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PRINCIPLES OF LIFE INSURANCE

4.0 INTRODUCTION

In the previous chapter, we have discussed essentials of Insurance contract. But in this chapter, we explained one of the important type of Insurance i.e. Life Insurance. If somebody suffer economic hardship and dies, at that time Dependent Survivors needs life Insurance. Life Insurance is a way to replace the loss of Income that occurs when the earning member of family dies. It is a contract between insured phases and the company that is providing the Insurance. If insured pus on dies while the contract is in force, the insurance company pays a specified sum of money to the person on persons you name as beneficiaries.

4.1 OBJECTIVES

At the end of this lesson you will be able to know:

- Various principles applicable to life insurance contract.
- In case any of these principle is missing the insurance contract will become void.

4.2 UTMOST GOOD FAITH

The commercial contracts are normally subject to the principle of “Caveat Emptor” i.e. let the buyer beware. In most of these contracts each party to the contract can examine the item or services which is the subject matter of contract. For eg. If you go to the market to buy vegetables then you have to be careful yourselves about quality while buying the vegetables and after buying you cannot question the vendor.

**Notes**

Each party believes in the statement of the other party. So long as there is no attempt to mislead & the answers are given truthfully, the question of avoiding the contract would not arise.

In the Insurance contract the product sold is intangible. It cannot be seen or felt. Most of the facts relating to health, habits, personal history and family history are known to one party only, the proposer. The insurer can know most of these facts only if the proposer decides to disclose these facts. It is true that the underwriter can have the assistance of medical report for life Insurance proposal. Sometimes, these aspects are not detected by the medical examination. e.g., a person suffering from high B.P. or diabetes can manage to hide these facts from the examining doctor. The history of past serious sickness, operations and injuries can be suppressed. These aspects may affect the life expectancy of the proposer. Hence, these constitute material information from the underwriter's point of view. Non-disclosure of such facts would put the insurer as well as the community of policyholders at a disadvantage.

It is for these reasons that the law imposes a greater duty on the parties to an Insurance contract than in case of other commercial contracts. This duty is one of utmost good faith (**uberrima fides**). It is the duty of the assured to make a full disclosure to the underwriter without being asked. In a contract of Insurance, there is an implied condition that each party must disclose every material fact known to him. This type of contract is called *uberrima fides* i.e. contract of utmost good faith.

Hence utmost good faith can be defined as a positive duty to disclose accurately & fully all facts material to the risk being proposed whether requested or not.

The material fact is the material, which would influence the judgement of a prudent insurer in fixing the premium or determining whether he will cover the risk.

Therefore, facts regarding age, height, weight, previous medical history, smoking/ drinking habits, operations, details of earlier Insurances and hazardous occupation must be disclosed.

There are certain circumstances, which need not be disclosed e.g.:

- (a) Facts which every one is supposed to know in general
- (b) Facts of common knowledge
- (c) Facts which lessen the risk
- (d) Facts which could be reasonably discovered by reference to previous policies records of which are available with the insurer



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In Insurance contract, the level of good faith above the level of what is in the usual commercial transaction is required. Therefore, Insurance contracts are based on the principles of warranty, representation and concealment. We must understand the nature of warranty, representation and concealment.

4.3 WARRANTY:

A warranty in Insurance is a statement or condition which is incorporated in the contract relating to risk, which the applicant presents as true & upon which it is presumed that the insurer relied in issuing the contract.

In fact, Marine Insurance developed the doctrine of warranty because the marine underwriter was rarely called upon or got a chance to inspect the ship as it might be lying thousands of miles away at ports or in voyage. Therefore, he had to depend entirely upon the word of the person seeking the Insurance. Hence, all information in the application for the Insurance was warranted to be absolutely exact and true. **If it turned out to be untrue, the Insurance was voidable whether the misstatement was intentional or unintentional, material to the loss or immaterial.**

INTEXT QUESTION 4.1

1. If a person is suffering from Cancer/heart disease whether it is duty of person to inform to the insurance company.
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4.4 INSURABLE INTEREST

The Insurance Act 1938 doesn't define the insurable interest but it has been defined as follows by Mac-Gillivray

“Where the assured is so situated that the happening of the event on which the Insurance money is to become payable

**Notes**

would as a proximity cause, involve the assured in the loss or diminution of any right recognised by law or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability.”

The object of Insurance should be lawful for this purpose, the person proposing for Insurance must have interest in the continued life of the insured & would suffer pecuniary loss if the insured dies. If there is no insurable interest, the contract becomes wagering (gambling) contract. All wagering contracts are illegal & therefore null & void.

Own Life Policy

So long as the Insurance is on one’s own life, the “Insurance Interest” presents no difficulty. A person has insurable interest in his own life to an unlimited extent. The absence of a limit in this case is reasonable. When a person insures his life he obtains protection against loss to his estate; for in the event of his untimely death the estate would not benefit by the future accumulation he hopes to make during the normal span of life. It is not easy to compute with any degree of certainty what the future earnings of a person would be. Hence no limit may be fixed in respect of life Insurance he may effect.

Where, however, insurer rejects a proposal for an amount of assurance, which is disproportionate to the means of the proposer, it is not normally for lack of Insurable interest but on considerations of “moral hazard”. Indeed it may also be presumed in a case where a person proposes for a policy for a large amount, which he may not be able to maintain having regard to his income, that it will be financed by some other person and that there is no insurable interest.

INTEXT QUESTION 4.2

1. Whether can you take life insurance policy of Mr Amitabh Bachan?
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4.5 INSURANCE ON THE LIFE OF SPOUSE

As a wife is normally supported by her husband, she can validly effect an insurance on her life for adequate amount. The service and help rendered by the wife used to be thought of as the basis of insurable interest which supports any policy which a man takes on the life of his wife. In Griffiths v. Elemming the

Court of Appeal in England stated that it was difficult to uphold such interest on the basis of pecuniary interest but thought that such interest could be presumed on broader grounds.

Parent and Child

Following the practice in U.K. in India also a parent is not considered to have insurable interest in the life of the child. The same is the case with a child in respect of his parent's life. Whether this position requires to be reviewed now appears to be engaging the attention of people here.

A Hindu is under a legal obligation to maintain his parents. Even as per traditional law Sec.20 of the Hindu Adoption and Maintenance Act has given statutory form to the legal obligation. The parents have, therefore, a right to maintenance subject to their being aged or infirm. An order for maintenance of parents may also be passed under Sec. 125 of the Code of Criminal Procedure, 1973. It may be stated, therefore, that a parent has pecuniary interest in the life of the child, and an assurance effected on that basis cannot be hit by Sec.30 of the Contract Act as a wagering contract.

However, it may be noted that the pecuniary interest is not a present interest unless the parent is unable to maintain himself or herself at the time when the Insurance is effected. It may therefore, be argued that a parent cannot have insurable interest in the life of the child until the right to maintenance arises; but when a person is not able to maintain oneself how can he be expected to have the means to insure the life of his children?

As a matter of fact in India, even today a child is a potential breadwinner for the parents in their old age. The present affluent circumstances of a parent do not alter that situation. Under the traditional law a right to maintenance could be claimed only against the sons; the statute has now extended the obligation to the daughters as well.

Having regard to the social and economic set up of the people in the country a review of the question seems to be appropriate.

On the life of other relations

In the case of other relations, insurable interest cannot be presumed from the mere existence of their relationship. Moral obligations or duties are not sufficient to sustain an insurable interest.



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In every other case, the insurable interest must be a pecuniary interest and must be founded on a right or obligation capable of being enforced by Courts of law.

The following are illustrations of such cases of insurable interest:

- (a) **Employer – Employee:** An employer has insurable interest in the life of his employee, and the employee in the life of the employer;

An employer can create insurable interest in the lives of his employees by undertaking to provide monetary benefit to the family or estate of the employees in the event of death. Group Insurances effected by companies on the lives of their employees are on the basis of such insurable interest.

- (b) **Creditor – debtor:** A creditor has insurable interest in the life of his debtor upto the amount of the debt;

This is not a satisfactory basis; for in the event of death of the debtor after the debt has been repaid, the creditor would still be entitled to the policy moneys and thus can be in a position to gain by the death of the debtor once the loan is repaid. The better arrangement would be for the debtor to take out a policy for the required amount and mortgage the policy to the creditor. The creditor then cannot take benefits under the policy in excess of his dues.

- (c) **Partner:** A partner has insurable interest in the life of his co-partner to the extent of the capital to be brought in by the latter.

- (d) **Surety and principal debtor-Co-surety:** A surety has insurable interest in the life of his co-surety to the extent of the proportion of his debt and also in the life of his principal debtor.

Effect on Contract when Insurable interest is not present:

Where, therefore, the proposal is on the life of another, unless the proposer has insurable interest in the life to be assured, the contract shall be void. Lack of insurable interest is a defence, which the insurer may plead in resisting a claim. There may be also cases where Insurance

on one's own life is surreptitiously financed and held by another for his benefit, which if detected by the insurer, may be declared void.

As a life Insurance contract is not one of indemnity, the existence of insurable interest and the amount thereof will have to be considered at the time of effecting the contract since lack of such interest would render the contract void. If insurable interest existed at the inception of the policy, the contract would be enforceable though such interest might cease later.



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4.5 SUMMARY:

Insurance contracts are influenced by number of legal principles i.e. commercial as well as insurance. As the insurer does not any thing about the proposer therefore, the duty of disclosing the material facts has been imposed on the proposer. The decision of the insurer will depend upon the material facts disclosed by the proposer. The insurable interest should also be present at the time of taking the policy. No one can take the policy in the name of third party with which the proposer is not having any legal relationship and financial loss in case of any mishap with the proposer.

4.6 TERMINAL QUESTIONS:

1. It is the duty of the assured to make a full disclosure to the underwriter without being asked. Discuss.
2. Is it essential that insurable interest should be present in every insurance contract? If yes, explain.

4.5 OBJECTIVE TYPE QUESTIONS

1. Choose the correct Option
Statement A: Commercial contracts are subject to the principle of "Caveat Emptor"
Statement B: Insurance contracts are also subject to the principle of "Caveat Emptor"
 - a. Both statements are correct
 - b. Both statements are wrong
 - c. Statement A is correct
 - d. Statement B is correct

**Notes**

2. Insurable interest means
Statement A: Legal right to insure.
Statement B: Have suffered financial loss.
 - a. Both statements are correct
 - b. Both statements are wrong
 - c. Statement A is correct
 - d. Statement B is correct
3. One of the fundamental principles of life insurance is
 - a. There is an insurer & policyholder
 - b. Utmost good faith
 - c. Insurable interest
 - d. Both b & c
4. Facts which need to be disclosed.
 - a. Facts of common knowledge
 - b. Facts which lessen the risks
 - c. Facts which every one is supposed to know in general
 - d. Family History
5. Non disclosure/Misrepresentation/Concealment of _____ information makes contract voidable. (Material/Immaterial)
True/False
6. A person has insurable interest in his own life.
7. Parents have insurable interest in the life of child.
8. A creditor has unlimited insurable interest in the life of debtor
9. An employer has an insurable interest in the life of his employees to the extent of the value of his services
10. The duty of disclosure of material facts arises in life insurance:
 - a. only during the proposal stage

- b. Only during the policy period if there is a change in risk
- c. Only at the time of renewal
- d. All of the above

4.6 ANSWERS TO INTEXT QUESTIONS

4.1

- 1. Yes the person should disclose to the insurance company as per the principle of utmost good faith otherwise at the time claim the insurance can refuse to make the payment.

4.2

- 1. No you can not take such policy because you have neither legal relationship nor you will loose financially in case of any mis-happening with Mr Bachan life.

4.7 ANSWERS TO OBJECTIVE TYPE QUESTIONS

4.5

- | | |
|-------------|----------|
| 1. c | 2. a |
| 3. d | 4. d |
| 5. material | 6. True |
| 7. False | 8. false |
| 9. true | 10. d |



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