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L.L.B Part- 2nd

Subject- Insurance Act

Paper- 8th

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Topic- Discuss the physical and Moral Hazards in fire Insurance.

Physical hazards in fire insurance-

The insurance industry uses the terms like risks, perils and hazards to differentiate between various conditions of insurance. The possibility of loss is denoted by the term 'risk', whereas the term 'peril' denotes the cause of the loss. The condition that increases the possibility of the loss is denoted by the term 'hazard'.

Physical hazards in fire insurance mean any physical condition that increases the possibility of a loss. These physical hazards can include any material, structural, or operational features of the business. Such physical hazards create or increase the opportunity for injury or damage caused due to fire.

The insurance company needs to have a detailed knowledge of the physical hazard while underwriting the policy and deciding whether to accept the risk. This helps them to decide the insurance terms, rates, nature, premium and other conditions for the fire insurance policy. The physical hazards in the fire insurance indicate the dangers of the subject of the insurance. Such hazards can be identified by the inspection of the risk.

Following are the physical hazards in the fire insurance:

Nature of the construction material:

Here the physical hazards are the material used in construction. The nature of the material, whether they are combustible or non-combustible plays an important role here.

The lighting and the heating system in the premises:

The system of the lighting and the heating in the premises can be a physical hazard. The wire and the cable material of the building can cause a fire. It is essential that these elements are in good shape and are not worn-out.

Unclear premises:

Fire can spread easily if there is rubbish scattered everywhere. Such rubbishes can be of a hazardous nature as far as the fire insurance is considered.

Smoking cigarette in the premises:

Smoking is the enemy of the inflammable materials. Especially in factories, where there is combustible material present, indiscriminate smoking becomes a physical hazard.

Nature of business occupation:

Any business involved in the usage of petroleum, kerosene or chemicals, the probability of the hazard increases. Such materials are considered as physical hazards in fire insurance.

Nature of the adjoining premises:

A fire can spread quickly from the adjoining premises to the premises of the insured. Hence the nature, construction, and the occupation of such adjoining premises are considered as the physical hazard.

Moral Hazards in Fire Insurance-

The purpose of a fire insurance is to offer you financial coverage in case of loss or damage due to fire. Further, a fire insurance policy comprises of hazard, which is a condition which increases the chances of risk in an insured peril.

Moral hazard is a situation in which one party gets involved in the risky situation or ignores safety measures, knowing that is safeguarded against the risk and there is the other party who will incur all the losses.

In case of moral hazard in fire insurance policy, the hazards are related to the attitude and conduct of people. It means, they comprise of those dangers which are linked with the honesty, integrity and character of the policyholder. Further, those losses result from the dishonesty of the policyholder or his/her team. Due to such claims, fire insurance companies have to suffer monetary losses.

Usually, moral hazards happen when the policyholder clearly understands that someone else will pay for his/her mistakes. As a result, the policyholder acts carelessly. It, in turn, gives them the incentive to act carelessly and more riskily. This economic concept is called moral hazards.

Moral hazards can be influenced by the decisions taken by the policyholder after the fire insurance contract is signed. The expenditure or cost incurred by the policyholder in order to mitigate risk is counted as the individual's care.

Case: 1

Established in 2002, L.S Engineering made a name for itself in the engineering business. To ensure the complete protection, the company purchased a fire insurance for its office. The coverage available under the fire insurance policy was Rs 10 lakh. As the company had purchased a fire insurance, it started acting carelessly and did not pay heed towards the safety of its workplace. Neither the company installed fire sprinklers or extinguishers, nor it paid attention towards the maintenance of buildings.

Last year, a fire erupted at the office due to spark in the machines. In the absence of fire extinguishers, the fire spread fast and damaged goods worth Rs 10 lakh. As the company had a fire insurance policy, it approached the insurer for the claim settlement.

The fire insurance company appointed a surveyor who came to inspect the site and submitted its final report to the insurer. Though the claim of L.S Engineering was valid, and the insurer paid the claim, it was the case of moral hazards in a fire insurance.

It was not mentioned in the fire insurance policy document bought by L.S Engineering that it should install fire extinguishers and other mechanisms, however, the company was morally responsible for taking immediate actions to prevent the fire and curtail its impact after the accident.

Just because, L.S Engineering had a fire insurance policy, it doesn't mean, it can act carelessly. It was the duty of L.S Engineering to take all the steps to mitigate losses or damages.

Case: 2

Nearly ten years ago, Minal Joshi bought a fire insurance policy for her office. She also purchased a fire insurance for her office after learning the lesson from the fire occurred in her neighborhood in which goods worth Rs 50 lakh got damaged. In the absence of a fire insurance policy, the owner had to incur all losses by own.

Though Minal bought a fire insurance policy for her office; she did not pay attention towards the maintenance of her office building. All the electric cables were outdated, due to which a short-circuit happened and the fire erupted at the office.

Unfortunately, due to fire, goods worth Rs 20 lakh got damaged. As Minal had a fire insurance policy, she approached the fire insurance company for the claim settlement. It was a legitimate claim, and therefore, the insurer settled it.

However, it was the case of moral hazards. Minal did not pay attention towards the safety of her office building as she thought she had a fire insurance policy and it would take care of all her expenses. Due to this reckless attitude of Minal, the fire insurance company had to incur losses by settling the huge claim amount.

The End