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Law of Insurance, Leasing, Hire- Purchase and Loans

AAT Level II

BLA - Business Law

Shanilka Perera
LL.B, Dip. in Counseling and Psychotherapy

JMC Jayasekera Management Centre (Pvt) Ltd
Pioneers in Professional Education
65/2A, Chittampalam Gardiner Mawatha, Colombo 02 | T: +94 112 430451 | E: info@jmc.lk | F: +94 115 377917

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Law of Insurance, Hire Purchase and Leasing

Shanilka Perera

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A) Insurance

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1) What is Law of Insurance?

- Law of insurance is in its essence a contract.
- It is a contract between two parties, the insurer and the insured.
- In this contract, the insurer agrees to pay a certain amount of money if there is an occurrence of specified uncertain event.
- In return, the insured promises to pay a premium.
- This contract is expressed through the "insurance policy".
- The insurance is taken as a precaution or a cover to a risk that is likely to happen, but do not know the timing of the occurrence.

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2) The purpose and mechanism of insurance

- The main purpose of Insurance is to spread the risk of losses that arises from uncertain events.
- The money received from the insured persons (premium) will be collected and created a pool.
- This total money will be used in investments.
- If the said uncertain event occurs, then that person will be paid compensation for his/her losses from the collected pool.

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3) What is the applicable law?

- Insurance Industry Act No. 43 of 2000.
- This Act established the Insurance Regulation Commission of Sri Lanka, which acts as the sole regulator in the insurance industry.
- Apart from that, English law is applicable for insurance relating to;

i) Life
ii) Fire
iii) Marine

- All the remaining types of insurance is governed under Roman-Dutch Law. However, in the case of a *"Casus Omissus"* in the RDL, then principles of English Law will be applicable.

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4) Main elements of an Insurance Contract

a) Offer for insurance / proposal
b) Acceptance of the insurance offer / proposal
c) Consideration
d) Intention to create legal relation
e) Legal validity
f) Competency of the parties.

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5) Who are the main parties in an insurance agreement/contract?

There are three parties to a contract, the insured, insurer and the third party.

a) Insured

this is the party that brings the insurance offer/proposal.

b) Insurer

This is the party / insurance company that accepts the insurance proposal. The insurer has the right to accept or reject the offer made by the insured.

c) Third party

Apart from the first two parties, at the time the insurance proposal becomes valid, there can be third parties in place. Ex: beneficiaries in a health assurance, the outside parties in a motor-vehicle insurance.

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6) What are the categories of insurance

- There are two main categories of insurance;

a) Indemnity insurance

This type of insurance governs against a loss or damage to a subject mater. Ex: fire insurance, marine insurance

b) Contingency insurance

This type of insurance governs a pre-agreed situation. On the occurrence of the pre-agreed event, regardless of the loss, the amount of money will be paid as per the agreement. Ex: accident assurance.

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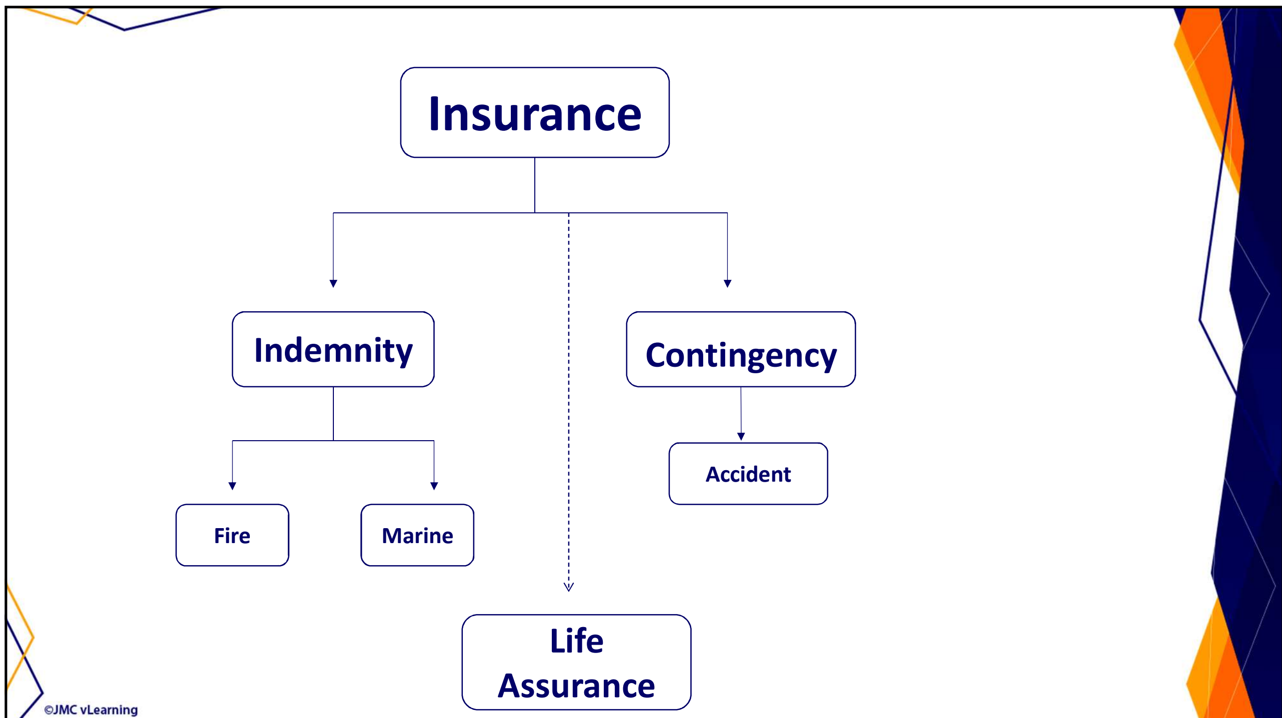

a) Indemnity Insurance

- Indemnity insurance includes classification of insurance such as;

i) Fire Insurance

- Covers loss or injury to person or property. Any loss incurred due to fire caused by negligence is also covered.

Ex: **Harris v Poland (1941)** - hid her jewellery under coal and by mistake lit the coal on fire. She was entitled to receive compensation for her loss which occurred due to fire although it was her negligence as to why the loss occurred.

- This means there is no pre-agreed amount. Compensation equivalent to that of the loss will be paid, hence indemnity.

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ii) Marine Insurance

- Losses and accidents relating to marine voyages are covered under this.
- There are several policies with different options;

❖Voyage Policies - the subject matter of the voyage is insured to that voyage only.

❖Floating Policies – ship and other particulars are not named; insurance is described in general terms.

❖Time policies – insurance is applicable only to a specific period.

❖Valued Policies –there is an agreed value regarding the subject matter.

❖Unvalued policies – the subject matter of the insurance is not valued but is left to be determined later.

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- There are certain implied warranties in Marine Insurance;

i) At the beginning of the voyage, the ship shall be seaworthy (applicable to voyage policies only).

ii) At the beginning of the voyage, the ship shall be fit enough to carry the cargo to its destination. (applicable to voyage policies only).

iii) If the ship is anchored in port, it shall be reasonably fit to face normal dangers that may occur at the port.

iv) The voyage should be legal or for a legal purpose and such voyage should be done in a legal manner.

Greenock SS Co. v Maritime Insurance Co. Ltd (1903)

In this case, the ship left from the port without sufficient coal to reach the destination. It was held that by leaving from one port to another without sufficient coal made the sea "unseaworthy".

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b) Contingency insurance

- There is no indemnity in this type of insurance.
- The obligation of the insurer is to pay an agreed amount on the happening of an agreed event regardless of the loss.

i) Life Assurance

– this type of insurance is different from the others. In here, it is certain that the event will occur, that is, it is certain the policy holder will face death. As death is certain, if the policy holder dies, his beneficiaries will be entitled to receive the benefits provided under the insurance policy.

ii) Accident insurance

- this is a type of insurance where there is an agreement that on the occurrence of certain events, the insurance company will pay a specified amount as entitled.

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7) What are the principles of insurance?

- The principles of insurance exists to;

i) Establish the trust between the parties under insurance;

ii) To improve fairness between the parties in the insurance agreement;

iii) To not allow parties to make a profit.

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- The recognized principles of insurance are;

a) Utmost good faith

b) Indemnity

c) Subrogation

d) Contribution

e) Insurable interest

f) Proximate cause

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a) Utmost good faith (Uberimae Fidei)

- Utmost good faith refers to the mutual understanding between the insurer and the insured.
- The mutual understanding implies that both parties reveal all relevant information relating to the insurance contract.
- This means that the insurer must reveal all relevant and key information.
- Similarly, the insured must reveal all relevant and key information.
- When such information is shared, it builds a trust between the insurer and the insured

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- In utmost good faith, the insured must reveal
- Facts that help to determine the acceptance of the risk.

  ex: the status of a person's health.

- Facts that are relevant to determine the premium that should be paid.

Ex: Higher the age, higher the premium.

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- It is not necessary to reveal

a) Common knowledge
b) Facts necessary to reduce risk
c) Facts not relevant to the contract
d) Facts that can be assumed by the insurer based on available information.

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- The insurer must however reveal;

a) All the risks covered under the insurance policy.
b) All the risks not covered under the insurance policy.
c) The nature of the insurance policy or contract.
d) The amount of premium to be paid.
e) The date and time the premium should be paid.
f) The policies applicable in case of non-payment.
g) The facts relating to the ownership of the insurance policy.
h) The facts relating to invalidity and validity of the contract.

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- Utmost good faith is defeated in these instances;

a) Failure to disclose important information with intention. Ex: Not revealing the fact that you are a heart patient intentionally.

b) Failing to disclose important information due to negligence. Ex: Assuming that an important information is not in fact important. An accident or injury that happened when you were younger.

c) Failing to disclose important information due to an honest mistake or innocent misrepresentation Ex: Failing to disclose a genetic disease because you didn't know about it in the first place.

d) Disclosing untrue facts with intention to cheat. Ex : Stating a false age when obtaining insurance policy.

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Looker v Law Union Insurance Company

- In this case, the person called looker failed to disclose that he had suffered from pneumonia before. This was held to be a non-disclosure of a material fact. Therefore, when he died of a second pneumonia attack, the insurance company refused to pay his beneficiaries. The court agreed that the insurance company has the right to refuse payment as he had failed to disclose a material fact.

London Assurance v Mansel

- In this case, the insured stated that he already had two other insurance policies. Therefore, the new insurance company reduced their premium to match the other two companies' premium. However, in reality, his other two applications were rejected. Court held that a material fact had not been disclosed and, the insured had to pay back the loss the new insurance company incurred by giving him a reduced premium.

Buultjens v Ceylon Insurance Co. ltd (1960)

- In this case, the insured had replied "No" to a vague question that was asked by the insurance company. When he attempted to claim a loss, company stated that he had lied. The court held that questions asked by the insurance company must be specific. If they are vague, then it is the fault of the insurance company, and they are liable to pay the loss claimed.

O'Conner v Kirby and Company (1971)

- In this case, there was an innocent misrepresentation. While the insured usually parks in the street, he had mistakenly stated he parks the vehicle in a garage. Although this is an innocent misrepresentation, no loss can be claimed.

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- The remedies that are available to an innocent party if the utmost good faith is breached are;

a) Termination of the agreement
b) Refusal to pay for any claim
c) Be free of the legal responsibilities
d) Claim back any losses incurred by the innocent party.

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b) Indemnity

- This concept states that the person who is insured is not entitled to receive any profit nor loss from the compensation that he would receive.
- Therefore, any person who is insured but has suffered a loss, can only be compensated to the value of the loss he has incurred.
- Regardless of the insurance policy, only the loss is compensated, nothing more, nothing less.
- For example, if your accident insurance cover is for 10 million, and you got into an accident and suffered a loss of 5 million; You will only be compensated 5 million even if the insurance cover is for 10 million.
- But, if your loss is over 10 million, for instance if it is 15 million, you will only receive a maximum of 10 million as your insurance policy is only for 10 million.
- Nevertheless, you can claim any loss that is within the range of your insurance policy but can never make a profit from the insurance.

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- For example,

Castallain v Preston (1883)

- In this case, a house which was about to be sold caught up in a fire and was damaged.
- The seller had obtained insurance, so he claimed the loss.
- After claiming the loss, he anyway sold the house.
- The insurance company claimed to return their payment under the policy.
- This was because the seller had obtained a profit. He obtained money from selling the house and as well as obtained compensation for the damaged house.
- Therefore, it is well established now that the insured cannot obtain a profit through insurance

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c) Subrogation

- This means the passing of rights and advantages from the insured to the insured person.
- For example, A has taken an insurance against fire. His house was burnt because of the negligence or mistake of B. Normally, A has the right to sue / take legal action to recover the loss from B.
- However, as he has taken insurance, it is much faster to claim it from the insurance company.
- If A decides to claim the loss through insurance, then the insurance company can sue/ take legal action against B for his negligence and recover the compensation paid to A.
- In simple terms, the right to sue B was transferred from A to the insurance company after they paid compensation for the loss. This process is called subrogation.

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d) Contribution

- Sometimes, a certain property might be insured in more than one insurance company.
- In such an instance, if there is a loss that occurred, then in order to adhere to the principle of indemnity, all the insurance companies will pay compensation in a proportionate manner so that the loss is covered, while the insured do not make a profit.

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- Compensation is calculated as follows;

Compensation =

$$\frac{\text{value of the insurance policy issued by particular insurance company}}{\text{value of the insurance policies issued by insurance companies}} \times \text{loss incurred}$$

Note: Life assurance has no effect of contribution. If you have taken multiple life assurance policies, then you or your beneficiaries are entitled to receive full amount covered under such policies. Contribution is applicable to all other types of insurance except life assurance.

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e) Proximate Cause

- Loss is covered only if there is a proximate cause.
- This means the loss covered in the insurance policy should match with the cause that created the loss to the insurer.
- If the cause of the loss is proximately close (similar) with what is covered in the insurance policy, the loss will be compensated.
- If it is not proximate, then the claim for insurance will not be accepted.
- For example, there is an insurance policy taken against fire that is occurred through electricity, heat or radiation. However, if the fire was caused by a terrorist activity or by a mob, then there is no proximate cause.

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f) Insurable interest

- This means the person who is buying insurance must have an interest on the subject matter which is insured.
- There should be a benefit to the insured when the subject matter is in existence but also a loss when the subject matter is gone.
- However, under life assurance, when the person who was insured is lost, then the beneficiaries should suffer a loss.

Griffith v Fleming (1909)

- spouses have an insurable interest in each others' lives, but also an interest with their own lives.

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Macura v Northern Assurance Co. ltd (1925)

- In this case, person called Macura sold his business to a company, but he was still the major shareholder. The company was destroyed by fire. As the property was still under Macura's name, he claimed insurance.

His claim was refused. The court held that he has no insurable interest although he is a shareholder. This is because a company has a separate legal personality. Therefore, the right person to claim with an insurable interest would be the company itself.

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Delby v India & London Life Assurance Co (1854)

- in this case it was held that a creditor has an insurable interest in the life of a debtor because the debtor owes creditor money. The debtor must be alive and healthy for the creditor to receive money. If the debtor dies, creditor suffers a loss. Therefore, a creditor has insurable interest on the life of a debtor.

Hebden v West (1863)

- in this case it was held that an employee who has been employed for a certain fixed period has an insurable interest in the life of the employer.

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B) Hire-Purchase

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1) What is Hire Purchase?

- This is a contract between two parties named hirer and the owner.
- The owner is the person who owns the asset, and he lets the “hirer” hire the asset.
- The hirer is the person who hires it for a particular period and for an agreed amount of money to be paid in installments. For example, hirer agrees to hire the asset and have the possession of it while using it.
- At the payment of the last installment the ownership of the asset is transferred to the hirer, who becomes the new owner.

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- Hire purchase agreements often involve guarantors or surety.
- Guarantors or the surety exist as a precaution if the hirer does not fulfil his obligations to the owner.
- The main condition in hire purchase is that the ownership of the property is only passed after the full payment for the product.
- The law relating to hire purchase is governed under;

Consumer Credit Act, No. 29 of 1982

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2) What are the rights of the hirer?

- Right of hirer to purchase at any time with rebate. (sec. 7)
- Right to terminate the agreement at any time. (sec. 8)
- Right to appropriate payments in respect of two or more agreements. (sec. 9)
- Assignment and transmission of hirer's right or interest under hire-purchase agreement. Fourteen days prior notice must be given to the owner and also the written consent of owner is needed.(sec. 10)
- If the owner re-possess the product and thereafter sells it; however, t if he earned an excess amount than that of the stated price, the hirer has the right to claim the excess amount. (sec. 16)

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3) What are the obligations of the hirer?

- Obligation of hirer to comply with agreement. (sec. 12)
- Obligation of hirer in respect of care taken of goods (sec. 13)
- Obligation of hirer in respect of use of goods. This means the hirer must use them only as prescribed in the hire-purchase agreement. (sec. 14)
- Obligation of hirer to give information as to whereabouts of goods. (sec. 15)
- If goods are sold or disposed fraudulently by the hirer, shall be guilty of an offence and shall be liable to a fine not exceeding five thousand rupees or to imprisonment for a term not exceeding six months to both such fine and imprisonment. (sec. 17)

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3) What are the rights of the owner?

- Rights of owner to terminate hire-purchase agreement for defaults in payment of hire or unauthorized act or breach of express condition. (sec 18)
- In such an instance;

i) The owner can retain any such deposits or installments paid to him.

ii) Reclaim possession of the goods.

iii) Claim damages for any loss incurred.

iv) Assign his rights and obligations to another.

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4) What are the obligations of the owner?

- Obligation of owner to supply copies and information (sec. 24)
- In general, comply with the terms and conditions of the hire-purchase agreement.
- Respect and comply with the rights of the hirer.

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C) Leasing

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1) What is leasing?

- In leasing, the owner (lessor) allows another party (lessee) to use the subject matter for a specific period in return for a rent.
- The law applicable to leasing is the Finance Leasing Act, No. 56 of 2000.
- As per this Act, all financial institutes should be registered under the Central Bank of Sri Lanka. Henceforth, they will be known as " registered finance leasing establishments".

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2) What are the different types of leasing?

a) Finance leasing / Full-pay out leasing

- lessor transfers all benefits and liabilities to the lessee
- when the economic life of the asset is over, ownership is transferred from lessor to the lessee.
- Lessor mainly helps to finance the leasing.

b) Operating leasing

- Ownership, risks and benefits are still with the lessor, they are not yet transferred lessee.
- Lessor is a financier.
- Lessor also provides additional services during the use of the product.

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c) Sale and lease back

- Lessee initially owns the asset.
- Lessee sells it to the lessor on the agreement that it will be leased back to him for a fixed lease rental per period.
- This method helps to liquidate assets quickly.

d) Direct Leasing

- In here, the lease is owned by the lessor, and he simply lets the lessee hire it for a specific lease rental per period.

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e) Single investor leasing

- Lessor find a lender/investor to finance the asset.
- Investor does not deal with the lessee.
- Any dividends/interest receivable to the investor/lender can only be obtained from the lessor.
- Investor/lender cannot or has no right to claim anything from the lessee.
- Lessee only has his obligation of making lease rentals to the lessor and not to the investor/lender.

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f) Leveraged Lease

- Asset is financed by an investor/lender.
- The lessor arranges equity.
- The investor/lender can approach the lessee.
- If any receivables due to the investor/lender, if not paid by lessor, lessee is liable to pay to the investor/lender.

g) Domestic Lease

- If all parties to the lease resides in the same country, then it is a domestic lease.

h) International Lease

- The parties to the lease resides in different countries
- This can be divided into two: import lease; cross-border lease.
- If lessor and lessee are in the same country but the goods are supplied from another country, then it is an import lease.
- Cross-border lease occurs when the lessor and lessee are from different countries regardless of the place where the good are supplied.

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3) What are the benefits of leasing to the lessor?

a) Rental income is obtained at the beginning of the leasing period.
b) The goods/asset can be re-possessed in a convenient manner if the lessee breaches the agreement.
c) The lessor has the absolute ownership.
d) Absolute ownership will reduce the risk.
e) Income through interest.
f) Transfer fee acts as an income at the time of transfer to the lessee.

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4) What are the benefits of leasing to the lessee?

a) It is much faster than obtaining any other credit facility.
b) Finance that is equivalent to price of asset can be obtained.
c) Equity of the lessee can be used for another purpose.

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Summary

1) Insurance

- What is the law of insurance
- The purpose and mechanism of insurance
- What is the applicable law?
- Main elements of an Insurance Contract
- Who are the main parties in an insurance agreement/contract?
- What are the categories of insurance?
- What are the principles of insurance?

2) **Hire-Purchase**

- What is Hire-Purchase
- Rights and obligations of hirer and owner

3) Leasing

- What is leasing
- Types of leasing
- Benefits of leasing

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