

ANALYSIS OF PROVISIONS OF SECTION 45 OF THE INSURANCE ACT, 1938

Dear Friends,

As you are aware that Insurance is a promise made by an insurance company to the insured to indemnify him from financial loss on occurrence of insured risk/s. An Insurance Policy is a contract between insured and the insurance company and based on the principle of good faith. An insured is required to disclose all material facts to the insurance company so that insurance company assess the risk associated with the proposal and charge appropriate premium.

PRINCIPLES AND CHARACTERISTICS OF AN INSURANCE CONTRACT

The following are the fundamental principles and characteristics of an insurance contract :

1. ESSENTIALS OF A VALID CONTRACT

An insurance contract is just like any other contract, and hence it has the essentials of a valid agreement, as per Section 10 of the Indian Contract Act, 1872. The following are the features of a valid contract:

- i) Offer and acceptance,
- ii) Competency of parties,
- iii) Free consent,
- iv) Lawful consideration,
- v) Lawful object.

2. INDEMNITY CONTRACT

Indemnity is one of the main purposes of an insurance contract. Section 124 of the Indian Contract Act, 1872, has defined indemnity contract as an agreement between two parties where one party promises to save the other from some loss that would occur to him due to the conduct of the promisor himself or any other person.

But one cannot make a promise to indemnify another from loss caused to him due to something caused not by a human, like the Act of God.

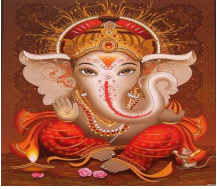
Thus, the concept of life insurance falls outside the purview of indemnity, as per the decision in *Gajanan Moreshwar v. Moreshwar Madan Mantri*.

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



3. ALEATORY CONTRACT

An aleatory contract is a type of contingent contract whose performance depends on the occurrence of an uncertain event, beyond the control of both parties. Such events are usually natural disasters and deaths. This concept can be seen in many insurance policies and thus, aleatory contracts are sometimes called aleatory insurance. Under such insurance policies, the insurer has to pay only when an uncertain event occurs.

***For example,** A and B enter into a contract where A promises to provide B with financial support if B's house catches fire. Here, B's house catching fire is an uncertain event. The contract can be performed only when B's house catches fire and not any time before that.*

4. UBERRIMAE FIDEI

Insurance contracts are contracts of uberrimae fidei. The term 'uberrimae fidei' means 'good faith'. This means that, in a contract of insurance, both the insurer and the insured must be fully transparent with each other about all the material facts, and not withhold any information that goes against the interest of the other party.

5. CONTRACT OF ADHESION

Insurance policies are normally standardised and fixed. Thus, as the terms of an insurance policy are not formed with the consent of the insured, the insurer must explain the clauses in the insurance policy to the insured. The insurer party is at an advantage as the insured does not get to negotiate on the terms of the contract. The insured must understand all the terms well and choose the policy that suits his interests the best.

6. PRINCIPLE OF SUBROGATION

The term subrogation also means substitution, where one party is substituted by another party, which allows a third party to sue and claim damages on behalf of another. This principle is used frequently in insurance contracts. It allows the insurer to have all the rights that the insured has against the third party who caused an insurance loss to the insured. Thus, after the insured faces losses, the insurance company pays for those losses and then claims reimbursement from the other party or his insurance company.

7. INSURABLE INTEREST

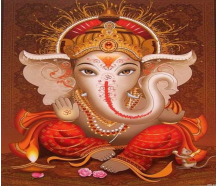
Insurable interest is one of the requisite elements in an insurance contract. A thing is insurable only if the insured will face pecuniary losses when it is destroyed. Thus, the insured must have an actual financial interest in the subject matter of the insurance contract.

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



8. PRINCIPLE OF CONTRIBUTION

In some instances, an insured may subscribe to multiple insurance policies in respect of the same subject matter, and it is not forbidden by law. It is also called double or multiple insurances. In such cases, the insured cannot make more than one claim for the same loss to make a profit.

9. REINSURANCE

In certain situations, the insurer might get the insured property, reinsured by another insurer, if he fears that an insurance claim above his capacity may arise. It is also called 'insurance for insurance'.

10. PRINCIPLE OF LOSS MINIMIZATION

According to this principle, the insured must take the necessary steps, like any reasonable prudent man, in taking care of the subject matter of the insurance contract, so that financial losses to the subject matter are reduced as much as possible.

11. PRINCIPLE OF PROXIMATE CAUSES

In some instances, an accident may be caused by multiple causes. In such cases, it is the nearest or the most proximate cause that must be taken into account. The insurer would pay only for the nearest cause.

SECTION 45 OF THE INSURANCE ACT, 1938- *The strict construction of term "Warranty" for breach of which the entire contract is avoided, regardless of the materiality of the statement, is now subject to the provisions of Section 45.*

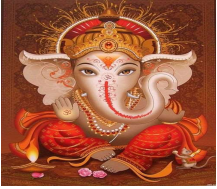
"POLICY NOT TO BE CALLED IN QUESTION ON GROUND OF MIS-STATEMENT AFTER TWO YEARS.—*No policy of life insurance effected before the commencement of this Act shall after the expiry of two years from the date of commencement of this Act and no policy of life insurance effected after the coming into force of this Act shall after the expiry of two years from the date on which it was effected, be called in question by an insurer on the ground that a statement made in the proposal for insurance or in any report of a medical officer, or referee, or friend of the insured, or in any other document leading to the issue of the policy, was inaccurate or false, unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that it was fraudulently made by the policy-holder and that the policy-holder knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose:*

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



Provided that nothing in this section shall prevent the insurer from calling for proof of age at any time if he is entitled to do so, and no policy shall be deemed to be called in question merely because the terms of the policy are adjusted on subsequent proof that the age of the life insured was incorrectly stated in the proposal.

PLEASE NOTE THAT: *the provisions of Section 45 have been amended by Insurance Laws(amendment) Act,2015 , came into effect from 26/12/2014.*

The amended Section provides as follows:

(1) No policy of life insurance shall be called in question on any ground whatsoever after the expiry of three years from the date of the policy, i.e., from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later.

(2) A policy of life insurance may be called in question at any time within three years from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later, on the ground of fraud:

Provided that *the insurer shall have to communicate in writing to the insured or the legal representatives or nominees or assignees of the insured the grounds and materials on which such decision is based.*

Explanation I.—*For the purposes of this sub-section, the expression "fraud" means any of the following acts committed by the insured or by his agent, with intent to deceive the insurer or to induce the insurer to issue a life insurance policy:—*

(a) the suggestion, as a fact of that which is not true and which the insured does not believe to be true;

(b) the active concealment of a fact by the insured having knowledge or belief of the fact;

(c) any other act fitted to deceive; and

(d) any such act or omission as the law specially declares to be fraudulent.

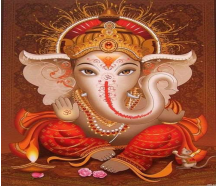
Explanation II.—*Mere silence as to facts likely to affect the assessment of the risk by the insurer is not fraud, unless the circumstances of the case are such that regard being had to them, it is the duty of the insured or his agent keeping silence, to speak, or unless his silence is, in itself, equivalent to speak.*

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



(3) Notwithstanding anything contained in sub-section (2), no insurer shall repudiate a life insurance policy on the ground of fraud if the insured can prove that the misstatement of or suppression of a material fact was true to the best of his knowledge and belief or that there was no deliberate intention to suppress the fact or that such misstatement of or suppression of a material fact are within the knowledge of the insurer:

Provided that in case of fraud, the onus of disproving lies upon the beneficiaries, in case the policyholder is not alive.

Explanation.—A person who solicits and negotiates a contract of insurance shall be deemed for the purpose of the formation of the contract, to be the agent of the insurer.

(4) A policy of life insurance may be called in question at any time within three years from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later, on the ground that any statement of or suppression of a fact material to the expectancy of the life of the insured was incorrectly made in the proposal or other document on the basis of which the policy was issued or revived or rider issued:

Provided that the insurer shall have to communicate in writing to the insured or the legal representatives or nominees or assignees of the insured the grounds and materials on which such decision to repudiate the policy of life insurance is based:

Provided further that in case of repudiation of the policy on the ground of misstatement or suppression of a material fact, and not on the ground of fraud, the premiums collected on the policy till the date of repudiation shall be paid to the insured or the legal representatives or nominees or assignees of the insured within a period of ninety days from the date of such repudiation.

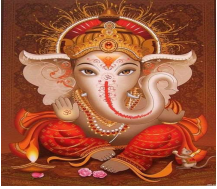
Explanation.—For the purposes of this sub-section, the misstatement of or suppression of fact shall not be considered material unless it has a direct bearing on the risk undertaken by the insurer, the onus is on the insurer to show that had the insurer been aware of the said fact no life insurance policy would have been issued to the insured.

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



(5) Nothing in this section shall prevent the insurer from calling for proof of age at any time if he is entitled to do so, and no policy shall be deemed to be called in question merely because the terms of the policy are adjusted on subsequent proof that the age of the life insured was incorrectly stated in the proposal.'

LET'S INTERPRET ABOVE PROVISIONS

The provisions of Section 45 are Special Provisions of Law to protect interest insured and its beneficiaries because of absence of any such law.

This Section provides that an insurance policy cannot be avoided after expiry of three years on the basis of mis-statement, or untrue statement, unless insurers are able to establish;

- 1. That the statement was inaccurate or false;*
- 2. That such statement was on a material matter or that the statement suppressed facts which was material to disclose;*
- 3. That the statement was fraudulently made by the insured;*
- 4. That the insured knew at the time of making the statement that it was false to his knowledge of facts which it was material to disclose had been suppressed.*

This section places burden on insurer to prove the allegation levied by it on the insured before avoiding the insurance policy. It means that insurer has to give proof to establish the above-mentioned circumstances and unless the insurer is able to do so , there is no question of the policy being avoided on the ground of misstatement of facts.

Under Section 45 , it is imperative that to avoid the contract the insurer must prove that material facts have been suppressed and that either the suppression of material facts or the fraudulent representation of material facts occurred with the full knowledge of the insured.

PLEASE NOTE THAT: *the insurer under Indian Law has no right to avoid the contract by merely making out some inaccuracy or falsity in respect of any recitals or items in the proposal for insurance , or even in the report of the Medical Officer or any other document connected with contract of insurance.*

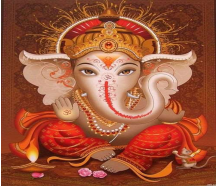
The Doctrine of Warranty will not, therefore apply to a policy after the expiry of a period of two years. The period of two years will have to be computed from the date of which the policy was effected, that is, the date from which the contract becomes effective.

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



SECTION 45 OF THE ACT, 1938- contemplates that the period of two years will be from the date on which the policy was effected, and not from the date of commencement of the risk mentioned in the policy, which may be prior to the date of the letter of acceptance issued by the insurer or the date of payment of the first premium.

Normally , the date of commencement of the policy will be the date of acceptance or the payment of the first premium or compliance by the proposer with any other requirements, whichever is later, but the risk may be ante-dated to suit the requirements of the policyholder. The word “ the date on which it was effected”, in Section 45 would, therefore ,refer to the date of the contract comes into existence and will not refer to the risk date if there has been any ante-dating. Similarly, it will not refer to the date on which the formal policy document was issued, which will be some time later than the date of contract.

PLEASE NOTE THAT: After amendment in 2015 a few conditions of Section 45 has been reconstructed , as such no policy of Life Insurance shall be called in question on any ground whatsoever after expiry of three years, however a policy of life insurance may be called in question at any time within three years, on the ground that any statement of or suppression of a fact material to the expectancy of the life of the insured was incorrectly made in the proposal or other documents on the basis of which the policy was issued or revived and on the ground of fraud , provided that the insurer shall have to communicate in writing the grounds and materials on which such decision is based.

This Section further clarified that no insurer shall repudiate a life insurance policy on ground of fraud if the insured can prove that the mis-statement of or suppression of a material fact was true to the best of his knowledge and belief or that there was no deliberate intention to suppress the fact or that such mis-statement of or suppression of fact are within the knowledge of the insurer.

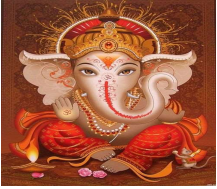
However, in case of repudiation of the policy on the grounds of fraud, the premiums collected on the policy till the date of repudiation shall be paid to the insured or legal representatives or nominees or assignees of the insured within a period of 90 days from the date of such repudiation.

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



PLEASE NOTE THAT : According to an IRDAI notification, the insurer has only a three-year window for calling a policy in question on the ground of misrepresentation or suppression of a material fact not amounting to fraud, from the date of issuance of policy or date of commencement of risk or date of revival of policy or date of rider of the policy, whichever is later. It is regardless of whether claim has arisen or not and when it is intimated. Once this period of three years is over, the policy cannot be called in question, the notification says

LET'S DISCUSS SOME JUDICIAL DECISIONS:

1. ***Sheo Shankar Ratanlalji Khamele Vs. LIC (AIR1971 Bom304)***- The Hon'ble Bombay High Court observed that " We are unable to read in Section 45 of the Insurance Act, 1938 that the word " effected" means the date on which a formal policy in cold prints is issued. In order to make a contract there is a proposal and acceptance. As soon as the proposal is accepted by the other contracting party , the contract is complete and that is the basis of the right of one party and liability of other. The liability does not for the first time arise on the formal document of the policy. It is only a formal expression of a contract which has already taken place. In our opinion , the phraseology used in Section 45 of the Insurance Act, 1938 relates to a date from which the policy of insurance that is a contract of insurance , becomes effective and such date would be the date of the acceptance of the proposal form which the risk on the life of the proposer is covered."

BRIEF FACTS: In the above case the proposal was made on 30.07.1956. The first premium paid on 03.08.1956 and the risk was covered from 04.08.1956. The Court has decided that the policy became effective from 04.08.1956.

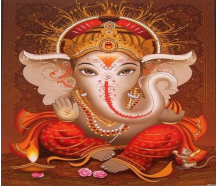
2. *In case of back-dated policies ,the effective date of commencement will be date of acceptance of the proposal ,i.e., the date of issue of the first premium receipt. However, depending upon the mode of payment opted by the insured , the date of the next premium payable will be reckoned from the date policy is dated back. [LIC Vs. Mani Ram, III 2005 CPJ31(SC)].*
3. *It has been held that where a policy has lapsed and is revived, the period of two years shall nevertheless commence from the original date. " Whether the revival of the lapsed policy constitutes a new contract or not for other purposes, it is clear from the operative part of Section 45 that the period of two years has to be calculated from the date on which the policy was originally effected."*[Mithoolal Nayak Vs. LIC AIR 1962 SC 814]

FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



4. It has been held that when the repudiation of claim of the appellant on the policy of insurance on the ground of false statement on material facts or suppressed facts is made after a period of two years of the date of on which policy was effected , Section 45 applies even though the assured died within two years of commencement of policy.[Vaid Mahesh Chandra Vs. LIC (1968) 38 Com Cases 767].

5. LIC Vs. Janaki Ammal, AIR 1968, Mad 324-

BRIEF FACTS:

- i) the policy was taken on 18/02/1954 and the insured died on 18/08/1955 i.e., within a period of two years of affecting the insurance policy.
- ii) The claim was repudiated on 10/08/1959.
- iii) The LIC had contended that as the insured has died within 2 years of effecting the insurance. The policy did not come under purview of the provisions of Section 45 of the Insurance Act, 1938 and the insurer repudiated the claim on the grounds of false statement and misrepresentation of material facts in the proposal forms and documents relevant to issuance of policy.

HON'BLE HIGH COURT- held that since the LIC repudiated the claim more than two years after the policy was effected , Section 45 was clearly attracted and unless the LIC was able to establish that the false statements were on material matters , that they were made fraudulently by the insured and that he knew at the time of making them that they are false, the repudiation could not be sustained.

Whether the life assured has made a statement , "fraudulently" or not will have to be judged in the light of the provisions of Section 17 of the Indian Contract Act, 1872.

SECTION 17 OF THE INDIAN CONTRACT ACT, 1872

'FRAUD' DEFINED.— 'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:—

(1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;

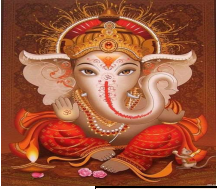
(2) the active concealment of a fact by one having knowledge or belief of the fact;

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Mobile No. +91 9920830041

Email ID: cs.deepakpsingh@gmail.com



(3) a promise made without any intention of performing it;

(4) any other act fitted to deceive;

(5) any such act or omission as the law specially declares to be fraudulent.

Explanation.—Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or unless his silence, is, in itself, equivalent to speech.

Illustrations

(a) A sells, by auction, to B, a horse which A knows to be unsound. A says nothing to B about the horse's unsoundness. This is not fraud in A. (a) A sells, by auction, to B, a horse which A knows to be unsound. A says nothing to B about the horse's unsoundness. This is not fraud in A."

(b) B is A's daughter and has just come of age. Here the relation between the parties would make it A's duty to tell B if the horse is unsound. (b) B is A's daughter and has just come of age. Here the relation between the parties would make it A's duty to tell B if the horse is unsound."

(c) B says to A—"If you do not deny it, I shall assume that the horse is sound". A says nothing. Here, A's silence is equivalent to speech. (c) B says to A—"If you do not deny it, I shall assume that the horse is sound". A says nothing. Here, A's silence is equivalent to speech."

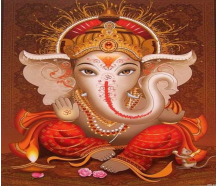
(d) A and B, being traders, enter upon a contract. A has private information of a change in prices which would affect B's willingness to proceed with the contract. A is not bound to inform B. (d) A and B, being traders, enter upon a contract. A has private information of a change in prices which would affect B's willingness to proceed with the contract. A is not bound to inform B."

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Mobile No. +91 9920830041

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PLEASE NOTE THAT *Whether certain facts are or are not material will have to be decided having regard to the views of a reasonable and prudent insurer about these facts.*

Materiality is a question of fact, to be decided in the circumstances of each case and may be generally taken to embrace every circumstance which would influence the judgement of a prudent insurer in fixing the premium or determining whether he will take the risk and if so, at what and on what conditions.

CONCLUSION

Section 45 has placed certain restrictions on the common law right of the insurer to repudiate an insurance policy in certain circumstances. Thus, onus in all such cases, rests heavily on the party alleging fraud, namely, the insurer. The statutory provisions make a policy indisputable, subject to the exceptions provided therein. The assured is thereby protected from losing the benefits of insurance because of any innocent misrepresentation. The provisions of Section 45 protects both an insurance company as well as an insured.

DISCLAIMER: *the article presented here is only for sharing information with the readers. The views are personal, shall not be considered as professional advice. In case of necessity do consult with professionals for more clarity and understanding of subject matter.*

SOURCES:

1. <https://indiankanoon.org/doc/299780/>
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FCS DEEPAK P. SINGH

(B.Sc., LLB, FCS, AIII, CIAFP, CRMP)

Mobile No. +91 9920830041

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