



INTRODUCTION TO INSURANCE



Insurance Education Series

A consumer education initiative by



भारतीय बीमा विनियामक और विकास प्राधिकरण
**INSURANCE REGULATORY AND
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INTRODUCTION TO INSURANCE

FOREWORD

An investment in knowledge pays the best interest - Benjamin Franklin

Education in schools has been traditionally focused on enhancing knowledge in conventional subjects like Science, Mathematics, Social Studies and different languages. The focus on aspects which are of paramount importance in life like risk, finance and insurance have been left out for higher secondary and under-graduate education only. However, the importance of awareness in these areas from early stages of life cannot be overemphasized as they help in making the young financially literate and taking an informed decision in respect of the above as and when required.

Insurance is a specialized field of study. However, to make it easy and simple to comprehend, we chose to bring out a basic book on insurance education. This book gives information in a very simple and easily understandable language about the basic aspects of insurance like risk, peril, law of large numbers, insurable interest, principles of indemnity, contribution, subrogation, etc., and importance of insurance in one's life; need for Life insurance, General/Non-life Insurance (covering Motor insurance, Householders insurance etc), Health insurance and an outline of insurance sector in India.

A student having awareness of these aspects can assess the risks that his family and the assets of his family are exposed to. He can impress upon his parents and elders of the need for insurance to help the family in protecting the life and assets so that the impact of sudden contingencies does not lead to problems, loss and inconvenience. This would create a positive outlook which will ultimately lead to insurance inclusion.

It gives me immense pleasure in bringing out this book aimed at enhancing insurance awareness for the younger generation of our country. The book is also a part of IRDAI's continued effort for promoting financial literacy under the National Financial Literacy Mission.

I acknowledge the efforts of Insurance Institute of India, an academic body for promoting insurance professionalism in India and abroad, for their inputs in bringing out this book. If the book can help a student in understanding about insurance, identifying risks in one's life and help him look for possible solutions through insurance, the purpose of this book would be more than served.

With best wishes,

T.S. VIJAYAN
Chairman, IRDAI

Key learning objectives

After reading this booklet, the reader will be able to understand the following:-

1. The concept of insurance
2. Principles on the basis of which insurance works
3. Need of insurance
4. Overview of Indian Insurance Sector

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CHAPTER 1

INTRODUCTION TO INSURANCE

Learning outcomes

- A. Understanding risks and perils
- B. Learning about savings and investment
- C. Knowing about concept of insurance

A. Risks and perils

Every day, we hear stories about accidents and other misfortunes that someone has suffered. Some of these include:

- i. All of a sudden, people fall seriously ill.
- ii. Motor vehicles are stolen and people die or get injured in accidents involving motor vehicles.
- iii. House and belongings are destroyed by fire.
- iv. Large scale loss of lives and destruction of property in cyclones and tsunamis.

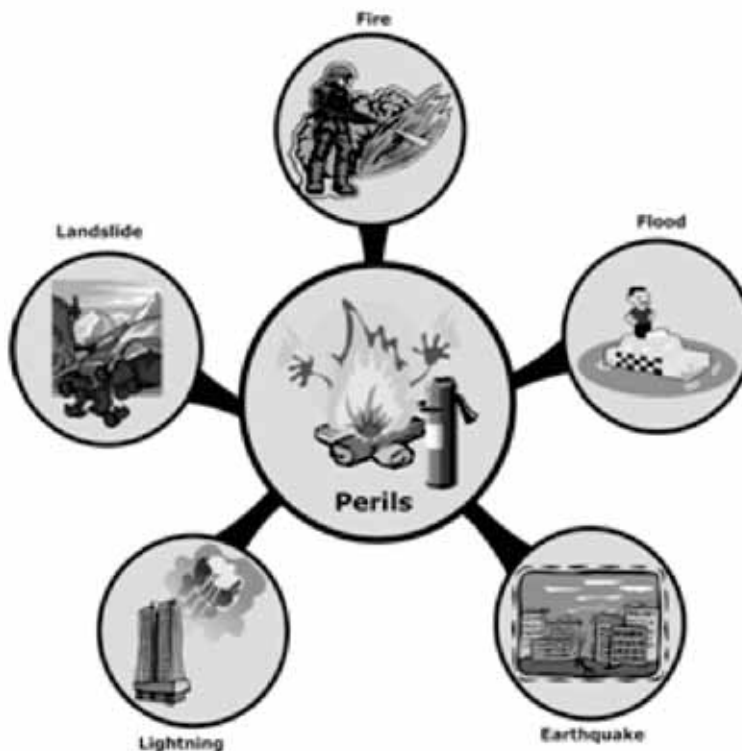
Life is full of uncertainties and surprises. Protecting oneself, one's families and society from these uncertain events has been one of the biggest concerns of man for centuries.

Definition

'Risk' is a term that we use to refer to the chance of suffering a loss as a result of uncertain events like the above.

The events that give rise to such risks are known as perils.

Some examples of perils



We face many such risks in our day-to-day life including risks to our life, health, property and so on.

We don't know whether and when something unfortunate will happen to us or our family members or property. It may not always be possible for us to prevent such a happening. For instance, we cannot prevent a storm or somebody's death from occurring.

B. Savings and investment

It is possible for us to take measures to reduce the financial consequences that arise due to the above mentioned risks and protect ourselves financially. One of the ways by which this is normally done is with the help of savings and investment.

Example

We would have seen or learnt from our parents or elders about the need to save for the future. By saving or investing money, the money so accumulated can be used to cope with the loss. However, such savings can only give back our own money plus some returns.

What would happen if a human life is lost or a person is disabled permanently or temporarily?

Example

A person dies suddenly. Where would the person's family get the money from to support itself? How would the person's family meet the various living expenses after his death?

A person suffers a paralytic stroke that leaves him permanently bed-ridden. Such an event would result in loss of income to the household and put the family in a lot of hardship.

The loss suffered is so large in all such situations that one's savings may not be sufficient to take care of the financial burden.

C. Insurance

Luckily for us, there is something called 'Insurance'. It is founded on a simple idea. Even though an event like death or a fire can come as a terrible economic blow to someone, when we take the society as a whole, during any given year, only a few would suffer in such manner. If a small contribution is collected from everyone in the community and pooled to create a common fund, the amount so pooled can be used to pay money to the few unfortunate members who have been subject to the loss.

Definition

Insurance is a mechanism of risk transfer and sharing by pooling of risks and funds among a group of individuals who are exposed to similar kinds of risks for the benefit of those who suffer loss on account of the risk.

INTRODUCTION TO INSURANCE

Insurance is, thus, a financial tool specially created to reduce the financial impact of unforeseen events and to create financial security. Indeed, everyone who wants to protect himself against financial hardship should consider insurance.



Traditionally, “the joint family” has been an informal social security in India. In modern society, social security is available only to those who are employed in the organised sector. Insurance is considered one of the tools of social security for formal and informal sectors and is largely carried out in two ways.

- i. The first way is known as Social Insurance. Here, the State or government takes care of those who are subjected to losses due to some risk event. Examples are, providing a pension when one grows old or providing free medical treatment, meeting the cost of hospitalization etc. The fund for this purpose comes from a pool made up from taxes or mandatory social security contributions required to be made by all those who work and earn an income. The Employees’ State Insurance scheme (ESI) that provides medical care and other benefits to employees and Employees’ Provident Fund Organization (EPFO) that provides pensions and survivors’ benefits in the event of an employee’s death are the popular schemes under this head.
- ii. The second way is through voluntary Private Insurance. Here, individuals and groups can buy insurance from an insurance company by entering into a contract of insurance with the company. The insurance company enters into a contract (an insurance policy) whereby it (insurer) undertakes, in exchange for a small amount of money (premium), to provide financial protection by agreeing to pay the insuring person (insured) a fixed amount of money (sum assured) on the happening of a certain event (insured peril).

Insurance companies collect premiums to provide for this protection and losses are paid out of the premiums so collected from the insuring public. In other words, an insurance contract promises to make good to the insured a certain sum in consideration for the premium received from the insured.

Example

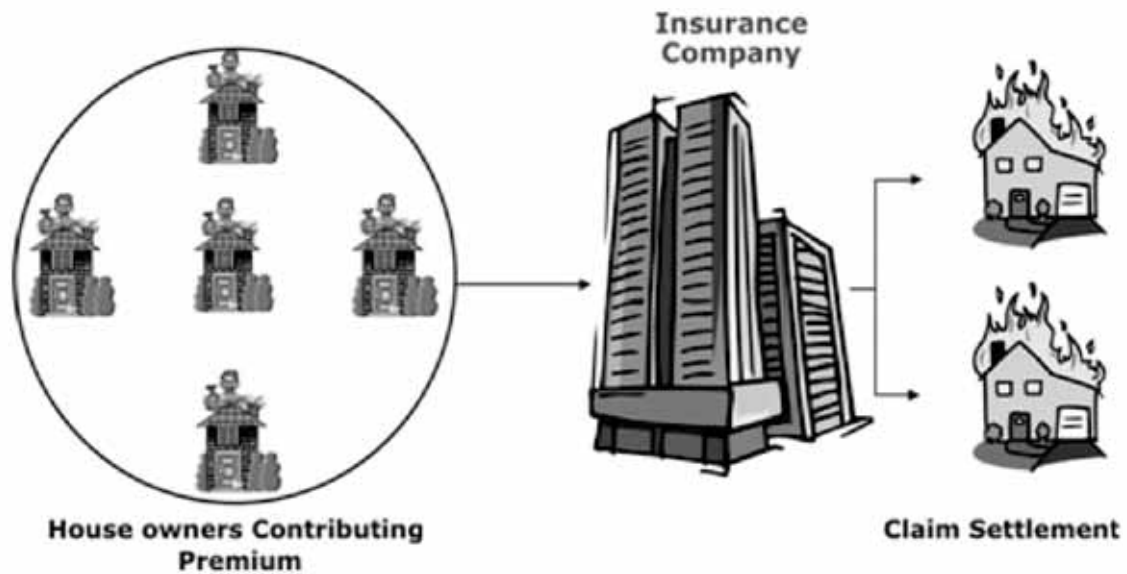
The following two examples explain the concept of insurance.

INTRODUCTION TO INSURANCE

Example 1

In a village, there are 400 houses, each valued at Rs.20,000. Every year, on an average, 4 houses get burnt, resulting into a total loss of Rs.80,000.

Number of houses	400
Value of each house	Rs. 20,000
Houses that get burnt every year (average)	4
Total loss (4 houses X Rs. 20,000)	Rs. 80,000
Contribution to be made by 400 house owners to compensate for loss of Rs. 80,000 = $Rs. 80,000 / 400$	Rs. 200



If all the 400 owners come together and contribute Rs.200 each, the common fund would be Rs.80,000. This is enough to pay Rs.20,000 to each of the 4 owners whose houses got burnt. Thus, the risk of 4 owners is spread over 400 houses/ house-owners of the village.

Example 2

There are 1000 persons, who are all aged 50 and are healthy. It is expected that of these, 10 persons may probably die during the year. If the economic value of the loss suffered by the family of each dying person is taken to be Rs.20,000, the total loss would work out to Rs.2,00,000.

Number of persons	1000
Economic value of each person	Rs. 20,000
Persons that may die during the year (probable)	10
Total loss (10 persons X Rs. 20,000)	Rs. 2,00,000
Contribution to be made by 1000 people to compensate for loss of Rs. 2,00,000 = $Rs. 2,00,000 / 1000$	Rs. 200

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If each person of the group contributes Rs.200 a year, the common fund would be Rs.2,00,000. This would be enough to pay Rs.20,000 to the family of each of the ten persons who may die. Thus, 1000 persons share the risk of loss due to death suffered by 10 persons.

From the above, it can be seen that insurance is a very useful financial tool for pooling, sharing and transfer of the risk so that the financial loss caused to a person who suffers due to a peril is compensated.

Case study: Risk and protection

Sheetal and Simran are friends from the same class and regularly go home together. Sheetal always carries an umbrella and Simran makes fun of her. Sheetal simply smiles and says that as the umbrella protects her from sun and rain, she does not feel it to be an additional burden to carry along with text books in her school bag.

One day, it suddenly started raining. Simran did not get either raincoat or umbrella because of which she got wet as did her bag and books. Sheetal used her umbrella to protect her and her bag from rain. Sheetal offered to share her umbrella and asked Simran to come to her house. After reaching Sheetal's home, Simran found that Sheetal's father was carefully sorting out a bunch of papers and making notes. Sheetal's mother had refreshments arranged for all of them, without making much noise.

When Simran asked Sheetal's mother why uncleji was so serious, she said, "Actually, your uncle is finalising papers for purchase of an insurance policy".

"What is an insurance policy," Simran enquired.

Sheetal's mother explained, "Insurance offers protection against unforeseen risks, just like a raincoat or umbrella protects against rain".

"What is a risk?", Simran asked.

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Sheetal's mother said, "See Simran, we face many risks in our lives. For example, if you drench yourself in rain, you may fall sick. There is a risk of illness. Due to rain, there could be a short circuit of electricity. There is a risk of electronic breakdown of this TV as well as other domestic appliances. There is a risk of theft of our car which is parked in the garage and there is also the risk of an accident while crossing the road.

So risk is an inherent part of our life. Whether and when loss would be caused because of risk and how much loss is caused cannot be foreseen, known or controlled at all times. While we cannot avoid most of these risks, by purchasing insurance, we can transfer the risk to the insurance company."

Simran asked, "How does this happen"?

Sheetal's mother explained, "Suppose the downpour is heavy resulting in a flood, our car could get immersed in water. It could damage a few vital parts necessitating repairs. Since we have insured our car, the insurance company will reimburse the expenses of repairs, thereby reducing the impact of loss because of damage to the car."

Simran asked innocently, "But aunty, why cannot the rain be stopped" and then, she sneezed.

Sheetal's mother exclaimed, 'Bless you!' and told her, "Had you taken an umbrella you could have protected yourself from getting wet. See, now since you got wet, can we stop you from sneezing"?

Everyone laughed.



**Stay cheerful without fear,
health insurance is here.**

CHAPTER 2

PRINCIPLES OF INSURANCE

Learning outcomes

- A. To know that insurance follows law of large numbers
- B. Knowing what is Insurable interest
- C. Knowing that Utmost good faith operates in Insurance Contracts
- D. Understanding Indemnity
- E. Learning about Subrogation and Contribution
- F. Understanding Proximate cause

The principles of insurance are:

- i. Law of large numbers
- ii. Insurable interest
- iii. Utmost good faith
- iv. Indemnity
- v. Subrogation and contribution
- vi. Proximate cause

A. Law of large numbers

Imagine that in a village there are 1000 persons who are all aged 50 and are healthy. Based on previous experience, it is expected that of these, 10 persons may die during the year. If the economic value of the loss suffered by the family of each dying person is taken to be Rs.20,000, the total loss would work out to Rs.2,00,000. If each member contributes Rs.200 a year, this would be enough to pay Rs.20,000 to the family of each of the ten persons who dies. You would have wondered whether the prediction of number of actual deaths of ten is accurate. What would be the impact if the insurance company's predictions about the risk turned out to be wrong or inaccurate and the number of deaths turns out to be 15 or 5? If the actual number of persons who die during a year were to be higher than ten, the amount collected would not be sufficient to compensate those who suffer the loss.

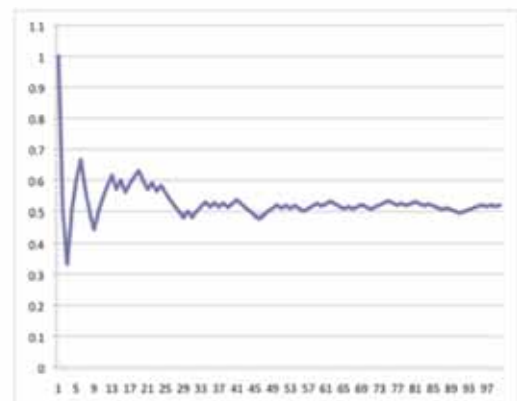
You need not worry too much about the accuracy of estimates. What saves the insurer is a wonderful principle of nature known as the law of large numbers. Simply put, it states that the more the number of members who are insured, the more likely it is that the actual result would be closer to the expected.

Example

Try this simple experiment. Toss one rupee coin. We all know that the theoretical probability that the outcome will be 'heads' is equal to $\frac{1}{2}$. Does this mean that if you toss a coin four times you will always get two heads and two tails? When can you be hundred percent sure that you will get heads exactly half the time? The answer is, you would have to toss it a very large number of times. You would also notice that the more number of times you toss the coin, the more you would find that the result is coming closer to half.

Law of large numbers -Number of tosses of a coin

Insurance works on this law of large numbers. Insurance companies are able to make near accurate predictions about their risks because they typically spread that risk amongst thousands, even millions, of members who have signed contracts with them and who are their policy holders. This is the reason



why when you purchase an insurance policy, the insurance company is able to give you an assurance that your losses would be compensated if they occur due to the insured event.

B. Insurable interest

Another important principle is insurable interest. Let us understand it with the help of a few examples.

Example 1

Shri Manoj was staying with his wife and son. An insurance agent visited him offering health insurance. Manoj indicated that he wanted to take health insurance for all the members of his family. He also wanted to take a policy for his good neighbour. The insurer said that Manoj can take a policy for his family but cannot take a policy for his neighbour.

The reasons why the insurer refused to issue insurance policy to Manoj's neighbour was because Manoj did not have an insurable interest in his neighbour's health.

Insurable interest is the term we use to describe the relationship between the insured and the subject matter of insurance (in the above case it is the health of Manoj and his family on one hand and Manoj's neighbour). This relationship gives Manoj a particular type of interest in the health of himself, his wife and child, whereby he benefits from the good health and suffers a financial loss by way of hospital expenses if one of the members of his family falls ill. We buy insurance to ensure that the loss suffered is compensated for in some way. The position is not so in case of Manoj's neighbour as Manoj does not suffer any financial loss due to his neighbour falling ill.

Insurable interest exists when an insured person derives a financial benefit from the continued existence of the insured object or suffers a financial loss from the loss of the insured object. A person has an insurable interest in something when loss-of or damage-to that thing would cause the person to suffer a financial loss.



Example 2

If the house you own is damaged by fire, you suffer a financial loss resulting from the fire. By contrast, if your neighbor's house, which you do not own, is damaged by fire, you may feel sympathy for your neighbor but you have not suffered a financial loss from the fire. You have an insurable interest in your own house, but not in your neighbor's house.

Imagine that you had insured your house. Later you sold the house to buy a bigger house. There was fire in the house after you sold the house. Since you do not own the house anymore, you will not suffer any loss. Therefore, now you do not have any insurable interest in the house. Insurable interest should be there at the time the loss is suffered.

People have an insurable interest in their property to the extent of loss suffered, but not more. The principle of indemnity dictates that the insured is compensated for a loss of property, but is not compensated for more than what the property was worth.

A lender, who gives loan against the security of house, has an insurable interest on the property because if there is a loss to the house, he would suffer a loss by not getting back the money. However, the insurable interest of the lender is not in excess of the value of the loan.

C. Utmost good faith

While ordinary commercial contracts are good faith contracts, insurance contracts are contracts of utmost good faith. Let us distinguish between good faith and utmost good faith with the help of example.



Example

Example 1: You have accompanied your parents to a car showroom where they sell cars. Your father asks the salesman certain details about the car being considered. The salesman is bound to give correct answers to the questions. Similarly, the brochures about the particular car model cannot make a mis-representation (tell a lie) about the model. This obligation to disclose only the truth applies when we speak of contracts of good faith.

Is the car salesman obliged to disclose (tell) everything he may know about the car? The answer is No. The buyer has to be aware of what he is buying.

Example 2: Shri Kishore aged 45 years applied for insurance on his life with policy term of 15 years. The insurer promises to pay the sum assured to the legal heirs of Kishore in case Kishore dies during the policy term. The insurer has to predict the chances of Kishore's survival over term of the insurance i.e., the next fifteen years. Can the insurer make an accurate prediction without knowing complete details about Kishore like his state of health, past diseases, family health history, habits etc. The insurer would not be in a position to know these facts unless they were completely disclosed by Kishore. Any problem in health would adversely impact the chances of survival till the policy term, which in turn would result in insurer paying the sum assured to the claimants of Kishore. Thus, the cost of insurance is more for insurer in case the ill-health of insured is not disclosed. Imagine the policy sold has special features and conditions listed in the policy document. Can Kishore know about these features and conditions unless the same are disclosed to Kishore by the insurer?

In Example 1 above, while the buyer of the car can see, touch and test-drive the car, the purchaser of insurance gets only a promise that he or claimants on his behalf would be paid an amount when something happens.

On the other hand, the seller of the car clearly knows what he is selling and what his costs are in manufacturing the car. In the case of the insurer (Example 2), when he is entering into a contract, he is able to guess (estimate) the chance of the loss and the amount of the loss that may happen (which would be huge compared to the premium collected) based on his knowledge

of the 'risk' that he is accepting. Here, we should note that when an insurance contract is entered into, the insured person knows everything about the risk insured but the insurer knows nothing. The insurer can assess the probability of loss (depending on which he decides to accept the risk and charge the premium) only based on what the insured tells him about the risk. Similarly, the insured would not understand what the benefits are in relation to the cost paid (premium paid) unless the same are made known to him to enable him to make an informed choice.

Insurance contracts thus stand on a different footing as compared to other kinds of commercial contracts. Disclosure of all material information has to be made by both the parties to the contract. Hence the contracts of insurance are referred to as contracts of utmost good faith. Since these contracts are based on prediction of an event (known as a contingency), they are called as contingent contracts. The prediction depends on complete disclosure being made of all facts that would impact the risk.

The proposer in insurance thus has a legal obligation (legal duty) to disclose everything and all material facts that are relevant to the subject-matter of insurance.

Definition

A material fact is one which would affect the judgment of a prudent insurer in deciding whether to accept the risk and if so, at what rate or premium and subject to what terms and conditions.

Example

- i. In respect of insuring a factory, one must disclose the type of construction of the building and the nature of goods stored;
- ii. In the case of goods in transit (Marine Cargo insurance), the method of packing and the mode of transportation has to be disclosed.
- iii. In the case of life insurance, the state of the health of those proposed for insurance, details of past ailments and the treatments done have to be disclosed.

D. Principle of indemnity

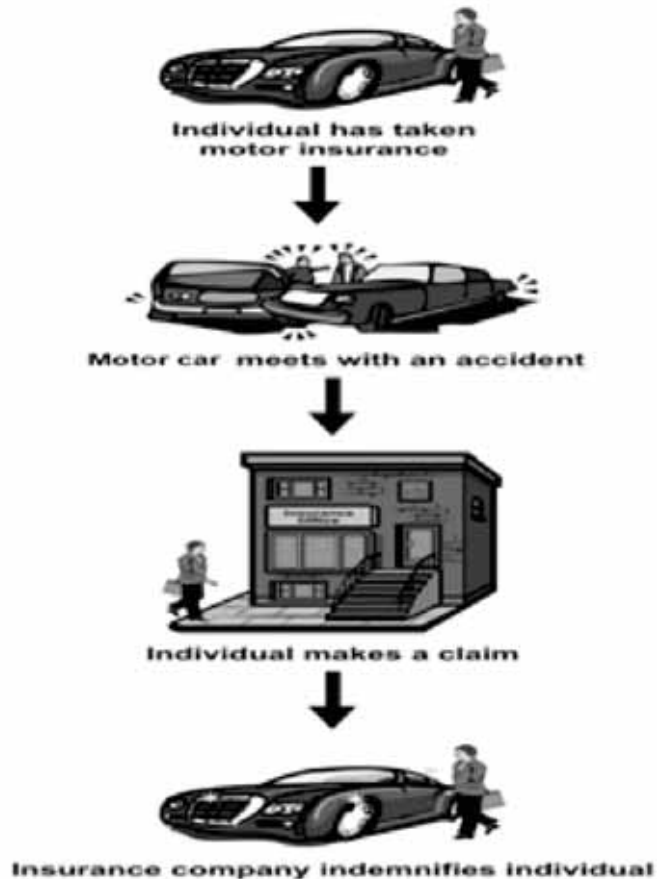
Let us understand the principle of indemnity with the help of an example.

Example

Jayesh had a shop which caught fire and as a result, a part of the goods that were stored was destroyed. The shop was insured for its full value of Rs.5,00,000. Jayesh claimed Rs. 5,00,000 since he had insured his shop for Rs. 5,00,000. The insurance company's surveyor examined the damage and estimated that the loss was only Rs. 64,000. The insurance company paid Rs.64,000 as compensation, even though Jayesh had a policy of Rs. 5,00,000 and claimed for more. The insurer was applying a law known as the "Principle of Indemnity".

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You get compensated for what you lose - no more, no less.



The principle of indemnity means that the loss, and only the loss, is compensated. Insurer has to indemnify (i.e. pay for the financial loss suffered by) the insured. At the same time, the insured should not be paid anything more than the financial loss suffered by him. In other words, the insured should not be able to make a profit out of the loss suffered.

The insurance contract is for compensating the person who experiences a loss so that he is brought back to the same financial position as before the loss. The insurance policy indemnifies or guarantees compensation only for the amount of loss and for nothing more.

One should note that insurance policies have a sum insured, which indicates the total value of the risk that is taken over by the insurer through the policy.

Sum insured should be understood depending on the type of insurance as:

- i. The value of a car,
- ii. The value of a house,
- iii. The estimated medical expenditure or
- iv. The amount that would take care of a family's financial needs in case of the breadwinner's death.

Payment of any higher amount would normally mean a profit for the insured.

Payments for loss or damage under insurance contracts are limited to the actual amount of the loss or damage or the sum insured, which would be the maximum liability of the insurer. The purpose here is to ensure that one should not expect to make profit out of a loss through insurance.

Consider this situation

Consider a case where Mrs. X takes insurance on her life. Suppose she were to die. Would it be possible to exactly estimate the actual amount of loss or damage suffered? You would find that the above questions cannot be answered easily. The value of a person's life cannot be measured precisely.

Life insurance contracts hence follow a different principle. The life insurer pays an amount that is fixed at the beginning of the contract. Such amount is known as sum assured. Thus, life insurance contracts are known as contracts of assurance rather than contracts of indemnity.

E. Subrogation and Contribution

What are subrogation and contribution?

Both principles of subrogation and contribution arise from the principle of indemnity.

a) Subrogation

Consider this situation

On his transfer from Kolkata to Mumbai, Mr. Rajan sends his household goods worth Rs. 1,00,000 through M/s. Jayant Transports. During the transit, part of the goods got damaged due to the truck driver's negligence.

The insurer assessed the loss and found that the value of the damage was Rs. 30,000 and paid this amount to Mr. Rajan as indemnity. However Mr. Rajan took up the matter against M/s Jayant Transports with the Court of Law and the Court ordered M/s. Jayant Transports to pay Rs. 30,000 to Mr. Rajan. Having already received Rs. 30,000 from the insurer, Mr. Rajan would be making a profit out of the loss if he gets Rs. 30,000/- from the transporter also.

From this situation, one should observe the following:

- i. The insurance company has to compensate Mr. Rajan as per the insurance contract at the earliest without making him wait for the Court's judgement.
- ii. Mr. Rajan should not get two compensations and make a profit out of his loss.

In such situations, the insured's right to claim from anywhere else is taken over by the insurer when he pays a claim. Since the insurer has paid the amount of loss to the insured, the insurer would be the one who has borne the loss. Hence, the name of the insurer should be substituted

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for the insured and the right to recover the amount of loss from the person causing loss has to be transferred to the insurer who paid for the loss and compensated the insured. This taking over of the insured's right by the insurer is called 'subrogation' in insurance parlance. In other words, on payment of the claim, the insured's right to claim from anywhere else gets 'subrogated' to the insurer.

In the matter of subrogation, one should be clear that the insurer's rights of subrogation are limited to the amount he has paid towards claims. If, in the case cited above, the Court had ordered M/s. Jayant Transports to pay Rs.50,000 (instead of Rs.30,000) to Mr.Rajan, the insurer would have subrogation rights only up to Rs.30,000 that it paid and the balance Rs.20,000 would go to Mr.Rajan.

How subrogation works



b) **Contribution**

Consider this situation

Mr. Kishore had a car worth Rs.5,00,000 and he took full insurance for this car from two insurance companies. The car was totally damaged in an accident and total loss was Rs.5,00,000. Mr. Kishore filed a claim with the 1st company and got paid Rs.5,00,000. He goes to the 2nd insurance company and makes a claim for Rs.5,00,000. The second company informed Mr.Kishore that he was not eligible for getting any more sum because he was already indemnified by the 1st Company. If the 2nd company had also paid him, he would have made a profit out of his loss, to the disadvantage of all the other members who had contributed premiums.

This situation is against the principle of indemnity in insurance as Mr. Kishore would be making a profit out of his loss.

The principle of contribution refers to the right of an insurer who has paid a loss under a policy to recover a proportionate amount from other insurers who are also liable for the loss.

Example

If a property is insured under two fire policies each for Rs. 300,000, in the event of a partial loss of Rs.1,00,000, the insured is entitled to recover his full loss from any one of the insurers who, thereafter is entitled to recover from the other insurer his proportionate share i.e. Rs. 50,000. So, the different insurers under different policies contribute in indemnifying and paying for the loss caused by an insured peril.

F. **Principle of proximate cause**

Let us understand the principle of proximate cause with the help of an example.

Example

Mr. Prathamesh had taken an accident insurance policy which covered death by accident. While walking on the road one day, he was hit by a car. He was rushed to the hospital. Being a person with a weak heart, he could not stand the shock of the event and died after a few hours from heart failure. The insurance company disputed the claim saying it was the heart attack rather than the accident which had caused his death. The court ruled that even though the immediate cause of death may have been collapse of the heart, the proximate cause of death was the accident and ordered the company to pay the claim.

The above example is a case of a key principle in insurance, known as proximate cause. The word 'proximate' means 'nearness' or 'closeness'. The concept is that the cause that is 'closest' (in its effect) to the loss, is considered to decide whether a claim is payable or not.

If loss to an insured property is the result of two or more causes acting simultaneously or in succession (one after another), it becomes necessary to choose the most important, the most effective or the most powerful cause which has brought about the loss. It is the active efficient cause that sets into motion a train of events which brings about a result, without the intervention of any other force. This cause is termed as "proximate cause", all other causes being considered as "remote". If the proximate cause of loss is covered under the policy, the claim becomes payable.

CHAPTER 3

PERSONAL NEEDS

Learning outcomes

Having a brief idea about

- A. Life insurance
- B. Health insurance
- C. Property insurance
- D. Travel insurance
- E. Pensions
- F. Group insurance

A. Life insurance

Human life is perhaps the most important and invaluable asset. This asset is subject to risks of death and disability due to natural and accidental causes. When human life is lost or a person is disabled permanently or temporarily, there is a loss of income to the household.

Though human life cannot be valued, it is possible to estimate the loss of income that would be suffered in future years in the event of a risk like death or disability. Life insurers try to place a monetary value on such loss and provide insurance cover for such loss. Life insurance is a financial cover for a contingency linked with human life, like death, disability, accident and retirement. Life insurance products provide a definite amount of money in case the life insured dies during the term of the policy or becomes disabled on account of an accident.

Who needs life insurance?

- i. Primarily, anyone who has a family to support and is an income earner needs life insurance.
- ii. In view of the economic value of their contribution to the family, housewives too need risk cover.
- iii. Even children can be considered for life insurance in view of their future income potential that is at risk.

Basic types of life insurance policies

- i. **Term insurance:** Under this plan, the sum assured is paid only on the death of the insured during the period specified. There is no maturity value in term insurance.
- ii. **Endowment assurance:** Under this type of plans, the sum assured is paid at the end of the term as maturity or on the death of the insured during the term of the policy. This is available as With Profits (Bonus) or Without Profits type. Money-back plans are endowment policies with the provision for return of a part of the sum assured in periodic installments during the term and balance of sum assured at the end of the term.
- iii. **Whole life insurance:** It offers to pay the sum assured when the life assured dies, no matter when the death occurs. There is no fixed term for cover of death. The premiums can be paid throughout one's life or for a specified limited period.
- iv. **Unit Linked Insurance Plans:** These are essentially life insurance plans where the premiums are invested in the capital markets and the returns are therefore linked to the performance of the specific fund and the overall market. The fund choice is made by the customer and therefore the investment risk is borne by the customer. There is also specified life insurance risk cover available for which premium will be deducted before investment. There are also various charges applicable in this type of policies.

- v: There are other varieties among life insurance policies such as Variable Insurance Policies, Joint Life Policies and children's policies.

B. Health Insurance

Health insurance covers expenses towards treatment of diseases and / or injury. A health insurance policy could be either on an indemnity basis which involves reimbursement of expenses up to a specified limit or on a fixed benefit basis where the insurer pays a fixed amount of benefit irrespective of what the expenses are.

A health insurance policy (on indemnity basis) would normally cover expenses reasonably and necessarily incurred under the following heads in respect of insured person subject to overall ceiling of sum insured (for all claims during one policy period):

- i. Room, boarding expenses
- ii. Nursing expenses
- iii. Fees of surgeon, anaesthetist, physician, consultants, specialists,

Anaesthesia, blood, oxygen, operation theatre charges, surgical appliances, medicines, drugs, diagnostic materials, X-ray, dialysis, chemotherapy, radio therapy, cost of pace maker, artificial limbs, cost of organs and similar expenses.

Normally, health insurance policies are not issued for less than one year period.

A Personal Accident cover is also available for protection. In the event of death or disability, permanent or temporary, of the insured, arising as a result of an accident, it provides for compensation, which is either the whole or a percentage of the sum insured depending on the kind of loss.



C. Property insurance

In respect of insurance relating to property, there are many products available.

- a) **Householder insurance** is one of the most important insurance policies to buy as home is one of the largest financial investments made because of which it is very important to protect it.



- b) **Loss of or damage to property and assets** may be covered against fire and perils of nature including flood, earthquake etc. Machinery of industries may be insured against breakdown. Goods in transit can be insured under a Marine Cargo insurance cover. Insurance coverage is available for loss or damage to ships and aircrafts as well. The indirect loss caused due to inability to use the property or assets as a result of peril, called **consequential loss**, can also be insured.

- c) A **Motor Insurance** policy covers damage to the vehicle. Motor insurance covers your vehicle, be it a motorcycle, a car or a lorry, in case of accidents or theft. Further, while driving a vehicle, it is possible that the vehicle hits someone and causes death/ injury or damage to someone's property. As per the law, the owner of the vehicle is legally liable to pay compensation for any injury or damage to any person's life or property caused by the use of the vehicle in a public place. As insurance is a contract, where the insurer and the insured are the two parties involved, this liability can be to any other person, or in other words, to any **'third party'** to the contract. Hence, such liabilities are generally called **'third-party liabilities'**. Driving a motor vehicle without third-party insurance in a public place is a punishable offence in terms of the Motor Vehicles Act, 1988. A motor third party insurance policy is mandatory according to Motor Vehicles Act, 1988.



Property insurance is based on the principle of indemnity. The idea is to bring the insured to the same financial position as he /she was before the event occurred. It safeguards the investment in the property. Where there is no insurance, losses can destroy a project or an industry. Thus, general insurance offers stability to the economy and to the society.

D. Travel Insurance

Travel insurance is called by different names by insurance companies, but offers insurance protection while one travels. Travel insurance protects the insured person and his family from domestic and international travel related perils and losses like accidents, unexpected medical expenditure during travel, baggage loss, interruption or delays in flights etc.



The following covers are usually available under travel insurance though the combination may vary.

- i. Medical expenses with or without cashless facility (most travel insurance products offer cashless facility)
- ii. Personal accident
- iii. Loss of baggage
- iv. Delay in baggage arrival
- v. Loss of passport
- vi. Travel delay
- vii. Repatriation
- viii. Transportation of dead body etc.

The list, however, is not exhaustive.

E. Pensions

Consider this scenario

Anil was working as Senior Manager in a private company and was earning comfortably. He was living a luxurious life. After retirement, he received only provident fund amount which he invested in fixed deposits presuming that the interest would be sufficient for his needs after retirement. However, Anil fell seriously ill immediately after retiring. He was admitted to hospital and most of his deposits had to be closed for making payment to the hospital for treatment. The interest on remaining deposits was not sufficient to meet the expenses of Anil and his family. He had to depend on his children and relatives for his household expenses and health costs. Would it not be a



good idea for Anil to create a mechanism by which his savings get accumulated when he was young so as to give a regular source of income to meet his old age expenses?

Financial independence during old age is a must for everybody. Many people provide for their old age, by setting aside a portion out of their regular income during their earning period, to take care of post-retirement days. However there is a risk that one may live too long after one's retirement. In such a situation, one's savings may run out and may not be sufficient to meet one's income needs. We should appreciate that when an employee retires, he no longer gets his salary, but his need for a regular income continues. We should understand pension as a method of getting a regular income after one's retirement.

A pension or an annuity is a fixed sum paid regularly to a person, typically following retirement from working life. Many countries create funds for their citizens and residents to provide income when they retire (or become disabled). Insurance companies allow people to create funds from their savings from which they can get pension when they are old.

Pension becomes an ideal method of meeting this risk of surviving for long period after retirement because the pensioner can get definite income which is guaranteed throughout his lifetime.

There are two types of annuities (pension plans):

a) Immediate Annuity

In case of an immediate annuity, the annuity payment from the insurance company starts immediately. Purchase price (premium) for the immediate annuity is to be paid in lump sum in one installment only.

Example

Mira's grandfather retired from a private school at the age of 60 and received a sum of Rs. 15 lakhs as his provident fund. He invested Rs. 12 lakhs out of this for purchasing an immediate annuity from a life insurance company. Mira's grandfather would start getting his annuity payment every month from the next month itself.

b) Deferred Annuity

Under deferred annuity policy, the person pays regular contributions to the insurance company till the vesting age/vesting date. He has the option to pay as single premium also. The insurance company will take care of the investment of funds. The fund will accumulate with interest and the total amount will be available on the vesting date. The policyholder has the option to purchase an annuity for the entire amount or encash upto say 1/3rd of this corpus fund on the vesting date and purchase an annuity for the balance amount. This partial encashment is called commutation and the amount so received is tax-free.

Example

Shreyas saw a pension policy lying on his father's table. When he asked about it, his father, who is 45 years old, said that he would be paying a regular contribution of Rs. 50,000 per year for fifteen years, so that when he retires at the age of 60, he will have a sizeable fund with which he would purchase an annuity so that pension would be paid to him till the end of his life.

This is a deferred annuity. The vesting date would be the date when Shreyas's father would attain 60 years. On that day he would have an option to either purchase an annuity for full amount or commute a portion of the amount and purchase annuity for the balance amount.

While term insurance policies offer protection against the risk of early death, annuities are insurance policies that offer protection against the risk of surviving for too long.

F. Group insurance

Another kind of insurance is group insurance. In group insurance, schemes are offered by insurance companies to provide certain classes of individuals, the benefit of insurance coverage at moderate cost.

Example

Shri Kishore, an account holder of X Bank, has taken a credit card of the bank. He is exposed to the risk of loss of card and its fraudulent usage by another person. He has to approach an insurance company for this purpose. Similarly the bank has issued credit cards to thousands of other account holders. In this case, the risk to which all the card holders are exposed is similar. Issuing of individual policy for each card holder would be cumbersome and involving huge cost for the insurer. Similarly, the ability of Kishore to bargain with the insurer for a better rate for insurance for his credit card would be much less than that of the bank negotiating for its thousands of card holders. The bank can secure a cheaper insurance cover from the insurer. The insurer would be willing to offer cheaper rate because of reduced cost of acquiring business and better administration of the policies through the bank.

From the example, it can be seen that Kishore as a member of the group of credit card holders of X Bank can secure an insurance policy from the insurer on better terms. The policy taken by the bank is called a Group Policy. X bank is called Master policyholder or Group administrator. The cardholders like Kishore and others are called members or beneficiaries. A certificate will be issued to Kishore and other group members as an evidence of insurance.

Groups should consist of persons who assemble together with a commonality of purpose or engaging in a common activity. Examples of groups are employees of an organization, depositors, account holders or borrowers of a bank, members of a professional group or

association etc. Group policies can be issued for the above groups. Group policies could be group life insurance policies, group health policies or group non-life policies. However, the group should not be formed solely for the purpose of obtaining group insurance policy.

Group insurance taken by a bank for its customers



Case study: Group insurance

All villagers of Rudrapur assembled near the Chabutara. While villagers were sitting on their haunches, the Mukhia was sitting on a makeshift stage. The farmers of the village were there to discuss the serious problems faced by them year after year. One year it was loss of entire crop due to sudden downpour of rain at the time of harvest. The second year it was inundation as the river flowing nearby suddenly swelled, resulting in submerging of crops and many households, killing cattle, damaging tractors, agriculture pump sets etc. Most recently, last year there was a severe drought in the village.

There was a distraught look on everyone’s face to find a solution for mitigating such losses at least this year.

The only graduate of the village had come today from the city and all of them gathered to hear from him if he could provide any solution. “Certainly”, said Mr. Graduate. “We can protect ourselves through insurance. For protection from the losses to crops, agricultural machinery and cattle, each farmer can take agricultural insurance and other general insurance policies.”

The Mukhia enquired “Is protection only for our agricultural activity? What about loss of life, treatment in case of diseases etc.?”

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Mr. Graduate answered “For protection of life and health all you need is to have a group insurance, covering all households of this village”.

“Why is group insurance better than individual insurance”? One gentleman asked.

“Group insurance is offered to a homogenous group whose members are similar. For e.g. we are all part of this Gram Panchayat and the Gram Panchayat can take a group insurance covering all the villagers. Further, as it saves lot of administration work of issuing multiple insurance policies for the same risk, it is cheaper in comparison to individual insurance”.

“It is a very good idea” everyone nodded in agreement.

“Can we get health treatment under insurance for our families”? asked one lady sitting in one corner.

“Of course”, said Mr. Graduate. “But you have to purchase a group health insurance for availing such facility. One more thing you may be interested to know is about cashless facility under health insurance. Nowadays, most of the insurance companies have tie-ups with a network of hospitals and the claim amounts are directly paid to them in case of hospitalization so that hospitals do not charge money from you. It means, you just have to walk in with your proof of insurance to the network hospital to have free access to healthcare as per the policy under cashless facility”.

The Mukhia then rose from his chair and told. “Now we are going to take agricultural insurance for our crops and live stock and insure the entire village under Group insurance for our health and life”. Everyone applauded the decision.

CHAPTER 4

INSURANCE AND INDUSTRIES/ BUSINESSES

Learning outcomes

- A. Risks faced by business enterprises
- B. Shopkeepers' Package Policy

A. Risks faced by business enterprises

a) Business enterprises

In the previous chapter we have seen that insurance protects against misfortunes that affect a person and his assets. Insurance can also help out in protecting large and small industries, ships, aeroplanes, factories, hotels or even small shops.



In the world around us, we see a lot of small, medium and large enterprises. The word ‘enterprise’ usually means a complex company, business or project. Some enterprises are worth crores of rupees operating across the country and are run by the Government or by large business houses while some are locally run small businesses. Enterprises may do various activities like producing things like medicines, furniture, manufacturing equipment like vehicles, televisions, processing like making jam out of fruits, pickles or marketing goods and services etc. Most of the enterprises that we see around us are usually ‘small enterprises’ which do their businesses in a small way locally.

b) Risks faced by business enterprises

Let us look at the enterprises that we see near us. A hotel, a bakery or a provision shop is set up by an entrepreneur/businessman by investing his money for the purpose of earning money. However, in this process, he has to face various risks.

i. **Business related risks:** It is possible that the food prepared does not taste good and no one comes to eat in the hotel; or customers may develop a liking for some other type of food and may not come to the bakery to buy cakes or biscuits; or nobody visits the provision store when there is a weekly market nearby and provisions are available at low prices. These are business related risks that an entrepreneur can expect and take caution against as part of building his business. He can always try to compete with others in the market by making better food, reducing prices, making new varieties of cakes etc., so that he attracts more customers for his products. Such risks are normal business risks and are generally not insurable.

Now, let us look at other types of risks that he is facing.

ii. **Risks from natural calamities:** The hotel may be destroyed by an earthquake, the bakery could be washed away by floods and a fire can destroy the provision shop. Though he is all along exposed to such risks which can ruin him completely, the entrepreneur can do practically nothing about these as all these are events beyond his control. Insurance can take care of such risks that are chance events beyond human control.

The interesting part about these events is that though these can happen any time, these may not happen to one enterprise all the time. Rather, though all shops are always exposed to the

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risk of an accidental fire, in the normal case, the fire will actually strike only a very few shops in a small town and that too only once in a long period of time. Such risks are always there but their occurrence would be unexpected or accidental; and if the event happens, the loss can be defined and measured.

Insurance takes care of the second set of risks that are unpredictable or chance events. In the context of a shop, insurance works when the risks are shared by a large number of shopkeepers. By the system of insurance, the risks of a large number of similar shopkeepers exposed to same type of risks get pooled together. All of them contribute small amounts towards insurance. If any of the shopkeepers are affected by the insured risk, their loss is compensated from the pooled contribution. In operation, an insurance company takes over the specific risks of a large number of shopkeepers and collects premiums from all of them. The insurance company takes care of the fund and when the loss occurs, pays the value of the loss to the shopkeeper.

By their own studies, insurers know the kind of risks different categories of enterprises are exposed to. They have accordingly devised certain package policies for the ready use of certain groups- there are package policies for industries, factories, commercial premises, farmers, householders and shopkeepers etc.

B. Shopkeepers' Package Policy

Shopkeepers' Package Policy is designed to insure all the insurable risks of a large number of shopkeepers. It provides wide coverage against various accidental happenings like fire, earthquake, lightning, flood, burglary etc. The policy gives cover for the building, its contents, money kept in the shop etc. Based on the specific requirements of shopkeepers and on payment of additional premium, they can take additional coverage for others risks like the following:



- i. Losses due to dishonesty by employees
- ii. Losses due to incapacity to do normal business activity soon after a loss/ damage to the shop /building due to fire, burglary etc.
- iii. Damage to the neon sign and glow sign boards of the shops
- iv. Legal liability to any third party arising out of insured's business.

The cost of policy or the **premium** is determined on the basis of the type of insurance policy and cover selected. It broadly depends upon the:

- i. Perils (specific events that can cause a loss) covered
- ii. The coverage opted

- iii. The value of the items covered
- iv. The deductibles (the part of the loss that the insured agrees to bear himself) opted
- v. Construction of building, nature of occupancy
- vi. The location of property and contents of the shop etc.

Case Study: Industrial disaster and insurance protection

A Story of Industrial Disaster vis-à-vis Insurance Protection

Union Carbide India Ltd (UCIL) established a pesticide manufacturing plant in Bhopal during 1970s. Pesticides are chemicals to protect crops from getting damaged by pests. These chemicals are highly poisonous. On the night of December, 3, 1984, a poisonous gas, namely, Methyl Isocyanate (MIC) started leaking from a tank at UCIL Bhopal plant. Leakage of this gas claimed approximately 3800 lives as per official records and thousands of people became sick and suffered from several health related problems.

As we know, human life is invaluable and the true price of a life cannot be compensated. But the company was legally bound to pay compensation to the kith and kin/dependents of the victims who died due to this major event. UCIL was made to compensate the damages and they had to spend a huge amount of money on account of the legal battle for the damages payable due to happening of this event.

As a part of risk management, having insurance helps to make good the losses. Insurance also helps to assess the risk which indirectly ensures adequate preventive measures needed as precautions for avoidance of such accidents. In case of the unfortunate happening of the event, by having insurance, losses can be minimized as consequent financial liabilities could be transferred to the insurer.

Eventually, the chain of events led to the introduction of Public Liability Insurance Act in India. The main objective of the Public Liability Insurance Act, 1991 is to provide for damages to victims of an accident which occurs as a result of handling of any hazardous substances. The Act applies to all owners associated with the production or handling of any hazardous chemicals.

In such a situation, the company's Workmen's Compensation Policy takes care of the liabilities of the company to its employees. Under liability insurance, the insurance company would similarly take care of the company's liability to the public.

Further, if the 3800 people who died had life insurance policies, their families would have received some financial benefit to tide over the financial loss due to their sudden death. Personal accident policies would have given compensations for death and disabilities as well. If the thousands of sick people had health policies, their treatment costs would have been met by insurers.

CHAPTER 5

INSURANCE SECTOR IN INDIA

Learning outcomes

- A. Understanding regulatory framework
- B. Knowing about IRDAI's role and functions
- C. Learning about insurers, intermediaries and other institutions

A. Understanding insurance sector in India

a) Insurance regulation in India

- i. The Government began to exercise some sort of control on insurance business by passing the **Life Insurance Companies Act** and the **Provident Fund Act** in the year 1912.
- ii. Thereafter, based on the changing requirements of the industry, a comprehensive legislation, **The Insurance Act, 1938**, was passed followed by subordinate legislation including Insurance Rules, 1939.
- iii. This Act was further extensively amended in 1950 and thereafter in 1999 when the **IRDAI Act, 1999** was introduced.
- iv. Some other existing legislations in the field are - the Life Insurance Corporation (LIC) Act, 1956, the Marine Insurance Act, 1963, General Insurance Business (Nationalisation) Act, 1973, Motor Vehicles Act, 1988, the Redressal of Public Grievances Rules, 1998 framed by Central Government with regard to Insurance Ombudsman etc. Provisions of the Indian Contract Act, 1872 are applicable to the contracts of insurance and some of the provisions of the Companies Act, 2013 (previously Companies Act, 1956), are applicable to the companies carrying on insurance business.

Some of these Acts are under the process of revision as well.

v. Insurance Regulatory and Development Authority of India (IRDAI)

On 6th January 2000, the President of India gave his assent to the Insurance Regulatory and Development Authority of India Bill, which enabled opening up of the insurance sector to private players. The Insurance Regulatory and Development Authority of India (IRDAI*) Act, 1999 facilitates the establishment of Insurance Regulatory and Development Authority of India as an autonomous regulatory body for the Indian insurance industry. Accordingly, on 19th April, 2000, Insurance Regulatory and Development Authority of India (IRDAI*), was created under the IRDAI* Act, 1999 to regulate, promote and ensure orderly growth of the insurance industry and to protect the interests of policyholders.

Composition of IRDAI

The Authority consists of a

- i. A Chairperson
- ii. Five whole-time members and
- iii. Four part-time members

* Now renamed as Insurance Regulatory and Development Authority of India (IRDAI)

Functions of IRDAI

IRDAI has been set up mainly

- To protect the interests of holders of insurance policies;
- To regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

IRDAI issues certificate of registration to insurance companies and licenses to all intermediaries who are engaged in insurance related activities. IRDAI makes regulations for the various institutions/ entities operating in the insurance industry and supervises compliance with these regulations through returns and inspection. IRDAI also facilitates resolution of complaints against insurance companies.

As a part of its developmental role, IRDAI emphasizes on empowering public through policyholders' education, which helps to increase the insurance reach for the benefit of common man. It has adopted multipronged approach for educating consumers and organizes Insurance Awareness campaigns directly and through industry promoting insurance education across the country.

b) Indian insurance market

After opening up of the insurance sector in 2000, a number of private players entered Indian insurance market increasing the competition among Insurers for the benefit of consumers.

- i. By 2014, the insurance industry of India consisted of 52 insurance companies of which 24 are in Life insurance business and 28 are Non-life insurers.
- ii. Among Life insurers, **Life Insurance Corporation of India (LIC)** is the sole public sector company.
- iii. Out of 28 Non-life insurance companies, there are **six public sector insurers** of which two are specialized insurers namely, Export Credit Guarantee Corporation of India for export credit insurance and Agriculture Insurance Company of India Ltd. for crop insurance. Four private sector insurers are registered to exclusively underwrite policies in Health, Personal Accident and Travel insurance segments.
- iv. In addition to these, there is a sole national re-insurer, namely, **General Insurance Corporation (GIC)** of India.

B. Other institutions in Indian Insurance Market

In addition to the insurers, there are other institutions which are operating in the Indian insurance market.

a) Distribution channels and other intermediaries

- Intermediaries involved in distribution of insurance products are agents (individual, corporate and micro-insurance), brokers, web aggregators, Common Service Centres.
- Intermediaries like surveyors and loss assessors are involved in claim assessment of general insurance.
- Specialized intermediaries for health services called Third Party Administrators (TPAs) operate in Health insurance for issuance of policy cards, for organizing cash less treatment facility through network of hospitals, handling and settlement of claims.
- Insurance Repositories are intermediaries introduced recently to electronically maintain data of insurance policies for ease in storage, retrieval and servicing of insurance policies.

b) Insurance Ombudsman

In case a grievance of a policyholder is not redressed by the insurer, alternate grievance redressal mechanism is provided for in the insurance sector through the institution of Insurance Ombudsman set up under the Redressal of Public Grievance Rules, 1998.

Subject matter of complaints that can be taken up before Insurance Ombudsmen are partial or complete repudiation of claims and delay in settlement, non-issuance of policy, dispute relating to premium and interpretation of clauses in relation to claim. There is no provision for appeal against the order of Ombudsman under the Redressal of Public Grievances Rules. If not satisfied, the policyholder or claimant may ignore the award and go to the court, consumer forum etc., and if the customer consents, the insurer is has to implement the award unless it chooses to approach Court.

c) Self-Regulatory institutions

Self-regulation in insurance is through the Life insurance council and the General insurance council. These Councils include all registered life and general insurance companies as their members respectively and are statutory bodies constituted under the Insurance Act, 1938.

d) Training Institutions

As the various intermediaries in insurance sector have to fulfill specific requirements of eligibility like training and passing of examinations, training institutions form an important part of the Insurance Sector. Institutions like Insurance Institute of India, National Insurance Academy, Indian Institute of Insurance and Risk Management, Institute of Actuaries of India, Agent Training Institutes, etc. provide training, conduct examinations and provide professional manpower for the insurance sector.

Chart I
Indian insurance market

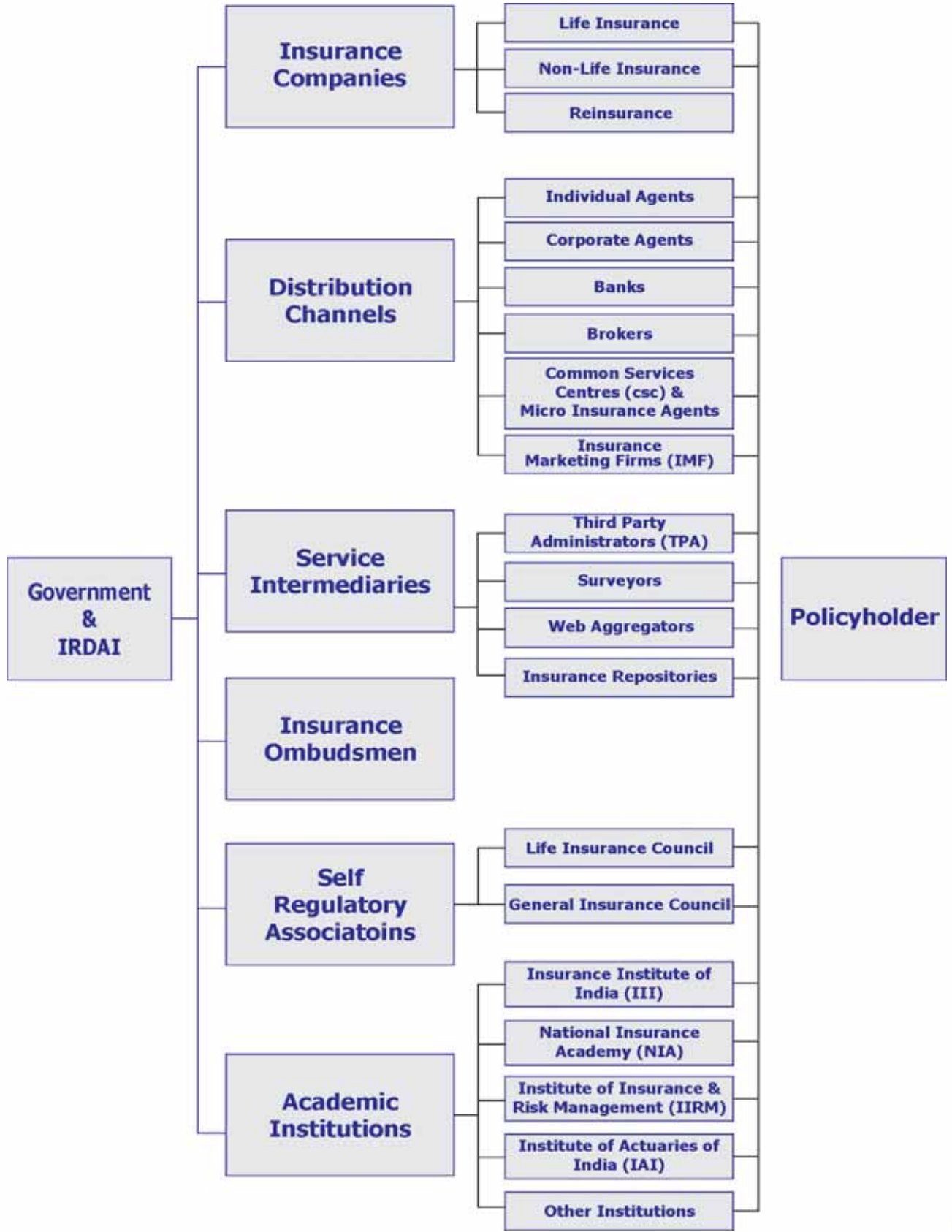
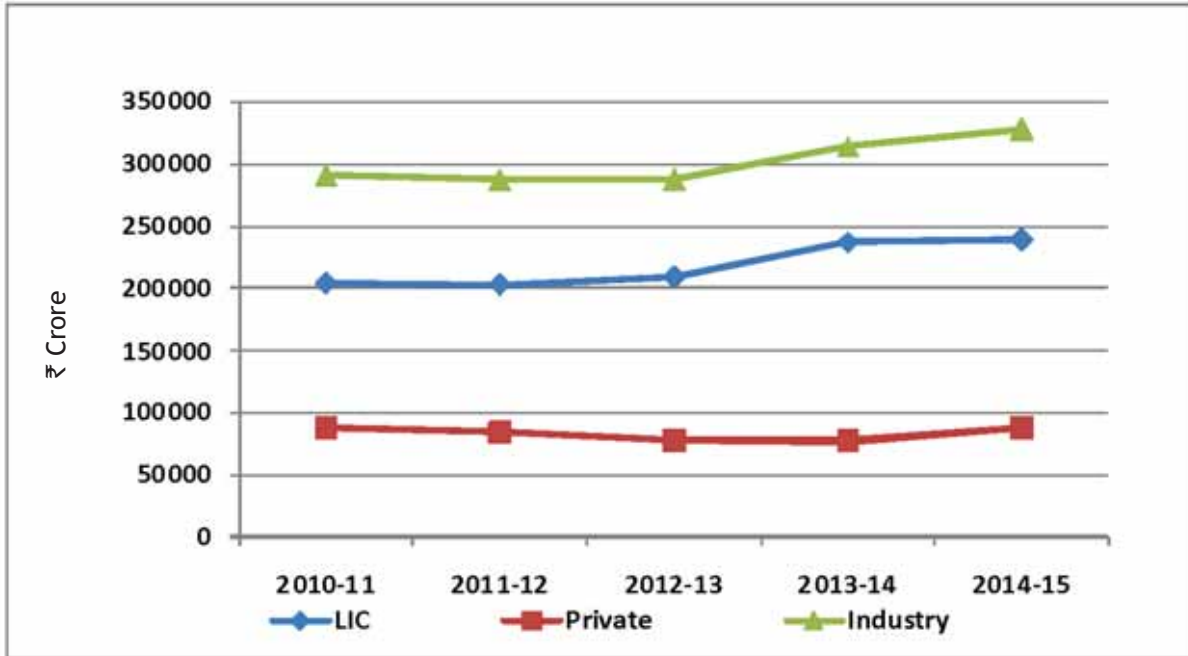
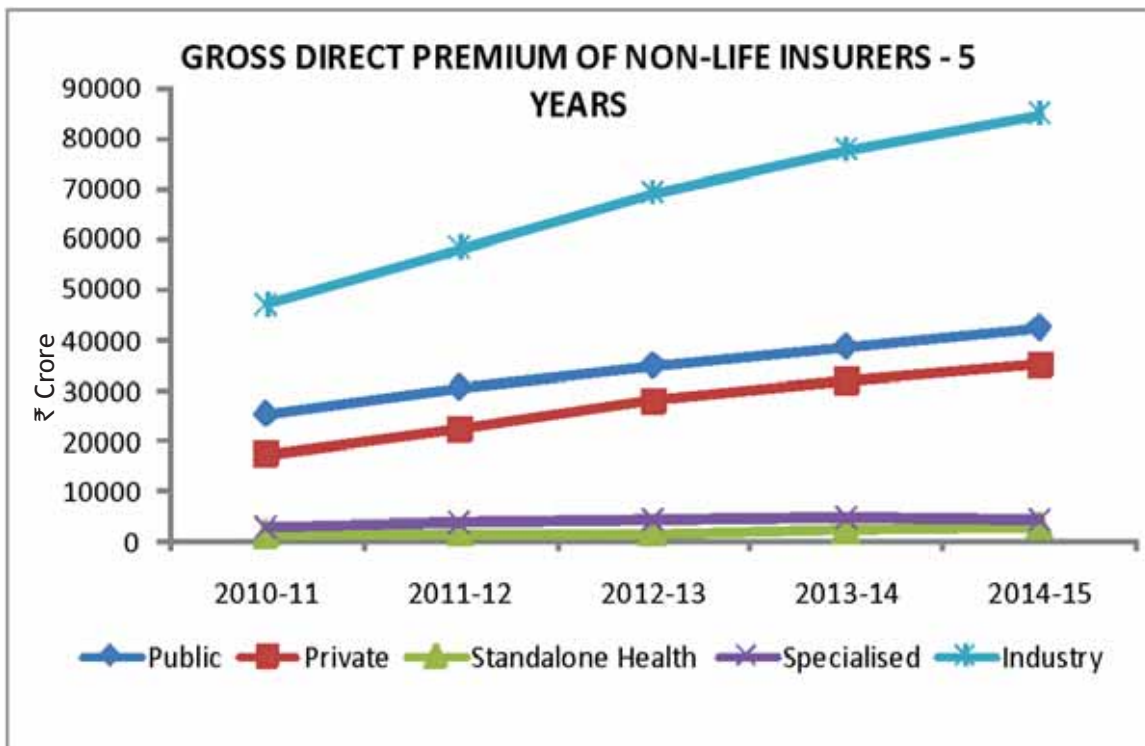


Chart 2
Total premium of life insurers in India-Last 5 years



Source : IRDAI Annual Report

Chart 3
Total Premium of General Insurance sector-Last 5 years



Source : IRDAI Annual Report

Chart 4
Insurance Penetration in India

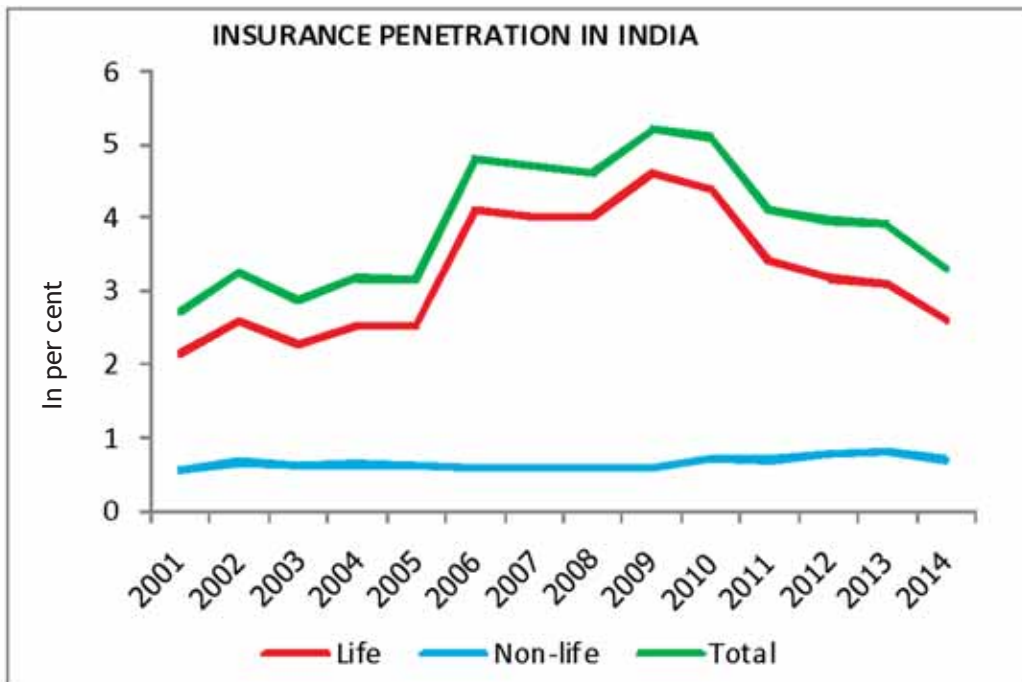
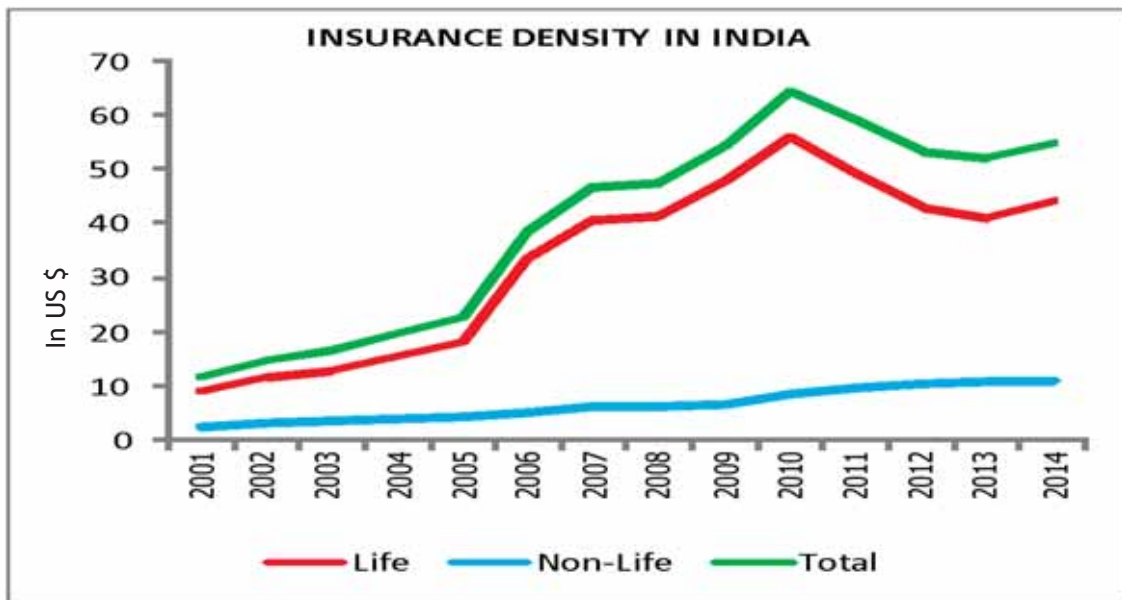


Chart 5
Insurance Density in India



* Insurance penetration is measured as ratio of premium (in USD) to GDP (in USD).

* Insurance density is measured as ratio of premium (in USD) to total population.

* The data of Insurance penetration is available with rounding off to one digit after decimal from 2006.

Source: Swiss Re, Sigma, Various Issues. (IRDAI Annual Report)

Disclaimer:

This handbook is intended to provide you general information only and is not exhaustive. It is an education initiative and does not seek to give you any legal advice.

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