

**Cihan University**  
**Department of Business**  
**Administration**

**Insurance Industry**  
**Fourth year**

**Dr. Wrya Najm Rashid**

# Cotenants

- **What is insurance?**
- **Definition and nature of insurance**
- **History of Insurance**
- **Functions of Insurance**
- **Insurance Contracts parties**
- **Why we need Insurance?**
- **Characteristics of Insurable risks**
- **What are the Principles of Insurance?**
- **Insurance premium**
- **Reinsurance**
- **Types of Insurance**

# Nature of Insurance

- **Insurance** is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as premium
- Insurance is a contract between two parties whereby one party agrees to undertake the risk of another in exchange for consideration known as premium
- And promises to pay a fixed sum of money to the other party on happening of an uncertain event.

**Insurance** is defined as a co-operative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to ensure themselves against that risk

- Insurance provides protection from loss due to unforeseen events or circumstances Example:-
- Illness
- Death
- Fire
- Theft
- Liability
- Automobile accident

# History of Insurance

- Property insurance as we know it today can be traced to the Great Fire of London, which in 1666 devoured more than 13,000 houses.
- in 1681, economist Nicholas Barbon and eleven associates established the first fire insurance company.
- In the late 1680, Edward Lloyd opened a coffee house, which became the meeting place for parties in the shipping industry wishing to insure goods and ships, those willing to underwrite such ventures.

- The first life insurance policies were taken out in the early 18th century.
- The first company to offer life insurance was the Amicable Society, founded in London in 1706 by William Talbot .
- In the late 19th century "accident insurance" began to become available.
- The first company offer accident insurance was the Railway Passengers Assurance Company, formed in 1848 in England.

## **Functions of Insurance:**

### **A- Primary Function:-**

- 1- It Provides Certainty
- 2- It Provides Protection
- 3- Risk-Sharing

### **B- Secondary Function:-**

- 1 - Prevention of Loss
- 2- Provides Capital
- 3- Improves Efficiency
- 4- Helps Economic Growth

## How does Insurance work?

- Insurance works by pooling risk or creation of a common pool.
- The insurance Company gathers together people who want insurance protection and sets itself up to operate a pool.
- It takes contributions in the form of premiums from many people exposed to the same risks and pays a few who suffer losses.
- Insurers use past experience to determine the losses that may occur in a year.
- These losses are expected to be generally in line with their prediction for the year

## **Insurance works through the following steps:**

- 1- Risk is transferred from an individual or entity (insured) to (insurer).
- 2- The insurer pools all the risk exposures together to calculate potential future losses with some level of accuracy.
- 3- The insurer uses various forecasting techniques, depending on the distribution of losses.
- 4- The pooling of the risk leads to an overall reduction of risk in society because insurers' accuracy of prediction improves as the number of exposures increases.
- 5- Insurers pool similar risk exposures together to calculate their own risk of missing the prediction.

# Insurance Contracts parties

1- **Insurer:** Is the part who agrees to pay for the losses

2- **Insured:** Is the part who claim for the damage from the insurer.

# Benefits of insurance to Economy

- 1- Rapid investment
- 2- Improve Quality of Life
- 3- Competition will bring Consumer Friendly Products
- 4- Large Scale Mobilization of Funds
- 5- Insurance & Reinsurance Facilities to Major Projects

# Benefits of insurance to Government

- 1- Long Term Funds for Infrastructure
- 2- Long Term Debt Market Instruments Available
- 3- Increased Employment Opportunities & Compensation
- 4- Reduced Financial Burden of Rural, Social & Backward Classes
- 5- Contributions in Disasters (Sharing of Social Responsibilities)

# Benefits of insurance to Industry

- 1- Transfer of Technical Expertise
- 2- Innovative Products and Pricing Options
- 3- Domestic Industry will Utilize Technology and Service Customer with Loyalty
- 4- Market Driven Economy will Benefit Customer the most.

# The Purposes of Insurance

## **(a) To provide Security and Safety**

- The Life Insurance provides security against early death and payment in old age to lead the comfortable life.
- Similarly in general Insurance, the property can be insured against any contingency i.e. fire, earthquake etc.

## **(b) To provide Peace of Mind**

- The uncertainty due to fire, accident, death, illness, disability in the human life, it is beyond the control of the human beings.
- By way of Insurance, it may be compensated financially but not emotionally.
- The financial compensation provides not only peace of mind but also motivates to work more and more.

## **(c) To Encourage Savings**

- Life Insurance provides protection and investment while general Insurance provides only protection to the human life and property respectively.
- Life Insurance provides systematic saving because once the policy is taken then the premium is to be regularly paid otherwise the amount will be lost.

## **(d) To Reduce the Business Losses**

- In business the huge amount is invested in the properties i.e. Building and Plant and Machinery.
- These properties may be destroyed due to any negligence, if it is not insured nobody would like to invest a huge amount in the business and industry.
- The Insurance reduced the uncertainty of business losses due to fire or accidents etc.

## **(e) Welfare of Employees:**

- The welfare of the employees is the responsibility of the employer. The employer is supposed to look after the welfare of the employees.
- The provisions are being made for death, disability and old age.
- Though these can be insured through individual life Insurance but an individual may not be insurable due to illness and age.
- But the group policy will cover his Insurance and the premium is very low in group Insurance.
- The expenditure paid on account of premium will be allowable expenditure.

# Characteristics of Insurable risks

- 1- Fortuitous in Nature:** The happening of the insured event must be accidental
- 2- Monetary Value:** the risk must lead to a loss capable of being measured in financial terms.
- 3- Insurable Interest:** In order for a person to insure any property, one must have insurable interest in it.
- 4- Homogeneous Exposure:** There must be a large number of similar exposures to enable insurers to forecast expected losses.
- 5- Public Policy:** The contract of insurance must not be different to what the society considers just and moral

## **A risk that was perfectly suited for insurance would meet the following requirements:**

- 1- The number of similar exposure units is large.
2. The losses that occur are accidental.
3. A disaster cannot occur.
4. Losses are definite.
5. The probability distribution of losses can be determined.

# Methods of insurance

1- Co-insurance – risks shared between insurers

2- Dual insurance – having two or more policies with overlapping coverage of a risk (both the individual policies would not pay separately – under a concept named contribution, they would contribute together to make up the policyholder's losses.



3- Self-insurance – situations where risk is not transferred to insurance companies and solely retained by the entities or individuals themselves

4- Reinsurance – situations when the insurer passes some part of or all risks to another Insurer, called the reinsurer

# Principles of Insurance

## *1-Principle of Utmost Good Faith*

- According to this principle, the insurance contract must be signed by both parties (i.e. insurer and insured) in an absolute good faith or belief or trust.
- The person getting insured must willingly disclose and surrender to the insurer his complete true information regarding the subject matter of insurance.
- The insurer's liability gets void (i.e. legally revoked or cancelled) if any facts, about the subject matter of insurance are either omitted, hidden or presented in a wrong manner by the insured.
- The principle of Utmost Good Faith applies to all types of insurance contracts.

## *2-Principle of Insurable Interest*

- The principle of insurable interest states that the person getting insured must have insurable interest in the object of insurance.
- A person has an insurable interest when the physical existence of the insured object gives him some gain but its non-existence will give him a loss.
- In simple words, the insured person must suffer some financial loss by the damage of the insured object.
- For example: - The owner of a taxi has insurable interest in the taxi because he is getting income from it. But, if he sells it, he will not have an insurable interest left in that taxi.

### *3-Principle of Indemnity*

- Indemnity means security, protection and compensation given against damage, loss or injury.
- According to the principle of indemnity, an insurance contract is signed only for getting protection against unpredicted financial losses arising due to future uncertainties.
- Insurance contract is not made for making profit else its sole purpose is to give compensation in case of any damage or loss.
- compensations is limited to the amount assured or the actual losses, whichever is less.

- 
- The compensation must not be less or more than the actual damage.
  - Thus, insurance is only for giving protection against losses and not for making profit.
  - However, **in case of life insurance, the principle of indemnity does not apply?** because the value of human life cannot be measured in terms of money
  - The amount of compensation depends observed by the insurance company on the degree of intensity (adequacy) of insurance.

# Questions

Q/ Someone has insurance his house against fire. If the amount of insurance was \$ 150,000. The house's value has been estimated at the time of the accident in \$ 200,000 and the actual loss was \$ 180,000.

- **Required/ calculate amount of compensation must be paid?**

Q/ Someone has insurance his house against fire. If the amount of insurance was \$ 50,000. The house's value has been estimated at the time of the accident in \$ 50,000 and the actual loss was \$ 20,000.

- **Required/ calculate amount of compensation must be paid?**

Q/ Someone have insurance his house against fire. If the amount of insurance was \$ 200,000. The house's value has been estimated at the time of the accident in \$150,000 and the actual loss was \$ 100,000.

**Required/ calculate amount of compensation must be paid?**

## *4-Principle of Contribution*

- Principle of Contribution is a consequence of the principle of indemnity.
- It applies to all contracts of indemnity, if the insured has taken out more than one policy on the same subject matter.
- According to this principle, the insured can claim the compensation only to the extent of actual loss either from all insurers or from any one insurer.
- If one insurer pays full compensation then that insurer can claim proportionate claim from the other insurers.

Q/ Someone has insurance his properties against the risk of fire with the three insurance companies.

A. The amount of \$ 80,000. (B) \$ 60,000, (c) \$ 40,000

The actual loss was estimated in \$ 80,000, and the properties were estimated at the time of the accident in amount of \$ 180,000.

- **Required/ calculate amount of compensation must paid by each company?**

Q/ Business man insure his factory against the risk of fire with three insurance companies, a) the amount of \$ 40,000, (b) the amount of \$ 60,000, and (c) the amount of \$ 50,000, during the contract fire occurred and caused losses amount of \$ 20,000 and it estimated the actual value of the plant at the time of the accident amount of \$ 180,000.

- **Required: Determine how much each company will bear the insurance companies of the compensation paid if the insurance policy are subject to the relative clause?**

## ***5-Principle of Subrogation***

- Subrogation means substituting one creditor for another.
- Principle of Subrogation is an extension and another corollary of the principle of indemnity.
- It also applies to all contracts of indemnity.
- According to the principle of subrogation, when the insured is compensated for the losses due to damage to his insured property, then the ownership right of such property shifts to the insurer.
- The insurer can benefit out of subrogation rights only to the extent of the amount he has paid to the insured as compensation.

## *6-Principle of Proximate Cause*

- The Principle of Proximate cause means when a loss is caused by more than one causes,
- the proximate or the nearest or the closest cause should be taken into consideration to decide the liability of the insurer.
- The principle states that to find out whether the insurer is liable for the loss or not,
- the proximate (closest) and not the remote (fairest) must be looked into

# Insurance premium

- An insurance premium is the amount of money that an individual or business must pay for an insurance policy.
- The insurance premium is considered income by the insurance company once it is earned, and also represents a liability in that the insurer must provide coverage for claims being made against the policy.
- The types of premium are:

**Net premium:** This term mean the portion of the premium required to pay expected future losses.

**Commercial premium:** A general term for an amount made up of the net premium plus expenses and commissions.



Q/ If the loss rate is 0.0022 for a particular risk and amount of insurance is \$40000, the administrative expenses is 15% of the net premium and a profit margin of 18% of net premium, reserve fluctuations reverse 3% of the net premium.

**Required/ calculate the net premium? Then commercial premium?**

**Q/** The following data about insurance against the risk of fire, which was obtained from an insurance company:

Losses arising	value of insured property	year
10000	450000	2008
12000	300000	2009
12500	350000	2010
9500	500000	2011
8000	400000	2012

If owner wanted insure his house against fire by amount of (\$ 200,000)

**Calculate the net premium? Then the commercial premium? If the administrative expenses was 20% of the net premium and a profit margin was 18% of net premium, reserve fluctuations reverse was 4% of the net premium.**

# Reinsurance

- **Reinsurance** is insurance that is purchased by an insurance company (the "ceding company")
- from one or more other insurance companies (the reinsurer") directly or through a broker as a means of risk management, sometimes in practice including tax mitigation and other reasons described below.

## There are two basic methods of reinsurance:

**1- Facultative Reinsurance**, which is negotiated separately for each insurance policy that is reinsured.

- Facultative reinsurance is normally purchased by ceding companies for individual risks not covered, or insufficiently covered, by their reinsurance treaties, for amounts in excess of the monetary limits of their reinsurance treaties and for unusual risks.

**2- Treaty Reinsurance** means that the ceding company and the reinsurer negotiate and execute a reinsurance contract under which the reinsurer covers the specified share of all the insurance policies issued by the ceding company which come within the scope of that contract.

**Q/** The insurance company (a) contracted with re-insurance company against fire the reinsurer company (b) that the return of 30% of any operation received by the Commission after the deduction 2% of the value of the premium as commission to them. Company (a) accepted the insurance against the fire risk to the factory in amount of \$ 500,000, and the insurance premium estimated 0,005 of the amount of insurance and the document is subject relative to the terms and happened fire the plant and the ability of losses amount is \$ 300,000 while the real value estimated for the plant time of the accident is \$ 600,000.

**Required:** identify reinsurance company share for each the premiums and compensations?

# Types of Insurance

## 1- Life insurance

- Life insurance is a contract between an insurance policy holder and an insurer, where the insurer promises to pay a designated beneficiary a sum of money (the benefit) in exchange for a premium, upon the death of an insured person (often the policy holder).

## 2- Fire Insurance

- Fire insurance covers damage or loss to a property because of fire.
- It is a specific form of insurance in addition to homeowner's or property insurance, and it covers the cost of replacement and repair or reconstruction above.

### 3- Marine insurance

- Marine insurance covers the loss or damage of ships, cargo, terminals, and any transport or cargo by which property is transferred, acquired, or held between the points of origin and final destination.

### 4- Property insurance

- Provides protection against most risks to property, such as fire, theft and some weather damage.
- This includes specialized forms of insurance such as fire insurance, flood insurance, earthquake insurance, home insurance.
- Property is insured in two main ways—open perils and named perils.



THANK YOU