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Class 11 commerce   Sub. BST. Date 13.10.2020

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BUSINESS SERVICES

Functions of Insurance

The various functions of insurance are as follows:

(i) Providing certainty: Insurance provides certainity of payment for the risk of loss. There are uncertainties of happenings of time and amount of loss. Insurance removes these uncertainties and the assured receives payment of loss. The insurer charges premium for providing the certainity.

(ii) Protection: The second main function of insurance is to provide protection from probable chances of loss. Insurance cannot stop the happening of a risk or event but can compensate for losses arising out of it.

(iii) Risk sharing: On the happening of a risk event, the loss is shared by all the persons exposed to it. The share is obtained from every insured member by way of premiums.

(iv) Assist in capital formation: The accumulated funds of the insurer received by way of premium payments made by the insured are invested in various income generating schemes.

Principles of Insurance

The principles of insurance are the rules of action or conduct adopted by the stakeholders involved in the insurance business. The specific principles of utmost significance to a valid insurance contract consists of the following:

(i) Utmost good faith: A contract of insurance is a contract of uberrimae fidei i.e., a contract found on utmost good faith. Both the insurer and the insured should display good faith towards each other in regard to the contract. It is the duty of the insured to voluntarily make full, accurate disclosure of all facts, material to the risk being proposed and the insurer to make clear all the terms and conditions in the insurance contract. Thus, it is binding on the proposer to disclose all material facts about the subject matter of the proposed insurance. Any fact, which is likely to affect the mind of a prudent insurer in deciding to accept the proposal of insurance or in fixing the rate of premium is material for this purpose. Failure to make disclosure of material facts by the insured makes the contract of insurance voidable at the discretion of the insurer.

(ii) Insurable Interest: The insured must have an insurable interest in the subject matter of insurance. One fundamental fact of this principle is that 'it is not the house, ship, machinery, potential liability of life that is insured, but it is the pecuniary interest of the insured in them, which is insured.' Insurable interest means some pecuniary interest in the subject matter of the insurance contract. The insured must have an interest in the preservation of the thing or life insured, so that he/she will suffer financially on the happening of the event against which he/she is insured. In case of insurance of property, insurable interest of the insured in the subject matter of the insurance must exist at the time of happening of the event. In order to name insurable interest however, it is not necessary that one should be the owner of the property. For example, a trustee holding property on behalf of others has an insurable interest in the property.

(iii) Indemnity: All insurance contracts of fire or marine insurance are contracts of indemnity. According to it, the insurer undertakes to put the insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against. In other words the insurer undertakes to compensate the insured for the loss caused to him/her due to damage or destruction of property insured. The compensation payable and the loss suffered are to be measured in terms of money. The principle of indemnity is not applicable to life insurance.

(iv) Proximate Cause: According to this principle, an insurance policy is designed to provide compensation only for such losses as are caused by the perils which are stated in the policy. When the loss is the result of two or more causes, the proximate cause means the direct, the most dominant and most effective cause of which the loss is the natural consequence. In case of loss arising out of any mishap, the most proximate cause of the mishap should be taken into consideration.

(v) Subrogation: It refers to the right of the insurer to stand in the place of the insured, after settlement of a claim, as far as the right of insured in respect of recovery from an alternative source is involved. After the insured is compensated for the loss or damage to the property insured by him/her the right of ownership of such property passes on to the insurer. This is because the insured should not be allowed to make any profit, by selling the damaged property or in the case of lost property being recovered.

(vi) Contribution: As per this principle it is the right of an insurer who has paid claim under an insurance, to call upon other liable insurers to contribute for the loss of payment. It implies, that in case of double insurance, the insurers are to share the losses in proportion to the amount assured by each of them. In case there is a loss, when there is more than one policy on the same property, the insured will have no right to recover more than the full amount of his actual loss. If the full amount is recovered from one insurer the right to obtain further payment from the other insurer will cease.

(vii) Mitigation: This principle states that it is the duty of the insured to take reasonable steps to minimise the loss or damage to the insured property. Suppose goods kept in a store house catch fire then the owner of the goods should try to recover the goods and save them from fire to minimise the loss or damage. The insured must behave with great prudence and not be careless just because there is an insurance cover. If reasonable care is not taken like any prudent person then the claim from the insurance company may be lost.