CHAPTER II

DEFINITION AND PRINCIPLES OF INSURANCE

(i) Insurance can be defined as the "pooling of risks" in its concise form. It is a device by which people co-operate in sharing risk. Dinsdale defines it as a "means of spreading over the many, losses which would otherwise be borne by the individual"[1] Riegal and Miller defines insurance from the functional standpoint as "a social device whereby the uncertain risks of individuals may be combined in a group and thus made more certain, small periodic cantributions by the individuals providing a fund out of which those who suffer losses may be reimbursed. It is the application of the statical law of large numbers to the economic of risk." (2)

The legal definition considers insurance as a "contract", the insurer agreeing to meet any financial loss the insured may fall into as is set in the contract and the insured agreeing to pay a consideration (the premium).

In this country the insurers can either be one of two, namely (a) Companies (b) Societies. An example of an insurance company is the "Great Eastern Life Assurance Company" and "Companies" are defined in the Companies Ordinance 1946 under which they are registered. "Societies" are registered under the Co-operative Societies Ordinance 1948 (an example is the Malaysian Co-operative Insurance Society Limited - MCIS). There is another class of insurers - the "State". This is not found in Malaya but in India and Burma where Life insurance is nationalised. We include societies in the definition of insurance companies and as such would be "any institution undertaking insurance business in Malaya". These "insurance companies" (although the insurance function is not exactly a financial function) have attained the title of "financial institutions" because "insurance companies" are investing large sums of money every year and hold large amounts of financial assets. Moreover insurance companies because of the considerable amount of prepayment, especially in the life business, can also be considered as a "savings institution". Thus we can safely conclude that these companies' function as "financial institutions" is just as important to the economy as their function as "risk bearing institutions".

(ii) <u>Principles of Insurance</u>

Before an analysis of the operations of an insurance

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(1) Dinsdale, W.A., "<u>Elements of Insurance</u>" London: Sir Isaac Pitman and Sons Ltd. 1958 2ND Edition P. 1.

company it would be proper to have a brief idea of the principles of insurance. No matter what class of business that an insurance company takes (whether life or general insurance business) there are certain common general principles. These principles are as follows:-

(a) insurable interest
(b) good faith
(c) indemnity (with the corollaries of subrogation and contribution)
(d) proximate cause
(e) probability principle

This doctrine of'insurable interest' implies that the person insured must possess some real interest in the subject matter insured. If there is any departure from this principle, gaming or gambling is the result rather than one of insurance risks.

"It would be impossible to transact insurance business in the absence of 'good faith' and for the purposes of insurance this means utmost good faith"(3) This principle is very necessary because only one party knows the full circumstances of the subject matter presented for insurance and the insurer will decide upon the acceptance of the risk chiefly upon the information provided by the proposer. The insurer or an insurance company must likewise act in good faith. This principle and that of 'insurable interest' are laid down as conditions for insurance to be transacted in the ' 'Insurance Act 1963'. For instance under Section 15(4) of the Act it states that"......a form of proposal which does not have prominently displayed therein a warning that if a proposer does not fully and faithfully give the facts as he knows them or ought to know them, he may receive nothing from the policy."(4) This merely emphasizes the utmost good faith principle.

Indemnity, however is a principle only applicable to general insurance business and not life insurance business. The principle of indemnity is "to place the insured after a loss in the same position as he occupied immediately before the event"(5) This principle denotes the payment to the insured in the event of the risk having occured.

The next is the principle of "proximate cause". The rule is that the immediate and not the remote cause should be regarded." This cause is in relation to how death occurred in life insurance business or to loss of property, damage and so forth in general business.

Finally, there is the probability principle. This takes into account the theory of large numbers. For

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(2) Riegel,R., and Miller,J.S., "<u>Insurance Principles and Practices</u>" Englewood Cliffs N.J. Prentice Hall Inc.1959 4th Edition Pp 2-6.

instance, in life insurance business ten thousand people are insured. But all of them will not meet with death at the end of the year. Only a small percentage. This is the probability. The importance of this principle lies in the fact that it is the basis under which the premium rates to be paid by the insured is computed. In fact this principle is the most important aspect because the practice of insurance business leans onto it.

(iii) Types of Insurance

Insurance, according to Dinsdale, can be divided into four main types, namely;

(a) Marine
(b) Fire
(c) Life
(d) Accident (6)

The criterion for this classification is the nature or type of risk. Under these four branches we can safely include the various types of "insurance policies" sold by any insurance company. In the accident group there is a coverage of heterogeneous risks which are not included under marine, fire or life. For instance accident insurance will include 'workmen's compensation, motor, personal accident, property damage, burglary insurance or flambeyant insurances such as voice, legs, face and so forth. Legal classification: There is a legal classification of insurance business in Malaya. This classification divides the business into two main groups, namely;

(a) Life insurance business
(b) Non-life or general insurance business. (7)

This classification is made to facilitate the registration of insurance companies in Malaya. Companies that intend undertaking insurance business has to register itself under one of the two or both. For the number of insurance companies registered for business and the groups refer to table I

There are ninety-three registered companies in Malaya. Eight companies are carrying both life and general insurance,

TABLE I INSURERS REGISTERED

Companies registered at 31-12-65.		93
The types of business carried on by these companies are:-		
(i) Both life and general Insurance	8	
(ii) Life Insurance only.	11	
(iii) General Insurance only	74	93

eleven carrying only life insurance and seventy-four carrying only general insurance.

(3) Dinsdale, W.A., Op cit. P 67

Types of policies sold:- The types of policies (8) sold will be discussed under: (a) Life insurance policies and (b) general insurance policies.

(a) According to Mehr and Osler, acturially there are three basic types of life insurance policies. They are; "Term" "Endowment" and "whole-life". There is another called the "Annuity". A term policy can be defined as a contract which offers financial protection against the occurance of death within the given period of time stated in the policy. It offers no protection or values in case of survival beyond the specified period. This is, therefore, assurance (9) for a specified period alone, either one or five years.

Next, there is the endowment policy which provides for payment of the sum assured when the life assured reaches a specified age or at his death, whichever occurs first. Thus an endowment policy may be said to be a form of savings. If the assured survives till the policy matures he receives the monies. If death occurs first then the sum assured would go to the beneficiaries.

The whole life contract offers protection for the whole life of the assured regardless of how many years premiums are tobe paid. Premium payments may be throughout life or may cease at sixty or sixty-five years of age. Premiums may also be paid once and for all. Nonetheless the 'limited payment! basis is the most popular in Malaya.

Finally ~~there~~ is the annuity which is the reverse of the life insurance procedure. The assured pays the insurer a specified capital sum in return for a promise from the insurer to make to him a series of payments as long as he lives.

Life assurance policies are either participating or non participating policies. A policy holder can choose between participating or non participating policies. However slightly higher premiums are charged for the former. Participating policies are paid in the form of bonuses. In Malaya the most popular type of life insurance policy among the insuring public is the endowment policy. The least popular is the annuity. In fact a great majority of the companies in Malaya do not sell this annuity policy. Term policies are not very popular too because the proceeds are not obtainable (forfeited) after the specified period. This type of policy pays only if death occurs within the term period.

(b) The general insurance policies sold are the marine, fire, motor and accident (or miscellaneous category) policies. Though motor insurance should fall under the accident group, its importance in this country has called for a separate mention. Motor insurance policies are the most popular of the policies sold by insurance companies in Malaya. Almost all the companies sell motor insurance. ~~companies~~.

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(4) <u>Insurance Act 1963, Federation of Malaya</u> Kuala Lumpur, Government Printers 1965 P.11

(5) Dinsdale, W.A., <u>Op. Cit</u>. P.74

(6) In the United States and Canada this is known as <u>Casualty</u> insurance.

(7) Insurance Act 1963. <u>Op. Cit</u>. P.1

(8) The word policies here refer to the insurance 'contract' between the insurance companies and the insured. This word should be distinguished from that used as the "policies" of the company.

(9) The words "assurance" and "insurance" are synonymous in this exercise.