

**INSURANCE AND RISK MANAGEMENT EXAM**  
**SUGGESTED ANSWERS – NOV 2004**  
**PAPER – 1 : PRINCIPLES AND PRACTICE OF INSURANCE**

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1. Distinguish briefly between :
  - (a) Peril and Hazard
  - (b) Assignment of the policy and Assignment of the proceeds of the policy
  - (c) Agent and Broker
  - (d) Actual cash value of the assets and Fair market value of the assets
  - (e) Implied conditions and Express conditions

**(a) Peril is defined as the cause of Loss.**

**Hazard refers to the conditions which may create or increase the chance of loss.**

- (b) Assignment of the policy means transfer of rights of the policy by the insured to another. This requires the permission of the insurer. Assignment of the proceeds of the policy means mere transfer of rights of receiving the benefits under the policy by the insured to another. This does not require the permission of the insurer.**

- (c) Agent is the representative of the insurer. He represents only one insurance company and the products and services which he offers is limited to that company.**

**Broker is the representative of the insured. He can represent any number of insured and sell the products and services of various insurers.**

- (d) Actual cash value of the assets would mean the written down value of the assets after taking into account depreciation and inflation in the value of the assets over a period of time (Replacement cost – depreciation)**

**Fair market value of the assets is the price that would normally be determined in a free market during a transaction entered into by a willing buyer and a willing seller. This can be taken as the actual cash value when the replacement cost of the assets cannot be determined.**

- (e) Implied conditions are implied by law and are applicable to any contracts of insurance whether specifically included in the policy or not.**

**Express conditions are special conditions agreed to between the insured and the insurer and are clearly stated on the face of the policy.**

2. Define Risk Management and explain briefly the different techniques of the same.

**Risk Management may be defined as a managerial function, which is directly concerned with:**

- **Identification of sources of risks to which the firm is exposed**
- **Estimation of the probable frequency and size of the potential losses**
- **Consideration of various techniques and methods available to tackle these risks**
- **Implementation of the selected techniques and methods**
- **Periodical evaluation of the results achieved**

**Techniques dealing with the problem of risks**

- **Risk avoidance - Simplest way to deal with the problem of any risk is to avoid it altogether. This technique is not always possible nor is it practical in all cases.**
- **Loss prevention and reduction – Financial consequences of risks may be eliminated or minimized through various loss prevention and loss reduction measures. Some of these measures may prevent the loss from occurring while others may reduce the extent of loss.**
- **Risk retention – The firm may decide to bear the loss for its own by treating the losses as normal operating expenses of running the business. Or the firm may decide to create a fund to which periodical payments would be credited and from which losses would be paid as and when incurred.**
- **Risk transfer – The firm may decide to shift the risk burden on others. There are different ways the main one being Insurance. Other ways are hedging, sub-contracting, asking for sureties, diversification, indemnity agreements, incorporation etc.**



4. Explain the salient features of an Endowment Policy and its suitability to the Indian Market.

**Endowment policy used to be the largest selling product in the Indian Market because of its features of assured periodical income. The term 'endowment' refers to the accumulated value of the investment made under the policy. Thus, endowment plans promise protection from risk in the event of death of the insured during the policy term as well as an assured sum upon the maturity of the policy. In this type of policy, the maturity of the policy is usually chosen to coincide with the retirement of the person. These policies are issued for specific terms chosen by the proposer who can choose the duration of the policy which may be 10,15,20 or 30 years. Where the duration is short the premium involved is higher.**

**It is to be noted that whether the assured meets a premature death or not the full amount of the policy has to be paid by the insurance company provided the premiums have been paid as stipulated in the policy. Hence, it pays the face amount of insurance if the insured dies within a specified period; if the insured survives to the end of the endowment period, the face amount is paid to the policy owner at that time. The mathematical concept of endowment insurance = term life insurance + pure endowment [ to pay the face amount if the insured dies during the period + to pay the maturity amount only if the insured is living at the end of a specific period, with nothing paid in case of prior death.]**

**The economic concept divides endowment insurance into two parts: decreasing term insurance and increasing savings.**

**Variations of endowment insurance are enormous worldwide.**

**Single premium endowment policies are popular in European countries.**

**Long-term endowment policies are common in United Kingdom**

**Retirement income policy, Semi endowment policy, Modified endowment policy**

**Juvenile endowment policies are some of the types of endowment insurance policies.**

**An Endowment Policy has the Following Features:**

- **It covers the risk for a prescribed time period at the expiry of which the sum under the policy, along with the accumulated bonus (if the policy is with profits) is paid back to the assured**
- **The payment of an endowment at the end of the term has made these policies very popular in our country**
- **This policy provides old age benefits. Generally, a parent's responsibility ends once the children are financially independent and well established in life. Then, the individual has to provide for his old age i.e. on his retirement. At this stage of life when he receives the insured sum, he can use the amount in two ways:**
  - **For purchasing an annuity policy for getting a stream of monthly pension for rest of his life**
  - **For parking the money in some investment of his choice**

- **Premium on endowment policy is payable for the whole term of the policy, unless such period is preceded by the death of the policyholder**
- **Unlike whole life policies, the premium rates for endowment plans are higher and the bonus rates lower**
- **The cost of an endowment policy is much more than that of the whole life plans. But, the main advantage of this plan is the lump sum payments that the policyholder gets during his lifetime after the termination of policy**
- **These policies are eligible for loans within the surrender value of the policy**
- **These policies can be issued to people upto 65 years of age while the maximum age at maturity is 75 years. The minimum age at entry is 1 years (as per LIC plans).**

#### **Suitability of the Product:**

- **Endowment plan is most suitable for a person who is the family's bread earner, because it provides life insurance cover to him thus covering the risk to which his family is exposed**
- **Besides taking care of the risk of untimely death of the policy-holder, the insurance amount is also paid once the term is over**
- **If a person wants to meet expenditure like his children's education and marriage the term of the policy can be selected to suit these contingencies**
- **If the policyholder wants to channelise his funds towards any investment scheme which provides for a steady source of income during his retired life, he can buy this plan**
- **This plan is basically meant for those who look for savings besides taking life cover**

#### **Examples of endowment policies:**

**Endowment with and without profit plans, limited payment endowment with profits, Jeevan Mitra, Marriage or Educational Annuity, New Janaraksha, Bhavisha Jeevan, Jeevan Griha, Double and Triple Cover, Bima Nivesh, Jeevan Mitra Triple Cover and Bima Nivesh 2001 of LIC, Endowment Assurance Plan and Flexible Bond of HDFC Life, ICICI Pru Save n Protect Plan, ICICI Pru Assurance etc.**

#### **Money Back Policy**

**Under these plans the policy proceeds are paid to the insured in a number of separate cash payments. The timing of receipt of payments can be as per the available option. As in case of other policies life insurance cover is provided. The premium can be paid by the insured in lump sum payment or in a number of separate instalments.**

**The following are the features of these policies:**

- It provides for periodic payments of survival benefit at fixed intervals during the term of the policy as long as the policyholder is alive
- On death of the policyholder, during the term of the policy, the death claim payable is the full sum assured without deducting any survival benefit amounts that may have been already paid
- However on survival, upto maturity of the policy the sum assured after deducting the survival benefits paid earlier is repaid.
- The bonus is also calculated on the full sum assured.
- The minimum age for eligibility under this policy is twelve years (as provided by LIC).

**Suitability of this policy:**

- Persons desirous of receiving periodic payments in addition to insurance cover can opt for such a policy, which can be used for various purposes like down payment for a house, for the purchase of an asset or investment in business.
- Variants of such plans exist for children's education and marriage wherein the periodical receipts can be used as required

**Examples of Money Back Plan are Money Back with Profits (75), New Money Back, Jeevan Surabhi 15, 20 and 25 years and Jeevan Shanchays Plans of LIC, Money Back Plan of HDFC Life and Dhana Shree of AMP Sanmar, etc.**

5. Write short notes on the following :
- (a) Subrogation
  - (b) Erection all risks insurance

**(a) Subrogation :**

**Subrogation means the transfer of the rights of an assured against the third party for any loss/damages caused by him, in favour of the insurer after the insurer has indemnified the insured for such loss / damages.**

**Principle of Subrogation is corollary to the principle of indemnity. By this while the insured recovers his loss from the insurer, he is prevented from making any profit by obtaining compensation once again from the offending party.**

**Insurer by the right of subrogation is able to mitigate his liability which eventually leads to his lowering the premium rates to the advantage of the policy holder.**

**Principle of subrogation is applicable only to general insurance contracts.**

**(b) Erection all risks insurance :**

**Erection All Risks Insurance, otherwise known as EAR Insurance provides cover for the projects under construction. It covers the project machinery and materials against all risks (subject to certain exclusions) right from the time when the project materials are unloaded at the site of erection till the time the project is erected, tested, commissioned and handed over.**

**As the projects may involve in addition to the Principal, Erection contractors, Sub-contractors etc., a single policy can protect the interest of all of them in the event of something happening to the project machinery and materials resulting in financial loss to any one or all of them.**

**The policy sum insured will take into account the FOB/CIF value of all the items insured as well as various expenses like duty, incidentals and cost of erection. The sum insured initially selected is subject to adjustment based on actual construction cost after completion of project.**

6. (a) What does the term “Material Fact” means in relation to insurance?  
(b) When insuring his house Mr.Gupta furnished all the details in the proposal form but for a question “Whether any other property adjacent to the house is of inferior construction” did not reveal the fact that the next house was a thatched hut.

Because of a short-circuiting in the insured house the clothes kept in the room caught fire which ultimately resulted in the entire house being gutted. The fire spread to the neighbouring hut also and destroyed the same.

Insurance company refused to pay the claim on the plea that Mr.Gupta suppressed the fact that the neighbouring house was a thatched hut.

Do you feel that the insurer’s stand is right and that Mr.Gupta cannot recover his loss?

- (c) While insuring the generator in his factory for breakdown risks Mr.Johnson replied the query in the proposal form ‘Furnish the past claims history’ as “not relevant and hence not giving the details” inspite of the fact that he had few claims made with his previous insurer for breakdown losses for the same generator.

Mr.Johnson had to once again face a breakdown loss in the current year and lodged a claim with the present insurer. Having come to know of the past losses through the surveyor, the insurer denied liability on the plea that the past claims history was not furnished to them and there is a suppression of a material fact.

Comment on the insurer's stand of denying the claim.

**(a) A material fact is a fact or information which affects the judgement of a prudent underwriter in deciding whether to accept the risk and if so, at what rate of premium and subject to what terms and conditions. It is binding on the part of the parties, the insured and the insurer, to expressly disclose all the material facts pertaining to the contract. Non-disclosure of material facts by either party will render the contract null and void.**

**(b) Non-disclosure of the fact that the adjacent house is a thatched house amounted to suppression of a material fact. Had it been revealed, the insurer's decision with regard to acceptance of the risk or fixing rates terms and conditions of cover might have been different. Insurer can avoid the contract if it comes to know of this fact after issue of the cover.**

**But in this case it is clear that the fire loss to the insured house has neither taken place nor aggravated because of the existence of the thatched house. Considering this aspect insurer can waive this suppression and can settle the claim subject to other conditions of the policy. Judiciary also favours such a customer friendly approach to disposal of claims by insurers.**

**(c) The insurer's stand is not maintainable in this case.**

**To the specific query in the proposal form "Furnish the past claims history" Mr. Johnson had refused to give the details as "not relevant and hence not giving the details". The insurer had then every opportunity to decide against acceptance of the risk and if accepted, fix whatever rates, terms and conditions of coverage that it would have desired. Action on its part in going ahead and providing coverage would amount to waiver of its right and the insurer cannot later put a question mark over this matter and deny liability when the claim arose.**

7. Mr. Arun, as a bachelor, took a life policy from insurer "Life Secure" and named his mother as his nominee. During the tenure of the policy, he married Miss Shaila, but he did not change the nomination in his policy. Subsequently when the policy was in force, Mr. Arun died of heart attack. Mrs. Arun lodged a claim with the insurance company, simultaneously as Mr. Arun's mother filed a claim as the official nominee of the deceased.

Insurance company found the claim to be otherwise in order, but being confronted with the situation of two parties staking the claim, did not want to take any risk of being questioned for wrong payment, if payment was made to one of them. It advised both the parties to get the issue settled through legal process before it can make payment to any one of them.

Is the stand taken by the insurer correct in the circumstances of the case? Discuss the issue taking reference to the judicial disposals and the case law relating to nomination.

**The stand taken by the insurer is not correct.**

**The policyholder is entitled to authorize an individual to receive policy monies. The insurance company is duty bound to make the payment to the nominee as mentioned in the policy. There is no need for any apprehension on the part of the insurer that its action of making payment to the nominee would be questioned.**

**Further simply because the nominee receives the policy monies the interest of any one who has the legal right to receive the money does not get affected as the mere nomination does not have the effect of conferring on the nominee any beneficial interest in the amount payable under the life insurance policy on the death of the assured. The nomination only indicates the hand which is authorized to receive the amount, on the payment of which the insurer gets a valid discharge of its liability under the policy. The amount however can be claimed by the heirs of the assured in accordance with the law of succession governing them.**

8. (a) Write short note on Marine Cargo Insurance.

(b) Jackson & Co. imported 20,000 numbers of a particular type of bearing from UK. The consignment was packed uniformly in 40 boxes. The cost incurred by the company is as below :

Suppliers' invoice amount including ocean freight	:	Rs.1,35,00,000
Duty	:	Rs. 81,00,000
Insurance, inland freight and incidentals	:	Rs. 2,00,000
<b>Total</b>	<b>:</b>	<b>Rs.2,16,00,000</b>

Jackson & Co., proposed to insure the consignment under a Marine cargo Insurance Policy for Rs.2,50,000 and the insurer issued the policy accordingly.

As the ocean carrier delivered only 36 boxes and there was a short delivery of 4 boxes, the company lodged the claim both on the ocean carrier and the insurer for Rs.25,00,000. While the carrier refused to pay any claim, the insurance company offered to settle the

claim only for Rs.21,60,000 being the actual value lost by the Jackson and Company which the insured did not agree.

Do you feel that the insurer's stand is in order and why? And what is the position with regard to the claim on carrier?

- (a) **Marine Cargo Insurance deals with insurance of all and any type of goods carried in the ship from one place to another and covers the goods against the risks associated with the ocean voyage and also the inland transit. The term marine cargo insurance refers not only to cargo carried by ship but also by rail. Road and air and any other normal mode of conveyance. Policies are issued to cover a single voyage or transit or in case of parties having regular transport of cargo an annual policy to take care all such transport of cargo. Policies are issued covering the cargo against limited perils or against all risks. The policy can also be extended to cover against war risks and strike and riots.**

**Unlike policies like fire, marine policy is what is known as an Agreed Value Policy. The value of the cargo is agreed between the insurer and the insured and incorporated in the policy. And in the event of the claim irrespective of the market value of goods on the date of loss the settlement under the policy will be made in relation to the sum insured.**

**The principle of subrogation is very significant with regard to marine insurance. As loss or damage to the goods take place mostly while they are in the custody of carriers, for which they are responsible as per relevant acts, the insurer after settling the claim with the insured, will pursue recovery from carriers under letter of subrogation.**

- (b) **As explained in part (a) above, a marine cargo policy is an agreed value policy. Irrespective of the market value of the goods on the date of loss the settlement under the policy will have to be made in relation to the sum insured unless there is intentional over insurance by the insured. Hence in this case the claim for loss of four boxes bearings will have to be settled for the proportionate sum insured namely Rs.25,00,000/-**

**As regards refusal of claim by the ocean carrier, the insurer, while settling the claim with Jackson & Co., will obtain a letter of subrogation from them and pursue recovery from the carriers. Any recovery, if effected from the carrier will go to the credit of the insurer as long as Jackson & Co have been fully indemnified under the policy.**

9. Outline the areas on which the Statutory Auditor is required to express his opinion during certification of Financial Statements of insurance companies.

**The Statutory Auditor has to express his opinion on :**

- 1. Whether the balance sheet gives a true and fair view of the insurer's affairs as at the end of the financial year/period**
- 2. Whether the revenue account gives a true and fair view of the surplus or the deficit of the financial year/period**
- 3. Whether the profit and loss account gives a true and fair view of the profit or loss account for the financial year/period**
- 4. Whether the receipts and payments gives a true and fair view of the receipts and payments for the financial year/period**
- 5. The financial statements are prepared in accordance with the requirements of the Insurance Act, 1938**
- 6. Investments have been valued in accordance with the provisions of Act and the regulations**
- 7. The accounting policies are appropriate and are in compliance with the applicable accounting standards and the accounting principles**
- 8. Certify the management report and that there is no apparent mistake or material inconsistencies with the financial statement**

**He has to certify that he has verified the cash balances and securities relating to the insurer's loans reversions and life interest and investments.**