Insurance

- Certain principles apply when making a claim and calculating the compensation to be paid

1. Indemnity
2. Contribution
3. Subrogation
4. Average Clause

Insurance

The Principle of Indemnity

- This states that the insured cannot gain/make profit from making an insurance claim.
- Because of this principle there is no point of insuring something for more than it is worth.

Insurance

<u>The Principle of Indemnity Example</u>

- A house valued at €300,000 which is insured for €450,000 burns down.
- The insurer will only pay €300,000 because the loss incurred was only €300,000.
- If €450,000 compensation is paid then the insured would gain €150,000 from the house burning down.

Insurance

The Principle of Contribution

- This states that if a risk is insured by two or more insurance companies, any compensation payable will be shared between the companies.

Insurance

The Principle of Contribution Example

- A person insures a house valued at €300,000 with two insurance companies for €300,000 each.
- The person will only receive €300,000 if the house burns down.
- Each insurer will only contribute €150,000 each.
- If each paid €300,000, then the individual would gain from the house burning down; this goes against what principle?

Insurance

The Principle of Subrogation

- This passes on the legal right to recover any loss suffered from the insured over to the insurer
- When the insurer pays out compensation, the insurer can claim from someone else who might have caused the loss.
- After paying compensation for a loss suffered, the insurance company is entitled to take over any property.

Insurance

Under-insurance (Average Clause)

- This means to insure an item for less than it's worth and can be used to keep premiums down.
- If an item is not insured for its full value, then the amount of compensation paid, in the case of partial loss, will be reduced.
- The formula for calculating the compensation when an item is underinsured is

$$\frac{\text{Sum Insured}}{\text{Market Value}} \times \text{Loss incurred}$$

Insurance

Under-insurance (Average Clause)

example

- A house is worth €300,000
- It is only insured for €150,000 **i.e.** ½ of its value
- If fire destroys the house, the most one could receive in compensation is €150,000 (**i.e.** ½ of its value)

Insurance

Over-insurance

- The principle of indemnity prevents one from over-insuring. ***WHY?***

i.e. for insuring something for more than it is worth.