CHAPTER – II

CONCEPTUAL FRAMEWORK OF INSURANCE:
AN OVERVIEW.
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2.1 INTRODUCTION:

Insurance may be described as a social device to reduce or eliminate risks of loss of life, property and productive activity. It is a provision, which a prudent man makes against inevitable contingencies, loss or misfortune. Under the plan of insurance, a large number of people associate themselves by sharing risks attached to individuals. As in private life, in business also there are dangers and risks of different kinds. The aim of all types of insurance is to make provision against such dangers. The risks which can be insured against include fire, the perils of sea, death and, accidents and burglary. Any risk contingent upon these, may be insured against at a premium a commensurate with the risk involved. Therefore, collective bearing of risks is insurance. Therefore, this chapter throws light on the conceptual clarifications of insurance, features of insurance, difference between assurance and insurance, functions of insurance, pre-requisites for the success of insurance, scope and kinds of insurance, role of insurance in promoting industry and commerce, and its utility in general.

2.2 INSURANCE: CONCEPTUAL CLARIFICATIONS.

The term ‘insurance’ has been defined by different experts on the subject. The views expressed by them through various definitions can be classified into
three categories viz., (1) General Definitions, (2) Functional Definitions and (3) Contractual Definitions.

The General Definitions are given by the social scientists and they consider insurance as a device for protection against risks, or provision against inevitable contingencies or a co-operative device of spreading risks. In the words of John Magee\(^1\) “insurance is a plan by which larger number of people associate themselves and transfer to the shoulders of all, risks that attach to individuals”. According to Sir William Bevridges\(^2\), “The collective bearing of risks is insurance”. Boone and Kurtz defined insurance as a “substitution for a small known loss (the insurance premium) for a large unknown loss which may or may not occur”. According to Thomas, “insurance is a provision which a prudent man makes against for the loss or inevitable contingencies, loss or misfortune”. Whereas Allen Z. Mayerson defined insurance as a “device for the transfer to an insurer of certain risks of economic loss that would otherwise come by the insured”, and Gosh and Agarwal\(^3\) considered insurance as a “Co-operative form of distributing a certain risk over a ground of persons who are exposed to it”.

Functional Definitions are based on economic or business oriented since it is a device providing financial compensation against risk or misfortune. In the words of D.S. Hansell, “Insurance may be defined as a social device providing financial compensation for the effects of misfortune, the payments being made from the

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\(^2\) Sir William Bevridge, “Insurance For All and Everything, the New Way” Series VII London, 1924. PP.6-7.
accumulated contributions of all parties participating in the scheme”. According to Robert I. Mehr and Emerson Commack⁴, “Insurance is purchased to off-set the risk resulting from Hazards which exposes a person to loss” and Riegel and Miller⁵ defined insurance as a “social device whereby the uncertain risks of individuals may be combined in a group and thus made more certain, small periodic contributions, by the individuals providing a fund, out of which those who suffer losses may be reimbursed”.

The Contractual Definitions consider insurance as a contract of indemnity the losses on happening of certain contingency in future. It is a contractual relationship to secure against risks. In the words of Justice Tindall, “Insurance is a contract in which a sum of money is paid to the assured as consideration of insurer’s incurring the risk of paying a large sum upon a given contingency.” E.W.Patterson⁶ defined insurance as a “contract by which one party for a compensation called the premium assumes particularly risks of the other party and promises to pay him or his nominee a certain or ascertainable sum of money on a specified contingency.” Whereas Justice Channell considered insurance as a “Contract whereby one person called the insurer, undertakes in return for the agreed consideration called premium, to pay to another person called the insured, a sum of money of its equivalent on specified event”.

2.2.1 Features of Insurance:

Following are the main features of insurance, viz:

(i) **Sharing of risks:** Insurance is a co-operative device to share the burden of risk which may fall on happening of some unforeseen events, such as the death of head of the family or on happening of Marine Perils or loss of by fire.

(ii) **Evaluation of risk:** For the purpose of ascertaining the insurance premium, the volume of risk is evaluated, which forms the basis of insurance contract.

(iii) **Co-operative device:** Insurance is a co-operative form of distributing a certain risk over a group of persons who are exposed to it. A large number of persons share the losses arising from a particular risk.

(iv) **Payment on happening of specified event:** On happening of specified event, the insurance company is bound to make payment to the insured. It is certain in life insurance, but in the case of fire, marine or accidental insurance, it is not necessary. In such cases, the insurer is not liable for payment of indemnity.

(v) **Amount of payment:** The amount of payment in indemnity insurance depends on the nature of losses occurred, subject to a maximum of the sum insured. In life insurance, however, a fixed amount is paid on the happening of some uncertain event or on the maturity of the policy.

(vi) **Large number of insured persons:** The success of insurance business depends on the large number of persons insured against similar risk. This
will enable the insurer to spread the losses of risk among large number of persons, thus keeping the premium rate at the minimum.

(vii) **Insurance is not a gambling:** Insurance is not a gambling. Gambling is illegal which gives gain to one party and loss to the other. Insurance is a valid contract to indemnity against losses. Moreover, insurable interest is present in insurance contracts and it has the element of investment also.

(viii) **Insurance is not charity:** Charity pays without consideration but in the case of insurance, premium is paid by the insured to the insurer in consideration of future payment.

(ix) **Protection against risks:** Insurance provides protection against risks involved in life, materials and property. It is a device to avoid or reduce risks.

(x) **Spreading of risk:** Insurance is a plan which spreads the risks and losses of few people among a large number of people. In the words of John Magee\(^7\) “Insurance is a Plan by which a large number of people associate themselves and transfer to the shoulders of all, risks attached to individuals”.

(xi) **Transfer of risk:** Insurance is a plan in which the insured transfers his risk on the insurer. This may be the reason that Mayerson observes that insurance is a device to transfer some economic losses to the insurer, otherwise such losses would have been borne by the insured themselves.

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\(^7\) Magee J.H., 1957. OP. Cit. Ch-21.
(xii) **Ascertaining of losses:** By taking a life insurance policy, one can ascertain his future losses in terms of money. This is done by the insurer to determining the rate of premium, which is calculated on the basis of maximum risks.

(xiii) **A contract:** Insurance is a legal contract between the insurer and insured under which the insurer promises to compensate the insured financially within the scope of insurance policy, and the insured promises to pay a fixed rate of premium to the insurer.

(xiv) **Based upon certain principles:** Insurance is a contract based upon certain fundamental principles of insurance which includes, utmost good-faith, insurable interest, contribution, indemnity, causa proxima, subrogation etc., which are the basis for successful operation of insurance plan.

(xv) **Institutional setup:** After nationalization, the insurance business in the country is operating under statutory organizational set up. In India, the Life Insurance Corporation (LIC), the General Insurance Corporation (GIC) and its Four Subsidiary Companies are operating in the various fields of insurance. But, since 1999, acceptance of the Insurance Regulatory and Development Authority (IRDA) bill in the Parliament, the private companies are returning to the insurance sector.

(xvi) **Insurance for pure risk only:** Pure risk gives only losses to the insured, and no profits. Examples of pure risks are accident, misfortune, death, fire, injury
etc. which are all one-sided risks and the ultimate result in loss. Insurance companies issue policies against pure risks only, not against speculative risks. Speculative risks have chances of profits or losses.

(xvii) **Social device**: Insurance is a plan of social welfare and protection of interests of the people. Riegel and Miller observe “Insurance is of Social Nature”.

(xviii) **Based on mutual good faith**: Insurance is a contract based on good faith between the parties. Therefore, both the parties bound to disclose the important facts affecting to the contract before each other.

(xix) **Regulation under the law**: The government of every country enacts the law governing insurance business so as to regulate and control its activities for the interest of the people. In India the LIC Act, 1956 and GIC Act 1972 (Nationalization) are the major enactments in this direction, but recently another regulation Act (IRDA-1999) was passed in the parliament.

(xx) **Wide Scope**: The scope of insurance is much wider and extensive. Various types of policies have been developed in the country against risks on life, fire, marine, accident, theft, burglary etc.,

Thus, insurance is a device for the transfer of risks from the insured to insurers, who agree to it for a consideration, and promise that the specified extent to loss suffered by the insured shall be compensated.

8. Riegel and Miller, 1965 OP. Cit. PP. 1-10.
2.2.2 Difference between Assurance and Insurance:

The terms, ‘Assurance’ and ‘Insurance’ are commonly used in insurance contracts. On a historical point of view, the word ‘Assurance’ is more older used in all types of insurance contracts by the end of 16th century. But, from the year 1826, this term is used to indicate life insurance only and the word ‘Insurance’ for all other types of insurance like marine, fire etc. This is because that in life insurance, there is an assurance from the insurer to make payment of the policy either on the maturity or on death. Thus, the word ‘Assurance’ indicates certainty. On the other hand, the word insurance is used against indemnity insurance, like fire insurance, marine insurance etc. In these types of insurance, the insurer is liable to indemnity only in case of loss to property or goods, otherwise not.

2.2.3 Functions of Insurance:

The functions of insurance are usually categorized under three heads viz: (1) Primary functions, (2) Secondary functions and, (3) other functions.

The primary functions of insurance are to provide protection against future risk, accidents and uncertainty; collective bearing of risk, assessment of risk, and providing certainty. The secondary functions of insurance are to caution individuals and businessmen to adopt suitable device to prevent unfortunate consequences of risk by observing safety instructions, installation of automatic sparkler or alarm systems, prevention of losses. Moreover, it is also to relieving the businessmen from security investments, by paying small amount of premium against larger risks.
and uncertainty, and providing development opportunity to those larger industries having more risks in their setting up. The other functions of insurance are to act as the means of savings and investment, source of earning foreign exchange and promoter of exports.

2.2.4 PRE-REQUISITES FOR THE SUCCESS OF INSURANCE:

For making successful operation of insurance, the following factors are essential. viz:

(i) Presence of a large number of risks.

(ii) More risks in the life or property of a person so that he may feel necessary to be insured.

(iii) Probability of real loss on account of risk.

(iv) Presence of a large number of people exposed with the same nature and kind of risks.

(v) Involvement of loss from the risk must be large enough.

(vi) The loss from the expected risk should be determinable in advance.

(vii) The happening of loss/event must be beyond the control of the insured.

(viii) The loss to all the insured should not take place at a time. Otherwise, the insurer may face problem in discharging all the claims at a time.

(ix) The cost of insurance should be feasible, it means the premium rates should be reasonable so that a large number of people can opt for insurance as a device against risk.
2.2.5 LIMITATIONS OF INSURANCE:

In spite of a number of advantages of insurance, it has certain limitations. On account of such limitations, the benefits of insurance could not be availed in full. These limitations are:

(i) All the risks cannot be insured, only pure risks can be insured, and speculative risks are not insurable.

(ii) Insurable interest, means financial interest on the subject matter of insurance either at the time of insurance or at the time of loss, or at both the times must be present in the absence of which the contract of insurance becomes void.

(iii) In case the loss arisen from the happening of the event cannot be valued in terms of money, such risks are not insurable.

(iv) Insurance against the risk of a single individual or a small group of persons are not advisable since it is not practicable due to higher cost involved.

(v) Another most important limitation is that the premium rates are higher in our country and as such, certain category of people cannot avail the advantage of insurance. The main reason for the higher rate of premiums is the higher operating cost.

(vi) It becomes difficult to control moral hazards in insurance. There are certain people who misutilize the insurance plans for their self-interest by claiming false claims from insurance companies.

(vii) Insurance is not a profitable investment. Its main object is to provide security against risks. Insurance business cannot be a source to acquire profits.
(viii) Certain specified risks can be insured with co-operation of the government only, such as, unemployment insurance, insolvency of banks, food insurance etc.,

2.3 **SCOPE AND KINDS OF INSURANCE:**

Broadly, insurance may be classified on the basis of the following:

I. Classification on the basis of nature of insurance.

II. Classification from the business point of view.

III. Classification from risk point of view.

I. **Classification on the basis of nature of insurance.**

On the basis of nature of insurance, insurance may be further divided under five sub heads:

1. **Life insurance:** May be defined as a contract in which the insurer, in consideration of a certain premium, either in a lump sum or by other periodical payments, agrees to pay to the assured or to the person for whose benefit the policy is taken, the assured sum of money on the happening of a specified event contingent on the human.

A contract of life insurance, as in other forms of insurance, requires that the assured must have at the time of the contract an insurable interest in his life upon which the insurance is effected. In a contract of life insurance, unlike other insurance, interest has only to be proved at the date of the contract, and not necessarily present at the time when the policy falls due.
A person can assure in his own life and every part of it, and can insure for any sum whatsoever, as he likes. Similarly, a wife has an insurable interest in her husband and vice-versa. However, mere natural love and affection is not sufficient to constitute an insurable interest. It must be shown that the person effecting an assurance on the life of another is so related to that other person as to have a claim for support. For example, a sister has an insurable interest in the life of a brother, who supports her.

A person not related to the other can have insurable interest on that other person. Suppose, a creditor has insurable interest in the life of his debtor to the extent of the time of issue of the policy. An employee has an insurable interest in the life of the employer arising out of contractual obligation to employ him for a stipulated period at fixed salary. Similarly, an employer to the employee, who is bound by the contract to serve for a certain period of time.

2. **Fire insurance**: It is a contract to indemnity the insured for distribution of or damage to property caused by fire. The insurer undertakes to pay the amount of the insured is loss subject to the maximum amount stated in the policy. Fire insurance is essentially a contract of indemnity, not against accident, but against loss caused by accident. It is becoming very common in fire insurance policies to insert a condition called the average clause, by which the insured is called upon to bear a portion of the loss to himself. The main object of this clause is to check under insurance and to encourage for full insurance. It impresses upon the
property-owner for the need of having his property accurately valued before insurance.

3. Marine insurance: A contract of marine insurance is an agreement whereby the insurer undertakes to indemnity, the assured in a manner and to the extent thereby agreed, against marine losses, that is the losses incidental to marine adventure. There is a marine adventure when any insurable property is exposed to marine perils, which is also known as perils of the seas, means the perils consequent on, or incidental to the navigation of the sea or the perils of the seas, such as fire, war perils, pirates, rovers, thieves; captures, jettisons, barratry and any other perils which are either of the like kind or may be designed by the policy.

There are different types of marine policies, viz: Voyage Policy, time policy, valued policy, unvalued policy, floating policy, wager or honour policy.

4. Social insurance: Social insurance has been developed to provide economic security to weaker sections of the society who are unable to pay the premium for adequate insurance. Pension plans, disability benefits, unemployment benefits, sickness insurance etc. are the various forms of social insurance.

5. Miscellaneous insurance: The process of fast development in the society gave rise to a number of risks or hazards. To provide security against such hazards, many other types of insurance have also been developed. The
important among them are; (i) Vehicle insurance on buses, trucks, motorcycles, (ii) Personal accidents insurance, (iii) Burglary insurance (iv) Legal liability insurance, wherein the assured is liable to pay the damages to property or to compensate the loss of personal injury or death. (v) Crop insurance against losses due to heavy rain and floods, cyclone, draughts, crop diseases etc. (vi) Cattle insurance against the loss of cattles from various kinds of diseases. Moreover, insurance policies are available against crime, medical insurance, bullock cart insurance, jewelry insurance, cycle rickshaw insurance, radio-T.V. insurance etc.

II. Classification from business point of view:

From a business point of view, insurance has been divided into two broad categories: (i) Life Insurance (A detailed discussion of the life insurance is given under the sub heading 2.3, I, 1 in this chapter) and (ii) General Insurance, which refers to fire, marine and miscellaneous insurance business whether carried on singly or in combination with one or more of them, but does not include capital redemption business and annuity certain, business. GIC in India was nationalized in 1972.

III. Classification from risk point of view:

From risk point of view, insurance can be classified into four categories: (i) Personal insurance, (ii) Property insurance, (iii) Liability insurance, (iv) Fidelity guarantee insurance.
A brief description of each is given below:

1. **Personal insurance**: Personal insurance refers to the loss to life by accident, or sickness to individual, which is covered by the policy. The insurer undertakes to pay the sum insured on the happening of certain event or on maturity of the period of insurance. The insurable sum is determined at the time of effecting the policy and include life insurance, accident at insurance, and sickness insurance. Life insurance contains the element of investment and protection, while the accidental sickness or health insurance contain the element of indemnity only.

2. **Property insurance**: Contract of property insurance is a contract of indemnity. Proof by the assured of loss is an essential element of property insurance. The policies of insurance against burglary, home-breaking or theft etc. fall under this category. The assured is required to protect the insured property. After the loss has taken place, the assured usually required to notify the police as to losses.

3. **Liability insurance**: Liability insurance is the major field of General insurance whereby the insurer promises to pay the damage of property or to compensate the losses to a third party. The amount of compensation is paid directly to third party. The field of liability insurance includes workmen compensation insurance, third party motor insurance, professional indemnity insurance and third party liability insurance etc. In liability insurance, there may be various reasons for the arising of liability; viz., accident of a worker at the workplace, defective goods, explosion in the factory during the process of production,
formation of the poisonous gas within the factory, due to the uses of chemicals and other such substances in the manufacturing process.

4. **Fidelity guarantee insurance:** In this type of insurance, the insurer undertakes to indemnify the assured (employer) in consideration of certain premium, for losses arising out of fraud, or embezzlement on the part of the employees. This kind of insurance is frequently adopted as a precautionary measure in cases where new and untrained employees are given positions of trust and confidence.

### 2.4 **Principles of Insurance:**

Insurance business is conducted on certain fundamental principles, which are applicable to all types of insurance and miscellaneous insurance contracts, with exception of principle of indemnity. This principle does not apply to life insurance. The important principles are: (i) Principle of co-operation, (ii) Principle of probability, (iii) Principle of insurable interest, (iv) Principle of utmost good faith, (v) Principle of warranties, (vi) Principle of indemnity, (vii) Principle of subrogation, (viii) Principle of contribution, (ix) Principle of causa proxima, and (x) Principle of mitigation of loss. Each one of the above cited principle is briefly explained as below:

i) **Principle of co-operation:** Insurance is a business based on the principle of cooperation. It is a voluntary device to share the risks and uncertainties collectively. Insurance is based on the ideology of common interest and welfare cooperation is based on the cooperative principle, “One for all, and
all for one”. Really speaking the origin and development of insurance is based on cooperation.

ii) **Principle of probability**: It is one of the important determinants of insurance premium. Insurance is a contract to bear the risk against consideration, that is premium. Premium is the value of insurance and an important factor of insurance cost. The rate of premium depends on the quantum of risk and probability of risk. The rate of premium will be more where the quantum of risk and its probability are more.

iii) **Principle of insurable interest**: The assured must have an actual interest in the subject matters of insurance, either in full or in part. One may be said to have an interest in the subject matter of insurance who may be injured by the risk to which the subject matter is exposed.

iv) **Principle of utmost good faith**: A contract of insurance is a contract based on the utmost good faith. The utmost good faith refers to the parties to the contract (insured and insurer) who are legally bound to reveal to each other all information about the subject matter, which would influence each other's decision. If this principle is not observed by either party, the contract may be avoided by the other. The whole truth must be disclosed about the subject matter of insurance and circumstances surrounding it, so that the underwriter may know the extent of his risk and how much he must charge for the
insurance policy. The willful or innocent withholding of any relevant fact is taken as more serious and on discovering the truth, the underwriter can declare the contract void.

This principle of utmost good faith is applied in all types of insurance contracts. The assured must disclose to the insurer every material circumstances which is known to him. But, the following circumstances need not be disclosed;
a. The circumstances that diminish risk.
b. Circumstance which is superfluous to disclose by reason of any insurer with ordinary cause of his business.
c. Circumstance to which the information is waived by the insurer.
d. Circumstance which is not to be disclosed by reason of any express or implied warranty.
e. Circumstance which is known to the insurer, such as statutory provision.
f. Circumstance of which its original source is the insurer himself.
g. Circumstance to which the insurer refuses to accept.
h. Circumstance which is public nature.
i. Circumstance which is relating to the prevailing law of the country, and
j. Circumstance which is irrelevant.

v) **Principle of warranties:** According to section 35 of Marine Insurance Act, “A Warranty is an undertaking by the assured that some conditions shall be fulfilled, or that a certain thing shall be or shall not be done”. A warranty
may be expressed or implied. An express warranty is a condition which is set forth in the policy or attached there. An implied warranty is an essential condition implied by law, though not written in the policy.

vi) **Principle of indemnity:** This principle is applied to all other contracts of insurance except life insurance, personal and sickness insurance. This principle is specially applied to fire, marine, burglary or any other policy of indemnity. Under the indemnity contract, the insurer undertakes to "indemnify" the insured against loss suffered by the insurer. Literally, indemnity means, "make good the loss". This means that the assured, in the case of loss against which the policy has been made shall be indemnified subject to the value of the policy. A contract of insurance, however, ceases to be a contract of indemnity if the insurer promises to pay a fixed sum on the happening of the event insured against whether the assured has suffered any loss or not. Even contracts of fire or burglary insurance need not necessarily be contracts of indemnity where the insurer agrees to pay a certain fixed sum irrespective of the loss.

Therefore, indemnity restores the insured to the same financial position on happening of loss as he enjoyed immediately prior to the loss or damage. This is in conformity with the basic concept of insurance, whereby an insurer is required to compensate the unfortunate people for the loss sustained, but does not allow a person to earn profit from misfortune.
vii) **Principle of subrogation:** Subrogation is the substitution of one person in place of another in relation to a claim, its rights, remedies or securities. This principle is applicable to both fire and marine insurance. Having satisfied the claim of the assured, the insurer stands in his place, and subrogated to all the rights of the insured.

viii) **Principle of contribution:** It is applicable in all types of insurance contracts, except life insurance. Where an insurer gets the subject matter insured with more than one insurer, and in case of loss/damage to the insured property, all of them shall be called upon to contribute towards the claim in proportion to the sum assured with each. Federation of Insurance Institute, Bombay defined “Contribution is the right of an insurer who has paid a loss under a policy, to recover a proportionate amount from other insurers who are liable for the loss”. This principle ensures equitable distribution of losses between different insurers. A policy holder is not entitled to claim from each insurer more than the retable proportion of the loss to which one is liable.

ix) **Principle of causa proxima:** In order to make the insurer liable for loss, such loss must have been proximately caused by the peril insured against. Every loss that clearly and proximately results, whether directly or indirectly, from the event insured against is within the policy (Stanely V/s. Western Insurance Co. (1886). The question which is the causa proxima of a loss, can only arise where there has been succession of
causes. The proximate cause is the nearest cause. The insured may recover damages from the insurer only in such cases when the loss has been caused by insured peril and the cause has been immediately or proximate to the loss. It means the cause must be nearest and not the remote.

Proximate does not mean “nearest in time”. The time that elapses between cause and result may be long or short, but will not affect the cause and effect. The cause which is truly proximate is that which is proximate in efficiency. It is not the latest, but direct, dominant, operative and efficient cause.

x) **Principle of mitigation of loss:** The principle of mitigation of loss places a duty on the part of insured to make every effort, and to take all such steps, as a man of ordinary prudence to mitigate or minimize the loss in the event of some mishap to the insured property. Literally this term refers to make less severe or painful. This makes the insured be more careful or active to protect the subject matter from any possible loss. If he fails to act in such a manner, the insurer can avoid the claim of the insured on the ground of negligence on the part of insured. In acting vigilantly in saving the property, the insured is not bound to risk his life in doing all precautions as a man of ordinary prudence, the insurer shall be liable to bear the entire loss resulting from the peril insured against.
2.5 **DOUBLE INSURANCE AND REINSURANCE:**

Double insurance and re-insurance are the two important methods of getting insurance. The vast growing population countries like India, Chaina and others are essentially require such kind of insurance at this juncture. Hence, following is the brief summary of both the insurance methods.

2.5.1 **DOUBLE INSURANCE:**

Double insurance refers to the method of getting insurance of same subject matter with more than one insurer or with same insurer under different policies. This means that one can get insurance policies on a subject matter more than its value. Double insurance is possible in all types of insurance. A person can insure his life in different policies for different sums. In life insurance the assured can claim the sum insured with different policies on the maturity or to his nominee after his death. This becomes possible in life insurance because life insurance is not an indemnity insurance.

In indemnity insurance such as Fire and Marine insurance only the real loss can be indemnified. In fire and marine insurance, where the same subject matter is insured with more than one insurer, the insured is entitled to the real loss in proportion to the insured sum on different policies obtained from different insurance companies. In other words, the total claim can not be exceeded the real loss, payable proportionate by each insurer. If any one of the insurers pays more than his share, he is entitled to a contribution from other insurers. An insured is not
entitled to benefit from all the insurance policies. In case the total loss is less than the value of the insurance policies issued by different insurance companies, the insured can claim in full against all the policies.

2.5.2 REINSURANCE:

Reinsurance is an agreement between the insurance company by which a portion of risk of loss is transferred to another insurance company. This happens when an insurance company has undertaken more risk burden on its shoulders than its bearing capacity. Therefore, it is a device to reduce the risk. Usually, an insurance company insure a profitable venture comes in its way, even if the risk involved is beyond the capacity. By transferring the risk to any other insurance company, the insured reduces its liability. According to the Riegel and Miller, “Reinsurance is the transfer by an insurance company a portion of risks to another company”.

Reinsurance does not affect the contract between the original insurer and the assured, It can be resorted in all types of insurance contracts, which involves larger risks. As the contract of reinsurance is a contract of good faith the reinsurer is not liable to the assured and the contract is co-extensive with the original policy.

2.6 RISK, UNCERTAINTY AND PROBABILITY:

2.6.1 RISK:

In ordinary parlous, risk is the chance of loss, sometimes it is defined as uncertainty with respect to financial loss. Allen L. Mayerson⁹ says that risk means

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uncertainty. Bajpai O.P.\textsuperscript{10} and Mehr and Oslar\textsuperscript{11} also share this view. Risk always conveys possibility of loss and of uncertainty with respect to its occurrence\textsuperscript{12}. From these definitions risk is confused with uncertainty. The confusion persists even after F. H. Knights clear distinction between the two. According to Knight, risk is doubt as to the outcome when it is possible to determine the priority or empirically what the probability is uncertainty is doubt about the outcome in their situation. The distinction between the two terms has been further clarified by Willett A. H. ‘Risk and Uncertainty’ says Willet\textsuperscript{13}, are the objective and subjective aspects of apparent variability in the course of natural events. Therefore the uncertainty is the psychological response of an individual to risk. According to Prof. Irving Preffer\textsuperscript{14}, ‘Risk is measured by subjective probability, whereas, uncertainty is measured by a subjective degree of belief. Therefore we may, adopt the definition given by William Q. Heins,\textsuperscript{15} risk is the objective doubt about the outcome in a given situation.

It is evident from the above discussion or connotations that risk is not mere chance of loss. If a loss is certain to occur, the risk is zero. Knowledge of possible losses and their probabilities does not make one sure of the result. Doubt still remains which result will occur. Risk is the doubt a person would have about the

\textsuperscript{11} Mehr, R.J. and Oslar, Lebert W. “Modern Life Insurance”, Illinoe’s, 1966. P.30.
\textsuperscript{14} Irving Preffer, “Insurance and Economic Theory”, P.179.
future outcome even if he knew all the possible outcomes and their probability or chance of occurrence.

2.6.2 Uncertainty:

Uncertainty is subjective doubt about the outcome in given period. Subjective doubt exist even when one knows all possible results and the probability of their occurrences. For similarly placed persons risk is the same under given circumstances. Uncertainty varies even among these persons. It depends upon the information they have and their ability to use the information to estimate the risk. If the estimate is correct, uncertainty is equal to risk.\(^\text{16}\)

There are two types of uncertainties viz. (I) Primary and (ii) Secondary uncertainties. The primary uncertainties arise from random acts of nature and unpredictable changes in consumer’s preference. The secondary uncertainties arise from lack of communication, from each decision-maker having no way of finding out the concurrent decisions and plans made by others. While insurance has to contend with primary uncertainties or a part of them, investment has to take into consideration both primary and secondary uncertainties.

2.6.3 Probability:

The science of insurance is based on the theory of probability. The theory defines probability as the ratio of the member of cases favourable or unfavourable to an event to the number of all possible cases, all possible cases being considered

\(^{16}\) Ibid, P. 5.
likely. Therefore, it is concluded that the probability of happening of an event is equal to the number of ways favourable to the event, divided by the total number of ways in which the event may or may not happen.

The application of this theory to life insurance is found in the fact that the number of deaths in a given group follows a definite mortality law and it is not a matter of change alone. This mortality law is based on the theory of probability. To carry on the business on sound lines, the insurance companies ought to know as to how many policyholders will die during a given period. After taking into consideration the length of life and ages at death in the past, it is possible to predict probabilities of death and of survival in the future on the basis of past experience, the insurance companies construct the mortality table. The mortality table is an instrument by means of which the probabilities of life and death are measured. The mortality table is the basis of premium computation in Life Insurance.

Therefore, by applying the theory of probability, insurance companies predict the chance of loss. The actuaries take into consideration the various probabilities in such a way that the insurance companies remain solvent even if conditions are relatively unfavourable. The insurance companies charge premiums that are low enough to attract the public and competitive with those of other companies. And this enables the companies to balance the receipts and payments.
2.6.4 UNDERWRITING OF RISKS:

An insurer receives insurance proposals having different kinds of risks or hazards. It is not, however, practical to accept all these proposals. Only the proposals which are favourable and advantageous to the insurer are accepted and the others are rejected. This process of accepting or rejecting a proposal in view of the risks involved in each, is called underwriting. According to the Mowbray and Blanchard, "Underwriting is Selection of risks for the insurer and determination of what amounts and what terms acceptable risks will be insured". Therefore, underwriting is the process of deciding to accept or reject an insurance proposal based on the risk factors. This activity is done by the underwriters of the life insurance corporation, for which no fee is charged.

2.7 LIFE INSURANCE POLICIES:

Life insurance is an attempt to meet the varying wants of community, so it has taken different forms. Those forms are based on a number of factors.

A. Duration of insurance, such as whole life Policy, endowment policy and term policy.

B. Profit sharing, that is without profit-policy or non-participating policy and with profit policy or participating policy.

C. Payment of sum assured i.e., guaranteed policy and annuity policy.

D. Payment of premium, such as single premium, limited payment policy, and whole life payment policy.

E. Number of assured, such as single life policy and joint life policy.
On the basis of pattern given above, the LIC has been issuing different types of insurance policies. The insured has the choice to select from these policies according to his requirement.

2.8 ROLE OF INSURANCE IN THE DEVELOPMENT OF INDUSTRY AND COMMERCE:

The role of insurance for the development of commerce and industry of a country is very basic and it is a known fact that the origin of insurance was for the development of business. The development of insurance and the business are complementary to each other for the economic development of a country. The importance of insurance for the development of business activities has been productive, promotional and guiding. Insurance is the creator, planner and protector of industries and commerce. It has removed the territorial limitations of business to international.

The role of insurance in the development of industry and commerce can be classified into the following categories:

(I) Protective role and (II) Promotional role.

(I) Protective role: Insurance has been playing protective role towards the development of industry and commercial institutions. The major protective measures include, the settlement of claims, providing protection from risks arising out of natural calamities, providing protection from the risks caused by human beings, giving protection against statutory liabilities, providing financial security, providing protection from loss of profits, providing
protection from debts, providing protection to the business institution due to sudden death of the key men, and also providing stability in commercial and industrial activities.

(II) **Promotional role of insurance:** Insurance plays important role in setting up industrial and commercial units, by way of capital formation, new investment, industrial entrepreneurship, under-writing of shares and investment in capital market. In addition to protective measures, it plays promotional role also, which are mainly covering extension of credit facilities, facilitating industrialization and commercialization, increasing business and industrial efficiency, providing capital, investment in shares and debentures, subscription of shares and debentures in new companies, promoting, setting up of industrial estate, contribution towards the development of basic industries, and to the service institutions, under-writing of shares and debentures, investment in securities, contribution towards the development of infrastructure and towards fulfillment of social statutory obligations, contribution towards the development of international trade, extension of export credit, and also increasing competing ability among small and medium-scale units.

2.9 **Significance of Insurance:**

The risks and uncertainties of man have been increasing day by day in this modern world. Along with this change, the significance of insurance also has
increased. Insurance becomes an inseparable part of human life. Insurance plays important role in the socio-economic prosperity of a country, as it is evident from the contribution of insurance in various industrial and commercial activities. Royce writes that at the present time the importance of insurance has been considerably increasing. This importance is not only increasing the fulfillment of objectives of certain people or some category of people, but also contributes towards the socio-economic development of modern social system. There will be no exaggeration to say that industrial world without insurance like a car without shock absorber. An individual is safe when he is insured against death or accident or any other uncertain loss. It protects the farmer with his crop in the field against ruin by flood, rain, fire and wind storm, etc. Similarly in the case of businessmen, who run industrial or commercial activities. While stating the significance of insurance, Dinsdale writes, that no one can remain safe without insurance in this world.

The significance or the utility of insurance can be categorized into the following four groups viz:

I) Significance for the individuals/family.
II) Significance for the business.
III) Social significance; and
IV) National significance.

I) Significance for the Individuals/Family:

Following is the importance or uses of insurance for an ordinary man or a family:
Angell writes insurance provides security and stability that it is a permanent base to secure against uncertain risk. A man's life always involved with different types of risks like death, old age, accident, sickness etc. Similarly he is concerned about the risk of property and money by theft, dangers of fire, etc. Insurance is a source of investment. The money paid as premium is an investment and also covers the risk. Element of investment has made the insurance more attractive.

Magee writes, although the insurance companies to give the right of complete success, but it has contributed towards increase in the average life of the people. By the method of publicity it creates awareness among the people about need for i.e. medical investigations, prevention of diseases, self-precautions, and to maintain good health. Insurance relieves the people from mental worries due to safeguard provided by it against future risk and uncertainties. People who have insured their lives, need not worry about the future and can concentrate more efficiently on the present tasks. This may be the reason that Angell observes that those who have little worried about the future, can be a more efficient worker. Death or accident is the instance in which the people become unsupportive. On the death of the earning member, the family members, especially the dependants face much problems of subsistence. Insurance is such a mean to make oneself self-reliant economically. Mark Doreman observes that the basic element of insurance is to provide economic self-sufficiency to the insured.

If a person mortgages his property against any debt and fails to return the debt before his death, the mortgagee takes charge of the property. In case
mortgaged property was secured by insurance policy the liability of paying off the
debt can be transferred to the insurer. Riegel and Miller observe that the important
function of insurance is to reduce uncertain risks of individuals into certainty.
Insecurity in life is the main cause of mental worries. A person insure against such
uncertain risks get rid of himself from the bad effects and can lead a mental peace
or peaceful life. And Insurance is a deliberate and rational planning for future.
Insurance is not only plan for one’s life or dangers in life, but also can manage to
meet with the needs of education and marriage of children, housing etc. Moreover
it is an easier means of meeting the statutory liabilities. A third party insurance
cover can shift the liability on a third party who causes the loss or injury to any
property.

Insurance is a method of capitalization of earning capacity of a person. For
example, a person is earning Rs.24000/- per annum and he expects this income for
another 15 years. By getting an insurance policy of Rs.3.00 lakh, he can capitalize
his income so that in case of his death, any time within 15 years, his legal nominee
can claim this amount from the insurance company. Insurance companies create
awareness among the people for the need to protect themselves from possible risk
of life, property charges and the goods. Certain insurance companies dealing in
motor vehicle insurance, charges reduced premium rates for the renewal of policies
if the owner of the vehicle did not make any claim for payment in the previous year.
The insurance companies grant loans against insurance policy to the insured upto
certain percentage of the premium money paid, keeping in view of the surrender
value of the policy on that date. Such loan facility is given to the insured for his business purpose or for some important domestic purpose. Insurance is an important way of obtaining tax rebate. The money paid towards, insurance premium is deducted from the gross income, and thereby increasing savings leads to increase in demand for goods in the economy, this is really an investment. The money saved towards the payment of premium is totally safe, because the insurance policy cannot be acquired by creditors through any degree obtained from the court. This is possible only against the property and not against the policy.

II) Significance to the business:

Insurance is an inseparable part of business and no business can survive without insurance. Well-known authorities like Peter Drucker, Lord Harvick, and others observe that without insurance no individual economy can survive. This is because that business is the name for risk and uncertainty and it is insurance that gives protection against various risks. Emperor George-IV once commented “Insurance is an important and progressive industry”.

Significance of insurance towards industry and business is described as follows;

The movable and immovable property of the business is always subjected to risks. Even the production process is involved by dangers to workmen and property. It is the insurance that promise safety security against these risks. Insurance extends various kinds of short-term and long-term credit to businessmen. Insured property
can be used for getting bank loans by mortgaging the policy. And perils may be caused by natural calamities or by the actions of people in the form of theft, decoity, civil disturbances, etc. Insurance protects safety against perils. But, in the case of death of key-man who runs the business, especially in the case of sole trading business, the loss of the sole trader badly affects the survival of other members of the family. The insurance claim paid by the insurance companies can help in protecting against the loss of key-man.

Insurance determine the cost of accidents. In accident insurance, the cost of the subject matter insured is determined in advance, thereby the cost of products can be fixed. The insurance companies advice the business institutions in the safety matters and the measures to be followed in preventing losses. The business institutions adopted safety measures, the premium rates may be comparatively lower. The money so saved by low rate premium can help in the capital formation. The employee's interest can be secured by way of insurance. In case of any economic problem in business, it will have adverse impact on employee's interest. Insurance can safeguard and protect the interests of employees in paying pension, gratuity and other economic benefits through its policies.

Foreign trade is usually involved by marine peril and losses. Insurance helps in the development of foreign trade by making insurance claims against losses of ships and cargo. The Contribution has been beneficial towards the growth of larger business houses. Larger credit facilities, larger-buildings, wide channel of distribution system, larger production and marketing plans, bearing various
industrial and commercial risks are the major means of contributions towards the business from the insurance companies. It is said that insurance is the founding father of large-scale industrial system and the whole business mechanism. A small business can keep the production cost lower and compete with large-scale business by transferring the business risks in the shoulders of insurance companies. Therefore, insurance companies extend easy terms of credit to small medium scale industries in their development.

Insurance is the most important to partnership business in the business arena. In case the death of a partner or he leaves the firm, it is required to repay the capital invested by him in the business together with interest, profits shared, goodwill etc. This will have an adverse impact on the conduct of business. A joint partnership policy can solve such problems of making payment to the diseased partner. Insurance provides stability to business as it secures the business property and profits. It encourages for investment and capital formation. These are ways for stability of business. Business has social responsibility towards its employees under which it is the responsibility of the employer to promote labour welfare programmes, viz; to make provisions for old age, benefit like pension, provident fund, gratuity; and accidental benefit, retirement benefit, medical and housing etc. All these provisions can be covered under the comprehensive policy.

Insurance promotes faster development of industrialization of a nation. On one side it protects the business from various kinds of risk, and on the other, the insurance companies make involvement in business activities by way of direct
investment, under-writing of shares, and extension of credit facilities. Insurance companies operate in different schemes of human resources development. For the purpose of developing skill of supervisory and branch officers, different divisional training centres have been set up. Life Insurance Corporation runs seven such centres in the country.

III) Social significance:

Insurance is a social device which removes various social problems like unemployment, crime, dissolution of family, and many other social problems. J. Royle observes that insurance is a combination of private–public interests. It gives more attention towards social welfare, economy, offerings and public interests. The social significance of insurance is briefly described below:

Insurance provides economic security and better family life. It secures the family from sudden illness, death or accident of the bread-earning member of the family. Insurance is the key for the wellbeing, and prosperity. It facilitates and encourages for education in the society. Insurance policies support education to the children. It also extends scholarships for poor students, in addition to extension of loan facility for education. Insurance companies create additional employment opportunities to the people. More than 70,000 people are employed in General Insurance Corporation and in its four subsidiary companies. Similarly, nearly 1,25,000 people are employed in Life Insurance Corporation. The number of insurance agents employed in LIC numbered more than 5.50 lakhs in India.
Insurance distributes the risks of a person among a large number of people. George Rejda writes, “Insurance distributes the burden of loss of a person among the Scholders of entire society”. The root cause of any social evil in the society is lack of education, poverty and unemployment. The lack of opportunity to the people makes the way for committing social evils like theft, decoity, prostitution, extremism etc. Insurance helps a person to become self sufficient economically by providing for education, employment and protection against risk of life and property.

Insurance creates health awareness in the society for maintenance of good health. Insurance companies have started health improvement movement throughout the world, by distributing useful materials for health education. It also provides for free medical check up at the proposal stage of the policy, which will help in identifying any disease in a person, and advice him to take medical care. Insurance companies operates loss prevention programmes by creating awareness among the people. It appoints good number of experts in the field. The reduction in premium rates is allowed to those insured who follow safety measures. The four subsidiary companies of General Insurance Corporation has set up a company known as “The Loss Prevention Association of India”. It gives direction to the people towards loss prevention measures. It also operates “Occupational safety” programme. Insurance contributes towards the development of public utility services like water supply, electricity generation, housing, public works, etc. The
LIC and the four subsidiaries of General Insurance Corporation in India extend credit to the development of these utility service.

Insurance is a way of earning and saving. Insurance companies provide employment to the large number of people in the country with good income by way of salaries and commission. On the other hand, one can get himself relieved from economic worries by insuring against risks. All these things increase the living standard of the people. Insurance is a social device for reducing risk and uncertainties, which are made certain. It provides financial compensation for the effects of misfortune. It also protects public properties of the government as well as religious, educational and charitable institutions. Moreover, insurance is an important device of social security. It contributes towards social welfare activities of the government, especially to schedule castes, scheduled tribes, physically handicapped persons, etc.

IV) National Significance:

Significance of insurance to nation are as under;

Insurance increases the national savings by way of small contributions of the people towards insurance premium and contributes towards investment in public utility services as well as various plans of government, such as housing infrastructure development, foreign trade etc. The insurance makes available finance to industrial and commercial activities in the country. Thereby it facilitates for capital formation. Further, Insurance provides additional employment opportunities to the people.
Insurance contributes towards national plans like five-year plans, rural development, self-employment, construction of industrial estates. The premium collected by insurance companies by small savings from the insured are invested in such national schemes like electricity generation and irrigation, construction of dams and bridges, railway-lines, scientific research etc.

Insurance contributes towards the national income of the nation. Different types of commercial and industrial units are set up every year with the financial assistance extended by insurance companies, in addition to providing for employment to good number of people in insurance companies. The government receives income from the industrial units by the way of taxes and duties etc. and from employees by the way of income tax. This way it contributes towards national income.

Insurance contributes towards social security measures. The government under its social security schemes, supports for old age pension, unemployment, disability, etc. Under the social insurance scheme, these measures are provided to society by the government. Insurance companies operate business in other countries by opening branches and earn foreign exchange for the country. Besides, Insurance companies invest in government securities and such companies contribute towards the development of capital market in the country by investing in shares and debentures.

Since, insurance helps both directly and in directly contributes to the economic development in the country.