1. Details of Module and its structure

Module Detail	
Subject Name	Business Studies
Course Name	Business Studies 01 (Class XI, Part- 1)
Module Name/Title	Business Services – Part 3
Module Id	kebs_10403
Pre-requisites	Basic knowledge of functioning of Business Services
Objectives	After going through this lesson, the learners will be able to understand the following: • Define Insurance • List the Functions of Insurance • Explain the Principles of Insurance • Differentiate Types of Insurance
Keywords	Insurance, Life Insurance, Marine Insurance, Fire Insurance

2. Development Team

Role	Name	Affiliation
National MOOC Coordinator	Prof. Amarendra P. Behera	CIET, NCERT, New Delhi
Program Coordinator	Dr. Rejaul Karim Barbhuiya	CIET, NCERT, New Delhi
Course Coordinator (CC) / PI	Dr. Punnam Veeraiah	CIVE, RIE Campus, Bhopal
Course Co-Coordinator / Co-PI	Dr. Nidhi Gusain	CIET, NCERT, New Delhi
Subject Matter Expert (SME)	Ms. Deepti Madhura	Amity Institute of Education, New Delhi
Review Team	Dr. Munipalle Usha Ms. Preeti Sharma	UPGC, Osmania University, Hyderabad, Kenriya Vidyalaya, Sector 24 Noida
Technical Team	Mr. Shobit Saxena Ms. Khushboo Sharma	CIET, NCERT, New Delhi CIET, NCERT, New Delhi

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1. Introduction

An increase in manufacturing sector and the service sector of the economy has also led to an increase in the chances of occurrence of a loss or an uncertainty. A business must take risks in order to gain profit or sustain in its environment. Risks in business cannot be eliminated but they can be controlled to some extent by adopting appropriate measures and one such measure is getting the goods insured. Therefore, Insurance is a means of protection from financial loss.

2. Meaning of Insurance

Insurance is a contract, represented by a policy, in which an individual or entity receives financial protection or reimbursement against losses from an insurance company. It can also be called as a financial instrument that helps to cover the loss due to any uncertainty by paying for it on behalf of the owner.

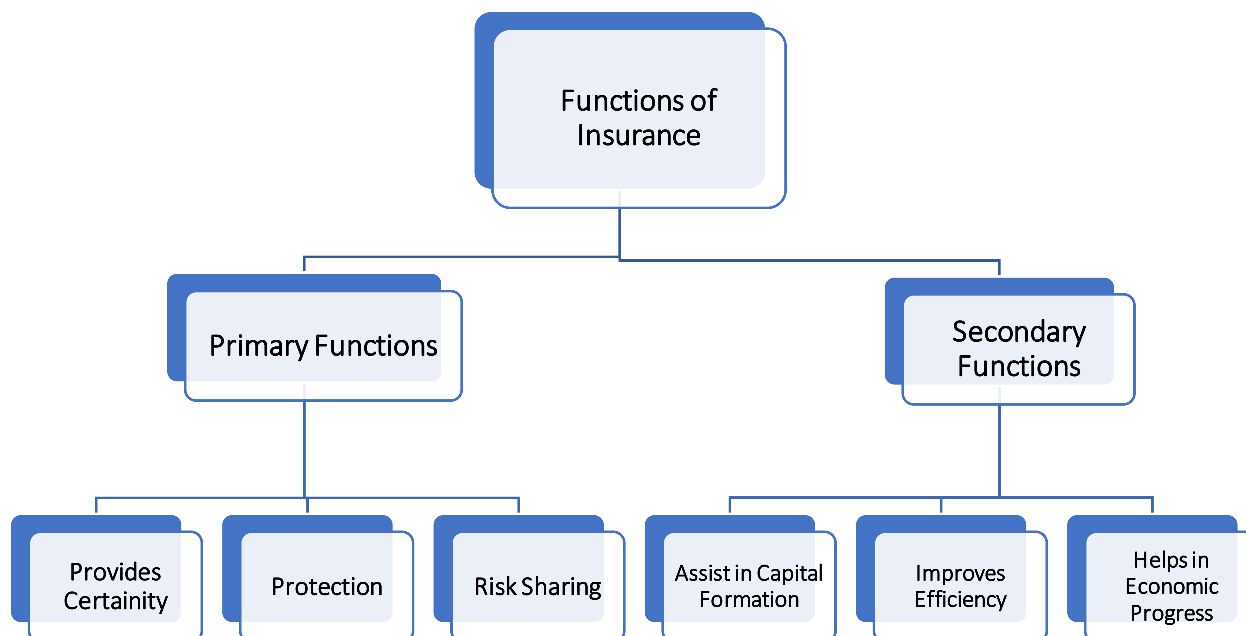
For Example:

A house is destroyed in fire due a natural calamity. It is not possible to foresee such a loss as no one can predict it. If the house is insured, then the owner of the house can claim the money against the loss and can buy or construct a new house. In the absence of such a fund, the owner must bear the loss all by himself.

To get the house insured, an amount must be paid every year to a company, that will bear the expenses in case of any loss to the house. The amount paid is called "Premium" and the company is any "Insurance Company". The owner of the house is known as "Insured" and the agreement between the Insurance company and the Insured is called "Policy".

Thus, we can define Insurance as a form of contract between two parties, Insured and Insurance Company, whereby the Insured signs a policy stating to pay a fixed amount repeatedly known as a premium to the Insurance Company and incase of any calamity or loss the Insurance company pays for the loss.

3. Functions of Insurance



Primary Functions of Insurance are:

i. Insurance provides Certainty

Insurance provides certainty of payment at the uncertainty of loss. Insurance relieves the person from such difficult task. The risk will occur or not, when will occur, how much loss will be there? In other words, there is the uncertainty of happening of time and amount of loss. Insurance removes all these uncertainties and the assured is given certainty of payment of loss. The insurance company charges the premium for providing the said certainty.

ii. Insurance provides Protection

The main function of the insurance is to provide protection against the probable chances of loss. The time and amount of loss are uncertain and at the happening of risk, the person will suffer the loss in absence of insurance. The insurance guarantees the payment of loss and thus protects the assured from sufferings. The insurance cannot check the happening of risk but can provide for losses at the happening of the risk.

iii. Risk-Sharing

The risk is uncertain, and therefore, the loss arising from the risk is also uncertain. When risk takes place, the loss is shared by all the persons who are exposed to the risk. The share is obtained from every insured member by the way of premiums.

Secondary Functions of Insurance are:

Besides the above primary functions, the insurance works for the following functions:

i. Assists in Capital Formation

The insurance companies provide capital to the society. The premium payments received by the companies are invested in the economy as capital in a productive channel. The industry, the business, and the individual are benefited by the investment and loans of the insurers.

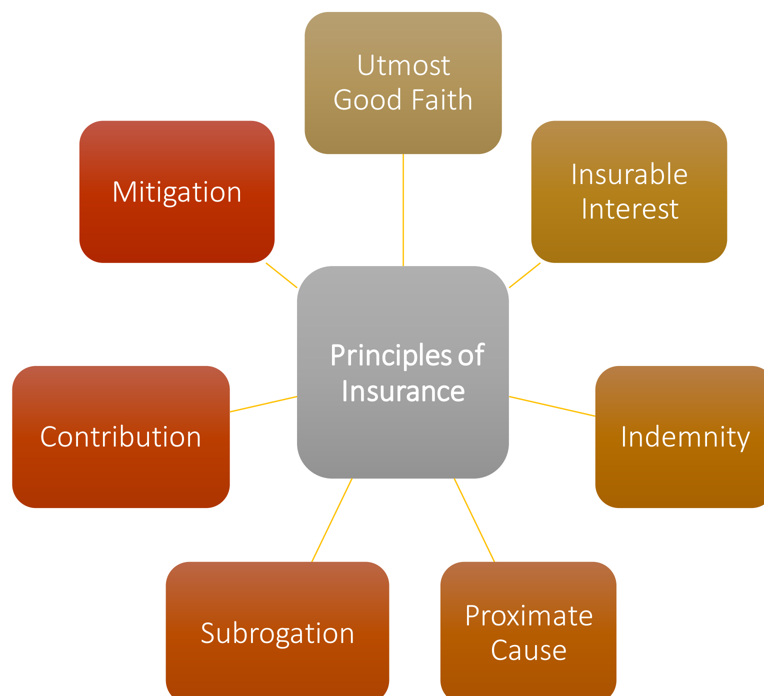
ii. Improves Efficiency

The insurance eliminates worries and miseries of losses at death and destruction of property. The carefree person can devote his body and soul together for better achievement, it improves not only his efficiency, but the efficiencies of the masses are also advanced.

iii. Helps in Economic Progress

The insurance by protecting the society from huge losses of damage, destruction, and death, provides an initiative to work hard for the betterment of the masses. The property, the valuable assets, the man, the machine and the society cannot lose much at the disaster.

4. Principles of Insurance



i. Principle of Utmost Good Faith

Both parties involved in an insurance contract—the insured (policy holder) and the insurer (the company) should act in good faith towards each other. The insurer and the insured must provide

clear and concise information regarding the terms and conditions of the contract. It is the duty of the insured to voluntarily make full, accurate disclosure of all facts, material to the risk being proposed and the insurer to make clear all the terms and conditions in the insurance contract.
Thus, it is binding on the proposer to disclose all material facts about the subject matter of the proposed insurance. Any fact, which is likely to affect the mind of a prudent insurer in deciding to accept the proposal of insurance or in fixing the rate of premium is material for this purpose. Failure to make disclosure of material facts by the insured makes the contract of insurance voidable at the discretion of the insurer.
This is a very basic and primary principle of insurance contracts because the nature of the service is for the insurance company to provide a certain level of security and solidarity to the insured person's life. However, the insurance company must also watch out for anyone looking for a way to scam them into free money. So, each party is expected to act in good faith towards each other.

ii. The Principle of Insurable Interest

Insurable interest just means that the subject matter of the contract must provide some financial gain for the insured (or policyholder). The insured must have an insurable interest in the subject matter of the insurance contract in case there is no loss or damage.
In case of life insurance, the insurable interest must exist at the time of taking the policy, not necessarily at the time of taking the claim.
In fire insurance contract, the insurable interest must exist both at the time of taking the policy and claiming the compensation.
In marine insurance contract, the insurable interest must exist at the time of claiming the compensation in order to name insurable interest
However, it is not necessary that one should be the owner of the property. For example, a trustee holding property on behalf of others has insurable interest in the property.

iii. The Principle of Indemnity

Indemnity is a guarantee to restore the insured to the position he or she was in before the uncertain incident that caused a loss for the insured. The insurer (provider) compensates the insured (policyholder). The insurance company promises to compensate the policyholder for the amount of the loss up to the amount agreed upon in the contract. Essentially, this is the part of the contract that matters the most for the insurance policyholder because this is the part of the contract that says she or he has the right to be compensated. But the principle of indemnity is not applicable to life insurance.

iv. The Principle of Proximate Cause

The loss of insured property can be caused by more than one incident even in succession to each other. Property may be insured against some but not all causes of loss.If the proximate cause is one in which the property is insured against, then the insurer must pay compensation. If it is not a cause the property is insured against, then the insurer doesn't have to pay.

When buying your insurance policies, you will most likely go through a process where you select which instances you and your property will be covered for and which ones they will not. This is where you are selecting which proximate causes are covered. If you end up in an incident, then the proximate cause will have to be investigated so that the insurance company validates that you are covered for the incident.

This can lead to disputes when you have suffered an incident you thought was covered but your insurance provider says it's not. Insurance companies want to make sure they are protecting themselves but sometimes they can use this to get out of being liable for a situation.

For example, all passengers travelling by aero plane are insured against death caused by plane crash. If a passenger dies during the course of flight due to heart attack, the insurer is not liable to pay for the compensation for death of the passenger under the provisions of the air flight contract

v. The Principle of Contribution

Principal of contribution states that each policy on the same subject pays their proportion of the loss incurred by the policyholder. It implies, that in case of double insurance (when insurance for same article is taken from two different insurance companies), the insurers are to share the losses in proportion to the amount assured by each of them.

For Eg: The owner of a mansion insures it under two policies from two different insurance companies to cover it fully. Let's say you have a policy with General Insurance company that covers Rs.30, 00,000 in property damage and a policy with Reliance Insurance that cover Rs.50, 00,000 in property damage.

If fire destroys the mansion and causes Rs.24,00,000 worth of damage,

The liability of each insurer will be calculated as follows:

$$\frac{\text{Sum insured by each insurer}}{\text{Total sum insured by all insurers}} \times \text{Amount of loss}$$

General Insurance company:30, 00,000/80, 00,000x 24,00,000 = Rs. 9,00,000

Reliance Insurance company: 50, 00,000/80, 00,000x 24,00,000 = Rs. 15,00,000

Thus, the total amount of compensation received by owner cannot be more than his actual amount of loss, i.e. Rs. 24,00,000.

vi. The Principle of Subrogation

Subrogation is substituting one creditor (the insurance company) for another (another insurance company representing the person responsible for the loss). After the insured (policyholder) has been compensated for the incurred loss on a piece of property that was insured, the rights of ownership of this property go to the insurer.

For Eg: In an accident, a car is damaged and the damage is caused by a third party and your file a claim with your insurance company to pay for the damages on your car and your medical expenses. Your insurance company will assume ownership of your car and medical expenses in order to step in and file a claim or lawsuit with the person who is actually responsible for the accident (i.e. the person who should have paid for your losses).

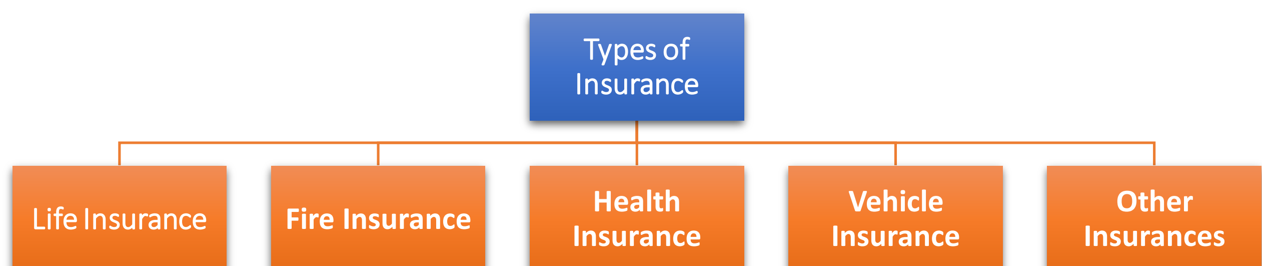
The insurance company can only benefit from subrogation by winning back the money it paid to its policyholder and the costs of acquiring this money. Anything paid extra from the third party, is given to the policyholder. So, let's say your insurance company filed a lawsuit with the negligent third party after the insurance company had already compensated you for the full amount of your damages. If their lawsuit ends up winning more money from the negligent third party than they paid you, they'll use that to cover court costs and the remaining balance will go to you.

vii. The Principle of Mitigation or Loss Minimization

In an uncertain event, it is the insured's responsibility to take all precautions to minimize the loss on the insured property. Therefore, it is the responsibility of the insured to take all measures possible to minimize the loss on the property. The claim from the insurance might be lost incase reasonable care is not taken of the insured property.

5. Types of Insurance

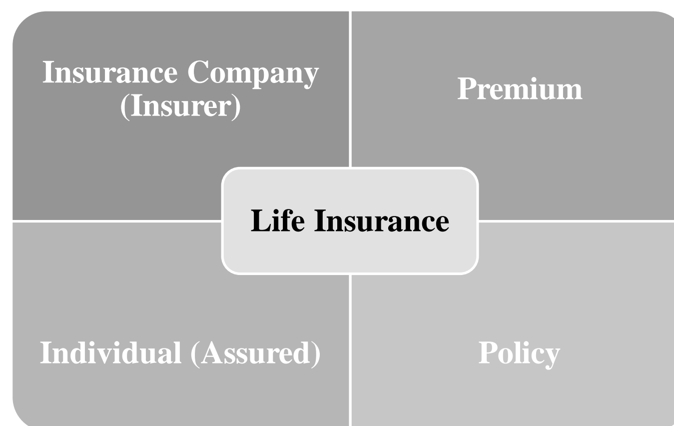
There are various types of Insurance that exist and are offered by various Insurance companies. Law regulates these companies and insurance is issued only after the fulfilment of legal formalities. Some of these insurance is described below:



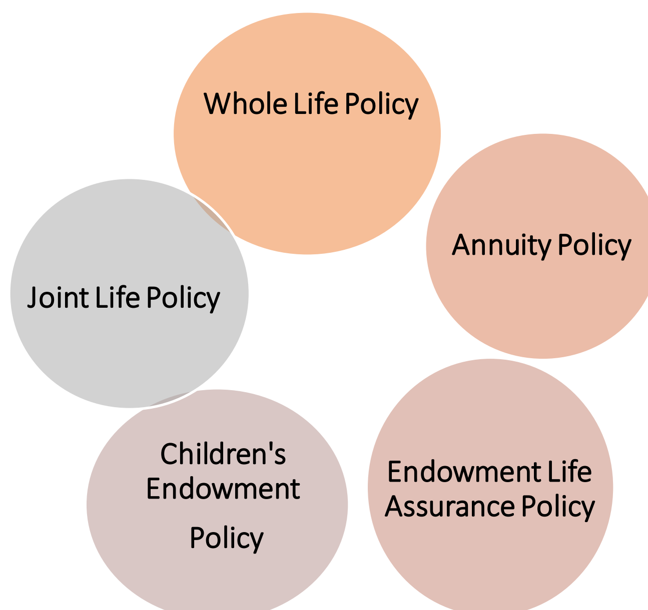
5.1. Life Insurance

A life insurance policy is taken as a protection against the uncertainty of life. There are various types of insurance policies available to suit the requirements of an individual.

Life insurance is defined as a contract involving an insurer and an insurance company. The contract is called Insurance Policy. The person whose life is insured is called the assured. The insurance company is the insurer. The assured agrees to pay a certain amount, either in a lump sum or by other periodical payments to the insurance company. This amount is called premium and can be paid in one lump sum, or periodically i.e., monthly, quarterly, half yearly or yearly. The company promises to pay a certain sum of money either on the death of the person or on his attaining a certain age (i.e., the expiry of certain period). Thus, the person is sure that a specified amount will be given to him when he attains a certain age or that his dependents will get that sum in the event of his death.



5.1.1 Types of Life Insurance Policies



a. Whole Life Policy

It is a policy that guarantees to remain in force for the insured's entire lifetime. It is also called "straight life" or "ordinary life". This life insurance policy represents a contract between the insured and insurer that as long as the contract terms are met, the insurer will pay the death benefit of the policy to the policy's beneficiaries when the insured dies.

The premium will be payable for a fixed period (20 or 30 years) or for the whole life of the assured.

b. Annuity Policy

Under this policy, the assured sum or policy money is payable after the assured attains a certain age in monthly, quarterly, half yearly or annual instalments. The premium is paid in instalments over a certain period or single premium may be paid by the assured. This is useful to those who prefer a regular income after a certain age.

c. Endowment Life Assurance Policy

It is a policy wherein the Insurance Company undertakes to pay a specified sum when the insured attains a particular age or on his death whichever is earlier.

The sum is payable to legal heir/s or nominee in case of death of the assured. Otherwise, the sum will be paid to the assured after a fixed period. Thus, the endowment policy matures after a limited number of years. It is also a medium of saving money over the years.

d. Children's Endowment Policy

This policy is taken by a person for his/ her children to meet the expenses of their education or marriage. The agreement states that a certain sum will be paid by the Insurance Company when the children attain a particular age. The premium is paid by the person entering into the contract.

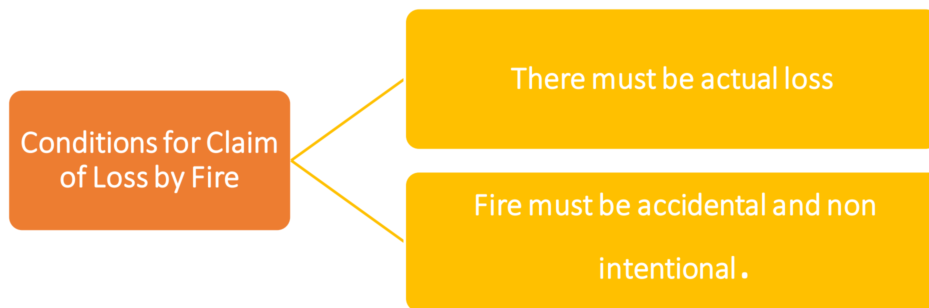
e. Joint Life Policy

As the name suggests this policy is taken up by two or more persons. The premium is paid jointly or by either of them in instalments or lump sum. The assured sum is payable upon the death of any one person to the other survivor or survivors. Usually this policy is taken up by husband and wife jointly or by two partners in a partnership firm where the amount is payable to the survivor on the death of either of the two.

5.2 Fire Insurance

Fire insurance is property insurance that covers damage and losses caused by fire. It is a contract whereby the insurance company, undertakes to pay for any loss or damage caused by fire during a specified period up to the amount specified in the policy.

A premium of a specific amount is usually paid to the insurance company and usually, the fire insurance policy is for a period of one year after which it is to be renewed from time to time. The premium may be paid either in lump sum or in fixed instalments.



The main elements of a fire insurance contract are:

- **Insurable Interest**

  The insured must have insurable interest in the subject matter of the insurance. Without insurable interest the contract of insurance is void. For example, a person has insurable interest in the property he owns; a businessman has insurable interest in his stock, plant, machinery and building.

a) **Utmost good faith**

  The insured should be truthful and honest in giving information to the insurance company regarding the subject matter of the insurance. He is duty-bound to disclose accurately all facts regarding the nature of property and risks attached to it. The insurance company should also disclose the facts of the policy to the proposer.

b) **Indemnity**

In the event of loss, the insured can recover the actual amount of loss from the insurer. This is subject to the maximum amount for which the subject matter is insured. For example, if a person has insured his house for Rs. Fifty Lakhs, the insurer is not necessarily liable to pay that amount, although the house may have been totally destroyed by fire; but he will pay the actual loss after deducting depreciation within the maximum limit of Rs. Fifty Lakhs. The purpose being that a person should not be allowed to gain by insurance.

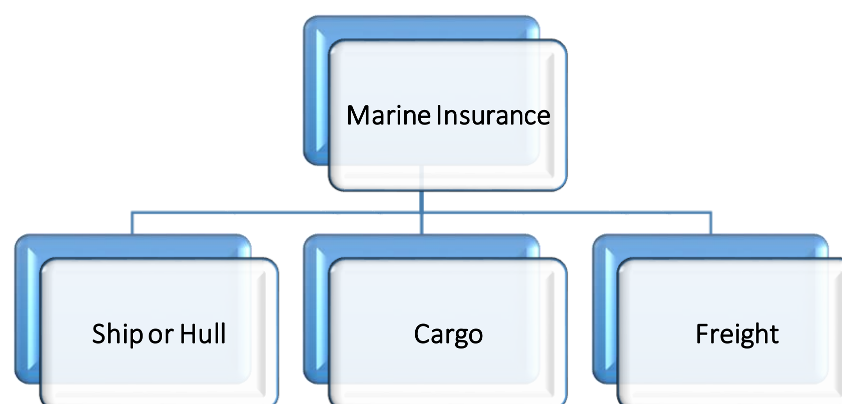
c) The Principle of Proximate Cause The insurer is liable to compensate only when fire is the cause of damage or loss.

5.3 Marine Insurance

Marine insurance provides protection against loss by marine perils or perils of the sea. Marine perils are collision of ship with the rock, or ship attacked by the enemies, fire and captured by pirates and actions of the captains and crew of the ship. These perils cause damage, destruction or disappearance of the ship and cargo and non-payment of freight. So, marine insurance insures ship hull, cargo and freight. Thus, it is a device wherein the insurer undertakes to compensate the owner of a ship or cargo for complete or partial loss at sea.

The insurance company guarantees to pay for the losses due to damage of the ship or cargo arising out of the risks incidental to sea voyages. The insurer in this case is known as the underwriter and a certain sum of money is paid to the insurance company in consideration for the guarantee/ protection he gets.

There are three things involved in a marine insurance:

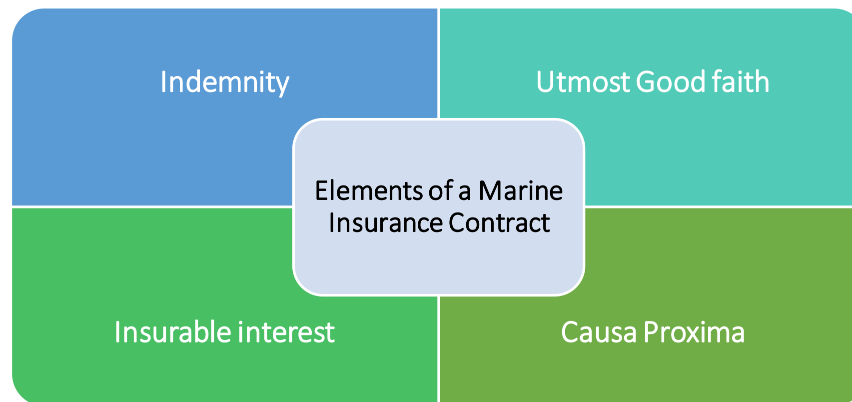


(a) Ship or hull insurance: The ship is exposed to many dangers at sea; the insurance policy is for indemnifying the insured for losses caused by damage to the ship.

(b) Cargo insurance: The cargo while being transported by ship is subject to many risks. These may be at port i.e., risk of theft, lost goods or on voyage etc. Thus, an insurance policy can be issued to cover against such risks to cargo.

(c) Freight insurance: If the cargo does not reach the destination due to damage or loss in transit, the shipping company is not paid freight charges. Freight insurance is for reimbursing the loss of freight to the shipping company i.e., the insured. The fundamental principles of marine insurance are the same as the general principles.

Main elements of a marine insurance contract are:



a) **Indemnity**

The contract of marine insurance is a contract of indemnity. The insured can, in the event of loss recover the actual amount of loss from the insurer. Under no circumstances, the insured can make profit out of the marine insurance contract. But cargo policies provide commercial indemnity rather than strict indemnity. The insurers promise to indemnify the insured "in the manner and to the extent agreed." In case of 'Hull Policy', the amount insured is fixed at a level above the current market value.

b) Utmost good faith

The contract of marine insurance is a contract of utmost good faith. Both the insured and insurer must disclose everything, which is in their knowledge and can affect the insurance contract. The insured is duty-bound to accurately disclose all facts which include the nature of shipment and the risk of damage it is exposed to.

c) **Insurable Interest**

Insurable interest must exist at the time of loss but not necessary at the time when the policy was taken.

d) Causa Proxima

The principle of Causa Proxima will apply to it. The insurance company will be liable to pay only if that or nearest cause is covered by the policy. For example, if a loss is caused by several reasons then nearest cause of loss will be considered.

Summary

Insurance is a contract, represented by a policy, in which an individual or entity receives financial protection or reimbursement against losses from an insurance company. It can also be called as a financial instrument that helps to cover the loss due to any uncertainty by paying for it on behalf of the owner. Functions of insurance are to provide certainty, protection, risk sharing and assisting capital formation. Principles of Insurance are Utmost good faith, Insurable interest, Indemnity, Proximate cause, Subrogation, Contribution, and Mitigation. There are different types of Insurance: Life insurance, Fire insurance, Marine insurance.