CHAPTER : 1

INTRODUCTION

1.1 BRIEF HISTORY OF INSURANCE

The Indian life insurance industry has its own origin and history, since its inception. It has passed through many obstacles, hindrances to attain the present status. Insurance owes its existence to 17th century England. In fact, it took shape in 1688 at a rather interesting place called Lloyd's Coffee House in London, where merchants, ship-owners and underwriters met to discuss and transact business. The first stock companies to get into the business of insurance were chartered in England in 1720. The year 1735 saw the birth of the first insurance company in the American colonies in Charleston. In 1759, the Presbyterian Synod of Philadelphia sponsored the first life insurance corporation in America for the benefit of ministers and their dependents.

Life insurance in its modern form came to India from England in 1818 with the formation of Oriental Life Insurance Company (OLIC) in Kolkata mainly by Europeans to help widows of their kin. Later, due to persuasion by one of its directors (Shri Babu Muttyal Seal), Indians were also covered by the company. However, it was after 1840 that life insurance really took off in a big way. By 1868, 285 companies were doing business of insurance in India. Earlier these companies were governed by Indian company Act 1866.

By 1870, 174 companies ceased to exist, when British Parliament enacted Insurance Act 1870. These companies however, insured European lives. Those Indians who were offered insurance cover were treated as sub-standard lives and were accepted with an extra premium of 15% to 20%. By the end of the 18th century, Lloyd's had brewed enough business to become one of the first modern insurance company.
1.2 MEANING AND CONCEPT OF INSURANCE

Life is a roller coaster ride and is full of twists and turns. Insurance policies are a safeguard against the uncertainties of life. As in all insurance, the insured transfers a risk to the insurer, receiving a policy and paying a premium in exchange. The risk assumed by the insurer is the risk of death of the insured in case of life insurance.

Insurance policies cover the risk of life as well as other assets and valuables such as home, automobiles, jewelry etc. On the basis of the risk they cover, insurance policies can be classified into two categories:

(a) *Life Insurance*

(b) *General Insurance*

Life insurance products cover risk for the insurer against eventualities like death or disability. Non-life insurance products cover risks against natural calamities, burglary, etc.

Insurance is system by which the losses suffered by a few are spread over many, exposed to similar risks. With the help of Insurance, large numbers of people exposed to a similar risk make contributions to a common fund out of which the losses suffered by the unfortunate few, due to accidental events, are made good. Insurance is a protection against financial loss arising on the happening of an unexpected event. Insurance policy helps in not only mitigating risks but also provides a financial cushion against adverse financial burdens suffered.

Insurance is defined as a co-operative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to ensure themselves against that risk. Risk is uncertainty of a financial loss. Insurance is also defined as a social device to accumulate funds to meet the uncertain losses arising through a certain risk to a person injured against the
risk. Insurance provides financial protection against a loss arising out of happening of an uncertain event. A person can avail this protection by paying premium to an insurance company. A pool is created through contributions made by persons seeking to protect themselves from common risk. Any loss to the insured in case of happening of an uncertain event is paid out of this pool. Life insurance has come a long way from the earlier days when it was originally conceived as a risk-covering medium for short periods of time, covering temporary risk situations, such as sea voyages. As life insurance became more established, it was realized what a useful tool it was for a number of situations that includes temporary needs, threats, savings, investment, retirement etc. Insurance is a contract between two parties whereby one party agrees to undertake the risk of another in exchange for consideration known as premium and promises to pay a fixed sum of money to the other party on happening of an uncertain event (death) or after the expiry of a certain period in case of life insurance or to indemnify the other party on happening of an uncertain event in case of general insurance. The party bearing the risk is known as the 'insurer' or 'assurer' and the party whose risk is covered is known as the 'insured' or 'assured'.

According to the U.S. Life Office Management Inc., “Life Insurance provides a sum of money if the person who is insured dies whilst the policy is in effect.”

The definition of insurance can be seen from two view points:

(a) **Functional Definition**

(b) **Contractual Definition**

(a) **Functional Definition**

Insurance is a co-operative device of distributing losses, falling on an individual or his family over large number of persons each bearing a nominal expenditure and feeling secure against heavy loss.
(b) Contractual Definition

Insurance may be defined as a contract consisting of one party (the insurer) who agrees to pay to other party (the insured) or his beneficiary, a certain sum upon a given contingency against which insurance is sought.

1.3 PRINCIPLES OF INSURANCE

Insurance is based upon:

(a) Principles of Co-operation

(b) Principles of Probability

(a) Principles of Co-operation

Insurance is a co-operative device. If one person is providing for his own losses, it cannot be strictly insurance because in insurance the loss is shared by a group of persons who are willing to co-operate.

(b) Principles of Probability

The loss in the form of premium can be distributed only on the basis of theory of probability. The chances of loss are estimated in advance to affix the amount of premium. Since the degree of loss depends upon various factors, the affecting factors are analyzed before determining the amount of loss. With the help of this principle, the uncertainty of loss is converted into certainty. The insurer will not have to suffer loss as well as gain windfall. Therefore, the insurer has to charge only so much of amount which is adequate to meet the losses.

The insurance, on the basis of past experience, present conditions and future prospects, fixes the amount of premium. Without premium, no co-operation is possible and the premium cannot be calculated without the help of theory of probability, and consequently no insurance is possible.
1.4 FUNCTIONS OF INSURANCE

The functions of Insurance can be bifurcated into three parts:

(a) Primary Functions

(b) Secondary Functions

(a) Primary Functions

The primary functions of insurance include the following:

➤ *Provide Protection*

The primary function of insurance is to provide protection against future risk, accidents and uncertainty. Insurance cannot check the happening of the risk, but can certainly provide for losses of risk. Insurance is actually a protection against economic loss, by sharing the risk with others.

➤ *Assessment of risk*

Insurance determines the probable volume of risk by evaluating various factors that give rise to risk. Risk is the basis for determining the premium rate also.

➤ *Collective bearing of risk*

Insurance is a device to share the financial loss of few among many others. Insurance is a mean by which few losses are shared among larger number of people. All the insured contribute premiums towards a fund, out of which the persons exposed to a particular risk are paid.

➤ *Savings and investment*

Insurance serves as a tool for savings and investment, insurance is a compulsory way of savings and it restricts the unnecessary expenses by the insured. For the purpose of availing income-tax exemptions, people invest in insurance also.
(b) Secondary Functions

The secondary functions of insurance include the following:

➢ **Prevention of Losses**

Insurance cautions individuals and businessmen to adopt suitable device to prevent unfortunate consequences of risk by observing safety instructions; installation of automatic sparkler or alarm systems, etc. Reduced rate of premiums stimulate more business and better protection to the insured.

➢ **Small capital to cover large risks**

Insurance relieves the businessmen from security investments, by paying small amount of premium against larger risks and uncertainty.

➢ **Contributes towards the development of large industries**

Insurance provides development opportunity to large industries having more risks. Even the financial institutions may be prepared to give credit to sick industrial units which have insured their assets including plant and machinery.

➢ **Source of Earning Foreign Exchange**

Insurance is an international business. The country can earn foreign exchange by way of issue of insurance policies.

➢ **Risk Free Trade**

Insurance promotes exports insurance, which makes the foreign trade risk free with the help of different types of policies under marine insurance cover.
1.5 IMPORTANCE OF INSURANCE

The process of insurance has been evolved to safeguard the interests of people from uncertainty by providing certainty of payment at a given contingency. Insurance not only serve the ends of individuals, or of special groups of individuals, it tends to pervade and transform our modern social order, too. The role and importance of insurance, here, has been discussed from an individual, business and society’s view:

(A) Individual

- Insurance provides security and safety

Insurance provides safety and security against the loss on a particular event. In case of life insurance, payment is made when death occurs or the term of insurance expires. The loss to the family at a premature death and payment in old age are adequately provided by insurance. In other words security against premature death and old age sufferings are provided by life insurance. In other insurance, too, this security is provided against the loss at a given contingency. For example, property of insured is secured against loss due to fire in fire insurance.

- Insurance affords peace of mind

Insurance provides security which is the prime motivating factor. It tends to stimulate an individual do more work.

- Insurance protects mortgaged property

At the death of the owner of the mortgaged property, the property is taken over by the lender of money and the family is deprived of the use of the property. On the other hand, the mortgagee wishes to get the property insured because at the damage or destruction of the property he may lose his right. Insurance provides adequate amount to the dependents at the early death and the
property-owner to pay off the unpaid loans. Similarly, the mortgagee gets adequate amount at the loss of the property.

➢ **Insurance eliminates dependency**

At the death of the husband or father or earning mother, the loss to the family needs no elaboration. Similarly, at destruction of property and goods, the family would suffer a lot. The economic independence of the family is reduced or, sometimes, lost totally. Insurance tries to eliminate dependency.

➢ **Life Insurance encourages saving**

The elements of protection and investment are present only in case of life insurance. In property insurance, only protection element exists. In most of the life policies elements of saving predominates. Systematic saving is possible because regular premiums are required to be compulsorily paid. In insurance the deposited premium cannot be withdrawn easily before the expiry of the term of the policy. The compulsion to pay premium in insurance is so high that if the policy-holder fails to pay premiums within the days of grace, he subjects his policy to lapsation and may get back only a very nominal portion of the total premiums paid on the policy. For the preservation of the policy, he has to try his level best to pay the premium.

➢ **Life Insurance provides profitable investment**

Individuals unwilling or unable to handle their own funds are pleased to find an outlet for their investment in life insurance policies. The elements of investment i.e. regular saving, capital formation, and return of capital along with certain additional return are perfectly observed in life insurance. Life insurance fulfils all these requirements at a low cost.
(B) Business

➢ *Business efficiency is increased with insurance*

When the owner of a business is free from the botheration of losses, he will certainly devote much time to the business. The carefree owner can work better for the maximization of the profit. The new as well as old businessmen are guaranteed payment of certain amount with the insurance policies at the death of the person; at the damage, destruction or disappearance of the property or goods. The uncertainty of loss may affect the mind of the businessman adversely. Insurance removes the uncertainty and stimulates the businessmen to work hard.

➢ *Enhancement of Credit*

Business can obtain loan by pledging the policy as collateral for the loan. And persons can get more loans due to certainty of payment at their deaths. The insurance properties are the best collateral and adequate loans are granted by the lenders.

➢ *Business continuation*

In partnership, business may discontinue at the death of any partner although the surviving partners can re-start the businesses, but in both the cases the business and the partners will suffer economically. Insurance policies provide adequate fund at the time of death. Each partner may be insured for the amount of his interest in the partnership and his dependents may get that amount at the death of partner. With the help of property insurance, the property of the business is protected against disasters and the chance of disclosure of the business is reduced.

➢ *Welfare of Employee*

The welfare of employees is the responsibility of the employer. The former work for the latter. Therefore, the latter has to look after the welfare of the
former which can be provision for early death, provision for disability and provision for old age. These requirements are easily met by the life insurance, accident and sickness benefit and pensions which are generally provided by group insurance. The premium for group insurance is generally paid by the employer. This plan is the cheapest form of insurance for employers to fulfill their responsibilities. The employees will devote their maximum capacities to complete their jobs when they are assured of the above benefits. The struggle and strife between employees and employer can be minimized easily with the help of such schemes.

(C) Society

➢ Wealth of the society is protected

The loss of a particular wealth can be protected with insurance. Life insurance provides for loss of human wealth. The human force, if it is strong, educated and care-free, will generate more income. Similarly, the loss of damage of property at fire, accident etc., can well indemnified by property insurance, cattle, crop, profit and machines are also protected against their accidental and economical losses. With the advancement of the society, the wealth or the property of the society attracts more hazard and so new types of insurance are also invented to protect them against possible losses. Through the prevention of economic losses, insurance protects the society against degradation. Through stabilization and expansion of business and industry, the economic security is maximized. The present, future and potential human and the property resources are well protected.

➢ Economic Growth of the country

For the economic growth of the country, insurance provides protection against loss of property and adequate capital to produce more wealth. Welfare of employees creates a conducive atmosphere to work. Adequate capital from insurers accelerates production cycle. Similarly in business, too, the property
and human materials are protected against certain losses, capital and credit are
expanded with the help of insurance. Thus, the insurance meets all the
requirements for the economic growth of a country.

1.6 TYPES OF LIFE INSURANCE POLICIES

A life insurance policy could offer pure protection (insurance), another variant
could offer protection as well as investment while some others could offer only
investment. In India, life insurance has been used more for investment purposes
than for protection in one’s overall financial planning. Followings are the types
of life insurance policy:

➢ Term Life Insurance Policy

As its name implies, term life insurance policy is for a specified period. It
depends on the length of time. It has one of the lowest premiums among
insurance plans and also carries an added advantage of fixed payments that do
not increase during the term of the policy. In case of the policy holder's
untimely demise, the benefit amount specified in the insurance agreement goes
to the nominees.

➢ Whole Life Insurance Policy

Whole life insurance policies do not have any fixed term or end date and is
only payable to the designated beneficiary after the death of the policy holder.
The policy owner does not get any monetary benefits out of this policy.
Because this type of insurance involves fixed known annual premiums, it's a
good option to ensure guaranteed financial benefits for surviving family
members.

➢ Money Back Plan

With a money back plan, policyholder receives periodic payments, which are a
percentage of the entire amount insured, during the lifetime of policy. It's a
plan that offers insurance coverage along with savings. These policies provide for periodic payments of partial survival benefits during the term of the policy itself. A unique feature associated with this type of policies is that in the event of death of the insured during the policy term, the designated beneficiary will get the full sum assured without deducting any of the survival benefit amounts, which have already been paid as money-back components. Moreover, the bonus on such policies is also calculated on the full sum assured.

**Pension Plan**

Pension plans are different from other types of life insurance because they do not provide any life insurance cover, but ensure a guaranteed income, either for life or for a certain period. The Policyholder makes the investment for a pension plan either with a single lump sum payment or through installments paid over a certain number of years. In return, he gets a specific sum every year, every half-year or every month, either for life or for a fixed number of years. In case of the death of the insured, or after the fixed annuity period expires for annuity payments, the invested annuity fund is refunded, usually with some additional amounts as per the terms of the policy.

**Endowment Policy**

It is the most popular life insurance plan. This policy combines risk cover with objective of savings and investment. If the policy holder dies during the policy period, he will get the assured amount. Even if he survives he will receive the assured amount. The advantage of this policy is if the policy holder survives after the completion of policy tenure, he receives assured amount plus additional benefits like bonus from the insurance company. Designed primarily to provide a living benefit, along with life insurance protection, the endowment policy makes a good investment if policyholder wants coverage, as well as some extra money.
There are two types of Endowment policy:

(a) Without-profit endowment plan

(b) With-profit endowment plan

(a) Without profit endowment plan

These plans do not participate in the profits the insurance company makes each year. Apart from the sum assured, the policyholder could possibly get a loyalty bonus, which is a one time payout.

(b) With-profit endowment plan

These plans share the profits the insurance company makes each year with the policyholder. So they offer more returns than without-profit endowment plans and are more expensive i.e. the premiums will be higher than without-profit endowment plans.

- **Unit-linked insurance plan (ULIP)**

Unit-linked insurance plans gives a policyholder greater control on where premium can be invested. The annual premium is invested in various types of funds that invest in debt and equity in a proportion that suits all types of investors. A policyholder can switch from one fund plan to another freely and can also monitor the performance of his plan easily. ULIP is suitable for those who understand the stock market well.

**1.7 FEATURES OF LIFE INSURANCE CONTRACT**

Human life is an income generating asset. This asset can be lost through unexpected death or made non functional through sickness or disability caused by an accident. On the other hand there is a certainty that death will happen, but its timing is uncertain. Life insurance protects against loss.
Life insurance contract may be defined as the contract, whereby the insurer in consideration of a premium undertakes to pay a certain sum of money either on the death of the insured or on the expiry of a fixed period. The definition of the life insurance contract is enlarged by Section 2(ii) of the Insurance Act 1938 by including annuity business. Since, the life insurance contract is not an indemnity contract; the undertaking on the part of the insurer is an absolute one to pay a definite sum on maturity of policy at the death or an amount in installment for a fixed period or during the life.

Features of Life Insurance Contract:

Followings are the features of life insurance contract:

i. Nature of General Contract

ii. Insurable Interest

iii. Utmost Good Faith

iv. Warranties

v. Proximate Cause

vi. Assignment and Nomination

In life insurance contract the first three features are very important while the rest of them are of complementary nature.

(i) Nature of General Contract

Since the life insurance contract is a sort of contract it is approved by the Indian Contract Act. According to Section 2(H) and Section 10 of Indian Contract Act, a valid contract must have the following essentialities:

(a) Agreement (offer and acceptance)

(b) Competency of the parties
(c) Free consent of the parties

(d) Legal consideration

(e) Legal objective

(a) Agreement (offer and acceptance)

An offer or proposal is intimation to another of one’s intention to do or to abstain from doing anything with a view to obtaining the assent of that other person to such an act or abstinence. When the person to whom the proposal or offer is made signifies his assent to it, the offer is said to be accepted. The offer and acceptance in life insurance is of typical nature. The Agents’ canvassing or publication of prospectus and of uses of insurance constitutes invitation to offer because the public in general and individual in particular are invited to make proposal for insurance. Submission of proposal along with the premium is an offer and the dispatch of acceptance-letter is the acceptance. The risk will commence as soon as the acceptance letter is dispatched by the insurer. When the proposal is not accompanied with the first premium, it would be an invitation to offer by the prospect and the letter of insurer (generally acceptance letter with modification is sent) asking the proposal to pay the first premium without any alteration is an offer and the payment of first premium by the prospect is acceptance. As soon as premium is dispatched, acceptance is made provided there was no alteration in the terms and conditions.

Another case may be when the insurer desires to accept the proposal only on certain modifications. The letter (generally the acceptance letter) sent to the prospect about the desire of change in terms and conditions are an offer if the first premium was not sent along with the proposal. But if the first premium was sent along with the proposal, it would be a counter-offer. If the premium was not already sent, it would be an acceptance. Thus the acceptance letter sent by the insurer is not always acceptance. It would be acceptance only when the first premium was accompanied with the proposal and the proposal is
acceptable on normal rates and terms. In other cases it would be an offer or counter-offer.

(b) Competency of the Parties

The essential element of a valid Contract is that the parties to it must be legally competent to contract. Every person is competent to contract who is of the age of majority according to the law, who is of sound mind, and who is not disqualified from contracting by any law. The insurer will be competent to contract if he has got the license to carry on insurance business. Majority is attained when a person completes age of 18 years. A minor is not competent to contract. A contract by a minor is void excepting contracts for necessaries. The minor can repudiate the contract at any time during his minority. If the life insurance policy is issued to a minor, the insurer cannot repudiate it but the minor can repudiate it during his minority. At the attainment of majority, he has to exercise the option, within a reasonable time, whether he would continue to carry on the policy or not. Generally, insurer accepts the proposal forms completed by the guardians of the minors. So, the incompetence of contract does not arise. Persons of sound mind can enter into a contract. A person is said to be of sound mind for the purpose of making a contract if at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests. A person who is usually of unsound mind, but occasionally of sound mind may make a contract when he is of sound mind. A person usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind. So, an intoxicated person cannot enter into a contract. The contract may be avoidable at his option, but in order to be avoided, it must be repudiated by the insured within a reasonable time of his becoming sober. Similarly, when an originally valid contract has been entered into, it will not be affected by one of the parties becoming lunatic afterwards. A contract with an alien enemy is void. An alien enemy is disqualified from, and is incapable of entering into contract or enforcing it. When an alien with whom an insurance contract has been entered into becomes
an enemy afterwards, the contract is either suspended or terminated as from the declaration of war.

**(c) Free Consent of the Parties**

In life insurance, both parties must know the exact nature of the risk to be underwritten. If the consent is not free, the contract is generally avoidable at the option of the party whose consent was not freely given.

**(d) Legal Consideration**

The presence of a lawful consideration is essential for a legal contract. The insurer must have some consideration in return of his promise to pay a fixed sum at maturity or death whichever may be the case. The consideration need not be money only. It should be anything valuable or to which value may be assigned. It may be interest, right, dividend, etc. The first premium is consideration and subsequent premiums are merely conditions to contract.

**(e) Legal Objective**

The contract would be legal only when the object is legal. The object of a legal life insurance contract is to protect oneself or one’s family against financial losses at the death of the insured. The contract is, sometimes, to provide for financial emergencies that may occur in old age. In brief the contract will be lawful only when the objective is legal. The objective will be legal only when there is insurable interest. Without having this interest, the object of the contract would not be legal. It would be wager contract and against public policy.

**(ii) Insurable Interest**

Insurable interest is the pecuniary interest. The insured must have insurable interest in the life to be insured for a valid contract. Insurable interest arises out of the pecuniary relationship that exists between the policy-holder and the life assured so that the former stands to loose by the death of the latter and/or
continues to gain by his survival. If such relationship exists, then the former has insurable interest in the life of the latter. The loss should be monetary or financial. Mere emotion and expectation do not constitute insurable interest in the life of his friend or father merely because he gets valuable advices from them.

Insurable interest in life insurance may be divided into two categories.

(a) Insurable interest in own life and

(b) Insurable interest in other’s life.

The latter can be sub-divided into two classes:

(a) Where proof is not required and

(b) Where proof is required

Again this insurable interest where proof is required can be divided into two classes:

(i) Insurable interest arising due to business relationship, and

(ii) Insurable interest in family relationship

<table>
<thead>
<tr>
<th>Insurable interest</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Own’s life</strong></td>
</tr>
<tr>
<td>Proof is not required</td>
</tr>
<tr>
<td><strong>Business Relationship</strong></td>
</tr>
<tr>
<td><strong>Other’s life</strong></td>
</tr>
<tr>
<td>Proof is required</td>
</tr>
<tr>
<td><strong>Family Relationship</strong></td>
</tr>
</tbody>
</table>
(A) Insurable interest in own’s Life

An individual always has an insurable interest in his own life. Its presence is not required to be proved. Bunyon says, ‘Every man is presumed to possess an insurable interest in his estate for the loss of his future gains or savings which might be the result of his premature death’. The insurable interest in own life is unlimited because the loss to the insured or his dependents cannot be measured in terms of money and, therefore, no limit can be placed to the amount of insurance that one may take on one’s own life. Thus, theoretically, a person can take a policy of any unlimited amount on his own life but in practice no insurer will issue a policy for an amount larger than amount seems suitable to the circumstances and means of the applicant.

(B) Insurable interest in other’s life

Life insurance can be affected on the lives of third parties provided the proposed has insurable interest in the third party. There are two types of insurable interest in other’s life. First where proof is not required and second, where proof is required.

(a) Proof is not required

There are only two such cases where the presence of insurable interest is legally presumed and therefore need not be proved.

➢ Wife has insurable interest in the life of her husband

It is presumed and decided by Reed vs. Royal Exchange (1795) that wife has an insurable interest in the life of her husband because husband is legally bound to support his wife. The wife will suffer financially if the husband is dead and will continue to gain if the husband is surviving. Since, the extent of loss or gain cannot be measured in this case; the wife has insurable interest in the husband’s life up to an unlimited extent.
Husband has insurable interest in the life of his wife

It was decided in Griffith vs. Fleming (1909) that the husband has insurable interest in his wife’s life because of domestic services performed, by the wife. If the wife is dead, husband has to employ other person to render the domestic services and other financial expenditures will involve at her death which are not calculable. The husband is benefited at the survival of his wife, so it is self-proved that husband has insurable interest in his wife’s life. Since the monetary loss at her death or monetary gain at his survival cannot be measured, there is unlimited insurable interest in the life of wife.

(b) Proof is required

Insurable interest has to be proved in the following cases:

Business Relationship

The policyholder may have insurable interest in the life of assured due to business or contractual relationship. In this case, the amount of insurance depends on the amount of risk involved. Example, a creditor may lose money if the debtor dies before the loan is repaid. The continuance of debtor’s life is financially meaningful to the creditor because the latter will get all his money repaid at the former’s survival. The maximum amount of loss to a creditor may be the amount of outstanding loan plus interest thereon and the amount of premium paid. So, the maximum amount of insurable interest is limited to the outstanding loan, plus interest and amount of premium expected to be paid. The interest is calculated on the estimation of duration of debt to be paid. The full amount of policy is payable irrespective of the payment of loan and interest. Since it is life insurance, the full policy amount is paid. A trustee has insurable interest in respect of the interest of which he is trustee because at the survival of the other person, the trustee is benefited and at his death he will suffer. A surety has insurable interest in the life of his principal. If the principal (the debtor) is dead, the surety is responsible for payment of outstanding loan, or
obligated amount. At the survival of principal, he will not suffer this loss. Insurable interest is limited, up to the amount of outstanding loan, interest and premium paid. A partner has insurable interest in the life of each partner. At the death of a partner, the partnership will be dissolved and the surviving partner will lose financially. Even if the firm continues at the death of the partner, the firm has to pay deceased partner’s share to his dependents. This will involve a huge financial loss to the partnership. Therefore, the firm collectively can purchase insurance policies in the life of each partner of the firm. Similarly all the partners have insurable interest in life of each partner because they will financially suffer at the death of partners.

➢ **Family Relationship**

The insurable interest may arise due to family relationship if pecuniary interest exists between the policyholders and life assured because mere relationship or ties of blood and of affection does not constitute insurable interest. The proposer must have a reasonable expectation of financial benefit from the continuance of the life of the person to be insured or of financial loss from his death. The interest must be based on value and not on mere sentiments. Similarly, mere moral obligation is not sufficient to warrant existence of insurable interest although legal obligation to get support will form insurable interest of the person who is supported in life of the person. Thus a son can insure his father’s life only when he is dependent on him and the father can take insurance policy on his son’s life only when he is dependent on his son.

**General Rules of Insurable Interest in Life Insurance:**

➢ **Time of Insurable Interest**

Insurable interest must exist at the time of proposal. Policy, without insurable interest, will be wager. It is not essential that the insurable interest must be present at the time of claim.
➢ **Services**

Except the services of wife, services of other relatives will not essentially form insurable interest. There must be financial relationship between the proposer and the life-assured. In other words, the services performed by the son without dependence of his father, will not constitute insurable interest of the father in the life of his son. Vice-versa is not essential for forming insurable interest.

➢ **Insurable Interest must be valuable**

In business relationship the value or extent of the insurable must be determined to avoid wager contract of additional insurance. Insurance is limited only up to the amount of insurable interest.

➢ **Insurable interest should be valid**

Insurable interest should not be against public policy and it should be recognized by law. Therefore, the consent of life assured is very essential before the policy can be issued.

➢ **Legal responsibility may be basis of insurable interest**

Since the person will suffer financially up to the extent of responsibility, the proposal has insurable interest to that extent.

➢ **Insurable Interest must be definite**

Insurable interest must be present definitely at the time of proposal. Mere expectation of gain or support will not constitute insurable interest.

➢ **Legal Consequence**

Insurable interest must be there to form legal and valid insurance contract. Without insurable interest, it would be null and void.
(iii) Utmost Good Faith

Life insurance requires that the principle of utmost good, faith should be preserved by both the parties. The principle of utmost good faith says that the parties, proposer (insured) and insurer must be of the same mind at the time of contract because only then the risk may be correctly ascertained. They must make full and true disclosure of the facts material to the risk.

➤ Material facts

In life insurance material facts are age, income, occupation, health, habits, residence, family history and plan of insurance. Material facts are determined not on the basis of opinion, therefore, the proposer should disclose not only those matters which the proposer may feel are material but all facts which are material.

➤ Duty of both parties

It is not only the proposer but the insurer also who is responsible to disclose all the material facts which are going to influence the decision of the proposer. Since the decision is taken mostly on the basis of subject-matter, the life to be insured in life insurance, and the material facts relating to the subject-matter are known or is expected to be known by the proposer; it is much more responsibility of the proposer to disclose the material facts.

➤ Full and True Disclosure

Utmost good faith says that there should be full and true disclosure of all the material facts. Full and true means that there should be no concealment, misrepresentation, half disclosure and fraud of the subject matter to be insured.

➤ Legal Consequence

In the absence of utmost good faith the contract will be avoidable at the option of the person who suffered loss due to non-disclosure. The intentional non-
disclosure amounts to fraud and the unintentional non-disclosure is voidable at the option of the party not at fault. Once the voidable contract has been validated by the party not at fault, the contract cannot be avoided by him later on. For instance, if the insurer has continued to accept the premium when, certain non-disclosure, say miss-statement of age, has been disclosed the insurer cannot invalidate the contract and cannot refute to pay the amount of claim. If the party not at fault does not exercise its option, the contract will remain valid.

 Indisputability of Policy

The doctrine of utmost good faith works as a great hardship for a long period on the plea of miss-statement at the time of proposal. In such cases, it would be very difficult to prove or disprove whether a particular statement made, at the time of policy was true. Therefore, to remove this hardship, certain sections in the concerned Act are provided. In India, Section 45 of the Insurance, Act 1938 deals with such dispute. It is called indisputable clause, “...No policy of life insurance, after expiry of two years from the date on which it was effected, be called into question by an insurer on the ground that a statement made in the proposal for insurance or in any report of a medical officer or referee or friend of the insured or in any other document leading to the issue of the policy was inaccurate or false, unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that it was fraudulently made by the policy-holder and that the policyholder knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose. Provided that nothing in this section shall prevent the insurer from calling for proof of age at any time if he is entitled to do so.

(iv) Warranties

Warranties are an integral part of the contract, i.e., these are the basis of the contract between the proposer and insurer and if any statement, whether
material or non-material, is untrue, the contract shall be null and void and the
premium paid by him may be forfeited by the insurer. The policy issued will
contain that the proposal and personal statement shall form part of the Policy
and be the basis of the contract. Warranties may be informative and
promissory. In life insurance the informative warranties are more important.
The proposal is expected to disclose all the material facts to the best of his
knowledge and belief. Warranties relating to the future may only be statements
about his expectation or intention, for instance, the insured promises that he
will not take up any hazardous occupation and will inform the insurer if he will
take the hazardous occupation.

➢ **Breach of Warranty**

If there is breach of warranty, the insurer is not bound to perform his part of the
contract unless he chooses to ignore the breach. The effect of a breach of
warranty is to render the contract voidable at the option of the other party
provided there is no element of fraud. In case of fraudulent representation or
promise, the contract will be Void ab initio.

(v) **Proximate Cause**

The efficient or effective cause which causes the loss is called proximate cause.
It is the real and actual cause of loss. If the cause of loss (peril) is insured, the
insurer will pay; otherwise the insurer will not compensate. In life insurance
the doctrine of Causa Proxima (Proximate Cause) is not applicable because the
insurer is bound to pay the amount of insurance whatever may be the reason of
death. It may be natural or unnatural. So, this principle is not of much practical
importance in connection with life assurance, but in the following cases the
proximate causes are observed in the life insurance, too.

➢ **War-risk**

Where Policy is issued on exclusion of war and aviation risks, the proximate
cause of death is important because the Insurer waives its liability if death
occurred, in this case, while the insured was in field or is engaged in operation of war and aviation. Only premium paid or surrender value whichever is higher is payable and the total Policy amount is not payable.

- **Suicide**

If suicide occurs within one year of the policy, or there was intention to commit suicide, the payment of policy would be restricted, only up to the interest of the third party in the policy provided, the interest was expressed at least one month before the suicide.

- **Accident Benefit**

A problem arises when an insured under an accident Policy is killed or suffers an injury which has an immediate cause and also a remote cause. In accident benefit policy, double of the Policy amount is paid. So, the cause of death in this Policy is of paramount importance.

**(vi) Assignment and Nomination**

The Policy in life insurance can be assigned freely for a legal consideration or love and affection. The assignment shall be complete and effectual only on the execution of such endorsement either on the Policy itself or by a separate deed. Notice for this purpose must be given to the insurer who will acknowledge the assignment. Once the assignment is completed, it cannot be revoked by the assignor because he ceases to be the owner of the Policy unless reassignment is made by the assignee in favour of the assignor. An assignee may be the owner of the policy both on survival of the life assured, or on his death according to the terms of transfer. The life policies are the only Policies which can be assigned whether the assignee has an insurable interest or not.

The holder of a policy of life insurance on his own life may, either at the time of affecting policy or at any subsequent time before the Policy matures, nominate the person or persons to whom the money secured by the policy shall
be paid in the event of his death. A nomination can be cancelled before maturity, but unless notice is given of any such cancellation to the insurer, the insurer will not be liable for any bonafide payment to a nominee registered in the records. When the policy matures, or if the nominee dies, the sum shall be paid to the Policy-holder or his legal representatives.

1.8 LIFE INSURANCE IN INDIA

Life insurance in the modern form was first set up in India through a British company called the Oriental Life Insurance Company in 1818 followed by the Bombay Assurance Company in 1823 and the Madras Equitable Life Insurance Society in 1829. All these companies operated in India but did not insure the lives of Indians. They insured the lives of Europeans living in India. Some of the companies that started later did provide insurance for Indians, as they were treated as “substandard”. Substandard in insurance parlance refers to lives with physical disability. Pioneering efforts of reformers and social workers like Raja Rammohan Ray, Dwarakanath Tagore, Ramatam Lahiri, Rustomji Cowasji and others led to entry of Indians in insurance business. The first Indian insurance company under the name ‘Bombay Life Insurance Society’ started its operation in 1870, and started covering Indian lives at standard rates. Later ‘Oriental Government Security Life Insurance Company’, was established in 1874, with Sir Phirozshah Mehta as one of its founder directors. Insurance in India can be traced back to the Vedas. For instance, yogakshema, the name of Life Insurance Corporation of India's corporate headquarters, is derived from the Rig Veda. The term suggests that a form of ‘community insurance’ was prevalent around 1000 BC and practiced by the Aryans.

Insurance business was conducted in India without any specific regulation for the insurance business. They were subject to Indian Companies Act 1866. After the start of the ‘Be Indian Buy Indian Movement’ (called Swadeshi Movement) in 1905, indigenous enterprises sprang up in many industries. It was during the swadeshi movement in the early 20th century that insurance witnessed a big
boom in India with several more companies being set up. Not surprisingly, the Movement also touched the insurance industry leading to the formation of dozens of life insurance companies along with provident fund companies (provident fund companies are pension funds). In 1912, two sets of legislation were passed: the Indian Life Assurance Companies Act and the Provident Insurance Societies Act. There are several striking features of these legislations. They were the first legislations in India that particularly targeted the insurance sector. They did not include general insurance business. The government did not feel the necessity to regulate general insurance. They restricted activities of the Indian insurers. As these companies grew, the government began to exercise control on them. The Insurance Act was passed in 1912, followed by a detailed and amended Insurance Act of 1938 that looked into investments, expenditure and management of these companies' funds.

In 1914 there were only 44 companies; by 1940 this number grew to 195. Business in force during this period grew from Rs.22.44 crores to Rs.304.03 crores (1628381 polices). Life fund steadily grew from Rs.6.36 crores to Rs.62.41 crores. In 1938, the insurance business was heavily regulated by enactment of insurance Act 1938 (based on draft bill presented by Sir N.N.Sarcar in Legislative Assembly in January 1937). From here onwards the growth of life insurance was quite steady except for a setback in 1947-48 due to aftermath of partition of India. In 1948, there were 209 insurances, with 712.76 crores business in force under 3,016,000 policies. The life fund by then grew to 150.39 crores.

By the mid-1950s, there were around 170 insurance companies and 80 provident fund societies in the country's life insurance scene. However, in the absence of regulatory systems, scams and irregularities were almost a way of life in most of these companies. Despite the mushroom growth of many insurance companies, the per capita insurance in Indian was merely Rs.8.00 in 1944 (against Rs.2,000 in US and Rs.600 in UK), besides some companies were indulging in malpractices, and a number of companies went into
liquidation. Big industry houses were controlling the insurance and banking business resulting in interlocking of funds between banks and insurance companies. This shook the faith of the insuring public in insurance companies who were seen as custodians of their savings and security. The nation under the leadership of Pandit Jawaharlal Nehru was moving towards socialistic pattern of society with the main aim of spreading life insurance to rural areas and to channelize huge funds accumulated by life insurance companies to nation building activities. The Government of India nationalized the life insurance industry in January 1956 by merging about 245 life insurance companies and forming Life Insurance Corporation of India (LIC), which started functioning from 01.09.1956. After completing the arduous task of integration of about 245 life insurance companies, LIC of India gave an exemplary performance in achieving various objectives of nationalization. The non-life insurance business continued to thrive with the private sector till 1972. Their operations were restricted to organized trade and industry in large cities. The general insurance industry was nationalized in 1972. With this, nearly 107 insurers were amalgamated and grouped into four companies- National Insurance Company, New India Assurance Company, Oriental Insurance Company and United India Insurance Company. These were subsidiaries of the General Insurance Company (GIC). For years thereafter, insurance remained a monopoly of the public sector. It was only after seven years of deliberation and debate that R. N. Malhotra Committee report of 1994 became the first serious document calling for the re-opening up of the insurance sector to private players. The sector was finally opened up to private players in 2001. The Insurance Regulatory and Development Authority, an autonomous insurance regulator set up in 2000, has extensive powers to oversee the insurance business and regulate in a manner that will safeguard the interests of the insured. Insurance is a federal subject in India. There are two legislations that govern the sector- The Insurance Act-1938 and the IRDA Act- 1999. The insurance sector in India has come a full circle from being an open competitive market to nationalization and back to a liberalized market again. Tracing the developments in the Indian insurance
sector reveals the 360 degree turn witnessed over a period of almost two centuries.

1.9 IMPORTANT MILESTONES IN LIFE INSURANCE REGULATIONS IN INDIA

TABLE : 1

IMPORTANT MILESTONES IN LIFE INSURANCE REGULATIONS IN INDIA

<table>
<thead>
<tr>
<th>Year</th>
<th>Significant Regulatory Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1818</td>
<td>Establishment of the Oriental Life Insurance Company in Kolkata</td>
</tr>
<tr>
<td>1912</td>
<td>The Indian Life Insurance Companies Act enacted as the first statute to regulate the life insurance business.</td>
</tr>
<tr>
<td>1928</td>
<td>The Indian Insurance Companies Act enacted to enable the government to collect statistical information about both life and non-life insurance businesses.</td>
</tr>
<tr>
<td>1938</td>
<td>Earlier legislation consolidated and amended by the Insurance Act with the objective of protecting the interests of the insuring public.</td>
</tr>
<tr>
<td>1956</td>
<td>245 Indian and foreign insurers and provident societies taken over by the Central government and nationalized. LIC formed by an Act of Parliament, viz. LIC Act,1956, with a capital contribution of Rs. 5 crore from the Government of India.</td>
</tr>
<tr>
<td>1972</td>
<td>Nationalization of general insurance business in India</td>
</tr>
<tr>
<td>1993</td>
<td>Setting up of Malhotra Committee</td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>1994</td>
<td>Recommendations of Malhotra Committee</td>
</tr>
<tr>
<td>1995</td>
<td>Setting up of Mukherjee Committee</td>
</tr>
<tr>
<td>1996</td>
<td>Setting up of (interim) Insurance Regulatory Authority and Recommendations of the IRA</td>
</tr>
<tr>
<td>1997</td>
<td>Mukherjee Committee Report submitted but not made public</td>
</tr>
<tr>
<td>1997</td>
<td>The Government gives greater autonomy to LIC, GIC and its subsidiaries with regard to the restructuring of boards and flexibility in investment norms aimed at channeling funds to the infrastructure sector</td>
</tr>
<tr>
<td>1998</td>
<td>The cabinet decides to allow 40% foreign equity in private insurance companies-26% to foreign companies and 14% to NRI’s, OCB’s and FII’s.</td>
</tr>
<tr>
<td>1999</td>
<td>The Standing Committee headed by Murali Deora decides that foreign equity in private insurance should be limited to 26%. The IRA bill is renamed the Insurance Regulatory and Development Authority (IRDA) Bill 1999. Cabinet clears IRDA Bill.</td>
</tr>
<tr>
<td>2000</td>
<td>President gives Assent to the IRDA Bill and Monopoly of Public Sector Insurance company marks an end and Private companies make inroad.</td>
</tr>
</tbody>
</table>
1.10 Malhotra Committee

In 1993, Malhotra Committee- headed by former Finance Secretary and RBI Governor R.N. Malhotra- was formed to evaluate the Indian insurance industry and recommend its future direction. The Malhotra committee was set up with the objective of complementing the reforms initiated in the financial sector. The reforms were aimed at creating a more efficient and competitive financial system suitable for the requirements of the economy keeping in mind the structural changes currently underway and recognising that insurance is an important part of the overall financial system where it was necessary to address the need for similar reforms. In 1994, the committee submitted the report and some of the key recommendations included:

(i) Structure

Government stake in the insurance Companies to be brought down to 50%. Government should take over the holdings of GIC and its subsidiaries so that these subsidiaries can act as independent corporations. All the insurance companies should be given greater freedom to operate.

(ii) Competition

Private Companies with a minimum paid up capital of Rs.1bn should be allowed to enter the sector. No Company should deal in both Life and General Insurance through a single entity. Foreign companies may be allowed to enter the industry in collaboration with the domestic companies. Postal Life Insurance should be allowed to operate in the rural market. Only one State Level Life Insurance Company should be allowed to operate in each state.

(iii) Regulatory Body

The Insurance Act should be changed. An Insurance Regulatory body should be set up. Controller of Insurance- a part of the Finance Ministry- should be made independent.
(iv) Investment

Mandatory Investments of LIC Life Fund in government securities to be reduced from 75% to 50%. GIC and its subsidiaries are not to hold more than 5% in any company (their current holdings to be brought down to this level over a period of time)

(v) Customer service

LIC of India should pay interest on delays in payments beyond 30 days. Insurance companies must be encouraged to set up unit linked pension plans. Computerisation of operations and updating of technology to be carried out in the insurance industry. The committee emphasised that in order to improve the customer services and increase the coverage of insurance policies, industry should be opened up to competition. But at the same time, the committee felt the need to exercise caution as any failure on the part of new players could ruin the public confidence in the industry. Hence, it was decided to allow competition in a limited way by stipulating the minimum capital requirement of Rs.100 crores. The committee felt the need to provide greater autonomy to insurance companies in order to improve their performance and enable them to act as independent companies with economic motives. For this purpose, it had proposed setting up an independent regulatory body- The Insurance Regulatory and Development Authority.

1.11 THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (IRDA)

Reforms in the Insurance sector were initiated with the passage of the IRDA Bill in Parliament in December 1999. The IRDA since its incorporation as a statutory body in April 2000 has fastidiously stuck to its schedule of framing regulations and registering the private sector insurance companies. Since being set up as an independent statutory body the IRDA has put in a framework of
globally compatible regulations. The other decision taken simultaneously to provide the supporting systems to the insurance sector and in particular the life insurance companies was the launch of the IRDA online service for issue and renewal of licenses to agents. The approval of institutions for imparting training to agents has also ensured that the insurance companies would have a trained workforce of insurance agents in place to sell their products.

The regulatory body for insurance IRDA has been established with the following mission:

‘To protect the interests of the policy holders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto.’

Duties, Powers and Functions of IRDA

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

(1) 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.

(2) Without prejudice to the generality of the provisions contained in subsection (1), the powers and functions of the Authority shall include:

(a) Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;

(b) 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;

(c) Specifying requisite qualifications, code of conduct and practical
training for intermediary or insurance intermediaries and agents;

(d) Specifying the code of conduct for surveyors and loss assessors;

(e) Promoting efficiency in the conduct of insurance business;

(f) Promoting and regulating professional organizations connected with the insurance and re-insurance business;

(g) Levying fees and other charges for carrying out the purposes of this Act;

(h) 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;

(i) 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);

(j) 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;

(k) Regulating investment of funds by insurance companies;

(l) Regulating maintenance of margin of solvency;

(m) Adjudication of disputes between insurers and intermediaries or insurance intermediaries;

(n) Supervising the functioning of the Tariff Advisory Committee;

(o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional
organizations referred to in clause (f);

(p) Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

(q) Exercising such other powers as may be prescribed.