Q) What is insurance contract? What are the nature of insurance contract?

Ans: An insurance contract is a legal agreement that spells out the responsibilities of both the insurance company and the insured, as well as the specific conditions of coverage and the policy term and cost. An insurance contract is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. standard features of an insurance contract include the offer and the acceptance, consideration, legal capacity and purpose, and indemnification.

## Nature or Characteristics of Insurance

On the basis of the definitions of insurance discussed above, one can observe the following nature or characteristics:

### 1. Contract

Insurance is a contract between the insurance company an

d the policyholder wherein the policyholder (insured) makes an offer and the insurance company (insurer) accepts his offer. The contract of insurance is always made in writing.

### 2. Consideration

Like other contracts, there must be lawful consideration in insurance also. The consideration is in the form of premium which the insured agrees to pay to the insurer.

### 3. Co-operative Device

All for one and one for all is the basis for cooperation. The insurance is a system wherein large number of persons, exposed to a similar risk, are covered and the risk is spread over among the larger insurable public. Therefore, insurance is a social or cooperative method wherein losses of one is borne by the society.

### 4. Protection of financial risks

An insurer is protected from financial risks which can be measured in terms of money. As such insurance compensates only financial or monetary loss or risks.

### 5. Risk sharing and risk transfer

Insurance is a social device for division of financial losses which may fall on an individual or his family on the happening of some unforeseen events. When insured, the loss arising out of the events are shared by all the insured in the form of premium. Therefore the risk is transferred from one individual to a group.

### 6. Based upon certain principles

The insurance is based upon certain principles like insurable interest, utmost good faith, indemnity, subrogation, causa-proxima, contribution, etc.

### 7. Regulated by Law

Insurance companies are regulated by statutory laws in almost all the countries. In India, life insurance and general insurance are regulated by Life Insurance Corporation of India Act 1956, and General Insurance Business (Nationalization) Act 1972, and IRDA Regulations etc.

### 8. Value of Risk

Before insuring the subject matter of the [insurance contract](https://accountlearning.com/characteristic-features-of-an-insurance-contract/), the risk is evaluated in order to determine the amount of premium to be charged on the insured. Several methods are being adopted to evaluate the risks involved in the subject matter. If there is an expectation of heavy loss, higher premiums will be charged. Hence, the probability of occurrence of loss is calculated at the time of insurance.

### 9. Payment at contingency

An insurer is liable to pay compensation to the insureds only when certain contingencies arise. In life insurance, the contingency — the death or the expiry of the term will certainly occur. In such cases, the life insurer has to pay the assured sum.

### 10. Insurance is not gambling

An insurance contract cannot be considered as gambling as the person insured is assured of his loss indemnified only on the happening of such uncertain event as stipulated in the contract of insurance, whereas the game of gambling may either result into profit or loss.

### 11. Insurance is not a charity

Premium collected from the policyholders under an insurance is the cost of risk so covered. Hence, it cannot be taken as charity. Charity lacks the element of [contract of indemnity](https://accountlearning.com/classification-contracts-formation-performance-execution-contracts/) and compensation of loss to the person whosoever makes it.

### 12. Investment portfolio

Since insurers’ liability to pay compensation to the insured arises on the happening of certain uncertain event, the insurers do not have to keep the collected premium with them. They invest the premium received in selected securities and earn interest and dividend on them. Thus, the insurers have two sources of income: the insurance premium and the investment income (i.e. interest / dividend) which occurs over time.