Chapter 1

History of Insurance

Insurance in India

Insurance was practiced in India even in the Vedic times and the Sanskrit term "Yogakshema" in the Rigveda is in reference to a form of Insurance practiced by the Aryans 3000 years ago.

The first Indian Life assurance Society was called "Bombay Mutual Assurance Society Ltd."

- "Oriental Life Assurance Society Ltd" in 1874,
- "Bharat Insurance" in 1896 and
- "Empire of India" in 1897 followed it.

History of Insurance

In the Swadeshi Movement of 1905 Mahatma Gandhi's call to Indians to give their business only to Indian Companies gave a boost to the new companies and they consolidated their position.

More Indian companies entered the Life Insurance sector namely

- Hindustan Co-operative,
- United India, Bombay Life,
- National and
- Laxmi Insurance.

These companies had to compete with 150 foreign offices including some of the largest Insurance groups in the world.

Insurance in Modern India

- Government started exercising control on Insurance business by passing the "Insurance Act" in 1912.
- This Act was comprehensively amended and passed as a New Act in 1938 for controlling Investment of funds, expenditure and Management.
- The Office of Controller was established. Again, this Act was amended in 1950.

By 1955, 170 Insurance offices and 80 P.F. Societies registered companies were doing Life Insurance business in India.

In view of surge in malpractices in Life Insurance business, due to the illiteracy level being high and lack in will for penetration/ spread of Life Insurance business, it was nationalized by Government of India and LIC Act was passed in June' 1956, and this Act came into force from 1.9.1956.

General insurance (which deals with non-life business i.e insurance of property) also nationalized in 1972 after the merging of 55 Indian and 52 Non-Indian companies were nationalized by forming four general insurance companies.

The Govt. India, while liberalizing the Indian economy, also felt the liberalization of the

insurance sector because of lower penetration of insurance as compared to Indian population and its size and other developing countries.
Initially the Govt. formed a Malhotra committee in 1993 to study whether the insurance sector should be opened for private players.
The committee recommended to Liberalize, Privatize and Globalize (LPG) the insurance sector. In 1999, the Authority known as Insurance Regulatory & Development Authority through IRDA Act 1999 was formed.
Liberalization of Insurance industry will undoubtedly benefit Indian economy, the Government, Industry, Employee, and Consumer & Society in the following manner:

Benefits to Economy
1. Rapid investment
2. Improve Quality to Life (New risk covers)
3. Competition will bring Consumer Friendly Products
4. Large Scale Mobilization of Funds
5. Insurance & Reinsurance Facilities to Major Projects
6. Export Projects covered at Home

Benefit to Government
1. Long Term Funds for Infrastructure
2. Long Term Debt Market Instruments Available
3. Increased Employment Opportunities & Compensation
4. Reduced Financial Burden of
5. Rural Social & Backward Classes
6. Contributions in Calamities (Sharing of Social Responsibilities)

Benefit to Industry
1. Transfer of Technical Expertise
2. Innovative Products and Pricing Options
3. Improved Prospects for National Cos.
4. Market Driven Economy will Benefit Customer the most

Benefit to Consumer
1. Superior Quality at Lower Prices
2. Wider Choice of Products
3. World Class Service to the Consumer
4. Increased Penetration of Insurance

Benefit to Employee
1. Human Resource Development
2. Exposure to 'State of the Art-Practices"
3. Greater job Opportunities
4. Higher Remuneration
5. Professional Management Practices

Benefits to Society

1. Insurance Companies Act as Guardians in number of Ways: -
2. Risk cover for Large Industry. Trade & Property
3. Environmental Risks get Reduced
4. Hit and Run Compensations
5. Crop Insurance for Covering Risk of Nature - Poor Rainfall etc.
6. Socio-Economic Responsibilities Burden shared
7. Education Medical wealth Accident

Benefits to Government

1. Long term funds and debt instruments are available to develop the economy.
2. Infrastructure funds are available to create roads, bridges, communication housing etc. It reduces the burden of the Govt.
3. Investment in the Rural and Social sector supports the Govt. efforts
4. Capital market: If the insurer is investing the fund in the capital market then industry can enhance their production capacity, which will have the multiplier effect on the growth of the economy.

IRDA – Insurance Regulatory & Development Authority of India

- IRDA is an autonomous, statutory body tasked with regulating and promoting the insurance and reinsurance industries in India
- It was founded in 1999 and is headquartered in Hyderabad
- IRDA is a 10-member body including the chairman, five full-time and four part-time members appointed by the government of India
- Subhash Chandra Khuntia is the current Chairman of IRDA

Mission statement of the Authority:

- To protect the interest of & secure fair treatment of shareholders
- 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

Insurers

- The Indian market is a regulated market and nobody can carry on insurance business without obtaining a license from IRDA. The insurance company should be an Indian Company, and should have minimum Rs. 100 Cr paid up capital.
- A Company can carry either life or non-life (general) insurance but not both. In the Indian market there are public sector insurers and private sector insurers, with or without foreign holding.
- General Insurance Corporation of India, a public sector company, is an insurance company doing exclusively reinsurance business.
- There is one Life Insurance Company in the public sector. Remaining 23 are in the private sector.

  There are 27 insurance companies registered as Non-life (General) Insurance companies.
  - Agriculture Insurance Company of India Limited., a public sector company, is a specialized insurer for risk related to Crop insurance.
  - Export Credit and Guarantee Corporation of India, a public sector company, is a specialized insurer for risks related to export credit
  - There are eight General insurance companies in the public sector. The remaining 26 General Insurance companies are in the private sector.
  - There are four standalone health Insurance companies, in the private sector, specialized in health insurance.
- In all there are 24 Life Insurance companies and 34 Non-life (general) insurance companies.

Intermediaries involved in Insurance industry

An intermediary is a person or an agency who acts as a link between the insurance company and the policyholders.

In Indian Insurance market the following intermediaries are operating in the insurance sector.

Agents

1. Agents – An individual is allowed to become an agent for maximum one life and one non – life and one health insurance company.

The agent represents the insurance company before the customer.

Corporate Agents

Corporate agent is a corporate body which acts as agent for one life, one non – life and health insurance company.

Bancassurance

Banks can become corporate agents. They can become agents for one life, one non-life and a health insurance company.

Brokers

a) Direct Brokers deals with all insurance companies. They represent the client before insurance companies.

b) Re-Insurance Brokers acts as an intermediary between insurance companies and reinsurance companies.

c) Composite Brokers can do direct insurance as well as reinsurance.

Banks as Brokers

IRDA has now allowed Banks to act as Brokers.

The Banks as Brokers Regulation (2013) has been released by IRDA empowering Banks to act as Brokers.

The Bank has tie-ups with more than one Insurance company to market products of Life General and Health Insurance Policies.

Point of Sales Person means an individual who possesses the minimum qualifications, has undergone training and passed the examination as specified in these Guidelines and solicits and markets only such products as specified by Authority.

Definition of Insurance

Insurance may be defined as the transfer of risk from the insured to the insurer.

The insured is the person (or firm or company) confronted by risk, who transfers the risk to the insurance company, which specializes in the assumption of risk and accepts the risk.

- The insurer accepts the risk for a fee called the "PREMIUM".
- The insurer assesses the loss and 'underwrites' the risk for a "PREMIUM".

Insurance as a security is the need of all human beings.

Man is afraid of uncertainty, risks and death. Although it is a reality, that one day each one will die; early or later, timely or untimely is the question, which has no answer.

- Man is afraid of risk & losses in future.
- Man is forever in search of security & certainty.

In early history man lived in a joint family, groups and communities to be secure.

In the earlier days, whenever an earning member would die due to disease or death, the other member of the social group (or family or clan) would contribute to bail the survivors in the family out of financial difficulties. This contribution was in the shape of food-clothing and shelter.

Later, as commercial considerations grew stronger and stronger; nucleus family growth became a common practice, and these contributions and sharing started becoming individualistic.

The 'assurances' which were earlier, a common practice became rare.

This is the concept of growth of Insurance.

CONCEPT OF INSURANCE

Basic concept of insurance business is protection of the economic value of assets. Every asset has a value. If some asset is damaged or destroyed, the owner suffers the monetary loss. If an insured insurance company pays for the loss, the extent of loss suffered by the subject is limited. Losses of unfortunate few are shared by and spread over too many exposed to the same risk

The asset whichever is purchased or created is for the purpose of its expectation of future needs/benefits.
Loss of assets by any reason deprives the owner of the expected benefit.
Insurance helps to reduce the adverse consequences due to loss of assets.
For example a cow is purchased: milk is sold in the market and income is generated. Factory is established to produce goods and sell them and funds are generated. Another example is that of a motorcar if purchased for personal use it only provides comfort and convenience to the owner in his day-to-day requirement in normal life and there is no monetary gain rather its value reduces due to use. In case if the same car is purchased to be used as a taxi, it generates income for the owner and he gains
Every asset has a limited life and during that time it performs to the expectation of the owner. Knowing this well, the owner keeps a provision to replace the same when the asset is not functioning satisfactorily.
But in case of early destruction or non-functioning of the asset, because of an accident or fire or any other unfortunate event the owner is deprived and suffers financially. Insurance is a method, which helps to reduce such adverse consequences.
The concept of insurance is that people are exposed to the same risk pool money, and all of them share the loss suffered by a few. The insurance companies play the role of implementing the said concept to collect in advance the shares in the shape of premiums and create a fund out of which the losses of few are paid.
Following example shows how the insurance concept actually works.

Example

There are 1000 motorcycles all valued at Rs. 50,000/-. It is expected that out of these 10 motorcycles either are stolen or total loss during the year. The loss of each person is Rs.50,000/-, the total loss would be Rs.5,00,000/-. If each motorcycle owner contributes Rs.500/- the common fund would be Rs.5,00,000/-. This would be enough to pay Rs.50,000/- to each of the 10 owners of the motorcycle. Thus 1000 persons share the risk in case of 10 motorcycle owners.

Purpose & need of Insurance

Assets are likely to be destroyed or made non-functional due to perils like fire, floods, breakdowns, lightning and earthquakes etc. Every asset is exposed to risk means possibility of loss or damage, which may or may not happen. This is because of uncertainty about the risk that insurance plays the role. Insurance becomes relevant only if there are uncertainties of occurrence of event leading to loss

No uncertainty - No Insurance

An asset generates income, which can be lost on early destruction due to accidents. Insurance does not protect the assets but only compensates the insured by way of payment of claim.

CONCEPT OF RISK

Risk involves the chance an investment's actual return will differ from the expected return. Risk includes the possibility of losing some or all of the original investment. Different versions of risk are usually measured by calculating the standard deviation of the historical
A probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive action. ... A risk is not an uncertainty (where neither the probability nor the mode of …

What is a hazard?

A hazard is a situation that poses a level of threat to life, health, property, or environment. Hazards can be dormant or potential, with only a theoretical risk of harm; however, once a hazard becomes "active", it can create an emergency. A hazardous situation that has come to pass is called an incident.

Types of hazard

Hazards are generally labelled as one of five types.

Physical hazards are conditions or situations that are concerned with subject matter of insurance i.e. building, machinery or human being. The description of the same helps the insurer to decide the rates to be charged. Physical hazards can be both natural and human made elements.

Chemical hazards are substances that can cause harm or damage to the body, property or the environment.

Moral Hazard relates to the human beings approach towards the insured property whether he cares for the same “Prudent as if uninsured”, if not then his moral hazard is not good and cause loss to insured property of its own to have more amount at the time of loss.
Morale hazard is not like moral hazard but his indifferent attitude towards the insured property which may cause loss without the instinct of dishonesty. It can be said moral hazard is an act of dishonesty whereas moral hazard is indifferent intention with no intention to put the insurer to loss.

What is Peril?

Peril is the cause of loss which is essentially important as most of the general insurance policies are not issuing comprehensive policies which cover all the risk/ cause of losses. There are so many exclusions/ conditions which deprives the insured of getting the loss.

Nature of Perils

The perils relevant to an insurance claim can be classified under three headings:

Insured perils: Those named in the policy as insured from e.g. fire, lightening, storm and theft;

Excepted or excluded perils: Those stated in the policy as excluded either as causes of insured perils e.g. riot, earthquake or war or a result of insured perils e.g. certain type of explosion;

Uninsured or other perils: Those perils not mentioned in the policy at all. Smoke and water may not be excluded nor mentioned as insured in a fire policy.

2. HOW INSURANCE WORKS?

Theory of probability:

Let us assume that a particular city has a population of 1 lakh.
In the city, on an average in a year 10000 are affected by way:

This data as per statistic is certain.
Then what is uncertain?
Uncertainty is as to who will die or get disabled during day-to-day high-risk prone fast life.
Though the number of deaths, accidents etc. is known,
What is not known is the name, age, time, place and of the 'PERSONS'.
If it is known that 200 persons are prone to accidental death in a year, it is not known which 200 individuals?
Due to this certainty, that 10000 people will die in an accident, or get injured and disabled or die natural death or die of disease; all 1 lakh people will fear.

- Accident
- Possibility of injury or death and its consequences to varying degrees as per their age, behaviour, nature of work, environment hazards and many other factors. Grownups and breadwinners may fear more and dependents may fear less.
  In a city of 1 lakh houses & shops, there are about 1000 thefts every year, though some particular 1000 people are affected by the theft, all others (maybe more than 90000) will fear theft, and will like some solution to this problem.

"Many would contribute to mitigate losses of a few".
This method of sharing losses of a few by many is the basis or core philosophy of insurance.

3. PURPOSE OF INSURANCE

Every human being has fear in his mind.

- The fear is whether he will be able to meet the basic needs of life i.e. Food, clothing and Housing (Roti, Kapda and Makkan).
- He has fear not only for himself but also for his dependents.
- The source of income to meet his basic needs may be through service or business.
- If he was able to meet his basic needs then he acquired the assets i.e. vehicles, property or jewellery.
- Then he gets additional fear of saving the assets from destruction. (The assets may be destroyed through accident, fire or earthquake etc. and the income may be cut off due to certainty i.e. old age and death or uncertainty i e. accident, illness or disability.)

- As you know, old age and death is certain for every human being while accidents, illnesses, disabilities and destruction of assets may be random.
- A certain number of accidents will take place but with whom, it is uncertain.

Therefore, to overcome these problems, **the Insurance plays a very important role.**

The principal source of income of an individual comes from the compensation for work performed by him. If this source of income gets cut off then:

Family will make social and economic adjustments like:

- Wife may take employment at the cost of home making responsibilities
- Children may have to go for work at the cost of education.
- Family members might have to accept charity from relatives, friends etc. at the cost of their independence and self-respect.
- Family standard of living might have to be reduced to a level below the essentials for health and happiness.

4. NATURE OF INSURANCE

The basic threats which all of us may encounter to varied extent and which result in cut off of income or sudden increase in - uncalled for expenses (beyond our means or higher than our earnings) i.e. dislocates the human life, are:

5. NEED OF INSURANCE

To provide Security and Safety

- In general Insurance, the property can be insured against any contingency i.e. fire, earthquake etc.
- The uncertainty due to fire, accident, death, illness, disability in the human life, is compensated financially by general insurance.
- Insurance is the only way to assist and provide adequate cover at the time of suffering.
- General Insurance provides only protection to human life and property respectively.

ROLE OF INSURER

Companies conducting insurance business are known as 'Insurers'. Insurers bring together persons exposed to the same risk by collecting premiums from them and pay compensation to those who suffer. The insurer on the lines explained in examples determines premium. Insurer's role is that of a trustee and has to ensure that nobody takes undue advantage of the arrangement.In a nutshell both underwriting and claim settlement are to be done with great care.

INSURANCE AS A SOCIAL SECURITY TOOL

Various laws passed by the state for this purpose involve the use of insurance, compulsory or voluntary, as a tool of social security. The Employees State Insurance Act, 1948 provides for the Employees State Insurance Corporation to pay the expenses of sickness, disability, maternity and death and for the maintenance of hospitals, dispensaries, etc. for the benefit of industrial employees and their families, who are insured persons.The scheme operates in certain industrial areas as notified by the government.

Social security is an obligation of the state. Subject has been included in list III of the seventh schedule of the constitution of India as “Social Security and Social Insurance" and “Welfare of labour including, inter alia, liability for workmen's compensation, etc.” Further, Article 41 of the Directive Principles of State Policy called upon the state to make provision for public assistance in the case of, inter alia, sickness and disablement and in other cases of undeserved want.

Insurers play an important role in the social security schemes sponsored by the government i.e. Solatium Fund, the Personal Accident Social Security Scheme and the Hut Insurance Scheme. The Crop Insurance Scheme (RKBY) is also of social significance.

Rural insurance schemes are designed to provide social security to the rural families. The insurance companies have introduced special insurance schemes, at subsidised rates of premium to cover cattle and other livestock for the beneficiaries of IRDP and various other government sponsored programmes and financial institutions.

Companies of their own also offer on commercial basis insurance covers, which have the objective of social security. Examples: Janata Personal Accident, Jan Arogya, Bhavishya Arogya, Raj Rajeshwari Mahila Kalyan Yojna, etc.

ROLE OF INSURANCE IN ECONOMIC DEVELOPMENT

Insurers play a vital role in mobilizing funds for economic developments of the country. Savings out of insurance funds are utilized in investments for economic growth.

Strength of insurance companies lies in the huge amount collected and pooled together. This collected amount is called premiums. This is known as pooling of risks.

The very existence of risk that is uncertainty concerning the future is a severe handicap in economic activities. Insurance removes the fear, worry and anxiety associated with this future uncertainty and thus encourages free investment of capital in business enterprises and promotes efficient use of existing resources. Thus insurance encourages commercial and industrial development and thereby contributes to a vigorous economy and increased national productivity.

These days organization of industries, commerce and trade depends on insurance, because no bank or financial institutions lend money without having insurance cover as collateral security. Insurers are closely associated with agencies and institutions engaged in fire loss prevention, cargo loss prevention, and Industrial and road safety. Insurers have established the Loss Prevention Association of India with the intention of creating awareness of the need for loss prevention and implementing loss prevention measures in various sectors.

Before acceptance of risk, the insurer arranges for the survey and inspection of the property to be insured by a qualified engineer and other experts not only to evaluate but also to suggest improvements to avoid losses, which in turn, not only reduces the rates but also reduces the loss potentials.

Insurance ranks with export trade, shipping and banking services as an earner of foreign exchange to the country. Insurers are also operating in foreign countries and earning foreign exchange and representing invisible exports.

Cattle and other livestock and also equipment like pump sets are rural business. Various rural schemes provide necessary financial protection against loss or damage to poor farmers and other peoples of weaker sections of society.