INTRODUCTION TO INSURANCE

Lecture (2)

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Insurance Historical Background

- Insurance is not a new phenomenon, it goes back to Babylon in 17th century BC. “Code of Hammurabi”.
  - Ancient Egyptian and burying death associations.
  - Prophet Joseph, Noah.
  - ILAF Quraish.
  - Marine Insurance is the oldest form of insurance “ since1182.”
  - The claim awareness against the risks affecting Cargo shipments were there.
  - First life insurance contract goes back to 1583 in London. Life assurance of the Captains and the ships’ crew was also practiced.
  - Fire Insurance was in place on 1666 when a fire destroyed most of London city and the cost was estimated at that time with Sterling pound 10 million.
  - Edward Lloyd’s Coffee house 1688
  - Personal accident flourished with the development of the speedy transportation means and in particular by the end of the 1st half of the nineteenth century.
  - Insurance in its modern forms was not practiced in Egypt till the 2nd half of the nineteenth century via European companies (Generali- Gresham)

Insurance Historical Background

- Policies were following the legal system of such countries.
- The councilors of such countries were the judges in any conflicts between the contracting parties.
- It remained the same till the year 1875 when different courts were established in Egypt and the insurance has become part of its functions.
- 1876 laws do not include any specific sections for insurance but the commercial law was the applicable one.
- 1900 1st Insurance company
- Mohamed Abdou Fatwa in 1902 It was about a life contract.
- Impact of the Fatwa.

Insurance Definition

- There are many definitions to insurance, as every one look at it based on his specialization and its correlation with insurance.

- There are Legal and Technical definitions.

- The Egyptian Civil Law article 747 defines insurance as “Insurance is a contract by which the insurer is obliged to pay to the insured or the beneficiary for whom the contract is assigned to, a lump sum / annuity of money or any other form of compensation in case of suffering a loss as a result of a specific event/ risk stated in the contract, in return for a consideration paid by the insured to the insurer on one single payment or on installments “

Insurance Definition

- ***Technically there are several definitions, all of which concentrated on the following facts:-***
  - ✓ A vehicle to which the risk is transferred to, company, Mutual association, cooperative,
  - ✓ Losses are shared between those who exposed to the same risk
  - ✓ Qualitative and quantitative methods are deployed to forecast the trend of the risk.
  - ✓ Only future risks are insured.
  - ✓ Ability to measure/ evaluate risks is a pre requisite
  - ✓ It is a social system or tool which replaces the uncertainty of suffering from a large loss (the value of the subject matter) to certainty of paying a small loss in the form of insurance premium.

Classes of Insurance

- ***Insurance can be classified in many different ways***:

- ***First: classification according to the vehicle carrying it out:-***
    - ✓ Self Insurance.
    - ✓ Mutual Insurance carried out by mutual associations.
    - ✓ Commercial Insurance, carried out by conventional companies & or Lloyd’s.
    - ✓ Governmental Insurance, such as the social insurance in Egypt or Workmen compensations.
    - ✓ Cooperative insurance.
    - ✓ Private insurance Funds.

Classes of Insurance

- ***Second: according to the insured risk***
  - ✓ Personal Insurance, covering risks those causes total or partial loss to the future income
  - ✓ Property Insurance
  - ✓ Third party liability Insurance.

- ***Third: Practical classification which differs and develops according the constant changes in our life***

- ***Forth: Public and private insurance***
  - ✓ Private insurance the insured is free whether to affect the insurance or not.
  - ✓ Public Insurance wherein the insured is obliged to insure the risk by law.

Classes of Insurance

- ***Examples of public/compulsory insurance in Egypt are:-***
  - Motor act insurance.
  - Social insurance.
  - Fidelity guarantee.
  - Pension insurance carried out by the Social Insurance Association.
  - Decennial Liability.
  - The liability of the mall owners.
  - Insurance funds managed by employers in accordance with their internal by-laws.
  - Professional indemnity insurance.

Classes of Insurance

- ***Fifth: EFSA's Classification***
    - ✓ Life Assurance.
    - ✓ Saving schemes.
    - ✓ Fire and all related insurances, such as BI and MB.
    - ✓ Marine insurance which includes Marine Cargo, Inland Transit. and liability Insurance associated herewith.
    - ✓ Hull Insurance and all related Insurances.
    - ✓ Aviation Insurance and all related liability insurances.
    - ✓ Energy whether onshore or offshore and all related liability
    - ✓ Miscellaneous Accident and liabilities.
    - ✓ Motor Insurances and all related liability insurance.
    - ✓ Medical Insurance.
    - ✓ Others.

Technical Principles of Insurance

- Insurance as risk management tool

- ***The special features of insurance made it a must have technical principles that can be summarized as follows:-***

  - ✓ Uncertainty, for any risk to be insured, the uncertainty must be there either on the insured side or the subject matter insured. Uncertainty means:-
    - The risk is either certain or uncertain to happen, It is probable.
    - The risk must happen in the future so a risk that happened in the past is not insurable.
    - It must be accidental , unintentional or unplanned for

  - ✓ Financial Loss, insurance takes care of losses wherein the loss can be measured if and when it happens, Sentimental losses that cannot be measured are uninsurable

Technical Principles of Insurance

- ***Ability to calculate the different probabilities of the risk happening in order to calculate the premium.***
  - In life
  - In Non life

- ***Decentralization of risk(spread of risk): one of the most important principles***.
  - Geographical spread
  - Classes of business spread
  - Time spread
  - Reinsurance spread

- ***Ability to prove the loss/event***
  - Time of the loss
  - Place of the loss
  - Cause of the loss

Legal Principles of Insurance

General

- Insurance contract visa vi other contracts

- ***What are the main corner stones in any contract?***
  - Offer and acceptance
  - Competent parties (Minors- Insane - Intoxicated-Corporations acting outside its scope of character
  - consideration
  - Legal purpose, Must not protect or encourage illegal interest

Legal Principles of Insurance

1- Utmost Good Faith

- Most commercial contracts are subject to the principle of “ let the buyer beware”.
- Insurance contracts requires higher standard of honesty compared to other contracts.
- ***Abuses are categorized as:***
  - Material misrepresentation.
  - Concealment.
  - Breach of a warranty.
  - Breach of utmost good faith.
- What does it mean?
- Material information, what does it mean.

Legal Principles of Insurance

1- Utmost Good Faith

- ***Meeting the principle by.***
  - Insurer
  - Insured

- ***When is it applicable?***

- Breaching the duty of disclosure.
  - Good faith or unintentional.
  - Bad faith, intentional.

- Gap between the principle and the practice.

Legal Principles of Insurance

2- Insurable Interest

- Insurable interest is where some one has a valid reason to insure and stand to suffer a direct financial loss if the event insured against occurs.

- Insurance is a personal contract follows the person not the property.

- ***Its importance:-***
  - Mitigating the unethical practices.
  - Enable the insurance companies fixing the sums insured or the interest of the insured.
  - Determining the maximum amount of the indemnity.
  - Segregate between the insurance and bargaining.

Legal Principles of Insurance

2- Insurable Interest

- ***When is it exist?***
  - Property and liability insurance.
  - Marine insurance.
  - Life Assurance, Relative/ not relatives.

- ***What Constitutes insurable interest?***
  - Ownership- Lease-CCC- legal liability- life assurance on own life or relatives.

- Gap between the principle and practice.

Legal Principles of Insurance

3- The Proximate Cause

- ***What does it mean?***
  - Any insurance policy shall define the covered/excluded risks
  - In the event of a claim the insurer need to ascertain the cause of the loss in order to determine if the cause is insured or not
  - Is that all???????
- Can we isolate the proximate cause from other causes.
- What if not?

Legal Principles of Insurance

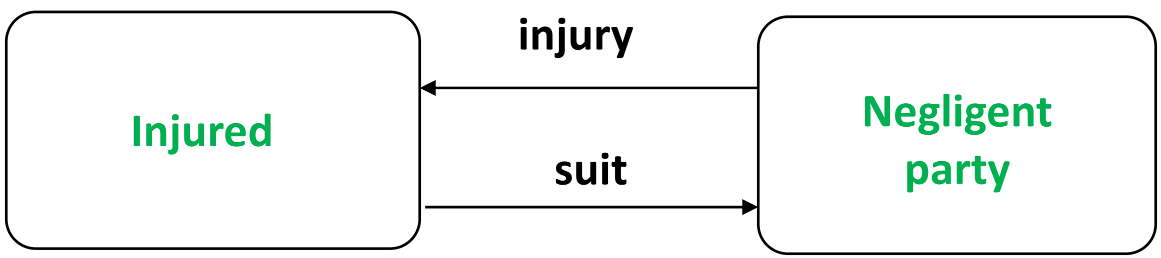
4- Indemnity

- Principle of insurable interest determines if a loss is suffered; the principle of indemnity measures the loss.
- As per the principle a person cannot collect from insurance more than his actual loss. It is illegal to make profit out of insurance
- Actual Cash Value(ACV) = replacement value (RV) –Depreciation (DEP)
- ***RC =*** the cost to repair or replace with like kind and quality of material
- ***DEP =*** A measure of ‘betterment’
- Gap between the principle and the practice

Legal Principles of Insurance

5- Subrogation

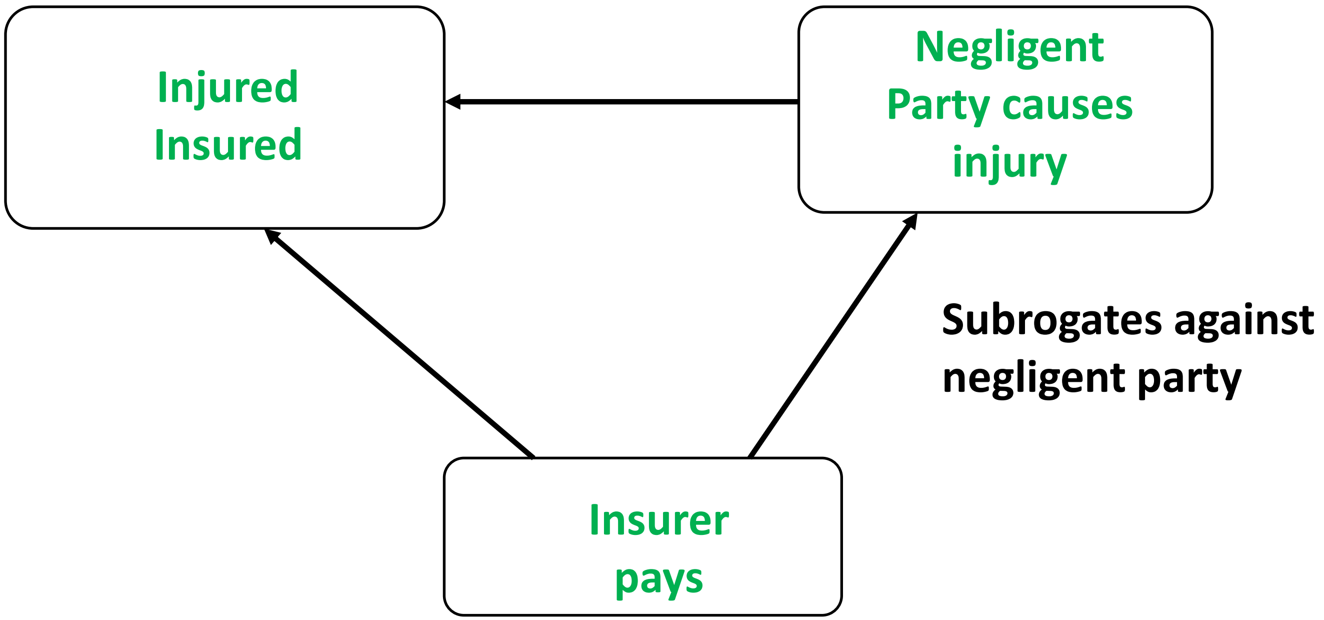
No Insurance contract or
If insurance does not exist



Legal Principles of Insurance

5- Subrogation

- One who indemnifies another's loss is entitled to recovery from any liable third parties



Legal Principles of Insurance

5- Subrogation

- Allows the insurer to pursue the rights of remedies which the policyholder may possesses against the third party
- Always in the name of the insured
- Reinforces the principle of indemnity - can only collect once.
- Holds rates below what they would otherwise be – salvage.
- Places burden of the loss on those responsible i.e. negligence.

Legal Principles of Insurance

5- Subrogation (Important Facts)

- subrogation does not exist where the principle of indemnity does not apply - life insurance.
- subrogation is ALWAYS waived for AN INSURED.
- If an insured violates or destroys insurer's subrogation rights, insured may forfeit collection rights under the contract.
- The insurer is entitled to subrogation dollars only after insured has collected fully for the loss.
- Subrogation Clause visa vi Subrogation rule

Legal Principles of Insurance

6- Contribution

- Similar to subrogation, contribution principle stemmed out of the indemnity principle.
- Its intention is to stop the abuse and not to make any gains out of insurance.
- If, at the time of the loss, there were more than one policy covering the same risk, all were valid at the time of the loss, the insured cannot claim more than his actual loss from all policies exist.
- Each company shall only pay its portion of the loss.

Legal Principles of Insurance

6- Contribution

- ***To apply such a clause :-***
  - The insurable interest must be there.
  - Covering the same risk and subject matter insured.
  - All policies should be valid and operating at the time of the loss.

- Upon receiving claim advice , the insurance company shall inform all other companies and check whether the principle may operate or not.
- Contribution clause:- As per this clause the insurer is only committed to pay his share of the loss and the insured has to get in touch with each company to collect his own claim.

- ***Contribution Rule:-*** Mainly to stop the operation of the above clause

- Practical difficulties.

Economical and Social Benefits of Insurance

- One of the insurance definitions is “the peace of mind”

- ***Benefits to insured:-***
  - Offers security and reduces the uncertainty.
  - Indemnify loss of properties or income.
  - Maintain and even improve the standard of living.
  - One of the main investment vehicles.
  - Via social insurance and group life schemes , it is an incentivizing tool that urges for maintaining the good team members.
  - Encourage well keeping of the machinery also covers loss of profit

- ***Benefits to insurers:-***
  - It is the only source of their existence
  - Increases the profit of the company via the investment.

Economical and Social Benefits of Insurance

- ***Benefits to the economy:-***
  - Offers protection to the capital whether property or human being.
  - Increases having ratios since it offers insurance and saving in one product.
  - Invest in many projects that offers all kind of services/products to the community.
  - Improve employment ratio
  - Enriches the sources of the state welfare through taxes, stamps, whether on the premium or on profit generated.
  - Improves productivity since it gives once more the peace of mind.
  - Reduces the economy waste since whether claim are paid or not it is at the end of the day ECONOMY WASTE.