

Insurance Claims

(1) What do you mean by Insurance?

Answer: Insurance is a financial arrangement or contract between an individual or an entity (the insured) and an insurance company (the insurer). In this arrangement, the insured pays a regular fee, known as a premium, to the insurance company in exchange for protection or coverage against specific risks or potential financial losses. The insurance company, in turn, agrees to provide compensation or benefits to the insured if the specified events or risks occur.

The primary purpose of insurance is to help individuals and businesses manage and mitigate financial risks. It provides a safety net by spreading the risk of loss across a larger pool of policyholders. When an insured event occurs (such as an accident, illness, property damage, or death), the insurance company compensates the policyholder or beneficiary according to the terms and conditions outlined in the insurance policy.

(2) What are the Principles of Insurance?

Answer: The principles of insurance are the fundamental concepts and guidelines that govern the insurance industry and the relationships between insurers (insurance companies) and insured parties (policyholders). These principles serve as the foundation for how insurance operates and are crucial for both insurers and policyholders to understand. There are several key principles of insurance, which include:

1. **Principle of Utmost Good Faith (Uberrimae Fidei):** This principle requires both the insurer and the insured to act honestly and in good faith throughout the insurance transaction. The insured must provide accurate and complete information when applying for coverage, and the insurer must provide clear and honest terms and conditions in the policy.
2. **Principle of Insurable Interest:** To purchase insurance, the insured must have a legitimate financial interest in the subject matter of the insurance policy. In other words, the insured must stand to suffer a financial loss if the insured event occurs. For example, a person can insure their own property but cannot insure someone else's property in which they have no financial interest.
3. **Principle of Indemnity:** The principle of indemnity states that insurance is meant to compensate the insured for their actual financial loss, not to provide a source of profit. In the event of a covered loss, the insured should receive an amount that restores them to the same financial position they were in before the loss occurred, without gaining or losing financially.

4. **Principle of Subrogation:** When an insurance company pays a claim to the insured, it gains the right to step into the insured's shoes and pursue legal action against any responsible third parties to recover the amount it paid out. This principle helps prevent the insured from double recovery (getting compensated by both the insurer and a third party).
5. **Principle of Contribution:** This principle applies when the insured has multiple insurance policies covering the same risk. In such cases, if the insured claims under one policy, they cannot receive more than the actual amount of their loss from all the policies combined. Each insurer pays its proportionate share based on the policy limits.
6. **Principle of Proximate Cause:** Insurance policies typically specify the cause of loss that triggers coverage. The proximate cause is the primary reason for the loss. If the proximate cause is covered by the policy, the claim will be paid, even if other contributing factors are not covered.
7. **Principle of Loss Minimization:** The insured has a duty to take reasonable steps to minimize or prevent further loss once an insured event occurs. Failure to do so may affect the extent of the insurer's liability.
8. **Principle of Causa Proxima:** This principle is often used when determining the cause of loss when multiple events or factors contribute to a loss. It considers the event that is closest in terms of causation to the loss.

(3) What are the functions of Insurance?

Answer: Insurance serves several important functions in society and the economy. These functions are designed to provide individuals and businesses with financial protection and peace of mind in the face of various risks and uncertainties. Here are the primary functions of insurance:

1. **Risk Transfer:** Insurance allows individuals and businesses to transfer the financial burden of potential losses to an insurance company. When you purchase insurance, you essentially transfer the risk of a particular event (such as a car accident or a natural disaster) to the insurer. In exchange for premiums, the insurer agrees to cover the costs associated with the event, up to the policy limits.
2. **Risk Pooling:** Insurance operates on the principle of risk pooling, which involves spreading the financial risk of a loss among a large group of policyholders. Not everyone in the pool will experience a loss at the same time, so those who do not experience losses help cover the costs of those who do. This helps reduce the financial impact of individual losses.
3. **Financial Security:** Insurance provides financial security and stability to policyholders. Knowing that they have insurance coverage in place can give individuals and businesses

the confidence to take risks and invest in their future without the constant fear of unexpected financial setbacks.

4. **Loss Prevention and Mitigation:** Insurance companies often offer risk management services and incentives to policyholders to prevent or mitigate potential losses. For example, they may provide discounts for installing security systems in homes or conducting regular vehicle maintenance to reduce the risk of accidents.
5. **Legal Requirements:** In many cases, insurance is required by law. For example, auto insurance is typically mandatory in most states to ensure that individuals can cover the costs of accidents they may cause. Similarly, businesses may be required to have liability insurance to operate legally.
6. **Lender Requirements:** Lenders often require borrowers to have insurance coverage as a condition of getting a loan. For instance, mortgage lenders require homeowners to have homeowners' insurance to protect the property, and auto lenders require borrowers to have auto insurance to protect the vehicle.
7. **Peace of Mind:** Insurance provides peace of mind to individuals and businesses. It helps alleviate the anxiety and stress associated with unexpected events by providing financial support when needed most.
8. **Economic Stability:** The insurance industry plays a crucial role in stabilizing the economy by absorbing and redistributing risk. Insurance companies invest the premiums they collect, which contributes to the overall financial health of the economy.
9. **Facilitating Commerce:** Insurance facilitates economic activities by reducing the financial risks associated with trade and business operations. It allows businesses to take calculated risks and expand their operations without fear of catastrophic financial losses.
10. **Social Welfare:** Certain types of insurance, such as health insurance and life insurance, contribute to the welfare of society by providing financial support to individuals and families during times of illness, disability, or the death of a breadwinner.

(4) What is average clause in insurance claims?

Answer: The "average clause" in insurance refers to a provision commonly found in property and casualty insurance policies, particularly in policies related to property insurance, such as homeowners' insurance or commercial property insurance. This clause is also known as the "coinsurance clause" or "underinsurance clause." The purpose of the average clause is to ensure that policyholders adequately insure their property and share in the risk of loss with the insurance company.

(5) What is salvaged stock?

Answer: Salvaged stock, also known as salvage merchandise or salvage goods, refers to products or inventory that have been damaged, discontinued, or otherwise deemed unsellable by the original retailer or manufacturer. These goods are typically sold at a significantly reduced price compared to their original retail value due to their condition or other factors that make them less desirable in the primary retail market.

(6) What is meant by short sales?

Answer: In the context of insurance, a "short sale" typically does not refer to a financial transaction as it does in the context of stock trading. Instead, "short sale" in insurance is often a term used to describe the sale of an insurance policy with a term or coverage period that is shorter than the standard or typical term for that type of policy.

(7) How is Gross Profit calculated under loss of profit policy?

Answer: In insurance, calculating the gross profit under a Loss of Profit (LOP) policy is a crucial step in determining the amount of compensation that a business may be entitled to if it suffers a loss due to a covered peril (e.g., fire, flood, or other insured events) that interrupts its normal operations. Gross profit is an essential component in the calculation of the business interruption insurance claim.

(8) Why is the average clause applied in insurance claims ?

Answer: The average clause is applied in insurance claims for several reasons, primarily to ensure that policyholders adequately insure their property or assets, and to share the risk of loss between the insured and the insurance company. Here are the main reasons why the average clause exists in insurance:

1. **Encourages Adequate Coverage:** The average clause encourages policyholders to maintain insurance coverage that is proportional to the value of the insured property or assets. By requiring policyholders to insure their property at a certain percentage of its actual replacement cost value (RCV), insurers aim to prevent underinsurance, where policyholders would be inadequately covered in the event of a loss.
2. **Risk Sharing:** Insurance is based on the principle of risk sharing. Policyholders pay premiums to the insurer, which, in turn, pools these premiums to cover potential losses. The average clause helps ensure that policyholders participate fairly in sharing the risk of loss. If a policyholder underinsures their property, they effectively shift more of the risk to the insurer, potentially leading to higher premiums for everyone.
3. **Prevents Moral Hazard:** Without the average clause, policyholders might be tempted to underinsure their property intentionally, knowing that they could receive full compensation in the event of a loss. This behavior could lead to moral hazard, where

insured individuals or businesses take on riskier behavior because they have less to lose financially. The average clause discourages such behavior.

4. **Balances Premium Costs:** By requiring policyholders to insure their property at a certain percentage of its RCV, the average clause helps maintain a balance in premium costs. If some policyholders were allowed to underinsure significantly while paying lower premiums, it could lead to increased costs for others in the insurance pool.
5. **Risk Management:** Adequate insurance coverage is an essential component of risk management. For both individuals and businesses, being adequately insured helps ensure financial protection in the event of a significant loss. The average clause promotes responsible risk management by encouraging policyholders to assess and insure against the true value of their assets.
6. **Equitable Settlements:** When a loss occurs, the average clause helps ensure that policyholders receive settlements that are proportionate to their level of coverage. This promotes fairness in the claims settlement process, as those who have taken steps to insure their property adequately receive a more substantial payout to help them recover from the loss.

(9) What types of losses are considered under loss of profit policy?

Answer: A Loss of Profit (LOP) policy, also known as Business Interruption Insurance, is designed to provide coverage for financial losses that a business may suffer due to the interruption of its normal operations caused by specific events or perils. The types of losses considered under a Loss of Profit policy typically include:

1. **Loss of Revenue:** This is the primary component of a business interruption claim. It covers the revenue or income that the business would have earned if the interruption event had not occurred. Loss of revenue can result from a variety of factors, including a fire, natural disaster, equipment breakdown, or other covered perils.
2. **Extra Expenses:** In addition to lost revenue, the policy may cover extra expenses that the business incurs to mitigate the effects of the interruption or to expedite the resumption of operations. These expenses can include costs associated with temporary relocation, renting equipment, overtime wages, and other expenses necessary to minimize the business's downtime.
3. **Fixed Costs:** Many business interruption policies also cover fixed costs that continue even when operations are disrupted. Fixed costs include expenses like rent or lease payments, loan repayments, utilities, insurance premiums, and salaries of key employees who are retained to assist in recovery efforts.
4. **Profits or Net Income:** Business interruption insurance typically covers the loss of net income or profits that the business would have earned during the interruption period.

This is calculated based on the business's historical financial data, taking into account factors like seasonal fluctuations and trends.

5. **Payroll Expenses:** Some policies may cover payroll expenses for non-operational employees who are retained during the interruption period, particularly if the business intends to resume operations as soon as possible.
6. **Extended Indemnity:** Some policies offer extended indemnity coverage, which continues to pay for losses even after the business resumes operations until it reaches a specified level of pre-interruption revenue or income. This helps bridge the gap during the recovery period.
7. **Contingent Business Interruption:** This coverage extends protection to losses resulting from the interruption of a key supplier or customer's operations. If a supplier or customer experiences a covered loss that affects your business, contingent business interruption coverage can compensate for the resulting financial impact.
8. **Ordinary Payroll Coverage:** This covers the payroll expenses of employees who are not deemed essential to the business's recovery efforts but are retained during the interruption period. It helps businesses avoid the cost of layoffs during a crisis.

(10) Describe the steps to be followed to lodge claim before the insurance company for indemnification of loss of stock due to fire.

Answer: Lodging a claim with an insurance company for indemnification of loss of stock due to fire is an important process that requires attention to detail and proper documentation. Here are the steps to follow when filing a fire insurance claim:

1. Immediate Action:

- Ensure the safety of yourself and others, and try to minimize further damage or loss.
- Contact the fire department immediately to extinguish the fire and document their response.
- If it's safe to do so, try to mitigate additional damage to the remaining stock, such as moving it away from the fire or covering it to protect it from smoke or water damage.

2. Notify the Insurance Company:

- Contact your insurance company as soon as possible to report the fire incident. Be prepared to provide your policy number and details about the incident.
- Follow the insurer's specific procedures for reporting claims, which may include contacting a dedicated claims department or agent.

3. Claim Documentation:

- Gather and organize all relevant documentation, including your insurance policy, inventory records, and financial statements.

- Document the extent of the fire damage through photographs, videos, or written descriptions.
- Keep records of any firefighting efforts and their impact on the property and stock.

4. Secure the Property:

- Take reasonable steps to secure the damaged property to prevent further losses or damage. This may include boarding up broken windows, covering exposed areas, or fencing off the damaged area.

5. Inventory of Damaged Stock:

- Prepare a detailed inventory list of the stock that was damaged or destroyed in the fire. Include information such as the quantity, description, cost, and value of each item.
- If possible, retain samples or remnants of damaged stock as evidence.

6. Financial Documentation:

- Prepare financial records and documents that demonstrate the value of the damaged or lost stock. This may include purchase invoices, sales records, accounting ledgers, and tax returns.
- Provide evidence of the stock's value before the fire, such as profit and loss statements or balance sheets.

7. Loss Assessment:

- The insurance company will assess the loss and may send an adjuster to inspect the damage. Cooperate fully with the adjuster, providing them with access to the damaged property and all relevant documentation.

8. Claim Submission:

- Complete the insurance company's claim forms accurately and honestly. Include all required information, such as the cause of the fire, the date and time of the incident, and a detailed description of the loss.
- Submit the claim documentation promptly to your insurance company, following their preferred method (online, mail, or in person).

9. Follow-Up and Communication:

- Maintain open and regular communication with the insurance company throughout the claims process.
- Keep records of all interactions, including dates, times, and the names of individuals you speak with.

10. Review Settlement Offer:

- Once the insurance company has reviewed your claim, they will provide a settlement offer. Carefully review the offer to ensure it adequately covers your losses.
- If you have questions or concerns about the settlement offer, discuss them with your insurance company.

11. Settlement and Recovery:

- If you accept the settlement offer, the insurance company will provide compensation for your loss based on the terms of your policy.
- Use the funds to replace the lost stock, repair or rebuild the damaged property, and resume your business operations.

(11) Explain the following terms used in insurance claims:

(a) Insurance Claim

Answer: An insurance claim is a formal request made by a policyholder or a beneficiary to an insurance company for compensation or payment as a result of a covered loss or event. When individuals or businesses purchase insurance policies, they do so to protect themselves financially against the risk of certain events or perils that could result in financial loss. When one of these covered events occurs, the policyholder can file an insurance claim to seek reimbursement or coverage for the associated costs or damages.

(b) Consequential Loss

Answer: Consequential loss, also known as consequential damages or indirect loss, refers to financial losses or damages that result as a consequence or indirect outcome of a particular event or incident, rather than being the direct or immediate consequence of that event. Consequential losses are often associated with insurance policies and legal contracts, where they are subject to specific terms and conditions.

(c) Period of Indemnity

Answer: The "period of indemnity" is a critical concept in insurance, particularly in property and business interruption insurance policies. It refers to the time frame during which an insured business can receive coverage for its financial losses resulting from a covered event or peril, such as a fire, natural disaster, or other insured incident.

(d) Amount of Indemnity.

Answer: The amount of indemnity in an insurance policy refers to the maximum financial compensation or coverage limit provided by the insurer for a covered loss or event. This amount represents the most the insurance company will pay out to the policyholder or beneficiary under the terms and conditions of the policy. The specific amount of indemnity can vary widely depending on the type of insurance and the terms of the policy.