loss-prevention. They employ wide specialists in fire prevention, occupational safety engineers and specialists in fire prevention, occupational safety and health, and products liability.

Answer to Question No. 2(b)(i)

Life Insurance and General Insurance

The following are the various types of insurance businesses recognised under the Insurance Act, 1938:

- (a) Life insurance business
- (b) General insurance business (also called "Non-Life" business). This is sub divided into the following 3 sub-categories:
 - a. Fire insurance business
 - b. Marine insurance business
 - c. Miscellaneous insurance business

Life insurance business covers the risk of contingencies dependent on human life. For example payment of an amount (called “sum assured”) on the death of the life assured. Further, annuity contracts (which provide for periodic payments to life assured as long as the policyholder is alive) or the provisions of accident benefits also form part of life insurance business.

All businesses other than Life are classified as General insurance business. Fire insurance, as the name suggests covers the risks associated with loss due to a fire accident to properties. Marine insurance means the business of effecting insurance contracts upon vessels of any description, including cargoes, freights and other interests which may be insured for transit by land or water or both and includes warehouse risks or similar risks incidental to such transit. Miscellaneous insurance include all insurance businesses other than Fire and Marine insurance business (and Life insurance business). It includes Motor, Liability, Health and Burglary insurances.

Generally, indemnity based health insurance policies (which reimburse hospitalisation expenses) were classified under the General insurance business. Under the Insurance Bill, Health insurance business has been categorised as a separate line of business than the General insurance business. Standalone health insurance companies have been licensed by IRDA to sell only health insurance policies, given the huge potential for this business.

Answer to Question No. 2(b)(ii)

Endowment Scheme and Pure Insurance Scheme

Endowment Insurance – An endowment insurance offers death cover if the life insured dies during the term of the policy and also offers a Survival benefit if the life insured survives until the maturity of the policy.

Pure protection plan is a simple risk cover insurance product where the sum assured becomes payable upon the happening of the risk event during the term of the policy. It is also called term insurance. It has the lowest possible premium among all the other insurance plans available. Premiums of this policy are fixed and it does not increase during the term period of the policy.

Question No. 3

(a) Write short notes on any two of the following:

- (i) Directors' and Officers' Insurance
- (ii) Engineering Insurance

(b) M/s. Brown & Co. insured their stock against fire risk by taking following policies:

<i>Sum insured</i>	<i>Rs.</i>
<i>Standard Fire Policy with A</i>	<i>2,00,00,000</i>
<i>Standard Fire Policy with B</i>	<i>2,50,00,000</i>
<i>Fire Declaration Policy with C</i>	<i>3,50,00,000</i>

On 15-6-2013, there was fire in their godown and loss was assessed for Rs. 1,50,00,000. Value of stock at the time of fire was Rs. 7.5 crores. Apportion the loss over the three policies

(10 marks)

Answer to Question No. 3(a)(i)**Directors' and Officers' Insurance**

The D&O policy provides cover for the personal liability of Directors and Officers arising due to wrongful acts in their managerial capacity. Defence costs are also covered and are payable in advance of final judgment. This policy provides protection for claims brought against directors, officers and employees for actual or alleged breach of duty, neglect, misstatements or errors in their managerial capacity.

Answer to Question No. 3(a)(ii)**Engineering Insurance**

The rapid industrialization has led to increasing use of machines in industries. Though use of machinery results in increased production capacities, in the event of accident and breakdowns, they can be potential sources of financial loss and could even result in the closure of business.

In spite of proper care and maintenance of machinery, mishap may yet occur. Sometimes the extent of damage may be quite high and may also lead to fatal or non-fatal injuries to human beings nearby. The remedy for such losses is offered by various companies in form of engineering insurance.

The various engineering policies offered by insurance companies are divided under the following three major heads:

1. Project Insurance
2. Operational Machineries Insurance
3. Business Interruption Insurance

Answer to Question No. 3(b)

In this case, there is a fire declaration policy, so first standard fire policy with A and standard fire policy with B will used

Share of loss	:	Insured value/Value of Property * Loss
Share of Loss of A	:	Rs. (2,00,00,000/7,50,00,000)* 1,50,00,000
		= Rs. 40,00,000
Share of Loss of B	:	Rs. (2,50,00,000/7,50,00,000)* 1,50,00,000
		= Rs. 50,00,000
Total Loss apportioned to A and B	=	Rs. 90,00,000
Actual Loss Incurred	=	Rs. 1,50,00,000
Excess of Loss	=	Rs. 60,00,000

Since in this case, standard life policy could not indemnify the full loss so insurance claim will be apportioned to declaration life policy.

C's Share in loss	=	Rs.(3,50,00,000/7,50,00,000)* 1,50,00,000
	=	Rs. 70,00,000

Since the excess of loss is Rs. 60,00,000 so C will have to contribute Rs. 60,00,000 only

Question No. 4

*Define Risk Management and explain briefly the different techniques of the same.
(20 marks)*

Answer to Question No. 4**Risk Management**

'Risk, in insurance terms, is the possibility of a loss or other adverse event that has the potential to interfere with an organization's ability to fulfill its mandate, and for which an insurance claim may be submitted'.

Risk management ensures that an organization identifies and understands the risks to which it is exposed. Risk management also guarantees that the organization creates and implements an effective plan to prevent losses or reduce the impact if a loss occurs.

Techniques of Risk management : There are five major methods of handling and controlling risk.

- (a) Risk avoidance;
- (b) Risk retention;
- (c) Risk transfer;
- (d) Loss control; and
- (e) Insurance.

Risk Avoidance

Risk avoidance is one method of handling risk. For example, you can avoid the risk of being pick pocketed in Metropolitan cities by staying out of them; you can avoid the risk of divorce by not marrying; a career employee who is frequently transferred can avoid the risk of selling a house in a depressed real estate market by renting instead of owning; and a business firm can avoid the risk of being sued for a defective product by not producing the product.

Risk Retention

Risk retention is a second method of handling risk. An individual or a business firm may retain all or part of a given risk. Risk retention can be either active or passive.

Active Risk Retention

Active risk retention means that an individual is consciously aware of the risk and deliberately plans to retain all or part of it.

Passive Risk Retention

Risk can also be retained passively. Certain risks may be unknowingly retained because of ignorance, indifference, or laziness. This is often dangerous if a risk that is retained has the potential for destroying a person financially.

Risk Transfer

Risk transfer is another technique for handling risk. Risks can be transferred by several methods, among which are the following:

- (a) Transfer of risk by contracts;
- (b) Hedging price risks; and

- (c) Conversion to Public Limited Company.

Loss Control

Loss control is another important method for handling risk. Loss control consists of certain activities undertaken to reduce both the frequency and severity of losses. Thus, loss control has two major objectives:

- (a) Loss prevention.
- (b) Loss reduction.

Insurance

Insurance is a more commonly known concept that describes the act of guarding against risk. An insured is the party who will seek to obtain an insurance policy while the insurer is the party that shares the risk for a paid price called an insurance premium. The insured can easily obtain an insurance policy for a number of risks. The most common types of insurance policy taken out is a vehicle/auto insurance policy as this is mandated by law in many countries. Other policies include home owner's insurance, renter's insurance, medical insurance, life insurance, liability insurance, etc.

Question No. 5

- (a) *Explain the principles of Contribution and subrogation.*
- (b) *Explain the principle of insurable interest.* (10 marks each)

Answer to Question No. 5(a)

Principle of Subrogation : Subrogation means the restitution of the rights of an assured in favour of the insurer against the third party for any damages caused by the third party, after the insurer has indemnified the assured for the loss.

In accordance with this principle the insurance company acquires the right of the insured to sue the third party to compensate for the loss inflicted, when it indemnifies the insured for the losses suffered by him. This means that, if another vehicle hits your vehicle, and the insurer pays you the claim, then the insurer, not you, can sue the owner of that vehicle to claim damages.

Right of subrogation of the insurer

Where the insurer pays for a total loss, either of the whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject matter as from the time of the casualty causing the loss.

Principle of Contribution : As per the doctrine of contribution the indemnity provided for the loss occurring on the asset, which is insured with several insurers has to be proportionately shared among them according to the rateable proportion of the loss.

Contribution is the right of an insurer to call upon others similarly, but not necessarily equally, liable to the same insured to share the cost of an indemnity payment.

Right of Contribution

Where the assured is over-insured by double insurance, each insurer is bound, as between himself and the other insurers, to contribute rateably to the loss in proportion to the amount for which he is liable under his contract.

If any insurer pays more than his proportion of the loss, he is entitled to maintain a suit for contribution against the other insurers, and is entitled to the like remedies as a surety who has paid more than this proportion of the debt

Answer to Question No. 5(b)

The principle of insurable interest.

Insurable Interest

The Insurance Act 1938 doesn't define the insurable interest but it has been defined as follows by Mac-Gillivray "Where the assured is so situated that the happening of the event on which the Insurance money is to become payable would as a proximity cause, involve the assured in the loss or diminution of any right recognised by law or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability." The object of Insurance should be lawful for this purpose; the person proposing for Insurance must have interest in the continued life of the insured & would suffer pecuniary loss if the insured dies. If there is no insurable interest, the contract becomes wagering (gambling) contract. All wagering contracts are illegal & therefore null & void.

Insurable interest in Own Life Policy

So long as the Insurance is on one's own life, the "Insurance Interest" presents no difficulty. A person has insurable interest in his own life to an unlimited extent. The absence of a limit in this case is reasonable. When a person insures his life he obtains protection against loss to his estate; for in the event of his untimely death the estate would not benefit by the future accumulation he hopes to make during the normal span of life. It is not easy to compute with any degree of certainty what the future earnings of a person would be. Hence no limit may be fixed in respect of life Insurance he may effect. Where, however, insurer rejects a proposal for an amount of assurance, which is disproportionate to the means of the proposer, it is not normally for lack of Insurable interest but on considerations of "moral hazard". Indeed it may also be presumed in a case where a person proposes for a policy for a large amount, which he may not be able to maintain having regard to his income, that it will be financed by some other person and that there is no insurable interest

Insurance on the Life of Spouse

As a wife is normally supported by her husband, she can validly effect an insurance on her life for adequate amount. The service and help rendered by the wife used to be thought of as the basis of insurable interest which supports any policy which a man takes on the life of his wife. In *Griffiths v. Elemming the Court of Appeal in England* stated that it was difficult to uphold such interest on the basis of pecuniary interest but thought that such interest could be presumed on broader grounds.

Parent and Child

Following the practice in U.K. in India also a parent is not considered to have insurable

interest in the life of the child. The same is the case with a child in respect of his parent's life. Whether this position requires to be reviewed now appears to be engaging the attention of people here.

A Hindu is under a legal obligation to maintain his parents. Even as per traditional law Section 20 of the Hindu Adoption and Maintenance Act has given statutory form to the legal obligation. The parents have, therefore, a right to maintenance subject to their being aged or infirm. An order for maintenance of parents may also be passed under Section 125 of the Code of Criminal Procedure, 1973. It may be stated, therefore, that a parent has pecuniary interest in the life of the child, and an assurance effected on that basis cannot be hit by Section 30 of the Contract Act as a wagering contract. However, it may be noted that the pecuniary interest is not a present interest unless the parent is unable to maintain himself or herself at the time when the Insurance is effected. It may therefore, be argued that a parent cannot have insurable interest in the life of the child until the right to maintenance arises; but when a person is not able to maintain oneself how can he be expected to have the means to insure the life of his children?

As a matter of fact in India, even today a child is a potential breadwinner for the parents in their old age. The present affluent circumstances of a parent do not alter that situation. Under the traditional law a right to maintenance could be claimed only against the sons; the statute has now extended the obligation to the daughters as well. Having regard to the social and economic set up of the people in the country a review of the question seems to be appropriate.

On the life of other relations

In the case of other relations, insurable interest cannot be presumed from the mere existence of their relationship. Moral obligations or duties are not sufficient to sustain an insurable interest.

In every other case, the insurable interest must be a pecuniary interest and must be founded on a right or obligation capable of being enforced by Courts of law. The following are illustrations of such cases of insurable interest:

- (a) *Employer – Employee* : An employer has insurable interest in the life of his employee, and the employee in the life of the employer; An employer can create insurable interest in the lives of his employees by undertaking to provide monetary benefit to the family or estate of the employees in the event of death. Group Insurances effected by companies on the lives of their employees are on the basis of such insurable interest.
- (b) *Creditor – debtor* : A creditor has insurable interest in the life of his debtor upto the amount of the debt; This is not a satisfactory basis; for in the event of death of the debtor after the debt has been repaid, the creditor would still be entitled to the policy moneys and thus can be in a position to gain by the death of the debtor once the loan is repaid. The better arrangement would be for the debtor to take out a policy for the required amount and mortgage the policy to the creditor. The creditor then cannot take benefits under the policy in excess of his dues.
- (c) *Partner* : A partner has insurable interest in the life of his co-partner to the extent of the capital to be brought in by the latter.

- (d) *Surety and principal debtor-Co-surety*: A surety has insurable interest in the life of his co-surety to the extent of the proportion of his debt and also in the life of his principal debtor.

Effect on Contract when Insurable interest is not present: Where, therefore, the proposal is on the life of another, unless the proposer has insurable interest in the life to be assured, the contract shall be void. Lack of insurable interest is a defence, which the insurer may plead in resisting a claim. There may be also cases where Insurance on one's own life is surreptitiously financed and held by another for his benefit, which if detected by the insurer, may be declared void. As a life Insurance contract is not one of indemnity, the existence of insurable interest and the amount thereof will have to be considered at the time of effecting the contract since lack of such interest would render the contract void. If insurable interest existed at the inception of the policy, the contract would be enforceable though such interest might cease later.

Question No. 6

Distinguish briefly between any four of the following:

- (a) *Peril and Hazard*
- (b) *Assignment of the policy and Assignment of the proceeds of the policy*
- (c) *Agent and Broker*
- (d) *Actual cash value of the assets and Fair market value of the assets*
- (e) *Implied conditions and Express conditions.* (5 marks each)

Answer to Question No. 6(a)

Peril and Hazard

Peril is defined as the cause of loss. Thus, if a house burns because of a fire, the peril, or cause of, loss, is the fire. If a car is totally destroyed in an accident with another motorist, accident (collision) is the peril, or cause of loss. Some common perils that result in the loss or destruction of property include fire, cyclone, storm, landslide, lightning, earthquakes, theft, and burglary.

Factors, which may influence the outcome, are referred to as hazards. These hazards are not themselves the cause of the loss, but they can increase or decrease the effect should a peril operate. The consideration of hazard is important when an insurance company is deciding whether or not it should insure some risk and what premium to charge. So a hazard is a condition that creates or increases the chance of loss. There are three major types of hazards: Hazard can be physical or moral or Morale.

Answer to Question No. 6(b)

Assignment the policy and Assignment of the proceeds of the policy

An assignment of an insurance policy by an insured is the transfer of the rights to receive the benefits under a contract accruing to the party in that party. In life insurance, assignment is the transfer of rights to receive benefits stated in the life insurance policy. The concept and procedure for assignment is dealt with section 38 of the Insurance Act, 1938. The Section treats the assignment and transfer at par.

An Assignment of the proceeds of the policy means that the insured assigns the rights of receiving the proceeds from the insurance policy to a third party. Mere transfer of the rights of receiving the benefits of the policy, which the insured is entitled to, does not require the approval of insurer. This is because it does not amount to the assignment of the policy or its subject matter. The assignee thus only stands in the place of insured for receiving the benefits of the policy. Where due to breach of a condition the insurer declines to pay, the assignee cannot recover anything from the insurer.

Answer to Question No. 6(c)

Agent and Broker

The basic difference between an Insurance Broker and an Insurance Agent is that while an Insurance Broker represents the client, while an Insurance Agent represents the insurance company. As a corollary to the above, an Insurance Broker is licensed to recommend the products of any insurance company, whereas Insurance Agent at any point in time can sell the insurance products of only one insurance company with which he is attached.

Answer to Question No. 6(d)

Actual cash value of the assets and Fair market value of the assets

The actual amount of payment to be made to the insured for the loss is based on the Actual cash value (ACV) of the property, which is insured. Usually ACV is determined using the three methods

1. Replacement cost less depreciation
2. Fair Market value
3. Broad evidence Rule'

Fair Market value is the price which would normally be determined in a free market during a transaction entered into by a willing buyer and willing seller.

Answer to Question No. 6(e)

Implied conditions and Express conditions

Conditions are stipulations in the policy, which help in regulating the contract. These may be implied or express conditions

Implied conditions : In the absence of express conditions, the insurance contract is subject to implied conditions, which relate to

1. Good faith
2. Insurable interest
3. Subject matter of insurance
4. Identification of the subject matter.

Implied conditions can be expressed in policy explicitly, or can be modified or excluded by express conditions.

Express conditions are clearly stated in the insurance policy. There are two types of express conditions.

General express conditions which are applicable to all policies of that class and are therefore printed on the policy document

Specific conditions are the conditions which are applicable only to a specific policy. Generally specific conditions are handwritten or rubber stamped on the policy.



TEST PAPER 2/2013

Time allowed : 3 hours

Max. Marks : 100

NOTE : Answer Any 5 Questions.

Question No. 1

- (a) Define the scope and aim of Electronic Equipment Insurance.
- (b) Define underwriting. Discuss its objectives and the activities involve in it.
(10 marks each)

Answer to Question No. 1(a)

This is an omni bus cover against all risks for electronic equipment. In addition to break down cover, it provides protection against fire and allied perils, burglary, terrorism etc.

It is a requirement of this insurance that the sum insured shall be equal to the cost of replacement of the insured by new property of the same kind and same capacity which shall mean its replacement cost including freight, dues and customs duty, if any, and erection cost.

The policy covers the following:

- (a) Material damage.
- (b) Damage to external Data Media

Answer to Question No. 1(b)

Underwriting can be defined as “assumption of liability”. Underwriting involves the selection of policyholders after thoroughly evaluating all hazards, establishing prices and then determining the terms and conditions of the insurance policy. The term ‘Underwriting’, refers to the formal acceptance of a risk by the insurance company for a price, which is termed as ‘Premium’.

Objectives of Underwriting

The objectives of underwriting are three-fold: Producing a large volume of premium income that is sufficient to maintain and enlarge the insurance company’s operations and to achieve a better spread of the risk portfolio; Earning a reasonable amount of profit on insurance operations; Maintaining a profitable book of business (by ensuring underwriting profits) – that contains all the policies that the insurer has in force; More spread – across the profile and geography.

Activities involved in Underwriting Process

The underwriting process follows a series of stages, at the end of which the status

of a risk is decided. It is only after the risk has been weighed and all possible alternatives evaluated that the final underwriting is done. When a proposal for insurance is received, the underwriter has four possible courses of action:

- I. Accept the risk at standard rates
- II. Charge extra premium depending on the risk factor
- III. Impose special conditions
- IV. Reject the risk.

The activities involved in underwriting process includes-

1. Assimilating information about the applicant
2. Evaluating and making a decision
3. Executing the decision

Question No. 2

- (a) *Compare and contrast the features of term life insurance and universal Life insurance.*
- (b) *Distinguish between Pure risks and speculative risk. (10 marks each)*

Answer to Question No. 2(a)

Life Insurance

Under a whole life insurance policy, the purchaser agrees to pay premiums to a life insurance company in exchange for a guarantee of a specified benefit payable to their spouse or other beneficiaries upon their death. Earnings on a whole life insurance policy are set by the life insurance company based on the overall return on its investments.

Universal Life Insurance

Universal life insurance was created to provide more flexibility than whole life insurance by allowing the policy owner to shift money between the insurance and savings components of the policy. Premiums, which are variable, are broken down by the insurance company into insurance and savings, allowing the policy owner to make adjustments based on their individual circumstances. For example, if the savings portion is earning a low return, it can be used instead of external funds to pay the premiums. Unlike whole life insurance, universal life allows the cash value of investments to grow at a variable rate that is adjusted monthly.

Universal life offers the following advantages:

1. Lower-cost life insurance (compared to whole life insurance)
2. No-Lapse Protection
3. A tax-advantaged savings element that provides a cash value with a guaranteed minimum interest rate
4. Flexibility to adjust your premium payment and death benefit as your needs change
5. Favorable loan features.

Universal Life insurance is flexible-premium, adjustable-benefit, permanent life insurance that can accumulate values beyond the guaranteed cash value. In addition to its cash values which can be used for children's educations, to supplement retirement income and for incidental expenses, universal life insurance is flexible enough to change as your needs change.

Life Insurance vs. Universal Life Insurance

The flexibility provided by universal life insurance policies is attractive. Also, higher interest rates mean money doesn't have to work as hard to generate the same return. As a result, universal life insurance premiums are typically lower during periods of high interest rates than whole life insurance premiums for the same amount of coverage. And, while the interest paid on universal life insurance is often adjusted monthly, interest on a whole life insurance policy is adjusted annually. This means that during periods of rising interest rates, universal life insurance policy holders see their cash values increase much more rapidly than those in whole life insurance policies

Answer to Question No. 2(b)

With regards insurability, there are basically two categories of risks;

1. Speculative or dynamic risk; and
2. Pure or static risk

Speculative or Dynamic Risk

Speculative (dynamic) risk is a situation in which either profit OR loss is possible. Examples of speculative risks are betting on a horse race, investing in stocks/bonds and real estate. The outcome of such speculative risk is either beneficial (profitable) or loss. Speculative risk is uninsurable.

Pure or Static Risk

The second category of risk is known as pure or static risk. Pure (static) risk is a situation in which there are only the possibilities of loss or no loss, as oppose to loss or profit with speculative risk. The only outcome of pure risks are adverse (in a loss) or neutral (with no loss), never beneficial. Examples of pure risks include premature death, occupational disability, catastrophic medical expenses, and damage to property due to fire, lightning, or flood.

It is important to distinguish between pure and speculative risks for three reasons. First, through the use of commercial, personal, and liability insurance policies, insurance companies in the private sector generally insure only pure risks. Speculative risks are not considered insurable, with some exceptions.

Second, the law of large numbers can be applied more easily to pure risks than to speculative risks. .

Finally, society as a whole may benefit from a speculative risk even though a loss occurs, but it is harmed if a pure risk is present and a loss occurs.

Question No. 3

- (a) *What do you mean by Indemnification?*
- (b) *"Insurance entails certain costs to Society". Explain. (10 marks each)*

Answer to Question No. 3(a)

The term "indemnification" means compensation for damages or loss. Indemnity in the legal sense may also refer to an exemption from liability for damages. The concept of indemnity is based on a contractual agreement made between two parties, in which one party agrees to pay for potential losses or damages caused by the other party. A typical example is an insurance contract, whereby one party (the insurer) agrees to compensate the other (the insured) for any damages or losses, in return for premiums paid by the insured to the insurer.

Answer to Question No. 3(b)**Cost of Insurance to the society**

Though insurance provides vast benefits to individuals and society, it carries some social costs that must be realized. Heavy expenditure is incurred in running of insurance companies, which are increasing over time. This results in scarce economic resources being diverted for the development of insurance industry.

Besides, insurance sometimes has the effect of encouraging unscrupulous individuals to resort to fraud, which is a heavy cost to the companies and the nation. Also, it has now become increasingly common to make highly inflated claims particularly in motor insurance and health insurance to cover 'deductibles'. This results in heavy underwriting losses to insurance companies who are forced to raise premiums. In our own country, most of the nationalized insurance companies all along have been incurring heavy underwriting losses. The huge increase in motor insurance and health insurance premiums is a direct result of this factor. The costs of insurance thus also include:

1. Fraudulent claims
2. Inflated claims

Question No. 4

- (a) *Can a person recover anything under a Personal Accident policy, if he dies a natural death ?*
- (b) *What are the major exclusions in a medical insurance policy ?*

(10 marks each)

Answer to Question No. 4(a)**Personal Accident Insurance**

Personal accident insurance provides protection to the insured person financially, if he is injured. This policy provides monetary compensation in case of death or disablement resulting from accidental injury arising out of EXTERENAL, VIOLENT AND VISIBLE MEANS. Medical expenses incurred for treatment of injuries from such accident are also reimbursed to a certain extent on payment of additional premium. The policy also pays a pre-determined sum if death occurs as a result of an accident. All of us are exposed to the risk of accident, which is a threat to our financial security, and therefore it is prudent to have adequate personal accident cover to manage this contingency. For handling accident risks, personal accident policy, janata personal accident policy and gramin personal accident policies are available in India. Other personal accident policies are offered to particular groups like students, NRI's, women etc.

Scope of cover

Personal accident policy pays compensation to the insured in the event of happening of one or more of the following listed below which may be selected by insured at the time of taking policy :

- On death
- On permanent total and partial disability and
- On temporary total disability

In case of accidental death during the policy period, normally, the policy, in addition covers funeral expenses of the insured person. (some companies even provide removal of mortal remains). Permanent total disablement occurs when an individual is unable to perform his regular duties for the remaining part of his life. (loss of both eyes, upper limbs, lower limbs etc. are treated as total disability).

Thus on the basis of above discussion and after referring the scope of policy, we may say that in normal circumstances a person cannot recover anything under a Personal Accident policy, if he dies a natural death.

Answer to Question No. 4(b)

Generally a medical insurance policy does not cover the following unless otherwise provide.

- (a) Any sickness or illness for first 30 days during the policy
- (b) Any medical expenses relating to pregnancy Diseases caused by war, invasion or due to nuclear weapons etc.
- (c) Any expenses incurred for spectacles, cosmetic treatment etc.
- (d) Medical expenses incurred for purchasing tonics, vitamins unless incurred as part of the treatment.

Question No. 5

- (a) *What is an "insurable Interest"? What are the policy requirements for an insurance interest ?*
- (b) *Define Maritime Perils and discuss about Insured perils or Uninsured perils in detail. (10 marks each)*

Answer to Question No. 5(a)**Definition**

The legal right to insure arising out of a financial relationship recognized under the law, between the insured and the subject matter of insurance.

The existence of insurable interest is an essential ingredient of any insurance contract. It is an important and fundamental principle of insurance. Insurable interest simply means "right to insure". The policyholder must have a pecuniary or monetary interest in the property, which he has insured. The subject matter of insurance can be any type of

property or any event that may result in a loss of a legal right or creation of a legal liability.

Therefore the essentials of insurable interest include:

There must be some property, right, interest, liability or potential liability capable of being insured.

It is this property, right etc, which must be the subject matter of insurance.

The insured must stand in a relationship with the subject matter of insurance whereby he benefits from its safety, well being or freedom from liability and would be prejudiced by its loss, damage or existence of liability.

The relationship between the insured and the subject matter of insurance must be recognized at law.

For example, the subject matter of insurance under a fire policy can be a building, stocks, machinery, under a liability policy it can be a person's legal liability for injury or damage, a ship in a marine policy etc. Any damage to the property must result in financial loss to the policyholder. Only then insurable interest is said to exist. There are a number of ways in which insurable interest will arise or be limited:

- (a) *By Common Law*: under common law insurable interest is automatically created by 'ownership' rights. Similarly, the common law of 'duty of care' that one owes to the other may give rise to a liability which is also insurable. For E.g. the owner of a tractor who depends on it for his agricultural operation stands to lose financially if the tractor meets with an accident, as his business will come to a standstill. Thus the owner has an insurable interest in the asset, i.e., his tractor. Hence the tractor forms the subject matter when insurance is purchased on it.
- (b) *By Contract*: sometimes insurable interest is also created by contractual obligations. For example, a lease agreement between a landlord and a tenant may make a tenant responsible for the maintenance or repair of the building. This contract places the tenant in a legally recognized relationship to the building which gives him insurable interest.
- (c) *By Statute*: sometimes an act of parliament may create insurable interest either by granting a benefit or by imposing a duty.

Answer to Question No. 5(b)

As per Section 2(e) of The Marine Insurance Act, 1963, "maritime perils" means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seizures, restraints and detentions of princes and peoples, jettisons, barratry and any other perils which are either of the like kind or may be designated by the policy;

Maritime Perils (Insured and Uninsured)

Maritime perils can be defined as the fortuitous (it represents an element of chance or ill luck) accidents or casualties of the sea caused without the willful intervention of human agency. There are different forms of perils at sea, of which only a few are covered

by insurance while others are not. In this part we will be enumerating both the insured and uninsured perils of the sea.

Marine insurance coverage

Fire – is a common peril at sea.

1. *Pirates and Thieves* – according to Carver: “ Piracy is forcible robbery at sea, whether committed by marauders from outside the ship or by mariners or passengers within it.
2. *Barratry* – it is an act willfully committed by the master and the crew against the owner or charterer of the ship. Barratry includes fraudulent sale of cargo or deviation of ship, the crew’s refusal to discharge the cargo, etc.
3. *Jettison* – this is throwing of cargo overboard due to either a deliberate act or at the wake of grave danger.
4. *Taking at Sea* – is a situation when the vessel is captured by the enemy or others.
5. *Foundering at Sea* – if a ship has been reported lost and after a stipulated time, there is no news of its whereabouts then it is presumed to be lost due to perils of the Stranding – arises when the ship deviates from its course due to an accident and is stranded in shallow waters and suffers damages.
6. *Collision* – is caused when the ship collides with another ship or with other objects, causing damage.
7. *All other Perils* – This includes all perils similar in nature to the ones mentioned in the policy.

Perils not explicitly dealt with – there are two other losses the insurer is bound to provide cover for. They are:

- (A) *Insurer’s Liability in respect of General Average Loss (Section 66)* – General average loss is expenditure or loss incurred consciously while countering a peril for saving the ship and /or consignment. This is borne proportionately by all having insurable interests in the marine adventure.
- (B) *Insurer’s liability in respect of salvage charges* – These are charges awarded to a salvager for retrieving property from the sea. This is not part of a marine contract. This amount is contributed by all holding insurable interest in the marine adventure. The insurer is liable to cover the salvage charges incurred by the assured. This is treated as part of general average loss.

Uninsured Perils

All losses and damages caused due to reasons not considered as perils of the sea are not provided insurance cover.

Wear and Tear – This is the regular deterioration that inflicts the vessel due to the corrosive action of the sea, action of winds and other maintenance problems caused to the body of the ship due to sailing. This includes perishable commodity that is transported.

Leakage – If a leak develops in a vessel then insurance does not provide cover for the loss caused, unless the leak is caused by an accident. Ordinary leakage of liquid cargo is also not covered.

Breakage of goods – Goods damaged due to movement of the ship are not covered by insurance. But goods damaged by the violent action of the waves are covered, as this is treated as a peril at sea.

Inherent Vice – This refers to the inherent properties of the cargo being transported. Thus, the insurer cannot be made liable for perishable commodity, which has an inherent process of decomposition. This would apply to fruits, vegetables, meat, etc.

Loss by Rats and Vermin – This loss is not considered as a peril of the sea. (e.g. Hamilton v Pandrof- a rat gnawed a hole in a pipe, causing damage to the cargo of rice by seawater, there was no negligence. The insurer was not held responsible).

Loss by Delay – This means that the insurer of the vessel and the cargo cannot claim for loss caused due to delay, even if the delay is caused by a peril of the sea, which is covered by insurance. (Normally, coverage till completion of transit/ reaching destination and not defined in terms of date/days – except in case of annual declaration policies).

Question No. 6

Write short note on any four of the following

- (i) *Endowment insurance*
- (ii) *'Property accident aspect' of the Motor Insurance Policy*
- (iii) *Coinsurance*
- (iv) *Advance Loss of Profit Insurance.*
- (v) *Fidelity Guarantee Insurance.* (5 marks each)

Answer to Question No. 6(i)

Endowment Insurance

An endowment insurance offers death cover if the life insured dies during the term of the policy and also offers a Survival benefit if the life insured survives until the maturity of the policy.

Some of the key features of an Endowment insurance plan are -

- If the life insured survives the entire term of the plan, then a specified amount is paid to him/her on maturity of the plan.
- If the life insured dies before the maturity of the plan, then the death cover benefit is paid to the nominee/beneficiary.
- *Savings element* : After deducting the death cover charges & administration charges from the premium, the remaining amount is invested by the insurance company. The returns earned are later paid back to the life insured in the form of bonuses.

- *Goal-based investment* : Helps in accumulating money for specific plans like a child's higher education or marriage, etc.
- Some insurance companies also allow partial withdrawal or loans against these policies.
- There are different variants under this plan –
 - Higher death cover than the maturity benefit
 - Maturity benefit is double the death cover, known as a double endowment insurance plan.

Answer to Question No. 6(ii)**'Property accident aspect' of the Motor Insurance Policy**

Property accident aspect of motor insurance help pay for other drivers' and property owners' expenses after the insured found at fault in an accident. This includes repairing damaged cars or fixing any other property involved. It can also help mitigate out-of-pocket legal fees associated with damaged property.

Answer to Question No. 6(iii)**Coinsurance**

Co-insurance is a term that describes a splitting or spreading of risk among multiple parties. Coinsurance has different meaning for different types of policies. For property related policies the insured bears a portion of the risk only when it is underinsured. The main reason behind this is to ensure that the principal insured willingly protects the property insured.

Answer to Question No. 6(iv)**Advance Loss of Profit Insurance**

This insurance policy is also known as business interruption insurance. this policy covers monetary loss due to delayed commissioning of the project as a result of loss during construction/erection which is covered under a project insurance policy. The cost covered under this policy includes

- (a) Loss of gross profit
- (b) Loss of gross earning
- (c) Increased cost of working
- (d) Loss of rent
- (e) Special expenses etc

Answer to Question No. 6(v)**Fidelity Insurance**

Fidelity insurance protects organizations from loss of money, securities, or inventory resulting from crime. Common Fidelity claims allege employee dishonesty, embezzlement, forgery, robbery, safe burglary, computer fraud, wire transfer fraud, counterfeiting, and other criminal acts.

These schemes involve every possible angle, taking advantage of any potential weakness in your company's financial controls. From fictitious employees, dummy accounts payable, non-existent suppliers to outright theft of money, securities and property. Fraud and embezzlement in the workplace is on the rise, occurring in even the best work environments.

Liabilities covered by crime insurance usually fall into two categories, although many policies combine both types of coverage:

- Money and security coverage pays for money and securities taken by burglary, robbery, theft, disappearance and destruction.
 - Employee dishonesty coverage pays for losses caused by most dishonest acts of your employees, such as embezzlement and theft.
-

TEST PAPER 3/2013

Time allowed : 3 hours

Max. Marks : 100

NOTE : Answer Any 5 Questions.

Question No. 1

Hyderabad Air Show tragic:

“In March, 2010, an Air show was undertaken at Begumpet in Hyderabad which turned out to be very tragic for some people. Two pilots of naval aircraft and a civilian were killed after an aircraft crashed on a nearby residential building. Seven others were also injured in the mishap.”

- (a) What are the risks involved in the above event ? (10 marks)
- (b) Identify and discuss, how such risks can be managed insurance and who should be taking insurance (10 marks)

Answer to Question No. 1(a)

There are many risks involved in the above event namely

- (a) Property Risk
- (b) Public Liability Risk
- (c) Reputation Risk
- (d) Risk for loss of Profit
- (e) Personal Risk

Answer to Question No. 1(b)

Property Risk can be managed by taking insurance cover for the aircraft. This insurance cover should be taken by the airline.

Public Liability Risk can be managed by taking the public liability insurance. This risk should be taken so as to compensate the effected party under absolute liability principle. This insurance cover should be taken by the airline.

Reputation Risk : Reputation risk can be retained by the company and the company should take all necessary steps to avoid any wrong happening. Alternatively insurance cover can also be taken by the insurance company for handling reputation risk

Risk for Loss of Profit : any event due to which business operations are suspended, results in loss of profit and additional expenses in form of standing expenses. Loss of profit policy may be taken by the airline so as to manage this risk.

Personal Risk : It refers to the risk borne by the travelers in the aircraft. This risk can be managed by the traveler by taking travelling insurance.

Question No. 2

- (a) *Distinguish between Peril and Hazard.* (10 marks)
- (b) *Explain with example each of the following categories of Hazard:*
- (i) *Physical Hazard*
 - (ii) *Moral Hazard*
 - (iii) *Morale Hazard.* (10 marks)

Answer to Question No. 2(a)**Peril and Hazard**

Peril is used to mean both the event which will give rise to some loss, and the factors which may influence the outcome of a loss. When we think about cause, we must be clear that there are at least two aspects to it. We can see this if we think back to the two houses on the river bank and the risk of flood. The risk of flood does not really make sense, what we mean is the risk of flood damage. Flood is the cause of the loss and the fact that one of the houses was right on the bank of the river influences the outcome. Flood is the peril and the proximity of the house to the river is the hazard. The peril is the prime cause; it is what will give rise to the loss. Often it is beyond the control of anyone who may be involved. In this way we can say that storm, fire, theft, motor accident and explosion are all perils.

Peril is defined as the cause of loss. Thus, if a house burns because of a fire, the peril, or cause of, loss, is the fire. If a car is totally destroyed in an accident with another motorist, accident (collision) is the peril, or cause of loss. Some common perils that result in the loss or destruction of property include fire, cyclone, storm, landslide, lightning, earthquakes, theft, and burglary.

Factors, which may influence the outcome, are referred to as hazards. These hazards are not themselves the cause of the loss, but they can increase or decrease the effect should a peril operate. The consideration of hazard is important when an insurance company is deciding whether or not it should insure some risk and what premium to charge. So a hazard is a condition that creates or increases the chance of loss. There are three major types of hazards: Hazard can be physical or moral or Morale.

Answer to Question No. 2(b)(i)**Physical hazard**

Physical hazard relates to the physical characteristics of the risk, such as the nature of construction of a building, security protection at a shop or factory, or the proximity of houses to a riverbank. Therefore a physical hazard is a physical condition that increases the chances of loss. Thus, if a person owns an older building with defective wiring, the defective wiring is a physical hazard that increases the chance of a fire. Another example of physical hazard is a slippery road after the rains. If a motorist loses control of his car on a slippery road and collides with another motorist, the slippery road is a physical hazard while collision is the peril, or cause of loss.

Answer to Question No. 2(b)(ii)**Moral Hazard**

Moral hazard concerns the human aspects which may influence the outcome. Moral hazard is dishonesty or character defects in an individual that increase the chance of loss. For example, a business firm may be overstocked with inventories because of a severe business recession. If the inventory is insured, the owner of the firm may deliberately burn the warehouse to collect money from the insurer. In effect, the unsold inventory has been sold to the insurer by the deliberate loss. A large number of fires are due to arson, which is a clear example of moral hazard. Moral hazard is present in all forms of insurance, and it is difficult to control. Dishonest insured persons often rationalise their actions on the grounds that "the insurer has plenty of money". This is incorrect since the company can pay claims only by collecting premiums from other policy owners. Because of moral hazard, premiums are higher for all insured, including the honest. Although an individual may believe that it is morally wrong to steal from a neighbour, he or she often has little hesitation about stealing from an insurer and other policy owners by either causing a loss or by inflating the size of a claim after a loss occurs.

Answer to Question No. 2(b)(iii)**Morale Hazard**

This usually refers to the attitude of the insured person. Morale hazard is defined as carelessness or indifference to a loss because of the existence of insurance. The very presence of insurance causes some insureds to be careless about protecting their property, and the chance of loss is thereby increased. For example, many motorists know their cars are insured and, consequently, they are not too concerned about the possibility of loss through theft. Their lack of concern will often lead them to leave their cars unlocked. The chance of a loss by theft is thereby increased because of the existence of insurance. Morale hazard should not be confused with moral hazard. Morale hazard refers to an insured who is simply careless about protecting his property because the property is insured against loss. Moral hazard is more serious since it involves unethical or immoral behaviour by insureds who seek their own financial gain at the expense of insurers and other policy owners. Insurers attempt to control both moral and morale hazards by careful underwriting and by various policy provisions, such as compulsory excess, waiting periods, exclusions, and exceptions. When used in conjunction with peril and hazard we find that risk means the likelihood that the hazard will indeed cause the peril to operate and cause the loss. For example, if the hazard is old electrical wiring prone to shorting and causing sparks, and the peril is fire, then the risk, is the likelihood that the wiring will indeed be a cause of fire.

Question No. 3

- (a) *What are the legal aspects of third party motor insurance? Are there any exemptions to the concept of compulsory third party insurance? Discuss.*
(10 marks)
- (b) *Explain the features of the Term Assurance Policy. Comment on the relevance of such policy to a self-employed person, who has limited income with no material savings and who is the sole breadwinner of the family.*
(10 marks)

Answer to Question No. 3(a)

Motor insurance being a contract like any other contract has to fulfil the requirements of a valid contract as laid down in the Indian Contract Act 1872. In addition it has certain special features common to other insurance contracts.

- Motor Vehicles Act in 1939 was passed to mainly safeguard the interests of pedestrians. The current act is MV Act 1988. According to the Act, a vehicle cannot be used in a public place without insuring the third party liability.
- No insurer can deny TP cover to any owner of a motor vehicle (Section 146 of MV Act 1988).
- According to Section 24 of Motor Vehicles Act “no person shall use or allow any other person to use, a motor vehicle in a public place, unless the vehicle is covered by a policy of insurance.”
- The policy comes into effect from the issuance of certificate of insurance to the proposer or the insured.

Compulsory insurance in respect of motor vehicles comprises the following liabilities:

- Liability arising out of bodily injury or death of the third party or arising out of the damage to his property.
- Compulsory insurance of passengers carried on hired vehicles.
- Compulsory insurance of passengers carried by reason of a contract of employment.
- Compulsory insurance of an employee under workmen’s compensation act considering the factors such as:
 - Who was driving the vehicle?
 - Whether working as conductor or ticket examiner/coolies
 - Nature of goods carried in the goods carriage

Exceptions

Both the central and state/local body government owned vehicles (public transport corporations also) do not fall under compulsory insurance. However for the exemption to be effective, the concerned government authority must pass an order for such exemption only with a fund established by the concerned government debt/corporate to meet the liabilities arising out of the use of the vehicles. Limitations of liability (Liability to TP injury / death is unlimited. This is a major change brought in by MV Act 1988 and that is why IRDA has brought in pool arrangement to manage TP portfolio). Liability coverage is limited to any one accident. The limitations are:

- Liability coverage of goods vehicle under workmen’s compensation is as per WC Act.
- Only upto Rs. 1,00,000 and passengers are limited to less than six. This limit is over and above the coverage available to the driver.

- Liability coverage limit is upto Rs. 15, 000 in case of a hired passenger vehicle. The passengers here also include passengers under contract of employment.
- Liability coverage of any vehicle other than the mentioned above is limited to the rupee value of actual liability.
- Liability coverage in case of any damage to the property of third party is upto Rs. 6,000.

Answer to Question No. 3(b)

Term Insurance policy furnishes protection for a limited number of years. It terminates with no maturity value. The face amount of the policy is payable only if the insured's death occurs during the stipulated term. Nothing is paid in case of survival. Generally it is issued for a short period but customarily provides protection for at least a set number of years, such as 10 or 20 years, or to a stipulated age, such as 65 or 70 years. It is more comparable to property and liability insurance contracts than to any other life insurance contract. Initial premium rates are low compared to other life products because the period of protection is limited.

There are many features of term assurance policies, few of them are discussed below:

1. *Renewability* – continuation of the policy for another term without reference to insured's insurability; premiums increase at each interval.
2. *Convertibility* – is an option to change over to a cash value policy [whole life or endowment] without reference to insured's insurability; conversion allowed on attained age method or on original age method.
3. *Re-entry* – is the facility to pay lower premium than otherwise if insured can demonstrate that they meet certain continuing insurability conditions.

Re-entry term premiums are based on select / mortality split.

Relevance of such policy to a self-employed person, who has limited income with no material savings and who is the sole breadwinner of the family

This policy is very useful for a person who is self employed and has limited income with no material saving. This policy provides security cover at a very low premium. Such person may take benefit of this policy and can secure his dependants. Though the insured does not get anything at the time of survival but it gives economic security to the dependants.

Question No. 4

- (a) *What is the relevance of "utmost good faith" to life insurance contracts? Are there any exemptions to this concept ?* (10 marks)
- (b) *What are the special features of a term insurance life policy? Explain.* (10 marks)

Answer to Question No. 4(a)

Utmost good faith is the most important principle of Insurance contract. In insurance contracts, the rule of caveat emptor [let the buyer beware] does not generally apply.

This doctrine is supported by Representation through an application Concealment Warranty. An application for life and health insurance is the applicant's proposal to the insurer for protection and is the beginning of the policy contract. The proposed insured is required to give accurate answers to questions in the application relating to his personal and family history, habits, employment, insurance already in force, and other applications for insurance that either are pending or have been postponed or refused etc. A failure to do so leads the insurer being estopped [i.e., prevented] from denying the correctness or truth of information in the application. Insurers place great reliance on this information to issue the requested policy. This principle of insurance stems from the doctrine of "Uberrimae Fides" which is essential for a valid insurance contract. It implies that in a contract of insurance, the concerned contracting parties must rely on each other's honesty. Insurance contracts are different from other contracts. Normally the doctrine of "Caveat Emptor" governs the formation of commercial contracts which means 'let the buyer beware'. The buyer is responsible for examining the good or service and its features and functions. It is not binding upon the parties to disclose the information, which is not asked for.

However in case of insurance, the products sold are intangible. Here the required facts relate to the proposer, those that are very personal and known only to him. The law imposes a greater duty on the parties to an insurance contract than those involved in commercial contracts. They need to have utmost good faith in each other, which implies full and correct disclosure of all material facts by both parties to the contract of insurance.

The term "material fact" refers to every fact or information, which has a bearing on the decisions with respect to the determination of the severity of risk involved and the amount of premium. The disclosure of material facts determines the terms of coverage of the policy.

Any concealment of material facts may lead to negative repercussions on the functioning of the insurance company's normal business. For instance life insurance companies normally segregate the quality of lives depending upon the state of health of the people. Healthy people are accorded a higher status in the table and different (lower) rates of premium are applicable to them since their risk of ill health is lower. If a person suppresses facts about his ill health and manages to buy a policy at rates applicable to the low risk group then other policyholders in the same group have to share his risk. This results in adverse selection.

Hence as per the principle of utmost good faith it is binding on the part of parties, the insured and the insurer, to expressly disclose all the relevant material facts pertaining to the contract. This doctrine is incorporated in insurance law and both the parties are expected to adhere to a high degree of honesty. Based on such faith, the insurer and the insured execute the contract of insurance. Thus each party believes that on fulfillment of the conditions for which the insurance policy was purchased, the other party would perform his duties as promised by him. Non-compliance by either party or any non-disclosure of the relevant facts renders the contract null and void.

Answer to Question No. 4(b)

Special features of a term insurance life policy : A term insurance plan provides a pure risk cover where the sum assured becomes payable upon death of the life assured during the term of the policy. Since there is only a risk cover, the premiums are usually

low and affordable and the policy assures a financial security to the family members upon death of the life assured. The term of the policy is fixed and where the life assured survives the full term, no amount is payable. Some variants of pure protection plans also assure a return of some or whole of the premiums paid if the life assured survives the term of the policy. The benefit arising to the insurance company in such case is the income out of the premiums invested during the term.

Question No. 5

- (a) *A Shipping Company owns an ocean-going steamer valued at Rs. 32 crores. The steamer has been insured with three different insurance companies X, Y and Z. The amount underwritten by X is Rs. 6 crores, by Y is Rs. 10 crores and by Z is Rs. 16 crores. The steamer met with an accident and the loss is valued at 4 crores. Calculate the liability of each individual insurer. (10 marks)*
- (b) *Explain 4 risk handling techniques. (10 marks)*

Answer to Question No. 5(a)

The cost of steamer = Rs. 32 crores

The insurance value of steamer

A = Rs. 6 crores,

B = Rs. 10 crores

C = Rs. 16 crores

Thus the total sum insured amounts to Rs. 32 crores.

Hence the liability of each individual insurer = (Amount underwritten by the insurer * amount of loss)/total sum insured

So, the liability of insurer A = Rs. $(4 \times 6) / 32 = \text{Rs. } 75 \text{ lakhs.}$

The liability of insurer B = Rs. $(4 \times 10) / 32 = \text{Rs. } 1.25 \text{ crore.}$

The liability of insurer C = Rs. $(4 \times 16) / 32 = \text{Rs. } 2 \text{ crores.}$

Answer to Question No. 5(b)

Once risk is identified and analyzed, it is important to plan and adopt a suitable strategy for controlling the risk. Risk planning and controlling is the stage which comes after the risk analysis process is over. Some of the major methods of handling and controlling risk are:

- (a) Risk avoidance;
- (b) Risk retention;
- (c) Risk transfer;
- (d) Loss control; and
- (e) Insurance.

Question No. 6

Write short notes on the following:

- (a) Characteristics of risk*
- (b) Distinction between Insurance and Speculation*
- (c) Exceptions to the principle of indemnity*
- (d) Exceptions under a personal accident policy*
- (e) Functions of capital in an insurance company.*

(5 marks each)

Answer to Question No. 6(a)**Characteristics of Risks**

Risk is the potential of loss (an undesirable outcome, however not necessarily so) resulting from a given action, activity and/or inaction. The notion implies that a choice having an influence on the outcome sometimes exists (or existed). Potential losses themselves may also be called "risks". Any human endeavor carries some risk, but some are much riskier than others. Risk can be defined in many different ways.

- The probability of something happening multiplied by the resulting cost or benefit if it does.
- The probability or threat of quantifiable damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive action.

Risk is part of every human endeavor. From the moment we get up in the morning, drive or take public transportation to get to school or to work until we get back into our beds (and perhaps even afterwards), we are exposed to risks of different degrees.

Answer to Question No. 6(b)**Distinction between Insurance and Speculation**

Insurance and speculation both are different. Insured takes an insurance policy so as to transfer the risk posed by him to the insurer while speculation is a situation in which either profit OR loss is possible. Examples of speculative transactions are betting on a horse race, investing in stocks/bonds and real estate. Speculative transactions are uninsurable.

Answer to Question No. 6(c)**Exceptions to the Principle of indemnity**

In non-life insurance this covers Personal Accident Insurance and certain types of Health Insurance such as 'Critical Illness', 'Hospital Cash', etc., where the agreed amount is paid as claims without having to establish the actual spending by the policyholder). The life of a person is different from a material or property. The principle of valuing material property like replacement cost less depreciation and discounted cash flows cannot be applied to determine the monetary value of the life of a person.

The value of life is broadly determined by certain qualitative factors and is subject to one's opinion. The most important factor here is the earning capacity of the person

and the insurable value is the value of the policy taken up by the person. A life insurance policy is not subject to the principle of indemnity but is a valued policy wherein the agreed upon amount in full is paid to the beneficiary in case of loss of life.

Answer to Question No. 6(d)

Exceptions under a personal accident policy

Personal Accident Insurance

Personal accident insurance provides protection to the insured person financially, if he is injured. This policy provides monetary compensation in case of death or disablement resulting from accidental injury arising out of External, Violent and Visible means. Medical expenses incurred for treatment of injuries from such accident are also reimbursed to a certain extent on payment of additional premium. The policy also pays a pre-determined sum if death occurs as a result of an accident. All of us are exposed to the risk of accident, which is a threat to our financial security, and therefore it is prudent to have adequate personal accident cover to manage this contingency. For handling accident risks, personal accident policy, Janata personal accident policy and Gramin personal accident policies are available in India. Other personal accident policies are offered to particular groups like students, NRI's, women etc.

Scope of cover

Personal accident policy pays compensation to the insured in the event of happening of one or more of the following listed below which may be selected by insured at the time of taking policy:

- (a) On death;
- (b) On permanent total and partial disability; and
- (c) On temporary total disability.

In case of accidental death during the policy period, normally, the policy, in addition covers funeral expenses of the insured person. (Some companies even provide removal of mortal remains). Permanent total disablement occurs when an individual is unable to perform his regular duties for the remaining part of his life. (Loss of both eyes, upper limbs, lower limbs etc. are treated as total disability).

Answer to Question No. 6(e)

Capital plays a very important function in an insurance company. Insurance companies invest the capital in the insurance business which helps the insurance company to sustain initially. Initially most of the premium income is spent and the capital with the insurance provides subsistence to workers. Adequate capital is very important for proper functioning of an insurance company.
