The Six Key Principles

How did insurance come into being? And how is it actually defined? Here, we look at the origins of insurance and the central principles that make up any insurance contract. These principles are important to understand to ensure that your insurance policies are covered on the correct basis.

1. Insurable interest
Not all risks are insurable. Insurable risks have certain characteristics: they must be capable of financial measurement; there must be a large enough number of similar risks; they must not be against public policy; the premium needs to be reasonable; and there must be an ‘insurable interest’ for the person insuring.

Insurable interest is where you have a valid reason to insure and stand to suffer a direct financial loss if the event insured against occurs.

Insurable interest exists when an insured derives a financial or other benefit from the continuous existence of an insured object. For example, a person has an insurable interest in their own car – but not in their neighbour’s car.

To demonstrate insurable interest, there must be something tangible that can be insured – such as property, life or rights imposed by law.

2. Utmost good faith
Most commercial contracts are subject to the principle of caveat emptor (let the buyer beware). Under these contracts, there is no need to disclose information that is not asked for. Insurance contracts are different in that they are based on facts which are within the knowledge of the insured, but of which insurers will not generally be aware. As the insurer is at a disadvantage, the law imposes a duty of uberrima fides or ‘utmost good faith’.

The principle of utmost good faith requires anyone seeking insurance to disclose all relevant facts. These are facts that would influence the judgement of a prudent underwriter in fixing the premium or determining whether they will take on the risk. Where material non-disclosure can be proved, a contract can be voided.

In a new development, duties of disclosure will no longer apply to personal policies from 6 April 2013 – see our ‘Facing the Facts’.
3. Proximate cause
An insurance policy will define the perils or insured events that cover is provided for. For example, a building insurance policy will provide various covers as standard – such as fire, lightning strikes and earthquakes – and cover for additional risks, such as escape of water, storm or accidental damage, can be requested.

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. 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 the proximate cause.

4. Indemnity
Indemnity is considered to be the exact compensation required to restore the policyholder to the financial position they enjoyed immediately before a loss occurred.

Indemnity settlements can be reduced where it can be proved that there is under-insurance, and therefore the insurers are only receiving a premium for a proportion of the entire value at risk. If this is the case, any claims payment will be reduced in direct proportion to the under-insurance.

5. 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 also ensures that the policyholder only receives the indemnity settlement entitled to and therefore they will not profit from the incident.

6. Contribution
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 is the right of an insurer to call upon the other insurers to share the costs 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.

Find out more
We provide a wide range of risk and insurance services to businesses and private individuals. Please get in touch if you would like to know more, or visit our website at: www.belmontint.com.