

CHAPTER 5

LEGAL PRINCIPLES OF AN INSURANCE CONTRACT

Insurance contracts – Legal aspects

The insurance contract

Insurance involves a contractual agreement in which the insurer agrees to provide financial protection against certain specified risks for a price or consideration known as the **premium**.

The contractual agreement takes the form of an **insurance policy**.

Legal aspects of an insurance contract

A contract is an agreement between parties, enforceable at law. The provisions of the **Indian Contract Act, 1872** govern all contracts in India, including insurance contracts.

An insurance policy is a contract entered into between two parties, viz., the company, called the insurer, and the policy holder, called the insured and fulfils the requirements enshrined in the Indian Contract Act, 1872

Elements of a valid contract

- Offer and acceptance
- Consideration
- Agreement between the parties
- Free consent
- Capacity of the parties
- Legality

Offer and acceptance

When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of the other to such act, he is said to make an offer or proposal. Usually, the offer is made by the proposer, and acceptance made by the insurer.

When a person to whom the offer is made signifies his assent thereto, this is deemed to be an acceptance. Hence, when a proposal is accepted, it becomes a promise.

The acceptance needs to be communicated to the proposer which results in the formation of a contract.

When a proposer accepts the terms of the insurance plan and signifies his assent by paying the deposit amount, which, on acceptance of the proposal, gets converted to the first premium, the proposal becomes a policy.

If any condition is put, it becomes a counter offer.

The policy bond becomes the evidence of the contract

Consideration

This means that the contract must contain some mutual benefit for the parties. The premium is the consideration from the insured, and the promise to indemnify, is the consideration from the insurers

Agreement between the parties

Both the parties should agree to the same thing in the same sense. In other words, there should be “consensus ad-idem” between both parties. Both the insurance company and the policyholder must agree on the same thing in the same sense.

Free consent

There should be free consent while entering into a contract.

Consent is said to be free when it is not caused by Coercion Undue influence Fraud Misrepresentation Mistake. When consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is voidable.

Capacity of the parties

Both the parties to the contract must be legally competent to enter into the contract. The policyholder must have attained the age of majority at the time of signing the proposal and should be of sound mind and not disqualified under law. For example, minors cannot enter into insurance contracts.

Legality

The object of the contract must be legal, for example, no insurance can be had for illegal acts. Every agreement of which the object or consideration is unlawful is void. The object of an insurance contract is a lawful object

Insurance contracts – Special features

Uberrima Fides or Utmost Good Faith

This is one of the fundamental principles of an insurance contract. Also called uberrima fides, it means that every party to the contract must disclose all material facts relating to the subject matter of insurance

Material facts

Material fact has been defined as a fact that would affect the judgment of an insurance underwriter in deciding whether to accept the risk and if so, the rate of premium and the terms and conditions

Insurable interest

The existence of „insurable interest“ is an essential ingredient of every insurance contract and is considered as the legal pre-requisite for insurance.

Proximate Cause

Proximate cause is a key principle of insurance and is concerned with how the loss or damage actually occurred and whether it is indeed as a result of an insured peril. If the loss has been caused by the insured peril, the insurer is liable. If the immediate cause is an insured peril, the insurer is bound to make good the loss, otherwise not

Indemnity

The principle of indemnity is applicable to Non-life insurance policies. It means that the policyholder, who suffers a loss, is compensated so as to put him or her in the same financial position as he or she was before the occurrence of the loss event. The insurance contract (evidenced through insurance policy) guarantees that the insured would be indemnified or compensated up to the amount of loss and no more.

The philosophy is that one should not make a profit through insuring ones assets and recovering more than the loss. The insurer would assess the economic value of the loss suffered and compensate accordingly.

Subrogation

Subrogation means the transfer of all rights and remedies, with respect to the subject matter of insurance, from the insured to the insurer.

It means that if the insured has suffered from loss of property caused due to negligence of a third party and has been paid indemnity by the insurer for that loss, the right to collect damages from the negligent party would lie with the insurer. Note that the amount of damage that can be collected is only to the extent of amount paid by the insurance company