Model Answer **Fundamentals of Insurance**

B. Com (Hon's) (Fifth Semester) Examination, 2013

Paper Title: Fundamentals of Insurance

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Note: These model answers are a depiction of important points which an examinee must have to mention to secure high marks in particular question. The length of the answer may vary as per the examinee's understanding, interpretation and his/her ability to comprehend the content.

Ans.1 Short Answer Type Questions

(i) **Joint–Life Policy:** This policy covers more than one life under a single policy. Under this plan, the sum assured is payable on the expiry of the term or on the death of one of the assured lives during the endowment period.

(ii) **(ii) Subject Matter:** Anything in respect of which we purchase an insurance policy (to protect ourselves against the risk of loss) may be the subject matter of insurance.

(iii) Insurable Interest: The doctrine of insurable interest states that, in order to have a valid policy of insurance/assurance, the policyholder must:

(1) Gain a benefit from the continued existence of the item being insured; or

(2) Suffer a loss on its destruction.

Without insurable interest a contract of insurance or life assurance is void.

(iv) Proximate Cause: The rule of 'proximate cause' means that the cause of the loss must be proximate or immediate and not remote. If the proximate cause of the loss is a peril insured against, the insured can recover. When a loss has been brought about by two or more causes, the real or the nearest cause shall be the proximate cause.

(v) Benefits of Fire Insurance:

- Fire insurance protects us financially from the loss of our possessions, home & business.

- Fire insurance also makes good the consequential losses suffered as a result of fire, if specifically covered within the terms of the policy.

(vi) Average Policy: An average policy is one which contains the average clause. This clause required the insurance company to pay only that portion of the loss which is borne by the insured amount to the actual value of the subject matter of the insurance. For example a value of the property is Rs.1,00,000. It is insured for Rs.60,000 (60% of the total value) and the amount of loss is Rs.60,000. The insurance company will not pay Rs.60,000 to the policyholder but will pay Rs.36,000 (60% of Rs.60,000).

(vii) Annual Policy: The Annual Policy is issued for a period of 12 months to cover goods belonging to the assured. If a business involves regular dispatch of goods throughout the year, and the quantity can be reasonably estimated in advance, an annual policy can be obtained on the basis of estimated annual dispatches.

(viii) Characteristics of Social Insurance

- Social insurance is based on the law, rather than on contract. Cost and benefit are established by and can be changed by government.
- The focus of social insurance is to provide maximum benefits to the lower income groups. Unless lower income groups are subsidized to high income groups, the payments of the former will not be large enough to furnish the minimum level of protection that are desired.

(ix) Personal Accident Insurance: Personal Accident Insurance provides an ideal protection against death or disability. It provides for specific benefits of insured person suffering injury, resulting in death or disablement arising solely and directly from an accident caused by violent external and visible means.

(x) Benefits of Crop Insurance:

1. If the farmers do not get a standard amount of product, from the farms; they are compensated by insurance companies under crop insurance.
2. If the farmers are unable to get minimum required price for their product they are compensated under crop insurance scheme.

Ans. 2

a) **Principle of Subrogation:** The doctrine of subrogation refers to the right of the insurer to stand in the place of the insured, after settlement of a claim, in so far as the insured's right of recovery from an alternative source is involved. If the insured is in a position to recover the loss in full or in part from a third party due to whose negligence the loss may have been precipitated, his right of recovery is subrogated to the insurer on settlement of the claim. The insurer, therefore, recover the claim from the third party. If the damaged property has any value left, or any right against a third party, the insurer can subrogate the left property or right of the property because if the insured is allow to retain, he shall have realized more than the actual loss, which is contrary to principle of indemnity.

b) Principle of Contribution: 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. This principle of contribution enables the total claim to be shared in a fair way. The doctrine of contribution operates as a corollary of the doctrine of Indemnity and hence is applicable in case of general insurance. 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 ratable proportion of the loss. The amount of total compensation or indemnity provided to the insured by all the insurers should not exceed the amount of loss.

Ans. 3 Re-insurance: Re-insurance is a transaction in which one insurer agrees for a premium, to indemnify another insurer against all or part of the loss that insurer may sustain under its policy or policies of insurance. The company purchasing Re-insurance is known as the ceding insurer; the company selling Re-insurance is known as the assuming insurer, or, more simply, the Re-insurer. Re-insurance can also be described as the "insurance of insurance companies".

Difference between Re-insurance and Double Insurance

Sl. No.	Double Insurance	Re-insurance
1	Insured purchase more than one policy.	Insured purchase only one insurance policy.
2	An insured can get insurance policy from more than one insurer for the same subject matter.	For the purpose to reduce the risk insurer purchase the insurance policy form another insurer/insurers.
3	Insured wants to make his life more secure.	Insurer wants to make his position more secure.
4	The term and condition of insurance may vary company to company.	The term and condition of the insurance is same as fixed by the first insurer in the main policy.
5	The date of maturity of policy in case of life insurance may be differ company to company.	The whole amount of insurance is payable at the same time.
6	All the insurance companies are under obligation for payment of the claim.	The insured can claim to the ceding insurer only not the Re-insurer.
7	The owner of the goods him/herself gets the insurance policy from more than one company.	The risk bearer company gets the insurance policy from Re-insurer for the goods whose owner is somebody else.

8	It is the duty of the policyholder to inform all the insurer in case of loss of the goods.	The owner of the goods has no knowledge about the fact of Re-insurance. That's why he will inform to the ceding insurer only.
9	All the insurance companies are in obligation to bear the loss proportionately.	In case of Re-insurance the amount of loss is borne by ceding insurer and Re-insurer both. Insured will get the entire amount from ceding insurer.

Ans.4 *"Life insurance is an insurance against dying too soon."* Life insurance, usually referred to as "life assurance", insures the insured against the happening of certain event i.e. death through the time when it may happen is uncertain. The life insurance contract can be described as 'contingent contracts' because the loss of life can't be compensated and only a specified sum of money is paid if the insured dies. The basic purpose of life insurance is to protect the family from the economic hardships after the death of the bred-winner member of the family. People usually purchase Term policies to secure their families in case of their unforeseen or premature death. Some Term policies also provide protection against permanent or partial disability. The main advantage of term policy is that it is very economical and easily affordable even by low income people. So we can say that Term policy is the ideal policy of life insurance because it provides security to that segment who really need the protection. People also purchase Whole-Life Policy who likes to secure a lump-sum amount to their dependents after their death. The basic difference between the Term and Whole-Life Policy is that Term policy provides security for a certain specified period for which policy has been purchased. On the other hand Whole-Life Policy promises to give the sum assured at any time on the occurrence of death irrespective when it occurs.

"Endowment insurance is an insurance against living too long". People are the most hopeful creature on the earth. They like to live a long life happily. The people who are able to fulfill all the responsibilities of their life on time can be said a happy and successful people. As nothing

can be done without money so we can say that we must have money on every walks of our life to fulfill our various responsibility such as marriage of daughter, education of children, meet the various contingencies like serious disease, accidents etc. People also need money for their old age so that they will not have to depend on anybody for their livelihood. For fulfilling all the above purpose we can purchase Endowment insurance policy as the basic purpose of Endowment insurance is to safe our future by the way of early investment. Endowment policies which can be purchased to meet these obligations are:

1. Joint Life Endowment Policy
2. Double Endowment Policy
3. Fixed Term Marriage Endowment Policy
4. Educational Annuity Policy
5. Triple Benefit Policy
6. Anticipated Endowment policy
7. Children's Deferred Endowment Policy

At present, insurance companies are selling an ideal combination of investment plus family protection cover in the mode of various products. We should decide how much amount of protection and how much amount of investment we need, accordingly we can purchase the insurance product from the insurance market.

Ans. 5 The Accumulation Approach:

Under this approach, surrender value is the accumulation of overcharges in the net premium, which upon the surrender of the policy is no longer required to pay the amount of claims, therefore, theoretically he should pay all the accumulated reserve but if it is allowed, the insurer will be left a very small amount for meeting other obligations because a huge expenses are involved at the time of surrender.

The accumulation approach is very scientific because it allows surrender values to all types of policies, whereas, in practice surrender values on the term policies and pure endowment policies are not allowed because there the question of payment may or may not arise. Had the surrender

values allowed on these policies, the insurer may be losing when claims would not arise on the policies.

The accumulation approach regards reserve for policy as the basis of distribution of surrender values. The reserve is calculated in this case on gross premium. So the expenses are also deducted from the premium received.

Thus, the reserve would be equal to all the premiums paid and interest earned thereon minus shares of death claims and of over all expenses of the insurer.

The surrender value can be the largest amount which the insurer can pay without going into loss. The full amount of reserve to a particular policy cannot be given as a surrender value because there are certain expenses and loss because of surrendering the policies. Thus,

Surrender Value = Full Reserve-Surrender Charges

Forms of Payment of Surrender Value:

- Cash Surrender Value
- Reduce Paid-up Insurance
- Extended Term Insurance
- Automatic Premium Loan
- Purchase of Annuity **[Proper Explanation is required]**

Ans. 6 Insurance on the risks of transportation of goods is one of the oldest and most vital forms of insurance. The value of goods shipped by business firms each year cost millions of rupees. All types of ocean going vessels and their cargo, the legal liability of ship owners and cargo owners can be insured by ocean marine contracts. Marine insurance contract being a contract should firstly satisfy the essential elements of a valid contract then after it should also fulfill the insurance principles as applicable to marine insurance.

- **Insurable interest:** For an insurance contract to be valid, the insured must possess an insurable interest in the subject matter of insurance. The insurable interest is the pecuniary interest where the policy holder is benefited by the existence of the subject

matter and is prejudiced by the damage of the subject matter. "*In the case of Marine Insurance the insured may not have insurable interest at the time of contract but he must have the reasonable expectations of acquiring it and it must exist at the time of loss.*" It is essentially required that something must exist which may be exposed to marine perils and there must be some legal or justified relationship which imply a benefit to the holder by its preservation and the insured is affected by its damage/loss/detention or occurrence of a liability in connection thereof.

- **Utmost Good-Faith:** The insured is bound to disclose all material facts to the insurer before the contract is entered into. For example: If an equipment is transported and insurance cover was obtained as such implying as is a new one and actually the equipment is one which has been renovated, the insurer may cancel the contract as it was a concealment of fact. The duty of the Utmost Good Faith applies also to the insurer. If this is not observed by either of the parties, the contract can be avoided by other party.
- **Indemnity:** The principle of indemnity implies that on the happening of an event insured against, the insured will be placed by the insurer in the same pecuniary position that he occupied immediately before the event. In marine insurance indemnity depends on the contract. In case of valued policy, the measure of indemnity is the agreed value. However in case of unvalued policies, unless provided, the indemnity has to be calculated as per the provision of the sec 18 of marine insurance Act, 1993. Indemnity valuation is difficult because value of cargo keeps on changing and its value increase the more and more it gets closer to destination.

Ans. 7 The fire insurance contract, principle and practice are governed by the conditions contained in the policy. The conditions must be fully complied with to make the insurer liable under the contract. The conditions may be implied or express.

Implied Conditions: The following conditions are implied conditions in fire insurance.

- Existence of Property
- Insured Property
- Insurable Interest
- Good Faith

- Identity

Express conditions: The express conditions in fire insurance are as under:

- Misdescription
- Alteration
- Exclusions
- Fraud
- Claim
- Reinstatement Clause
- Insurer's Rights after a Fire
- Arbitration
- Purchaser's Interest Clause
- Loss Procedure
- Contribution and Average **[Proper explanation of all the points is required]**

Ans. 8 The insurance sector has been mostly confined to cities. However, in the rural areas where human life and income-generating rural assets need more protection, there is tremendous scope for developing insurance business. Rural areas having 70 percent of total population, livelihood to two-third of the total population, supply of raw materials to industrial production and other economic activities have compelled the insurance sector to make the insurance companies enter in the rural population. Crop insurance, cattle insurance, life and property insurance have abundant scope of development in rural areas.

Types of Rural Insurance Policies:

- **Crop Insurance**
- **Cattle and Livestock Insurance**
- **Poultry Insurance**
- **Rural Property Insurance**
    1. Agricultural Pump Set Policy
    2. Animal Driven Carts Insurance

3. Hut Insurance
4. New Well Insurance

- **Package Insurance**
  1. Composite Package Insurance
  2. Farmer's Package Insurance

[Proper explanation is required]

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