Banking, Insurance and Risk Management

MBA

III SEMESTER

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UNIT–I

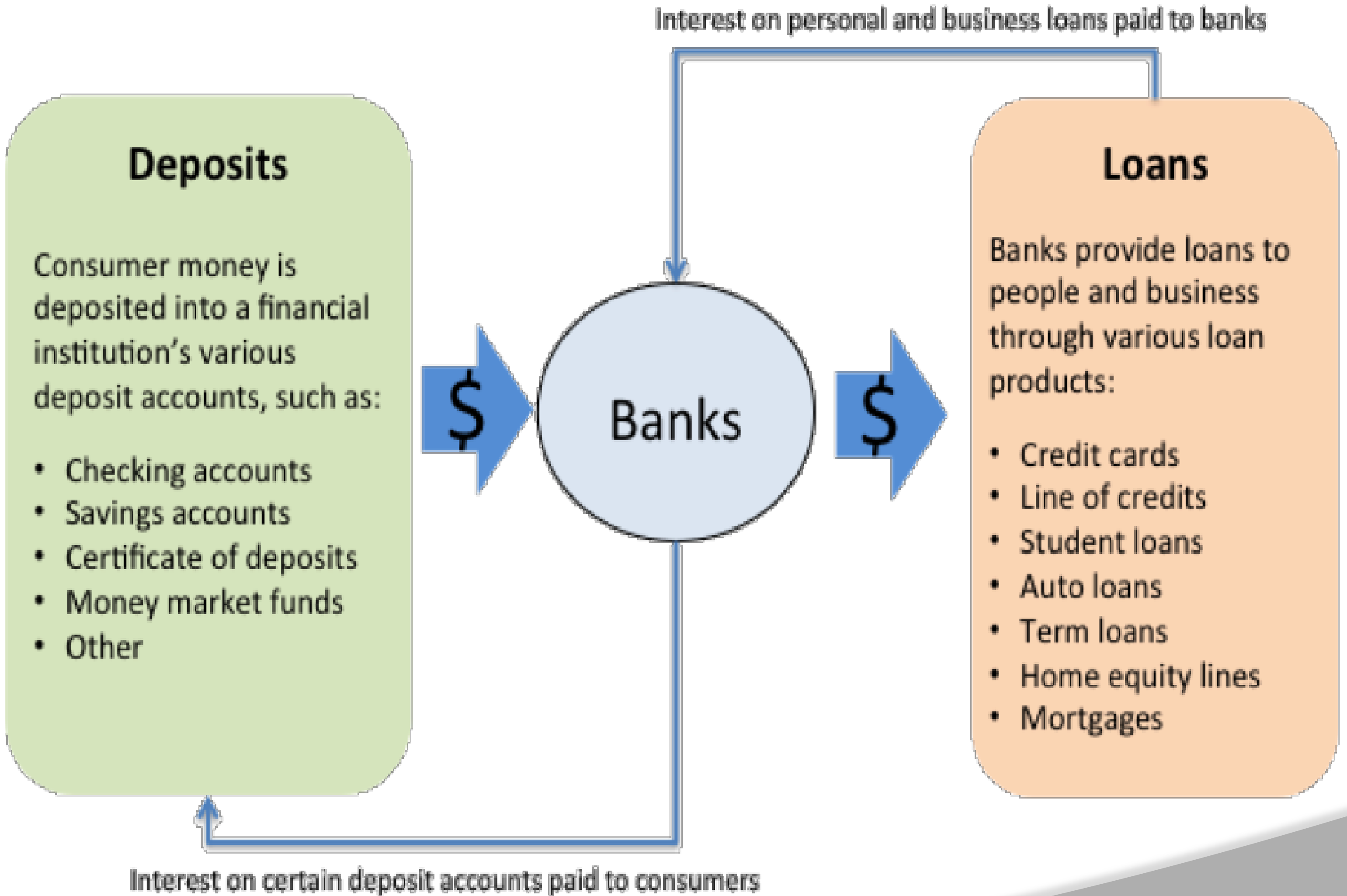
Introduction to banking sectors, History of banking business in India, Structure of Indian banking system, Types of accounts, advances and deposits in a bank, New dimensions and Products, E-banking, Mobile banking, Net banking, CRM, Cheque system and KYC system

Introduction to banking sectors

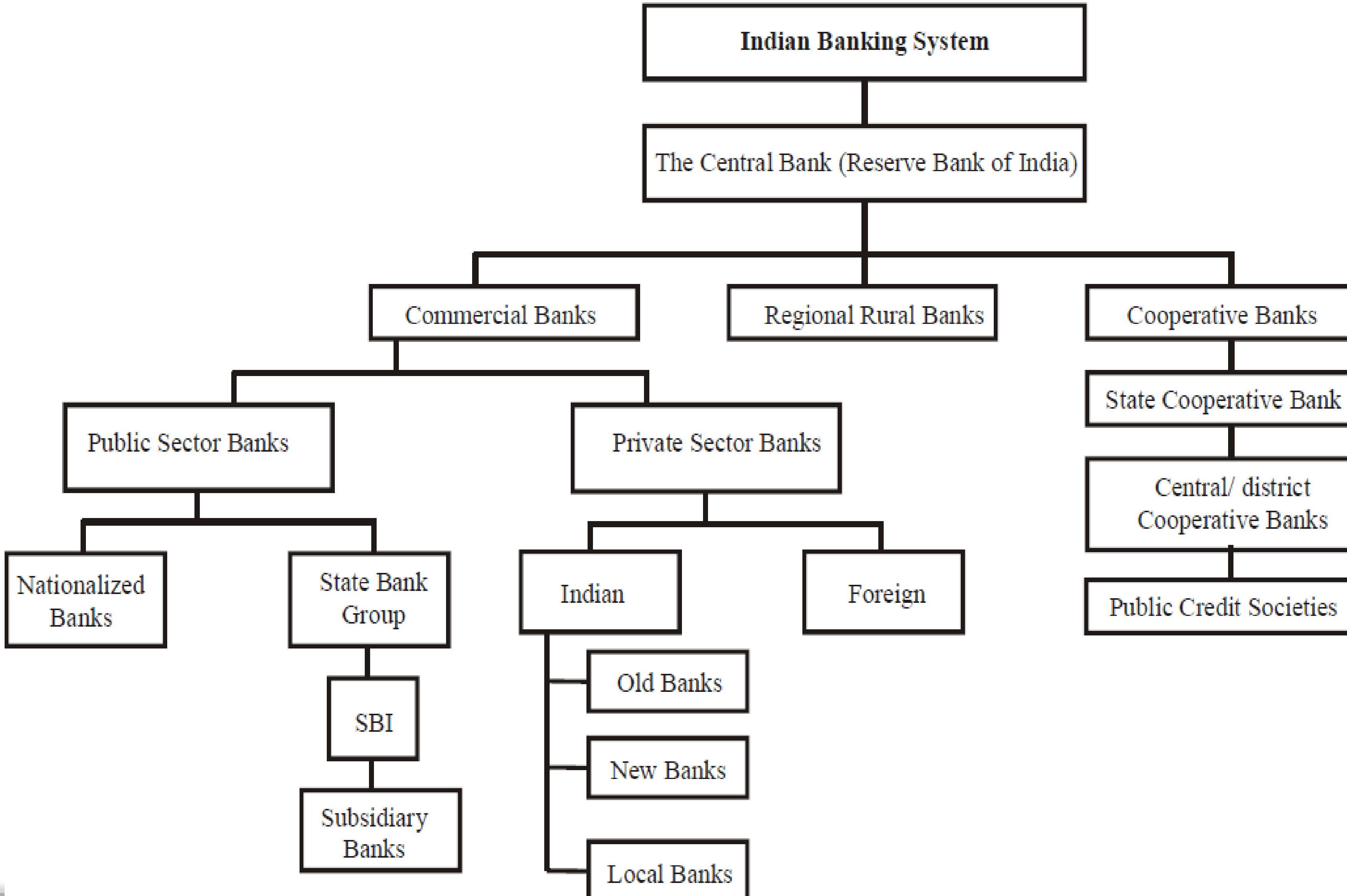
L. Henry defined a banker as "One who in the ordinary course of business honours cheques drawn upon by persons from and for whom he receives money on current account". This definition is very restrictive in the sense that any person or institution engaged in the business of attracting deposits may be called as bank.

Kinley's Definition: A bank is an "establishment which makes to individuals such advance of money as may be required and safely made and to which individuals entrust money when not required by them for use

Structure of Indian banking system



Scheduled Banks structure



History of Banking

- Early phase (1786-1935)
- Pre-Nationalization (1935-1969)
- Post-Nationalization (1969-1990)
- Modern Phase (1990-present)

Cheque system

BASIS FOR COMPARISON	CHEQUE	DEMAND DRAFT
Meaning	Cheque is a negotiable instrument which contains an order to the bank, signed by the drawer, to pay a certain sum of money to a specified person.	Demand Draft is a negotiable instrument used for the transfer of money from one place to another.
Payment	Payable either to order or to bearer.	Always payable to order of a certain person.
Issuance	Cheque is issued by an individual.	Demand Draft is issued by a bank.
Bank Charges	No	Yes
Drawer	Customer of the bank.	Bank itself.
Parties Involved	Three Parties- Drawer, Drawee, Payee.	Two Parties- Drawer, Payee.
Dishonour	Yes, due to insufficient balance or other similar reasons.	No

UNIT–II

Banking regulation act-1949, Reserve Bank of India Act-1934, Establishment of RBI, Functions and credit control system, Role of commercial banks and its functions, Banking sector reforms in India and deficiencies in Indian banking including problems accounts and Non -Performing Assets

STRUCTURE AND FUNCTIONS OF RESERVE BANK OF INDIA

INTRODUCTION

- It is the Central Bank of India Established in "1st April 1935" under the "RESERVE BANK OF INDIA ACT".

- Its head quarter is in Mumbai (Maharashtra). Its present governor is "MR. D Subbarao".

- It has "22 Regional Offices", most of them in State capitals.

BRIEF HISTORY

- It was set up on the recommendations of the “Hilton Young Commission”.
- It was started as Share-Holders Bank with a paid up capital of 5 crores.
- Initially it was located in Kolkata.
- It moved to Mumbai in 1937.
- Initially it was Privately Owned.
- Since Nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

PREAMBLE

Its advantage."The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as

"...To regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to

FUNCTIONS OF RBI

- Issue of currency
- Development role
- Banker to government
- Banker to bank
- Role of RBI in inflation control
- Formulate monetary policy
- Manager of foreign reserve
- Clearing house functions
- Regulations of banking system

Issue of Currency

- To ensure adequate quantity of supplies of currency notes and coins of good quality.
- Issues new currency and destroys currency and coins not fit for circulation.
- It has to keep in forms of gold and foreign securities as per statutory rules against notes & coins issued.

Developmental Role

- To develop the quality of banking system in India.
- Performs a wide range of promotional functions to support national objectives.
- To establish financial institutions of national importance, for e.g: NABARD,IDBI etc.

Banker to the Government

Performs all banking function for the central and the state governments and also acts as their banker excepting that of Jammu and Kashmir. It makes loans and advances to the States and local authorities. It acts as adviser to the Government on all monetary and banking matters.

Banker to banks

- Maintains banking accounts of all scheduled banks.
- RBI also regulates the opening /installation of ATM Fresh currency notes for ATMs are supplied by RBI.
- RBI regulates the opening of branches by banks.
- It ensures that all the N.B.F.S follow the Know Your Customer guidelines.

Banker to banks

- The Reserve Bank of India also regulates the trade of gold. Currently 17 Indian banks are involved in the trade of gold in India.
- RBI has invited applications from more banks for direct import of gold to curb illegal trade in gold and increase competition in the market.
- Collection and publication of data.
- It issues guidelines and directives for the commercial banks.

Role of RBI in inflation control

- Inflation arises when the demand increases and there is a shortage of supply There are two policies in the hands of the RBI.

- Monetary Policy: It includes the interest rates. When the bank increases the interest rates than there is reduction in the borrowers and people try to save more as the rate of interest has increased.

- Fiscal Policy: It is related to direct taxes and government spending. When direct taxes increased and government spending increased than the disposable Income of the people reduces and hence the demand reduces.

Formulate monetary policy

- Maintain price stability and ensuring adequate flow of credit in the economy.
- It formulates implements and monitors the monetary policy.
- Instruments: qualitative & quantitative.

Quantitative Measures

- Quantitative Measures “BANK RATE” also called “Discount Rate”.
- It also includes “Repo Rate”.
- “Open Market Operations” buying and selling of government securities.
- “Variable Reserve Ratio” it includes C.R.R and S.L.R

Qualitative Measures

1. Direct Action
2. Moral persuasion
3. Legislation
4. Publicity

BANK RATE

- It’s the interest rate that is charged by a country’s central bank on loans and advances to control money supply in the economy and the banking sector.
- This is typically done on a quarterly basis to control inflation
- and stabilize the country’s exchange rates.
- A fluctuation in bank rates Triggers a Ripple-Effect as it
- impacts every sector of a country’s economy.
- A change in bank rates affects customers as it influences
- Prime Interest Rates for personal loans.
- The present bank rate is 9%

REPO RATE

- Whenever the banks have any shortage of funds they can borrow it from the central bank. Repo rate is the rate at which our banks borrow currency from the central bank.
- A reduction in the repo rate will help banks to get Money at a cheaper rate.
- When the repo rate increases borrowing from the central bank becomes more expensive.
- In order to increase the liquidity in the market, the central bank does it.
- The present repo rate is 8%

REVERSE REPO RATE

- It’s the rate at which the banks park **surplus funds** with reserve bank.
- While the Repo rate is the rate at which the banks **borrow** from the central bank.
- It is mostly done , when there is surplus liquidity in the market by the central bank.
- The present reverse repo rate is 7%

CRR (cash reserve ratio)

- Cash Reserve Ratio (CRR) is the amount of Cash(liquid cash like gold)that the banks have to keep with RBI.
- This Ratio is basically to secure solvency of the bank and to drain out the excessive money from the banks.
- The present CRR rate is 4.75%.

SLR (Statutory Liquidity Ratio)

- It is the amount a commercial bank needs to maintain in the form of cash, or gold or govt. approved securities (Bonds) before providing credit to its customers.
- SLR rate is determined and maintained by the RBI (Reserve Bank of India) in order to control the expansion of bank credit.
- The present SLR rate is 23%.

Quantitative Methods

1. Direct Action: The central bank may take direct action against commercial banks that violate the rules, orders or advice of the central bank. This punishment is very severe of a commercial bank.

2. Moral persuasion: It is another method by which central bank may get credit supply expanded or contracted. By moral pressure it may prohibit or dissuade commercial banks to deal in speculative business.

Quantitative Methods

3. Legislation:

The central bank may also adopt necessary legislation for expanding or contracting credit money in the market.

4. Publicity:

The central bank may resort to massive advertising campaign in the news papers, magazines and journals depicting the poor economic conditions of the country suggesting commercial banks and other financial institutions to control credit either by expansion or by contraction.

Manager of Foreign Exchange

- To facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.
- It acts as a custodian and Manages the **Foreign Exchange Management Act,(FEMA) 1999.**
- RBI buys and sells foreign currency to maintain the exchange rate of Indian Rupee v/s foreign currencies like the US Dollar, Euro, Pound and Japanese yen.

Clearing House Functions

The RBI operates clearing houses to settle banking transactions. The RBI manages 14 major clearing houses of the country situated in different major cities. The State Bank of India and its associates look after clearing houses function in other parts of the country as an agent of RBI.

Regulation of Banking system

- The prime duty of the reserve Bank is to regulate the banking system of our country in such a way that the people of the country can trust in the banking Up to perform its duty.
- The Reserve Bank has following powers in this regard:

Licensing:

- According to the section 22 of the Banking Regulation Act, every bank has to obtain license from the Reserve Bank. The Reserve Bank issues such license only to those banks which fulfill condition of the bank.

Regulation of Banking system

- **Management:**

  Section 10 of the Banking Regulation Act embowered the Reserve Bank to change manager or director of any bank if it considers it necessary or desirable.

- **Branch Expansion:**

  Section 23 requires every bank to take prior permission from Reserve Bank to open new places of business in India.

- **Power of inspection of Bank:**

  Under Section 35, the Reserve Bank may inspect any bank and its books and accounts either at its own initiative or at the instance of the Central Government.

UNIT –III

Introduction to insurance, Need and importance of insurance, principles of Insurance, characteristics of insurance contract.

Branches of insurance and types of insurance, life insurance and its products: role of agents and brokers.

DEFINITION

In financial sense

It is a social device in which a group of individuals (insured) transfer risk to another party (insurer) in order to combine loss experienced, which permits statistical prediction of losses and provides for payment of losses from funds contributed (premium) by all members who transferred risk

Definition (Contd.)

- In legal sense
- It is a contract by which one party (Insurer)
- in consideration of price paid to him
- proportionate to risk provides security to the other party (Insured) that
- he shall not suffer loss, damage or prejudice by the happening of certain specified events.
- Insurance is meant to protect insured against uncertain events which may cause disadvantage to him

ELEMENTS IN INSURANCE

- Insurance - combination of three elements
- Insurance as a Transfer System - transferring of risks from Insured to IC which is financially sound and has capacity and willingness to take risks.
- A Loss exposure can give rise to three types of losses, namely:
- Property loss (including net income loss),
- Liability loss, and
- Human and personnel loss.

ELEMENTS IN INSURANCE

Insurance as a Business - insurance primarily attempts to meet its costs and expenses from premium that it earns and also make a reasonable margin of profit for its own sustainability.

- Other benefits to society as a whole such as:
- Payments for the costs of covered losses
- Reduction of the insured's financial uncertain
- Efficient use of resources
- Support for credit
- Satisfaction of legal requirements
- Satisfaction of business requirements
- Source of investment funds for infrastructure development
- Reduction of social burden

FUNDAMENTAL ADVANTAGES

- **Transfer of risk** from one person (Insured) to another (Insurer)
- **Sharing (Pooling) of losses** on some equitable basis such that
  - fortuitous (random) losses will be indemnified (paid)
- Reduction in tension and fear
- Credit multiplication
- Avenue for investment

FUNDAMENTAL PRINCIPLES OF INSURANCE

- ***Principle of Uberrimae Fides* (Utmost Good Faith) –**
  - A positive duty voluntarily to disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not.
  - Non-disclosure of any fact may be unintentional on the part of the insured.
  - Even so such a contract is rendered voidable at the insurer's option and it can refuse any compensation.
  - Any concealment of material facts is considered intentional.

Fundamental Principles Of Insurance (Contd.)

- ***Principle of* Indemnity**
- On the happening of insured event for which insurance policy is taken up insured should be replenished the amount of loss
- Insured should not derive any unwarranted benefit from a loss
- **Made in following ways**
- Cash payment
- Repair
- Replacement
- Reinstatement

Fundamental Principles Of Insurance (Contd.)

- ***Principle of* Subrogation**
  - Restitution of rights of an assured in favour of Insurer against third party for any damages caused by him in place of assured after Insurer has indemnified him for the loss

Objectives of the principle:

- Prevents insured from profiting from damage.
- Enforces rule of law that guilty is brought to book and made to pay for the loss.
- Helps Insurer to partially or fully recover amount paid for loss.
- Helps to lower insurance rates.

Fundamental Principles Of Insurance (Contd.)

- **Principle of Contribution**
  - It means indemnity provided for loss occurring on asset, which is insured with several insurers has to be shared pro rata
  - Corollary of doctrine of Indemnity and hence is applicable in case of GI.

Requisites

- Insured asset/Person (in case of hospitalization insurance) must be common to all policies
- Risk insured against must be common to all policies
- All policies must be in force during the occurrence of loss

Fundamental Principles Of Insurance (Contd.)

- **Principle of Proximate Cause**
- Literally means nearest cause or direct cause. Immediate cause of mishap, which resulted in the loss.
- While determining 'proximate cause' sequence of events according to their *time of occurrence is irrelevant.*
- Many court judgments act as precedents in arriving at decisions while making settlements.
- The insurance company is liable to indemnify only against the insured perils.

SOME OTHER IMPORTANT CONCEPTS

- **Underwriting** - assumption of liability; formal acceptance of a risk by IC for a price (Premium)
- **Objectives**

❑ Producing a large volume of premium income sufficient to maintain and enlarge IC's operations and to achieve a better spread of risk portfolio;

❑ Earning a reasonable amount of profit on insurance operations;

❑ Maintaining a profitable book of business

❑ More spread – across the profile and geography

Some other important concepts (Contd.)

- **Proposal Form** (application for insurance) - The insurance proposal has to be in writing or confirmed in writing and can not be oral alone
- **Cover Notes** - an evidence of insurance; a temporary and limited agreement, sent prior to completion of preparation of final policy document, **or** pending some information to be filled in, **or** when proposal is under consideration **or** policy is being prepared for delivery.
- **The Slip** - document mentioning all the essential information needed for assessing risk proposed
- **Certificate of Insurance -** generally printed, dated, signed, numbered. Mentions brief details of insured, location and situation of property, sum insured and period of insurance.

GOVERNING LEGISLATIONS

- **THE INSURANCE ACT, 1938**
- **Important provisions**

Registration; ; Accounts and audit; Investments; Limitation on management expenses; Prohibition of Rebates; Powers of Investigation by CG

- **GENERAL INSURANCE BUSINESS NATIONALIZATION ACT, 1972**
- **To provide** need-based, low cost insurance covers to rural population, crop insurance scheme, social security benefits; benefits of insurance available to the masses

INSURANCE REGULATOR

INSURANCE REGULATORY AND DEVELOPEMNT AUTHORITY (IRDA)

After opening up of insurance sector, IRDA is Regulator for monitoring of operations of ICs. HO in Hyderabad

Focus on three areas -

- Protection of interest of consumers
- Ensure financial soundness of insurance industry
- Pave way to help a healthy growth of insurance market

SOME OTHER IMPORTANT STATUTES

- The Motor Vehicles Act, 1939
- Marine Insurance Act, 1963
- The Merchant Shipping Act, 1958
- The Bill of Lading Act, 1856
- The Indian Ports (Major Ports) Act, 1963
- Indian Railways Act, 1989
- The Carriers Act, 1865
- The Indian Post Office Act, 1898
- The Carriage by Air Act, 1972
- Multi-modal Transportation Act, 1993
- Public Liability Insurance Act, 1991
- The Indian Stamp Act, 1899
- FEMA 1999
- The Consumer Protection Act, 1986

INSURANCE MARKET PARTICIPANTS

- **Buyers -** general public, traders, corporate, clubs, hospitals, schools, etc.
- **Intermediaries**
- **Agents -** governed by IRDA (Licensing of Insurance Agents) Regulations, 2000. Qualifications and disqualification prescribed

  Testing & Certification -to pass stipulated examination after undergoing training program of 50 (75 hours for composite) at accredited institutions (online / off-line).

- **Corporate Agents –** professionals e.g. ICAI,ICSI, ICWA, MBA, Actuarial Society of India, CAIIB
- **Brokers**

Insurance market participants (Contd.)

- **Development Officers (DO)**
- This arrangement in vogue in Public Sector Insurers. Purely an internal arrangement in organizing marketing force of IC. Link between branch manager and Agent
- **Some of the main functions**
- Disseminating information, Soliciting, negotiating, procuring, or effectuating an insurance contract or renewal
- Inspecting risk, Setting a rate, Investigating or assessing claim
- **Direct Sales**
- DSA - sales activity procured by staff of IC itself

INSURANCE ACT 1938

- The Insurance Act of 1938 was the first legislation governing all forms of insurance to provide strict state control over insurance business.

- Purpose:- to safe guard the interest of insured, setting the norms for carrying out the business of insurance smoothly, Minimizing disputes

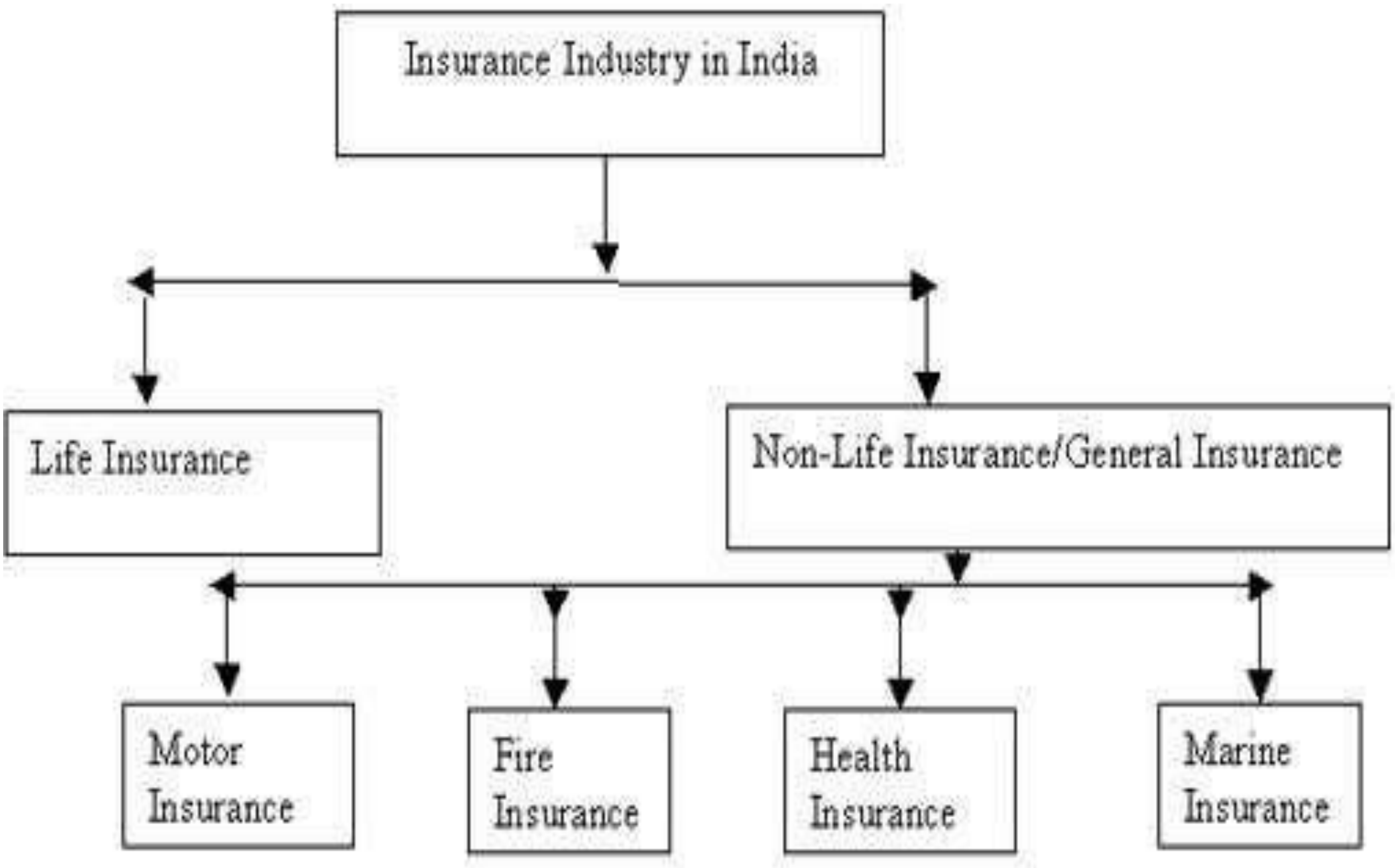
INSURANCE ACT 1938

Dictionary of business and Finance defines "Insurance as a form of contract agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make good a loss, damage or injury to something of value in which the insured has a interest as a result of some uncertain event.

IMPORTANCE OF INSURANCE

- Provides protection against occurrence of uncertain events.
- Device for eliminating risks and sharing losses.
- Co-operative method of spreading risks.
- Facilitates international trade.
- Serves as an agency of capital formation.
- Financial support.
- Medical support.
- Source of employment.

Types of insurance



Life insurance:

- Life insurance is a contract between the policy owner and the insurer,
- where the insurer agrees to reimburse the occurrence of the insured individual's death or other event such as terminal illness or critical illness.
- The insured agrees to pay the cost in terms of insurance premium for the service. Specific exclusions are often written in the contract to limit the liability of the insurer, for example claims related to suicide, fraud, war, riot and civil commotion is not covered.

General Insurance

- Insuring anything other than human life is called general insurance.
- Examples are insuring property like house and belongings against fire and theft or vehicles against accidental damage or theft. Injury due to accident or hospitalisation for illness and surgery can also be insured. Your liabilities to others arising out of the law can also be insured and is compulsory in some cases like motor third party insurance

Fire insurance

- Insurance that is used to cover damage to a property caused by fire. Fire insurance is a specialized form of insurance beyond property insurance, and is designed to cover the cost of replacement, reconstruction or repair beyond what is covered by the property insurance policy. Policies cover damage to the building itself, and may also cover damage to nearby structures, personal property and expenses associated with not being able to live in or use the property if it is damaged.

Health insurance

- A type of insurance coverage that pays for medical and surgical expenses that are incurred by the insured. Health insurance can either reimburse the insured for expenses incurred from illness or injury or pay the care provider directly. Health insurance is often included in employer benefit packages as a means of enticing quality employees.

Marine Insurance

- Marine Insurance covers the loss or damage of ships, cargo, terminals, and any transport or cargo by which property is transferred

PRINCIPLES OF INSURANCE

- Principle of Insurable interest.
- Principle of Utmost Good Faith.
- Principle of Indemnity.
- Principle of Subrogation.
- Principle of Contribution.
- Principle of Causa Proxima.
- Principle of Mitigation of Loss.

LIFE INSURANCE PLANS

- Term Insurance.
- Endowment Insurance Plan.
- Money Back Policy.
- Group Life Insurance.

REGULATIONS OF INSURANCE BY IRDA

- Deposits.
- Investments.
- Valuation Of Assets.
- Submission of Returns.
- Insurance Advertisements.
- Foreign Exchange laws.

ACTS GOVERNING INSURANCE

- The insurance Act, 1938 to govern all form of insurance and to provide strict control over insurance business.
- Insurance Regulatory and authority act, 1999 (to provide) for the establishment of an authority to protect the interest of the holder of insurance policy, to regulate, promote and ensure orderly growth of insurance industry and for matter connected therewith or incidental thereto and future to amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the general insurance business (Nationalization) act, 1972.
- The Actuaries Act, 2006 (An Act to provide for regulating and developing the profession of Actuaries and for matters connected therewith or incidental thereto).

INSURANCE LAW REGULATIONS

- Insurance law regulations in India manage all the matters related to various insurance companies in the country. The concept of insurance in India dates back to the ancient period.
- Entry of Private Companies.
- Regulatory Authorities.
- Insurance Regulatory and Development Authority.

INSURANCE REGULATORY & DEVELOPMENT AUTHORITY

- Insurance Regulatory & Development Authority is regulatory and development authority under Government of India in order to protect the interests of the policyholders and to regulate, promote and ensure orderly growth of the insurance industry.
- Powers and Functions of IRDA.
- Impact Of IRDA On Indian Insurance Sector.

IRDA was established by an act enacted in Indian Parliament known as IRDA Act 1999 and was amended in 2002 to incorporate some emerging requirements as well as to overcome some deficiencies in the entire process.

INSURANCE REGULATORY & DEVELOPMENT AUTHORITY

a) To protect the interests of the policyholders

b) To promote, regulate and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto

c) Conduction of insurance businesses across India in an ethical manner.

INSURANCE REGULATORY & DEVELOPMENT AUTHORITY

- **Utmost good faith** - Duty of Disclosure, Material facts, Representations, Breaches of utmost good faith, Void, voidable and unenforceable contracts, case laws and court decisions
- **Insurable Interest** - Importance of insurable interest, conditions fulfilling requirements of an insurable interest, persons having insurable interest (and nature of relationship), mandatory requirements for insurance in certain types of relationship. case laws and court decisions.

INSURANCE REGULATORY & DEVELOPMENT AUTHORITY

- **Principle of Indemnity -** Definition, Principles, only one indemnity for a single incident, prohibition of more than a single indemnity, case laws and court decisions
- **Subrogation&Contribution -** Importance, how, when it arises and operates, case laws and court decisions
- **Proximate / probable cause of loss -** Doctrine of proximate cause, application of the doctrine, case laws and court decisions

UNIT–IV

Regulatory and legal framework governing the insurance sector, history of IRDAI and its functions: Business and economics of insurance need for changing mindset and latest trends.

Regulatory and legal framework governing the insurance sector

- The law of India has following expectations from IRDA...
- To protect the interest of and secure fair treatment to policyholders.
- To bring about speedy and orderly growth of the
- common man, and to provide long term funds for accelerating growth of the economy.
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates.

Regulatory and legal framework governing the insurance sector

- To ensure that insurance customers receive precise, clear and correct information about products and services and make them aware of their responsibilities and duties in this regard.
- To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery.
- To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players.

Regulatory and legal framework governing the insurance sector

- To take action where such standards are inadequate or ineffectively enforced.
- To bring about optimum amount of self-regulation in day to day working of the industry consistent with the requirements of prudential regulation.

Regulatory and legal framework governing the insurance sector

Section 14 of IRDA Act, 1999 lays down the duties, powers and functions of IRDA..

Subject to the provisions of this Act and any other law for the time being in force, the Authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

1. Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include, -

Regulatory and legal framework governing the insurance sector

- Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
- Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
- Specification requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;

Regulatory and legal framework governing the insurance sector

- Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;

- Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);

Regulatory and legal framework governing the insurance sector

- Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
- Regulating investment of funds by insurance companies;
- Regulating maintenance of margin of solvency;
- Adjudication of disputes between insurers and intermediaries or insurance intermediaries;
- Supervising the functioning of the Tariff Advisory Committee;

Regulatory and legal framework governing the insurance sector

- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating
- Professional organizations referred to in clause (f);
- Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
- Exercising such other powers as may be prescribed.

Regulatory and legal framework governing the insurance sector

As per the section 4 of IRDA Act' 1999, Insurance Regulatory and Development Authority (IRDA, which was constituted by an act of parliament) specify the composition of Authority

The Authority is a ten member team consisting of

- A Chairman;
- Five whole-time members;
- Four part-time members,

(all appointed by the Government of India)

Regulatory and legal framework governing the insurance sector

(1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, an Authority to be called "the Insurance Regulatory and Development Authority".

(2) The Authority shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue or be sued.

Regulatory and legal framework governing the insurance sector

(3)TheThe head office of the Authority shall be at such place as the Central Government may decide from time to time.

(4) Authority may establish offices at other places in India.

Regulatory and legal framework governing the insurance sector

- The Chairperson and every other whole-time member shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:
- Provided that no person shall hold office as a Chairperson after he has attained the age of sixty-five years:
- Provided further that no person shall hold office as a whole-time member after he has attained the age of sixty-two years.

Regulatory and legal framework governing the insurance sector

- A part-time member shall hold office for a term not exceeding five years from the date on which he enters upon his office.
- Notwithstanding anything contained in sub-section (1) or sub-section (2), a member may -

✓ relinquish his office by giving in writing to the Central Government notice of not less than three months; or

✓ be removed from his office in accordance with the provisions of section

Regulatory and legal framework governing the insurance sector

- The Central Government may remove from office any member who-
- is, or at any time has been, adjudged as an insolvent; or
- has become physically or mentally incapable of acting as a member; or
- has been convicted of any offence which, in the opinion of the Central Government, involves moral turpitude; or

- has acquired such financial or other interest as is likely to affect prejudicially his functions as a member; or
- has so abused his position as to render his continuation in office detrimental to the public interest.
- No such member shall be removed under clause (d) or clause (e) of sub-section (1) unless he has been given a reasonable opportunity of being heard in the matter.

Regulatory and legal framework governing the insurance sector

The institution of Insurance Ombudsman was created by a Government of India Notification dated 11th November, 1998 with the purpose of quick disposal of the grievances of the insured customers and to mitigate their problems involved in redressal of those grievances. This institution is of great importance and relevance for the protection of interests of policy holders and also in building their confidence in the system. The institution has helped to generate and sustain the faith and confidence amongst the consumers and insurers.

Regulatory and legal framework governing the insurance sector

The governing body of insurance council issues orders of appointment of the insurance Ombudsman on the recommendations of the committee comprising of Chairman, IRDA, Chairman, LIC, Chairman, GIC and a representative of the Central Government. Insurance council comprises of members of the Life Insurance council and general insurance council formed under Section 40 C of the Insurance Act, 1938. The governing body of insurance council consists of representatives of insurance companies.

Regulatory and legal framework governing the insurance sector

Insurance Ombudsman has two types of functions to perform (1) conciliation, (2) Award making. The insurance Ombudsman is empowered to receive and consider complaints in respect of personal lines of insurance from any person who has any grievance against an insurer. The complaint may relate to any grievance against the insurer i.e.

a) Any partial or total repudiation of claims by the insurance companies,
b) Dispute with regard to premium paid or payable in terms of the policy,
c) Dispute on the legal construction of the policy wordings in case such dispute relates to claims;
d) Delay in settlement of claims and
e) Non- issuance of any insurance document to customers after receipt of premium

GRANTS BY CENTRAL GOVERNMENT

The Central Government may, after due appropriation made Government may think fit for being utilized for the purposes of this Act.

(1) There shall be constituted a fund to be called "the Insurance Regulatory and Development Authority Fund" and there shall be credited thereto-

- all Government grants, fees and charges received by the Authority;
- all sums received by the Authority from such other source as may be decided upon by the Central Government;
- the percentage of prescribed premium income received from the insurer.

Regulatory and legal framework governing the insurance sector

(2) The Fund shall be applied for meeting -

- The salaries, allowances and other remuneration of the members, officers and other employees of the Authority;
- The other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

Regulatory and legal framework governing the insurance sector

1. The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.
2. The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.

Regulatory and legal framework governing the insurance sector

3 The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the accounts of the Authority shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books of account, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.

4 The accounts of the Authority as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit-report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Regulatory and legal framework governing the insurance sector

- Insurance Policy
- Claim form
- FIR, Fire Brigade Report
- Accounting statements like past 3 years Balance Sheets, Stock Registers, Purchase and Sales invoices, Sales tax returns, Excise duty records, Profit and Loss accounts etc.
- Act of God Perils - newspaper cuttings, photographs and meteorological reports

Regulatory and legal framework governing the insurance sector

- If company proposes to settle the claim then Letter of subrogation, the discharge voucher, if the policy is subject to Agreed Bank Clause (if Bank's or other Financial Institution's interest is involved, the discharge voucher has to be signed by their authorised signatories).

Regulatory and legal framework governing the insurance sector

- **Inspection of the scene**
- **Identification of property insured**
- **Securing evidences** - photographic, samples, telltale
- **Examination of probable cause** - process of elimination of probable causes, acceptance of more than one probable cause of loss, elimination of loss due to exception or exclusion
- **Verification of damage** - physical evidence, identification from physical evidence, absence of physical evidence, nature of goods involved, properties of goods involved, duration of fire

Regulatory and legal framework governing the insurance sector

- Assessment of the damage
- Calculation of value at risk
- Assessment
- Concurrent and non-concurrent assessment
- Compliance with warranties
- Lien of financial institutions

Regulatory and legal framework governing the insurance sector

- **Occurrence as reported**
- **Inspection of the scene**
- **Securing evidence** - Physical evidence, Identification of physical evidence, absence of physical evidence
- **Securing evidences** - photographic, samples, telltale
- **Analysis of the situation** - valuation in operating parameters of machinery or apparatus, purpose of application of the machinery or apparatus, scope of the project

Regulatory and legal framework governing the insurance sector

- **Examination of probable cause** - process of elimination of probable causes, acceptance of more than one probable cause of loss, elimination of loss due to exception or exclusion
- **Assessment of the damage** - Reparability of item or equipment damaged, whether repairs can be done in situ or whether it requires a relocation elsewhere, if not repairable, reasons thereof, whether the reasons towards non-repairability are satisfactory and if yes the concurrence, if no the specific objections

Loss assessment in operational covers - Determination of current replacement cost, adjustments for obsolence, improvements and modifications for older machinery or equipments, availability of equivalent equipments and comparison of available equipments for capacity, operational ease, control systems, etc and basis for arriving at equivalent costs.

Loss assessment in project covers - Basis of declaration of values for insurance vis-à-vis cost of the project, whether the entire project is fully Insured, whether the project is correctly insured if the insurance is taken by the contractor for a particular contract, whether claims involved in such situations relate to the relevant part of the project, whether there is an increase between original (historic) cost and actual procurement for repairs and replacement, impact of variation in exchange rate, customs duty, etc resulting in escalation

Regulatory and legal framework governing the insurance sector

Determination of adequacy of sum insured for operational covers - The replacement value of damaged item machinery or apparatus supported by order, invoice or quotation, - if not available methods of determination - scaling up or down from available quotations, determination by scaling up indices (domestic for local products) and international plus foreign exchange adjustments between date of installation and date of loss.

Regulatory and legal framework governing the insurance sector

- **Determination of adequacy of sum insured for project covers** - satisfying whether the value declared represents the completely erected value of the project, if no - method of projecting a value based on level of billing variation with respect to original projections, extent of escalation available, alternate method by scaling up through indices beyond original date of completion.
- **Assessment**
- **Concurrent and non-concurrent assessment**
- **Compliance with warranties**
- **Lien of financial institutions.**

Regulatory and legal framework governing the insurance sector

Requirement as to capital - No insurer carrying on the business of life insurance, general insurance or re- insurance in India on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be registered unless he has, -

(i) A paid-up equity capital of rupees one hundred crores, in case of a person carrying on the business of life insurance or general insurance; or

(ii) A paid-up equity capital of rupees two hundred crores, in case of a person carrying on exclusively the business as a re-insurer :

Regulatory and legal framework governing the insurance sector

Provided that in determining the paid-up equity capital specified under clause (I) or clause (ii), the deposit to be made under section 7 and any preliminary expenses incurred in the formation and registration of the company shall be excluded :

Provided further that an insurer carrying on business of life insurance, general insurance or re-insurance in India before the commencement of the Insurance Regulatory and Development Authority Act, 1999 and who is required to be registered under this Act, shall have a paid-up equity capital in accordance with clause (I) and clause (ii), as the case may be,

within six months of the commencement of that Act.".

Insurance Market Dynamics and Underwriting Cycle

Demand Pattern:

- Relatively fixed
- pricing not very important
- demand curve relatively flat.
- price is mainly determined by supply.

Commodity Nature

- Generally price and features in a particular segment are more or less same.
- Price cannot be a differentiating proposition so they tend to create brand names for their products.

Insurance Market Dynamics

- **Attributes creating brand:**

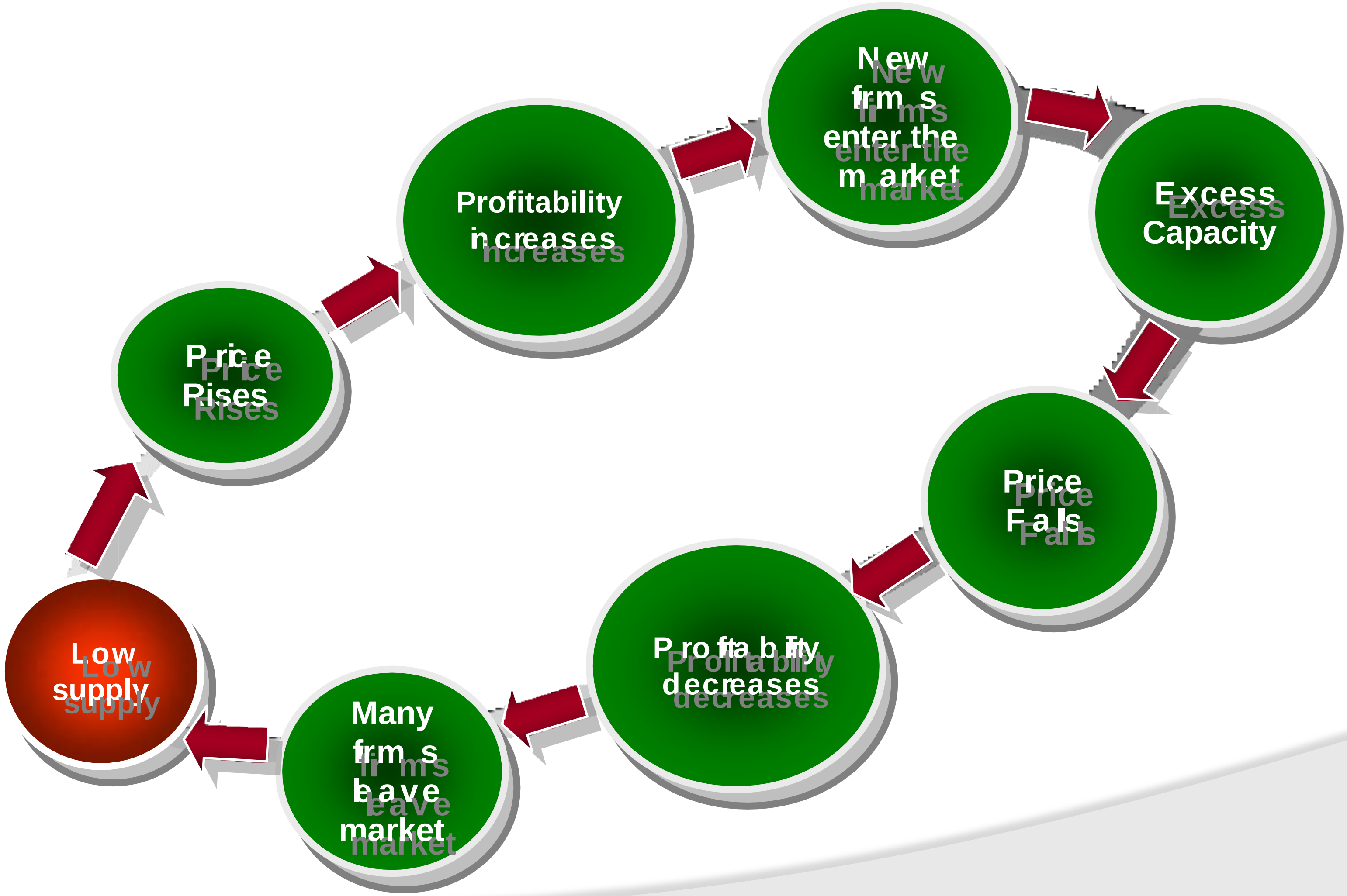
  Scheme coverage, financial strength of company, flexibility in customizing insurance program to meet customer needs and claims- handling setup.

  This may cause different insurers to have different demand curves. This somewhat **de-commoditize** insurance products.

- Different insurance companies have different supply curves because of the following:
- **Underwriting selection** -Less claims, less cost, more profit, more supply
- **Cost of company expenses, taxes, commission** - Different companies have different degrees of success at controlling expenses. Commodity-type nature of the insurance market place gives it a business cycle.

Insurance Market Dynamics

- The business cycle begins with low supply. The low supply may be due to insurers losing money.



Legal Principles of Insurance

Legal Principles of Insurance

- Insurance - contractual agreement between the insurer and the insured.

- Should also meet all the requirements of a valid contract:
  - Offer and acceptance
  - Consideration
  - Legal capacity of parties and
  - Purpose of contract should be legal and not contrary to public interest

Legal Principles of insurance

Offer and Acceptance

- Should be a definite and unqualified offer by one party , accepted by another party in the exact terms.
- Free Consent
- Need not be in writing, verbal contracts are also valid.
- The offer is made by the prospect and the insurer may accept the same or make a counter offer with some modifications

Consideration

- The binding force in any contract.
- Consideration made by insurer- promise to pay/ compensate in case of insured event occurring.
- Consideration made by the Insured- payment of premium or the promise to pay future premiums
- In life insurance, only the first premium constitutes consideration.
- Subsequent premiums are conditions for continuation of contract.

Legal Capacity

- Parties to the contract must be capable of entering into a contractual agreement.
- Minor, insane or intoxicated persons are not competent to make or enter into contracts.

Legal Purpose

- A contract, the purpose of which is illegal or against public interest in unenforceable.
- Presence of insurable interest is a must.

Legal Principles of Insurance

Insurance contracts are special type of contracts which have certain additional distinguishing features associated with it.

- Indemnity
- Insurable interest
- Subrogation
- Utmost good faith
- Adhesion
- Waiver & estoppels

Indemnity

- Insurer will make good the loss / damage in such a manner that financially, the insured is neither better off nor worse off as a result of the loss.

- Principle is generally applied in insurance where the loss suffered by the insured is measurable in terms of money.

- *It does not apply to insurance of persons where it is not possible to measure the financial loss caused by death of the insured or bodily injury sustained.*

- Any loss or damage under an insurance contract is settled based on the sum insured under the policy.

Indemnity

- The insured cannot gain by over-insuring his property. But he will lose by under-insurance.

- Principle of indemnity states that the insured cannot claim more than what he has lost, although he has insured the property for a higher value.

- He cannot get full indemnity under the policy if he has insured property for a lower value.

- Fire Insurance: provision can be made to cover the building, plant and machinery on reinstatement value basis- *the cost of replacing or reinstating the destroyed property by new property which is neither superior to, nor more extensive than the insured property when new*

Indemnity

- Wholesale merchants: in respect of goods only, by effecting contract price insurance, if due to operation of an insured peril any loss occurs, the settlement of losses is allowed on the basis of the contract price and not on market value.
- Marine policies are construed to be Agreed Value policies, i.e. when the basis of valuation of the consignment is agreed in advance and incorporated in the policy, settlement of claim is made accordingly.
- In other words, even incidentals and profit to a reasonable extent can be included in the marine cover.
- As regards the customs duty element, it is one of pure indemnity and when a claim arises, claim settlement is made on the basis of either the insured customs duty or actual customs duty, whichever is less.

Insurable Interest

- The insured must
  - bear a legal relationship to the subject matter of the concerned insurance cover.
  - He should stand to benefit by the safety of the property, rights, and interest and lose by any loss, damage, injury or creation of liability
- Insurable interest is required throughout the period of contract in all classes of property insurance except Marine Insurance, where such existence is necessary only at the time of a claim.

Insurable Interest- Life Insurance

- Insurable interest in life insurance contracts requires somewhat different relationship to exist.
- The family relationship of husband and wife is universally accepted to satisfy the requirement of insurable interest.
- Acceptance of other relationships depends.
- Insurable interest has to be established to exist at the time of entering into the contract only.

Subrogation

- The transfer of rights and remedies of the insured to the insurer who has indemnified the insured.
- Applicable only to indemnity contracts… not to life insurance.
- If subrogation rights are not given to the insurer, the insured can recover the losses from the insurer as well as the person responsible for the loss, viz., carrier, bailee etc.
- This defeats the very principle of indemnity
- The insurer gets the right only after indemnifying the insured. But by an express condition under fire insurance contracts the position is altered. The insurer gets the subrogation rights even before indemnifying the insured.

Subrogation

- Subrogation applicable only to the extent of indemnification by the insurer. He cannot recover more than what he has paid.

- In cases where the insured has not been indemnified fully, any amount recovered from any third party in excess of the claim payment made by the insurer has to go insured

- The insurer, after making good the loss, tries to recover the same from the person who was responsible for the loss.

- Therefore, insurance contracts are subjected by law to a higher duty, that is, of utmost good faith.

Utmost good faith

- The law requires all contracts, to be made in good faith- in absence of fraud or deceit.
- Commercial contracts will be a nullity if one of the parties has committed breach of trust, resulting in fraud or deceit.
- In Insurance, the insurer, in a majority of cases has no knowledge or no opportunity to inspect the risk , as the proposer only has this information.
- Insurance Contracts are therefore subject to the Principle of Utmost Good faith.
- States that the proposer must, in utmost good faith, declare all material facts that would influence the insurers decision to accept the risk.

Utmost Good Faith

- This principle is more applicable to the insured, who will do well to scrutinize the document issued to him with care and satisfy himself that what he has received is really what he wanted

- The principle of utmost good faith can cause harassment to the insured if a proposal form is vaguely filled in and does not give the details, which the insurer wants.

- As far as possible it is advisable to get the insurance companies' representative / surveyor to inspect the risk and satisfy himself that what the proposer wants is acceptable to him.

- The policy should be issued to the extent possible on the basis of an inspection by the insurer. He will then not be able to contest that there was any misrepresentation or concealment of facts.

Average

- If the sum insured is less than the sum to be insured the principle of average will be applied and the claim settlement will be less than the loss actually suffered.

- The market value of the insured at the time of a loss will be taken by the insurer as the sum to be insured.

- Exceptions to this rule are as follows:
  - In cases of wholesale merchants, by effecting contract price insurance, if any loss occurs to goods due to insured peril, loss settlement is allowed on the basis of the contract price and not market value.
  - Under Marine insurance, even incidentals and profit to a reasonable extent be included can be included in the marine cover.
  - As regards the customs duty element, it is one of pure indemnity and when a claim arises, claim settlement is made on the basis of either the insured customs duty or actual custom

Contribution

- Defined as the right of an insurer, who has paid a loss under a policy to recover a proportionate amount from other insurers, who are also liable for the loss.

- If two insurances are affected on the same property, the insured cannot claim from both the insurers. By the contribution principle, each insurer will pay the loss to the extent of his ratable proportion.

Proximate Cause

- This principle serves to define the scope of coverage under the insurance contract and also to protect the rights of the parties to the contract.
- *"The active efficient cause that sets in motion a chain of events which brings about a result, without the intervention of any new force started and working actively from a new independent source."*
- Effect of this principle is to keep scope of the insurance within the limits intended by both the parties when the contract was made.
- In the absence of this rule, every loss could be claimed by the insured and every loss could be rejected by the insurer

Consideration

- In case of Insurance - Amount of premium paid to the Insurance company.
- The Insurance Act stipulates that payment of premium for any general insurance policy should be effected before assumption of the risk (either by cheque or in cash).
- The obligation is on the part of the proposer and the insurance company to account for the premium before the date of commencement of insurance.
- It is advisable to submit the proposal and effect payment of the bill, well in advance to ensure that there is no gap as between the time at which a policy is decided to be taken or renewed.

Adhesion

- The terms and conditions of the contract are fixed by one party (insurer) and with minor exceptions, must be accepted or rejected in total by the other party (the proposer or the prospective policy owner).

- It is not drawn up by negotiation between the two parties.

- Any ambiguity or unclear elements in the contract will be construed in favour of the party not participating in the design of the wording of the contract- insured.

Waiver and Estoppel

1. Directly related to the responsibilities of insurance agents.

2. Waiver is defined as the intentional and voluntary giving up of a known right. An insurance company may waive its right to cancel a policy for nonpayment by accepting late payments.

3. *Estoppel* means that a party may be precluded by his or her acts of conduct from asserting a right that would act to the detriment of the other party, when the other party has relied upon the conduct of the first party and has acted upon it. An insurer may waive a right, and then after the policyholder has relied upon the waiver and acted upon it, the insurer will be estopped from asserting the right.

Co-insurance

- Sharing of insurance by two or more insurers (or even by the insured himself) in some agreed proportion.

- The co-insurance where there is a sharing of risk between the insurer and the insured (also called copay) is called under- insurance in India.

- In a co-insurance, claims under a policy are shared by all insurers in the same proportion as their shares bear to the total value insured.

- Co-insurance is generally observed in large commercial insurance, where one insurer does want to retain the whole risk.

Co-insurance – operates in 3 ways

- Each insurer issues a separate policy for his share of the insurance and will attach a co-insurance clause limiting his liability in accordance with the share of premium held by him.

- One insurer acts as a leader and is responsible for risk survey, rating, and collection of premium and completion of insurance contract.
- The leading company prepares a specification showing the shares of all insurers and attaches to it, the policy.
- Each insurer then puts his signature on the specification for its share in the policy.
- This is called collective policy.

- The third method is very common.
- Involves leading office to issue the policy and sign on behalf of the participating insurers.
- A clause called collective insurance clause is incorporated in the policy, which sets out the liability of each insurer in case of a claim under the policy.

Some problems of Co-insurance

- Insurers, particularly lead insurers do not prefer it. They have to provide services to the insured without enjoying the full premium.

- Recovery of claims from co-insurers is also a problem.

- The insured usually does not prefer co-insurance, particularly the first type of co-insurance where each co-insurer issues a separate policy.

- Liaising with all co-insurers in case of a claim, may be a tedious job.

Endorsement/riders

- An endorsement usually changes a provision in the contract to which it is attached.
- It may add or delete exclusion, for example, or define or redefine a term used in the contract.
- Policyholders often assume that endorsements improve the coverage provided by the contract (as in "my contract was endorsed to cover theft losses").
- However, endorsements can remove coverage just as well as they provide it. Some endorsements, for example, may serve to define perils in ways that eliminate coverage courts have found the standard contract to provide.

Legal Liability

Legal Liability Insurance

- Protects individuals and organizations against financial implications due to lawsuits.
- The concept of legal liability has developed from the English common law principle of 'Duty of care'.
- Means that every individual owes a duty of care, which means not causing any injury or suffering to fellow citizens. When this duty is breached, the person is legally liable to compensate the affected parties.
- There are three areas of law under which legal liability risks may arise:
  - *under statute,*
  - *under contract and*
  - *at common law.*

Torts

Involves a breach of civil duty and the person who commits the tort is known as the tortfeasor.

Torts can be classified as under:

- Intentional torts
- Absolute liability/strict liability.
- Negligence

Types of Torts

Intentional Torts

- Result in injury or suffering to others.
- Acts are committed intentionally and are within the control if the insured- can be generally avoidable and are not insurable.
- Some examples
  1. **Libel**: It is the publication of a false statement in a permanent form designed to damage the reputation of another person.
  2. **Slander**: It is similar to libel but in verbal form
  3. **Assault**: It is touching another person unlawfully

Absolute Liability

- Absolute Liability: Sometimes liabilities arise because a law dictates it- arises because of a statute.
- In this case, the negligence or fault need not be established by the affected party. It is also known as 'No Fault Liability'.
- Eg- Employer is legally liable for injury to employee even if there is no negligence on part of the employer.

Strict Liability

- If land is used unnaturally by bringing or collecting or keeping some thing for one's own purposes which can cause mischief to others if it escapes, the person is prima facie answerable for all the damage which is the natural consequence of its escape.
- In case of strict liability certain defenses are allowed..
- For example, if an employee has sustained injuries resulting from his direct disobedience or drunkenness then the employer is not liable. But in case of absolute liability, such defenses are not allowed.

Types of Torts…

Other Liabilities

- **Law of negligence:**
  - Simply put it means- negligence means not doing something, which a reasonable man would do, and doing something, which a reasonable man would not do.
- **Duty of care:**
  - Lord Atkins‘, 'Neighbour principle' comes to some help in deciding if duty or care exists.
  - States that a general duty of care exists towards all legal neighbours - those closely and directly affected by our act or omission at the time the tort is committed.
- **Vicarious Liability:**
  - Follows the legal doctrine *‘respondent superior’*. The word 'vicarious' means 'in place of others'.
  - Vicarious liability arises in case of employer - employee relationship.
  - Employers are vicariously liable to others for the actions of their employees committed while performing their duty.
  - Based on the principle that the employer is financially stronger than the employee and is better able to bear the damage.

Indian Civil Justice System…….

Supreme Court of India

- This apex court is the final court of permissible appeal.
- It also deals with:
- Inter-state matters
- Matters involving more than one State
- Matters between the Union Government and any one or more States

High Courts

- Next in hierarchy after Supreme Court.
- Every state in India has a high court that works under direct guidance and supervision of the Supreme Court.
- The uppermost court in the state & generally the last court of regular appeal.
- Can be approached in writs for violation of fundamental rights under articles 32 and 226 of the Indian Constitution.
- When apparently there is no effective remedy available to a person in equity, he can always move the High Court in an appropriate writ.

Subordinate Courts

- District Courts- hear appeals from districts
- Appellate Labour Courts- hear appeals from the judgments and orders of the subordinate original Labour Courts and officers, under the provisions of various labour and related laws.
- Accident Claims Tribunals- try the claims of road and rail accidents
- City Civil Courts- only present in presidency towns- Mumbai, Chennai & Kolkata.
- Special Courts- setup from time to time to try particular matters deemed to be Important to public life
- Sub-subordinate courts- Litigation mostly begins in these courts
- Labour Courts

Personal Property and Liability Insurance

The sphere of general insurance

- The sphere of general insurance can be divided into five categories.
  - Property Insurance
  - Motor Insurance
  - Liability Insurance
  - Marine Insurance
  - Pecuniary Insurance

Benefits of General Insurance

- Property, motor and liability insurance can offer useful and economical solutions to various key problems in the risk management process of financial planning.

- Some of them are
  - Financial planning also involves preserving wealth like house (property), a car and jewellery.
  - The extent of losses arising from risk concerning property can be huge.
  - Clients may be exposed to the risk of claims by third parties due to loss arising from their acts or omission. For example, negligent driving resulting in a road accident will be liable for the damages.

Property Insurance- Householders' and Houseowners' Insurance

- Protects your home from unpredictable events.
- The typical home insurance, in addition, covers your valuable personal property as well-The contents inside your home like furniture, clothing, stereo, computer equipment, jewelry etc.
- There are lots of schemes available in home insurance. Under the House Holders insurance policy, coverage is available for 10 sections.

Medical Insurance

The risks generally considered under the health insurance include

- Medical Expenses
- Personal Accident/ Loss of Income Due to a Disability
- Long Term Care Expenses

Mediclaim policy

- The Company will pay the Insured the amount of expenses reasonably and necessarily incurred by or on behalf of such Insured Person, not exceeding the Sum Insured in aggregate mentioned in the schedule :

- **Age limit:** 5 years to 80 years. Children between the age of 3 months and 5 years of age can be covered provided one or both parents are covered concurrently.

- **Family discount:** 10%in the total premium will be allowed comprising the insured and any one or more of the following:
  - Spouse
  - Dependent children (i.e. legitimate or legally adopted children)
  - Dependent parents

Mediclaim policy

- **Payment of claim:** All medical treatments will have to be taken in India only.
- **Cumulative bonus:** For each claim free year of insurance, the Sum Insured shall be progressively increased by 5% upto a maximum accumulation of 10 claim free years.
- In case of a claim by Insured, who has earned such cumulative bonus, the increased percentage will be reduced by 10% of Sum Insured at the next renewal, however basic Sum Insured will be maintained and will not be reduced.
- For existing policy holders (as date of implementation) the accrued amount of benefit of cumulative bonus, the bonus will be added to the Sum Insured, subject to the maximum 10 claim free years.
- Cumulative bonus will be lost if policy is not renewed on the date of expiry.
- Waiver: In exceptional circumstances the seven days exception in period of renewal is permissible to be entitled for Cumulative bonus although the policy is renewed only subject to Medical Examination and exclusion of diseases.

Insurance of Business Risk

- **Key person Insurance**: is insurance that a business purchases on the life of a person whose continued participation in the business is necessary to its success and whose death would cause financial loss to the business.

- **Business assets and liabilities Insurance:** These insurance policies are designed to cover the insured against various types of legal liabilities which may arise in anyone of the following ways:

Liability policies:

- Workmen's compensation insurance: Designed to provide indemnity to the insured arising out of injuries and/or loss or damage to a third party due to defective goods that may be sold, repaired, serviced, tested or supplied by the insured

- Product liability insurance: Designed to provide indemnity to the insured arising out of injuries and/or loss or damage to a third party due to defective goods.

- Public liability insurance: Designed to protect the insured against liabilities to third parties arising out of their business activities

Liability policies:

- Directors' and officers' liability insurance: Directors and officers of a company if they breach any of their duties and the company sustains losses, are liable to parties like shareholders. This cover offers them protection from these losses
- Professional indemnity insurance: Designed to cover people who provide professional services in the course of their work & provides indemnity to the insured against legal liability to third party arising from negligence, omissions and mistakes committed by the insured in the course of carrying out their duties to that third party.

Life Insurance Need Analysis

Life Insurance Needs

Two questions need to be answered:

- How much income would be needed for specific purposes if the person should die now: and
- When would it be needed?

Life Insurance Needs

The amount of needs normally constitute the total of the following

- The amount of the client's liabilities such as loans, credit card debts etc
- The immediate expenses that will be incurred at the time of death
- The funds required to support the dependants for the desired period

Human Life Approach

Involves a capitalization of the part of a wage earner's income devoted directly to the support of his/her family.

- **Human Life Value**
  - Used by most insurance agents/planners and at most financial- planning Web sites.
  - Chartered Life Underwriters (CLUs) know the method as Human Life Value Concept or the Human Capitalization Method.
  - According to this concept, an individual's net worth is the present value of that person's future income stream that will be allocated to others.
- **Needs Approach:** Arguably the best way to pinpoint a smart life insurance figure is through a needs analysis, which can be broken down into a simple formula:
- **Short-term needs + long-term needs - resources = how much life insurance you need**
- Experts advise an analysis at least once every three years, or whenever you have had a major life change.

Human Life Approach

- **Capital Need Analysis Approach:** The assumption is that all income needs will be met from earnings on an investment fund that will be kept intact and available to the younger generation when the surviving spouse dies.
- **Steps:**

  1.First step is valuing the estate - construct a personal balance sheet.

  2.Second step is to estimate the amount of capital available to meet the income needs of the family.

  3.Third step is to examine the income position of the family - income analysis

Insurance Policy Analysis

Type of Life Insurance Policies

There are three basic classes of life insurance contracts. They are:

- **Term Insurance**
- **Whole Life Insurance**
- **Pure Endowment**

Type of Life Insurance Policies

Term Insurance

- Provide coverage for a specified period of time.
- In case of death of the policyholder during the term, the sum assured is paid to the nominee of the policy holder.
- In case of survival for the specified period, nothing is payable

Whole Life Insurance

- Cover the insured for their entire life subject to renewal premiums being paid.
- Contains a savings element.
- In case of death of the insured, the sum assured is paid to nominee.
- On maturity, the sum assured is paid to the insured.

Endowment

- Carries a specified benefit amount, regardless of whether the insured survives till the maturity date or not
- Maturity date is reached either:
  - At the end of a stated term or
  - On the insured reaching a particular age.
- On maturity- amount paid either to the insured or to nominee in case of death while the policy is in force.

The new generation products include

- Universal Life
- Adjustable Life
- Variable Life
- Variable Universal Life
- Interest-Sensitive Whole life
- Indeterminate Premium Products

Life Insurance Policy Riders

- Riders are add-on benefits that could be attached with the basic policy.
- They enhances the coverage of the basic policy & are relatively inexpensive.
- The following are the various types or riders available
  - Critical illness rider
  - Payor Benefit
  - Term rider
  - Surgical rider
  - Spouse rider
  - Waiver of Premium rider
  - Accidental Death rider
  - Disability rider
  - Guaranteed insurability rider
  - Disability Income benefit

Life Insurance Policy Riders

Critical Illness Rider

- The insurer agrees to pay a specific sum of money to the insured if he contracts a critical illness covered under the policy.

Waiver of premium

- The company waives off its right to collect renewal premiums that become due when the insured becomes totally disabled

Payor Benefit Rider

- Waives off the balance premiums if the premium payor dies or is disabled during the premium payment term

Term Rider

- Under this policy in the event of death during the term of this benefit, the beneficiary would receive an additional death benefit amount, which is over and above the sum assured.

Accidental Death Rider

- If the insured dies due to accident, the insurer pays the beneficiary an amount in addition to the death benefit provided by the insurance company

Spouse Rider

- Insured can cover his/ her spouse without taking a fresh policy.
- In case of death of spouse, insured gets the spouse benefit sum assured
- If the insured dies before the spouse, he/ she may convert the rider into a contract with the insurance company.

Life Insurance Policy Riders

Surgical Rider	Guaranteed Insurability Rider	Payor Benefit Rider
• This rider added to a life insurance policy provides financial support in case of medical emergencies	• Guarantees the insured the right to purchase additional life insurance at different stages in his/her life without having to undergo any further medical examination.	• This rider provides a monthly income benefit to the insured if he/she becomes totally disabled while the policy is in force.

Life Insurance Policy Selection

- Choice of a life insurance policy depends on age and needs of the person, life cycle stages, attitudes, expectations and financial well being of an individual.
- The choice of a life insurance plan by an individual, actually depends on a number of factors:

Needs	Extent and the period of time over which the protection is required
Special Needs	Depend upon status and occupation. In some occupations, risk of disability/ mortality is more
Risk bearing Capacity and Wealth of Individual	The amount of risk that the individual may be willing to take and the wealth he has
Premium	Affordability of premium outgo in relation to disposable income
Returns on Life Insurance Plans	In case of early death, returns on Life insurance would be high, but in case held till maturity, returns would be comparable to return on Savings deposits.
Tax Features of Life Insurance Policy	Premiums paid are eligible for tax rebates under the Income tax Act.

Calculation of costs

- **Belth Method:**

  $$\frac{(P + CVP) \times (I + i) - (CSV + D)}{(F - CSV) \times 0.001}$$

- **0.001 = Policy cost per thousand conversion**
- **i = Interest rate selected equivalent to the after-tax rate of return that could have been generated from investing an amount equivalent to the premium and the cash surrender value (P+CVP) in an alternative investment vehicle having similar investment risk characteristics**
- **D = Dividend or bonus**
- **F = Death benefit**
- **P = Annual premium**
- **CSV = Cash surrender value at the end of current policy year**
- **CVP = Cash surrender value at the end of the previous year**

What are Annuities?

- An annuity is any series of payments made or received at regular intervals.
- Annuity benefits protect against the risk of outliving one's financial resources.
- Life annuity- Insurance company GUARANTEES that the individual will receive the same payments each year no matter how long they live. Purchased the same way as life insurance.
- A person can either purchase the annuity with a one-time large payment or with smaller yearly premiums before the annuity's payments begin.

Annuities- Features

- Usually the person who buys the annuity determines the amount per month they wish to receive.

- If the insured dies before payments begin, the premiums paid are returned to the beneficiary.

- The size of the payments, in relation to the total amount of the contract, depends on the annuitant's (the owner of the annuity) age when the payments begin and the sex of the annuitant.

- *Annuities* start where life insurance ends. It is called the ‘reverse’ of life insurance.

Annuity benefits: Relevant Factors

- The amount of principal invested
- The time over which the principal accumulates at interest
- The interest rate earned on investment
- The number & timing of periodic annuity payments

Annuities- Types

Number of lives covered

- Single
- Joint

Period of payment

- Annuity Certain
- Pure life Annuity
- Life and period certain
- Refund Annuity

Method of paying premium

- Single Premium
- Regular Premium Payments

Beginning of payment of annuity

- Immediate
- Deferred

Quantum of annuity installment

- Fixed
- Variable
- Index Linked

Business Liability Insurance

- Designed to cover the insured against various types of legal liabilities which may arise in anyone of the following ways:

- **Pursuant to contract:** An example - a contract where A promises to indemnify B (the other contracting party) against any liability to third parties.

- **Pursuant to the Common law**: A typical example- the tort of negligence where a person could be liable for damage sustained by a third party due to his negligence.

- **Pursuant to legislation:** A typical example - strict liability imposed on an employer for injuries or death sustained by the employees under the Workmen's Compensation Act.

Liability Policies

Workmen’s Compensation Insurance

- The Workmen’s Compensation Act imposes legal liability on the employer to pay specific compensation to a workman in the event that he is stricken with a specified occupational' disease or is injured or dies from accidents that occur out of and during the course of employment.

- Under the Act, a workman is defined as all manual labourers and non-manual workers, whose monthly income does not exceed Rs 3,500.

What does this cover?

- In the event of death 40% of monthly wages of the deceased workman multiplied by the relevant factor.

- In the event of permanent incapacity of the worker, 50% of the monthly wages of the deceased workman multiplied by the relevant factor or an amount of Rs 24,000 whichever is more.

- In the event of temporary disablement, a half-monthly payment of the sum whether total or partial results from the injury equivalent to 25% of the monthly wages of the workman to be paid in accordance with the provisions.

What does this cover?

- Half monthly payment shall be payable on the 16th day:
  - From the date of disablement where such disablement lasts for a period of 28 days or more
  - After expiry of the waiting period of 3 days from the date of disablement where such disablement lasts for a period of less than 28 days and thereafter half monthly during the disablement or during a period of 5 years, whichever is shorter.
- Medical expenses subject to limits imposed in the act.

Product Liability Insurance

- Designed to provide indemnity to the insured arising out of injuries and/or loss or damage to a third party due to defective goods that may be sold, repaired, serviced, tested or supplied by the insured.
- The indemnity normally includes legal costs and expenses, and the scope of coverage may be extended to include product recall and/or product guarantee.
- The following are the normal exceptions
  - War-related risks
  - Radioactive-related risks
  - Natural perils
  - Risks, which should be insured under other types of policies like Workmen's compensation policy and product liability policy

Director’s and Officer’s Liability Insurance

- Indemnifies the director for any damages payable by him.
- Indemnifies the company for any cost reimbursed to the director to enable him to legally defend any action.
- Is made on a “claims made" basis, which means that, irrespective of when the act incurring liability occurs, the claim against the insurer must be made during the currency of the policy.

- The following are typical exclusions of the policy:
  - Criminal fines and penalties
  - Breach of professional duty
  - Fraudulent and/or dishonest acts of the director

Professional Indemnity Insurance

- This type of insurance is designed to cover people who provide professional services in the course of their work.
- It provides indemnity to the insured against legal liability to third party arising from negligence, omissions and mistakes committed by the insured in the course of carrying out their duties to that third party.
- Typical examples of such professionals are engineers, doctors, architects, lawyers and financial planners.
- It usually covers legal expenses and costs reasonably incurred and carried out with the consent of the insurer.
- They are usually issued on a "claims made" basis.

Normal Exceptions

- The following are typical exclusions of the policy:
  - Loss resulting from lack of fidelity of employees or partners
  - Claims arising from libel or slander unless committed during the course of discharge of professional duties
  - Claims arising from war-related or radioactive related risks
  - Claims already known or arising from known circumstances
  - Risks that should be insured under other types of policies

Insurance Regulatory & Development Authority (IRDA)

- The Insurance Act, 1938 - provided for setting up of the Controller of Insurance to supervise and regulate the insurance sector.
- The need for a strong, independent and autonomous Insurance Regulatory Authority was felt after the opening up of the insurance Industry .
- The IRDA Act, 1999 is an act to provide for the establishment of an Authority to
    - protect the interests of holders of insurance policies,
    - to regulate, promote and ensure orderly growth of the insurance industry and
    - for matters connected therewith or incidental thereto and further,
- To amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General insurance Business (Nationalisation) Act, 1972 to end the monopoly of the Life Insurance Corporation of India (for life insurance business) and General Insurance Corporation and its subsidiaries (for general insurance business).

Provisions of the IRDA Act

- **Composition of Authority:** Authority shall consist of a chairperson, not more than 5 full time members and not more than 4 part time members,
- **Tenure of service:** A period of 5 years and eligible for re-election till the age of 65 years.
- **Removal from office:** If adjudged insolvent, mentally or physically incapable to perform duties, convicted of any moral offence, abuse of authority, has a vested financial or other interest which is likely to affect functioning.
- **Bar on future employment of members:** The Chairperson and the whole-time members shall not, for a period of two years from the date of having held such post, take up employment in the Central or State Government or in any company in the insurance sector.

Provisions of the IRDA Act

- **Administrative powers of Chairperson**: Powers of general superintendence and direction in respect of all administrative matters of the Authority.

- **Vacancies, etc., not to invalidate proceedings of Authority** : No Act or proceeding of the Authority shall be invalid merely by reason of any vacancy in, or any defect in the constitution of, the Authority, any defect in the appointment of a person acting as a member of the Authority, any irregularity in the procedure of the Authority not affecting the merits of the case.

Provisions of the IRDA Act

- **Officers and employees of Authority:** The Authority may appoint officers and such other employees as it considers necessary for the efficient discharge of its functions under this Act.

- The terms and other conditions of service of officers and other employees of the Authority shall be governed by regulations made under this Act.

Duties, Powers and Functions

- To issue to the applicant a certificate of registration, to renew, modify, withdraw, suspend or cancel such registration
- Protection of the interests of the policy-holders
- Specifying requisite qualifications code of conduct and practical training for intermediary or insurance intermediaries and agents surveyors and loss assessors
- Promoting efficiency in the conduct of Insurance Business.
- Promoting and regulating professional organizations connected with the insurance and reinsurance business
- Levying fees and other charges for carrying out the purposes of this Act.

Duties, Powers and Functions

- Conducting Audit of Insurance companies and intermediaries.

- Control & regulation of the rates, advantages, terms and conditions that may be offered by insurers for general insurance business not controlled & regulated by the TAC* under section 64U of the Insurance Act, 1938

- Prescribing the form & manner in which books of account shall be maintained & statements will be rendered by insurers and other intermediaries

- Regulating investment of funds by insurance companies, maintenance of margin of solvency, adjudication of disputes between insurers and intermediaries or insurance intermediaries

Tariff Advisory Committee

Provisions of the IRDA Act

- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations
- Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector
- Supervising the functioning of the Tariff Advisory Committee
- Exercising such other powers as may be prescribed.

Provisions of the IRDA Act

- **Grants by Central Government:** The Central Government may, make to the Authority grants of such sums of money as the Government may think fit for being utilised for the purposes of this Act.
- **Fund:** A Fund to be called **"The Insurance Regulatory and Development Authority Fund"** is to be established and the following sums will be credited thereto :-
  - All Government grants, fees and charges received by the Authority
  - All sums received by the Authority from such other source as may be decided upon by the Central Government
  - The percentage of prescribed income received from the insurer.
- **The Fund shall be applied for meeting the following expenses :-**
  - the salaries, allowances and other remuneration of the members, officers and other employees of the Authority
  - the other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

Provisions of the IRDA Act

- **Accounts and audit:** The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in the form prescribed by the Central Government in consultation with the Comptroller and Auditor General of India.

- The accounts of the Authority shall be audited by the Comptroller and Auditor General of India at intervals specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor General of India.

Provisions of the IRDA Act

- The Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time

- However, Authority must, as far as practicable, be given an opportunity to express its views before any such direction is given. The decision of the Central Government, whether a question is one of policy or not, shall be final.

Agent

- According to Section 182 of the Indian Contracts Act, an 'agent' is a person' employed to do any act for another or to represent another in dealing with a third person. The person for whom such act is done or who is so represented is called the 'principal'.

- The lawyer is the agent of the client, when he argues the case in court. An ambassador is an agent of his country. It is the function, which determines the relationship of agency, not the designation.

- The Insurance Act defines an insurance agent *as one who is licensed under Section 42 of that Act and is paid by way of commission or otherwise, in consideration of his soliciting or procuring insurance business, including business relating to the continuance, renewal or revival of policies of insurance. He is, for all purposes, an authorized salesman for insurance.*

Agents Regulations

- The Insurance Regulatory and Development Authority (IRDA), constituted by the IRDA Act of 1999, issued the IRDA (Licensing of Insurance Agents) Regulations, 2000.

- Deal with the issue of licences under Section 42 of the Insurance Act, 1938 and other matters relating to agents.

- By another notification in October 2002, these Regulations were made ineffective for corporate agents and the new IRDA (Licensing of Corporate Agents) Regulations, 2002 were issued.

- These Regulations deal with the issue of licences and other matters relating to corporate agents.

Agents Regulations

- License will not be given if the person is
  - (a) a minor,
  - (b) found to be of unsound mind
  - (c) Found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or attempt of commit any such offence
  - (d) found guilty of or knowingly participating in or conniving at any fraud, dishonesty or misrepresentation against an insurer or an insured
  - (e) not possessing the requisite qualifications and specified training
  - (f) not passed such examinations as are specified by the Regulations
  - (g) found violating the code of conduct as specified by the Regulations.

- Besides Individuals, collectives like companies, firms, banks, cooperative societies, etc., can also become agents after designating one or more persons as 'Corporate Insurance Executives', who will be required to obtain licences.

Remuneration of Agents

- A life insurance agent is paid a stated percentage of the premium collected through his agency as commission.

- Section 40 A (1) of the Insurance Act stipulates the maximum amount of commission or remuneration which can be paid to a life insurance agent:
  - 35% of the first year's premium,
  - 7.5 % of the second and
  - Third year's renewal premium and
  - 5% of subsequent renewal premium.

Remuneration of Agents- Exceptions

- During the first ten years of the insurer's business, he may be paid 40% first year's premium.
- Under certain circumstances, commission of 6% can be paid on the renewal premium even beyond the third year.
- Within these limits, the manner of remunerating the agent will be determined by the insurer.
- Normally, under terms assurance plans, commission rates are less.
- Similarly, for shorter duration policies, commission rates are lesser than under longer duration plans.

Procedure for becoming an agent

- The Insurance Act, 1938 lays down that an insurance agent must possess a licence issued by the IRDA, under Section 42 of that Act.
- The IRDA has authorized designated persons, in each insurance company, to issue the licences on their behalf.
- The fee for the licence, the manner of making application, etc., have been described in the IRDA Regulations.
- The license will be valid for three years and may be to act as an agent for a life insurer, for a general insurer or as a “composite insurance agent”, working for a life insurer as well as a general insurer.
- No agent is allowed to work for more than one life insurer or more than one general insurer.

Qualifications for becoming an agent

- The person (individual or corporate insurance executive) must:
  - Be at least 18 years old
  - Have passed at least the 12th standard or equivalent examinations, if he is to be appointed in a place with a population of 5000 or more, or 10th standard otherwise
  - Have undergone at least 100 hours practical training in life or general insurance business, from an institute approved and notified by the IRDA.
  - For a composite insurance agent, the applicant should have completed at least 150 hours of practical training in life and general insurance business, which may be spread over six to eight weeks.
  - Have passed the pre-recruitment examination conducted by the Insurance Institute of India or any other IRDA recognized examination body.

Qualifications for becoming an agent

- Applications for renewal have to be made at least thirty days before the expiry of the licence, along with the renewal fee of Rs.250.

- If the application is not made before the date of expiry of licence, an additional fee of Rs.100 is payable.

- If the application is made after the date of expiry, it would normally be refused.

- Prior to renewal of the licence, the agent should have completed at least 25 hours of practical training in life or general insurance business or at least 50 hours practical training in life and general insurance business in the case of a composite insurance agent.

Disqualifications

- A person with the following disqualifications is debarred from holding a licence:
  - He has been found to be of unsound mind by a court of competent jurisdiction
  - He has been found guilty of criminal breach of trust, misappropriation, cheating, forgery or abetment or attempt to commit any such offence.
- The licence once issued, can be cancelled whenever the person acquires a disqualification.

Insurance Pricing

- Pricing generally refers to methods used to determine general rate levels, and the phrase rating procedure recognizes special characteristics of an exposure for which coverage is sought. Most insurance prices rely on claim data.

- Loading process adjusts estimated (or actual) claim costs to account for the cost of administering the insurance claim and providing other services associated with insurance. Loading also may include an allowance for uncertainty and profit.

- Rate is the price per unit of exposure.
  - Net premium= rate needed to pay losses and loss adjustment expenses (cost of expected loss)
  - Loading= other expenses (allowance for profit, contingencies, commission, taxes and fee) (cost of doing business)
  - Office premium=net premium + loading

Objectives of Rate Making

- **Regulatory Objective:**
  - Regulations require reasonable, adequate and not unfairly discriminatory rates for property and liability insurance . Insurance rates are adequate if, they are high enough to maintain the solvency of insurers.
  - The fairness requirement requires that rate differentials among insured should reflect differences in expected losses and expenses for these insured
- **Strategy in competitive market**:
  - When there is a competition among insurers, pricing helps them understand the expected outcome of their pricing strategy.
  - An insurer whose rates are unreasonably high will be underbid by competing insurers, forcing the insurer to lower rates or lose business.
  - At the other extreme, an insurer whose rates are inadequate, ultimately becomes insolvent and is withdrawn from the market

Basic Rating Methods

Individual/ Judgement Rating

- Each exposure is individually evaluated. Rating is based largely by underwriter's judgement.
- Each Insured is charged a unique premium based on the judgement of the person setting the rate supplemented by knowledge of premium charged to similar insured and stats.
- Reliance on this method alone is not common in the industry today.

Class/ Manual rating

- Insureds are classified on the basis of few observable characteristics and all in one class are charged the same premium.
- The person has to be put in the correct class.
- Widely used for individual life insurance and health insurance rates, automobile insurance rates, homeowner's insurance rates on dwellings, and general liability and workers' compensation rates for small organizations.

Modification/ Merit Rating

- The rate distinguishes among insureds in the same rating class on the basis of difference in expected losses or expense per exposure unit.
- The distinctions may be based on past experiences, size of exposures, or detailed analysis of the quality of the exposure.
- For types are:
- Schedule rating
- Experience rating
- Retrospective rating
- Premium discount plans

Types of Merit Ratings

- **Schedule Rating:** Modification based on a comparison between some specified characteristics of a standard insured and the corresponding characteristics of the proposed insured.

- **Experience and retrospective ratings:** Claim-sensitive rating methods. Both the methods recognize the claim activity of the insured organization in setting the rate for insurance coverage. Available only to large organizations.

- **Premium Discount Plans:** Reduce rates for large-premium insureds on the ground that economies of Large scale arise. The most important premium-discount plans are those recognizing that not all the expenses of servicing an insured increase proportionately with the size of the premium. Premium-discount plans usually apply a table of discounts to the premiums otherwise charged.

Underwriting

- The process of selection and classification of risk exposures to determine the extent of premium payable by a particular individual.
- The goal of underwriting is to avoid a disproportionate amount of bad risks.
- In addition, an underwriter has to gain a sufficient number of exposure units in each class.
- For the insurance concept to be viable, the main class should be those in the standard category, namely, the category consisting of those exposed to an average level of risk.

Factors Influencing Underwriting

- Age
- Build
- Physical condition
- Personal history
- Family history
- Residence
- Habits
- Occupation
- Morals
- Sex
- The nature of the insurance plan
- Economic status

The Underwriter gets information from

- **Agent:** The insurance agent or broker is normally appointed the field underwriter as he usually gets precise information as to what types of risks are deemed acceptable to the insurer. He is required to submit a report containing relevant information about the insured. As he is the only representative from the insurer to see and speak to the prospect, he is expected to report any instances of false representations.

- **The Applicant:** A substantial amount of information is supplied by the applicant, by way of completion of an application form.

- **Medical Sources:** The insurer may also send the applicant for the relevant medical examinations and tests or apply for attending physician's report to ascertain the health of the applicant.

Underwriting Methods

Life insurers resort to two methods of underwriting, namely:

- **The Judgement method**; and
- **The Numerical rating system**

Underwriting Methods

- **Judgment method:**
  - Regular and routine applications are managed by the clerical staff.
  - The more difficult or borderline cases will be referred to senior supervisors for their assessment.
  - Suitable in cases where there is only one unfavourable factor or the only decision applicable is either to accept or reject the case.

- **Numerical Rating system:**
  - Based on the premise that a large number of factors determine the nature of the risk.
  - An insured with an average risk is given a 100% rating.
  - Adverse factors will increase the rating by an amount relative to the seriousness, while a favourable factor will reduce the rating by an amount related to the extent of favourability of the factor involved.

Reinsurance

- A reinsurance policy is a contract where an insurer of a risk or several risks transfers part of such risks to a party or parties who are known as reinsurers.

- The transfer can be-made individually or by way of pre-arrangement. In such cases, the insurer is known as the cedant. Usually under such arrangements, the original insured is not a party to the reinsurance contract.

- The cedant is still totally and primarily liable to the original insured under the original insurance policy where the reinsurer is liable only to the cedant under the reinsurance contract.

- In turn, the reinsurer, if it so wishes can transfer part or all of the risk that it bears to another party who is called the retrocessionaire

Why Reinsurance?

- **Security** - Enables the insurer to transfer a portion of a risk to a reinsurer, thereby decreasing its risk exposure and reducing its losses in the event a claim is made.

- **Capacity** - If an applicant applies for coverage beyond the maximum capacity, rather than rejecting the application, the direct insurer can cede part of the risk to a reinsurer to an extent that allows it to accept the risk. This ensures that it does not lose valuable business without having to sacrifice underwriting limits.

- **Stability -** Reinsurance allows the direct insurer to "smoothen" the fluctuations in losses and tamper it, making the business more stable.

- **Protection against catastrophes:** By spreading its risks through reinsurance, it can protect itself from risks of catastrophes.

Types of Re-insurance

- **Facultative reinsurance**
- **Treaty reinsurance.**

Facultative Re-insurance

- Each risk is transferred on an individual basis.
- The terms of the reinsurance contract are negotiated.
- The reinsurer has the discretion to decline or accept the risk or make counter offers or accept a smaller portion of the risk.
- **Advantages :**
  - It accords flexibility to the cedant and reinsurer as the term for every risk to be ceded can be negotiated on an individual basis.
- **Disadvantages:**
  - The duty imposed on the cedant under the law is onerous.
  - It is time consuming.
  - It can be costly in view of the extra work that needs to be done.

UNIT –V

Introduction to Risk, meaning and types of risk in business and individual Risk management process, methods, Risk identification and measurement, risk management techniques, non insurance methods.

What is a Risk?

- An uncertain event or condition, which if occurs, would have an undefined or unknown impact on achievement of objective.

Causal Forces

- Natural Perils: Fire, wind, hail, explosion.
- Human Perils: Theft, riot, vandalism, negligence.
- Economic Perils: Stock market declines, inflation, technological advances.

Classification of Risks

Pure

No Prospect of gain, only Loss. Eg- Fire

Types:

- **Property Damage Risk-** Risk of loss to personal belongings due to theft, accident, fire & Natural disasters
- **Liability Risk-** Risk of economic loss resulting from your being held responsible for harming others or their property
- **Personal Risk-** Risk of death, poor health or outliving savings

Speculative

Offers the possibility of gain or loss.

These are generally not Insurable

Fundamental

Tend to affect large sections of society or even the world, rather than an individual.

Particular

Restricted Consequences

Most insurable risks are particular risk

Financial

Possibility of Financial Risks

Methods of handling risks

Avoiding	Controlling	Accepting	Transferring
To avoid the risk altogether. For Eg: Not Investing in the stock market, to avoid financial loss	Take steps to prevent losses. For Eg: Controlling the risk of fire in a cotton godown by banning smoking in godown.	To accept or retain the risk and to assume all financial responsibility for that risk.	Transferring the risk to another party and shifting the financial responsibility to that party, Generally for a fee Eg. Insurance

Basic Characteristics of Insurance

- **Risk pooling:**
  - Risk transfer from individual to a pool of the insurance company's policyholders.
  - The company charges premium for accepting risk
  - It 'pools' premiums from a group of policyholders into a general fund to fund the death benefits under contract.

- **Law of large numbers:**
  - Larger the pool, more predictable the amount of losses in a given period.
  - Since not all members of the pool are the same age or in the same health condition, we can assume not all of them will be making a claim at the same time.

Requirements of Insurable Risks

- **Sufficient number of homogeneous exposure**
- **The loss must occur by chance**
- **The loss must be definite**
- **The loss must be significant**
- **The loss rate must be predictable**
- **The loss must not be catastrophic to the insurer**

Advantages and Disadvantages of insurance in handling risks

Advantages

- **Indemnification:**
  - Rupee benefits paid or services rendered to insured who suffer covered losses
  - Continuity in operations at or close to the same rate as before the accident.
- **Reduction of uncertainty**
  - Permits lengthening planning horizons
  - Allows the firm to accept more uncertainties in other areas
  - May contribute to improved performance

Disadvantages

- **Less incentive for loss control:**
  - Insurer's expected loss estimate will rise, causing premiums to rise.
  - Insurance does not cover all the financial consequences of insured events.
  - Lax attitude toward loss control of insured events is likely to increase the incidence of non-insured events.
- **Exaggeration or false reporting of insured claims:**
  - Subsequently premiums may rise or there may be difficulty retaining insurance coverage.
  - Insured may benefit, but society does not

Personal Risk Management

What is Risk Management?

- Process that uses physical & human resources to accomplish certain objectives concerning most pure loss exposures.
- Concerned with recognizing risks, severity and controlling of risks.
- The identification, analysis and economic control of risks which can threaten the life, assets or earning capacity of an individual/enterprise.

Objectives of Risk Management- Post Loss

Survival

- Most important & Basic Post loss objective.
- Aim is to ensure atleast partial resumption of operations within reasonable time frame

Continuity of operations

- Important for the entity to continue to serve clients and customers.
- They may otherwise turn to competitors and not return

Earnings Stability

- Continue operations at no increase in cost.
- Funds to replace lost earnings resulting from loss of operation.
- A combination of the above.
- Perfect stability is not the goal

Continued Growth

- Product & Market Development.
- Acquisitions & Mergers

Social Responsibility

- Good citizenship resulting in a good image

Objectives of Risk Management- Pre Loss

Economy

- Firms seek to prepare for possible happenings in economical ways consistent with post loss goals.

Reduce Anxiety

- Reduce fear created because of uncertainty and costs.

Meeting External Obligations

- Satisfies responsibilities imposed by others.
- Requirement of insured property as collateral

Social Responsibility

- Measures taken prior to loss contributes to the reduction of fear of loss.

Steps in Personal Risk Management

- **Identify/Analyse loss exposure / risks**
- **Determine the technique**
- **Implement the technique**
- **Monitor Decisions**

Identification of Risk Exposures

Collection of Information

- An appropriate advice to the client on insurance requires sound understanding of the client's current position and future plans.

- This requires collection of information about the client, which may generally include:
  - Banks statements
  - Tax returns
  - Last annual statement for insurance policies
  - Superannuation details
  - Credit card statement, current and previous cheque book

Types of Financial Needs

- Financially providing for the individual and his family during unpredictable events such as the death or disability of the breadwinner.

Emergency Fund	Reserved for use during crises or emergencies
Educational Fund	Keeping aside a sum of money for child's higher education needs.
Final Expenses	Fund to be used for payment of liabilities/ expenses immediately after an individuals death.
Fund to redeem mortgage	Keep aside a sufficient sum of money for paying off loans in case of death.
Income Needs	Income to family in case the breadwinner passes away. Required for essentials, non-essentials and expense payments.
Retirement Income	For helping the client live out his retirement comfortably
Accumulation needs	Accumulation of money for purchase of an asset, starting a business, charity and so on.
Other needs	Any other need not discussed above.

Need Based Analysis- Steps

Fact finding

Important notice to Clients

Personal Information

Data on Dependants

Data on Employment

Personal Priorities

Retirement Needs

Monthly Income & Expenses

Assets and Liabilities

Investment Preferences

Need Based Analysis- Steps

Need Analysis

Life Cycle stage of Client

Occupation/Employment

Needs of Dependants

Goals and objectives of clients

Existing Life Insurance

Investment Preferences

Monthly Income & Expenses

Need Based Analysis- Steps

- Step 3 is to quantify the Insurance needs of the client.

Quantification of clients Insurance Needs

↓

Family Income Protection

↓

Disability Income Protection arising from critical illness & accidents

↓

Retirement Needs

↓

Savings needs

Family income protection

- This need normally arises when client has dependants who could be left without any financial support in case of clients death.

- Adequate insurance coverage should be available to provide for their needs until a time when such needs are no longer necessary.

- The amount of needs normally constitute the total of the following:
  - The amount of the client's liabilities such as loans, credit card debts, etc
  - The immediate expenses that will be incurred at the time of death
  - The funds required to support the dependants for the desired period

Family income protection

- The computation of the amount can be based on three of the following

Needs Based Approach

- Annual income needed by family after clients death- subtract clients personal expenses from current living expenses- (C)
- Identify dependant with longest dependency period and ascertain the duration- (D)
- Identify inflation rate and rate of return
- Based on the above, calculate PV- (E)
- List and quantify fair market value of family assets that can be used by dependants in case of client's death. Obtain total amount- (F)
- Calculate shortfall- Subtract (F) from (E). This will give you (G)

Multiple Approach

- Ascertain the following:
  - The current annual gross income of the client (J)
  - A suitable rate of return is derived (K)
  - The number of years to retirement (L)
- In time value calculation, the following inputs are used:
  - pmt: J
  - i: K
  - n: L
- Calculate PV (AD) to get family income protection needs.

Capital Preservation Approach

- The insurance proceeds are used as a principal sum to generate interest and only the interest is used to provide for the dependants needs.
- Upon the dependants needs being fully satisfied, the principal sum can be distributed to the designated beneficiaries.
- To calculate the life insurance needs, divide real income by rate of return less inflation rate and add the amount derived by the first year income required.

Disability Income Protection

- If the client is disabled or critically ill, further protection will be required. Disability income would fall under:
  - Medical expenses- The medical costs involved. Can be estimates at best, due to the number of uncertainties involved. **The amount is derived by subtracting the insurance proceeds.**
  - Ancillary Expenses- Client may require ongoing treatment to combat the disability/ illness.

    After subtracting the amount of insurance proceeds from existing policies that can cater to this need (like disability income insurance) from the total amount, the shortfall is derived.

Disability Income Protection

How to calculate maintenance amount

- PMT- The annual income required for the whole family including the client.
- I- The inflation adjusted rate of return.
- N- The period when payments will be required.
- Calculate PV(AD) to get the monthly expenses.

Need Based Approach- Steps

Presenting Recommendations

↓

Implement the insurance

↓

Monitor and review the plan

Presenting, Implementing and monitoring

- The planner will present the recommendations to the client, who may accept them or wish to make modifications.

- After study and analysis, an insurance plan suitable and acceptable to the client will be finalized.

- The planner will then implement the plan with the services of Life Insurance Agents or Brokers if required.

- Once implemented regular monitoring and review of the plan has to be done to ensure relevance to the client's needs.

- Certain events may also trigger off the need for review. For instance, instead of sending his child to a local university, the client may want to send him overseas.

Frequency of Review

- There is no set frequency for conducting of the review.
- However it is recommended that a review be held periodically.
- Reviews can be held when required by the client or when the planner is of the opinion that certain circumstances warrant the need for a review of the plan.

Establishing and implementing changes

- The periodic reviews will highlight if any changes are required to be made.
- Once a change is identified, the Planner will once again create a new plan with the changes incorporated.
- The new plan will be presented to the client and the client will be given the opportunity to peruse through it.
- The changes will then be implemented after such discussions with the client.

Treaty Re-insurance

- Risks of a specified class or classes of business are reinsured. For example:-Liability or property insurance.

- Usually renewable every year.

- **Advantages :**
    - Easy to administer
    - Less costly
    - Less onerous for the cedant in fulfilling his obligations

- **Disadvantage:**
    - The treaty reinsurance contract is binding on both the parties . It becomes an automatic process and is less flexible.

Thank You