THE PRINCIPLES OF *insurance*

Read time: 8 mins

Hello,

Insurance has developed extensively over the centuries and is now a highly complex and sophisticated response to risk. There are six core principles that have been established over time and been upheld by the courts and by Parliament, these are as follows:

- Insurable Interest
- Indemnity
- Underinsurance
- Contribution
- Subrogation
- Proximate Cause

This guide will explore the above principles in more detail, in addition we will also explore the consequence of the Consumer Insurance (Disclosure and Representations) Act 2012 which created the concepts of 'consumer' and 'non-consumer' insurance, and removed the obligations of 'utmost good faith' on consumers entering insurance contracts.

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Learning lab

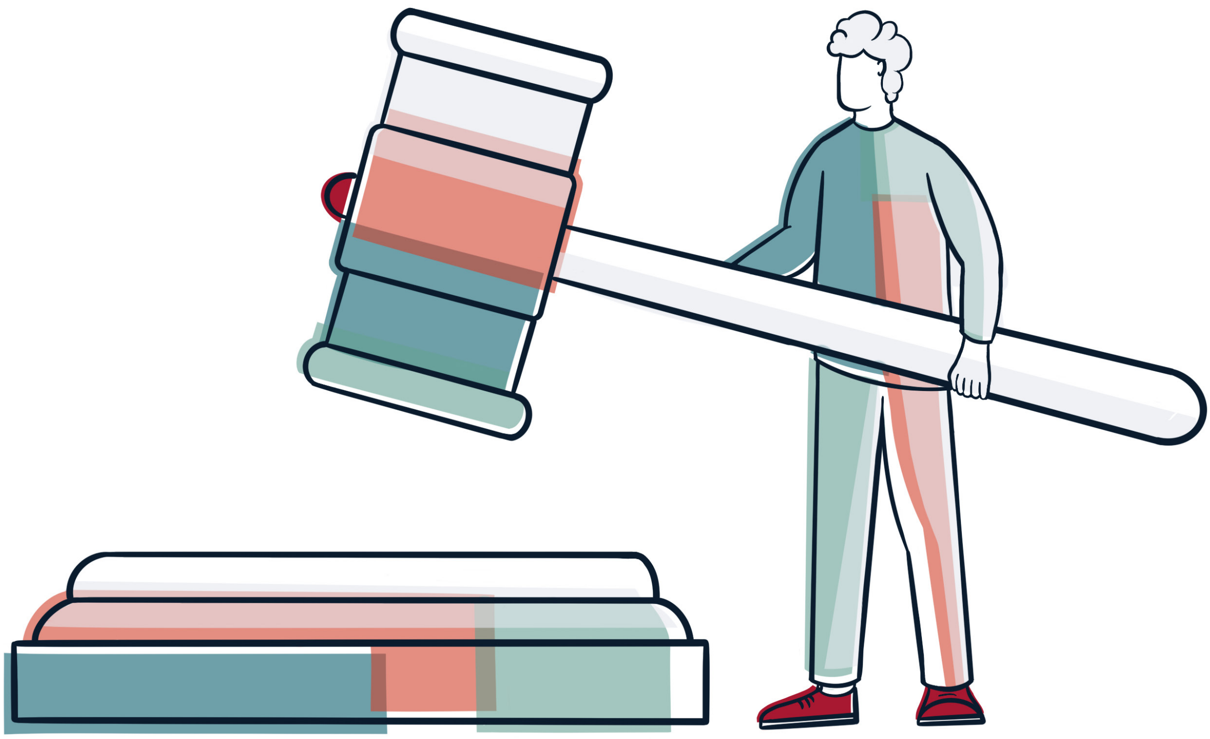
Insurable Interest

What is Insurable Interest?

Insurable interest is the principle that defines who can take out an insurance policy. In insurance law, you can only buy insurance for something or someone in which you have an insurable interest.

Insurable interest is where you have a valid & legal right to insure and stand to suffer a direct financial loss if the event insured against occurs. To demonstrate insurable, there must be something tangible that can be insured such as property, life or rights imposed by law.

In other words, a person has an insurable interest in their own home or car – but not those of their neighbour's.



Insurable Interest

What is Insurable Interest?

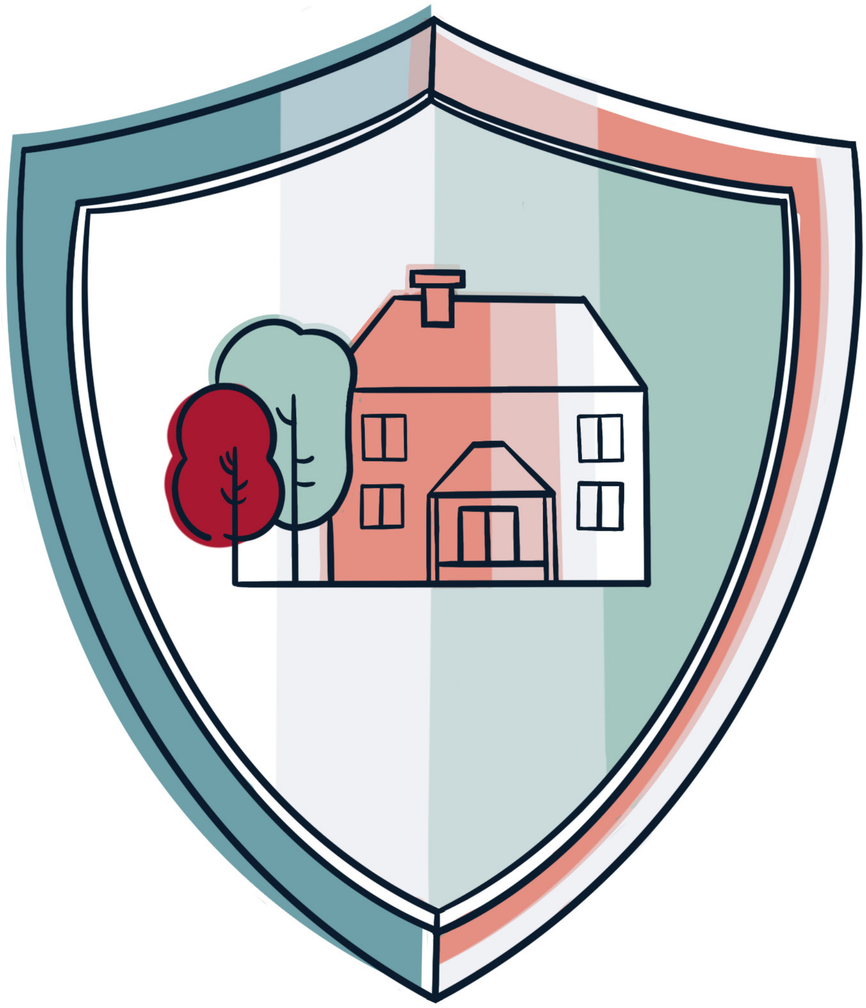
In every contract of insurance, an insurable interest must be present: For **life assurance** policies, insurable interest will apply at inception only, as these are benefit NOT indemnity policies, i.e. the sum assured or benefit is agreed before the policy is taken out.

For other **General Insurance** policies, insurable interest must apply both at the start of the policy and at the time of any loss/claim. These are contracts of indemnity, and as a result the insured can only recover to the extent of their loss, i.e. the value of the property that has been damaged/lost.

!

Insurable interest does not apply with regards to criminal acts, property or activity:

- You cannot claim if you deliberately damage your own property.
- Stolen property cannot be insured. As you do not legally own it, there is no insurable interest.
- Similarly, any illegal trades cannot be insured, so any contract would be void.



WHAT IS Indemnity?

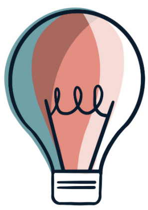
Indemnity

What is Indemnity?

Indemnity is a fundamental principle of insurance. A contract of indemnity will provide financial compensation in the event of a loss, its aim is for the insured to be returned to the same financial position they were in immediately before the loss happened. Remember that the insured should not be worse or better off as a result of a claim.

Applying the Principle of Indemnity

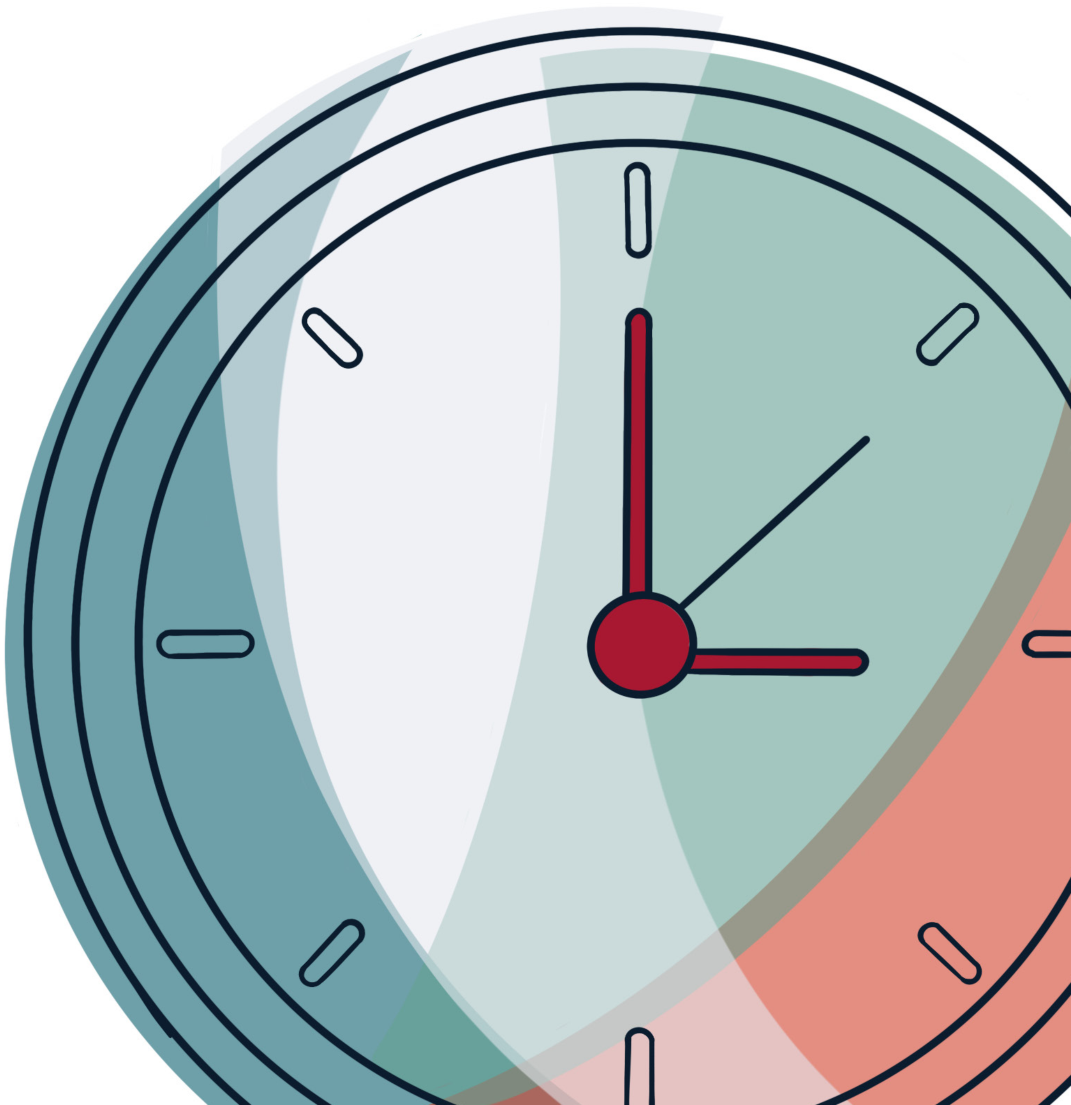
To apply the principle of indemnity, the insurer is obliged to provide sufficient compensation to purchase a similar item in both age and specification to the lost one. Therefore, for indemnity to work in practice, insurers sometimes apply a "**Wear and Tear**" clause.



For example, if a tablet that you have had for a number of years was stolen and as a result of the claim that you submitted the insurer provided you with a brand new tablet, then you would be better off and the principle of indemnity would be "breached".

Insurers can therefore deduct an amount from any claim to allow for the age or “Wear and Tear” of an item. This, however, led to complaints from customers, so insurers introduced the concept of Reinstatement.

Here, no deduction is made for wear and tear, and generally, the insured will receive adequate compensation to replace the damaged/stolen item with a new comparable item.



Settlement options

The insurer has a range of settlement options available to indemnify the insured:

Cash payment

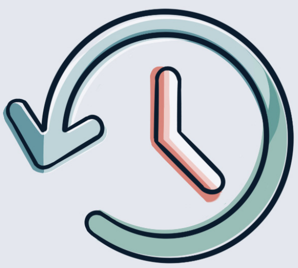
Here the insurer agrees to a financial settlement of the claim and will either send a cheque or complete a BACS transfer.

Repair

This is very common in motor insurance.

Replacement

Providing a replacement item for the one lost/damaged, this is a popular option on household policies, especially around electrical goods.



Reinstatement

Where the insurer restores/rebuilds damaged buildings or machinery.

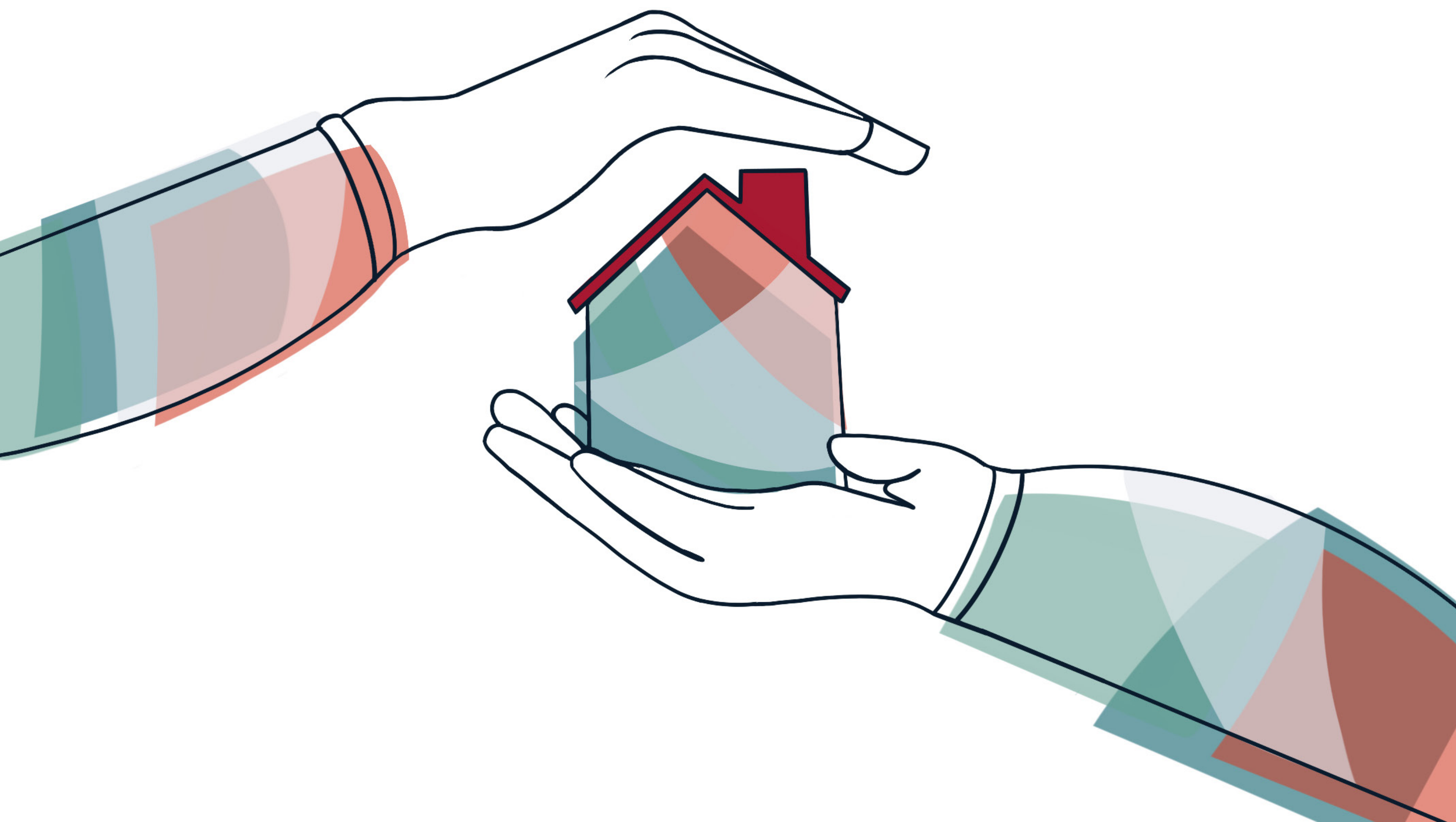
WHAT IS Underinsurance?

Underinsurance

What is Underinsurance?

Underinsurance is where a customer does not insure the full value of the risk, this could be an innocent or deliberate mistake. Underinsurance normally comes to light in the event of a claim. The loss adjuster appointed by the insurer will calculate the actual loss and if this is more than the sum insured then underinsurance has occurred, which can affect the settlement figure.

In these cases the insurer has not received the full premium for the risk that has been covered. To help compensate for underinsurance, the majority of policies have what is known as an **average clause** included in the wording. This means that if an underinsurance has occurred, any settlement figure will be reduced in proportion to the underinsurance.



Underinsurance

Example

If the total value of a customer's contents was £50,000 and they are only insured for £30,000 then they would only be paying for 60% of the premium and therefore, should be entitled to only 60% of the claim figure.

The **average clause** is calculated as follows:

(**Sum Insured** divided by **Actual Loss**) x **Claim Value** = **Settlement Figure**

Using the above example, if a claim is submitted for £10,000 then the settlement figure would be as follows:

(£30,000 divided by £50,000) x £10,000 = £6,000.
So, instead of £10,000, the claimant would only receive £6,000.

Most policies have a tolerance that allows for some element of underinsurance. This is typically around 10-15%. By applying a tolerance, the insurer is allowing for any errors and/or misunderstandings on the part of the customer.

Contribution

What is Contribution?

Contribution is where an insured party may have policies with two or more insurers covering the same risk, although not necessarily with equal degrees of liability. Therefore, in the event of a claim, all of the insurers should pay an equitable proportion of the claim payment.

Contribution occurs when the following conditions exist:

- There must be more than one policy of indemnity involved and all the policies covering the loss must be in force.
- All the policies must cover the same peril causing the loss.
- All the policies must cover the same subject-matter.

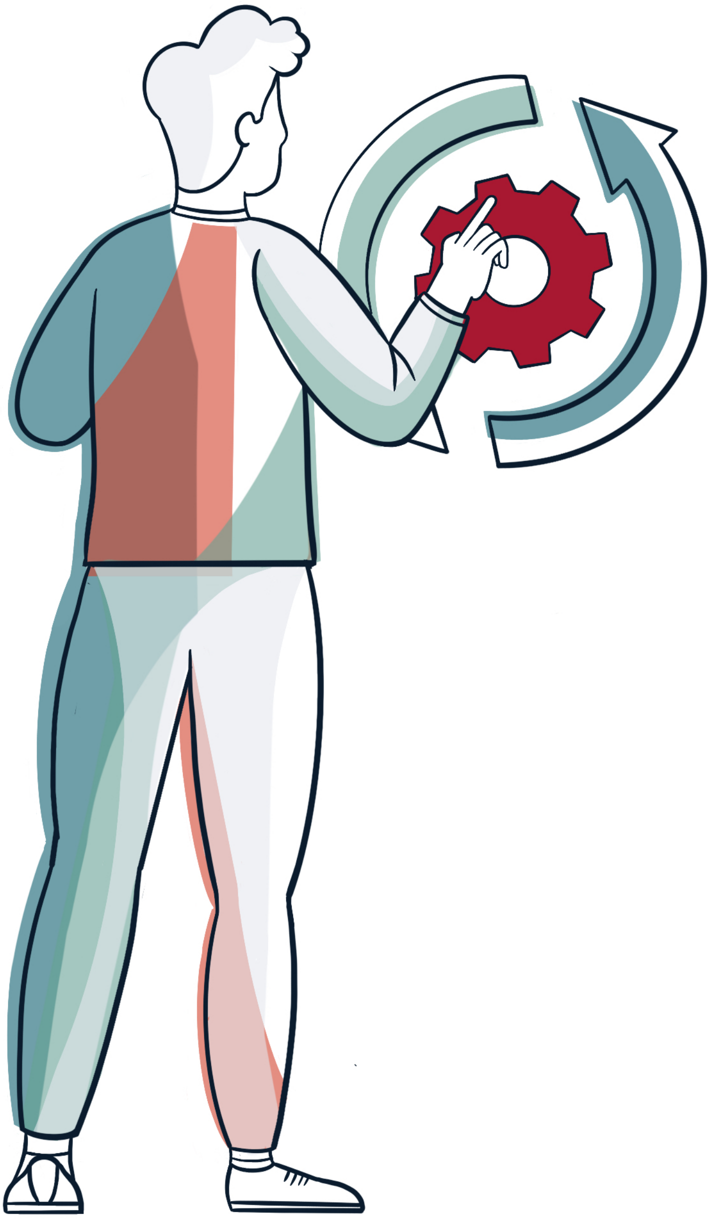
Contribution is the right of an insurer to call upon the other insurers to share the cost of such a claim payment. The fundamental point is that, if an insurer has paid a claim in full, it can recoup a proportion of the costs from the other insurers of the risk.

Contribution
Example

If a customer lost some possessions whilst on holiday then these could be covered under a travel insurance policy as well as personal possessions away from the home under their household policy.

Contribution means that the insurer from whom the customer will claim (in this example it would most likely be the travel insurer), will ask for details of any other insurance that the claimant has.

The travel insurer will liaise with the home insurer to agree the settlement, each insurer will then pay a proportion of the claim. This process happens in the background, the result will be that the claimant will receive one payment from one insurer for their claim.



WHAT IS Subrogation?

Subrogation

What is Subrogation?

If a policyholder has a claim paid by their insurer, they may also have a right to pursue funds from another source, such as a third-party who caused the incident.

The principle of subrogation allows the insurer to pursue any rights or remedies which the policyholder may possess, always in the name of the insured.

This means that once an insurer has paid out under an insurance contract, the insurer can “step into the shoes” of the insured. The insurer acquires the rights to:

- Use the insured's name to proceed against any third party who was responsible for causing the loss.
- Claim from the insured any sums received by way of compensation from that third party.

The insurer has no greater rights than the insured and can only pursue actions against a person who could have been pursued by the insured.

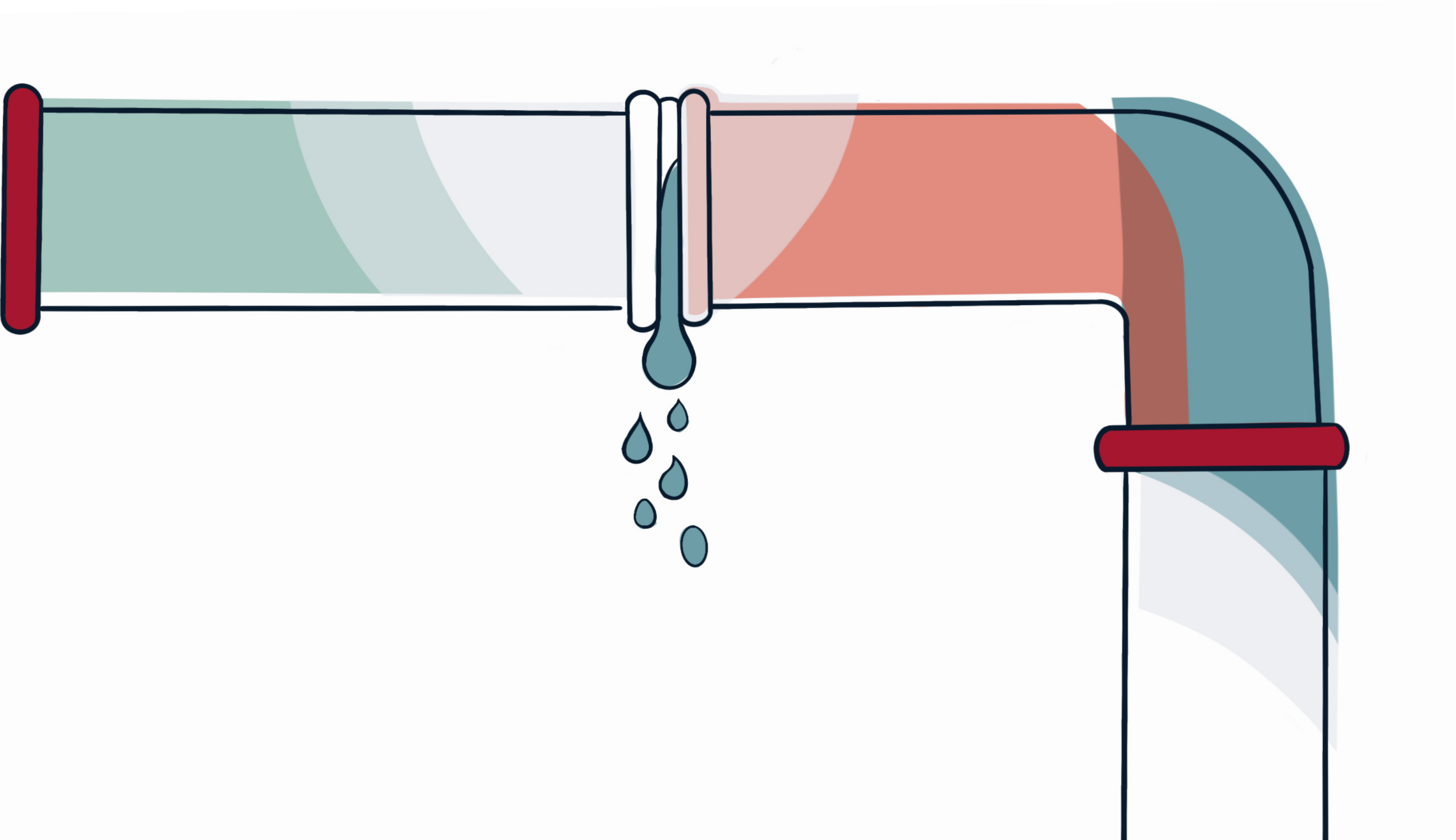
Subrogation

Example

For example, during an annual boiler & heating service, the engineer makes a careless error resulting in a burst pipe on one of the customer's radiators, which causes significant damage.

The customer has the right to claim damages from the engineer for negligence, however, having a home insurance policy which covers such damage, means that the customer can choose to claim from their insurer rather than directly pursuing the engineer.

By claiming on their home insurance, the insurer would pay the claim and then step into the customer's shoes to claim their rights of recovery from the engineer. If the insurer is successful they would keep any settlement amount to offset their costs.



Proximate Cause

What is Proximate Cause?

An insurance policy will define the perils, or insured events, that cover is provided for (and those that are excluded). All contracts are subject to terms and conditions that will exclude certain causes of loss. Therefore, in the event of a claim, it is important to ascertain the cause of the loss in order to determine if that cause is insured or excluded.

There may be multiple elements involved in a claim, so it is the 'proximate cause' that is taken into account. The proximate cause is the dominant cause that sets in play a chain of events.

Example

For example, if lightning damaged a building and weakened a wall, following which the weakened wall was blown down by high winds, lightning would be considered as the proximate cause.

WHAT IS CIDRA 2012?

CIDRA 2012
Example

The Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) reformed insurance law in the UK and created the concepts of 'consumer' and 'non-consumer' insurance. It removed the obligations of 'utmost good faith' on consumers entering insurance contracts but places a duty on the insured to take reasonable care not to misrepresent a risk to an insurer.

What is meant by Consumer Insurance?

Consumer insurance contracts are defined as:

"A contract between an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession".

The wording is intended to be broad enough to cover contracts which cover both private and business use, as long as the main purpose of the contract is for private use.

If it is not clear whether a customer is a consumer or a commercial customer, a firm must treat the customer as a consumer.

Consequences of CIDRA

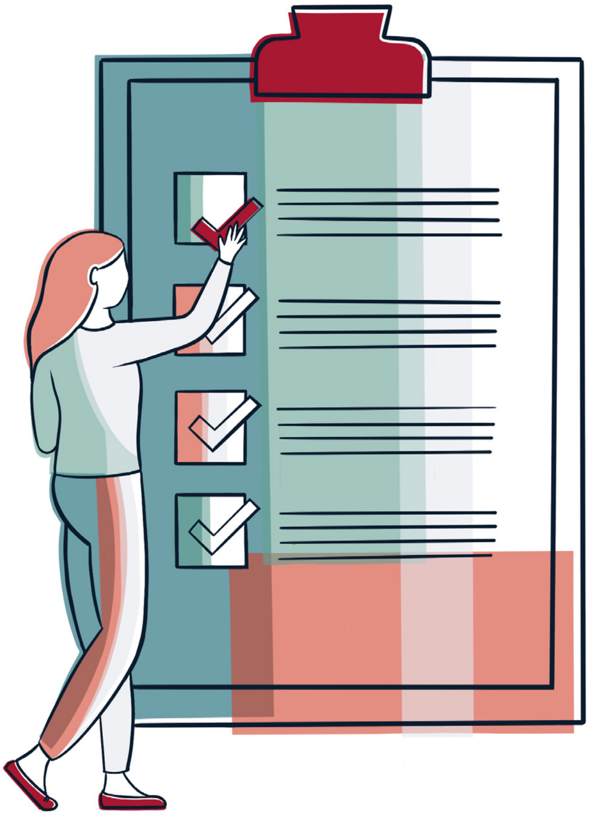
-For Insurers

CIDRA stipulated that all a consumer has to do is answer all questions honestly and reasonably. Therefore, it is up to the insurer to ask all the questions they want their customers to answer.

Non-Disclosure and Misrepresentation

CIDRA does not define what a misrepresentation is, however, in common law it is a representation that is either inaccurate or misleadingly incomplete. In some circumstances an omission can amount to a misrepresentation. However, if a misrepresentation was honest and reasonable the insurer must pay the claim.

If there is carelessness on the part of the customer then the insurer will apply a proportionate remedy. In other words - what would have the insurer done if they had known the full facts.



An insurer can only refuse to pay a claim if they prove that the customer made deliberate or reckless misrepresentations.

An insurer will need to prove that the misrepresentation was deliberate or reckless, as the customer knew:

a. that the misrepresentation was untrue or misleading, or did not care whether it was or not; and

b. that the matter to which the misrepresentation related was relevant to the insurer, or did not care whether it was or not.

If a misrepresentation does not meet the above criteria then it must be treated by the insurer as a careless representation.

CIDRA

-Your Obligations

Remember when you complete a quote using our quotation system, you are entering the details on behalf of your client.

Checklist

Therefore, you need to ensure that:

- The client answers all the questions reasonably and honestly.
- You ask the exact questions that the insurer has stated on a proposal form before they proceed with the cover.
- You confirm with your client all the details that will be disclosed to the insurer.
- You do not speculate or estimate any response.

If you are aware of a misrepresentation then you should ask the client to amend their statement.

You should also advise the client that if a misrepresentation is deliberate then the insurer may cancel the policy or refuse to pay a claim.

Remember you are acting on behalf of your client, so if you fail to disclose or misrepresent your client then the insurer may cancel the policy or refuse to pay a claim.

Contact us

- 02920 265 265
- info@thesource.co.uk
- www.sourceinsurance.co.uk

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