

GENERAL PRINCIPALS OF INSURANCE

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WHAT IS INSURANCE?

- Represented in a form of policy, **Insurance is a contract in which the individual or an entity gets the financial protection**, in other words, **reimbursement from the insurance company** for the damage (big or small) caused to their property.
- The insurer and the insured enter a **legal contract** for the insurance called the **insurance policy** that provides financial security from the future uncertainties.



In simple words, **insurance is a contract, a legal agreement between two parties**, i.e., the individual **named insured and the insurance company called insurer.**

In this agreement, the insurer promises to help with the losses of the insured on the happening contingency.

The insured, on the other hand, pays a premium in return for the promise made by the insurer.

The contract of insurance between an insurer and insured is based on certain principles, let us know the principles of insurance in detail.



PRINCIPALS OF INSURANCE

- The concept of insurance is risk distribution among a group of people. Hence, cooperation becomes the basic principle of insurance.
- To ensure the proper functioning of an insurance contract, the insurer and the insured have to uphold the 7 principles of Insurances mentioned below:
 - **Utmost Good Faith**
 - **Proximate Cause**
 - **Insurable Interest**
 - **Indemnity**
 - **Subrogation**
 - **Contribution**
 - **Loss Minimization**
- Let us understand each principle of insurance with an example.



PRINCIPAL OF ATMOST GOODFAITH

- The fundamental principle is that both the parties in an insurance contract should act in good faith towards each other, i.e. they must provide clear and concise information related to the terms and conditions of the contract.
- The Insured should provide all the information related to the subject matter, and the insurer must give precise details regarding the contract.
- **Example** – Jacob took a health insurance policy. At the time of taking insurance, he was a smoker and failed to disclose this fact. Later, he got cancer. In such a situation, the Insurance company will not be liable to bear the financial burden as Jacob concealed important facts.



PRINCIPAL OF PROXIMATE CAUSE

- This is also called the principle of 'Causa Proxima' or the nearest cause. This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property. If the proximate cause is the one in which the property is insured, then the company must pay compensation. If it is not a cause the property is insured against, then no payment will be made by the insured.
- **Example –**
- Due to fire, a wall of a building was damaged, and the municipal authority ordered it to be demolished. While demolition the adjoining building was damaged. The owner of the adjoining building claimed the loss under the fire policy. The court held that fire is the nearest cause of loss to the adjoining building, and the claim is payable as the falling of the wall is an inevitable result of the fire.

In the same example, the wall of the building damaged due to fire, fell down due to storm before it could be repaired and damaged an adjoining building. The owner of the adjoining building claimed the loss under the fire policy. In this case, the fire was a remote cause, and the storm was the proximate cause; hence the claim is not payable under the fire policy.



PRINCIPAL OF INSURABLE INTEREST

- This principle says that the individual (insured) must have an insurable interest in the subject matter. Insurable interest means that the subject matter for which the individual enters the insurance contract must provide some financial gain to the insured and also lead to a financial loss if there is any damage, destruction or loss.
- **Example** – the owner of a vegetable cart has an insurable interest in the cart because he is earning money from it. However, if he sells the cart, he will no longer have an insurable interest in it.
- To claim the amount of insurance, the insured must be the owner of the subject matter both at the time of entering the contract and at the time of the accident.



PRINCIPAL OF INDEMNITY

- This principle says that insurance is done only for the coverage of the loss; hence insured should not make any profit from the insurance contract.
- In other words, the insured should be compensated the amount equal to the actual loss and not the amount exceeding the loss. The purpose of the indemnity principle is to set back the insured at the same financial position as he was before the loss occurred. Principle of indemnity is observed strictly for property insurance and not applicable for the life insurance contract.



Example – The owner of a commercial building enters an insurance contract to recover the costs for any loss or damage in future. If the building sustains structural damages from fire, then the insurer will indemnify the owner for the costs to repair the building by way of reimbursing the owner for the exact amount spent on repair or by reconstructing the damaged areas using its own authorized contractors.



PRINCIPAL OF SUBROGATION

- Subrogation means one party stands in for another. As per this principle, after the insured, i.e. the individual has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property goes to the insurer, i.e. the company.
- Subrogation gives the right to the insurance company to claim the amount of loss from the third-party responsible for the same.
- **Example** – If Mr A gets injured in a road accident, due to reckless driving of a third party, the company with which Mr A took the accidental insurance will compensate the loss occurred to Mr A and will also sue the third party to recover the money paid as claim.



PRINCIPAL OF CONTRIBUTION

- Contribution principle applies when the insured takes more than one insurance policy for the same subject matter. It states the same thing as in the principle of indemnity, i.e. the insured cannot make a profit by claiming the loss of one subject matter from different policies or companies.
- **Example** – A property worth Rs. 5 Lakhs is insured with Company A for Rs. 3 lakhs and with company B for Rs.1 lakhs. The owner in case of damage to the property for 3 lakhs can claim the full amount from Company A but then he cannot claim any amount from Company B. Now, Company A can claim the proportional amount reimbursed value from Company B.



PRINCIPAL OF LOSS MINIMISATION

- This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimise the loss to the insured property.
- The principle does not allow the owner to be irresponsible or negligent just because the subject matter is insured.
- **Example** – If a fire breaks out in your factory, you should take reasonable steps to put out the fire. You cannot just stand back and allow the fire to burn down the factory because you know that the insurance company will compensate for it.



BENEFITS OF INSURANCE

- The insurance gives benefits to individuals and organisations in many ways. Some of the benefits are discussed below:
- The obvious benefit of insurance is the payment of losses.
- Manages cash flow uncertainty when paying capacity at the time of losses is reduced significantly.
- Complies with legal requirements by meeting contractual and statutory requirements, also provides evidence of financial resources.
- Promotes risk control activity by providing incentives to implement a program of losing control because of policy requirements.



- The efficient use of the insured's resources. It provides a source of investment funds. Insurers collect the premiums and invest those in a variety of investment vehicles.
- Insurance is support for the insured's credit. It facilitates loans to organisations and individuals by guaranteeing the lender payment at the time when collateral for the loan is destroyed by an insured event. Hence, reducing the uncertainty of the lender's default by the party borrowing funds.
- It reduces social burden by reducing uncompensated accident victims and the uncertainty of society.

