















SUGGESTED ANSWERS TO QUESTIONS

GROUP – A SECTION – A

1.

- (i) (A)
- (ii) (D)
- (iii) (A)
- (iv) (B)
- (v) (B)
- (vi) (D)
- (vii) (B)
- (viii) (C)

SECTION - B

2. (a)

Banks in the process of financial intermediation are confronted with various kinds of financial and non-financial risks viz., credit, interest rate, foreign exchange rate, liquidity, equity price, commodity price, legal, regulatory, reputational, operational, etc. These risks are highly interdependent and events that affect one area of risk can have ramifications for a range of other risk categories. Thus, top management of banks should attach considerable importance to improve the ability to identify, measure, monitor and control the overall level of risks undertaken.

The broad **parameters of risk management function** should encompass:

- (i) Organisational structure;
- (ii) Comprehensive risk measurement approach;
- (iii) Risk management policies approved by the Board which should be consistent with the broader business strategies, capital strength, management expertise and overall willingness to assume risk;
- (iv) Guidelines and other parameters used to govern risk taking including detailed structure of prudential limits;
- (v) Strong MIS for reporting, monitoring and controlling risks;
- (vi) Well laid out procedures, effective control and comprehensive risk reporting framework;
- (vii) Separate risk management framework independent of operational Departments and with clear delineation of levels of responsibility for management of risk; and
- (viii) Periodical review and evaluation.

2. (b)

Debt Repudiation refers to a situation of outright default where the borrower refuses to make any further payments of interest and principal. In contrast, debt rescheduling refers to temporary postponement of payments during which time new terms and conditions are agreed upon between the borrower and lenders. In most cases, these new terms are structured to make it easier for the borrower to repay.

Debt Rescheduling is typically pursued as a solution to financial distress or temporary difficulties in meeting debt obligations. It aims to provide the borrower with a revised repayment plan that is more manageable, allowing them to repay their debt over an extended period.

Debt repudiation can occur for various reasons, such as the borrower considering the debt to be illegitimate, unfair, or unsustainable. It is a more extreme measure taken when the borrower believes

that the debt was incurred under duress, fraud, or other circumstances that invalidate the debt's legitimacy. Debt repudiation often leads to legal disputes and can damage the borrower's reputation in the financial markets, making it harder for them to access credit in the future.

In summary, debt rescheduling involves renegotiating the terms of a debt agreement to make it more manageable for the borrower, while debt repudiation is the outright refusal to acknowledge or repay a debt obligation, often due to a belief that the debt is unjust or illegitimate.

3. (a)

The management of **Interest Rate Risk** should be one of the critical components of market risk management in banks. The regulatory restrictions in the past had greatly reduced many of the risks in the banking system. Deregulation of interest rates has, however, exposed them to the adverse impacts of interest rate risk. The Net Interest Income (NII) or Net Interest Margin (NIM) of banks is dependent on the movements of interest rates. Any mismatches in the cash flows (fixed assets or liabilities) or repricing dates (floating assets or liabilities), expose banks' NII or NIM to variations. The earning of assets and the cost of liabilities are now closely related to market interest rate volatility.

Interest Rate Risk (IRR) refers to potential impact on NII or NIM or Market Value of Equity (MVE), caused by unexpected changes in market interest rates. Interest Rate Risk can take different forms:

Gap or Mismatch Risk: A gap or mismatch risk arises from holding assets and liabilities and off-balance sheet items with different principal amounts, maturity dates or repricing dates, thereby creating exposure to unexpected changes in the level of market interest rates.

Basis Risk: Market interest rates of various instruments seldom change by the same degree during a given period of time. The risk that the interest rate of different assets, liabilities and off-balance sheet items may change in different magnitude is termed as basis risk. The degree of basis risk is fairly high in respect of banks that create composite assets out of composite liabilities. The Loan book in India is funded out of a composite liability portfolio and is exposed to a considerable degree of basis risk. The basis risk is quite visible in volatile interest rate scenarios. When the variation in market interest rate causes the NII to expand, the banks have experienced favourable basis shifts and if the interest rate movement causes the NII to contract, the basis has moved against the banks.

Embedded Option Risk: Significant changes in market interest rates create another source of risk to banks' profitability by encouraging prepayment of cash credit/demand loans/term loans and exercise of call/put options on bonds/debentures and/or premature withdrawal of term deposits before their stated maturities. The embedded option risk is becoming a reality in India and is experienced in volatile situations. The faster and higher the magnitude of changes in interest rate, the greater will be the embedded option risk to the banks' NII. Thus, banks should evolve scientific techniques to estimate the probable embedded options and adjust the Gap statements (Liquidity and Interest Rate Sensitivity) to realistically estimate the risk profiles in their balance sheet. Banks should also endeavour for stipulating appropriate penalties based on opportunity costs to stem the exercise of options, which is always to the disadvantage of banks.

Yield Curve Risk: In a floating interest rate scenario, banks may price their assets and liabilities based on different benchmarks, i.e., TBs yields, fixed deposit rates, call money rates, MIBOR, etc. In case the banks use two different instruments maturing at different time horizon for pricing their assets and liabilities, any non-parallel movements in yield curves would affect the NII. The movements in yield curve are rather frequent when the economy moves through business cycles. Thus, banks should evaluate the movement in yield curves and the impact of that on the portfolio values and income.

Price Risk: Price risk occurs when assets are sold before their stated maturities. In the financial market, bond prices and yields are inversely related. The price risk is closely associated with the trading book, which is created for making profit out of short-term movements in interest rates. Banks which have an

active trading book should, therefore, formulate policies to limit the portfolio size, holding period, duration, defeasance period, stop loss limits, marking to market, etc.

Reinvestment Risk: Uncertainty with regard to interest rate at which the future cash flows could be reinvested is called reinvestment risk. Any mismatches in cash flows would expose the banks to variations in NII as the market interest rates move in different directions.

Net Interest Position Risk: The size of non-paying liabilities is one of the significant factors contributing towards profitability of banks. When banks have more earning assets than paying liabilities, interest rate risk arises when the market interest rates adjust downwards. Thus, banks with positive net interest positions will experience a reduction in NII as the market interest rate declines and increases when interest rate rises. Thus, large float is a natural hedge against the variations in interest rates.

3. (b)

Market risk is defined as the risk of losses in on-balance sheet and off-balance sheet positions arising from movements in market prices.

The market risk positions subject to capital charge requirement are:

- ✓ The risks pertaining to interest rate related instruments and equities in the trading book; and
- ✓ Foreign exchange risk (including open position in precious metals) throughout the bank (both banking and trading books).

Scope and Coverage of Capital Charge for Market Risks

These guidelines seek to address the issues involved in computing capital charges for interest rate related instruments in the trading book, equities in the trading book and foreign exchange risk (including gold and other precious metals) in both trading and banking books. Trading book for the purpose of capital adequacy will include:

- ≈ Securities included under the Held for Trading category.
- ≈ Securities included under the Available for Sale category.
- ≈ Open gold position limits.
- ≈ Open foreign exchange position limits.
- ≈ Trading positions in derivatives, and
- ≈ Derivatives entered into for hedging trading book exposures.

The minimum capital requirement is expressed in terms of two separately calculated charges:

- “Specific risk” charge for each security, which is designed to protect against an adverse movement in the price of an individual security owing to factors related to the individual issuer, both for short (short position is not allowed in India except in derivatives and Central Government Securities) and long positions, and
- “General market risk” charge towards interest rate risk in the portfolio, where long and short positions (which is not allowed in India except in derivatives and Central Government Securities) in different securities or instruments can be offset.

4. (a)

The Major **Changes in Basel III** when compared to other accords Basel I and II are:

- (i) **Better Capital Quality:** One of the key elements of Basel III is the introduction of much stricter definition of capital. Better quality capital means the higher loss-absorbing capacity. This in turn will mean that banks will be stronger, allowing them to better withstand periods of stress.
- (ii) **Capital Conservation Buffer:** Another key feature of Basel III is that now banks will be required to hold a capital conservation buffer of 2.5%. The aim of asking to build conservation buffer is to ensure that banks maintain a cushion of capital that can be used to absorb losses during periods of financial and economic stress.
- (iii) **Counter cyclical Buffer:** This is also one of the key elements of Basel III. The countercyclical buffer has been introduced with the objective to increase capital requirements in good times and decrease the same in bad times. The buffer will slow banking activity when it overheats and will encourage lending when times are tough i.e., in bad times. The buffer will range from 0% to 2.5%, consisting of common equity or other fully loss-absorbing capital.
- (iv) **Minimum Common Equity and Tier 1 Capital Requirements:** The minimum requirement for common equity, the highest form of loss-absorbing capital, has been raised under Basel III from 2% to 4.5% of total risk-weighted assets. The overall Tier 1 capital requirement, consisting of not only common equity but also other qualifying financial instruments, will also increase from the current minimum of 4% to 6%. Although the minimum total capital requirement will remain at the current 8% level, yet the required total capital will increase to 10.5% when combined with the conservation buffer.
- (v) **Leverage Ratio:** A review of the financial crisis of 2008 has indicted that the value of many assets fell quicker than assumed from historical experience. Thus, now Basel III rules include a leverage ratio to serve as a safety net. A leverage ratio is the relative amount of Tier I capital to total assets (Not risk-weighted). This aims to put a cap on swelling of leverage in the banking sector on a global basis. Banks were expected to maintain a leverage ratio of over 3% under Basel III.
- (vi) **Systemically Important Financial Institutions (SIFI):** As part of the macro-prudential framework, systemically important banks will be expected to have loss-absorbing capability beyond the Basel III requirements. Options for implementation include capital surcharges, contingent capital and bail-in-debt.

4. (b)

A credit default swap is an agreement between the buyer and seller to exchange the borrower's credit risk. It can be thought of as insurance against credit risk.

The CDS buyer buys protection by making periodic payments to the seller until the end of the CDS life, or a credit event occurs. Buying protection has a similar credit risk position to selling a bond short.

On the other hand, the CDS seller collects periodic payments and profits, if the issuer's credit remains stable or improves, while the swap is outstanding. Selling protection has a similar credit risk position to owning a bond or loan.

In the given scenario, a Credit Default Swap (CDS) can help the bank manage its exposure to the A-rated oil company and address its concerns about a significant credit commitment. Here's how a CDS can assist the bank:

- (i) **Risk Mitigation:** The bank can enter into a CDS contract with a counterparty, typically an insurance company or another financial institution. By purchasing a CDS, the bank can effectively transfer the credit risk associated with the ₹900 crs. credit commitment to the counterparty.
- (ii) **Exposure Limit:** The bank's credit portfolio management team has placed a limit of ₹300 crs. for the credit exposure to the oil company. By using a CDS, the bank can limit its direct exposure to

₹300 crs. while still accommodating the oil company's credit request of ₹900 crs. The remaining ₹600 crs. of credit exposure is covered by the CDS counterparty.

- (iii) **Default Protection:** In the event of a credit event or default by the oil company, the CDS contract would be triggered, and the counterparty would be responsible for compensating the bank for the losses incurred. This provides a measure of protection to the bank against potential default or credit deterioration of the oil company.
- (iv) **Risk Transfer:** Through the CDS, the bank transfers the credit risk associated with the ₹600 crs. credit commitment to the counterparty. This allows the bank to mitigate the potential losses and reduce its direct exposure to the oil company, addressing its concerns about significant exposure.
- (v) **Capital Optimization:** By utilizing a CDS, the bank can optimize its capital allocation. Instead of allocating the full ₹900 crs. credit commitment to the oil company, the bank can allocate a smaller portion while relying on the CDS to cover the remaining exposure. This enables the bank to manage its capital more efficiently and potentially deploy it to other lending opportunities.

5. (a)

Operational risk has been defined by the Basel Committee on Banking Supervision as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition is based on the underlying causes of operational risk. It seeks to identify why a loss happened and at the broadest level includes the breakdown by four causes: people, processes, systems and external factors. The Basel Committee has identified the following types of operational risk events as having the potential to result in substantial losses:

- ≈ Internal fraud: For example, intentional misreporting of positions, employee theft, and insider trading on an employee's own account.
- ≈ External fraud: For example, robbery, forgery, cheque kiting, and damage from computer hacking.
- ≈ Employment practices and workplace safety: For example, workers compensation claims, violation of employee health and safety rules, organized labour activities, discrimination claims, and general liability.
- ≈ Clients, products and business practices: For example, fiduciary breaches, misuse of confidential customer information, improper trading activities on the bank's account, money laundering, and sale of unauthorized products.
- ≈ Damage to physical assets: For example, terrorism, vandalism, earthquakes, fires and floods.
- ≈ Business disruption and system failures: For example, hardware and software failures, telecommunication problems, and utility outages.
- ≈ Execution, delivery and process management: For example: data entry errors, collateral management failures, incomplete legal documentation, and unauthorized access given to client accounts, non-client counterparty mis-performance, and vendor disputes etc.

5. (b)

Off-balance sheet exposures are contingent in nature. Where banks issue guarantees, committed or backup credit lines, letters of credit, etc., banks face payment obligations contingent upon some event. These contingencies adversely affect the revenue generation of banks. Banks may also have contingent assets (for example, a bank may have purchased insurance to protect against certain negative events). Here banks are the beneficiaries subject to certain contingencies. Derivatives are off-balance sheet market exposures. They may be swaps, futures, forward contracts, foreign currency contracts, options, etc.

Contingent exposure may become a fund-based exposure. Such exposures may become a part of the banking book or trading book, depending upon the nature of off-balance sheet exposure. Therefore, off-balance sheet exposures may have liquidity risk, interest rate risk, market risk, default or credit risk and operational risk. A bank should also examine the potential for substantial cash flows from its off-balance sheet activities (other than the loan commitments already considered), even if such cash flows are not always a part of bank's current liquidity analysis.

Contingent liabilities, such as letters of credit and financial guarantees, represent potentially significant cash drains for a bank, but are usually not dependent on a bank's condition. A bank may be able to ascertain a 'normal' level of cash outflows on an ongoing concern basis, and then estimate the scope for an increase in these flows during periods of stress. However, a general market crisis may trigger a substantial increase in the amount of draw downs of letters of credit because of an increase in defaults and bankruptcies in the market.

Other potential sources of cash outflows include swaps, written over-the-counter (OTC) options, and other interest rate and forward foreign rate contracts. If a bank has a large swap book, for example, then it would want to consider the circumstances under which the bank could become a net payer, and whether or not the potential net pay out is significant. For example, if a bank is a swap market-maker, the possibility exists that in a bank-specific or general market crisis, customers with in-the-money swaps (or a net in-the-money swap position) would seek to reduce their credit exposure to the bank by asking the bank to buy outstanding warrants, together with any hedges against these positions, since certain types of crisis may simulate an increase in early exercise (for American style options) or requests that the bank repurchase options. These exercise and repurchase requests could result in an unforeseen cash drain, if hedges are either quickly liquidated to generate cash or to meet insufficient cash requirements.

SECTION - C

6. Report to the Management:

To

The Management
PRAKS BANK

Subject: Asset Liability Management Policy Recommendations

Dear Management,

Following our detailed discussion on Asset Liability Management (ALM), I have formulated a policy proposal based on the guidelines issued by the Reserve Bank of India (RBI) regarding the placement of volatile portions of money in different maturity buckets. The policy aims to effectively manage capital, reserves, and deposit accounts while adhering to the RBI guidelines.

Placement of Current and Saving Account Deposits:

According to the RBI guidelines, savings bank deposits and current account deposits are classified into volatile and core portions. The volatile portion comprises 10% of savings bank deposits and 15% of current account deposits. The placement of these portions is as follows:

a. Volatile Portion (to be placed in 14 days bucket):

Savings Bank Deposits = ₹400 Crore

Current Account Deposits = ₹150 Crore

b. Core Portion (to be placed in 1-3 years bucket):

Savings Bank Deposits = ₹3,600 Crore

Current Account Deposits = ₹850 Crore

Placement of Term Deposits (up to less than 12 months maturity):

The term deposits are to be placed in their respective maturity buckets as follows:

1 month maturity bucket:	₹400 Crore
1 month to less than 3 months maturity bucket:	₹800 Crore
3 months to less than 6 months maturity bucket:	₹1,200 Crore
6 months to less than 12 months maturity bucket:	₹2,000 Crore
Total:	₹4,400 Crore.

Other Relevant Information:

Capital: ₹1,180 Crore

Reserves: ₹12,000 Crore

Borrowing from RBI: ₹400 Crore

The capital and reserves are to be placed in over 5 Years' Bucket as per RBI guidelines.

Please note that the proposed placements are in line with the RBI guidelines on Asset Liability Management, which aim to ensure effective management of the bank's assets and liabilities while considering the maturity profiles.

Should you require any further information or clarification, please do not hesitate to contact me. I am available to discuss the details of this report and address any questions you may have.

Thank you for your attention to this matter.

Sincerely,

Management Accountant

**GROUP - B
SECTION - A**

7.

- (i) (D)
- (ii) (D)

SECTION – B

8. (a)

A person is said to possess an **insurable interest** in a property, if he has a legal relationship with the said property, by which he would stand to lose financially, if the property is lost or destroyed. The principle of insurable interest adds legal validity to an insurance contract without which such contracts would be wagering or gambling in nature according to the Indian Contract Act 1872. Presence of insurable interest prevents fraudulent practices. In the absence of insurable interest, an unconcerned person can purchase policies on someone else's property and inflict loss on it deliberately to get the proceeds of the insurance settlement. Insurable interest provides the right to secure insurance and claim compensation to the insured based on the principle of indemnity. For example, people have insurable interests in their own homes and vehicles, but not in their neighbor's homes and vehicles, and almost certainly not those of strangers.

An insurance contract must meet four conditions in order to be legally valid:

- it must be for a legal purpose;
- the parties must have a legal capacity to contract;
- there must be evidence of a meeting of minds between the insurer and the insured;
- there must be a payment or consideration.

To claim the amount of insurance, the insured must be the owner of the subject matter, both, at the time of entering the contract & at the time of the accident.

8. (b)

Nomination is a facility that enables a policy holder to nominate an individual who can claim the proceeds of the policy upon the demise of the policy holder. Nomination is dealt with under Section 39 of the Insurance Act, 1938 which lays down that the policy holder who holds a policy of insurance on his own life, may nominate the person or persons to whom the money secured by the policy shall be paid in the event of death.

Where the nominee is a minor, a major should be appointed to receive the money secured by the policy in the event of death of the policy holder during the minority of the nominee.

Difference between Nomination and Assignment:

Nomination	Assignment
Nomination is appointing some person(s) to receive policy benefits only when the policy has a death claim.	Assignment is transfer of rights, title and interest of the policy to some person(s).
By merely nominating someone, the right, title and interest of the insured over the policy is not transferred straight forwardly to that nominated person and remains with the insured person only	The insurer is bound to pass over the benefits, claims and / or interests to the assigned person(s). Even during the time, the insured is alive (or even prior to the death of the insured person). Since the policy benefits are assigned till the time the assignment is revoked once again.
Nomination is done at the instance of the Insured.	Along with the instance of the insured, consent of insurer is also required.
It can be changed or revoked several times.	Normally assignment is done once or twice during the policy period. Assignment can be normally revoked after obtaining the "no objection certificate" from the concerned Assignees.
No attestation is prescribed in case of nomination.	Attestation is required in case of assignment.

9. (a)

A **Unit Linked Insurance Plan (ULIP)** is a product offered by insurance companies that, unlike a pure insurance policy, gives investors both insurance and investment under a single integrated plan.

A Unit Link Insurance Plan is basically a combination of insurance as well as investment. A part of the premium paid is utilized to provide insurance cover to the policy holder, while the remaining portion is invested in various equity and debt schemes.

The money collected by the insurance provider is utilized to form a pool of fund that is used to invest in various markets instruments (debt and equity) in varying proportions just the way it is done for mutual funds. Policy holders have the option of selecting the type of funds (debt or equity) or a mix of both based on their investment need and appetite. Just the way it is for mutual funds, ULIP policy holders are also allotted units and each unit has a net asset value (NAV) that is declared on a daily basis. The NAV is the value based on which the net rate of returns on ULIPs are determined. The NAV varies from one ULIP to another based on market conditions and the fund's performance.

The significant difference between a protection cum savings plan and a ULIP:

ULIP	Protection-cum-Savings Plan
ULIPs are instruments which provide both protection against death of insurer and savings along with investment options.	Protection-cum-Saving Plan are instruments which provide both protection against the life style after retirement, Child Education, Child Future and Savings.
Lock in Period is 5 Years	Lock in Period is 15 Years
Most of the ULIPs allow the investors to track the portfolio.	In this plan, investment premium is common with the fund. Hence, investor cannot track individual portfolio.
One can redeem units at the prevailing unit prices.	Policyholder will get the sum assured plus bonuses, as per the plan.

9. (b)

Engineering Insurance:

Engineering insurance is a type of insurance policy wherein a wide range of risks related to engineering are covered. It is a comprehensive insurance policy that offers economic safeguard against risks faced by ongoing construction projects, installation projects, and machines and equipment in project operation.

Engineering insurance covers the various risks in a manufacturing organization, especially plants. The various categories of Engineering insurance are as follows:

- i. Contractors All Risks Policy – designed to protect the interests of contractors and principals in respect of civil engineering projects like buildings, bridges, tunnels etc.
- ii. Erection All Risks Policy – is concerned with erection of electrical plant and machinery and equipment and structures involving no or very little civil engineering work.
- iii. Marine-cum-erection Policy – comments with the delivery of the first consignment of plant and machinery at the site of erection.
- iv. Machinery breakdown Policy–Insurable property include boilers, electrical, mechanical and lifting equipment.
- v. Contractors Plant & Machinery Policy – Policy given to a Contractor who may be using his plant and machinery at different projects during the course of the year.
- vi. Boiler & Pressure Plant Policy.
- vii. Machinery Loss of Profits Policy or Machinery insurance indemnify an insured against material damage resulting from breakdown or explosion or collapse of machinery – such damage may also result in business interruption at the Insured's premises.
- viii. Advance Loss of Profits Policy – risk of delay of project due to accidental damage to project materials.
- ix. Deterioration of Stock Policy – covers loss due to breakdown of refrigeration.
- x. Electronic Equipment Policy - physical loss or damage necessitating repairs or replacement.
- xi. External Data Media – covers cost of replacing damaged external storage media.
- xii. Increased cost of working – indemnifies against all additional cost incurred to ensure continued data processing on substitute equipment, if such costs are incurred as an unavoidable consequence of loss or damage indemnifiable under material damage section of the policy.

10. (a)

In carrying on its business as an insurer, a company assumes a risk of the proposer in regard to life or assets for the payment of premium. Such a risk will arise in the future, in life cases after a long period of time depending on the term of the policy and on non-lives after a little while during the contracted period of cover. The quantum of risks so assumed by an insurer has to be provided for. It may so happen that the quantum of risk so assumed by an insurer may exceed its capacity to bear. In each circumstance, the concept of re-insurance plays a leading role.

Reinsurance is also known as insurance for insurers or stop-loss insurance. Reinsurance is the practice whereby insurers transfer portions of their risk portfolios to other parties by some form of agreement to reduce the likelihood of paying a large obligation resulting from an insurance claim.

The party that diversifies its insurance portfolio is known as the ceding party. The party that accepts a portion of the potential obligation in exchange for a share of the insurance premium is known as the reinsurer.

The agreement or the arrangement for re-insurance is primarily between two insurance companies and the insured do not have any role to play in the arrangement. The insured cannot and does not have any recourse of claim against the re-insurer and as far as the insured is concerned, the liability to discharge any claims under the policy stays wholly and clearly is with the insurer.

The quantum of re-insurance depends on the volume of business underwritten by the primary insurer and also the quality of risks underwritten. In cases, where costly assets are under-written or where the sum assured is beyond the capacity of the insurer to bear, the part or whole of the risk is passed on to one or more re-insurers for the payment of a premium. Where a claim under the policy arises, the insurer will discharge the liability under the policy to the insured and claim contribution from the re-insurer(s).

The assessment of re-insurance pass over is determined by a combination of factor like the financial strength of the insurer, the seriousness of risk, the quantum of the cover etc. The choice of the re-insurance is left to the insurer but IRDAI has the regulatory function in that. The re-insurance programme of an insurer must be submitted to the IRDAI and its clearance obtained before the start of the year. In granting the approval, the IRDAI will go by the character of risks, the type of re-insurance cover contemplated, the portion of the risk that is planned to be passed on, the payment record of the reinsurer and about the availability of re-insurance policies in the Indian market. Care will be taken to see that an insurer does not pass the entire risk, without retaining any part of it, to the re-insurer making a mere conduit in the processes. This will mean that the Indian insurer is only a front and the device adopted by it will mean the presence of a foreign party in the Indian market.

There are two types by of re-insurance arrangement prevalent in the market. Facultative and treaty re-insurance programmes. In the case of the former, an arrangement is entered into between the insurers for every policy that is insured. It is purchased by the leading companies for individual risks for amount in excess of their limits. A treaty re-insurance means that a leading company and the re-insurer negotiate and execute a contract under which the re-insurer cover a specific share of all the insurance policies issued by the insurer under a particular line of business.

In India, a practice used to exist that all companies wanting to have re-insurance contracts must offer a fixed percentage of the risks to the General Insurance Corporation of India-designated as a national re-insurer. This was meant to save valuable foreign exchange which otherwise used to be spent on payment of re-insurance premium to the foreign re-insurer and brokers. With the establishment of branches of foreign re-insurers in India after 2015, this feature has been slowly given up. Large risk like Air India, ONGC, GAIL, Reliance, etc. still continues to be covered by proper re-insurance agreements, retaining parts of the risk by the insurer, other Indian companies, GIC, etc. The reinsurance market in India is developing on professional lines.

10. (b)

Loss control is a risk management technique that seeks to reduce the possibility that a loss will occur and/or reduce the severity of those that do occur. Loss control involves identifying risks and is accompanied by voluntary or required actions one should undertake to reduce risk.

Loss control programs benefit both policyholders and insurers. As mentioned above, policyholders may benefit from lower premiums, while insurers are able to cut down on their costs associated with having to pay out claims. Insurance companies identify activities that cause a claim to be filed by the insured, and attempt to reduce the odds of these activities occurring so they don't have to pay out claims and dip into profits. Main Objectives of Loss control are

Loss prevention:

Loss prevention aims at reducing the probability of loss so that frequency of losses is reduced, e.g., if you follow good health habits, watch your weight and give up smoking, the chances of heart attacks are minimized. Loss prevention is important for business of the enterprises as loss frequency can be reduced by enforcement of strong safety measures.

Loss reduction:

Loss reduction involves reduction in severity of loss. This can be achieved by installing sprinkler system in a warehouse which would help in speedy extinguishment of fire, installing perfect partition wall between two highly inflammable commodities, practicing segregation and constructing of fire-resistant materials to minimize losses.

SECTION - C

11. (a)

Since the claim lodged by Mr. H has been turned down by M/s Z General Insurance Company on the ground that “Spontaneous Combustion” is not covered under a standard fire policy, he can take up the matter with insurance ombudsman (Legal Representative) of his state and file a complaint with that office. The ombudsman is an internal redressal machinery of insurer created by the industry with the backing of the central government. The decision of the ombudsman is binding on the Insurance Company, but not the claimant. The ombudsman would look into the entire matter of issuance of cover note by the insurer without any stipulation and give the benefit to the claimant.

The very fact that there was no warranty stipulated in the cover note strengthens the case of the claimant, and benefit of doubt must go in his favour.

If Mr. H still does not get justice, then he can approach the District Forum and State Forum for redressal of his grievance.

11. (b)

A Cover Note is a temporary risk document issued by the insurer till it is replaced by a stamped policy document. Insurers all over the world honour this document. The cover note describes the risk proposed for insurance and also stipulates conditions which are relevant and necessary.

In the present case, since no warranty pertaining to “Spontaneous Combustion” being an excluded Peril was incorporated in the Cover note issued by the insurer, it cannot disown its liability under the claim at this stage. The claim will have to be honoured by the insurer.
