CHAPTER 1: INTRODUCTION

1.1 Insurance Contract

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. An insurer is a company selling the insurance and insured is the person buying the insurance. The insurance rate is a factor used to determine the amount to be charged for a certain amount of insurance coverage, called the premium.

The insurance contracts are designed by the insurer. The insured has no ability to make changes to the contract. It shows that the insurer bears the burden if there is any ambiguity in any terms of the agreement or the contract. Insurance works on the basic principle of risk-sharing. A great advantage of insurance is that it spreads the risk of a few people over a large group of people exposed to risk of similar type.

The insurance contracts are unilateral agreements. This means that only the insurer makes legally enforceable promises in the contract. The insurer is legally bound to pay the benefits under the contract if the insured has paid the premiums and fulfilled certain other requirements. The purpose of entering into insurance contracts is to leave a person in the same financial position he was in immediately prior to the incident. In other words person will be remunerated according to the total sum he has assured. Buying an insurance coverage provides the insured with the peace of mind and assurance that he is protected against any damage or loss.

1.1.1 What is an insurance policy?

The Insurance Agreement or Contract between the insurer and the insured which is put in writing is called a policy. The insured is known as the policy holder and he/she undertakes to make periodical payments and the insurer agrees to pay for damages/losses for the covered perils of the policy if certain defined events occur.
1.2 Why Insurance Is Needed?

All assets have some economic value. There is also a possibility that these assets may get damaged or destroyed or non operational due to risks like breakdowns, fire, floods, earthquake etc. Different assets are exposed to different types of risks. A vehicle has a risk of theft or meeting with an accident, a house is exposed to catching fire, a human is exposed to the risk of death or accident. Hence, insurance is needed to compensate the insured in future losses and damages against life and property.

1.2.1 Uncertainty

The basic need of insurance arises due to various risks. Risks are uncertain and unpredictable in nature. Any risk that could be quantified could be insured. Obtaining insurance for an asset actually implies that in case the asset suffers any loss or damage in value due to anticipated risk, the insurance company compensates the insured.

1.3 Essentials Of A Valid Insurance Contract

1.3.1 Offer and acceptance

When applying for insurance, the first thing to do is to get the proposal form from an insurance company and fill in the requested details. Then the form has to be forwarded to the company. This is the insurance offer. If the insurance company accepts the offer and agrees to insure the person, it is the acceptance. In some cases, insurer may agree to accept the offer after making some changes to the proposed terms.

1.3.2 Consideration

It is the premium or the future premiums that one has to pay to the insurance company. For insurers, consideration also refers to the money paid out to the insured in case he files an insurance claim.
1.3.3 Legal capacity

One needs to be legally capable to enter into an agreement with his/her insurer. If any person is a minor or a mentally ill, then he or she may not have the legal capacity to enter into contracts. Similarly, insurers are considered to be competent if they are licensed under the prevailing regulations.

1.3.4 Legal purpose

If the purpose of the contract is to encourage illegal activities, it is invalid.

1.3.5 Additional factors

There are some additional factors that also need to be considered, including under-insurance and excess clauses that create situations in which the full value of an insured asset is not remunerated.

**Excess:** To avoid small claims, the insurers have introduced provisions like excess. For example, if a person has a motor insurance with the applicable excess of Rs 50,000. If the car had an accident with the loss amounting to Rs 60,000, the insurer will pay the Rs. 10,000 because the loss has exceeded the specified limit of Rs 50,000. But, if the loss comes to Rs. 45,000 then the insurance company will not pay a single cent.

**Under-insurance:** This is to save on premiums. Ex: if a house is insured at Rs. 5 million when the total value of the house is Rs.8 million it is an under insurance. At the time of partial loss, the insurer will pay only a proportion of Rs.5 million while the insured has to cover the remaining portion of the loss. This is called under-insurance.

1.4 Principles Of Insurance Law

1.4.1 Doctrine of utmost good faith

All insurance contracts are based on the concept of "uberrima fidei" or the doctrine of good faith. It is the mutual faith between the insured and the insurer. In insurance
agreements, both the Insurer and the insured are required to observe this principle. When applying for life insurance, it is the duty of that person to disclose all past illnesses to the insurer. Likewise, the insurer cannot hide information about the insurance coverage that is being sold. Utmost good faith is of a continuing nature. No alterations could be made to the contract without the consent of both parties. The insurer cannot subsequently demand for high premium nor deny liability to avoid payments.

1.4.2 Misrepresentation

These are statements made by one party to another before entering into an insurance contract. These statements are some matters relating to the contract but not an integral part of the contract. These statements are said to have been fulfilled when the final acceptance of the policy is conveyed to the insured. If representations are made on the essential part of the contract then it becomes a warranty and in case if those statement found to be false then the policy can be avoided.

1.4.3. Warranties

A breach of warranty will avoid the policy even if it may not relate to the risk insured. A Warranty may be expressed or implied. Implied warranties are mostly in relation to marine insurance. It is defined as a promise undertaken by the insured. The warranty should be in the policy or it must be incorporated by reference.

1.4.4 Conditions

Conditions are terms under which an insurance policy is granted. It specifies the duties of the assured. They can be conditions precedent or conditions subsequent. The conditions precedent is required for a valid contract. The non fulfillment of which will make the contract void. The conditions can be further classified in to implied and expressed conditions.
1.4.5 Principle of subrogation

Subrogation allows an insurer to sue a third party that has caused a loss to the insured and pursue getting back some of the money that it has paid to the insured as a result of the loss. For example, if someone is injured in a road accident that is caused by the reckless driving of another party, then the injured will be compensated by the insurer. However, the insurance company may also sue the reckless driver in an attempt to recover that money.

1.4.6 Indemnity

Most types of insurance policies other than life and personal are contracts of indemnity where insurer undertakes to indemnify the insured for the actual loss suffered on happening of an event.

1.4.7 Insurable interest

It is the legal right to insure any type of property or any event that may cause financial loss or create a legal liability. This is called insurable interest.

If a person is living in his Aunt's house and applies for home owners insurance believes that he/she may inherit the house later. Insurers will reject the offer because he/she is not the owner of the house.

It is also the principle of insurable interest that permits married couples to take out insurance policies on the lives of their spouses as they may suffer financially if the spouse dies. Insurable interest also exists in some business arrangements, between a creditor and debtor, between business partners or between employers and employees.

1.5 Problem Identification

A motor vehicle accident can disrupt one's life on many ways. The injuries sustained may need time to heal. This means time taken away from work and family. This will
create financial problems and emotional strain for the victim of motor accident and his/her family members. It is also needed to consider the stress of dealing with the insurance companies responsible for covering damages to vehicle and other property etc.

Auto insurance companies make money when a person pays his insurance on time and never claims. When a claim is filed the insurer wants to pay the minimum. If a person was in an accident and his car was destroyed and he was in hospital for some days the insurance company will pay the minimum unless the insured disagrees and goes for litigation. This is one of the problems that the insured will have to face with.

It should also keep in mind that the insurer is not only bound to pay covered claims for losses, but also to defend the insured if someone else files a claim against the insured. It reveals that many people obtain insurance policies mainly for the fulfillment of the legal requirement and most of them are unaware that the insurer’s duty is also to defend them if there are actions against the insured.

Insurance is such a vast subject that a few people only familiar with the benefits that they could obtain through insurance. Therefore, it is necessary to investigate the present situation of motor insurance claims in detail. Insurance providers often have their own strategy to handle claims and they don’t have a specific guide lines for the same.

The victims of accidents or their relatives sometimes are not aware of the terms and conditions of the insurance contract and also they are unaware that they could claim compensation from the insurer. Therefore, it is very important that a person is well conversant with the terms and conditions of insurance agreements. There are instances where the insured or his family members not proceeding with legal action to recover the loss when claims are denied by the insurers. It may be due to financial difficulties of the insured or his/her family members or due to the reason that they are unaware of the litigation procedure.

When there are disputes with regard to auto insurance, the terms of the insurance agreement provides for the insured to demand for arbitration where he could prove his
case to receive compensation which he is entitled to. It is very important that claims should be forwarded to the insurer within the specified time period. The claims forwarded to the insurers will be refused after the specified time. Therefore, insured must well aware of this situation as once the time lapses he/she has no way of making a claim for the loss or damage he/she suffered.

Insurer can deny policyholder’s claim on bad faith insurance claims. Insurers are required to act in good faith with the people insured with them. If a person feels that he/she is treated unfairly then he/she will have no alternative but to go in to litigation. Bad faith may not be clear in every situation. It is defined primarily in case law.

- Undue delays in handling claims
- A biased investigation
- Refusal to defend a case brought against the insured
- Harassment or threats against the insured
- Refusal to make reasonable settlement
- Interpreting the policy in unreasonable manner
- Threatening to accept a low offer
- Denying legitimate claim
- Failure to inform the insured of additional benefits
- Altering policy without policyholders knowledge/consent

In settlement of personal injury cases, when the offer is made on the injury claim one must ensure whether his/her rights are violated and also whether he/she is receiving the full amount under the agreement.

The rising costs of car insurance are encouraging people to avoid obtaining a policy. It is noted that vehicle insurance is rising each year and the increase has been particularly unaffordable for young drivers. It is also noted that the cost of being caught without vehicle insurance is cheaper. This encourages some drivers to continue driving without motor insurance. Even in developed countries there are millions of drivers and it is said that these figures will go up if the motor vehicle insurance keep rising.
1.6 The Objective Of The Study

Motor vehicle accidents are the most common type of vehicular accidents in Sri Lanka and almost all countries in the world. The purpose of getting motor insurance is to minimize the financial burden that a vehicle owner suffers in an accident and this is why motor vehicle insurance is a must for all motorists. However, many motorists are not aware of the importance of the motor insurance and many of them may not even think of obtaining a policy due to the high cost.

The objective of this study is to briefly explain what the motor insurance policy is, why it is important to obtain a policy, what has to be considered in obtaining a policy and also to discuss the benefits of such a policy. An attempt has also been made to identify the deficiencies/weaknesses or loopholes in the present system of motor insurance and finally the recommendations/suggestions to rectify these situations.

The law says one must have a basic motor insurance liability if he/she owns or drives a motor vehicle. Motor insurance protects motorists in the occurrence of accidents they may cause. It can also provide cover for the motorist’s own vehicle. The Motor Traffic Act requires all motorists to be insured against their liability for injuries to others (including passengers) and for damage to other people’s property resulting from use of a vehicle on a road. It is an offence to drive a car or allow others to drive it without insurance.

However, many of the motorists do not realize the role motor insurance plays in protecting them against a loss or damage in an accident. Many of the insured have not realized the fact that when a motor insurance is purchased, it protects one’s investment at today’s price. Motor insurance policies are mostly purchased as a legal requirement and therefore, much attention is not paid to understand the many benefits of it. The Policy Document sets out the terms and conditions of the policy. Though the policy must be read carefully to ensure as to whether it gives the level of cover that one is seeking, it is hardly being done. The insured must always get a clear picture as to the policy does or does not cover and get it explained by the insurer if there are any thing unsure about the policy.
One can shop around and decide as to the insurer from whom the insurance policy is taken. However, it is important to see what is and is not covered by the policy. It is not advisable to go for a cheaper policy as they may not offer the same level of protection. Most policies have a standard excess i.e. the amount one has to agree to pay the first part of any claim. Higher the excess one is agreeing to pay, a cheaper the policy he/she might get.

Many different types of motor insurance cover are available. The comprehensive cover offers protection for accidental damage, theft, fire damage as well as liability towards third parties.

Third party - this is the minimum legal requirement and covers the injured for injuries to third party, including passengers or their property, but does not cover damage to the vehicle.

To receive this protection, the policy holders, have to pay a premium to the insurer. The insurer then accumulates all premiums collected into a fund. This will be used to compensate the policyholder who would suffer a loss or damage from a motor accident. In other words the loss is paid from the monies collected from the policy holders who have contributed but not met with accidents.