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Date and Time: 11 August 2020 21:39:00 IST

Job Number: 123028836

Documents (17)

1. *Chapter 1-10—Introduction*

   Client/Matter: -None-

2. *Chapter 11—Insurance Intermediaries*

   Client/Matter: -None-

3. *Chapter 12-17—Nature and Scope of Life Insurance*

   Client/Matter: -None-

4. *Chapter 18-21—The Definition, Nature and Scope of Fire Insurance*

   Client/Matter: -None-

5. *Chapter 22-27—Nature and Scope of Marine Insurance Contract*

   Client/Matter: -None-

6. *Chapter 28-35—Nature and Scope of Miscellaneous Insurance*

   Client/Matter: -None-

7. *APPENDIX I-IV*

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    Client/Matter: -None-

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    Client/Matter: -None-

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    Client/Matter: -None-

Chapter 1 Introduction

Nature of Insurance

Hindu philosophy gives the axiomatic truth of the nature of insurance Yat bhavathi tat nasyathi which means whatever is created will be destroyed. The universe as a whole is created; as a thing created it is but natural that it will be destroyed. Creation is inevitably followed by destruction. Destruction is an optimum change to the worse; in that sense change is a natural course and its occurrence involves risk. Risk is therefore inevitable in life. Business is a course of life; so in life and business, there lie a variety of risks. Risk is closely connected with ownership. The owners want to save themselves from risk and out of this desire, the business of insurance born.

The aim of all insurance is to protect the owner from a variety of risks which he anticipates. He who seeks this protection is called the assured or insured and the other person who takes the risk by undertaking to protect that other from loss is called the underwriter or insurer and he does this for a small consideration called the premium. So a contract of insurance may be defined as a contract whereby one person, called the insurer, undertakes, in return for the agreed consideration, called the premium, to pay to another person, called assured, a sum of money or its equivalent on the happening of a specified event. The happening of the specified event must involve some loss to the assured or at least should expose him to adversity which is in the law of insurance commonly called the risk. The nature of insurance depends on the nature of the risk sought to be protected. The chief and classical varieties of insurance contracts are (i) life (ii) fire (iii) marine and in the modern times new varieties have been added from time to time like liability insurance and third party risk. The categories of insurance form a list which is not closed. In fact, in modern times, the happening of any event may be insured against at a premium directly proportional to the risk involved on its happening. An element of uncertainty must be present in the course of the happening of the event insured against; in some cases, in almost all non-life insurance contracts, the happening of the event itself is uncertain while in life insurance the event insured, that is the death of an individual is a certain event, but the uncertainty lies in the time when it happens.

The fundamental function of insurance is to shift the loss suffered by a sole individual to a willing and capable professional risk-bearer in consideration of a comparatively small contribution called the premium. From the viewpoint of an economist, insurance is a process whereby the risk of financial loss arising from death or disability of a person or damage, deterioration, destruction or loss of property owing to perils to which they are exposed, is assumed by another. In this process, the professional risk-bearer collects some small rate of contribution from a large number of people and if there is any unfortunate person amongst them, the risk-bearer i.e. the insurer, relieves the sufferer from the effects of the loss by paying the insurance money. According to Maclean,

Insurance is a method of spreading over a large number of persons a possible financial loss too serious to be conveniently borne by an individual.[1]

Thus it serves the social purpose; it is a social device whereby uncertain risks of individuals may be combined in a group and thus made more certain; small periodic contribution by the individuals providing a fund out of which those who suffer losses may be reimbursed.

Thus the institution of insurance serves a two-fold purpose, the immediate, short range and proximate purpose and the far-sighted long-range and remote purpose. The immediate and direct object is to protect the individual assured from any loss or damage to his life or property by distributing the loss among a large number of persons through the media of the professional risk-bearers, the insurers, thus serving also the sociological purpose. The far-sighted and long-range purpose is to accelerate the economic growth of the nation. The insurers collect the savings of numerous policy-holders and these funds are invested in organised commerce and industry. They help the running

of giant industries and mobilise capital formation. By insuring the lives of the workmen, they are relieved of their anxiety and worry and put their heart and soul in their work. The employer too by insuring the lives of workmen, his machinery, building etc, will have peace of mind and can become carefree. So it has been rightly said: Life insurance is one of those agencies which improves the mental, moral and national circumstances and raises the condition of the community of which they are members.[3] These observations apply equally to all branches of insurance. The insurance company will have large funds available with them, which they may utilise in helping the formation of big industries directly or by underwriting securities of those companies which tend to help in the growth of the commercial prosperity of the nation.

There is no denying the fact that growth of industrialisation is an adventure in which the triumvirate namely, industry, credit and cover of insurance make a sojourn in each others companionship.[4]

Insurance thus reduces the fears of future risk to the individual insured and by capital formation it helps the growth of industry, accelerates production, lubricates the machinery of production and distribution and improves the economy of the nation. It mobilises the resources, accelerates and stabilises growth and helps in the establishment of a welfare state.

History of Insurance

Marine Insurance

Marine insurance was the oldest type of insurance in England and it was imported from the cities of Northern Italy where it probably began at about the end of the 12th century. On the passing of the Bubble Act 1720, two companies, London Assurance and Royal Exchange Assurance obtained charters in the same year. The Act created a monopoly in marine insurance to these corporations by prohibiting other corporations, partnerships and societies from engaging in marine insurance as a business. Even before these corporations were granted the charters, individual merchants used to meet in Lambard Street and effect contracts of marine insurance and they continued as competitors to the chartered companies. It was only during the 18th century that marine insurance was started as a specialised business. Coffee-houses were the common meeting places for businessmen and business transactions of importance were negotiated there during the later half of the 17th century and the early 18th century. Of such coffee-houses, Lloyds coffee-house named after its proprietor Edward Lloyd, who opened the coffee-house in Tower Street, London, became a rendezvous for the ship owners, seamen and merchants. Some time later, the proprietor of Lloyds started a business newspaper called Lloyds List (1734) which is published even today. Slowly it gained influence and found place in the premises of the Royal Exchange and some time later moved to its own building adjacent to that and became a worldwide organisation.

The Royal Exchange Assurance and the London Exchange from the corporate side, and Lloyds, being a common meeting place for individual underwriters started and developed marine insurance in England. The corporations monopoly was repealed after a little over a century, in 1824, when a few joint stock companies entered the field. Many companies were formed after the passing of the Joint Stock *Companies Act* 1862. By about this time the steamship was invented and foreign trade improved. As a result marine insurance also expanded and provided sufficient business to both the joint stock companies and the individual underwriters, who created a world market for marine insurance. The marine insurance business today is regulated by the provisions of the English *Marine Insurance Act* 1906.

In India even during Aryan period, there was evidence of the existence of some thing like marine insurance. But marine insurance, as known in the civilised world today, had its origin only in England. Seven marine insurance companies, of which none is in existence today, were started between 1797 and 1810, in Calcutta. Later, mostly composite offices were started. Most of the British offices had branches in India and they acted as world offices. Early monopoly and later increased rates of duties charged on British offices tempted them to form independent offices in the colonies of the Commonwealth including India and thus the British offices exercised tremendous influence in the Indian insurance market. The rules in English law were applied in India with little variation to adapt them to Indian circumstances. After Independence and with the abolition of the Privy Council, the Indian Superior courts including the Supreme Court started drawing authority from the other foreign sources, like the American cases. But today marine insurance is regulated by the Indian *Marine Insurance Act 1963*, which is but a replica of the English *Marine Insurance Act* 1906.

Fire Insurance

After marine insurance, fire insurance was the next to be organised in England. The great fire of London 1666, was

mainly responsible for the establishment of this branch of insurance. Added to this the effects of the Industrial Revolution in England enormously exposed the properties to the risk of fire and the need for fire insurance increased. Again impetus for organised action was given by the disaster of the Tooley Street Fire in, 1861. If the first great fire originated this branch of insurance the second became responsible for streamlining the organisation and blended the two paradoxical principles of competition and collaboration. The fire officers committee consisting of representatives of all insurers was formed. It established, for public benefit, a fire testing station with the collaboration of government departments and ultimately established the joint fire research association (1946). The fire offices had enough business both at home and abroad.

In India most of the successful fire insurance business was only through brokers and branches of foreign companies of Britain, America, and even Japan. The Alliance British and Foreign Fire Insurance Co first established an agency office at Madras and probably this agency office was the first to issue a fire policy in India. Soon other offices like the Royal Insurance Co, the Liverpool and London and Globe, North British and Commercial Union started many branch offices at Bombay, Calcutta and other presidency towns. Slowly the business spread to the mofussil areas. During the last century, many fire offices were started but were closed down shortly.

Life Insurance

In England, even before the mortality tables were available, mutual life assurance was prevalent in the 17th century commencing with short term insurances and all these mutual offices disappeared with the passing of the Bubble Act 1720. Only the Amicable Society survived. It was started in 1705 and its business increased by 1757. In 1807, a fresh charter was obtained and the Amicable Society thereafter transacted life insurance according to modern methods. For a number of decades, it was the only society which offered whole life assurance. In the meanwhile, mortality tables were prepared which made it possible to do profitable and scientific life insurance business. Towards the end of the 17th century the requirement of insurable interest was done away with when the life insurance business became a way for gambling. To check this evil, the Life Assurance Act 1774 was passed. Then came big joint stock companies which started business on sound and scientific principles. Protective legislations like the Policies of Assurance Act 1867 and the Life Assurance *Companies Act* 1870 were passed. The Act of 1867, which regulated the life insurance business was repealed and replaced by the Assurance *Companies Act* 1909 and the legislation now in force is in the Insurance Companies Acts, 195867. In the later years, ordinary life business was extended to accident insurance and further by industrial and technological advancements to industrial insurance. Instances of this branch can be found in liability insurance such as engineering, motor vehicles and aviation insurances.

In India, the known history of life insurance commenced in 1871 with the starting of the Bombay Mutual followed in 1874 by the Oriental, both in Bombay. There was a steady growth from 1870 to the beginning of this century as many other life offices were established in India. The history during the first half of this century may, for purpose of convenience be divided into the following periods:

Period of Mushroom Growth (19001912) During this period there was a mushroom growth of Indian companies and this was mainly due to the Swadeshi movement which promoted the boycott of British goods, British institutions and everything British. This gave encouragement to the erstwhile and shyful indigenous talent and capital. Many life offices were established with complete Indian capital. This indiscriminate mushroom growth, led to the appearance of some evil which had to be checked for which the Indian Life Assurance Act (Act 6) of 1912 was passed on the lines of the English Assurance *Companies Act* of 1909. It may be said that the authoritative history of Indian insurance began to be recorded for the first time when, the Government of India under this Act started publishing returns of life insurance companies in India in the year 1914.

Period of Struggle and Steady Growth (19131938) This is the period between the two world wars. During this period, indigenous life offices had to pass through a critical period. The sudden growth of business due to the impetus given by the national movement brought with it evils of its own due to accumulation of wealth and inexperience in business. When this was checked by the Life Assurance Act (Act 6) of 1912, followed by the first world war and the consequent economic slump, business had to struggle for its steady growth. Many small offices had to be wound up and the few that survived had to face the competition of many flourishing foreign offices.

After the first world war, when the Britishers refused to grant even the promised dominion status, there was again a united national movement demanding complete independence and to denounce and once again to pledge to boycott British institutions. This anti-British national spirit again gave life to the Indian life offices and their business. The government was compelled to protect the Indian insurance business and in 1934, Sri SC Sen was appointed as special officer to investigate and report on reform of insurance law. In 1936, a committee under the chairmanship of

Sri NN Sircar was appointed to examine the report of the special officer. In 1937, a draft bill was introduced and in 1938 the *Insurance Act* was passed. The Act provided for a uniform control by government over all insurers, Indian as well as foreign, as a result of which several foreign offices discontinued their business in India.

Period of Stability and Consolidation (19381950) Being free from the competition of the foreign offices, the Indian offices gained stability and they brought about the necessary changes in their office organisation, terms and conditions in their policies etc, to conform to the provisions of the 1938 Act. After the second world war, the swadeshi movement gained strength and national spirit increased. By this time the Indian industries also started developing. The business of insurance assumed significant size and importance as large amounts of capital were available with them for investment in the developing industries. There was sometimes malinvestment of insurance funds for the selfish purposes of the people in charge of these offices. In 1945, the government appointed a committee under the chairmanship of Cowasji Jehangir, which condemned the malpractices in the matter of investing the funds available with the insurers. This led to the regulation of investments and the *Insurance Act* has been so amended several times.

The partition of the country, made a good number of policy-holders leave their policies. The non-devaluation of the Pakistan currency in September 1949, created a number of problems. An informal committee was again appointed under Sri SR Ranganathan and this reviewed the entire insurance law and submitted its report on the basis of which the Insurance Amendment Act 1950 was passed. The Act made far reaching changes to make insurance institutions more useful for the countrys economic growth. It provided for amongst other things, appointment of a controller of insurance, *constitution* of a life insurance council and a general insurance council and also made provisions for the appointment of investigators and administrators for ill-managed and sick companies. Provisions regarding investments are also made. To reduce drain of foreign exchange compulsory reinsurance with Indian insurers was insisted upon.

Period of Boom and Nationalisation (1950 upto date)Political independence under the stewardship of our first Prime Minister Jawaharlal Nehru, the people of India moved to achieve their economic independence by the Five Year Plans. The agrarian society was to be industrialised by governmental activity and planning. The level of education was also rising as a consequence of which the insurance consciousness in the people of the country increased. There was increased confidence in domestic companies. The leading insurers also indulged in vigorous developmental programmes. All these contributed to a boom in the insurance business and in particular in life business. Huge amount of capital were available with the insurers and the government found it handy to utilise these funds for its developmental plans and also to ensure the investing public, a better security. The life insurance business was first nationalised in 1956 by the passing of the *Life Insurance Corporation Act 1956*. The Life Insurance Corporation was created on 1 September 1956 conferring on it the exclusive privilege of carrying on life insurance business in India except to the extent otherwise expressly provided in the Act.

The controlled business of all insurers whose business was nationalised was taken over by the Corporation along with their assets and liabilities. The original capital of the Corporation was Rs 5 crores which was provided by the Central Government under the Act. The creation, control and extension of the Corporation is in the hands of the Central Government.

Along with the life, fire and marine, other insurance like motor vehicles, aviation, burglary and other liability insurances also developed. In the beginning this business was monopolised by British firms. The Indian insurer got into this business during the present century. All reinsurance business was in the hands of the foreign firms and the first Indian reinsurance concern, namely, the Reinsurance Corporation of India was formed in 1957 with a view to stop the heavy drain on our foreign exchange. After the nationalisation of the life business, the *Insurance Act 1938* applied mainly to the general insurance. By a drastic amendment in 1968 to the Act, more effective control and supervision was provided over the general insurance companies requiring increased deposits from them, giving the controller of insurance more powers to inspect and issue directions to the insurers in all matters including the appointment and removal of their directors, constituting a tariff advisory committee to fix, control and regulate the rates of premiums, conditions of policies etc. The function of the tariff advisory committee in fixing and revising the rates of tariff was held as a legislative power and not an administrative one and so binding on the insured in the same manner as any other provisions of the *Insurance Act*.[5] In spite of such control there was a persistent public demand for the nationalisation of the general insurance business, on which, an ordinance was promulgated by the President of India on 13 May 1971, which was replaced by the General Insurance (Emergency Provisions) Act 1971. Finally, in 1972, the general insurance business was also nationalised by setting up a government corporation called the General Insurance Corporation with four subsidiary companies for carrying on the general insurance business. The nationalised insurance companies were expected not to confine themselves to the present activities but would cover new fields in due course.

Also new standards of behaviour in their dealing with their customers, the policy holders and developing a new insurance jurisprudence have been set up by the judiciary in India. Courts in India imposed on the two corporations as part of their duties to act in consonance with the principles laid down in the directive principles in the *Constitution*. They have been equated to sovereign instrumentalities. In *Asha Goel v LIC*, Kantharia J rightly observed:

The business activities of the LIC are not of a purely commercial nature. LIC is a statutory corporation being an Authority or an Instrumentality of the State within *Article 12 of the Constitution*, the contract of the life insurance entered into by the Life Insurance Corporation are for the welfare and benefit of the society as it is the primary goal of the LIC to promote the welfare of the people.

Hence a writ under Article 226 can lie against the LIC for enforcement of its liability though contractual.

Even in conducting litigation the judiciary kept the state and its instrumentalities on a higher pedestal than a common litigant. It has been said that the obligation on the part of the state or its instrumentality like the

LIC or GIC to act fairly can never be over emphasised.[7] They should not behave like cantankerous litigants. In *Assam and Meghalaya SRTC v Abdul Razak*, the State Road Transport Corporation without extending a helping hand on humanitarian grounds to the victim aged 28 years who, due to rash and negligent driving, suffered multiple injuries including a leg injury resulting in amputation of the leg from the thigh, hotly contested an award of compensation of Rs 60,000 as high. The court observed, Public policy should resist the temptation to litigation like cantankerous litigants for insignificant amounts, raising technical pleas.

This is precisely what the Supreme Court has said in Trustees, *Bombay Port Trust v Premier Automobiles Ltd.* [9] In *National Insurance Co v Jugal Kishore*, the insurer, an instrumentality of the state, while defending the claim for compensation on the ground that its liability was not in excess of the statutory liability, did not file a copy of the policy before the tribunal or the High Court. Had they produced the policy there would have been no need to come to the Supreme Court. Ojah J, therefore remarked:

This court has consistently emphasised that it is the duty of the party in possession of document which would be helpful in doing justice in the cause to produce it and such party should not be permitted to take shelter behind the abstract doctrine of burden of proof. This duty is greater in the case of instrumentalities of the state. The obligation on the part of the state or the instrumentalities to act fairly can never be over emphasised.

In a series of cases the judges reiterated their strong disapproval of state undertakings like the ESIC, LIC, GIC, STRC etc raising technical pleas to defeat honest claims of victims of accidents by legally permissible but marginally unjust contentions including narrow limitation.[12]

Era of Privatisation

The insurance sector is open to participation by private insurance entities on the recommendation of the Malhotra Committee. This does not mean that the public sector entities do not continue their activities in the insurance sector. After this privatisation, both public and private sector entities play their roles simultaneously. In this context, financial institutions play a key role in the growth process of insurance. More competitive environment and rapid expansion in insurance sector is expected to emerge with new private participants. The nature and scope of the insurance sector is fast changing with the passing of the *IRDA Act 1999*, the details of which are discussed in the next chapter.

Chapter 2 The Insurance Regulatory and Development Authority

Introduction

In the last decade of the last century, there was a wave of liberalisation in all economic sectors of the country including the insurance sector. By that time, insurance was in the public sector and for recommending changes in

the insurance sector, the government appointed a committee in April 1993 under the chairmanship of Sri RN Malhotra, ex-governor of the Reserve Bank of India. This committee on reforms of the insurance sector submitted its report on 7 January 1994 to the then Union Finance Minister recommending many changes including its privatisation. The terms of reference of the committee included a requisition of recommendation, for creating a more efficient and competitive financial system suitable for the requirements of the changing scenario of the economy of the country and in particular the examination of the structure of the insurance industry. Recommendations were also sought from the committee for strengthening and modernisation of the insurance regulatory system for smooth development of the insurance sector. Far-reaching and virulent changes were recommended to supplement the hitherto monopolistic insurers in the arena of the insurance industry.

It recommended far-reaching amendments to regulate the insurance sector to adjust with the economic policies of privatisation. The most important recommendations are listed below:

1. Recommendation of the entry of private entities into the insurance sector to introduce healthy competition between the new private insurers and the existing monopolistic entities including limited participation of foreign equity, banking and cooperative sector.
2. Recommendation of gradual withdrawal of government capital in the existing public sector monopolistic entities, the Life Insurance Corporation and the General Insurance Corporation and its subsidiaries and also de-linking of the subsidiaries making them independent entities.
3. Recommendation that the General Insurance Corporation would exclusively deal with the reinsurance business.
4. Recommendation to spread the insurance sector to rural areas by taking assistance of institutions like *panchayats*, selected voluntary organisations, mahila mandals and cooperatives.
5. Recommendation to delink the tariff advisory committee from the General Insurance Corporation and the committee should act as an independent statutory authority.
6. In pursuance of the last but most important recommendation of the Malhotra Committee the government had taken a decision in 1996 to establish a Provisional Insurance Regulatory and Development Authority to replace the erstwhile authority called the Controller of Insurance, constituted under the *Insurance Act 1938*, which first worked under the Ministry of Commerce and was later transferred to the Ministry of Finance.

The decision for establishment of the Insurance Regulatory and Development Authority was implemented by the passing of the *Insurance Regulatory and Development Authority Act 1999* (Act 4 of 1999). The Preamble of the Act reads:

An Act to provide for the establishment of an authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the Insurance industry and for matters connected therewith or incidental thereto and further to amend the *Insurance Act 1938*, the *Life Insurance Corporation Act 1956* and the *General Insurance Business (Nationalisation) Act 1972*.

As can be seen from the above the first and the most important object of the Act is to establish a regulatory authority as recommended by the Malhotra Committee. Every institution, more so a financial institution where the ownership is divested from its management and the right of the management is vested in a body other than the owners, an impartial independent and potent regulatory authority is inevitable. When the insurance industry was a part of the public sector with a monopoly, the owner was a single entity, the government, and in such a case it was sufficient if it is regulated by a governmental body like the Controller of Insurance; but when insurance is to be privatised, there is a greater need of a regulatory authority since the smooth functioning of business depends upon the trust and confidence reposed by customers in the solvency of the entity now permitted to enter the scene of the insurance market. If the customers cannot repose trust in the company to keep the promises it makes, the insurance products pale into insignificance in their value of the customer-consumers. The regulatory framework in relation to insurance is desired to take care of three major concerns, viz,

(a) the protection of the interest of the consumers;

(b) to ensure the financial soundness of the insurance industry, and

(c) to pave the way to help a healthy growth of the insurance market, where both the government and private parties play simultaneously.

The need for a strong regulatory authority was not felt so long as insurance remained a monopoly of the government. With the granting of the permission for the private entities to play along with the instrumentalities of the government the need for an independent regulatory authority became paramount. With the passing of the *Insurance Regulatory and Development Authority Act 1999* (hereinafter referred as the Authority) this has become a reality.

The Act is a small enactment containing 32 sections divided into 6 chapters. There are schedules attached to it of which the second and third schedules merely declare that the principle of the exclusive dealings of the Life Insurance Corporation and General Insurance Corporation be withdrawn by introducing amendments to *s 30 of the Life Insurance Corporation Act 1956* and *s 24 of the General Insurance Business (Nationalisation) Act 1972* and they read:

After s 30 insert the following:

30A. Exclusive privilege of corporation to cease:

Notwithstanding anything contained in this Act, the exclusive privilege of carrying on the life insurance business in India by the Corporation shall cease on and from commencement of the *Insurance Regulatory and Development Authority Act 1999* (41 of 1999) and the corporation shall, thereafter carry on life insurance business in India in accordance with the provisions of the *Insurance Act 1938* (Act 4 of 1938).

After s 24, insert the following:

Exclusive privilege of corporation and acquiring companies to cease:

Notwithstanding anything contained in this Act, the exclusive privilege of the corporation and the accruing companies of the carrying on of general insurance business in India shall cease on and from the commencement of the *Insurance Regulatory and Development Authority Act 1999* and the corporation and the acquiring companies shall, thereafter, carry on general insurance business in India in accordance with the provisions of the *Insurance Act 1938* (4 of 1938).

Further, the subsidiaries of the General Insurance Corporation were delinked and made independent entities. All these companies have to do insurance business along with the new entrants, the private entities. The *Insurance Act 1938* as amended by the Act applies alike to all companies, old and new as amended by the first schedule of the 1999 Act. Section 30 of the Act says that The *Insurance Act 1938* shall be amended in the manner specified in the first schedule.

The Insurance Regulatory and Development Authority Act 1999

Establishment of IRDA

Chapter 2 of the Act 2 provides for the establishment of the Insurance Regulatory and Development Authority. It declares the Authority to be a body corporate with perpetual succession and common seal. It can hold property, enter into contracts and is entitled to sue and is liable to be sued by its name. The Authority shall have its head office at such a place as the Central Government notifies and it may establish its branches at other places in India. Section 13 provides for the transfer of all properties rights and liabilities of the Provisional Insurance Regulatory and Development Authority to the present authority.

Composition

The Act states that the Authority should consist of a chairperson, not more than five full-time and not more than four part-time members to be appointed by the Central Government.[13] The chairperson and other members shall hold office for 5 years and are eligible for reappointment. The chairperson shall not be above 65 years and other persons above 62 years. The members are permitted to relinquish their offices and are also liable to be removed from office in accordance with the provisions of s 6. The Central Government may remove a member from office if he has or at any time has been adjudged as:

(i) an insolvent or (b) has become mentally or physically incapable of acting as a member or (c) has been convicted of any offence involving moral turpitude or (d) has acquired financial interest as is likely to effect prejudicially his functions as a member or (e) has abused his position as to render his continuation

detrimental to the public interest. He can be removed only after giving him a reasonable opportunity of being heard in the matter.

(ii) their salaries and allowances are to be prescribed by rules (s 7). The chairperson and the whole-time members cannot accept for a period of two years from the time they cease to hold office any government appointment, central or state, or in a company in the insurance sector without previous approval of the Central Government. The chairperson should have the power of general superintendence and direction in respect of all administrative matters of the Authority.[16]

Meetings

The Authority shall hold its meetings at such times and places and shall observe such rules and procedures including quorum as determined by the regulations made by itself.[17] If the chairperson is absent, a member present may be elected to preside over that meeting and the decision of the Authority is by majority and if they are divided equally the president has a second casting vote. Any vacancy or defect of appointment or mere irregularity in proceeding does not invalidate the proceeding.[19] The Authority can recruit necessary staff and their terms and conditions of service shall be according to the regulations under Chapter 13. All the assets and liabilities of the Interim Insurance Regulatory and Development Authority are transferred to the Authority under the Act.[20]

Duties, Powers and Functions of the Authority

The lone s 14 in Chapter 4 provides for the duties, powers and functions of the Authority.

Duties

The only duty of the Authority is to regulate, promote and ensure orderly growth of the insurance and the reinsurance business. This is subject to the provision of the Act and any other law for the time being in force.[21]

Powers and Functions

Section 14 (2) describes and delineates the powers and functions of the Authority and it contains cll (a) to (q). The last sub-cl (q) suggests that the powers and the functions mentioned therein are not exhaustive and the Authority reserves its powers to add to the list s 14 (2) which reads as:

Without prejudice to the generality of the provisions contained in sub-s (1), the powers and functions of the authority shall include:

(a) issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;

(b) protection of the interests of the policy-holders in matters concerning assigning of policy, nomination by policy-holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;

(c) specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;

(d) specifying the code of conduct for surveyors and loss assessors;

(e) promoting efficiency in the conduct of insurance business;

(f) promoting and regulating professional organisations connected with the insurance and re-insurance business;

(g) levying fees and other charges for carrying out the purposes of this Act;

(h) calling for information from, undertaking inspection of, conducting inquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;

(i) control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under *s 64 U of the Insurance Act 1938* (4 of 1938);

(j) specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

(k) regulating investment of funds by insurance companies;

(l) regulating maintenance of margin of solvency;

(m) adjudication of disputes between insurers and intermediaries or insurance intermediaries;

(n) supervising the functioning of the Tariff Advisory Committee;

(o) specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);

(p) specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

(q) exercising such other powers as may be prescribed.

The Act by amending the *Insurance Act* in effect transfers all the powers and duties hitherto enjoyed and discharged by the Controller to the Authority.

Finance and Accounts

Chapter 5 deals with finance, accounts and audit of the Authority. Section 15 provides that the Central Government may grant such sums of money as the government may think necessary. Further, s 16 provides that a fund maybe created and called The Insurance Regulatory and Development Authority Fund and consists of:

(a) the government grants, fees and charges received by the Authority;

(b) all sums received by the authority from such other sources as may be decided upon by the Central Government and

(c) the percentage of prescribed premium income received from the insurer.

The funds shall be utilised for the payment of the salaries, allowances, etc of the members and other employees of the Authority and other expenses of the Authority incurred in discharging its functions.[22] The Authority shall maintain proper accounts and accounts of the Authority shall be audited by the Comptroller and Auditor-General of India or his nominee.

Power of the Central Government

Chapter 6, though captioned as miscellaneous, still contains very important provisions. Sections 1820 preserves the control of the Central Government over the Authority which intends to control the insurance sector. By s 18 the Central Government is secured of the power to give direction to the Authority on the question of policy, other than those relating to technical and administrative matters and cl 2 provides that the decision of the Central Government is final on the question as to whether a particular matter is one of policy or not.

Supercession The Central Government is also invested with the power to supercede the Authority by notification in the official gazette when the Authority does not discharge its duties properly or defies the directions of the Central Government. On the notification of the supercession of the chairman, the members should vacate their offices and a new Authority may be constituted. There is no prohibition for nominating the vacating members as the chairperson of the newly appointed authority.

Parliamentary Control The ultimate control is vested with Parliament by requiring the notification of supercession and the full report of the action is therefore, to be laid before each House of Parliament at the earliest. A duty is cast under s 20 on the Authority to furnish an annual report of its activities including the activities for promotion of the development of the insurance business during the previous financial years and copies of these reports shall be laid before each house of Parliament.

Interim Arrangements

If at any time, the Authority is superseded under sub-s (1) of *s 19 of the Insurance Regulatory and Development Authority Act 1999*, the Central Government may, by notification in the official gazette, appoint a person to be the Controller of Insurance till as such time the Authority is reconstituted under sub-s 3 of s 19 of the Act.

In making any appointment under this section, the Central Government shall have due regard to the following considerations, namely, whether the person to be appointed has had experience in industrial, commercial or insurance matters and whether such person has actuarial qualifications.

Insurance Advisory Committee

The Act in s 25 also provides for establishment of an Insurance Advisory Committee. The chairperson and members of the Authority shall be ex-officio members of the advisory committee. The advisory committee shall consist of not more than 20 members to represent the interests of commerce, industry, transport, agriculture, consumer fora, surveyors, agents, intermediaries and research bodies engaged in the study of safety and loss. It shall advise the Authority in making regulations and on such other prescribed matters.

Rule Making Power

Section 24 empowers the state and Central Governments to make rules and s 26 empowers the Insurance Regulatory Authority to make regulations on the subjects mentioned in the respective sections. The rules and regulations so made shall be laid before each House of Parliament. Section 28 makes it clear that the provisions of the Act shall be in addition to and not in derogation of any law for the time being in force.[24] Three schedules are attached to the Act making amendments in the *Insurance Act 1938* in Sch 1, the *Life Insurance Corporation Act 1956* in Sch 2 and the *General Insurance Business (Nationalisation) Act 1972* in Sch 3. The second and third schedules contain only one section each, which abolish the exclusive privilege of the Corporationsof conducting life insurance business by LIC (s 30) and general insurance business by the GIC and its subsidiaries (s 24A) and directing them to conduct their respective business in India. In accordance with the provisions of the *Insurance Act 1938*, they are not abolished but their sole privilege to run the business is withdrawn. These entities have to carry on the business side-by-side with the newly permitted private entities. It is made possible for the private entities even to collaborate with foreign investors within certain limits and subject to certain conditions. In the emerging scene of the gradual privatisation it is rightly felt that there should be government regulation through an independent authority and so the Insurance Regulatory Authority originally set up provisionally, is no permanently constituted under the Act. It is but proper in view of the change that there should be greater control to safe-guard interests of the policy holders and to improve the methods of conducting the insurance business in India. The first schedule introduces a good number of amendments to the *Insurance Act 1938*. Particularly to shift all the powers and the duties of the Central Government, the Controller of Insurance and to a limited extent the Insurance Tariff Commissioner to the chairperson of the Insurance Regulatory Authority. The Insurance Regulatory Authority is empowered to make Regulations under s 32, and *s 114 A of the Insurance Act 1938* and under *s 26 of the Insurance Regulatory and Development Authority Act 1999* on matters specified in the respective sections. Under s 26, the IRDA can make regulations on the advice of the Insurance Advisory Committee. The Insurance Regulatory and Development Authority is to insurance law what SEBI is to company law. Both make regulations which by the doctrine of delegated legislation have the same force as law made by the Parliament itself. Both the Central Government and Parliament exercise control over this part of the law. Whenever the insurance company wants to take approval from IRDA, it has to follow Regulations, Guidelines and Circulars of IRDA and all those are binding on the insurance companies.

Chapter 3 Registration of Insurance Companies

Introduction

The insurance sector is now open for private companies and control over them has become all the more necessary. For this purpose, the *Insurance Regulatory and Development Authority Act* by amending the *Insurance Act 1938*, prescribes that no person shall start a new business on any branch of the insurance business, after the commencement of the *Insurance Regulatory and Development Authority Act 1999*, unless he has obtained a certificate of registration for the particular class of insurance business he proposes to carry out and that existing insurers are given breathing space of three months.[26] The Indian insurance market is protected from invasion by foreign capital by prohibiting the issuance of a certificate of registration to foreign insurance companies. A foreign company however, is permitted to play in the Indian insurance market only through an Indian insurance company.

The Indian company is not permitted to allot more than 26 per cent of its equity capital.

Procedure of Registration

An insurance company must be first incorporated under the *Companies Act 1956* and must also be registered with the Insurance Regulatory and Development Authority which is governed by both the *Companies Act 1956* and the *Insurance Regulatory and Development Authority Act 1999*.

Section 3 of the Insurance Act provides that every application for registration shall be made in such a manner as may be determined by the Insurance Regulatory and Development Authority and shall be accompanied by the documents mentioned therein. Separate Regulations are passed by IRDA called the IRDA Registration of Indian Insurance Companies Regulations 2000. As per that a new entrant Indian insurance company desiring to carry on insurance business in India shall make an application for registration in form IRDA/R1. This form requires the applicant to give his details prescribed therein with which the Insurance Regulatory and Development Authority will screen his status and if it is satisfied that he can carry on all functions in respect of the insurance business including management of investments within his own organisation and is a *bona fide* applicant, and that his previous application has not been rejected in the previous five financial years, and his previous certificate has not been withdrawn or cancelled and his name contains the words insurance company or assurance company, the Authority gives him an application for registration in form IRDA/R2; otherwise it will reject his application after giving him a reasonable opportunity for hearing as to why his application shall not be rejected. The order rejecting the application must be communicated to him by the Authority within 30 days of such rejection.

The applicant on receipt of the rejection order may apply to the Authority within 30 days for reconsideration of its decision. An applicant whose application has been finally rejected may make a fresh application after a period of two years with a new set of promoters or for a new type of insurance business.

If his application in form IRDA/R1 is accepted, the Authority will furnish him with an application in form IRDA/R2. Generally a filled in application in form IRDA/R2 must be accompanied with the documents mentioned in Reg 10 (2) including evidence that he has paid the requisite Rs 50,000 thousand rupees for each kind of insurance business applied for, and made the deposit required under *s 7 of the Insurance Act 1938*. The Authority gives preference in granting of the certificate of registration to those applicants who propose to carry on the business of providing health covers to individuals or groups of individuals. On receipt of application in form IRDA/R2, the Authority makes an inquiry as it deems fit and if it is satisfied in that inquiry that:

1. the applicant is eligible, and in its opinion, is likely to meet effectively its obligations imposed under the Act;
2. the financial condition and the general character of management of the applicant is sound;
3. the volume of business likely to be available to, and the capital structure and earning prospects of the applicant will be adequate;
4. the interests of the general public will be served if the certificate is granted to the applicant in respect of the class of insurance business specified in the applications; and
5. the applicant has complied with the provisions of ss 2 (c), 5, 31 (a), 32 and 32 (a) has fulfilled all the requirements of these sections applicable to him, may register the applicant as an insurer for the class of business for which the applicant is found suitable and grant him a certificate in form IRDA/R3. The certificate issued in the beginning will be valid for a year. Thereafter, there shall be an annual renewal.

Renewal of Registration

An insurer who has been granted a certificate under s 3 of the Act, shall make an application in form IRDA/R5 for the renewal of the certificate, to the Authority before 31 December each year, and such an application shall be accompanied by evidence of the payment of the fee which shall be the higher of:

(i) fifty thousand rupees for each class of insurance business, and

(ii) one-fifth of one per cent of total gross premium written direct by an insurer in India during the financial year preceding the year in which the application for renewal of certificate is required to be made, or Rs 5 crores, whichever is less; and in the case of an insurer solely carrying on reinsurance business, instead of the total gross premium written direct in India, the total premium in respect of facultative reinsurance accepted by him in India shall be taken into account.

If the insurer fails to apply for the renewal of registration before the date specified in sub-reg (1) the Authority may accept an application for renewal of registration on receipt of the fee payable with the application along with an additional fee by way of penalty of 10 per cent of the fee payable with the application.

Manner of Payment of Fee for Renewal of Certificate

The fee for renewal of certificate shall be paid to the account of the Insurance Regulatory and Development Authority with the Reserve Bank of India.

Issue of Duplicate Certificate

The Authority may, on receipt of a fee of Rs 5,000, issue a duplicate certificate to the insurer, if the insurer makes an application to the Authority in form IRDA/R4.

Cancellation or Suspension of Certificate

Without prejudice to any penalty which may be imposed or any action taken under the provisions of the Act, the registration of an Indian insurance company or insurer who;

1. conducts its business in a manner prejudicial to the interests of the policy holders;
2. fails to furnish any information as required by the Authority relating to its insurance business;
3. does not submit periodical returns as required under the Act or by the Authority;
4. does not cooperate in any inquiry conducted by the Authority;
5. indulges in manipulating the insurances business;
6. indulges in unfair trade practices;
7. fails to make investment in the infrastructure or social sector specified under sub-s 1 (a) of s 27 (d) of the Act;

may be suspended for a class or classes of insurance business for such period as may be specified by the Authority by an order.

It is also provided that the Authority for reasons to be recorded in writing may, in case of repeated defaults of the type mentioned above, impose a penalty of cancellation of Certificate.

Manner of Making Order of Suspension or Cancellation of Certificate No order of suspension or cancellation shall be imposed except after holding an inquiry in accordance with the procedure specified in the above regulation.

Manner of Holding Inquiry Before Suspension or Cancellation For the purpose of holding an inquiry regarding the malpractices of insurance, the Authority may appoint an inquiry officer. The inquiry officer shall issue to the insurer a notice at the registered office or the principal place of business of the insurer. The insurer may, within 30 days from the date of receipt of such notice, furnish to the inquiry officer a reply, together with copies of documentary or other evidence relied on by it or sought by the Authority from the insurer. The inquiry officer shall give a reasonable opportunity of hearing to the insurer to enable it to make submissions in support of its reply made under the sub-regulation. The insurer may either appear in person or through any person duly authorised by the insurer before the inquiry officer. An advocate shall be permitted to represent the insurer at the inquiry if it is considered necessary, the inquiry officer may ask the Authority to appoint a presenting officer to present its case.

The inquiry officer shall, after taking into account all relevant facts and submissions made by the insurer, submit a report to the Authority and recommend the penalty to be awarded as also the justification of the penalty proposed.

Show-cause Notice and Order On receipt of the report from the inquiry officer, the Authority shall consider the same and if considered necessary by it, issue a show-cause notice as to why a penalty as it considers appropriate should not be imposed. The insurer shall, within 21 days of the date of receipt of the show-cause notice, send a reply to the Authority. The Authority after considering the reply to the show-cause notice, if received, shall as soon as possible but not later than 30 days from the receipt of the reply, if any, pass such orders as it deems fit. If no reply is furnished to the Authority by the insurer within 90 days of the service of the notice, the Authority can

proceed to decide the issue *ex parte*. The order passed shall give reasons therefore including justification of the penalty imposed by that order. The Authority shall send a copy of the order to the insurer.

Publication of Order The order of the Authority passed shall be published in at least two daily newspapers in the area where the insurer has his principal place of business.

Effect of Suspension or Cancellation of Certificate From the date of suspension or cancellation of the certificate, the insurer shall cease to transact new insurance business.

Existing Insurers The existing insurers are regulated by a separate set of guidelines for registration. They are required to make an application in form IRDA/R2 (the same form as in the case of new insurers) for grant of certificate of registration within three months from the commencement of the *IRDA Act 1999*.

Every application shall be accompanied by:

a) original certificate of registration;
b) confirmation that the requirements of s 7 of the Act have been met;
c) evidence of having paid Rs 100 crores or more paid up share capital, in case of an application for grant of certificate of registration for reinsurance business;
d) an affidavit by the principal officer of the applicant certifying that the requirements of s 6 of the Act have been compiled with;
e) a certified copy of the standard forms of the insurer and statements of the assured rates, advantages, terms and conditions to be offered in connection with insurance policies together with a certificate in case of life insurance business by an actuary that such rates, advantages, terms and conditions are workable and sound;
f) the original receipt showing payment of fee of Rs 50,00 for each class of business and;
g) any other information required by the authority during the processing of the application for registration.

The authority shall register every applicant, who submits an application in accordance with the sub-regulation, and grant a certificate in form IRDA/R3. This brings the existing insurer on par with new insurers in respect of paid up capital requirements. The existing insurers are also required under the transitory provisions to comply with all the regulations, as in case of new insurers. However, of the compliance of the regulations relating to accounts, assets, liabilities, solvency margins and reinsurance a 12 months period is given and on an application the Authority may grant a further period of not more than 12 months if it is satisfied that there are valid reasons for such an extension.

The existing insurers need not requisition an application for obtaining a form for registration in form IRDA/R1 and the first screening is done at this stage. From the contents of form R1 which contains the complete biography of the applicant the IRDA decides whether the applicant can run the proposed business or not.

Chapter 4 Other Regulations

Introduction

The regulation dealing with registration of insurers is discussed in the previous chapter and the other regulations made by the Authority are discussed in this chapter.

Registration of Meetings

The Authority in consultation with the Insurance Advisory Committee passed a separate regulation prescribing procedure for conducting its own meetings called IRDA (Meetings) Regulations 2000 and the meetings of the Insurance Advisory Committee called Insurance Advisory Committee (Meetings) Regulations 2000.

Appointed Actuaries and Actuarial Report

Every insurer doing the life insurance business must appoint a qualified actuary exclusively for himself to advice him on matters relating to tariff, investments and manner of maintaining accounts. The actuary plays an important role in the life insurance business, particularly in product development, determination of premium rates, study of mortality rates and construction of mortality tables, laying down standards for underwriting, valuation of assets and liabilities and method of distributing surplus. In general insurance also actuaries are consulted in matters relating to rating and technical matters. The Malhotra committee report says that there were only 67 actuaries (Fellows of the Institute of Actuaries, London) in the service of the LIC. The Actuarial Society of India has been conducting examinations for qualifying as actuaries only since 1989. A person qualifying as a Fellow of the Actuarial Society of India is a qualified actuary and can be appointed as actuary by an insurer with the approval of the IRDA.

The IRDA made two regulations called IRDA (Appointed Actuary) Regulations 2000 and IRDA (Actuarial Report and Abstract) Regulations 2000, The first deals with qualifications for appointment, his powers and duties and the second with the details to be given and the format for the actuarial report and duties and the second with the details to be given and the format for the actuarial report.

It is especially provided that abstracts and statements shall be prepared separately in respect of:

(i) linked insurers;

(ii) non-linked insurers; and

(iii) health insurance business.

Separate general forms are prescribed for the above three types of insurers.

Statements of solvency and margin details must also be appended in form K.

Assets and Liabilities

The assets and liabilities of any person show his financial status and his solvency. The authority requires that every insurer shall prepare a statement of the value of assets in a prescribed form [IRDA assets form AA.] It also requires that every insurer shall prepare a statement of the amount of liabilities in accordance with Sch 2A, in respect of life insurance business and in Form HG in accordance with Sch 2B, in respect of general insurance business as the case may be. It shall also prepare a statement of solvency margin in accordance with Sch 3A in respect of life insurance business and in Form KG in accordance with Sch 2B in respect of general insurance business, as the case may be. If it has business outside India the above forms must be separately furnished for business in India and the total business transacted by the insurer.

On scrutiny of the above forms and returns if the IRDA still has doubts and if it covers that it is necessary and expedient, it may ask the appointed actuary of the company to make a personal visit to its office to elicit from him any clarification or further information.

Method of Valuation

The method of valuation of the assets is prescribed so that the insurer may not boost their values and create a false credit; for that purpose the following provisions are made. The following assets should be placed with value zero:

(i) agents balances and outstanding premiums in India, to the extent they are not realised within a period of 30 days;

(ii) agents balances and outstanding premiums outside India, to the extent they are not realisable;

(iii) sundry debts to the extent they are not realisable;

(iv) advances of an unrealisable character;

(v) furniture, fixtures, dead stock and stationary;

(vi) deferred expenses;

(vii) profit and loss appropriation account balance and any fictitious assets other than pre-paid expenses;

(viii) reinsurers balances outstanding for more than three months;

(ix) preliminary expenses in the formation of the company.

(2) The value of computer equipment including software shall be computed as under:

(i) seventy-five percent of its cost in the year of purchase;

(ii) fifty percent of its cost in the second year;

(iii) twenty-five percent of its cost in the third year; and

(iv) zero percent thereafter.

(3) All other assets of an insurer have to be valued in accordance with the regulation called The Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditors Report of Insurance Companies) Regulations 2000.

Statement of Assets

Every insurer shall prepare a statement of assets in form IRDA-Assets-AA

Valuation of Liabilities

Separate and detailed rules have been made for valuation of liabilities regarding life insurance insurers and general insurance insurers.

Solvency Margin

Every insurer shall determine the required solvency margin, the available solvency margin, and the solvency ratio in form K as a specified under the Insurance Regulatory and Development Authority (Actuarial Report and Abstract) Regulations 2000.

Separate forms are prescribed for showing solvency margins of life and general Insurance business. A Separate regulation called IRDA (Assets, Liabilities and Solvency Margin) Regulation 2000 has been passed.

The requirement of registration of insurance companies with the IRDA gives information only of the existence of the companies but not of their status. It was long back recognised even in the *Insurance Act 1938* that for the successful running of insurance companies they must maintain the solvency margin. To protect the interests of the policy holders the IRDA must know the financial balance sheet, that is, assets and liabilities of the company and so a separate regulation was issued by the IRDA called the IRDA Assets, Liabilities and Solvency Margins (both available and expected must be stated in the forms prescribed by the schedules). Power is also reserved by the IRDA to call the actuary to attempt to seek clarification and further information on the insurers and if it is not satisfied it may refuse to grant renewal of the registration of the insurer. The disclosure of details in the accounts, and returns and reports, create a transparency in the financial status of the company.

Preparation of financial statements

The IRDA is constituted under the *IRDA Act 1999* to protect the interests of the share holders and policy holders by controlling the activities of the insurance companies. It is to act not only as a watchdog but also as an advisor and with reference particularly to the erring companies by constantly committing acts of malfeasance and misfeasance to act as a bloodhound. It is also to act as an advisory body to develop healthy and prosperous trends in the insurance market. To reign and control the insurance sector it is given the power to grant a Certificate of Registration without which no company can commence and continue to carry on insurance business. To have a constant vigil over their activities, registration is made renewable every year. The registration of an insurer only serves as its visiting card and makes the Insurance Regulatory and Development Authority only to know about its existence and the fact that it is doing insurance. To keep a constant and effective vigil over its activities and continued financial status the Authority must know the details of its activities.

The activities of a financial institution can be known from its Balance Sheet which in turn is based on the record of daily transactions. The account books reveal the nature and conduct of the nature of its business. But an intelligent person can, by manipulating his accounts, create an image favourable to him because accounts can reveal as

effectively as they can hide. Therefore, to give transparency to the real nature of the financial institutions, detailed and minute directions are given by promulgating a regulation called IRDA (Preparation of Financial Statements and Auditors Report of Insurance Companies) Regulations 2000.

The Regulation provides for details of accounting principles for preparation of financial statements applicable separately to the life insurance business and the general insurance business in its Sch A and B. Every Balance Sheet Revenue Account, Policy-holders Account Receipts and Payments Account (Cash Flow Statement) and Profit & Loss Account (Share Holders Account) of an insurer shall be in conformity with the Accounting Standards (AS) issued by the ICAS, to the extent applicable to insurers carrying on Life Insurance business except that:

i) Accounting Standard3 (AS-3) Cash Flow Statementscash Flow Statement shall be prepared only under the Direct Method.

ii) Accounting Standards17 (AS17) Segment Reporting shall apply irrespective of whether the securities of the Insurer are traded publicly or not.

A similar provision is made with reference to the general insurance business. Certain items are prescribed to be disclosed by way of notes to the Balance Sheet. The prescribed financial statements must be accompanied by a management report in the form of verification to the filed financial statements.

Audit Report

Schedule C of the above Regulation deals with the auditors report that the report of the auditor on the Financial Statements of every insurer shall deal with the matters specified namely:

1.

(a) that they have obtained all the information and explanations, which to the best of their knowledge and belief were necessary for the purposes of their audit and whether they have found them satisfactory;

(b) whether proper books of account have been maintained by the insurer so far as appears from an examination of those books;

(c) whether proper returns, audited or unaudited from branches and other offices have been received and whether they were adequate for the purpose of audit;

(d) whether the actuarial evaluation of liabilities is duly certified by the appointed actuary including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the authority, and/or the actuarial society of India in concurrence with the authority.

2. The auditors shall express their opinion on:

(a) whether the balance sheet gives a true and fair view of the insurers affairs as at the end of the financial year/period;

(b) whether the revenue account gives a true and fair view of the surplus or the deficit for the financial year/period;

(c) whether the profit and loss account gives a true and fair view of the profit or loss for the financial year/period; the financial statements stated at (a) above are prepared in accordance with the requirements of The *Insurance Act 1938* (4 of 1938), The Insurance Regulatory and Development Act 1999 (41 of 1999) and the *Companies Act 1956* (1 of 1956), to the extent applicable and in the manner so required.

3. Investments have been valued in accordance with the provisions of the Act and these Regulations.

4. The accounting policies selected by the insurer are appropriate and are in compliance with the applicable accounting standards and with the accounting principles, as prescribed in these Regulations of any order or direction issued by the authority in this behalf.

5. The auditors shall further certify that:

(a) they have reviewed the management report and there is no apparent mistake or material inconsistencies with the financial statements;

(b) the insurer has complied with the terms and conditions of the registration stipulated by the authority.

(c) a certificate signed by the auditors which shall be in addition to any other certificate or report which is required by law to be given with respect to the balance sheet certifying that:

(i) they have verified the cash balances and the securities relating to the insurers loans reversions and life interests (in the case of life insurers) and investments;

(ii) to what extent, if any, they have verified the investments and transactions relating to any trusts undertaken by the insurer as trustee; and

(iii) no part of the assets of the policy holders funds has been directly or indirectly applied in contravention of the provisions of The *Insurance Act 1938* (4 of 1938) relating to the application and investment of the policy holders funds.

In company jurisprudence an auditor is said to be a watchdog but not a bloodhound; he is not expected to be a Sherlock Homes, but the Regulations require him to act with higher circumspection and vigilance than that of a mere watchdog.

Investment

A commercial company can make its investments of the available assets in secured methods. But the insurance sector owes an obligation to national interest, a new phase developed due to nationalisation of the insurance market. As noted earlier, the two corporations, i.e., the Life Insurance Corporation and the General Insurance Corporation discharged their duties of acting in consonance with the principles laid down in the directive principles in the *Constitution*. They helped the country in financing five year plans and fostered their might to develop the economy of the country in the process of industrialisation of the country. The investments of these instrumentalities of the state were utilised for the welfare and benefit of the society and helped in establishing a new insurance business. Even after privatisation they continue to work and the investment regulation is the same for all insurers. From that point of view the IRDA passed a Regulation called IRDA (Investment) Regulations 2000.

Every insurer shall submit to the Authority certain prescribed verified returns at such intervals, say yearly or quarterly. The Authority is empowered to call for additional information.

It is also provided that every insurer shall constitute an investment committee which shall consist of a minimum of two non-executive directors of the insurer, the principal officer, chiefs of finance and investment divisions, and wherever an appointed actuary is present, the appointed actuary. The decisions taken by the Investment Committee shall be properly recorded and be open to inspection by the Authority.

Rural Insurance

When insurance was nationalised the insurance business was confined only to cities and better-off segments of society. In pursuance of the recommendations of the Administrative Reforms Commission in 1974, Life Insurance Corporation formulated its objectives, amongst others, to spread the life insurance business much more widely and in particular to the rural areas and to the socially and economically backward classes with a view to reaching all insurable persons in the country and providing them, at a reasonable cost, adequate financial cover against death. Over the years LIC has acquired a significant presence in the rural sector. According to the Malhotra Committee report nearly 45 per cent of its new business was gained from this sector during 199293. It has also introduced various group insurance schemes for the weaker sections of society. The General Insurance Corporation and its subsidiaries also tapped well the rural sector. The Malhotra Committee observed that premium income from Rural Non-Traditional Insurance Business (RNTB) increased from Rs 25 lakhs in 1974 to Rs 111 .24 crores in 199293. A good part of this business comes from the insurance of livestock, major part of which comes from Integrated Rural Development Programme (IRDP) and bank credit linkages where insurance is mandatory. But still there is need for more intensive work in rural areas for spreading RNTB.

It is hoped that in case private players enter the insurance market there is every likelihood that they would prefer to concentrate their activity in the lucrative urban business and neglect the less profitable rural market. One of the important objectives of establishing Insurance Regulatory and Development Authority is to see that the new entrants may also be compelled to penetrate into rural areas to do a reasonable proportion of their total business. For this purpose the IRDA made a regulation called IRDA (Obligations of Insurers to Rural or Social Sectors)

Regulation 2000.

Re-insurance

When an insurer issues a policy to the insured he is said to have entered into a contract of insurance. In doing insurance business it may issue a number of policies. At a particular stage it may feel that the risk undertaken by it, is beyond its capacity, then it may retain the risk which it can bear and the balance may be transferred to another insurer called the reinsurer under a contract of reinsurance. Though the original insurer has no interest in the subject-matter of insurance he is said to have acquired an insurable interest under its contract of insurance. It cannot insure for more than the original insurance. Thus a contract of insurance creates in the insurers an insurable interest sufficient to support a reinsurance to the full amount of their liability on the original policy.

The Malhotra Committee observed that reinsurance relating to the life insurance business is relatively less when compared to the general insurance business. When the Life Insurance Corporation took over the business of two hundred and forty-five insurers in 1956, it might have resorted to reinsurance but now it does not require any such arrangements because of its financial strength and capacity to bear all its risks fully. But in the matter of general insurance due to rapid progress and acceleration of development and large-scale industrialisation in the post-independence period there was an increase in business, including assumption of even larger and more complex risk by the general insurance companies. This increase in business enhanced the need for reinsurance protection which necessitated the Indian general insurers to go to the foreign market. In order to reduce the foreign intervention and increase domestic retention, in 1956, the Indian Reinsurance Corporation was formed by the Central Government. To minimise the drain of foreign exchange, several measures like obligatory non-reciprocal cession by the subsidiaries of GIC, market pools for fire and marine hull business, inter-company cessions were adopted. The government started regulation in the reinsurance market by introducing ss 101A, 101B and 101C in the *Insurance Act 1938*, which was further streamlined by the Insurance Regulatory and Development Authority by issuing two regulations, one for general insurance and another for life insurance. These provisions are intended to regulate and maximize retention of reinsurance within the domestic market.

Advertisement and Disclosures

With the privatisation of insurance, private players jump into the field and where there was monopoly there was no competition and so there was no necessity for the Life Insurance Corporation and General Insurance Corporation to issue advertisements. Now that there is competition, advertisement becomes necessary and the insurers make some material disclosures. To see that innocent share holders and policy holders are not deceived, the Insurance Regulatory and Development Authority promulgated a regulation called the Insurance Regulatory and Development Authority (Insurance Advertisements and Disclosure) Regulation 2000. The other Regulations relating to licensing of Insurance Agents and Loss Assessors appointment of ombudsman, registration of insurers are discussed at the relevant places.

Chapter 5 Contract of Insurance

Definition

A contract of insurance is a contract either to indemnify a person against a loss which may arise on the happening of an event or to pay a sum of money on the happening of some or any event for an agreed consideration. To put it in other words it is a contract under which one party undertakes to pay to another person a sum of money or its equivalent on the happening of a specified event. Under such a contract one party agrees to take the risk of another persons life, property or liability in consideration of certain comparatively small periodic payments. The person to be paid or indemnified is called the insurer or assured, the person who undertakes to indemnify or pay money is called the insurer or assurer or underwriter, the last word being generally used in marine insurance; the consideration received in the form of periodic payments is called the premium or premia; and the document containing the contract is called the insurance policy.

It follows that every contract of insurance must have the following essential elements:

(a) There must be a contract between parties who are called the insurer and the insured.

(b) The contract must be that the insurer undertakes to protect the insured from any loss or damage to be insured on the happening of the event.

(c) In consideration for the above, the assured undertakes to make the insurer a periodical payment of a sum of money called premium.

(d) The contract must be in writing and the document is called the insurance policy.

In *Medical Defence Union Ltd v Department of Trade*, some medical and dental practitioners formed the Medical Defence Union which was to conduct legal proceedings on behalf of its members, indemnifying members against claims for damages and costs and giving advice to members on various matters and providing educational guidance. Members had the right to request for the Unions help. The members in return had to pay an appropriate annual subscription for their class of membership. The Department of Trade sought a declaration that the Union was doing insurance business under the general law and therefore within the 1974 Act. The Union sought a declaration that they did not carry on any class of insurance business. The Court held that on the occurrence of some event, there had to be a right to receive money or moneys worth, and where the entitlement was merely to some benefit other than money or moneys worth, the contract was not one of insurance, and so the Union was not an insurance company.

The learned judge said:

> I do not know whether a satisfactory definition of contract of insurance will ever be evolved. Plainly it is a matter of considerable difficulty. It may be that it is a concept which is better to describe than to attempt to define... Plainly a provision for the payment of money is one of the usual elements in a contract of insurance; the main difficulty lies in formulating what extension of this concept there should beplainly there must be some... In view of the St Christophers case it may be that the term money or moneys worth will not suffice by itself. A possible addition would be or the provision of services to be *paid for by the insured*. As at present advised I would hesitate to omit the last seven words.

In *Department of Trade v Chrispheres,* the defendant company formed an association for providing facilities for motorists and owners of motor vehicles. In the event of a member becoming unable to drive his own car because of an accident he would be entitled to a chauffeur service where the association would provide him with a driver for his car or if necessary a car and a driver. All fully licensed drivers above 25 years of age were eligible for membership of the association. The Department of Trade and Industry sought a declaration that the association was carrying on insurance business within the Insurance *Companies Act* 1958. It was held that the arrangement made by the defendant amounted to an insurance business as contracts of insurance are not confined to contracts for the payment of money but may provide for some corresponding benefit.

It was observed that there are several considerable doubts as to whether a revised grill consisting of insurance and non-insurance benefits is a contract of insurance within the Insurance *Companies Act* 1982 or a contract for insurance outside the statute. A contract of insurance which is not statutory in nature should be construed like any other contract.

Thus it can be seen that a contract of insurance is a species of a contract of indemnity and hence the specified event must be such that on the happening of it the insured must suffer some loss or at least the happening of the event must adversely affect the interest of the assured resulting in some loss to him. Speaking about the nature of the contract and the event involved, Channel J observed:

It must be a contract whereby, from some consideration, usually, but not necessarily, for periodical payments called a premium, you secure to yourself some benefit, usually, but not necessarily the payment of a sum of money upon the happening of some event... Then the next thing that is necessary is that the event should be one which involves some element of uncertainty. There must be either

some uncertainty whether the event will ever happen or not, or if the event is one which must happen at some time or another there must be uncertainty as to the time at which it will happen.

To illustrate the statement, in the case of life insurance, if a life policy is taken, the event insured is the death of a human being, and death of a mortal is certain; but then the uncertainty lies not in the happening or non-happening of the event, but in the point of time when the death occurs. On the other hand the happening of the event insured, itself, may or may not happen. For example, in the case of fire insurance or marine insurance, the accident of fire or the loss of the ship or other property insured may itself not happen. Either type of uncertainty is sufficient; but there must be some element of uncertainty about the event insured.

Classification of Contracts of Insurance

Contracts of insurance have been classified into various categories by different writers and with the progress and development of civilisation and economic growth new varieties of insurance are emerging. Some writers classify the contracts according to the nature of the interest affected while some others according to the nature of the event.

According to the Nature of the Interest Affected

This classification is from the nature of the interest of the insured sought to be protected by the insurer. A person may take out a policy protecting himself from loss likely to be caused by loss of life, that is death, or from any injury to his body, loss of property, or involvement in liability to others. From this point of view the categorisation may be (a) Personal, (b) Property, and (c) Liability insurances.

Personal Insurance When a person takes a life insurance, either on his own life or on anothers life about his health or personal accident, the nature of the interest affected is the life, health and body and so these are said to be personal insurance contracts.

Property Insurance When the interest affected by the happening of the event insured against is the proprietary interest of the insured the contracts are called proprietary insurance contracts. Under this category come fire insurance, marine insurance etc.

Liability Insurance In this type, when the event insured against happens, the insured would be exposed to some liability to third parties and this is called a Liability Insurance Contract. More common examples of this type of insurance are motor vehicles insurance, aviation insurance, industrial insurance etc.

According to the Nature of the Event

In another perspective all insurance contracts may be classified according to the event on the happening of which the insurer would be liable to pay the agreed money to the insured. From this angle, they may be classified as:

Life Insurance The sum insured becomes payable on the death of the insured or on the attainment of a particular age.

Fire Insurance In this class of contracts, the sum is payable on the accident of fire by which the insured property is destroyed or damaged. Here the loss insured is the damage caused by fire.

Marine Insurance Here the sum becomes payable on the happening of a perilous event at sea.

Miscellaneous Insurance This includes a variety of new insurances which go in the modern times under the terms Social Insurance or Liability Insurance, Industrial Insurance, Motor Vehicles Insurance, Aviation Insurance, etc. Comparatively, these types are rather new as the first three types i.e., life, fire and marine have been recognised since long.

In England the classification made by the Insurance *Companies Act* is industrial insurance, liability insurance, marine, aviation and transport insurance, motor vehicles insurance, ordinary long term insurance, pecuniary loss insurance, personal accident insurance and property insurance.

There is no hard and fast rule for the classification. They depend on the authors view. Some writers classified broadly all insurance contracts as property and non-property insurances, the first dealing with proprietary losses while the latter dealing with loss of personal life and safety. Common examples of the property insurance are fire and marine insurances, while the latter include life, accident, liability etc, insurances. None of these is a water-tight compartment and the categories of insurance are not a closed list. However, in India, the Controller of Insurance publishes insurance data according to the classification depending upon the nature of the event, and thus, this may be called the official classification, namely (a) life, (b) fire, (c) marine and (d) general or miscellaneous insurance and this classification has been followed in this book.

Nature of the Insurance Contract

As we have noted, a contract of insurance is one in which one person agrees to take risk of another persons life, limb or property. In this sense, about the nature of the insurance contract, there are many different views of which the following are predominant: (a) that it is an aleatory contract, (b) that it is a contract of utmost good faith, (c) that it is a contract of indemnity and (d) that it is a contract of wager.

Contract is Aleatory

It is commonly said that an insurance contract is an aleatory contract. Lord Mansfield said that there is no doubt, and in reality, the insurance contract, whatever may be the type is a contract of speculation. Websters New International Dictionary says that contracts of insurance are aleatory contracts depending on an uncertain event or contingency as to both profit and loss. If we take an example of a person taking a fire insurance policy on his house, he pays a little and if the house is not burnt, he loses that small amount, but if the house is destroyed by fire he is entitled to recover a huge amount, the value of the house. Thus it is apparently a gamble in which if the event happens in a certain way, the insured will have a small loss, the loss of premium and if the event happens in another way the insurer loses heavily in that, he has to pay the huge sum, the value of the house. Thus there is speculation and so it is called an Aleatory Contract.

Contract of Utmost Good Faith

In England till the passing of the Misrepresentation Act 1967, it is a cardinal principle of commercial law that he who buys should beware, *caveat emptor,* and thereof in business transactions each party must take care of his interest when he buys the promise of the other and the other party is not bound to disclose any defect which an ordinary inquisition would reveal. But even before 1967, contracts of insurance stood and now also they stand on a different footing and form an exception to this rule because the parties do not stand on equal footing either with regard to the knowledge of the subject matter or with regard to the economic aspect of the obligation. It has been noted while explaining the aleatory nature of the contract that the parties do not stand on equal footing with regard to the economic aspect of the obligation created by the contract. With regard to the knowledge about the subject matter of insurance the one party, say the insured, has better or all the means of knowledge than the other party, the insurer. Scrutton L J observed:

As the underwriter knows nothing and the man who comes to him to ask him to insure knows everything it is the duty of the assured, the man who desires to have a policy, to make a full disclosure to the underwriters without being asked of all the material circumstances, because the underwriters know nothing and the assured knows everything. This is expressed by saying that it is a contract of utmost good faith *uberrima fides.*

For these reasons of economic inequality in the status of the contracting parties and of the superior knowledge of one party about the subject matter of the insurance, a contract of insurance, is justly made an *uberrima fides* transaction and an exception to the commonly accepted commercial rule of *caveat emptor.*

The law relating to good faith requirement is contained in the *Marine Insurance Act* and these rules *mutatis mutandis* apply to all classes of insurance. The relevant provisions are:

Insurance is uberrimae bidei: A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

Disclosure by Assured: (i) Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstances which is known to the assured; and the assured is deemed

to know every circumstance which, in the ordinary course of business, ought to be known by him. If the insured fails to make such disclosure, the insurer may avoid the contract.

(ii) Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.

(iii) In the absence of inquiry the following circumstances need not be disclosed, namely:

(a) Any circumstance which diminishes the risk.

(b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know the matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know.

(c) Any circumstances as to which information is waived by the insurer.

(d) Any circumstance which is superfluous to disclose by reason of any express or implied warranty.

(iv) Whether any particular circumstance, which is not disclosed, be material or not is, in each case, a question of fact.

(v) The term circumstance includes any communication made to, or information received by, the assured.

Disclosure by Agent Effecting Insurance: Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is affected for the assured by an agent, the agent must disclose to the insurer:

(a) Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and

(b) Every material circumstance which the assured is bound to disclose, unless it comes to his knowledge too late to communicate it to the agent.

It is now well settled that an insurance contract is a contract of utmost good faith and therefore, the contracting parties are placed under a special duty towards each other, not merely to refrain from active misrepresentation but to make full disclosure of all material facts within their knowledge. It has been said that there is no class of documents to which the strictest good faith is more rightly required in courts of law than policies of insurance.

Scope of Duty of Disclosure The rule of good faith imposes the duty to make disclosure of all material facts, known or imputed, but it must be noted that a non-disclosure is not the same thing as concealment. Concealment involves a positive breach of a negative duty while non-disclosure is a negative omission of a positive duty. In considering the scope of this duty of disclosure the following points may be noted:

1. The duty to disclose extends only to material facts. So every material fact must be disclosed which he knows or ought to know. Failure to disclose may be willful or inadvertent or even may be due to the partys erroneous belief that the fact not disclosed is not material. Whether or not a fact is material, is a question of fact. This question does not depend upon what the particular insured thinks nor even what the insurers think but whether a prudent and experienced insurer would be influenced in his judgment if he knew it. The final judgment therefore, does not lie with either party but with the court. In *LIC v Sakunthalabai* the assured did not disclose that he had suffered from indigestion for a few days; the court held that it is not a material fact and non-disclosure did not affect the validity of the policy. Non-disclosure of a conviction in a criminal case of the assured was held to be a ground for invalidating the policy. The test generally applied by the court is whether it is a fact which increases the risk or whether the insurer would have rejected to give a policy on those terms if the fact had been disclosed. In *Rohini Nandan v Ocean Accident and Guarantee Corp* the plaintiff insured against fire and burglary in respect of furniture, household goods, personal effects and jewels on his house in the first floor of a building from 1 July 1954. On 5 August 1974 there was a burglary and he claimed indemnity. The insurer refused the claim on the ground that he suppressed the fact that there was a burglary in the ground floor of the premises in 1949 in his brothers house. The court held that the earlier burglary in the ground floor of the premises was not a material fact as it has no bearing on the risk undertaken by the insurer. The *Marine Insurance Act*, both in England and in India, applies this objective test of the judgment of an ordinary prudent insurer. Since marine and non-marine insurance law is identical in this respect, that is the proper test. The Privy Council also applied the same test. The insured had taken a life insurance policy through his brother, who was an authorised agent of the Insurer. Before taking the policy the insured had undergone an operation for adenoma thyroid but he did not disclose the same in the application form at the time of

taking the policy. The insurer repudiated the claim when the insured made a claim on the ground of non-disclosure of material fact and it was held that the insurer was right in doing so.

2. The duty extends only to those material facts about which he knows or ought to know. It may be noted here that ignorance of the fact is an excuse but ignorance of the materiality of the fact is not. There is no breach of good faith, if the party to the contract is not aware of the fact. Suppression of illness not affecting the expectation of life cannot be a ground to repudiate the policy. In case of life insurance policy, the misstatement alleged must be one of material facts as regards health. It was held that the misstatement of the insured that she is a government servant is not a ground to repudiate the policy.

3. The duty to disclose extends to the authorised agents of the insured; but this duty of the agent is limited to facts within the knowledge of the principal which are presumed to have been communicated in due course to the agent or to facts which the agent must have come to know during the course of his agency.

4. As utmost good faith is required not only from the insured but also from the insurer, the duty to disclose all relevant facts is a mutual duty of the insured as well as the insurer. The policy holder insured the spinning mill together with its blow-room and at the same time the insured had not suppressed any material facts. The insurance company also did not inform the insured that the insured should install a TAC-approved Automatic Diversion System or Co-2 Flooding System in the chute-feeding arrangement between blow room and carding section. Subsequently, the insurance company demanded additional premium from the insured on account of non-installation of such device and it was held that the insurance company was not entitled to claim additional premium on account of its failure to inform the insured about the installation of such device. This rule applies equally to all types of insurance. For example, the assured must declare the state of his health in a life insurance or the present condition of a building or ship in the case of fire or marine insurance as the case may be. Similarly, the insurer may be called upon to produce the last audited balance sheet for the satisfaction of the assured.

This duty does not extend to the assignee of the proceeds of the policy, as such assignee owes no duties of this nature to the insured.

The assured however cannot recover damages for his breach but can only rescind the contract.

5. The duty of disclosure applies only to negotiations preceding the formation of the contract. When a relevant fact comes to the knowledge of either party after the completion of the contract, there is no duty to disclose and as such non-disclosure of such facts does not again offend the rule of good faith, e.g., the assured finds on a subsequent medical check-up after the policy is issued, that he is suffering from a serious complaint. The policy in such circumstances is not affected due to the non-disclosure of a fact, though material as it came to his notice after the policy is issued. Thus in *Ratanlal v Metropolitan Insurance Co*, the insured Pyarelal made a proposal on 23 January 1946 along with the first premium for the insurance. After consideration of the medical report etc, the insurer accepted the proposal on 26 March and communicated the acceptance to the insured on 27 March. As money was in deposit the insurer took the risk on 28 March and informed the insured about it. On the 27th evening the insured complained of exhaustion to his doctor which was a simple ordinary disorder and the doctor came on 28 March but did not prescribe any medicine. However, the insured died a few weeks later on 19 April. The insurer repudiated his liability on the ground of non-disclosure. The court rejected the contention on the ground that the complaint was subsequent to acceptance on 26 March. To put it in short, the duty to disclose is not a continuing duty; it must be observed throughout the negotiations and continues only until they are completed and the contract is concluded. Insured found suffering from T.B meningitis after commencement of the policy but before revival of lapsed policy. It would amount to fraud and the insurer was entitled to avoid the policy for non disclosure of the same.

6. The duty of disclosure is deemed to have been cast on the insured when the insurer specifically asks a question. Generally, the negotiations for insurance an contract commence with a printed proposal form supplied by the insurer to the insured. The proposal form contains questions seeking answers from the insured. Whether the question asked therein is logically relevant or not, it will be deemed to be a material fact and so either a false answer or a dubious answer to such a question may amount to a breach of duty of disclosure. For example in *Anglo African Merchants Ltd v Bayley*, the subject matter insured was the army surplus leather jerkins not used for 20 years. They were described as new mens clothes in bales for export. Megaw J, held that since the underwriters were not told that the goods were government surplus and were 20 years old amount to non-disclosure. If the half truth is such that it does not invoke an inquiry, the disclosure of it is no disclosure.

7. The duty does not extend to certain types of facts though they are material. In other words, the assured is not

bound to disclose the following facts unless the insurer expressly questions him about them. The facts that need not be disclosed may be noted as:

(a) *Facts which he is not aware of:* A person is said to know or be aware of a fact when he actually knows or but for his wilful abstention from making an inquiry by which he could have known it. In spite of his due diligence, if he does not know, there can be no breach of duty of disclosure as he can disclose only what he knows. The insured died of aids and he had no knowledge that he was having aids on the date of signing the declaration. It was held that the insurer was not entitled to avoid the payment particularly after two years from the date of taking the policy. When once he knows the fact, the fact that he did not know about its materiality does not absolve him from his duty of disclosure.

(b) *Facts within the knowledge of the insurers*: The *Marine Insurance Act* in this regard says that an assured need not disclose any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common, notoriety of knowledge and matters which an insurer in the ordinary course of business, as such ought to know. This principle is not confined to the branch of marine insurance alone. Thus in *Woodcott v Excess Insurance,* the assured, whose criminal record had been disclosed to the agent, though neither the assured nor the agent communicated the information to the insurer, could recover under his fire policy. In *BAS Chopra v New Zealand Insurance,* where the assured insured his car giving higher value on the advice of an Officer of the insurance, as it was held that insurer cannot plead misrepresentation by the insured as knowledge of the Officer is imputed to the insurer.

(c) *Facts of which information is waived by the insurer*: Where the insured communicates certain facts to the insurers and the facts are such that they are put on inquiry which they fail to make, the insurer is deemed to have notice of all the facts which such inquiry would have revealed. Thus constructive knowledge applies both to the insurer and the insured.

(d) *Facts which tend to diminish the risk*: The *Marine Insurance Act* also says that in the absence of inquiry any circumstance which diminishes the risk need not be disclosed.

(e) Any circumstance, which it is superfluous to disclose by reason of any express or implied warranty. Declaration was given by the insured that after the date of submission of the proposal but before the issue of the premium receipt, in case there is any change in his general health, the same would be informed to the insurer. It was held that the contract stood vitiated as information about accident was not given to the insurer before receipt of the first premium receipt.

The duty of disclosure is on both sides though it is more onerous on the insured because most of the facts relating to the subject matter of the contract are within his exclusive knowledge and they may be such that an insurer cannot find them out on reasonable inquiry. Further, though theoretically the onus of good faith lies equally on both parties, it is the insured that has to be very particular about the observance of the rules for it is the facts relating to the insured that vary in each case while the disclosures of the insurer being made through their published prospectus do not vary much with each individual insured. In *Srinivas Pillai v LIC,* Srinivas Pillai and his wife Ranganayagi took out a joint life endowment policy for Rs 25,000 commencing on 31 December 1959 at Pondicherry. They gave the usual statements and joint declarations. In answer to the question in column 12 (8) relating to the date of last delivery Ranganayagi stated that she had delivered a female child on 18 May 1959 when in fact she delivered on 31 August 1959. It is the declared policy of the LIC not to issue a policy on a female when she is pregnant or within six months after delivery. After taking the policy the wife fell ill and was admitted in a hospital on 10 January 1960 and died on 17 January 1960. The husband preferred to claim. The LIC repudiated the claim as it was found that she delivered her last child within 6 months before the policy and that she was also suffering from tuberculosis. In the suit filed by the claimant, the LIC failed to prove that she had TB, but the other ground was established which meant that the insured had knowingly falsely stated the date of her last delivery in order to obtain the policy and therefore upheld the repudiation and dismissed the claim. The court also observed:

Contracts of insurance are based on the rocky foundation of utmost good faith. Such good faith is not a matter of art but has to be really and sincerely appreciated by the insured who proposes their lives for insurance with the Corporation.

The rules of utmost good faith have been relaxed to some extent by the *Insurance Act 1938* and now with reference to Life Insurance Contracts on the expiry of two years if the premium has been paid regularly, the insurance policy cannot be set aside on the ground that a fact has not been disclosed, unless there is a deliberate concealment, amounting to fraud on the insurance company. When the insured died after two years from the date of taking the policy, it was held that the insurer cannot repudiate the policy on the ground that there was any inaccurate or false statement made at the time of taking the policy. It is the duty of the insurance company to verify

correctness of information furnished by the insured and the insurer cannot avoid the payment by taking plea that the insured had not supplied correct information with reference to his health at the time of taking the policy. For example in *Glickman v Lancashire and General Assurance Co Ltd,* one Mr Glickman made a proposal for the insurance of his house against fire. One of the questions in the proposal form was whether the house had been previously offered for insurance to any other insurance company, and if so with what results. Glickman left this question without any answer. The policy was issued and the insurance company, subsequently found that on two previous occasions proposals for insuring the house had been rejected. It was held that the insurance company could avoid the contract under the rule of utmost good faith.

In *East and West Insurance Co v Venkayya,* one Venkayya had a policy of insurance. He failed to pay the premium and the policy lapsed. He applied for the renewal of the policy. In the application form for renewal, one of the questions was whether between the date of lapse of the policy and the application for the renewal of the policy, he suffered from any illness.

Venkayya answered no. The renewal was granted, but subsequently the company came to know that during that period Venkayya underwent treatment for some skin trouble. It was held that under the rule of utmost good faith, the insurance company was not liable under the contract. The approach of LIC in the matter of repudiation of a policy admittedly issued by it should be one of the extreme care and caution. It should not be dealt with in a mechanical and routine manner.

It was held that the insurer was not liable when the insured suppressed the information in the proposal form that he was suffering from a particular ailment and as a result of that ailment when insured died.

The insured fraudulently suppressed the material fact that he was having stomach ailment at the time of taking the policy as well as revival of the policy. On the death of the insured, when the claim for the policy money was made by the widow of the insured and the insurer repudiated the policy on ground of fraud even though the insured paid premiums for more than two years. It was held that the insurer was entitled to avoid the policy.

The insurer alleged that deceased-insured had obtained life insurance policy by suppressing material information about ailments in proposal form. However there was a gap of six years between date of discharge of deceased and obtaining policy. It was held that even though there was suppression of material facts by the insured because of large gap, the dependents were entitled to claim the policy. The insured gave wrong answers willfully while taking the policy and at the same time he took sick leave. It was held that the insurer was entitled to repudiate the policy.

Effect of Nondisclosure A contract of insurance is made a contract of utmost good faith for the reasons stated supra. The insurer believes all that is stated by the insured and the insured, being in a better position to know about the subject matter of the contract is cast with a duty to disclose all material facts. If he fails to disclose all material facts the question iswhat is its effect on the validity of the contract of insurance? In the explanation to *s 17 of the Indian Contract Act* it has been said that mere silence does not amount to fraud unless there is a duty to speak or silence amounts to speech. So where he knows a material fact and suppresses it knowing that it is material to the contract it amounts to fraud; but where he does not know about the materiality of the fact, it may have the same effect as misrepresentation. Therefore the effect of mere non-disclosure does not amount to fraud. In case of fraud, the party defrauded can not only avoid the contract but can also claim damages. In the case of all non-disclosures the insurer can avoid the contract and whether he would be entitled to damages is a different question depending upon his knowledge of materiality.

In *Lambert v Cooperative Insurance Society,* a lady renewed a policy of insurance on jewelry owned partly by her and partly by her husband who had been convicted twice for two crimes involving dishonesty in the year before. She did not disclose these convictions of her husband while seeking renewal. It was held that she had a duty to disclose this though her husband was not an insured. Again the non-disclosure of the conviction of one of the directors of the insured company of handling stolen property was held to be a non-disclosure and would entitle the insurer to repudiate the policy.

Contract of Indemnity

According to Porter indemnity is the controlling principle of insurance law and it is by reference to this principle that all problems in insurance can be solved. This statement of Porter is generally true except with some supposed qualifications. It is well settled that a contract of insurance is a contract of indemnity, but in some cases this indemnity is not complete. All contracts of insurance cannot be strictly called contracts of indemnity. The principle of indemnity is an important element in non-life insurance policies. The word indemnity means a promise to save

another person from harm or from the loss caused as a result of a transaction entered into at the instance of the promisor. Therefore the liability of the promisor in a contract of insurance is the contingency itself. The *Indian Contract Act* defines indemnity as a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of another person. This principle of indemnity is associated in contract law with the principle of guarantee where there are three parties, the creditor, the principal debtor and the surety or the favoured debtor. Insurance law does not have the element of guarantee. This is clear from the fact that there are only two parties to the insurance contract. On the other hand, indemnity is coupled with the principle of subrogation or substitution of the rights of the assured by those of the insurer. Further, indemnity is based upon the occurrence of the contingency which itself is really the risk insured against. In short, the risk is the contingency. Thus a contract of insurance is, like a contract of indemnity, a contract of contingency. It therefore follows that any variation of the risk must be on mutual consent and if it is not so, the contract becomes voidable at the hands of the rightful party.

Some writers and judges even classify the contracts of insurance as indemnity contracts and non-indemnity contracts and place in the latter category life insurance, personal accident insurance and sickness insurance.

It is well settled that contracts of fire and marine insurance are contracts of indemnity. In *Castellain v Preston,* Cotton LJ, observed that a marine policy is usually a contract to indemnify the person for the loss which he has sustained in consequence of the peril insured against. In the same case Brett LJ observed:

The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the insured, in case of a loss against which the policy has been made, shall be fully indemnified; but shall never be more than fully indemnified. That is a fundamental principle of insurance and if ever a proposition is brought forward which is at variance with it that is to say, which either will prevent the insured from obtaining a full indemnity, or which will give the assured more than a full indemnity, that proposition must certainly be wrong.

Again it was observed in *Dalby v India and London Life Assurance Company* that policies of insurance against fire and marine insurance risks, are contracts of indemnity and the insurer agrees to compensate the loss sustained by the insured. If we analyse the principles applicable to marine and fire insurance we come to the conclusion that they are strictly contracts of indemnity.

To illustrate a few:

(i) the insured will not be permitted to make a profit in the transaction. For example, if he recovers anything by selling the damaged goods, he has to account for it to the insurance company;

(ii) in marine and fire insurance the insurer will pay only compensation, that is the actual loss or damage;

(iii) the principle of subrogation is applied, for example, if the insured suffers damage by the negligence of a third party, the insured may have two claims, one against the insurance company under the policy and the second, against the third party who caused by his negligence, the damage. In such a case the insurance company, after payment of the claim is entitled to be subrogated to all the rights of the insured against the third party and can proceed against such party. As observed in *Castellain v Preston*:

> As between the underwriter and the assured, the underwriter is entitled to the advantage of every right of the assured whether such right consists in contract, fulfilled or unfulfilled, or in a remedy for tort capable of being insisted on or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable which can be or has been exercised or has accrued and whether such right could or could not be enforced by the insurer in the name of the assured, by the exercising or acquiring of which right or condition the loss against which the assured is insured, can be, or has been diminished.

> Where insurer pays to insured value of goods lost due to negligence of a third party, held, rights and remedies of insured against such third party stand transferred to and vested in the insurer. Such equitable assignment of rights and remedies of insured in favour of insurer, implied in contract of indemnity is known as subrogation.

(iv) The principle of contribution is applied to marine and fire insurance contracts. If the insured takes out a number of policies from different companies and if the loss occurs, the insurer who so pays can call upon the other insurers to contribute equally or rateably the payment made by him and they will be liable to contribute according to their respective assurances.

(v) Again in fire insurance the principle of reinstatement is applied and the insurance company has an option to reinstate the building or repair the damaged property.

Though a contract of insurance is said to be a contract of indemnity, this is not completely true for the following reasons:

(a) The principle that the assured should not recover more than the loss suffered by him, may be modified by the express terms of the policy. The insured, a co-sharer of a building, insured the whole building by paying the premium for the whole building. When the building was damaged completely, the insureds claim for loss for the whole building was repudiated by the insurer. It was held that, having accepted the premium for the whole building, the insurer was liable to pay the loss for the whole building.

(b) The parties may estimate the loss and value the policy. If there is no gross over valuation, the contract is enforceable though the amount recovered is slightly more than the actual loss suffered by him. Valued policies are common in the case of insurances on ships and profits.

(c) Again in every contract of insurance there will be a sum insured and though the contract of insurance is described as a contract of indemnity, on the happening of the event the insured can recover no more than the sum insured though it does not completely indemnify the assured. It is only upon the proof of the actual loss, that the assured can claim reimbursement of loss to the extent it is established, not exceeding the amount stipulated in the contract of insurance which signifies the outer limit of the insurance companys liability.

Though *prima facie* the insurer indemnifies the assured, as his liability may be limited in several respects, a contract of insurance cannot be said to be a contract of perfect indemnity.

Divergent opinions are expressed on the applicability of the principle of indemnity to contracts of life insurance. Lord Mansfield observed that a life insurance contract is a contract of indemnity. This principle was recognised in *Godsall v Boldero.*

But this dictum was criticised in subsequent cases and it was laid down in *Dalby v The Indian and London Assurance Co,* that a life insurance contract is not a contract of indemnity. If we analyse a life insurance contract we find that the amount mentioned in the policy is not the estimation of the value of life because human life cannot be estimated in value correctly, that is, the loss or damage that may be caused by the death of a human being is incapable of exact estimation. A person takes out a life insurance policy for a value usually based upon his capacity to pay premium. Therefore, a life insurance contract is not a contract of indemnity. It has been pointed out in some cases that a life insurance contract with reference to ones own life is not a contract of indemnity; but a life insurance contract with reference to the life of another person may be regarded as a contract of indemnity and to that extent Lord Mansfields dictum may be justified and the statement made by Porter may apply. For example, if a creditor takes out a policy of insurance on the life of the debtor, the creditor will be paid only the compensation with reference to the damage he may suffer due to the death of the debtor.

In conclusion, it may be said that though there is a doubt whether a contract of life insurance is a contract of indemnity or not, it is well settled and without doubt it may be said that contracts of fire and marine insurance are all contracts of indemnity.

Contract of Wager

There are two competing views about the question whether a contract of insurance is a contract of wager. In 1892 Lord Bramwell observed:

All life insurance is a sort of wager. I stake 20 a year as long as I live, against 1000 to be paid to my executors when I die. If I die early I win, if I live long I lose.

This observation applies equally to all forms of insurance. According to Sir William Anson all insurance contracts are wagering contracts. He points out that there is not much distinction between the insurance on cargo and the wager in a horse race. Commenting on *Wilson v Jones,* Anson says that all contracts of insurance are wagering

contracts even though there is an insurable interest; but they are permissible under law. According to him a wager is a promise to give money or moneys worth upon the determination or ascertainment of an uncertain event, the consideration being either something given or promised to be given by the other party in the event determining in a particular way. Anson pointed out further that though insurance is a wagering contract it is permitted by law and therefore enforced by law. On the other hand wager has been defined by J Hawkins in *Carlill v Carbolic Smoke Ball Company:*

A contract by which two persons professing to hold opposite views touching the issue of a future uncertain event mutually agreed dependent upon the determining of the event that one shall win from the other a sum of money neither of the contracting parties having any other interest.

If we apply this definition to an insurance contract we find that it is not a contract of wager for the following reasons:

(i) In the case of an insurance contract, the risk of loss or damage is existing whether there is insurance or not; while in the case of wager the risk is created by the agreement between the parties.

(ii) In a contract of insurance there is an insurable interest, that is, the insured has some interest in the subject matter but in the case of a wager parties have no interest whatever.

(iii) A fine distinction is drawn between a contract of insurance and one of wager. It is essential in a wagering contract that one party must win and the other party must lose; but in the case of an insurance contract the insurance company only may lose. It can never win because if the loss takes place it has to pay and premium cannot be called a profit. The insured neither wins nor loses because if the loss happens he is paid only the compensation.

In *Tyrie v Fletcher,* it was observed that a contract of insurance is not a wagering contract although the risk is the essence of the contract. The assured is moved to effect the insurance by the risk of loss and does not create the risk of loss by the contract itself as in the case of pure wager. In a pure wager the interest of the contracting parties in the event wagered on is created by the fact that they have contracted to pay each other certain sums on a certain event, neither sum being due until the event has been decided in one way or the other; whereas in insurance the motive for the contract springs from the existence of something which may be lost and the danger of the loss thereby to the person who seeks insurance. Such a person pays, but not merely risks money, to obtain security against possible loss.

In *Wilson v Jones* Willis J observed:

A policy is properly speaking a contract to indemnify the insured in respect of some interest which he has against the perils which he contemplates it will be liable to. The distinction between a wagering contract and one which is not depends upon whether a person making it has or has not an interest in the subject matter of the contract.

Otherwise if involvement of an element of chance to gain or lose is an indicia of wager, every business is a wager. A trader purchases goods hoping that their market value rises; if it rises as he expects he gets a good profit and if it falls contrary to his expectations he has to suffer a loss. Consequently, in the law of insurance both under the common law and the statutes, it has been maintained that a contract of insurance without insurable interest is a wager and hence void. In *Lucena v Craufurd* it was observed that:

There is a material distinction between a contract of wager and a contract of insurance. The wager may have any speculative chance or expectation as the subject matter; but in an insurance contract a chance or expectation cannot be subject matter as it definitely pre-supposes loss of some right of property either in possession or ownership.

The difficulty arises because of the semblance of the two contracts as both depend upon speculation. A wager is an aleatory contract; and some time an insurance contract is also called an aleatory contract or a contract involving risk or speculation. Porter says that the term is well applied to insurance contracts since it is certainly a contract of mutual risk wherein the premium is risked against a chance of loss. Aleatory is a French word which means one in which the equivalent consists in chances of gain or loss, that is, the parties take chances as they do in throwing a dice. If this is the sense in which we take it, it is somewhat similar to a wagering contract and the insurance contract is not an aleatory contract. Lord Simmons in *Macaura v Northern Assurance Co Ltd* laid down that a fire insurance policy is not an aleatory contract but it is a contract of indemnity; because he must prove interest at the time of loss.

Chapter 6 Insurable Interest

Definition

It has been said that it is a general principle of common law that every contract entered into by the parties is enforceable at their instance irrespective of its subject matter provided it is not either illegal, immoral or contrary to public policy. So in the beginning an insurable interest was not a requirement for the validity of a contract of insurance and Roche J observed that there is nothing in the common law of England which prohibits insurance even if no interest exists. It is in fact a principle of public policy that persons who enter into contractual engagements should be required to fulfil them, and contracts of insurance are no exception to it. The concept of insurable interest is a subsequent development of insurance practice and in this branch of law it has a double meaning.

Insurable interest means an interest which can be or is protected by a contract of insurance. This interest is considered as a form of property in the contemplation of law. It is assimilated to an actionable claim transferable to the same extent and within the same limitations. The two meanings of the term insurable interest in insurance law are, firstly in indemnity insurances, unless there is some proprietary interest which is sought to be covered by the policy there is no loss suffered and in such types therefore the contract by its very nature requires some interest to be involved in the subject matter and this is called contractual insurable interest and in other cases of insurance where loss is not necessary to be proved this is not necessary. For example, a fire insurance contract is a contract to indemnify the insured subject to the policy amount and if the assured has no interest in the property, by its damage, he suffers no loss and so he cannot recover anything. The contract is perfectly valid though nothing is recoverable under such a contract. In life insurance the contract is to pay a certain sum of money to the insured on the happening of an event and so the contract does not require an insurable interest. So it led to the practice of insuring the lives of public men in whose life the insured had no interest. To condemn this practice the Life Assurance Act 1774 was passed under which it is said that the insured must have an insurable interest in the life insured. The Act did not define insurable interest. This Act mainly dealt with life and accident assurances. Then the Gambling Act 1845 was passed which applied to all insurances not covered by the Life Assurance Act 1774 and marine insurance. Marine insurance was regulated by the *Marine Insurance Act* 1906 in England. So the interest required by these Acts to support an insurance is called statutory insurable interest and this is the second meaning.

A contract of insurance being primarily a contract of indemnity, insurable interest, contractual or statutory, is a necessary element in every contract of insurance. It is only the presence of insurable interest that distinguishes a contract of insurance from a wagering contract and hence it is a *sine qua non* for the validity of the contract of insurance. All the statutes say that an insurance contract will become a wagering contract and hence void if it is effected without an insurable interest. Every contract of insurance, to whichever class it belongs, shall show an insurable interest and without it, it is illegal or void and hence unenforceable.

Then what is an insurable interest? None of the above statutes attempts a comprehensive definition of insurable interest. Therefore, in this connection we may note with interest some of the definitions of the expression given by authors and judges. According to Patterson, insurable interest is,

A relation between the insured and the event insured against, such that the occurrence of the event will cause substantial loss or injury of some kind to the insured.

Rodda says:

Insurable interest may be defined as an interest of such a nature that the occurrence of the event insured against would cause financial loss to the insured.

It is also defined as,

When the assured is so situated that the happening of the event on which the insurance money is to be payable would as an approximate result involve in the loss or diminution of any right recognised by law or in any legal liability there is an insurable interest to the extent of the possible loss or liability.

Thus it is any interest which the assured is deemed to have in the subject matter of insurance if in the event of its

loss, damage, or destruction that person will be subject to the risk of losing some economic benefit or advantage. It is an interest or right which the law will recognise in the preservation of the thing or the continuance of the life which has been insured. It need not be a legal interest. The test laid down by the courts is whether the insured stands in such a relation to the subject matter that by happening of the event insured against he will sustain some pecuniary loss.

In *Lucena v Craufurd,* Lawrence J defined insurable interest as,

The having some relation to, or concern in, the subject of the insurance, which relation or concern, by the happening of the perils insured against may be so affected as to produce a damage, detriment or prejudice, to the person insuring and where a man is so circumstanced with respect to matters exposed to certain risks or dangers, he may be said to be interested in the safety of the thing with respect to it as to have benefit from its existenceprejudice from its destruction.

To put it in short, in his Lordships words in the same case: interest means if the event happens, the party will gain advantage, if it is frustrated, he will suffer a loss. Lord Blackburn crisply remarked that he did not know a better definition of the expression than that given by Lawrence J. The above decision emphasises the benefit and detrimental aspects of the legal interests that the assured must necessarily possess to be a rightful party to take out a valid policy of insurance. Insurable interest is property in the nature of an actionable claim.

Even in India it is strange that the *Insurance Act 1938* does not contain a definition of insurable interest. The only section, namely s 68 which makes a passing reference to the words insurable interest stands repeated by s 48 of the Insurance Amendment Act 1950. Briefly stated there is no legislative guidance in Indian Law on the subject. The definition in *s 7 of the Marine Insurance Act 1963* is not exhaustive.

Nature of Insurable Interest

In *Lucena v Craufurd* it has been pointed out that the interest must be enforceable at law. Mere hope, however strong it may be, is not sufficient. Lord Eldon observed that expectation though founded on highest probabilities is not interest and it is equally not interest whatever might have been the chances in favour of expectation. If moral certainty is a good ground of insurable interest there are hundreds, perhaps thousands, who would be entitled to insure, for example, in the case of a ship, the dock company, the dock master, the warehouse keeper, the porter and every person who has nothing to do with it.

Walton J observed that the definition of insurable interest has been continuously expanding, and dicta in some of the older cases which would tend to narrow it, must be accepted with caution. A study of the modern cases reveals that a vested or proprietary interest is not essential, but such interest may be merely possessory, inchoate, contingent, defeasible, equitable or expectant. In respect of expectant interests, there must be a subsisting right or title in the insured at the time of the loss with respect to the subject out of which the expectancy arises; but a mere expectation of profit without any interest in the goods will not however be sufficient to constitute insurable interest. If we study the modern cases on insurable interest we find that meaning of the term insurable interest is liberally interpreted. It is not always the legal interest or a full interest that is required by the courts, but it should be such that it would be sufficient if it is recognised by court of law or equity as such interest. The following points may be gathered from these cases:

- (i) The interest should not be a mere sentimental right or interest, for example, love and affection alone cannot constitute insurable interest.
- (ii) It should be a right in property or a right arising out of a contract in relation to the property.
- (iii) The interest must be pecuniary, that is, capable of estimation in terms of money. In other words, the peril must be such that its happening may bring upon the insured an actual or deemed pecuniary loss. Mere disadvantage or inconvenience or mental distress cannot be regarded as an insurable interest. Claim for damages for mental agony and inconvenience is not maintainable.
- (iv) The interest must be lawful, that is, it should not be illegal, unlawful, immoral or opposed to public policy.

Time or Duration of Interest

The time when the insurable interest must be present varies with the nature of the insurance contracts. The question is whether insurable interest should exist at the time when the contract is formed or should it also continue to exist until it is discharged. In life insurance the presence of insurable interest is necessary at the commencement

of the policy although it is not necessary afterwards, not even at the time of occurrence of the risk. So it should be there in life policies at the time of taking the policy. It need not exist at the time when the loss takes place or even when the claim is made under the policy. Life insurance contracts, as we have noted, are not strictly speaking contracts of indemnity. For example when a creditor insured the life of the debtor, the policy continues even after the debt is paid because the subject matter of insurance in that type of contract is the life of the debtor and not the debt. Similarly, when a husband insures the life of the wife or vice versa, notwithstanding the dissolution of the marriage the policy subsists, as here also the subject matter of insurance is the life of the other spouse and not the marriage.

At one time it was thought, and the rule in the marine insurance was extended to life insurance also that the interest must be shown to exist at the time of loss. But the decision was overruled in *Dalby v India and London Life Assurance Co* where it was held that the insurable interest need be proved to have existed at the time of taking the policy and at that date only. In fire insurance it is required both at the commencement of the policy and at the time when the risk occurs. In a sense, therefore, it may be said that insurable interest is doubly insisted upon in fire insurance law. The insurable interest is necessary at both the times because it is treated as a personal contract and also a contract of indemnity; eg, if a house is to be insured against risk of fire, the person effecting a fire policy must have an interest in the house as it is a personal contract. Again, if the owner of a house takes out a fire insurance policy and later on sells the house, he loses the insurable interest and he cannot claim under the policy if a fire takes place and damages the house as he has no insurable interest as fire insurance is also an indemnity contract. In a marine insurance contract, the presence of insurable interest is necessary only at the time of the loss. It is immaterial whether he has or has not an insurable interest at the time when the policy was taken.

Insurable Interest and Life Insurance

It is always difficult to define with precision what constitutes insurable interest in life policies; but one thing is settled, here as well as in England, that for the validity of a contract of life insurance, as in the case of other types of insurances, there must be an insurable interest. The preamble to the English Life Assurance Act 1774 reads:

Where it hath been found by experience, that the making of insurance on lives, or other events, wherein the assured shall have no interest, has introduced a mischievous kind of gaming; for remedy whereof, be it enacted... that from and after the passing of the Act, no insurance shall be made by any person or persons, bodies politic or corporate, on the life or lives of any person or persons, or on any other event or events whatever, wherein the person or persons for whose use, benefit or on whose account such policy or policies shall be made, shall have no interest, or by way of gaming and wagering and that every insurance made contrary to the true intent and meaning thereof shall be null and void to all intents and purposes whatsoever.

The doctrine of insurable interest was recognised in English law only in the latter half of the 18th century by this statute requiring insurable interest as a condition for the validity of the policy. This Act laid down three rules:

(i) In every contract of insurance, the insured or the person for whose benefit the insurance was effected must have an interest in the subject matter.

(ii) The person for whose benefit the policy was effected shall not recover more than the value of such insurable interest.

(iii) Every policy shall have inserted in the policy, the name of the person interested or for whose benefit the policy was taken.

In life policies, the following persons have been recognised as having insurable interest and they may conveniently be considered under three main headings, namely: (a) by relationship by marriage, blood or adoption, (b) by contractual relationship, and (c) by statutory duty.

Blood Relationship

This may be discussed under the following heads:

On Ones Own Life Every person is presumed to have insurable interest in his own life without any limitation. Every person is entitled to recover the sum insured whether it is for full life or for any time short of it. If he dies, his nominee or dependents are entitled to receive the amounts.

By Husband or Wife With the due development of the life insurance business, just as a person is presumed to

have an insurable interest in his own life, it is now well settled in England and America that a wife has an insurable interest in the life of the husband and vice versa. It forms an exception to the general rule that interest necessary to support the insurance of another persons life must be capable of expression in terms of money or pecuniary interest. Dr SS Hubner observes that life insurance is a husbands privilege, a wifes right and a childs claim. The rule that a wife has an insurable interest in the life of her husband was recognised earlier on the supposed reason that she depends on him. There was a difference of opinion on the other question whether a husband has an insurable interest in the life of his wife. After the passing of the English Married Womens Property Act, it is settled by its s 2 that a husband is presumed to have an insurable interest in the life of his wife. Therefore at the present time the husband and wife are presumed to have an insurable interest in the life of the other. This was laid down in *Reed v Royal Exchange Assurance Co*. In this case a policy was effected by the husband on the life of his wife with the intention to defraud the creditors. The premium was paid by the husband. It was held that the policy was valid and the creditors were entitled to receive from the policy amount a sum equal to the premium paid.

Before leaving this topic we may note that the presumption arises only during the period of coverture and the policies taken during that period only will be valid and they will continue to be operative even after the dissolution of the marriage. For example, *A* takes out a policy on the life of his wife *B* and subsequently even if they are divorced still the policy continues to be valid. On the other hand, if *A* takes out a policy on the life of *B* whom he proposes to marry, or who has been divorced by him, the policy is not valid for want of insurable interest at the commencement of the risk, that is, at the time when the contract is made.

Parent and Child In England it has been laid down that a parent has no insurable interest in the life of the child because mere love and affection is not sufficient to constitute an insurable interest. If the person has any pecuniary interest in the life of the child, whether natural or adopted, he can take out an insurance policy on the life of such child. A child, whether natural or adopted, is presumed to have an insurable interest in the life of the parent because it depends on the life of the parent for support. Even if such interest is proved, if a person affects a life insurance on a boy whom he intends to adopt, the insurance is not valid.

In this respect, it may be submitted that the English Law is covered and restricted to the statutory insurable interest. In England, the requirement of insurable interest is governed by the English *Marine Insurance Act* 17451906, the English Life Assurance Act 1774 and English Gambling Act 1845. But there is no statute in India corresponding to the English Assurance Act and therefore the English decisions on this subject must be viewed with caution.

The English Act restricts the sentimental interest as being sufficient interest by express provision only to the relationship of the husband and wife. In case of all other relationships courts in England require proof of pecuniary interest. On the other hand in USA in other close relationships also it has been held that sentimental interest is sufficient. Thus, apart from the relationship of husband and wife, a few courts in America have held the relationship of parent and child, grandparent and grandchild, brother and sister as sufficient to raise the presumption of the existence of insurable interest. Even there they did not go beyond the above relationships and they also held that such interest cannot be presumed in other cases like uncle and nephew, brother-in-law or mother-in-law and son-in-law or daughter-in-law, step brothers and sisters, a foster child and an illegitimate child have been held to have insurable interest without proof of any pecuniary interest. It has also been held that any relative may insure the life of another where he is so related to the other to have a claim for maintenance enforceable at law.

There is no express statutory provision in India on insurable interest and therefore, it is submitted, that we may draw on the decisions of foreign courts including those in England and America on the principles of justice, equity and good conscience. So we have to follow those which are in conformity with our social, economic and religious background. American decisions seem to be more adaptable to India as in both these countries the reason for the requirement of insurable interest is public policy or contractual and not any enactment of legislature as in England. Therefore even in India, sentimental interest based on any close family relationship besides that of husband and wife may be held to constitute sufficient insurable interest as in many states of USA, like New York and Pennsylvania. Some American decisions are quoted with approval in an Indian case. So in India also it may be concluded that apart from husband and wife and close relations any person legally entitled to claim maintenance can take out insurance on such other persons life without proof of insurable interest.

Other Relations The relationship by itself may not create an insurable interest. When one relation effects an insurance on the life of the other, there must be actual dependence on the person whose life is assured, that is, there must be a reasonable expectation of benefit from the continued existence of such person and in such a case, there will be an insurable interest.

Contractual Relationship

A wide variety of relations may acquire insurable interest by reason of contractual relationship and some of the common instances may be noted hereunder:

Debtor and Creditor A creditor has an insurable interest in the life of the debtor. The creditors interest is limited to the extent of the values of the debt. It is immaterial whether the debt is secured or unsecured. The creditor has insurable interest in the life of the debtor because the chance of obtaining repayment materially depends upon the continuance of the life of the debtor. The creditor has also an insurable interest in the life of the surety, as a surety is only a favoured debtor. On the same principle the surety has an insurable interest in the life of the principal debtor. A policy on the life of the debtor will not cease to be operative even though the debt has been satisfied or the debt becomes time barred before the debtor dies.

Similarly, a surety can insure the life of a co-surety and a mortgagee, the life of his mortgagor. In these relations it may be noted that the person who is in the position of a creditor only has an insurable interest in the life of the person in the position of the debtor and not *vice versa.*

Partner and Co-partner In *Powell v Dewy* it has been held that one partner has no insurable interest in another save where the latter is indebted to him personally or to the partnership, and to the extent only of such indebtedness. Again it has been held that a partner has an insurable interest in the life of his co-partner to the extent of the amount of capital which the latter has contracted to bring in.

Similarly, the following are also said to have insurable interest:

(i) Principal and Agent

(ii) Master and Servant

(iii) Trustee and Co-trustee

Insurable interest is not limited to the absolute ownership of the property. Father was in lawful possession of the sons property. He was not in possession of the property as a lessee also. Father insured the property and the insurer also was aware of fact that the property was in the name of the insureds son. When loss incurred, it was held that the father-insured was entitled to insure the property as a trustee of the property. It may be noted that this is not an exhaustive list but only an illustrative one.

Insurable Interest and Fire Insurance

A fire insurance contract is considered as a personal contract. It is only an agreement with a particular person to pay a certain sum of money if he suffers any loss or damage due to fire with reference to the property insured. In *Saldar* s case it was observed that what is insured in a fire policy is not the bricks and materials but the interest of the assured in the subject matter of insurance. Therefore, it is not necessary that the assured must have full ownership in the property and any special interest or entitlement to a particular property in the subject matter is sufficient to enable a person to take out a fire policy. In England it has been held that an insurable interest is not synonymous with a legal interest. A person is presumed to have an insurable interest in the property if he has a pecuniary interest in the continued existence of the property. The interest of the following persons may be noted as illustrations of the above proposition:

Interest of the Bailee

A bailee is a person to whom goods are delivered for some purpose under a contract that they shall be returned or otherwise disposed of according to the directions of the person who delivered them. An ordinary bailee is in possession of the goods, therefore he is entitled to insure them for full value because he will be liable for loss or damage to the owner and also he has a lien over the goods. If the bailee insures for full value and if he receives the same from the insurer, he must hold the excess amount in trust for the bailor.

Interest of an Agent

An agent is in possession of goods and to the outside world he is in the position of his principal and therefore he has an insurable interest in the goods. He can take out a policy in his own name and for full value of the goods. An agent without possession of the goods has no insurable interest. If the agent has a lien on the goods he has

insurable interest to the extent of his claim.

Purchaser and Seller

An interest under an agreement to purchase was held to be an insurable interest.In India *s 54 of the Transfer of Property Act 1882* lays down that a contract for the sale of immovable property does not by itself create an interest in the property, just because he is the legal owner of the property. This is followed in England too. Likewise a purchaser if he becomes a full owner can insure the property; but if it is merely a contract for sale and not a contract of sale of immovable property, the purchaser in England has an insurable interest because he is an equitable owner. While in India, he does not get any property and therefore has no insurable interest. If the property is destroyed by fire before the completion of the sale and if the seller received the insurance amount the buyer has no right against the seller. Therefore, a special provision has been made in *s 49 of the Transfer of Property Act* which lays down that the purchaser has a right to demand the reinstatement of the property from out of the insurance money received by the seller.

Mortgagor and Mortgagee A mortgagor as the owner of the property has an insurable interest and he can insure for the full value of the property. The mortgagee also can insure for the full value of the property if it is intended for the benefit of the mortgagor also.If the property is destroyed and if he receives an amount of full value, the excess must be paid over to the mortgagor. *Section 72 of the Transfer of Property Act* lays down certain restrictions on this right of the mortgagee. According to this section he is not entitled to insure the property to a greater amount than that specified in the mortgage deed or if no amount is fixed he cannot insure for more than two-third of the value of the property, that is two-third of the amount required to reinstate the property. The section prohibits an insurance by the mortgagee if there is already an insurance by the mortgagor.

Lessor and Lessee In the case of a lease, both the lessor and lessee are entitled to have the insurance effected as both have an insurable interest. The lessor can insure for the full value of the property because generally he is the owner of the property; but in certain cases, the lessee can insure for the full value, for example, if he is liable to keep the property in repair or if he is liable to the owner for loss by fire. In *Castellain v Preston* it has been held that a tenant of premises has an insurable interest founded upon the beneficial enjoyment of the premises, which he loses in the event of its destruction. Again, a tenant who has taken on rent a furnished house has an insurable interest in the furniture.

A Lien Holder A person having a lien or charge on the property has an insurable interest to the extent of the value of the lien or charge. Hire Purchase agreement: Vehicle finance under the hire purchase agreement. Insurance policy issued in the name of the finance company and the loanee. Under the hire purchase agreement the finance company had a right to take possession of the property in case loanee failed to pay instalments property. When property lost, it was held that the finance company had insurable interest and was entitled to claim the loss.

Insurable Interest and Marine Insurance

It is not possible to give a precise definition of insurable interest so as to cover all cases which constitute it. It has been said that an insurable interest is in the nature of an inchoate right ever present for perfection in those who possess the right, but never perfected until all legal requirements have been performed. An insurable interest is *sui juris* and peculiar in its texture and its operation. A person can be said to have insurable interest in the subject matter insured where he has such a relation or connection with or concern in, such subject matter that he (i) will derive pecuniary benefit or advantage from its preservation or (ii) will suffer pecuniary loss or damage from its destruction, termination or injury by the happening of the event insured against.

Under a marine policy, we have already noted that the assured must be interested in the subject matter at the time of loss and it need not subsist at the time when the insurance is effected. The *Marine Insurance Act 1963* in India deals with insurable interest in ss 717. The Indian Act of 1963 and English *Marine Insurance Act* 1906 define insurable interest as follows:

In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or he may be prejudiced by its loss, or by damage thereto, or by detention thereof or may incur liability in respect thereof.

In *Tomlison (Haullers) Ltd v Haplurane,* the plaintiffs who were road carriers insured tobacco and cigarette consignments which they had contracted to carry to the customers depot by a Lloyds goods in transit, policy, with

the defendant insurer. This they did as they were required under one of the terms of carriage. Before the goods could be unloaded at the owners depot the lorries and the tobacco were stolen without the plaintiffs fault. The plaintiffs claimed the value of the goods. The insurer contended that the policy did not cover the owners interest but only the carriers interest in respect of their negligence. In appeal the House of Lords held that (i) this was a policy on goods and not merely in respect of the carriers negligence; (ii) the carriers had an insurable interest in the goods the value of which was recoverable under the policy but that; (iii) the carrier must account to the owners for their share of the loss after deducting what was due to them as carriers.

Once the marine cargo which was insured and in transit handed to sea carrier by Indian seller, the unpaid seller ceased to have insurable interest in the marine cargo. In case of non delivery of goods to foreign purchaser, the insurer was not liable to indemnify the resultant loss to the unpaid seller. According to the terms of the policy it was the duty of the appellant - consignor (claimant) to disclose the defects in each and every consignment at the time of dispatch to the insurer. Every time instead of consignor, the consignee used to disclose the defects in the goods to the insurer. It was held that it is a settled proposition of law that a stranger cannot alter the legal obligations of the parties to the contract and hence the insurer was not liable for the loss.

This is a case which supports the principle that a person having a limited interest also can insure such interest with other interest as well.

A person may be having the following types of interests:

(i) a defeasible interest;

(ii) a contingent interest;

(iii) a partial interest;

(iv) the risk undertaken by insurance;

(v) the creditor of money on bottomry or respondentia;

(vi) the master or any member of the crew of a ship in respect of their wages;

(vii) the person advancing money in respect of a freight which cannot be recovered.

Chapter 7 Premium

Definition

The premium is considered as the consideration for which the insurer undertakes to discharge the liability arising under the contract. Lawrence J defined premium as a price paid adequate to the risk. It is thus the price for which the insurer undertakes his liabilities under the contract. It is the insurer that bargains for its payment either in lump sum or in installments. The adequacy of premium as that of consideration is purely a concern of the parties and once it is agreed upon it is sufficient for the purpose of the law. Generally the premium is calculated according to business principles and once it is settled the insurer cannot subsequently question the adequacy of the premium because the agreement is conclusive. The only limitation by law on the freedom of the insurer in fixing the premium is that the bases of the premium shall be communicated to the controller of insurance. They shall be certified by an actuary. Insurer cannot increase the premium unilaterally without taking the consent from the insured by issuing an advance notice.

In law, the payment of the premium is not a condition precedent to complete a contract of insurance. Actual payment of the premium is not necessary to the creation of a valid contract of insurance. But in actual practice, the payment of the premium is usually made a condition precedent only in the case of first premium but not in the case of subsequent premiums. A stipulation that the insurance shall not attach until the premium is paid will not be implied. If there is such a condition expressly provided in the policy the insurer will not be liable until the premium has been paid. Generally the proposal form constitutes a proposal and the issuance of policy constitutes acceptance; as we know that for an acceptance to be valid it should be unconditional, and a policy containing such a stipulation constitutes a conditional acceptance or a counter offer and the payment of the first premium becomes

an acceptance that concludes the contract, until then it is open. The court will not also enforce a contract of insurance where there is such a stipulation in the policy until the premium has been paid. In life insurance the payment of the premium is a condition precedent. But payment of premium without acceptance or issuance of policy may not always amount to acceptance. Cheque had been drawn and dispatched by bank on 2-3-1992 for payment of premium and was received by the Insurance Company on 4.3.1992 and thereafter the policy was issued on that date. When an accident occurred on 3-3-1992, It was held that even if the policy had been prepared after the accident it could be said that valid premium had been paid by the owner prior to the accident and the insurer was liable.In *LIC v Komalvalli*, Raja Vasireddy sent a proposal for insurance of Rs 50,000 on his life on 27 December 1960 and the report of his medical examiner along with cheques towards the first premium. The cheques were encashed by the LIC on 29 December 1960 and 11 January 1961. He died on 12 January 1961 and his widow claimed the sum assured by the policy. The Divisional Manager, Masulipatnam said the proposal was yet to be accepted as it was not considered and terms of acceptance fixed the premium amount calculated. According to the Financial Powers Standing Order 1960, the Divisional Manager was the competent authority to underwrite proposals for Rs 50,000 and above and he had not ordered the acceptance of the proposal. Reversing the High Court decision the Supreme Court dismissed the claim holding that:

The mere receipt and retention of premium until after the death of the applicant or the mere preparation of the policy document is not acceptance. It must be signified by some act or acts agreed on by the parties or from which the law raises a presumption of acceptance...the general rule is that the contract of insurance will be concluded only when the party to whom an offer is made accepts it unconditionally and communicates his acceptance to the person making the offer. The final acceptance that of the assured or the insurer however depends simply on the way in which negotiations for an insurance have progressed.

Though the insurance companies are made liable to bear entire loss or damage to third parties on account of statutory compulsions when there was a valid contract between the insurer and insured but making the insurance company liable would be against principles of equity when no premium has been paid (as in case of dishonoured cheque).

The insurer cannot assume risk unless and until premium is received or deposited and the policy issued can assume the risk from a retrospective date provided such date is not earlier than the date on which the premium had been paid in cash or cheque to the insurer.

The claimant requested the insurance company by writing a letter and sending a cheque along with the letter to arrange for insurance against flood, inundation etc., however, the insurance company did not issue any acknowledgement of receipt to the claimant. On the loss of the goods when claim was made by the claimant, it was held that liability cannot be fastened on insurance company for damages claimed by claimant because there was no concluded contract.

The policy holder made the payment on 17th March and died on 20th March. The insurer issued the policy later. It was held that the contract was concluded on the payment of first premium by the insured and the fact that the policy was issued later on is immaterial. In addition to that, the policy contained a clause that the policy was made effective w.e.f. 20th March.

In case of marine insurance, payment of premium and issue of policy are concurrent conditions. Therefore, the insurer is not bound to issue the policy unless the premium is paid. But as a matter of practice a marine policy is issued without insisting upon payment of the premium. Once there is a condition as to the payment of the premium the courts will enforce it strictly. For example in *Handler v Mutual Reserve Fund Life Association,* a policy of life insurance contained the condition of punctual payment of the premium within 30 days of the due date. The policy holder failed to pay the premium even within the extended time. It was held that his policy came to an end because it subsisted only so long as the premiums were paid regularly. This case was followed in *Sankuni Menon* v *Empire of India Life Assurance Co.* The condition as to the payment of the premium may be waived by the insurer; but it cannot be waived by the agent. Provision may be made in the policy for increasing or reducing the premium as the risk is increased or diminished. The insurer by mistake insured the property for higher claim by accepting lesser premium. It was held that the insurer was entitled to fix higher premium at the time of renewing the policy.

The Mode or Method of Payment

The payment of the premium is usually made in cash. If no other method is indicated it should be paid in cash and tender in any form other than cash can be refused. In *London and Lancashire Life Insurance Co v Fleming* it has been held that the onus of proving that the premium has been paid in cash lies on the assured. The insurers may

accept any other method of payment, say by cheque, promissory note or any other thing of value. For example, the insurers acknowledgment of receipt of premium by debiting against the coal supplied by the insured, or the insurers receipt of premium partly in cash and partly by promissory note were held valid payments of premium. The payment of premium could be by two modes and it may be by way of barter or by cash and payment of premium in any one of the modes is valid when there is an agreement between the insurer and insured. The insurer may agree to receive payment of a premium by cheque, a bill of exchange or a promissory note. Such an agreement may be implied from a course of dealing between the parties. It may be even agreed to be adjusted by settlement of accounts. In the case of payments by negotiable instrument, say by cheque, it must be handed over at an anterior date providing sufficient time for encashing it. When once it is accepted and encashed the date of payment is the date on which the instrument is handed over and not the date when the money is received under the instrument. The premium may be agreed to be received in installments and in such a case the payment of the first installment is the satisfaction of the condition that the insurance does not attach until the premium is paid.

In *Prince of Wales Life Insurance Co v Harding* two companies in the habit of reinsuring each other, by the ordinary course of business gave a receipt for each premium as it felt due, though no payment was made until the periodical statements of account when the balance was struck and paid over by the company owing it, it was held that a premium was paid on the day on which the receipt for it was given. Though the payment was not made in cash, but receipts were given as if actual payments were made within the days of grace and the amounts were entered into the mutual accounts of the parties, though the accounts were settled subsequently, it was held the dealings between the parties amounted to payment of the premium within the days of grace. The premium may be agreed to be received by post and in such a case, even if the money is stolen or lost in transmission the payment is deemed to have been made. In the absence of such an agreement the insured sends the money by post at his own risk. Payment to an agent is valid if he is authorised to receive the premium in that mode. The employer, by entering into an agreement with the insurance company agreed to deduct the premium from the salary of the insured-employee. The employer failed to pay the premium for two months even after deducting the premium from the salary of the insured-employee and the insured-employee died thereafter. It was held that the employer acts as an agent of the insurer and cannot repudiate the claim on the ground of non-payment of premium. The Insurer cancelled the policy due to dishonour of the cheque and the accident occurred after cancellation of the policy. It was held that the insurer was not liable. If he has no authority either to receive, or to receive it in the manner received by him it will not bind the company unless by the course of dealings the agent has an implied authority. If the cheque is not honoured, it will be deemed to have not been paid unless the insured himself preferred the cheque to cash. The date on which risk is assumed by LIC is not the date on which it is posted, but the date on which the company received the cheque.

Days of Grace

There is no moral obligation on the part of the insurer to demand the payment of the premium; but as a matter of practice, a notice demanding payment is sent to the insured. Even though the notice is not received, it is the duty of the insured to pay the premium. If the notice is lost by an accident or by inadvertence and consequently not received by the assured, the general rule is that it is not a defence for non-payment of the premium. There is another view that if there is a course of dealing between two parties creating a right to believe that the assured will get the notice, then the insurer will not be permitted to set up the failure of payment as a defence in an action on the policy.

Section 50 requires the insurer to give a notice of the options available when a policy lapses, within three months therefrom, if they are not set forth in the policy. The LIC has incorporated them in the policies and so need not give any such notice.

Generally most of the policies or renewal notices contain a stipulation enabling the assured to renew the policy after the due date on payment of the premium during a further period and this further period is called days of grace. For example in *Webb and Hughes v Bracey,* 15 days further time was given and even in that period the renewal premium was not paid and hence the policy was held to lapse. It is the privilege of the insurer to include such days of grace. In the absence of such a stipulation in the policy, that is if such further period is not stipulated either in the policy or in the renewal notice, the assured is not entitled to days of grace.

The scope and effect of stipulations granting a further time for payment vary according to the expressed intention of the insurer in the stipulation. If loss occurs during the days of grace it may be stipulated that either the insurer will still be liable notwithstanding the non-payment of the premium before due date, provided it is paid before the lapse of days of grace or the insurer will not be liable for such loss. Generally, when the insurer extends the original due date by granting days of grace the insurer will be liable if the payment is made within the days of grace, though after

the loss occurred. In such cases, the notice demanding the payment of the premium states that the payment may be made within 30 days from the due date or any other period of time may be given. They are intended to give an opportunity to the assured to pay the premium after the due date and to prevent the lapsing of the policy. The importance of the days of grace is that the payment of the premium within the days of grace will be deemed to be a payment on the due date.

In *Stuart v Freeman* the policy was on the life of another person and the premium was payable quarterly. One of the conditions in the policy was that it should have no effect if at the time of the death any premium remains unpaid for more than 30 days. After the due date of the premium the assured died. The plaintiff paid the premium after the death but within the days of grace. It was held that the payment was valid and the policy would not lapse even though the death has occurred after the due date on the ground that payment within the days of grace is deemed to be payment on the due date. The days of grace will be available even in such cases where the premium is not paid in cash but adjusted in any other manner, eg, by the adjustment of surrender value. Payment of the premium after the days of grace cannot revive the policy even though the company receives the premium by mistake or otherwise. The advantage of days of grace can be taken not only by the assured but also by any person interested in the policy, eg, a mortgagee may pay the premium within the days of grace though the policy was taken by the mortgagor. Again in the stipulation granting the advantage of days of grace the insurers may exclude their liability for any loss arising before the renewal premium is paid. This arises when the stipulation gives the insurer an option, exercisable at any time, to accept or decline the renewal. The insurance company refused to renew the mediclaim policy of the insured on the ground of his past conduct i.e., having gone into litigation for payment of his claim against the insurance company. It was held that the act of the insurance company was arbitrary in refusing to renew the policy, the policy is required to be renewed with effect from the date when it fell due for its renewal. Renewal cannot be refused on the ground that the insured had contracted disease during the period of expiring policy.

Forfeiture

Forfeiture of the Policy for Non-Payment

Usually the insurance contracts used to lay down conditions regarding the forfeiture of the policy, if the policy lapses due to non-payment of the premium in due time. The deceased was insured by the Insurance Company and the first premium was paid on 21-8-1995. At the request of the policy holder, the policy was backdated with effect from 28-4-1995. The policy also contained a clause that the premium should be paid within a period of one month, otherwise the policy would lapse. It was held that the Insurance Company was right in submitting that one year came to an end on 28-4- 1996 but not 21 -8-1996 and the insured was liable to pay premium on that date as it became due and payable.If the policy is forfeited the result is that the insurer will not be liable under the policy and even the premiums already paid need not be refunded by the insurer to the insured. When premiums paid for three years and thereafter subsisted only as a paid-up policy for reduced sum then the insurer was not liable to pay interest under contract of insurance or under any statute or under *Interest Act, 1978* from respective dates of payment of premiums to date of settlement of claims. As equity leans against forfeiture, the courts while interpreting these conditions providing forfeiture of the policy not only strictly interpreted them against the insurers but even leaned against them. In *Reserve Bank of India v Peerless General Finance and Invest Co,* Chinnappa Reddy J observed:

What is important is that if the policy holder commits default and does not pay any one of the first three premiums, the premiums already paid automatically stand forfeited to the LIC entitling the policy holders to no benefits. Since it is the poorer class of policy holders that may ordinarily be expected to commit default in payment of premiums, the forfeiture clause in practice operates harshly, specially against that class, the very class which requires greater security and protectionthus we notice that the incidence of lapsing or forfeiture of policies is highest and of a high order in the first three years after a policy is issued...We cannot help but feel distressed that despite *articles 38*, *39*, *41* and *43* of the *Constitution*, the LIC of India, an instrumentality of the State which is given the monopoly of life insurance business in the country has taken no steps to offer proper security and protection to the needy poor rural folk. If the LIC is really interested in treating the poorer policy-holders less harshly and move liberally, the time has come for the LIC to revise its terms and conditions and to think in the *direction of deleting the forfeiture clause altogether* as has now been done by the Peerless Co, or to delete it at last for policies for small amounts.

The courts used to lean liberally in favour of the insured and the onus of proof was laid and laid heavily on the insurer to establish the breach of the condition. This rule the insurers themselves to a practice of realising that forfeiture is a serious matter and therefore, they themselves provided certain reliefs against forfeiture.

Relief Against Forfeiture

(i) For the payment of the premium, days of grace are generally given.

(ii) If the premium is not paid even during the days of grace the insurers were providing non-forfeiture clauses. According to these non-forfeiture clauses, it is usually provided that if the premium is not paid the policy will not be forfeited but it will be treated as a paid up policy, that is, the policy will be reduced to the total of the premiums paid and in such a case the assured need not pay further premiums but the amount will be paid as calculated according to the terms of the contract on the happening of the event. A paid up policy is really a fully paid up policy for a reduced amount proportionate to the number of premiums actually paid. The amount that is paid by LIC in regard to a lapsed policy, is not refund of the premiums paid on various dates, but a reduced lump sum instead of the assured sum and therefore payment of interest thereon from the respective dates of payment of premium does not arise.

(iii) The insurer may agree to pay in cash the surrender value of the policy, that is, a percentage like 33 per cent of the premiums paid. The value of a current policy depends upon the life insurers expectation of life; and the value though nominal only at the commencement of the risk, usually increases according to the length of the period during which the policy remained in force. Provision is made in a policy whereby the assured becomes entitled on notice to surrender the policy and to be paid its surrender value. An option is generally given to the assured either to take a fully paid up policy for a reduced amount proportionate to the number of premiums actually paid or to adjust the surrender value for future premiums.

(iv) Even though the policy lapsed for non-payment of the premium, the assured may apply for the renewal of the policy on payment of a penalty and satisfying other conditions. In *LIC v Bharathi* it was held that for revival of a lapsed policy if certain requirements are prescribed, the insurer cannot impose new conditions.

Insured has a legal or contractual right to insist with the insurer to renew the policy once the insurer accepted the premium.

The *Insurance Act, 1938* has laid down certain rules in favour of the insured with reference to life insurance contract. They are listed below:

(a) According to s 50 (1) of the Act which is applicable to the Life Insurance Corporation, the insurer must give, within three months of the date on which the premium was due and not paid, notice to the policy holder informing him about the options available to him. The LIC has set forth in the policy itself the options available to the insured and so there is no need to give a separate notice to the insured. For example, the options are:

    (i) either to treat the policy as paid up policy, or

    (ii) to accept the guaranteed surrender value, or

    (iii) to keep the policy alive for such time as the surrender value will be sufficient etc. This must be provided in the policy itself.

(b) According to s 113, which also applies to the Life Insurance Corporation without any modifications as it applies to any other insurer, the assured can surrender the policy. If the premium has been paid for three consecutive years, the policy of life insurance will acquire a guaranteed surrender value taking into account the premium paid and also the bonus if any. Every such policy shall show the guaranteed surrender value. Notwithstanding any contract to the contrary, a policy which has earned the surrender value shall not lapse by reason of non-payment of the premium; but shall be kept alive to the extent of the paid up sum in the policy and this is the minimum required by law. In *Tolomal v Luxmi Insurance Company* where the insured has paid premiums for more than three years and defaulted to pay further premiums, the policy was kept alive for a whole year thereafter and the assignee of the policy subsequently paid two more premiums and when the policy was thus in force the insured died. The claim on the policy was allowed subject to the charge for payment of the sums advanced to keep the policy alive.

Under the policies insured by the Life Insurance Corporation liberal surrender value is allowed after premiums have been paid for at least two years or to the extent of one-tenth of the number stipulated for in the policy provided such one-tenth exceeds the premium for one full year. The Life Insurance Corporation does not keep the policies alive as in the case of *Tolomal.* Further, under these policies, if the premiums are paid for at least three years and the insured dies within six months from the date of default, the full sum assured by the policy will be payable subject to usual deductions. The policy can also be revived during the life-time of the assured and not later than the expiry of five years from the due date of the first unpaid premium, without including the days of grace being counted for this period, on production of evidence of health etc, to the satisfaction of the Corporation.

Surrender value generally means the value which the insurer is ready to pay at any particular time during the currency of the policy in consideration of being relieved from the liability under the policy. Notice should be given to the insurer regarding the intention to surrender. If the insured is unable to pay the premium he can surrender the policy and receive the surrender value.

The Return of the Premium

The general rule is that premium once paid cannot be asked to be refunded even if the insured is unable to enforce his policy against the insurance company. But to this general rule certain exceptions have been laid down in which he may ask for a refund of the premium though he cannot enforce the policy. Further in certain cases he may be entitled to have a right to the return of only a part of the premium and this may arise where:

(i) there has been over-insurance, or

(ii) there is an express term to that effect in the policy, or

(iii) when the company goes into liquidation.

> The marine rules are now contained in ss 8284 of the English and Indian Marine Insurance Acts 1906 and 1963 respectively.
>
> *Section 84 of the Marine Insurance Act* of 1906 in England and the *Marine Insurance Act 1963* in India lay down the following rules:

(i) If the consideration totally fails and if there is no fault or illegality on the part of the assured, the total premium is returnable.

(ii) If the consideration is apportionable, a proportionate part of the premium is returnable.

(iii) If the policy is void or avoided by the insurer from the commencement of the risk the premium is returnable if there is fraud or illegality.

(iv) If the subject matter insured in not imperilled the premium is returnable.

(v) If the insured has no insurable interest throughout the currency of the risk the premium is returnable unless it is a gaming or wagering contract.

> They include the provision that where the insured has over-insured, a proportionate part of the premium is returnable and such a doctrine has no place in non-marine insurance law. It may be noted that it is unsafe to rely on marine decisions to non-marine cases for re-payment of premium; but generally three cases arise in which the entire premium is to be refunded or returned, namely.

(i) where there has been fraud on the part of the insurer in inducing the policy to be taken;

(ii) where the policy has become void; and

(iii) where no risk has been incurred by the insurer and these rules are applicable to all branches of insurance.

Fraud on the Part of the Insurer

In *Tanjore Life Assurance Company v Kuppannarao* it was held that the fraud of the insurer entitles the insured to get back the premium paid by him. Under *s 65 of the Indian Contract Act* he can claim the refund of the premium by avoiding the contract. There must be a fraudulent representation and breach of good faith on the part of the insurer before a claim for return of the premium is laid by the assured. In *Carter v Boelum,* Lord Mansfield CJ observed:

The policy would be equally void against the underwriter if he concealed...and an action would lie to recover the premium.

Where the policy has otherwise been rendered worthless to the assured the assured can claim for a return of the premium.

But fraud on the part of the assured will not be a ground for claiming refund of the premium, because a person cannot take advantage of his own fraud and no court will assist a person who does not come with clean hands. In *Mithoolal v Life Insurance Corporation* it was held:

It is a well established principle that courts will not entertain an action for money had and received, where in order to succeed the assured will have to prove his own fraud.

But on the other hand if the insurer or his agent is guilty of false or fraudulent misrepresentation in inducing the insured to enter into the contract or issuance of the policy, he can revoke the contract and claim refund of the premiums paid by him so far. In *Kettlewell v Refuge Assurance Company* where fraud was discovered after premiums were paid for four years, the court ordered return of the premiums paid even though the insurer was on risk for some years. If there is only an innocent misrepresentation or non-disclosure by the assured, though the insurer is entitled to avoid the policy, he should return the premium.

In *Anderson v Thornton,* Parke J observed:

In cases of insurance, material misstatement or concealment vitiates the contract and whether it be fraudulently made or not is a matter which is wholly immaterial except with reference to the return of the premium...The insurance never bound the defendant, consequently the plaintiff was entitled to the return of the premium.

Section 84 (3) (a) of the English *Marine Insurance Act* 1906, states:

When the policy isavoided by the insurer as from the commencement of the risk, the premium is returnable provided that there has been no fraud or illegality on the part of the assured.

If there is fraud on the part of the assured, the insurer may resort to any of the following recourses:

(i) Refuse to receive further premiums and repudiate the contact.

(ii) To apply to the court for cancellation of the policy.

(iii) If the policy has matured, defence of fraud may be set up in any action for the recovery of insurance amount.

(iv) If the evidence is likely to be lost, a suit may be filed for a declaratory decree under the *Specific Relief Act*.

On the other hand, if the insurer files a suit for the cancellation of the policy on the ground of fraud or innocent misrepresentation of the insured, cancellation, declaration etc being equitable remedies, on the maxim he who seeks equity must be ready to do equity, the court in apportionate cases may compel him to return the premium or submit to any terms which the court may think fit. For example, in *Prince of Wales etc Assurance Co v Palmer,* the defendant effected a policy in his brothers name and on his brothers life. The brother dies and it was found that he was poisoned by Palmer. The insurance company filed a suit for declaration that the policy was void. The court granted the declaration on condition that the premium should be returned and it should be applied towards the costs of all parties.

Where the Policy has Become Void ab initio

As in the case of any contract, where it becomes void *ab initio,* if consideration is paid, it can be claimed to be returned. The contract may become void for various reasons like:

(i) when the parties were never ad idem;

(ii) when the company which issued the policy does so *ultra vires*;

(iii) where the terms of the contract are uncertain, that is, when the subject matter is incapable of identification;

(iv) where the object or consideration is illegal. In all these cases, it has been held that the insurer is bound to return the premium, and the right to claim a return of the premium has further been held to be enforceable by an action for money had and received, and not by an action on the policy.

Parties not in ad idem It is a well-known principle of law of contracts that when there is no consensus *ad idem* or error *in consensu* the contract becomes void. Parties are not said to be at *ad idem* when they do not think at the same time about the same thing in the same manner. There must be a meeting of the minds. The minds are expressed by offer and acceptance. The particular instance when there will be error *in consensu* is when the agreement is brought about by a mutual mistake of fact essential to the contract. In *Beach v Pearl Life,* where the proposer thought the proposal was for a policy on the life of her mother and the insurers agent thought that the life of her grandmother was the life intended to be insured and the policy was also accordingly issued and there was no evidence to show that the inconsistencies crept in due to fault of either party, it was a clear case of mutual mistake as the parties were not *ad idem* to the subject matter of the insurance. The claim made on the death of the mother was dismissed and the insurer agreed to return the premiums received by it. Similarly, the life of another person may be insured on the mistaken belief of both the insurer and the insured that the person insured is still living while in fact he is dead already by the date of issuance, or a fire policy may be effected on a house under the mistaken belief of both the parties that the house was there, though in fact by that time the house was burnt. In both the cases, the insurance becomes void and the premium has to be refunded. But this is again subjected to a limitation, that is, in case where the parties may be estopped from pleading *non est factum.*

In *Summers v London and Manchester,* Mrs Summers sent a proposal on the life of her son Harry Summers whose name and occupation were mentioned, but the agent thinking that it was a proposal on her husbands life, mentioned the age of her husband and the sum assured and the premium were calculated on that basis. On the death of her son she claimed the sum assured and produced a Record of Lost Policy issued by the insurer where her sons name was noted as the life insured. The insurer resisted the claim on the ground of *non est factum* and that the parties were not *ad idem* and so agreed to return the premiums paid. But the Industrial Assurance Commissioner held that by their conduct in issuing the Record of Lost Policy which lead the proposer to believe that her proposal to insure her sons life was accepted they were estopped from pleading that there was no contract. In such cases, the assured is entitled to claim a return of the entire premium paid by him as a payment under a void contract. In particular, the *Marine Insurance Act* 1906 in its s 84 (3)(a) provides:

Where the policy is void...the premium is returnable provided that there has been no fraud or illegality on the part of the assured; but if the risk is not apportionable and has once attached the premium is not returnable.

Ultra Vires the Powers of the Company When a policy is issued by a company which is *ultra vires* its power, the policy is void and strictly speaking they cannot rectify it but they will nevertheless be liable to return the premium. In *Re Argonaut Marine Insurance Co Ltd* where a marine insurer issued a fire policy the premium was held returnable.

A similar view was expressed when marine policies were issued by a Life Insurance Company, or where life policies were issued by an insurance company prohibited by its memorandum of association from carrying on the life insurance business, the court held that the assured was entitled to a return of the premium on the ground that such a policy is void. But these decisions have been criticised and distinguished in *Sinclair v Brougham.*

Where the Terms of the Contract are Uncertain In such a case the subject matter of the contract will become incapable of identification. Under *s 29 of the Indian Contract Act* where the terms of the contract are not certain or not at least capable of being made certain, the contract is void. In particular, the property insured has to be described, and the object of the description is three-fold, namely, to identify the subject matter, to show the nature of the risk and to define the risk. Risk is the consideration for the premium and for the risk to be attached to the policy the subject matter must be described adequately and correctly. It will not be capable of identification where the assured has no property answering the description of the subject matter contained in the policy or where the contract is otherwise void for uncertainty.

Where the Object or Consideration is Illegal A contract of insurance may become void due to illegality as any contract is void under *s 23 of the Indian Contract Act* whose object or consideration is unlawful or opposed to public policy. Cases of illegal contracts of insurance present some difficulty. If the object or consideration is merely unlawful under s 23, the contract between the parties only becomes void and under *s 65 of the Indian Contract Act*, premium is returnable and can be claimed by the assured; but in cases where the object or consideration is illegal within the meaning of s 23, difficulty arises. In English law the maxim *in pari delicto potior est conditio defendentis* applies and the law leaves the parties exactly where they were, that is, the law refuses to help either party. If the insurer files a suit for the premium or the assured files a suit under the policy or seeks refund of the premium, in all these cases the suits will be dismissed. But even under the general principles of law of contract where the parties are not *inpari delicto* or where there is *locus poenitentiae* before the illegal object is carried out, this maxim has no application. From this it is clear that where the policy is illegal the illegality of the policy cannot be relied on by the insurers if the facts of the case show that the assured was not *in pari delicto* with them. Even where both parties are

equally guilty, when the contract becomes void by reason of illegality, the question that arises in India is whether s 65 applies? In this respect there is a conflict of judicial opinion. According to the Bombay High Court as held in *Gulabchand v Fulbai* that a person who paid money can get it back under *s 65 of the Indian Contract Act* even though both parties are equally guilty and the illegal purpose has been carried out.

Another view is that s 65 will not apply to cases where the object of the agreement is illegal and its operation is restricted only to cases where the contract is vitiated or becomes void by reasons of impossibility, mistake or failure of consideration and therefore, the premium once paid under such a policy cannot be claimed to be refunded. According to Pollock and Mulla as there is no specific provision covering the cases governed by *in pari delicto,* English law would apply.

Even in English law there are however several exceptions and a premium paid under an unlawful policy is recoverable in the following cases:

(i) Even before the risk has begun to run, if the insured gives notice to the insurers abandoning the contract the insured can recover the premium. It is a principle of the law of contract that before the object of the contract is carried out if one party has *locus poenitentiae* he cannot only avoid the contract but also claim refund of any money paid by him under contract. But if the policy runs for a time and becomes void from a future date, the insured is not entitled to the return of any part of the premium.

    Though the rule that premium is recoverable under such circumstances is severely criticised, it is the well established policy of the law to give the assured a chance of repentance while the unlawful contract is still executory.

(ii) If both the insurer and the insured are under a mistake of fact about its legality, and honestly believe that it is a lawful contract, in *Oom v Bruce* the assured was held entitled to recover the premium. In that case an agent in London made an insurance on SS Bruce from a port in Russia which was to proceed to London. It was made in fact after the commencement of hostilities between Russia and England. But before the news reached London the ship was confiscated. It has been held that the policy was void *ab initio* and the premium was returnable.

(iii) If the assured is blameless himself but was induced by the fraud of the insurer to make the contract though the contract is unlawful he can still recover the premium. In such circumstances it cannot be said that the parties are *in pari delicto.* But the rule would be otherwise where a representation by the insurer or his agent is either erroneous or innocent. The effects of inducements made by the insurance agents have been considered and it has been held in *Horse v Pearl Life Assurance Co* that where the assured is induced to take an illegal policya policy on the life of his mother to cover funeral expenses relying on a representation as to the legality of the contract based on the insurers practice made by the agent, the assured cannot recover the premium paid. The court also observed that insurance agents are not to be treated as persons who are under a greater obligation than others to know the law. Proposers are therefore not to place more reliance than warranted and to act on the assumption that what they say is in order. But when the agent induces him to enter into such a contract by fraudulent misrepresentation the insurer can recover the premium.

Where no Risk is Incurred by the Insurer

Lord Mansfield said in *Stevenson v Snow* that equity implies a condition that the insurer shall not receive the price of running a risk if he runs none. The risk is the consideration for the premium to be paid and therefore if the risk insured against is not run the consideration fails and the assured is entitled to a refund of the premium. In *Stevenson v Snow* it was observed that an assured is entitled to the return of the premium if the risk is not run, even if the cause of or the risk not being run is the fault, will or pleasure of the assured. The court will order the refund of the premium if the risk has not been incurred and in marine insurance, it will not inquire the reasons or motive of the assured. It has been held in *Wolenburgh v Royal Co-op Collecting Society* that Lord Mansfields dictum in *Stevenson v Snow* that equity implies a condition that the insurer shall not receive the price of running a risk if he runs none applies and in such cases even if it is by the neglect or fault of the insurer, it does not matter.

Return of Partial Premium

Where there is a partial failure of consideration there will be a partial return. In marine insurance the risk is generally considered as divisible. On the other hand, in life policies, risk is not considered ordinarily as divisible

except when the policy is issued for a particular period of time, eg, say 12 months. But Porter says that though in life insurance generally the risk is considered as invisible, in certain cases the risk is divisible and a proportionate part of the premium is returnable. For example, if a person agrees to pay higher rates of premium for extraordinary risks like military service, he may get a return of proportionate premium if he does not take up the military service. In fire insurance also the risk is considered as not divisible and therefore proportionate part of the premium cannot be claimed to be refunded. But where there has been over insurance, a proportionate part of the premium is returnable. So far as the assured, honestly over-valued the subject matter of insurance and on that basis he has paid the premium, to the extent of the excess, the insurer has not undertaken any risk and as such there is a failure of consideration and to that extent the premium is refundable. As far as marine insurance is concerned the *Marine Insurance Act* states:

Where the assured has over-insured under an unvalued policy, a proportionate part of the premium is returnable.

The same principle applies to liability insurance where the amount of the premium is dependent upon the amount of wages or the number of vehicles plied or used.

Again the policy made provides expressly circumstances when a part of the premium is returnable. Similarly, when the insurance company goes into liquidation during the currency of the policy there will be a premature determination of the policy and a rateable portion of the premium is returnable.

It may also be noted that where there is no total failure of consideration that is, when the risk is attached to the policy even for a short time there cannot be a claim for return of the premium. Just as a stipulation specifying that he can claim a return of the premium in certain circumstances entitles the assured to claim a return of the premium in whole or in part, a stipulation that the premium is not returnable even in cases where the assured under law is entitled to a return of the premium debars him from claiming a return of the premium. Where the assured has been guilty of fraud, though there is failure of consideration the premium is not returnable. This is doubted and a contrary view was held by Blackburn J in his dissenting judgment in *Fowkes v Manchester and London Ass and Loan Association* holding that it is not returnable. It would not disentitle him if there is innocent misrepresentation.

Chapter 8 The Risk

Meaning of Risk

A contract of insurance is a contract under which the insurer undertakes to protect the insured from a specified loss if it occurs. The insured is afraid of loss which is called the risk of loss and the insurer undertakes to indemnify him from the apprehended loss if it occurs for a consideration called the premium. The insurer calculates the premium according to the probability, nature and extent of risk from which the insured desires to be protected. The risk of loss is co-extensive with the value of the insurable interest the insured has. The law does not compel a man to insure, but if he so desires he may like to be covered in respect of all or certain risks, so he must describe in his proposal form the risk, which he wants to be covered by the insurer. The insurer fixes the premium according to the nature, quantity, quality and probability of the risk desired to be covered by the policy. The life-blood of an insurance contract is the risk it deals with. The determination of the dimensions of the risk covered by the contract is important to both parties; it is important to the assured as from that he can know the exact extent of the risk covered by the contract so that he may adjust his economic affairs and to the insurer because he has to calculate the exact premium required to cover it. In this context, risk remains the risk until the happening of the contingency. Once the contingency happens it becomes a definite loss and it is against this loss the insurer undertakes to indemnify the assured.

Scope of Risk

The insurer indemnifies the insured only against the loss caused during the period insured, for which the direct and proximate cause is the peril insured against. In *Xantho* s case the scope of the risk is neatly described as: It is open to the parties by agreement to extend or limit the liability of the insurer in respect of the operation of the risk. In the absence of such agreement:

(i) the risk includes (a) the loss caused, *i.e.*, risk brought about by the negligence not only of the insured but even by his servants or strangers and (b) risk brought about wilfully or maliciously by the insureds servants or strangers, but

(ii) the risk does not include (a) loss caused by the willful misconduct of the insured or caused with his convenience whether it amounts to a crime or not, (b) loss due to ordinary wear and tear and (c) inherent vice of the subject matter insured as in (d) and (e) the risk is such that it must happen and the risk in insurances is that which may happen and not which must happen.

Time of Loss

Firstly, the contingency must happen during the subsistence of the policy. It is sufficient if the peril insured against happens during the period of insurance though the full effect to the peril is manifested or the extent of the loss is discovered after the period of insurance. But where the event happens at or before the beginning of the insurance and only the loss is manifested during the operation of the policy, the loss is not recoverable. Similarly, if the operation of the peril begins partly before the commencement of the policy and party afterwards and if the loss is apportionable, so much loss referable only to events which occurred after the commencement of the policy and before the expiration of the policy are recoverable unless by the operation of the peril before the commencement, the subject matter of insurance is so damaged that it does not answer the description. Where the loss is wholly attributable to the operation of the peril after the policy ceases to be in operation the loss cannot be recovered. But all this is subjected to a contract to the contrary. These difficulties are avoided in practice by resorting to the insertion of express terms in the policy like: The policy covers all losses disclosed during its currency irrespective of the time when they were actually sustained.

Causa Proxima

It must be caused by the peril insured against. In considering the cause of the loss, as in other branches of law like torts and contracts, the rule of proximate cause, the maxim *in jure non remota causa, sed proxima, spectatur* is to be regarded. The maxim means in law the immediate and not the remote cause is to be considered in measuring the damages. This rule is applied in the law of insurance also. There cannot be an event without cause and effect. In *Hamilton, Fraser and Co v Pandorf and Co,* where damage to cargo was caused by seawater escaping through a hole in a pipe gnawed by rats it was held that damage was due to dangers and accidents of the sea, Lord Halsbury observed:

A subtle analysis of all events which led upto, and, in that sense caused a thing, may doubtless remove the first link in the chain, so far that neither the law nor the ordinary business of mankind can permit it to be treated as a cause affecting the legal rights of the parties to a suit. In this case the existence of the rats on the board, their thirst, the hardness of their teeth, the law of gravitation which caused the water to descend upon the rice, the ship being afloat, the pipe being lead, and its capacity of being gnawed, each of these may be represented as the cause of the water entering, but I do not assent to the view that this contract can have a different meaning attached to it according as you regard each step in the chain of events as the origin out of which the damage ultimately arises.

Where there is a succession of causes which must have existed in order to produce a particular result, the direct and proximate cause i.e., the last cause must be looked into and the other rejected although the result would not have been produced without their occurrence. In *Pink v Fleming* there was an insurance on a cargo of oranges and was warranted free from partial loss or damage unless such loss or damage was consequent on collision with any other ship. There was a collision during the voyage and the vessel had to be put into the port for repairs. In order to make repairs the cargo had to be discharged into lighters and subsequently reloaded. When the vessel arrived at her destination it was found that the fruit was considerably damaged partly due to its being handled in the course of unloading and reloading and partly from natural decay which as a consequence of its perishable nature arose, owing to the delay in the voyage. The question was whether or not this damage to the cargo was a consequence of or was caused by the collision within the meaning of the policy. The court held that the loss was not recoverable. Lord Esher M R said:

The proximate cause of the loss was the handling of the fruit, though no doubt the cause of the handling was the necessary repairs, and the cause of the putting into port for repairs was the collision. There were three causes of the result, but according to the English law of marine insurance, only the last of them is to be looked at for the purpose of determining the liability of the underwriters.

In *Ionides v Universal Marine Insurance Co* it was observed that the maxim *causa proxima* is peculiarly applicable

to the law of insurance. In *Leyland Shipping Co v Norwich Union Fire Insurance Society Ltd,* it was held that the maxim *causa proxima* has to be applied to all policies and the doctrine has to be applied for the purpose of ascertaining which of the successive causes is the cause to which the loss is to be attributed within the intention of the policy. Lord Shaw observed:

To treat *causa proxima* as the cause which is nearest in time is out of the question. Causes are spoken as if they were distinct from one another as beads in a row of links in a chain, but if the metaphysical logic has to be referred to, it is not wholly so, the chain of causation is a handy expression, but the figure is inadequate, causation is not a chain, but a net. At each point influences, forces, events, precedent and simultaneous, meet; and the radiation from each point extends indefinitely.

The learned judge by his observation gave a new dimension to the concept of *causa proxima* by extending it from a lineal single dimension to double dimension plane. The same learned judge explained that the proximate cause of an event is the real and efficient cause to which the event may be attributed and the application of the doctrine varies according to the question whether the loss was caused by the peril insured against.

For the purpose of deciding whether the loss was caused by the peril covered by the policy the doctrine may be applied. Where the causes are successive the peril insured against may be the last cause for the loss in which case it can safely be said that the loss is caused by the peril insured against. In such cases there is no necessity to inquire into the cause or causes unless the further question arises as to whether the peril was brought into operation by an excepted cause. On the other hand, if the peril insured against is not the last cause for the loss but is only a preceding cause, the further question arises whether the last cause is a mere consequence of the preceding cause of the peril insured against or was there a break in the chain of causation? If the last cause is a mere probable and reasonable consequence of the peril insured against without any *novus actus interveniens,* the peril insured against will have to be treated as the real and efficient cause and the insurer will be liable; on the other hand, if the connection between the preceding cause and the last cause is interrupted by the intervention of a fresh cause, which is not a mere reasonable and probable consequence directly and naturally resulting in the ordinary course of events from the peril insured against the insurer will not be liable. If there is a complete snap of the chain of the events, though the peril insured against has caused to produce that loss, such a loss also cannot be recovered from the insurer. In such cases, the relation of cause and effect does not exist between the peril insured against and loss. Where a person becomes weakened by a railway accident and by reason of that weakness he could not avoid a street accident and was run over by a bus, his death is due to a street accident and not due to the railway accident. Where a business premises or a factory is insured against fire, the policy-holder can recover only indemnity for the physical loss of property by fire. Though there may be a consequential loss of profits which could have been earned during the period or reinstatement or replacement, it cannot be recovered under an ordinary fire policy as in such cases the chain of causation is broken and the connection between the peril and the loss is not causal but accidental.

Where the causes do not succeed one another, but operate concurrently and produce the loss, the above rules will not help. There are cases where the causes do not form a chain but a net. In such cases the better opinion is that the insurer will be liable because it is a loss caused by the peril insured against also. For example, when a person while bathing dies due to drowning, and falls into the water in a fainting fit, the death is said to be caused by accident notwithstanding the fact that the water was only one foot deep and had he not been unconscious he could not have died.

When there are excepted causes, often difficulty arises whether the loss is caused by the excepted cause or the peril insured against. If they operate independently or when they are disconnected there will be no difficulty. The real difficulty arises when the loss is the combined effect of both, the causes and they are so connected that but for the presence of both the loss would not have occurred.

Fire insurance policy covering risk of loss and damage caused by riot, strike, malicious damage and explosion and consequential loss. The excepted peril clause in the policy is loss caused by cessation of work. There was a lockout in the company and insured argued that workers before leaving company premises due lockout did not follow instructions for planned shutdown of the plants causing damage and thereby the loss occurred was not maintainable. In such a case recourse had to be made to the doctrine of *causa proxima* and in its application the causes may be classified as follows:

Cases where the Peril Insured Proximately or Immediately Follows the Excepted Peril This may be illustrated by the following cases:

The assured, a person with normal sight and hearing, crossed a main line and waited for one train to pass and was crossing in front of an approaching second train which he ought to have seen, when he was run over and killed. Though the death is caused by accident, a peril insured against, it is attributable to his want of care and hence was held to fall within an exception of exposure of the insured to obvious risk of injury and so the insurer was held not liable. In another case, a person fell from the platform on the rails and then a passing train crushed him. The death was not caused by the fit but by the accident. The effect of the preceding cause was held to have been exhausted. The policy contained a clause that complications arising from pre-existing disease will be considered part of that pre-existing of condition. The insured was having diabetes at the time of taking the policy and it may lead to cardiac disease. It was held that repudiation of the policy by the insurer on that ground that the insured was having pre-existing disease which may lead to cardiac disease was not maintainable. Again where a shop was on fire due to which a disorderly mob was brought together on an adjacent premises which broke a shop window, the breakage of the window was held to be by the disorderly mob but not by fire. Similarly, where a person was injured by a shell and became crippled and was run over by a passing motor car because he could not move away from the cars line it was held that death was caused due to an accident but not due to the shell injury which is an excepted cause of the consequence of liabilities. In another case there was an air raid and it facilitated the commission of an isolated act of burglary. The loss was held to be caused by burglary but not by the excepted cause of the consequence of hostilities. The insureds fire policy covers loss due to riot, strike and malicious and terrorism damage and exception clause is theft. Due to cyclone the roof of premises had blown up ten persons by using force entered the premises and committed theft. It was held that the loss was covered by riot and maintainable.

Cases where the Excepted Peril Proximately or Immediately Follows an Excepted Cause The following illustrations may be noted under this category:

Hernia was caused by an accidental fall and due to that the assured died. There was an exception against hernia. But still death was held due to the fall and not due to hernia. The excepted cause was a sequel to the peril insured against. On the other hand, where a man was weakened by an accident and he is attacked by a disease wholly disconnected with the accident, an exception against disease would apply. The policy covers buildings, stocks and furniture/fixtures against flood and inundation. The policy also contains exclusion clauses and the loss is resulted due to earthquake, typhoon. The exclusion clause did not cover loss due to subsidence. During the subsistence of the policy the insured property damaged due to floods. It was held that the insurer was liable and the court did not accept the insurers contention that the loss incurred due to structural defect caused by subsidence in view of the non inclusion of subsidence in the non exclusion clause. The insured insure the property against loss by fire. The policy also contained a clause that it would cover the loss caused on account of militant related violence including riot, strike and malicious damage. The insured lost the property due to theft by militants. It was held that the loss was not covered by the policy because loss caused must be because of outbreak of fire and as a result theft should occur. The insureds vehicle was taken away by some unknown persons in the guise of hiring it. It was held that it would be sufficient if factum of taking away the property of the insured and thereby depriving him from using the property permanently would entitle the insured to claim the loss from the insurer.

Cases where the Excepted Peril and the Insured Peril are Concurrent and Immediate Causes In such cases the insurer will not be liable:

In *Wayne Tank and Pump Co v Employers Liability Assurance Corporation*, a firm of engineers by name Wayne Tank and Pump Company were installing new equipment into an old mill manufacturing plasticine at Bathampton in Somerset. They took a public liability policy with the defendants to indemnify them against liability they may incur as a result of accidents happening in the course of installation. The policy contained an exception excluding the insurers liability consequent upon damage caused by the nature or condition of the goods supplied by the insured.

The installation went up in flames on account of two causes namely, (a) use of unsuitable and dangerous plastic material by the insured and (b) servant of the insured switched on the installation and leaving it unattended when the installation had not been tested. The first cause came within the exception and the second was an insured peril. The court came to the conclusion that the effective, dominant and proximate cause of the loss was the defective goods supplied by the insured and so the insurer was not liable. It was also held that even assuming that both the causes were equally effective, the insurer was not liable, as one of the causes was an excluded peril.

If the other concurrent cause is not an excepted peril the rule would be otherwise. In those cases also the above discussion equally applies *i.e.*, whether the precedent cause is the effective cause and the subsequent cause is a mere reflection of the precedent cause or does it constitute a *novus actus interveniens.* In cases of simultaneous operation also the above rules apply.

Further, the policy may modify or altogether exclude the operation of the doctrine of proximate cause.

Application of Rule in the various Classes of Insurance

Life Insurance

In life insurance the insurer proceeds on the calculation of the average duration of human life. The insurance is against death due to natural causes. If the cause of death is other than natural e.g., if the assured voluntarily puts an end to his life the insurer is not liable. This is on the grounds of public policy and also by the application of the maxim *causa proxima.*

Accident Insurance

In accident insurance the proper question is whether the result in respect of which the claim is made arose directly and proximately from the accident insured against. In *Isitt v Railway Passengers Assurance Co*, a railway passenger was insured against death from the effect of an injury caused by an accident. He fell down from the train and his shoulder was dislocated. He was undergoing treatment in the hospital and had an attack of pneumonia and he died. Applying the maxim *causa proxima* it was held that death was the result of the accident and therefore the insurance company was liable. The insured suffered total loss of vision in the right eye due to accidental fall. The insurer repudiated the claim on the ground that the loss of eyesight was due to disease phthisis bulbi which was not covered under the policy. Medical Board constituted by the State Commission opined that the loss of vision could have been caused by fall while playing. It has also opined that phthisis bulbi can be caused due to the accident also. In the stated circumstances, it was held that the loss is covered by the policy. The accidental insurance policy should be taken by the insured before the accident.

Fire Insurance

The maxim *causa proxima* is applied liberally in fire insurance. The question is whether the loss arose proximately from the fire. The loss may arise directly by fire or indirectly by the efforts to extinguish the fire. In *Stanley v Western Insurance Co* it was observed that any loss resulting from the fire and resulting from the necessary and *bona fide* efforts to put out the fire whether by spoiling of goods by water or throwing the articles out of window or pulling down a house for the purpose of preventing the spreading of the fire and flames is within the policy of fire insurance. In *Marsden v City and Country Fire Assurance Co* during the course of a fire accident, a mob looted the goods and it was held that the insurance company was not liable because the proximate cause of the loss was not fire but the subsequent independent lawless acts of the mob.

Marine Insurance

The maxim is applicable to marine insurance but the application is very difficult due to the different kinds of maritime perils. To make a marine insurer liable the insured must prove three things namely,

(i) that the loss is caused by the perils of the sea;

(ii) that the peril is one that is insured against in the policy; and

(iii) that the peril insured against is the proximate cause for the loss sustained.

In *Dugdeon v Pembroke* a ship lying in her owners yard was insured under a time policy. It was lost due to the violent action of the winds and waves. It was in evidence that the ship was unseaworthy at the time when she was sent to sea, but the owners did not know about it. The insurers argued that as the ship was unfit for the voyage they were not liable. It was held by the House of Lords applying the maxim *causa proxima* that the immediate cause of the loss was the violent action of the winds and waves and therefore the insurance company was liable even though the loss could not have happened but for the concurrent action of some other cause namely the unseaworthiness of the ship. In *McCarthy v Abel* the owner of a ship insured the ship and the freight separately. He abandoned the ship to the underwriters for some time due to restrictions in the port by the enemy government. Subsequently, the restrictions were removed. The ship owner filed a suit against the insurer for the loss of freight. It was held that the proximate cause for the loss of freight was his own act of abandonment and therefore the insurer was not liable.

In *Grer v Poole* a policy was taken on goods on a French ship. The ship was injured by collision and the master,

not having sufficient funds for the necessary repairs, gave a bottomry bond on the ship, the freight not being sufficient to pay the bond, the assured had to pay the deficit amount to get his goods. The insurer was not held liable on the ground that the loss was not caused by perils of the sea, but by want of funds on the part of the master. Similarly, in *Powell v Gudgeon* a ship was disabled due to the perils of the sea and she went into a port for repairs. The master of the ship sold away some of the goods to pay for the expenses of repairs. The owners of the goods filed a suit against the insurer. It was held that the insurance company was not liable as the proximate cause of the loss was the act of the master selling away the goods and not the peril of the sea.

Sometimes the application of the rules increase the liability of the insurer. The negligence of the insured or his agents does not relieve the responsibility of the insurance company. The loss may be caused by the negligence of the servants of the assured, eg, due to unskillful navigation but by the application of the maxim *causa proxima* the insurance company is made liable. In *Trinider Anderson and Company v Thames and Mersey Marine Insurance Company* the owners of a ship brought an action against the insurance company for loss of freight. The loss of freight was due to the stranding of the ship and it was due to the negligence of the master. It was held by the court that the proximate cause of the loss was due to stranding of the ship though it was due to the negligence of the master and therefore the insurer was liable. This was given statutory recognition in the later part of *s 55 (2) of the Marine Insurance Act* 1906 which reads that unless the policy otherwise provides the insurer is liable for any loss proximately caused by a peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew.

Arnould in his treatise on marine insurance rightly comments that the maxim *causa proxima* has a two-fold operation, that is, partly to limit and partly to enlarge the liability of the insurer. This two-fold operation of the rule is further illustrated by the following cases: In *Ionides v Universal Marine Insurance Company* there was a marine policy on goods from Rio to New York free from all consequences of hostilities. During the American civil war the confederates extinguished the lights on Cape Hatters. As the lighthouse was not working, the ship unable to find her way, ran on to the rocks and was grounded becoming a total wreck. A portion of the goods was seized by the enemy troops. The other portion was lost or damaged. Applying the maxim *causa proxima* the court held that the insurance company was not liable for the loss caused by the enemy and for the other loss, the insurance company was liable because the loss was caused by the peril of the sea. The court rejected the argument that the loss was due to the non-working of the lighthouse which was due to enemy action and pointed out that it was a remote cause. In *Leyland Shipping Company v Norwich Union Insurance Co,* a ship was insured under a time policy free from all consequence of hostilities. On her voyage the ship was struck by an enemy torpedo and was badly damaged. She got into a nearby port for repair. She stayed afloat for two days. Subsequently there was a big gale and as a consequence of bad weather the ship stranded and was lost. Applying the maxim *causa proxima* it was held that the torpedo by the enemy ship was the proximate cause of the loss and therefore the insurance company was not liable. In *Fenwick (Fr William) and Company v North of England Indemnity Association,* the ship owners of the ship SS Harwood, insured the ship against war risk and in the course of her voyage she ran upon a submerged wreck of another ship which had been sunk by an enemy submarine a few hours earlier. There was no negligence on the part of the owners. Applying the maxim *causa proxima,* it was held that the insurance company was not liable because the loss was not proximately caused by the perils insured against (*i.e.* war risk). Billache J dismissing the suit observed that his decision would have been different if the ship had been deliberately sunk at the particular spot with the object of damaging passing vessels.

The Risk and the Duty of the Assured

> If the insured accelerates happening of the risks or if when it occurs refrains from doing what ought to be done to minimise the damage consequent thereon, hazards the chance of recovering nothing on the contract.

It is the duty of the insured not to do anything which will accelerate the happening of the risk, i.e., he should not contribute anything which will cause the happening of the risk. Not only should he refrain from accelerating the risk but there is a positive duty on the assured to prevent the happening of the risk if possible. Once the risk takes place it is the duty of the insured to minimise the loss or damage. He must act as a reasonable man not having an insurance policy. The duty to mitigate damages is a general principle applicable in all branches of law and it is applied to the law of insurance especially in view of the fact that insurance is a contract of indemnity. Sometimes the insurance companies encourage the insured to take all possible steps to minimise the loss and to save the property by inserting a clause in the policy to the effect that the insurance company will be ready to pay all such expenses. For example in marine insurance policies we find the sue and labour clause.

No person is entitled to look on and let his property be lost just because it is insured. He is bound to take all