GBA (S5) 03

Exam Code : IB

Insurance and Banking

SEMESTER V

BACHELOR OF BUSINESS ADMINISTRATION

BLOCK - 1



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BACHELOR OF BUSINESS ADMINISTRATION

INSURANCE AND BANKING

DETAILED SYLLABUS

BLOCK-1

UNIT 1. Insurance

Meaning and Characteristics of Insurance; Importance of Insurance; Principles of Insurance; Features of Insurance; Classification of insurance

UNIT 2. Risk and Undertaking of Risk

Meaning and importance of Risk Management; Principles of Risk Management; Features of Business Risks; Causes of Business Risks; Types of Business Risks; Methods of Handling Risks

UNIT 3. Policy Service and Claim Settlement

Insurance Documents; Nomination and Assignments; Alterations and revival; Surrender value and paid up value; Claim and their settlement

UNIT 4. Life Insurance

Meaning of life Insurance; Difference between life insurance and non-life insurance; Features of life insurance; Advantages of life insurance; Types of life insurance plan

UNIT 5. Fire Insurance

Defining Fire Insurance : Causes of Fire, Fire Prevention, Functions of Fire Insurance, The beginning of Fire Insurance; Kinds of Fire Insurance Policies; Procedure of Recovering Fire Insurance Claim

UNIT 6. Marine Insurance

Defining Marine Insurance; Marine Insurance Contract; Insurance of Property; Marine Insurance Act 1963; Difference Between Fire and marine Insurance; Kinds of Marine Insurance Policies; Types of Marine Losses : Total Loss, Partial Loss

UNIT 7. Banking Sectors

Evolution and Meaning of Banking; Development of Banking In India; Corporate banking; Retail banking; International Banking; Rural banking

UNIT 8. Types of Banks

Savings Bank, Commercial Banks, Regional Rural Banks (RRBs),Investment Banks, Development Banks, Land Development Banks, Exchange Bank , Co-operative Banks, Export Import (EXIM) Bank of India

COURSE INTRODUCTION

The course “Insurance and Banking” of B.B.A. 5th semester will focus on the different aspects of insurance and banking. In today’s world the financial sector plays an important role and within this financial sector *Banking* and *Insurance* has a significant role to play. Due to the increasing complexities of life there has been an increase in the demand for banking services along with the increase in insurance services to cover various commercial and personal risks. This course covers the syllabus in most easy manner, enabling the students to know the subject to the point.

BLOCK INTRODUCTION:

This is the first block of the course “Insurance and Banking”. This block consists of eight units.

The first unit explains meaning and characteristics of Insurance, importance of Insurance, principles of Insurance, features of Insurance and classification of insurance.

The second unit is about meaning and importance of rish Management, Principles of Risk Management, Features of Business Risks and causes of Business Risks, Types of Business Risks etc.

The third unit describes Insurance Documents, nomination and assignments, alterations and revival, surrender value and paid up value, claim and their settlement.

The fourth unit enlightens meaning of life Insurance, difference between life insurance and non-life insurance, features, importance, advantages of life insurance and types of life insurance plan.

The fifith unit explains definition of fire, causes fire, fire prevention, function of fire insurance, beginning of fire insurance, kinds of fire insurance policies and procedure of recovering fire insurnce claim.

The six unit explains marine insurance contract, it’s property, Marine Insurance Act 1963, difference between fire and marine and kinds of marine in policies, types of marine loss.

The seven unit is about evolution and meaning of banking, development of banking in India, corporate banking, retail banking, international banking and rural banking.

The eight unit describes different types of Banks.

While going through this block, you will get some boxes marked with “ACTIVITY” which will help you in making your learning more active and efficient. And, at the end of each section, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be better if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PROGRESS” given at the end of each unit.

UNIT 1 : INTRODUCTION TO INSURANCE

UNIT STRUCTURE

1.1 Learning Objectives
1.2 Introduction
1.3 Meaning and Characteristics of Insurance
1.4 Importance of Insurance
1.5 Principles of Insurance
1.6 Features of Insurance
1.7 Classification of Insurance
1.8 Let Us Sum Up
1.9 Further Readings
1.10 Answers to Check Your Progress
1.11 Model Questions

1.1 LEARNING OBJECTIVES

After going through this unit, you will be able to :

- discuss the meaning and characteristics of insurance
- learn the importance of insurance
- explain the principles and features of insurance
- discuss the classification of insurance.

1.2 INTRODUCTION

In this unit we will first discuss the concept of insurance, its characteristics as well as its importance. It will be followed by a discussion of the principles of insurance and at the end of this unit you will get a fair idea on different types of insurance. Insurance is a contract in which an individual or entity receives financial protection against losses from an insurance company.

1.3 MEANING AND CHARACTERISTICS OF INSURANCE

Meaning Of Insurance : Insurance is the tool to minimize the loss

by spreading it over a numbers of persons who are exposed to such risks and wants to protect themselves against such risks.

Therefore, insurance can be defined as a mechanism to protect life and property against certain risks. It is a social as well as an economic tool to reduce the burden of risks by sharing it with other members of the community. Insurance is a contract between two parties, one is the **insured** (buyer of insurance policy) and the other is the **insurer** (insurance company). In a contract of insurance the insured pays a certain sum of money, known as **premium**, to the insurer and in turn, the insurer agrees to pay to the insured a certain sum in the event of the occurrence of risk against which insurance has been done. The purpose of insurance is to transfer the financial loss to insurer who spreads it over large number of policy holders. The insurance company pools the resources of many who are exposed to similar risks and are ultimately able to pay up the losses suffered by few of them.

Characteristics of Insurance : The characteristics of insurance are discussed below-

a) **Sharing of Risks :** Insurance is the device to share the financial loss. The loss may occur due to sudden death of the earning member of a family or destruction of the house due to break out of fire, or loss due to theft of the car etc. Through insurance, the risks of such losses are shared by the insured by paying premiums. If the loss arises the insurer will compensate the insured on the basis of the premiums paid and the policy value.

b) **Protection :** Insurance is also regarded as a device of protection. The insurance of property ensures that in case of any damage to the property, the owner would be compensated. In the absence of insurance, the owner has to bear the whole loss from his own pocket which may not be possible for the owner. In case of life insurance, it is also an avenue of investment besides being a device to protect the family on the death of the bread earner.

c) **Co-operation :** Insurance is a device of co- operation. An insurer through his insurance policies brings a group of persons together who wish to insure against a particular risk. In case the loss arises,

the insurer compensates the particular insured who suffered the loss. Thus, a group of persons, by paying premiums, share the financial loss. The insurer compensates the loss out of the premiums received from the insured which otherwise may not be not possible from his own capital.

d) Contingency : The insurance is associated with a contingency that may happen or may not happen except in case of life insurance. In life insurance the insurer's liability to pay the assured sum arises on the death of the insured or on the expiry of the policy term, whichever is earlier. But in case of general insurance, like fire insurance, marine insurance etc., the liability of the insurer arises only when the contingency arises.

e) Amount of Payment : The payment of compensation by the insurer depends on the policy value and the extent of loss suffered by the insured. The insured claims the compensation from the insurer if the loss arises. The insured has to pay the premiums regularly to claim the compensation from the insurer.



CHECK YOUR PROGRESS

Q.1 : State whether the following statements are true or false :

a) Insurance is not a contract. (True/False)

b) Premium is paid by the insurer to the insured. (True/False)

c) Assured sum is paid by the insurer to the insured. (True/False)

d) In case of general insurance, the liability of the insurer arises on the expiry of the policy term. (True/False)

1.4 IMPORTANCE OF INSURANCE

The above discussion gives us an idea that insurance provides protection against loss. In this section we will discuss the importance of insurance in business as well as in society.

Importance of Insurance in Business :

a) **Reduces the Impact of Loss :** Business is full of risks and uncertainties. The businessmen face various risks like, changes in price, changes in demand, risk of loss due to fire or natural calamities etc. Such risks result in heavy damages and insurance is the only means to reduce the burden of loss.

b) **Collateral Security :** Business needs finance. Sometimes it becomes essential to borrow money from banks and other financial institutions. But banks and the financial institutions provide funds against security. This is because in the event of failure of the borrower to return the borrowed money, the lender (banks/ financial institutions) recover their money and interest by selling such security. In this case, insurance policies can be placed as a security against loans. However, the loan amount will depend on the value of the policy and the premiums paid.

c) **Welfare of Employees :** Employees are an integral part of a business organization. They play an important role in the success of the organization. But they are prone to various risks specially those who work in factories. It is the responsibility of the employer to protect them as well as their families. This can be done by insuring against disability, accidental death while working in the factory, pension schemes etc.

d) **Prevention of Loss :** Insurance companies assist those institutions which are engaged in loss preventive measures such as, health organizations, fire brigade etc. The objective is to reduce the losses of the society. It results in lesser number of cases for payment of compensation. It will ensure more savings and reduction in premium for the insurance policies. Thus, the insurers and the society as a whole will be benefited.

e) **Capital Formation :** Insurance increases the propensity to save. It helps in the capital formation of a country. The funds collected by the insurance companies are invested in profitable business activities. The funds are also invested in the creation of infrastructural facilities

in the country. Thus, insurance helps in the development of the country.



ACTIVITY 1.1

a) Why is the role of insurance in business activities considered important?

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1.5 PRINCIPLES OF INSURANCE

Insurance business runs under certain principles. In this section we will discuss the principles of insurance. It has already been mentioned that insurance is a contract between two parties- insurer and the insured. The Indian Contract Act, 1872 provides for the fulfillment of certain conditions to consider a contract to be a valid contract. For example, there must be an offer and acceptance of the offer, legal object, free consent of the parties etc. As insurance is a contract, certain provisions of the Indian Contract Act, 1872 are applicable to an insurance contract.

Besides these conditions, insurance contacts have some special principles, which we are going to discuss now-

- **Utmost Good Faith :** The insurance contract is based on the principle of utmost good faith. Utmost good faith means a voluntary duty to disclose all material facts accurately in respect of the risk being proposed to be insured. The principle of utmost good faith applies to both the parties to the insurance contract and they must disclose all the material facts before entering into the contract.
- **Insurable Interest :** In a contract of insurance there must be a subject matter and the insured must have insurable interest in the subject matter of insurance. Insurable inter'est refers to the monetary relation of the insured with the subject matter of the insurance. That is, the insured must be benefited by the existence of the subject matter and suffer loss in the event of damage to the subject matter.

Therefore, the subject matter of insurance in case of fire insurance may be the house or the factory, the ship in case of marine insurance and the life of the insured in case of life insurance.

- **Causa Proxima :** In the contract of insurance the liability of the insurer to compensate the loss arises if the loss of the subject matter of insurance arises due to its immediate cause and not the remote cause. The immediate cause means the direct and the most dominant cause of the loss which are specifically mentioned in the insurance policy.
- **Subrogation :** The principle of subrogation refers to the right of the insurer to recover the loss from the third party due to whose negligence the loss aroused. It means the insurer takes the position of the insured to recover the loss from the third party, if the third party is responsible for such loss. However, the insurer acquires the right only after compensating the insured. The amount of claim by the insurer from the third party is limited to the extent of the amount of compensation that has already been paid to the insured.
- **Indemnity :** All insurance policies except life, personal accident and sickness insurance policies, are the contacts of indemnity. The principle of indemnity implies that the insured will be placed nearly in the same position as he was before the loss arose in respect of the subject matter of insurance. For example a person insured his house against fire for Rs. 1 lakh and he suffered the loss to the extent of Rs. 50 thousand, then he will be compensated for the actual loss i.e. for Rs. 50 thousand. The principle of indemnity does not allow the insurer to make any profit from the insurance contract.
- **Contribution :** If the subject matter of insurance is insured with more than one insurance company under different insurance policies then the principle of contribution will apply. In the event of loss, the co- insurers will contribute towards the loss in proportion of their undertaking of risk or any insurer can compensate the insured fully and then it can claim from the other insurance companies their share to meet the total loss.

- **Assignment of Insurance Policy :** Transferring the benefits of an insurance policy to another is known as assignment of insurance policy. Life and marine insurance policies can be freely assigned but fire and accident policies can not be assigned without the prior consent of the insurer except changes of interest by will or operation of law.
- **Warranties :** In an insurance contract warranties are the important condition to be fulfilled by the insured. On non- fulfillment of the warranties, the insurer may refuse to compensate the insured. Warranties which are written in the policy are called express warranties. For example, in case of fire insurance proper electrical fittings are an express warranty. Warranties which are not written in the policy are called implied warranties. For example, in case of marine insurance ***seaworthiness*** of the ship is an implied warranty.
- **Mitigation of Loss :** Insurance of a property does not mean that the insured is not required to take care of his property. If the loss occurs the insured must take all the steps which a man of ordinary prudence will take to minimize the loss to the property. The principle of mitigation of loss imposes a duty on the insured to take reasonable care of the insured property. If any negligence is proved on the part of the insured, the insurer may refuse to compensate for the loss.



Seaworthiness : Reasonably fit to encounter the perils of the sea.

1.6 FEATURES OF INSURANCE

Insurance can only cater for risks when the following features are present:

1) **There must be large numbers of similar risks :** If an insurance fund is made up from the contributions of small number of persons, the contributions by individuals are likely to be so high as to be totally unacceptable. In other words, the risk will be high if the group is small and the chance of eliminating the possibility of serious losses cannot be ruled out completely. A fire insurance or marine insurance company cannot operate with only 50 houses or 25 ships. In life

insurance too, there must be a large number of persons in each age group, health and occupational classification.

2) **The loss caused by the risk must be definite :** The peril must produce a loss that is definite in time or place. Though, the time and place of death are not certain, yet there is certainty of death, which is difficult to avoid and consequently its loss. Likewise, the loss caused by the burglary to a shop keeper or to a godown due to fire is definite. This certainty is necessary because the cost of insurance depends on the extent of the hazard. If the incidence of risks is small, the premium will be low and vice versa. This estimate is possible on the statistical data based on past experience.

3) **The Occurrence of the loss must be accidental or fortuitous :** Insurance in the commercial sense is not possible, if the possibility of loss is so high as to be a near certainty. There must be either uncertainty whether the event will ever happen or not, or if the event is one which must happen at some time there must be uncertainty as to the time when it will happen. Ideally, the loss should be beyond the control of the insured. Losses due to “depreciation”, for example, are uninsurable because there is nothing accidental about their occurrence. Insurance may be written to over against untimely death, because death is certain but the time of its happening is uncertain.

4) **The potential loss must be large enough to cause hardships :** The peril insured must be capable of producing a loss so large that the insured could not bear it himself without economic distress. Very large risks, such as the consequences of a “Jumbo-Jet” crashing or of earth quake, may be insured. If very minor risks are insured, the cost may be higher than the value of protection given and this may also increase the cost of insurance to those who seek protection against really serious hazards. Insurance against breakage of shoe-strings of damage to shoeshine or loss of pen or an ordinary book are unknown. The loss involved in these cases is so small that it is not worth the time, effort and expense to enter into an insurance contract to get indemnity for such losses from the insurer.

5) **The cost of insuring must be economically feasible :** The cost of insurance must be within the reach of every one, otherwise, it will be confined to a very small section of people. The cost of an insurance policy includes the premiums paid the insured and the management expenses incurred by the insurers. If the chance of loss is much above 40 per cent, the cost of policy will exceed the amount that the insurance company is obliged to pay under the contract. To make insurance attractive, the premium has to be far less than the face value of the policy. The chance of loss involving small damages to an automobile or a ship is so high that the collision policies are usually written to exclude minor losses, say, of Rs. 50 or 100.

6) **It must be possible to calculate the chance of loss :** The likelihood of an event and probable extent of loss may be mathematically calculated or it may be based on the statistical results of past experience. If there are no available statistics of chance of loss, it is impossible to predict losses, inspite of a large number of exposures, and to determine the amount of premiums that would be required to accumulate a common fund. or pool to meet these losses.

7) **The possible loss must not be catastrophic :** The risk must be unlikely to produce a loss to a great many insured units at the same time. In practice, no insurance company can afford to insure a type of loss that is likely to happen to any great percentage of those exposed to it. For example, if all the policyholders of a life company die prematurely, or all policyholders lose their ships by accidents or they lose their houses by fire, the company will become bankrupt. In other words, the risks of death or property damage on a national level as a result of war are so enormous, particularly with nuclear war, that insurance funds, at least on a commercial scale, would be quite inadequate. Indeed, insurance is an arrangement whereby the unfortunate few, who lose are indemnified by the fortunate many who escape loss.

8) **There must be an insurable interest to protect :** Though both

gambling and insurance transactions contemplate the risk of loss, the insurance contract also provides security against the consequences of a loss. A contract of insurance is basically concerned with preserving the interest of the insured, as against the wagering contract which is confined to the stake money which is put at risk on the unknown result of a future event.

9) **It must be consistent with public policy :** The insurance contract should not be against the public conscience, as for example, insurance effected by robbers, pick-pockets, murderers for fines imposed for these offences.



CHECK YOUR PROGRESS

Q.2 : Write down three significance of Insurance.

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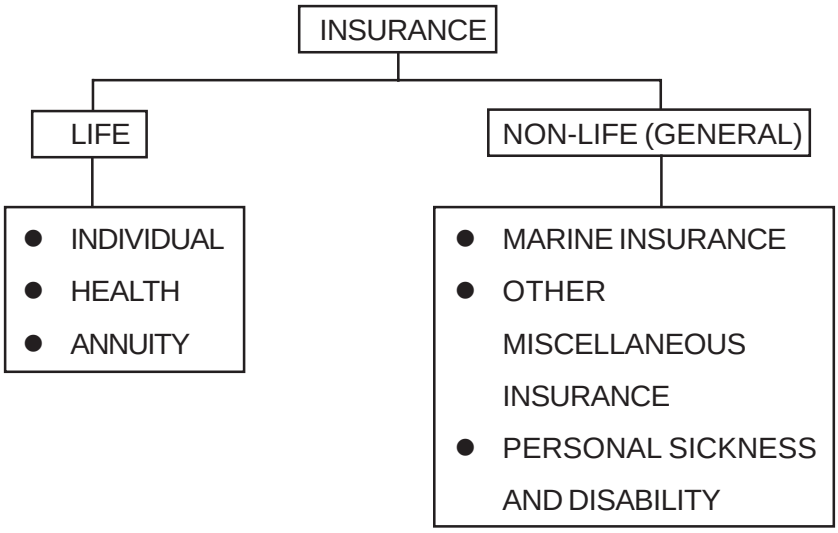
Q.3 : State five principles of Insurance.

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1.7 CLASSIFICATION OF INSURANCE

Insurance can be classified as under :



Now we will discuss the above elements of classification in detail:

A) Life Insurance : Life insurance is a contract between the policy owner and the insurer, where the insurer agrees to pay a designated beneficiary a sum of money upon the occurrence of the insured individual's or individuals' death or other event, such as terminal illness or critical illness.

a) *Individual :* Individual Life insurance generally is underwritten taking into account the actuarial risk of death of the one individual being insured –a one person– one policy type of coverage.

b) *Health :* Health insurance, like other forms of insurance is a form of collectivism by means of which people collectively pool their risk, in this case the risk of incurring medical expenses.

c) *Annuity :* A life annuity is a financial contract in the form of an insurance product according to which a seller (issuer)-typically a financial institution such as a life insurance company-makes a series of future payments to a buyer (annuitant) in exchange for the immediate payment of a lump sum (single-payment annuity) or a series of regular payments (regular-payment annuity), prior to the onset of the annuity.

B) Non-Life Insurance : Non-life insurance policies also called general policy, includes automobile and homeowners policies, provide payments depending on the loss from a particular financial event. General insurance typically comprises any insurance that is not determined to be life insurance.

a) *Marine insurance :* Marine insurance is a type of insurance that covers boats and ships, as well as their cargo and in some instances the places where the boat or ship is docked.

b) *Personal sickness and disability :* Disability insurance policies provide financial support in the event the policyholder is unable to work because of disabling illness or injury. It provides monthly support to help pay such obligations as mortgage and credit card.

c) *Miscellaneous Insurance :* Miscellaneous Insurance exists to

help people gain a good understanding of the various kinds of insurance coverage's that are available to people today.



CHECK YOUR PROGRESS

Q.4 : State whether the following statements are true or false :

a) According to the principle of utmost good faith there must be a subject matter of insurance.

b) After insuring a property, the owner is not required to take care of his property.

c) The principle of subrogation refers to the right of the insured to recover the loss from the third party.

d) According to the principle of indemnity the insurer cannot make profit from the insurance contract.



1.8 LET US SUM UP

In this unit we have discussed the following :

- Insurance is a contract between two parties- insurer and the insured.
- Premium is paid by the insured to the insurer and in turn the insurer compensates the insured for the loss suffered by him.
- In case of life insurance the assured sum is paid to the insured on the expiry of the policy term or to his dependents in case of his death.
- In case of general insurance the liability of the insurer to pay compensation arises in case of loss to the subject matter of insurance. The loss must occur from the risk against which the property is insured.
- Insurance reduces the impact of the loss, ensures the welfare of employees and helps in the capital formation of a country.
- An insurance contract is based on certain special principles like, utmost good faith, causa proxima, indemnity etc.



1.9 FURTHER READING

1) Mishra, M. N., Mishra, S. B. (2005); *Insurance Principles and Practice*; S. Chand Publisher.

2) Tripathy, Nalini Prava, Pal, Prabir (2009); *Insurance : Theory And Practice*, Phi Learning Pvt. Ltd.

3) Tripathy, Manas, Mishra, Simita, Mishra, K. C. (2009); *General Insurance Business Operations and Decision Making*; Cengage Learning India.



1.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1 : a) False, b) False, c) True, d) False

Ans. to Q. No. 2 : a) Prevention of Loss, b) Capital formation, c) Collateral Security.

Ans. to Q. No. 3 : a) Insurable interest, b) Indemnity, c) Mitigation of loss, d) Subrogation, e) Contribution.

Ans. to Q. No. 4 : a) False, b) False, c) False, d) True.



1.11 MODEL QUESTIONS

Q.1 : Define insurance. Explain the importance of insurance in business.

Q.2 : Discuss the characteristics of insurance.

Q.3 : Explain the underlying principle of an insurance contract.

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UNIT 2: RISK AND UNDERTAKING OF RISK

UNIT STRUCTURE

2.1 Learning Objectives

2.2 Introduction

2.3 Meaning and importance of Risk Management

2.4 Principles of Risk Management

2.5 Features of Business Risks

2.6 Causes of Business Risks

2.7 Types of Business Risks

2.8 Methods of Handling Risks

2.9 Let us sum up

2.10 Further Reading

2.11 Answers To Check Your Progress

2.12 Model Questions

2.1 LEARNING OBJECTIVES

After going through this unit, you will be able to :

- discuss business risk and its importance
- define principles of risks management
- causes of business risks
- explain methods of handling business risks.

2.2 INTRODUCTION

In the earlier unit we have discussed the concept of insurance. In this unit we will first discuss the concept of business risk, its causes and the importance of risk management. Risk means the uncertainty of a financial loss. Every risk involves the loss of one or other kind. Then we will cover the meaning of insurance, its characteristics as well as its importance. Our discussion then will cover the principles of insurance etc.

This unit will give you some basic idea about the benefits of risk

management in organizations. Insurance is a method of risk management. The principles of the insurance contract will necessarily form a part of our discussion in this unit.

2.3 MEANING AND IMPORTANCE OF RISK MANAGEMENT

Meaning of Risk Management:

We often use the term 'risk'. Think about the situations when we use this term. Usually when we think about it which investing our money or when we foresee some danger to our health, property or income. Thus, we use the term 'risk' for the probable negative outcome of our activities or for the opposite situation of our expectation. So risk is associated with our life and property and the common characteristic is that risk is associated with future uncertainties.

Let us have a look at some definitions of 'risk'-

According to Boon and Kurtz, "Risk is the chance of loss or injury."

According to Williams and Heins, "Risk is the variation in the possible outcome that exists in nature in a given situation."

Life Insurance Corporation of India has defined the concept of risk as "A condition where there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for; there is no requirement that the possibility be immeasurable, only that it must exist."

Risk management is the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events or to maximize the realization of opportunities. We cannot separate risk from our life and in business also risk is often unavoidable. Business risks mean all those risks which are associated with business. Business organizations are established keeping in mind the future opportunities in which a businessman expects to earn maximum profit from his business. A businessman or an industrialist establishes a shop or a factory, starts production or marketing activities, recruits

people etc. in order to earn profit. All these need investment of money. So earning profit is the primary motive for investment but profit earning is not certain. Thus, there is the involvement of a risk element. The businessman may not be able to earn the expected profit inspite of his best efforts because of unforeseen circumstances like the sudden break down of machinery, damage of factory building due to breakout of fire, changes in price, fashion, changes in government policies etc. These factors cause risk and business can not be run without taking such risks.

We know that risk is unavoidable in business. In modern days business is surrounded by different complexities and, therefore, may be more risky. Under such circumstances, risk management occupies great importance in business organizations.

Risk management is the process of minimizing, monitoring and controlling the chances of occurring losses as well as reducing the impact of any unfortunate losses. Thus, it focuses on two sets of measures to be taken by the management of an organization-

- Preventive measures; and
- Corrective measures.

Risk management process consists of the following steps-

Importance of risk management

The importance of risk management may be discussed as under-

- **Risk identification:** Risk management process helps in the identification of the risks in different areas that may be faced by a business firm. Business firms are engaged in different activities like production, marketing, financing etc. and risk management helps the firms to identify the risks in such areas.
- **Handling of risks:** The risk management process also helps the business firms in the effective handling of the risks. The management of such organizations can develop appropriate preventive strategies for such risks.

- **Safeguard against loss:** The accidental loss and natural disasters can not be controlled by human beings. Such incidents cannot be anticipated and loss from such incidents can ruin a business firm. The risk management process helps the business firms to prepare themselves against such losses.

There are different methods of handling risks such as, avoidance of risk, risk deduction, risk retention, risk transfer etc.



CHECK YOUR PROGRESS

Q1: What do you mean by risk management? (Answer in 3 lines)

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Q2: Write three important aspects of risk management.

a. .....

b. .....

c. .....

2.4 PRINCIPLES OF RISK MANAGEMENT

The International Organization for Standardization (ISO) identifies the following principles of risk management.

Risk management should:

- create value
- be an integral part of organizational processes
- be part of decision making
- explicitly address uncertainty
- be systematic and structured
- be based on the best available information

- be tailored
- take into account human factors
- be transparent and inclusive
- be dynamic, iterative and responsive to change
- be capable of continual improvement and enhancement

2.5 FEATURES OF BUSINESS RISKS

Let us discuss some of the features of business risks-

- **Risks are inherent in all businesses** be it manufacturing, trading or service generating business. The businessmen have to invest money in expectation of profit which may not be fulfilled. It means there may be loss in business. But businessmen have to bear the risk and profit earning acts as a motivating factor for such risk bearing.
- Modern business environment is too dynamic. The condition of business may change due to the change in government policies or change in fashion etc. But the businessmen invest money by **predicting the future**. Such prediction may sometime prove wrong and therefore it possesses great risks for the businessmen.
- Business risks depend on the **scale of operation** of the business. A small- scale business is less risky as compared to a large- scale business.
- Business risks depends on the **nature of business**. Different businesses possess different risks as they are exposed to different types of business environment. For example, in case of export- import business, a firm may encounter a higher risk because it has to deal with foreign countries. Any change in situations in those countries due to political, economic or social reasons etc. may result in loss in business.
- Risks in business are conditioned by some **internal factors**

which vary from firm to firm. The financial position of a firm, the relation between management and labour union, the relation between the firm and its suppliers etc. are some factors which may create risks for the business.

- Another feature of business risks is that the businessmen are well aware about the existence of business risks but it is **difficult** for them **to measure** the impact of such risks on their businesses. The extent of loss can not be predetermined accurately.
- **Elimination of risks in business is not possible**. In preparing plans and taking decisions the businessmen may forecast the future and take into account the risks factors. They can adopt certain measures to reduce the burden of such risks but can not eliminate them altogether.



CHECK YOUR PROGRESS

Q3: State two features of business risks.

a) .....

b) .....

Q4: Fill in the blanks :

a. Business risks depend on the scale of …….. of the business.

b. In preparing plans and taking decisions in business the businessmen forecast the ……..

c. Risks in business are conditioned by …… factors which vary from firm to firm.

2.6 CAUSES OF BUSINESS RISKS

You are aware that risk is the common factor for all types of businesses but the degree and type of risks are different for different businesses. It is necessary to have an idea about the different causes underlying

business risks. Now we will discuss some of these causes-

1. **Political causes:** The political environment plays an important role in business. It mainly includes governmental policies, legal framework, political stability etc. Any change in such factors may create risks for the business.

2. **Economic causes:** Business organizations are economic institutions. Their main objective is to earn profit. But this objective may not be fulfilled for various reasons like, increase in cost of production, reduction in prices, increase in competition, changes in demand etc. Thus, all these factors cause risks for the business.

3. **Social causes:** Besides being an economic institution, business organizations are also considered as social organizations. Therefore, success of a business firm to a great extent depends on its compliance with social norms. The changes in social values, customs, tastes and preferences of the customers may create opportunities for business. But improper handling of such factors will be risky for the business.

4. **Technological causes:** Another major area of concern for business firms is the fast changing technology. Huge amount of money is required to be invested in plant and machineries. But the fast changing technology makes the machineries obsolete very soon. Therefore, such factors possess great risks for the business.

5. **Natural causes:** The risks from natural causes can not be accurately forecast. Natural calamities like earthquake, flood etc. cause heavy loss. Therefore, the management of a business organization should adopt proper policies to face such eventualities.



ACTIVITY

Q1: Point out certain risks that a business organization may face due to change in demand.

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2.7 TYPES OF BUSINESS RISKS

The following are the types of business risks:

A. PURE AND SPECULATIVE RISKS:

Pure Risk: This is type of risk where the chance of loss is there without any possibility of gain to the individual. This is a category of risk in which loss is the only possible outcome; there is no beneficial result. Pure risk is related to events that are beyond the risk-taker's control and, therefore, a person cannot consciously take on pure risk. For example, the possibility that a person's house will be destroyed due to a natural disaster is pure risk. In this example, it is unlikely that there would be any potential benefit to this risk.

Speculative Risks: It implies a situation which involves not only the chance of loss but also a possibility of gain as well. A category of risk that, when undertaken, results in an uncertain degree of gain or loss. All speculative risks are made as conscious choices and are not just a result of uncontrollable circumstances. For example, investing in government bonds has much less speculative risk than investing in junk bonds, because government bonds have a much lower risk of default.

B. INTERNAL AND EXTERNAL RISKS:

Internal Risks: This risk is caused by the internal events associated with the working of a business enterprise. Internal risks can be controlled through efficient handling .Examples of internal risks are workers strike, breakdown of machinery, carelessness or dishonesty of employees etc.

External Risks: Forces belonging to the external environment affecting the particular business enterprise causes external risks. This risk cannot be controlled or can be controlled with great difficulty. Examples of external risks are changes in the market conditions, distribution, technology, political environment etc.

C. FUNDAMENTAL AND PARTICULAR RISKS:

Fundamental Risks: Fundamental risks involve losses that are impersonal in origin and consequence. They are group risks caused for the most part by economic, social, and political phenomena, although they may also result from physical occurrences. They affect large segments or even all of the population. Particular risks involve losses that arise out of individual events and are felt by individuals rather than by entire group. They may be static or dynamic. Unemployment, war, inflation, and floods are all fundamental risks. The burning of a house and the robbery of a bank are particular risks.

Particular risks: Particular risks are personal in origin. They are considered to be the individual's own responsibility, inappropriate subjects for action by society as a whole. They are dealt with by the individual through the use of insurance, loss prevention, or some other technique.

D. STATIC AND DYNAMIC RISKS

Static Risks: Static risks involve those losses that would occur even if there were no changes in the economy, if we could hold consumer tastes, output and income, and the level of technology constant, some individuals would still suffer financial loss. These losses arise from causes other than the changes in the economy, such as the perils of nature and the dishonesty of other individuals. Static losses involve either the destruction of the asset or a change in its possession as a result of dishonesty or human failure. Static losses tend to occur with a degree of regularity over time and, as a result, are generally predictable.

Dynamic Risks: Dynamic risks are those resulting from changes in the economy. Changes in the price level, consumer tastes, income and output, and technology may cause financial loss to members of the economy. These dynamic risks normally benefit society over the long run, since they are the result of adjustments to misallocation of resources.

E. FINANCIAL AND NON-FINANCIAL RISKS:

The term risk includes all situations in which there is an exposure to adversity. In some cases this adversity involves financial loss, while in others it does not. The risky situations, likely to cause financial losses are referred as financial risks. And when the possibility of a financial loss does not exist, then the situation is risky which is not financial.



CHECK YOUR PROGRESS

Q5: Write four causes of business risks

a. .....

b. .....

c. .....

d. .....

Q6: State True or False :

a. The business risks from natural causes can be accurately forecast. (True or false).

b. Dynamic risks are those resulting from changes in the economy. (True or false).

c. Fundamental risks involve losses that are personal in origin. (True or false).

d. This risk is caused by the external events associated with the working of a business enterprise. (True or false).

2.8 METHODS OF HANDLING RISKS

Risk is a concept with several meanings depending on the context and the scientific discipline in which it is used. In common language, one speaks of risk as being the "possibility or chance of meeting danger, suffering loss or injury" or "exposure to adversity or danger." However, in insurance the word "risk" has a technical meaning different from the one current in ordinary speech. For the study of insurance "risk is uncertainty concerning loss" and uncertainty is incidental to life, In other words, risk is uncertainty and is present in all things and all lives in all times. The concept of a man free from all risks is as theoretical as the concept of perfection. This uncertainty leads to fruitful discussion, optimism scientific planning, economic development, on the one hand and gives rise to dispute, fear, failure, retrogression, on the other hand. Through experience, man has devised various methods of meeting the risks faced by families and businessman. There are various ways in which risk may be handled. These are (a) Risk may be avoided (b) Risk may be assumed (c) The hazard may be reduced (d) The loss may be reduced (e) The risk may be shifted (f) Risk may be reduced (g) Risks may be shared (h) Risks may be transferred

a. **Risk may be avoided:** The first method of handling risk is the avoidance of risk altogether. One can avoid the risk of his house burning by selling the house, or by setting fire to it immediately. Similarly, it is possible to avoid involvement in an aeroplane or taxi accident by not engaging an aircraft or taxi. Also, one can stop smoking or not starting it, if one wants to avoid the risk of early death. Carried to its logical conclusion, however, avoidance of risk would make the life miserable, very tame and unbearable, if not impossible. Moreover, some risks are inherent in life it self and cannot be avoided. Nevertheless, avoidance is possible where a choice is possible. If a man buys a house, he runs the risk of it being destroyed by fire. A house with a roof covering of dried straw, reeds, etc. is a

greater risk attaching to the thatched-cover house and will accept a smaller risk of buying a house of standard construction. In this case, the risk has not been avoided so much as reduced.

b. Risk may be assumed: Because the element of risk is incidental to life and cannot usually be avoided, it may be accepted. Hence, the assumption of risk is the path of least resistance in meeting uncertainty There are three ways in which risks may be accepted : (a) Some risks are accepted in ignorance. For example, ownership of a house involves the risk of loss due to fire, earthquake, explosion, burglary, etc. The owner might have covered these risks but might not be aware of his legal liability for persons injured in his premises. His failure to insure this liability may be a result of his unawareness of the exposure, Many risks are, thus, covered in this manner. (b) Some risks are accepted inadvertently. Although, exposure to risk is recognized, the opportunity to transfer it is neglected. For instance, a family man might fully realize that the family will face the risk of loss of income, if death of the bread-winner takes place and the family is unable to assume this risk. He might postpone the purchase of life insurance till some persuasive insurance agent sells it to him. (c) Some risks are accepted intentionally. Where there is no other economical way of meeting risks, a man has to shoulder the risk. For example, a man might wish to insure the risk of premature death, but if his occupation is racing motor cycle or swinging from one rope to another at a height of 100 ft, in a circus show, he will be unable to buy insurance. Also by cycling without light or with two persons or traveling in train without valid ticket. One takes a calculated risk of being caught and brought to justice by the authorities. Likewise, where the degree of risk is slight or the loss exposure is too small, a man may be willing to shoulder it without any worry. Students, for instance,

generally lose pen, pencils, text books, wrist watches. They accept this risk and do not seek to secure themselves against it as it would cost more than the cost of these articles. These relatively inexpensive losses are within their reach and can be replaced with a minimum of financial sacrifice.

When the risk is assumed deliberately, provision is sometimes made against the consequences of loss by the creation of a sinking fund or by building up a reserve fund. This method might be used by some large concerns but is not suitable for small firms and persons of moderate means. Moreover, this self-insurance method is dangerous in the initial stages of the fund creation, when the accumulated funds might not be adequate to meet the expected huge losses. At best this method is suitable for making up small losses or to meet those risks where the insurers are not willing to write the coverage.

c. **The hazard may be reduced:** The third method of handling the risks is to reduce the hazards (Hazard is a condition which may create, increase the chance of loss from a given peril). The use of concrete and steel materials, metal pipes for protecting insulated electric wires in the construction of buildings would prevent rats from burning the building by causing a short circuit. A good police force will diminish burglary and crimes, an alert proctorial staff in the university will reduce indiscipline amongst the students an efficient fire department and a model building code will reduce fire losses. Likewise, a carefully devised and administered factory law along with proper safety measures will lessen the industrial accidents. Also, the installation of an automatic traffic signal at the intersection of two heavily traveled highways can reduce the frequency rate of accidents. In the same manner, the progress of medical science has contributed significantly in eliminating or controlling many diseases like T.B. malaria, Cancer, etc. that were greatly feared

in the past. It should, however, be remembered that it is not always possible to eliminate all the hazards.

d. **Losses may be reduced**: Steps can be taken to reduce the losses that will result in if a peril (a contingency which may cause a loss) materializes. Through this method the chance of the occurrence of the accident is not eliminated, but the impact of the loss is lessened. The provision of sand and water in the buckets in a cinema hall or the presence of fire extinguishers or an automatic sprinkler system in a factory or a super bazaar does not change in the least the likelihood of a fire's starting, but it does curtail the spread of the fire. Thus, the amount of damage done will be a minimum one. Likewise, periodic medical check up may not reduce the chance of getting heart-disease but the regular medical examinations may lead to recommendations and treatment which may be helpful for maintaining a better health and may reduce the extent of the loss of income arising from death. Reduction of the hazard and the minimizing of loss generally are coexistent aims and are frequently found together. For instance, the regular physical check-ups not only reduce the loss from disease but also reduce the hazard.

e. **Risk may be shifted:** Various methods have been evolved for shifting the risks to other parties

(i) The first method of shifting the risk is hedging. Which is the process of making commitments on both sides of a transaction in such a way that the risks compensate each other? For example, a dealer who has promised to sell a large quantity of goods on some future date, may want to insure against the possibility of heavy losses through a rise in price by buying the same commodity early or passing on some of his forward sales to other dealers.

(ii) *Sub-contracting* is another method of shifting the risk. Under this method, the general contractor can give contract to various persons for providing electric wiring, plastering, plumbing, glasses, electric goods, timber, etc. By doing so, he has shifted a portion of the risk of increasing cost of these items to his sub-contractors, who must bear their respective losses.

(iii) The third method of shifting risk us by the use of surety bonds where a surety would guarantee a specific done within the time limit, the surety to pay compensation to the party concerned or has to arrange the work through some other party.

(iv) The formation of *limited liability companies* is yet another form of shifting the risk on to the shoulders of others. The shareholders have no liability beyond the value of the shares subscribed by them, thus, shifting the risk from owners to creditors. By these methods, the risk is reduced through entering into contracts with third parties, as also the chances of heavy profits to individual are reduced.

f. Risk may be reduced: The last method of treating risks, with which we are concerned, is reducing risk by insurance. The owner of a house may fear that some houses in his locality may be damaged or burnt. He is uncertain as to whether or not his own house will be damaged or burnt and is not certain as to the loss he will suffer on that account. He cannot set up an emergency or reserve fund to make up that loss as this method is not suitable when only one house is involved. However, he can reduce the risk by combining his risk with the risks of several other owners through the services of an insurance company. The combination of risks enables the persons to predict the losses and to reduce the risk. One can be sure of his share of loss in advance and can do the needful. Likewise, the uncertainty about death can be eliminated by

combining the premature death risk of one man with those of many others. In this manner, the share of the cost of an individual can be precisely determined and spread equitably amongst the members of the group.

Certainly out of the above-mentioned methods of handling risk, the last method of reducing it through insurance is superior. This method involves buying a promise from the insurance company to pay an agreed sum of money to the buyer in case of any loss in consideration of a certain sum of money. The philosophy behind the insurance is that an individual exposed to a particular joins hand with several other individuals similarly exposed which reduces the risk to a great extent. Through the services of an insurance company, therefore, an individuals or business man is able to exchange uncertainty of a large sum of money for a certainty of a small premium. In other words, insurance is a plan for dealing with some of the risks to which the modern society is exposed. These risks can be classified into (a) Business risks, and (b) Personal risks, Business risks are those risks which a business man has to face in the ordinary course of the business such as possibility of loss of goods by theft, fire, accident or depression. On the other hand, personal risks are those risks which an individual has to face in his personal capacity such as the loss of income suffered by the dependants due to the death of the bread-winner, loss of health, injuries in an accident etc.

Risks can also be classified into (a) Dynamic risks or speculative risks which are uninsurable and (b) Static risks or pure risks which are insurable. Dynamic risks which may result in either a profit or loss may be divided into three categories: (i) Management risks (b) Political risks and (c) Innovation risks. Management risks may be further sub-divided into market, financial, and production risks.



2.9 LET US SUM UP

In this unit, we have discussed the following:

- Risk management is the process of minimizing, monitoring and controlling the chances of occurring losses as well as reducing the impact of any unfortunate losses.
- Business risks mean all those risks which are associated with business.
- The following are the causes of business risks:
  a. Political causes:
  b. Economic causes
  c. Social causes
  d. Technological causes
  e. Natural causes
- The following are the types of business risks:
  a. pure and speculative risks
  b. internal and external risks
  c. fundamental and particular risks
  d. static and dynamic risks
  e. financial and non-financial risks
- we have also discussed the methods of handling risks



2.10 FURTHER READING

1) Nalini PravaTripathy, Prabir Pal, (2009); *Insurance: Theory And Practice*, Phi Learning Pvt. Ltd

2) Manas Tripathy, Simita Mishra, K. C. Mishra; (2009); *General Insurance Business Operations and Decision Making*;Cengage Learning India.



2.11 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1 :

Risk management is the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events or to maximize the realization of opportunities.

Ans. to Q. No. 2 :

a. Safeguard against loss

b. Handling of risks

c. Risk identification

Ans. to Q. No. 3 :

a. Risks are inherent in all business

b. Business risks depend on the nature of business.

Ans. to Q. No. 4 :

a. Operation b. Future c. internal

Ans. to Q. No. 5 :

The causes of business risks are:

a. Technological causes b. Economic causes

c. Social causes d. Political causes

Ans. to Q. No. 6 : a. False b. True

c. False d. False



2.12 MODEL QUESTIONS

1. What do you mean by Risk management?
2. Discuss the features of business risks.
3. Explain any three causes of business risks.
4. Write short notes on:
   (a) Pure and speculative risks
   (b) Internal and external risks
   (c) Fundamental and Particular risks
   (d) Static and dynamic risks
   (e) Financial and non financial risks

UNIT 3: POLICY SERVICE AND CLAIM SETTLEMENT

UNIT STRUCTURE

3.1 Learning Objectives

3.2 Introduction

3.3 Insurance Documents

3.4 Nomination and Assignments

3.5 Alterations and revival

3.6 Surrender value and paid up value

3.7 Claim and their settlement

3.8 Let us sum up

3.9 Further Readings

3.10 Answers To Check Your Progress

3.11 Model Questions

3.1 LEARNING OBJECTIVES

After going through this unit, you will be able to :

- know the insurance documents
- identify the procedures towards alteration and revival
- describe the surrender value and paid up value
- discuss the procedures for settlement of death claims and maturity claims in life insurance
- discuss the recent improvement in policy servicing.

3.2 INTRODUCTION

In this unit we are going to discuss policy servicing and claim settlement. The first thing in opening an insurance policy involves a written proposal made by the proposer in prescribed application form issued by the insurance company. In the application form, the insured person (the proposer) is required to give information like his/her income, age, health, occupation etc. Then the information gathered by the agent

from his personal source (agents report) is included in the application form along with the information given by the insured. After that, a detailed examination of the document is done by the risk assessor (underwriters).

Now, in this unit, we are going to discuss on the insurance documents which include proposal forms, first premium receipt, certificate of insurance etc and the concepts of alterations and revival. Again, at the end of this unit, we will get a fair idea on the procedures for settlement of death claims in life insurance and maturity claims in life insurance and after that we will discuss policy servicing.

3.3 INSURANCE DOCUMENT

The following are some of the insurance documents that are involved in policy servicing:

a. **Proposal Forms:** This is a type of form issued by the insurance company which contains queries intended to extract all the information concerning the particular risk that the insurance policy proposes to cover. A proposal form contains the following items:

- **i.** Name of the potential insured
- **ii.** Address of the potential insured
- **iii.** Profession
- **iv.** Sum insured
- **v.** Signature, date, place etc.

The proposer should give a valid age proof and medical report along with the proposal form

b. **First premium receipt:** The first premium is an acknowledgement of the proposal that is issued by the company after the insured has paid the first installment of premium and risk has been accepted by the insurer.

c. **Policy Form:** A policy form is an evidence of contract on insurance. A policy document must be duly carried out and stamped in

compliance with provisions of Indian Stamp Act, 1899.The following are some of the items of policy form:

i. Recital Clause

ii. Operative Clause

iii. Attestation Clause

iv. Condition

v. Schedule

vi. Endorsement

d. Certificate of Insurance: The certificate of Insurance is required by the Motor vehicle Act, 1988. This certificate is an evidence of insurance to the police and the registration authorities.



CHECK YOUR PROGRESS

Q1: Fill in the blanks:

a.The first premium is an ……of the proposal that is issued by the company.

b. A policy form is an …… of contract on insurance.

c. In the application form, the insured person is required to give information like his/her ……, age, ……, occupation etc.

d. The certificate of Insurance is required by the …… Act, 1988.

e. A detailed examination of the document is done by the ……

3.4 NOMINATION AND ASSIGNMENT

After opening an insurance policy, there are some important features and benefits. The most important benefit is the nomination facility. It is an important and mandatory feature of the policy. There is another feature

called assignment offered in the policy. Now in this section we are going to discuss the concepts of nomination and assignment.

a. **Nomination:** Nomination is a right given to the proposer to appoint a person or persons to receive the benefit under the policy in the event of his/her death. Nomination is a benefit where in case of death of the policy holder the funds are given to beneficiary (nominee), whose name is mentioned by the policyholder while proposing for the policy. The policyholder has the option to change the nominee at any time during the term of the policy. The details of the nominee will typically include full name, age, address of the nominee and nominee's relationship with the life assured. One can have multiple persons as nominees and can also specify their shares of the policy proceeds in percentage terms. Section 39 of Insurance Act, 1938, deals with such nomination. A life assured who has attained 18 years of age, can make nomination. Nomination ensures smooth transfer of policy proceeds when the life assured is not around. Nomination is a part of life insurance proposal. While applying for life insurance one can mention the nominee details in the proposal itself.

   The policyholder can change nomination as many times as he wants. The same can be done using a 'change of nomination form' from the life insurance company. The nominee himself cannot influence the policy. In the currency of the policy and the lifetime of the life assured, the nominee has a little role to play. The nominee comes into the picture only after the death of the life assured, where he can claim the benefits under the policy.

b. **Assignment:** When the policyholder wants to give another person the rights of the policy, this is done through a deed and the insurer needs to be given a notice for the same. The policyholder is called the assignor and the person whom he appoints is called the assignee. In this process the policyholder transfers the title and

'assignee' derives the title from the assignor. The assignment is of two types- a) conditional assignment and b) absolute assignment.

3.5 ALTERATIONS AND REVIVAL

A. Alterations: After the policy is issued, the policyholder in a number of cases finds the terms not suitable to him and desires to change them. However, no alteration is permitted within one year of the commencement of the policy with some exceptions. The following alterations are allowed.

a. Alteration in class or term.

b. Reduction in the Sum Assured

c. Alteration in the mode of payment of premiums

d. Removal of an extra premium

e. Alteration from without profit plan to with profit plan

f. Alternation in name

g. Correction in policies

h. Settlement option of payment of sum assured by installments

i. Grant of accident benefit

j. Grant of premium waiver benefit under CDA policies

k. Alteration in currency and place of payment of policy monies

A fee for the change or alteration in the policy is charged by the Corporation called quotation fee and no additional fee is charged for giving effect to the alteration.

B. Revivals: If the premium under a policy is not paid within the days of grace period the policy lapses. Revival is a fresh contract wherein the insurer can impose fresh terms and conditions. A policy can be revived under the following types of revival:

a. Ordinary Revival: If a revival of the policy is effected within 6 months from the due of first unpaid premium no personal statement regarding health is required and the policy is revived

on collection of delayed premium plus interest. The rate of interest to be charged for such delayed premium will depend on the date of commencement of the policy.

b. Revival on non-medical basis: For revival of the policy on non-medical basis the amount to be revived should not exceed the prescribed limit for non-medical assurance taken by the life assured.

c. Revival on medical basis: If a policy cannot be revived under ordinary revival or revival on non-medical basis it can be revived with medical requirements. The medical requirements will depend upon the amount to be revived.

d. The other schemes for revival are:

i. Special Revival Schemes

ii. Revival by installment

iii. Loan- cum- revival

iv. Survival Benefit- cum- revival.



CHECK YOUR PROGRESS

Q2 : What do you mean by “nomination”?

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Q3 : What do you mean by “assignment”?

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Q4: State True or False:

a. The policyholder can change nomination only one time. (True /False).

b. The policyholder has the option to change the nominee at any time during the term of the policy. (True /False).

c. Nomination is not a part of life insurance proposal. (True /False).

d. The policyholder is called the assignor. (True /False).

e. No alteration is permitted within one year of the commencement of the policy. (True /False).

3.6 SURRENDER VALUE AND PAID UP VALUE

A. Surrender Value: The sum of money an insurance company will pay to the policyholder or annuity holder in the event his or her policy is voluntarily terminated before its maturity or the insured event occurs. This cash value is the savings component of most permanent life insurance policies, particularly whole life insurance policies. Also known as “cash value”, “surrender value” and “policyholder’s equity”.

According to LIC, “The cash value payable by LIC on termination of the policy contract at the desire of Policyholder, but before the expiry term, is known as Surrender Value. A policy can be surrendered, provided, it is kept in force for at least three years.”

B. Paid up Value: Paid up value is the value of a lapsed policy to be paid at the time of maturity. The paid up value of the life insurance is simply buying a single pay life policy with the cash value of the current policy. The paid up value is the amount of coverage we could get without paying any more on our policy.

Paid-up Value is the reduced amount of sum assured paid by the Insurer, in case the Insured discontinues payment of premiums. This is applicable only when the Insured has paid the premiums in full for the first three years.

If payment of premium is discontinued before expiry of the term, the policy does not remain in force for the full sum assured, but acquires reduced value in terms of the contract. It is calculated as:

According to LIC rules and regulations, once you pay the premiums on a life insurance policy for 3 full years, the policy does not become wholly void even if no subsequent premiums are paid. Such policies are known as paid-up policies. In such cases, the sum originally assured is reduced to a sum bearing the same ratio to the full sum assured as the number of premiums actually paid to total number of premiums originally stipulated as payable under the policy. If 6 out of the originally stipulated 30 premiums are paid, the sum assured under a paid-up policy would still be 20 percent of the original sum assured by the policy.

3.7 CLAIMS AND THEIR SETTLEMENT

'Claim' is a demand by an individual or organization to recover under a policy of insurance for loss which may come within that policy. It may be a demand by an individual against an insurer for damages covered by a policy held by him. The payment of claim constitutes the main service of insurance to the community, though in fire insurance, they may or may not arise, as they depend upon the happening of fortuitous events. The customers assess the company on the basis of the claims service provided by the company. Indeed, this single factor determines the reputation of the insurer amongst the buying community of the insurance market. Even if the insurer has acquired the goodwill on account of his being prompt in issuing a policy, or collection of premium or for issuing timely notice for the renewal of the policies, the whole effect can become negative if the claims service is inefficient and delayed. Consequently, the customers lose confidence in the insurance company and, as such, the otherwise equitable claims seem to be as inequitable. Thus, as D.S. Hansell has rightly pointed out that the "acid

test" for the success of the company for the policyholders is the claims service provided by the company.

In fact, the handling of claims is one of the most complicated procedures of the insurance business which requires a wide knowledge of insurance, a fund of common sense, with the good judgement of values which goes with it, a working knowledge of the law, and ability to hold a balance between the interest of the insured and the insurer. It is a misconception in the minds of some people that insurance companies generally try to avoid the claims payment, or try to create unnecessary delays, which naturally creates unpleasantness in the last leg of insurance journey. No doubt, a speedy claim service requires thorough investigation by the insurer, which might sometime be misunderstood for his being unwilling to settle the claims or might create a first impression on the policyholders that the insurance company wants to avoid its liability on one pretext or the other. But this is a gross distortion of the true position. Indeed, a vast majority of claims are settled quite amicably within a short period of time. In consequence, the handling of claims has become the most important factor of advertisement of the insured.

It is important that the insurance company should be immediately notified of the claims, or as soon as the circumstances permit the notice of the claims should be sent. Early notification is necessary so that the insurers may make whatever investigations they consider necessary. Delay may seriously prejudice their position and this is particularly true of certain types of serious claims, involving large sums of money. The insured may submit the claim either personally or through any authorized agent acting on his behalf, such as an advocate, an insurance agent, the insurer's employee, claims inspectors, loss adjusters etc. The duty of providing full particulars and proof of loss rests squarely upon the insured. Subsequently, the insurers make a careful investigation on various aspects of their loss and require reasonable proof. Although, it is the intention of the insurer to make an early payment of various

cases, the speed in payments should not be obtained at the cost of a comprehensive investigation. Once the claim is found to be valid, it must be paid immediately, as the delay will result in the loss of goodwill and possible future loss of business. The claim may be settled by the insurer in any of the four ways : (a) Cash payment, (b) Replacement of the asset, (c) Repair of the damaged property and (d) Reinstatement.

It is to be noted that the claims negotiator, working on behalf of the insurer has to play an important role in the settlement of the claim. He should be a tactful person and should not seriously prejudice the interests of the insurers. He should explain the position of claim to the policyholder in a non-technical language, so that, he will be able to follow the insurer's view point provided he has ordinary common sense. Even if the claim is refused, it must be explained to the policy holders with reasons as it is necessary to clear up any misunderstanding and there is no reason why a policyholder will not accept the position with good grace. Care should, however, be taken to collect every piece of information which must be preserved so that it is ready for use as and when necessary.



CHECK YOUR PROGRESS

Q5: What do you mean by surrender value?

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Q6: What do you mean by paid up value?

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3.8 LET US SUM UP

In this unit we have discussed on the following concepts:

- The following are some of the insurance documents that are involved in policy servicing:
  - Proposal Forms
  - First premium receipt
  - Policy Form
  - Certificate of Insurance
- **Nomination and Assignment:** Nomination is a right given to the proposer to appoint a person or persons to receive the benefit under the policy in case it becomes a death claim. Assignment is given when the policyholder wants to give another person the rights of the policy, this is done through a deed and the insurer needs to be given a notice for the same.
- **Alterations and Revival:** Alteration means, after the policy is issued, the policyholder in a number of cases finds the terms not suitable to him and desires to change them. Revival is a fresh contract wherein the insurer can impose fresh terms and conditions.
- **Surrender Value:** The sum of money an insurance company will pay to the policyholder or annuity holder in the event his or her policy is voluntarily terminated before its maturity or the insured event occurs.
- **Paid up Value:** Paid up value is the value of a lapsed policy to be paid at the time of maturity.
- The claim may be settled by the insurer in any of the four ways : (a) Cash payment, (b) Replacement of the asset, (c) Repair of the damaged property and (d) Reinstatement.



3.9 FURTHER READING

1) Mishra, M. N., Mishra, S. B. (2005); *Insurance Principles and Practice*; S. Chand Publisher.

2) Tripathy, Nalini Prava, Pal, Prabir (2009); *Insurance : Theory And Practice*, Phi Learning Pvt. Ltd.



3.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1 : a. acknowledgement b. evidence
c. income, health d. Motor Vehicle
e. risk assessor

Ans. to Q. No. 2 : Nomination is a right given to the proposer to appoint a person or persons to receive the benefit under the policy in case it becomes a death claim.

Ans. to Q. No. 3 : Assignment is given when the policyholder wants to give another person the rights of the policy, this is done through a deed and the insurer needs to be given a notice for the same.

Ans. to Q. No. 4 : a. False b. True
c. False d. True

Ans. to Q. No. 5 : Surrender Value: The sum of money an insurance company will pay to the policyholder or annuity holder in the event his or her policy is voluntarily terminated before its maturity or the insured event occurs.

Ans. to Q. No. 6 : Paid up value is the value of a lapsed policy to be paid at the time of maturity.



3.11 MODEL QUESTIONS

1. Explain the insurance documents involved in policy servicing.
2. What is alterations and revival?
3. Write short notes on “claims and their settlement” in insurance policy.
4. Fill in the blanks:
   (i) Surrender value is also known as ---------- value.
   (ii) ---------- is the value of a lapsed policy to be paid at the time of maturity.

UNIT 4: LIFE INSURANCE

UNIT STRUCTURE

4.1 Learning Objectives

4.2 Introduction

4.3 Meaning of life Insurance

4.4 Difference between life insurance and non-life insurance

4.5 Features of life insurance

4.7 Advantages of life insurance

4.8 Types of life insurance plan

4.9 Let us sum up

4.10 Further Reading

4.11 Answers To Check Your Progress

4.12 Model Questions

4.1 LEARNING OBJECTIVES

After going through this unit, you will be able to :

- explain the concept of life insurance
- outline the difference between life insurance and non-life insurance
- discuss the features of life insurance
- describe the importance and advantages of life insurance
- explain the different types of life insurance

4.2 INTRODUCTION

In this unit we are going to discuss the concept of life insurance. Life insurance contract is a contract in which the insurer in consideration of a certain premium either in lump sum or other periodical payments agrees to pay to the assured an agreed sum of money on the happening of a contingency e.g. death of the insured. The difference between the life insurance and non-life insurance will also be discussed.

We will also discuss in the following sections the features,

importance and advantages of life insurance. Again, at the end of this unit we will get a fair idea on the different types of life insurance.

4.3 MEANING OF LIFE INSURANCE

According to Life Insurance Act,1938, life insurance refers to the contract of insurance on human life, under which if any individual's death ,other than accident ,or happening of any event concerning to human life, a certain amount is guaranteed to be paid to the assured or his/her legal representatives.

So, from the above definition given by Life Insurance Act,1938 now we can get an idea that , the subject matter of life insurance is human life and to protect the human life from future uncertainties.

The duration of life insurance normally exceeds a year and the sum assured is paid on the happening of certain event or on the maturity of the policy.

4.4 DIFFERENCE BETWEEN LIFE INSURANCE AND NON-LIFE INSURANCE

In the above section we have discussed life insurance and now we are going to discuss the meaning of non-life insurance before discussing the difference between life insurance and non-life insurance.

Non-life insurance is insurance where the insurer in consideration of a premium paid by the insured agrees to compensate him for the financial loss suffered by him due to some unexpected event which is covered by the terms of the policy. There are different types of non-life insurance which are as follows:

a. Marine Insurance
b. Fire Insurance
c. Motor Vehicle insurance and
d. Personal Accident insurance

The above types of insurance will be discussed in the next units.

Now we will discuss the differences between life insurance and non-life insurance from the following:

Life Insurance	Non-Life insurance
1. There is an assurance as to the occurrence of the event i.e. death but there is uncertainty about thetiming.	1. Here, the event insured against may or may not occur.
2. The insurer is committed to compensate the insured.	2. The insurer is under no obligation to compensate the insured.
3. The principle of indemnity does not apply to life insurance contract.	3. This insurance is a contract of indemnity and the assured can recover the actual loss subject to the maximum amount of the policy.
4. The life insurance contract is always a long-term contract.	4. These contracts are annual contracts.

4.5 EATURES OF LIFE INSURANCE

The following are some of the features of life insurance:

a. There should be elements of a valid contract. Life insurance is a contractual relationship between the insured and the insurer, so there must be essential elements of a valid contract in accordance with the provision of Indian Contract Act,1872

b. The person who is going to insure should have interest in the object of insurance called insurable interest.

c. Warranties are important features of life insurance. If there is some untrue statement regarding material, facts or figures, the

contract shall become null and void and the insurer will be entitled to forfeit the premium paid by him.

d. Again, nomination is an essential feature of life insurance. Generally, nomination means the act of officially naming a person and here the person is named to collect the amount to be paid by the insurer on the death of the assured.

e. Premium is also a feature of life insurance. Premium is the amount paid by the insured for the loss undertaken. Premium can be single premium, limited premium or whole-life premium.

4.6 DVANTAGES OF LIFE INSURANCE

There are some advantages of Life insurance. This can be discussed as follows:

a. **Tax Relief:** Life insurance is helpful in a way that it is the best way to have benefit of tax deduction on income tax.

b. **Security and Protection:** life insurance gives full guarantee of protection and security against risk of death of the saver.

c. **Helps in taking credit:** it helps in acquiring loans on the security of any policy that has acquired loan value.

d. **Liquidity provider:** this insurance policy plan can be used to meet some type of monetary needs that may arise from time –to-time. Some of the monetary needs are marriage provisions, children's education etc.

4.7 TYPES OF LIFE INSURANCE

According to 'Life Insurance Corporation of India' there are 12 types of insurance plans. They are as follows:



1. **Whole Life Policy:** Whole life policy is a life insurance policy that remains in force for the insured's whole life and requires premiums to be paid every year into the policy. This policy is suitable for people of all ages who wish to protect their families from financial crises that may occur owing to the policyholder's premature death. According to LIC "This plan is mainly devised to create an estate for the heirs of the policyholder as the plan basically provides for payment of sum assured plus bonuses on the death of the policyholder. However, considering the increased longevity of the Indian population, the Corporation has amended the above provision, thereby providing for payment of sum assured plus bonuses in the form of maturity claim on completion of age 80 years or on expiry of term of 40 years from date of commencement of the policy whichever is later. The premiums under the policy are payable up to age 80 years of the policyholder or for a term of 35 years whichever is later.

   If the payment of premium ceases after 3 years, a paid-up policy for such reduced sum assured will be automatically secured provided the reduced sum assured exclusive of any attached bonus

is not less than Rs.250/-. Such reduced paid-up policy is not entitled to participate in the bonus declared thereafter but the bonuses already declared on the policy will remain attached, provided the policy is converted into a paid-up policy after the premiums are paid for 5 years.

2. **Endowment Assurance Policy:** An endowment policy is a life insurance contract designed to pay a lump sum after a specified period of time or on earlier death. Normally, an endowment assurance policy matured period is ten, fifteen or twenty years up to a certain age limit. In the case of critical illness some policies also pay out. Endowments can be surrendered and the holder then receives the surrender value which is determined by the insurance company depending on how long the policy has been running and how much has been paid in to it.

3. **Term Assurance Plans:** This plan of assurance is designed to meet the needs of those who are initially unable to pay the larger premium required for a Whole Life or Endowment Assurance Policy, but hope to be able to pay for such a policy in the near future. This plan would be found useful also in cases where it is desired to leave the final decision as to the plan to a later date when, perhaps a better choice could be made. Policy holders get an option of converting a policy into endowment assurance or limited payment whole life assurance.

4. **Children Plan:** This plan is specially designed to meet the increasing educational, marriage and other needs of growing children. It provides the risk cover on the life of child not only during the policy term but also during the extended term (i.e. 7 years after the expiry of policy term). A number of Survival benefits are payable on surviving by the life assured to the end of the specified durations. You may choose Sum Assured (S.A.), Maturity Age, Policy Term, Mode of Premium payment

and Premium Waiver Benefit. You may pay the premiums regularly at yearly, half-yearly, quarterly or through Salary deductions over the term of policy. Premiums may be paid either for 6 years or upto 5 years before the policy term.

5. **Plans for handicapped Dependents:** This is an Endowment Assurance plan designed for the benefit of handicapped dependants. Premiums are payable quarterly, half-yearly or yearly throughout the term of the policy or till the earlier death. Alternatively, the premium may be paid in one lump sum (single premium). The policy provides for the Guaranteed additions at the rate of Rs.60 per thousand Sum Assured for each completed policy year while the policy is in full force. The Guaranteed Additions are payable at the end of the policy term or on earlier death.This is a with-profit plan and participates in the profits of the Corporation's life insurance business. It gets a share of the profits in the form of loyalty additions which are terminal bonuses payable along with death or maturity benefit. Loyalty addition may be payable from fifth year onwards depending on the experience of the Corporation.

6. **Plans for high Worth Individuals:** This is an endowment Assurance plan offering the choice of three premium paying terms. It provides financial protection against death throughout the term of the plan Product summary with the payment of maturity amount on survival to the end of the policy term. Premiums are payable yearly, half-yearly, quarterly or monthly, as opted by the customers, throughout the premium paying term or till earlier death. The policy provides for the Guaranteed Additions at the rate of Rs. 50/- per thousand Sum Assured for each completed year for first five years of the policy. The policy participates in the profits of the Corporation's life insurance business from the 6th year onwards. The Sum Assured along with accrued guaranteed additions and vested simple

reversionary bonuses and Terminal Bonus, if any, is payable in a lump sum on death of the life assured during the policy term.

7. **Money Back Plans:** There may be money back policy for different years, say 20 years and 25 years.

The money back policy 20 years: This is type of endowment insurance plan scheme provides for periodic payments of partial survival benefits as follows during the term of the policy as long as the policy holder is alive. Here, 20 percent of the sum assured becomes payable each after 5, 10, 15 years and the balance of 40 percent plus the accrued bonus become payable at the 20th year.

The money back policy 25 years: In the money back policy 25 years, 15 percent of the sum assured becomes payable each after 5, 10, 15 and 20 years and the balance of 40 percent plus the accrued bonus become payable at the 25th year. In this policy one important feature is that if at any time the event of death occurs within the policy term, the death claim comprises the full sum assured without deducting any of the survival benefit amounts, which have already been paid.

The following are some of the types of money back policy:

a. Jeevan Surabhi (15 years, 20 years and 25 years)
b. Jeevan Rekha(closed for Sale)
c. Bima Bachat
d. Special money back plan for women

8. **Other Special Plans:** Other Special plans are the plans where there is provision of dual benefits. Here, both insurance as well as investment life insurance corporation of India offers the following plans:

a. Bima Gold (closed for Sale): in this Bima Gold plan the

policy holder should have to pay premiums over the entire duration of the plan and certain amount of sum assured is paid at regular intervals during the currency of the intervals. On the maturity of the plan, the policy holder will receive all the premiums paid, less the amount already paid out in the intervening years. The minimum age for entry should be 14 to 63 years but the maximum age at the maturity should not be more than 75 years.

b. New Bima Gold: this is a plan where the premiums that are paid over the term of the plan are paid back during the policy term in instalments and life insurance cover is available not only during the term but also during the extended period of the plan. The minimum sum assured under the policy is Rs. 50,000.

c. Bima Nivesh 2005: This policy is the revised version of LIC's bima nivesh plan 2004. This plan is for those who have no regular income but have a good periodical income. This plan is available for the term of 5 years and 10 years.

There are some other plans also, such as Jeevan Saral, and jeevan Madhur.

9. Group Insurance Schemes: Group Insurance Schemes is life insurance plan which provide protection to a group of people. This insurance scheme provides the benefits at a very low rate to the associations, employers etc.

Following are some of the types of group insurance plan.

a. Group term insurance schemes

b. Group insurance schemes in lieu of EDLI (Employee's Deposit Link Insurance)

c. Group gratuity Schemes

d. Group superannuation Schemes

e. Rural group life insurance schemes

10. Pension Plans: This plan is for the senior citizen and for those who plan for secured future. Following are some of the types of Pension Plan:

a. *Jeevan Needhi:* In this policy, on the survival of the policy the accumulated amount (sum assured + guaranteed additions + bonus) is used to generate a pension for the po0licy holder.

b. *Jeevan Akshya*-V: This is an Immediate Annuity plan, which can be purchased through lump sum payment as Single Premium. The plan provides for annuity payments which are available throughout the life time of an annuitant. Various options are available for the type and mode of payment of annuities.

c. *New Jeevan Dhara*-I: 'New Jeevan Dhara-I' is suitable for professionals who do not have any pension scheme, can provide a pension for themselves for post retirement expenses.

d. *New Jeevan Suraksha-I:* 'New Jeevan Suraksha 1' is a unique plan designed to provide pension from a chosen retirement date. The plan can be taken by anyone who wishes to set apart an amount as pension.

11. Unit Plans: Unit plans are investments plans for those who realise the world of hard earned money. This plan helps in tax saving. E.g. Pension Plus Plan.



CHECK YOUR PROGRESS

Q1. State true or false for the following statements:

(i) Fire insurance is a non life insurance policy. (True/False)

(ii) Life insurance policy never helps in acquiring loans. (True/ False)

(iii) Children plan is designed to meet the educational, marriage and other needs of a child. (True/False)

Q2. Write any two advantages of Life Insurance Policy.

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4.8 LET US SUM UP

- In this unit we have discussed on the concept of Life insurance. Life insurance is a contract in which the insurer in consideration of certain premium, in lump sum or by other periodical period, agrees to pay to the assured the assured sum of the money, on the happening of a specified event or at the expiry of certain period.
- We also discussed on the difference between life insurance and nonlife insurance.
- There are certain features of life insurance. They are as follows:
  - i. a valid Contract
  - ii. Premium
  - iii. The person who insure should have interest for life insurance
  - iv. Warranties
  - v. nomination

- Advantages of life insurance

  i. Liquidity provider
  ii. Tax Relief
  iii. Security and Protection
  iv. Helps in taking credit

- The following are the types of Insurance

  i. Whole Life Policy
  ii. Endowment Assurance Policy
  iii. Term Assurance Plans
  iv. Children Plan
  v. Plans for handicapped Dependents
  vi. Plans for high Worth Individuals
  vii. Money Back Plans
  viii. Other Special Plans
  ix. Group Insurance Schemes
  x. Unit Plans
  xi. Pension Plans



4.9 FURTHER READING

1) Mishra, M. N., Mishra, S. B. (2005); *Insurance Principles and Practice*; S. Chand Publisher.
2) Tripathy, Nalini Prava, Pal, Prabir (2009); *Insurance : Theory And Practice*, Phi Learning Pvt. Ltd.
3) Tripathy, Manas, Mishra, Simita, Mishra, K. C. (2009); *General Insurance Business Operations and Decision Making*; Cengage Learning India.



4.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1 : (i) True, (ii) False, (iii) True

Ans. to Q. No. 2 :

(a) Tax Relief: Life insurance is helpful in a way that it is the best way to have benefit of tax deduction on income tax.

(b) Security and Protection: life insurance gives full guarantee of protection and security against risk of death of the saver.



4.11 MODEL QUESTIONS

1. Define Life Insurance Policy.
2. State the features of Life Insurance Policy.
3. Write short notes on:
   (a) Money back plans
   (b) Pension plans
   (c) Group insurance scheme.

UNIT 5: FIRE INSURANCE

UNIT STRUCTURE

5.1 Learning Objectives

5.2 Introduction

5.3 Defining Fire Insurance

5.3.1 Causes of Fire

5.3.2 Fire Prevention

5.3.3 Functions of Fire Insurance

5.3.4 The beginning of Fire Insurance

5.4 Kinds of Fire Insurance Policies

5.5 Procedure of Recovering Fire Insurance Claim

5.6 Let us sum up

5.7 Further Reading

5.8 Answers To Check Your Progress

5.9 Model Questions

5.1 LEARNING OBJECTIVES

After going through this unit, you will be able to :

- define Fire Insurance
- explain the causes of fire
- describe the fire prevention methods
- describe the different kinds of fire insurance policies
- state the procedure of recovering Fire Insurance Claim.

5.2 INTRODUCTION

Fire Insurance is one of the most popular forms of insurance. It has acquired an important position in all the industrialised countries of the world. People are now increasingly aware of the hazards of fire and the devastation it may cause. Colossal amounts are being spent for research into the causes of fire and the means of fire preventions. But fire is still one of the most common natural and accidental hazards. This unit

deals with the important topic of fire insurance. We will discuss the different aspects of fire insurance in on bid to educate the bearers about its importance in view of the frequency of fire ascedanty and incalculate devastations such accident may cause.

5.3 DEFINING FIRE INSURANCE

Discovery of fire is integral to human civilization as fire is used for variety of purposes. But fire is also a great hazard as fire accidents are very common occurrence entailing vast devastation of wealth. Fire insurance is a kind of guarantee against such losses. Each year claims worth 40-50 crores on account of fire are paid by the insurance companies in India and much more damage caused by fire goes unclaimed in the absence of insurance policies. Fire insurance belongs to the category of general insurance.

Section 2 (64) of the Insurance Act defines fire insurance as follows : “Fire insurance business means the business of effecting otherwise than incidentally to some other class of business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies.” The considerable security provided by fire insurance policies has led to their rapid popularity not only amongst the individuals and business circles, but also in the industries godowns, religious organizations, places of worship like mosques and temples, colleges, universities and other educational and charitable institutions, cinema-houses, clubs and hotels, railways, transport, buses banks, which all are most vulnerable to large scale arson. This under lines the need for protection from unexpected and unfortunate calamities of fire and highlights the importance of recognizing and meeting them intelligently through fire insurance schemes. Thus, insurance provides a security to the insured that fire in the wrong place or out of control should not prove to be a scourge.

Let us now discuss the causes of fire.

5.3.1 Causes of fire

Broadly speaking, there are two main causes of fire waste: (a) Physical hazard and (b) Moral hazard. As has already been defined, hazard is a condition that may create or increase the chance of loss arising from a given peril. In order to find out the real cause of loss it is necessary to go behind the perils, which apparently cause loss. For example, if a fire breaks out in the garage, the apparent cause of loss no doubt, is fire itself, but it hides the real cause. But if we go further to find why fire has occurred, we have find that a pile of oily rags was left lying around the garage which is the cause of fire and is the real cause of loss. Subsequent enquiries may reveal that poor "house-keeping" is the basic cause of loss. For insurance purposes, however, fire is the peril as well as cause of loss, but the hazards may increase the chance of loss. Physical hazards refer to the inherent risk of fire in the property which may be on account of the situation, inflammable nature, construction of the premises, artificial lighting and heating, lack of extinguishing appliances, trade processes involved in the insured premises, proximity of fire brigades, etc. For examples, a pile of oily rags in the cellar, near the furnace, or a thatched dwelling or hazardous processes like the production of gunpowder in a building or boiling of sugar-cane juice in giant boilers or the cooking gas dealer's stock etc may increase the chance of loss by fire or explosion. Besides, the physical hazard, moral hazard is another cause of fire and is concerned with any human element involved with the risk. The insured property may be willfully and maliciously set on fire either by the owner himself or somebody else. An extreme example of bad moral hazard is the person who effects a policy of insurance in order to make a profit by means of false and exaggerated claims. Thus, dishonesty of the insured will increase the probability of loss by arson. Also, the loss of fire due to moral hazard may

be if a person is careless about the safety and welfare of his employee, where he fails to take reasonable care of his property or where his habits increase the risk of loss due to fire. Besides, the general state of the economy has a bearing on the rate of fire occurrences. In times of great distress such as trade depression, the claims on account of fire losses increase because the unsuccessful owners of property, in order to realize the capital tied up in stocks which they could not sell and to earn profit, may cause fire. These willful and unlawful acts of setting one's own property to fire with an evil purpose are known as incendiarism . Also there are cases where third parties out of malice, political situation or caste or religious fanaticism may set fire to the properties belonging to other political, religious, or lingual groups. Such intentional and unlawful acts are known as "arson". Again, some persons may well be tempted to set fire to the property of others with the intention to get reward on giving first hand information about the out break of the fire and assisting with extra efficiency in its extinction. Finally, there are cases of "passive dishonesty" where the insured is either personally careless or his employees are careless or he fails to maintain proper safeguards against fire or where the third parties are careless. As for instance, vagrants and children have often caused fire damage by leaving cigarettes or other burning substances. In short, both moral and physical hazards are responsible for enormous loss to property worth crores of rupees every year.

5.3.2 Fire Prevention

In order to minimize the fire hazards, the insurance companies employ skilled officials, known as fire surveyors, who inspect the risks insured or offered for insurance and to make suggestions. Besides, the insurance companies, fire protecting associations, fire testing stations, tariff associations etc. are constantly educating the public and industry on the hazards of fire and means of fire

prevention. These organizations have set standards for the construction of buildings and building materials so that the fire wastes are minimum. Also, the insurers offer inducements by way of lower premiums for well constructed fire proof buildings and for the installation of fire extinguishing appliances, which reduce the hazard of fire. The institution of Fire Protection Associations (FPA) help in conducting a permanent publicity campaign for mobilizing public opinion in favour of various fire-preventive methods and for reducing the fire waste. Moreover, colossal amount of money is being spent on carrying out researches into the causes of fire and means of fire prevention, including the discovery of new means, and checking the efficiency of existing means, of avoiding or resisting fire. This task has been entrusted to the Fire Testing Stations in industrially advanced countries.

5.3.3 Functions of Fire Insurance

Under a fire insurance contract the insurers, in return for the premium, undertake to pay for or make good a loss sustained by the insured as the result of damage to properly described in the policy and caused by fire or some other insured peril, up to the limit of the insured. Thus, insurance company acts as a middleman between all the members of the society who are exposed to the fire risk on the one hand and the victims of the fire losses, who are also members, on the other. The premium is charged from all the members and is utilized for meeting the losses of some of the members. In other words, the primary function of fire insurance is to spread the heavy fire losses of insured members over the whole of the insuring community, by compensating the unfortunate few from the funds built up from the contributions of all members. After taking a fire policy the insured feels protected against the risk of fire. Such a state of mind in fields and factories encourages production. Indeed, insurance imbues them with a

sense of security and a feeling of confidence in the unknown future, which ultimately pushes up economic growth.

It should, however, be remembered that though the greatest advantage of fire insurance is that it removes anxiety and worry from the minds of insured which creates a buoyant effect on their psychological build up, yet the insurance plan does not, in any way, minimize fire wastes. Surprisingly, fire insurance schemes sometimes encourage the dishonest insurers to set fire to their own properties in order to realize their cash values from the insurance company. Broadly speaking, the total loss due to fire waste to the society remains the same and is an irrecoverable dead loss.

5.3.4 The Beginnings of Fire Insurance

Compared to marine and life insurance, fire insurance has not a long history and is of late origin. The first recorded suggestion for a fire insurance company seems to have been made in 1609 by Count von Oldenburg in Germany, But the company was not formed It, however, originated as a municipal undertaking in certain German cities such as Hamburg, where fire compensation was paid to the property-owners on the payment of an annual contribution, calculated on the basis of annual rent of the property.

In India, fire insurance business was developed by the British entrepreneurs on the pattern of English insurance companies. Some of the earliest companies under English domination were formed in Calcutta : Sun Insurance Office Ltd., (1710) Royal Exchange Assurance (1720) London Assurance (1720) Phoenix Assurance Company Ltd. (1782) Norwich Union Fire Insurance Society Ltd. (1797) Later on, insurers from Australia (1886) Canada (1851), France (1828), Hong Kong (1835) Japan (1879) Kenya (1937), New Zealand (1859), Sweden (1855), Switzerland (1861) and United State of America (1810) also joined the English insurers.

Thus most of the insurance business in our country was in the hands of the foreigners, having their Head Offices in their respective countries. Later on, Indian insurers also joined the foreigners. In 1971, the general insurance companies were nationalized. From 1st January, 1971, fire insurance business is being transacted only by the General Insurance Corporation of India and its four subsidiary companies : (1) National Insurance Co., Ltd., Calcutta, (2) New India Assurance Co; Ltd., Bombay, (3) Oriental Fire & General Insurance Co. Ltd., New Delhi (4) United India Fire & General Insurance Co. Ltd Madras. Thus, the management of 64 Indian and 42 foreign insurance companies is now vested in the central Government.

In the previous sections we have discussed various aspects of fire insurance. Let us now go into the kinds of fire insurance policies.

5.4 KINDS OF FIRE INDURANCE POLICIES

Fire insurance companies issue a large variety of policies so as to have a policy for everybody, suiting his requirements and financial position. Insurers are always eager to devise newer varieties to the extent possible for them. Thus, as fire insurance developed, various additional risks were included within the cover of a fire policy or could be added by the payment of an additional premium. These included special perils, such as earthquake, riot and civil commotion, impact damage to buildings, flood, storm, lighting damage, etc. Of late, consequential loss of profit insurance was introduced which provides for compensation for profit lost through interruption of business following a fire. Besides, rent policies have also developed for the owners, if the tenant is not obliged to continue payment while the premises are uninhabitable because of fire, or for tenant, if his obligation to pay rent does not cease in the event of a fire. Thus, in practice, any concessions are given to the insured according to the nature of the subject-matter and modifications to the

principle of indemnity are made to meet the varying circumstances and the requirements of the insured. Since the insured suffers tangible as well as intangible losses, equity demands that certain modifications to the rigid application of the principle of indemnity be made. Therefore, in cases, even distinct departure from indemnity is necessitated. The four main types of fire policies are:

(1) Valued policy

(2) Specific Policy

(3) Average Policy and

(4) Floating Policy.

Besides, there are some other subsidiary types of policies like Declaration Policy, Reinstatement or Replacement Policy, Consequential Loss Policy, Comprehensive Policy, Excess Policy, Sprinkler Leakage Policy, Adjustable policy, Maximum value with Discount Policy, Blanket Policy, Rent Policy, Transit Policy and Policies on Buildings in course of erection.

1. **Valued Policy:** A valued Policy is a policy which provides that a special amount shall be paid in the event of total loss of the property. In other words, it is a policy in which the amount payable in case of loss is fixed at the time the policy is taken. In the event of loss, the fixed amount is payable by the insurer irrespective of the actual amount of loss, Thus, at the time of loss, the market value of the subject matter of insurance is not taken into account. Valued policy can be legally challenged because it is not a contract of indeminity, rather it violates the principle of indemnity because the amount of insurance may be higher or lower than the market value. Such policies are not very commonly issued.

   Usually, most fine arts policies which are issued on pictures, sculptures, works of arts, Jewellery, specified articles, furniture, antiques and similar rare articles are valued policies. These rare

and valuable articles are under valued policies. These rare and artistic pieces present a difficulty in their valuation at the time of loss and for this purpose expert services are needed. Even minor damage to these articles reduces their value considerably and necessitates the payment of an agreed value. Valued policies have an advantage that the insured knows in advance the exact amount of compensation payable at the time of loss and he need not prove the value of the insured articles at the time of loss. However, this method ignores any appreciation in the value of these articles, and if all appreciation is brought to the notice of insurance company, revaluation of the inventory is done at the expense of the insured. This method, to be effective, must make a provision of frequent revaluation. From the point of view of the insurer the valued policy violates the principle of industry as the value of some articles might depreciate in value due to wear and tear, change in habit, tastes and fashion, etc. In such a case, the insurer has to pay more than the loss and therefore, it increases the moral hazard and might tempt the insured to set fire to his own property. In addition to this disadvantage, this method poses a big problem in the settlement of partial losses claims, where opinions differ on the extent of loss. In any case, this method guarantees an agreed amount to be paid at the time of loss.

2. **Specific Policy:** A specific policy is that which insures a risk for a specific sum. Under such a policy, the insurer will pay the whole loss to the insured provided that it does not exceed the specified sum mentioned in the policy. The value of the property is not taken into account. Thus, if a building worth Rs. 20.000 is insured against fire for Rs 10,000 while the damage to the property is assessed at Rs 8,000 the assured will get the whole loss of Rs 8,000 from the insurance company. Even if the loss be Rs 10,000 this full amount can be recovered. But if the loss is for Rs. 12,000 then only Rs. 10,000 can be recovered. Hence, in a specific policy the

value of property insured has no relevance in arriving at the measure of indemnity and the sum assured sets the upper limit of loss compensation. In fact, specific policy is a case of under insurance and does not penalize the under- insurance and does penalize the under insurer except when there is a total loss.

3. **Average Policy :** The "average Clause" is often inserted in fire policies, making them average policies. An average policy requires the insurer to pay that proportion of actual loss as the insurance bears to the actual value of the property at the time of loss. The amount of claim is arrived at by dividing the insured sum by the actual value of the object insured and then multiplying it by the amount of the loss. Thus, if a person insures his property for Rs 15,000 and the market value of the property at the time of loss is Rs. 20,000 and the loss assessed is Rs 8,000 then in this case the proportion of the insured amount (15,000) to the actual value of the property at the time of loss (20,000) comes to 75 per cent. Hence, under an average policy a ratable proportion of loss is paid which is arrived at as follows :-

$$\text{Amount of claim} = \frac{\text{Insured amount}}{\text{Actual value of property}} \times \text{Actual loss}$$

$$= \frac{15{,}000}{20{,}000} \times \text{Rs. } 8{,}000$$

= Rs. 6,000

The effect of average clause is that the insured has to bear a rateable proportion of the loss where the value of goods at the outbreak of fire is greater than the sum insured. In the example given clause is inserted the insured has to bear Rs. 6,000 of the loss by himself on account of under insurance, which comes to Rs. 2,000. But if the insured amount is equal to the value of the property or more than that, it is not a case of under insurance and the insured could have recovered the entire loss of Rs 8,000.

1. **Floating Policy**: A floating policy is one which covers different kinds of goods lying in different localities and sites under one sum and for one premium. Such a policy is common in respect of goods lying in docks or warehouses and is taken by big manufacturers, traders, importers, exporters and industrialists whose goods and raw materials lie in different warehouses, godowns and localities. Since with every transaction of sale and export or fresh purchases and imports, the quantities of goods stored at different places may fluctuate from day to-day it becomes difficult for the owner to take a policy for a specific amount. Hence, the best way open for him is to take out a floating or fluctuating or variable policy for all the goods. Under such a policy the insurers fix the average rate of premium which is ascertained by taking into account the total premium that would have been paid if each lot of goods lying in different locations had been insured under specific policies for specific amounts. Then an average of the total on a percentage basis is found out. These rates are likely to be revised annually. Generally, a floating policy contains the “average clause”, which is meant to penalize the under insurance. Also it contains a “marine clause” which provides that if any goods are covered under marine insurance policy against fire, this policy becomes inoperative and the insured can recover the loss only under the marine insurance policy.

2. **Stock Declaration Policy:** a stock declaration policy is one that provides for an estimated sum insured, based on the maximum amount likely to be at risk during the year; the actual amounts at risk during the year are submitted, in periodic declarations, usually monthly declarations. Since insured has to submit periodic information in the declaration regarding the insured risk on the basis of which the policy is issued it is known as declaration policy. The normal form of fire policy is not suitable for covering stock-in-trade, where great fluctuations in the value at risk can

occur throughout the policy period. In such a case, if the businessman takes a policy of the maximum value of goods, they unnecessarily have to pay higher amount of premium. Contrarily, if they take out a policy for minimum amount of goods, much of their stock remains uncovered. To cover this situation, special declaration policies can be arranged. Under the declaration policy, the maximum value of the goods which the insured may hold at any time during the year is insured which sets the upper limit of the liability of the insurance company. 75 percent of the premium is paid provisionally. The insured must make periodic declaration, usually monthly, on a fixed date, regarding the value of stock at risk on that date. However, if the declaration is not made on the specified date, the maximum sum insured will be considered the declaration amount. At the end of the year, the average stock at risk is calculated and the final premium is based on that, with a refund or extra premium payable, as necessary, when compared with the provisional (75 per cent) payment. It is usually agreed upon that the maximum refund will not exceed one-third of provisional (75 percent) payment. The declaration policy contains an average clause which discourages under insurance. The amount of declaration offers scope for fraud, as the insured might under declare the clues of his stock in order to pay lower rates of premium. The insurance companies therefore, issue these policies to persons of reputation and integrity.

3. **Reinstatement Policy:** Under such a policy, the insurer undertakes to re-instate the asset or property destroyed. In other words, the insurer promises to pay the cost of the replacement of the property damaged or destroyed by fire. Thus the insurer, instead of paying cash, may reinstate or replace the property, effecting settlement of a “new for old” basis. The modes of discharge by the insurer are alternative and if the insurer elects one, he cannot afterwards change the other. If, for instance, he offers to pay he cannot

subsequently claim in re-instate, and vice versa. In calculating the amount of claim, depreciation is not deducted from the original value of the asset. Replacement cost insurance is a departure from the principle of indemnity, ordinarily considered one of the essential ingredients of property insurance. Instead of collecting only the actual cash value of his property, the policyholder can recover the full replacement cost of his property with no deduction for depreciation. These policies are generally issued on buildings, plant and machinery and not on materials, stock or merchandise. Since the replacement cost insurance allows the policyholders to obtain new merchandise for old, the policy is also called “New Lamps for Old” policy or Replacement Policy”. Because of the moral hazard inherent in this type of transaction, this coverage is only sold to carefully collect insured. The policyholders can collect the replacement cost of his building only if he actually rebuilds it: many policies even require that the building be rebuilt on the same site. If the structure is not rebuilt, only the actual cash value of the property is paid. Thus, the payment on a reinstatement or replacement basis is made only after the expenditure has actually been incurred. The reinstatement insurance is subject to average, the basis of valuation for the purposes of average brings the cost of reinstatement.

In short, reinstatement or replacement policies were devised because under the ordinary fire policies the measure of indemnity is the market value of the subject matter damaged or destroyed (after taking into account depreciation also). Hence, the amount of indemnity is far less than the amount to be spent in reinstating or replacing the property damaged. But in the replacement or reinstatement policy the bases of settlement in the event of destruction is the cost of rebuilding the premises, or in respect of plant its replacement by similar machinery in a condition equal to but not better or more extensive than its condition when new.

Where the property is damaged, reinstatement means the repair of the damage and restoration of the damaged portion of the property to a condition substantially the same as but not better or more extensive than its condition when new.

4. **Consequential Loss Policy:** The purpose of this policy is to cover the loss which is consequent to the fire, intangible and considerable. In other words, the consequential loss policy covers loss of profits due to interruption of business after the outbreak of fire and the expenses of management. It is also called “Loss of Profits Policy”. The need of consequential loss policy arises because the ordinary fire policy covers only the physical loss or damage caused by fire. Hence, for a manufacturing or mercantile concern, a landlord, or any other businessman, this is not sufficient. In addition to the loss of physical property a businessman may also suffer a loss through the temporary suspension of his business activities and lack of production while the premises are being repaired or rebuilt or a alternative premises are sought after at fire. Many businesses such as bakeries and florists may also suffer losses due to a change in temperature or humidity, caused by fire damage due to heating or air conditioning equipment. To cover this risk, a businessman should buy consequential loss insurance. The consequential loss is separately calculated from the actual loss. Initially, a fixed percentage of the amount payable under the ordinary fire policy was paid to the insured as the amount of consequential loss. But it was found to be too inadequate and in recent years. More scientific methods have been evolved to find out the profit based on reduction of output and increased cost of working in maintaining the concern at its pre-fire level.

   Thus, the consequential loss insurance provides for the following: (i) any net profit lost. (ii) all standing charges like expenses that are still incurred during the period of disruption, such as salaries of officers and employees, payroll of the workers, loss or use of

premises while they are uninhabitable because of fire payment or rent, mortgage and outlays for taxes heat and electricity. (iii) Any necessary additional expenses incurred in minimising the loss like extra clerical help in re-writing records, renting expensive lodgings and temporary accommodation in a total, or a small store where rent, meals and laundry will cost much more than at home or factory, Business interruption insurance is a necessity for nearly all business. For many manufacturing establishments the loss due to suspension of operations may greatly exceed the loss due to physical destruction of the property. The two most important policies sold to manufacturing and mercantile firms are Use and Occupancy insurance (U and O) and extra expenses insurance. Some business like newspapers, banks, public utilities, post office, drycleaners, oil companies, cooking gas companies etc. cannot afford to close down, even though a fire destroys their physical plant. Hence, business interruption insurance is not of much value to these concerns as the business is not interrupted but, since the cost of emergency operation from temporary accommodation may be unusually high, they may take Extra Expense Insurance. Extra Expense insurance provides for the cost of carrying on the business from provisional rented offices without the customary equipment on an emergency basis. Thus, companies whose income would not decrease in case of a fire but whose expenses would skyrocket need extra expense insurance. Consequential loss policies or loss of profit policies are very popular, though these were criticized as being a departure from the principle of indemnity, ordinarily considered one of the immutable ingredients of property insurance.

5. **Comprehensive Policy :** It has increasingly become the practice for insurers to grant policies which cover many or all of the perils like fire, explosion, bursting or overflowing of water tanks, apparatus or pipes, earthquake, flood hail storm impact damage by vehicles or animals or articles from the air including aircraft, riot and civil

commotion storm or tempest, spontaneous combustion, self-heating or fermentation subsidence and landslip subterranean fire, thunderbolt, strikes, burglary or house-breaking labour disturbances, public liability etc. Giving many forms of cover in one single policy provides much facility and more benefits to the policyholder who gets all risks covered in "All-in-policy" or "All Insurance Policies". Besides, these policies are also beneficial to the insured and are a source of income or additional premium. Such combined policies may be found both with commercial premises; such as a trader's combined policy, and private dwellings, in the householder's or house-owner's policy. This type of policy is so popular in England that both the fire policy and the burglary policy for private premises have virtually disappeared as separate documents. It should, however, be remembered that the comprehensive policy does not cover each and every risk. Indeed, the policy contains many exclusions and limitations which should be carefully considered.

6. **Excess policy:** An excess policy is one which covers the insured against certain hazards, which applies only to loss or damage in excess of a stated amount. Generally, a businessman covers his stock under one specific policy. But when the stock of the merchant fluctuates from time to time it creates a problem as to what should be the sum for which the policy should be taken. If the policy is taken for the maximum amount, up to which his stock may go, he might be unnecessarily put to the burden of paying the premium. But, if he takes a policy of less value he might not be fully covered. In such a situation, therefore, he might take two policy's one policy for an amount below which his stocks do not fall (this can be found out from his past experience) and another policy will be taken to cover the maximum additional amount by which the stock may rise at times. The first policy is called the "First Loss Policy" and the second "Excess Policy". Thus, an excess policy is one which covers the insured against certain hazards which applies

only to loss or damage in excess of a stated amount. For instance, if a merchant's stock.varies between Rs. 20,000 and Rs 25,000 he may take the first Loss Policy for Rs 20,000 and an excess Policy Prof Rs 5,000 (the balance) Like a declaration policy the actual value of excess stock is to be declared every month. On the basis of these periods declarations the average amount of risk and the amount of premium are calculated. Usually the policy contains an average clause. If the amount of excess stock is more than what has been mentioned in the excess policy, it cannot be recovered from the insurance company. Since the probability of the insurer being called upon to pay a loss under an excess policy is remote, the premium rates are always lower than the rates of First Loss Policy.

7. **Sprinkler Leakage Policy :** In Industrially advanced countries an effective fire-fighting equipment, known as sprinkler system is installed in the buildings which automatically operates when ire breaks out. The installation or sprinkler entitle the insured firm to earn a substantial premium discount. As the name suggests, this comprises a net-work of sprinkler valves, invariably set in the roof or ceiling, which operate automatically and throw a shower of water on he surface when a certain abnormally high temperature is reached. At the same time, it rings a warning bell. Sometimes, the sprinkler system operates automatically or the water leaks out accidentally which causes considerable damage to the building or the goods lying in the building. Thus, in order to cover such losses, a sprinkler leakage policy can be arranged. There are a number of exclusions to such a policy, particularly if the system operates through the neglect of the insured or if in the normal course of a fire the insured fails to take all possible precautionary measure, the insurer will not be responsible. The insured is also expected to keep the apparatus for sprinkling water in order to prevent it from being damaged. It should however, be remembered that

sprinkler leakage policy is quite separate from the standard form of other policies covering the insured premises.

8. **Adjustable Policy :** An adjustable policy covers the risk in respect of goods for a period of twelve months at the full annual premium for the amount of existing stock a risk and allows for a prorata adjustment of premium at any time. The adjustable policy is a contract limited to merchandise or stock-in-trade other than farming stock. A notice of adjustment by the insured and its acceptance by the insured are essential conditions of adjustable policy. The amount of premium is determined in the ordinary manner and is paid in full and at the inception of the policy. When there is variation in the value of stock, the same is informed by the insured to the insurer. On receiving this information, a suitable endorsement on the policy, is made and the premium is adjusted on pro rata basis. The premiums are adjusted on the expiry of the policy term. In certain respects, adjustable policy is similar to declaration policy but the main difference between the two is that in case of declaration policy, the liability of the insured is limited to the insured amount and the periodical declarations have no relation with the measure of indemnity. However, in an adjustable policy the liability of the insured is limited to the value of last declaration made by the insured. The declaration policies, therefore, provide a good margin of safety. Even if the insured takes a policy of unusually inflated price, the final premium payable by him will not be affected and he will get a refund of premium. Contrarily the premium is payable on the actual of declaration. Suppose, a merchant takes a declaration policy on his stock for Rs, 50,000 on 1st January; On 1st April he makes a declaration for Rs 35,000 On 15th April, the stock is destroyed by fire and the loss is estimated at Rs 45,000 In this case, the insured can recover full loss loss of Rs. 45,000 from the insurance company, after giving an explanation of declaring low value of his stock (35,000) just before 15 days of the outbreak of

fire. Under an adjustable policy, the insured can recover the amount of the last declaration in this case being Rs 35.000.

As already stated, the amount of premium in an adjustable policy is determinein the ordinary manner and is adjusted at the expiry of the policy term, consider, for example, a merchant whose goods fluctuate as under : First three months Rs. 40,000 next six months Rs. 50,000 and last three months Rs. 25,000. In this case, the average annual premium would be calculated as under :-

Since the value of goods in the beginning of the year was Rs. 40,000 (first three months), so premium will be charged on this amount for 12 months. Then, in the next six months the value of goods was Rs. 50,000 i.e. Rs. 10,000 more than Rs 40,000. Hence ½ (6 months) of Rs 10, 000, which comes to Rs. 5,000 will be added to Rs 40,000 = 45,000. For the last three months the value being 25,000 hence, pro rata adjustment will be made ¼ (3 months) of 15,000 (40.000 – 25,000) = 3,750. This amount will be deducted from Rs. 45,000 (Rs. 45,000 – 3,750) = 41,250, If the rate of premium is : First three months ½ of annual premium, Next six months ¾ of annual premium and Last three months ½ of annual premium, then the average annual premium on Rs. 41,250 will be payable (0.5 + 0.75 - 0.5) = 1.75 divided by 3 = 0.58 percent of annual premium on Rs. 41,250.

9. Maximum Value with Discount Policy : Under such a policy the insurance is taken for the maximum amount of the stock of the year and the full premium is paid. No periodic adjustments or declarations are to be made. At end of the policy term, one third of the premium is refunded in the form of discount to the insured in consideration for variations in the value of the goods. This method does away with the botheration of declarations and serves as a rough and ready made method of coverage for maximum amount at risk. However it is confined to certain types of commodities

according to customs of the trade and it is an arbitrary method of coverage for the maximum amount. The amount refunded by way of discount by the insurer is not based on any scientific principle and as such, it may be inequitable to any of the parties.

10. **Blanket Policy :** Blanket policy is issued to cover several different properties or all assets fixed as well as current of the insured under one insurance. In other words, it is a policy which covers more than one type of property in one location or one or more type of property at several locations. For example, a businessman may have a blanket policy to insure a building and its contents at one location, or any insure furniture, flxtures, and stock in two or more buildings under a blanket policy. Hence, this policy covers all contents in one insurance without the customary divisions between fixed assets (building, machinery, furniture) as well as current assets (stock), without regard to separate building. The only condition is that all goods to be insured must belong to the one and the same insured. Such policies are not very common and are neither beneficial to the insured not to the insurer.

11. **Rent Policy :** Rent insurance policy protects the building owners against the loss of rent. In the event that a tenant does not pay rent because of fire, the insurance company will pay such loss. Such an insurance may constitute a separate policy, or can be included within other forms of cover and may be effected either by the owner, or by the tenant, or by an owner-occupier. If the tenant is not obliged to continue payments as the premises are uninhabitable because of fire, the owner can claim rent. Also, if the obligation of the tenant to pay rent does not cease in the event of a fire or if his tenancy agreement requires such insurance, he can take this policy. Likewise, in the event of fire, the owner-occupier would be required to pay for alternative accommodation during the period of repairs and reinstatement, so he can also take a rent policy.

12. Transit Policy : A transit policy covers goods in course of transit from one place to another by rail, road, air or sea transports. Under this policy the insurance company promises to make up for the loss or damage to merchandise while it is being moved.

13. Builder's risk insurance : Builder's risk insurance policies are also issued by fire insurance companies to protect against loss to buildings including machinery and equipment, in course of construction, and to materials incidental to construction. With the value of the construction changing during the building process, a fixed amount policy would not properly cover the risk. This type of insurance may be written on a reporting form or on a certificate of work completed. This policy is also known as contractors' all risks or contract works risks policy.



CHECK YOUR PROGRESS

Q1. Define fire insurance

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Q2. Fill in the blanks:

i. These willful and unlawful acts of setting one's own property to fire with an evil purpose are known as ----------.

ii. In India, fire insurance business was developed by the ----------

iii. ----------covers the insured against certain hazards, which applies only to loss or damage in excess of a stated amount.

5.5 PRODEDURE OF RECOVERING FIRE INSURANCE CLAIM

When the subject-matter of insurance is lost or damaged after the outbreak of fire, the insured victim looks towards the insurance company for the timely help and for rehabilitating himself. The following procedure is adopted in order to register and recover the fire insurance claim from the insurer on the occurrence of a loss or damage by fire : (1) Notice of loss (2) Evidence of loss. (3) Police Report in case of arson. (4) formal statement of claim (5) Inspection of loss (6) Ascertainment of loss (7) Application of average clause (8) Estimation of claim when more than one fire take place. (9) Estimation of claim when property is insured with more than two insurers. (10) Estimation of claim when books and records are destroyed. (11) Payment in accordance with the terms of the policy (12) Rejection of claim under certain circumstances (13) Settlement of claim when the property is insured with more than one insurer.

1. **Notice of Loss :** It is obvious that the insurers cannot be liable to meet a claim unless they receive a notices of that claim. Hence, immediately after the occurrence of a fire, the insured must give notice of loss to the insurance company so that the informal claim is registered. Early notification is necessary so that insurers may make whatever preliminary investigations they may deem expedient. This communication must be sent to the company immediately after the loss or as soon as the circumstances permit. But sooner the information is sent, the better. Delay of any kind may seriously prejudice the position of the policyholder and may reduce the chance or recovery from any negligent party as enquiries were not put in hand due to delays.

2. **Evidence of Loss :** The notice of loss must be accompanied, if possible, by the evidence of loss, the time, place and circumstance under which the loss occurred. He must also mentioned that the

loss has been sustained by the insured peril and the role played by him to mitigate the loss. In order to claim the insured money, the insured must have taken all possible steps as are within his powers to mitigate the loss. The duty of providing full particulars and proof of loss rest entirely upon the insured.

3. **Police Report in case of arson :** If the loss or damage due to five is caused by arson (i.e. act of setting something on fire intentionally and unlawfully) by some known person, the matter should at once be reported to the nearest police station. Even if there is a slightest suspicion of anybody's involvement in this arson. The same should also be included in the report. A copy of the police report should also be sent to the company. If the fire-brigade was summoned, the fire brigade records will also be submitted.

4. **Formal Claim Form :** The insurance companies them0selves send a claims form on receipt of the notice of fire loss. This printed form is sent to the insured with the request that the same should be submitted along with the maximum possible details and evidences so that the insurer is able to determine his liability towards his claim. The form contains all possible details of the property lost or damaged, the market value of the property lost or damaged, the time place and circumstances under which the loss occurred. Sometimes, the insurer requires the insured to send an affidavit in support of the claim along with other evidences of the loss. However, reputable insurers allow a liberal interoretation of what constitutes a proof and unless there are reasons for suspecting the honesty and integrity of the insured the insurer will never insist on technicalities. If the amount claimed is small and the company considers it reasonable, it is more than probable that the insurer will admit the claim and send the cheque in full settlement without further enquiry. Nothing creates a better impression upon the policyholder than prompt settlement of claims. It rather helps to counteract the popular misconception that insurance companies

usually avoid the payment of claims or try to reduce the claims money. But if the claims are for large sums, a through investigation will be made.

5. **Inspection of Loss :** If the claim form shows a serious claim (heavy loss or the damage is large) the company on the receipt of the intimation of fire will have the loss or damage inspected by its authorized expert and specialized staff, known as “assessors” or “surveyors” or “valuers” who have the right of entry and inspect the place and property. The negotiation will naturally take place over a period of time. The assessors get the value of the loss computed and are employed by the insurers to adjust claims in fire insurance. These assessors or valuers inspect the damaged subject-matter of insurance at the scene of fire and contact the insured, his neighbours, employees, and other persons connected with the fire scene, and collect the desired information. This investigation enables the assessors to have an idea of the nature, and extent of loss and origin and causes of fire. They also prepare a detailed item-wise list of the subject-matter left at the scene of fire and get it attested by the insured in order to avoid any attempt of exaggerated claim by the insured at some later stage. Besides, the assessors also carry out salvage operations. I.e. the wreckage of the subject-matter of insurance having some scrap or salvage value, will be taken into account to reduce the net cost of the claim. If the insured agrees to retain the salvage, an appropriate sum is deducted from the claim payment. The damaged and undamaged goods will be separted in order to prevent any further loss taking place.

6. **Ascertainment of Loss :** Having inspected the site of loss and collected the relevant evidences, the assessors will now determine the liability and ascertain the total extent of loss. In determining the liability of the insurer the assessor has to take into account a number of factors, such as (a) the time of the outbreak of fire.

This is an important consideration as no liability attaches if the fire takes place before the commencement of risk or after the expiry of the policy. (b) the number of policies on the same subject-matter, inorder to distinguish the concurrent insurances from non-concurrent insurance and apportion the amount of loss (c) the real cause of fire as it directly affects the liability of the insurer. For this purpose, the assessor may interview all persons and witnesses connected with fire, study the police report, fire-brigade report. Or newspaper reports of the fire incident, (d) Now the assessor is in a position to calculate the final loss in accordance with the policy conditions. The amount of compensation is to be paid within the framework of the principle of indemnity, except in cases of valued policy, replacement policy, consequential loss policy, or any other policy issued by waiving the indemnity principle. However, the amount so determined cannot exceed the insured value. If, however, the insurer and the insured fail to agree upon various points concerning loss, the matter is referred to the arbitrator.

7. **Application of Average Clause :** In ascertaining the extent of the actual loss, the assessors have to see if the policy is subject to an average clause. (In India all fire policies are subject to average clause). The presence of average clause in the policy requires the valuation of the undamaged property also. These amounts are usually determined by mutual agreement between the insurer and the insured. This clause is inserted to penalize under insurance by a corresponding underpayment (pro rata) of loss. For the purpose of loss. For the purpose of loss, fire policies are divided into average policies and non-average policies and both of them are further sub-divided into (a) concurrent policies which cover exactly the same kind of subject matter is exactly the same situation and (b) non-concurrent policies which do not cover exactly the same kind of subject-matter in exactly the same situation. It is to be noted that if one of the several concurrent or non-concurrent policies is

subject to average, there is invariably a condition in other policies worded in such a manner as to make all of then average policies. Hence, in an average policy the insurance company will be called upon to pay only such proportion of the loss as the sum insured bears to the total value of the property. For instance, if the property valued at Rs. 20,000 at the time of loss has been insured for Rs. 12,000 only then on a loss of Rs 12,000 taking place, the insurance company will pay only

$$\text{Rs. } \frac{12{,}000}{20{,}000} \times 12{,}000 = \text{Rs. } 7{,}200$$

In the absence of the average clause, the assessor will determine the liability at Rs 12,000.

8. **Estimation of claim when more than one fire take place :** When more than one fire take place during the currency of one five insurance policy, i.e. one fire takes place in January and the other in march, still a third in June, of the same year, then in such a case, the insurer will pay in the aggregate a sum upto the original amount of insurance. Nothing more than the amximum amount insured will be paid. Suppose, a policy of Rs. 10,000 is obtained on a building valuing at Rs 30,000 which catches a series of fires and the loss is estimated at Rs. 15,000 in the first fire, Rs. 12,000 in the second fire and Rs. 3,000 in the third fire. In such a case, the insurance company will pay only Rs. 10,000 (sum insured) in settlement of all the three fires as follows :-

$$\text{First fire } \frac{10{,}000}{30{,}000} \times 15{,}000 \text{ (loss)} = \text{Rs } 5{,}000$$

$$\text{Second fire } \frac{10{,}000}{30{,}000} \times 12{,}000 \text{ (loss)} = \text{Rs } 4{,}000$$

$$\text{First fire} \quad \frac{10{,}000}{30{,}000} \times 3{,}000 \text{ (loss)} = \text{Rs } 1{,}000$$

Total Claims Rs. 10,000

But if the insured has, after the happening of the first fire, paid an extra premium, and a further extra premium after the second fire, then the insurer will cover to the full extent of the risk second or third time.

9. Estimation of claim when property is insured with more than two insurers : Sometimes a property damaged or destroyed by fire is insured with two or more than two offices (double insurance), then in such a case the claim is settled by the application of the contribution clause in the policy, i.e. the liability of the insurer is limited to its rateable proportion. Thus, in such a situation each office will pay a rateable proportion of the loss. For instance, if a building is insured with X co. for Rs 10,000 with Y co. for Rs 8,000 and with Z co. for Rs 2,000 then of the actual loss X co. will pay ½ (10,000/20,000), Y Co. (2/5 (8,000/20,000), Z co. 1/10 (2,000/20,000) The insurer can claim the loss of 20,000 from any insurer in any order he likes but the co-insurers will make adjustments among themselves in such a manner that the above proportion is shared. Also, if any policy contains an average clause, then it will be applicable to all other policies. Thus, this rateable proportion is affected by the average clause. If average and contribution clauses apply simultaneously the average clause is applied first to ascertain the liability and then the contribution clause is applied. But in case where the total loss of each policy exceeds the amount of each policy, the contribution clause has no effect whether the policy is subject to average or not. In such case, each policy will pay its full liability.

10. Estimation of claim when account books and records are

destroyed : Sometimes, When the loss is due to fire, involves extensive damage and destruction of all the account books and records of stock and stores, then in such a case neither the value of the loss can be easily determined nor the claim is estimated. Generally the practice is to estimate the stock and to value the loss and claim by constructing an estimated Trading and Profit and Loss Account for the period of interval from the date of last account till the date of fire. The value of the opening stock of the estimated Trading Account is known with the help of the closing stock of the last balance sheet. Credit purchases are verified by the creditors directly and the cash purchases are interpolated on the basis of past records (Past ration or cash to credit purchases). Likewise, cash and credit sales are found out. Other things remaining the same, the past ratio of gross profit to sales is applied to current year also and the gross profit is estimated. With the help of these available figures [Opening stock which is the closing stock of last year, purchases (cash plus credit), sales (cash plus credit) and the ratio of gross profit to sales), the balancing figure of the credit side is known and is the estimated value of stock and stores as on the date of loss or damage. On the basis of this the assessor will assess the amount of loss and settle the matter with the insured.

11. **Payment of claim :** After the ascertainment of actual loss by the assessors, he will sell the salbage at the price obtainable, and settle the claim amicably. The assessor will take a declaration from the insured regarding his acceptance of claim money in full and final settlement of his claim. This declaration and assessor's final and comprehensive report are sent to the insurance company, which verify that all the warranties have been fully complied with then finally, the insurance company will settle the claim in accordance with the terms of the policy. Here are four basic ways in which claims may be settled : (a) Cash payment (b)

Replacement of insured property (c) Repair of insured property, (d) Reinstatement. The basic principle which applies in this respect is the principle of indemnity. The fee of the assessor is paid by the insurer but the insured has to bear the cost incurred in the preparation of his claim and documents.

12. **Rejection of claim:** Under certain circumstances, the insurance company rejects the claims. These reasons of rejection will differ from case to case but the following are common reasons of rejection: (1) When no insurable interest exists at the time of loss or at the time of taking out a policy (2) When the principle of good faith is not observed and the claim is fraudulent. (3) When the loss has arisen out of an "excepted peril" or "perils excluded" (4) When the loss was not caused directly and proximately through one of the perils insured against. (5) The loss occurred due to any defect in the insured property not disclosed at the time of insurance. (6) When the insured has not played an active role in mitigating the loss at the time of fire (7) When the policy conditions and warranties have not been fully complied with. It should however, be remembered that the report of the assessor is usually final and it cannot be called in one question by the insurer or the insured.

13. **Ex Gratia payment :** Sometimes, the insurance company does not think itself legally obligated to pay or regards it as a moral obligation on its part to make good the loss due to some technical ground and remove the hardships of the insured or to prevent and even larger expense of defending itself in the courts. In such a situation, they do not always take a purely legalistic view and hardly avoid the payment of claim. Such payments are called "ex-gratia payments" which denote an act of grace. In other words, an ex-gratia claim payment "is a payment, either in full or in part, where there was no legal obligation on the insurer to make such a payment. It is a payment, therefore, out of grace (or favour) and not out of obligation". In other words, it is a payment made where

no legal obligation to pay exists. As such, it has the nature of a gift, which acquires no legal rights. It is to be noted that ex-gratia payments should not be made liberally but only in extraordinary circumstances as these payments will affect the profits of the company. However, in various occasions the insurance company feels that there are good sympathetic or commercial ground (not legal grounds) where it is expedient to go out of the way to help the insured and to remove his hardships. Some of the occasion when there are strong ground for making the ex-gratia payment are : (a) A breach of warranty or policy condition, though, it gives the insurance company a right to refuse any payment of compensation, yet this is too much or may be a little "harsh." (b) A wider interpretation of claim is itself is a good advertisement and provides solace to the policyholders who might be placed in the similar circumstances. (c) Outright rejection of the claim might bring negative goodwill of the firm and night lead to a substantial loss of business. Likewise, there are various strong grounds for non-payment of exgratia payments such as the payments without obligations will unnecessarily increase the premium rates, the loss which does not come within the purview of the policy should be rejected and night create a tendency amongst the policyholders to claim something. Even if it is a clear case to be rejected or refused. In short, though these payments involve some cost, yet they keep the reputation of the company as a fair" and "Generous" as against "uncompromising" and "harsh" in the insurance market. The liberal interpretation of claims serves as a sort of self-advertisement and enhances the goodwill of the company and provides comfort to other policyholders. However, the "too ready to make payments" attitude of the company should not set an unfortunate precedent and raise the expectations of each and every policyholder to get something irrespective of the policy conditions and warranties.



CHECK YOUR PROGRESS

Q3. Mention the steps for recovering fire insurance claim.

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5.6 LET US SUM UP

In this unit we have discussed about the following:

- Fire insurance is a kind of guarantee against losses caused by fire.
- There are two main causes of fire wastes, namely- physical hazards and moral hazards.
- In order to minimize the fire hazards, the insurance companies employ skilled officials, known as fire surveyors, who inspect the risks insured or offered for insurance and to make suggestions.
- The four main types of fire policies are:

  (1) Valued policy

  (2) Specific Policy

  (3) Average Policy and

  (4) Floating Policy.

- The following procedure is adopted in order to register and recover the fire insurance claim from the insurer on the occurrence of a loss or damage by fire : (1) Notice of loss (2)

Evidence of loss. (3) Police Report in case of arson. (4) formal statement of claim (5) Inspection of loss (6) Ascertainment of loss (7) Application of average clause (8) Estimation of claim when more than one fire take place. (9) Estimation of claim when property is insured with more than two insurers. (10) Estimation of claim when books and records are destroyed. (11) Payment in accordance with the terms of the policy (12) Rejection of claim under certain circumstances (13) Settlement of claim when the property is insured with more than one insurer.



5.7 FURTHER READING

1) Mishra, M. N., Mishra, S. B. (2005); *Insurance Principles and Practice*; S. Chand Publisher.
2) Tripathy, Nalini Prava, Pal, Prabir (2009); *Insurance : Theory And Practice*, Phi Learning Pvt. Ltd.



5.8 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1 : Section 2 (64) of the Insurance Act defines fire insurance as follows : "Fire insurance business means the business of effecting otherwise than incidentally to some other class of business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance policies."

Ans. to Q. No. 2 : (i) incendiarism, (ii) British entrepreneurs, (iii) excess policy

Ans. to Q. No. 3 : 1) Notice of loss (2) Evidence of loss. (3) Police Report in case of arson. (4) formal statement of claim (5) Inspection of loss (6) Ascertainment of loss (7) Application of average clause

(8) Estimation of claim when more than one fire take place. (9) Estimation of claim when property is insured with more than two insurers. (10) Estimation of claim when books and records are destroyed. (11) Payment in accordance with the terms of the policy (12) Rejection of claim under certain circumstances (13) Settlement of claim when the property is insured with more than one insurer.



5.9 MODEL QUESTIONS

1. Explain different kinds of fire insurance policies.
2. Describe in brief, how fire insurance can be claimed?
3. Write short notes on the following:
   (a) Causes of fire
   (b) Fire prevention
   (c) Functions of fire insurance

UNIT 6: MARINE INSURANCE

UNIT STRUCTURE

6.1 Learning Objectives

6.2 Introduction

6.3 Defining Marine Insurance

6.4 Marine Insurance Contract

6.5 Insurance of Property

6.6 Difference Between Fire and marine Insurance

6.7 Kinds of Marine Insurance Policies

6.8 Types of Marine Losses

6.8.1 Total Loss

6.8.2 Partial Loss

6.9 Let Us Sum Up

6.10 Further Readings

6.11 Answer to Check Your Progress

6.12 Model Questions

6.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- explain Marine Insurance
- describe marine insurance contract
- state the difference between fire and marine insurance
- explain the meaning of marine insurance policies
- discuss the various types of marine losses

6.2 INTRODUCTION

In the earlier unit we have discussed life and fire insurance. In this unit we are going to discuss marine insurance, marine insurance contract, insurance of property and Marine Insurance Act 1963.

Marine insurance is the oldest form of insurance business. Its history has been linked closely with that of navigation and of trade, the development

of them often having gone hand in hand. In the absence of marine insurance, the progress in commerce and international trade would have been seriously affected.

At the end of this unit you will get a fair idea on the difference between fire insurance and marine insurance also you will come to know about the kinds of marine policies and the various types of marine losses.

6.3 DEFINING MARINE INSURANCE

Marine insurance is a device to secure protection from loss or damage to property while in shipment. The insured finds his interest (in the property on the ship or cargo freight) protected from many risks of overseas transport. Such risks include collision, burning and sinking of the ship, spoilage of the cargo from sea water, mutiny, piracy or willful destruction of the ship and cargo by the master (captain) of the ship or the crew.

There are two major branches of marine insurance: (a) Ocean marine insurance and (b) Inland marine insurance. The ocean marine insurance covers ships, cargoes and freight of both ocean going and inland ships while inland marine insurance is written to insure three broad types of business, namely, domestic shipments, instrumentalities of transport and communication, and property floater policies.

Through effecting a marine insurance policy (ocean marine or inland marine) the insurer agrees to compensate the owner of a ship or cargo against complete or partial loss or destruction at sea or at any place specified in the policy in return of the premium. Marine insurance in this country is regulated by Marine Insurance Act, 1963, which came into force on 1st august, 1963. Prior to this, this business was regulated by the English marine Insurance Act, 1906 as well as the Common Law to the extent it was not violative of the provisions of the Act.

6.4 MARINE INSURANCE CONTRACT

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured in the manner and to the extent thereby

agreed, against marine losses, that is to say, losses incidental to marine insurance. Marine insurance contract may also be defined as a contract by which the insurer promises to compensate the insured for all losses incidental to marine adventure, that may be sustained by the subject-matter insured. The insured undertakes to pay a certain sum of money called the premium in consideration of the insurer's guarantee to make good the losses arising from certain specific perils which may include "perils of the sea" as well as any land risks incidental to a sea voyage. The contract is embodied in a document called the Marine policy. The insurer is often called "the underwriter" and the contingency insured against is referred to as "the risk".

The term "maritime adventure" includes the following : (a) any insurable property exposed to maritime perils, (b) The earnings or acquisition of any freight passage money, commission, profit or other pecuniary benefit or the security for any advances, loans or disbursements are endangered by the exposure of property to maritime perils and (c) Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for insurable property by reason of maritime perils. Maritime perils are consequent on, or incidental to the navigation of the sea, that is to say, perils of the seas, fire, war perils pirates rovers, thefts, captures, seizures, restrainst and detainments of princes and people, jettisons, barratry and other perils which are of the like kind or may be designated by the policy.

As in the case of every type of insurance a contract of marine insurance is embodied in a policy and must specify the following: (a) The name of the assured or of some person who affects the insurance on his behalf (b) The subject-matter insured and the risks insured against. (c) The voyage, or period of time, or both as the case may be. (4) The sum insured (e) The name of the insurer. (f) The rate or amount of premium (g) The risk insured against etc. The contract is concluded when the proposal is accepted by the insurer and it is not essential for the company to issue policy for this purpose. The contact comes into force from the time the ship or covering note or other customary memorandum is issued, even if such instrument is unstamped. Insurance company may take some time to issue the policy.

6.5 INSURANCE OF PROPERTY

The insurance of property in marine insurance may be divided into three broad categories : (1) Hull or ship (2) Cargo or Goods (3) Freight or the cost of transporting the goods. In other words, the object of marine insurance policies may be to protect goods, ships, freight or any of the above from loss due to some perils insured against.

- **Hull Insurance:** Hull Insurance refers to the insurance of the actual ship or vessel and its machinery, as it moves from one port to another and is subject to the marine risks or perils of the sea. These policies are normally taken on an annual basis and cover all perils of the sea. The owners of the ship can, therefore, take out an insurance policy on their ships.
- **Cargo Insurance:** As the name cargo suggests, cargo insurance covers “goods carried in a ship” or merchandise carried by the ship”. In other words, when the goods or cargo to be carried from the port of departure to the port of destination forms the subject matter of insurance, it is called cargo insurance. Cargo insurance policies may be arranged for the duration of a voyage or as time policies or open policies or on other bases.
- **Freight Insurance:** The term “freight” means payment received for the transportation of goods. It is exactly equivalent in its field to the use of the word “fare” to describe payments made for the transportation of people. The freight interest is owned by the person who is operating the vessel. This person may be the owner of the ship or he may be the charterer of the vessel. Generally, the ship-owner and the freight received are one and the same person. Freight may be paid either in advance or on the arrival of the goods at the port of destination. If the freight is paid in advance, and the goods are lost, the freight received does not lose anything but the cargo owner will lose it. Hence, cargo owners usually insure it along with the goods by adding it to the value of the goods. If freight is to be paid on the port of destination, then according to marine law, it becomes payable only if the goods reach

the port of destination. In case they fail to reach destination on account of being lost in the way or any marine perils, the shipping company or the freight receiver loses freight. To protect itself against such a loss of freight, the freight receiver or the shipping company purchases a marine insurance policy. This is called “Freight Insurance”. Generally the freight receiver and the shipping company are one and the same company, and, therefore, the shipping company takes out a policy to cover the hull insurance and the freight insurance.

6.6 DIFFERENCE BETWEEN FIRE AND MARINE INSURANCE

Although the two classes of insurance are basically contracts of indemnity and are issued for a short period, say one year or for a specific voyage, the following comparison should be noted :-

FIRE INSURANCE	MARINE INSURANCE
1. Under a fire insurance policy, only the actual loss based on the market value of the property at the time it was destroyed by the fire or the amount insured whichever is less, is indemnified	1. Under a marine insurance policy the insured is also allowed a margin of expected profits, say, upto 10 to 15 per cent of the insured amount.
2. Insurable interest must exist at the time of taking out the policy as well as at the time of loss.	2. Insurable interest must exist only at the time of loss and need not Exist when the insurance is affected.
3. A fire policy can not be transferred without the permission of the insurance company	3. A marine policy can be freely transferred from one party to another.

6.7 KINDS OF MARINE INSURANCE POLICIES

There are various kinds of Marine Insurance Policies which are known by different names. Chief among them are : (1) Time Policy, (2) Voyage

Policy, (3) Mixed Policy, (4) Valued Policy. (5) Open or Unvalued Policy, (6) Floating Policy, (7) Block Policy (8) Named Policy, (9) Single Vessel and Fleet Policies, (10) Currency Policy (11) Blanket Policy, (12) Wagering or Honour Policy. The Marine Insurance Act deals with only the first six types of policies. Now we shall discuss the above types of policies in detail as below:

1. **Time Policy:** When the contract is for insuring a subject matter for a definite period of time irrespective of the number of voyages made the policy is called a "time policy" A time policy has nothing to do with the voyage of the ship. The ship may pursue any course it likes, the policy would cover all the risks from the perils of the sea for a stated period of time, say, "from noon 1st January, 1976, to noon 1st January 1977".
2. **Voyage Policy:** When the contract is to insure the subject matter at and from, or from one place to another or other as, e.g., Bombay to Karachi, or Calcutta to Tokyo or Madras to London, the policy is called a "Voyage Policy". Thus, a voyage policy is one by which the subject matter is insured on a specified voyage from the port of departure to the port of destination, the limits of the risk being defined by the places.
3. **Mixed policy:** A mixed policy combines the characteristics of a time policy and voyage policy. It insures the subject-matter from and to certain places between specified periods. In other words, it is a policy which covers the risk during a particular voyage for a specified period. Such a policy contains a contract for both voyage and time
6. **Valued Policy :** This is a policy in which is inserted the agreed value of the thing insured. In other words, it is a policy which specifies or expressly declares the agreed value of the subject-matter insured.
5. **Unvalued Policy :** An unvalued or open policy is the one in which the value of the subject-matter of insurance is not stated, but is left to be ascertained and proved later on when the loss occurs. In other words, unvalued policies leave the value of the loss to be subsequently decided subject to the limit of the sum insured, in case of loss. The value so left undecided is called. "Insurable value" and forms the basis of the measure of indemnity, when the loss occurs.

6. **Floating Policy:** This is a marine policy describing the insurance in general terms without starting the name of the ship. It, thus, mentions the amount for which the insurance is taken out, and leaves the name of the ship or ships and other particulars to be defined by subsequent declarations.
7. **Blanket Policy:** Like floating policy, a blanket policy covers several different properties or exposures under one form. And within the geographical and time limits instead of under separate items. It is taken for a certain amount but the premium is paid on the whole of it in the beginning of the policy and is re-adjusted at the end of the term of the policy in accordance with the actual amounts at risk as shown by the accounts and records of the insurance companies.
8. **Named Policy:** Named policy specifies the specific vessel by which the shipment is made. This policy differs from the floating policy only in respect of the declaration of the name of the ship. In a floating policy, the name of the ship is not specified at the time of taking out the policy but is declared afterwards when the shipment is made. But in a named policy the name of the vessel, by which shipment is made, is mentioned with the specified interest.
9. **Single Vessel and Fleet Policy:** When the owner of the vessels or ships insures his individual vessels separately, it is called “Single Vessel Policy”. But when an individual or a corporation insures whole fleet of liners or steamers under one policy, it is called a “Fleet Policy”.
10. **Block Policy:** Block Policy is a special type of marine insurance policy which covers all the property of the insured against most perils, including transportation. The interest is covered from the time of collection, through the land journey, and to the port of shipment and finally reaching the port of destination.
11. **Currency Policy:** A currency Policy is one which is issued in foreign currency. In other words, a currency policy specifies the sum insured and the value of the goods in foreign currencies such as pound sterling, dollar, francs, yen, rubles, mark, bats tika etc.

12. **Wagering Policy:** A wager policy is one which does not have any evidence that the insured has any insurable interest in the subject matter of insurance or in which the underwriter dispenses with any proof of interest. Such policies are clearly indicated by such words as "policy Proof of interest" (PPI) or "Interest or No Interest" or other expressions of the same types, in order to make a clear distinction and to make the point clear, since these policies do not have any insurable interest these are void and nothing but the gambling contract. Hence, they are known as "Wager Policies" and cannot be enforced in a court of law.
13. **Interest Policy:** All policies which can be legally enforced are called "Interest Policies". In contradiction to the wagering policies, Interest policies are insurable and are not void but they are legally enforceable contracts.
14. **Composite Policy:** A policy underwritten by more than one underwriter is known as Composite Policy". But the liability of each underwriter is distinct and separate i.e. each underwriter is responsible for only that specified portion of the risk which has been underwritten by him.
15. **Port Risk Policy:** A port policy is that policy which covers the ship when it is anchored in a port. Thus, all losses or damages to the subject matter of insurance after the arrival of the ship on the port are covered during a certain period.
16. **Construction Builder's Risk Policy:** This type of policy is issued for the builders of the ships and is issued for a period exceeding one year. It covers risks of vessels during period of construction.



CHECK YOUR PROGRESS

Q 1: Define Marine Insurance

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Q 2: State any two differences between fire insurance and marine insurance.

i. .....

ii. .....

Q 3: What are the six types of marine insurance policies that deal with Marine Insurance Act, 1963?

a. .....

b. .....

c. .....

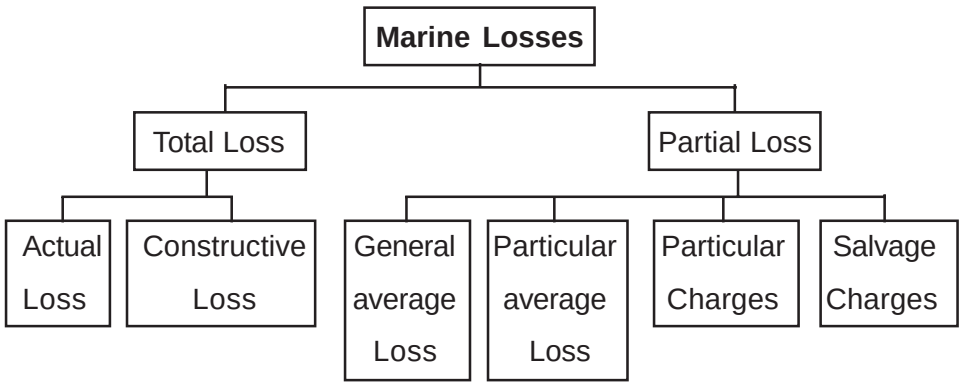
d. .....

e. .....

f. .....

6.8 TYPES OF MARINE LOSSES

Marine Losses may be divided into two broad classes: (1) Total Loss, and (2) partial Loss. Total loss may be further divided into : (a) Actual Total Loss, and (b) Construction Total Loss, Besides, partial losses may also be classified into : (a) Particular Average Loss, (b) particular charges, (c) General Average, and (d) Salvage Charges. Thus, a loss may be either total or partial. A loss other than a total loss is partial loss. Insurance can be taken to cover either total loss or partial loss or both.



We shall discuss the kind of total and partial losses in detail below, along with the procedure of making the claim.

6.8.1 Total Loss

The complete destroying or ruining of the property insured is known as "total loss". In other words, when the subject-matter insured or the goods are totally lost or completely destroyed there is total loss.

As already discussed, the total loss may be either actual total loss or constructive total loss.

A. Actual Total Loss : When the subject-matter insured is wholly destroyed or so damaged that it ceases to be a thing of the insured, or where the insured is irretrievably (which cannot be got or recovered or remedied again) deprived of the possession of the subject matter it is called actual total loss. The loss is considered to be actual in four cases:

1. *Physical destruction of goods:* Where the subject-matter is actually destroyed or irreparably damaged, damaged, or lost completely.

2. *Alteration of species or kind:* Where the subject matter ceases to be a thing of the kind insured, or where it ceases to exist in specie.

3. *Irretrievable deprivation:* When the insured is deprived of the possession of the subject-matter which cannot be recovered or remedied again, it is known as irretrievable deprivation. An irretrievable subject matter cannot be restored to the insured.

4. *Lost by a decree of a Court:* Where the subject matter is lost to the owner by a decree of a court, in consequence of a peril insured against.

In all the above cases the total loss is said to be actual loss. In case of an actual total loss where the subject matter has ceased to be the kind insured the insured is entitled to the full amount of the total loss from the insurer.

B. Constructive Total Loss: A constructive total loss occurs when the ship or cargo is justifiably abandoned because its total

loss appears unavoidable or when the ship or the cargo is so damaged that it is commercially impossible to repair, recover or restore it to the original position, when saved. In particular, total loss is considered to be constructive in three cases.

1. *Deprivation of the possession:* Where the assured is deprived of the possession of his ship or goods by a peril insured against, and it is unlikely that he can recover the ship or goods, as the case may be or the cost of recovering the ship or goods would exceed their value when recovered.
2. *Huge costs of repairing the Vessel:* In the case of damage to a ship, by the perils insured against, where the cost or repairing the damage exceeds the value of the ship when repaired.
3. *Huge cost of repairing and forwarding the goods:* In the case of damage to goods, where the cost or repairing the damage and forwarding the goods to their destination exceeds their value on arrival.

6.8.2 Partial Loss

A loss under a marine insurance policy which does not either completely destroy or render worthless the insured property, is known as "partial Loss." Partial loss is divided into two main classes (1) particular Average Loss and (2) General Average Loss. Besides, two more terms are used, which are Particular charges, and Salvage charges. These have been discussed in detail.

A. **Particular Average Loss***:* Particular average loss is a loss which is borne by one of a number of carriers in marine insurance, such as partial loss of cargo, hull, or freight, falling entirely on the interest concerned. This means, primarily a loss suffered by the insured without benefit to or right of remuneration from others. A loss to be particular must fulfill four conditions: (1) The loss must be a partial loss, i.e. it should be of the part

of the subject matter or damage thereto or both. (2) Only a particular subject matter should have been lost or damaged. (3) The loss should be accidental and fortuitous and not intentional. (4) The loss should be proximately caused by a peril insured against. If al the above essential features are present, then there is a particular average loss. The loss may be on hull (ship) or on cargo or on freight.

B. General Average Loss: General average loss means a loss suffered through expenses voluntarily incurred and sacrifices intentionally made by a master of a ship of a part of a ship's cargo to preserve the rest from destruction. Since these losses are for the benefit of all, these losses and expenses must be shared proportionately by each of the interests involved as such ship-owner, cargo-owner, and freight-earner.



CHECK YOUR PROGRESS

Q 4: State True or False:

a. Freight refers to the cost of transporting the goods or the hire for the use of the vessel. (True or False)

b. Particular average loss is a loss which is borne by one of a number of carriers in marine insurance. (True or False)

c. A constructive total loss occurs when the ship or cargo is justifiably abandoned because its total loss appears avoidable. (True or False)

d. The underwriters are responsible to pay for the partial losses. (True or False)

e. A partial loss is technically called non-average. (True or False)

Q 5: What do you mean by Total Loss?

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6.9 LET US SUM UP

In this unit we have discussed about the following:

- Marine insurance is a device to secure protection from loss or damage to property while in shipment.
- A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured in the manner and to the extent thereby agreed, against marine losses, that is to say, losses incidental to marine insurance.
- The insurance of property in marine insurance may be divided into three broad categories: (1) Hull or ship (2) Cargo or Goods (3) Freight or the cost of transporting the goods.
- There are various kinds of Marine Insurance Policies which are known by different names. Chief among them are: Time Policy, Voyage Policy, Mixed Policy, Valued Policy, Open or Unvalued Policy, Floating Policy, Block Policy. Named Policy, Single Vessel and Fleet Policies, Currency Policy Blanket Policy, Wagering or Honour Policy. The Marine Insurance Act deals with only first six types of policies.
- Marine Losses may be divided into two broad classes: (1) Total Loss, and (2) partial Loss.



6.10 FURTHER READINGS

1) M. N. Mishra, S. B. Mishra, (2005) ; *Insurance Principles and Practice*; S. Chand Publisher

2) Nalini PravaTripathy, Prabir Pal, (2009); *Insurance: Theory And Practice*, Phi Learning Pvt. Ltd

3) Manas Tripathy, Simita Mishra, K. C. Mishra; (2009); *General Insurance Business Operations and Decision Making*;Cengage Learning India.



6.11 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: Marine insurance is a device to secure protection from loss or damage to property while in shipment.

Ans to Q No 2: The two differences between fire insurance and marine insurance are as follows:

1. **Fire Insurance:** Under fire insurance, policy only the actual loss based on the market value of the property at the time it was destroyed by the fire or the Amount insured whichever is less, Is indemnified

   Marine Insurance: Under a marine insurance policy the insured is also allowed a margin of expected profits, say, upto 10 to 15 per cent of the insured amount.

2. **Fire Insurance:** Insurable interest must exist at the time of taking out the policy as well as at the time of loss.

   Marine Insurance: Insurable interest must exist only at the time of loss and need not Exist when the insurance is affected.

Ans to Q No 3: a. Time Policy b. Voyage Policy c. Mixed Policy d. Valued Policy e. Open or Unvalued Policy f. Floating Policy,

Ans to Q No 4: a. True b. True c. False d. False e. False

Ans to Q No 5: The complete destroying or ruining of the property insured is known as Total Loss**.**



6.12 MODEL QUESTIONS

Q 1: Define Marine Insurance.

Q 2: Describe Marine Insurance Contract.

Q 3: Discuss the insurance of Property.

Q 4: Briefly discuss marine Insurance Act 1963.

Q 5: What are the differences between Fire Insurance and Marine Insurance?

Q 6: Discuss the various kinds of Marine Insurance Policies.

Q 7: What are the types of Marine Losses.

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UNIT 7: BANKING SECTORS

UNIT STRUCTURE

7.1 Learning Objectives

7.2 Introduction

7.3 Evolution and Meaning of Banking

7.4 Development of Banking In India

7.5 Corporate banking

7.6 Retail banking

7.7 International Banking

7.8 Rural banking

7.9 Let Us Sum Up

7.10 Further Readings

7.11 Answers to Check your Progress

7.12 Model Questions

7.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss the meaning of Banking
- explain the recent development in Banking sector in India
- describe corporate banking and retail banking
- describe international banking and
- describe rural banking

5.2 INTRODUCTION

In this unit we are going to discuss about Banking and its development in India. There is no agreement among the economists as to the origin of the word 'Bank'. Now, in the following sections we are going to discuss the meaning of 'Bank' and then after our discussion on the different aspects of banking in the end of this we will get as fair idea on the concept of different banking types i.e. corporate banking, retail banking, international banking and rural banking.

7.3 EVOLUTION AND MEANING OF BANKING

The origin of the word 'Bank' can be trace to a German word "Banck" which means joint stock fund. And from this word an Italian word "Banco" which means Heap of Money was coined.

But some believe that, the word "bank" is derived from a French word "Bancus" or "Banque" which means 'bench' where valuables are kept. But now-a-days the common people use the word "Bank" which is an English word that it means an institution accepting money as deposit for lending.

In India, the various banks are regulated by Reserve Bank of India and under the Banking Regulation Act, 1949, "banking company" may be defined as a company which transacts the business of banking in India [Section 5(c)]. So, from the above, we can say that, a bank is an institution which deals in money and credit.

According to Section 5 (1) (b) of Banking Regulation Act, 1949, "Banking means accepting for the purpose of lending or investment, of deposit of money from the public, repayable on demand or otherwise and withdrawal by cheques, draft, order or otherwise".

According to Section 5 (1) (c) of Banking Regulation Act, 1949 defines banking company as, "any company which transacts the business of banking in India".

We will understand banking in a better way by the following features:

a. *Deals in Money:* A bank is an institution that accepts deposits in terms of money from the public and helps them by offering loan in terms of money to the needy people.

b. *Deposits must be withdrawable:* The deposits (except fixed deposits) made by the public must be withdrawable by cheques, draft etc.

c. *Creation of credit:* The bank can create additional money and can lend loan to the needy people.

These are some of the features of banking.



CHECK YOUR PROGRESS

Q 1: Define 'Banking Company'

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Q 2: Fill in the blanks:

a. A bank is an institution that accepts ..... in terms of money.

b. The bank create additional ..... and can lend ..... to the needy people.

c. The deposits made by the public must be withdrawable by .....

7.4 DEVELOPMENT OF BANKING IN INDIA

Banking in India is a very old institution and it originated in the last decades of the 18th century. The oldest bank in existence in India is the State Bank of India, a government-owned bank that traces its origins back to June 1806 and that is the largest commercial bank in the country. . But the functions of banking had taken place effectively after the first decade of 20th century. "English Agency Houses" established by East India Company which was basically a trading firm, first dealt with carrying out with banking business as a part of their main business but because of their dual function and lack of capital they failed during the third decade of 18th century.

Then, East India Company in the first half of 19th century established the following three banks and these banks are known as "presidency Banks":

a. Bank of Bengal in 1809

b. Bank of Bombay in 1840

c. Bank of Madras in 1843

After India's independence in 1947, the Reserve Bank was nationalized and given broader powers. In 1969 the government nationalized the 14 largest commercial banks; the government nationalized another six in 1980.

Currently, India has 96 scheduled commercial banks (SCBs), 27 public sector banks, 31 private banks (these banks are with Government stakes); and 38 foreign banks. They have a combined network of over 53,000 branches and 17,000 ATMs. According to a report by ICRA Limited, a rating agency, the public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively.

The partition of India in 1947 had an adverse impact on the economies of Punjab and West Bengal, paralyzing banking activities these for months. The Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 conceived of an economy in which the state had some. This resulted into greater involvement of the state in different segments of the economy including banking and finance. The major steps to regulate banking included:

- In 1948, the Reserve Bank of India, India's central banking authority, was nationalized, and it became an institution owned by the Government of India.
- In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India."
- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

However, despite these provisions, control and regulations, banks in India except the State Bank of India, continued to be owned and operated by private persons. This changed with the nationalization of major banks in India on 19 July 1969.

In the early 1990s, the then Narasimha Rao government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as *New Generation tech-savvy banks*, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, Axis Bank (earlier

as UTI Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, revitalized the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks, and foreign banks.

7.5 CORPORATE BANKING

Corporate banking normally helps and gives financial assistance to the large corporate houses, both domestic and multinational and public sectors and government sector houses.

The following are the features of Corporate Banking:

a. They offer business current accounts
b. They make commercial loans
c. They participate in syndicated lending
d. They provide capital market services and corporate solutions.
e. They deal with very fewer borrowers and the account size is normally large.

The following are some of the services rendered by Corporate Banking:

a. They deal in working capital and term loans, project financing.
b. Cash management both short term and long term holdings of cash.
c. Financing export and import
d. Handling foreign currency



CHECK YOUR PROGRESS

Q 3: State True or False:

a. Corporate banking does not give financial assistance to the large corporate houses.(True or False)
b. “English Agency Houses” was established by East India Company.(True or False)
c. In 1979, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) .(True or False)
d. SCBs stands for scheduled commercial banks.(True or False)

7.6 RETAIL BANKING

It is the part of a bank's operations providing services at its branches for small account holders. It is a major form of commercial banking that mainly targets the consumers rather than corporate clients. Retail banking refers to banking in which it carries out transactions directly with consumers, rather than corporations or other banks. Services offered by retail banking include are savings and checking mortgages , accounts, personal loans, housing loans, consumption loans, educational loans, fixed deposit accounts, debit/credit cards and certificates of deposit (CDs). It is more of domestic than international. The bank accepts deposits and makes small loans.

The following are some of the characteristics of retail banking:

1. It targets large number of small customers
2. Its Various products
3. Use of different channels

So, from the above we got to know that, in retail banking large number of transactions is made with small values. Review committee

7.7 INTERNATIONAL BANKING

International banks are those which are operated in different countries. Their services are delivered for the benefit of the non-resident Indians, exporters, importers, tourists, foreign peoples etc. their registered office is situated in one country but they operate through branches in other countries. Their services include providing short term finance in foreign currency, handling letters of credit, arranging foreign currency credits, etc.

The following are some of the characteristics of International Banking:

1. It covers different geographical area
2. Risk both financial and political

The following are some of the services rendered by International Banking:

a. Remittance: Normally we understand remittance as "a payment of money sent to a person in another place". But in this sense, remittance is the service by which the bank makes funds from it customer at one

place to him and authorized by him at another place in India or abroad.

b. Export Credit: A credit opened by an importer with a bank in an exporter's country to finance an export operation (Credit means money available for a client to borrow)

c. International letter of Credit: A letter of credit is a commercial document of assured payment by which the applicant (buyer/importer) bank undertakes to make payment to the sellers on production of the document specified in the credit. And international letter of credit means it facilitates global commerce through the banking channels all over the world.

d. Beneficiary: The recipient of funds or other benefits

Bank Guarantee: There are two types of guarantee under bank guarantee they are finance guarantee and performance guarantee. Finance guarantee is where the bank guarantees the beneficiary certain amount on behalf of its customer who has a commercial relationship with the beneficiary. And performance guarantee is where the bank guarantees the performance of a contract of goods /service supplied under contract by its customer.

7.8 RURAL BANKING

In India, rural sector is the backbone of the Indian economy which gives over 40 % of the Gross National Product. But, it was felt that though 65% of India's population lives in villages, its banking penetration remain low. The banking reach in rural areas in India is uneven, and till 1955 "Sate Bank of India" came with Rs. 5 crores of rural credit and only 0.9 percent of total credit was provided by the banks. And due to which the farmers were not able to get equipped with fertilizers and modern machineries and equipment.

But then SBI settled this problem by setting a target of 400 branches in 5 years in different districts and sub-districts. In the year 1975, the Government of India constituted a "Working Group on rural Banks" headed by Mr. M Narasimhan. Its main aim was to provide institutional credit to rural people and they recommended the establishment of Regional Rural Banks. The Government of India then after some modification established the

Regional Rural Banks (RRB) under the “Regional Rural Bank ordinance 1975”.

The operations of RRBs are limited to one to five districts with homogeneity in agro-climatic condition. The basic objectives of RRB are as follows:

a. To provide cheap credit facilities to the farmers , small entrepreneurs, artisans etc
b. To speed up the growth of economic development of a particular region.
c. To educate them about the banking transactions and the various facilities offered by the banks
d. To increase employment opportunities by offering them with various credit facilities
e. To promote the entrepreneurs in the rural areas
f. To save the farmers and the poor people from the moneylenders



CHECK YOUR PROGRESS

Q 4: What do you mean by retail banking?

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Q 5: Name three services rendered by International Banking.

a. .....

b. .....

c. .....



7.9 LET US SUM UP

In this unit, we have discussed the concept and evolution of Bank. A bank is an institution which deals in money and credit. We have also got a fair idea on the development of bank in India. The oldest bank in existence in India is the State Bank of India, a government-owned bank that traces its origins back to June 1806 and that is the largest commercial bank in the

country. We also discussed the corporate banking, retail banking, international banking and rural banking. Corporate banking normally helps and gives financial assistance to the large corporate houses, both domestic and multinational, and public sectors and government sector houses. Retail banking refers to banking in which it carries out transactions directly with consumers, rather than corporations or other banks.



7.10 FURTHER READING

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3) Natarajan S. & Parameswaran R. (2006). *Indian banking*. New Delhi, S. chand & Co. Ltd.
4) Paul R.R. (2007). *Money banking & international trade.* , New Delhi, Kalyani Publishers



7.11 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: "Banking Company" may be defined as a company which transacts the business of banking in India.

Ans to Q No 2: a. deposits b. money, loan c. cheques

Ans to Q No 3: a. False b. True c. False d. True

Ans to Q No 4: Retail banking refers to banking in which it carries out transactions directly with consumers, rather than corporations or other banks.

Ans to Q No 5: The three services rendered by international banking are as follows:

a. Bank Guarantee b. International letter of Credit

c. Export Credit



7.12 MODEL QUESTIONS

Q 1: Discuss the evolution and development of banking in India?

Q 2: What o you mean by 'Banking'?

Q 3: What do you mean by Corporate Banking and also its features?

Q 4: Write short notes on:

a. Retail Banking

b. International Banking

Q 5: Define Rural Banks.

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UNIT 8: TYPES OF BANKS

UNIT STRUCTURE

8.1 Learning objectives

8.8 Introduction

8.3 Savings Bank

8.4 Commercial Banks

8.5 Regional Rural Banks (RRBs)

8.6 Investment Banks

8.7 Development Banks

8.8 Land Development Banks

8.9 Exchange Bank

8.10 Co-operative Banks

8.11 Export Import (EXIM) Bank of India

8.12 Let Us Sum Up

8.13 Answers to Cheek Your Progress

8.14 Model Questions

8.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- discuss about savings bank and commercial banks
- explain the Regional Rural Banks and its features
- explain the Investment Bank and Development Bank
- discuss the Land Development Bank and Exchange Bank
- explain the Co-operative Bank and Export Import Bank of India

8.2 INTRODUCTION

In the previous unit we have discussed about the meaning and development of banking sector in India.In this unit we will discuss about different types of banks that are operating in India. In present situation banking institutions has become an important part of the society. While walking or traveling you might have seen different banks like State Bank of India, Reserve Bank of India, IDBI Bank, ICICI Bank, NABARD, EXIM Bank, Assam Gramin

Vikash Bank etc. Though these all are bank, depending upon nature and functions they are different and classified into different categories. In this unit we will discuss about different types of banks operating in India.

8.3 SAVINGS BANK

Saving banks collect savings from poor and middle income people of the society. These banks are established to promote saving habit among the common public. All commercial banks in our country carry on the functions of savings bank. Indian Post also perform functions of savings bank. Depositors are allowed to withdraw money from their account. But, there are restrictions on the number of withdrawals to be made in a month.

8.4 COMMERCIAL BANKS

Commercial banks are those banks which perform all kinds of banking functions such as accepting deposits, advancing loan, providing agency services and general utility services . Among the functions rendered by commercial banks accepting deposit and lending money are the primary functions. Deposits mobilized by commercial banks are repayable on demand and commercial banks provide loans and advances for short period. Agency services provided by commercial banks include collection of bills, cheques, dividend, payment of bill, rent, premium etc. General utility services include issue of letter of credit, travelers' cheque, accepting valuables for safe custody etc. Besides all banking activities commercial banks perform the function of credit creation.

Commercial banks are profit making business firm dealing in money and credit. A commercial bank is like a reservoir in which surplus money of the households flow as savings. Money collected in the form of savings is given as loan against interest to businessmen and others who need them for investment or other productive uses.

Commercial banks in India are regulated by the Reserve Bank of India. For undertaking commercial banking business in India, whether it is Indian or foreign, public or private, a license from the Reserve Bank of India is required. RBI also supervises the commercial banks in order to ensure compliance of the regulatory policy framework.

8.5 REGIONAL RURAL BANKS (RRBs)

India is a vast country with large population living in rural areas. But, Indian banking system is not yet able to reach the rural areas in the country. With a view to extend banking service in rural areas of India, the government of India set up a new category of bank known as Regional Rural Banks in the year 1975. These banks have been established under the Regional Rural Bank Act of 1976. Prathama Bank is the first RRB, established on 2nd October 1975. RRBs came in to existence with the joint effort of the central government, state governments and commercial banks. Share capital of a Regional Rural Bank is contributed by the central government, state government and sponsored bank in the ratio of 50:15:35 respectively.

RRBs were established on the recommendation of the Narasimham Committee in order to provide access to low cost banking facility to the rural masses. RRBs operate in a much localized manner, the area of operation of the RRBs is limited to few districts in a state. The RRBs mobilise deposits primarily from rural or semi-urban areas and provide loans and advances mostly to small and marginal farmers, agricultural laborers, rural artisans and other segments of priority sector.

Besides doing primary banking business the RRBs give emphasis in providing credit to small and marginal farmers and agricultural labourers, whether individually or groups and to co-operative societies. The RRBs also grants loans and advances to artisans, small entrepreneurs, petty traders, commerce and industry or other productive activities.

In the year 1991 total numbers of RRBs stood at 196 operating in 518 districts across the country. But, after initiating the process of consolidation in the year 2005 the numbers of RRBs reduce to 61 as on 31st March 2013.

Features of RRBs

Though RRBs operates in a similar way as commercial banks, following features make it distinct from other banks. These features are:

a) The area of operation of a RRB is limited to a specific region comprising one or more districts in any state.

b) RRBs grant loans and advances to the economically weak section of

the society, particularly to the farmers, agricultural labourers, artisans, small entrepreneurs, petty traders etc.

c) The RRBs are allowed to pay interest 0.5 per cent more than other financial institutions on their term deposits.



CHECK YOUR PROGRESS

Q 1: Name two functions of a commercial bank.

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Q 2: Write two features of RRBs.

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8.6 INVESTMENT BANKS

Investment banks are organizations which assist business corporations and government bodies in raising capital through sales of shares, debentures, bonds and other securities. Nature of investment bank is completely different from other banks. They primarily act as middlemen between business corporations and investors.

Investment banks are classified as 'originators', 'underwriters' and 'retailers'. As originators they bring out new securities; as underwriters they underwrite the issues; and as retailers they sell the securities to the ultimate investors. Investment banks render highly useful services to the business world by providing long-term capital. Investment banks also give advice to the business corporations on issues relating to financing and mergers.

8.7 DEVELOPMENT BANKS

Development banks are specialized financial institutions. Such banks are generally established to cater the needs of a specific sector like agriculture, industry etc. Like other banking institutions these banks never accept deposit from public. They provide medium term and long term finance to the industrial houses. Besides providing financial assistance development banks provide consultancy services to corporate houses.

Development banks play a very important role in the process of industrial development. In India development banks are classified into following categories:

- **Industrial Development Banks:** These institutions cater the needs of industrial sector of the country by providing financial and technical services to various industrial houses. Examples of such institutions are Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), and Small Industries Development Bank of India (SIDBI) etc.
- **Agricultural Development Banks:** These institutions are helping the growth and development of agriculture sector by providing refinance and technical support to various institutions engaged with agricultural finance. National Bank for Agriculture & Rural Development (NABARD) is an example of such institution.
- **Export-Import Development Bank:** Export-Import Bank of India (EXIM Bank) is an example of Export-Import Development Bank. This bank work for promotion of Export-Import business in India.
- **Housing Development Banks:** These institutions cater housing need of the society by providing credit facility for purchasing of land and construction of houses. There are such institutions at national and state level. National Housing Bank (NHB) is a national level institution working for the development of housing sector in India.

Again, according to level of operation these banks can be classified as All India Development Banks and State Level Development Banks. Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), and Small Industries Development Bank of India (SIDBI), National Bank for Agriculture & Rural Development (NABARD), Export-Import Bank of India (EXIM Bank), National Housing Bank (NHB) etc. are the examples of All India Development Bank. These institutions operate throughout the country.

State Level Financial Corporation's (SFCs), State Industrial Development Corporations (SIDCs) are the examples of state level development organisations. These institutions operate all over the state in which they have been established.



CHECK YOUR PROGRESS

Q 3: What do you mean by a investment bank?

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Q 4: Give two examples of development banks.

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8.8 LAND DEVELOPMENT BANKS

Agriculturists need long term credit for making permanent improvement in land, for purchasing tools and equipments, repaying old debts etc. Land Development Banks fulfills the requirements of such long term credit need of farmers. The long term loans are granted against the security of immovable property such as land. Traditionally long term credit needs of farmers were met by money lenders who use to exploit the farmers. The Land Development Bank now known as Co-operative and Rural Development Banks (CARDBs) was established to help the Indian farmers. In India, the first cooperative land mortgage bank was established at Jhang in Punjab in 1920. But, effective beginning was made in Madras with the establishment of a Central Land Development Bank in 1929. Assam State Cooperative Agricultural & Rural Development Bank (ASCARD Bank) is also an example of Land Development Bank.

8.9 EXCHANGE BANK

Exchange banks are financial institutions, primarily associated with financing foreign trade. Exchange bank supply necessary foreign exchange for settlement of transactions in foreign trade. Now a days most of the commercial banks undertake the business of foreign trade. So, there is no such bank called exchange bank. Following are the various functions of an Exchange Bank:-

1. Remitting money from one country to another country,
2. Discounting of foreign bills,

3. Buying and selling of gold and silver, and
4. Helping import and export trade.

8.10 CO-OPERATIVE BANKS

Co-operative banks are established on the principle of co-operation. These banks provide short-term credit to farmers, artisans, petty traders and small business man. Co-operative banks accept all kinds of deposit from the public and make advances. We will discuss about Co-operative banks in Unit four.

8.11 EXPORT IMPORT (EXIM) BANK OF INDIA

The Export Import Bank of India was established on 1st January, 1982 under a separate Act of Parliament. In India it is the apex institution in the field of financing foreign trade. Primary function of EXIM bank is to assist and support development of such financial institutions which are associated with financing export and import. Following are the objectives of EXIM Bank of India:

- To ensure integrated and co-ordinate approach in solving the allied problems encountered by exporters in India.
- To pay specific attention on the exports of capital goods;
- Export projection;
- To facilitate and encourage joint ventures and export of technical services;
- To extend buyers' credit;
- To tap domestic and foreign markets for undertaking development and financial activities in the export sector.

Following are the functions performed by EXIM Bank of India

(a) Planning, promoting and developing exports and imports;
(b) Providing technical, administrative and managerial assistance for promotion, management and expansion of exports; and
(c) Undertaking market and investment surveys and techno-economic studies related to development of exports of goods and services.



CHECK YOUR PROGRESS

Q 5: Mention two functions of exchange bank.

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Q 6: Write two objectives of establishing EXIM Bank of India.

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8.12 LET US SUM UP

In this unit we have discused the following:

- Saving banks are established to promote saving habit among the common public.
- Accepting deposit and lending money are the primary functions performed by commercial banks.
- Regional Rural Banks were set up by the Government of India with a view to extend banking service in rural areas.
- Development banks are established to cater the needs of a specific sector like agriculture, industry etc.
- Primary function of EXIM Bank of India is to assist and support development of such financial institutions which are associated with financing of export and import.



8.13 FURTHER READING

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8.14 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: Accepting deposit and lending money are the two important functions performed by a commercial bank.

Ans to Q No 2: a) The area of operation of a RRB is limited to a specific region comprising one or more districts in a state.

b) RRBs grant loans and advances to the economically weak section of the society, particularly to the farmers, agricultural labourers, artisans, small entrepreneurs, petty traders etc.

Ans to Q No 3: Investment banks are organizations which assist business corporations and government bodies in raising capital through sales of shares, debentures, bonds.

Ans to Q No 4: Two examples of development banks are Industrial Development Bank of India(IDBI), National Bank for Agriculture and Rural Development (NABARD)

Ans to Q No 5: Following are the two functions of Exchange Banks:-

1. Remitting money from one country to another country,
2. Discounting of foreign bills.

Ans to Q No 6: Following are the two objectives of EXIM Bank of India:

1. To ensure integrated and co-ordinate approach in solving the allied problems encountered by exporters in India.
2. To pay specific attention on the exports of capital goods.



8.15 MODEL QUESTIONS

Q 1: What is a commercial bank?

Q 2: Write a note on Development Banks.

Q 3: What are the objectives of EXIM Bank of India?

Q 4: Discuss briefly about different types of banks.

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