Insurance contract : all you need to know

By **Abanti Bose** - December 20, 2021

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Introduction

Many uncertain events can occur in a person's life causing damage to his life and property. This incites a need to protect oneself from the losses incurred from such events. This is what the concept of insurance is based on.

Section 2(8) of the Insurance Act, 1938, defines an "Insurance Company' as any company, association or partnership that can be wound up under the Companies Act, 1956, or the Indian Partnership Act, 1932. Section 2(9) of the Act defines an 'insurer' as any individual, body of individuals or any corporated body that carries on an insurance business.

Insurance contract : meaning

- An insurance contract is essentially a contract between two parties, where one of them is called an "insurer" and the other party is "insured".
- In this type of contract, the insurer promises the insured party that he will save or indemnify him from losses caused by a particular contingent event, on the payment of an amount called "premium".
- Insurer usually refers to the insurance company that sells the insurance and the insured or policyholder is the person who buys it by paying the premium. In a contract of insurance, the insurer or insurance company advertises the insurance policy, which is an invitation to offer.
- Then, on seeing the invitation to offer, the insured makes an offer to the insurer. When the insurer accepts, it becomes an insurance contract.

Purpose of insurance

The following are the two main purposes of insurance contracts :

1. Protection against uncertain events: The main purpose of an insurance contract is to make the insured person secure and financially protected from certain uncertain contingencies that would cause a huge financial burden.
2. Better management of finances: Many people have the tendency to make poor financial decisions that could potentially leave them without any support when faced with an unfortunate situation. By subscribing to an insurance policy, the insured would be able to make better financial decisions.

Types of insurance

There are broadly two types of insurance, based on what they cover, which are life insurance and general insurance.

Life insurance

Life insurance covers the life of the insured. On the death of the insured, the insurer would pay a sum of money to the nominee or beneficiary of the contract. This provides the insured with an assurance that his family will be financially stable even on his demise. The different types of life insurance policies are endowment plans, child plans, pension plans, etc.

General insurance

General insurance, on the other hand, covers everything except life, such as health, house, motor vehicles, fire, travel, etc. It provides financial assurance against losses incurred from events other than the death of the insured.

History of the insurance sector in India

Ancient times

The concept of insurance was loosely practised in ancient Indian society. It also finds mention in some religious scriptures such as Dharmasastra and Arthasastra. The scriptures mention that communities pool their resources and redistribute them when natural calamities hit them.

British rule

With the advent of the British, the concept of insurance in India changed. India had its first British insurance firm with the establishment of the Orental Life Insurance Company in 1818, which later failed in 1834. Subsequently, the British Insurance Act was enacted in 1870. Most of the insurance companies in India were owned and operated by foreigners. In 1912, the Government of India passed the first statute called Indian Life Assurance Companies Act, 1912. For the first time, in 1914, the Government of India started to publish the returns of insurance companies in India. And, in 1928, the Indian Insurance Companies Act was enacted, empowering the government to collect data on the business of both Indian and foreign insurers. In 1938, Insurance Act, 1938, was enacted, whose importance was diminished by subsequent legislation.

Post-independence

In the 1950s, the Government of India started to nationalize the insurance sector of the country. In 1956, the Life Insurance Corporation Act, 1956 was enacted which led to the establishment of Life Insurance Corporation, popularly known by its abbreviation LIC, which has a monopoly over the life insurance business in India. After the enactment of this Act, life insurance fell out of the purview of the Insurance Act, 1938. In 1973, the General Insurance Business (Nationalisation) Act, 1972 came into effect, nationalizing general insurance business.

Liberalization policy

In 1991, liberalization and privatization brought forth many changes in the Indian economy. When the need to reopen the insurance sector to private parties arose, the central government set up a committee headed by R.N. Malhotra, former governor of RBI, to examine the changes to be made in the insurance sector. The eight-member committee recommended privatization of the insurance sector and the establishment of the Insurance Development Regulatory Authority (IRDA), an autonomous body to regulate the insurance sector. Finally, the monopoly of LIC over the life insurance sector ended and the IRDA Act, 1999 was enacted.

Principles and characteristics of an insurance contract

The following are the fundamental principles and characteristics of an insurance contract :

1. Essentials of a valid contract

An insurance contract is just like any other contract, and hence it has the essentials of a valid agreement, as per Section 10 of the Indian Contract Act, 1872. The following are the features of a valid contract:

- Offer and acceptance,
- Competency of parties,
- Free consent,
- Lawful consideration,
- Lawful object.

2. Indemnity contract

Indemnity is one of the main purposes of an insurance contract. Section 124 of the Indian Contract Act, 1872, has defined indemnity contract as an agreement between two parties where one party promises to save the other from some loss that would occur to him due to the conduct of the promisor himself or any other person. But, one cannot make a promise to indemnify another from loss caused to him due to something caused not by a human, like the Act of God. Thus, the concept of life insurance falls outside the purview of indemnity, as per the decision in *Gajanan Moreshwar v. Moreshwar Madan Mantri*.

3. Aleatory contract

An aleatory contract is a type of contingent contract whose performance depends on the occurrence of an uncertain event, beyond the control of both parties. Such events are usually natural disasters and deaths. This concept can be seen in many insurance policies and thus, aleatory contracts are sometimes called aleatory insurance. Under such insurance policies, the insurer has to pay only when an uncertain event occurs. For example, A and B enter into a contract where A promises to provide B with financial support if B's house catches fire. Here, B's house catching fire is an uncertain event. The contract can be performed only when B's house catches fire and not any time before that.

4. Uberrimae Fidei

Insurance contracts are contracts of uberrimae fidei. The term 'uberrimae fidei' means 'good faith'. This means that, in a contract of insurance, both the insurer and the insured

must be fully transparent with each other about all the material facts, and not withhold any information that goes against the interest of the other party.

5. Contract of Adhesion

Insurance policies are normally standardised and fixed. Thus, as the terms of an insurance policy are not formed with the consent of the insured, the insurer must explain the clauses in the insurance policy to the insured. The insurer party is at an advantage as the insured does not get to negotiate on the terms of the contract. The insured must understand all the terms well and choose the policy that suits his interests the best.

6. Principle of Subrogation

The term subrogation also means substitution, where one party is substituted by another party, which allows a third party to sue and claim damages on behalf of another. This principle is used frequently in insurance contracts. It allows the insurer to have all the rights that the insured has against the third party who caused an insurance loss to the insured. Thus, after the insured faces losses, the insurance company pays for those losses and then claims reimbursement from the other party or his insurance company.

7. Insurable Interest

Insurable interest is one of the requisite elements in an insurance contract. A thing is insurable only if the insured will face pecuniary losses when it is destroyed. Thus, the insured must have an actual financial interest in the subject matter of the insurance contract.

8. Principle of Contribution

In some instances, an insured may subscribe to multiple insurance policies in respect of the same subject matter, and it is not forbidden by law. It is also called double or multiple insurances. In such cases, the insured cannot make more than one claim for the same loss to make a profit.

9. Reinsurance

In certain situations, the insurer might get the insured property, reinsured by another insurer, if he fears that an insurance claim above his capacity may arise. It is also called 'insurance for insurance'.

10. Principle of Loss Minimization

According to this principle, the insured must take the necessary steps, like any reasonable prudent man, in taking care of the subject matter of the insurance contract, so that financial losses to the subject matter are reduced as much as possible.

11. Principle of Proximate Causes

In some instances, an accident may be caused by multiple causes. In such cases, it is the nearest or the most proximate cause that must be taken into account. The insurer would pay only for the nearest cause.

Process of forming an insurance contract

The procedures for life insurance and general insurance are as follows:

Life insurance

1. Fill a proposal form: The form would require many details such as name, nationality, residential address, occupation, date of birth, etc. It would also require information of the proposer's medical history, diseases, etc. to be filled. It would also have questions regarding the risk posed by the event, amount insured, term of insurance, premium to be paid, details of double insurance if any, etc.
2. Proof of age: After filling the proposal form, the person must submit the necessary documents to prove his age, such as certificates of school exams, municipal records, etc. This is done because older clients have more risks and hence, they are required to be paid more premium.
3. Presentation of proposal form to agent: After the completion of the first two steps, the agent will have to verify the authenticity of the proposal form and the documents submitted along with it, and prepare a report based on it.
4. Medical examination: The terms and procedures for a person with normal health and a person with a family history of diseases would be different. Hence, details about the insured person's health conditions, medical history of family members, habits, occupation, salary, etc. must be given. It is usually done by Life Insurance Corporation (LIC) authorised doctors.
5. Final scrutiny by the branch office: On examining the agent's report and the medical report, the branch office would determine whether or not to accept the proposal.
6. Final decision: After the scrutiny, the branch office accepts or rejects the proposal and sends a letter to the person informing him of the decision.
7. Deposition of premium: Then, the branch office issues a notice to the person to pay the premium, which may be paid periodically.
8. Issue of insurance policy: Finally, the life insurance policy is issued. It is a document that contains important details of the insured and the terms and conditions of the policy.

General insurance

1. Selection of the insurer: Firstly, the proposer or insured must select a suitable insurance policy, by taking the subject matter and his interests into consideration.
2. Filling up the form and presentation of goodwill: The proposer should then fill up the proposal form, filling up details such as name, occupation nationality, etc. like how it is required for a health policy. The proposer should also present a certificate of goodwill.
3. Certification of the agent: Recommendation of the insurance agent is also necessary for the effectiveness of the proposal form, and the proposer will not be able to proceed with it otherwise.
4. Survey of the subject matter: The company then examines the subject matter on the recommendation of the agent and determines the validity of the proposal.
5. The decision of the insurer: After that, the insurer or insurance company makes a decision on the proposal and issues a notice regarding the same to the proposer.
6. Deposition of Premium: After notifying the acceptance of the proposal, the company will also notify the proposer about the premium to be deposited.
7. Issuing of the policy: After the premium is deposited, the temporary cover note of the insurance policy will be issued and after its period expires, a permanent cover note of the insurance policy would be issued.

Conclusion

As insurance contracts are standardised, the formation of insurance contracts does not go through a phase of negotiation. On observing the formation of insurance contracts, one can find that insurance policies by nature are invitations to offer and the real offeror is the insured. Insurance contracts possess features that are contracts on their own, such as contracts of indemnity and aleatory contracts.

Here is a sample of an insurance contract: *https://www.irdai.gov.in/ADMINCMS/cms/Uploadedfiles/TAC1718/122N114V01.pdf*.