PRINCIPLES OF INSURANCE CONTRACT

Insurance may be defined as a Contract between two parties of which one party called INSURER undertakes, in exchange for a fixed sum called PREMIUMS, to pay the other party called INSURED a fixed amount of Money on the happening of a Certain Event

The INSURANCE CONTRACT INVOLVES

(A) THE ELEMENTS OF GENERAL CONTRACT Pg 41–42 Arif Khan

1. Agreement
2. Legal Relationship
3. Lawful Consideration
4. Capacity of Parties.
5. Free & Genuine Consent.
6. LAWFUL Object
7. Agreement Not Declared VOID
8. Certainity & possibility of Performance
9. Legal formalities.

(B) ELEMENTS OF SPECIAL CONTRACT RELATING TO INSURANCE

1. Insurable Interest
2. Utmost Good faith Uberrimae Fidei
3. Indemnity
4. Subrogation
5. Proximate Cause
6. mitigation of Loss

DEFECTIVE CONTRACTS

A Contract which does not fulfill the criteria mentioned above (Elements of a General Contract) becomes a defective Contract. a defective Contract does not have any Legal binding/enforcement

1. VOID CONTRACT – A contract which legally does not Exist is called a void contract. In other words, "a Contract which ceases to be enforceable by law becomes VOID when it ceases to be enforceable.

It is Valid when it is entered into, but something happens after that, which makes the contract VOID.

2. <u>VOIDABLE CONTRACT</u> – When Either parties of the Contract is in BREACH of the Essential terms of the Contract, the other party has a right to consider the contract VOID. Also note that IF the Aggrieved party chooses to "overlook the Breach" or to "Waive the Breach", the contract will remain un-affected and remains in full force.

3. <u>UNENFORCEABLE CONTRACTS</u> – These contracts are the ones which are neither VOID, NOR VOIDABLE but which cannot be enforced through the courts, as <u>for Example</u>, An Insurance Policy without proper STAMP-DUTY cannot be produced as evidence of contract in Court.

UnEnforceable Contracts are fully VALID Contracts but the parties cannot enforce them through the courts.

4. <u>ILLEGAL AGREEMENTS</u> – Illegal agreements are those agreements, which involve the breaking of some Rule of basic public policy and are CRIMINAL in nature.

An Illegal Agreement is not only VOID, but also punishable under Law.

RISK

Risk means uncertainity concerning loss, and not the loss itself, or the cause of loss, or the chance of loss.

Risk involves uncertainity about the effects / implications of an activity with respect to something that humans value. such as health, well being, wealth, property etc)

RISK Vs UNCERTAINITY

	RISK	UNCERTAINITY
1.	Risk is a situation where there is a possibility of loss	Uncertainity means a situation where the outcome is not certain
2.	Risk can list all possible outcomes.	Uncertainity cannot list all possible outcomes.
3	Risk Assign all the probability to outcomes	Uncertainity cannot.

DOUBLE INSURANCE

When the subject matter of Insurance is Insured twice its called Double Insurance. This can be either with two different companies or with same company under two policies.

The Question of Double Insurance does not arise in the case of Life Insurance as it is not a contract of INDEMNITY we cannot assess the value of a LIFE hence a customer (INSURED/PROPOSER) can take/purchase as much life cover as he wants, and on happening of the Event of Insurance, the Insurer (Insurance Co.) is bound to pay the sum Insured to the nominee, provided all the terms of Insurance contract are fulfilled timely.

Example If Mr. X has taken 3 Insurance from 3 different companies

$$\frac{5\text{ lacs}}{\text{HDFC}} + \frac{5\text{ lacs}}{\text{LIC}} + \frac{15\text{ lacs}}{\text{Bajaj Allianz}} = \frac{25\text{ lacs}}{\text{TOTAL}}$$

in case of Death of Mr. X, his nominee will be paid full 25 lacs combined by all 3 insuring companies.

In case of INDEMNITY CONTRACTS (Like Fire, marine, property) when the same subject matter has been insured with more than one Insurer, the Insured can claim his loss from each of the Insurers, but the total claim can in no case exceed the amount of actual loss or the total Insured value in the aggregate, whichever will be smaller. Each Insurer is bound to contribute proportionally to the amount for which he is liable under the Contract. and as such if any of the Insurer pays more than his legitimate share, he is entitled to a contribution from the other Insurers. The insured will not be entitled to benefit from over insurance he has taken.

Example

Mr X (insured)

	HDFC	LIC	BAJAJ ALLIANZ	ICICI LOMBARD
Sum insured:	Rs 1,00,000	Rs 1,00,000	Rs 1,00,000	Rs 1,00,000

Now suppose Mr. X has a loss to his property of the Value = 40,000/.

	HDFC	LIC	BAJAJ ALLIANZ	ICICI LOMBARD
∴ Claim ⇒	10,000	Rs 10,000	Rs 10,000	Rs 10,000

REINSURANCE

It is an arrangement whereby an insurer who has accepted insurance lays off part of his own risk with another insurer in order to reduce his own liability.

Example

Suppose Mr X (insured) wants an Insurance of Rs 50 crore, but M/s A (Insurer) has the capacity to Insure upto only Rs 25 crore, he can choose to either accept or reject to Do the insurance of Mr X. If he chooses to go Ahead with the Insurance deal, he may choose to do an insurance of Rs 25 crore from his own Company, and choose to involve M/s B (2nd Insurer) in the contract and M/s B will cover the value of Rs 25 crore for the Insured i.e. Mr X. So when a claim of Rs 50 crore will come, both the insurers, A & B will pay their share of Rs 25 crore each

OVER INSURANCE

If the Sum assured is for more than the actual value of the property and the financial interest of the insured is in that property, then it is a situation of over Insurance.

Example Value of property: Rs 1,00,000
Insured Value: Rs 1,25,000

In this case if the loss to the property happens, the Insurance company is only Liable to pay upto Rs 1,00,000 ONLY even when the Insured has purchased the Insurance of 1,25,000. Because as per the Principle of Indemnity Insurance is not a contract of making profit. The purpose of Insurance is to bring back the insured in the same financial position as he was before the loss. Hence even if the Insured Value is of Rs 1,25000/- the Insurance company is not Liable to pay more than Rs 1,00000 which is the actual value of the property.

Hence we understand there there is no point taking over insurance and paying a higher premium than required.

UNDER INSURANCE

If the sum insured is less than the actual value of the property, at the event of claim, it may result in Economic Loss

$$\text{claim} = \frac{\text{Insured Value} \times \text{Actual Loss}}{\text{Value of Property.}}$$

Suppose Property Value = 1,20,000
Insured Value = 80,000
Actual Loss = 48,000

$$\therefore \text{Claim} = \frac{80{,}000 \times 48{,}000}{1{,}20{,}000}$$

$= Rs 32,000/-$.

Thus we see that for a loss of Rs 48,000/- the insured will only get Rs 32,000 ∴ his loss will be of Rs 16,000 which he will have to bear from his Pocket even after taking Insurance of Under Insurance.