INSURANCE AND RISK MANAGEMENT

M.Com (BANKING)

Semester – III, Paper – III

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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging a head in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining 'A' grade from the NAAC in the year 2016, Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 443 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education in 2003-04 with the aim of taking higher education to the door step of all the sectors of the society. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even to housewives desirous of pursuing higher studies. Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn be part of country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson-writers of the Centre who have helped in these endeavors.

Prof. P. RajaSekhar
Vice-Chancellor Acharya
Nagarjuna University

SEMESTER-III

313CO21 - INSURANCE AND RISK MANAGEMENT

SYLLABUS

Learning Outcomes :

After successful completion of this course, the students will be able to:

1. *Acquire knowledge of Risk management by individuals, Corporate Risk Management.*
2. *Know the concepts relating to* Indian Insurance Industry
3. *Understand the* Management of Insurance Companies
4. *Comprehend the* Life Insurance vs. Non-Life Insurance Pricing

Syllabus :

Unit –I : Introduction: Concept of Risk, Risk vs Uncertainty; Types of Risks, Methods of handling poor risk, definition of risk management, Risk management objectives – Risk management by individuals, Corporate Risk Management.

Unit- II : Definition, Causes and benefits of insurance, elements of an insurable risk, principles of insurance, kinds of insurance – Mathematical basis of insurance ; Probability and its use in insurance – Duel applications of law of large numbers, pooling in insurance, theories of risk management, classical theory, and modern theory – Globalization of insurance and its impact in India.

Unit –III : Indian Insurance Industry: Insurance sector reforms, liberalization of insurance markets, Insurance players in India, Regulation of Insurance Business inIndia, Legal frame work, Insurance Contracts, Registration and License – Accounting Principles and Taxation Aspects of Insurance.

Unit IV : Management of Insurance Companies: Types of Insurance Organizations, Organizational structure of insurance companies, Functions of Insurers - Product design and Developments: Product Development Process, Product Design in Emerging Scenario – Underwriting : Objectives and Principles of Underwriting, Underwriting in non-life Insurance Business – Claims Management: Claims Settlements in General Insurance and in Life Insurance.

Unit-V : Insurance Pricing: Fundamentals of Insurance Pricing, Pricing objectives, Types of Rating, Life Insurance vs. Non-Life Insurance Pricing, Rate Making Entities- Insurance Intermediaries and their Functioning, Surveyors and Loss Assessors, Third Party Administrators, Agents, Brokers, Corporate Agents, Bank assurance.
Reinsurance: Role of reinsurance, Techniques of Reinsurance, Nature of Reinsurance Risks, Reinsurance in Indian Perspective.

FURTHER READINGS :

1. Dr. P. K. GUPTA ; Insurance and Risk Management, Himalaya Publishing House,

CONTENTS

LESSON -1

RISK AND ITS TYPES & METHODS

LEARNING OBJECTIVES :

After reading this chapter the student will be able to understand :

- ❖ Introduction about risk in general and specifically financial and non-financial
- ❖ To Analyse the difference between risk and uncertainty
- ❖ To Describe definition of risk management
- ❖ To Discuss risk management objectives
- ❖ To Describe risk management by individuals
- ❖ To Explain corporate risk management

STRUCTURE OF THE LESSON :

1.1 Introduction
1.2 Nature of Risk
1.3 The concept of Risk
1.4 Definition of Risk
1.5 Risk vs. Uncertainty
1.6 Loss and chance of loss
1.7 Perils
1.8 What is a Hazard?
1.9 Types of Risks
1.10 Risks related to business activities
1.11 Risk related to financial institutions
1.12 Pure risk
1.13 Methods of Handling Poor Risk
1.14 Summary
1.15 Key words
1.16 Self Assessment questions
1.17 Suggested Readings

1.1 INTRODUCTION :

Risk is a part and parcel of our daily lives. Risks are all around us whether we are aware of them or not. We may be familiar with some of the risks and then there are others, which may have escaped our attention. There are risks, which we have learned to live with such as “Will I live to see this year through” and then there are risks, which do not cross the mind like “The possibility of house or property getting damaged by an earthquake or lightening”.

Human beings are considered the most intelligent creatures on this earth. The thinking power available to human beings is enormous and this has led human beings to define their style of living and distinguish between good and bad situations. The criteria for deciding whether the situation is good or bad depend upon individual’s perception. However, one thing is sure — that human beings always prefer and strive for happy situations and wants to avoid the adverse ones. Actually, the zeal to be happy always has given birth to the jargon risk.

1.2 NATURE OF RISK :

We are born into a world of uncertainties and every moment thereafter is coloured by uncertainty – including our last moments and death itself, which has come to be the symbol of the uncertain and the unknown. Uncertainty, when related to death becomes a less than welcome notion. But uncertainty or risk do not always conjure up negative attitudes. Imagine life without uncertainty knowing what words would be spoken, what sights would be seen how every game would turn out, never the pleasure of surprise, never the joy of winning. There would have been no triumph in success if there had been no hazard of failure.

Even with the infinite variety of uncertainties that face each of us every moment or every day, we sometimes seek out additional risks to add zest to our lives. Gambling in one form or another has existed in all societies and at all levels of civilizations; all of us are gamblers on occasion, and from the history man has constantly tried to control uncertainty and to reduce risk major advances in human progress have been achieved through minor reductions in risk. The banding of persons into tribes, the discover of fire, the domestication of animals, and the evolution of agriculture have all been means of reducing risk.

1.3 THE CONCEPT OR RISK :

People express risk in different ways. To some, it is the chance or possibility of loss; to others, it may be uncertain situations or deviations or what statisticians call dispersions from the expectations. Different authors on the subject have defined risk differently. However, in most of the terminology, the term risk includes exposure to adverse situations. The indeterminateness of outcome is one of the basic criteria to define a risk situation. Also, when the outcome is indeterminate, there is a possibility that some of them may be adverse and therefore need special emphasis. Look at the popular definitions of risk.

1.4 DEFINITION OF RISK :

The word risk has been defined in many different ways by economists, insurance managers and scholars.

- According to **knight** “risk as measurable uncertainty”
- According to **M. Ahmad**, capability to estimate risk factor in a way to overcome any kind of uncertain burden and manage the organization for the sake of future survival.
- According to **Willett**, Risk as the objectified uncertainty regarding the occurrence of an undesirable event.
- According to **Pfeffer**, Risk as a combination of hazards measured by probability.
- According to above definitions it is evident that the risk involves nature of uncertain losses.

As it can be viewed in a physiological phenomenon that is meaning full in term of human experiences and reactions. Another way it can also be viewed as an objective phenomenon that may be or may not be recognized as we are uncertain about many types of losses that may or may not occur for causes yet to be recognized.

There is no single definition of risk. Different disciplines were defining risk on the bases of perspective tendency and working condition of the subject matter.

Example 1:

From **financial point of view**, risk is defined as uncertainty to the occurrence of financial deficit/loss.

From Economic point of view, risk can be defined as a sudden occurrence of individual/group economic crises. Generally, Economists, behavioral scientists, risk theorists, statisticians, and Actuaries each have their own concept of risk. Some of these definitions are forwarded for your consideration.

- Risk is the possibility of an unfortunate occurrence.
- Risk is a combination of hazards.
- Risk is unpredictability – the tendency that actual results may differ from predicted results.
- Risk is uncertainty of loss.
- Risk is the possibility loss.

Example 2 :

The following are some the basic examples of risks which can result to uncertain able losses.

- The risk of being killed in auto accident
- The risk of house damage as a result of flooding or earth quick.
- The risk of car collision in ice road

Generally, Risk can be defined as: "a condition in which there is a possibility of an adverse deviation between a desired/expected out come from an actual one". On the other hand, it is the identification, measurement, and treatment of exposures to potential losses.

According to the dictionary, risk refers to the possibility that something unpleasant or dangerous might happen.

- an unwanted event which may or may not occur
- the cause of an unwanted event which may or may not occur
- the probability of an unwanted event which may or may not occur
- the statistical expectation value of unwanted events which may or may not occur.
- the fact that a decision is made under conditions of known probabilities ("decision under risk")

Risk is the probability of an outcome having a negative effect on people, systems or assets. Risk is typically depicted as being a function of the combined effects of hazards, the assets or people exposed to hazard and the vulnerability of those exposed elements

Risk is a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for At its most general level, risk is used to describe any situation where there is uncertainty about what outcome will occur. Life is obviously risky.

The degree of risk refers to the likelihood of occurrence of an event. It is a measure of accuracy with which the outcome of a chance event can be predicted.

In most of the risky situations, two elements are commonly found:

i. The outcome is uncertain, i.e., there is a possibility that one or other(s) may occur. Therefore, logically, there are at least two possible outcomes for a given situation.
ii. Out of the possible outcomes, one is unfavorable or not liked by the individual or the analyst.

1.5 RISK VS. UNCERTAINTY :

Uncertainty is often confused with the risk. Uncertainty refers to a situation where the outcome is not certain or unknown. Uncertainty refers to a state of mind characterised by doubt, based on the lack of knowledge about what will or what will not happen in the future.4 Uncertainty is said o exist in situations where decision makers lack complete knowledge, information or understanding concerning the proposed decision and its possible consequences.

Risk is sometimes defined as an implication of a phenomenon being uncertain – that may be wanted or unwanted.

Uncertainty can be perceived as opposite of certainty where you are assured of outcome or what will happen. Accordingly, some weights or probabilities can be assigned into risky situations but uncertainty, the psychological reaction to the absence of knowledge lacks this privilege. Decision under uncertain situations is very difficult for the decision-maker. It all depends upon the skill, the judgment and of course luck. Uncertainties and their implications need to be understood to be managed properly. Uncertainty being a perceptual phenomenon implies different degrees to different person. Assume a situation where an individual has to appear for the first in the newly introduced insurance examination.

(a) an individual student undergone a training in insurance.
(b) an individual with training or experience in insurance

A's perception towards uncertainty of performance in examination is different from that of B. Nonetheless, in both situations, outcome that is the questions which will be asked in the examination are different. Uncertainty may be –

(a) Aleatory uncertainty – uncertainty arising from a situation of pure chance, which is known; or
(b) Epistemic uncertainty – uncertainty arising from a problem situation where the resolution will depend upon the exercise of judgment.

Risk vs. Uncertainty

Risk	**Uncertainty**
Quantifiable	Non-Quantifiable
Statistical Assessment	Subjective Probability
Hard Data	Informed Opinion

Comparison basis	**Risk**	**Uncertainty**
Definition	An event, if occurs, can affect any project objective	There is no information about the future event or impact
Key future	Risk can be measure	Uncertainty cannot be measured
Control	As the outcome are known, risk can be controlled	As the outcomes are unknown, uncertainty cannot be controlled
Probability	Risk have the probability of occurring	Probabilities of uncertainties cannot be guessed

Risk and uncertainty are different terms, but people tend to confuse them. Managing risks is easier because you can identify them and develop a response plan based on your experience. However, managing uncertainty is very difficult, as previous information is not available, too many parameters are involved, and you cannot predict the outcome.

1.6 LOSS AND CHANCE OF LOSS :

- ❖ A risk refers to a situation where there is the possibility of a loss. What is a loss?
- ❖ Loss has been defined in many ways. Loss, in accounting sense, means that portion of the expired cost for which no compensating value has been received.
- ❖ Loss refers to the Act or instance of losing the detriment or a disadvantage resulting from losing. Loss means being without something previously possessed.

- The chance of loss refers to a fraction or the relative frequency of loss. The chance of loss in insurance sense is the probability of loss.
- For example, assume there are 10,000 factories in the insurance pool which may be affected due to earthquake and on the basis of past experience, 5 have been affected, then the probability of loss is 0.0005.
- The whole game of insurance business is based on the probability of loss. If the insurer estimates correctly, he wins else loses or is forced to close the business.
- From the insurer's perspective, it is the probability of loss that accentuate the need for insurances. The probabilities of losses may be ex-post or ex-ante. In practice, the ex-ante probabilities are widely used for undertaking risk in insurance business.
- The chance or probabilities of loss estimation requires accounting for causes of losses popularly characterized as perils and hazards

1.7 PERILS :

Perils are the events that cause loss or damage to property. Fire, flooding, or vehicle impact are all examples of perils.

A peril is something that can cause a financial loss. In insurance, it is the probable cause that exposes a person or property to the risk of injury, damage or loss, and against which an insurance policy is purchased. Some examples of perils include car crash, theft, disability, illness, fire, flood, earthquake, etc. The term peril can be also used to describe the type of insurance policy you have. Insured perils or named perils will be always listed in an insurance policy, with the exception of an all-risk policy that covers all risks except those that are specifically excluded.

A peril refers to the cause of loss or the contingency that may cause a loss. In literary sense, it means the serious and immediate danger. Perils refer to the immediate causes of loss. Perils may be general or specific, e.g., fire may affect assets like building, automobile, machinery, equipment and also, humans. Collusion may cause damage to the automobile resulting in a financial loss.

i. **Natural Perils** : Our very existence on the planet earth ensures that we live with risk as the almighty in all his wisdom has although gifted nature with many sources of energy unbalance or disturbances beyond limits take the form of risk called perils, which can lead to unexpected losses. There are unexpected natural phenomena, which year in and year out cause untold misery, loss of life and property. The most recent example in the Indian context being the Gujarat Earthquake on Jan 26th 2001, which caused widespread devastation. Nearly 20,000 lives were lost, numerous villages and localities were razed to the ground and lakh were rendered homeless. There is no stopping the fury of nature and the havoc that it plays with mankind. Volcanic eruptions, fire due to lightning, landslides, cyclones, hurricanes, storms, floods, the vagaries of weather, unseasonal rainfall and prolonged dry spells, hailstorms are some other examples of natural risks that can cause losses. These perils are also called Act of God perils, and there is little that mankind can do to stop them, he can only learn to live with them and devise means to lessen the negative impact. A global survey of losses for the year 2006 conducted by Sigma estimated the insured losses due to natural calamities at 14.8 billion dollars and out of this 12.6 billion dollars was on account of floods alone (while looking at these figures we have to bear in mind that these are only for insured losses, the actual figure may be actually much more). 40% of the lives lost during the year in catastrophes were on account of natural disasters with a major contribution being the lives lost due to floods in India & Bangladesh in and Southern Africa in February'2000 and Tsunami in 2005-06.

ii. **Man Made Perils**: Then there are the manmade perils, which cause loss, these are an outcome of our society and are the violent actions and unethical practices of people, which result in deviation from the expected. There are many of these but only a few are being discussed to illustrate their significance.

a) **Theft :** In our daily newspaper provides a fair idea about this rampant malady in our society. The entire page is full of incidents of thefts of motorcycles, daylight robberies and burglaries loss to human life by accident, terrorism, enmity, adulteration murder etc. The figure for the exact extent of losses due to such incidents is not available for India but a study done by the FBI in USA way back in 1974 estimated that such losses in material terms alone exceeded $3 billion that year. Not only outsiders but insiders also steal. Employees steal tools, equipments and goods from their employers worth millions every year.

b) **Riots, Strikes and Malicious Damage:** - These are perils, which every property owner faces. During Riots miscreants damage, Public and Private property, loot stores, inflict injury or death to innocent people and the police personnel and bring business to a standstill causing untold damage. Similarly strikes sometimes turn violent resulting in damage to life and property. Strikes also result in loss of production causing huge monetary losses, which may even result in bankruptcy. Vandals target unoccupied houses when the proprietors are on vacation and damage the property, in some cases setting it on fire. Cars parked in the street are also often vandalized.

c) **Accidents :** Accidents are caused by people and they cause injury to themselves or to others and also damage to property. Automobile accidents alone contribute the maximum share of losses due to this peril. As per WHO study each year “Road Traffics” take the lives of 1.2 million men, women & children around the world and seriously injure millions more. In addition to automobile accidents, accidents due to carelessness of humans result in huge losses to property and life. A carelessly dropped cigarette can lead to fire resulting in heavy losses to property and even life. Thousands of workers lose their lives and limbs every year in industrial accidents caused by human error or carelessness.

In one of the reports by Sigma for the year 2006 puts the global figure of manmade insured losses at 5 billion dollars with 50% being attributed to Industrial fires. 11700 people lost their lives and out of these 65% were killed in transport related disasters (which appreciating the extent of losses. We must remember that Sigma’s report is only a study of major disasters and only 350 events during the year have been evaluated / studied. The figures therefore just give an idea whereas the ground reality may be even more alarming)

Economic Perils : The third category of Perils or cause of Risk is economic in nature and the examples of this type of Risk are Depression, Inflation, Local fluctuations and the instability of Industrial firms. Depression in the market leads to low production levels and an increase in unemployment. Low production results in reduced profits or losses for business houses whereas unemployment stops the income of individuals causing mental and physical suffering. When Inflation is there in the economy the buying power of money declines and the real value of savings and income is reduced. People whose livelihood is based on fixed income such as pensioners (Retired persons) during such periods are the hardest hit and may find it impossible to make both ends meet. This fluctuation in the general economy can cause unfavourable deviation from the expectations and create risks for both Industries firms as well as individuals. Sometimes it so happens that even though the general economic condition in the country is stable there are some areas, which may experience recession local fluctuations and can effect the Individuals or the business houses in the same manner as the general fluctuation in economy i.e. Depression & Inflation. When particular area is effected the value of investments made in the area declines and jobs are also lost. At time it is the individual firms which are to blame. The owners lose part or whole of their investment and workers lose their jobs. There are many towns and communities, which are dependent on one single Industry for their wellbeing and when this Industry fails or decides to shift operation the entire town or community is exposed to risk.

Examples of perils :

i. Fire or lightning: Includes damage caused by lightning or an event caused by a lightning strike, such as a fire.
ii. Weight of ice, snow, and sleet: Refers to snow accumulation or an ice dam that causes damage to your home, such as a roof leak.
iii. Windstorm & hail: Includes damage caused by a wind or hailstorm.
iv. Theft & vandalism: Refers to stolen belongings and willful damage to your property.
v. Accidental water/steam overflow or discharge: Refers to water damage from a sudden break or blockage in your plumbing or HVAC system
vi. Falling objects: Includes damage from a tree that falls on your house.
vii. Power surges: Refers to sudden and accidental damage from an artificially generated electrical current or power surge.

1.8 WHAT IS A HAZARD? :

A hazard is a condition or circumstance that increases the probability that a peril will occur. In other words, a hazard makes the occurrence of a peril more likely. For example, factors like slippery roads, and driving under the influence of alcohol can increase the probability of an accident. Here, the accident is a peril whereas slippery roads or driving under the influence of alcohol are hazards.

i. **Hazards**: Hazards are the conditions that increase the severity of loss or the conditions affecting perils. These are the conditions that create or increase the severity of losses. Economic slowdown is a peril that may cause a loss to the business, but it is also a hazard that may cause a heart attack or mental shock to the proprietor of the business. While perils are the direct cause of loss hazards are the underlying factors, which increase the probability of occurrence of loss. There are conditions, which are more hazardous than others e.g., working, as an electrician is a more hazardous occupation than that of a banker as it is more susceptible to accidents. Owning a property on the banks of Ganga is more hazardous than a property in Chandigarh as it is exposed to the risk of damage due to floods. Similarly dealing in textiles is more hazardous than dealing in hardware as the risk of loss due to fire is greater. Hazards are categorized into three types known as physical hazards, moral hazards and morale hazards.

ii. **Physical hazard:** actions, behaviors or physical conditions that increase the possibility of a peril. For example, smoking is considered to be a physical hazard that increases the likelihood of a fire or illness.

iii. **Moral hazard:** hazards that occur due to immoral behavior such as dishonesty and fraud. For example, a business owner may burn down his warehouse to collect the insurance money or an accident victim may exaggerate his injuries.

iv. **Morale Hazard:** hazards that result from circumstances that make people or institutions adopt a careless or reckless attitude, which increases the possibility an injury or loss. For example, having insurance can make a person less careful about avoiding an injury or loss.

v. **Societal Hazards** — Legal and Cultural — These refer to the increase in the frequency and severity of loss arising from legal doctrines or societal customs and structure. For example, the construction or the possibility of demolition of buildings in unauthorized colonies.

1.9 TYPES OF RISKS :

There are mainly two types of risk in this concept which includes Financial and non-financial risk.

1. **Financial and Non-financial Risks :**Financial risk involves the simultaneous existence of three important elements in a risky situation.

   a) That someone is adversely affected by the happening of an event,
   b) The assets or income is likely to be exposed to a financial loss from the occurrence of the event and
   c) The peril can cause the loss.

For example, loss occurred in case of damage of property or theft of property or loss of business. This is financial risk since risk resultant can be measured in financial terms. When the possibility of a financial loss does not exist, the situation can be referred to as non-financial in nature. Financial risks are more particular in nature. For example, risk in the selection of career, risk in the choice of course of study, etc. They may or may not have any financial implications. These types of risk are difficult to measure. As far as insurance is concerned, risk is involved with an element of financial loss.

2. **Individual and Group Risks**: A risk is said to be a group risk or fundamental risk if it affects the economy or its participants on a macro basis. These are impersonal in origin and consequence. They affect most of the social segments or the entire population. These risk factors may be socio-economic or political or natural calamities, e.g., earthquakes, floods, wars, unemployment or situations like 11th September attack on US, etc. Individual or particular risks are confined to individual identities or small groups. Thefts, robbery, fire, etc. are risks that are particular in nature. Some of these are insurable. The methods of handling fundamental and particular risks differ by their very nature, e.g., social insurance programmes may be undertaken by the government to handle fundamental risks. Similarly, fire insurance policy may be bought by an individual to prevent against the adverse consequences of fire.

3. **Pure and Speculative Risks**: Pure risk situations are those where there is a possibility of loss or no loss. There is no gain to the individual or the organization. For example, a car can meet with an accident or it may not meet with an accident. If an insurance policy is bought for the purpose, then if accident does not occur, there is no gain to the insured. Contrarily, if the accident occurs, the insurance company will indemnify the loss.

   Speculative risks are those where there is possibility of gain as well as loss. The element of gain is inherent or structured in such a situation. For example — if you invest in a stock market, you may either gain or lose on stocks.

The distinguishing characteristics of the pure and speculative risks are:

a) Pure risks are generally insurable while the speculative ones are not.
b) The conceptual framework of the risk pooling can be applied to pure risks, while in most of the cases of speculative risks it is not possible. However, there may be some situation where the law of mathematical expectation might be useful.

c) Speculative risk carry some inherent advantages to the economy or the society at large while pure risks like uninsured catastrophes may be highly damaging.

Types of Pure Risk : The following are the important types of pure risks; a) Personal risks b) Property risks c) Liability risks

Personal Risks : are risks that directly affect an individual; they involve the possibility of the complete loss or reduction of earned income, extra expenses, and the depletion of financial assets. In other words, they refer to the possibility of loss to a person such as: death, disability, loss of earning power etc. there are four major personal risks: a) Risk of premature death b) Risk of old age c) Risk of poor health d) Risk of unemployment

Property Risk : this refers to losses associated with ownership of property. Persons owning property are exposed to the risk of having their property damaged or lost from numerous causes. Property risk stems from diverse perils accompanied by different hazards: physical, moral. Real estate and personal property can be damaged or destroyed because of fire, lightening, tornadoes, windstorms, and numerous other causes. There are two major types of loss in the damage of property;

- ❖ A direct loss is defined as a financial loss that results directly from the physical damage, destruction, or theft of the property. For example, if a factory is damaged by a fire, the physical damage to that is known as direct loss.
- ❖ An indirect loss is a financial loss that results indirectly from the occurrence of a direct physical damage or theft loss. It is also known as consequential loss.

Liability Risk : Liability risk is the possibility of loss arising from intentional or unintentional damage made to other persons or to their property. is another type of pure risk that most persons face? One can be made legally liable, if he or she do something that result in bodily injury or property damage to someone else. The court of law may order that person to pay substantial damages to the person who is injured. Motorists are being held legally liable for the negligent operation of their vehicles. Producers are also being sued because of defective products that harm or injure customers

Speculative risks are those where there is possibility of gain as well as loss. The element of gain is inherent or structured in such a situation. For example — if you invest in a stock market, you may either gain or lose on stocks. Speculative risk can be differentiated from the pure risk in three ways;

i. Private insurers generally insure only pure risks. Speculative risks are not considered insurable and other techniques must have used to cope with risk.
ii. The law of large numbers can be applied more easily to pure risks than to speculative risks. The law of large numbers is important because it enables insurers to predict loss in advance. But, it cannot be applied to speculative risks in order to predict future loss experience
iii. Society may benefit from a speculative risk even though a loss occurs, but it is harmed if a pure risk is present and loss occurs. For example, a firm may develop new technology for producing cheaply. As a result, some competitors may fail.

3. Static and Dynamic Risks : Dynamic risks are those resulting from the changes in the economy or the environment. For example economic variables like inflation, income level, price level, technology changes etc. are dynamic risks. Since the dynamic risk emanates from the economic environment, these are very difficult to anticipate and quantify. Dynamic risk involves losses mainly concerned with financial losses. These risks affect the public and society. These risks are the best indicators of progress of the society, because they are the results of adjustment in misallocation of resources. On the other hand, static risks are more or less predictable and are not affected by the economic conditions. Static risk involves losses resulting from the destruction of an asset or changes in its possession as a result of dishonesty or human failure. Such financial losses arise, even if there are no changes in the economic environment. These losses are not useful for the society. These arise with a degree of regularity over time and as a result, are generally predictable. Example for static risk includes possibility of loss in a business: unemployment after undergoing a professional qualification, loss due to act of others, etc.

4. Quantifiable and Non-quantifiable Risks : The risk which can be measured like financial risks are known to be quantifiable while the situations which may result in repercussions like tension or loss of peace are called as non-quantifiable.

5. Fundamental and particular Risk: A fundamental risk is a risk that affects the entire economy or large number of persons or groups within the economy. Examples include high inflation, cyclical unemployment & war. The risk of a natural disaster is another important fundamental risk. Tornadoes, earthquakes, floods and forest fires can result in property damage as well as the loss of numerous lives. A particular risk is a risk that affects only individuals and not the entire community. Examples are car thefts, bank robberies, etc. Here, only individuals experiencing such losses are affected, not the entire economy. The distinction between a fundamental and particular risk is important since government assistance may be necessary to insure a fundamental risk. Social insurance and government insurance programs, as well as government guarantees and subsidies,

1.10 RISKS RELATED TO BUSINESS ACTIVITIES :

Most risks in business environment are speculative in nature. The finance literature considers five types of risks that business organizations face in the course of their normal operation: business risk, financial risk, interest rate risk, purchasing power risk, and market risk.

1. **Business Risk :** This the risk associated with the physical operation of the firm. Variations in the level of sales, costs, profits, are likely to occur due to a number of factors inherent in the economic environment. Business risk is independent of the company’s financial structure.
2. **Financial Risk :** This is associated with debt financing. Borrowing results in the payment of periodic interest charge and the payment of the principal upon maturity. There is a risk of default by the company if operations are not profitable. Other financial risks include: bankruptcy, stock price decline, insolvency, etc. Bond holders are less exposed to financial risk than common stock holders because they have a priority claim against the assets of an insolvent firm.
3. **Interest Rate Risk :** This is a risk resulting from changes in interest rates. Changes in interest rates affect the price of financial securities such as the price of bonds, stock, etc---
4. **Purchasing power Risk :** This risk arises under inflationary situations (general price rise of goods and services) leading to a decline in the purchasing power of the asset held. Financial assets lose purchasing power if increased inflationary tendencies prevail in the economy.
5. **Market Risk :** Market risk is related to stock market. It refers to stock price variability caused by market forces. It is the result of investors reactions to real or psychological expectations. The market in many cases, is also affected by such events like presidential election, trade balances, wars, new inventories, etc. market risk is

also called systematic or non-diversifiable risk. All investors are subject to this risk. It is the result of the workings of the economy; and cannot be eliminated through portfolio diversification.

1.11 RISK RELATED TO FINANCIAL INSTITUTIONS :

1. **Credit Risk :** The risk that a customer, counterparty, or supplier will fail to meet its obligations. It includes everything from a borrower default to supplier missing deadlines because of credit problems. Credit risk is the change in value of a debt due to changes in the perceived ability of counterparties to meet their contractual obligations (or credit rating). Also known as default risk or counterparty risk, credit risk is faced by lending institutions like banks, investors in debt instruments of corporate houses, and by parties involved in contractual agreements like forward contracts. There are independent agencies that assess the credit risk in the form of credit ratings.
2. **Market Risk :** The risk that process will move in a way that has negative consequences for a company. Market Risk is the change in value of assets due to changes in the underlying economic factors such as interest rates, foreign exchange rates, macroeconomic variables, stock prices, and commodity prices. All economic entities that own assets face market risk. For example, bills receivable of software exporters that are denominated in foreign currencies are exposed to exchange rate fluctuations; while value of bonds/government securities owned by investors depend on prevailing interest rates. Organizations with huge exposures, either have a dedicated treasury department, or outsource market risk management to banks. Modeling market risk requires forecasting the changes in the economic factors, and assesses their impact on the asset value. Almost popular measure for expressing market risk is Value-at-Risk, which is ‘the maximum loss’ from an unfavourable event, within a given level of confidence, for a given holding period. Various financial instruments like options, futures, forwards, swaps, etc. can be used effectively to hedge the market risk. Availability of huge data on various markets has facilitated the development of many sophisticated models
3. **Operational :** The risk that people, processes, or systems will fail or that an external event will negatively affect the company. Practically speaking, all organizations face operational risk. For a financial institution/bank, operational risk can be defined as the possibility of loss due to mistakes made in carrying out transactions such as settlement failures, failures to meet regulatory requirements, and untimely collections. No concrete model of managing credit risk is available till today. Still lot of research is being done in this direction.
4. **Other** : Extensions of the above categories, viz., business risk is that future operating results may not meet expectations; organizational risk arises from a badly designed organizational structure or lack of sufficient human resources.

1.12 PURE RISK :

Pure risk refers to a situation in which there is only a possibility of loss or no loss, with no chance of gain. In other words, pure risk is a type of risk that involves only the possibility of loss, not gain. This type of risk is generally insurable, as it can be quantified and measured using statistical methods. Pure risk refers to events that can lead to financial losses such as death, disability, injury, illness, natural disasters, and other similar events that cannot be controlled or predicted.

Personal Risks : Personal risks are risks that directly affect an individual. They involve the possibility of the complete loss or reduction of earned income. There are four major personal risks.

i. **Risk of Premature Death :** Premature death is defined as the death of the household head with unfulfilled financial obligations. If the surviving family members receive an insufficient amount of replacement income from other sources or have insufficient financial assets to replace the lost income, they may be financially insecure. Premature death can cause financial problems only if the deceased has dependents to support or does with unsatisfied financial obligations. Thus, the death of a child aged 5 is not premature in the economic sense.

ii. **Risk of Insufficient Income during Retirement** : It refers to the risk of not having sufficient income at the age of retirement or the age becoming so that there is a possibility that individual may not be able to earn the livelihood. When one retires, he loses his earned income. Unless he has sufficient financial assets from which to draw or has access to other sources of retirement income such as social security or a private pension, he will be exposed to financial insecurity during retirement.

iii. **Risk of Poor Health :** It refers to the risk of poor health or disability of a person to earn the means of survival. For example, losing the legs due to accident, heart surgery that is costly. Unless the person has adequate health insurance, private savings or other sources of income to meet these losses, he will be financially insecure. The loss of insecurity is significant if the disability is severe. In case of long-term disability, things will become worst and someone must take care of the disabled person. The loss of earned income can be financially painful.

iv. **Risk of Unemployment :** The risk of unemployment is another major threat to financial security. Unemployment can result from business cycle downswings, technological and structural changes in the economy, seasonal factors, etc. Employers are increasingly hiring temporary or part-time workers to reduce labor costs. Being temporary employees, workers lose their employee benefits. Unless there is adequate replacement income or past savings on which to draw, the workers (unemployed, part time and temporary) will be financially insecure. By passage of time, past savings and unemployment benefits may be exhausted.

Property Risks : It refers to the risk of having property damaged or lost because of fire, windstorm, earthquake and numerous other causes. There are two major types of loss associated with the destruction or theft of property.

i. **Direct Loss:** A direct loss is defined as a financial loss that results from the physical damage destruction, or theft of the property. For example, physical damage to a factory due to fire is known as direct loss.

ii. **Indirect or Consequential Loss:** An indirect loss is a financial loss that results indirectly from the occurrence of a direct physical damage or theft loss. For example, in factory, there may be apparent financial losses resulting from not working for several months while the factory was rebuilt and also extra expenses termed as indirect loss. Regardless of the cost, business may lose its customers. In this case, it is necessary to setup a temporary operation at some alternative location and extra expenses would occur. These are the indirect expenses resulting from the damage of the factory.

Liability Risks These are the risks arising out of the intentional or unintentional injury to the persons or damages to their properties through negligence or carelessness. Liability risks generally arise from the law. For example, the liability of an employer under the workmen's compensation law or other labor laws in India. In addition to the above categories, risks may also arise due to the failure of others. For example, the financial loss arising from the non-performance or standard performance in an engineering or construction contract. Examples of liabilities risks. In fact, our life has many liabilities risks i.e.:

i. Motorists can be held legally liable for negligent operation of their vehicles
ii. Business firms can be held legally liable for defective products that harm or injure customers
iii. Engineers, accountants and other professionals can be sued by clients because of alleged acts of malpractice
iv. Physicians ,and pharmaceutics, can be sued by patients because of alleged acts of malpractice.

1.13 METHODS OF HANDLING PURE RISK :

It is known, that individual not only expose to risks, but the society as well. Thus, there is no escape from the presence of risks. So, the existence of risks is considered a source of discomfort to most individuals and enterprises, and the uncertainty accompanying them cause anxiety and worry. Consequently, the individuals and enterprises should accordingly seek methods of dealing with these risks in other words Techniques for Managing Risks,. The optimal method to mange or to handle pure risks depends upon the nature of exposure units and the circumstances of individual or organization(enterprise) exposed to loss.

Risk Avoidance : Risk avoidance means avoidance of activity that may lead to loss. That is, risk is avoided when the individual or organization refuse to accept the risk even for an instant.

Examples :

- The person can avoid the risk of drowning by staying away from water.
- The person can avoid the risk of divorce by not marriage
- The business firm can avoid the risk of being sued for defective product by not producing the product.
- The person can avoid the risk of death or disability in airplane crash by refusing to fly.

From our viewpoint, risk avoidance is a method of dealing the risk, but it is a negative rather than a positive technique. So, it is possible but it may not feasible. Not all risks should be avoided. For example, if you avoid the risks of death in airplane crash by refusing to fly by the airplane. How can you travel for example? To America or London, do you think, you can travel by car or bus, the answer, no. So, this method is not practical method

Loss Control : By virtue of this method, the total amount of loss may be reduced. The total amount of loss is a function of loss frequency and loss severity. Thus, loss control represents efforts designated to reduce both frequency and severity of losses. These efforts generally have two objectives. They are: (i) Loss prevention (ii) Loss reduction

Loss prevention : Loss prevention efforts are aimed at reducing the probability of loss so that the frequency of losses is reduced.

Examples of loss prevention :

- The number of heart attacks can be reduced if persons control their weight, give up smoking and eat healthy diets.
- The number of cars accidents can be reduced if the roads are lightning and motorists take a safe driving course.
- A boiler explosion in business can be prevented by periodic inspections by a safety engineer.
- Fires in factories can be prevented by forbidding workers to smoke in a building where highly flammable materials are used

Loss reduction : A loss reduction effort aims at reducing the severity of loss. In other words, loss reduction efforts are designed to lessen the severity of loss that does occur (i.e. after it occurs)

Examples of loss reduction:

- Factories can install sprinkler system at ceiling of stores, so that a fire will be promptly extinguished and consequently, the loss will be reduced.
- Factories can be constructed with fire resistant materials to minimize fire damage.

Risk Retention : Risk retention is considered the most common method of dealing with risk. It means the risks are kept (retained) by individuals or organizations exposed to them. It is known that individuals and organization face an unlimited array of risks. So, when nothing is done about these risks. That is individuals or organizations do not take positive action to avoid, reduce or transfer these risks. We can say, the losses involved in these risks are retained

Risk Transfer to Noninsurance Companies By virtue of this method, the risk shifted to (transfer to) someone else other than insurance companies, and there are 3 methods, they are

Example of risk transfer to noninsurance companies :

- The risk of equipment breakage in laboratory in a school can be transferred to students by collecting 30 S.R "breakage fee" from all students in the school taking chemistry classes at the beginning of semester.
- The risk of a defective household appliances (Television – Receiver – Video – Stereo ….. etc.) can be transferred to the retailer shop in exchange of responsibility for all repairs after the warranty expires.

Insurance : The previous methods may not solve the problem of dealing with risks, but insurance can handle these risks by transferring them to an insurance organization. So, Insurance is the most practical method for handling major risks, for most people and organizations because it has 3 characteristics, they are:-

- Risk transfer is used because a risk is transferred to the insurer.
- The pooling technique is used to spread the losses of the few over the entire group
- The risk may be reduced by application of the law of large numbers by which an insurer can predict future loss experience with greater accuracy.

1.14 SUMMARY :

Risk Management is the vast subject that includes all areas and all aspect of organizational activities. While insurance industry is a sector which is heavily dependent upon satisfaction of its customer, the customer satisfaction can be ensured by providing the desired services to the customer which might could be bale the organization to develop long term relationship with the customers. That can only be satisfied by analyzing through a proper policy of risk management and the location of expected risk. As the risk factor in

Indian insurance sector and as well as in global scenario variables of risk turning towards are demographical and geographical areas of the globe. The focus of an efficient risk management procedure should be on making the other managers realize the implication of their action on organization risk level, and learn to manage it. Risk management is widely and continuously pursuance to manage the firms risk levels by using different easy available resources.

1.15 TECHNICAL TERMS :

1. **Risk :** In finance, risk refers to the degree of uncertainty and/or potential financial loss inherent in an investment decision. In general, as investment risks rise, investors seek higher returns to compensate themselves for taking such risks. Every saving and investment product has different risks and returns.
2. **Uncertainty :** uncertainty, doubt, dubiety, skepticism, suspicion, mistrust mean lack of sureness about someone or something. uncertainty may range from a falling short of certainty to an almost complete lack of conviction or knowledge especially about an outcome or result.
3. **Perils :** [uncountable] serious danger. in peril The country's economy is now in grave peril. The heroine finds herself in mortal peril. She seemed blissfully unaware of the peril she was in. They warned that his life was in imminent peril.
4. **Hazards :** A hazard is a dangerous phenomenon, substance, human activity or condition. It may cause loss of life, injury or other health impacts, property damage, loss of livelihoods and services, social and economic disruption, or environmental damage.
5. **Pure risk :** Pure risk refers to risks that are beyond human control and result in a loss or no loss with no possibility of financial gain. Fires, floods and other natural disasters are categorized as pure risk, as are unforeseen incidents, such as acts of terrorism or untimely deaths.

1.16 SELF-ASSESSMENT QUESTIONS :

1. Define Risk? Explain its role in insurance sector
2. Discuss about Risk vs uncertainty
3. Differentiate Risk and Hazards
4. Explain risk related to business organization
5. Write a notes on the methods of handling of pure risks
6. Explain risk management objectives and its process
7. Analyse Corporate Risk Management

1.17 SUGGESTED READINGS :

1. Dr.P.K. Gupta “Essentials of Insurance and Risk Management” Himalaya Publishing House.
2. E. Rejda George & MC NarmaMicheal Principles of Risk Management and Insurance
3. Jatinder Loomba “Risk Management and Insurance Planning” PHI Publishers, New Delhi
4. Dr. Sunil Kumar “Insurance and Risk Management” Galgotia Publishing Company.

Dr. P. Srinivas Rao

LESSON -2
RISK MANAGEMENT

AIMS & OBJECTIVES :

After reading this chapter the student will be able to

- Understand the definition of risk management
- Discuss risk management objectives
- Describe risk management by individuals
- Explain corporate risk management

STRUCTURE OF THE LESSON :

2.1. Risk Management
2.2. Definition of Risk Management
2.3. Risk Management Objectives
2.4. Risk management Process
2.5. Risk Management by Individuals
2.6. Corporate Risk Management
2.7. Types of Risk Management Strategies
2.8. Summary
2.9. Technical Terms
2.10. Self Assessment questions
2.11. Suggested Readings

2.1. RISK MANAGEMENT :

Risk management encompasses the identification, analysis, and response to risk factors that form part of the life of a business. Effective risk management means attempting to control, as much as possible, future outcomes by acting proactively rather than reactively. Therefore, effective risk management offers the potential to reduce both the possibility of a risk occurring and its potential impact. Risk management is a technique of controlling and avoiding threats to business organisation. It involves determining, analyzing and mitigating harmful risk to an organisation's capital and earnings. Risk management is a practice which is required and followed by every business irrelevant of their size and nature. It aims at recognizing the potential threats in advance and takes all necessary steps to avoid their adverse effects on business operations. These risks and unfortunate events are faced by every business organisation and may harmfully affect its capital or even may lead to its permanent closure. Timely identification and prioritization of these risks are quite important which is all done by implementing risk management techniques. Risk management is a continuous process and works throughout the life of the project towards monitoring all risk factors. It focuses on controlling all possible future events by analyzing various past information like the probability of occurrence, historical data, lessons learned etc. Risk management supports the organisation in the achievement of their goals by ensuring that all activities are running on their normal track. It develops a safe and secure work environment for all staff and customers and increases the stability of business operations.

Understanding Risk Management : Risk management occurs everywhere in the realm of finance. It occurs when an investor buys U.S. Treasury bonds over corporate bonds, when a fund manager hedges his currency exposure with currency derivatives, and when a bank performs a credit check on an individual before issuing a personal line of credit. Stockbrokers use financial instruments like options and futures, and money managers use strategies like portfolio diversification, asset allocation and position sizing to mitigate or effectively manage risk. Inadequate risk management can result in severe consequences for companies, individuals, and the economy. For example, the subprime mortgage meltdown in 2007 that helped trigger the Great Recession stemmed from bad risk-management decisions, such as lenders who extended mortgages to individuals with poor credit; investment firms who bought, packaged, and resold these mortgages; and funds that invested excessively in the repackaged, but still risky, mortgage-backed securities (MBSs).

What are the most common responses to risk? :

- **Risk avoidance:** Avoidance is a method for mitigating risk by not participating in activities that may negatively affect the organization. Not making an investment or starting a product line are examples of such activities as they avoid the risk of loss.
- **Risk reduction:** This method of risk management attempts to minimize the loss, rather than completely eliminate it. While accepting the risk, it stays focused on keeping the loss contained and preventing it from spreading. An example of this in health insurance is preventative care.
- **Risk sharing:** When risks are shared, the possibility of loss is transferred from the individual to the group. A corporation is a good example of risk sharing — a number of investors pool their capital and each only bears a portion of the risk that the enterprise may fail.
- **Transferring risk:** Contractually transferring a risk to a third-party, such as, insurance to cover possible property damage or injury shifts the risks associated with the property from the owner to the insurance company.
- **Risk acceptance and retention:** After all risk sharing, risk transfer and risk reduction measures have been implemented, some risk will remain since it is virtually impossible to eliminate all risk (except through risk avoidance). This is called residual risk.
- **Limitations and risk management standards:** Risk management standards set out a specific set of strategic processes that start with the objectives of an organization and intend to identify risks and promote the mitigation of risks through best practice. Standards are often designed by agencies who are working together to promote common goals, to help to ensure high-quality risk management processes. For example, the ISO 31 000 standard on risk management is an international standard that provides principles and guidelines for effective risk management. While adopting a risk management standard has its advantages, it is not without challenges. The new standard might not easily fit into what you are doing already, so you could have to introduce new ways of working. And the standards might need customizing to your industry or business.

2.2. DEFINITION OF RISK MANAGEMENT :

Risk management has been defined in a variety of ways by different writers and users of the term. Although they vary in detail, most definitions offered thus far stress two points: first, that risk management is concerned with risk and, second, that it is a process or function that involves managing those risks. We propose the following definition of risk management.

i. “Risk management is a scientific approach to dealing with risks by anticipating possible losses and designing and implementing procedures that minimize the occurrence of loss or the financial impact of the losses that do occur.”

ii. Risk management is an integrated process of delineating (define) specific areas of risk, developing a comprehensive plan, integrating the plan, and conducting the ongoing evaluation' – Dr. P.K. Gupta.
iii. Risk Management is the process of measuring, or assessing risk and then developing strategies to manage the risk' – Wikipedia

Note first that risk management is described as a "scientific approach" to the problem of risk. Although risk management seeks to proceed in a scientific manner, it must be admitted that risk management is not a science in the same sense as the physical sciences are, any more than management itself is a science. As the term is generally understood, a science is a body of knowledge based on laws and principles that can be used to predict outcomes. Scientists seek to discover and test these laws through laboratory experiments aimed at uncovering the principles that govern or control the events being studied. The standard method of physical sciences, for example, is the controlled experiment, but risk managers cannot use this method. Instead, risk management derives its rules (laws) from the general knowledge of experience, through deduction, and from precepts drawn from other disciplines, particularly decision theory. Although risk management is not a science, it uses a scientific approach to the problem of managing risk. This scientific approach that distinguishes risk management from earlier approaches to risk decisions can be illustrated by contrasting it with those earlier approaches.

2.3. RISK MANAGEMENT OBJECTIVES :

The objectives of risk management can be broadly classified into two: 1. Pre-loss Objectives, 2. Post-loss Objectives

Pre-loss Objectives :

An organization has many risk management objectives prior to the occurrence of a loss. The most important of such objectives are as follows;

a. The first objective is that the firm should prepare for potential losses in the m ost economical way possible. This involves as analysis of safety program, insurance premiums and the costs associated with the different techniques of ha ndling losses.
b. The second objective is the reduction of anxiety. In a firm, certain loss exposures can cause greater worry and fear for the risk manager, key executives and unexpected stockholders of that firm. For example, a threat of a lawsuit from a defective product can cause greater anxiety than a possible small loss from a minor fire. However, the risk manager wants to minimize the anxiety and fear associated with such loss exposures.
c. The third preloss objective is to meet any externally imposed obligations. This means that the firm must meet certain obligations imposed on it by the outsiders. For example,
government regulations may require a firm to install safety devices to protect workers from harm. Similarly, a firm's creditors may require that property pledged as collateral for a loan must be insured. Thus, the risk manager is expected to see that these externally imposed obligations are met properly.

Post-loss Objectives :

Post-loss objectives are those which operate after the occurrence of a loss. They are as follows:

a. The first post-loss objective is survival of the firm. It means that after a loss occurs, the firm can at least resume partial operation within some reasonable time period.

b. The second post loss objective is to continue operating. For some firms, the ability to operate after a severe loss is an extremely important objective. Especially, for public utility firms such as banks, dairies, etc, they must continue to provide service. Otherwise, they may lose their customers to competitors.
c. Stability of earnings is the third post-loss objective. The firm wants to maintain its earnings per share after a loss occurs. This objective is closely related to the objective ofcontinued operations. Because, earnings per share can be maintained only if t he firm continues to operate. However, there may be substantial costs involved in achieving this goal, and perfect stability of earnings may not be attained.
d. Another important post-loss objective is continued growth of the firm. A firm may grow by developing new products and markets or by acquiring or merging with othe r companies. Here, the risk manager must consider the impact that a loss will have on the firm's ability to grow.
e. The fifth and the final post-loss objective is the social responsibility to minimize the impact that a loss has on other persons and on society. A severe loss can adversely affect the employees, customers, suppliers, creditors and the community in general. Thus, the risk manager's role is to minimize the impact of loss on other persons.

Thus, there are the pre-loss and post-loss objectives of risk management. A prudent risk manager must keep these objectives in mind while handling and managing the risk.

Importance of Risk Management : Risk management is an important process because it empowers a business with the necessary tools so that it can adequately identify and deal with potential risks. Once a risk has been identified, it is then easy to mitigate it. In addition, risk management provides a business with a basis upon which it can undertake sound decision-making. For a business, assessment and management of risks is the best way to prepare for eventualities that may come in the way of progress and growth. When a business evaluates its plan for handling potential threats and then develops structures to address them, it improves its odds of becoming a successful entity. In addition, progressive risk management ensures risks of a high priority are dealt with as aggressively as possible. Moreover, the management will have the necessary information that they can use to make informed decisions and ensure that the business remains profitable.

Risk Management Structures : Risk management structures are tailored to do more than just point out existing risks. A good risk management structure should also calculate the uncertainties and predict their influence on a business. Consequently, the result is a choice between accepting risks or rejecting them. Acceptance or rejection of risks is dependent on the tolerance levels that a business has already defined for itself. If a business sets up risk management as a disciplined and continuous process for the purpose of identifying and resolving risks, then the risk management structures can be used to support other risk mitigation systems. They include planning, organization, cost control, and budgeting. In such a case, the business will not usually experience many surprises, because the focus is on proactive risk management.

i. **Response to Risks**: Response to risks usually takes one of the following forms:
ii. **Avoidance:** A business strives to eliminate a particular risk by getting rid of its cause.
iii. **Mitigation:** Decreasing the projected financial value associated with a risk by lowering the possibility of the occurrence of the risk.

iv. Acceptance: In some cases, a business may be forced to accept a risk. This option is possible if a business entity develops contingencies to mitigate the impact of the risk, should it occur.

When creating contingencies, a business needs to engage in a problem-solving approach. The result is a well-detailed plan that can be executed as soon as the need arises. Such a plan will enable a business organization to handle barriers or blockage to its success because it can deal with risks as soon as they arise.

2.4. RISK MANAGEMENT PROCESS :

Risk management begins with the process of identification evaluation of risk, and also analyze and provide the clue of economic control to the identification of risk, which expose the assets or earning capacity of an organization. Thus risk management performs such important functions; first and foremost functionof risk management is the identification of risks, which provides detail study of internal and external environments. The second most important function of risk management is roanalyse the degree of vulnerability of an organization that may create different sources of risks, lastly, risk management functions assign and evaluate the conomic value of these exposures. Therefore, exposures of above risks require a careful measurement and evaluation of impact of each risk in and on the organization. A suitable evaluation of risks would enable the organization to plan I advance and will help to arrange the required resources to ee the estimated risk exposures.

Risk Analysis Process : Risk analysis is a qualitative problem-solving approach that uses various tools of assessment to work out and rank risks for the purpose of assessing and resolving them. Here is the risk analysis process:

i. **Establish the Context** : The purpose of this stage of planning enables to understand the environment in which the respective organization operates, that means the thoroughly understand the external environment and the internal culture of the organization. You cannot resolve a risk if you do not know that it is. At the initial stage it is necessary to establish the context of risk. To establish the context there is a need to collect relevant data. There is a need to map the scope of the risks and objectives of the organization.

ii. **Identify existing risks:** After establishing the context, the next step in the process of managing risk is to identify potential risks. Risks are about events that, when triggered, will cause problems. Hence, risk identification can start with the source of problems, or with the problem itself. Risk identification requires knowledge of the organization, the market in which it operates, the legal, social, economic, political, and climatic environment in which it does its business, its financial strengths and weaknesses, its helplessness to unplanned losses, the manufacturing processes, and the management systems and business mechanism by which it operates. Risk identification mainly involves brainstorming. A business gathers its employees together so that they can review all the various sources of risk. The next step is to arrange all the identified risks in order of priority. Because it is not possible to mitigate all existing risks, prioritization ensures that those risks that can affect a business significantly are dealt with more urgently.

iii. **Assess the risks:** Once risks have been identified, they must then be assessed as to their potential severity of loss and to the probability of occurrence. These quantities can be either simple to measure, in the case of the value of a lost building, or impossible to know for sure in the case of the probability of an unlikely event occurring. Therefore, in the assessment process it is critical to make the best educated guesses possible in order to properly prioritize the implementation of the risk management plan. The fundamental difficulty in risk assessment is determining the rate of occurrence since statistical information is not available on all kind of past incidents. Nevertheless, risk assessment should produce such information for the management of the organization that the primary risks are easy to understand and that the risk management decisions may be prioritized. Thus, there have been several theories and attempts to quantify risks. In many cases, problem resolution involves identifying the problem and then finding an appropriate solution. However, prior to figuring out how best to handle risks, a business should locate the cause of the risks by asking the question, "What caused such a risk and how could it influence the business?"

iv. **Develop an appropriate response:** Once a business entity is set on assessing likely remedies to mitigate identified risks and prevent their recurrence, it needs to ask the following questions: What measures can be taken to prevent the identified risk from recurring? In addition, what is the best thing to do if it does recur?

v. **Develop preventive mechanisms for identified risks:** Here, the ideas that were found to be useful in mitigating risks are developed into a number of tasks and then into contingency plans that can be deployed in the future. If risks occur, the plans can be put to action.

vi. ***Review and evaluation of the plan*** **:** Initial risk management plans will never be perfect. Practice, experience and actual loss results, will necessitate changes in the plan and contribute information to allow possible different decisions to be made in dealing with the risk being faced. Risk analysis results and management plans should be updated periodically. There are two primary reasons for this – a) To evaluate whether the previously selected security controls are still applicable and effective and b) To evaluate the possible risk level changes in the business movement. There are risks that do no change and are static in nature. However, other dynamic risks of not continually monitored and reviewed may grow like a bubble and their financial, legal and ethical impacts soon get out of control.

2.5. RISK MANAGEMENT BY INDIVIDUALS :

Risk management by individuals refers to the process of identifying, assessing, and mitigating risks that individuals may face in their personal lives. It involves taking proactive measures to minimize the impact of potential risks and protect oneself from adverse events. Here are some key aspects of risk management for individuals:

- ❖ **Risk Identification:** The first step in risk management is identifying potential risks. This can include various areas of life such as health, finance, career, relationships, and personal safety. By recognizing potential risks, individuals can better prepare for them and take necessary actions to reduce their impact.
- ❖ **Risk Assessment:** Once risks are identified, individuals need to assess their likelihood and potential consequences. This involves evaluating the probability of a

risk occurring and the potential impact it may have on their life. It helps individuals prioritize risks and allocate resources accordingly.

- **Risk Mitigation:** Risk mitigation involves taking actions to reduce the probability or impact of risks. This can include implementing safety measures, purchasing insurance, diversifying investments, maintaining an emergency fund, or improving one's skills and knowledge. The goal is to minimize the negative consequences of risks and increase one's resilience.
- **Risk Transfer:** In some cases, individuals may choose to transfer the risk to a third party, such as purchasing insurance policies. By paying a premium, individuals transfer the financial burden of certain risks to an insurance company. This can provide a sense of security and protect against significant financial losses in case of unfortunate events.
- **Regular Review:** Risk management is an ongoing process that requires regular review and adjustment. Individuals should periodically reassess their risks, evaluate the effectiveness of their risk mitigation strategies, and make necessary updates based on changing circumstances.
- **Financial Planning:** Effective financial planning plays a crucial role in individual risk management. By establishing a budget, setting financial goals, and saving for emergencies, individuals can create a strong financial foundation that can help them withstand unexpected events.
- **Emotional Resilience:** In addition to practical measures, developing emotional resilience is essential in risk management. Building a positive mindset, cultivating coping strategies, and maintaining a support system can help individuals better navigate and recover from challenging situations.

It's important to note that risk management cannot eliminate all risks entirely, but it aims to minimize their potential impact and enhance an individual's ability to cope with them. It's a proactive approach that empowers individuals to make informed decisions and take necessary actions to protect themselves and their interests.

2.6. CORPORATE RISK MANAGEMENT :

In global corporate scenario there are lof of private players are participating actively in different ways that always having the possibility of risks due to variety of reason. These risks always a great challenge before the corporate sector and the private players involving huge investment in several activities. The corporate entity keeps in minds to solve the problem which is always expected to its business. The problem is not managed properly can resulted into heavy losses for the sector. The losses may be in terms of money, material opportunities or human life. Corporate risk management refers to all of the methods that a company uses to minimize financial losses. Risk managers, executives, line managers and middle managers, as well as all employees, perform practices to prevent loss exposure through internal controls of people and technologies. Risk management also relates to external threats to a corporation, such as the fluctuations in the financial market that affect its financial assets.

The goal of corporate risk management is to create a reference framework that will allow companies to handle risk and uncertainty. Risks are present in nearly all firms' financial and economic activities. The risk identification, assessment, and management process is part of companies' strategic development; it must be designed and planned at the highest level, namely the board of directors. The risk appetite of the company must also be defined by the board. An integrated risk management approach must evaluate, control, and monitor all risks and their dependencies to which the company is exposed. In general, a pure risk is a combination of the probability or frequency of an event and its consequences, which are usually negative. Risk can be measured by the volatility of results, but higher moments of the distribution are often necessary. Uncertainty is less precise because the probability of an uncertain event is often unknown or subjective, as is its consequence. In this case, we would refer to precautionary rather than preventive activities to protect against uncertainty. Lastly, financial risk management consists in undertaking opportunistic activities related to future risks that may generate positive or negative results. Corporate risk management is defined as a set of financial and operational activities that maximize the value of a company or a portfolio by reducing the costs associated with risk (Stulz, 1996, 2003). The main risk management activities are diversification and risk hedging using various instruments, including derivatives and structured products, market insurance, self-insurance, and self-protection. The main costs firms seek to minimize are costs of financial distress, risk premium to partners (stakeholders), expected income taxes, and investment financing. Managers' behavior toward risk (risk appetite and risk aversion) and corporate governance also affect the choice of risk management activities.

There are eight main risks :

- **i.** ***Pure risk*** (often insurable, and not necessarily exogenous in the presence of moral hazard and known in the presence of adverse selection); Pure risks can be divided into three different categories: personal, property, and liability. Many cases of pure risk are insurable. Pure risks are a loss only or at best a break-even situation. Fundamental risks are the risks mostly emanating from nature. Having dealt with the meaning of risk we shall now attempt to divert our attention to another aspect of the nature of risk which we shall call as Classification of risk. Investing in the stock market is an example of a speculative risk. One can only speculate on whether the investment will produce a profit or a loss. Insuring an automobile is an example of pure risk. If the insured auto is involved in an auto accident, there is most definitely going to be some sort of damage (loss). Most pure risks can be divided into three categories: personal risks that affect the income-earning power of the insured person, property risks, and liability risks that cover losses resulting from social interactions. Not all pure risks are covered by private insurers. The 4 essential steps of the Risk Management Process are: Identify the risk.- Assess the risk.- Treat the risk.- Monitor and Report on the risk.

- **ii.** ***Market risk*** (variation in prices of commodities, exchange rates, asset returns); Market risk is rated based upon, but not limited to, an assessment of the following evaluation factors: The sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchanges rates, commodity prices, or equity prices. Section 203(f) of the market risk rule requires that a subject banking organization adequately document all material aspects of its internal models, management and valuation of covered positions, control, oversight, validation and review processes and results, and internal assessment of capital adequacy. It is important for many reasons other than the obvious – "My account is worth less today than it was yesterday." It defines what should or should not be purchased by an investor at any given time and in any given situation. Every investor is unique and likewise every investor's perception of risk is unique. Market risk is a measure of all the factors affecting the performance of financial markets. From an investor's perspective, it refers to the possibility of an investor experiencing losses due to factors that affect the overall performance of the financial markets in which such investor has made investments.

- **iii.** ***Default risk*** (probability of default, recovery rate, exposure at default); Default risk is the risk a lender takes that a borrower will not make the required payments on a debt obligation, such as a loan, a bond, or a credit card. Lenders and investors are exposed to default risk in virtually all forms of credit offerings. For a simple example of default risk, consider a borrower who takes out a $300,000 home loan. The bank that made the loan does not know with certainty whether the borrower will repay the loan on time, so it assumes default risk in the transaction. There are two types of default risk investing funds and non-investing funds. In investing fund rating is AAA, AA, or BBB, which shows the low risk and sign that money can be supported, whereas, in non-investing trouble, the ratings given are below or equal to BB, which is the sign of high-risk securities. The formula for estimating the default risk premium is as follows. The interest rate charged by the lender, i.e. the yield received by providing the debt capital, is subtracted by the risk-free rate (rf), resulting in the implied default risk premium, i.e. the excess yield over the risk-free rate. Default can be of two types: debt services default and technical default. Debt service default occurs when the borrower has not made a scheduled payment of interest or principal. Technical default occurs when an affirmative or a negative covenant is violated. The default risk premium is an additional amount of interest rates paid by a borrower to lender/ investor as compensation for the higher credit risk of the borrower assuming his failure to pay back the principal amount in the future and can be mathematically described as the difference in between the interest rates .

iv. ***Operational risk*** (employee or management errors, fraud, IT system breakdown, derivative mispricing); Operational risk summarizes the uncertainties and hazards a company faces when it attempts to do its day-to-day business activities within a given field or industry. A type of business risk, it can result from breakdowns in internal procedures, people and systems—as opposed to problems incurred from external forces, such as political or economic events, or inherent to the entire market or market segment, known as systematic risk. Operational risk focuses on how things are accomplished within an organization and not necessarily what is produced or inherent within an industry. These risks are often associated with active decisions relating to how the organization functions and what it prioritizes. While the risks are not guaranteed to result in failure, lower production, or higher overall costs, they are seen as higher or lower depending on various internal management decisions.

Because it reflects man-made procedures and thinking processes, operational risk can be summarized as a human risk; it is the risk of business operations failing due to human error. It changes from industry to industry and is an important consideration to make when looking at potential investment decisions. Industries with lower human interaction are likely to have lower operational risk.

v. ***Liquidity risk*****:** Liquidity risk occurs when an individual investor, business, or financial institution cannot meet its short-term debt obligations. The investor or entity might be unable to convert an asset into cash without giving up capital and income due to a lack of buyers or an inefficient market. Risk of not possessing sufficient funds to meet short-term financial, obligations without affecting prices. May degenerate into default risk. Minimum level of liquid and ready reliable assets to meet the normal operating expenses in corporate sector is crucial, liquid risk in corporate sector arises due to inappropriate policies and measures. However, the excess of liquidity is also costly for the corporate sector because an ideal liquid asset carriers less cost to the organization. Therefore, suitable risk management system can prevent the corporate risk. There are two different types of liquidity risk. The first is funding liquidity or cash flow risk, while the second is market liquidity risk, also referred to as asset/product risk. An example of liquidity risk would be when a company has assets in excess of its debts but cannot easily convert those assets to cash and cannot pay its debts because it does not have sufficient current assets. Another example would be when an asset is illiquid and must be sold at a price below the market price.

vi. ***Information risk*** paucity in maintaining the confidential matter of top official those are responsible for planning policies and its execution. The untimely disclosure of confidential information can create great risk for the entire corporate risk. The term “information security risk” refers to the damage that attacks against IT systems can cause. IT risk encompasses a wide range of potential events, including data breaches, regulatory enforcement actions, financial costs, reputational damage, and more. Risks to information assets include noncompliance with legal regulations, technology risks centered on cyber security and system maintenance, external and internal data breaches, and management risks related to managing change, system planning, and providing proper training. Information System-Related Security Risk. Definition(s): A measure of the extent to which an entity is threatened by a potential circumstance or event, and typically a function of: (i) the adverse impacts that would arise if the circumstance or event occurs; and (ii) the likelihood of occurrence.

vii. ***Money Market Risk***: Three key risks. Assessing risk in money market funds. Because they invest in fixed income securities, money market funds and ultra-short duration funds are subject to three main risks: interest rate risk, liquidity risk and credit risk. Resources mobilization in corporate sector keeps an another pivotal importance, due to the lack of current market fluctuations trend, high interest rate in borrowing external capital, fixation of high debenture rate and preference shares, etc are the major problems to the corporate sector that create corporate risks. The most common types of market risk include interest rate risk, equity risk, commodity risk, and currency risk. Interest rate risk covers the volatility that may accompany interest rate fluctuations and is most relevant to fixed-income investments. Examples of market risk are: changes in equity prices or commodity prices, interest rate moves or foreign exchange fluctuations. Market risk is one of the three core risks all banks are required to report and hold capital against, alongside credit risk and operational risk. Risk measures the uncertainty that an investor is willing to take to realize a gain from an investment. Description: Risks are of different types and originate from different situations. We have liquidity risk, sovereign risk, insurance risk, business risk, default risk, etc. Market risk is a measure of all the factors affecting the performance of financial markets. From an investor's perspective, it refers to the possibility of an investor experiencing losses due to factors that affect the overall performance of the financial markets in which such investor has made investments.

viii. ***Supervision risk*:** usually organization always suffers due to the faulty supervision of its personnel they have been appointed for the supervision of the organizations. Faulty selection process, inefficient trainee, bad working environment leads the corporate upto a great extent of risk, the corporates can face big losses due to the above reason which can be mitigate through the better supervision. Supervision Risk and Analysis provides analysis in support of the agency's core mission functions of supervision and supervision policy. The organization includes Economic & Policy Analysis, Risk Analysis, Supervision System & Analytical Support, and Systemic Risk Identification and Support. A risk-based supervision framework is a structured process aimed at identifying the. most critical risks that face each insurance company and, through focused review by the. supervisor, assessing the company's management of risks, and the company's financial. Types of Risk in Insurance. Financial Risk: Financial risk is a risk whose monetary value of a loss on a particular event can be measured. Non-Financial Risk: Non-financial risk is a risk whose monetary value of a loss on a particular event cannot be measured. The Four Types of Risk Management. 4 Types of

Risk Management. The four types of risk management are quite different and cover a wide range of scenarios. ...Risk Avoidance. ...Risk Reduction. ...Risk Transfer. ..Risk Retention.

2.7. WHO IS RESPONSIBLE FOR DEVELOPING A RISK MANAGEMENT STRATEGY?

Determining who will be the best person or function to identify, assess, and develop a risk management strategy won't necessarily be the same each time — it will depend on the scope, nature, company structure, complexity, resource availability, and team capabilities. So who is responsible for developing a risk management strategy? It might be the responsibility of a risk management committee member, an audit team member, a project manager, a risk specialist, or someone else – like an external consultant. When deciding which direction to go, other things to consider include:

i. The drivers and benefits behind developing a risk management strategy.
ii. The end-to-end process, from initiation to completion.
iii. Other parties who can bring additional insight and value.
iv. How and where to document the risk management strategy.
v. Risk management software and tools that can simplify and streamline work.
vi. Conducting a formal review of the findings.

what are the 10 types of risk management strategies to follow?

It's important to know that there are many different risk management strategies, each with its own benefits and uses. Here are ten types to follow.

❖ **Type 1: Business Experiments:** This risk management strategy is useful in running 'what-if' scenarios to gauge different outcomes to potential threats. From IT to marketing teams, many functional groups are well versed in conducting business experiments. Financial teams also run experiments to gauge return on investments or assess other financial metrics.

❖ **Type 2: Theory Validation:** Theory validation strategies are conducted using questionnaires and surveys of groups to gain feedback based on experience. If a new product or service has been developed or there are enhancements, it makes sense to get direct, timely, and relevant feedback from end users to assist with managing potential challenges and design flaws, and thus better manage risks.

❖ **Type 3: Minimum Viable Product Development:** Developing complex systems that offer nice-to-have features isn't always the best route. A good risk management strategy considers building software using core modules and features that will be relevant and useful for the bulk of their customers — this is called a Minimum Viable Product (MVP). It helps to keep projects within scope, minimizes the financial burden, and helps companies get to market faster.

❖ **Type 4: Isolating Identified Risks:** Information technology teams are used to engaging with internal or external help to isolate security gaps or flawed processes that might leave room for vulnerabilities. In doing so, they become proactive in identifying security risks ahead of an event rather than waiting for a malicious and costly breach to occur.

❖ **Type 5: Building in Buffers:** Whether it's a technology or audit project, project managers recognize the need to build in a buffer. Buffers reduce risks by ensuring initiatives stay within the intended scope. Depending on the project, buffers may be financial, resource or time-based. The goal here is making sure that there are no surprises posing unforeseen risks.

- **Type 6: Data Analysis:** Data gathering and analysis are key elements in assessing and managing various risks. For instance, qualitative risk analysis can help identify potential project risks. Conducting a thorough qualitative risk analysis helps to isolate and prioritize risks, and to develop strategies to address, monitor, and re-evaluate them.
- **Type 7: Risk-Reward Analysis:** Conducting an analysis of risks versus rewards is a risk strategy that helps companies and project teams unearth the benefits and drawbacks of an initiative before investing resources, time, or money. It’s not only about the risks and rewards of investing funds to take on opportunities — it’s also about providing insight into the cost of lost opportunities.
- **Type 8: Lessons Learned:** With every initiative or project that your company does or doesn’t complete, there will inevitably be lessons that can be learned. These lessons are a valuable tool that can significantly reduce risks in future projects or undertakings — but lessons are only useful if teams take the time to document them, discuss them, and develop an action plan for improvement based on what’s been learned.
- **Type 9: Contingency Planning :** Things seldom go as planned, and while having a plan is great, it’s seldom enough. Companies need to plan to have multiple plans or options based on various scenarios. Contingency planning is all about anticipating that things will go wrong and planning alternate solutions for the type of risks that may surface and foil your original plan.
- **Type 10: Leveraging Best Practices**: There’s a reason best practices are mentioned under risk management strategies. Best practices are usually tried and tested ways of doing things and while they may differ from industry to industry and project to project, best practices ensure companies don’t have to recreate the wheel. Ultimately this reduces risks.

Effectively managing risk has always been critical for success in any company and industry but never more so than today. Being able to identify and properly assess risks reduces missteps and saves money, time, and valuable resources. It also clarifies decision-makers and their teams and helps leaders recognize opportunities and the actions they need to take. An important part of your risk strategy should also involve managing your company’s risks by using integrated risk management software that facilitates collaboration and visibility into risk to increase the effectiveness of your risk management programs.

2.8. SUMMARY :

Risk Management is the vast subject that includes all areas and all aspect of organizational activities. While insurance industry is a sector which is heavily dependent upon satisfaction of its customer, the customer satisfaction can be ensured by providing the desired services to the customer which might could be bale the organization to develop long term relationship with the customers. That can only be satisfied by analysing through a proper policy of risk management and the location of expected risk. As the risk factor in Indian insurance sector and as well as in global scenario variables of risk turning towards are demographical and geographical areas of the globe. The focus of an efficient risk management procedure should be on making the other managers realize the implication of their action on organization risk level, and learn to manage it. Risk management is widely and continuously pursuance to manage the firms risk levels by using different easy available resources.

2.9. TECHNICAL TERMS :

1. **Risk Management :** Risk management is the process of identifying, assessing and controlling financial, legal, strategic and security risks to an organization's capital and earnings.
2. **Corporate Risk Management :** Corporate risk management is defined as a set of financial and operational activities that maximize the value of a company or a portfolio by reducing the costs associated with risk (Stulz, 1996, 2003).
3. **Volatility :** Volatility is a rate at which the price of a security increases or decreases for a given set of returns. Volatility is measured by calculating the standard deviation of the annualized returns over a given period of time.
4. **Effective risk management :** Effective risk management means attempting to control, as much as possible, future outcomes by acting proactively rather than reactively. Therefore, effective risk management offers the potential to reduce both the possibility of a risk occurring and its potential impact.

2.10. SELF-ASSESSMENT QUESTIONS :

1. Define Risk? Explain its role in insurance sector
2. Discuss about Risk vs uncertainty
3. Differentiate Risk and Hazards
4. Explain risk related to business organization
5. Write a notes on the methods of handling of pure risks
6. Explain risk management objectives and its process
7. Analyze Corporate Risk Management

2.11. SUGGESTED READINGS :

1. Dr. P. K. Gupta “Essentials of Insurance and Risk Management” Himalaya Publishing House.
2. E. Rejda George & MC Narma Micheal Principles of Risk Management and Insurance
3. Jatinder Loomba “Risk Management and Insurance Planning” PHI Publishers, New Delhi
4. Dr. Sunil Kumar “Insurance and Risk Management” Galgotia Publishing Company.

Dr. KRISHNA BANANA

LESSON – 3
INTRODUCTION TO INSURANCE

AIMS & OBJECTIVES :

After studying this lesson, you will be able to…

- Understand the meaning of insurance.
- Know the history of Indian Insurance.
- Understand the role & importance of Insurance.

STRUCTURE OF THE LESSON :

3.1 INTRODUCTION :

Indian History of Insurance : The growth of insurance industry is associated with the general growth of industry, trade and commerce. The origin of insurance services may be traced back to 14th Century in Italy when ships carrying goods were covered under different perils. Thus, marine insurance become oldest insurance practice. The systematic and orderly beginning of the insurance industry took place in UK at Lloyds coffee house in Tower Street in London. In developing countries, insurance sector has assumed special significance as it has the potential to speed up the rate of growth of the economy. Insurance Industry assists the development process of an economy in several ways. Primarily, it acts as mobiliser of savings, financial intermediary promoter of investment activity, stabilizer of financial market, risk manager and an agent to allocate capital resources efficiently. Regrettably, the Indian insurance industry has lagged behind even amongst the developing countries of the world. Although general insurance services started in India about 150 years ago, their growth has been dilatory, as reflected by low insurance penetration and density. Several factors are responsible for this state of affairs, the chief being the monopoly status of the industry till recently.

The life insurance business was nationalized in 1956 and the general insurance industry in 1973. The lack of competition has impeded the development of insurance industry in India, resulting in low productivity and poor quality of customer services. The process of liberalization and globalization of the Indian economy started in right earnest in mid-1980s. The market mechanism was the motivating factor underlying the new economic policy. In consonance with the new economic policy, insurance sector was opened up for the private sector in 1999. The new competitive environment is expected to benefit the consumers, industry and the economy at large. The consumer will have a greater choice in terms of number and quality of products, low premium rates, efficient after sales services while the economy will benefit in terms of larger flow of savings, increased availability of investible funds for long term projects, enhanced productivity and growth of multiple debt instruments. It is a generally acknowledged phenomenon that there are enormous risks in every sphere of life. For property, there are fire risks; for shipment of goods, there are perils of sea; for human life, there are risks of death or disability; and so on. The chances of occurrences of the events causing losses are quite uncertain because these may or may not take place. In other words, our life and property are not safe and there is always a risk of losing it. Sometimes when you make an insurance claim, the premium amount is less than what it should be. So, in that case, you first have to pay the remaining amount and then claim the insurance money. The extra amount to be paid under such circumstances is called ‘deductible’. You can pay lesser premiums and higher deductibles in an agreement with the insurer. A simple way to cover this risk of loss money - wise is to get life and property insured. In this business, people facing common risks come together and make their small contributions to the common fund. While it may not be possible to tell in advance, which person will suffer the losses, it is possible to work out how many persons on an average out of the group may suffer the losses. When risk occurs, the loss is made good out of the common fund. In this way, each and every one shares the risk. In fact, insurance companies bear risk in return for a payment of premium, which is calculated on the likelihood of loss.

Insurance is a legal agreement between two parties – the insurer and the insured, also known as insurance coverage or insurance policy. The insurer provides financial coverage for the losses of the insured that s/he may bear under certain circumstances. Let’s discuss in detail what is insurance and how it works, the insurance benefits, and types. Insurance coverage can be defined as a contract in the form of a financial protection policy. This policy covers the monetary risks of an individual due to unpredictable contingencies. The insured is the policyholder whereas the insurer is the insurance-providing company/the insurance carrier/the underwriter. The insurers provide financial coverage or reimbursement in many cases to the policyholder. The policyholder pays a certain amount called ‘premium’ to the insurance company against which the latter provides insurance cover. The insurer assures that it shall cover the policyholder’s losses subject to certain terms and conditions. Premium payment decides the assured sum for insurance coverage or ‘policy limit’.

3.2 BASIC TERMS USED IN INSURANCE :

Different terms are used in the insurance. Important among them are given below.

i. **Insured :** the party or the individual who seeks protection against a specified task and entitled to receive payment from the insurer in the event of happening of stated event is known as insured. an insured is normally in insurance policy holder.

ii. **Insurer :** the party who promises to pay indemnity the insured on the happening of contingency is known as insurer. the insurer is an insurance company.

iii. **Beneficiaries :** the person or the party to whom the policy proceeds will be paid in the event of the death or happening of any contingency is called beneficiary.

iv. **Contract :** an agreement binding at law between two or more parties is called contract.

v. **Premium :** the amount which is paid to the insurer by the insured in consideration to insurance contract is known as premium. it may be paid on monthly, quarterly, half yearly, yearly or as agreed upon it is the price for an insurance policy.

vi. **Insured sum :** the sum for which the risk is insured is called the insured sum, or the policy money or the face value of the policy. this is the maximum liability of the insurer towards the insured.

vii. **Peril :** a peril is an event that causes a personal or property loss by fire, windstorm, explosion, collision premature death, sickness, floods, dishonesty etc.

viii. **Hazard :** hazard is a condition that may create, increase or decrease the chances of loss from a given peril.

ix. **Exposure :** an exposure is a measure of physical extent of the risk. an individual who owns a business house may be subjected to economic loss and individual loss because of his business and personal exposure.

3.3 MEANING & DEFINITION :

Thus, insurance is a device by which a loss likely to be caused by uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join themselves against such an event. The document which contains all the terms and conditions of insurance (i.e. the written contract) is called the 'insurance policy'. The amount for which the insurance policy is taken is called 'sum assured'. The consideration in return for which the insurer agrees to make good the loss is known as 'insurance premium'. This premium is to be paid regularly by the insured. It may be paid monthly, quarterly, half yearly or yearly. Insurance is a contract between two parties. One party is the insured and the other party is the insurer. Insured is the person whose life or property is insured with the insurer. That is, the person whose risks are insured is called insured. Insurer is the insurance company to whom risk is transferred by the insured. That is, the person who ensures the risk of insured is called insurer.

- ❖ Insurance is a contract between insurer and insured. It is a contract in which the insurance company undertakes to indemnify the insured on the happening of certain event for a payment of consideration. It is a contract between the insurer and insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against. Some definitions of insurance are given below: It is a kind of risk management plan to use an insurance policy as a hedge against an uncertain loss
- ❖ Insurance coverage does not mitigate the magnitude of loss one may face. It only assures that the loss is shared and distributed among multiple people
- ❖ Various clients of an insurance company pool in their risks. Hence, they pay the premiums together. So when one or a few incur a financial loss, the claimed money is given out of this accumulated fund. This makes each client bear a nominal fee
- ❖ Insurance coverage can be provided for medical expenses, vehicle damage, property loss/damage, etc. depending on the type of insurance
- ❖ Premium, policy limit, and deductible are the main components of an insurance coverage policy. The policy buyer should check them thoroughly while buying an insurance policy

- ➢ **According to Gosh and Agarwal**, "insurance may be defined as a co -operative form of distributing a certain risk over a group of persons who are exposed to it'.
- ➢ **According to Mc Gill**, "Insurance is a process in which uncertainties are made certain".
- ➢ In the words of **Jon Megi**, "Insurance is a plan wherein persons collectively share the losses of risks".

Features of Insurance Coverage :

Insurance coverage has the below mentioned salient features: i. Insurance follows important characteristics – These are follows

- **sharing of risk:** 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 family or on happening of marine perils or loss of by fire.
- **co-operative:** it **i**s a co-operative **device** 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.
- **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.
- **Evaluation of risk:** for the purpose of ascertaining the insurance premium, the volume of risk is evaluated, which forms the basis of insurance contract.
- **Payment of happening of specified event:** on happening specified event, the insurance company is bound to make payment to the insured. happening of specified event is certain in life insurance, but in the case of fire, marine of accidental insurance, it is not necessary. in such cases, the insurer is not liable for payment of indemnity.
- **Transfer of risk:** insurance is a plan in which the insured transfers his risk on the insurer. this may be the reason that may person observes, that insurance is a device to transfer some economic losses would have been borne by the insured themselves.
- **Spreading of risk:** insurance is a plan which spread the risk & losses of few people among a large number of people. john magee writes, “insurance is a plan by which large number of people associates themselves and transfers to the shoulders of all, risk attached to individuals”.
- **Protection against risks:** insurance provides protection against risk involved in life, materials and property. it is a device to avoid or reduce risks.
- **Insurance is not charity: c**harity pays without consideration but in the case of insurance, premium is paid by the insured to the insurer in consideration of future payment.
- **Insurance is not gambling:** insurance is not a gambling. gambling is illegal, which gives gain to one party and loss to other. insurance is a valid contact to indemnity against losses. moreover, insurable interest is present in insurance contracts it has the element of investment also.
- **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, the insured promises to pay a fixed rate of premium to the insurer.
- **Social device:** insurance is a plan of social welfare and protection of interest of the people. ridged and miller observe “insurance is of social nature”.
- **Based upon certain principle:** 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 operating in the various fields of insurance.
- **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 general insurance act 1972 and the life insurance act 1956 are the major enactment in this direction.
- **Insurance is for pure risk only:** pure risks give only losses to the insured, and no profits. examples of pure risks are accident, misfortune, death, fire, injury, etc., which are all the sided risks and the ultimate results in loss. insurance companies issue policies against pure risk only, not against speculative risks.

- **Based on mutual goodwill:** insurance is a contract based on good faith between the parties. therefore, both the parties are bound to disclose the important facts affecting to the contract before each other. utmost good faith is one of the important principles of insurance.

3.4 BENEFITS OF INSURANCE COVERAGE :

An insurance policy performs various functions and comes with multiple benefits. Below are some of its most fundamental advantages, along with some of the secondary and the rest are additional ones. The basic functions of insurance coverage are:

i. **Provides Protection:** Insurance coverage does reduce the impact of loss that one bears in perilous situations. It provides monetary reimbursement during financial crises. It not only protects the insured from financial woes but also helps in checking mental stress arising out of it.

ii. **Provides Certainty:** Insurance coverage provides a feeling of assurance to the policyholders. The insured pays a small portion of the income for this certainty that will help in the future. So, there is a certainty of handsome financial aid against the premium. It will protect the policy buyer when met with accidents, hazards, or any vulnerabilities.

iii. **Risk Sharing:** The very manner in which insurance policy functions makes it a cooperative scheme. An insurer would be unable to pay from one's capital. An insurance company pools in collective risks and premiums because it covers a large number of risk-exposed people. The payout to the one who claims insurance coverage is out of this fund. Thereby, all policyholders share the risk of the one who actually suffered the loss.

iv. **Value of Risk:** Insurance policy assesses the volume of risk and also anticipates the various causes of it. It evaluates the amount for insurance coverage and the premium payment amounts on a risk value basis. It safeguards against unforeseen events and consequential loss.

Additional Benefits And Secondary Functions :

Above were the primary benefits of an insurance coverage policy. Apart from the above, it also has some additional benefits and secondary functions that it performs such as the ones mentioned below:

i. **Capital Generation :** The fund generated from the various premiums acts as a pooled investment for the insurance company. The insurers invest this lump sum into money market instruments. For instance, in stocks, mutual funds, and other productive channels. This helps in generating income and profit for the business. It guards against the loss of capital for the company.

ii. **Economic Growth:** Insurance policies mobilize domestic savings into providing financial stability. It also directs towards loss mitigation due to damage or destruction for the insured community. It not only equivalently spreads the risks but also promotes trade and commerce by utilizing the fund.

iii. **Saving Habits**: Insurance policies help inculcate saving habits among individuals. They keep a portion of income to pay premiums that will act as a guard for unknown future predicaments. Many insurance plans come as insurance-cum-savings or insurance-cum-investment schemes. This further encourages people to save and invest.

3.5 TYPES OF INSURANCE COVERAGE :

Insurance policies can cover up medical expenses, vehicle damage, loss in business or accidents while traveling, etc. Life Insurance and General Insurance are the two major types of insurance coverage. General Insurance can further be classified into sub-categories that clubs in various types of policies. These are:

i. **Life Insurance :** One can avail the life insurance in order to protect the family due to premature death or death during the tenure of the policy. It provides the family with a lump sum when the insured person meets with an untimely death. This helps the grieving family to battle with financial struggles that may occur in absence of a breadwinner.

ii. **General Insurance:** Non-life insurance policies count as general insurance policies that include insurance coverage for home, auto, education, etc. as mentioned below:

   a) **Health Insurance**: You can buy health insurance for yourself or for your family that may include your spouse, parents, siblings, and children. Some insurance companies have tie-ups with hospitals. So here you can use your policy number to avail of cashless services in-network hospitals. In other cases, you can claim reimbursement for hospitalization and treatments. Do check the coverage of the type of disease/illness/health issue. Also, verify what type of costs are covered.

   b) **Education Insurance:** Education insurance can also serve as an investment scheme. You pay premiums by the time your child is 18 years of age or attains a certain age as decided by the insurance policy. You can have a lump sum with imposed regulations that you can use for a child’s educational purposes and not any other. Use an education calculator to estimate the amount you may need when the child grows up. Such calculators are often provided by insurance companies or insurance offering sites. The parent/ foster parent/legal guardian is the owner of the policy.

   c) **Home/Property Insurance:** If man-made or natural calamities damage your valuable property then this policy can cover the financial loss and provide monetary aid. Losses due to theft, floods, or any other mishaps can be alleviated.

   d) **Motor/Auto/Vehicle Insurance:** This is one of the mandatory policies in current times. First of all, it protects your valuable asset against road accidents or any other damage and covers the losses. Secondly, the traffic rules suggest you carry insurance papers while driving.

   e) **ravel Insurance:** You may have seen that you get an option to buy insurance for minimal costs when booking a rail or air ticket. Alternatively, you can buy travel insurance if you are a frequent flyer and especially if you travel internationally. You can claim for baggage loss, trip cancellation, or delay in flight.

Apart from the types of insurances discussed above, there are miscellaneous insurance coverage policies for furniture, goods, machines, etc. There are other types of insurance such as Fire Insurance (damage due to fire), Marine Insurance (for cargo ships), Tenant Insurance, Landlord’s Insurance, and so on. Group Medical Insurance Policies often cover the employees of an organization if the latter has any.

3.6 IMPORTANCE OF INSURANCE :

Insurance play’s significant role for not only an individual or for a family but it has spread over the entire nervous system of the nation. Not only does is serve the ends of individuals, it tends more and more both to pervade and transform our modern social order.

According to the author, Dins dale, “No one in modern world can afford to be without Insurance**”** provides various advantages to various fields. We can classify the importance as under

Individual Aspects :

For an individual the importance of insurance lies in the following points**:**

1. Security for health and property
2. Encourage savings
3. Encourage the habit of forced thrift
4. Provide mental peace
5. Increase efficiency
6. Provision for the future
7. Awareness for the future
8. Credit Facility
9. Tax exemption
10. Contribution to the conservation of health
11. Cover for legal liability
12. Security to the mortgaged property
13. Poster economic independence

Economic Aspects :

1. Safety against risk
2. Protection to employees
3. Basis of Credit
4. Protection from the loss of key man
5. Encourage loss prevention methods
6. Reduction of cost
7. Promote foreign trade
8. Development of big industries
9. Increase in efficiency

Social Aspects :

1. Stability in family life
2. Development of employment opportunity
3. Encourage alertness
4. Contributes to the development of basic facilities

National Aspects :

1. Increases the national savings
2. Helps in development of opportunities
3. Develops the money market
4. Earns foreign exchange
5. Capitalizes the savings

3.7 FUNCTIONS OF INSURANCE :

Insurance becomes very useful in today’s life. It plays significant role in this competitive era. According to Sir William Beveridge the functions of insurance can be divided into three categories.

1. Primary functions
2. Secondary functions
3. Indirect functions

1. **Primary Function :**
   a) ***Provide protection*** **:** The most important function of insurance is to provide protection against risk of loss. It is one check the reality of the misfortune happening, and pays the cost of damages of losses.
   b) ***Provide certainty*** **:** The future is totally uncertain. Any misfortune happening may occur at any stage of life. The amount of loss and time of losses both are uncertain. Insurance provides certainly towards the losses. The policy holders pay the premium to get certainty
   c) ***Distribution of risk*** **:** It is a co-operative effort where the risk is distributed among the group of People. Thus, no one have to bear the losses occurred due to uncertainty.

2. **Secondary Function :**
   a) ***Helps in economic progress*** **:** Insurance plays an important role in economic progress. It gives fully certainty to the industrialists towards the risks. The entrepreneurs can more concentrate on Innovative and profitable techniques of the production. They should not require Thinking over the risks. The industrialists can establish new industries in environment. Thus, industries have got development in economic and commerce of the nation.
   b) ***Prevents losses*** **:** insurance plays vital role in preventing the losses. The amount of premium is minimized by using such appliances like the fire extinguisher. If one uses interior Machinery which may be caused for misfortune, the amount of premium will be high. Thus, indirectly, insurance provides help to minimize the chances of risks.

3. **Indirect Function :**
   a) ***A forced savings*** **:** Life insurance is also a method of savings in India. Income tax act gives relief in payment of income tax because government wants to habituate general public to save money. It encourages the habit of thrift and savings among the people. Thus, it becomes compulsory savings to people of nation.
   b) ***Promote foreign trade*** **:** It is compulsory to take marine insurance policy in foreign trade in India. Foreigners can't issue the foreign trade bill unless the cargo is fully insured. Thus, Foreign trade is totally depending upon the insurance sector of the nation. It gives relief to entrepreneurs from the uncertainty of foreign trade.
   c) ***Others*** **:** Insurance provides certainties towards risks in entrepreneurship. It gives Confidence in general public. It is one of the important sources of investment which develops the trade and commerce of the nation.

3.8 LIMITATIONS OF INSURANCE :

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

i. All the risks cannot be insured. Only pure risks can be insured and speculative risks are not insurable.
ii. Insurable interest (financial interest) in 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 arises 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 important limitation is that the premium rates are higher in our country & 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 may utilize the insurance plans for their self-interest by claiming false claims from insurance companies.

3.9 INSURANCE REGULATORY & DEVELOPMENT AUTHORITY :

Organizational Structure Of Irdai :

Composition of IRDAI : As per Sec. 4 of IRDAI Act, 1999, the composition of the Authority is: a) Chairman; b) Five whole-time members; c) Four part-time members, (appointed by the Government of India)

- ❖ IRDAI's Head Office is at Hyderabad: All the major activities of IRDAI including ensuring financial stability of insurers and monitoring market conduct of various regulated entities is carried out from the Head Office.
- ❖ IRDAI's Regional Offices are at New Delhi & Mumbai: The Regional Office, New Delhi focuses on spreading consumer awareness and handling of Insurance grievances besides providing required support for inspection of Insurance companies and other regulated entities located in the Northern Region. This office is functionally responsible for licensing of Surveyors and Loss Assessors. Regional Office at Mumbai handles similar activities, as in Regional Office Delhi, pertaining to Western Region.

Insurance Regulatory Framework :

1. Insurance Regulatory and Development Authority of India (IRDAI), is a statutory body formed under an Act of Parliament, i.e., Insurance Regulatory and Development Authority Act, 1999 (IRDAI Act 1999) for overall supervision and development of the Insurance sector in India.
2. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938. The key objectives of the IRDAI include promotion of competition so as to enhance customer satisfaction through increased consumer choice and fair premiums, while ensuring the financial security of the Insurance market.
3. The Insurance Act, 1938 is the principal Act governing the Insurance sector in India. It provides the powers to IRDAI to frame regulations which lay down the regulatory framework for supervision of the entities operating in the sector. Further, there are certain other Acts which govern specific lines of Insurance business and functions such as Marine Insurance Act, 1963 and Public Liability Insurance Act, 1991.
4. IRDAI adopted a Mission for itself which is as follows :
   - ➢ To protect the interest of and secure fair treatment to policyholders;
   - ➢ To bring about speedy and orderly growth of the Insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
   - ➢ To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
   - ➢ To ensure speedy settlement of genuine claims, to prevent Insurance frauds and other malpractices and put in place effective grievance redressal machinery;

- To promote fairness, transparency and orderly conduct in financial markets dealing with Insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
- To take action where such standards are inadequate or ineffectively enforced;
- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

5. **Entities regulated by IRDAI :** a. Life Insurance Companies - Both public and private sector Companies, b. General Insurance Companies - Both public and private sector Companies. Among them, there are some standalone Health Insurance Companies which offer health Insurance policies. c. Re-Insurance Companies, d. Agency Channel, e. Intermediaries which include the following: Corporate Agents, Brokers, Third Party Administrators, Surveyors and Loss Assessors.
6. **Regulation making process :** Section 26 (1) of IRDAI Act, 1999 and 114A of Insurance Act, 1938 vests power in the Authority to frame regulations, by notification. Section 25 of IRDAI Act, 1999 lays down for establishment of Insurance Advisory Committee consisting of not more than twenty five members excluding the ex-officio members. The Chairperson and the members of the Authority shall be the ex-officio members of the Insurance Advisory Committee. The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to making of regulations under Section 26. Accordingly the draft regulations are first placed in the meeting of Insurance Advisory Committee and after obtaining the comments/recommendations of IAC, the draft regulations are placed before the Authority for its approval. Every Regulation approved by the Authority is notified in the Gazette of India. Every Regulation so made is submitted to the Ministry for placing the same before the Parliament.

The Authority has issued regulations and circulars on various aspects of operations of the Insurance companies and other entities covering :

- Protection of policyholders' interest
- Procedures for registration of insurers or licensing of intermediaries, agents, surveyors and Third Party Administrators;
- Fit and proper assessment of the promoters and the management
- Clearance /filing of products before being introduced in the market
- Preparation of accounts and submission of accounts returns to the Authority.
- Actuarial valuation of the liabilities of life Insurance business and forms for filing of the actuarial report;
- Provisioning for liabilities in case of non-life Insurance companies
- Manner of investment of funds and periodic reports on investments
- Maintenance of solvency
- Market conduct issues

Supervisory Role :

1. The objective of supervision as stated in the preamble to the IRDAI Act is "to protect the interests of holders of Insurance policies, to regulate, promote and ensure orderly growth of the Insurance industry", both Insurance and Reinsurance business. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938 to enable the Authority to achieve its objectives.
2. Section 25 of IRDAI Act 1999 provides for establishment of Insurance Advisory Committee which has Representatives from commerce, industry, transport, agriculture, consume for a, surveyors agents, intermediaries, organizations engaged in

safety and loss prevention, research bodies and employees' association in the Insurance sector are represented. All the rules, regulations, guidelines that are applicable to the industry are hosted on the website of the supervisor and are available in the public domain.

3. Section 14 of the IRDAI Act,1999 specifies the Duties, Powers and functions of the Authority. These include the following:
   - To grant licenses to (re) Insurance companies and Insurance intermediaries
   - To protect interests of policyholders,
   - To regulate investment of funds by Insurance companies, professional organisations connected with the (re)Insurance business; maintenance of margin of solvency;
   - To call for information from, undertaking inspection of, conducting enquiries and investigations of the entities connected with the Insurance business;
   - To specify requisite qualifications, code of conduct and practical training for intermediary or Insurance intermediaries, agents and surveyors and loss assessors
   - To prescribe form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other Insurance intermediaries;

Prudential Approach: Reporting, Risk Monitoring And Intervention :

Reporting Requirements : Insurers are required to submit various returns like financial statements on an annual basis duly accompanied by the Auditors' opinion statement on the annual accounts; reports of valuation of assets, valuation of liabilities and solvency margin; actuarial report and abstract and annual valuation returns giving information about the financial condition for life Insurance business; Incurred But Not Reported claims in case of general Insurance business; Reinsurance plans on an annual basis; and monthly statement on underwriting of large risks in case of general Insurance companies; details of capital market exposure on a monthly basis; Investment policy, Quarterly and annual returns on investments.

Solvency of Insurers : In order to monitor and control solvency requirements, it has been made mandatory to the insurers to submit solvency report on quarterly basis. In case of any deviation, the Supervisor initiates necessary and suitable steps so as to ensure that the Insurer takes immediate corrective action to restore the solvency position at the minimum statutory level. Computation of solvency margin takes into account the inherent risk that respective line of business poses to the insurer. Higher requirements are placed for risky lines of business compared to others posing less risk to the insurers. Even though the insurers are required to maintain a minimum solvency ratio of 150% at all times, the actual solvency margin maintained by insurers are well above the required solvency margin leading to the solvency margin ratio significantly higher than 150% on average. Quarterly solvency ratio reports have to be submitted to the Supervisor, maintaining minimum solvency ratio of 150%. This provides the regular a mechanism to monitor the solvency position periodically over the financial year in order to ensure compliance with the requirements and hence to initiate suitable action in the event of any early warning signal on the Insurer's financial condition.

Asset-Liability Management: Under Asset-Liability Management reporting, Insurer must provide the year wise projected cash flows, in respect of both assets and liabilities. Insurers must maintain mismatching reserves in case of any mismatch between assets and liabilities as a part of the global reserves. Further, Life insurers are required to submit a report on sensitivity and scenario testing exercise in the prescribed format. Non-life insurers must submit a report on ‘Financial Condition’ covering the sensitivity analysis of the financial soundness in meeting the policyholders’ liabilities. The supervisor requires management of investments to be within the insurer’s own organization. In order to ensure a minimum level of security of investments in line with Insurance Act Provisions, the regulations prescribe certain percentages of the funds to be invested in government securities and in approved securities. The regulatory framework lays down the norms for the mix and diversification of investments in terms of Types of Investment, Limits on exposure to Group Company, Insurer’s Promoter Group Company. Investment Regulations lay down the framework for the management of investments. The exposure limits are also prescribed in the Regulations. The Investment Regulations require a proper methodology to be adopted by the insurer for matching of assets and liabilities.

Reinsurance : Transfer of risk through Reinsurance is recognized only to the extent specified in the regulations. Due safeguards are built in to ensure that adjustments are made to provide for quality of assets held. No other risk transfer mechanism exists in the current system. In order to minimize the counterparty risk, the re-insurers with whom business is placed must have the minimum prescribed rating by an independent credit rating agency as specified in the regulations. Legislation has specified the minimum capital requirements for an Insurance company. It further, prescribes that Insurance companies can capitalize their operations only through ordinary shares which have a single face value.

Reinsurer : General Insurance Corporation of India (GIC of India) is the sole National Reinsurer, providing Reinsurance to the Insurance companies in India. The Corporation’s Reinsurance programme has been designed to meet the objectives of optimising the retention within the country, ensuring adequate coverage for exposure and developing adequate capacities within the domestic market. It is also administering the Indian Motor Third Party Declined Risk Insurance Pool – a multilateral Reinsurance arrangement in respect of specified commercial vehicles where the policy issuing member insurers cede Insurance premium to the Declined Risk pool based on the underwriting policy approved by IRDAI.

Corporate Governance : In order to protect long- terms interests of policyholders, the IRDAI has outlined appropriate governance practices applicable to Insurance companies for maintenance of solvency, sound long-term investment policy and assumption of underwriting risks on a prudential basis from time to time. The IRDAI has issued comprehensive guidelines for adoption by Insurance companies on the governance responsibilities of the Board in the management of the Insurance functions. These guidelines are in addition to provisions of the Companies Act, 1956, Insurance Act, 1938 and other applicable laws. Corporate Governance Guidelines issued by IRDAI, requires insurers to have in place requisite control functions. The oversight of the control functions is vested with the Boards of the respective insurer. It lays down the structure, responsibilities and functions of Board of Directors and the senior management of the companies. Insurers are required to adopt sound prudent principles and practices for the governance of the company and should have the ability to quickly address issues of non-compliance or weak oversight and controls. The Guidelines mandated the insurers to constitute various committees viz., Audit Committee, Investment Committee, Risk Management Committee, Policyholder Protection Committee and Asset-Liability Management Committee. These committees play a critical role in strengthening the control environment in the company.

On and off site Supervision : Onsite Inspections : The Authority has the power to call for any information from entities related to insurance business – Insurance companies and the intermediaries, as may be required from time to time. On site inspection is normally carried out on an annual basis which includes inspection of corporate offices and branch offices of the companies. These inspections are conducted with view to check compliance with the provisions of Insurance Act, Rules and regulations framed there under. The inspection may be comprehensive to cover all areas, or may be targeted on one, or a combination of, key areas. When a market-wide event having an impact on the insurers occurs, the Supervisor obtains relevant information from the insurers, monitors developments and issues directions as it may consider necessary. Though there is no specific requirement, events of importance trigger such action. The supervisor reviews the “internal controls and checks” at the offices of Insurance companies, as part of on-site inspection.

Off-site Inspection : The primary objective of off-site surveillance is to monitor the financial health of Insurance companies, identifying companies which show financial deterioration and would be a source for supervisory concerns. This acts as a trigger for timely remedial action. The off-site inspection conducted by analyzing periodic statements, returns, reports, policies and compliance certificates mandated under the directions issued by the Authority from time to time. The periodicity of these filings is generally annual, half-yearly, quarterly and monthly and are related to business performance, investment of funds, remuneration details, expenses of management, business statistics, auditor certificates related to various compliance requirements. The statutory and the internal auditors are required to audit all the areas of functioning of the Insurance companies. The particular area of focus is the preparation of accounts of the company to reflect the true and fair position of the company as at the Balance Sheet date. The auditors also examine compliance or otherwise with all statutory and regulatory requirements, and in particular whether the Insurance company has been compliant with the various directions issued by the supervisor. In addition, the Authority relies upon the certifications which form part of the Management Report. The Board is required to certify that the management has put in place an internal audit system commensurate with the size and nature of its business and that it is operating effectively. All Insurance companies are required to publish financial results and other information in the prescribed formats in newspapers and on their websites at periodic intervals.

Micro Insurance and Rural & Social Sector Obligations : The IRDAI had issued micro Insurance regulations for the protection of low income people with affordable Insurance products to help cope with and recover from common risks with standardized popular Insurance products adhering to certain levels of cover, premium and benefit standards. These regulations have allowed Non Governmental Organizations (NGOs), Self Help Groups (SHGs) and other permitted entities to act as agents to Insurance companies in marketing the micro Insurance products and have also allowed both life and non-life insurers to promote combi micro Insurance products. The Regulations framed by the Authority on the obligations of the insurers towards rural and social sector stipulate targets to be fulfilled by insurers on an annual basis. In terms of these regulations, insurers are required to cover year wise prescribed targets (i) in terms of number of lives under social obligations; and (ii) in terms of percentage of policies to be underwritten and percentage of total gross premium income written direct by the life and non-life insurers respectively under rural obligations.

3.10 SUMMARY :

Insurance is a contract between two parties. One party is the insured and the other party is the insurer. That is, the person whose risks are insured is called insured. Insurer is the insurance company to whom risk is transferred by the insured. That is, the person who ensures the risk of insured is called insurer. The Indian insurance industry has lagged behind even amongst the developing countries of the world. Although general insurance services started in India about 150 years ago, their growth has been dilatory, as reflected by low insurance penetration and density. The life insurance business was nationalized in 1956 and the general insurance industry in 1973. The lack of competition has impeded the development of insurance industry in India, resulting in low productivity and poor quality of customer services.

3.11 TECHNICAL TERMS :

1. **Cover note:** cover note unstamped document issued by or on behalf of insurers as evidence of insurance pending issue of policy.
2. **Damages:** monetary compensation award at law for a civil wrong or breach of contract.
3. **Indemnity:** compensation for actual loss suffered is call indemnity.
4. **Reinsurance:** reinsurance is a method where by the original insurer transfer all or part of risk he has assumed to another company or companies with the object of reducing his own commitment to an reducing his own commitment to an amount that he can bear for his own account commensurate with his financial resources in the event of loss.
5. **Double insurance:** double insurance implies that subject matter is insured in two or more insurance companies (insurers) and the total sum insured exceeds the actual value of subject matter. in other words, the same subject matter is insured in more than one insurer.
6. **No claim bonus:** the bonus is getting under the policy, if the claim is not reported during the policy period and after that the time renewal (in time) then as per the policy term no claim bonus is avail for the vehicle insurance policy and the rate of bonus is different in different general insurance companies, and the maximum rate should be up to 50% as per the norms.

3.12 SELF-ASSESSMENT QUESTIONS :

1. Explain the growth and development of Insurance in India?
2. Discuss the concept and functions of life insurance?
3. What are the different forms of Insurance? Explain?
4. Discuss the principles of Insurance?
5. What is the role of distributions channels in the promotion of Insurance business in India?
6. Explain the role and responsibilities of an agent?
7. What is the role of IRDA in the promotion & development of insurance in India?
8. How to select the policy? Discuss the components of it?
9. Discuss different types of distributions in theory of probability?
10. Discuss different risk theories in insurance?

3.13 SUGGESTED READINGS :

1. Dr P.K.Gupta, Insurance and Risk Management, Himalaya Publishing House
2. Srivastava, RM ., "Management of Indian Financial Institutions", Himalaya Publishing House, Mumbai, 2005
3. Srinivasan NP and Saravanavel, P., "Development Banking in India and Abroad", Kalyani Publications, Ludhiyana, 2001

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LESSON – 4
PRINCIPLES OF INSURANCE

AIMS & OBJECTIVES :

After studying this lesson, you will be able to…

- Understand the meaning of life insurance.
- Understand the principles of insurance.
- Know the meaning of insurance policies.

STRUCTURE OF THE LESSON :

4.1 INTRODUCTION :

Life insurance is an agreement between you (the policy owner) and an insurer. Under the terms of a life insurance policy, the insurer promises to pay a certain sum to a person you choose (your beneficiary) upon your death, in exchange for your premium payments. Proper life insurance coverage should provide you with peace of mind, since you know that those you care about will be financially protected after you die. Proceeds from a life insurance policy make cash available to support your family almost immediately upon your death. Life insurance can pay any debts that you may leave behind. Life insurance can pay off mortgages, car loans, and credit card debts, leaving other remaining assets intact for your family. Life insurance proceeds can also be used to pay for final expenses and estate taxes. Finally, life insurance can create an estate for your heirs.

Your life insurance needs will depend on a number of factors, including :

i. Whether you're married
ii. the size of your family
iii. the nature of your financial obligations
iv. your career stages
v. your goals.

For example, when you're young, you may not have a great need for life insurance. However, as you take on more responsibilities and your family grow, your need for life insurance increases. Determining Life Insurance Needs There are tools to help you determine how much coverage you should have. Your best resource may be a financial professional. At the most basic level, the amount of life insurance coverage that you need corresponds directly to your answers to these questions:

i. What immediate financial expenses (e.g., debt repayment, funeral expenses) would your family face upon your death?
ii. How much of your salary is devoted to current expenses and future needs?
iii. How long would your dependents need support if you were to die tomorrow?
iv. How much money would you want to leave for special situations upon your death, such as funding your children’s education, gifts to charities, or an inheritance for your children?

Since your needs will change over time, you’ll need to continually re-evaluate your need for coverage.

4.2 LIFE INSURANCE-CONCEPT :

Life insurance is a contract under which the insurer (Insurance Company) inconsideration of a premium paid undertakes to pay a fixed sum of money on the death of the insured or on the expiry of a specified period of time whichever is earlier. In case of life insurance, the payment for life insurance policy is certain. The event insured against is sure to happen only the time of its happening is not known. So, life insurance is known as ‘Life Assurance’.

The subject matter of insurance is life of human being. Life insurance provides risk coverage to the life of a person. On death of the person insurance offers protection against loss of income and compensate the titleholders of the policy. Meaning of Life Insurance Life insurance is a contract to a certain sum of money on the death of a person in consideration of the certain annuity for his life calculated according to the probable duration of life. A life insurance is a contract in which one party agrees to pay a given sum of money upon the happening of a particular event contingent upon the duration of human life in consideration of immediate payment of smaller sum.

4.3 FEATURES OF LIFE INSURANCE PLANS :

Waiver of premium. This feature pays the premium of a policy if you become seriously ill or disabled.

- ❖ Accelerated death benefit. This feature allows you to receive cash advances against the death benefit of your policy if you're diagnosed with a terminal illness. Many people with this benefit use the money to help pay for treatment and other expenses when they have only a short time to live.
- ❖ Guaranteed purchase option. With this feature, you can purchase coverage at designated future dates or life events without proving you're in good health.
- ❖ Long-term care riders. Some life products include this option, which allows you to use the benefits of your policy to pay for long-term care in exchange for a reduced life benefit.
- ❖ Spouse or child term riders. Life policies with this feature allow you to purchase term life insurance for your spouse or dependent child, up to age 26. This option can be a more affordable way to purchase coverage if you can't afford separate policies.
- ❖ Cash value plans. This type of policy pays out upon your death and also accumulates value during your lifetime. You can use the cash value as a tax-sheltered investment, as a fund from which you can borrow and use to pay the policy premiums later.
- ❖ Mortgage protection. This feature, typically found on term life policies, will pay your mortgage if you die.

- ❖ Cash withdrawals and loans. Many universal and whole life policies allow you to withdraw or borrow money, using the cash value of the policy as collateral. Interest rates tend to be relatively low. You can also use the cash value of your life policy to pay your premiums if you need or want to stop paying premiums for a period of time. You must pay back the loan or your beneficiaries will receive a reduced death benefit.
- ❖ Survivor support services. Some life policies offer services that provide objective financial and legal assistance to beneficiaries.
- ❖ Employee assistance programs. This feature makes resources available to you for problems that can affect your personal and professional life. Resources are usually free and help address issues such as substance abuse, stress, marital problems, legal concerns and major life events.

4.4 PROCEDURE FOR TAKING A LIFE POLICY :

i. Life policy is based on the principle utmost good faith. The procedure-filling in the form is quite simple. It is almost like a home industry where the person who wishes to make an investment in the form of insurance. The first thing to do is to fill in a proposal form. The proposal form contains the following details:

a) Name, nationality, permanent residential address, occupation, nature of duties, present employer’s name, length of service, previous employment record, father’s name in full.
b) Place of birth, date of birth, proof of age and district of birth.
c) Term of insurance, nature of insurance, type of policy, amount to be insured, mode of premium payable — yearly, half-yearly, quarterly and monthly.
d) Personal information regarding height, weight where the life is proposed.
e) Details of any previous policies whether one or double insurance.
f) Family history, history of father, mother, brothers, sisters, children.
g) Information regarding diseases likes epileptics, asthma, tuberculosis, cancer, leprosy, etc.
h) Information regarding previous records of accident, injury, operation diseases.

ii. **Medical Examination :** If the applicant has a family history of disease, then the investment procedure is more detailed and description about permanent immunity and other family diseases have to be given including habits, name, income, occupation and salary. A person of normal health almost goes through a medical examination as a matter of formality.

iii. **Medical Report :** The next step after filling-in proposal form is to undergo a medical examination from one of the doctors approved by the Life Insurance Corporation. The examination is usually of a routine kind where the identification of the applicant, his appearance, measurement, weight, condition of teeth, eyes, throat, tongue, ears, and condition of heart, chest, digestion, nerve system and past operation is taken into consideration to find out the life span of the individual.

iv. **Agent’s Report :** The third step consists of a report which is confidential in nature. It is made by the agent who is underwriting the life of the person. His report consists of the age of the person insuring himself, his health, occupation, soundness of payment of premium, proper health and longevity of life.

v. **Acceptance of Proposal :** The Life Insurance Corporation accepts the proposal of the insurer on the commitment made by the agent and after taking into consideration the doctor’s medical report. The factors which play a dominating role is the mode of premium, type of policy, the age of the applicant, his health, occupation and habits.

Once these factors have been considered and the Life Insurance Corporation’s officers are satisfied, the form is accepted. An investor’s form will be rejected only if he suffers from serious diseases or the longevity of life cannot be guaranteed.

vi. Proof of Age : The next step after accepting the proposal of a person is to ask him to submit the proof the age. The person who is interested in insuring himself may give this proof by submitting any of the following documents:

- A copy of a certificate giving details of the school leaving examination with age or date of birth stated therein;
- Municipal records;
- Original horoscope prepared at the time of birth, if no proof of age is available;
- In the case of uneducated families, entry in the family record through birth registers;
- Employer’s Certificate’
- Any other satisfactory proof.

vii. Mode of Premium : When an investor takes a life policy on his portfolio, he must pay some installment to the life insurance company for this investment. This installment is called premium and may be paid periodically. It may be paid annually, half-yearly, quarterly or monthly. Usually, a period of 30 days is given as grace beyond the due date of payment of premium. The rates of premium are different for different kinds of policies offered as investment.

viii. Issue Of Policy : When all these formalities are completed the Life Insurance Corporation sends a life policy to the insured. This legal document between the life company and the insured states the details of the policy. It gives details regarding the age, address, sum assured, type of policy with or without profits, date of maturity, premium, mode of payment of premium, name of person who is entitled to receive the ultimate sum, amount at the termination of the policy, the surrender value of the policy, the settlement of claims of policy and all other conditions of the contract

4.5 BASIC PRINCIPLES INSURANCE :

Contract of insurance has all the essential elements of general contract. According to section 2(h) and section 10 of the Indian Contract Act 1872, a valid contract must have the essential elements of offer and acceptance, consideration, legal parties, sound mind and free consent of the parties. Further, Insurance transactions need be governed by special principles in order to protect the interests of the contracting parties, particularly the customer. It is in view of this that the contracts are governed by certain special basic legal principles.

These make insurance contracts very unique and different from other kinds of commercial contracts. As one shall see below, there are, however, differences between life and general insurance with regard the application, of the principles.

Nature of Contract : The nature contract is a fundamental principle of a contract of insurance required for a valid contract. Essential elements of a valid contract are:

i. Agreement (offer and acceptance) –insurance is an agreement between insurer and insured. Proposal is made by one party and accepted by other.
ii. Lawful consideration- premium is consideration for insurance contract
iii. Lawful objects- object of insurance is lawful and not against to public policy. It is for public welfare

iv. Free consent- consent of parties to contract should be free. I.e., not by means of coercion, undue influence, fraud, misrepresentation etc.
v. Competent parties (legal capacity of parties) - parties to an insurance contract should be competent to contract. i.e., they should not be idiot, lunatic, minor, insolvent etc.
vi. Consensus ad idem- parties to contract should understand the subject matter of insurance in same sense.

The Principle of Insurable Interest : The existence of insurable interest is an essential ingredient of any insurance contract. A general definition used for insurable interest is “The legal right to insure arising out of financial relationship, recognized under law, between the insured and the subject matter of insurance.” Therefore, just as the owner of a house or a factory has an insurable interest in the house or factory, the bank that has lent money for the construction of the house or the factory too has an insurable interest in these to the extent of the outstanding loan amount since in the event of the damage or destruction of the property, the bank stands to lose a part or the whole of the money lent. The essentials of insurable interest are:

1. There must be a property capable being insured.
2. Such a property must be subject matter of interest

The insured should have a legal relation to the subject matter insurable interest could arise in a number of ways such as; Ownerships, Mortgagee, Trustee, Bailee, Lessee etc.

Referring to life insurance, a person is deemed to have insurable interest on his own life to an unlimited extent, as in the event of his pre-mature death. Spouses are presumed to have insurable interest in each other’s life. However, in case of other members of the family, insurable interest is not presumed to exist. A person cannot, therefore, insure, say his brother or sister though they may dependent on him.

The Principle of Utmost Good Faith : The principle of utmost good faith is mostly discussed in the context of the duty of the insured towards the insurer, though it is equally applicable to the insurer’s duty towards the insured. In insurance contract, the prosper is the only person who is deemed to have known all the facts of the subject matter of insurance and the insurer is to completely rely on what the proposer has disclosed. The proposer, should therefore, furnish all material facts concerning the property proposed insurance which would enable the insurance company to decide the appropriate rates and the terms and condition.

The Principle of Indemnity : The object of insurance is to place insured in the same financial position as was just before the loss. This principle prevents the insured from making a profit out of loss and ensures public interest at large. For example, if machinery insured and is destroyed by fire, the insurance company will make good to loss by taking into consideration the depreciation and wear the tear of the machinery having been in use by the insured for some time.

- In the case of personal accident policies, it is not possible to place a value on life as such. Hence personal accident policies are called benefit policies. There are four methods of indemnification and they are. 1) Cash payment, 2) Repair, 3) Replacement, 4) Reinstatement
- In case of life insurance, however, the economic value of a human life cannot be measured precisely before death. It could in fact be unlimited. Hence, ***life insurance cannot strictly be a contract of indemnity***. This does not however, mean a person can be granted life insurance for an unlimited amount.

The Principle of Subrogation : Subrogation is principle, which applied to all contracts of indemnity. It means that after payment of the loss the insurer gets the right of taking all steps to recover any money in compensation from a third party. Technically speaking "Subrogation is the right, which an insurer gets, after he has indemnified the loss, to step into the shoes of the insured and avail himself of all the rights against third party in respect of loss indemnified." The subrogation principle prevents the insured of collecting the twice of the same loss at first instance, and wrong doer would escape liability at second.

Contribution : The contribution is the right of an insurer who has paid a loss under a policy to recover a proportionate amount from other insurer who is liable for the loss. Such situations only arise:

i. When different insurer has agreed to contribute the loss by way of collecting proportionate premium.
ii. The policies are in existence at the time of loss.
iii. The policies are legally enforceable at law.
iv. The interest covered under all the policies are same, and affected in favour of a common insured.

Indemnity is also governed by the principle of contribution. The insurer is required to contribute proportionately loss to the extent of its interest. If a property has been insured with more than one insurer, in the event of a loss the insured will get a proportionate part of the loss from each insurer, so that the insured does not make a profit out of the settled claim.

The Proximate Cause : proximate cause can be defined as the indemnification of losses concurrent with the perils specified under insurance contracts and not in general. Properties are exposed to various perils like fire, earthquake, explosion, perils of sea, war, riot, civil commotion and so on, and policies of insurance covering various combinations of such perils can be procured. Policies of insurance usually afford protection against some of these perils, expressly exclude certain perils from the cover, and by implication other perils are covered. The insurer's liability under the policy arises only if the cause of the loss is a peril insured against and not as expressly excluded or other peril.

Mitigation Of Loss :

Mitigation of Loss is applied in valid insurance contract. In the event of some mishap or accident to the insured property, the insured must make necessary effort to safeguard his remaining property and minimize the loss, as much as possible. If he does make any reasonable efforts to reduce the loss, insurer will be liable for payment of all loss resulting from the peril insured against. If he is negligent to preserve the property, the insurer may avoid the payment of loss.

4.6 KINDS OF INSURANCE :

Insurance can be classified into 2 groups i.e. life insurance and nonlife (general) insurance.

- ❖ **Life Insurance :** It is governed by the LIC act 1956. It is a contract in which the insurer, inconsideration of payment of premium compensate to a person on death or on the expiry of certain period whichever is earlier.
- ❖ **General Insurance :** General Insurance covers a wide range of services. Section 6(b) of the insurance act 1938 defines General Insurance. It includes all the risks except life.

4.7 TYPES OF LIFE INSURANCE PLANS :

Term Life Insurance Or Term Plan : Term life insurance is the most popular type of life insurance. Term insurance is widely considered to be the simplest and purest form of life insurance. Term insurance is a type of life insurance that offers death benefit to the beneficiary if the life insured dies during policy tenure. Term insurance is the most affordable types of life insurance. The most distinctive feature of a term insurance plan is the high amount of coverage offered at extremely nominal premium rates. It is thus cheaper than other types of life insurance policies. In general, term life insurance does not offer maturity benefits. But certain types of term plans also offer maturity benefits, i.e., term plan with return of premiums (TROP) if the policyholder outlives the policy term. One can also increase the amount of coverage offered by a term plan by opting for additional riders, such as Accidental Death Benefit or Child Support riders.

Whole Life Insurance Plan : Whole life insurance is a type of life insurance that offers coverage right until the death of the policyholder. In whole life policy, you can opt for either a participating or non-participating policy, as per your financial needs and risk appetite. Though the premiums for participating whole life insurance are higher in comparison, dividends are paid out at regular intervals to the policyholders. The premium rates for a non-participating policy are lower, but the policyholder generally cannot avail the benefits of regular dividends.

Unit Linked Insurance Plan (ULIP) : Unit Linked Insurance Plan or ULIP is a type of life insurance product that offers dual benefits of investment and life insurance. Among the different types of life insurance policies available, ULIPs enjoy a high amount of popularity owing to their versatile nature. A portion of the premiums paid towards ULIPs is directed towards ensuring insurance coverage, while the rest of the premium is invested into a bouquet of investment instruments, which can include market-backed equity funds, debt funds and other securities.

ULIPs are extremely flexible instruments since investors can easily switch or redirect their premiums between the different funds available. ULIPs are also touted as having an edge over other market instruments in terms of tax-saving benefits, since their proceeds are exempted from LTCG (Long Term Capital Gains).

Endowment Policy : Endowment Policy is a type of life insurance policy which acts as, both, an instrument for insurance and saving. Endowment plans aim to provide maturity benefits to the life insured, in the form of a lump sum payment at the end of the policy tenure, even if a claim hasn't been made. Endowment plan is the most suitable types of life insurance for people looking to get maximum coverage alongside having a sizable savings component. They help the policyholder inculcate the habit of savings, even while providing financial security to their family. Endowment plans can broadly be classified into two types: with profit and without profit. Policyholders can choose from these two types based on their risk appetite.

Money Back Policy : Being one of the best types of life insurance policies, a money-back policy offers policyholders a percentage of the total sum assured at periodic intervals in the form of Survival Benefits. Once the policy reaches maturity, the remaining amount of the Sum Assured is handed over to the policyholder. However, if the policyholder dies while the term is ongoing, their dependents are given the entire Sum Assured without any deductions.

Retirement Plan : A retirement plan is a type of life insurance that focuses on providing you financial stability and security post your retirement. After you retire, you lose your regular income from employment. Investing in retirement plans can help you create a stable regular income stream. If you continue to invest until retirement, the plan will help you take care of your expenses after retirement. A retirement plan requires you to invest a certain part of your income regularly during your working life. At the time you retire, the amount that you create over the years will be converted into a regular income stream. Retirement plans also involve death benefits. Thus, if the policyholder passes away during the course of the policy, their beneficiaries will be provided with an assured sum.

Child Insurance : A child insurance plan is a savings cum investment plan that provides financial protection for the child's future upon the unfortunate demise of the policyholder. It is ideal for ensuring the future needs of the child are well taken care of, even in the absence of the life insured. Parents can invest in the best child insurance plans, in order to meet the financial requirements for their child's education, marriage or to fulfil a multitude of other financial goals their child might have.

Group Insurance Plan : A group life insurance policy is a type of life insurance that covers a group of people inside a single insurance policy. Unlike individual life insurance policies, which cover one person for a period, group insurance covers a minimum of 10 members. Employers, banks, corporate, and other homogeneous groups of persons can buy group Life Insurance policies for their employees and customers. While employers would want to offer financial protection to their employees' families banks and lending institutions aim to keep the debt off the borrowers' family after their death.

a. The plan under which the group is covered is called the Master Plan.
b. The policy is issued to the manager of the group (master) but will remain in the name of the group only.

For example, Ram is the manager of a firm, to protect his employees, he has taken a group insurance policy. Now the policy will be issued to Ram in the name of the firm. One of the distinct features of these life insurance policies is that you get insurance till the time you are part of the group. If you leave the group, your cover ceases to exist.

Savings And Investment Plan : Savings and investment plans from life insurance are the plans which channel your regular savings into long-term investment goals. Guaranteed Savings Plans and i Select Guaranteed Future are two of the many such plans with Canara HSBC Life Insurance. With these plans, you can start investing your surplus money every month or year and benefit from:

a. Guaranteed sum assured at maturity
b. Guaranteed bonuses and boosters depending on your investment tenure
c. Additional life cover for the family
d. Guaranteed Savings Plan offers maturity value as a tax-free lump sum amount

You can also protect your financial goal with a premium protection option. This option allows the planned investments to continue even after your demise..

4.8 FUNCTIONS OF AN INSURER :

The functions performed by any insurer necessarily depend on the type of business it writes, the degree to which it has shifted certain duties to others, the financial resources available, the size of the insurer, the type of organization used, *etc*. These functions, which are normally the responsibility of definite departments or divisions within the firm.-Production-Underwriting-Rate making-Managing claims and losses-Investing and financing-Accounting and other recordkeeping-Providing miscellaneous other services such as legal advice, marketing research, engineering, and personnel management

- ❖ **Production :** One of the most vital needs of an insurance firm is securing a sufficient number of applicants for insurance. To enable the company to operate often called production in the context of the insurance industry. Corresponds to the sales or marketing function in an industrial firm is a proper term for insurance because the act of selling is production in its true sense. Insurance is an intangible item and does not exist until a policy is sold.

- **Underwriting :** Under writing is a process of studying the risk in new proposal and deciding to accept or reject the proposal. It is a challenging task where the underwriter has to consider the applicants side and also the risks that the company will have to face, if it accepts the new policy. It is different for life and general insurance.
- **Rate Making :** Rate making is usually supervised by specialists known as actuaries. An actuary is a highly skilled mathematician who is involved in all phases of insurance company operations, including planning, pricing and research. Rate making refers to pricing of insurance i.e, deciding premium.
- **Managing Claims and losses :** Claims management refers to settling losses under insurance contracts and adjusting any differences that arise between the company and the policyholder. The objectives of claims settlement include confirmation of a covered loss, reasonable and timely payment of claims and personal support to the insured.
- **Investment and financing :** Insurance companies are referred to as closed and investment trusts engaged in the underwriting of risks as a means of obtaining funds for investment.

4.9 INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (IRDA-1999):

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 committee was set up with an objective of complementing the reforms in the Indian Financial Sector. The reforms were aimed at "Creating a mere efficient and come positive financial system suitable for the requirement of the economy keeping in mind the structural changes currently underway and recognizing that insurance is an. important part of the overall financial system where it was necessary to address the need for similar reforms."

The Insurance Regulatory and Development Authority (IRDA) is a national agency of the Government of India, based in Hyderabad. It was formed by an act of Indian Parliament known as IRDA Act 1999, which was amended in 2002 to incorporate some emerging requirements. Mission of IRDA as stated in the act is "to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto."

Duties, Powers And Functions f 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 sub-section (1), the powers and functions of the Authority shall include,

   i. Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
   ii. 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;
   iii. Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;

iv. Specifying the code of conduct for surveyors and loss assessors;
v. Promoting efficiency in the conduct of insurance business;
vi. Promoting and regulating professional organisations connected with the insurance and re-insurance business;
vii. Levying fees and other charges for carrying out the purposes of this Act;
viii. Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
ix. 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);
x. 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;
xi. Regulating investment of funds by insurance companies;
xii. Regulating maintenance of margin of solvency;
xiii. Adjudication of disputes between insurers and intermediaries or insurance intermediaries;

4.10 SELECTION OF RIGHT POLICY :

The idea of the right policy differs from person to person. What will be a good option for someone else, may not be as attractive for you. Thus, it becomes important to choose the policy that suits you the best. Here is how you can choose the right type of life insurance policy:

- **Choose According to the Goal :** Different life insurance policies can help fulfil different goals. You should be clear about the goal that you want to achieve with your life insurance policy.
- **Consider the Sum Assured :** Ascertain the needs and wants of your family members as well as the daily expenses and choose a cover that can fulfill all these. The general rule that goes is that you should select a sum assured which is at least 10 times your annual income.
- **Policy Term :** While some policies are made to achieve long-term goals and have a longer time frame, some policies have shorter terms as well. Select a policy that has multiple time frames.
- **Riders :** Riders can enhance your sum assured and can cover those occurrences which the basic policy doesn’t. Choose a policy with maximum riders.
- **Check Information of the Company :** Apart from the policy, research about the company that provided the policy as well. Check out for the following: Claim settlement ratio- Solvency Ratio- Exclusions

4.11 SUMMARY :

Life insurance is an agreement between you (the policy owner) and an insurer. Under the terms of a life insurance policy, the insurer promises to pay a certain sum to a person you choose (your beneficiary) upon your death, in exchange for your premium payments. Insurance gives protection to your family members in case of any unexpected conditions. There are many forms of policies like endowment policy, money back policy, unit linked policy, whole life policy, children’s policies and other variants are available in the market. Insurance is based on certain principles. IRDA is the regulatory, meant for the development and protects the interest of the policy holders. In our day-to-day life, we sometimes make the statements like it may rain today, train is likely to be late, doubt that he will win the race and so on are the basis for the theory of probability. Theory of probability is a branch of mathematics which has been developed to deal with situations involving uncertainty. The theory had its beginning in the 16th century. It originated in the games of chance such as throwing of dice and now probability is used extensively in biology, economics, genetics, physics, sociology etc. LIC was having its branches in almost all parts of the country and it attracted people local people to become their agents. Traditionally, tied agents had been the primary channel of insurance distribution in the Indian market. The agents are from various segments in society and collectively cover the entire spectrum of society.

4.12 TECHNICAL TERMS :

1. **Endowment policy :** An endowment plan is a life insurance plan that offers a life cover* and helps you grow your money. It provides returns that are fixed at the time of the purchase of the policy. It can be used to save for various goals like buying a house, your child's education or marriage, starting a new venture and more.
2. **Money back policy :** Money back policies are low-risk policies that are not market-linked. They provide you with assured returns at regular intervals during the policy term. The returns are fixed at the time of the purchase of the policy.
3. **Unit linked policy :** The full form of ULIP is Unit Linked Insurance Plan. A ULIP is an insurance plan that offers the dual benefit of investment to fulfil your long-term goals, and a life cover` to financially protect your family in case of an unfortunate event.
4. **Whole life policy :** Whole life insurance is a type of permanent life insurance, which means the insured person is covered for the duration of their life as long as premiums are paid on time.
5. **Children’s policies :** The core child protection legislation for children is enshrined in four main laws: The Juvenile Justice (Care and Protection) Act (2000, amended in 2015); The Prohibition of Child Marriage Act (2006); The Protection of Children from Sexual Offences Act (2012), and The Child Labour (Prohibition and Regulation) Act (1986 .

4.13 SELF-ASSESSMENT QUESTIONS :

1. Explain the growth and development of Insurance in India?
2. Discuss the concept and functions of life insurance?
3. What are the different forms of Insurance? Explain?
4. Discuss the principles of Insurance?
5. What is the role of distributions channels in the promotion of Insurance business in India?
6. Explain the role and responsibilities of an agent?
7. What is the role of IRDA in the promotion & development of insurance in India?
8. How to select the policy? Discuss the components of it?
9. Discuss different types of distributions in theory of probability?
10. Discuss different risk theories in insurance?

4.14 SUGGESTED READINGS :

1. Dr P.K.Gupta, Insurance and Risk Management, Himalaya Publishing House
2. Srivastava, RM ., "Management of Indian Financial Institutions", Himalaya Publishing House, Mumbai, 2005
3. Srinivasan NP and Saravanavel, P., "Development Banking in India and Abroad", Kalyani Publications, Ludhiyana, 2001

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LESSON – 5
MATHEMATICS & INSURANCE

OBJECTIVES:

After studying this lesson, you will be able to…

- Understand the meaning of probability.
- Understand the probability theorems.
- Know the distribution network of insurance policies.

STRUCTURE :

5.1 INTRODUCTION :

In our day-to-day life, we sometimes make the statements:

1. It may rain today
2. Train is likely to be late
3. It is unlikely that bank made a mistake
4. Chances are high that the prices of pulses will go down in next September
5. I doubt that he will win the race. and so on.

The words may, likely, unlikely, chances, doubt etc. show that the event, we are talking about, is not certain to occur. It may or may not occur. Theory of probability is a branch of mathematics which has been developed to deal with situations involving uncertainty. The theory had its beginning in the 16th century. It originated in the games of chance such as throwing of dice and now probability is used extensively in biology, economics, genetics, physics, sociology etc.

5.2 RANDOM EXPERIMENT AND ITS OUTCOME :

Observe the following situations :

1) Suppose we toss a coin. We know in advance that the coin can only land in one of two possible ways that is either Head (H) up or Tail (T) up.
2) Suppose we throw a die. We know in advance that the die can only land in any one of six different ways showing up either 1, 2, 3, 4, 5 or 6.
3) Suppose we plant 4 seeds and observe the number of seeds germinated after three days.

The number of germinated seeds could be either 0, 1, 2, 3, or 4. In the above situations, tossing a coin, throwing a die, planting seeds and observing the germinated seeds, each is an example of a random experiment In
(1), the possible outcomes of the random experiment of tossing a coin are: Head and Tail. In
(2), the possible outcomes of the experiment are: 1, 2, 3, 4, 5, 6 In
(3), the possible outcomes are: 0, 1, 2, 3, 4.
A random experiment always has more than one possible outcome. When the experiment is performed only one outcome out of all possible outcomes comes out. Moreover, we cannot predict any particular outcome before the experiment is performed. Repeating the experiment may lead to different outcomes.
Some more examples of random experiments are...

- Drawing a ball from a bag containing identical balls of different colours without looking into the bag.
- Drawing a card at random from a well shuffled deck of playing cards

A deck of playing cards consists of 52 cards which are divided into four suits of 13 cards each-spades, hearts, diamonds, and clubs. Spades and clubs are of black colour and others are of red colour. The cards in each suit are ace, king, queen, jack, 10, 9, 8, 7, 6, 5, 4, 3, and 2. Cards of kings, queens and jacks are called face cards.

5.3 PROBABILITY OF AN EVENT :

Suppose a coin is tossed at random. We have two possible outcomes, Head (H) and Tail (T). We may assume that each outcome H or T is as likely to occur as the other. In other words, we say that the two outcomes H and T are equally likely. Similarly, when we throw a die, it seems reasonable to assume that each of the six faces (or each of the outcomes 1, 2, 3, 4, 5, 6) is just as likely as any other to occur. In other words, we say that the six outcomes 1, 2, 3, 4, 5 and 6 are equally likely.

Before we come to define probability of an event, let us understand the meaning of word Event. One or more outcomes constitute an event of an experiment. For example, in throwing a die an event could be “the die shows an even number”. This event corresponds to three different outcomes 2, 4 or 6. However, the term event also often used to describe a single outcome. In case of tossing a coin, “the coin shows up a head” or “the coin shows up a tail” each is an event, the first one corresponds to the outcome H and the other to the outcome T. If we write the event E: “the coin shows up a head” If F:“ the coin shows up a tail” E and F are called elementary events. An event having only one outcome of the experiment is called an elementary event. The probability of an event E, written as P(E), is defined as……

$$P(E) = \frac{Number\ of\ outcomes\ favourable\ to\ E}{Number\ of\ all\ possible\ outcomes\ of\ the\ experiment}$$

Probability And Its Use In Insurance :

- The probability of an event refers to the chances of its occurrence of the total set of possible occurrences
- For a given pool of automobile covers sold by an insurance company, it is important to find out for the underwriter, what is the chance of occurrence of an automobile accident? If he correctly estimates the probability, the correct cost of bearing the risk i.e. the premium will be charged from the clients, otherwise, if adverse happens the claims may ruin the company
- A probability distribution or a theoretical frequency distribution is the distribution of all possible outcomes of a random variable (A random variable is a variable whose outcome is uncertain)

Probability Distributions :

- Probability distribution can either be discrete or continuous.
- A discrete distribution can take limited values which can be listed; however, a continuous can take any value within a given range.
- In Insurance we use the three popular variable distributions- the Binomial, the Normal and the Poisson

5.4 THE BINOMIAL DISTRIBUTION :

- Assuming the probability of occurrence of an event is p. Then the probability q that the event will not occur can be stated by the equation q = 1 – p.
- Using the following formula, we can calculate how often an event will happen i.e. the probability of r events in n possible times is
- n! X pr qn-r r! (n – r)!
- Note that expression n! is read "n factorial" and refers to a successive multiplication of the numbers n, n-1, n-2……1. The means and variance of binomial distribution are np and np q respectively

5.5 THE NORMAL DISTRIBUTION :

As the number of observations increases, the binomial distribution may be used to approximate what is called the normal distribution, which is a very useful type of mathematical distribution If its mean and standard deviation are known the distribution is said to be completely defined

5.6 THE POISSON DISTRIBUTION :

- The Poisson distribution is another theoretical distribution that is useful in risk management applications. For example, auto accident
- The probability of an event under the Poisson distribution can be estimated using the following formula where p = the probability that an event n occurs r = the number of events for which the probability estimate is needed m = mean = expected loss frequency e = a constant, the base of the natural logarithms, equal to 2.71828
- The mean m of a Poisson distribution is also its variance. Consequently, its standard deviation s is equal to m
- Poisson distribution is best be used when the probability of occurrence of an event is small and the population size is very large

Dual Application Of Law Of Large Numbers :

- It implies from the above discussion that a large sample will improve our estimates of the underlying probability
- Even in the case of priori probabilities where the probability is known must be applied to large number of trials if we expect actual results to approximate in true probability
- Therefore, in the case of empirical probabilities the requirements of a large number have dual application
- To estimate the underlying probability accurately, the insurance company must have sufficiently large sample, the more accurate will be the estimate of the probability
- Once the estimate of the probability has been made, it must be applied to a sufficient large number of exposure units to permit the underlying probability to work itself out

5.7 POOLING IN INSURANCE :

- Pooling of risks is the underlying feature of insurance
- Insurance companies try to make a group or pool of homogenous exposures with a view to reduce the losses arising from that exposure

5.8 THEORIES OF RISK MANAGEMENT :

Names of the theories

- Classical Theory of Risk
- Ruin Theory
- Collective Risk Theory
- The Modern Risk Theory

Classical Theory of Risk :

- The basic concept in the insurance is the insurance contract.
- In its simplest form, insurance contract gives right to the insured to claim an amount of money (say S), from the insurance company, if certain events should occur
- In order to be entitled for this right, the inured pays the company a premium P
- Now, if the probability of events leading to a claim is p, the premium is determined so that P = pS
- If F(x) is defined as the probability distribution that claim payments will not exceed x, then

Ruin Theory :

- Assume that an insurance company has a portfolio of n independent contract with premiums P1, P2, pn… in and risks M1, M2, …Mn The risk of the portfolio will be M2 = M12 + M22 + ….. + Mn2
- Further assume that the gain on this portfolio is denoted by z. If premiums are determined by principle of equivalence E { Z } = O
- If Reserve fund for this company is S, in addition to premiums collected for contracts in force, the probability that the company will not be able to fulfil its commitments under the contracts in the portfolios denoted by Probability {z < - S} = f (-S) M
- If S is large such that the Pr (Probability of Ruin) is smaller than this maximum, the company may choose to give dividends, else it should invoke additional capital fund. If this additional funds is raised by loading the premiums so that premium actually paid = (1 + l) Pi then

Collective Risk Theory :

- This theory was created by Lundberg primarily
- He considered an insurance company as a container or as a dam. Into this dam follows a continuous stream of premiums, and out of the dam goes a sequence of claim payments. Accordingly
- P (t) = the total value of premiums received in the period (o, t)
- Q (n1t) = the probability that n claims occur in the period (o, to)
- G(x) = the probability that if a claim should occur, the amount payable will not exceed the formula
- The expected value of claim payments will be

The Modern Risk Theory :

- The Insurance Company has initial Capital S
- In each operating period, the company underwrites a portfolio of insurance contracts with a claim distribution F(x). Assume F(x) = O for x£ O
- In each operating period, the company collects an amount of premium P
- If at the end of an operating period, the company's capital exceeds z, the excess is paid out as dividends or taxes, as the case may be
- If at the end of an operating period, the capital is negative, the company is ruined, and has to go out of business

5.9 REGULATION OF INSURANCE BUSINESS IN INDIA :

This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process of re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners. Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000.

The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market. The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%.

The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests. In December, 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national re-insurer.

Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002. Today there are 24 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 23 life insurance companies operating in the country. Beside IRDA Act and Insurance Act, 1938, there are some common Act/Regulation to the General and Life Insurance Business in India and some Acts have been made for specific requirement of Life Insurance/General Insurance Acts/Regulations common to General and Life Insurance Business in India

The following Acts regulate the Insurance Business in India.

- Insurance Act,1938
- IRDA Act,1999
- Insurance Amendment Act,2002
- Exchange Control Regulations (FEMA)
- Insurance Co-op Society
- Indian Stamp Act,1899
- Consumer Protection Act,1986
- Insurance Ombudsman

5.10 DISTRIBUTION CHANNELS :

In today's Indian Insurance market, the challenge to insurers and intermediaries is two-pronged: Building faith about the company in the mind of the client Intermediaries being able to build personal credibility with the clients Prior to privatization, the only public sector insurer LIC was having the monopoly in insurance sector. LIC was having its branches in almost all parts of the country and it attracted people local people to become their agents.

Traditionally, tied agents had been the primary channel of insurance distribution in the Indian market. The agents are from various segments in society and collectively cover the entire spectrum of society. Of course, the profile of the people who acted as agents may not have been sufficiently knowledgeable about the different products offered and may not have sold the best possible product to the client. Nonetheless, the customer trusted the agent and company. This arrangement worked adequately in the absence of competition.

Agents : "Insurance Agent" means an individual appointed by an insurer for the purpose of soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance. “Composite Insurance Agent” means an individual who is appointed as an insurance agent by two or more insurers subject to the condition that he/she shall not act as insurance agent for more than one life insurer, one general insurer, one health insurer and one each of the mono-line insurers.

Qualifications of Agent : The applicant shall possess the minimum qualification of a pass in 12th Standard or equivalent examination conducted by any recognised Board/Institution, where the applicant resides in a place with a population of five thousand or more as per the last census, and a pass in 10th Standard or equivalent examination from a recognised Board/ Institution if the applicant resides in any other place.

Code of Conduct. 1) Every agent shall adhere to the code of conduct specified below: -

a) Every insurance agent shall,

- i) identify himself and the insurer of whom he is an insurance agent;
- ii) show the agency identity card to the prospect, and also disclose the agency appointment letter to the prospect on demand;
- iii) disseminate the requisite information in respect of insurance products offered for sale by his insurer and take into account the needs of the prospect while recommending a specific insurance plan;
- iv) where the Insurance agent represents more than one insurer offering same line of products, he should dispassionately advice the policyholder on the products of all Insurers whom he is representing and the product best suited to the specific needs of the prospect;
- v) disclose the scales of commission in respect of the insurance product offered for sale, if asked by the prospect;
- vi) indicate the premium to be charged by the insurer for the insurance product offered for sale;
- vii) explain to the prospect the nature of information required in the proposal form by the insurer, and also the importance of disclosure of material information in the purchase of an insurance contract;
- viii) bring to the notice of the insurer every fact about the prospect relevant to insurance underwriting, including any adverse habits or income inconsistency of the prospect, within the knowledge of the agent, in the form of a report called “Insurance Agent’s Confidential Report” along with every proposal submitted to the insurer wherever applicable, and any material fact that may adversely affect the underwriting decision of the insurer as regards acceptance of the proposal, by making all reasonable enquiries about the prospect;
- ix) obtain the requisite documents at the time of filing the proposal form with the insurer; and other documents subsequently asked for by the insurer for completion of the proposal;
- x) advise every prospect to effect nomination under the policy
- xi) inform promptly the prospect about the acceptance or rejection of the proposal by the insurer;

xii) render necessary assistance to the policyholders or claimants or beneficiaries in complying with the requirements for settlement of claims by the insurer;

xiii) render necessary assistance and advice to every policyholder introduced through him/her on all policy servicing matters including assignment of policy, change of address or exercise of options under the policy or any other policy service, wherever necessary;

Broker : "insurance broker" means a person for the time-being licensed by the Authority under regulation 11, who for a remuneration arranges insurance contracts with insurance companies and/ or reinsurance companies on behalf of his clients. "Composite broker" means an insurance broker who for the time-being licensed by the Authority to act as such, for a remuneration, arranges insurance for his clients with insurance companies and/or reinsurance for his client/s; "direct broker" means an insurance broker who for the time-being licensed by the Authority to act as such, for a remuneration carries out the functions as specified under regulation 3 either in the field of life insurance or general insurance or both on behalf of his clients; "reinsurance broker" means an insurance broker who, for a remuneration, arranges reinsurance for direct insurers with insurance and reinsurance companies. “person” means- an individual; or a firm; or a company formed under the Companies Act, 1956 (1 of 1956); or a co-operative society registered under the Co-operative Societies Act, 1912 or under any law for the registration of co-operative societies; or any other person recognized by the Authority to act as an insurance broker;

Functions of a direct broker : The functions of a direct broker shall include any one or more of the following:

(a) Obtaining detailed information of the client's business and risk management philosophy;
(b) Familiarizing himself with the client's business and underwriting information so that this can be explained to an insurer and others;
(c) Rendering advice on appropriate insurance cover and terms;
(d) Maintaining detailed knowledge of available insurance markets, as may be applicable;
(e) Submitting quotation received from insurer/s for consideration of a client;
(f) Providing requisite underwriting information as required by an insurer in assessing the risk to decide pricing terms and conditions for cover;
(g) Acting promptly on instructions from a client and providing him written acknowledgements and progress reports;
(h) Assisting clients in paying premium under section 64VB of Insurance Act, 1938 (4 of 1938);
(i) Providing services related to insurance consultancy and risk management;
(j) Assisting in the negotiation of the claims; and
(k) Maintaining proper records of claims;

Requirements of Capital : (1) Any applicant seeking to become an insurance broker under these regulations should satisfy the following conditions:

(i) It shall have a minimum amount of capital as mentioned below:

Category	Minimum amount (Rupees)
(a) Direct broker	fifty lakhs
(b) Reinsurance broker	two hundred lakhs
(c) Composite broker	two hundred and fifty lakhs

i. The capital in the case of a company limited by shares and a cooperative society shall be in the form of equity shares;
ii. The capital in the case of other applicants shall be brought in cash;

iii. The applicant shall exclusively carry on the business of an insurance broker as licensed under these regulations.

(2) No part of the capital of an applicant shall be held by a non-Indian interest beyond 26% at any time. For the purposes of these regulations, the calculations of non-Indian interest shall be made in the same manner as specified in Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000 for an insurer.

A license once issued shall be valid for a period of three years from the date of its issue, unless the same is suspended or cancelled pursuant to these regulations.

Remuneration – (1) No insurance broker shall be paid or contract to be paid by way of remuneration (including royalty or license fees or administration charges or such other compensation), an amount exceeding:

A. on direct general insurance business -
   i. On tariff products:
      a) 10 percent of the premium on that part of the business which is compulsory under any statute or any law in force;
      b) 12½ percent of the premium on others.
   ii. On non- tariff products:
      - 17½ percent of the premium on direct business.

B. On direct life insurance business -
   Individual insurance
      - 30 percent of first year's premium
      - 5 per cent of each renewal premium

Annuity :

- immediate annuity or a deferred annuity in consideration of a single premium, or where only one premium is payable on the policy:
- 2 percent of premium deferred annuity in consideration of more than one premium:
   i. 7½ percent of first year's premium
   ii. 2 percent of each renewal premium

Code Of Conduct :

Conduct in matters relating to client's relationship— Every insurance broker shall:

a. conduct its dealings with clients with utmost good faith and integrity at all times;
b. act with care and diligence;
c. ensure that the client understands his relationship with the broker and on whose behalf the broker is acting;
d. treat all information supplied by the prospective clients as completely confidential to themselves and to the insurer(s) to which the business is being offered;
e. take appropriate steps to maintain the security of confidential documents in their possession;
f. hold specific authority of client to develop terms;
g. understand the type of client it is dealing with and the extent of the client's awareness of risk and insurance;
h. obtain written mandate from client to represent the client to the insurer and communicate the grant of a cover to the client after effecting insurance;
i. obtain written mandate from client to represent the client to the insurer/ reinsurer; and confirm cover to the insurer after effecting re-insurance, and submit relevant reinsurance acceptance and placement slips;
j. Avoid conflict of interest.

Conduct in matters relating to Sales practices— Every insurance broker shall: —

a. confirm that it is a member of the Insurance Brokers Association of India or such a body of brokers as approved by the Authority which has a memorandum of understanding with the Authority;
b. confirm that he does not employ agents or canvassers to bring in business;
c. identify itself and explain as soon as possible the degree of choice in the products that are on offer;
d. ensure that the client understands the type of service it can offer;
e. ensure that the policy proposed is suitable to the needs of the prospective client;
f. give advice only on those matters in which it is knowledgeable and seek or recommend other specialist for advice when necessary;
g. not make inaccurate or unfair criticisms of any insurer or any member of the Insurance Brokers Association of India or member of such body of brokers as approved by the Authority;
h. explain why a policy or policies are proposed and provide comparisons in terms of price, cover or service where there is a choice of products;
i. state the period of cover for which the quotation remains valid if the proposed cover is not effected immediately;
j. explain when and how the premium is payable and how such premium is to be collected, where another party is financing all or part of the premium, full details shall be given to the client including any obligations that the client may owe to that party; and
k. Explain the procedures to follow in the event of a loss.

Conduct in relation to furnishing of information — Every insurance broker shall: —

(a) ensure that the consequences of non-disclosure and inaccuracies are pointed out to the prospective client;
(b) Avoid influencing the prospective client and make it clear that all the answers or statements given are the latter's -own responsibility. Ask the client to carefully check details of information given in the documents and request the client to make true, fair and complete disclosure where it believes that the client has not done so and in case further disclosure is not forthcoming it should consider declining to act further;
(c) explain to the client the importance of disclosing all subsequent changes that might affect the insurance throughout the duration of the policy; and
(d) Disclose on behalf of its client all material facts within its knowledge and give a fair presentation of the risk.

5.11 SUMMARY :

In our day-to-day life, we sometimes make the statements like it may rain today, train is likely to be late, doubt that he will win the race and so on are the basis for the theory of probability. Theory of probability is a branch of mathematics which has been developed to deal with situations involving uncertainty. The theory had its beginning in the 16th century. It originated in the games of chance such as throwing of dice and now probability is used extensively in biology, economics, genetics, physics, sociology etc. LIC was having its branches in almost all parts of the country and it attracted people local people to become their agents.

5.12 TECHNICAL TERMS :

1. **Insurance:** Insurance is a legal agreement between two parties – the insurer and the insured, also known as insurance coverage or insurance policy. The insurer provides financial coverage for the losses of the insured that s/he may bear under certain circumstances

2. **Life Insurance:** Life Insurance can be defined as a contract between an insurance policy holder and an insurance company, where the insurer promises to pay a sum of money in exchange for a premium, upon the death of an insured person or after a set period.
3. **Non-Life Insurance**: As per the definition, a non-life insurance policy is a type of policy that safeguards and compensates the losses incurred from a particular financial event. Some of the most popular types of non-life insurance policies are general insurance, property insurance, and casualty insurance.,
4. **Functions**: function, in mathematics, an expression, rule, or law that defines a relationship between one variable (the independent variable) and another variable (the dependent variable). Functions are ubiquitous in mathematics and are essential for formulating physical relationships in the sciences.
5. **Distribution Channels**: A distribution channel is the network of businesses or intermediaries through which a good or service passes until it reaches the final buyer or the end consumer. Distribution channels can include wholesalers, retailers, distributors, and even the internet.
6. **Probability**: Probability is a measure of the likelihood of an event to occur. Many events cannot be predicted with total certainty. We can predict only the chance of an event to occur i.e., how likely they are going to happen, using it.
7. **Pricing:** Pricing is a process of fixing the value that a manufacturer will receive in the exchange of services and goods. Pricing method is exercised to adjust the cost of the producer's offerings suitable to both the manufacturer and the customer.
8. **Re Insurance**: Issue: Reinsurance, often referred to as “insurance for insurance companies,” is a contract between a reinsurer and an insurer. In this contract, the insurance company the cedent transfers risk to the reinsurance company, and the latter assumes all or part of one or more insurance policies issued by the cedent.

5.12 SELF-ASSESSMENT QUESTIONS :

1. Explain the growth and development of Insurance in India?
2. Discuss the concept and functions of life insurance?
3. What are the different forms of Insurance? Explain?
4. Discuss the principles of Insurance?
5. What is the role of distributions channels in the promotion of Insurance business in India?
6. Explain the role and responsibilities of an agent?
7. What is the role of IRDA in the promotion & development of insurance in India?
8. How to select the policy? Discuss the components of it?
9. Discuss different types of distributions in theory of probability?
10. Discuss different risk theories in insurance?

5.14 SUGGESTED READINGS :

1) Dr P.K.Gupta, Insurance and Risk Management, Himalaya Publishing House
2) Srivastava, RM ., "Management of Indian Financial Institutions", Himalaya Publishing House, Mumbai, 2005
3) Srinivasan NP and Saravanavel, P., "Development Banking in India and Abroad", Kalyani Publications, Ludhiyana, 2001

Dr. Ch. V. R. Krishna Rao

LESSON - 6

INTRODUCTION TO INDIAN INSURANCE INDUSTRY

LEARNING OBJECTIVES :

- To make the students to know the basic concepts of insurance
- To make the students to know evolution of Indian Insurance Sector
- To make the students to know the basic key concepts of Insurance Sector reforms
- To make the students to know the basic concepts of liberalization of Insurance Markets in India
- To make the students to know the recommendations of Malhotra Committee on Architecture of Privatization of Insurance Business

STRUCTURE :

6.1 Introduction

6.2 Indian Insurance Market Size

6.3 Evolution of Insurance in India

6.4 Insurance Sector Reforms

6.5 Liberalization of Insurance Business

6.6 Summary

6.7 Keywords

6.8 Self Assessment Questions

6.9 Suggested Readings

6.1 INTRODUCTION :

The term Sinsurance‖ has neither been define under the Insurance Act 1938 nor in any other legislation regulating insurance business including Insurance Regulatory and Development Authority Act. However, an effort has been made in this chapter to define the term insurance with the help of definitions given by some authors and under judicial pronouncements. For better understanding the definition are discussed under three different heads that are: General, Functional and Contractual. India’s Insurance industry is one of the premium sectors experiencing upward growth. This upward growth of the insurance industry can be attributed to growing incomes and increasing awareness in the industry. India is the fifth largest life insurance market in the world's emerging insurance markets, growing at a rate of 32-34% each year. In recent years the industry has been experiencing fierce competition among its peers which has led to new and innovative products within the industry. Foreign Direct Investment (FDI) in the industry under the automatic method is allowed up to 26% and licensing of the industry is monitored by the insurance regulator the Insurance Regulatory and Development Authority of India (IRDAI). The insurance industry of India has 57 insurance companies - 24 are in the life insurance business, while 34 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. There are six public sector insurers in the non-life insurance segment. In addition to these, there is a sole national re-insurer, namely General Insurance Corporation of India (GIC Re). Other stakeholders in the Indian Insurance market include agents (individual and corporate), brokers, surveyors and third-party administrators servicing health insurance claims. The insurance industry has undergone numerous transformations in terms of new developments, modified regulations, proposals for amendments and growth in 2022. These developments have opened new avenues of growth for the industry while ensuring that insurers stay relevant with changing times and the latest digital disruptions. The Insurance Regulatory and Development Authority India (IRDA) is vigilant and progressive and is determined to achieve its mission of 'Insurance for all by 2047', with aggressive plans to address the industry's challenges.

The growth of the insurance market is being supported by important government initiatives, strong democratic factors, conducive regulatory environment, increased partnerships, product innovations, and vibrant distribution channels. Insurance Industry was largely dominated by offline channels like corporate agents, offline brokers or banks. Today, rapid digitization, product innovation and progressive regulation policies have made it possible for consumers to buy insurance through multiple distribution channels with the click of a button. The instability of the covid-19 pandemic highlighted the necessity for consumers to invest in products that would increase financial security, one of them being life insurance.

6.2 INDIAN INSURANCE MARKET SIZE :

The insurance industry in India has witnessed an impressive growth rate over the last two decades driven by the greater private sector participation and an improvement in distribution capabilities, along with substantial improvements in operational efficiencies. Private players have seen decent growth in individual single premium, group single premium, and individual non-single premium. Private Life Insurers are expected to grow their retail APE at a CAGR of over 17% between 2021-23, and new retail term premiums are expected to double in 5 years. The Private Non-Life insurance segment is forecasted to grow at 14% in FY23. According to the latest data released by the insurance regulator – the Insurance Regulatory and Development Authority of India - LIC improved its market share by 67.72% as of October, a gain of 447 basis points (bps). At the end of 2021-22, private players had 36.75% share of the life insurance market, while LIC had 63.25%. As of November 2022, life insurers' have reported a 34.71% year-on-year (YoY) increase in premiums to Rs 2.06 trillion (US$ 25 billion), with LIC's premium witnessing 42% growth and private insurers growing 21.48% YoY. LIC's group single premium was up 53% YoY during this period and individual non-single premium up 14.6%.

The life insurance industry is expected to increase at a CAGR of 5.3% between 2019 and 2023. India's insurance penetration was pegged at 4.2% in FY21, with life insurance penetration at 3.2% and non-life insurance penetration at 1.0%. In terms of insurance density, India's overall density stood at US$ 78 in FY21. Premiums from India's life insurance industry is expected to reach Rs. 24 lakh crore (US$ 317.98 billion) by FY31. In FY23 (Until October 2022), premiums from new businesses of life insurance companies in India stood at US$ 25.3 billion. In October 2022, life insurers' new business premiums grew to Rs. 15,920.13 crore (US$ 1.94 billion), according to Life Insurance Council data. The gross first-year premium of life insurers increased by 12.93% in 2021-22 to Rs. 314,262.42 crore (US$ 40.06 billion). Between April 2021-March 2022, gross premiums written off by non-life insurers reached Rs. 220,772.07 crore (US$ 28.14 billion), an increase of 11.1% over the same period in FY21. In May 2022, the total premium earned by the non-life insurance segment stood at Rs. 36,680.73 crore (US$ 4.61 billion), a 24.15% increase as compared to the same period in the previous year. The market share of private sector companies in the general and health insurance market increased from 48.03% in FY20 to 49.31% in FY21. Six standalone private sector health insurance companies registered a jump of 66.6% in their gross premium at Rs 1,406.64 crore (US$ 191.84 million) in May 2021, as against Rs. 844.13 crore (US$ 115.12 million) earlier.

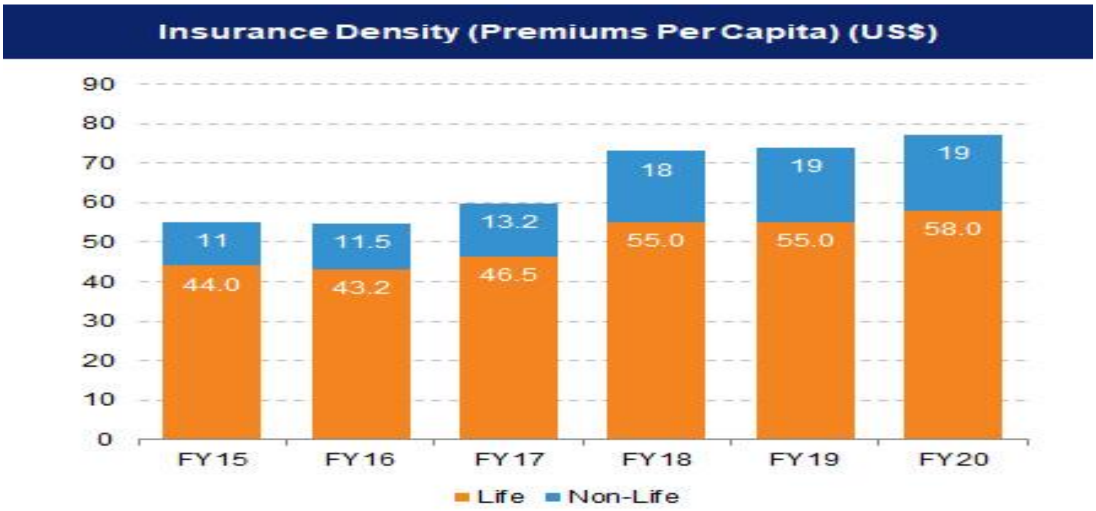

Fig 1.Indian Insurance Market Size
(Source: https://www.ibef.org/industry/insurance-sector-india)

6.3 EVOLUTION OF INSURANCE IN INDIA :

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

Origin and Development of Marine Insurance : In India even during Aryan period, there was evidence of the existence of something like marine insurance. But marine insurance, as known in the civilised world today, had its origin only in England. Seven marine insurance companies, of which none is in existence today, were started around 1810, in Calcutta. Later, mostly composite offices were started. Most of the British offices had branches in India and they acted as world offices. Early monopoly and later increased rates of duties charged on British offices tempted them to form independent offices in the colonies of the Commonwealth including India and thus the British offices exercised tremendous influence in the Indian insurance market. The rules in English law were applied in India with little variation to adapt them to Indian circumstances. After Independence and with the abolition of the Privy Council, the Indian Superior courts including the Supreme Court started drawing authority from the other foreign sources, like the American cases. But today marine insurance is regulated by the Indian Marine Insurance Act, 1963.

Origin and Development of Fire Insurance : In India most of the successful fire insurance business was only through brokers and branches of foreign companies of Britain, America, and even Japan. The Alliance British and Foreign Fire Insurance Co. first established an agency office at Madras and probably this agency office was the first to issue a fire policy in India. Soon other offices like the Royal Insurance Co. the Liverpool and London and Globe, North British and Commercial Union started many branch offices at Bombay, Calcutta and other presidency towns. Slowly the business spread to the mofussil areas. During the last century, many fire offices were started but were closed down shortly.

Origin and Development of Life Insurance :\ The Indian Life Assurance Companies Act, 1912 was the first statutory measures to regulate life insurance business. Later in 1928, the

Indian Insurance Companies Act was enacted, *inter alia*, to enable the Government to collect statistical information about both life and non-life insurance business transacted in India by Indian and foreign insurers, including the provident insurance societies. Comprehensive arrangements were, however, brought into effect with the enactment of the Insurance Act, 1938. Efforts in this direction continued progressively and the Act, was amended in 1950, making far-reaching changes, such as requirement of equity capital for companies carrying on life insurance business, ceilings on share holdings in such companies, stricter controls on investments of life insurance companies, submission of periodical returns relating to investments and such other information to the Controller of insurance as he may call for, appointment of administrators for mismanaged companies, ceilings on expenses of management.

Origin and development of general insurance business in India : In India, general insurance was brought by Britishers. Their operation was through agencies. The Triton Insurance Company Ltd. was the first general insurance company established in India in 1858 at Kolkata. It was British owned company and its share was held by them. The first general insurance company to be set-up by Indian was Indian Mercantile Insurance Company Ltd. in Mumbai in 1907. It was to transact all types of general insurance business. Thereafter, a large number of both Indian and foreign insurance companies were set-up in the country However, till independence as much as 40% of the insurance business was held by foreigners main Britishers.

The Advent Of Life Insurance Business In India :

1818-Advent of life insurance business in India :
1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834. In 1829, the Madras Equitable had begun transacting life insurance business in the Madras Presidency. 1870 saw the enactment of the British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were started in the Bombay Residency. This era, however, was dominated by foreign insurance offices which did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for hard competition from the foreign companies.

1914-Government of India started publishing returns :

In 1914, the Government of India started publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies. In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

1950-The Insurance Amendment Act of 1950 abolished Principal Agencies :

The Insurance Amendment Act of 1950 abolished Principal Agencies. However, there were a large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business.

1956-Life Insurance Corporation came into existence :

An Ordinance was issued on 19th January, 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector.

6.4 INSURANCE SECTOR REFORMS :

The History Of General Insurance :

The history of general insurance dates back to the Industrial Revolution in the west and the consequent growth of sea-faring trade and commerce in the 17th century. It came to India as a legacy of British occupation. 1850-The British establish the Triton Insurance Company Ltd. General Insurance in India has its roots in the establishment of Triton Insurance Company Ltd., in the year 1850 in Calcutta by the British. 1907-The Indian Mercantile Insurance Ltd, was set up. In 1907, the Indian Mercantile Insurance Ltd, was set up. This was the first company to transact all classes of general insurance business. 1957-General Insurance Council is formed- 1957 saw the formation of the General Insurance Council, a wing of the Insurance Association of India. The General Insurance Council framed a code of conduct for ensuring fair conduct and sound business practices. 1968-Insurance Act was amended- In 1968, the Insurance Act was amended to regulate investments and set minimum solvency margins. The Tariff Advisory Committee was also set up then. 1973-General insurance business was nationalized- In 1972 with the passing of the General Insurance Business (Nationalization) Act, general insurance business was nationalized with effect from 1st January, 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on January 1st 1973.

The Process Of Re-Opening :

This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process of re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector.The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein , among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

April,2000, The IRDA was incorporated as a statutory body

Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.

August, 2000, The IRDA opened up the market

The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has

from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests.
December, 2000, The subsidiaries of the General Insurance Corporation of India were restructured as independent companies. In December, 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national re-insurer.
July, 2002, Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002.

Today there are 34 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 24 life insurance companies operating in the country. The insurance sector is a colossal one and is growing at a speedy rate of 15-20%. Together with banking services, insurance services add about 7% to the country's GDP. A well-developed and evolved insurance sector is a boon for economic development as it provides long- term funds for infrastructure development at the same time strengthening the risk taking ability of the country.

History of Insurance – Timeline

Year	**Event**
1818	Life Insurance business introduced in India through Oriental Life Insurance Company (Calcutta)
1829	Madras Equitable started transacting life insurance in the Madras Presidency
1834	Failure of the Oriental Life Insurance Company
1870	British Insurance Act enactment
1871	Set up of Bombay Mutual
1874	Set up of Oriental
1897	Set up of Empire of India
1914	Government of India published returns of the Insurance Companies in India
1928	Indian Insurance Companies Act enactment to enable the government to collect statistical data about the life and non-life business transacted in the country by both Indian as well as foreign insurers
1938	Consolidation of the earlier legislation and amendment of the Insurance Act
19th January 1956	Issuance of an ordinance to nationalize the life insurance sector and the LIC (Life Insurance Corporation) was set up
1907	Indian Mercantile Insurance Ltd. was set up
1957	Formation of the General Insurance Council
1968	Amendment of the Insurance Act to regulate the investments and set minimum solvency margins
1972	General Insurance Business (Nationalization) Act passed
1971	General Insurance Corporation of India incorporated as a company

01st January 1973	Insurance business nationalized
1993	RN Malhotra committee formed to propose recommendations for reforms in the insurance sector in India
1999	Insurance Regulatory and Development Authority (IRDA) established
2000	IRDA incorporated as a statutory body
August 2000	IRDA opened the market with the invitation for application for registrations
December 2000	Subsidiaries of the General Insurance Corporation of India were restructured as independent companies GIC was converted into a national re-insurer
July 2002	Bill to de-link the four subsidiaries from GIC passed in parliament
Presently	34 general insurance companies including the Export Credit Guarantee Corporation of India (ECGC) and Agriculture Insurance Corporation of India and 24 life insurance companies are operational in India

Table:1 (History of Insurance)
Source: https://testbook.com/banking-awareness/history-of-insurance

Classification Of Insurances :

The Present of Insurance Sector in India/ Insurance Players in India– So far as the industry goes, LIC, New India, National Insurance, United insurance and Oriental are the only government ruled entity that stands high both in the market share as well as their contribution to the Insurance sector in India. There are two specialized insurers – Agriculture Insurance Company Ltd catering to Crop Insurance and Export Credit Guarantee of India catering to Credit Insurance. Whereas, others are the private insurers (both life and general) who have done a joint venture with foreign insurance companies to start their insurance businesses in India.

On the basis of Nature of Interest : This classification is from the nature of the interest of the insured sought to be protected by the insurer. A person may take out a policy protecting himself from loss likely to be caused by loss of life, that is death, or from any injury to his loss of property or involvement in liability to others. From this point of view the categorization may be: (i) Personal (ii) Property, and (iii) Liability insurance

i. **Personal Insurance:** When a person takes a life insure either on his own life or on another‘s life about his health or personal accident the nature of the interest affected is the life, health and body and these are said to be personal insurance contracts.
ii. **Property Insurance:** When the interest affected by the happening of the event insured against is the proprietary interest of the contract are called proprietary insurance contracts. Under this category come fire insurance, marine insurance etc.
iii. **Liability Insurance:** In this type, when the event insured against happens, the insured would he exposed to some liability to third parties and this is called a Liability Insurance Contract. More common examples of this type of insurance are motor vehicles insurance, aviation insurance and public liability insurance etc.

On the basis of Nature of Event : In another perspective all insurance contracts may be classified according to the event on the happening of which the insurer would be liable to pay the agreed money to the insured from this angle, they may be classified as:

i. **Marine Insurance:** Here the sum becomes payable on the happening of a perilous event at sea.
ii. **Fire Insurance**: In this class of contracts, the sum is payable on the accident of fire by which the insured property is destroyed or damaged. Here the loss insured is the damage caused by fire.
iii. **Life Insurance:** The sum insured becomes payable on the death of the insured or on the attainment of a particular age.
iv. **Miscellaneous Insurance:** This includes a variety of new insurances which go in the modem times under the terms ‗Social Insurance or Liability Insurance, Industrial Insurance, Motor Vehicles Insurance, Aviation Insurance' etc. Comparatively, these types are rather new as the first three types i.e. life, fire and marine have been recognised since long.

Life Insurance Companies : Private Sector Companies

- Aegon Life Insurance Co. Ltd.
- Aviva Life Insurance Co. India Ltd.
- Bajaj Allianz Life Insurance Co. Ltd.
- Bharti AXA Life Insurance Co. Ltd.
- Birla Sun Life Insurance Co. Ltd.
- Canara HSBC Oriental Bank of Commerce Life Insurance Co. Ltd.
- DHFL Pramerica Life Insurance Co. Ltd.
- Edelweiss Tokio Life Insurance Co. Ltd
- Exide Life Insurance Co. Ltd.
- Future Generali India Life Insurance Co. Ltd.
- HDFC Standard Life Insurance Co. Ltd.
- ICICI Prudential Life Insurance Co. Ltd.
- IDBI Federal Life Insurance Co. Ltd.
- IndiaFirst Life Insurance Co. Ltd
- Kotak Mahindra Old Mutual Life Insurance Ltd.
- Max Life Insurance Co. Ltd.
- PNB MetLife India Insurance Co. Ltd.
- Reliance Life Insurance Co. Ltd.
- Sahara India Life Insurance Co. Ltd.
- SBI Life Insurance Co. Ltd.
- Shriram Life Insurance Co. Ltd.
- Star Union Dai-Ichi Life Insurance Co. Ltd.
- Tata AIA Life Insurance Co. Ltd.

General Insurance Companies : Private Sector Companies

- Aditya Birla Health Insurance Co. Ltd.
- Bajaj Allianz General Insurance Co. Ltd.
- Bharti AXA General Insurance Co.Ltd.
- Cholamandalam General Insurance Co. Ltd.
- Future Generali India Insurance Co.Ltd.
- HDFC ERGO General Insurance Co. Ltd.
- ICICI Lombard General Insurance Co. Ltd.
- IFFCO-Tokio General Insurance Co. Ltd.
- Kotak General Insurance Co. Ltd.

- L&T General Insurance Co. Ltd.
- Liberty Videocon General Insurance Co. Ltd.
- Magma HDI General Insurance Co. Ltd.
- Raheja QBE General Insurance Co. Ltd.
- Reliance General Insurance Co. Ltd.
- Royal Sundaram Alliance Insurance Co. Ltd
- SBI General Insurance Co. Ltd.
- Shriram General Insurance Co. Ltd.
- TATA AIG General Insurance Co. Ltd.
- Universal Sompo General Insurance Co.Ltd.

Health Insurance Companies :

- Apollo Munich Health Insurance Co.Ltd.
- Star Health Allied Insurance Co. Ltd.
- Max Bupa Health Insurance Co. Ltd.
- Religare Health Insurance Co. Ltd.
- Cigna TTK Health Insurance Co. Ltd.

(Source: https://www.acko.com/articles/general-info/insurance-sector-india/)

Insurance Sector Reforms :

The reforms for the insurance sector were announced by the Insurance Regulatory and Development Authority of India (IRDAI) for bolstering the ease of doing business in the insurance sector. Insurance Sector Reforms- Insurtech businesses are already using microfinance organisations as a platform to sell small-scale insurance products in rural India, improving insurance penetration- Consultations between the finance ministry and India's Insurance Regulatory Development Authority(IRDAI) have begun.- The "use and file" method might be given some consideration as the government concentrates on making doing business easier.

Key developments of the insurance sector :

i. **LIC IPO:** The Rs 21,000-crore initial public offering (IPO) of the government-owned behemoth Life Insurance Corporation of India (LIC) was the most talked-about market news for the better part of the year. LIC reserved up to 10 percent of its offer size for its policyholders.

ii. **Life insurers' focus on guaranteed return policies:** Life insurance companies launched traditional endowment policies, promoted as an opportunity for policyholders to take advantage of higher interest rates raised by RBI.

iii. **Higher health premiums, newer products:** The health insurance premiums for individuals rose by 8-15 percent this year primarily due to a sharp rise in claims during 2020 and 2021.

iv. **Newer motor insurance riders:** The IRDAI allows insurers to offer 'innovative' motor insurance riders in the form of pay-as-you-use, pay-as-you-drive and motor floater policies.

v. **Use-and-file procedure for quicker product launches:** Use-and-file norms allow insurance companies to launch new products without prior approval from the regulator. The steps taken by IRDAI are in alignment with its goal of infusing more flexibility and higher governance in the sector. This has helped the insurance industry to mature significantly and continue to focus on increasing penetration

Malhotra Committee The Architecture Of Privatization Of Insurance Business :

The Committee recommends as follows :

(i) The private sector should be allowed to enter insurance business. No single company should be allowed to transact both life and general insurance business. The number of new entrants should be controlled;

(ii) The minimum paid-up capital for a new entrant should be Rs 100 crore. However, a lower capital requirement can be prescribed for state level cooperative institutions taking up life insurance business;

(iii) The promoters' holding in a private insurance company should not exceed 40% of the total. However, if the promoters wish to start with a higher holding, they should be permitted to do so provided their holding is brought down to 40% within a specified period of time through public offering. No person other than the promoters should be allowed to hold more than 1% of the equity. Promoters should at no time hold less than 26% of the paid-up capital;

(iv) If and when entry of foreign insurance companies is permitted, it should be done on selective basis. They should be required to float an Indian company for the purpose, preferably in joint venture with Indian partner;

(v) Before the private sector is allowed to enter the insurance field, the Controller of Insurance should start functioning effectively;

(vi) Regulatory and prudential norms as well as conditions for ensuring level playing fields among insurers should be finalized early so that intending entrants into the insurance business would be aware of the stipulations they would have to comply with. These conditions should aim to ensure that life insurers do not neglect the small man or the rural business and that the general insurers have balanced portfolios;

(vii) Though nationalized insurance companies are in a position to face competition, it is essential that they quickly upgrade their technology, reorganize themselves on more efficient lines and are enabled to operate as board-run enterprises.

6.5 LIBERALIZATION OF INSURANCE BUSINESS :

Economic reforms, particularly those relating to the financial sector, raise several important issues regarding the insurance industry. The Malhotra Committee constituted to reform the insurance sector observed:

i. A majority of areas previously reserved for the public sector have been thrown open to the private sector to strengthen the forces of competition. Competition is growing in the banking sector which already includes numerous public sector banks as well as private sector banks, both Indian and foreign. A similar trend is also evident among non-banking financial institutions, including leasing companies, mutual funds, merchant banks, and other intermediaries dealing with securities business. In contrast, life and general insurance companies remain state monopolies. LIC is a moonlit. There is very little competition among subsidiary companies of G1C. The question arises as to why the consumer of insurance services should not be provided a wider choice so that he can get the benefits of competition in terms of range of insurance products, lower price of insurance covers, and better customer service;

ii. The Committee further observed: part of government share holding in selected public sector enterprises, including profitable public sector banks, is being offered to the public. Should a similar policy be adopted for the insurance industry? If so, how far should disinvestment go in order to make the insurance companies operationally autonomous, efficient and competitive;

iii. The Committee added: Regulation over the capital market as well as the banking sector has been considerably strengthened. On the other hand, thanks to nationalization, regulation of the insurance industry has atrophied. Re-establishment of effective regulation over the insurance business is a crucial issue which would become all the more urgent if the sector was to be liberalized;

iv. The Committee also observed “There is very high pre-emption of insurance industry's funds through government mandated investments. This affects the financial results of insurance companies and has implications for rates of insurance premium and returns on savings invested in life insurance. Pre-emption of commercial banks resources is being reduced. What changes should be made in regard to mandated investments of the insurance industry. The rapid growth of the capital market and likely development of government and corporate bond markets should offer greater investment opportunities and challenges to insurance companies”;

v. The Committee further added: Information technology is the key to better management, customer service, efficiency and competitiveness. It has not made much progress in the insurance industry. In this area, insurers abroad have a clear competitive edge over their counterparts in India. How to overcome this serious deficiency is an urgent issue that must be constructively addressed.

Impact of Liberalization on Insurance Industry :

The opening-up of insurance business for competition offers ample opportunities to both existing as well as new players to penetrate into untapped areas, sectors and sub-sectors and unexploited segments of population as presently both insurance density and penetration are at low level. Both indices being at very low level in the country even compared to the countries with the same level of economic development and per capita income are indicative of the vast potential of the growth of this sector in future.

- The world has become a global village. The Liberalization, Privatization and Globalization (LPG) wave has seeped across the global economies. The two pillars of India’s economic policy before 1991 have been protection and public sector.
- Thus the New Economic Policy 1991 was a departure from the regulated planned economic tradition to that of LPG movement. After nearly a decade of intense debate a consensus developed in India for ending the public sector monopoly in insurance and opens the industry to private sector participants subject to suitable prudential regulation.
- Today, to the credit of combined efforts of both the regulator and industry players, benefits of insurance are widely acknowledged, public confidence in the industry has been very much restored and the industry has become more dynamic. Following the recent reform in the insurance sector, Indian insurance industry is moving ahead.
- The main element in the reform process was the opening up of the insurance industry in 2000 with foreign direct investment permitted up to 26 per cent of equity. With this change global insurers have rushed into the country to capture the market. The reforms have two objectives.
- One to captureÂ a vast untapped population under suitable insurance cover. The second, to create a more efficient and competitive insurance industry and elevate the performance of insurance companies.
- The Insurance Regulatory and Development Authority (IRDA) since its incorporation as a statutory body in April 2000 has regulated the opening of insurance sector which has seenÂ 15 life and 23 non life private companies launch their operations in India

In the post liberalization phase, insurance industry has witnessed beneficial effects of competition.

- The market for pension product is developing and there is a unit linked insurance plan generated by private players. Opening of the insurance market to private and foreign players and a conversion of a monopolistic market to a liberalized one has transformed the insurance industry in India.
- Best international practices in service and operational efficiency through use of latest technologies, need based schemes etc. are available to customer. The credit for enlarging the insurance sector goes to both the public and private sector.
- While the private sector has come up with aggressive marketing strategy to establish their presence, the public sector has in turn redrawn its priorities and revamped their marketing strategies to reach out to greater mass of people It is in this backdrop of liberalisation of insurance sector the paper has analysed the new dimensions post liberalisation like raising of foreign direct limit, micro insurance in rural market, bancassurance, reinsurance and alternate risk transfer (ATR).

The Need for Raising FDI limit :

Reforms in Insurance sector was started in India way back in 1993 as a part of overall financial reforms. The main idea was to make insurance industry vibrant and dynamic so that it can support the growth process leading to overall economic growth of the country in post liberalization era. At present the foreign direct investment in insurance sector is permitted up to 26 per cent of equity.

Higher amount of Foreign Direct Investment (FDI) in insurance sector would increase penetration of insurance in India as existing companies will try to expand their reach and new companies making entry into the market will work for their space in the market. Higher amount of FDI is likely to enrich the business by bringing world class business practices and process. Simultaneously it would help expand distribution capabilities. It is proposed therefore to raise FDI limit from existing 26% to 49%. This will help the insurance industry in the following ways. Higher FDI in insurance sector can give much needed capital for growth of insurance sector which in turn will help in the long term economic development. Ambitious infrastructure projects of Government can get stable long term source of funds. Higher amount of FDI in insurance would increase penetration of insurance in India which is low compared to global average. An increase in FDI in insurance will benefit the economy as people will invest in long term fund which will increased the growth of economy.

Insurance in India is mainly confined to urban sector Vast potentials are lying untapped in rural India. For accessing into these areas new approach is necessary in the matter of product design, pricing and product delivery mechanism. As far as rural health is concerned there are many new entrants waiting for making entry into the market, considering huge potential. Private players may tap these potentials. Thus raising of FDI limit in insurance sector will strengthen the market and thus lead to the economic growth of the country.

Opportunities :

- **Untapped Market:** New corners will get the benefit of untapped market. While nationalized general insurance companies and LIC of India have done a commendable job in extending their services throughout the country but the choices available to the insuring public are inadequate in terms of services, products and prices the untapped potential is quite large. The Maihotra Committee, which went into various aspects of India‟s insurance industry, estimated that in life insurance, 22% of the insurable population has been tapped so far. In India, premium per capita is only 2 and premium as percentage of GDP is 0.55%, which is very less in comparison of USA where premium per capita is 1381 and premium as percentage of GDP is 4.80. This huge gap from the global bench mark is itself lucrative.

- **Mandatory Insurance:** In disaster prone areas, Government of India is going to make insurance mandatory. The interim report of the high power committee setup by the centre on disaster management, has proposed mandatory insurance of life and property by people residing in disaster prone area such as coastal belts, flood prone areas, site near nuclear, chemical and hazardous industries and thickly populated areas.
- **More Products Offered:** A state monopoly has little incentive to offer a wide range of products. It can be seen by a lack of certain products from LIC"s portfolio and lack of extensive categorization in several GIC products such as health insurance. More competition in this business will spur firms to offer several new products and more complex and extensive risk categorization.
- **Growth of Economy:** With allowing of holding of equity shares by foreign company either itself or through its subsidiary company or nominee not exceeding 26% of paid up capitalof Indian Insurance Company, various joint ventures between foreign investors and Indian partners will be operated resulting into supplementing domestic savings and economic progress of the nations.
- **Opportunity for Banks:** Banks with their wide area network with branches in all the parts of the country will have very good opportunity to enter the insurance business. They will succeed in this sector because they have data base of customers, trained staff, a good network of branches besides synergy benefits.
- **Better Customer Services:** It would result in better customers services and help improve the variety and price of insurance products. Competition will compel the players to bring new and innovative product, wider choice of prices and quality service to consumers.

Challenges :

Whether the insurer is old or new, private or public, expansion of market will present multitude of challenges.

a) **New Insurers :** New insurers will have to invest a minimum capital of Rs. 100 crore. The normal gestation period is of five years. Hence, the new insurers will have to lock up their capital for at least five years before earning any profits. Besides they will face problems of shortage of trained manpower for the insurance industry. The setting up of various offices and distribution network is a time consuming process. Further, the new insurers will have to compete with the established insurance companies like LIC and CIC which have a corporate image and market presence for several years.

b) **Expectations of the Consumers :** Today, LIC has more than 60 products and GIC has more than 180 products to offer in market. But most of them are outdated, as they are not suitable to the needs of the consumers. Hence, all the insurers will have to offer innovative products to the consumers. The consumers are particularly expecting good pension plans, health insurance, term insurance, and investment products like unit linked insurance from the life insurers. Similarly, the consumers expect innovative products from the general insurers for managing health care, property insurance, accident insurance and other products at an attractive terms and premium. The consumers also expect reduction in the premium of the insurance products as the mortality rate in India has come down by three times in the last five years.

c) **Premium on Customer Service :** The days of giving fixed insurance products are over. Now customers need insurance solutions that match their wants. The large scale of operation, public sector and cumbersome procedures hampers nationalized insurers. Therefore, potential private entrants expect to score in the areas of customer service, speed and flexibility, it may mean better products and choice for the consumer. For giving better services insurance companies will have to build call centre's to provide call free telephone-based sales and service. The call centers will provide product-related information, customer account information, query and complaint handling. These call centre's can also be used for outbound sales and marketing campaigns.

d) **Distribution Channel :** In the liberalized insurance market, there will be multiple distribution channels, which will include agents, brokers, corporate intermediaries, bank branches, affinity groups and direct marketing through telesales and internet. There will be competition among the channels. Intense competition will grow among the old and new insurers in the market to win consumers. This will pose a great challenge to the insurers in the liberalized insurance market.

There would be substantial shift in the distribution of insurance in India. Many of these changes will echo international trends, World-wide, insurance products move along a continuum from pure service products to pure commodity products then they could be sold through the medical shops, groceries, novelty stores, etc. Once the products gain awareness and popularity then they can move to remote channels such as telephone or direct mail.

e) **Consumer Education :** The existing level of awareness of the consumers for insurance products is very low, it is so because in census 2011, India had a literacy rate of 74% in which 82% for men and 65% for women of the population is literate and less than 20% well educated. Even the educated consumers are ignorant about the various products of insurance. Hence, it is necessary that all the insurers should undertake the extensive plan for education of consumers. The consumer organisations and media also can play very important role in education of the consumers. This will result in expansion of the insurance market and will also enable the needy consumer to purchase appropriate products. In fact, the private entrants have already started putting a lot more emphasis sn advertising and using creative tricks to educate the consumers.

f) **Consumer Grievance Redressal :**The insurers will have to face an acute problem of the redressal of consumers‟ grievances for deficiency in products and services. The IRDAI has already appointed ombudsman for looking into the grievances of the policyholders, its judgment will be binding on insurers. In the competitive e-market, awareness level of consumers will increase and it will help consumers to fight for their legal right for deficiency in services. Hence, the number of legal cases filed by the consumers against insurers is likely to increase substantially in future. This will be a challenge to the insurers.

g) **New Product Innovations :**One researcher shows that two products of LIC dominate with majority share out of 52 products. With more competition good products will become an important differentiator among the various competiting insurance products. A lot will depend on the kind of products that these outfits launch. Initially after launching simple products multinationals will shift to specialised products. Royal Sundaram Alliance for example will launch a mix of personal and commercial insurance policies. This will cover fire, marine, motor, personal accident and health insurance. HOEC-Standard Life will launch two core life insurance products and then another dozen of the same type.

h) **Positioning of Insurance Products :** On the ground, the biggest challenge for the insurance companies will be to change the mindset of people, specially in life insurance. In India, life insurance is seen more as a tax saving mechanism rather than safety net in case of death. ICICI Prudential Life Insurance chief marketing officer Sangata Gupta also says that "working on consumer attitude will be the greatest challenge.” New types of products should be futuristic in outlook. To start with, low premium high cover policies should be introduced and better savings products at a latter stage.

i) **Rura1 Area Exploitations :** It is said that the life insurance business suffers from high premium and low returns. A normally competitive industry should be able to increase coverage, mobilize large savings, and provide high returns. India is ranked at 27th in the world in terms of mobilizing savings in the form of insurance. In countries like U.K. and South Africa, life insurance premiums account for over 50 per cent of gross domestic savings (GDS). Insurance in India has been a priority of the urban few. Now with numerous companies set to enter, the rural areas are expected to be tapped as well. IRDA has made it mandatory for life insurers to sell 5 per cent of their aggregate policies in the rural areas during the first year of operation that will be progressively increased to l5 per cent by the fifth year. But with gestation period long and investments large new entrants will feel very difficult to do it.

j) **Information Technology :** Information technology (IT) has become an intrinsic part of the insurance industry world-wide from general accounting to customer service, reinsurance, underwriting, and risk management. Further, these have integrated application and are decision-oriented. In the Indian insurance industry IT is used as a reporting tool whereas overseas it is used more as a decision-making instrument. Once on line customers with net connectivity would be able to check policy details from their balance to nominee schemes, the type of loans available and the amount in their investment accounts. Similarly, insurance advisors can check their customer’s accounts as well as their own account.

Strategies :

To be more competitive and responsive to the needs of the societies, the insurance players would be required to concentrate on the following major strategies:

i. **Environmental Analysis:** The companies should concentrate on environmental change, its direction, magnitude and its short-term and long-term impaet, formulating strategies to meet the challenges of high competition, preparing contingency plans and then designing action plans for effective implementations of formulated strategies.

ii. **Restructuring Organisations:** The traditional hierarchy system is very slow in making decisions due to several levels of management, due to its procedural inflexibility and slow communication. A manager in the privatized scenario is required to be an organizational specialist, country specialist and a global specialist.

iii. **Speed, Cost Effectiveness and Innovations:** The insurance companies will have to make substantial investments in customer relationship management technologies. They will be required to have wide area networks (WAN) connecting branches spread across wide geographical locations and workout modalities facilitating premium payment through the internet. LIC is setting up an interactive response systems in more cities so that a policyholder needs not to travel to company’s office for information. After all, the customer should have the choice of getting work done in the shortest possible time without having to visit insurer’s office.

iv. **Human Resource Development:** Human capital is important for any organization especially for organizations whose activities revolve around special human interactions. Along with products and services the new insurers need people with the right set of knowledge, skills and aptitude for insurance. The persons who are involved in selling the product and those who are doing the back office work need to equip themselves with newer skills and insights into every aspect of company’s functioning. They have a daunting task of exploiting potential in the industry and at the same time bring good risks to the company for providing insurance coverage.

They have to retain the existing customers for which they need to have better understanding of products and services by creating healthy internal environment with group harmony. Existing companies will have to frame their human resource policies to retain the competent and motivated staff since new entrants will be eying them by offering lucrative salaries.

v. **Efficiency in Distribution:** It is very important factor and may prove bottleneck to the new players. Insurance companies are making the products available through ready distribution channels of banks, non-banking finance companies and housing companies. One has to be careful doing this, since creating distribution and distances doesn’t automatically mean controlling them. With the starting of corporate agencies, there will be more places from where customer can buy insurance besides the consultants and agents currently selling these policies. Taking this aspect into consideration Banc assurance has emerged which is defined as a service that the insurance companies use to offer their products through the distribution channels of banking industry.

A need to augment sources of revenues for survival has prompted two big classes of financial institutions to combine their strengths and create a new means of marketing and servicing their products. Convergence of banking sector traditionally considered being more competitive and insurance business having a vast untapped potential of growth has resulted into banc assurance.

vi. **Risk Management:** Like all intermediaries in financial markets, insurance companies will have to bring sophistication in market research techniques future portfolio expansion.

vii. **Efficient Marketing Strategies:** Marketing strategies for insurance products in the emerging scenario could be understood in following steps:

R $\longrightarrow$ STP $\longrightarrow$ MM $\longrightarrow$ I $\longrightarrow$ C

Where,
R = Market research,
STP = Segmentation, Targeting, Positioning,
MM = Marketing Mix,
I = Implementation, and
C = Control.

The focus of emerging strategies would centre on the prepositions like reduce costs, increase profitability, reduce time to market, improve customer intimacy, retain customers for life, establish strong partnerships. Formulation of a marketing strategy is more a process than an event. Environmental factors like macro-economic parameters, regulatory norms and themes, technology, infrastructure, legal set-up, competition by way of new entry, degree of globalization need be scanned and considered in framing the likely scenarios. The competitive advantage of a company may stem from the many discrete activities in value chains. Each of these activities can contribute to a company’s relative cost position or create a basis for a differentiation.

Ethical issues : The governance problems in service industry like insurance have been raised time and again and they have created as well as risk management techniques. Companies will need to leverage this sophistication backed by information technology to select good risks and rate them. On the other hand, insurance companies invest the policyholder’s funds as well as owned capital and accumulated surpluses and reserves. Companies try to earn highest rate of return possible on investments consistent with risk objectives, because premiums are related to investment performance. As the rate of return on investment increases, the company can lower the premiums it charges on new policies. Higher rate of return provide higher earning on cash values and lesser the need for premium revenues. Premium rates are a competitive factor and high investment returns are crucial in maintaining and improving an insurance company's sales position. Strong investment performance supports growth in policy sales and sense of helplessness among the employees and customers alike. Companies must realize this particularly in the emerging scenario of intense competition wherein customers will have a range of options. At the same time regulators and companies will have to be cautious of customers who indulge in unethical practices by manipulating or hiding vital information in their dealings with companies and inflict losses resulting in increase in cost of insurance. Ethics will have to be insured in every activity of the company.

Consequence of Privatization of Insurance Sector : While nationalized insurance companies have done a commendable job in extending volume of the business, opening up of insurance sector to private players was a necessity in the context of liberalization of financial sector. If traditional infrastructural and semi public goods industries such as banking, airlines, telecom, power etc. have significant private sector presence, continuing state monopoly in provision of insurance was indefensible and therefore, the privatization of insurance has been done as discussed earlier. Its impact has to be seen in the form of creating various opportunities and challenges. To mention few of them:

i. Privatization if Insurance was eliminated the monopolistic business of Life Insurance Corporation of India. It may help to cover the wide range of risk in general insurance and also in life insurance. It helps to introduce new range of products;
ii. It would also result in better customer services and help improve the variety and price of insurance products;
iii. The entry of new player would speed up the spread of both life and general insurance. It will increase the insurance penetration and measure of density;
iv. Entry of private players will ensure the mobilization of funds that can be utilized for the purpose of infrastructure development;
v. Allowing of commercial banks into insurance business will help to mobilization of funds from the rural areas because of the availability of vast branches of the banks;
vi. Most important not the least tremendous employment opportunities will be created in the field of insurance which is a burning problem of the presence day today issues; and lastly after opening up of insurance in private sector, various leading private companies including joint ventures have entered thefields of insurance both life and non-life business. Tata - AIG, Birla Sun life, HDFC standard life Insurance, Reliance General Insurance, Royal Sundaram Alliance Insurance, Bajaj Auto Alliance, IFFCO Tokio General Insurance, INA Vysya Life Insurance, SBI Life Insurance, Dabur CJU Life Insurance and Max New York Life. SBI Life insurance has launched three products Sanjeevan, Sukhjeevan and Young Sanjeevan so far and it has already sold 320 policies under its plan.

Post Privatization Development :

According to IRDAI Annual Report 2016-17 at the end of March 2017, there were 62 insurers operating in India of which 24 are in life insurers, 23 are in general insurance 6 are in health insurer and 9 are doing reinsurance business out of 62 insurers eight are in public sector. In life insurance business India is ranked 10 among 88 countries. Globally, the share of life insurance business in total premium was 55.3 percent. However, the share of life insurance business for India was very bright at 77.95% while the share of non-life insurance business was small at 22.05 per cent IRDAI Annual Report 2016-17.

6.6 SUMMARY :

India's economy is growing consistently. With the LPG move the Government is recognizing the need to improve infrastructure. Insurance industry has a major role to play in the economic development of the country as it plays a major role in providing long term funds for infrastructure development and at the same time strengthens the risk taking ability.

Insurance industry has a great social significance. It is associated with disasters calamity etc. Insurance companies generate funds out of insurance premium collected and help in uplifting the economy. It also has potential of employment opportunities.

The IRDA opened the insurance sector for private companies with a foreign equity of 26 per cent. It aimed at ending the monopoly of Life Insurance Corporation and General Insurance Corporation in the insurance sector of the country. Post liberalization it was found that there was insufficient savings available and a substantial problem of debt existed in rural India. Hence the need for micro insurance was felt instead of micro credit or loan to the rural people.

There are many challenges in providing micro insurance. The rural market has inadequate, inappropriate services and inadequate information. Micro insurance movement still needs further supervision and direction both from IRDA as well as the Government of India. Banc assurance has yet to take off in a big way.

With the increasing spread of ban king in almost every part of the country it is necessary to tap this medium as payment of premium and the settlement of maturity claims can effectively be done through bancassurance. Bancassurance in India appears to be gaining ground quite rapidly both through commission based arrangements and joint ventures between banks and insurance companies It provides product diversification by banks and a cost effective distribution channel for insurers.

Reinsurance is a type of risk management involving transfer of risk from insurance to reinsurer. It deals with risks that are not predictable and cause the greatest exposure for the insurance company. Alternative Risk Transfer (ART) is the gradual process for transfer of local risk to capital market by way of securitization insurance derivatives etc. With the increasing operation of Multinational Corporation's credit insurance and agricultural insurance the market for ART products is likely to grow rapidly in the near future.

6.7 KEYWORDS :

1. Insurance Sector,
2. Liberalisation,
3. Business,
4. Organizations,
5. Insurance Companies,
6. LIC,
7. GIC,
8. IRDA,
9. FDI,
10. ART,
11. Financial development

6.8 SELF ASSESSMENT QUESTIONS :

1. Briefly write short notes on Indian Insurance Market Size
2. Briefly explain Evolution of Insurance in India
3. Briefly explain key Insurance Sector Reforms
4. Briefly write short notes on Liberalization of Insurance Business
5. Consequence of Privatization of Insurance Sector
6. Briefly write short notes on Malhotra Committee the Architecture of Privatization of Insurance Business
7. Explain about Advantages and Disadvantages of Liberalization of Insurance Business

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6.9 SUGGESTED READINGS :

1. Periasamy, P. (2017). Principles and Practices of Insurance. Himalaya Publishing House Pvt. Ltd.
2. Sahoo, S., & Das, S. (2009). Insurance Management- Text and Cases (I ed.). New Delhi: Himalaya Publishing House.
3. Mishra, M., & Mishra, S. (2009). Insurance Principles and Practices. New Delhi: S. Chand and Company Ltd.
4. Nasreen , R. (2009). Insurance and Risk Management (I ed.). Lucknow: Word Press.
5. Gupta, P. (2009). Fundamentals of Insurance. New Delhi: Himalaya Publishing House.
6. Imam, A. (2011). Principles and Pactices of Life Insurance in India (I ed.). New Delhi: Anmol Publications Pvt. Ltd.

SDr. N. Ratna Kishore

LESSON -7

REGULATION OF INSURANCE BUSINESS IN INDIA

LEARNING OBJECTIVES :

1. To make the students to know the basic concepts of Regulation
2. To make the students to know evolution of Indian Insurance Regulation
3. To make the students to know the Insurance Contract
4. To make the students to know the Registration and Licensing
5. To make the students to know the Role of Cost & Management Accountants

COURSE OUTCOMES :

1. Students will be able to analyze the basic concepts of Regulation
2. Students will be able to analyze the basic steps in registration of Insurance Company.
3. Students will be able to evaluate the key concepts of Taxation Process in India.
4. Understand the conceptual framework of accounting standards

STRUCTURE :

7.1 Introduction
7.2 Regulation
7.3 Financial Regulation
7.4 Insurance Regulation
7.5 Insurance Contract-Legal Framework
7.6 Registration and Licensing
7.7 Introduction to Insurance Accounting Basics
7.8 Taxing Insurance in India
7.9 Role of Cost & Management Accountants
7.10 Summary
7.11 Keywords
7.12 Self Assessment Questions
7.13 Suggested Readings

7.1 INTRODUCTION :

Insurance industry is an important and integral component of the macro economy. It has emerged as a dominant institutional player in the financial market impacting the health of economy. It has multi-dimensional role in savings and capital market, while the primary role of an insurance company is to provide insurance coverage for managing financial risks, it plays a very crucial role in promoting savings by selling a wide range of products and also actively contributes in promoting and sustaining the capital market of a country. Insurance sector has micro and macro effects on the economy. The micro effects are on individual safety, investments, savings perspective, and contribution to growth of economy. The macro effects are financing infrastructure, promoting investments, contribution to capital formation, financial leveraging and accessing resources. In the emerging economy, characterized by the reduced role of state and declining state supported social security, the importance and the role of the insurance industry has increased significantly not only as a risk manager but also as retirement security and annuity provider. Moreover, growing institutionalization of the financial market has also provided a momentum to boost the insurance companies. There is phenomenal growth resulting from both micro and macro effects of insurance. If the insurance sector is not regulated, then it will go to affect adversely the insurance growth, like in the micro sense people will lose their savings and in the macro sense the financial market will destabilize and collapses. Therefore, there is a need to regulate insurance in the context of the changing market and economic environment is required for managing insurance companies effectively.

Regulation is the result of pressures from business, consumers, and environmental groups and results in regulation, which supports business and protects consumers, works, and the environment. Regulation is undertaken to ensure that the economic system operates in a manner consistent with the public interest and to overcome market failures. Regulation is an activity carried out on regular basis by the government by which it tries to direct, control and modify the behavior of its citizens, organization and business entities operating within its boundaries in a desired way so as to achieve an equalitarian growth and development of the country. It is a process enacted by the law that supervises or controls some specific activities made by the affected firms and it is planned in such a way that it protects the public from exploitation by industries with monopoly power. So government agencies will regulate the specified task of administering and enforcing the law. While enforcing the regulatory law, these agencies are actively supported by the courts.

7.2 REGULATION :

According to Philip Selznick (1985), “Regulation is sustained and focused control exercised by a public agency over activities which are valued by a community”. This definition very much states centered view of regulation with total emphasis being given to intervention of public agencies.

In the view of Posner (1971) “Regulation is supplied in response to the demand of public for the Correction of inefficient or inequitable market practices”.

Stigler (1971) states that “Regulation instituted primarily for the protection and benefit of the Public at large or some large subclass of the public”.

Robert Baldwin (1999) has defined regulation in three different senses,

(i) As a specific set of commands
(ii) As a deliberate state influence
(iii) As all forms of social control or influence

Julia Black (2002) states that

(i) Regulation is the promulgation of rules by government accompanied by the mechanisms for monitoring and enforcement, usually assumed to be performed through a specialist public agency.
(ii) It is any form of direct state intervention in the economy, whatever form that intervention might take.
(iii) Regulation is all mechanisms of social control or influence affecting all aspects of behavior from whatever source, whether they are international or not.

Rationale for Regulation :

i. **Economies of scale :** In some industries and activities due to technical and natural advantages, one firm may find it cheaper to expand production and the relatively large firm will take advantage and may gain market power. One cause is economies of large scale production. In insurance, as in banking, there are significant economies of scale. The financial economies of scale in property – liability insurance and reinsurance derive mainly from the pooling of risks – the larger and the better diversified a pool, the better it works. In terms of diversification, the more extensive the markets from which risks are drawn the better, since property risks are often correlated geographically. For life insurance, the financial economies come on the asset side rather than on the liability side as in property – liability. The larger the portfolio of assets, the better diversified a life can be and the larger the individual investments.

Reputational economies of the scale are particularly important in insurance. An insurance policy represents a promise. The value of the policy to the insured, therefore depends on his or her confidence that the promise will be kept. A large, long-established, and well known insurer is more likely to inspire such confidence than a new, small company that no one has ever heard of.

ii. Economies of Scope : A single, large firm may also have a cost advantage over a group of small firms when it is cheaper to produce a number of different commodities together rather than making each separately in a different firm. Savings made possible by simultaneous production of many different products by one firm are called economies of scope.

Economies of scope draw insurance companies into related activities and draw other financial institutions into insurance.

(i) Life insurance and property – liability: one obvious advantage of scope is between the two types of insurance – life and property – liability. Although the two businesses are different in important respects, there are similarities.

(ii) Insurance and other financial services – as we have seen, life insurance companies are already deeply involved in financial intermediation and in the financial markets.

(iii) Insurance and banking – the economies of scope between banking and insurance seem to lie principally in marketing. As we have seen, marketing costs are a significant part of the cost of insurance.

iii. Theory of Limit Pricing : Even if society reconciles itself to monopoly in such cases, it generally does not want to let the monopoly firm wield its market power without limits. Therefore it will consider regulating the company’s decisions on matters such as pricing. The first and most universal problem facing the regulator is how to prevent and regulate the firm from pricing and taking other actions that exploit the public and undermine the efficiency of the market, but to do so in ways that do not destroy the regulated firm or prevent it from serving the public effectively.

iv. Barriers to Entry : Lack of Information is one the barriers for a new company entering into the market of insurance. As we have seen the key to making a profit is pricing premiums correctly. The lack of actuarial information and also setting up of marketing network to sell the insurance products easily will act as a barrier to entry for a new firm.

Aims of Regulations :

Generally regulations has the following goals

- ✓ To enforce applicable laws
- ✓ To prosecute cases of market misconduct, such as insider trading.
- ✓ To license the providers of financial services.
- ✓ To protect clients and investigate complaints.
- ✓ To maintain confidence in the financial system.
- ✓ To face the challenges of market imperfections such as
    - i) Information asymmetry
    - ii) Market power

iii) Negative externalities.

Objectives of Regulation :

- ✓ To enhance the confidence of economic agents in the financial system.
- ✓ To foster the development of competitive and efficient financial markets.
- ✓ To promote public understanding of the financial system.
- ✓ To improve the framework for regulatory performance and accountability.
- ✓ To contribute to enhancement of financial stability.
- ✓ To strengthen the protection of financial service consumers.
- ✓ To promote financial inclusion and universal access to financial services.

To assure that the industry operates with a sense of fairness, equity and reasonableness in the market. To promote prudential regulation, this assures safety and soundness of financial systems and institution to increase the confidence of the stake holders. To guide financial firms on how to conduct the insurance business.

Methods of Regulation :

- ✓ Maintains of Capital Adequacy
- ✓ Maintains of Liquidity
- ✓ Exposure to Risk
- ✓ Maintains of Solvency Ratio

7.3 FINANCIAL REGULATION :

Financial regulations are a form regulation or supervision which subjects financial institution to certain requirements, restrictions and guidelines aiming to maintain the integrity of the financial system. This may be handled by either a government or NGO. Since the three powerful forces viz globalization, information technology and convergence will pose significant challenges to financial stability, the market requires regulation in order to protect the investors all stack holders and to protect financial stability in the economy

Table. 2.1 Types of Financial Regulations

Type of Financial Regulation	Measures taken by the Regulator
Competitive Regulation (Prevention of anticompetitive behavior)	✓ Rules designed to deal with the structure of industries ✓ Rules designed to prevent anticompetitive behavior ✓ Rules designed to ensure that markets remain contestable
Price Regulation	✓ Administering interest rates, fees and commissions ✓ Permitting price cartels ✓ Direct lending controls and compulsory investment schemes ✓ Restrictions on cross border capital Flows
Market Integrity (Prevention of Market Misconduct)	✓ Disclosure of Information ✓ Conduct of business rules ✓ Entry restrictions through licensing ✓ Governance and fiduciary responsibilities ✓ Conditions of minimal financial Strength
Prudential Regulation	✓ Entry and Capital requirements

(Prevention of Asymmetric Information)	✓ Balance Sheet restrictions ✓ Liquidity and Accountability requirements ✓ Customer support schemes ✓ Restrictions on associations among financial Institutions
Government Policy (Prevention of Systemic Instability)	✓ Maintenance of sustainable 'macroeconomic' environment ✓ Monetary, Fiscal and Credit Policy
Insurance regulation	✓ Rules designed to deal with the structure of insurance industries ✓ Rules designed to prevent anticompetitive behavior in insurance market ✓ Rules designed to ensure that markets remain contestable

Source: Carmichael et al. (2002)

7.4 INSURANCE REGULATION :

Regulation acquires significance in sensitive areas like financial transactions, where chances of mismanagement, deception, fraud etc., are more possible. If such malpractices do occur, the loser is the common man, who does not understand the intricacies of the transactions and can be misled. Hence, social supervision, that is, government supervision, becomes essential. This is true for all the sectors in the financial services viz. banking, stock markets and insurance (Palande, et al. 2003).

In common with other financial services, insurers are repositories of public trust, and accept money from the insured in return for a promise of payment at some future date or on the occurrence of some particular event. An insurance company can fulfill this commitment only if it has adequate professional capability, is financially soundly managed, holds adequate reserves to meet the requirement of funds with reference to the nature of term of liabilities, and invests its huge funds carefully, so this needs to explain the paradox that even while on the one hand, countries with a very stiff restrictive regime are trying to dismantle some of the redundant controls, and on the other hand, countries with a less interventionist policy are attempting an increased level of regulation.

Purpose of Insurance Regulation : The ultimate purpose of insurance regulation is to protect the policy holder or consumer by ensuring that the insurance firm will be able to pay in the event that the policy holder files a claim. In other words it is about the slovenly that is maintaining sufficient capital to meet the obligations. This is particularly important for life insurance or liability policies where there is typically a long time span between the purchase of the protection policy and the payment of the claim. The need for regulatory control arises because, insurance services or only produced and delivered after they are purchased and paid for by policy holders. Since policy holders, typically lack the skills and information to monitor the financial soundness of their insurers, government laws are needed. The purpose of insurance regulation is not to prevent insurance in solvencies all together as this would be highly distortive and inefficient, i.e the cost of achieving such a result would outweigh regulation benefits. One of the goal of insurance regulation should be to reduce insolvencies to en acceptable minimum to minimize their negative impact. The secondary of insurance regulation is to treat insurance customers fairly and promote efficiency and competition in the industry. Insurance regulation is micro prudential focusing on the solvency of the individual insurance companies.

Reasons for Insurance Regulation : Insurers are regulated by the states for several reasons including the following

1. Maintain insurer solvency
2. Compensate for inadequate consumer knowledge
3. Ensure reasonable rates
4. Make insurance available

Insurance Regulation in India : Regulation of insurance in India was introduced with the promulgation of the Indian Life Assurance Companies Act, in 1912. The Insurance Act, 1938 sought to create a strong and powerful supervisory and regulatory authority in the Controller of Insurance, who was a statutory functionary. It set out his role and responsibilities more clearly and emphatically and empowered him to direct, advice, caution, prohibit, investigate, inspect, prosecute, search, seize, fine, amalgamate, authorize, register, and liquidate insurance companies. In fact, the government perhaps exercised more control on insurance than on any other economic activity. Prior to nationalization, the insurance industry in India had suffered from certain weaknesses such as malpractice in claims settlement, unhealthy rate cutting and misuse of insurance funds for speculative and other purposes. Several financial scandals that arose even during a control regime did, in fact, further underline the need for strict and prudent regulation.

In 1999, the IRDA Bill was introduced which became Act and brought into effect from April 2000. The main objectives of the Act where to protect the interest of the holders of insurance policies, and to regulate, promote and ensure orderly growth of the insurance industry.

Regulatory Measures : "A sound regulatory mechanism is an essential prerequisite for the success of any market – related reforms, particularly when the sector under consideration is the financial sector" by C.S. Rao, Chairman, IRDA (2002).

- ❖ Development of stable & strong insurance system is essential for economic development of the country. Regulatory measures are required for instilling public confidence in insurance companies, deliver reliable and quality services. It has to secure the long-term stability of financial services through monitoring their financial soundness and fair treatment of their customer. With the experience of failure of non-banking.
- ❖ Financial institutes and loss of depositor's money, regulatory measures have a very effective, role to control with facilitating investment and trade. Insurance Act 1938 is being modified as per the suggestions of IRDA. Globalization of financial activity, innovations in financial instruments and practices have to be strictly controlled.
- ❖ There is often a conflict between strict regulation and development. Regulation is based on past experience where as development is future oriented. Developing new products, processing and servicing is not an easy matter. It is expected that regulations will work as driver for change and force the players to do things in a better way.
- ❖ Regulations by IRDA in India are praiseworthy as they are pro-development. It has emerged as prudential supervisor and developer of capacity in terms of risk pooling, reinsurance and skills. It has to guide towards insurance penetration and insurance density. It makes insurance available to poor in rural areas. Insurance companies have to provide risk cover as well as contribute to long-term investment.
- ❖ Regulation consists of rule making and enforcement: Economic theory offers complimentary rationale for regulating financial institutions. In financial services markets for regulatory service create outside discipline that controls and co-ordinates industry behavior. Institutions benefit from regulation that enhances customer

confidence, increases the convenience of customer transactions, or creates cartel profits.

- ❖ Governments in most developed economies have created elaborate systems of regulation for financial markets, in part because the markets themselves are complex and in part because financial markets are so important to the general economies in which they operate. The numerous rules and regulations are designed to serve several purposes, They fall into the following categories:
  1) To prevent issuers of securities from defrauding investors by concealing relevant information.
  2) To promote competition and fairness in the trading of financial securities.
  3) To promote the stability of financial institutions.
  4) To restrict the activities of foreign concerns in domestic markets and institutions.
  5) To control the level of economic activity.

7.5 INSURANCE CONTRACT-LEGAL FRAMEWORK :

According to E.R. Hardy Ivamy,
A contract of insurance in the widest sense of the term may be defined as a contract whereby one person, called the _insurer‘, undertakes in return for the agreed consideration, called the premium‘, to pay to another person, called the _fed‘ a sum of money, or its equivalent, on the happening of a specified even.

A contract of insurance is a contract either to indemnify a person against a loss which may arise on the happening of an event or for an agreed consideration. To put it in other words it is a contract the happening of some or any event for an agreed consideration. To put it in other words it is a contract under which one party undertakes to pay to another person a sum of money or its equivalent on the happening of a specified event. Under such a contract one party agrees to take the risk of another person‘s life, property or liability in consideration of certain comparatively small periodic payments. The person to be paid or indemnified is called the ‘insurer’ or ‘assured’, the person who undertakes to indemnify or pay money is called the ‘insurer’ or ‘assurer‘ or ‘underwriter‘, the last word being generally used in marine insurance; the consideration received in the form of periodic payments is called the ‘premium’ or ‘premia’; and the document containing the contract is called the _insurance policy‘

Regulation of insurance business cannot be studied without understanding its nature. It may be pointed out that the contract of insurance is a contract first, than it bears some specific features. Being a contract it shares all the characteristics of a general contract mentioned under Sec. 10 of the Indian Contract Act, 1872. The general and specific nature of contract of insurance have been discussed as follows:

General Nature of an Insurance Contract :

The general nature of an insurance contract has been discussed under the following heads:

Offer and Acceptance.
Consideration
Competency of the Parties.
Legality of Object
Free consent of the Parties

Offer and Acceptance : The offer for making insurance contract may come either from the insurer or from the prospect (the person willing to purchase insurance policies). The last act of the insured or the Insurer on which the contract is complete is the acceptance and any act that precedes his an offer or a counter-offer. The act that precedes the final offer or a counter-offer is in the nature of an invitation to make an offer. Offer is an intimation to another of one‘s intention to do or to abstain from doing anything with a view of obtaining the assent of that other person to such an act or abstinence.

Consideration : The contract of insurance also requires a lawful consideration for its validity like offer contract. The insurer must have some return for its promise. It need not be money but it must be valuable‘. It may be right, interest, profit or benefit according to one party of some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other in contract of insurance. It is to be noted that only the first premium is the consideration and statements in the application and the payment of the firms; annual premium. All subsequent premiums are not part of the consideration but are merely conditions to be fulfilled by the insured for keeping the contract in force. Since the subsequent premiums are not part of the consideration, the insurer cannot compel the insured to pay the premiums subsequent to the first premium.

Competency of the Parties :

Section 11 of the Contract Act, 1872 states that every person competent to contract

(i) who is of the age of majority according to the law to which he is subject and

(ii) who is of a sound mind and

(iii) Is not disqualified from contracting by any law to which he subject.

Both parties to the contract must have the competence to enter into a valid contract.

Legality or Object : A contract will be void if the object is illegal or against public policy. The object of a insurance contract will be legal if it is made for one‘s own protection or for protection of the family against financial losses occurring on account of surviving to a particular age or at death of the life covered as the case may be. In brief it can be mentioned that the person desiring a policy must have insurable Interest in the life proposed for insurance. Insurance without insurable interest will be void. According to Section 23 of the Indian Contract Act, 1872.

The object of an agreement is lawful unless

(i) it is forbidden by law, or

(ii) it is of such a nature that if permitted, it would defeat the provision of any law, or

(iii) it is fraudulent, or

(iv) it involves injury to the person or property of another, or

(v) the court regards it as unmoral or opposed to public polity

Consent of the Parties to Contract of Insurance must be free : Under a valid contract both parties must have the same thing in mind as to the subject matter of contract. Two persons are said to consent when they agree upon the same thing in the same sense. In a contract of insurance the insurer and the insured must be in genuine agreement as to the subject-matter of insurance that is the life to be insured, sum assured and the term of the insurance and every other particular relating to the contract.

Section 14 of the Indian Contract Act, 1872, lays down that consent is said to be free when it is not caused by

- Coercion,
- Undue influence,
- Fraud or
- Misrepresentation or,
- Mistake.

When there is no free consent the contract becomes voidable at the option of the party whose consent was so caused.

7.6 REGISTRATION AND LICENSING :

Registration of an Insurance company :
To obtain the certificate of Registration as an Indian Insurance company an applicant has to undergo three linear stages. The stage wise procedure as well as the required Documents are elucidated below: -

R1 Stage :
Further, the application is examined based on certain requirements as stated in Sub Regulation 7 of the IRDAI (Registration of Indian Insurance Companies) (Seventh Amendment) Regulations, 2016 which is as under:

1. All submissions in R-1 are examined by respective nodal Departments. The R-1 application also includes the following documents:
    - ✓ A certified copy of the Memorandum of Association and Articles of Association, where the applicant is a Company and incorporated under the Companies Act, 2013 (18 of 2013); or
    - ✓ A certified copy of the Act of Parliament setting up the statutory body to carry on insurance business;
    - ✓ The name, address and the occupation of the directors;
    - ✓ A certified copy of the annual report of Indian Promoters and the Foreign Investors for the last five years preceding the year of filing of requisition of registration application;
    - ✓ A certified copy of the shareholders' agreement between Indian Promoters and Foreign Investors of the applicant;
    - ✓ Projection of Business for 5 years duly approved by the Board of Directors of the applicant.
    - ✓ the general track record of conduct and performance of each of the Indian Promoters and Foreign Investors in the fields of business/profession they are engaged in;
    - ✓ the record of conduct and performance of the directors and persons in management of the Indian Promoters, Foreign Investors and the applicant
    - ✓ the capital structure of the applicant;
    - ✓ the ability to meet the obligation to provide life insurance or general insurance or health insurance to the
    - ✓ persons residing in the rural sector, workers in the unorganized sector or informal sector or for economically
    - ✓ vulnerable or backward classes of the society and other categories of persons specified by the Authority
    - ✓ the ability to meet the obligation to underwrite insurance business in third party risks of motor vehicles as specified by the Authority in respect of general insurance companies;
    - ✓ the planned infrastructure of the applicant;
    - ✓ the proposed business expansion plan for five succeeding years, including establishment of place of business in rural areas, to effectively carry out the insurance business;
    - ✓ and other relevant matters for carrying out the provisions of the Act.
2. During the process, IRDAI raises queries, seeks clarifications/documents if required. The application and submissions made by the applicant are examined from all perspectives including the financial, investment, corporate governance, solvency,

actuarial etc. by respective Departments. On receipt of satisfactory notes from various departments, the R1 application is taken to the Board for approval.

3. The Authority on being satisfied with the information submitted and on verification that-
   - ✓ the requisition in Form IRDAI/R1 is complete in all respects and is accompanied by all documents required therein; and
   - ✓ the applicant shall carry on all functions in respect of the insurance business including management of investments within India as may be specified; may accept the requisition and issue the application for registration to the applicant.
4. Once the Board approves, R1 clearance letter is issued to the applicant along with conditions if any, noted and advise them to make their compliance and file R2 application accordingly.

R2 Stage :

1. Application for registration R2 is filed by the applicant as prescribed under IRDAI (Registration of Indian Insurance Companies) (Seventh Amendment) Regulations, 2016.
2. The R2 application must include the following-
   Provided that in case of the Indian promoter being Limited Liability Partnership, such affidavit shall be signed by the Designated Partner
   - ✓ Evidence of having rupees one hundred crore or more paid up equity share capital, in case the application for grant of certificate is for life insurance business or general insurance business or health Insurance business;
   - ✓ Evidence of having rupees two hundred crore or more paid up equity share capital, in case the application for grant of certificate is for re-insurance business;
   - ✓ An affidavit by the promoters and foreign investors of the applicant certifying that the requirements of the second proviso to section 6(1) of the Act to the effect that paid-up equity capital is adequate after excluding any preliminary expenses of the company have been satisfied;
   - ✓ A statement indicating the distinctive numbers of shares issued to each Indian promoter and Investors in respect of share capital of the applicant
   - ✓ An affidavit by the managing director, chief executive officer or whole-time director of the Indian promoters and the foreign investors of the applicant certifying that the holding of foreign paid up equity capital, referred to in sub-clause (b) of clause (7A) of Section 2 of the Act, is calculated in accordance with Indian Insurance Companies (Foreign Investment) Rules, 2015 read with Regulation 11 of these Regulations and does not exceed forty nine percent of the total paid-up equity capital of the applicant company:
   - ✓ In case of there being foreign investment in the applicant, an affidavit by the managing director, chief executive officer or whole-time directors and the Indian promoters and Foreign Investors of the applicant certifying that the company is “Indian owned and controlled” as per clause (b) of sub-section (7A) of the section 2 of the Act read with Indian Insurance Companies (foreign Investment) Rules, 2015 and Guidelines issued by the Authority on “Indian Owned and Controlled” as amended from time to time;
   - ✓ Where the foreign direct investment is more than 26 percent, a certified copy of the approval given by FIPB in accordance with Indian Insurance Companies (Foreign Investment) Rules, 2015;
   - ✓ A certified copy of the published prospectus, if any

- ✓ A certified copy of the standard forms of the insurer and statements of the assured rates, advantages, terms and conditions to be offered in connection with insurance policies together with a certificate by an actuary in case of life insurance business that such rates, advantages, terms and conditions are workable and sound;
- ✓ A certified copy of the Memorandum of Understanding or Management Agreement or Shareholders Agreement or Voting Rights Agreements or any other agreements in whatsoever form entered into between the Indian promoters and the foreign investors, if any, or amongst the promoters as a whole including details of the support / comfort letters exchanged between the parties;
- ✓ Proof in support of payment of the non-refundable fee of rupees five lakh.
- ✓ A certificate from a practicing chartered accountant or a practicing company secretary certifying that all the requirements relating to registration fees, equity share capital, and other requirements of the Act have been complied with by the applicant;
- ✓ Any other information required by the Authority during the processing of the application for registration

3. While considering the application the following areas are also examined i.e.
    - ✓ The nature of insurance products;
    - ✓ The level of actuarial, accounting and other professional expertise within the management of the applicant company;
    - ✓ The organisation structure of the applicant to carry on all functions in respect of the insurance business including management of the investments within its own organisations;
    - ✓ All other relevant matters for carrying out the provisions of the Act
4. During process of R-2 application, IRDAI raises queries, asks for clarifications/documents if required. The application and submissions made by the applicant are examined from all angles including by respective Depts. After receipt of satisfactory notes from various departments, the R2 application is taken to the Board for approval.
5. Once the Board approves, R2 clearance letter is issued to the applicant along with conditions if any, stipulated by other departments and advise them to make their compliance accordingly for issuance of Certificate of Registration (R3).

R3 Stage :

1. The applicant then makes its submissions for compliance with the conditions of R-2 and requests for issuance of Certificate of Registration R-3 (CoR).
2. IRDAI examines R-3 request along with the following that-
    - ✓ The applicant is eligible, and in its opinion, is likely to meet effectively its obligations imposed under the Act;
    - ✓ The financial condition of the promoters, foreign investors and the general character of the management of the applicant are sound;
    - ✓ The volume of business likely to be available to, and the capital structure and earning prospects of the applicant will be adequate;
    - ✓ The interests of the general public will be served if the certificate is granted to the applicant in respect of the class of insurance business specified in the application; and
    - ✓ The applicant has complied with the provisions of sections 2C, 5, 31A and 32A of the Act and has fulfilled all the requirements of these sections applicable to it. may register the applicant as an insurer for the class of

business for which the applicant is found suitable and grant the applicant the certificate in Form IRDAI/R3: Provided that the Authority may impose such conditions as may be deemed fit at the time of grant of the Certificate of Registration. The applicant shall be bound by the conditions subject to which the certificate in Form IRDAI/R3 has been issued.

3. IRDAI examines if the submissions at R-3 stage are satisfactory and are in order and after being satisfied, issues the CoR. It may be noted that the Chairman is empowered to issue the CoR and the matter is not required to be placed before the Board for approval.
4. Due diligence in respect of CEO (Designate) if pending is taken up separately while processing application for CEO appointment / remuneration as per Corporate Governance Guidelines, 2016.

Though the above are broad in nature, IRDAI takes up the specific issues related to any of the requirements and examines the applications comprehensively before a Certificate of Registration is finally issued.

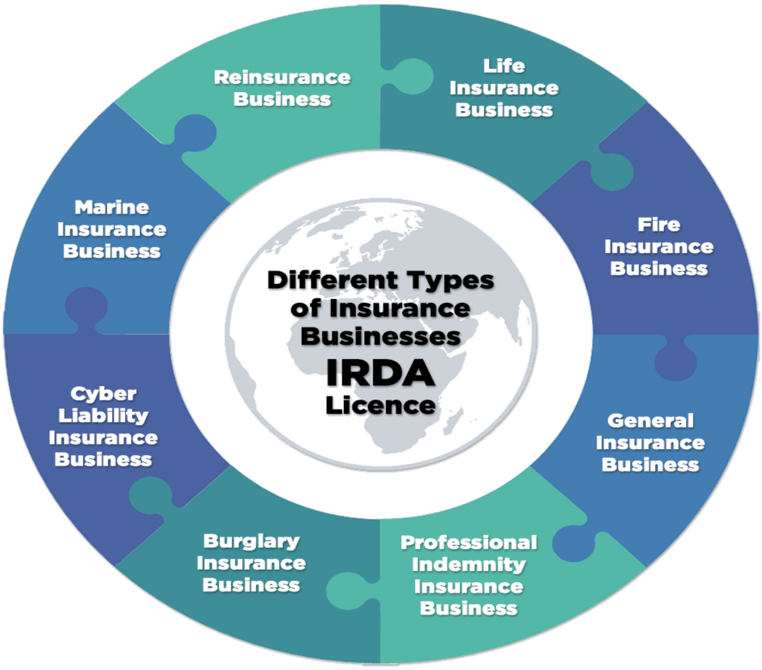

Fig2.1 IRDA License

Documents Required to Obtain Insurance Company License :

A candidate who wants to obtain insurance company license needs to file an application to the IRDAI in form IRDAI/R1 for an issuance of a demand for the registration application.

Documents that will support the application are:

- ✓ Applicant is a company formed under Companies Act 2013
- ✓ Certified of MOA and AOA
- ✓ Details of the directors such as- name, address and occupation
- ✓ Certified copy of the annual report of Indian promoters and foreign investors for the preceding last five years
- ✓ Certified copy of the shareholding agreement between Indian Promoters and foreign investors of the applicant
- ✓ Five-year business plan accepted by the Board of Directors

Application for Registration of Insurance Company License :

When the authority acknowledges the application for demand, the candidate will apply in Form IRDAI/R2 for the issuance of certificate of registration.

The application will contain the accompanying data :

- **Application for Life Insurance/General Insurance/Health Insurance**
  Evidence expressing that settled up value capital is more than Rs. 100 crore or more;
- **Application for reinsurance business**
  Evidence is expressing that settled up value capital is more than Rs. 200 crore or more;
- An affidavit provided by the Indian and foreign promoters affirming that the paid up equity capital is sufficient enough after barring preliminary expenses.
- Articulation of shareholding containing the distinctive number of shares gave to promoters;
- CEO, MD, WTD of Indian developers and foreign investors stating that the holding of remote paid-up equity capital is being calculated as referenced under the Indian Insurance Companies (Foreign Investment) Rules, 2015 read with different principles identified with it.
- FIPB approval if the FDI surpasses the restriction of 26%;
- Certified copy of published prospectus;
- Certified copy of MOU or any kind of agreement entered between the promoters such as-management agreement or shareholder agreement or voting agreement or any other kind of agreement;
- Confirmation of payment of expenses of rupee five lakh, which is non-refundable;
- PCA or PCS certificate affirming the consistence of registration charges, value share capital, other demands of the Act;

The authority in the wake of getting the application will take into the thought of the nature of insurance items, the degree of actuarial, bookkeeping and other expert specialists in the administration, the association structure. The authority will issue the certificate to the applicant in Form IRDAI/R after conducting an inquiry and feeling satisfied. The Authority may dismiss the application in the event they don't feel contended with the data gave by the candidate for the purpose of obtaining insurance company license.

The rejection will be conveyed to the candidate within the thirty days from the day of the order of rejection went with the ground of rejection. A candidate can speak to SAT within 30 days of receipt of dismissal order.

The candidate who has received the certificate of insurance company license must commence its business within 12 months of getting the certificate.

Registration Procedure of Obtaining Insurance Company License :

- A candidate can record an application for extra security or General Insurance organization or Health Insurance Business solely or Reinsurance Business.
- In the wake of accepting an application, the Authority may ask additional data or explanation identified with the thought of an application.
- After fulfillment, the Authority may concede approval and candidate at that point document a further application in Form IRDAI/R2 for award of certificate of registration.
- The Authority may dismiss the application for issuance of an order for an registration form by recording the explanation recorded as a hard copy.
- A candidate who is wronged by the choice will record an intrigue to Securities Appellate Tribunal inside 30 days of dismissal correspondence got.

Circumstances under which an applicant is not eligible to file an application under IRDAI/R1 :

- In case the authority has rejected your request for registration
- If foreign investors or Indian investors has decided to leave the project for any reason
- Time during the preceding two financial years from the date of requisition for registration application
- The Authority has dismissed the application for registration or pulled back by the candidate under any conditions whenever during the former two monetary years from the date of order for registration application;
- If controlling authority has abandoned your Certificate of Registration;
- In case applicant's name does not have the word 'insurance' or 'assurance'

Suspension of Certificate of Insurance Company License

- Neglects to conform to the arrangements of the activities identified with the estimation of benefits and liabilities.
- The insurer is in liquidation or is declared as a wiped out.
- The business or a class of the matter of the guarantor has been moved to any individual or has been moved to or amalgamated with the matter of some other safety net provider without the approval of the Authority.
- Default in consenting the provisions of the Act, or Rule or Regulations or direction or order gave by the Authority.
- Any case stays unpaid for over 3 months after the judgment is passed in court.
- Insurer conveys business other than Insurance business or recommended business.
- Defaults in consenting to the necessity of Companies Act, 2013, General Insurance Business Act, 1972 or Foreign Exchange Management Act, 1999 or Prevention of Money Laundering Act, 2002.
- Neglects to pay the yearly charges determined under Act.

7.7 INTRODUCTION TO INSURANCE ACCOUNTING BASICS :

Let's dive into some of the fundamental factors of insurance accounting that make it unique from other industries. With a better understanding of these industry-specific attributes, you can implement proper insurance accounting practices for your business.
Property/Casualty Insurance vs. Health/Lifestyle Insurance
The first thing to note is that the insurance industry is generally divided into two overarching specialties:

1. **Property/Casualty:** This category of insurance policies is designed to protect against liability and cover damages. Property insurance protects property in the case of damage or theft, or protects the owner if someone is injured on their property. Casualty insurance helps protect individuals from liability if they are responsible for damaging another person's property or causing an accident that resulted in injuries to another person.
2. **Health/Lifestyle:** Health and lifestyle insurance policies such as dental, life, vision, disability, estate planning, and more are designed to cover individual lifestyle needs and medical requirements.

Whichever distinction your insurance business falls under will impact certain aspects of your accounting practices. A few of the important differences are:

- **Varying contract durations:** Health/life insurance policies typically have a long-term contract, while property/casualty insurance policies typically have a shorter-term contract.

- **Predictability of claim outcomes:** Health/life insurance policies have pre-set terms that establish parameters for claim outcomes. However, property/casualty insurance policies are much less predictable because there are external factors that can significantly impact claim outcomes.
- **Asset categories:** For property/casualty insurance, the primary asset categories are bonds, common stocks, and reinsurance recoverable. For health/lifestyle insurance, the primary asset category is commercial mortgages.

Which Accounting Method Should Insurance Companies Use?

The accounting method you use for your insurance company will determine when you track expenses and income. There are two general accounting methods:

- **Cash-basis accounting:** Transactions are recorded when money changes hands.
- Using the cash-basis accounting method, you would not record a policy that's been sold until you receive the payment from the customer.
- **Accrual-basis accounting:** Transactions are recorded as soon as the income is earned or an expense is incurred.
- Using the accrual-basis accounting method, you would record the sale of a policy when the agreement is signed, regardless of whether the customer pays at that time or later.

When considering cash vs. accrual accounting, it can be tempting to lean toward cash-basis accounting because of its simplicity. However, accrual-basis accounting will give you a better long-term view of your business's financial health and allows you to account for insurance policies when they are sold—on the basis that you have the reasonable expectation that the policyholder will pay their premium—instead of when the premium is paid.

Unique Transactions That Apply to Insurance Accounting

Due to the nature of the insurance industry, there are certain unique transactions that need to be accounted for, such as:

- **Premium payments:** The amount you have been paid as a premium on a policy is accounted for as income. Policy premiums will be your primary source of income.
- **Claim payment:** Claims paid out to a policyholder are accounted for as an expense.
- **Interest payments:** If any interest is required on a claim payout, this will also be accounted for as an expense.
- **Reserves:** The amount your insurance agency needs to have for future payouts. These amounts are recorded as liabilities.
- **Agent commissions:** The commission agents earn when they sell a policy is recorded as an expense.

Statutory Accounting (SAP) :

Due to the unique financial relationships that insurance companies have with policyholders, there are a **separate set of accounting principles** that apply to insurance accounting, known as the Statutory Accounting Principles (SAP). The SAP revolves around three core values that are **designed to protect policyholders :**

1. **Conservatism:** Conservative valuations are necessary because expenses and income for policies are not recorded following the matching principle. The conservative approach is taken to protect the interests of policyholders by operating under the assumption that if the company had to liquidate immediately, it would ensure that it is able to meet its obligation to pay out policyholders with the actual income it has available.
2. **Recognition:** Only liquid, readily marketable assets should be accounted for on the balance sheet. Illiquid assets (such as equity) are counted against surplus once

acquired. This practice is used because only liquid assets can be accessed to pay out policyholders when needed.

3. **Consistency:** Accounting principles should be consistently applied period-over-period in order to establish useful financial records that can be used for comparison.

All insurance companies are **required to use statutory accounting** when preparing their financial statements because of the risky nature of the industry. This risk is due to the fact that insurance companies are wagering that only a small number of policyholders are going to need to collect on their coverage amounts and that their revenue from policy sales will cover these payouts. However, if the payouts exceed the amount of liquid assets the company has, it may have to file bankruptcy and potentially even be dissolved completely. So, in order to protect the financial well-being of your company and uphold your responsibility to policyholders, it is essential that you follow statutory accounting principles.

The General Accepted Accounting Principles (GAAP) are the accounting procedures followed by the majority of industries, whereas SAP are the accounting procedures used by insurance companies. While SAP falls under the GAAP, there are certain aspects that make this set of procedures different:

SAP :

- ✓ The goal of financial statements prepared using SAP is to evaluate an insurance company’s ability to pay out policyholders by assessing the business’s value based on the hypothetical situation where it would cease operations.
- ✓ SAP are set forth by the National Association of Insurance Commissioners (NAIC).
- ✓ SAP focuses on protecting policyholder interests to ensure entitled benefits can be paid.
- ✓ States have regulatory authority over how insurance companies implement SAP.
- ✓ In SAP, many assets are not included in financial statements.
- ✓ Under SAP, expenses are accounted for as soon as the sale on a policy is made.

GAP *:*

- ✓ In the case of GAAP, financial statements are used to evaluate the profitability of a business now and in the future.
- ✓ GAAP are regulated by the Financial Accounting Standards Board (FASB).
- ✓ GAAP focuses on protecting lenders and investors.
- ✓ GAAP is federally regulated.
- ✓ All assets are included in GAAP.
- ✓ The matching principle is used to account for expenses under GAAP.

Understanding these principles is important for correctly implementing statutory accounting at your business.

7.8 TAXING INSURANCE IN INDIA :

The primary regulator for insurance in India is the Insurance Regulatory and Development Authority of India (IRDAI) which was established in 1999 under the government legislation called the Insurance Regulatory and Development Authority Act, 1999. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014. On 16th September 2013, the Insurance Regulatory and Development Authority (IRDA) launched the Insurance Repository in India. The Insurance Business in India is governed by a number of acts.

TDS on Insurance Commission : As per Section 194D of Income Tax Act, Person responsible for paying to a resident commission or otherwise for soliciting or procuring insurance business including continuance, renewal or revival of policies is required to deduct TDS.

- ✓ The rate of TDS is 5%
- ✓ Moreover, if PAN is not quoted, the rate of TDS will be 20% in all cases.
- ✓ The Individual having Commission income, required to submit Income tax return in ITR – 3.

NO TDS :

- ✓ Insurance commission paid or credited, not exceeding ₹ 15,000.
- ✓ A person other than a company or firm may furnish a declaration in writing in Form No.15G/15H to the payer stating that there is no tax payable on his/her total income, subject to conditions

TDS on Life Insurance Maturity Value Under section 194DA, the tax shall be deducted at source (TDS) on payments of maturity value if:

- ✓ such amount is not exempt under section 10(10D), or
- ✓ such amount is not more than ₹ 1 lakh in a financial year.
- ✓ The rate of TDS is 1 %.

At the time of receipt of maturity value, the recipient is required to provide PAN details to the insurer. In case of failure to provided PAN details, TDS will be deducted @ 20%.

Inflated Insurance Premium :

Blame it on GST After the GST is implemented, insurance plans, including life, motor, and health would become more expensive, as taxes would be hiked. Although, the premium deciding factor of an insurance plan is subject to the insurance plan type you want to purchase but the 3 percent increase in GST is going to impact the insurance premium adversely.

Type of policy	**GST**	**Service**
Tax Pure risk insurance/term insurance	18%	15%
ULIPs	18%	15%
Annuity: single premium	1.8%	1.5%
Motor insurance	18%	15%
Endowment policies (1st year)	4.5%	3.75%
Endowment policies (2nd year onwards)	2.25%	1.88%

TAX Benefit on Insurance Investment : Payment of premium on life insurance policy and health insurance policy not only gives insurance cover to a taxpayer but also offers certain tax benefits. The following are the Benefits you can avail when you make the following **payments :** Deduction in respect of Life Insurance Premium, PPF, NSC, etc. [Section 80C] Taxpayer, being an individual or a Hindu Undivided Family (HUF), can claim deduction under section 80C in respect of premium on life insurance policy paid by him/it during the year. Overall deduction u/s 80C (along with deduction u/s 80CCC & 80CCD) allowed is up to ` 1, 50,000.
Deduction in respect of medical insurance premium [Section 80D]

As per section 80D, an individual or a HUF can claim deduction in respect of the Following payments:

- ✓ Medical insurance premium paid by assessee, being individual/HUF by any mode other than cash.

- ✓ Any contribution made by assessee, being individual to Central Government
- ✓ Health Scheme or such other Scheme as may be notified by the Central Government.
- ✓ Sum paid by assessee, being individual on account of preventive health check-up.
- ✓ Medical expenditure incurred by assessee, being individual/HUF on the health of a senior citizen person
- ✓ provided that no amount has been paid to effect or to keep in force an insurance on the health of such person Payment made via credit card/internet banking shall also be eligible for deduction.
- ✓ Deduction is allowed only if the payment is made from your own income during the previous year.
- ✓ Under this section, an amount of `25,000 is allowed to those individuals who have paid the amount towards a health insurance plan provided by the government for self or family on account of the health checkup of the policyholder or his family.
- ✓ An additional amount of `25,000 is allowed if the premium is paid towards the health checkup of parents whether dependent or not.
- ✓ For members above the age of 60 years, an amount of `30,000 maybe claimed as a deduction. For HUFs, the deduction is limited to `25,000 only if the amount has been paid for availing of the health insurance for one of the members of the HUF.
- ✓ In case the health checkup made is preventive in nature, then the deduction will go up by `5,000. However payment made by an assessee on account of preventive health check-up during the previous year as eligible for deduction within the overall limits prescribed in the section.

Section 10 (10D) :

- ✓ Any amount received under a life insurance policy qualifies for this deduction.
- ✓ A sum received could be Sum allocated by way of bonus, Survival benefit, Maturity benefit, Surrender value or Death benefit.
- ✓ There is no cap on maximum deduction allowed under Section 10 (10D).
- ✓ Neither any Income tax nor any TDS is deductible on such amount received.

7.9 ROLE OF COST & MANAGEMENT ACCOUNTANTS :

A Cost & Management (CMA) is well equipped to play different roles in General Insurance Industry. Apart from traditional sector, there is a vast scope for CMAs in providing professional services in the insurance sector. CMAs are equipped with world class financial competencies, analytical ability & excellent technical skills which make them world class professionals. The Cost & Management Accountants can play the following roles in the Insurance Sector:

Claims Administrator : The administration of insurance claims is of considerable importance, since the response time to these claims can be lengthy, and there is a high risk of claim rejection if the paperwork is not filled out properly. CMAs can provide their services by understanding the overall system of claim administration and assisting the concerned parties in documentation process.

Marketing and Distribution Channels : The financial services industry is an expanding, highly regulated field with many Cost & Management Accountants working in business and in practice. CMAs can help the public to appreciate the need for investment & financial planning. CMAs can render valuable advice to their clients in selecting among various alternative investment plans. Creating marketing strategies, conducting market research, developing brand positioning and promotional materials to develop and deliver products and services to meet customer needs.

Actuary : Data is the essence of the job of an actuary. CMAs with their expertise can assist in gathering, assembling and analyzing information to estimate the probability and likely costs of events such as death, sickness, injury, disability, or loss of property. CMAs can guide pension funds and various private companies to detect risks and help in designing procedures that can help mitigate risk. In other words, CMAs with expert knowledge on actuarial science can carry out actuarial services in a highly professional way.

Surveyor or Loss Assessor : Surveyors or Loss Assessors are professionals hired by insurance companies to assess the actual loss arising on the occurrence of fortuitous events such as fire, burglary and so on for settlement of claims. They act as intermediaries between the insurer and the insured in settling the claims. CMAs can be of immense help in estimation, measurement and determining the quantum and description of the loss and verify the cause and circumstances of the loss including extent of loss, nature of ownership and insurable interest.

Arbitration : Arbritation is a Procedure in which an insurance company and the insured or a vendor agree to settle a claim dispute by accepting a decision made by a third party. A CMA can assist the parties to a dispute either as a counselor he may decide on the dispute of the parties as an Arbitrator.

Insurance Investigator : Methods of defrauding insurance companies are manifold, as are the means of investigating them. An insurance investigator examines insurance claims that are suspicious or otherwise in doubt e.g. in case of a false claim the professional can investigate on the amount of loss actually suffered by the insured and the compensation claimed by the insured from the Insurance Company.

Risk Manager : Insurance companies operate under the increased scrutiny of an ever-changing regulatory environment. Risk managers are expected to fully understand how changes at the federal and state level impact their organizations. Cost Accountants can definitely help the board understand the top risks for the organization. Recommend and implement preventative measures to minimize costs and damage should a loss occur (such as disaster recovery plans, emergency evacuations and purchasing insurance).

Third Party Administrator : TPAs function as intermediaries between the insurance provider and the policyholder and facilitate processing of claims and settlement. Due to heavy amount of accounting data, the function of TPAs can be best performed by CMAs.

7.10 SUMMARY :

Regulation is the result of pressures from business, consumers, and environmental groups and results in regulation, which supports business and protects consumers, works, and the environment. Regulation is undertaken to ensure that the economic system operates in a manner consistent with the public interest and to overcome market failures. Regulation is an activity carried out on regular basis by the government by which it tries to direct, control and modify the behavior of its citizens, organization and business entities operating within its boundaries in a desired way so as to achieve an equalitarian growth and development of the country. It is a process enacted by the law that supervises or controls some specific activities made by the affected firms and it is planned in such a way that it protects the public from exploitation by industries with monopoly power. So government agencies will regulate the specified task of administering and enforcing the law. While enforcing the regulatory law, these agencies are actively supported by the courts.

We have seen the impressive growth in the insurance sector so far, but there needs to be a sustained effort to retain the growth momentum. Cost Accountants have been already providing valuable services in the various departments of life and non-life insurers and other intermediary services such as internal audit, management consultancy services, strategic consultancy services, investigation etc. Insurance companies in India have strived hard to create financial awareness and increase insurance penetration in the country. As the country strides into a new economic phase, we hope that the industry gets the attention and support that it rightfully deserves.

7.11 KEYWORDS :

1. **Arbitration** is a Procedure in which an insurance company and the insured or a vendor agree to settle a claim dispute by accepting a decision made by a third party.
2. **Premium payments:** The amount you have been paid as a premium on a policy is accounted for as income. Policy premiums will be your primary source of income.
3. **Claim payment:** Claims paid out to a policyholder are accounted for as an expense.
4. **Interest payments:** If any interest is required on a claim payout, this will also be accounted for as an expense.
5. **Reserves:** The amount your insurance agency needs to have for future payouts. These amounts are recorded as liabilities.
6. **Agent commissions:** The commission agents earn when they sell a policy is recorded as an expense.

7.12 SELF ASSESSMENT QUESTIONS :

1. Define Regulation
2. Explain concepts of Financial Regulation
3. Explain concepts Insurance Regulation
4. Define Insurance Contract
5. Explain steps in Registration and Licensing process
6. Explain Introduction to Insurance Accounting Basics
7. Briefly write short notes on Taxing Insurance in India
8. Explain Role of Cost & Management Accountants

7.13Suggested Readings

1. M C Khandelwal Sugan C Jain((2015), Accounting Standards and Policies, PointerPublishers, Jaipur
2. Dr. Jawahar Lal(2015), Accounting theory and practice, Third Edition, HimalayaPublishing House, Mumbai, ISBN 9789350513804
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4. SP Jain, KL Narang(2013), Advanced Accounting, Volume II, Nineteenth revised edition,Kalyani , Publishing House, ISBN 9789327229042
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LESION – 8

NATURE OF INSURANCE COMPANIES & UNDERWRITING IN INSURANCE BUSINESS

LEARNING OBJECTIVES :

- ❖ To know the deferent types of organizations in insurance system
- ❖ To understand the organizational structure of insurance system
- ❖ To know various functions of insurance companies.
- ❖ To examine the role of insurance in India

STRUCTURE OF THE LESSON :

8.1. Introduction
8.2. Types of insurance companies
8.3. Organisational structure of the insurance company
8.4. Functions of insurance
8.5. Principles of insurance
8.6. Major functions of insurance
8.7. Underwriting in Insurance Business
8.8. Summary
8.9. Key words
8.10. Self – assessment questions
8.11. Further readings

8.1. INTRODUCTION :

Insurance companies are organizations that provide financial protection against potential losses, such as accidents, illnesses, or property damage. They do this by selling insurance policies to individuals and businesses, which provide a specified amount of coverage in the event of a loss. In this type of contract, the insurer promises the insured party that he will save or indemnify him from losses caused by a particular contingent event, on the payment of an amount called "premium" An insurance premium equates to the money that is paid by any person or company/business for availing of an insurance policy. The insurance premium amount is influenced by multiple factors and varies from one payee to another. By nature insurance is a devise of sharing risk by large number of people among the few who are exposed to risk by one or the other reason. If a large number of subscribers to insurance serve the purpose of compensation to few among them exposed to uncertain risks appears as a co-operative look. Nature of Insurance: Insurance is a business that is based on risk management. Insurance companies use actuarial science to assess the risk of potential losses and determine the premium rates that they will charge. Insurance coverage can be defined as a contract in the form of a financial protection policy. This policy covers the monetary risks of an individual due to unpredictable contingencies. The insured is the policyholder whereas the insurer is the insurance-providing company/the insurance carrier/the underwriter.

8.2. TYPES OF INSURANCE ORGANIZATIONS :

Types of insurance firms represent various ways companies raise capital to start a company and enroll their insurance prospects.

Model of insurance companies

Government Insurance	The government is an insurance organization that provides life and health insurance to its employees and other citizens through a number of programs. These government programs also include Medicaid, the Social Security Medicare program, disability insurance and death benefits.
Lloyd's Associations for Insurance	It is not as common as stock or mutual. A reciprocal member agrees to share the insurance obligations with all other members of the unincorporated community. Both members insure each other and share the losses. A reciprocal is handled by an attorney-in-fact approved to handle all reciprocal business. It is a mutual group of people who choose to exchange insurance contracts. Each entity, or "syndicate," is responsible for the insurance sums they write.
Fraternal benefit societies for Insurance	A fraternal benefit society is an organized society or order working on the lodge basis without capital stock and operated solely to benefit its members and beneficiaries and not for profit. Fraternals sell protection only to their members. Most write just life insurance.
Risk retention groups and Purchasing groups	To allow pharmaceutical makers more choice when insuring against product liability. To encourage this process, it is allowed product manufacturers to create group self-insurance plans or group captive insurance firms, called risk retention groups (RRGs), shield them from exposure to product liability, and buy group-based liability insurance by purchasing groups (PGs). This was achieved by restricting the power of states to administer product liability insurance. Risk-retention groups and buying groups are limited. This exempts them from state benefits and guarantee funds.
Self-insurance	Some businesses and individuals prefer self-insurance. With this option, part or all of the risk of loss is borne without insurance coverage to fall back on when a loss occurs. Many big corporations are self-insured because they can absorb accidents, and their knowledge with lawsuits shows that self-insurance is cheaper than insurance coverage.
Governmental Insurers	Insurance companies may own or operate by state or federal government. The government often steps in to offer insurance not usually available from private insurers. Such insurance is also called residual market insurance. The government provides: • War risk insurance; • Nuclear-energy insurance; • Flood insurance; • Crop insurance. At the state level, the government is interested in providing unemployment insurance and can offer employees compensation payments through state funds
Cooperative insurance	Co-operative insurance organizations are those concerns which are incorporated and registered under co-operative societies act. The concerns are also called 'co-operative insurance societies'. These societies like mutual companies are a non-profit organization. The aim is to provide insurance protection to its members at the lowest reasonable price.

Joint stock companies	The joint stock companies are those which are organized by the shareholders who subscribe the necessary capital to start the business, are formed for earning profits for the stockholders who are the real owners of the companies. The management of a company is entrusted to a board of directors who are elected by the shareholders from among themselves. Before nationalization, according to insurance act, 1938, the policy-holders had a right to elect their representatives to the board of directors to the extent of one-fourth of the total number of directors of the company. Most of the insurance businesses were done on a joint stock basis before nationalization.
Partnership insurance	A partnership firm can also carry on the insurance business for the sake of profit. Since it is not an entity distinct from the persons composing it, the personal liability of partners in respect of the partnership debts is unlimited. In case of huge loss, the partners have to pay from their own personal funds and it will not be profitable for them to start an insurance business. In the early period before the advent of joint stock companies, many insurance undertakings were a partnership or unincorporated companies.
Individual insurer	An individual like other business can perform the business of insurer provided he has sufficient resources and talent of the insurance business. The individual organization has been rare in the field of insurance.

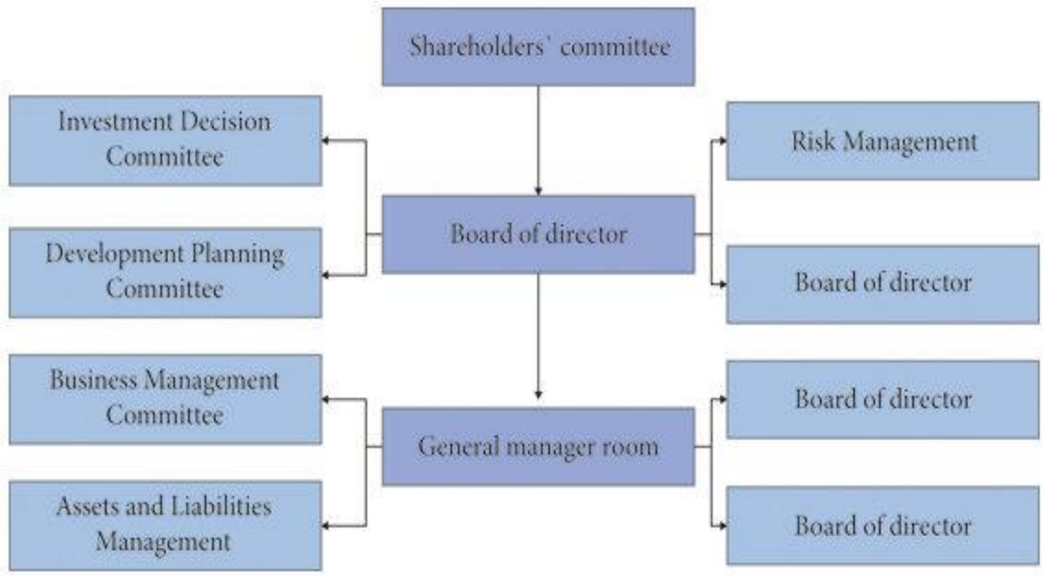
8.3. ORGANISATIONAL STRUCTURE OF THE INSURANCE COMPANY :

Insurance companies are generally organized in five broad departments: claims, finance, legal, marketing and underwriting. Marketing and underwriting are the “yes” departments, while claims and finance are the “no” departments. The legal department is often the referee between these competing interests. Underwriters seek to develop insurance products that can be sold to their customers for a profit. Though many standard insurance policies are made up of form documents, most underwriting departments will craft their own collection of forms and endorsements to provide the marketing department with the ability to say yes to customers and potential customers. While the underwriting and marketing departments want to sign up as many insured’s as possible to collect premiums, the claims department manages claims when an insured seeks to recover on its insurance assets.

When accommodation on a claim is requested by a good customer, or by a broker that brings the carrier a lot of business, the underwriting and marketing departments will sometimes intercede with the claims department. The marketing and underwriting departments are judged by their premium collections and retention ratios (i.e., the percentage of insureds who renew their policies with that insurer), while the claims department is judged by how little it incurs resolving claims. Thus, there is an inherent and perpetual tension among these departments. These financial measures drive insurance company management and profits, as well as the bonuses paid to department management.

Organizational Structure : The organizational structure of an insurance company generally depends on the company's size, age and specialty. Most of the time, it will start with a functional structure where workers are organized vertically based on what they do. From there, the company will often move into a divisional structure, where individual teams handle specific concerns. Large insurance companies that branch out into multiple offices have a choice between a centralized and a decentralized version of their current structure. This determines the level of autonomy of the individual branches.When most businesses start out, they use a common organizational chart. This breaks down to a leader, one or two managers, and a large pool of workers. Insurance companies, however, even new ones, are far too complex for that simple structure. Instead, they typically start out with a functional structure. A functional organizational structure, a person's job determines his or her position in the company. If the worker is an adjuster, he or she is in the adjustor group, an underwriter is in the underwriter group, and so on. This works very well for smaller offices where there are only a handful of people in any one group. When the company begins to expand, the functional structure tends to isolate one group from another, and that division may negatively impact the company.

A Model Of Insurance Company Organization :



Definition : Insurer also called 'insurance company' is the entity that accepts the risk and promises to pay for the losses that arise within the policy term. The insurer commits to pay for loss in exchange of the premiums, paid regularly.

Description: In an insurance contract, the insurer is one of the parties involved that promises to pay for the financial losses that may arise after an unfortunate event. The insurance company has the capacity to absorb the losses suffered by the insured.

- Insurer is an entity that sets the conditions for the coverage under the insurance agreement. Apart from it, an insurer is responsible to issue a policy and pay for the claims.
- Before accepting a risk proposal, an insurer evaluates the probability of risk occurrence. If underwriting the proposal or accepting the risk is favorable, only then the insurer provides financial compensation when an unexpected or bad event takes place.

Example: Ramanath bought a term plan from LIC Insurance Company Limited. The company here is the insurer that promises to reimburse Ramanath (insured) under the term plan if he dies within the policy term.

Functions Of Insurance : Insurance is defined as a contract, which is called a policy, in which an individual or organization receives financial protection and reimbursement of damages from the insurer or the insurance company. At a very basic level, it is some form of protection from any possible financial losses. The basic principle of insurance is that an entity will choose to spend small periodic amounts of money against a possibility of a huge unexpected loss.

Basically, all the policyholder pool their risks together. Any loss that they suffer will be paid out of their premiums which they pay. Hence, based on some principles the insurer has perform his functions.

8.5. PRINCIPLES OF INSURANCE :

As we discussed before, insurance is actually a form of contract. Hence there are certain principles that are important to ensure the validity of the contract. Both parties must abide by these principles.

1. ***Utmost Good Faith:*** A contract of insurance must be made based on utmost good faith. It is important that the insured disclose all relevant facts to the insurance company. Any facts that would increase his premium amount, or would cause any prudent insurer to reconsider the policy must be disclosed. If it is later discovered that some such fact was hidden by the insured, the insurer will be within his rights to void the insurance policy.
2. ***Insurable Interest:*** This means that the insurer must have some pecuniary interest in the subject matter of the insurance. This means that the insurer need not necessarily be the owner of the insured property but he must have some vested interest in it. If the property is damaged the insurer must suffer from some financial losses.
3. ***Indemnity:*** Insurances like fire and marine insurance are contracts of indemnity. Here the insurer undertakes the responsibility of compensating the insured against any possible damage or loss that he may or may not suffer. Life insurance is not a contract of indemnity.
4. ***Subrogation:*** This principle says that once the compensation has been paid, the right of ownership of the property will shift from the insured to the insurer. So, the insured will not be able to make a profit from the damaged property or sell it.
5. ***Contribution:*** This principle applies if there are more than one insurer. In such a case, the insurer can ask the other insurers to contribute their share of the compensation. If the insured claims full insurance from one insurer he loses his right to claim any amount from the other insurers.
6. ***Proximate Cause:*** This principle states that the property is insured only against the incidents that are mentioned in the policy. In case the loss is due to more than one such peril, the one that is most effective in causing the damage is the cause to be considered.

8.6. MAJOR FUNCTIONS OF INSURANCE :

Major functions of insurance may be categorised as below: 1. Primary Functions 2. Secondary Functions 3. Other Functions

1.Primary Functions The primary functions of insurance include the following :

- **Provide protection:** The primary purpose 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 the losses of risk. Professor Hopkins observes, "Insurance is a protection against economic loss by sharing the risk with others." He further adds "Insurance is the protection against economic loss".
- **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 longer people. Similarly, William Bevrigdge observes. "The collective bearing of risks is insurance." All the insured’s contribute the premiums towards a fund and out of which the persons exposed to a particular risk is paid. Similarly, Rigel and Miller

observe. "Insurance is a device whereby the uncertain risks may be made more certain."

- **Evaluation 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.
- **Provide certainty against risk:** Insurance is a device which helps to change from uncertainty to certainty. This may the reason that the function of insurance is to provide certainty. Similarly, Riegel and Miller observe, "The function of insurance is primarily to decrease the uncertainty of events."
- **Spreading risks:** One of the natural phenomena of insurance is spreading or distributing risks.

II Secondary Functions :

- **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. Prevention of losses cause lesser payment to the assured by the insurer and this will encourage for more saving by way of premium. Reduced rate of premiums stimulate for more business and better protection to the insureds. The loss Prevention Association of India formed by the Insurers, alerts the people about future risks and uncertainties through publicity measures.
- **Small capital to cover larger risks:**Insurance relieves that the businessmen and others from security investments, by paying small amount of premium against larger risk and uncertainty. There is no need for them to invest separately for security purpose and this money can be invested in other activities.
- **Contributes towards the development of larger enterprises:** Insurance provides development opportunity to those larger enterprises having more risks in their setting up. Even the financial institutions may be prepared to give credit to sick industrial units which have insured their assets including plant and machinery.

III Other Functions :

There are indirect functions of insurance which benefit the economy indirectly. Some of such functions are:

- **Means of savings and investments:** Insurance serves as savings and investment. Insurance is a compulsory way of saving and it restricts the unnecessary expenses by the insureds. For the purpose of availing income-tax exemptions also, people invest in insurance. Although investment is not the primary function of insurance investment service is proved to be an important benefit of insurance.
- **Source of earning foreign exchange:** Insurance is an international business. The country can earn foreign exchange by way of issue of marine insurance policies.
- **Promotes exports:** Insurance makes the foreign trade risk free through different types of policies issued under marine insurance cover. In case of loss of cargo and others due to nerine perils the insurance makes good the loss.
- **Provides social security:** Through various social protection plans, the insurance provides social security to people. It not only provides security at the time of death but also provides assistance to the insureds at the time of sickness, old age, maternity etc.

8.7. UNDERWRITING IN INSURANCE BUSINESS :

The term "underwrite" originates in the 17th century when marine vessels would be underwritten for insurance risk for overseas voyages. The insurance company would subscribe (literally to write underneath or under-write) the policy by signing their name at the bottom of the document and acknowledging consent that the policy is in force

Underwriting is one of the most important functions in the financial world wherein an individual or an institution undertakes the risk associated with a venture, an investment, or a loan in lieu of a premium. Underwriters are found in banking, insurance, and stock markets.The nomenclature ‘underwriting’ came about from the practice of having risk takers to write their name below the total risk that he undertakes in return for a specified premium in the early stages of the industrial revolution.

In the insurance world, underwriters determine whether an insurance agency should undertake the risk of insuring a client. They determine the risk and exposure of clients and also how much insurance should be granted to a client, how much they should pay for it and whether or not to offer an insurance policy to the client in the first place.

Insurance underwriting is defined as: “The process of choosing who and what the insurance company decides to insure. This is based on a risk assessment. It is pretty much the "behind the scenes" work in an insurance company where they determine who is insured and how much in insurance premium, they will charge the insured person”. Insurance underwriting also involves choosing who the insurance company will not insure

Underwriting in insurance: “Underwriting is the process insurers use to determine the risks of insuring your small business. It involves the insurance company determining whether your firm poses an acceptable risk and, if it does, calculating a fair price for your coverage”.

Key Points You Understand :

- Underwriting is the process through which an individual or institution takes on financial risk for a fee.
- Underwriters assess the degree of risk of insurers' business.
- Underwriting helps to set fair borrowing rates for loans, establish appropriate premiums, and create a market for securities by accurately pricing investment risk.
- Underwriting ensures that a company filing for an IPO will raise the capital needed and provide the underwriters with a premium or profit for their services.
- Investors benefit from the vetting process of underwriting grants by helping them make informed investment decisions.

Who Is An Insurance Underwriter? :

Insurance underwriters are professionals who evaluate and analyse the risks involved in insuring people and assets. Insurance underwriters establish pricing for accepted insurable risks. The term underwriting means receiving remuneration for the willingness to pay a potential risk. Underwriters use specialized software and actuarial data to determine the likelihood and magnitude of a risk.

Does Underwriting Apply To All Forms Of Insurance? :

By definition, insurance involves individuals or businesses transferring their risks to an insurer, which charges a fee to provide financial assistance should a loss occur. However, before an insurance policy is provided, insurers must understand the nature and scope of the level of risk they’re taking on, which requires underwriting. Underwriting applies to all forms of small business insurance, including: General liability insurance- Business owner’s policy

(BOP)- Umbrella / excess liability insurance- Workers' compensation insurance- Commercial auto insurance etc.

Prime Objectives of Underwriting : 1. To reduce the possibility of adverse selection against the insurer. 2. Prudent underwriting reduces the chances of Physical, Moral, and Morale hazards.

8.8. TYPES OF UNDERWRITING :

There are basically three different types of underwriting: loans, insurance, and securities.

1. **Loan Underwriting:** All loans undergo some form of underwriting. In many cases, underwriting is automated and involves appraising an applicant's credit history, financial records, and the value of any collateral offered, along with other factors that depend on the size and purpose of the loan. The appraisal process can take a few minutes to a few weeks, depending on whether the appraisal requires a human being to be involved.

   The most common type of loan underwriting that involves a human underwriter is for mortgages This is also the type of loan underwriting that most people encounter. The underwriter assesses income, liabilities (debt), savings, credit history, credit score, and more depending on an individual's financial circumstances. Mortgage underwriting typically has a "turn time" of a week or less.

   Refinancing often takes longer because buyers who face deadlines get preferential treatment. Although loan applications can be approved, denied, or suspended, most are "approved with conditions," meaning the underwriter wants clarification or additional documentation.

2. **Insurance Underwriting:** With insurance underwriting, the focus is on the potential policyholder—the person seeking health or life insurance. In the past, medical underwriting for health insurance was used to determine how much to charge an applicant based on their health and even whether to offer coverage at all, often based on the applicant's pre-existing conditions. Beginning in 2014, under the Affordable Care Act, insurers were no longer allowed to deny coverage or impose limitations based on pre-existing conditions.

   Life Insurance Underwriting seeks to assess the risk of insuring a potential policyholder based on their age, health, lifestyle, occupation, family medical history, hobbies, and other factors determined by the underwriter. Life insurance underwriting can result in approval—along with a range of coverage amounts, prices, exclusions, and conditions—or outright rejection.

3. **Securities Underwriting:** Securities underwriting, which seeks to assess risk and the appropriate price of particular securities—most often related to an IPO—is performed on behalf of a potential investor, often an investment bank. Based on the results of the underwriting process, an investment bank would buy (underwrite) securities issued by the company attempting the IPO and then sell those securities in the market.

   Underwriting ensures that the company's IPO will raise the capital needed and provides the underwriters with a premium or profit for their service. Investors benefit from the vetting process that underwriting provides and its ability to make an informed investment decision.

This type of underwriting can involve individual stocks and debt securities, including government, corporate, or municipal bonds. Underwriters or their employers purchase these securities to resell them for a profit either to investors or dealers (who sell them to other buyers). When more than one underwriter or group of underwriters is involved, this is known as an underwriter syndicate.

How Long Does Underwriting Take? :

The time frame for underwriting varies among different investment products, as the underwriter will have to spend some time examining the risk profile of each investment. Personal loans and insurance products are generally fairly simple to underwrite.

Personal Loans : For car loans, the process is managed by an algorithm that compares the applicant to other borrowers with a similar profile. This process takes only a few days at most, and in some cases, it is almost instantaneous.

Home mortgages tend to take longer because the underwriter will need to verify the borrower's income, employment, and credit history, which can take some time. Full approval for a home loan can take up to 45 days, although the underwriting process itself accounts for only a small part of this time frame.

Insurance : Underwriting insurance is the same as underwriting a loan, except that the insurers weigh the probability and size of the average claim compared to the premiums that they expect to collect. In the case of property and auto insurance policies, this is based on factors like the age of the insured, their geographical location, and their past history of making claims.

Life insurance policies are more complicated because they also account for the insured's medical history. Underwriting life insurance can also take a month or longer, although most decisions are issued in a few days.

Stocks And Bond Issues : Securities are the most complicated products to underwrite. When a company issues a bond or a stock offering, the underwriter (usually an investment bank) examines the company's accounts, cash flows, assets, and liabilities, and checks for any discrepancies. This can take anywhere between six and nine months.

8.9. PROCESS OF UNDERWRITING :

The underwriting process begins with an application evaluation from an underwriter. Underwriters are insurance professionals specializing in risk assessment and prevention. Simply put, they evaluate applications and decide how risky it is to cover something or someone—and how much it will cost the applicant for coverage.

The underwriting process may vary depending on the type of insurance you apply for. However, insurance underwriting typically follows some common steps, including:

1. Reviewing your application
2. Determining whether the insurance company should cover you
3. Recommending the kind of policy and conditions the insurance company should agree to
4. Searching for solutions that could reduce the frequency of future claims
5. Negotiating with insurance agents or brokers to find ways to cover you if there are any issues with your application
6. Assessing your coverage if you’ve made multiple claims, had trouble making payments, or are taking out a new policy

Typically, underwriting is part of the application approval process. However, an underwriter may be asked to review your profile, policies, and claims if your activity or risk changes. For example, if the insurance company notices a sudden uptick in claim payouts, they may review your case to determine if they need to adjust your policy conditions.

8.10. FACTORS THAT AFFECT THE UNDERWRITING PROCESS :

Underwriters consider numerous factors during the risk assessment process. These change from industry to industry. Some of the most common factors considered during the underwriting process include:

1. **Medical questions and exams:** Your age and health status are the most important factors in determining insurability and the amount you pay for insurance coverage. Health status is assessed through a physical exam, a health and medical history questionnaire, or a combination of both.
2. **Family health history:** Similarly, your family medical history could potentially impact your premiums. If your family has a history of certain diseases or conditions, your insurance provider may raise your premiums to offset their financial risk.
3. **Prescription history:** Your prescription history plays a key role in determining how much insurance coverage will cost. Insurance companies tend to look at your individual medical history to ensure you’re given a fair coverage decision. For example, you and another applicant may take the same medication for entirely different reasons, making it essential to understand your medical history before approving or denying your application.
4. **Tobacco use:** As a general rule, smokers or those with smoking-related medical conditions tend to get higher premiums than non-smokers.
5. **Occupation:** Your occupation may also impact your ability to get coverage. Most jobs are considered relatively safe. That said, some jobs come with higher mortality rates that could result in more claim pay-outs.For instance, those working in the fishing, hunting, and logging industries have some of the highest job mortality rates in the U.S. As a result, applicants may only qualify for flat-rate coverage, conditional policies, or get turned down.
6. **Driving record:** How’s your driving record? If you’ve got a history of unsafe driving, such as DUIs, speeding tickets, or car accidents, an underwriter may deem you too risky to insure. At the very least, your premium may be higher than someone with a solid driving record.
7. **Credit history:** It may not seem connected, but your credit history can have a direct impact on your monthly premiums. Some insurance companies even use a process called credit-based insurance scoring to predict an applicant’s risk.
8. **Lifestyle and hobbies:** Just like some jobs come with higher mortality rates, so do some lifestyle choices. For instance, if you regularly travel to dangerous locations or engage in hobbies like skydiving or aviation, an insurance company may charge higher rates to offset the risk of covering you.
9. **Citizenship status:** Finally, your citizenship status may impact your ability to get coverage. Some insurance providers won’t cover applicants with a green card or temporary visa.

Non-Life Insurance Underwriting Risks : Underwriting risk is the risk of loss, or of adverse changes in the value of insurance liabilities, due to inadequate pricing and provisioning assumptions. Non-life insurance underwriting risks are often divided into premium and catastrophe risks and reserve risk in order to separate the risks related to future claims of current insurance contracts and already incurred claims.

Premium Risk And Catastrophe Risk : Premium risk relates to future claims resulting from expected insured events which have not occurred by the balance sheet date. The frequency, severity and timing of insured events and hence future claims may differ from those expected. As a result, the claims cost for future claims exceeds the expected level and there is a loss or adverse changes in the value of insurance liabilities.

Catastrophe risk can be seen as an extreme case of Premium risk. It is the risk of low frequency, high severity extreme or exceptional events, such as natural catastrophes whose pricing and setting of provisioning assumptions include significant uncertainty. These events may lead to significant deviations in actual claims from the total expected claims resulting into a loss or adverse changes in the value of insurance liabilities.

Premium Risk And Catastrophe Risk Management And Control :

The Underwriting Committee (UWC) shall give its opinion on and propose actions in respect of various issues related to underwriting risk. The committee shall also consider and propose changes to the Underwriting Policy (UW Policy) that is the principal document for underwriting, and sets general principles, restrictions and directions for the underwriting activities. The Board of Directors of If P&C approves the UW Policy at least once a year. The Chairman of UWC is responsible for the reporting of policy deviations and other issues dealt with by the committee.

The UW Policy is supplemented with guidelines outlining in greater detail how to conduct underwriting within each business area. These guidelines cover areas such as tariff and rating models for pricing, guidelines in respect of standard conditions and manuscript wordings, as well as authorities and limits. In accordance with the Instructions for the Underwriting Committee, the Committee is responsible for monitoring compliance with the established underwriting principles.

The business areas manage the underwriting risk on a day-to-day basis. A crucial factor affecting the profitability and risk of non-life insurance operations is the ability to accurately estimate future claims and expenses and thereby correctly price insurance contracts. The premiums within the Private business area and the premiums for smaller risks within the Commercial business area are set through tariffs. The underwriting of risks in the Industrial business area and of more complex risks within Commercial is based to a greater extent on principles and individual underwriting than on strict tariffs. In general, pricing is based on statistical analyses of historical claims data and assessments of the future development of claims frequency and claims inflation.

Despite the diversified portfolio, risk concentrations and thereby severe claims may arise through, for example, exposures to natural catastrophes such as storms and floods. The geographical areas most exposed to such events are Denmark, Norway and Sweden. In addition, single large claims could have an impact on the insurance operations’ result. The economic impact of natural disasters and single large claims is managed using reinsurance and through diversification.

If P&C’s Reinsurance Policy stipulates guidelines for the purchase of reinsurance. The need and optimal choice of reinsurance is analyzed based on statistical models for single large claims, while If P&C cooperates with external advisors for the evaluation of the exposure to natural catastrophes and the probability of occurrence of catastrophe losses. The analysis relies on If P&C’s Internal Model, including catastrophe models in which catastrophes are simulated based on historical meteorological data, supplemented by statistical models as well as internal and external expert opinions. Different reinsurance structures are evaluated by looking at the expected costs versus the benefits of reinsurance, their impact on result volatility and decreased capital requirement.

Reserve Risk : Reserve risk relates to incurred claims, resulting from insured events which have occurred at or prior to the balance sheet date. The final amount, frequency and timing of claims payments may differ from those originally expected. As a result, technical provisions are not sufficient to cover the cost for already incurred claims and there is a loss or adverse changes in the value of insurance liabilities.

In financial accounting the technical provisions include, in addition to the above-described provisions for claims outstanding, the provisions for unearned premiums. The technical provisions for unearned premiums are intended to cover anticipated claims costs and operating expenses during the remaining term of insurance contracts in force.

Reserve risk includes revision risk, which is defined as the risk of loss, or of adverse change in the value of insurance and reinsurance liabilities, resulting from fluctuations in the level, trend, or volatility of revision rates applied to annuities, due to changes in the legal environment or in the state of health of the person insured.

Technical provisions and economic value of insurance liabilities always include a degree of uncertainty as they are based on estimates of the size, timing and the frequency of future claim payments. The uncertainty is normally greater for new portfolios for which complete run-off statistics are not yet available, and for portfolios including claims that take a long time to settle. Workers' Compensation (WC), Motor Third Party Liability (MTPL), Personal Accident and Liability insurance, are products with the latter characteristics.

The underwriting challenges that the insurance company will face in near future may include

- Terrorism cover
- Environmental and pollution issues
- High tech/ high value project
- Coverage 's for intellectual property right
- Cyber security / liability - Insurance as a comprehensive solution under one umbrella.
- Credit risk - Performance guarantee
- Contingent business interruption
- Long term insurance cover e.g., latent defect insurance (high rise building) Insurers have to make use of the advances being made in science and technology to better analyze the risk and have better pricing capability

8.11. SUMMARY :

Underwriting is one of the most important functions in the financial world wherein an individual or an institution undertakes the risk associated with a venture, an investment, or a loan in lieu of a premium. In India the underwriting business growing very rapidly. The prime objective of this concept is providing necessary protection with minimum effort. We consider different types of underwritings in practice. In the sector of insurance so many factors have influenced the process of underwriting. This lesion tries to analyze crucial parts in this concerned. The insurance sector in India is very fast-growing sector which contributes large scale of investment and funds to the industrial sector. We have different types of insurance companies. Each of the insurance company have works in a specific path. Insurance companies must be controlled by the authorities. The companies are performing several functions.

8.12. KEY WORDS :

1. **Credit risk :** Credit risk is the probability of a financial loss resulting from a borrower's failure to repay a loan. Essentially, credit risk refers to the risk that a lender may not receive the owed principal and interest, which results in an interruption of cash flows and increased costs for collection.
2. **Cyber security :** Cyber security is the practice of defending computers, servers, mobile devices, electronic systems, networks, and data from malicious attacks. It's also known as information technology security or electronic information security.
3. **Third party liability :** Third-party liability insurance is a type of policy under which the insurance company offers cover for the insured against legal liabilities that arise due to the loss/damage caused by them to a third person's body or their property.
4. **Investment bank :** An investment bank is a financial services company that acts as an intermediary in large and complex financial transactions. An investment bank is usually involved when a startup company prepares for its launch of an initial public offering (IPO) and when a corporation merges with a competitor.
5. **Fraternal benefit :** A fraternal benefit society is a membership organization that is legally required to offer life, health and related insurance products to its members, be not-for-profit, and carry out charitable and other programs for the benefit of its members and the public.

8.13. SELF – ASSESSMENT QUESTIONS :

1. What are the key features of underwriting?
2. What is the process of underwriting? What factors influence the process?
3. Write a note on underwriting risk in non – life insurance.
4. Brief the different types of underwritings exists in India.
5. Write various objectives of insurance.
6. Brief the various types of insurance companies.
7. What are the major and secondary functions of insurance?
8. What are the basic principles of insurance?

8.14. SUGGESTED READINGS:

1. R. N. Chaudhary, General Principles of Insurance Law, Central Law Publication First Edition, 2012
2. R.K. Nagarjun, Law of Insurance, New Era Publication, Second Edition, 2012
3. M. J. Mathew Insurance Principle & Practices, RBSA Publishers, 2 nd Revised Edition, 2005
4. Avtar Singh, Law of Insurance, Eastern Book Publication, 3rd Edit
5. Introduction to Underwriting - by Everett Randall
6. Dr. P.K. Gupta Insurance and Risk Management

Dr. K. SIVAJI

LESSION – 9

PRODUCT DESIGN AND DEVELOPMENT

AIMS & OBJECTIVES :

After study this lesson the student should be able to :

- To understand the product design methods in insurance industry
- To Know the process of the product design
- To Evaluate the present scenario in insurance product design.

STRUCTURE OF THE LESSON :

9. 1 INTRODUCTION :

Product design as a verb is to create a new product to be sold by a business to its customers. Designing a product is a very broad concept, it is essentially the efficient and effective generation and development of ideas through a design process that leads to new products. A design is a plan or specification for the construction of an object or system or for the implementation of an activity or process or the result of that plan or specification in the form of a prototype, product, or process. The basic design defines the platform, production facility and structural configurations and dimensions in enough detail to allow the detailed design to start. Basic design results enable reliable cost and schedule estimates and the ordering of long-lead major equipment and structural components. The purpose of design is much more closely linked to strategy than aesthetics. Design is the process of intentionally creating something while simultaneously considering it's objective (purpose), function, economics, socio cultural factors, AND aesthetics. Design theory is a system that helps graphic designers better understand how they can communicate a message to audiences through visuals. It involves identifying the different elements in an image and explaining why they're important. A simple design can be characterized as a design that is not elaborate or artificial but is crisp and concise. It's unambiguous and unadorned, and it uses the least possible number of components, classes, or methods, or the simplest solution. Simple design is unaffected, unassuming, and humble.

When designing an insurance product, the insurer has to align the customer's needs, preferences, appropriate delivery mechanisms, regulatory requirements, and knowledge of local and global conditions. Pertinently, financial gain or social remedies certainly have to be a constant eye for insurers to succeed in their launches. To achieve higher scales — let us take a look at some of the factors for insurance product design and some important questions that pave the way or qualify the product in a better way, One of the main issues associated with insurance product design is proper communication to lay customers. In addition, there are other issues to be considered, such as the concerns of shareholders and regulators.

Factors To Consider For An Insurance Product Design :

i. **Target market:** It is highly recommendable to identify the target market and needs of the target population, e.g., the needs of persons living in rural areas will be different from the needs of the urban populations. Segmentation and target definition in an early stage will lead product engineers to predict the ROI closer to the accuracy rate of 95 per cent — to implement the same, customer segmentation in data science can be widely used.

ii. **Eligibility to buy:** To purchase insurance, certain conditions must be fulfilled for apotential customer to be eligible to buy insurance. These are

iii. **Age:** Insurance companies offer plans for Infants to Super seniors. In some cases, minimum age and maximum age are the constraints for certain exclusions or loadings.

iv. **Income:** The insurer may ask for income proof based on the declarations and the amount of insurance coverage asked by the customer.

v. **Health:** The insurer may ask for medical examinations and reports, wherever necessary, wherever necessary, based on declarations—the amount of insurance coverage. However, nowadays, tailor-made coverage is updated on a needed basis. Laying good provisions of benefits- Clear demarcation of the beneficiaries- Remedies available in case of any problem or litigation

9.2 INSURANCE PRODUCT DEVELOPMENT :

Insurance companies throughout the world are constantly looking for new areas / opportunities to sell insurance. Having an excellent product design is an important factor in achieving consistent and organic growth in revenue and is being practiced by most companies today. Insurance companies need to think about the following advancements to support the superior success of the product launch and utmost customer satisfaction.- Analytics — for the rate and determination of product scope- User experience- Cyber security - Data Science- Cloud computing and so on.

- **Data Collection:** For efficiency and effectiveness, predictions and cross-verifications are required in this process of gathering and measuring information -a company should focus on the variable interest attached to the specific line of business. These kinds of data collection are essential for other lines of business-like insurances in Health, Fire, and Engineering etc.
- **Connected Insurance:** There is only a size fit for some solutions. Thereby it is imperative to associate with partners and satisfy the needful customer. In the case of motor, home, and health insurance, connected insurance can be illustrated more effectively with various devices. And understanding the usage and risk associated with them, as well as being more target-oriented.
- **Automation In Insurance:** Good policy management using prebuilt RPA and Artificial intelligence use cases can automate insurance policies, identify potential risks associated with legal compliances and reduce turnaround time for the frequent updates requested by the customer.
- **Core System Modernization:** Running with a legacy system and attaining effectiveness is quite impossible. Even if a system is not upgraded completely, a certain level of modernization is not avoidable.

- **Digital Transformation:** Replacing manual or non-digital information with digital processing is inevitable. Some aspects include going paperless, converting policies or prospects through mobile applications, etc.
- **Risk Prediction:** This system should also be planned while devising new products so that the health status of the risk, creditworthiness, duplication of any reinsurance retention limits, and other financial limits can be checked.
- **Efficient Customer Services:** Finally, this is where insurance companies need to be more vigilant and skilled enough to cater to the wide variety of customers with less workforce utilization. Still, to achieve 100 per cent compliance satisfaction, companies should improve their knowledge base.

9.3 DESIGN OF PRODUCT :

Design of an insurance product refers to features of the product in terms of benefits offered and price charged. Benefit can be offered on uncertainties such as death, survival, sickness etc or it can comprise of certain timely payments. Various guarantees, choices and options offered to the customer also come under the preview of product design. One of the examples of guarantee offered in a product is the guarantee that maturity benefit will not be less than some percentage of total premiums paid. Guarantees are common in unit linked design, making it a marketable product. Some examples of options and choices are surrender options, policy loan, switching of funds for unit linked insurance, premium discontinuance etc. In this point a question arises that is

Why Is New Product Design Required At All? : In the market place all firms are trying to get more and more customers and thereby targeting more and more profits. This leads to an introspection of their own products and finding out what is lacking or what could have been better. This introspection could lead to the following reason of looking at product design: Awareness of a gap in the existing product range. This might be the result of looking at other companies' products. It can also be as a result of change in the market such as: The market awareness of a new product need or product feature. For example, increase in risk aversion increasing the need for guarantees. A legislative or fiscal change making new product or feature more attractive. The availability of new financial instruments making a new product feasible. For example, inflation linked bonds by government making possible inflation linked guarantees in unit linked products.

Awareness of an inadequacy in an existing product such as:

Insufficient profitability and inefficient use of capital – development of new improved profits testing matrices or change in shareholder's preferences making product unprofitable or capital inefficient.

Inadequate premium rates for non-linked products or charging structure for unit linked products. This may be because of changes in demographics, change in future expense outlook and changes in future investment outlook.

9.4 PRODUCT DESIGN AND VARIOUS FACTORS :

Customer needs is the most important factor that affect the product design of a company. Hence, product design acts as a bridge between the creativity and customer needs. Customers desire various features in the products, which is then made possible by innovation in terms of product design. Other important factors affecting product design are:

- **Profitability:** Insurer wants to ensure that the premiums charged for non-linked contracts and charges of unit linked contracts will be sufficient to cover the benefits to be provided and the expenses to be incurred in future, and provide a profit margin. After all an insurer can survive only if it is profitable in the long run.

- **Sensitivity of profit:** This factor is mainly relevant to unit - linked design where different charges can be designed in a way to reduce sensitivity of profits to particular risk. For instance:
- **Investment return:** if there are no investment guarantees then most of the investment risk is borne by the policyholder.
- **Mortality:** make the charge for this variable at the company's discretion.
- **Expenses:** make the charge for this variable at the company's discretion.
- **Withdrawal rates**: don't offer any guaranteed surrender values.
- **Matching**: try to match income (the charges) with outgo (expenses and benefit costs) as closely as possible by duration, especially with regard to the initial expenses.

Similarly for non-linked products it may be possible to reduce the exposure of profit to unpleasant variations in future experience The sensitivity of profitability to high withdrawal rates could also be reduced by using a commission system whereby there is some "clawback" (return) of commission for early withdrawals.

Marketability: There is no use of product design if the product is unattractive to prospective customer and hence, difficult to sell in market. Product design needs to be attractive to the market in which the product will be sold. Marketability is greatly enhanced by innovative design features and additions of options and guarantees. There should be a balance between attractive product design and making the product simple to understand. Analysis of target market will provide an indication of required level of simplicity in the product. A financially sophisticated target market allows a complex and attractive design, whereas targeting lower income group customers with less financial knowledge would make simple design more attractive.

Competitiveness: Usually products of the company are comparable to the products offered by other market competitors or participants. Premium rates or charges should not be too high or low when compared to competitors. In case product is unique and have features which cannot directly be compared in the market, higher price can be offered. In that case also, care should be taken to ensure timely monitoring of market place to see when that price becomes uncompetitive and then take suitable corrective action. This factor will also depend upon how the products are marketed and should be looked at along with marketing aspect.

Level of risk: Consideration will need to be given to the acceptability of the level of risk associated with a proposed product design. The level of risk that may be acceptable will depend upon the company's ability or willingness either to absorb risk internally or to reinsure or hedge it. All the risks cannot be hedged or reinsured. For example, risk of higher surrenders or lapses is difficult to hedge, the design should discourage surrenders or lapse by suitable penalties when premium is not paid and by encouragement to pay premium. One important aspect related to level of risk is the level of guarantees offered in the product. Higher the guarantees higher the risk. Guarantees improve the marketability of the product and increase the risk too. Hence, there should be a balance between risk and marketability.

Administration systems: The system requirements of a new product may limit either the benefits to be provided or the charging structure to be adopted. For example, if the insurer's computer policy administration system cannot cope with administering a waiver of premium option, the product should not have one (unless it is so important that it is worth spending money on enhancing the system). This aspect is also linked to the aspect of simplicity particularly for insurer's staff. A complex administration system also increases the chances of errors and associated losses.

Regulatory requirements: All the above factors would only possible if it is allowed by the regulations imposed on the company. In India, there are several restrictions directly or indirectly on the level of charges, commissions, benefits etc., which has to be followed while designing any product. Apart from above important factors, in order to achieve higher sales, the product design should also consider the following factors: a) How comprehensive are the features? b) Whether distributors need special training to sell the product? c) Whether sales illustrations are simple and clear to the prospective customer? d) Whether distributors (and sales team of insurers) could explain about other products in the market, and how these differ from the products of the insurer?

9.5. INFLUENCING OTHER FACTORS IN DESIGNING OF INSURANCE PRODUCT:

Target Population : It is important to identify the target market and the needs and demands of the target market. This is needed in order to identify groups of potential customers who have similar needs. E.g. the needs of persons living in rural areas will be different from the needs of the urban population. An insurer should keep this factor in mind before designing insurance products. This would assist the actuary in applying proper mortality rates.

Eligibility to buy in order to purchase insurance, there are certain conditions to be fulfilled so that a potential customer can be eligible to buy insurance. These are:

Age: Insurance companies offer plans right from childhood to old age. In some plans the insurance company may specify a minimum age after which insurance may be given. For example, an insurance company may say, to avail a term insurance plan the minimum entry age is 18 years. In case of some plans the company may specify a maximum entry age after which an individual may not be able to buy that plan. For example, an insurance company may say the maximum entry age for a particular insurance plan is say 65 years.

Income: A person seeking insurance should be able to pay for the premiums in the long term. The insurance should be affordable as per his /her income. E.g. the person seeking insurance should earn a specified income per month or annual income as may be determined by the insurer. The insurer may ask income proof wherever necessary based on declarations and amount of insurance cover asked for by the customer.

Health: Insurance should not be used as a medium of committing any fraud. Customer knows facts about their health which they can hide and take insurance in order to profit at the expense of the company. The person seeking insurance should be in normal health at the time of purchase of this product. The insurer may ask for medical examination and reports, wherever necessary, based on declarations and amount of insurance cover asked for. However, these days' insurers offer cover even if a person is suffering from some disease, but at a higher premium as compared to other people with good health.

Other Conditions :

i. The customer should be an Indian citizen or a foreign national resident in India.
ii. The customer should choose a period of insurance cover (policy term) that covers a minimum and maximum period.
iii. The customer should choose a period of premium payment that covers a specified duration, say; at least 5 years. Alternatively, he/she can choose to pay a lump sum amount (Single Premium) with the application (proposal form).
iv. The customer can select any frequency of payment of premium, i.e. monthly, quarterly, half-yearly, etc.

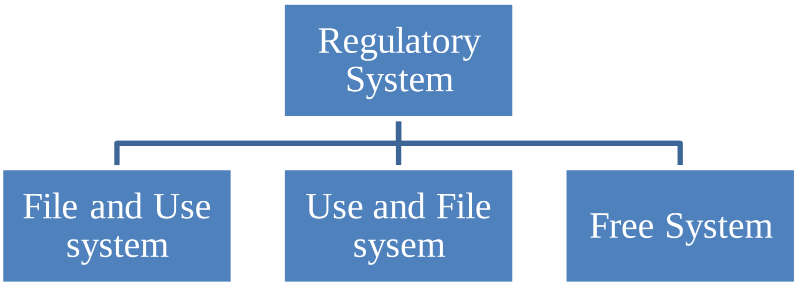
v. During the period of contract, the customer can change frequency of payment of premium from one mode (i.e. monthly) to another mode (i.e. half-yearly), according to his/her convenience.

vi. The sum assured cannot be changed during the period of contract. Sometimes, insurers allow alterations for increase in sum assured, subject to approval of regulator. Such freedom to policyholders would be subject to actuarial considerations since increase in sum assured is suspected to be a moral hazard.

vii. The customer should not engage in occupations such as divers, stuntman, etc. Some insurers may put conditions on occupation, though they may grant cover.

9.6 THE ROLE OF REGULATIONS IN INSURANCE PRODUCT DESIGN :

Insurance regulations are varied from one country to another. In some countries little regulations which means more freedom for insures and adverse in some countries. The following are some aspects in this regard.



File and use system: Under this system, insurers are required to file the product in an application form that adheres to the instructions of the regulators, and file with the regulator. Once the regulatory clearance is obtained, the product can be introduced in the market. A file and use document is prepared and filed with regulator which explains the features of products apart from all other technical details such as:

i. Event on which benefits and payments are made under the product
ii. Type of premium payment with the modes allowed
iii. Maximum and minimum entry age, maturity age, policy terms, premium payment terms
iv. Commission levels payable to agents or other channels
v. Withdrawal terms and charges
vi. Financial projections including assumptions used for pricing the product along with scenarios testing
vii. Loans and other facilities if available
viii. Options and guarantees offered by the product
ix. Target market
x. Distribution channel used
xi. General Policy Provisions such as suicide claim provisions, Exclusions, Grace period, nomination requirement, policy alterations, revivals approach

Other miscellaneous information: Along with the application form and file and use document, the insurer would need to enclose the following while filing the proposal: i. Specimen proposal form (application form for insurance), ii. Specimen policy contract , iii. Specimen sales literature , iv. Specimen benefit illustration, v. Profit testing results for sample model points . vi. Cashflow projections for sample model points ,vii. Premium tables and so on . Profit testing is the process of checking the premiums to see if its affordable and satisfies the internal profit criteria. Benefit illustration is a document used to show the premiums and benefit structure of the product to prospective policyholder.

- **Purposes of the file and use system**: The main purposes of this system are: To ensure that the products manufactured by insurers suit the interests of the public so that buyers can be attracted; and To ensure that the products are capable of generating enough profits so that the solvency of the insurers can be ensured. The regulators may check out technical analysis in order to ensure that products benefit the common man in terms of affordability.
- **Use and File system:** Under this system, insurers can introduce the product in the market after it is designed. Later on, the product can be filed with the regulator. If, after passage of time, the regulator feels that the product is no longer in the interest of public, it may require the insurer to stop selling the product henceforth. In this model, the insurer is given freedom with restrictions. The objective here is to provide an opportunity to the insurer for innovation in the product design. Another reason is to ensure speedy launch of the product in the market. Here, no technical analysis may be done by the regulator. The regulator would act when he receives complaints from the public in respect of the product. However, the primary disadvantage would be that the product might lead to mis-selling and insolvency issues.
- **Free system:** Under the 'free' system, insurers design products and sell these without any intervention from the regulator. This may be regarded as 'freedom with responsibility'. The regulator may monitor the insurer through 'solvency test', 'asset-liability matching' test, etc. However, the regulator may require the insurer to stop new sales, if he thinks that the insurer's operations are not in the interest of the public. This system ensures survival of the fittest. The philosophy behind this method is that the insurers in the market could offer products for sale at prices determined by the market. However, this system could create issues for the regulator if the solvency of insurer is not monitored by the regulator at regular intervals.
- **Focus of all above methods:** In all the above methods, the main focus lies on the customer. Customers should be able to choose amongst a wide range of products that should be affordable. In India currently "File and Use" method is prevalent. However, there are some discussions about "Use and file" system also for some simple product, which is not yet launched

Other Regulatory Impacts :

Apart from above, in India there are two product regulation, linked product regulations and non-linked product regulations, issued by regulator in year 2013. These regulations directly or indirectly impact the product design: Some of the provisions of these regulations impacting product design are listed below:

- **Minimum death benefit:** To ensure that protection component of the insurance product remains high, regulation stipulates minimum amount that should be payable on death. In case of death due to suicide, within 12 months from the date of inception of the policy, the nominee of the policyholder shall be entitled to at least 80% of the premiums paid.
- **Minimum policy term and premium paying term:** To ensure that the products remain fairly long term to protect the interest of policyholders, regulation stipulated minimum policy term and premium paying term for insurance products.
- **Commissions or remuneration in any form:** Commission or remuneration in any form for the procurement of all individual policies, group term insurance, group credit insurance and group saving variable insurance policies in respect of all the Distribution Channels except the Direct Marketing shall not exceed the stipulated limit in the regulation.

- ❖ **Surrender value calculations:** As per the regulation surrender value in most of the cases would be higher of guaranteed surrender value (GSV) and special surrender value. GSV is precisely defined in the regulation. Also, guidance is provided for the calculation of SSV. Regulation also defines the time period of when the policy will acquire surrender values. There are limits on surrender charges for group products as well.
- ❖ **Advance Premium:** Collection of advance premium shall be allowed, if premium is collected within the same financial year. The premium so collected in advance shall only be adjusted on the due date of the premium. The commission shall only be paid on such due date.

Level premiums :

- ❖ Except for group products, the premium chosen at the outset shall become payable throughout the premium paying term of the policy and shall not be altered during the term of the policy. Such premium shall be level / uniform and shall not vary over the term of the policy.00
- ❖ The insurer shall not accept any amounts less than the due stipulated regular premium payable as stated in the policy.
- ❖ Any additional payments made on ad hoc basis shall be considered as top-up premium and treated as single premium for the purpose of providing insurance cover.
- ❖ Service tax, if any, shall not be included in the contractual premium and shall be collected from the policyholder separately as over and above such premium.

Misleading names : As per the regulations, the misleading and misrepresenting the benefits through the name of the products shall not be allowed.

Benefits offered on Maturity :

- ➢ The product literature shall clearly indicate whether the product is protection oriented or savings oriented or a combination of the two.
- ➢ Where the products offer the maturity benefit as return of premiums paid or a percentage of return of premiums paid or a meager amount in excess of return of premiums paid, these products shall not be termed as savings products.
- ➢ The maturity benefits shall closely reflect the asset share in case of par products.
- ➢ At the most generic level, the asset share for a life insurance policy is the accumulation of monies in less monies out in respect of that policy. In other words, the accumulated cash flow in respect of a policy. Approval of innovative product. Any product design, which is not approved so far by the Authority, shall be treated as innovative product. The approval of these products would be subject to the conditions as stipulated in the regulations.

9.8 CHANGING SCENARIO OF INSURANCE INDUSTRY :

The Law Commission Member Secretary has commented that "Insurers should draft their policies in plain language to make it understandable to the common man."

Meaning Of Scenarios :

Scenarios are descriptions of potentially plausible events that may occur in the future, leading to a particular set of outcomes. They are based on assumptions about key driving forces, interconnections, and relationships, and have the ability to capture the uncertainties and complexities of a system in a coherent manner. Scenarios are not intended to comprehensively describe the future, but rather to highlight focal elements of different plausible futures and to highlight the key factors that will drive future developments. Sometimes the terms scenario, projection, and prediction (as well as others such as forecast and outlook) are used interchangeably, but while all are tools to investigate the future, each is nuanced in its meaning. A scenario-based projection is a hypothetical construct of what could possibly happen conditional upon fundamental assumptions.

When we considering the future, we often add ‘probability’, ‘possibility’, or ‘plausibility’ qualifications to emphasise relevance or importance.

- **Probability:** It refers to the concept of chance and likelihood, leading to an ordinal ranking of more or less likely futures. Any future is possible, but the selection of a probable or improbable scenario depends on the application.
- **Possibility**: It is a claim of reality, whether a future is potentially realisable or not. It is a binary distinction but may be challenged by absolute or contingent reasons.
- **Plausibility**: It is addresses the structure of an argument and places value on the credibility of a future, which can hold true even though the future itself may be factually fallacious. This is therefore a cognitive notion. Scenarios are challenged by the difference in interpretation of plausibility between developers and stakeholders.

Types Of Scenarios : Scenario design and development processes can be commonly distinguished and classified, based on the development process, their purpose, or certain characteristics. In practice, these typologies are rarely binary or independent, and instead can be imagined as a multi-dimensional matrix with unique outcomes.

Supporting Decision Making : Scenarios can be highly effective tools in support of decision making, offering a creative and structured mechanism to test and validate decisions in a scenario planning process. When managers make decisions about the future, concerning either near-term operations or long-term strategy, they cannot only expect positive outlooks, and must also be proactive in preparing for negative events. This outlook is a key characteristic of enterprise risk management, contrasting with the typically reactive approach of traditional risk management. Scenarios facilitate discussion on how risks can be planned for and be managed or mitigated effectively with strategies.

Aiding Communication : Scenarios routinely function as a communication tool in the industry, facilitating the sharing of ideas, risks, or responses. Communication may occur formally during the distribution process, or more informally during the development and research phase. Scenarios are especially valuable when discussing abstract ideas, or complex risks, as they provide examples and context to the issue, ensuring a consistent interpretation and understanding. Furthermore, by providing a well-crafted scenario which is mutually accessible to multiple parties, consumers of the scenario have an equal platform for communication across different sectors or areas of expertise.

Demonstrating Due Diligence : The insurance industry is required to practice due diligence to keep themselves and their insured’s safe. One component of due diligence is recognizing what risks exist, and where vulnerabilities exist within the organization. Scenarios assist in achieving this due diligence, as they provide a systemic and comparable platform for examining these risks, and a sheltered sandbox to identify and test potential vulnerabilities. These exercises can aid in answering questions such as what silent exposure may exist, or if there is clash potential on existing policies. By addressing areas of uncertainty and taking informed risks, insurers can demonstrate that potential consequences have been considered and reasonable precautions have been taken.

Identifying Bias : Scenarios provide a platform to explore hypothetical outcomes and identify potential (dis)inclinations or partialities that organisations have towards certain situations and decisions. Taking a broad set of scenarios mitigates well known behavioural effects like confirmation and availability biases. This yields a systemic benefit that is realized over time.

9.9 NEW SCENARIOS IN INSURANCE SECTOR IN INDIAN :

GIC - In A New Look : At present GIC is insuring both ways. An increase in foreign insurance premium at Rs. 600 crore has pushed the national reinsures total premium to over Rs. 3800 crore. GIC is willing to write more risks back home for domestic insurance companies. GIC apparently does not have much control on its motor, marine or fire losses as the entire chunk comes from the public and private insurance companies. At present every public and private general insurance company has to necessarily cede 20 per cent of its risk with GIC. The reinsurer is in talks with a host of companies to increase their cession limits back home. The quantum of foreign inward premium may be low in the total premium income but the increase in its share over the last one year is significant. GIC is keen to write more risks back home and looking at picking up a strategic stake in African reinsurance major East Africa apart from establishing its presence in London, Moscow and Dubai. Besides, it is examining new Asian markets like China, Korea and Malaysia. With the existing networth of about Rs. 2800 crore, the capacity to write business is almost four times.

Role of IRDA and TAC: IRDA had earlier indicated that the entire non-life business would be detariffed and left to market forces in the next two years. This would mean that the Tariff Advisory Committee would lose its prime reason for existence. The TAC was constituted to issue administered rates in business in the non-life sector. At present over two thirds of non-life business is governed by tariff rates. The businesses where rates are fixed include motor and fire insurance. Marine and many other classes are non-tariff where rates are decided by the operating offices. The TAC, which has its own secretariat, employees and offices in various centres is working towards becoming a data warehouse. IRDA has made it mandatory for the insurance brokers to invest Rs. 50 lakhs so that they can remain committed to their clients and offer professional services. Brokers are also required to take up professional indemnity policy of three-times of their brokerage income subject to a minimum amount of Rs. 50 lakhs. Thus the brokers have sunk in couple of crores to set up their businesses, are finding the going tough with the clients approaching the insurance companies directly to avail of the special 5 per cent discount. The insurance agents are able to earn 15 per cent discount if the sum assured is less than a crore of rupees, with an investment of just about Rs. 250/- per annum, while the insurance brokers earn 12.5 per cent return after having invested Rs. 50 lakhs for registering themselves

Inter – Competition Among Insures : Private insurance companies can give a good competition to the PSUs in terms of customer orientation and quick settlements. There is a big scope for financiers to book a good fee-based income by becoming corporate agents. Before the industry was opened up, the four public sector insurance companies were underwriting Rs. 14000/- crore premium a year. So far, the eight private insurers had taken away only 14 per cent of the business. They have an uphill task in taking on the four PSUs which have big network of officers, market reach and a vast development force. While there is a big business potential, the regulators, in a bid to create entry barriers, have forced the promoters to pump over Rs. I00 crore as capital. This will result in longer payback period of six to seven years. The insurance companies so far have been providing separate insurance cover for each and every segment but the efforts are on to provide a comprehensive insurance cover to machines, assets and the people. Attempts are also on to include the health and accident insurance for the IT companies where the insurers are trying to bundle the existing services to provide a comprehensive package. However, these companies are yet to approach the insurance Regulatory and Development Authority for seeking approval. Insurance companies are today looking at different segments where there is business potential and are trying to customize policies to suit the specific needs of their clients.

Unlimited Third-Party Liability Phobia : Unlimited third-party limit is another grey area causing worry to insurance companies. The unlimited third-party claims permitted under the law on road accidents is threatening the viability of the general insurance industry. It immediately requires a ceiling in the insurance claims. Nowhere in the world such unlimited third-party claim is allowed and there is no reason for Imposing it on motor insurance in India when there is a limit for mishaps in aviation and railways. The increase in premium rates of motor insurance have come as a life-blood to the much-maligned sector but the increase in third - party cases and unlimited third-party awards have threatened the viability of all public and private sector insurers.

New Risks And New Covers : Companies could purchase insurance products for their displaced workers as part of severance package. All the jobs displaced from off-shoring can be insured for as little as 4 to 5 per cent of saving coming out of off shoring these jobs. This sort of a proposal has been jointly developed by professionals of University of California and Brooking Institute for Trade-displaced workers. This would cover wage loss for all full-time workers. Once they are re-employed, compensating them 70 per cent of wage loss between their old and new jobs for up to two years. If this happens, the insurance premiums will increase, cutting into the gains from off-shoring less attractive to companies in periods of higher unemployment. This form of insurance will create a self-regulating mechanism, by aligning the rate of off shoring with the rate of employment. India, which is a country of traditions and rituals, have plenty of religious and social events which take place every now and then. These events are dominated by religious and regional factors and, therefore, various risks attached to these areas are giving birth to the event insurance. In Health sector also the new policies are designed by both the Government and the insurance companies.

Amended Rebating Provisions : Several insurance brokers have put their expansion plans on hold owing to the new notification put forward by IRDA, which enables the insurance companies to pass on rebates directly to the clients. Early this Year IRDA had decided to take action on insurance brokers indulging in rebating and called for submission of detailed returns from brokers. But from July 2003, IRDA itself has legalized rebating between the insurance companies and clients. Rebates have been legalized despite the fact that Section 41 of the Insurance Act of 1938 prohibits the offer of any direct or indirect inducement, including rebating to procure insurance business.

Insurance Business Cycle : Insurance business cycle is moving ahead rapidly. This cycle comprises alternating periods of expansion and recession which are integral features of market economics. A recession is a vicious phase of declining output, income, employment and sales, eventually giving way to an expansion, which is an analogous vicious cycle of rising economic activity. This cycle of insurance business is further examined and analysed by TAC which has the flexibility to take care of specific needs of insurers and ensure a healthy information exchange. TAC is doing the conversion of raw data into analysable data, creation and maintenance of a search engine, periodic deletion of aged data if deemed necessary, all enabling them to provide answers to online queries over the net. At present over two thirds of non-life business is governed by tariff rates.

Present Scenario : Public Sector Insurance Companies have finally ceased to be the GIC Subsidiaries. The Rs. 100 Crore of equity has been transferred to Government from GIC. The transfer of equity follows amendments in the General Insurance Business Nationalization Act, passed by Parliament. The possibility of tapping the capital market by public sector

Insurers cannot be ruled out in future. There are visible signs of market expansion and therefore, all the insurers are expanding the targets and concentrating on most profitable personal and health segment. The Commission structure has been the focus of debate today. The insurance players are trying to balance the diverse objectives of providing enough incentives upfront to draw full time agents and at the same time ensuring that commissions are spread over at increased rates to ensure persistency of service. IRDA cannot of its own notify changes as commission payments are fixed by law. Any change in commission structures would require a change in legislation. The insurers cup of woes has been similar to that of its peers in the industry. Third - party claims in motor insurance have hit these companies hard with some companies having to shell out as high as 300 per cent of the motor insurance premium collected. The new line of thinking is to tap the profitable personal lines of business. Companies are looking to bancassurance tie-ups. Emphasis also laid upon recruitment of unemployed graduates as agents. This would also provide some social stability. Companies have necessary infrastructure in the form of training centres to provide the mandatory IRDA training. Public Sector insurers expects banks to report good fee income through referrals to them. The insurance agents are able to earn 15 per cent discount, if the sum assured is less than one crore of rupees, with an investment of just about Rs. 250/- per annum while the insurance brokers earn 12.5 per cent return after having invested Rs. 50 lakhs for registering themselves.

9.10 SUMMARY :

The quality of a product is determining the future of the company in any industry. In insurance industry most important task is to introduce a customer-oriented product. In the process of product design several factors may consider which have influence on total industry. Meanwhile it is also considered that the role of regulatory authority in this concerned. However, it is very essential that the insurance company must identify and adopt the dynamics of customer requirements and needs in the society.

9.11 KEY WORDS :

1. Target marketing
2. Cloud computing
3. Maturity benefit
4. Rate of mortality
5. Level of risk
6. Advance premium

9.12 SELF – ASSESSMENT QUESTIONS :

1. What are the factors considering in design of an insurance product?
2. Why is new product design required at all for an insurance company?
3. What are the factors considering in a product design?
4. What are the other factors that are consider in product design?
5. What is the role of regulations in insurance product design?
6. What are the changes you observed in insurance industry?
7. Explain the role of IRDA in insurance industry.

9.13 FURTHER READINGS

1. *R.K Gupta - Insurance and Risk Management*
2. *Susan Conant - Risk Management and Product Design for Insurance Companies*
3. *Sankar Kumar MaityHAND BOOK OF GENERAL INSURANCE*

Dr. K. SHIVAJI

LESSION – 10
CLAIMS MANAGEMENT

AIMS & OBJECTIVES :

After studied this lesson the student should able to learn :

- To understand the concept of claims management
- To able to evolutes the performance of claims management
- To know the claim settlement in life insurance
- To understand the settlements in general insurance

STRUCTURE OF THE LESSON :

10.1 Introduction
10.2 Claim Management – ways of servicing
10.3 Claims management – A process
10.4 Claims management and Firms
10.5 Importance of Claims Management in the Insurance Sector
10.6 Faster Claim Management Process in insurance and software
10.7 How to access Claim Management?
10.8 Other things to be consider
10.9 Claim management in general insurance
10.10 Normal claim process followed by General Insurers
10.11 Claim under Motor insurance
10.12 Formalities for a health insurance claim
10.13 Claim management in life – insurance
10.14 Efficient Claim Management
10.15 Claim Settlement Process in Life Insurance
10.16 Five important things to know about life insurance claim
10.17 Summary
10.18 Key words
10.19 Self – assessment questions
10.20 Further readings

10.1 INTRODUCTION :

Claims management is the process of identifying, controlling and resolving demands by individuals or public entities to recover losses from any Member of the Association. Disposing of such demands for payment requires skills in insurance law, adjusting/investigation, loss control engineering and general business. Claims management is the function of supervising legal, adjusting, investigation and engineering services to resolve such demands.

10.2 CLAIM MANAGEMENT – WAYS OF SERVICING :

A firm providing claim management services acts in three ways.

1st Way Of Service : The first core product offering of claim management is advisory; claim managers can advise policy holders about their claim against a given financial product, represent them to ensure they receive the full funds to which they are entitled, and investigate claims in greater detail to provide impartial evidence from a credible source about the circumstance, merits or foundation of a given claim. Claim management can also reduce the operational burden associated by a financial claim by registering claims, providing clear information to policyholders, ensuring key documents are processed and filed, and expediting any claim assessment procedures contained within the wider claims process.

2nd Way Of Service : Claim management refers to assistance with the claim itself; namely, determining which party is responsible for any wrongdoing under the terms of a contract and the amount to be paid as part of the claim. If the product is simple (such as a guarantee) or the terms of the product are clear, this can be as simple as paying a financial sum to the party holding the policy. In claims involving more complicated products (such as performance bonds), claim management can also involve investigating why contractual terms were breached and determining responsibility. Claim management also encompasses the recovery of the sum paid to a party from the other responsible party – for example, in the case of a surety triggered by a principal declaring insolvency, the claim manager will pursue the principal for the value of the surety paid to the oblige who held it.

3RD Way Of Services : Finally, claim management can also refer to an investigation into wrongdoing regarding trade finance products. This typically takes the form of fraud prevention services, where companies can investigate claims to determine whether any fraudulent behaviour has taken place quickly and thoroughly to avoid frustrating legitimate customers.

10.3 CLAIMS MANAGEMENT – A PROCESS :

1. Two parties are bound together by a commercial agreement with contractual terms and conditions. Party A has agreed to buy goods from Party B, who will make and export the goods to Party As a country.
2. Party B asks for part payment for the goods up front to help with their businesses cash flow and the cost of production. Party A has provided this on the provision the payment is protected by a guarantee from a third-party bank that the money will be repaid should Party B fail to meet their contractual obligations and a performance bond that Party B will make a payment to Party A to compensate for their failure.
3. Party B accepts these terms and the payments but fails to meet its terms and produce and deliver the goods on time.
4. Party A makes a claim against their guarantee with the guarantor.
5. A case handler working for the guarantor engages with Party A to understand the situation and get as much information as possible before opening a case file representing Party As claim.
6. The guarantor will then serve as an investigator and adjudicator, reviewing the financial product, the contract, and the events of what has happened to investigate what wrongdoing has taken place, who is liable, and what compensation is appropriate.
7. The guarantor will also perform fraud checks on both parties to ensure that the claim is not fraudulent, and will handle any complexities involved (such as any subrogation of either party regarding the financial liability involved).
8. Having investigated the claim, the guarantor will either reject it and close the case file, or approve it.
9. Having approved the claim, the guarantor will ensure the correct payment is made to Party A immediately to compensate them for their loss.
10. Depending on the nature of the product agreed, the guarantor may then pursue Party B for some or all or the compensatory amount.

10.4 CLAIMS MANAGEMENT AND FIRMS :

Accurately assess claims and liability to avoid legal action. Maintain customer satisfaction with fast, thorough management and settlement of claims. Eliminate errors by maximizing consistency across the claims process. Quickly identify fraudulent or suspicious cases and investigate them thoroughly. Maintain profitability by reducing delays and fraudulent claims.

Claimants : Regarding a specific claim to maximise your security. Support throughout the process of reclaiming your finance. Expertise regarding legal, regulatory and financial complexities or issues. Reduce expenses incurred from potentially lengthy delays before settlement. Receive immediate payment from the settlement whilst claim managers pursue the liable principal in the contract for the funds owed.

10.5 IMPORTANCE OF CLAIMS MANAGEMENT IN THE INSURANCE SECTOR :

In addition to the competitive environment in which insurance companies operate, these businesses are challenged by more stringent compliance with government regulations and increasing expectations on the part of consumers. Efficient claims management is vital to the success of both large and small companies working within the insurance industry. Major components of the claims handling process include developing strategies to cut costs and reduce fraud while keeping customers satisfied. Small companies in particular can benefit from claims management tools and technology

10.6 FASTER CLAIM MANAGEMENT PROCESS IN INSURANCE AND SOFTWARE

Settling insurance claims is just one aspect of the claims management process. The time it takes to process a claim involves several stages beginning with a person filing a claim. The stages that follow determine if a claim has merit as well as how much the insurance company will pay.

Insurance customers expect a company to settle claims quickly and to their satisfaction. Because high customer satisfaction levels can give a company a competitive edge, reducing the time it takes to settle insurance claims is one way to decrease the number of customer complaints and improve service. Over 40 percent of drivers who submit a claim on their auto insurance are likely to switch insurers after making a claim, reports Insurance and Mobility Solutions, so keeping customers happy with a streamlined claims management process makes sound commercial sense.

The use of claims management system software that speeds the process and minimizes costs offers a practical solution. Simplifying the claim management process through automation helps reduce expenses for smaller companies that operate with smaller budgets.

Detecting The Fraud : Paying fraudulent claims costs insurance companies money – a cost the insurance industry then passes on to its customers. Consequently, underwriting guidelines become tougher and the insurance premiums consumers pay increase. Software tools designed to examine payment history and evaluate trends in claim payoffs can help insurance companies detect fraud suggests data analytics company SAS.

For example, how often the same individual files an insurance claim can be a warning that a person might be filing a fraudulent claim.

Unfortunately, settling claims too quickly increases a company’s chance of paying out on a greater number of fraudulent claims. Unlike large companies that can absorb some losses as a part of doing business, small companies quickly suffer the negative effect on net earnings when paying fraudulent claims. Then again, processing insurance claims too slowly increases the risk of losing dissatisfied customers. In a highly competitive insurance market, small companies can't afford to lose customers.

Lowering Costs : Monitoring costs throughout the claims management process determines how much of a customer's premium rate goes toward paying for the insurance company's administrative costs. Generally speaking, when settling a claim is delayed, it costs the insurance company more money. The higher claim costs reduce profitability.

For small and large insurance companies alike, automation of some of the claims management process can help decrease a company's operating costs. One example is the increased cost of investigating a claim manually. Information technology systems, though, improve efficiency by decreasing the number of claim errors, detecting fraud early and reducing the time it takes to process and settle a claim – all factors that cut an insurance company's costs and increase profitability.

Even in a healthy economy, running a small business can be tough. Other essential functions of the claims management process that can reduce costs include developing programs directed at preventing claims before they occur and avoiding future claims.

Avoiding Litigation : In most cases involving insurance claim disputes, the insurance company eventually agrees to pay an equitable amount if a customer has a legitimate claim and can present evidence supporting it. Although quickly settling a claim can avoid the chances for litigation, accurate liability assessment is crucial to achieving a quick resolution in a claim dispute. Insurers work to evade litigation because it substantially increases the company's cost of settling a claim.

For instance, one-time cases where a person misrepresents information, he provides on an insurance application can be expensive for an insurance company to prove legally. Causing a company financial loss is another reason to avoid litigation. Small insurance companies are not immune but rather are increasingly exposed to potential litigation involving claim disputes.

10.7 HOW TO ACCESS CLAIM MANAGEMENT? :

Generally, if you purchased a financial product aimed at limiting liability and financial risk from a trade financier, the provider will provide some level of claim management regarding that product. However, a number of banks, trade financiers and independent companies can also provide bespoke claim management services to both claimants (regarding specific complicated claims) and firms (regarding claims they need to investigate, value and pay).

10.8 OTHER THINGS TO BE CONSIDER :

I. When You Need To Claim:

1. **Take your time:** A breach of contract is a serious issue and often large amounts of finance are at stake. Take time to consider the implications for yourself and other parties involved and inform them of what has happened.
2. **Information is key:** Investigate and understand the crucial terms of the financial product you have purchased the payments, terms, and fees and what procedure you must follow to claim against it.
3. **Clarify your position:** You should discuss any potential claim with the trade financier who issued your product. You want to understand their process for managing your claim against that product, what firm and what team within that

firm will actually conduct the work involved, and what guarantees they will make to you regarding its resolution.

II. When Choosing A Partner :

- Scour the market: there are many firms offering claim management services. Each can offer different expertise and capabilities. Your choice will affect the quality of service you receive as well as the outcome of your claim.
- Know your rights (and responsibility): strict regulations govern the claims management industry. Usually, representatives dealing with claims will need to be qualified individuals working at reputable institutions in order for them to manage claims effectively.
- Follow the money: fees regarding claim management depend on the services provided. Significant fees can apply in certain circumstances, such as if you subsequently opt out of a policy or wish to change your claim manager. Find this out before you engage a management partner.

III. When Agreeing To Terms :

- Consider your settlement: how your claim is managed can affect what form your settlement takes (i.e., how it is paid to you).
- Confirm your rights: many claim managers will restrict who you can engage with once your claim is under management. If you want to use other agents, firms or contractors, check your ability to do so.
- Give yourself flexibility: it is common for parties to have a legal right to cancel any claim management contract in a fixed window (usually 14 days). Ensure this is included in any negotiations over the contract for managing your claim.

10.9 CLAIM MANAGEMENT IN GENERAL INSURANCE :

An insurance claim is a formal request to an insurance company asking for a payment based on the terms of the insurance policy. The insurance company reviews the claim for its validity and then pays out to the insured or requesting party (on behalf of the insured) once approved. The non-life insurance industry is witnessing shifting trends across policy administration, and claims—the two core functions in insurance.

The claims process is the defining moment in a non-life insurance customer relationship. To retain and grow market share and improve customer acquisition and retention rates, insurers are focused on enhancing customers' claims experience. In a highly competitive insurance market, differentiation through new and more effective claims management practices is one of the most important and effective ways to maintain market share and profitability.

In particular, insurers can transform the claims processing by leveraging modern claims systems that are integrated with robust business intelligence, document and content management systems. This will enhance claims processing efficiency and effectiveness. It can benefit the insurers both operationally and strategically by enabling them to reduce claims costs to improve their combined ratio, improve claims processing efficiency, and drive customer retention and acquisition.

Today in any insurance office the claim process is built on

- Claim document & content management tool
- Mobile based & smart phone-based technology solutions the key
- STP processing to minimize delay
- Modern claim processing platform which is seamless & robust

The Following Aspect Needs To Be Kept In Mind : General insurance being a market driven service industry, the customer has to be kept satisfied. With so many options available, a customer once lost is most likely a loss forever. Claim settlement can be used as a marketing tool. Brining in a new customer is much more costly than retaining the existing ones.

1. In a de tariffed market, pricing will be the key factor. Proper claims management and quick settlement at optimal cost will help keep the price competitive.
2. A dissatisfied customer is a bad publicity. It has all the potential to damage the reputation of the company. It is an accepted fact that most of the customers complaint relate to claims. It should be the endeavour of any insurance company to ensure that such complaints do not occur in the first place and in some cases if they do occur it is attended promptly, efficiently and transparently.
3. IRDA guidelines on “protection of policyholders interest’ stipulates certain obligation on the part of insurance company including time limit for claim settlement. This is a regulatory requirement and insurance company personnel at every level must understand its implication.
4. Delayed claim settlement generally results in higher claims cost. Claims cost is a very important factor vis-Ã -vis profitability. Why do delays take place in claim settlement? Nobody will buy the excuse that the claimant is not forthcoming with documents and other requirements for settlement of claim. Is it because of the delay in submission of survey reports? If so, who is responsible for this. Are we undertaking necessarily follow up steps for timely submission of report.
5. Claims files must be monitored as they progress. A little time spent thinking clearly right from the beginning will avoid lot of unnecessary and time-consuming patch-ups and straightening out later on. Unpleasant decisions conveyed timely with proper justification of the decision is better than procrastination which is bound to create more problems and unpleasant situations.It is therefore of utmost importance that the client is made aware in very clear terms about what exactly is covered and what is not. There should be a strong system of audit for examining the documents being issued.
6. Lot of time / energy / money is spent when claim cases go to Ombudsman / Consumer Forum/ Court. Besides, adverse comment brings bad name, when we are held liable. Insurance companies are invariably at the receiving end. The ‘watch and wait’ attitude must change. There is a need to find out why so many cases go to consumer forum or the ombudsman and what should be done about it.
7. Claims-settlement have social service angle which must be met. In times of natural calamity lot of bad publicity comes to insurance company for delay in settlement of claims. This is in spite of the fact that in such situation insurance companies goes out of their way to settle claims. In any case claims relating to the assets of weaker section needs to be attended on priority. So do the health / medical related claims.

10.10 NORMAL CLAIM PROCESS FOLLOWED BY GENERAL INSURERS :

The following is the generally used process in general insurance

- An insured or the claimant shall give notice to the insurer of any loss arising under contract of insurance at the earliest or within such extended time as may be allowed by the insurer.
- On receipt of such a communication, a general insurer shall respond immediately and give clear indication to the insured on the procedures that he should follow.

In cases where a surveyor has to be appointed for assessing a loss/ claim, it shall be so done within 72 hours of the receipt of intimation.

- Where the insured is unable to furnish all the particulars required by the surveyor or where the surveyor does not receive the full cooperation of the insured, the insurer or the surveyor as the case may be, shall inform in writing the insured about the delay that may result in the assessment of the claim.
- The surveyor shall be subjected to the code of conduct laid down by the Authority while assessing the loss, and shall communicate his findings to the insurer within 30 days of his appointment with a copy of the report being furnished to the insured, if he so desires. Where, in special circumstances of the case, either due to its special and complicated nature, the surveyor shall under intimation to the insured, seek an extension from the insurer for submission of his report.
- In no case shall a surveyor take more than six months from the date of his appointment to furnish on receipt of the survey report or the additional survey report, as the case may be, an insurer shall within a period of 30 days offer a settlement of the claim to the insured. If the insurer, for any reasons to be recorded in writing and communicated to the insured, decides to reject a claim under the policy, it shall do so within a period of 30 days from the receipt of the survey report or the additional survey report, as the case may be.
- Upon acceptance of an offer of settlement by the insured, the payment of the amount due shall be made within 7 days from the date of acceptance of the offer by the insured. In the cases of delay in the payment, the insurer shall be liable to pay interest at a rate which is 2 per cent above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

10.11 CLAIM UNDER MOTOR INSURANCE :

A claim under a motor insurance policy could be

- For personal injury or property damage related to someone else. This person is called a third party in this context) or
- For damage to insured own vehicle. This is called an own damage claim and insured is eligible for this if he is holding what is known as a package or a comprehensive policy.

Third Party Claim : In a third-party claim, where insured vehicle is involved, it is important to ensure that the accident is reported immediately to the police as well as to the insurance company. On the other hand, insured is a victim, that is, if somebody else’s vehicle was involved, he must obtain the insurance details of that vehicle and make intimation to the insurer of that vehicle.

Own Damage Claim : In the event of an own damage claim, that is, where insured vehicle is damaged due to an accident, insured must immediately inform insurance company and police, wherever required, to enable them to depute a surveyor to assess the loss.Insured must not attempt to move the vehicle from the accident spot without the permission of police and insurer.

Theft Claim : If own vehicle is stolen, he must inform the police and the insurance company immediately. In addition, you must keep the transport department also informed. As soon receives the policy document, he must read about the procedures and documentation requirements for claims.

If the party has to make a claim, he must ensure that he collects all the required documents and submit them along with the requisite claim form duly filled in, to the insurance company. There may be certain specific documentation requirements for specific types of claims. For instance, in respect of a theft claim, there is a special requirement that person should surrender the vehicle keys to the insurance company.

Property Insurance Claim : There could be several types of policies that cover property and the property itself could be stationery - like a building, or moving around - like your household goods being transported. on receipt of policy document must familiarize himself with the documents required for a claim as well as the procedures to be followed.

Whether or not a claim arises must follow the various dos and don’ts in respect of his property for the duration of the policy. These dos and don’ts are termed warranties and conditions in the policy document. In general, losses and damages, including those due to theft, fire and flood need be intimated to the relevant authorities such as the police, the fire brigade and so on. It is important to ensure that he must intimate insurance company to enable it to send a surveyor for surveying and assessing the loss.

Travel Insurance Claim : Travel insurance policy is generally a package policy that includes different types of covers like hospitalization, personal accident, loss/ damage to baggage, For ease of procedure and convenience, insurers normally attach the claim form with the policy document. This will contain the list of documents required in case of a claim and also the contact details including phone numbers of the claim’s administrator either in the destination country to which you are traveling or in another country that is designated to receive and process your claim intimation.

10.12 FORMALITIES FOR A HEALTH INSURANCE CLAIM :

The party can make a claim under a Health insurance policy in two ways:

1. Cashless basis and
2. Reimbursement basis

1. **On a Cashless basis:** For a claim on cashless basis, treatment must be only at a network hospital of the Third-Party Administrator (TPA) who is servicing your policy. Party must seek authorization for availing the treatment on a cashless basis as per procedures laid down and in the prescribed form. He must read the policy document as soon as he receives it, to understand claim process and not read it at the time claim arises.
2. **Claims on reimbursement basis:** Party must read the clause relating to claims in policy document as soon as he receives it to ensure that he understands the procedure and the documents required for making a claim on reimbursement basis. When a claim arises, he should inform the insurance company as per procedures required. After hospitalization, he has to ensure that he obtains and keep ready documents such as claim form, discharge summary, prescriptions and bills that he should submit for a claim.

Every insurer in their website clearly provides all relevant information relating to

- How to lodge a claim
- What documents to be kept in possession
- Whom to be contacted to lodge a claim
- What information needs to be provided in lodging a claim
- Claim process adopted by the insurer
- How to follow up on claims lodged
- Help desk details to support customer service

This information is also included as part of policy document in every sales brochure or communication.

10.13 CLAIM MANAGEMENT IN LIFE – INSURANCE :

Claim settlement is one of the most important services that an insurance company can provide to its customers. Insurance companies have an obligation to settle claims promptly. You will need to fill a claim form and contact the financial advisor from whom you bought your policy. Submit all relevant documents such as original death certificate and policy bond to your insurer to support your claim. Most claims are settled by issuing a cheque within 7 days from the time they receive the documents. However, if your insurer is unable to deal with all or any part of your claim, you will be notified in writing.

10.14 EFFICIENT CLAIM MANAGEMENT :

An effective claim management process adheres to all the regulations and guidelines, differentiates between genuine and invalid claims, and is fair and responsive. In the year 2018-19, the life insurance companies had settled 8.43 lakh claims on individual policies, 6,372 claims were repudiated, and 3,697 claims were rejected. The death claim settlement ratio of insurance companies ranges between 85.3-99.07 per cent for the year 2018-19, according to IRDA’s annual report 2019. Digging deep into the report, the average claim settlement amount paid by LIC is just around Rs 1.75 lakh whereas it is over Rs 15 lakh by Aegon. New-age life insurance companies like Aegon aggressively sell high sum assured term plans, unlike LIC which has been giving prime importance to the endowment and money-back policies. The total pay-out amount stands Rs 17,365 crore. These are some important aspects of efficient claim management. Let us dig deep into important aspects of efficient claim management.

- The claim management process should be speedy, hassle-free, customer-oriented, and data-driven.
- It must have a fair governance practice on fraud management irrespective of the fact that fraudulent claims are emanating from within the company or outside the company.
- The insurance agents must be trained to inform every customer about the pitfalls in claim settlement in case of misrepresentation of facts in addition to sharing other policy-related information.
- The concerned insurance agent or customer-facing entity must be prompt in all the communications related to claim settlement.

10.15 CLAIM SETTLEMENT PROCESS IN LIFE INSURANCE :

Life insurance is a contract between the policyholder and the insurance company in which the insurance company agrees to pay a definite amount of money to the nominee of the policyholder in exchange for a premium paid by the policyholder. Life insurance penetration in India is still on the lower end as compared to other countries. The life insurance penetration in India is 3.7 per cent of the GDP as against the world average the 6.31per cent. Once upon a time in India, life insurance was considered a waste of investment due to fraud and lack of awareness among the public. But due to the advancement in technology and insurance companies, life insurance has become accessible to many people. The level of awareness regarding life insurance has increased in recent days and the sector is growing an average at 11 per cent per annum.

Process Of Claims In Case Of Death :

A life insurance claim is a request for payment from an insurer, in consideration of the death of a policyholder. The claim is typically filed by someone with a legal right to receive benefits, such as the spouse or other beneficiary. The person filing the claim must provide evidence that the insured individual has died and that they are entitled to benefits under the terms of the policy. The insurer will then examine any evidence that has been provided and decide on whether or not to pay out any money.

Let us understand the step-by-step procedure of the life insurance claim process in India:

Step 1: Claim Intimation : n case of early death claims, the nominee of the policyholder or the immediate family members can lodge a claim with the insurance company. The liability claim intimation can be done online or offline which should contain basic information such as the Name of the Policyholder, Policy number, Date of Maturity, etc. In case of offline intimation, the claim form can be availed from the nearest life insurance branch and duly filled out before submission.

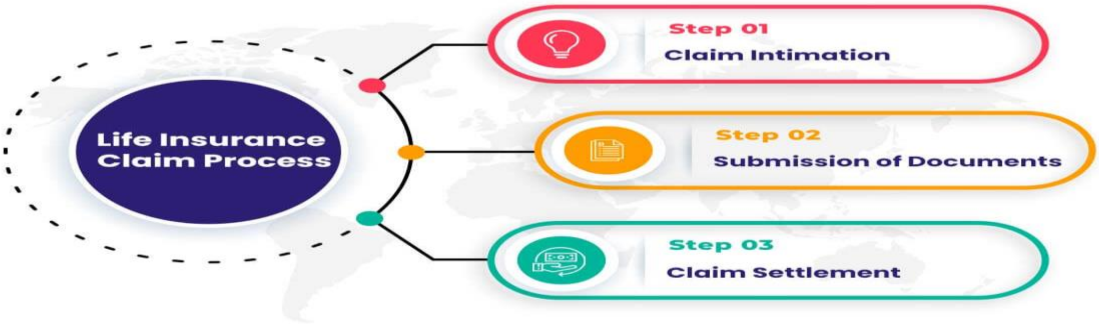
It is important to note that a claim intimation number is provided by the insurance company which is to be retained and used for any further communication with the insurance company.

Step 2: Submission of Documents : Once the claim intimation is done and the claim intimation number is obtained, the next step is to provide all the relevant documents to the insurance company. It is advisable to submit all the documents in one go to avoid to and pro communication with the insurance company.The following documents are to be provided by the nominee or the policyholder:

- Certificate of Death (Death Claim)
- Panchanama report (Death claim)
- Statement from the hospital if the insured is admitted
- Certificate from medical attendant stating that the illness of the insured
- F.I.R Report (Accident death claim)
- Cremation or burial report
- Certificate from an employer if the deceased is an employee.
- Age proof
- Residence proof
- Relation proof with the policyholder (Death claim)
- Deeds of assignment (if any)
- Policy document
- Duly filled claim form/ claim intimation number
- Bank account details

Any other documents as required by the insurance company

Step 3: Claim Settlement : As per regulation 8 of the IRDA (Policyholder's Interest) Regulations, 2002, the insurer is required to settle a claim within 30 days of receipt of all the required documents. If the claim is an early claim (a claim which occurred within 3 years from the date of policy start date) then there would be further investigation by the insurer. This procedure has to be completed within six months from the date of receiving written intimation of the claim.After receiving all the documents, the claim settlement procedure of life insurance is processed and the insurance company releases the funds into the account mentioned in the claim intimation form.



Life Insurance Maturity Claim Process : The life insurance maturity claim process is a process of claiming the maturity benefits from an insurance policy. These claims are a complicated process. It is important to understand the process and know how to handle it in case of an emergency. The process starts by reviewing the policy and determining if there are outstanding premiums or any other outstanding obligations that need to be paid before the claim can be processed.

After this, the life insurance company will request all necessary documentation and information that is required for a claim to be paid in full. This includes death certificates, copies of tax returns, mortgage statements, or any other documents that may be needed. The company will then review these documents and decide whether or not they will authorize the payment of the claim.

Life Insurance Rider Claim Process : Life insurance riders are an optional add-on to a regular life insurance policy that can provide additional coverage in the event of specific events. There are many types of life insurance riders:

- Accidental Disability Insurance Rider
- Critical Illness Insurance Rider
- Waiver of Premium Rider
- Accidental Death Benefit Rider, etc.

For different life insurance riders, different claim proceedings are required. Some riders may be valid with the death claim like accidental death rider or some riders need to process claims like waiver of premium rider in case of disability. To claim, the insured person submits the rider claim form to their insurer and provides any necessary supporting documentation.

- ❖ **For Critical Illness Rider Claim:** Submit necessary medical documents such as first diagnosis report, Doctor's report, etc.
- ❖ **For Accidental disability rider Claim:** Submit a copy of FIR, Certificate of disability, doctor's report, etc.

10.16 FIVE IMPORTANT THINGS TO KNOW ABOUT LIFE INSURANCE CLAIM

The life insurance claim process is a lengthy and complicated process that involves different levels of expertise. To make this process smoother, we have compiled a list of five important things you should know before starting your life insurance claim.

1. Know the reasons for life insurance claim rejection.
2. Life insurance claim is a process that takes time to complete.
3. The life insurance company will not pay out the claim unless all the necessary documents are provided.
4. If you have any doubts about your claim, it is best to contact the life insurance company for clarification.
5. Before buying a life insurance policy check all the claim settlement ratios of the insurer.

The process of life insurance claims is not as complicated as it may seem. There are many ways in which you can make your life insurance claim process go smoothly so that you get the maximum benefit out of your investment. Some tips to help you avoid big financial losses:

- Do not make any changes to your policy without first consulting an expert.
- Keep a copy of all documents related to your policy and keep them in a safe place.
- Make sure that the beneficiary listed on the policy is up-to-date and accurate.

10.17 SUMMARY :

The claim management is very important task in insurance industry. The efficiency of an insurance company depends upon the effective claim settlement and also causes to build goodwill in this field. The process of the claim settlement is not similar in life and non-life insurances. Settlement time for claim, honesty in settlements are the key points in the life insurance field. Different types of documents and procedures are required for different general insurance claims. All are discussed above.

10.18 KEY WORDS :

1. Claim management
2. Settlement of insurance claim
3. Fraud claim
4. De-tariffed market
5. Delayed claim
6. Third-party claim

10.19 SELF – ASSESSMENT QUESTIONS :

1. What is claim management in insurance sector? How it processed?
2. Brief the importance of claim management in general insurance.
3. What are the documents required for claim in life insurance?
4. Write a note on efficient claim management in insurance.

10.20 FURTHER READINGS :

1. Insurance Claims Solutions – by Dr.L.P.GUPTA
2. Investigation of Insurance Claims - by Govind Johri
3. Understand Insurance Fraud: Claims Investigation Process And Types Of Claims Investigated: Insurance Fraud Files - by Adolfo Bulleri.
4. Insurance and Behavioral Economics - by Professor Howard C. Kunreuther

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LESSON -11
INSURANCE PRICING

AIMS AND OBJECTIVES :

After studying this lesson the student should be able to :

- Know the Pricing objectives and Fundamentals of Insurance Pricing
- Understand about Life Insurance vs. Non-Life Insurance Pricing,
- Awareness about overall Insuring Pricing.

STRUCTURE OF THE LESSON :

11.1 INTRODUCTION :

Insurance : Represented in a form of policy, Insurance is a contract in which the individual or an entity gets the financial protection, in other words, reimbursement from the insurance company for the damage (big or small) caused to their property. The insurer and the insured enter a legal contract for the insurance called the insurance policy that provides financial security from the future uncertainties. In simple words, insurance is a contract, a legal agreement between two parties, i.e., the individual named insured and the insurance company called insurer. In this agreement, the insurer promises to help with the losses of the insured on the happening contingency. The insured, on the other hand, pays a premium in return for the promise made by the insurer. The contract of insurance between an insurer and insured is based on certain principles, let us know the principles of insurance in detail.

Insurance Pricing: Any company aims to set prices to maximize its profits. This is also referred to as optimal pricing. It is not different in the insurance sector. Ideal pricing (or premium in insurance terminology) must cover: Variable costs + Operating expenses + Profits. Setting an optimal price depends on understanding costs, price elasticity’s, consumer preferences, and the strategic actions of competitors. Some insurers are ahead of the curve in developing pricing systems that strike an effective and efficient balance. They achieve sufficient margin, overcome cost pressures, and at the same time attract new customers first time buyers and those previously served by competitors—and retain the best existing customers. Such companies tend to have systems and methods that have emerged as best practices in the industry.

11.2 FUNDAMENTALS/PRINCIPLES OF INSURANCE PRICING :

The concept of insurance is risk distribution among a group of people. Hence, cooperation becomes the basic principle of insurance. To ensure the proper functioning of an insurance contract, the insurer and the insured have to uphold the 7 principles of Insurances mentioned below: **i.** Utmost Good Faith; **ii.** Proximate Cause; **iii.** Insurable Interest; iv. Indemnity; v. Subrogation; vi. Contribution; vii. Loss Minimization. Let us understand each principle of insurance with an example.

i. **Principle of Utmost Good Faith:** The fundamental principle is that both the parties in an insurance contract should act in good faith towards each other, i.e. they must provide clear and concise information related to the terms and conditions of the contract. The Insured should provide all the information related to the subject matter, and the insurer must give precise details regarding the contract. Example – Jacob took a health insurance policy. At the time of taking insurance, he was a smoker and failed to disclose this fact. Later, he got cancer. In such a situation, the Insurance company will not be liable to bear the financial burden as Jacob concealed important facts.

ii. **Principle of Proximate Cause:** This is also called the principle of 'Causa Proxima' or the nearest cause. This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property. If the proximate cause is the one in which the property is insured, then the company must pay compensation. If it is not a cause the property is insured against, then no payment will be made by the insured. Example – Due to fire, a wall of a building was damaged, and the municipal authority ordered it to be demolished. While demolition the adjoining building was damaged. The owner of the adjoining building claimed the loss under the fire policy. The court held that fire is the nearest cause of loss to the adjoining building, and the claim is payable as the falling of the wall is an inevitable result of the fire. In the same example, the wall of the building damaged due to fire, fell down due to storm before it could be repaired and damaged an adjoining building. The owner of the adjoining building claimed the loss under the fire policy. In this case, the fire was a remote cause, and the storm was the proximate cause; hence the claim is not payable under the fire policy.

iii. **Principle of Insurable interest**: This principle says that the individual (insured) must have an insurable interest in the subject matter. Insurable interest means that the subject matter for which the individual enters the insurance contract must provide some financial gain to the insured and also lead to a financial loss if there is any damage, destruction or loss. Example – the owner of a vegetable cart has an insurable interest in the cart because he is earning money from it. However, if he sells the cart, he will no longer have an insurable interest in it. To claim the amount of insurance, the insured must be the owner of the subject matter both at the time of entering the contract and at the time of the accident.

iv. **Principle of Indemnity:** This principle says that insurance is done only for the coverage of the loss; hence insured should not make any profit from the insurance contract. In other words, the insured should be compensated the amount equal to the actual loss and not the amount exceeding the loss. The purpose of the indemnity principle is to set back the insured at the same financial position as he was before the loss occurred. Principle of indemnity is observed strictly for property insurance and not applicable for the life insurance contract. Example – The owner of a commercial building enters an insurance contract to recover the costs for any loss or damage in future. If the building sustains structural damages from fire, then the insurer will indemnify the owner for the costs to repair the building by way of reimbursing the owner for the exact amount spent on repair or by reconstructing the damaged areas using its own authorized contractors.

v. **Principle of Subrogation:** Subrogation means one party stands in for another. As per this principle, after the insured, i.e. the individual has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property goes to the insurer, i.e. the company. Subrogation gives the right to the insurance company to claim the amount of loss from the third-party responsible for the same. Example – If Mr A gets injured in a road accident, due to reckless driving of a third party, the company with which Mr A took the accidental insurance will compensate the loss occurred to Mr A and will also sue the third party to recover the money paid as claim.

vi. **Principle of Contribution:** Contribution principle applies when the insured takes more than one insurance policy for the same subject matter. It states the same thing as in the principle of indemnity, i.e. the insured cannot make a profit by claiming the loss of one subject matter from different policies or companies. Example – A property worth Rs. 5 Lakhs is insured with Company A for Rs. 3 lakhs and with company B for Rs.1 lakhs. The owner in case of damage to the property for 3 lakhs can claim the full amount from Company A but then he cannot claim any amount from Company B. Now, Company A can claim the proportional amount reimbursed value from Company B.

vii. **Principle of Loss Minimization:** This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimise the loss to the insured property. The principle does not allow the owner to be irresponsible or negligent just because the subject matter is insured. Example – If a fire breaks out in your factory, you should take reasonable steps to put out the fire. You cannot just stand back and allow the fire to burn down the factory because you know that the insurance company will compensate for it.

viii. **Getting Started:** Insurers considering a program to improve pricing should ask themselves questions such as the following in order to put themselves on the right path:

a. Is our pricing strategy bringing us all the benefits it should?
b. Do we truly understand the dynamics of customers' reactions to price changes?
c. Do we have the organizational capabilities to deliver a pricing step change that will give us a significant edge over our competitors?
d. What investments should we make in order to close any gaps in our pricing abilities?

Insurers that take the initiative to address the many pricing-related challenges (and opportunities) will very likely find themselves benefiting from their efforts in the years to come. They will be surer of having a finger on the pulse of their customers and will be well positioned to react with pricing moves. They will also know which moves will bring the best net result. Insurers that fail to take action may end up playing a guessing game that will diminish their pricing power going forward.

11.3 INSURANCE PRICING OBJECTIVES :

Minimizing Variable Costs

i. Minimizing the cost of risk bearing service (more effective underwriting)

ii. The most important variable cost for insurance companies is the determination of the cost of risk. Each insurance policy can be described as an exchange of risk for money.
iii. Detecting Fraudulent Claims
iv. Optimizing customer service
v. Reducing rent expenses ...
vi. Reducing other operating expenses
vii. Determine a realistic profit margin

11.4 TYPES OF RATE MAKING :

Rate making, or insurance pricing, is the determination of rates charged by insurance companies. The benefit of rate making is to ensure insurance companies are setting fair and adequate premiums given the competitive nature. The following are fundamental terms that are commonly used in rate making. A rate "is the price per unit of insurance for each exposure unit, which is the unit of measurement used in insurance pricing". The exposure unit is used to establish insurance premiums by examining parallel groups. The pure premium "refers to that portion of that rate needed to pay losses and loss-adjustment expenses". The loading "refers to the amount of the premium necessary to cover other expenses, particularly sales expenses, and to allow for a profit". The gross rate "is the pure premium and the loading per exposure unit". Finally, the gross premium is the premium paid by the insured consisting of the gross rate multiplied by the number of exposure units.

Objectives of Rate making : Rate making has several objectives under regulatory requirements regulated by the states and business objectives due to the goal of profitability: The goal of insurance regulation is to protect the public and three regulatory objectives are placed to meet certain standards:

i. The first regulatory requirement is that rates must be adequate; meaning the rates the insurers charge should be able to cover expenses.
ii. The second regulatory requirement is that rates must not be excessive; meaning rates should not be so high that policyholders are paying more than the actual value of their protection.
iii. The third regulatory objective is the rates must not be unfairly discriminatory; meaning exposures that are similar with respect to losses and expenses should not be charged significantly different rates.

The business objectives are set as a guide for insurers while designing the rating system. The rating system should meet each of the four objectives

i. For producers to be able to quote premiums with a minimum amount of their time and expense, the rating system should be easy to understand.
ii. To maintain customer satisfaction, the rates should remain stable over short periods of time. The rapid change of rates could lead to customer dissatisfaction.
iii. To meet the objective of rate adequacy, the rates should be responsive over time in comparison with changing economic conditions and loss exposures.
iv. Finally, to reduce the frequency and severity of losses, the rating system should encourage loss control activities. Loss control is important in insurance because it tends to keep insurance affordable.

Rate-making Methods :
In property and casualty insurance, there are three basic rate-making methods:

i. Judgment Rating is used when the factors that determine potential losses are varied and cannot easily be quantified There are no statistics regarding quantity of future losses and probability. This means an underwriter rates each exposure individually.
ii. The second rate making method is class rating, or manual rating. This rating means that exposures with similar characteristics are placed in the same underwriting class, and each is charged the same rate. The advantage of class rating lies with its easy application and ability to quickly be obtained.
iii. The third rate making method is merit rating. This rating means a plan which class rates, or manual rates are adjusted upward or downward based on individual loss experience. Merit rating is based on the assumption of loss experience will differ substantially from other loss experiences.

Rate making in Life Insurance : Life insurance actuaries determine the probability of death in any given year, and based on this probability determine the expected value of the loss payment. These expected future payment are discounted back to the start of the coverage period and summed to determine the net single premium. The net single premium may be leveled to convert to installment premiums. A loading for expenses is added to determine the gross premium. With determining life expectancy, age is the most important factor, other significant factors are sex of the individual and smoking. Thus, an actuary can reasonably estimate the average age of death for a group of 25-year-old males, who don't smoke.

Benefits of Insurance : The insurance gives benefits to individuals and organisations in many ways. Some of the benefits are discussed below:

i. The obvious benefit of insurance is the payment of losses.
ii. Manages cash flow uncertainty when paying capacity at the time of losses is reduced significantly.
iii. Complies with legal requirements by meeting contractual and statutory requirements, also provides evidence of financial resources.
iv. Promotes risk control activity by providing incentives to implement a program of losing control because of policy requirements.
v. The efficient use of the insured’s resources. It provides a source of investment funds. Insurers collect the premiums and invest those in a variety of investment vehicles.
vi. Insurance is support for the insured’s credit. It facilitates loans to organisations and individuals by guaranteeing the lender payment at the time when collateral for the loan is destroyed by an insured event. Hence, reducing the uncertainty of the lender’s default by the party borrowing funds.
vii. It reduces social burden by reducing uncompensated accident victims and the uncertainty of society.
viii. Candidates appearing for any government exams or competitive exams can check Previous Year Question Papers with solution PDF to understand the type of questions asked in the general awareness section of these examinations.

11.5 OPTIMAL INSURANCE PRICING :

Setting an optimal premium price provides a competitive advantage for the firms. As in any industry, the price is subject to the law of demand and supply. Since getting the best price is the top priority for insurance customers, even a small percentage change in premium prices causes many customers to switch providers. Therefore, optimal pricing in the insurance sector enables profit maximization by allowing operators to gain market share in segments of their choice (e.g. more profitable segments). McKinsey’s study supports this argument. As the below chart demonstrates, average profit distribution in the insurance sector varies significantly. McKinsey argues that the most profitable insurance companies use technology-enabled underwriting processes to effectively set premiums. Only the top 5% of insurance companies can make significant economic profit. Source: McKinsey

Top 6 ways of achieving optimal insurance pricing: As mentioned earlier, determining the optimal premium involves minimizing variable costs, operating costs, and optimizing the desired profit margin. For insurance practice, this means: Increase the efficiency of the underwriting process (minimizing variable costs). Detecting fraudulent claims more effectively (minimizing variable costs). Minimizing the customer service, rent and other expenses. Realizing the realistic profit margin that does not lead to a reduction in the customer satisfaction. (Respect the law of supply and demand). Minimizing Variable Costs

i. **Minimizing the cost of risk bearing service (more effective underwriting) :** The most important variable cost for insurance companies is the determination of the cost of risk. Each insurance policy can be described as an exchange of risk for money. Thus, each realized claim represents the variable cost of the insurance sector, which is difficult to determine compared to the variable costs of other sectors. For example, in the case of manufacturers, the variable costs, such as raw materials, are fairly certain, which makes it easier to minimize it. In the insurance sector, on the other hand, variable costs are a probabilistic distribution. Therefore, it is challenging to minimize it. In order to evaluate the risk, insurers check some statistical data about the person or company applying for the insurance (subject variables) or about the object to be insured (object variables). For example, in car insurance, insurers evaluate variables such as the segment of the car, the age of the policyholder, the mileage and previous penalties of the policyholder, etc. The idea is that there is a relationship between these variables and the expected damage that would cost the insurance company. Before AI/ML algorithms, primitive risk assessment models like linear regression and generalized linear model (GLM) were used for interpreting statistics. Nowadays, AI based underwriting assesses risk with more sophisticated analytics. Also, data was scarce before the growth of IoT devices. Therefore, insurers can assess risk more precisely today. Uncertainty of variable cost diminishes for the companies that adopt new technologies effectively. Such a progress makes it easy to determine optimal prices for insurance companies and provides a competitive advantage.

ii. **Detecting Fraudulent Claims :** According to the Coalition Against Insurance Fraud, fraudulent claims cost the U.S. $80 billion per year. Fraud is a factor that increases the costs for insurance companies and thus increases the premium prices. Therefore detecting fraudulent claims more effectively can be used either to increase profits or market share. Fraud detection may be enhanced by using AI/ML models: Using behavioral analytics increases the probability of foreseeing some fraudulent claims before they occur. For instance, analyzing customers' habits, companies can determine whether their behavior is consistent or not. If there is any suspicion, companies can investigate further. Automation of claim processing with chatbots that direct policyholders to capture streaming video of damage can reduce fraudulent claims by providing evidence to support the claimant's description. Using NLP and computer vision technologies to detect fraud more efficiently. For example fraudulent documents can be identified using computer vision techniques. Minimizing the operating expenses- Various business expenses such as customer service, rent and other expenses can be decreased thanks to technological advancements. This can help insurers give more flexibility in pricing. Some examples of operational efficiency improvements include:

iii. **Optimizing customer service :** Insurance chat bots and omni channel engagement with clients can significantly reduce customer service-related expenses and increase customer satisfaction due to: Optimized customer care response times. Engaging with customers via variety of platforms such as: WhatsApp -Mobile App-Website- Task automation. Allocating workforce to tasks that yield greater value. Also, predictive analytics, can assist insurance companies to prioritize their customers who need immediate claims processing, which in turn lowers operating expenses.

iv. **Reducing rent expenses :** Millennials and urbanites generally demand less physical interaction, and this process has accelerated following the Covid 19 pandemic. Thanks to digital technologies and applications insurance companies and brokers can benefit from this recent trend and reduce the number of branches. This means lower expenses and more room for maneuver in terms of pricing strategy.

v. **Reducing other operating expenses :** One of the cost drivers in commercial insurance is inspections. Plants and equipment need to be inspected for validating their current status and identifying relevant risks. Companies can outsource these inspections, lowering their costs.

vi. **Determine a realistic profit margin:** Jeff Bezos famously said "Your margin is my opportunity". This is definitely relevant in the insurance industry as identified in surveys. Venture funded companies are embracing that paradigm to set aggressive prices and gain market share. Their goal would be to dominate the market and set more profitable prices in the future when they have achieved substantial scale. Therefore, insurers need to take multiple factors in the account while pricing: Competitors' pricing, including some irrational moves by competitors.

The fact that market is mature. High price elasticity. It is important to note that while price is the greatest priority, it is not the only important factor that pulls the customers. Claims processing speed and effectiveness, customer service, consumer friendly digital interfaces etc. are all important factors for consumers picking an insurer.

Therefore, success in these areas may help charge a higher profit margin for your products.

11.6 PRICING PROCESS :

Although pricing has become an increasingly critical factor in achieving competitive advantage in the global insurance industry, many companies are still trying to find the right balance in their pricing schemes. Simply put, insurers need a system capable of attracting new business and retaining profitable existing business. But the schemes must also be sufficiently robust to overcome severe cost challenges. Why are so many insurers struggling with pricing? The reasons vary and tend to be country specific. And they are not mutually exclusive. For some companies, the problem is that despite price increases, their systems and processes have not reached a level of sophistication capable of delivering their intended pricing strategy. For others, overcapacity in their markets is driving prices down. One overarching trend, particularly in mature markets, is that customers are increasingly discerning and price sensitive. In addition, the entry of direct players and price aggregators has meant greater transparency, which allows customers to choose the least expensive deal. This transparency has contributed, in particular, to the commoditization of the motor-vehicle insurance industry. Some companies are feeling the effects of many of the above circumstances simultaneously.

The Six Steps to Pricing Power in Insurance : Fortunately, there are concrete actions that insurers can take to improve both pricing strategy and price realization. We call these actions the six steps to pricing power in insurance. In our view, insurers can enhance their pricing capabilities by acting on the following six imperatives:

- **Improve portfolio price management :** Too few insurers have reached their potential in terms of maximizing retention of the most profitable clients and improving the profitability of low-value clients. This goal can be achieved only by gaining a deeper understanding of one's own client base and by developing increasingly granular segmentation. The ability to generate deep client insight from comprehensive data collection is critical, particularly for identifying prospects for cross selling and for adding higher-margin auxiliary coverage alongside principal policies.
- **Sharpen new-business pricing :** Many insurers are tempted to attract clients with initial deep discounts, hoping for price appreciation at renewal time. But this strategy is proving increasingly ineffective. Insurers need to leverage data not only from their own client portfolios but also from a thorough examination of industry wide buying behavior in order to both optimize the pricing of new business and reinforce risk management. Insurers should also incorporate more realistic assumptions into customer lifetime-value projections in order to avoid being taken unawares when customers choose not to renew policies.
- **Minimize the variation between list and street prices :** Sales forces always have a certain amount of leeway in offering price discounts. But discount budgets are often abused, resulting in a distorted overall pricing structure and the generation of unprofitable portfolios. Minimizing the discrepancies in intended price, rating structure, and actual price is especially important in a business intermediated by agents and brokers. Moreover, the distribution of discount budgets must be controlled and linked to agents' overall performance. Agents who misuse their discount budgets should be penalized by having their pricing discretion curtailed going forward.
- **Align distribution objectives with companywide goals and pricing strategy :** Insurers' distribution networks are typically remunerated on the basis of top-line performance only. And in some cases, new business earns higher commissions than renewals. The result of such compensation schemes can be insufficient focus on retention and sales that lack the potential for long-term profitability. In our client work, we have observed that aligning distribution incentives with organizational objectives is crucial to success. Insurers need to base their design incentives on the bottom line (loss ratio) as well as on the top line. Furthermore, insurers need to provide agents with tools such as alternatives to monetary discounts (including higher deductibles, free supplementary coverage, and vouchers for future renewals) and access to first-rate customer-relationship-management systems that can help them retain their best customers. Agents should also receive regular training updates on how to retain customers and provide the best possible sales experience.
- **Incorporate customer and competitor elements into pricing :** Many insurers are adept at setting cost-oriented pricing structures that are based on claims experience. But few excel at incorporating client price sensitivity and prevailing market prices (those of competitors) into their own pricing. Although some insurers might say that regulations in their market do not allow demand-based pricing or that their agents do not like it, we have seen organizations find innovative ways to work within regulatory frameworks, ultimately earning returns of up to 5 percent of gross written premiums. (See the exhibit, "Insurers Need to Incorporate Both Customer and Competitor Elements into Pricing Strategies.")
- **Strengthen the organization's infrastructure :** To ensure that pricing initiatives can evolve smoothly, insurers need to put in place "enabling" organization

structures and processes. These should include a strong actuarial team, as well as sharp managerial oversight capable of translating the business strategy into a disciplined pricing strategy. Most insurers need a step change in pricing processes, including better dialogue among actuarial, marketing, and senior-management teams—with the last being truly able to understand, monitor, and critique the work of the actuaries. In addition, insurers need more frequent and dynamic updates to their pricing systems. Updating, in many cases, involves a fair amount of organizational courage and willingness to try new systems, conduct pricing tests, and stretch boundaries in terms of common practices.

11.7 TYPES OF INSURANCE :

There are two broad categories of insurance: Life Insurance - General insurance

a. Life Insurance – The insurance policy whereby the policyholder (insured) can ensure financial freedom for their family members after death. It offers financial compensation in case of death or disability. While purchasing the life insurance policy, the insured either pay the lump-sum amount or makes periodic payments known as premiums to the insurer. In exchange, of which the insurer promises to pay an assured sum to the family if insured in the event of death or disability or at maturity. Depending on the coverage, life insurance can be classified into the below-mentioned types:

- **i. Term Insurance :** Gives life coverage for a specific time period.
- **ii. Whole life insurance :** Offer life cover for the whole life of an individual
- **iii. Endowment policy :** a portion of premiums go toward the death benefit, while the remaining is invested by the insurer.
- **iv. Money back Policy :** a certain percentage of the sum assured is paid to the insured in intervals throughout the term as survival benefit.
- **v. Pension Plans :** Also called retirement plans are a fusion of insurance and investment. A portion from the premiums is directed towards retirement corpus, which is paid as a lump-sum or monthly payment after the retirement of the insured.
- **vi. Child Plans :** Provides financial aid for children of the policyholders throughout their lives.
- **vii. ULIPS :** Unit Linked Insurance Plans: same as endowment plans, a part of premiums go toward the death benefit while the remaining goes toward mutual fund investments.

b. General Insurance : Everything apart from life can be insured under general insurance. It offers financial compensation on any loss other than death. General insurance covers the loss or damages caused to all the assets and liabilities. The insurance company promises to pay the assured sum to cover the loss related to the vehicle, medical treatments, fire, theft, or even financial problems during travel.

General Insurance can cover almost anything, and everything but the five key types of insurances available under it are –

- i. Health Insurance: Covers the cost of medical care.
- ii. Fire Insurance: give coverage for the damages caused to goods or property due to fire.
- iii. Travel Insurance: compensates the financial liabilities arising out of non-medical or medical emergencies during travel within the country or abroad
- iv. Motor Insurance: offers financial protection to motor vehicles from damages due to accidents, fire, theft, or natural calamities.

v. Home Insurance: compensates the damage caused to home due to man-made disasters, natural calamities, or other threats

11.8 LIFE INSURANCE PRICING AND ANNUITY PRODUCTS :

Standard of Practice : Transmittal Memorandum: **TO:** Members of Actuarial Organizations Governed by the Standards of Practice of the Actuarial Standards Board and Other Persons Interested in the Pricing of Life Insurance and Annuity Products- **FROM:** Actuarial Standards Board (ASB)- **SUBJ:** Actuarial Standard of Practice (ASOP) No. 54, Pricing of Life Insurance and Annuity Products. This document is the final version of ASOP No. 54, Pricing of Life Insurance and Annuity Products.

History of the Standard: The ASB periodically reviews the completeness of ASOPs for all practice areas and asked the Life Committee to consider whether an ASOP addressing life insurance and annuity pricing principles would be appropriate. In October 2014, the ASB Life Committee distributed a Request for Comments regarding an ASOP focused on life insurance and annuity pricing. Sixteen comment letters were received. Most of the comments supported the drafting of such an ASOP. The pricing of products is one of the most important functions actuaries perform. Therefore, the ASB Life Committee believes that the profession would be well served by an ASOP providing guidance regarding life insurance and annuity product pricing. The ASB agreed and approved the creation of an exposure draft.

First Exposure Draft : In March 2016, the ASB approved an exposure draft of this proposed ASOP. Seventeen comment letters were received and considered in making changes that were reflected in the second exposure draft.

Second Exposure Draft : In June 2017, the ASB approved a second exposure draft with a comment deadline of October 31, 2017. Six comment letters were received and considered in making changes that are reflected in this final ASOP. The ASB thanks all those who made comments on each of the exposure drafts.

The Actuarial Standards Board (ASB) sets standards for appropriate actuarial practice in the United States through the development and promulgation of Actuarial Standards of Practice (ASOPs). These ASOPs describe the procedures an actuary should follow when performing actuarial services and identify what the actuary should disclose when communicating the results of those services.

11.9 NON-LIFE INSURANCE POLICY: TYPES, FEATURES, BENEFITS & IMPORTANCE :

Insurance in India can be divided into life and non-life. General insurance is highly popular as these policies provide financial compensation when losses occur. These losses can be caused due to various incidents like accidents, diseases, fire, natural or man-made mishaps, etc.

a) **Non-Life Insurance:** The **definition of non-life insurance** is, the losses that are incurred from a specific financial event are compensated to the insured this is called **non-life insurance**. General insurance, property insurance and casualty insurance are other names of non-life insurance. It can be defined as any insurance that is not related to life insurance. People, legal liabilities and properties are covered under a non-life insurance policy.

b) **Examples of Non-Life Insurance**: There are some examples of non-life insurance policies that completely justify the meaning of the term. General insurance policy examples are home owners policies, motor insurance policies, marine insurance, damage coverage from fire, calamities, theft, travel insurance or any online breach incident related to . It is very difficult to measure the amount of damage caused by online incidents as the probability of occurrence of these risks is extremely difficult to ascertain. However, these can be covered with the help of a non-life insurance policy.

c) **Non-life policies features include the following :** The amount specified in the policy is the sum insured which, during the policy period, symbolizes the insurer's maximum liability for claims. The insurer may specify the available amount of sum insured.

   i. The policy period of a non-life insurance plan is usually short, i.e., one year. The duration can be longer depending upon the type of insurance.
   ii. The premium of the policy is paid right before the insurance company issues the policy. When an application for insurance is received by the company, they assess the risk involved depending upon the type of cover required. For example, under health insurance, the age, medical history, and current medical status of a person will be taken into account before the insurance policy is issued.
   iii. Any claim is not fully borne by the insurance company. The policyholder needs to pay a small share, this share is called a deductible.
   iv. If no claims are made under a general insurance policy, then the policyholder is awarded a discount called No Claim Bonus. This is a cumulative discount on the premium of the policy that increases till it reaches a certain number.

d) The benefits of a non-life insurance policy are :

   i. In case of health insurance, financial help is provided at the time of a medical emergency.
   ii. It is mandatory by law to buy a third-party motor insurance policy. It can take care of the compensation to be paid to the third party in case of damage to property or life.
   iii. Home insurance covers the residential property of the policyholder against many unforeseen incidents, like fire, burglary, natural calamities, riots, etc.
   iv. Travel insurance plans offer insurance coverage to senior citizens and children as well. These help with issues like loss of baggage, accidents, loss of documents, etc. in a foreign land.
   v. Commercial insurance benefits the businesses with policies like employee benefits insurance, shopkeepers insurance, property and marine insurance, etc.

Policies of non-life available in India : The types of non-life insurance policies in India are: Marine insurance-Home insurance-Travel insurance- Health insurance- Motor insurance-Commercial insurance. In India, insurance policies for mobile, shop protection and bicycle are also provided under non-life insurance.

How to Apply for Non-Life Insurance? : The person looking for a non-life insurance policy should be ready with a few details like name, identity proof, residential proof, proof of ownership of the asset to be insured. After choosing a suitable insurance company, one should approach the insurer and submit the application or proposal for buying an insurance policy.

Importance of Non-Life Insurance Policy: Here are the reasons why buying a non-life insurance policy are important:

   i. Financial security at the time of need is one of the major upsides of buying a non-life insurance policy.
   ii. The insurance company will bear the cost of a financial liability. Thus, such risks are carried over to the insurance company from the policyholder.
   iii. Peace of mind related to possible financial crises.

Inclusions of Non-Life Insurance Policy: The inclusions of Non-life insurance are specific to the type of policy being purchased. For example, the inclusions of a Motor Insurance policy are Third-party Liabilities, Own Damage (Comprehensive policy), and a Personal Accident Cover. Under Health Insurance Hospitalization Costs, the cost of minor surgeries, ambulance charges, etc. is included. The inclusions of your insurance policy will be mentioned in the policy document.

Exclusions of Non-Life Insurance Policy: Some general exclusions of a Non-Life policy are raising a claim when the policy is not active, representing false or fraudulent information, producing fake documents, not raising a claim within the stipulated time, and not following the claim process diligently.

Things to Remember While Buying/Renewing Non-Life Insurance Policy Online:

i. Check the terms and conditions of the insurance policy before policy renewal or purchase. They are available online on the insurance company's website. Also, go through the fine print. In case of doubts, do not hesitate to get them cleared by contacting the insurer before you buy the policy.
ii. Compare insurance plans from different insurance companies and review coverage. Also compare the cost of each plan.
iii. The most important thing to remember is buying a policy that is suitable for your needs. Do not buy coverage that seems unnecessary but good to have. It will only increase the premium.

Step-by-Step Process to Renew Non-Life Insurance Online: One can renew non-life insurance online by first choosing a suitable insurance company and then by visiting their website of the mobile application. Note that there can be slight changes in the renewal process of each insurance company. Here is the general process of renewing an insurance policy online:

- **Step 1:** Login to your account.
- **Step 2:** Select the insurance policy that is about to expire or already expired.
- **Step 3:** Select the required coverage and click on renew
- **Step 4:** Go through the inclusions and exclusion, and terms and conditions of the insurance policy. Also, read through the fine print.
- **Step 5:** Make payment and receive the policy at your registered email address.

Why is it Important to Renew Non-Life Insurance Policy? : The uncertainties of life can be heavy on everyone, thus, buying a non-life insurance policy is important. Since the duration of such policies is short, it is equally important to keep the policy active by renewing it upon expiry. It will help you avail continuous coverage against financial liabilities and make a claim for an unfortunate incident.

How to Claim Non-Life Insurance Online : Making an online claim is easy and can be done instantly via the insurance company’s website or their mobile application. Get in touch with the insurance company to understand the claim process and the set of documents that will help in getting the claim settled. Once you are ready with the required details, login to your account and click on “raise claim”. Attach the supporting documents and send the details to the insurance company.

Non-Life Insurance Claim Settlement Process : The insurance company will review the claim application and begin an investigation into the matter. They may ask for more documents and evidence of the incident, for example, an accident claim, to help them understand the event better. Once all the process is complete the insurance company will settle the claim as per terms and conditions of the insurance policy.

Documents Required for Claiming Non-Life Insurance : Usually the following set of documents will be required to claim against a non-life insurance policy: Proposal form- Age proof- Address proof- Medical examination report for health and RC book of the vehicle for the motor insurance- Income proof- Invoice of the vehicle

Also, read: Health Insurance Glossary and Medical Terminology

11.10 NON-LIFE INSURANCE PRICING :

Basic Concepts and Assumptions:

i. **Agreement between an insurance company and a customer :** A non-life insurance policy is an agreement between an insurance company and a customer—the policyholder—in which the insurer undertakes to compensate the customer for certain unpredictable losses during a time period, usually one year, against a fee, the premium. A non-life insurance policy may cover damages on a car, house or other property, or losses due to bodily injury to the policyholder or another person (third party liability); for a company, the insurance may cover property damages, cost for business interruption or health problems for the employees, and more. In effect, any insurance that is not life insurance is classified as non-life insurance, also called general insurance or (in the US) property and casualty insurance. In Germany, the term is quite different: Schadenversicherung a similar name applies in Sweden.

ii. **Economic risk is transferred from the policyholder to the insurer :** By the insurance contract, economic risk is transferred from the policyholder to the insurer. Due to the law of large numbers, the loss of the insurance company, being the sum of a large number of comparatively small independent losses, is much more predictable than that of an individual (in relative terms): the loss should not be too far from its expected value. This leads us to the generally applied principle that the premium should be based on the expected (average) loss that is transferred from the policyholder to the insurer. There must also be a loading for administration costs, cost of capital, etc., but that is not the subject here.

iii. **Need for statistical methods :** The need for statistical methods comes from the fact that the expected losses vary between policies: the accident rate is not the same for all policyholders and once a claim has occurred, the expected damages vary between policyholders. Most people would agree that the fire insurance premium for a large villa should be greater than for a small cottage; that a driver who is more accident-prone should pay more for a car insurance; or that installing a fire alarm which reduces the claim frequency should give a discount on the premium. Until the mid 90’s, non-life insurance pricing was heavily regulated in Sweden, as in most other western countries. The “fairness” of premiums was supervised by the national FSA (Financial Services AuthorE. Ohlsson, B. Johansson, Non-Life Insurance Pricing with Generalized Linear Models, EAA Lecture Notes, DOI 10.1007/978-3-642-10791-7_1, © Springer-Verlag Berlin Heidelberg 2010 Non-Life Insurance Pricing ity), leading to a conform premium structure for all insurance companies on the market.

iv. **Market has been deregulated in many countries :** Today, the market has been deregulated in many countries; the legislation has been modified to ensure free competition rather than uniform pricing. The idea is that if an insurance company charges too high a premium for some policies, these will be lost to a competitor with a more fair premium. Suppose that a company charges too little for young drivers and too much for old drivers; then they will tend to loose old drivers to competitors while attracting young drivers; this adverse selection will result in economic loss both ways: by loosing profitable and gaining underpriced policies. The conclusion is that on a competitive market it is advantageous to charge a fair premium, if by fairness we mean that each policyholder, as far as possible, pays a premium that corresponds to the expected losses transferred to the insurance company.

v. **Predicted future costs for claims :** Most often a distinction is made between the overall premium level of an insurance portfolio, and the question of how the total required premium should be divided between the policyholders. The overall premium level is based on considerations on predicted future costs for claims and administration, the capital income on provisions for future costs (reserves) and the cost of capital (expected profit), as well as the market situation. On the other hand, the question of how much to charge each individual given the overall premium level involves the application of rather advanced statistical models. Before considering these, we will introduce some fundamental concepts. Rating Factors and Key Ratios For each policy, the premium is determined by the values of a number of variables, the rating factors; to estimate this relationship, a statistical model is employed.

The rating factors usually belong to one of the following categories :

i. Properties of the policyholders: age or gender if the policyholder is a private person, line of business for a company, etc.;
ii. Properties of the insured objects: age or model of a car; type of building, etc.;
iii. Properties of the geographic region: per capita income or population density of the policyholder's residential area, etc.

Limitations in that rating factors : The collection of variables that may be considered is determined by the availability of data. While the age and gender of a policyholder are usually readily accessible, it is much harder to get reliable data on a persons driving behavior or the number of in-bed smokers in a house. There are also limitations in that rating factors must not be considered offensive by the policyholders.

Using linear regression models : A statistician making contact with non-life insurance pricing for the first time might consider using linear regression models of the relationship between the claim cost and the variables at hand. Traditionally, however, rating factors are formed by dividing variables into classes, e.g. age into age intervals, if they are not already

11.11 DIFFERENCE BETWEEN LIFE INSURANCE AND NON-LIFE INSURANCE:

Is Non-Life Insurance Different From General Insurance? No, general insurance is not different from non-life insurance, both are typically the same. General insurance or non-life insurance provides coverage to people, legal liabilities and properties. Life insurance provides a lump sum amount of sum assured at the time of maturity or in case of death of the policyholder. Non-life insurance policies offer financial protection to a person for health issues or losses due to damage to an asset.

Difference Between Life Insurance and Non-Life Insurance

Comparison basis	Life insurance	General insurance
Definition	Life insurance protects against life risks where the insured individual is promised by the insurance company for uncertainties and ambiguities of life-related to death.	The insured individual is promised to be compensated by the insurance company for the damage caused due to an unfortunate circumstance or any loss. The valuable things of people are protected by general insurance
Policy Period	Long-term	Short-term
Nature of the	Life insurance is acknowledged as	Whereas general insurance can be

policy	an investment, and it is not a contract of indemnity	termed as indemnity's contract.
The insured	The policyholder receives the benefits of the insurance coverage.	The policyholder and the other people insured under the policy get the benefits of the insurance coverage.
Claims	The sum assured is paid at the maturity of the policy or death of the policyholder	Claim is processed as per the damage or financial loss suffered by the policyholder
Cost of the policy	Depends upon the amount of sum assured offered by the insurance policy	Depends upon the value of the insured asset

Difference Between Participating and Non-Participating Life Insurance :

A participating policy in life insurance is a policy that offers a share of the insurer's profits to the policyholder. The profit is paid out in the form of bonus or dividends. Whereas a Non-Participating is the one that does not offer a share of the company's profit to the policyholder. Here is a table that shows the difference between the types of Life Insurance policies:

Difference Between Participating and Non-Participating Life Insurance :

Type of difference	Participating policy	Non-Participating policy
Meaning	The policy offers a share in the company's profit.	There is no profit sharing in a non-participating policy.
Bonus Payout	Annual	Nil
Premium	Higher than non-participating policy due to possible profit sharing.	Lower than a participating policy.
Benefit	Dual benefit of insurance and a share in company's profit.	No additional benefit apart from insurance coverage.
Examples	Unit Linked Insurance Plans is one of the best examples of a participating policy.	Term insurance is an example of a non-participating policy.

11.12 SUMMARY :

After studying this lesson the student should be able to : Know the Pricing objectives and Fundamentals of Insurance Pricing; Understand about Life Insurance vs. Non-Life Insurance Pricing and Awareness about overall Insuring Pricing. Hence, the following aspects have covered like Benefits of Insurance, optimal insurance pricing (Top 6 ways of achieving), Pricing Process, Types of Insurance, Life Insurance Pricing and Annuity Products, Non-Life Insurance Policy: Types, Features, Benefits & Importance; Non-Life Insurance Pricing and Difference Between Life Insurance and Non-Life Insurance

11.13 TECHNICAL TERMS :

1. **Life Insurance :** Life Insurance can be defined as a contract between an insurance policy holder and an insurance company, where the insurer promises to pay a sum of money in exchange for a premium, upon the death of an insured person or after a set period.
2. **Non-Life Insurance :** As per the definition, a non-life insurance policy is a type of policy that safeguards and compensates the losses incurred from a particular financial event. Some of the most popular types of non-life insurance policies are general insurance, property insurance, and casualty insurance.
3. **Insurance Pricing :** Any company aims to set prices to maximize its profits. This is also referred to as optimal pricing. It is not different in the insurance sector. Ideal pricing (or premium in insurance terminology) must cover: Variable costs- Operating expenses- Profits- Setting an optimal price depends on understanding costs, price elasticity's, consumer preferences, and the strategic actions of competitors.
4. **Optimal Insurance Pricing :** Price optimization refers to a process or technique used in many industries to help determine what a company will charge for its product or service. In insurance, this process helps insurers fine-tune the premium it will charge for a policy.
5. **Annuity Products :** They're long-term contracts from an insurance company where you invest your money. In return for your investment, you get income in the form of regular payments through annuitization or a guaranteed lifetime income benefit that is available at an additional cost.

11.14 SELF ASSESSMENT QUESTIONS :

1) What is a Non-Life Insurance Policy?
2) Key Features & Benefits of Non-Life Insurance Policy:
3) Difference Between Life Insurance and Non-Life Insurance:
4) What is the Difference Between Participating and Non-Participating Life Insurance?
5) What is the meaning of non-life insurance?
6) What is a non-life insurance company?
7) What is the difference in life and non-life insurance?

11.15 SUGGESTED READINGS :

1) Esbjörn Ohlsson& Björn Johansson ; Part of the EAA Lecture ; Chapter- 3873 Accesses
2) Dr. P. K. Gupta: Insurance and Risk Management, Himalaya Publishing House.
3) Professor Howard C. Kunreuther, Professor Mark V. Pauly, Dr. Stacey McMorrow: Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry
4) Marshall Wilson Reavis : Insurance: Concepts & Coverage: Property, Liability, Life, Health and Risk Management.
5) Peter Zweifel, Roland Eisen: Insurance Economics (Springer Texts in Business & Economics

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LESSON - 12
INSURANCE PRODUCTS

AIMS AND OBJECTIVES :

After studying this lesson the student should be able to :

- Know the Different Types of General Insurance Policies in India
- Understand about Commonly used terms in Life Insurance,
- Awareness about Types of Life Insurance policies in India

STRUCTURE OF THE LESSON :

12.1 Introduction
12.2 Commonly used terms in Life Insurance
12.3 Different Types of General Insurance Policies in India
12.4 Benefits of General Insurance
12.5 Types of Life Insurance policies in India
12.6 Benefits of Life Insurance
12.7 Differences between Life and General Insurance
12.8 List of Insurance Companies in India
12.9 Summary
12.10 Technical Terms
12.11 Self Assessment Questions
12.12 Suggested Readings

12.1 INTRODUCTION :

Insurance products mean any product provided by an insurer in its insurance whereby such insurer or undertakes to indemnify the insured person as to loss from certain perils called risks which are mentioned in the insurance contract or to pay a specified amount with or without a benefit. There are two types of insurance needs- Long Term and Short Term. Short-term needs are for a year or two, but Long-Term needs can last for a lifetime. Life Insurance can be defined as a contract between an insurance policy holder and an insurance company, where the insurer promises to pay a sum of money in exchange for a premium, upon the death of an insured person or after a set period. Four types of insurance that most financial experts recommend include life, health, auto, and long-term disability. Many insurers use a rating system to classify and group policyholders based on the level of risk that the insurer would need to pay out a claim. Ratings can vary, depending on the insurance carrier, but they typically group people into a preferred, standard, and substandard classification. Home or property insurance, life insurance, disability insurance, health insurance, and automobile insurance are five types that everyone should have.

Need for Insurance : Insurance plans will help you pay for medical emergencies, hospitalisation, contraction of any illnesses and treatment, and medical care required in the future. The financial loss to the family due to the unfortunate death of the sole earner can be covered by insurance plans. Insurance plans are beneficial to anyone looking to protect their family, assets/property and themselves from financial risk/losses: The family can also repay any debts like home loans or other debts which the person insured may have incurred in his/her lifetime.

i. **Family maintain their standard of living**: Insurance plans will help your family maintain their standard of living in case you are not around in the future. This will help them cover the costs of running the household through the insurance lump sum payout. The insurance money will give your family some much-needed breathing space along with coverage for all expenditure in case of death/accident/medical emergency of the policyholderInsurance plans will help in protecting the future of your child in terms of his/her education. They will make sure that your children are financially secured while pursuing their dreams and ambitions without any compromises, even when you are not around

ii. **Building Wealth/Savings** : Many insurance plans come with savings and investment schemes along with regular coverage. These help in building wealth/savings for the future through regular investments. You pay premiums regularly and a portion of the same goes towards life coverage while the other portion goes towards either a savings plan or investment plan, whichever you choose based on your future goals and needs

iii. **Pay for the cost of repairs or rebuilding :** Insurance helps protect your home in the event of any unforeseen calamity or damage. Your home insurance plan will help you get coverage for damages to your home and pay for the cost of repairs or rebuilding, whichever is needed. If you have coverage for valuables and items inside the house, then you can purchase replacement items with the insurance money

iv. **Helps with long-term goals :** One of the most important benefits of life insurance is that it enables you to save and grow your money. You can use this amount to meet your long-term goals, like buying a house, starting a venture, saving for your child's education or wedding, and more

v. **Useful for retirement planning :** Life insurance can enable you to stay financially independent even during your retirement. Life insurance plans like annuity plans provide you with a fixed income for life. They are low-risk plans that help you maintain your current lifestyle, meet medical expenses and meet your post-retirement goals

vi. **Provides tax benefits :** Life insurance helps you plan for the future, while helping you save tax* in the present. The premiums paid under the policy are allowed as tax* deductions of up to ₹ 1.5 lakh per annum subject to conditions under Section 80C of The Income Tax Act, 1961. You can save up to ₹ 46,800/- in taxes* every year. Further, the amounts received under the policy are also exempt* subject to conditions under Section 10(10D) of the Income Tax Act, 1961.

12.2 COMMONLY USED TERMS IN LIFE INSURANCE :

- **Life Assured :** It is the person who is covered under the insurance policy
- **Proposer :** It is the person who pays the premiums of the policy. For example: If you have bought the policy for yourself, then you are both the Life Assured as well as the Proposer. Similarly, if you purchase an insurance policy for a family member, then you are the proposer and the family member is the Life Assured.
- **Nominee or Beneficiary :** It is the person you appoint at the time of buying the policy to receive the benefits of your insurance policy, in your absence.
- **Insurer :** The insurance company that sells the life insurance policy is called the Insurer (for example, ICICI Prudential Life Insurance).
- **Life Cover :** It is the amount that the Insurer will pay to your Nominee in case of an unfortunate event.

- **Maturity Benefit :** For Protection + Savings policies, the Insurer pays a certain lump sum of money on completion of the policy term. This amount is known as the Maturity Amount.
- **Premium :** A premium is the amount you pay to the insurer for receiving the benefits of the insurance policy. These payments can be made on a regular basis throughout the policy duration, for a limited number of years or just once, as per the options available under the policy you choose.
- **Premium Payment Term :** The number of years for which you pay the premiums is known as the Premium Payment Term.
- **Policy Term :** The number of years for which the Life Cover continues.

Factors that affect life insurance premium :

Now that you know what is life insurance and why you need it, find out the factors that can affect the life insurance premium:

- **Age:** One of the prime factors that affect the premium for a life insurance plan is your age. The life insurance premium is lower for younger people and gradually increases with age
- **Gender:** Studies have shown women live longer than men1. Therefore, the life insurance premium is lower for women as compared to men
- **Health conditions**: Your present and past health conditions can determine the premium for your life insurance plan. If you have any pre-existing illnesses or have suffered from an illness in the past that may resurface or affect your present health, you would be charged a higher premium
- **Family health history**: The chances of suffering from a disease that runs in your family are considerably high. So, if any hereditary illnesses run in your family, you may have to pay a higher premium
- **Smoking and drinking alcohol:** Lifestyle habits like smoking and drinking alcohol can impact your health and lead to multiple health issues. Therefore, insurance companies charge a high premium for individuals who smoke or drink alcohol
- **Type of coverage**: The type of coverage you opt for can increase or decrease the life insurance plan's premium. If you add any riders to your plan, the premium would increase. A longer policy term can also result in a higher premium compared to a shorter term. In addition to this, the type of life insurance plan you select also impacts the premium. For instance, term life insurance is the most affordable form of life insurance
- **Amount of coverage**: A higher sum assured would result in a higher premium and vice versa
- **Occupation:** If you work in a high-risk job, the premium for your life insurance plan would be higher than others. For example, if you work in construction or if your job puts you at any kind of risk, such as regular exposure to chemicals, the insurance company will charge a higher premium

12.3 DIFFERENT TYPES OF INSURANCE POLICIES IN INDIA :

Accidents or losses of any kind, including death, are the formidable realities that come uninvited, without a knock on the door, and turn our lives upside down. While there is absolutely nothing that we can do to stop these uncertainties, we can certainly make our lives shockproof. Insurance is a tool that provides us with much-needed protection from uncertainties. Now, selecting the correct type of insurance with the right amount is one prudent decision we need to make to safeguard our assets or financial stability. While there is a wide range of Insurance types available in the market, all of them can be broadly classified into two main categories: **1. General Insurance2. Life Insurance.** While Life Insurance provides you with financial coverage against your life, a General Insurance policy indemnifies you against any losses for your non-life assets.

The Major Kind`S Of General Insurance Policies In India :

General Insurance provides coverage against any financial loss incurred due to any loss or destruction of the insured asset. It safeguards your assets like a Bike, Car, Home, Travel, Health, or even your beloved electronic gadgets from any loss.The major kind of General Insurance Policies in India are: i) Health Insurance, ii) Motor Insurance, iii)Travel Insurance, iv) Property Insurance, v) Commercial Insurance, vi) Asset Insurance, vii) Pet Insurance, viii) Bite-Sized Insurance. Let's have an extensive look at all the above types of Insurance:

Health Insurance : A Health Insurance is your savior against the expenses incurred due to any illness or medical emergency.There are various types of health insurance available based on their coverage: i) Individual Health Insurance: Covers one policyholder, ii) Family Floater Health Insurance: Covers the complete family under a single policy, iii) Group Health Insurance: Covers the employees of an organization. These have different products under them based on their usage and many other factors. Here is a list of major types of health insurance products available in India: i) Senior Citizen Health Insurance, ii) Maternity Health Insurance, iii) AarogyaSanjeevani, iv) Super Top-Up Insurance, v) OPD Insurance, vi) Personal Accident Cover

Motor Insurance: You must have a Motor insurance policy not just because it is mandatory in India but also because the policy ensures that the vehicle has complete protection against physical damage from natural or artificial calamities and third-party liabilities arising from the insured vehicle. Based on the type of vehicle they cover, Motor Insurance is broadly categorized into:i) Car Insurance, ii) Two-wheeler Insurance, iii) Commercial Vehicle Insurance

The different types of Motor Insurance Policies available in the market under the ones mentioned above are as follows:

- **a) Third-party insurance Policy:** Pays the financial liability to the third party affected in the mishap, ensuring you do not face legal hassle due to the accident.
- **b) Comprehensive Insurance Policy:** Apart from covering third-party liabilities, these plans also cover the expenses incurred for repairing the damages to the policyholder’s vehicle due to an accident, fire, artificial and natural calamities, riots and other such instances.
- **c) Own Damage Policy:** With Own Damage Cover, you receive the same benefits as a comprehensive policy without the third-party liability portion of the policy.Additionally, you can purchase some add-ons like Zero depreciation cover, Loss of personal belongings cover, Pay-as-you-drive cover, Daily conveyance cover, etc. to ensure that you are covered against any eventuality.

Travel Insurance: Travel Insurance is your financial safeguard when you are travelling. It covers loss of baggage, loss of passport, hijacking, medical emergencies, delayed flights, accidental deaths, adventure sports etc. The major types of travel insurance are: i) Domestic Travel Insurance**:** For travel within the country, ii) International Travel Insurance**:** For travel outside the country, iii) Student Travel Insurance**:** If you are moving abroad for higher studies.

Under the above types, there are different products like Individual Travel Insurance, Family Travel Insurance, Senior Citizen Travel Insurance, Corporate Travel Insurance, Multi Trip Travel Insurance, Single Trip Travel Insurance and Schengen Travel Insurance.

Property Insurance: A Property Insurance Policy provides financial reimbursement to the owner/renter of a building and its contents.Some products available in the market under property insurance include: i) Home Insurance, ii) Shop Insurance, iii) Burglary Insurance, iv) Office Insurance, v) Fire Insurance**:**

Commercial Insurance : A Commercial Lines Insurance policy ensures that the business does not face any financial burden because of any financial and business risks. It provides coverage to business, its employees and ownership.
Furthermore, Commercial Insurance has several Insurance types based on the type of asset covered, viz:

- **a) Liability Insurance:** Provides coverage against damage to any third party and offers the following types of Policies:i) Directors and Office Liability Insurance , ii) General Liability Insurance , iii) Public Liability Insurance, iv) Cyber Insurance.
- **b) Marine Cargo Insurance:** This Insurance indemnifies the goods/cargo carried through inland transit.
- **c) Engineering Insurance:** A comprehensive insurance that provides complete protection against all risks associated with engineering and machinery, like the risk faced by the ongoing construction project, installation project and machines and equipment in project operation. It includes the following insurance products: i) Contractor's All-Risk Insurance, ii) Erection All Risk Insurance, iii) Plant and Machinery Insurance
- **d) Workmen Compensation Insurance:** Workmen Compensation provides financial coverage to employees who get injured or die in any mishap during work.
- **e) Crop Insurance:** Crop Insurance covers the financial losses that a bad crop season, crop failure or any other related menace might bring in for the agriculturists.
- **f)** Apart from the above major categories of General Insurance, there are a few more types as below:

Asset Insurance: Asset Insurance provides financial coverage to your assets like <u>Mobile</u>, TV, and other appliances or electronics so that their expensive repair doesn't hit your pocket.

Pet Insurance: Pet Insurance covers your furry baby's health and well-being requirements, such as any medical condition, such as pregnancy complications, dental treatments, and insect-borne diseases. It also covers a lot of other conditions like pet theft, loss or damages to a third party because of the pet, accidents, overseas coverage and many more, depending on your insurance provider.

Bite-Size Insurance: Bite-size Insurance, or small-ticket insurance/sachet insurance is available at very low premiums and focuses on specific needs. More than being a type, it is a category of insurance that is unrestricted across all categories like health, travel, property etc. A few common Bite-Sized insurance products available in the market are: i) Online Fraud Protection, ii) Cab Ride Insurance, iii) Backpack Insurance, iv) Marathon Insurance, and many more.

12.4 BENEFITS OF GENERAL INSURANCE :

Any individual needs to have a general insurance policy owing to the risks posed by accidents, medical emergencies, natural calamities, and other unforeseen circumstances. The policy provides financial protection in case such situations arise in our lives. We cannot predict an accident or calamity; however, we can be better prepared to handle them.Here are a few benefits that General Insurance provides:

- ❖ **Insurance coverage**:For most categories, having insurance coverage is compulsory by law. One example is the Motor Vehicles Act 1988, which made motor insurance compulsory. Thus, while following the mandatory regulation, you also ensure your beloved vehicle is financially protected.
- ❖ **Compensation against losses**: General Insurance Plans provide compensation against losses. Thus, across all categories, they serve one primary purpose: to provide financial protection and safeguard your savings in case any unfortunate situation arises.
- ❖ **Tax benefits:**Many General Insurance Plans provide tax benefits. For example, the premium paid towards medical insurance offers tax benefits under Section 80D of the Income Tax Act.

12.5 TYPES OF LIFE INSURANCE POLICIES IN INDIA :

Life Insurance can be defined as a contract between an insurance policy holder and an insurance company, where the insurer promises to pay a sum of money in exchange for a premium, upon the death of an insured person or after a set period. Here, at ICICI Prudential Life Insurance, you pay premiums for a specific term and in return, we provide you with a Life Cover. This Life Cover secures your loved ones' future by paying a lump sum amount in case of an unfortunate event. In some policies, you are paid an amount called Maturity Benefit at the end of the policy term.

Insurance Policy is consisting of five elements, such as: i) Premium. An insurance premium is one of the most important places to look when choosing your insurance. ii) Deductible, iii) Policy Limits, iv) Exclusions, v) Riders - Additional coverage and options.

Types of Life Insurance plans: There are two basic types of Life Insurance plans -1. Pure Protection2. Protection and Savings. Pure Protection Plan: A Pure Protection plan is designed to secure your family's future by providing a lump sum amount, in your absence. Protection and Savings Plan: A Protection and Savings plan is a financial tool that helps you plan for your long-term goals like purchasing a home, funding your children's education, and more, while offering the benefits of a Life Cover. Life Insurance provides financial coverage for the most uncertain part of human life: Life itself! Thus, it offers financial protection to the Life Assured's family in case of unfortunate events like the death or disability of the policyholder. In addition to the life coverage, some policies also provide a savings component and can be used as a prudent investment option. Below are the major types of Life Insurance policies in India:

The major kind of Life Insurance Policies in India are:i) Term Insurance, ii) Whole Life Insurance, iii) Endowment Policy, iv) Money Back Policy, v) Pension Plan, vi) Unit Linked Insurance Plans, vii) Child Plans.

Term Insurance Plans: Term Insurance is the most basic type of Life Insurance that provides Life Cover for a predetermined period called the 'term' of the policy. Since they do not offer any cash value, they are generally available at a much lower premium than other products for the same amount of coverage. If the Life Assured dies during the policy term, the nominee receives the Sum Assured, and there is no maturity value if the Life Assured survives the policy term. However, certain Term Plans offer the option of Return of Premium which is paid to the policyholder if Life Assured survives the policy term. Term insurance is a pure protection plan and is not market-linked. Moreover, the premiums for term insurance are lower as compared to any other life insurance product. The premiums are also more affordable if you buy them early in life. Experts often suggest that term plan should be a priority for you as soon as you start earning.Term insurance can be used for various purposes. In the absence of an income, your family can use the cover from the insurance to pay for their day to expenditure, education costs, or wedding expenses. If you have any outstanding debts, such as home loan, car loan, etc., your family can pay them off with the cover.Some term plans also give you the option to add riders, like critical illness^ coverage (providing a lump sum for the treatment of specified critical ailments) and accidental death benefit+ (paid over and above the sum assured in the unfortunate event of death due to an accident). These riders can provide you and your family with an extra layer of protection at a nominal increase in the premium.

ULIPs – Unit Linked Insurance Plans : ULIPs provide Life Coverage and capital-building opportunities by investing in various market-related instruments and funds of varying risks. ULIPs have some underlying funds related to different asset classes like Equity, Hybrid and Debt funds where a certain portion of the premium is invested as per the policyholder's risk appetite. While this portion of the premium helps generate returns, the other portion goes to the Life Coverage part. ULIPs are flexible to a certain extent. They allow partial withdrawal after a lock-in period of 5 years and the switching of funds that can help you customize your investment as per your financial goal and life stage. If you are looking for safer options, bonds can be a good choice. On the other hand, if you are open to more risk, hybrid funds and equities have the potential to offer better returns. Since each individual is different, ULIPs allow great flexibility for investment. Your risk appetite and investment preferences are likely to change with age. ULIPs permit you to take these factors into consideration and alter your investment strategy accordingly. ULIPs also provide flexibility in terms of partial withdrawals and fund-switching. They offer interesting benefits like loyalty additions and wealth boosters to help you generate more wealth over time. Additionally, the maturity amount from ULIPs is tax-free* subject to Section 10(10D) of the Income Tax Act of 1961.

Endowment Insurance Plans: A perfect mix of Investment and Insurance, Endowment Plans provide Life Coverage and help build a corpus for major life goals. A portion of the premium goes towards Sum Assured while the other portion is invested in certain low-risk investments. In case of the policyholder's demise during the policy term, the Sum Assured is paid to the nominee. However, if the policyholder survives the term, they receive a maturity amount along with the accrued bonuses. Thus, Endowment Plans serve the dual purpose of Insurance and Investment. Endowment plans are ideal for people who want guaranteed returns along with the protection of life insurance. An endowment plan is a life insurance policy that provides life coverage along with an opportunity to save regularly. This enables you to receive a lump sum amount on the maturity of the policy. In case of death during the policy term, your nominee(s) also receives a death benefit. Just like ULIPs, endowment plans are quite flexible too. You can choose a suitable method and time frame to pay the premium. Endowment plans also give you a chance to benefit from bonuses, that are paid additionally over and above the sum assured of your policy. Lastly, the returns generated on maturity from an endowment plan are tax-free* subject to Section 10(10D) of the Income Tax Act of 1961. The premiums paid can also be claimed as a deduction under Section 80C* of the same Act.

Money Back Insurance Plans: Money Back Policies are essentially the Endowment Plans only with the additional feature of payments at certain pre-defined intervals during the policy term. Additionally, on maturity, the maturity benefits are paid along with accrued bonuses. In case of the policyholder’s demise during the term, Sum Assured is paid to the nominee regardless of the survival benefits already paid.

A money back plan is a life insurance policy where the insured person gets a percentage of sum assured at steady intervals. Since you save regularly, the money back plan rewards you regularly. In simple words, a money back plan is an endowment plan with the benefit of increased liquidity with systematic payouts. Money back plans are designed to help you meet your short-term financial goals. The money back feature can add to your monthly or yearly income. The regular pay-outs, which are tax-free subject to Section 10(10D)* of the Income Tax Act of 1961 makes the process of investing highly rewarding. This is because you can benefit from the policy with immediate effect. For instance, with the ICICI Pru Cash Advantage Plan, as soon as your premium payment term ends, you start receiving money at regular intervals. These payouts are called Guaranteed Cash Benefits (GCB).Money back plans also have a maturity benefit. So, you get a lump sum payout at maturity that can be used to secure your future or help you fulfill your family's dreams.

Whole Life Insurance Plans : Also known as Traditional Life Insurance, Whole Life Insurance provides coverage for the policyholder's entire life. Besides this life cover, they also have a savings component and accrue periodic bonuses. Generally, the Whole Life Insurance Plans have a maturity period of 100 years, and if a policyholder survives this term; they are paid a maturity amount.

A whole life insurance plan is a life insurance policy that gives you life coverage for 99 years. Unlike other policies that have a relatively shorter term of 10-30 years, the long coverage period of such plans ensures protection for your family for an extended period of time. With coverage of up to 99 years, whole life insurance is ideal for those who have financial dependents even in their old age. The biggest advantage of this product is that not only does it provide lifelong protection to the insured but also provides a simple way to leave behind a legacy for their children. Whole insurance plans offer a lot of stability. After paying the premiums for 5 years, you get a guaranteed income on maturity. Moreover, the income received from a whole life insurance policy is tax-free* subject to Section 10(10D) of the Income Tax Act of 1961.Whole life insurance policies are beneficial for those who want to leave a financial legacy for their legal heirs. In the case of death of the policy holder during the term, the nominee receives the policy benefits, including a bonus for the total premiums paid.

Child Insurance Plans : Children deserve the best, and a child insurance plan helps to build a corpus for your child's future. A child plan is one of the most vital financial planning tools for parents. These plans can help you build a significant sum for your child's education and marriage expenses. A child plan provides maturity benefits either in the form of annual instalments or as a one-time payout after the child turns 18. There is also in-built insurance coverage for the parent. Protection is an important part of a child plan because the premium is paid by the parent. In case of an unfortunate event where the insured parent passes away during the policy term, child plans can give immediate payment to cover a child's expenses. One of the most important features of a child plan is that it allows you to choose how and where your money is invested. The premium you pay is invested in your choice of equity, debt, or balanced funds. ULIP child plans also ensure that, over time, your returns are adequate to counter inflation. Child plans also offer loyalty additions and wealth boosters that add to your overall savings. Moreover, you can either pay regular premiums or a single premium, based on your capacity. You can also use these plans as an emergency fund and make withdrawals from your investment on the completion of 5 policy years. Lastly, child plans allow you to get wider coverage with critical illness and accidental death benefits.

Retirement Insurance Plans: Pension Plan Also known as Retirement Plan, Pension Plan helps to accumulate wealth for the golden years of one's life and helps you deal with the financial uncertainties of the post-retirement phase. Thus, a pension plan allows you to contribute a specific portion of your income as a premium during your earning years. Subsequently, in your retirement phase, this accumulated amount is paid back to you in the form of an annuity or pension at regular intervals. Retirement plans are designed to help you build a sizeable corpus for your post-retirement days. They help you gain financial independence in your non-working years. A retirement plan allows you to save and invest for the long-term, thereby offering the potential to accumulate a significant amount of wealth. Since retirement plans offer insurance benefits, you can also ensure financial security for your loved ones by investing in these plans. Retirement plans give you the opportunity to get potentially better returns. This is done by investing your money in a mix of equity and debt. Moreover, the money you get on maturity is tax-free* subject to Section 10(10D) of the Income Tax Act of 1961. Retirement plans also allow you to move your money between funds tax-free*.Lastly, retirement plans offer you multiple options to withdraw your money, such as regular income, lump sum payment, or a combination of both.

12.6 BENEFITS OF LIFE INSURANCE :

Life insurance can offer several benefits to you and your loved ones, including the following:

- **Financial Security:** When you buy a life insurance policy, the insurance company charges a premium in exchange for providing financial security to your beneficiaries in case of an unfortunate event of death. The proceeds from life insurance can be used by the beneficiaries as an income replacement to cover day-to-day expenses.
- **Wealth Creation:** Some life insurance plans offer you the option to invest and grow your money. This enables you to stay financially prepared for your future needs. Life insurance can offer good returns and income.
- **Tax benefits:** Life insurance plans offer multiple tax$ benefits. The premiums paid towards a life insurance plan are deductible up to ₹ 1.5 lakh per annum under Section 80C$ and the maturity benefits are also tax-free subject to conditions prescribed under Section 10(10D)$ of The Income Tax Act, 1961.

12.7 DIFFERENCES BETWEEN LIFE AND GENERAL INSURANCE :

- **Life Insurance :** Life Insurance can be defined as a contract between an insurance policy holder and an insurance company, where the insurer promises to pay a sum of money in exchange for a premium, upon the death of an insured person or after a set period.
- **General Insurance :** Insurance contracts that do not come under the ambit of life insurance are called general insurance. The different forms of general insurance are fire, marine, motor, accident and other miscellaneous non-life insurance.

While life insurance covers the life of a person, general insurance provides cover to other aspects and assets in a person's life, for example, health, car, travel, home, etc.

Differences between Life and General Insurance

Factors	**Life Insurance**	**General Insurance**
Definition	Covers an individual’s life for a certain sum of money. Upon death of the insured, this money is paid out to next of kin.	All insurance plans, which cannot be classified as life insurance, is known as general insurance policies.
Investment or Insurance	Life insurance is a form of investment.	General insurance policies act as a contract of

		indemnity.
Contract Tenure	Long term	Short term
Insurance Claim	The sum insured is disbursed as death benefit or upon the maturity of life insurance policy.	Financial reimbursement for unexpected loss or damage of the insured object or person.
Policy Value	A policyholder decides the value of life insurance policy, which is reflected on the policy premiums.	General insurance claims or reimbursement amount on the loss amount suffered by the policyholder.
Insurance Holder	The policyholder must be present when the life insurance contract is being drawn out.	The policyholder must be present during the creation and enforcement of the contract.
Premium	Premium for life insurance plans are payable throughout the year.	General insurance premiums are cleared at once through lump-sum payments.

i. Now that you can tell life insurance from general insurance, let's learn more about the various insurance companies offering such plans in India.

Public Sector Insurance Companies :

i. Life Insurance Corporation of India. ...
ii. General Insurance Corporation of India. ...
iii. The New India Assurance Company Limited. ...
iv. United India Insurance Company Limited. ...
v. The Oriental Insurance Company Limited. ...
vi. National Insurance Company Limited. ...
vii. Agriculture Insurance Company Of India Limited.

General Insurance Companies in India 2023 :

i. Future Generali India Insurance Company. ...
ii. HDFC ERGO General Insurance Company. ...
iii. ICICI Lombard General Insurance Company. ...
iv. IFFCO TOKIO General Insurance Company. ...
v. Kotak Mahindra General Insurance Company. ...
vi. Liberty General Insurance Company. ...
vii. Magma HDI General Insurance Company.

12.8 LIST OF INSURANCE COMPANIES IN INDIA :

Insurance policies can come to your aid and deliver financial assistance when the need arises. Emergencies can occur at any time, whether medical or otherwise, which is the precise time when such insurance plans come into effect. However, before you can learn more about insurance in general, you should be able to categorise them based on type. Broadly, you can divide insurance policies into two types, namely life and general insurance.

List of Life Insurance Companies in India

Company name	Founding year	Headquarter location
Life Insurance Corporation of India	1956	Mumbai
Max Life Insurance Co. Ltd.	2000	New Delhi
HDFC Life Insurance Co. Ltd	2000	Mumbai
ICICI Prudential Life Insurance Co. Ltd.	2000	Mumbai
Aditya Birla SunLife Insurance Co. Ltd.	2000	Mumbai
Kotak Mahindra Life Insurance Co. Ltd.	2001	Mumbai
Pramerica Life Insurance Co. Ltd.	2008	Gurugram
TATA AIA Life Insurance Co. Ltd.	2000	Mumbai
Bajaj Allianz Life Insurance Co. Ltd.	2001	Pune
SBI Life Insurance Co. Ltd.	2001	Mumbai
Exide Life Insurance Co. Ltd	2001	Bengaluru
Reliance Nippon Life Insurance Company	2001	Mumbai
Sahara India Life Insurance Co. Ltd.	2000	Kanpur
Aviva Life Insurance Company India Ltd.	2002	Gurugram
PNB MetLife India Insurance Co. Ltd	2001	Mumbai
Bharti AXA Life Insurance Company Ltd	2005	Mumbai
IDBI Federal Life Insurance Company Limited	2008	Mumbai
Future Generali India Life Insurance Company Limited	2006	Mumbai
Shriram Life Insurance Co. Ltd.	2005	Hyderabad
Aegon Life Insurance Company Limited	2008	Mumbai
Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited	2007	Gurugram
Edelweiss Tokio Life Insurance Company Limited	2009	Mumbai

Star Union Dai-Ichi Life Insurance Co. Ltd.	2007	Mumbai
IndiaFirst Life Insurance Company Ltd.	2009	Mumbai

12.9. List of General Insurance Companies in India: Different types of general insurance include motor insurance, health insurance, travel insurance, and home insurance. A general insurance policy pays for the losses that are incurred by the insured during the period of the policy.In 1907, the Indian Mercantile Insurance Ltd, was set up. This was the first company to transact all classes of general insurance business.

List of General Insurance Companies in India

Company name	**Founding year**	**Headquarter location**
National Insurance Co. Ltd.	1906	Kolkata
Go Digit General Insurance Ltd.	2016	Bengaluru
Bajaj Allianz General Insurance Co. Ltd.	2001	Pune
Cholamandalam MS General Insurance Co. Ltd.	2001	Chennai
Bharti AXA General Insurance Co. Ltd.	2008	Mumbai
HDFC ERGO General Insurance Co. Ltd.	2002	Mumbai
Future Generali India Insurance Co. Ltd.	2007	Mumbai
The New India Assurance Co. Ltd.	1919	Mumbai
IffcoTokio General Insurance Co. Ltd.	2000	Gurugram
Reliance General Insurance Co. Ltd.	2000	Mumbai
Royal Sundaram General Insurance Co. Ltd.	2001	Chennai
The Oriental Insurance Co. Ltd.	1947	New Delhi
Tata AIG General Insurance Co. Ltd.	2001	Mumbai
SBI General Insurance Co. Ltd.	2009	Mumbai
Acko General Insurance Ltd.	2016	Mumbai
Navi General Insurance Ltd.	2016	Mumbai
Zuno General Insurance Ltd. (formerly known as Edelweiss General Insurance)	2016	Mumbai
ICICI Lombard General Insurance Co. Ltd.	2001	Mumbai

Kotak Mahindra General Insurance Co. Ltd.	2015	Mumbai
Liberty General Insurance Ltd.	2013	Mumbai
Magma HDI General Insurance Co. Ltd.	2009	Kolkata
Raheja QBE General Insurance Co. Ltd.	2007	Mumbai
Shriram General Insurance Co. Ltd.	2006	Jaipur
United India Insurance Co. Ltd.	1938	Chennai
Universal Sompo General Insurance Co. Ltd.	2007	Mumbai
Agriculture Insurance Company of India Ltd.	2002	New Delhi
Aditya Birla Health Insurance Co. Ltd.	2015	Mumbai
Manipal Cigna Health Insurance Company Limited	2012	Mumbai
ECGC Ltd.	1957	Mumbai
Max Bupa Health Insurance Co. Ltd	2008	New Delhi
Care Health Insurance Ltd	2012	Gurgaon
Star Health & Allied Insurance Co. Ltd.	2006	Chennai

Before picking general insurance or life insurance policy, you must perform adequate research on the same. This will allow you to pick the plan, which offers the most value for money.

Make sure to check the features of a policy, instead of deciding based on the premium rate alone.

12.9 SUMMARY :

After studying this lesson the student should be able to :Know the Different Types of General Insurance Policies in India- Understand about Commonly used terms in Life Insurance-Awareness about Types of Life Insurance policies in India. This lesson is also covered on some aspects like Benefits of General Insurance as well asBenefits of Life Insurance. It is also emphasized on Differences between Life and General Insurance.While life insurance policies indicate just one policy, general insurance can be divided further into subcategories.For any policyholder, distinguishing between life and general insurance plans is integral. The life insurance sector in India comprises of, 24 are life insurance companies, Among the life insurance companies, Life Insurance Corporation (LIC) of India is the only public sector company.

12.10 TECHNICAL TERMS :

Life Insurance: Life Insurance can be defined as a contract between an insurance policy holder and an insurance company, where the insurer promises to pay a sum of money in exchange for a premium, upon the death of an insured person or after a set period.

Life insurance policy: A life insurance policy is essentially a contract between an individual and an insurance provider, where the company promises to pay a specified amount of money to the family or beneficiary of the individual, in return for regular payments over a period of time.

Insurance Pricing: Any company aims to set prices to maximize its profits. This is also referred to as optimal pricing. It is not different in the insurance sector.

General insurance: General Insurance Corporation of India Limited, abbreviated as GIC Re, is an Indian public sector reinsurance company which has its registered office and headquarters in Mumbai.

NIAC: The New India Assurance Company Limited was founded by Sir Dorabji Tata on 23rd July 1919 and nationalized in 1973 with the merger of Indian companies. The company has 2329 offices and the employee strength is 18,783 as on 31st March 2016.

OIC: The Oriental Insurance Company Ltd. was incorporated in 1947. In 2003, all the shares of the company held by the General Insurance Corporation of India were transferred to the government of India.

12.11 SELF ASSESSMENT QUESTIONS :

1. What is a Life Insurance Policy?
2. What is a General Insurance Policy?
3. What are the Differences between Life insurance and General Insurance
4. What are the public sector insurance companies in India?
5. What are the private sector insurance companies in India?
6. What are the types of general insurance companies in India?
7. What are the factors of insurance policy?
8. Which type of Insurance is the most important?

12.12 SUGGESTED READINGS :

1. Esbjörn Ohlsson& Björn Johansson ; Part of the EAA Lecture ; Chapter- 3873 Accesses
2. Dr. P. K. Gupta: Insurance and Risk Management, Himalaya Publishing House.
3. Professor Howard C. Kunreuther, Professor Mark V. Pauly, Dr. Stacey McMorrow: Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry
4. Marshall Wilson Reavis : Insurance: Concepts & Coverage: Property, Liability, Life, Health
5. and Risk Management.
6. Peter Zweifel, Roland Eisen: Insurance Economics (Springer Texts in Business & Economics

Dr. KRISHNA BANANA

LESSON -13
INSURANCE INTERMEDIARIES

AIMS AND OBJECTIVES :

After studying this lesson the student should be able to :

- Know the The Role of Insurance Intermediaries
- Understand about Third -Party Administrator.
- Awareness about . Insurance intermediation in practice.

STRUCTURE OF THE LESSON :

13.1 INTRODUCTION :

Insurance: Insurance is an essential element in the operation of sophisticated national economies throughout the world today. Without insurance coverage, the private commercial sector would be unable to function. Insurance enables businesses to operate in a cost-effective manner by providing risk transfer mechanisms whereby risks associated with business activities are assumed by third parties. It allows businesses to take on credit that otherwise would be unavailable from banks and other credit-providers fearful of losing their capital without such protection, and it provides protection against the business risks of expanding into unfamiliar territory – new locations, products or services which is critical for encouraging risk taking and creating and ensuring economic growth. Beyond the commercial world, insurance is vital to individuals. Lack of insurance coverage would leave individuals and families without protection from the uncertainties of everyday life. Life, health, property and other insurance coverages are essential to the financial stability, well-being and peace of mind of the average person.

Insurance is a financial product that legally binds the insurance company to pay losses of the policyholder when a specific event occurs. The insurer accepts the risk that the event will occur in exchange for a fee, the premium. The insurer, in turn, may pass on some of that risk to other insurers or reinsurers. Insurance makes possible ventures that would otherwise be prohibitively expensive if one party had to absorb all the risk. Insurance is rarely an off-the-shelf product. Different people will pay different premiums based on their individual risk profile. The insurer is concerned with risk, and the consumer is concerned with getting the cover they need at a fair price. An insurance intermediary works as a bridge between insurers and consumers to ensure that everyone’s happy.Advancements in medicine, product development, space exploration and technology all have become a reality because of insurance. Consumers buy automobile insurance to cover both their cars and people who may be injured in accidents. Homeowners and renters buy insurance policies to protect their property and protect themselves from liability. People buy life and health insurance to protect themselves and their families from financial disaster in case of illness or death.

In some instances, governments require businesses to purchase insurance. Known as financial responsibility requirements, government-mandated purchases of insurance is intended to ensure that injured parties will be compensated. Businesses also require other businesses to buy insurance. For instance, a retailer may require its suppliers to carry product liability insurance. Similarly, hospitals may require doctors to carry medical malpractice insurance, and mortgage firms often require their clients to insurance the properties used as collateral. Distribution of insurance is handled in a number of ways. The most common is through the use of insurance intermediaries. Insurance intermediaries serve as the critical link between insurance companies seeking to place insurance policies and consumers seeking to procure insurance coverage.

The importance of insurance in modern economies is unquestioned and has been recognized for centuries. Insurance "is practically a necessity to business activity and enterprise." But insurance also serves a broad public interest far beyond its role in business affairs and its protection of a large part of the country's wealth. It is the essential means by which the "disaster to an individual is shared by many, the disaster to a community shared by other communities; great catastrophes are thereby lessened, and, it may be, repaired."

13.2 INSURANCE INTERMEDIARY :

Intermediaries, traditionally called "brokers" or "agents" or "producers," offer advice, information and other services in connection with the solicitation, negotiation and sale of insurance. Over the last two decades, many professional intermediaries have developed services that go beyond the services related to the transferring of risk from insureds to insurers; Intermediaries now offer services such as the evaluation and implementation of alternative means of funding for potential losses, risk management strategies and claims management. "Intermediaries or insurance intermediary includes insurance brokers, insurance consultants, surveyors and loss assessors."

The "intermediary" can be best described as a third party whose main job is to ensure that both the parties to a contract get what they want and the third party works for both parties for their joint benefit. However, with the Indian reference, the insurance broker has been recognized since the introduction of the Broking Regulations as a person representing the insured and adds value to the transaction. Such a relationship is inevitably contractually agreed by a mandate from the insured and is generally purposed to be paid for the services rendered, by way of brokerage. Such brokerage also forms part of and emanates usually out of the premium paid or payable over a period. An Insurance Intermediary acts as a bridge between the insurance provider and the end customer. They could be involved in the sales process like an insurance agent or an insurance broker, or the claims process like a surveyor or a third-party administration. An insurance intermediary acts as a bridge between insurers and their clients. Some intermediaries work with insurers, whereas others work with their clients. In most cases, though, they work to match the right insurer with the right consumer. They ensure that consumers get all the cover they need at a price they can afford, and that insurers don't take on any unnecessary risk.And if you're considering a career as an insurance intermediary, this guide may help you decide which role is for you. Also be sure to take a look at our award winning insurance software for insurers, brokers, agents, MGAs and program providers.

For example, the broker acts on behalf of the client when negotiating the contract of insurance and placing the policy. When the broker provides services that would otherwise be handled directly by the insurance company, such as premium payments and claims handling, the broker is essentially acting as agent for the company. This unique concept makes the insurance process more efficient for both the policyholder and the insurer. As a practical matter, regardless of the legal role in which a broker is acting, the manner in which the broker approaches all such placements for their clients is as an intermediary – working on behalf of their clients to facilitate the consummation of insurance contracts with carriers that have the ability and capacity to properly insure their risks. Having said that, determining whether an intermediary is legally an agent or broker is not always clear-cut.

Considering a Career as an Insurance Intermediary? :

We put together a comprehensive guide to starting your own insurance company. It includes all the qualifications you'll need, as well as some of the specialised roles you may be able to undertake – such as that of an intermediary. We also offer bespoke insurance software solutions for insurance companies of all sizes, including tailored brokerage and end-to-end fulfilment software. Head here to learn how our award-winning SAAS makes life easier for insurers, brokers, MGAs, agents and program providers.

An intermediary's status is determined by the totality of the facts regarding the specific transaction at issue. An intermediary might be called a "broker," but actually represent the insurance company in a particular transaction. In such situations, the broker is actually – and legally – considered the company's agent, not that of the customer. Although, such an activity-based approach is increasingly used around the world, the legal status of insurance intermediaries varies throughout the international insurance market. For purposes of this memorandum, included within the term "intermediary" are insurance agents, brokers, producers, advisors and consultants.

What is the Role of Insurance Intermediaries and Who Regulates them? :

The importance of insurance in modern economies is very vital and has been acknowledged and recognized for many centuries. Insurance intermediaries are nothing but entities that facilitate the selection and purchase of insurance policies, and render services to insurance companies and consumers that complement the insurance placement process.

What is the Regulating Authority for Insurance Intermediaries? :

Although the insurance sector has been privatized, the insurance companies can deal with intermediaries only if they are holding a valid registration issued by the authority (IRDAI) as per the norms laid down for licensing of intermediaries to function in this sector. They have been defined by IRDA Act, 1999 under section2 (1) (f) of the act as

13.3 THE ROLE OF INSURANCE INTERMEDIARIES :

As players with both broad knowledge of the insurance marketplace, including products, prices and providers, and an acute sense of the needs of insurance purchasers, intermediaries have a unique role – indeed many roles – to play in the insurance markets in particular and, more generally, in the functioning of national and international economies. Intermediary activity benefits the overall economy at both the national and international levels: The role of insurance in the overall health of the economy is well-understood. Without the protection from risk that insurance provides, commercial activities would slow, perhaps grinding to a halt, thus stunting or eliminating economic growth and the financial benefits to businesses and individuals that such growth provides. The role of insurance intermediaries in the overall economy is, essentially, one of making insurance – and other risk management products – widely available, thereby increasing the positive effects of insurance generally risk-taking, investment, provision of basic societal needs and economic growth.

There are several factors that intermediaries bring to the insurance marketplace that help to increase the availability of insurance generally :

- **Innovative marketing**: Insurance intermediaries bring innovative marketing practices to the insurance marketplace. This deepens and broadens insurance markets by increasing consumers' awareness of the protections offered by insurance, their awareness of the multitude of insurance options, and their understanding as to how to purchase the insurance they need.
- **Dissemination of information to consumers**: Intermediaries provide customers with the necessary information required to make educated purchases/ informed decisions. Intermediaries can explain what a consumer needs, and what the options are in terms of insurers, policies and prices. Faced with a knowledgeable client base that has multiple choices, insurers will offer policies that fit their customers' needs at competitive prices.
- **Dissemination of information to the marketplace**: Intermediaries gather and evaluate information regarding placements, premiums and claims experience. When such knowledge is combined with an intermediary's understanding of the needs of its clients, the intermediary is well-positioned to encourage and assist in the development of new and innovative insurance products and to create markets where none have existed. In addition, dissemination of knowledge and expansion of markets within a country and internationally can help to attract more direct investment for the insurance sector and related industries.
- **Sound competition**: Increased consumer knowledge ultimately helps increase the demand for insurance and improve insurance take-up rates. Increased utilization of insurance allows producers of goods and services to make the most of their risk management budgets and take advantage of a more competitive financial climate, boosting economic growth.
- **Spread insurers' risks**: Quality of business is important to all insurers for a number of reasons including profitability, regulatory compliance, and, ultimately, financial survival. Insurance companies need to make sure the risks they cover are insurable – and spread these risks appropriately – so they are not susceptible to catastrophic losses. Intermediaries help insurers in the difficult task of spreading the risks in their portfolio. Intermediaries work with multiple insurers, a variety of clients, and, in many cases, in a broad geographical spread. They help carriers spread the risks in their portfolios according to industry, geography, volume, line of insurance and other factors. This helps insurers from becoming over-exposed in a particular region or a particular type of risk, thus freeing precious resources for use elsewhere.
- **Reducing costs :** By helping to reduce costs for insurers, broker services also reduce the insurance costs of all undertakings in a country or economy. Because insurance is an essential expense for all businesses, a reduction in prices can have a large impact on the general economy, improving the overall competitive position of the particular market. Of course, the insurance cycle of "hard" and "soft" markets can have a significant impact on the benefits – both good and bad – of increased availability. Generally, however, increased availability benefits the consumer by leading to product competition, price competition, and improved services. By reducing insurance costs across markets, intermediaries make an important contribution to improving the economic conditions in a country.

Insurance Intermediaries have a broad knowledge of the insurance marketplace, including products, prices and providers available in the market. Further, they have an acute sense of the needs of insurance purchasers and play a unique role – in fact, many roles – to play in the insurance markets in particular and, in the functioning of national and international economies in general. Intermediary's role benefits the overall economy at both the national and international levels. The role played by insurance in the overall health of the economy is well-recognized. Without any protection from risk that insurance provides, the commercial activities would slow down and perhaps grind to a halt. This would in turn stunt or eliminate economic growth and the financial benefits to individuals/businesses and industries that such growth provides.

The role of insurance intermediaries in the economy is essentially, making insurance and other risk management products. These are widely available, thereby increasing the positive effects of insurance generally – risk-taking, investment, provision of basic societal needs and economic growth. There are many factors that intermediaries bring to the insurance marketplace that help to increase the availability of insurance in general. Insurance intermediaries having expertise bring innovative marketing practices to the insurance marketplace. This helps insurance markets by increasing consumers' awareness of the protections offered by insurance. Further, customer's awareness of the multitude of insurance options, and their understanding as to how to purchase the insurance they need for a particular purpose. They also disseminate the information to consumers.

13.4 INSURANCE INTERMEDIARIES :

Intermediaries furnish customers with the necessary information needed to make educated purchases and informed decisions for purchase. Intermediaries can explain the needs of the consumer, and what the options are in terms of insurers, policies, and prices. With the existence of such intermediaries and their knowledgeable client base that has multiple choices, insurers will offer such policies that suit their customers' needs at competitive prices. Intermediaries collect and evaluate information regarding placements, premiums, and claims experience of policies. When such information is combined with an intermediary's understanding of the needs of its clients, the intermediary is well-positioned to encourage and assist in the development of new and innovative insurance products and to create markets where it did not exist. Increased consumer knowledge finally helps increase the demand for insurance and improve insurance take-up rates. Quality of business is very essential to all insurers for many reasons like profitability, regulatory compliance, and, ultimately, financial survival. Insurance companies are required to be sure that the risks they cover are insurable and further spread these risks appropriately so they are not susceptible to catastrophic losses if any happens at any time. Intermediaries assist insurers in spreading the risks in their portfolio. Intermediaries are also associated with multiple insurers, a variety of clients, and, in many cases, in a broad geographical spread also. Thus, Insurance Intermediaries play a very vital role in the insurance sector.

Different Types of Insurance Intermediaries : There are a few different types of insurance intermediaries :

- ❖ **Insurance Agent**: Insurance Agent is another such intermediary in the sector. Insurance agents are those entities who have been licensed to conduct business on behalf of insurance companies. Such agents represent the insurer in the insurance process and generally work under the terms of an agency agreement with the insurer. The insurer-agent relationship can assume a number of different forms. In some markets, agents are "independent" and work with more than one insurance company (usually a small number of companies) without any restriction; in others, agents function exclusively – either representing a single insurance company in one geographic area or selling a single line of business for each of several companies. Agents can work in many different forms like independent, exclusive, insurer-employed and self-employed. Insurance agents work to solicit and procure business for insurance companies. This might involve selling new policies to new customers or renewing policies for existing customers. Their work benefits both the consumer and the insurer. They'll help ensure the consumer is not underinsured, and that they don't pay too much for cover they don't need. But they'll also help ensure the insurer doesn't take on any unnecessary risk.

- **Insurance Brokers:** Insurance brokers typically act for the policyholder in the insurance process and act totally independent in relation to insurers. Brokers help their clients in the choice of their insurance policies by presenting them with alternatives in terms of insurers and products. Acting as "agent" for the buyer, brokers usually work with many companies to place coverage for their clients. Brokers collect quotes from various insurers and help the clients in selecting the adequate policy from a range of products. Insurance brokers usually represent consumers. They'll take the time to understand their clients' needs, then liaise with multiple insurance companies to find them exactly the level of cover they need, at a fair price. If both brokers and insurers engage with clients to sell them cover, then what's the difference? The key difference between agents and brokers is that agents are only permitted to represent one insurance company within a sector. Brokers, though, can represent multiple insurers. Insurance brokers typically work for the policyholder in the insurance process and act independently in relation to insurers. Brokers assist clients in the choice of their insurance by presenting them with alternatives in terms of insurers and products. Acting as "agent" for the buyer, brokers usually work with multiple companies to place coverage for their clients.
- Brokers obtain quotes from various insurers and guide clients in determining the adequate policy from a range of products. In some markets, there are distinctions among brokers depending upon the types of insurance they are authorized (licensed) to intermediate – all lines of insurance, property and casualty or life/health coverage. While most, if not all, brokers are active in commercial lines, some also intermediate personal lines policies.
- **Retail brokers :** There are also distinctions between "retail brokers," who negotiate insurance contracts directly with consumers, and "wholesale brokers," who negotiate insurance contracts with retail brokers and agents, but not directly with consumers.
- **Reinsurance brokers :** Reinsurance brokers solicit, negotiate and sell reinsurance cessions and retrocessions on behalf of ceding insurers seeking coverage with reinsurers. Reinsurance brokers can also be involved in a reinsurer's retrocession of parts of its risk. As a technical matter, a broker's role may change during an insurance transaction and over the course of an on-going relationship with a client. Many brokers sometimes act as an "agent" of the insurer and other times as a "broker" of the client when assisting a client with insuring its risk exposures through an insurance contract with a traditional carrier.
- **Surveyors :** Some insurance claims involve covering the costs associated with damage, such as claims concerning fire, flood, and theft. In these claims, the insurer will hire a surveyor to assess the extent of the damage. After this, they'll determine how much the insurer should pay out to the insured. Surveyors are usually independent, impartial third parties. They're not there to reduce the amount the insurer has to pay, but nor are they there to ensure the consumer gets the biggest possible settlement. They're there to ensure the outcome is fair to both parties – that

the consumer gets exactly the settlement they're entitled to, and that the insurer isn't paying out more than is necessary.

- **Third -Party Administrator :** Insurance intermediaries facilitate the placement and purchase of insurance, and provide services to insurance companies and consumers that complement the insurance placement process. Traditionally, insurance intermediaries have been categorized as either insurance agents or insurance brokers. The distinction between the two relates to the manner in which they function in the marketplace. Some third-party administrators may take on more specialised roles. As part of a business health insurance plan, for example, the third-party administrator might liaise directly with healthcare providers to ensure the insured gets the treatment they need. And they might manage paperwork and process hospital bills, to ensure there are no delays in treatment or settlements. Insurance companies often hire third-party administrators to manage certain time-consuming tasks, including: i.) Claims processing, ii) Operational administration, iii) Marketing, iv) Underwriting, v) Actuarial services.

13.5 THIRD PARTY ADMINISTRATORS(TPA) :

TPA or third-party administrator is an intermediary between the insurance company and you, the policyholder. As the name suggests, they are a third party. This means that they are neither the policy holder, that is you or also called the first party, nor the direct insurer, which is the second party. Insurance is the mechanism to purchase protection against unexpected types of life events that can lead to a financial loss. These events range from an untimely death to chronic ailments, other serious health conditions, automobile accidents, or fire mishaps, etc. Once insured, you pay premiums to the insurer and in turn the insurer promises to process your claims and compensate you or your loved one for various unforeseen life events. When you consider an insurance purchase, you will encounter the term TPA in insurance. Here is everything you need to know about TPA and how it functions.

TPAs are typically used by insurers across the world and are always licensed as per local country regulations. These entities are contracted by different insurers to provide a myriad of services that enable their customers to receive accurate and prompt services. These range from claims management, policy management, and hospitalization support to sometimes even underwriting support and customer service. Given the number of claims, payment settlement demands, and the increasing need for efficiency, the health insurance industry in India has seen the largest adoption of TPAs.

In India, TPAs are licensed by the Insurance Regulatory and Development Authority of India (IRDAI) as per their regulations which are periodically reviewed. These regulations define the minimum requirements to seek registration as a TPA and outline the service offerings and the onus of what an insurer must allow their policyholders should they engage a TPA.

Functions of TPA :

i. TPA is the link between the insurer and the policyholder in case a claim is made.
ii. TPA is chosen by a health insurance firm.
iii. TPA makes the claim process easy by dealing with the documents and settling the hospital bills. TPA's are licensed by the Insurance Regulatory and Development Authority of India.
iv. TPA can be in link to various policyholders.
v. These are associated with the smooth settlement process.
vi. Role of TPA in Health Insurance
vii. Record Keeping

viii. All the records which are crucial to the policyholder are maintained by the TPA. These records are stored in a dedicated database.

Role of a TPA in Handling Your Insurance Policy :

In situations where you or your dear ones need medical care, be it due to an accident or an illness, TPAs help you deal with the issues that crop up when filing for health insurance claims. They ensure that you understand the paperwork needed for either cashless claims, or reimbursement, while also keeping track of the requisite documentation to facilitate a prompt settlement. However, it is important to note that insurers are not required to have a TPA, and several, in fact, take pride in handling all these service operations themselves.

- ❖ **Why Do We Need TPAs? :** India is now the world’s most populous country, and the cost of healthcare is increasing annually across the country. Our increasing financial prowess, environment, and lifestyle reflects in the poor health conditions of a large set of our population. From cardiac ailments, diabetes, to increasing road accidents, the need for health insurance can not be underscored enough. With increasing numbers of people insured for health coverage, claims volumes are also increasing. TPAs are often a necessity to provide scale and expertise to a demanding clientele of India’s insured. They offer a multitude of services to several insurers:
- ❖ **Issuance of health cards :** Whenever a policy is issued to you, a validation process is undertaken in the background to ensure your eligibility for the coverage. This process is completed through the issuance of an authorized health card which consists of details such as the policy number and the TPA responsible for claims processing.When you or a dear one is admitted, you need to produce this card and convey the emergency to your insurer or TPA. The health card is necessary for the processing of the claim.
- ❖ **Seamless claim processing and settlement :** Your TPA is responsible for expediting the claim and completing the processes as soon as intimation is received. The TPA must verify all the documents submitted in favor of the claim and validate the same as quickly as possible, to ensure the least amount of trouble for the policyholder. For this purpose, the TPA is allowed to request for all necessary information, following which, if the claim is validated, the TPA will then settle the claim either via the cashless or the reimbursement method. In the case of cashless settlements, the TPA will acquire all relevant documents from the hospital itself.
- ❖ **Offering value-added services :** TPAs also offer various other services like wellness programs, annual health checks, second opinion services, electronic health records, etc.
- ❖ **Helpline facility :** In addition to the above services, your TPA will also provide you access to all healthcare insurance information and claim assistance through a 24×7 customer service facility. This facility will be made available to you across the country.
- ❖ **Bolstering hospital networks :** Another major role of the TPA is related to strengthening the insurer’s underlying hospital network. TPAs work towards building a strong network of hospitals which offer quality healthcare solutions to policyholders. This is necessary to ensure cashless claims as well as negotiate the rates charged by the hospital. Policyholders prefer to purchase insurance from companies with the widest hospital network, since this makes effective care more accessible and TPAs essay an important role in enabling this aspect.

13.6 INSURANCE INTERMEDIATION IN PRACTICE :

The intermediary's role within this enterprise stems from two essential functions performed by the intermediary: reducing search costs and uncertainty .

- **Search costs :** Intermediaries reduce the search costs to insurance buyers looking for the right coverage and the right insurer for their risks, and they reduce sales and marketing costs to insurance companies in search of insurance buyers. Intermediaries know the insurance marketplace. They know their clients' risks; they know the insurers willing to cover those risks; and they know the best way to secure that coverage.
- **Uncertainty :** Insurance purchasers and companies do not have all the information relevant to the placement of a policy, which makes it difficult to negotiate a fair price and the proper terms and conditions of a policy. Purchasers know the risks in need of coverage, but may not know the financial health of the insurer or the prevailing conditions of the insurance market. Insurers, on the other hand, may have all the company and market financial information necessary to make a decision, but are not in a position to know enough about the risk and the prospective client.
- **Insurance marketplace :** Intermediaries know the insurance marketplace, they solicit and provide information on insurance purchasers and companies, and they make the information more easily understood to both parties to a transaction. In the interest of long-term client and insurer relations, brokers have a strong incentive to ensure that all parties have the information they need so as they are able to enter into a mutually beneficial arrangement.
- **Insurance purchasers and companies :** Insurance purchasers and companies may come to a transaction with unequal bargaining power. A small- or medium-sized insured may come to a transaction with significantly less clout than the large insurer with whom they need to do business. An intermediary is often able to balance the equation by leveraging its business volume with carriers, and thereby obtain better terms and conditions for the client."
- **Every carrier essentially offers the same promise – to compensate the insured for a loss:** To make that promise meaningful, however, the carrier must have the ability to properly understand and evaluate the risk presented and the capacity and financial solvency required to pay any claims that may result from that risk, as well as a reputation that suggests a willingness to make good on that promise.
- **Large national carriers :** There are literally thousands of insurance carriers, from large national carriers that offer a broad range of coverage's to small regional carriers that may specialize in a single product line. For most clients, coverage terms must be solicited from and negotiated with the carriers on a case-by-case basis. Clearly, numbers dictate that this cannot be done with every carrier in the marketplace that has the capacity to insure a given exposure.
- **Clients rely on intermediaries :** Clients rely on intermediaries to know a universe of carriers that are well-situated to address their needs and negotiate with selected companies to obtain the relatively best overall insurance value for them. To do this, the development of a relationship between intermediary and carrier is essential. In order to provide products and services to their clients, intermediaries must have expertise with the risk profiles presented by their clients and the savvy to go to the right place for the right coverage for each risk profile. The best way for an intermediary to evaluate a carrier's ability to insure a risk and its capacity to pay claims is by working with that carrier over time. Similarly, a carrier will be in a much better position to understand and evaluate the risk presented if it understands and trusts the intermediary presenting the risk to be insured.

In today's complex insurance marketplace, however, intermediaries have become more than middlemen between insurance companies and insurance buyers. They bring experience and expertise to the insurance marketplace, using their knowledge of the insurance markets, their familiarity with their clients and clients' risk, and their access to insurers forged through long-term relationships, to sell and service insurance coverage for costly, and in many cases unique, risks. Commercial insurance clients are generally professional risk managers. As sophisticated insurance purchasers, they realize that commercial insurance products are not commodities; rather, they are customized risk transfer tools, the price and terms of which are generally negotiated on a case-by-case basis. Placement of such risks can be a long and difficult process. Sophisticated commercial purchasers rely on their intermediary to fully understand and appreciate their insurance coverage needs and to find the coverages suited to address those needs.

13.7 INTERMEDIARIES AND RISK MANAGEMENT :

a) **Risk managers :** Risk managers increasingly use enterprise risk management tools to allow them to understand their risk profile, identify cost drivers and analyze enterprise-wide risk. Some intermediaries are active in providing such tools. One of the functions of some insurance intermediaries is to help clients manage their risks, improving their risk profiles and reducing the likelihood that an insured event will occur. Not all risks must be accepted as they are. When properly managed, risks can be controlled and minimized. Some can be avoided; others can be modified to limit their frequency or financial consequences.

b) **Risk management :** Risk management is the process of analyzing possible exposure to loss, reducing loss potential, and protecting financial assets. Businesses often look to their intermediary to act as consultants on risk management and advise them on the best ways to mitigate risk. Some intermediaries therefore represent their clients in all phases of the risk management process: helping clients evaluate risk exposures; implementing measures to minimize such exposures; identifying and facilitating the purchase of insurance products or risks management systems best suited to a client's insurance needs; and managing the claims process.

There are many ways to protect financial assets. Purchase of insurance is the traditional way to transfer risk, but there are other methods that intermediaries and their clients use to ameliorate risks. Use of alternative risk transfer mechanisms – such as forming a captive insurance company, accepting higher insurance deductibles, or setting up reserves to pay losses – is an example.

i. **Self-insurance**: Self-insurance can take many forms. Policyholders can assume higher deductibles or accept lower amounts of insurance coverage. Self-insurance programs, however, must be carefully balanced with a well-managed loss control program to minimize the exposure a business faces and to protect third parties that are injured. That is where skilled intermediaries come in – to act as consultants in designing programs.

ii. **Captives:** Creating a captive insurance company is a popular risk-financing alternative, especially when insurance costs are high. Captives are also popular options for commercial enterprises that want to finance and control their risks.

A captive insurer : A captive insurer is an insurance company that is wholly owned by a non-insurance organization, typically a large company or group of companies in the same business. An intermediary may help a client to establish a captive and/or manage the captive once it is up and running.

A captive's primary purpose : A captive's primary purpose is to insure or reinsure the risks of the parent organization, but they can also cover risks of non-related parties. A well-run captive can provide insurance coverage at lower rates than are generally available in the traditional insurance marketplace. Captives rely on reinsurance to spread the risk, just as traditional underwriters do.

The placement and servicing : These activities and services are beyond those typically associated with the placement and servicing of a policy contract, and have contributed to the evolution of intermediaries from their role as providers of basic brokerage services into full-service intermediaries, providing not only strict intermediation services, but a wide variety of fee-based risk management and consulting services, as well.

Let's now put this into perspective with a real-life example – let's take a policyholder named Kuldeep. His father needed to be admitted overnight with acute chest pain. The doctors determined that a bypass surgery was needed. Given that he was insured with a health insurance policy coverage of INR 10 lakh, also called sum insured, the family was not worried about the implications of this expense. Also, because the insurer and the hospital had a tie up, they didn't need to arrange for the large amount needed for the bypass surgery. The insurer had a cashless claims tie up, in this case, the TPA then handled all the paperwork needed to facilitate a seamless process. The TPA also served as the point of contact when the family was informed that select elements of the expense were not covered under the policy, such as a certain room type, and a few elective services that Kuldeep requested.

13.8 SUMMARY :

After studying this lesson the student should be able to :Know the The Role of Insurance Intermediaries - Understand about Third -Party Administrator. Awareness about . Insurance intermediation in practice. Intermediaries are valued by insured's and insurers as an essential element of the insurance marketplace. Intermediaries search the insurance marketplace to find and place coverage for their clients' risks. They also assist clients in the development of alternative risk transfer mechanisms for risks that otherwise would be impossible or prohibitively expensive – to insure, and they provide services to both insureds and insurers. Risk management involves far more complexity than the simple purchase of insurance. A large part of the task is preventing risk in the first place. Some Insurance Intermediaries are skilled in the art of working with their corporate clients in analyzing and controlling risk, setting up safety programs and other risk control techniques, and arranging alternative risk transfer mechanisms, as necessary. Given that the TPAs are specialized in understanding health claims, hospital requirements, and insurer procedures, they work hand-in-hand with the insurer to improve the quality of service provided to the policyholder and their family. They also serve as the focal point for ensuring that there are no ambiguities in what hospitals charge for services, and what is covered, and when payments are settled. In essence, they are primarily focused on ensuring peace of mind for the policyholder during the stressful times of a hospitalization.

13.9 TECHNICAL TERMS :

- **Insurance Intermediaries** : An Insurance Intermediary means individual agents, corporate agents including banks and brokers, insurance marketing firm. Insurance Intermediary also includes Surveyors and Third Party Administrators but these intermediaries are not involved in the procurement of business.
- **Third -Party Administrator** : TPA or third-party administrator is an intermediary between the insurance company and you, the policyholder. As the name suggests, they are a third party. This means that they are neither the policy holder, that is you or

also called the first party, nor the direct insurer, which is the second party. Their role is to serve as a conduit between both parties and perform operational services that help insurance companies deliver various services or benefits that they have committed to their policyholders.

- **Insurance marketplace** : The Health Insurance Marketplace is a service run by the federal government that helps people, families, and small businesses: Compare health insurance ...
- **Risk management** : Risk management is the process of identifying, assessing and controlling financial, legal, strategic and security risks to an organization's capital and earnings.

13.10 SELF- ASSESSMENT QUESTIONS:

1. What is Insurance?
2. What are the types of Insurance Intermediary?
3. What is the Role of Insurance Intermediaries
4. Discuss various types of Insurance Intermediaries.
5. What is Third -Party Administrator? Explain the functions of TPA.
6. Insurance intermediation in practice- Discuss.
7. Explain the importance of Intermediaries and Risk management

13.11 SUGGESTED READINGS :

1. Esbjörn Ohlsson& Björn Johansson ; Part of the EAA Lecture ; Chapter- 3873 Accesses
2. Dr. P. K. Gupta: Insurance and Risk Management, Himalaya Publishing House.
3. Professor Howard C. Kunreuther, Professor Mark V. Pauly, Dr. Stacey McMorrow: Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry
4. Marshall Wilson Reavis : Insurance: Concepts & Coverage: Property, Liability, Life, Health
5. and Risk Management.
6. Peter Zweifel, Roland Eisen: Insurance Economics (Springer Texts in Business & Economics

Dr. KRISHNA BANANA

LESSON - 14
REINSURANCE IN INDIAN PERSPECTIVE

AIMS AND OBJECTIVES :

After studying this lesson the student should be able to :

- Know the Role of Role of Reinsurance Business in India
- Understand about Techniques or Types of Reinsurance in India.
- Awareness about Legal Considerations of Reinsurance in India

STRUCTURE OF THE LESSON :

14.1 INTRODUCTION :

- Reinsurance companies, or reinsurers, are companies that provide insurance to insurance companies. Reinsurers play a major role for insurance companies as they allow the latter to help transfer risk, reduce capital requirements, and lower claimant payouts.
- Reviewing and drafting of contracts: a reinsurance broker assists the insurance company in placing the risk and selecting the best possible policy after reviewing and negotiating relevant terms and conditions of insurance contracts. Further, a broker continues to advise on and draft new contracts.
- For example, an insurance company might insure commercial property risks with policy limits up to $10 million, and then buy per risk reinsurance of $5 million in excess of $5 million. In this case a loss of $6 million on that policy will result in the recovery of $1 million from the reinsurer.
- A reinsurance, in its most basic sense, is insurance for insurers. It is the process through which insurers minimise the possibility of paying high amounts of money, in case of an insurance claim, by transferring a part of their risk portfolio to other parties.
- But, to understand reinsurance better, let us first look at a more familiar term — Insurance. By definition, insurance means — “an arrangement by which a company or the state undertakes to provide a guarantee of compensation for specified loss,

damage, illness, or death in return for payment of a specified premium." (Oxford Dictionary)

- Hence, in case of an insurance claim, the insurer (ceding party) has to pay the compensation to the claimant, which in most cases is large sums of money. However, to minimise the risk of paying the entire amount by themselves, insurance providers opt for diversifying their risk by sharing it through another party (reinsurer). Which brings us to the question:

14.2 IMPORTANT REASONS FOR REINSURANCE :

Insurers purchase reinsurance for four reasons:

i. To limit liability on a specific risk,
ii. to stabilize loss experience,
iii. to protect themselves and the insured against catastrophes, and
iv. to increase their capacity.

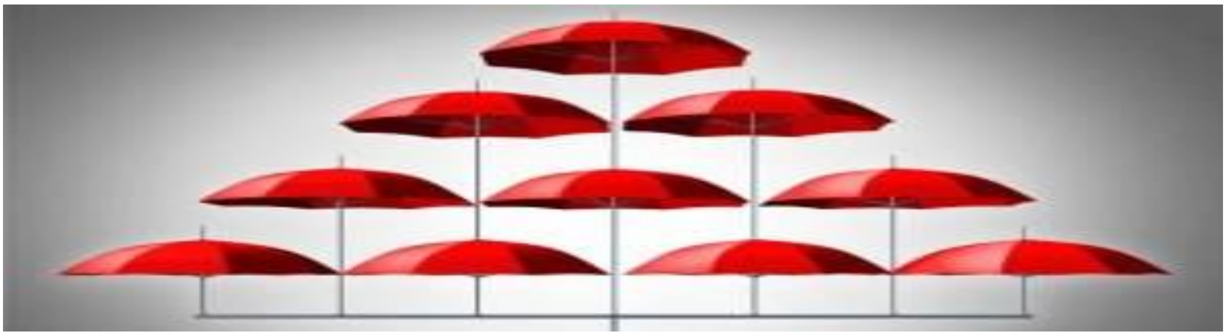
14.3 UNDERSTANDING WITH THE HELP OF AN EXAMPLE :

Daniel Finance (DF) is a small electronic gadget insurance company with an annual turnover of over Rs. 60,00,000 collected through premiums. Recently, a hefty insurance claim was made to DF, owing to a huge fire in a client's company building. The claim amount could have almost led the company to insolvency. However, to the company's benefit, Daniel Finance had already used a part of the premiums received to purchase a reinsurance contract that would pay out part or entire claim (as per the contract) to avoid large losses. Therefore, Daniel Finance could split the claim with the reinsurer and keep the company afloat.

Though it is important to note that legally, insurers are required to maintain enough reserves to pay all potential claims from all policies issued. Having a reinsurer can be looked at as protective gear, in place to avoid bankruptcy.

Further, depending on the needs and demands of an insurance company, the contracts with a reinsurer can change. Sometimes, an insurance company might need a risk-sharing of either part of their portfolio, or the entire portfolio. Based on this, there are two types of reinsurers.

Reinsurance :



Reinsurance is insurance of insurance, where one or more insurance companies agree to indemnify the risk, partially or altogether, for the policy issued by another one or more insurance companies.

Reinsurance indicates the process where the original insurer accepted the risk from the original insured gets the risk covered by another insurer or reinsurer for the same reason the original insured got protection.
Before proceeding to the study of reinsurance, the students must understand the meaning of certain terminologies commonly used in the reinsurance business transaction.
In the absence of such understanding, the student is likely to get confused, and the study might mean obsolete to him.

14.4 THE TERMINOLOGIES ARE USED :

All these terms relate to, indicate, or identify the insurer who primarily assumes the primary insured's risk and then gets the same reinsured according to need.
When an insurer reinsures the risk, he becomes known as reinsured/reassured/ceding company/direct company/original or primary insurer.

- **Reinsurance or Reassurance:** This means insurance of insurance. The original insurer gets the risk, assumed from the original insured (primary insured), and covered (reinsured) with another insurer (known as reinsurer) for the same reason as the primary insured does.
- The primary insurer, here, in fact, becomes the insured (known as reinsured), and the person or body or company giving him the protection becomes the insurer (known as reinsurer).

- **Reinsurer or Reassurer:** Meaning the person, body, or company giving reinsurance cover. They protect the insurer's interest in case of loss/damage of the property or subject matter insured and for which the insurer is liable under the policy of insurance.

- **Ceding Company:** The company ceding the risk, i.e., getting the risk reinsured, and has already been discussed.
- **Cession:** This means the amount of risk ceded for reinsurance, i.e., the amount reinsured.
- **Retrocession:** Means reinsurance of reinsurance. A reinsurer may like to get his interest protected by further reinsurance and so on.
- **Retention:** This refers to the amount of risk retained by the ceding company. The balance is usually reinsured. The amount of retention is dependent on the financial strength of the ceding company for that class of business. It is the refined figure of another term known as LIMIT.
- Normally "Limit1' is a rough guide of the ceding company, and depending on the quality and nature of the risk, the ceding co. may decide to enhance or reduce the limit for actual retention.
- **Line:** A line is equivalent to retention, i.e., the amount retained by the ceding co… A reinsurance arrangement is usually expressed in terms of "line," meaning that if a ceding company has a ten-line or twelve-line reinsurance arrangement (TREATY), it can automatically cede reinsure up to ten times or twelve times of the amount retained.
- **Primary Insured / Assured:** This refers to the primary insured (assured) originally insuring the risk at the first instance. He is one of the parties to the insurance contract and not in the reinsurance contract.
- **Reciprocity:** This is a widely used term in the transaction of the reinsurance business, indicating a situation involving the desire for the satisfaction of mutual interest.

- ❖ Normally, the direct insurers do transact reinsurance business in addition to the insurance business at one time or the other.

When they cede reinsurance business as such to another company, they also expect that at different times that company also would cede reinsurance business to them. This understanding of looking after each other's interests is expressed by the term ''Reciprocity". Broadly, speaking reinsurance is insurance for insurance. This means that the original insurer (who originally accepted the risk from the original insured) gets the risk covered with another (Reinsurer) for the same reason the original insured got protection for.

14.5 OBJECTIVE OF REINSURANCE :

The objective of the reinsurer is very similar to that of any insurance provider. It gives the insurer the surety that no matter what happens, you are insured. Following are the objectives of reinsurance

i. Risk is distributed to guarantee that a claim is covered.
ii. It gives a high level of underwriting stability during the claim period.
iii. Financial obligations that exceed the insurance firm's capability are outsourced to another company with the necessary resources. As a result, the ceding business is only left with the financial responsibility that it can meet.
iv. Profiting from a premium on the net amount.
v. To settle their claims, the real insured individual must work with just one insurance provider.
vi. Enhance the risk exposure capacity.

14.6 FUNCTIONS OF REINSURANCE :

While the main function of any reinsurance company is to reduce the risk associated with the insurance claims. There are a few other functions that a reinsurance company performs.

- ❖ **Income Smoothing**: By absorbing big losses, reinsurance may make an insurance company's results more predictable. This will very certainly lower the amount of cash required to offer coverage. The risks are spread out, with the reinsurer or reinsurers covering a portion of the insurance company's losses. Because the cedent's losses are restricted, income smoothing occurs. This ensures that claim payouts are consistent and that indemnification expenses are kept to a minimum.
- ❖ **Risk Transfer:** The risk is transferred from the main insurance company to the reinsurer, which helps the insurance company manage portfolios better.
- ❖ **Offering Expertise:** In the case of a specific risk, the insurance company may desire to use the experience of a reinsurer, or the reinsurer's ability to determine a suitable premium. In order to safeguard their own interests, the reinsurer will want to apply this knowledge to underwriting. This is particularly true in the field of facultative reinsurance.
- ❖ **Expanding Portfolio:** The reinsurer helps insurance companies expanding their portfolio by taking over some part of the risk. This helps both the insurer and the reinsurer.
- ❖ **Assurance of Claim Settlement:** The involvement of a reinsurer also offers an assurance of claim settlement to the policyholders in case of a catastrophic event.

14.7 REINSURANCE ADVANTAGES :

Apart from the main risk-bearing advantage. Following are the main advantages of reinsurance.

i. **Insurance funds protected**: In the case of reinsurance, the insurance funds are protected and kept safe in case of any unforeseen claim. It also helps the insurance company manage their funds better.
ii. **Encourages new underwriters:** Having reinsurance encourages insurance companies to have new underwriters. Which further leads to an increase and expansion in business.
iii. **It provides a limit on the quantum of liabilities:** By sharing the risk, the reinsurance also helps in reducing the size and number of liabilities that any insurance company has to bear. Which also helps in bettering the operations of the said insurer.
iv. **It further increases the goodwill of the main insurer:** A reinsurer helps in building goodwill for the insurance company. The better the claim settlement, the better the business in the future as a rule.
v. **Stability to profits:** With the addition of a reinsurer, profit is stable for insurance companies.

Benefits of Reinsurance : By covering the insurer against accumulated liabilities, reinsurance gives the insurer more security for its equity and solvency by increasing its ability to withstand the financial burden when unusual, major events occur. Insurers are legally required to maintain sufficient reserves to pay all potential claims from issued policies. Through reinsurance, insurers may underwrite policies covering a larger quantity or volume of risk without excessively raising administrative costs to cover their solvency margins. In addition, reinsurance makes substantial liquid assets available to insurers in the event of exceptional losses.

14.8 ROLE OF REINSURANCE BUSINESS IN INDIA :

The main reason for the practice of reinsurance that it enables a risk to be scattered over a much wider area and the principle of insurance is taken well care of. From what has been said so far, the students should be able to grasp the reason as to why reinsurance is resorted to. However, to sum up, in a systematic, disciplined way, the reasons can be grouped as under:- Risk Minimization by Spreading-Risk Transfer-Flexibility-Accumulation-Development-Prediction for Rating-New Insurer.

- **Risk Minimization by Spreading:** The fundamental concept of insurance is to spread the risk over as wider an area as possible to reduce the burden of loss at each stage.
- Reinsurance enables risk to be scattered over a much wider area, and the principle of insurance is taken good care of. This really helps in the ultimate viability of the rance operation.
- **Risk Transfer:** To an insurer, the need for reinsurance protection arises in the same way as the insured needs insurance protection.
- But for reinsurance, the business of insurance would not have developed to the extent of the present-day growth.
- **Flexibility:** In the absence of reinsurance, insurers would have been bound to limit their acceptance of risk only up to such an amount that they could digest. In other words, the insurers would have been unable to accept a risk beyond their financial strength or resources for that class of business. Consequently, insurers' service to the public would also have been limited. Reinsurance gives insurers flexibility by creating a condition that enables them to accept a risk beyond their financial capacity or resources. The insuring community is also left care-free about various risks to which they are subjected, irrespective of whatever may be the value per single risk.

- **Accumulation:** Reinsurance reduces the possibility of getting involved in an undesirable additional risk-load, which is otherwise eminent from the accumulation of risks from different sources. Examples of such accumulation are,
  - Heavy commitment on the cargoes of the same vessel,
  - Heavy commitment on the cargoes lying in the same port possibly because of the arrival of all vessels at the same time and,
  - The heavy commitment of an insurer on the property of a particular hazardous locality from the viewpoint of fire or conflagration fire.

It is possible that the various branches of an insurer, without knowing each other's position, may commit individually, thereby giving rise to a situation of heavy unbearable commitment as mentioned in (a) (b) or (c) above.
Reinsurance reduces such worries of insurers and keeps down the pressure of accumulation to a sustainable limit.

- **Development:** An insurance company's growth is particularly dependent on sound financial standing, which is primarily based on the stability of profit and loss. Profit cannot be expected if there is an untoward charge on the fund through a claim that it cannot sustain or for which there is no provision.
- Reinsurance tends to stabilize profits and losses and permits more rapid growth of an insurance company.
- **Prediction for Rating:** An insurer needs to have many similar cases in his book to predict an accurate rating structure. But assuming a large number of similar risks is in itself undesirable unless some precautionary measure is taken. It may not also be possible to get many similar cases by an insurer because of the operation of numbers of insurers in the market. Whatever it is, reinsurance takes care of such a situation in both ways. On the one hand, it protects the insurer by providing unsustainable losses, and on the other creates a forum for getting a large number of similar cases through reciprocity. this ASOP.

14.9 TECHNIQUES OR TYPES OF REINSURANCE IN INDIA :

i. **Facultative Reinsurance :** Facultative coverage protects an insurer for an individual or a specified risk or contract. If several risks or contracts need reinsurance, they are renegotiated separately. The reinsurer holds all rights for accepting or denying a facultative reinsurance proposal. A primary insurer purchases facultative reinsurance to cover a specific risk (or a group of risks) in the business. This form of contract offers a beneficial edge to the reinsurance business, as it helps in reviewing individual risks. On the other hand, reinsurance provides the insurer with additional protection for its equity and solvency in case of extreme events,

ii. Facultative reinsurance agreements are considered to be long-term coverage between two parties as compared to treaty reinsurance.

iii. **Treaty Reinsurance :** A reinsurance treaty is for a set period rather than on a per-risk or contract basis. The reinsurer covers all or part of the risks that the insurer may incur. A reinsurance contract that involves an insurance business acquiring insurance from another insurer is known as treaty reinsurance. The cedent is the firm that issues the insurance and transfers all of the risks associated with a specific class of policies to the purchasing company, the reinsurer.

iv. Treaty reinsurances are contracts based on an understanding of premium sharing. It provides better security for the ceding insurer's equity and more stability in the case of exceptional or major events. Treaty reinsurance is less transactional, and risks are less likely to be reduced.

v. **Proportional Reinsurance :** Under proportional reinsurance, the reinsurer receives a prorated share of all policy premiums sold by the insurer. For a claim, the reinsurer bears a portion of the losses based on a pre-negotiated percentage. The reinsurer also reimburses the insurer for processing, business acquisition, and writing costs.

vi. **Non-Proportional Reinsurance :** With non-proportional reinsurance, the reinsurer is liable if the insurer's losses exceed a specified amount, known as the priority or retention limit.

vii. In the case of non-proportional reinsurance, the reinsurer doesn't have a proportional share in the insurer's premiums and losses. The priority or retention limit is based either on one type of risk or an entire risk category.

viii. **Risk Attaching Reinsurance :** Under risk-attaching reinsurance, all claims established during the effective period are covered, regardless of whether the losses occurred outside the coverage period. No coverage is provided for claims originating outside the coverage period, even if the losses occurred while the contract was in effect.

ix. **Loss-Occurring Coverage :** Excess-of-loss reinsurance is a type of non-proportional coverage in which the reinsurer covers the losses exceeding the insurer's retained limit. This contract is typically applied to catastrophic events and covers the insurer either on a per-occurrence basis or for the cumulative losses within a set period.

14.10 REINSURANCE COMPANIES IN INDIA :

As discussed earlier, just as there are insurance companies that cater to the individual insurance needs of a person, reinsurance companies help protect the insurance companies from any kind of catastrophic loss. A reinsurance company functions through a procedure known as cession, a primary insurer (the insurance company) transfers policies (insurance obligations) to a reinsurer (the reinsurance company). Cession simply refers to the transfer of a portion of an insurer’s liabilities to a reinsurer.

Following this, just as individuals pay premiums to insurance companies, insurance companies pay insurance premiums to reinsurers.

Reinsurance companies in India

There are a number of reinsurance companies in India, that offer reinsurance services to insurance providers.

i. Münchener Rückversicherungs-Gesellschaft Aktiengesellschaft – India Branch (Munich Re- India Branch)
ii. Swiss Reinsurance Company Ltd, India Branch
iii. SCOR SE – India Branch
iv. Hannover Rück SE – India Branch
v. RGA Life Reinsurance Company of Canada, India Branch
vi. XL Insurance Company SE, India Reinsurance Branch
vii. AXA France Vie – India Reinsurance Branch
viii. Allianz Global Corporate & Specialty SE, India Branch
ix. Lloyd’s India Reinsurance Branch
x. Markel Services India Private Limited

14.11 NATURE OF REINSURANCE RISKS :

Reinsurance risk refers to the inability of the ceding company or the primary insurer to obtain insurance from a reinsurer at the right time and at an appropriate cost. The inability may emanate from a variety of reasons like unfavourable market conditions, etc.

What is 'Reinsurance Risk'

- **Definition :** Reinsurance risk refers to the inability of the ceding company or the primary insurer to obtain insurance from a reinsurer at the right time and at an appropriate cost. The inability may emanate from a variety of reasons like unfavourable market conditions, etc. Default risk by a reinsurer also affects the ceding insurance company in an adverse manner as it may affect their profitability.
- **Description :** Insurers transfer a part of their portfolio to a reinsurer in exchange for a premium. However, the unavailability of reinsurance at the right time and cost has ramifications for the ceding company. A default on the part of the reinsurer can lead to adverse impacts on the profitability and solvency of the ceding insurer. It may also lead to an adverse affect on the underwriting abilities of the insurer as the default by the reinsurer will augment the risk of the insurer. The ceding company has the onus of meeting the insured's claims in the event of a default by the reinsurer.Reinsurance is an arrangement whereby an insurer so has accepted all insurance, transfers a part of the risk to another insurer so that his liability on any one risk is limited to a figure proportionate to his financial capacity.
- As we all know, insurance is a very well-known concept. However, reinsurance is not known by many. Reinsurance is a lesser-known component of the insurance sector, and it receives less attention, yet it provides investors with excellent profits and protection. Though the idea behind the two is the same, reinsurance offers protection to not just insurers but also policyholders in a way. Which is essential in the times now.
- With the pandemic causing uncertainty every day, diversified risk management is better than a single holding of portfolios.
- **Difference Between Insurance And Reinsurance :** Insurance and reinsurance are important terms used in relation to financial protection. They may seem similar, but the meanings of these two terminologies are different. Insurance and reinsurance are terms used to define the financial protection of a person or company against risk. Both terms allow an individual or a company to transfer their potential loss to other companies in exchange for the payment of bonuses. Both terminologies serve to group probable risk; however, the probable risk is transferred in different ways. Let us understand the difference between insurance and reinsurance in detail.
- Insurance can simply be defined as an act that compensates for someone else’s loss. While reinsurance is an act by which an insurance company contracts an insurance policy to protect itself from the risk of loss.
- **Difference Between Insurance And Reinsurance Company :** Just like the name suggests, an insurance company is a company that provides insurance to single (separately multiple) individuals. The relation is business to customer (B2C). The customer pays a premium to the company for the insurance policy, which can be later claimed to incase of an event causing loss of the insured object. In contrast, a reinsurance company is a business to business (B2B). It acts as an insurance provider to an insurance provider. The insurance company pays a premium to the reinsurer based on the contract details.
- **Difference Between Reinsurance And Coinsurance :** While, by now, you must already know what reinsurance is, coinsurance is an important term that you must know about. Coinsurance refers to the distribution of risk among several insurance companies. It is the participation of one or more companies to share the same risk.
- **Difference Between Facultative And Treaty Reinsurance :** Facultative reinsurance is reinsurance for a single risk or a defined risk package that an insurance company

shares with another company. Whereas under the treaty reinsurance contract insurance companies may assign all risks to a reinsurance company.

How Reinsurance Works : Reinsurance allows insurers to remain solvent by recovering some or all amounts paid out to claimants. Reinsurance reduces the net liability on individual risks and catastrophe protection from large or multiple losses. The practice also provides ceding companies, those that seek reinsurance, the chance to increase their underwriting capabilities in number and size of risks. Ceding companies are insurance companies that pass their risk on to another insurer.

Several common reasons that insurers obtain reinsurance include: expanding an insurance company's capacity, stabilizing its underwriting results, financing, gaining catastrophe protection, spreading an insurer's risk, and acquiring expertise. As mentioned earlier, reinsurance is a way for insurance agencies to reduce the risk of paying large amounts of money all by themselves. A reinsurance helps insurers stay afloat by recouping either part or all of the money they've paid out to claims. It also lowers the net liability and protects against large or numerous losses in a disaster. Reinsurance also helps ceding companies to expand their underwriting capabilities in terms of quantity along with the risk they may take on. Some examples may be considered at this stage.

Example 1 : In life insurance, the actuary can predict with some certainty as to how many lives of a given age will die within a certain period. What he cannot forecast is which of the named persons will exactly die. This ignorance or limitation of knowledge, in fact, has aggravated the necessity of reinsurance further. If a life company has 100000 lives all aged 20 and each insured for $10,000, and if this company now gets a fresh proposal from a managed 20, but for an amount of $30,000, then a problem would arise since the company shall have to run the risk of an additional amount of $20000 which will definitely imbalance the account if simply the new entrant dies first. Therefore, this company shall feel the necessity of getting its load ($20000 in this case) reinsured with another company.

Example #2 : A general insurance company may have the capacity to bear up to $100000 for any property insurance or liability insurance. If a risk is placed for $300000 by the insured, the insurer shall have to reinsure $200000.In the case of assuming unlimited liabilities, the extent of loss may sometimes be considerable and, therefore, in all fairness, should have reinsurance arrangements beyond capacity. After seeing the terms related to Re-Insurance and examples, let us look at the various definitions given in the following paragraphs. By a reinsurance agreement, the reinsurer may undertake to reinsure the assured (i.e., the reinsured or reassured), considering the assured paying him a portion of the premium the assured receives against the proportionate amount of all assured's losses arising from insurances along a certain line.

This arrangement could not constitute a partnership but would, in fact, be a contract of reinsurance (English Insurance VS. National Benefit Insurance (1929), A. C. 114). This definition understandably refers to a treaty agreement discussed later.Reinsurance is an agreement to indemnify the assured (meaning reassured), partially or altogether, against a risk assumed. (Friend Bros V. Seaboard Surety Co, 56 N. E. 2d 6).A direct company may find that it has placed itself under liability to many policy-holders. It may consider that it has undertaken more than it can safely carry.Therefore the company, because of its outstanding contractual obligations, may desire to protect itself. It may seek to lessen its burden by getting some other company to assume a part of its liability in case of a loss.

The Original Or Primitive Or Direct : The Original Or Primitive Or Direct insurer, as is often called to represent the direct-writing company, may transfer or cede the whole or part of a risk to another company. The first insurer or cedar, in turn, enters into a contractual relationship with the second company, which is called the REINSURER. The original or the primary insurer is obligated directly to his insured or the policy-holder. The reinsurer is obligated to the ceding company. The original insurer has to account for its original assured in case of loss under a primary policy.

The direct company, known as the reinsured, by its contract may obtain the power to collect from the reinsurer because of the loss suffered by the original assured under the terms of the original policy. There may arise a contract of reinsurance from the business relationship established between the reinsurer and the reinsured. “Reinsurance is a contract which one insurer makes with another to protect the first insurer from risk already assumed” (Bethke Vs. Cosmopolitan Life Insurance Co., 262, APP 586).“It involves the principle of indemnity” (Union Central Life Insurance Co. Vs. Lowe, 182 N. E. 611).The contract of reinsurance was also defined in the American case of Stickel Vs. Excess Insurance Co. of America, Ohio Supreme Court; Nov. 22, 1939, 23 N. E. (2nd) 839 as “A contract whereby one, for a consideration, agrees to indemnify another wholly or partially against loss or liability because of a risk the latter has assumed under a separate and distinct contract as insurer of a third party.”

The students should recall that the primary concept of insurance is to spread the risk or loss of one onto many’s shoulders. Whilst it becomes unbearable for a man alone to bear the load of a loss, it becomes quite easier when a group collectively shares the same. In reinsurance also the same principle or concept is involved. It is indeed sharing and re-sharing of risks or spreading and further spreading of risks. The necessity emerges out of the same need as is felt by the original assured. Reinsurance is not double insurance or coinsurance since in such contracts, unlike reinsurance, there is a direct contractual relationship between the insured and insurer or co-insurer.

The students should get acquainted with a widespread term, known as retrocession, widely used in reinsurance transactions. This virtually means reinsurance of reinsurance. The students should appreciate that reinsurance enjoys no immunity from the operation of the principles governing sound practice for insurers. The reinsurer must also avoid a concentration in conflagration areas or catastrophe situations and maintain a wide distribution of its risks assumed from the ceding company. The reinsurer may probably have sufficient amounts ceded from several different sources, and unfortunately, the cession may relate to the same risk.
To relieve itself from this undesirable accumulation, the reinsurer would itself have to resort to reinsurance.

This act of reinsuring any part of reinsurance is termed as retrocession and comes within the same reinsurance study. To sum up, therefore, it may be said that:

1. To secure a large number of similar risks to permitting the prediction of losses with a reasonable degree of certainty, insurance companies have devised the practice of reinsurance.
2. Reinsurance is the transfer of insurance business from one insurer to another. Its purpose is to shift risks from an insurer, whose financial security may be threatened by retaining too large an amount of risk, to other reinsurers who will share in the risk of large losses.
3. Reinsurance tends to stabilize profits and losses and permits more rapid growth.
4. The entire area of reinsurance and retrocession is an example of the essential need for a spread of risk among many risk bearers. Much of the process goes on without the

policy-holder being aware of its existence since he is not a party to the reinsurance arrangement.

5. Reinsurance enables a risk to be scattered over a much wider area, which is the primary concept of the whole business of insurance.
6. The need for reinsurance arises in the same way as an original insured needs insurance protection.
7. The original insured is not a party to the reinsurance contract.

14.12 LEGAL CONSIDERATIONS OF REINSURANCE IN INDIA :

In the reinsurance business, 11 legal aspects should be considered for comprehensively dealing with the complex matters in reinsurance. The students should appreciate that the business of reinsurance is very much within the four walls of the business of insurance, and therefore, As applicable to the business of insurance, most of the legal considerations will also equally hold good in so far as the reinsurance business is concerned. The important legal considerations are summarized below in stratum.

i. As a general rule, reinsurance is a contract between the direct insurer and the reinsurer. The original assured is not a party and does not obligate the reinsurer to the assured. (Baltica Insurance Co. V. Carr, 330). If the reinsurers fail to meet their liability, the direct insurer would still be liable for the policyholder's whole loss. The policy holder's redress lies with the insurer and not the reinsurer.

ii. Contracts of reinsurance require Utmost Good Faith on the part of the insurer. Generally, the same rules regarding misrepresentation and non-disclosure that apply in connection with ordinary insurance contracts apply in cases of reinsurance contracts.

   Whereas an assured may not be under an obligation to describe his own bad character to his insurer, yet the insurer seeking reinsurance may be under the duty to disclose what he knows about the assured. (loonies V. Pender (1874) L. R. 9 0. B. 531).

iii. The contract of reinsurance is equally subjected to the requirement of Insurable Interest. It is a legal financial.

iv. The interest entitles the insured or the insurer to insure or reinsure. Insurers have an insurable interest against the policy they have issued because of a loss's possible financial involvement. This justifies the existence of insurable interest, thereby validating reinsurance contracts.

v. Reinsurance is an agreement to indemnify the direct insurer, partially or altogether, against a risk assumed by him in a policy issued to a third party. (Friend Bros. V. Seaboard Surety Co. 56N, E. ALR 962). Reinsurance is a contract, which involves the principle of indemnification (Union Central Life Ins. Co. V. Lowe, 182 N.E. 611).

vi. The reinsurer is obligated to the ceding company. The direct company, known as the reinsured, obtains the power to collect from the reinsurers because of the loss suffered by the original insured by its contract with the reinsurers.

vii. There may arise a contract of reinsurance from the business relationship established between the reinsurer and the reinsured. The risk assumed in reinsurance must be determined by examining the contract of reinsurance. It cannot be taken for granted that the reinsurance contract's risk is the same as that covered by the original Policy written by the direct insurer.

❖ Reinsurance does not mean double insurance. Double insurance exists where there are two policies in force covering the same insured's same interest on hazards that are identically the same and involving the same subject- matter. In reinsurance, different interests and different parts are involved. Whereas in double insurance, the original insured has a direct contractual relationship with the insurer, in the reinsurance contract, he holds no contractual relationship.

- ❖ Reinsurance does not mean coinsurance for the same reason as explained under double insurance. Whereas in coinsurance, the insured is contractually linked up with the various co-insurers directly to the extent of respective shares assumed by them. In reinsurance, he (insured) is not a party at all.
- ❖ Usually, reinsurers are liable as per the liability of the original insurer. Therefore, when the original insurers, on different considerations, make exgratia payments without admitting liability under an insurance policy, they cannot claim recovery from their reinsurers.
- ❖ When after making a claim, the insurers make any recovery from the liable third party as per policy terms and conditions, the reinsurers become entitled to such recovery proportionately. This means that the principle of subrogation applies. The insurer cannot make a profit by recovering from all the sources.

Many risks in almost all business classes may be too big for an insurer to digest or bear on his own account. The insurer's financial strength on that account may not be potent enough to bear a loss if it at all takes place. Moreover, there is the question of big catastrophe losses, which might cripple down the insurer financially and force him to disown any liability to the insured simply because of the inability to honor a claim. Whilst this possibility is very much there, on the other hand, the insured is also most reluctant to go from insurer to insurer and to place only that amount of business to each, as each would be able to bear.

It is indeed amidst these two extremes that we see the development of a system wherein the insured goes to one insurer which usually takes the whole risk and reinsures any balance beyond his retention capacity (i. e., beyond which he cannot consume from the viewpoint of financial strength for that class of business) with the reinsurers. Reinsurance, like insurance in general, has the element of chance involved. The reinsurer hopes that his premiums will take care of his losses and that he will obtain a profit in the course of events. When an insurer accepts risk for a huge amount of one event, although he may be in a position to make a reasonable gain, yet indeed he has subjected himself to serious possible liabilities. Under such circumstances, he may desire to reinsure a part or all of the risk with some other company or insurer. Reinsurance steps in as a method whereby the insurer may receive indemnity from his reinsurer in the event of reinsured's liability to the original insured.

14.13 SUMMARY :

After studying this lesson the student should be able to :Know the Role of Role of Reinsurance Business in India- Understand about Techniques or Types of Reinsurance in India.- Awareness about Legal Considerations of Reinsurance in India**.** In addition to it Important reasons for reinsurance: Understanding with the help of an example, The Terminologies are used, Objective of Reinsurance, Functions of Reinsurance , and Reinsurance Advantages. As reinsurance contracts are contracts of indemnity, the principle of contribution also equally applies to reinsurance contracts. By affecting the reinsurance contracts, the ceding company cannot recover from each reinsurer's full amount of loss independently. A reinsurance, in its most basic sense, is insurance for insurers. Like individuals need insurance for health, auto, life etc. Insurance providers need reinsurance to better manage their vast portfolios. A reinsurance contract not only helps insurance providers reduce their risk, but also helps them diversify their portfolio to expand their business. Our reinsurance brokers can help you find the right type of reinsurance company that can suit your needs and add leverage to your company. Through our online portal, you can now call or request a quote for the right reinsurance company.

14.14 TECHNICAL TERMS :

Reinsurance : Reinsurance, often referred to as “insurance for insurance companies,” is a contract between a reinsurer and an insurer. In this contract, the insurance company—the cedent—transfers risk to the reinsurance company, and the latter assumes all or part of one or more insurance policies issued by the cedent.

Legal Considerations : Legal consideration refers to the exchange of two or more things of value in a legally binding contract. Typically, money or currency is exchanged for some type of goods or services in these contracts. In order for any contract to be valid, it must have consideration.

Reinsurance business : Reinsurance is insurance that an insurance company purchases from another insurance company to insulate itself (at least in part) from the risk of a major claims event. With reinsurance, the company passes on ("cedes") some part of its own insurance liabilities to the other insurance company.

Double insurance : Double insurance. Previous Next. (1) Where two or more policies are effected by or on behalf of the assured on the same adventure and interest or any part thereof, and the sums insured exceed the indemnity allowed by this Act, the assured is said to be over-insured by double insurance.

Retention capacity : Capacity retention is a measure of the ability of a battery to retain stored energy during an extended open-circuit rest period. Retained capacity is a function of the length of the rest period, the cell temperature during the rest period, and the previous history of the cell. Capacity retention is also affected by the design of the cell. Nickel-cadmium cells are manufactured using a variety of electrode formulation processes. Each process is unique and electrodes made from each of these processes may possess different capacity retention characteristics. Other cell design parameters such as electrode spacing, electrode surface area, and separator material, also affect capacity retention.

14.15 SELF ASSESSMENT QUESTIONS :

1. What are the Important reasons for reinsurance?
2. How are you Understanding reinsurance with the help of an example?
3. Illustrate some of the Terminologies are used Reinsurance?
4. What is Reinsurance ? Explain the Objective of Reinsurance.
5. What are the Functions of Reinsurance –explain.
6. Explain the Reinsurance Advantages.
7. What is the Role of Reinsurance Business in India?
8. Explain regarding the Techniques or Types of Reinsurance in India
9. Reveal the some of the Reinsurance Companies in India
10. What is Nature of Reinsurance Risks?

14.16 SUGGESTED READINGS :

1. Esbjörn Ohlsson& Björn Johansson ; Part of the EAA Lecture ; Chapter- 3873 Accesses
2. Dr. P. K. Gupta: Insurance and Risk Management, Himalaya Publishing House.
3. Professor Howard C. Kunreuther, Professor Mark V. Pauly, Dr. Stacey McMorrow: Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry
4. Marshall Wilson Reavis : Insurance: Concepts & Coverage: Property, Liability, Life, Health and Risk Management.
5. Peter Zweifel, Roland Eisen: Insurance Economics (Springer Texts in Business & Economics

Dr. KRISHNA BANANA

313CO21

MODEL QUESTION PAPER

INSURANCE AND RISK MANAGEMENT

Max. Marks: 70 **Time: 3 hrs.**

SECTION A (Total: 5x3=15 Marks)

(Answer the following questions. Each answer carries 3 marks)

1.	a) Risk	(OR)	b) Uncertainty
2.	a) Insurable risk	(OR)	b) kinds of insurance
3.	a) Legal frame work	(OR)	b) Insurance players
4.	a) Product Design	(OR)	b) Underwriting
5.	a) Reinsurance	(OR)	b) Bank assurance

SECTION B (Total: 5x8 = 40 Marks)

(Answer the following questions. Each answer carries 8marks)

1. a) Explain about Types of Risks

(or)

b) Discuss briefly about Risk management by individuals

2. a) What isProbability?Explain the Probability and its use in insurance.

(or)

b) Discuss about theories of risk management

3. a) What is liberalization? Discuss briefly about liberalization of insurance markets

(or)

b) Discuss about the Regulation of Insurance Business in India

4. a) Explain about the Types of Insurance Organizations

(or)

b) Briefly explain about Product Development Process

5. a) What is Insurance Pricing ? Discuss about Fundamentals of Insurance Pricing

(or)

b) Briefly discussed about Insurance Intermediaries and their Functioning.

SECTION C (Total: 1x15 =15 Marks)

6. a) What is Reinsurance? Explain about Reinsurance in Indian Perspective

(or)

b) What is Globalization? Explain aboutGlobalization of insurance and its impact in India.