CHAPTER 1

DEVELOPMENT OF THE INSURANCE BUSINESS

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CHAPTER 1

DEVELOPMENT OF THE INSURANCE BUSINESS

1.1 ORIGIN OF INSURANCE

Insurance, conceived as a method of sharing the losses, embodying the principle of co-operation existed in the early civilisation. There is evidence that during Aryan civilisation, loss of profits in industry was insured by the village co-operatives in India.

Insurance as a technique of providing protection against fortuitous events for a consideration had its origin in the "bottomry bonds" which were issued by the Mediterranean Merchants as early as in the fourth century B.C. A bottomry loan was an advance of money on a ship during the period of a voyage. The loan was repayable with the agreed rate of interest, on arrival of the ship safely at the destination. If the ship was lost during the voyage, the obligation to repay the loan was extinguished. The interest payable constituted a sort of a premium for the risk of total loss. Similar loans were granted on the security of cargo and were called "respondentia bonds".

Reference to similar practice is also found in "Manab Dharma Shastra" (Code of Manu) which contained rules for "Seaform" contracts which were observed by the traders from Broach and Surat, who set sail in Indian-built ships laden with Indian merchandise to Lanka, Egypt and Greece.

Ancther fore-runner of insurance was the marine practice of general average whereby losses voluntarily insured to save the common venture was shared by contribution from all the interests-ship; frieght and cargo saved by the General Average Act. This practice dates back to 916 B. C. when the Rhodians practiced in their Mediterranean trade.

However, the earliest transactions of insurance as practiced today can be traced to the beginning of the fourteenth century in Northern Italy. The Italian merchants who were engaged in the Mediterranean trade with India via constantinopole and with the European countries by land, originated the practice of breaking up the bottomary bonds into two instruments covering separate transactions - the advance of money which was to be repaid on safe arrival of ship and the policy of assurance which paid the amount stated, in the event of loss at sea. This, then, was the beginning of the marine insurance.

1.2 HISTROY OF INSURANCE IN UNITED KINGDOM

This practice of marine insurance gradually spread northwards from Italy to Netherlands and then to London, where in the sixteenth century, it got firmly established in the mercantile transactions of Lombard Street, which was the centre for commerce. As insurance transactions multiplied, disputes became inevitable and in 1575 a Chamber of Assurance was established to register policies and settle disputes. This chamber played an important part during the formative period of marine insurance in London and devised a policy from whose wording is the basis of the modern marine policy.

The early history of marine insurance is closely linked up with the origin and rise of Lloyd's, Shipowners, sea captains and merchants used to congregate in coffee-houses to deal with their various mercantile transactions and gradually, individual merchants added the business of accepted marine risks to their other lines of activity. One such coffee-house made memorable in insurance history was started by Edward Lloyd around 1680 and in this coffee-house the practice of individual underwriting took shape.

Eventually, around the middle of eighteenth century, these individual underwriters formed themselves into an association with a common subscription. In the meanwhile, they met with stiff competition from the London Assurance and the Royal Exchange Assurance, who in 1720, obtained Royal Charters to transact marine insurance on an exclusive basis. This monopoly was repealed in 1824 after which many Joint Stock Companies were founded and these together with Lloyd's underwriters constituted the marine insurance market.

In 1871, the Lloyd's Act was framed to set up the Corporation of Lloyd's. In 1911 Lloyd's underwriters were empowered to transact other classes of insurance, commonly referred to as non-marine business. Today, Lloyd is regarded as a great international insurance centre.

Lloyd's underwriters operate alongwith giant insurance companies in a spirit of co-operation and healthy competition.

In 1906, the Marine Insurance Act was framed to codify the marine insurance law which till then consisted of a considerable body of case law, customs and usages that had developed during the preceeding three centuries.

1.3 FIRST INSURANCE

Although some form of fire insurance was transacted under Municipal auspices in Germany and though private charity in England, attempts to organise fire insurance in the modern form were made only after the Great Fire of London in 1666. A London builder Dr. Nicholas Barbon started the Fire Office in 1680. Other offices soon followed but their operations were confined to the insurance of buildings. In 1708, an office was established to insure goods and merchandise. These offices owned their own fire brigades and issued fire marks which were fixed to buildings to indicate that they were being insured by a particular office.

By the beginning of the 19th century, there were no less than 32 fire offices. These offices recognised the need for joint action to deal with common problems. In 1832, the London offices formed one common fire brigade. Associated action was extended to collection of loss experience on a common basis for the purpose of charging agreed rates. Eventually in 1858, an Association of English and Scottish Fire Offices was formed which came to be known in 1868 as the Fire Offices Committee which, since then, has been the central tariff institution for the fire insurance.

The Industrial Revolution brought about a great increase in material wealth in the form of factories, machinery and merchandise which had to be protected by fire insurance. With the introduction of complex manufacturing processes in industry, the system of fire insurance rating also became complicated and the Fire Offices Committee played a most useful part in introducing uniformity of rates and scientific classification of risks.

By the beginning of the 20th century, a number of further offices were formed. Lloyd's too, by then had commenced fire insurance. The market also introduced the loss of profits policy in 1900, followed by insurance against special perils. The insurances on re-instatement value basis were introduced during the inter-war period. On the technical side, the Fire Offices Committee established in 1935 a Testing Station for research purposes. In 1946, this was converted into the Joint Fire Research Organisation - a unique combination of a commercial interest and a Government department (Department of Scientific and Industrial Research). At the same time, with the approval of the Government, the Fire Protection Association was established with the purpose of advising the community in regard to the reduction of fire waste.

1.4 ACCIDENT INSURANCE

The beginning of accidents insurance is directly attributable to the conditions created by the Industrial Revolution in the 19th century. The invention of the railway led to the establishment of Railway Passengers Assurance Company in 1848 which covered only accidents sustained during railway travel to start with & later introduced annual personal accident policies on a 24-hour basis. Fidelity guarantee was transacted from the year 1840.

The Employer's Liability Act, 1880 which made employers liable under certain circumstances to pay compensation to workers, who were injured at work created the need for insurance protection, and the Employer's Liability Assurance Corporation Limited was founded to provide the requisite protection. The Workmen's Compensation Act, 1897, which established the principle of employer's liability for industrial accidents irrespective of negligence and the Workmen's Compensation Act, 1906, which extended this law to all classes of employment led to great expansion of this class of accident insurance, until 1948 when the above laws were repealed and a national insurance scheme for industrial injuries benefit was introduced.

In the early years of the 19th century, there were many explosions of boilers causing heavy damage and bodily injury. Although the Manchester Steam Users Association was formed in 1854 to provide inspection services for boilers, a system of combining insurance protection with inspection service was started by the Steam Boiler Assurance Company in 1858. The Boiler Explosions Act, 1882, which provided for investigation of all boiler explosions and imposition of class of insurance all the more necessary. Insurances of engines started about the same time in 1872, followed by insurances of electrical plant in 1887. The Engineering Offices Association was formed in 1920 to administer tariffs for certain classes of engineering insurance.

The employers liability insurances emphasised the need for liability insurance in another direction, viz. towards third parties. Early third party policies were issued in respect of horse drawn vehicles since 1880.

The first motor vehicle entered the U. K. from the continent in 1894 and the Law Accident Insurance Society Limited started writing motor insurance business from the year 1898 onwards. There was tremendous expansion of road transport during the inter-war period. In 1930, the Road Traffic Act was passed to introduce compulsory insurance of third party liabilities. Further legislation was passed in 1933 and 1934 and the current Act is Road Traffic Act, 1972. After World War II, motor insurers in the U. K. set up the Motor Insurers Bureau. Motor insurance today, constitutes the largest section of accident insurance.

Burglary insurance came to be transacted towards the end of the last century. In 1887, an enterprising Lloyd's underwriter agreed 'more in jest than in earnest' to extend a fire policy to cover burglary risks. This was widened gradually to include all risks cover on valuable property, money in transit insurance, goods in transit insurance and personal baggage insurance.

Aviation insurance had its small beginning in 1909-10. The interest in aeronautics was stimulated by World War I and the demand for insurance was felt with the first regular civil aviation service which began in 1919. The first such group was British Aviation Insurance formed in 1923 and later in 1931 called the British Aviation Insurance Company Limited. In 1935, another group, namely the Aviation and General Insurance Company Limited was formed.

An interesting feature of the development of insurance in the U. K. is the rise of composite offices through the process of amalgamation. The earliest insurers were all motor insurance. During the 19th century, the large fire offices brought smaller fire offices doing business. During this period, many accident specialist offices were established to underwriting workmen's compensation, motor, public liability and engineering insurances.

1.5 HISTORY OF INSURANCE IN INDIA

Although marine insurance as practiced today was introduced in Europe as early as in the 15th century and fire insurance in the U. K. in the 17th century, in India insurance was established only at the beginning of the 19th century. There is some evidence that between 1797 and 1810, marine insurance companies were established in Calcutta which was the centre of the East India Company's trade and commerce. It may, therefore, be said that marine insurance was the earliest form of insurance to be transacted in India.

Marine insurance was followed by fire insurance which was introduced by the Alliance British and Foregin Fire Insurance Company, which established an agency office in Madras in 1825. Other foreign insurance offices, mainly British, granted agency representations to leading British trading houses, who were actively operating in India in the field of import-export business. The British business houses were the managing agents for a large number of concerns such as tea estates, sugar factories, coal mines, jute mills, cotton mills and the like and naturally they controlled the insurance of these concerns which they placed with British insurance companies.

By the year 1885, 50 foreign offices commenced insurance business through agency houses. The majority of these offices were British and a few were from Australia, New Zealand and other continents. Some of these offices were members of the Fire Offices Committee formed in London in 1858 which introduced the East Indian Tariffs, which were observed by these offices in India. It was only in 1850 that an Indian Insurance Company was formed to transact general insurance, namely Triton Insurance Company.

Towards the end of the 19th century, the Indian businessmen in Western India started taking active interest in insurance business as brokers. During this period, fire insurance transactions were confined to the metropolitan cities of Bombay, Calcutta and Madras. These transactions were gradually extended to the other areas as industries developed outside these cities.

As a large number of offices were engaged in insurance business, competition was inevitable and the limited amount of business controlled by the brokers led to high rates of brokerage and commission.

Notwithstanding the competition, the brokers found themselves confronted with problems of a common nature and in 1882, they formed in Bombay an Association of Fire Insurance Agents. Similar associations were fromed in Calcutta in 1888 and in Madras in 1896.

The first Indian tariff for fire business was formed in 1894. The Bombay city and mofussil tariff was formed in 1895 followed by the

Calcutta tariff in 1900. In 1872, the first underwriters' association was established in Bombay. This association, worked in close conjunction with both the Fire Offices Committee and the Accident Offices Association of London.

As trade and industry developed there was an increase of insurance potential and many British offices. The insurance potential of the Indian market also attracted a few American offices. And in the early part of the 20th century insurance came to rest on a firm footing.

At this stage, the development of insurance in India was influenced by the Swadeshi movement which had gathered great momentum by then. The need for purely Indian insurance companies to cater to the insurance requirements of the mercantile community was keenly felt both on political and economic grounds and in 1907, the Indian Mercantile Insurance Company was established with Indian capital. This strong nationalist movement became stronger since then and at the end of the First World War seven of the largest Indian insurance offices were established.

The period between the two World Wars was a period of struggle for the newly established Indian insurance companies who with their limited experience had to contend with severe competition from the foreign insurers who had superior technical expertise and larger experience. The position was further aggravated by the fact that

Exchange Banks did not accord to recognition to the insurance policies issued by Indian insurance companies except upto small limits. In these unsettled conditions Government investigation became inevitable. Accordingly, in 1935 a special officer was appointed to investigate and report on insurance law reform and in 1938, the Indian Insurance Act was passed and brought into force in 1939. This Act incorporated the principle of uniform Government control over all insurers, both foreign and Indian. The Act was an important landmark in the history of insurance.

The Act made important provisions relating to the following :

(1) Statutory deposits and registration of insurers.

(2) Periodical returns to Government.

(3) Prohibition of rebating out of commission or premiums.

(4) Fixation of commission rates.

(5) Licensing of agents.

(6) Creation of the post of Superintendent of Insurance. (later redesigned as Controller of Insurance).

NOTE : This Act was a combined piece of legislation for life as well as general insurance business.

The period between 1940 and 1950 saw a steady development of Indian insurance. Under the strong influence of the Swadeshi spirit, Indian enterprise set up various industries like textiles, sugar, paper, cement, matches, paints, etc. These industries grew up under the protective tariffs. Moreover, as an indirect result of the Second World War which had broken in 1939, rapid expansion of Indian industries was helped. Naturally in this situation, the share of insurance business of the Indian insurance companies registered a sharp increase from 11 per cent in 1929 to 31 per cent in 1939.

The explosion which occurred on board of the S. S. Fort Stikine in Bombay Docks on 14th April 1944 created an extraordinary situation for the insurance industry. The war exclusion clause raised doubts about insurer's liability under the policies. However, the Government took a sympathetic view and issued the Bombay Explosion (Compensation) Ordinance, 1944, providing for compensation for losses of insured property. The scheme of compensation also extended to uninsured property and personal injuries.

The partition of the country in 1947 posed its own problems for the insurance industry. The cotton, wheat and jute growing territories of the Punjab, North West Frontier Province, Sind and Bengal were a highly developed market for fire insurance. The problem was aggravated by the large number of riot claims preferred against insurers. The settlement of the claims was a protracted process as there were difficulties in investigation and assessment due to lack of proper records which were destroyed in the riots.

During the Second World War period 10 composite offices (i.e. life and general) and 15 general offices were established as the direct result of the increase in insurance business potential with the purchase of several foreign business houses by Indian businessmen. The situation led to the appointment of Cowasjee Jahangir Committee whose recommendations, led to the amendment of the Insurance Act, 1938 in 1950. The principle changes were as follows :

(a) Limitation on expenses of management.

(b) Limitation of commission payable to principle agents and ordinary agents.

(c) Establishment of the Insurance Association of India.

The Act restricted the commission payable, to principal and ordinary agents. The principal agents, however, ceased to exist from 1957 from which date only ordinary agents were permitted. According to the amendment, the insurers had to regulate their management expenses including commission, within a scale prescribed under the Act.

The Act established a statutory association of insurers called the Insurance Association of India with Indian companies as members and foreign companies as associate members. The association had two councils - Life Insurance Council and General Insurance Council. The latter operated through the Executive Committee whose functions were to aid and advise insurers in the matter of rendering efficient service to policy holders and setting up standards of conduct and sound practices. The General Insurance Council also constituted the Tariff Committee to control and regulate rates, terms and conditions of the business. The Tariff Committee operated through the Regional Councils, in Bombay, Calcutta, Delhi and Madras.

The period from 1951 onwards was marked by a rapid development of insurance business, made possible by the large scale economic development through the successive Five Year Plans and increasing insurance consciousness among the people.

The insurers, Indian as well as foreign, operating in India formed the Indian Reinsurance Corporation, 1956, to provide reinsurance facilities. The reinsurance market was further strengthened by the setting up of another professional insurer, viz. The Indian Gurantee and General Insurance Company Limited in 1961 who received similar cessions, on a compulsory basis as the India Reinsurance Corporation.

The life insurance business was nationalised in 1956 and the Life Insurance Corporation of India was set up to transact life business on a monopoly basis. In the year 1964, the Life Insurance Corporation of India also entered the field of general insurance.

The need to save foreign exchange was particularly felt in marine hull insurance where the premiums are substantial and in accordance with the direction of the Reserve Bank of India, all Indian ships were insured in India since 1953. The capacity of the Indian insurance market being limited foreign reinsurance was still required, and the rates had to be fixed in consultation with London reinsurers. With the cooperation of the London Joint Hull Committee, in 1965, however, an Indian Hull Committee was formed under the aegis of the Tariff Committee, which assumed responsibility for rating Indian hulls.

To implement the accepted policy of the Government to introduce a socialistic pattern of society, there was a demand for nationalisation of general insurance. The Government took certain measures to introduce 'Social Control' in general insurance. In 1968, the Insurance Act was further amended which gave wide powers to the Controller of Insurance. There were also changes made in regard to the quantum of deposits to be paid into Reserve Bank of India, fees for registration of insurers and for obtaining agency licence.

On May 13, 1971, an Ordinance was promulgated by the President of India to take over the management of general insurance companies by the Government. In 1972, the General Insurance Business (Nationalisation) Act, 1972, was passed. Under the provisions of this Act, the General Insurance Corporation was established by the Government witheffect from 1st January 1973. All the 107 insurers were merged with one or the other of the four subsidiaries of the General Insurance Corporation (GIC) thereafter.