UNIT I

PRINCIPLES & PRACTICE OF INSURANCE

INTRODUCTION

Insurance is a way of managing risks. When you buy insurance, you transfer the cost of a potential loss to the insurance company in exchange for a fee, known as the premium. Insurance companies invest the funds securely, so it can grow, and payout when there's a claim. The life and property of an individual are surrounded by the risk of death, disability or destruction. These risks may result in financial losses. Insurance is a prudent way to transfer such risks to an insurance company.

What is Insurance?

Insurance is defined as a contract, which is called a policy, in which an individual or organisation receives financial protection and reimbursement of damages from the insurer or the insurance company. As part of the contract, the insurance company promises to make good the losses of the insured on happening of the insured contingency. The contingency is the event which causes a loss. It can be the death of the policyholder or damage/destruction of the property. There's uncertainty regarding the happening of the event and therefore it is termed as a contingency. The life insured pays a premium in return for the promise made by the insurer.

Why is Insurance Needed?

Here are some of the reasons why insurance could prove to be essential:

1. Insurance plans will help you pay for medical emergencies, hospitalization, contraction of any illnesses and treatment, and medical care required in the future.
2. The financial loss to the family due to the unfortunate death of the sole earner can be covered by insurance plans. The family can also repay any debts like home loans or other debts which the person insured may have incurred in his/her lifetime.
3. Insurance plans will help your family maintain their standard of living in case you are not around in the future. This will help them cover the costs of running the household through the insurance lump sum payout. The insurance money will give your family some much-needed breathing space along with coverage

for all expenditure in case of death/accident/medical emergency of the policyholder.

4. Insurance plans will help in protecting the future of your child in terms of his/her education. They will make sure that your children are financially secured while pursuing their dreams and ambitions without any compromises, even when you are not around.
5. Many insurance plans come with savings and investment schemes along with regular coverage. These help in building wealth/savings for the future through regular investments. You pay premiums regularly and a portion of the same goes towards life coverage while the other portion goes towards either a savings plan or investment plan, whichever you choose based on your future goals and needs.
6. Insurance helps protect your home in the event of any unforeseen calamity or damage. Your home insurance plan will help you get coverage for damages to your home and pay for the cost of repairs or rebuilding, whichever is needed. If you have coverage for valuables and items inside the house, then you can purchase replacement items with the insurance money.

TYPES OF INSURANCE POLICIES

There are several types of insurance plans available. Some of the commonly preferred ones include the following:

- **Life Insurance:** Life insurance is what you can avail to safeguard your family in case of your death during the tenor of the policy. Term insurance is the most basic form of life insurance available to buyers. Life insurance helps secure your family financially with a lump sum amount that is paid out in the event of the policy holder’s death within the policy period.
- **Health Insurance:** This is purchased for covering medical expenses revolving around various health issues, including hospitalization, treatments and so on. These insurance plans come in handy in case of medical emergencies; you can also avail of cashless facility across network hospitals of the insurer.
- **Child Plans:** These insurance policies are savings instruments that help in generating lump sum funds whenever children reach a certain age for pursuing higher studies. In these plans, the life assured is that of the child or the recipient of the funds while the parents are the policy owners.

- **Home Insurance:** These insurance plans cover any damages to the home on account of accidents, mishaps and natural calamities, among other such events.
- **Auto Insurance:** These are insurance plans for vehicles, including cars and bikes. These offer protection against natural calamities, damages to third parties (people who have incurred losses or been hurt in an accident with the policyholder's vehicle) and also damages to the vehicle along with mishaps and accidents.

How do Insurance Policies Work?

Individuals and companies can seek insurance from an insurance company, however, the decision to provide insurance is at the discretion of the insurance company. The insurance company would evaluate the claim application to make a decision. Insurance companies generally do not provide insurance to high-risk applicants.

The insurer and the insured enter into a legal contract for the insurance, which is called the insurance policy. This contract or insurance policy has details about the conditions and circumstances under which the insurance company will pay out the insurance amount to either the insured person or the nominees.

Insurance is a way of protecting yourself and your family from a financial loss. Generally, the premium for a big insurance cover is much lesser in terms of money paid. The insurance company takes this risk of providing a high cover for a small premium because very few insured people end up claiming the insurance. This is why you get insurance for a big amount at a low price.

NEED FOR INSURANCE

1. Insurance acts as a financial back-up at the time of emergency

None of us what the future holds. Unexpected emergencies such as injury, accidents, illness, and even death can leave you and your family facing tremendous emotional strain. Insurance plans help you emotionally and financially so that you can focus on rebuilding your life.

2. Insurance makes retirement secure

A retirement policy is a type of insurance plan that helps you to save part of your income over a long-term period and makes you financially secure post-

retirement. The accumulated income will be given back to the insured person as a pension.

3. Insurance helps in securing future

Your present life might be stable with a steady income flow that meets your and the family's needs. But life is uncertain. Some unforeseen crises can shake life. Without you, will your family be able to meet the requirements in the future? With the term insurance, you will be securing your family to help them receive a lump sum amount to help them take care of their needs.

4. Insurance encourages savings

Several life insurance plans, such as a money-back policy, help create regular savings by allocating some funds in the form of a premium every year. Unlike a basic life insurance plan that gives money back at the time of maturity, a money-back policy pays an amount to the policyholder after a few years of investing in the policy.

5. Insurance gives peace of mind

Along with financial security, insurance gives you peace of mind. Your home insurance policy will help you get coverage for damages to the home. Your family floater medical insurance plan will cover you and your family at the time of hospitalization. Any insurance plan comes in handy at a time of crisis.

BENEFITS AND IMPORTANCE OF INSURANCE

Insurance is a risk management tool not only benefits the individual and businesses but also benefits the society and economy in numerous ways. Following are some of the important benefits of insurance:

- **Provides peace of mind:**
  Insurance provides protection against various uncertainties that can put you or your family in financial crisis. By covering the uncertainties of human life and businesses, insurance provides a sense of security. Having life insurance gives you peace of mind that the financial stability of your family will remain intact even when you are not around. Having health insurance gives you a sense of

security that you do not need to shell out all your savings in the event of medical emergencies.

- **Promotes risk control:**
  As insurance works on risk transfer mechanism, it promotes risk control activity.
- **Promotes economic growth:**
  As insurance funds are invested in various projects like water supply, power and roads etc, it contributes to the overall economic growth of the nation. Also, insurance provides employment opportunity to people. Insurance contributes to economic growth in many other ways such as getting Foreign Direct Investment, paying taxes on the profit earned and by investing in the capital market etc.
- **Distribution of risk:**
  Risk of insurance is spread across various individuals and organisation instead of concentrating on only one.
- **Helps to get loan easily:**
  There are loan facilities offered against insurance policies. In case of home loans, having an insurance cover can help to get the loan easily from the lender.
- **Inculcates savings habit**:
  There are many life insurance products that come with investment cum protection benefit. Such products inculcate a regular saving habit among individuals. Plans like endowment insurance plans help in achieving long-term financial goals. Pension plans help to receive regular income flow in older age.
- **Provides tax benefit:**
  Insured gets the tax benefits for premium paid depending on the insurance product type. For example, the premium paid towards life insurance plans qualifies for tax deduction under Section 80C of the Income Tax Act. And, the premium paid towards health insurance plans qualifies for tax deduction under Section 80D of the Income Tax Act.
  Following are some of the examples that demonstrate the importance of insurance:

- **Case 1:**
  Ram, a software engineer living in Bangalore meets with an accident and dies on the spot leaving his wife and son in deep emotional shock. He was just 40! He also has a home loan of INR. 30 lakhs running. Luckily, Ram has taken a term insurance cover of INR. 1 Cr. at the age of 32 years for 25 years of the policy tenure. His wife received compensation from the insurance company

within 10 days which helped her pay off the debt and invest the corpus for future needs. If he had not taken the wise decision of investing in life insurance, his family would have been a huge financial crisis today! Insurance is important to secure your family's future.

- **Case 2:**
  Sunil, an employee in a multinational company in Mumbai suddenly fell unconscious due to high fever. He was then rushed to the nearest hospital. He was admitted for 3 days in the hospital for diagnosis and treatment. When he was discharged after 3 days, his hospital bill came up to around INR. 70,000. Luckily, he had taken a health insurance coverage for INR. 3, 00,000. As the hospital was listed in the network hospitals of his insurer, bills were directly settled to the hospital. If he had not known the importance of insurance, he would have to pay INR.70, 000 out of his pocket. Insurance helps you to have financial stability during unforeseen events.
- To conclude, shield your life and important assets against all the uncertainties with the help of insurance. Know what insurance coverages you need, compare and invest wisely. It's important to understand that the need for insurance is to secure what you love.

INSURANCE AND ECONOMIC DEVELOPMENT

Insurance companies assist businesses in reducing risk and protecting their employees:

- As with consumers, assisting businesses in reducing risk can have a long-term positive impact on the economy. Insurance is like the backbone of the economy. Businesses, like consumers, can endure financial hardship as a result of unforeseen obstacles.
- When an unfortunate event strikes, insurance is one of the strongest financial tools businesses have at their disposal to help them deal with the situation. Furthermore, when an employee is hurt on the job, company insurance helps to cover the costs of the person's care as well as any potential salary loss.
- Business insurance also aids in the expansion of a company. At its most basic level, insurance provides a protective safety net that allows organisations to engage in higher-risk, higher-return activities than they would otherwise. These acts assist firms in operating successfully, resulting in more jobs and increased overall economic activity.

Insurance companies provide financial security to customers:

- Consumers have become so accustomed to the routine that they are often unaware of the daily onslaught of risk and uncertainty. Unexpected problems can strike at any time, whether a car accident, house fire, a flooded basement after a major storm, or a work injury.
- By providing crucial financial protection, insurance can assist manage this uncertainty and potential loss. When a calamity occurs, an insurance policy can help consumers get the money they need. Many people in these situations would be financially pressured and possibly bankrupt if it weren't for insurance.

Insurance companies help in the funding of economic development projects:

- Insurance companies often invest the premiums that are not utilised to pay claims and other operating expenses. These investments frequently finance building construction and offer other critical assistance to economic development projects around the country through stock, corporate and government bonds, and real estate mortgages.
- Insurance is about much more than the monthly premiums that individuals and businesses must pay. The insurance business, as a whole, is an important thread in the fabric of a healthy economy.

Insurance has a favourable impact on the financial system's stability:

- One of the most important industries in the service sector is insurance. Insurance firms are an essential component of the financial system. In addition, insurance corporations have a significant role in the formation of state budgets. They are large taxpayers in the state. Taxes, as we all know, make up a large portion of the state budget. As a result, the insurance industry plays a critical role in maintaining the stability of the tax and financial systems.

Insurance provides employment:

- Unemployment is one of the most serious economic issues. This is a problem that many countries are dealing with these days. In most emerging countries, the

number of unemployed individuals is rising. However, the insurance system aids in the resolution of this economic issue by providing employment.

Insurance contributes to an increase in GDP:

- GDP is one of the most important macroeconomic metrics. The volume of GDP is used to determine each country's level of development. People can choose from a variety of insurance plans offered by insurance firms. These premiums are used by insurance companies in the financial and investment operations of the economy. As a result, this process boosts the economy's GDP.
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INSURANCE AS A SOCIAL SECURITY TOOL

Concept of social security

social security refers to protection provided by the society to its members against providential (act of God) mis happening over which a person has no control. in short it is an instrument of social and economic justice.
According to International Labour Organisation (ILO) social security is the security that the society furnishes through appropriate organisation against certain risks to which its members are exposed. these risks are essentially contingencies of life which the individual of small means cannot effectively provide by his own ability of foresight alone or even in private combination with his fellows.

Concept of insurance

Insurance provides protection against unexpected financial losses, so it is a way to manage your risk. When you buy an insurance cover from insurance company, if something bad happens to you due to insured risk the insurance company indemnifies i.e compensates your losses.

However in the Modern Times insurance has emerged as an investment. when you are young you prepare for your old age by opting for specific policies floated for providing financial assistance in old age in the form of regular pension for life in the form of annuities.

Jeevan Akshay, Jeevan Shanti are certain schemes floated by Life Insurance Corporation for providing social security to people in their old age.

Insurance as a social security tool

Today insurance has emerged as a social security cover where:
a common fund is established by employer state and workers out of which all the benefits in cash or kind
The contribution of the workers is nominal which is generally based on the limits of their paying capacity. while the employers and the state provide the major portion of the finances.
Under social security insurance cover, all losses accruing to workers is covered in case of: Medicare, unemployment, accidents at work- disability total or partial, workmen compensation, payment of annuities on retirement.

The major social security requirements in modern India are covered under the following insurance schemes provided by various insurance companies-

National pension scheme
Employees Provident Fund
employees State Insurance
National Health Insurance
Atal Pension Yojana
Maternity Benefit scheme
accident Insurance Scheme
Prime Minister's Vaya Vandana Yojana

Insurance plays a crucial role in alleviating peoples fear of sudden with Fortune by mitigating loss through service/ Finance compensation. it contributes to social protection of citizen by enhancing their social protection and peace of mind.

PRINCIPLES OF INSURANCE

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

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

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

Principle of Utmost Good Faith

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

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

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

Principle of Proximate Cause

This is also called the principle of 'Causa Proxima' or the nearest cause. This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property. If the proximate cause is the one in which the property is insured, then the company must pay compensation. If it is not a cause the property is insured against, then no payment will be made by the insured.

Example –

Due to fire, a wall of a building was damaged, and the municipal authority ordered it to be demolished. While demolition the adjoining building was damaged. The owner of the adjoining building claimed the loss under the fire policy. The court held that fire is the nearest cause of loss to the adjoining building, and the claim is payable as the falling of the wall is an inevitable result of the fire.

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

Principle of Insurable interest

This principle says that the individual (insured) must have an insurable interest in the subject matter. Insurable interest means that the subject matter for which the individual enters the insurance contract must provide some financial gain to the insured and also lead to a financial loss if there is any damage, destruction or loss.

Example – the owner of a vegetable cart has an insurable interest in the cart because he is earning money from it. However, if he sells the cart, he will no longer have an insurable interest in it.

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

Principle of Indemnity

This principle says that insurance is done only for the coverage of the loss; hence insured should not make any profit from the insurance contract. In other words, the insured should be compensated the amount equal to the actual loss and not the amount exceeding the loss. The purpose of the indemnity principle is to set back the insured at the same financial position as he was before the loss occurred. Principle of indemnity is observed strictly for property insurance and not applicable for the life insurance contract.

Example – The owner of a commercial building enters an insurance contract to recover the costs for any loss or damage in future. If the building sustains

structural damages from fire, then the insurer will indemnify the owner for the costs to repair the building by way of reimbursing the owner for the exact amount spent on repair or by reconstructing the damaged areas using its own authorized contractors.

Principle of Subrogation

Subrogation means one party stands in for another. As per this principle, after the insured, i.e. the individual has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property goes to the insurer, i.e. the company.

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

Example – If Mr A gets injured in a road accident, due to reckless driving of a third party, the company with which Mr A took the accidental insurance will compensate the loss occurred to Mr A and will also sue the third party to recover the money paid as claim.

Principle of Contribution

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

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

Principle of Loss Minimisation

This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimise the loss to the insured property. The principle does not allow the owner to be irresponsible or negligent just because the subject matter is insured.

Example – If a fire breaks out in your factory, you should take reasonable steps to put out the fire. You cannot just stand back and allow the fire to burn down

the factory because you know that the insurance company will compensate for it.

WHAT IS RISK INSURANCE

Risk insurance refers to the risk or chance of occurrence of something harmful or unexpected that might include loss or damage of the valuable assets of the person or injury or death of the person where the insurers assess these risks and, based on which, work out the premium that the policyholder needs to pay.

Explanation

Risk Insurance shall involve assessing the price to be paid to Insurance policyholders who have suffered from the loss that occurred to them, which is covered by the policy. It involves various types of risks such as theft, loss, or damage of property or also may involve someone being injured; there is a chance that something unexpected or harmful may happen at any point in time.

It evolves in calculating the pay of the financial value for the damages that might occur to the insured property or item that might be lost, injured, or destroyed accidentally or often occur to happen. It also states how much it would cost to replace or repair such an insured item to cover the loss suffered by the policyholder in case of such damage. Insurers shall calculate claims and evaluate their risks.

Types

The following are the different types of risk in insurance:

#1 – Pure Risk

Pure risk refers to the situation where it is certain that the outcome will lead to loss of the person only or maximum it could lead to the condition of the break-even to the person, but it can never cause profit to the person. An example of pure risk includes the possibility of damage to the house due to natural calamity.

In case any natural calamity occurs, it will damage the house of the person and its household items, or it will not affect the person’s home and household items. Still, this natural calamity will not give any profit or gain to the person. So, this will fall under the pure risk, and these risks are insurable.

#2 – Speculative Risk

Speculative risk refers to the situation where the direction of the outcome is not specific, i.e., it could lead to a condition of loss, profit, or break-even. These risks are generally not insurable. An example of speculative risk includes the purchase of the shares of a company by a person.

Now, the prices of the shares can go in any direction, and a person can make either loss, profit, or no loss, no profit at the time of the sale of those shares. So, this will fall under the Speculative risk.

#3 – Financial Risk

Financial risk refers to the danger in which the outcome of the event is measurable in terms of the money, i.e., any loss that could occur due to the risk can be measured by the concerned person in monetary value. An example of the financial risk includes a loss to the goods in the warehouse of the company due to the fire. These risks are insurable and are generally the main subjects of the insurance.

#4 – Non-Financial Risk

Non-Financial risk refers to the risk in which the outcome of the event is not measurable in terms of the money, i.e., any loss that could occur due to the risk cannot be measured by the concerned person in the monetary value. An example of the non-financial risk includes the risk of poor selection of the brand while purchasing mobile phones. These risks are uninsurable since they cannot be measured.

#5 – Particular Risk

Particular risk refers to the risk which arises mainly because of the actions or the interventions of the individual or the group of some individuals. So, the origin of the particular risk by individual-level and impact of the same is felt at a localized level. An example of a specific chance includes an accident on the bus. These risks are insurable and are generally the main subjects of the insurance.

#6 – Fundamental Risk

Fundamental risk refers to the risk which arises due to the causes which are not under the control of any person. So, it can be said that the fundamental risk is impersonal in its origin and the consequences. The impact of these risks is

essentially on the group, i.e., it affects the large population. The fundamental risk includes risks on the group by events such as natural calamity, economic slowdown, etc. These risks are insurable.

#7 – Static Risk

Static risk refers to the risk which remains constant over the period and is generally not affected by the business environment. These risks arise from human mistakes or actions of nature. An example of static risk includes the embezzlement of funds in a company by its employees. They are generally easily insurable as they are easy to measure.

#8 – Dynamic Risk

Dynamic risk refers to the risk which arises when there are any changes in the economy. These risks are generally not easy to predict. These changes might bring financial losses to the members of the economy. An example of the dynamic risk includes the changes in the income of the persons in an economy, their tastes, preferences, etc. They are generally not easily insurable.

DOUBLE INSURANCE

Double insurance refers to insurance where the same subject matter is insured twice or more than that. In such scenarios, the same subject is insured but with different insurance companies. The concept of Double insurance is not illegal at all. Double insurance come to light when a business avail insurance w.r.t the same risk and subject matter from two different insurers. This write-up will explore different instances where double insurance may occur and the real-life implications for businesses

General principles of Double Insurance

- The first point on concurrent insurance is that, in principle, a business entity should not be left without an insurance payment. Where there is a presence of double insurance, & a **business[1]** entity intends to claim w.r.t a loss covered by more than one policy, it will be entitled to claim whichever insurance policy it prefers.
- The insurance company that does not dispense cover w.r.t the double insured risk can approach other insurers for the contribution which has rendered similar cover.

- Therefore, if a business does claim under one insurance policy & not the other, the insurance company that has not paid out probably has to pay a share to the insurer who has paid out.

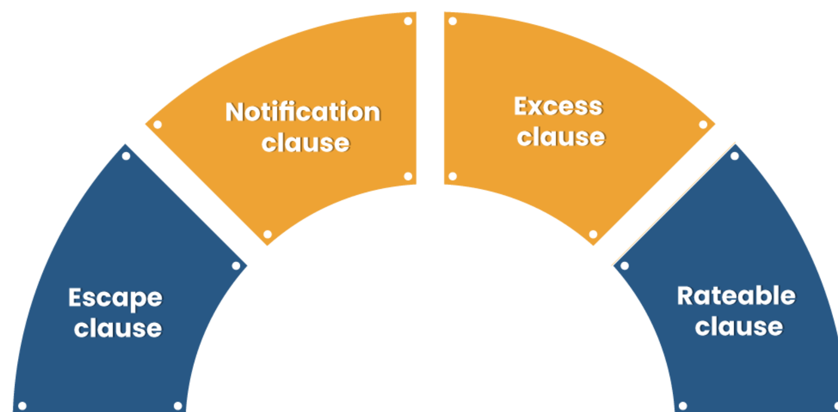
So why this trigger issues for insured's?

First, various insurance policies entail clauses that deter an insured from claiming under the insurance policy if another policy covers the identical loss. If one insurance policy entails this term, there are no issues because the insured can claim on another policy (The right of contribution will cease to exist between insurers as there is no double insurance).

If either of the policies entails such a clause, then there is no issue for the insured, as the clauses cancel each other & the insured can claim in both insurance policies for its loss (with the paying insurance policy claiming a contribution right from another insurance company).

The issue is that the term of these 'other insurance' clauses is not standard & this can leads to disagreement between insurers as to which insurance policy should respond, leaving the business waiting for a claim..

The legality of double insurance revolves around the following clauses:



Escape clause: The escape clause allows the insurers to reject any claim request if they found that the insured is levering another policy that renders the same benefits.

Notification clause: The notification clause mandates the insurer to make prior intimation to the insurer regarding the existence of the alternative policy, failing to which policy will be cancelled.

Excess clause: Excess clause talks about the disbursement of the actual claim amount that comes out after subtracting the claim sum that already has been availed by the insured from another insurer.

Rateable clause: This clause prevents insurers from dispensing the entire claim amount to the insured in the case of Double insurance.

Double insurance = Indemnity + insurance?

It is important for the company to be cautious when contractual indemnities are given w.r.t the risk that the insurance company may also encompass.

In some scenarios, it is aimed that the indemnity is called on first with the insured then claiming on insurance. For instance, with directors & officers liability insurance, the entity is often needed to indemnify the directors & then seek reimbursement under the insurance policy.

But, in other scenarios, the indemnity may be aimed to be an alternative to the insurance. In these scenarios, make sure that the indemnity is not caught by 'other insurance' norms or that indemnity arrangement don't render insurers with scope to argue that there ought to be a contribution right by the insurer against the indemnifier.

DIFFERENCE BETWEEN REINSURANCE AND DOUBLE INSURANCE

BasisofDifference	Double Insurance	Reinsurance
Meaning	In double insurance, the identical risk is protected with distinctive insurers or more than one insurance company	In the reinsurance, the risk is transferred to another insurer. The risk remains the identical.
Subject	This insurance is predominately secured for properties having a high worth.	This insurance encompasses the risk of the original insurance company.
Claim	You can make a claim to all insurers for compensation	In this insurance, claim is sought from the original insurer & it will claim from the reinsurer
Loss	The loss shall be shared by all the insurers	The reinsurer shall only be entitled to pay the proportion of the insurance.
Goal	The primary goal of double insurance is to render the benefit of insurance.	The primary goal of this insurance is to minimise insurer's risk.
Interest of Insured	The insured possess an insurable interest in such kind of plan.	The insured lacks insurable interest in such kind of plan.

OVER INSURANCE

Over-insurance can be described as having excess insurance coverage/policies that covers the same risk or having insurance cover in excess (more than) of the value of the possible loss that the insured can experience. Over-insurance occurs when an individual or a business has insurance cover in excess of the value of the risk(s) covered/insured. In simple terms, this means that an individual or a business has insurance cover which exceeds the actual value of the insured asset (for example, (1) a property with a market value of N$ 2.5 million is insured under an insurance policy for N$ 4 million or (b) a vehicle with a market value of N$ 150,000.00 is insured for N$ 250,000.00). Most over-insurance cases are common in the short-term insurance market, however, over-insurance may also occur in the long-term insurance market, although, generally it is difficult to place a value on the life of a person. There are however, long-term insurance scientific underwriting principles used by long-term insurance companies to determine over-insurance for life cover and disability benefits.

Additionally, over-insurance can also occur if an individual or business has more than one short-term insurance policy covering the same risk.

WHY IS OVER-INSURANCE A PROBLEM?

Over insurance poses a moral hazard on the insured/policyholder, for example, if the insured would end up making a profit from the loss that can potentially motivate the insured to intentionally cause the loss in order to make or realize a profit. If the insured is merely placed back into his or her original financial position, and there is no profit to be realized from the loss, it is expected that such status quo is also likely to discourage the insured from making efforts or intentionally initiate an insurance claim by prompting a fictitious loss.

Some insurance policies have limits on an insured and should the insured suffer a loss, the insurer only pays out up until the maximum limit and should the insured have two or more policies say on a vehicle, only one policy shall become payable. In this case, the insured looses out on the insurance premiums paid for the insurance cover over the period. Furthermore, having too many insurance policies/covers and paying a lot of insurance premiums could strain the policyholder's finances as the policyholder will have a low disposable

income and will lose out on the interest that could have been earned had the money been invested in other investment instruments.

STEPS TO PREVENT OR ADDRESS OVER-INSURANCE

Consumers need to be pro-active with their insurance and financial needs. It is your responsibility to ensure that your insurance policies are taken out for the correct value and that you do not have excessive policies. You can do so by visiting your insurance agent or broker at least once a year to re-asses your financial needs as well as the value of your properties to ensure that you have appropriate insurance policies/covers proportional to the value of your asset(s).

OVER INSURANCE

In case of over insurance a situation arises where insurance cover has been taken for the value which exceeds the actual cash value of the insured risks. It can be also known as the replacement value. In case of over insurance the insurer companies have to be very careful at the time of selling the insurance policy.

The insurance company in case of over insurance can bear much losses as the insured may be tempted to make false claim with a view to gain profit from the loss insured at over value. Over Insurance results into compensation to be paid by the insurance company in excess of the actual loss incurred by the insurer either by false claims or due to over valuation of the insured assets.

Many insurance companies have lately devised methods to prevent over insurance particularly in group health insurance or medi claim insurance. Recently in India it was observed that certain hospital in connivance with TPAs of respective insurance companies are staking claims for medical treatment of insured persons at much higher rates because of which many insurance companies are facing loss.

With the result many insurance companies have stopped cashless facilities because of this reason. These companies are bent upon to decide some basic modalities to provide cashless medical insurances. Inspite of taking many steps

to control the problem of over insurance there remains many type of insurance products subjected to over insurance abuse.

In fact it is duty of insured to purchase an insurance policy for the correct amount. For example if some get insurance of a factory valued at Rs. 100000/-(one lac only) for Rs. 150000/-(one lac fifty thousand). It is over ensured. But in case of any miss happening the insured must be under the impression that he would be compensated for the amount insured i.e., Rs. 150000/-. and shall gain the profit of Rs. 50000/-.

But coming down on the actual grounds it is found that the insurance company has it own methods to gauge the loss actually incurred and shall be liable to pay the market value of the loss only which is Rs. 100000/- only. In such cases the insured forgets that he had been paying insurance premium at the more higher rates instead of actual rate of premium per month.

In case any loan has been raised from any bank or financial institution it shall create more problems because due to the inflated inventory submitted to the bank the loan amount might have increased, whereas the actual value of the insured stock is less than the amount of loan.

In such cases the insurance company shall first pay to the bank or financing company and the remaining amount shall be born by the insured for obtaining insurance cover over and above the actual or market value.

UNDER INSURANCE

Under Insurance is to purchase an insurance policy for the value less than the actual or market value. Most of people are tempted to save on tine part of paying monthly premium.

Higher the insurance amount and higher the amount of premium keeping this fact in view and without going into the details of agreement of insurance (Insurance policy) people mostly on the advise of the insurance broker opt for the under insurance without keeping in mind the final consequences of such under insurance.

Under insurance is when the amount of insurance cover is less than the actual value of the insured items. It may also be less than the replacement value of the insured items. For example if a property of the actual and market value for Rs. 100000/- is insured for Rs. 50000/- only it is a case of under insurance.

In such a case the insured shall be required to pay the premium for sum assured of Rs. 50000/- only in place of Rs. 100000/-. Naturally the amount of premium shall less than what was required to be paid had the property been insured for full value of Rs. 100000/-.

Sometimes under insurance is done voluntary and willingly, but in many cases it can be ignorance or inability of insured to estimate the true and market value for replacement of insured property in case any loss or damage caused to the property.

Under insurance is neither beneficial to the insured nor to the insurance company. Both are at loosing feet. In case of any major disaster to the insured property because of any reason the insured person shall not be compensated with full value and only the sum amount insured shall be paid by the insurance company which shall not enough to replace the lost property or items.

Definition of 'Reinsurance'

Definition: It is a process whereby one entity (the reinsurer) takes on all or part of the risk covered under a policy issued by an insurance company in consideration of a premium payment. In other words, it is a form of an insurance cover for insurance companies.

Unlike co-insurance where several insurance companies come together to issue one single risk, reinsurers are typically the insurers of the last resort. The insurance business is based on laws of probability which presupposes that only a fraction of the policies issued would result in claims.

As a result, the total sum insured by an insurance company would be several times its net worth. It is based on this same probability of loss that insurance companies fix the insurance premium. The premiums are fixed in such a manner that the total premium collected would be enough to pay for the total claims incurred after providing for expenses.

However, there is a possibility that in a bad year, the total value of claims may be much more than the premium collected. If the losses are of a very large magnitude, there is a chance that the net worth of the company would be wiped out. It is to avoid such risks that insurance companies take out policies. Secondly, insurance companies take the support of reinsurers when they do not have the capacity to provide a cover on their own.

Broadly, reinsurance can be classified under two heads - treaty reinsurance and facultative reinsurance.

1. Treaty Reinsurance: Within this type of reinsurance, the reinsurer agrees to provide blanket coverage for all the policies written as well as those that have not been written by the insurer company for a specified duration of time. It can often prove risky for the reinsurer in case they have not studied all the policies issued by the insurer in depth.

2. Facultative Reinsurance: With this kind of reinsurance, a reinsurer offers coverage on each particular policy as a single transaction. Since the policies are not grouped together here, it offers the reinsurer greater scope to carefully analyze their risks and then undertake as to whether they wish to cover a part of the policy or the entire policy.

Most reinsurance policies are made on a proportional basis, wherein the reinsurer agrees to receive a certain proportion of the premiums collected for the policies it has undertaken the risks for.

Reinsurance is helpful for the insurance industry in several ways. Read on to learn more about how reinsurance helps the industry.

1. Reinsurance enables insurance companies to stay solvent by restricting their own losses. Sharing the risks with a reinsurer enables companies to honour the claims raised by people without being worried about too many people raising claims at the same time.

2. The main benefit of reinsurance lies in the insurer restricting losses to their own balance sheets. This situation is likely to arise in times of natural calamities when too many claims are raised at the same time, and insurers might be required to settle them all.

Reinsurance is especially helpful for the insurance industry at times when people can just buy online term plans which offer a range of benefits from the comfort of their own home. With the iSelect Star Term Plan, available on Canara HSBC Oriental Bank of Commerce, you can customize your plan and even get a discount on the premium you pay for insuring your spouse.

REFERENCE & CREDITS

1. Various educational Websites.
2. https://indiafreenotes.com/
3. https://bbamantra.com/bba-notes/

PREPARED & COMPILED BY:- VIBHOR KUMAR