THE NATURE OF INSURANCE

CIP-01

V3

Technical updaters

Since it was first published, a number of technical contributors have updated, reviewed and verified specific and specialised sections of this textbook. Their work has been invaluable in producing such a comprehensive textbook and is much appreciated.

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Version

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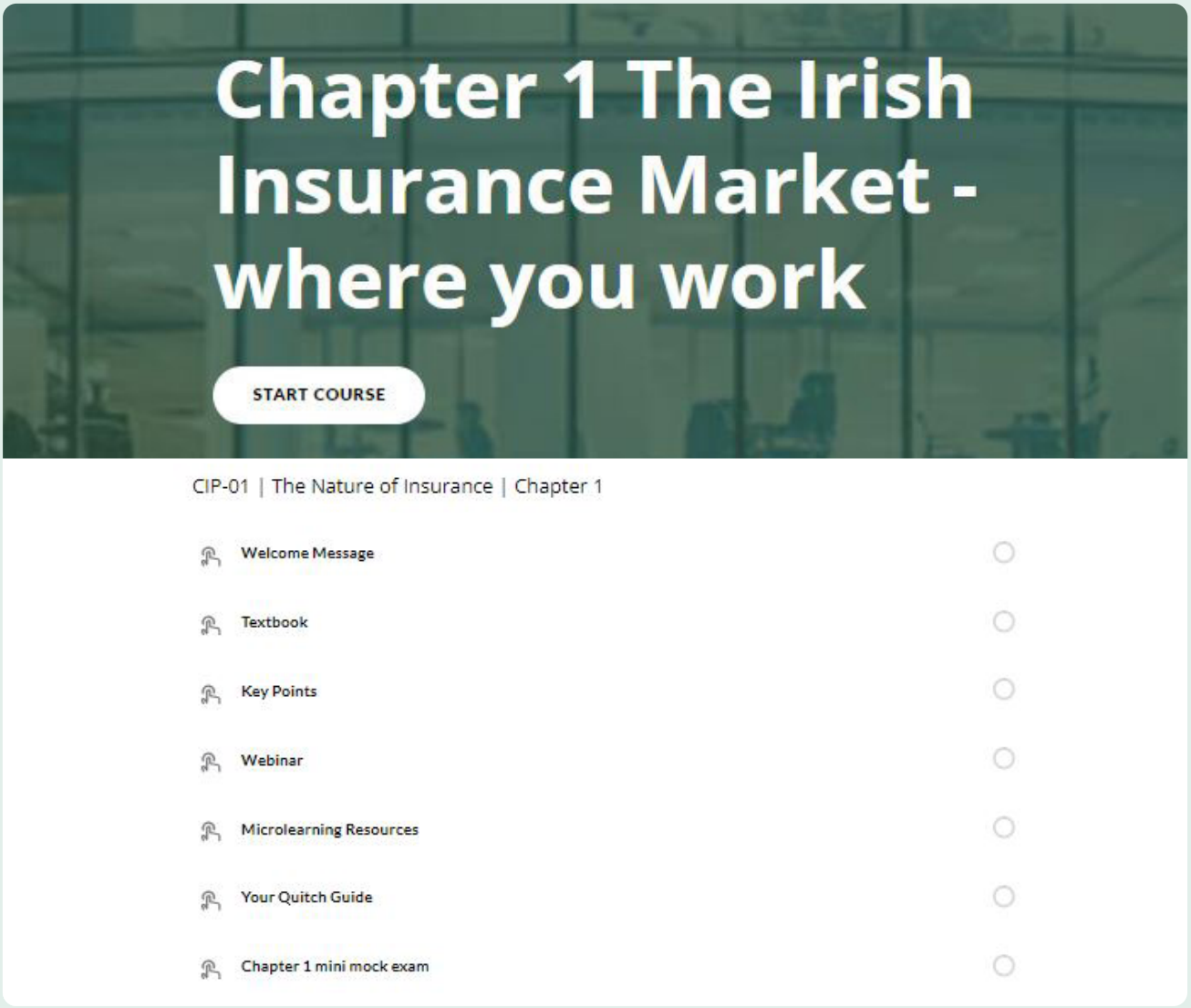

Your online learning supports provide you with a welcome to the module, identify how you learn best, provide you with your Guide to Success and give you invaluable study skills tips.

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All of the questions that feature in your exam are based on this textbook. The online learning supports listed on the previous page are provided to aid your study of the textbook, **not replace it**. The textbook includes key features designed to help you break down and remember the material as well as understand central concepts. These features work as follows:

Examples: These indicate how theories operate in simple day-to-day situations.

Extracts: Throughout this textbook you will see extracts from various relevant sources, such as reports, industry codes, speeches and legislation. In some cases, these extracts are summaries or abbreviations of the original source material. If necessary, the original source material should be accessed for the exact wording.

Just thinks: These offer you an opportunity to interact with the material by applying your learning.

Key terms: These appear in the margins and at the end of the textbook, and explain the meaning and context of insurance terms you may not have come across before.

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Quick questions: These appear throughout the textbook and are designed to test your knowledge as you go. You can check your answers at the end of each chapter.

End of chapter questions: These are a great opportunity to test your learning and understanding of the chapter's topics. You can check your answers at the end of the chapter.

Sample multiple-choice questions: These can be found at the end of each chapter and are examples of the type of questions that may appear on your exam paper. These questions and answers are provided to help you to focus your study and prepare for your exam.

Useful resources: These provide additional context to the material you're studying and keep you uptodate with current trends and developments. It is important to note however, that you will only be examined on the information contained within this textbook.

Index: At the end of the textbook, there is an index of legislation, legal cases, formulas and acronyms, and a glossary of key terms that provides a quick and easy reference to the material featured in the textbook.

Any questions? Contact our **Member Services** team on **01 645 6670** or **memberservices@iii.ie**, who will be happy to help. There is also a dedicated email for any CIP-related questions on cip@iii.ie

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Chapter

1

The Irish insurance market – where you work

What to expect in this chapter

If you are working or hope to work in the insurance industry, this chapter provides:

- an overview of who's who and what's what in insurance
- an idea of the size of the industry, e.g. employment levels, premium and claims volumes
- an introduction to the various professionals who work in this industry, e.g. insurers, advisers, reinsurers and industry bodies.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**The Irish insurance market**	Explain the structure and operation of the general and private health insurance markets.
B	**Insurance buyers**	
C	**Insurance providers**	
D	**Distribution channels**	
E	**Reinsurers**	
F	**The private health insurance market**	
G	**Industry and professional bodies**	Identify the functions of the main industry and professional bodies in the Irish insurance market.

A The Irish insurance market

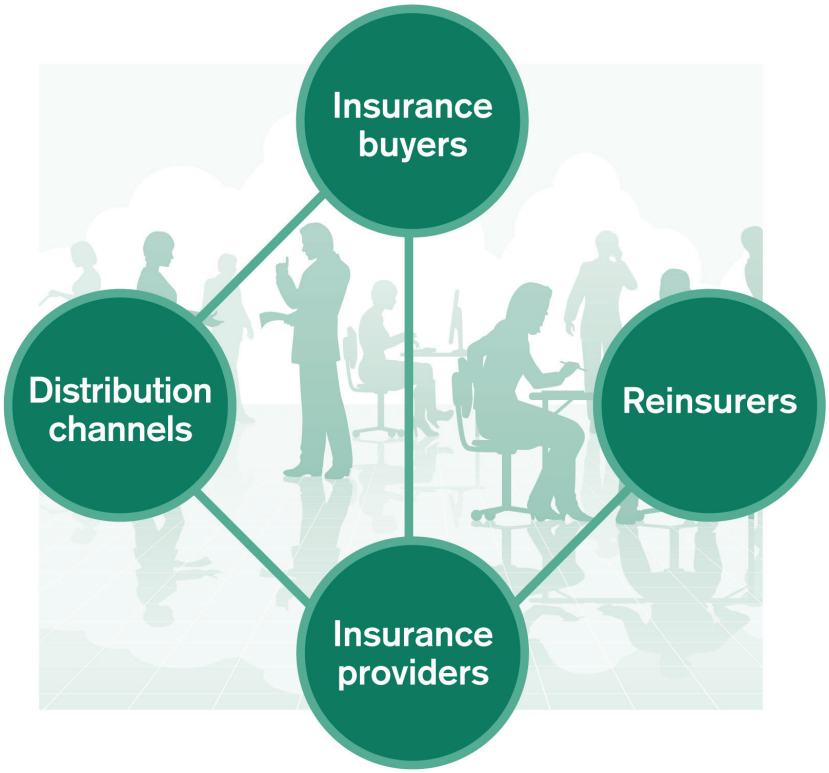
The insurance market involves four main groups as shown in Figure 1.1. These are:

- **Insurance buyers** – those who purchase insurance products and services, i.e. the customers
- **Insurance providers** – those who sell or provide insurance, e.g. insurers and the State
- **Distribution channels** – the means through which **customers** purchase insurance from insurers
- **Reinsurers** – those who provide insurance for insurers, i.e. other insurance companies or specialist reinsurance companies.

customer

a person (natural or legal/individual or firm) to whom an insurer or intermediary provides, or offers to provide, an insurance product or service, and any person who requests such a product or service; for an intermediary, the terms 'client' and 'customer' are interchangeable

Figure 1.1: Groups in the insurance market



In this chapter, we will learn about each of these groups as well as other organisations that, while not directly involved in the buying and selling of insurance, play an important role in how the market functions.

First, let's look at some key facts and figures to give you a feel for the Irish insurance market. In terms of gross premium income per class of business, motor insurance is the largest type of non-life insurance in Ireland. The exact figures vary from year to year, but motor premiums usually account for approximately 50% of all premiums collected by non-life insurers. Property is the second-largest class of insurance, followed by liability insurances in third place.

Approximately 28,000 people are employed, either directly or indirectly, in the insurance sector in Ireland. This includes those employed in insurance companies, insurance broking, loss adjusting, loss assessing, and outsourced services providers.

The insurance sector is therefore a major employer, with a wide range of job opportunities. One in four financial services jobs in Ireland are in the insurance industry.

Insurance Ireland

an industry body that represents Irish life and non-life insurers

The key facts and statistics in this section are drawn from the **Insurance Ireland**'s Factfile and Annual Report. The Factfile is an annual publication containing an analysis of the performance of the Irish insurance market. Insurance Ireland is discussed in greater detail in Section G1.

B Insurance buyers

These can be divided into four main groups:

1. private individuals
2. commercial concerns
3. public bodies
4. associations and clubs.

B1 Private individuals

Most people take out several types of insurance in their lifetime. As we saw in Section A, motor is the largest class of non-life insurance in Ireland in terms of gross premium income per class of business. Other types of cover purchased by individuals include household buildings and contents, private health, travel, gadget, mobile phone, caravan and pet insurance. What insurance have you taken out in the past?

B2 Commercial concerns

This is a broad category that can include a large multinational corporation with a multi-billion-euro turnover or a self-employed sole trader working from home. Partnerships and charitable organisations are included in this category. Types of cover sought include commercial property, motor fleet and liability insurance.

B3 Public bodies

Public bodies include local authorities and schools. In some cases, they may be large enough to have set up their own insurance fund through which they retain some risks. They may use the insurance market to cover other **risks**. Public bodies may also purchase specific cover for specialised classes of risk, such as professional indemnity insurance relating to negligent professional advice or cyber insurance for their IT systems.

B4 Associations and clubs

Whether it is a football club, an active retirement group or a scout troop, all clubs and associations will have some insurance needs, e.g. cover for possible injuries or damage to property owned. Such associations and clubs often come together in what is known as an **affinity group** (e.g. the Irish Farmers Association or trade unions) and approach insurance companies to provide group discounts or to discuss scheme arrangements for their members.

risk

uncertainty of future events and their outcome

affinity group

a group of people with a common interest or connection, who work together to achieve a common goal, e.g. to obtain discounted premium rates or exclusive insurance schemes

Quick question 1

Sarah is a self-employed architect operating as a sole trader. She wants to arrange a policy to cover her business activities. Is Sarah categorised as a private individual or a commercial concern?

The answer is at the end of this chapter.

Central Bank of Ireland

financial regulatory body in Ireland, responsible for the authorisation and supervision of all financial service providers

Consumer Protection Code (CPC)

Code issued by the Central Bank of Ireland setting out requirements that regulated firms must comply with in order to ensure a minimum level of protection for consumers

Quick question 1

Sarah is a self-employed architect operating as a sole trader. She wants to arrange a policy to cover her business activities. Is Sarah categorised as a private individual or a commercial concern?

The answer is at the end of this chapter.

Note: it is important to mention a group of insurance buyers that you will learn a lot more about in your studies. These are '**consumers**'. The **Central Bank of Ireland Consumer Protection Code (CPC)** defines consumers as any of the following:

a. a person or group of persons, but not an incorporated body with an annual turnover in excess of €3 million in the previous financial year (includes partnerships and other unincorporated bodies such as clubs, charities and trusts)

b. incorporated bodies with an annual turnover of €3 million or less in the previous financial year (provided the body is not part of a group with a combined turnover of more than €3 million).

… and includes a potential consumer.

C Insurance providers

Any company wanting to sell insurance in Ireland must be authorised by the Central Bank. The Central Bank must be satisfied that the applicant meets the conditions laid down in the **Insurance Acts and Regulations**.

Useful resources

Central Bank of Ireland website: www.centralbank.ie

Insurers can be distinguished from one another in terms of ownership and/or function. These categories include:

1. specialist insurance companies
2. composite insurance companies
3. captive insurance companies

The State, although not an 'insurer' in the usual sense of the word, also provides insurance for itself and other bodies and organisations in certain circumstances (see Section C4 for more information on The State as an insurer).

insurer
a regulated, risk-carrying entity (provider of insurance products)

specialist insurer
an insurer that offers a specific type(s) of insurance business not commonly offered in the wider insurance market

general insurance
any type of insurance other than life insurance; across the EU this is commonly known as 'non-life insurance'

composite insurer
insurer that accepts several types of insurance business (called classes or lines of business)

liability
being legally responsible for something, e.g. an accident or an injury to a third party

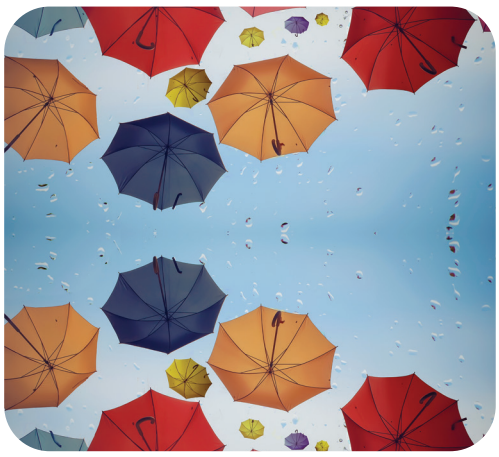
C1 Specialist insurance companies

Specialist insurers are authorised by the Central Bank to sell specific classes of insurance. They have expert knowledge in that particular class of insurance and can provide tailored cover to suit the risk. Examples include ARAG, which offers legal protection insurance and motor breakdown assistance, and DeCare Dental, which is a specialist dental insurer.

C2 Composite insurance companies

Most insurers in the Irish **general insurance** market are **composite insurers**. The range of business they accept usually includes:

- accident and health
- motor vehicle
- marine, aviation and transit
- fire and other damage
- **liability**
- credit.



Captives

Code issued by the Central Bank of Ireland setting out requirements that regulated firms must comply with in order to ensure a minimum level of protection for consumers

Quick question 2

What is unique about the owner of a captive insurance company?

C3 Captive insurance companies

Captives are usually formed by large multi-national organisations, e.g. Cadbury and Volkswagen. They only insure the risks of that particular organisation. For organisations of this size, using a captive is a cost effective and tax efficient risk management tool when compared with transferring its risks to the traditional insurance market.

The use of captives has become more common in recent years among large international businesses. These captives may be managed in-house or, in some cases, larger intermediaries with international customers (e.g. AON and WTW) will provide a range of captive management services.

Many captive companies operate from territories that provide a favourable tax regime such as Ireland, the Channel Islands, Bermuda and the Isle of Man.

Just think

Many captive insurance companies have chosen Ireland as a location rather than their home country or elsewhere. Why do you think this is?

There are many reasons for this e.g. an educated workforce, native English speakers, multilingual staff, a robust regulator, international airports, low tax rate. A key reason is that an Irish-based captive insurance company can issue policies to any country in the EEA.

C4 The State

The State can act as an insurer in situations where the insurance market is unable or unwilling to provide cover.

The State also acts as insurer for many of its own risks. For example, Government departments and many other State agencies do not have conventional insurance cover. Instead, these bodies operate under State indemnity, i.e. a self-insurance model where the State bears the financial risk associated with the costs of claims.

The State Claims Agency (SCA) deals with claims arising from such risks. It also manages personal injury claims (involving injuries to both employees and members of the public), property damage claims and clinical negligence claims brought against certain State authorities. These include, among others, all Government departments and other specified State bodies/authorities, the Attorney General, all Health Service Executive (HSE) facilities, public hospitals and other agencies providing clinical services and healthcare enterprises, An Garda Síochána, the prison services, and community and comprehensive schools.

The SCA also provides risk management advice and assistance to State authorities with the aim of reducing future claims and litigation.

Different authorities deal with other State claims. For example, IPB Insurance CLG insures local authorities and some of the largest public and national government bodies for liability, property and motor risks.

Useful resources

State Claims Agency website: www.stateclaims.ie

D Distribution channels

Distribution channels are the means through which insurers sell their products and services to insurance buyers. These can be divided into two main types – insurance purchased directly from the insurer and insurance purchased via an insurance intermediary (more commonly known as an insurance **broker**).

Direct insurance involves the seller (insurer) dealing directly with the buyer (customer). This distribution channel is greatly helped by technology, which allows the rapid collection, assessment and rating of information necessary for the **underwriting** function. Selling policies directly means the insurer does not have to pay an intermediary a fee or commission. In general, direct insurance takes place via branch offices, call centres and the internet.

An **insurance intermediary** (often abbreviated to 'intermediary') brings together buyers and sellers of insurance.

The Central Bank has defined the scope of the role of the different types of intermediaries. The main difference between these types of intermediaries is the type of advice provided and how they are remunerated. The legal and regulatory aspects of the role of intermediaries are dealt with in detail in the Compliance and Advice module.

D1 Other distribution channels

In recent years, there has been a significant growth in the types of distribution channels available to insurance buyers. Examples of these, as well as new, evolving distribution channels include:

- Building societies and banks (or 'bancassurance') promote products such as private health insurance, life insurance, serious illness cover, pensions policies, savings plans and household insurance.
- An Post offers a range of insurance products (car, home, travel, pet, cyber, farm, business and life) underwritten by product specific insurers but marketed to its customers as An Post Insurance. This process is known as **white labelling** and there are regulatory requirements regarding clarity in such situations.
- General insurers develop health plans through a registered private health insurer and promote products to their existing customer base.
- Tour operators and travel agents promote travel insurance (e.g. Ryanair).
- Retailers selling car insurance and other insurance products (e.g. Supervalu sell car and home insurance on behalf of AXA.)

Price comparison websites are useful tools for comparing market prices and products from a range of providers rather than contacting intermediaries or insurers directly. They are becoming increasingly popular, (e.g. www.compareinsuranceireland.ie, www.bonkers.ie, www.whoops.ie) and allow comparisons of a variety of insurance products, e.g. car insurance, mobile phone insurance. However, in the Irish market a customer cannot incept cover via a price comparison site, they can only compare prices and coverage.

distribution channel
the chain of individuals and organisations involved in getting a product or service from the producer to the customer

broker
an intermediary that provides their regulated activities on the basis of a fair analysis of the market

direct insurance
insurance sold by insurers where there is no intermediary in the selling or advising chain

underwriting
process of risk pooling, risk selection (choosing who and what to insure) and assessment of individual risks that meet the insurer's risk criteria

insurance intermediary (intermediary)
any person or firm, other than an insurer/reinsurer or their employees but including an ancillary insurance intermediary, which, for remuneration, takes up or pursues the activity of insurance distribution and is subject to the **Insurance Distribution Regulations 2018**

white labelling
insurance products underwritten by an insurer but marketed to a retailer's customers as its own product

Quick question 3

Price comparison websites are proving popular among insurance customers at the moment. Can you think of any disadvantages to using them?

reinsurance

insurance of an insurance company, e.g. against large insurance losses

reinsurer

a firm that takes on all or part of the risk covered under a policy issued by a primary insurer, in return for a premium

Lloyd's syndicate

a syndicate made up of one or more members of the Lloyd's market, who join together as a group to accept insurance/ reinsurance risks. Each syndicate tends to specialise in a particular type of insurance and is staffed by expert underwriters/ insurance professionals

Quick question 4

Name three types of reinsurers.

E Reinsurers

Reinsurance is a form of insurance for insurance companies. It is the transfer to a **reinsurer** of all or part of a risk underwritten by an insurer.

By providing reinsurance and accepting business originally underwritten by insurance companies, reinsurers play an important role in the market. They must be authorised by the Central Bank as reinsurance undertakings and, like insurers, they are subject to regulatory supervision.

The main types of reinsurer are:

- specialist reinsurers that do not sell insurance (only reinsurance)
- **Lloyd's syndicates**
- insurance companies that also act as reinsurers.

The last of these may at first seem odd. However, many insurers are prepared to accept shares of risks by means of reinsurance. They treat it as a means of further sharing risks.

Reinsurance is an international business and insurers usually spread their risks across a number of reinsurance companies, at home and abroad. Examples of reinsurers with operations in Ireland are Allianz Re, Hannover Re, Munich Re, Tokio Marine and Hiscox.

Reinsurance intermediaries/brokers have specialist knowledge and they play an important role in the reinsurance market. Their primary role is:

- securing business from insurers
- placing business with reinsurers
- servicing and maintaining the business.

We will learn more about reinsurance in Chapter 4E.

F The private health insurance market

In this section, we will consider the sellers and **advisers** that operate in the private health insurance market in Ireland.

It is important to note that the legislative framework of private health insurance creates a unique market. We will learn more about the regulatory constraints relevant to private health insurers in Chapter 4D of this textbook and later in the Personal General Insurance module.

According to a **Health Insurance Authority** (HIA) survey carried out in 2022[1], the main reasons for taking out private health insurance are:

- the high cost of medical treatment and accommodation
- long waiting lists or a perceived lack of access to public health services
- the belief that public health services are of an inadequate standard
- the offer of fully or partially paid insurance by an employer.

Customers without private health insurance commented that this was either because they felt it was unaffordable or no longer represented value for money. Of those interviewed, 46% saw private health insurance as a necessity, not a luxury. Interestingly, the Covid 19 pandemic has not changed the general public's view on health insurance.

adviser (advisor)

an individual involved in the advising process

Health Insurance Authority

a statutory regulator of the private health insurance market; established in 2001 under the **Health Insurance Acts**

Useful resources

Health Insurance Authority website: www.hia.ie

[1] The Health Insurance Authority (2022), *A Review of Private Health Insurance in Ireland 2021*, pdf, p.5, www.hia.ie

F1 Private health insurers

There are currently four **open membership undertakings** operating in the market – Irish Life Health, Laya Healthcare[2], Vhi Healthcare and the Hospital Saturday Fund (HSF) Health Plan Ltd.

HSF Health Plan Ltd operates differently from the other commercial private health insurers as it does not offer comprehensive in-patient plans.

open membership undertaking

a private health insurer that must accept any customer who seeks to take out cover

employee benefit consultant

intermediary employed to advise on and help place mainly health insurance business at a corporate level

F1a Other providers of health insurance

Restricted membership undertakings are schemes where membership is restricted to employees (and their dependants) of particular organisations. There are seven of these schemes in Ireland, e.g. the ESB Staff Medical Provident Fund. Although such schemes are subject to their own particular terms and conditions, they are regulated under the **Health Insurance Acts 1994-2022**.

F2 Employee benefit consultants

Employee benefit consultants normally work on a fee-for-service basis with large businesses that arrange health insurance for their employees as a fully or partially subsidised benefit. Only large corporate intermediaries, that want to provide an all-inclusive consultancy service to their customers, would hire employee benefit consultants.

Just think

Why might a medical card holder also purchase private health insurance?

A medical card holder might purchase private health insurance due to the long waiting lists to undergo a procedure under the public (medical card) healthcare system or to see a consultant. Other medical card holders might purchase private health insurance cover so that they can choose the consultant, the hospital and the type of in-patient care facilities they want, e.g. a private room.

Quick question 5

Which type of intermediary deals mainly with private health insurance?

[2] In August 2023, AXA Insurance acquired Laya Healthcare.

G Industry and professional bodies

Although not directly involved in the buying and selling of insurance, industry and professional bodies play an important role in the Irish insurance market. In general, these bodies do not have a regulatory function. Industry bodies represent the interests of their members, who work in a particular industry or sector. The role of professional bodies normally includes education and maintaining professional standards.

G1 Insurance Ireland

Insurance Ireland is the largest of the industry bodies in the insurance and reinsurance sector in Ireland. It has domestic and international member insurance companies (both life and non-life). Collectively, Insurance Ireland members insure over 95% of all life and non-life insurance business in Ireland.

Insurance Ireland

an industry body that represents Irish life and non-life insurers

Insurance Ireland has no statutory powers of regulation. Its role, as the voice of insurance and reinsurance companies in Ireland, is to represent and advocate on behalf of its members to Government, state agencies, regulatory bodies, public representatives, other national interest groups, the media and the general public.

Insurance Ireland also represents its members on a European and global level (see Section G3) and keeps them up-to-date on relevant policy and regulatory developments. It provides a forum for member debate and policy formulation on such issues.

The other roles undertaken by Insurance Ireland are as follows:

- InsuranceLink – This is a shared database established by Insurance Ireland to assist in the detection and defence of exaggerated injury claims, which may result in prosecutions for fraud. Those accessing and contributing to the database include insurers, third party service providers, intermediaries, large companies (e.g. Dunnes Stores) and public bodies (e.g. Córas Iompair Éireann (CIÉ) and Dublin City Council).
- Insurance Information Service (IIS) – This is a free service to the public, which aims to help those who want independent information about insurance, or need help in resolving a problem with their insurance company.

Declined Cases Agreement (DCA)

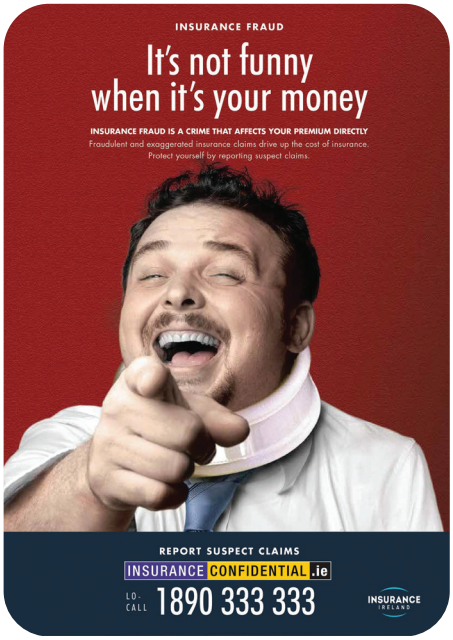
an agreement that ensures a designated insurer will provide cover to a motorist seeking insurance if the customer has approached and been declined by at least three insurers

- **Declined Cases Agreement (DCA)** – Insurance Ireland operates the DCA, which is adhered to by all motor insurers in Ireland, and assists those who are finding it difficult to obtain insurance quotes for compulsory third party motor insurance. The DCA is administered by a committee representing all motor insurers in the Irish market, in addition to representatives from the Consumers' Association of Ireland and the Financial Services and Pensions Ombudsman. In general, if an individual cannot obtain cover having approached at least three insurers, the first insurer approached will then be obliged to offer a quotation. If the individual has held a policy within the previous three years, the insurer of that policy is obliged to provide a quotation. The only grounds on which an insurer can refuse cover are when to provide insurance would be contrary to public interest. The DCA may also apply in cases where a quote is so high, or the terms of the policy offered are so stringent, that it amounts to a refusal.
- Annual Factfile – The annual factfile provides a detailed statistical analysis of the country's insurance sectors. This includes a breakdown of premiums, claims and market share, and the identification of market trends.
- Insurance Confidential – Established in 2003, this initiative addresses the increasing levels of insurance fraud in Ireland. If a member of the public suspects a person is falsely claiming or exaggerating their claim, they are encouraged to report the suspected case through the insurance confidential website or phone the LoCall helpline in confidence. All reports are passed to the relevant insurers or other bodies for investigation. This can result in a criminal prosecution or other consequences for the fraudster.

Just think

What do you think has prompted Insurance Ireland to become involved in fraud prevention and detection?

Insurance fraud costs insurance companies in Ireland an estimated €200 million annually.[3] Insurance Ireland is committed to reducing overall claims costs to its member companies and its activities in relation to fraud prevention and detection play an important role in this regard. Since its establishment thousands of cases of suspected fraud have been reported to Insurance Confidential.



[3] Insurance Ireland, 2021, '*Insurance Fraud Survey shows 84% in Ireland believe insurance fraud is unethical*', www.insuranceireland.eu

G2 Motor Insurers' Bureau of Ireland

The **Motor Insurers' Bureau of Ireland (MIBI)** was formed by an agreement between the Government and the motor insurance industry. It operates a scheme to pay compensation to victims involved in accidents with uninsured and unidentified vehicles. All motor insurers must, by law, be a member of MIBI.

The compensation provided by MIBI is determined according to the following circumstances:

- Personal injury claims – compensation may be awarded to the **claimant**, subject to liability, regardless if the vehicle is uninsured or unidentified.
- Vehicle/property damage claims – for claims of this nature to be covered, the vehicle must be identified by means of a valid registration plate. If identification is not possible, liability for vehicle or property damage will not exist unless there are significant personal injuries arising from the same accident. An **excess (deductible)** may apply to the vehicle or property damage claims.

  Where the damaged vehicle is comprehensively insured, or where the damaged property is covered under an insurance policy, the MIBI Agreement stipulates that the claim must be dealt with by the insurer of the damaged vehicle or property. However in such cases, a '**no claims discount**' protocol operates between MIBI and insurers which guarantees protection of the policyholder's no claims discount.

Useful resources

Motor Insurers' Bureau of Ireland website: www.mibi.ie

Motor Insurers' Bureau of Ireland (MIBI)

body set up between motor insurers and the Government, which aims to ensure that innocent victims of road accidents are properly compensated in circumstances where no effective motor insurance is in force

claimant

person or firm making a claim

excess/deductible

first part of each and every loss that is the responsibility of the insured; these terms are interchangeable in some sectors of the market

no claims discount

a reduction of premium for successive claim-free years, which increases each year up to a maximum of (usually) 5 years, held in consumer's own name

G3 Other industry and professional bodies

A selection of other industry and professional bodies is shown in Table 1.1.

Table 1.1 Other industry and professional bodies

Organisation	Membership and function
The Insurance Institute of Ireland	The professional standards, training and education body for the general insurance industry in Ireland.
Life Insurance Association (LIA)	An educational and professional body for people working in the financial services industry.
Brokers Ireland (BI)	An industry body representing insurance and financial brokers in Ireland. Its mission is to promote, support and protect its members in the areas of business development, education, legislation, lobbying and compliance.
Compliance Institute	A professional body of compliance officers and those employed by regulatory bodies.

Brokers Ireland

an industry body representing Irish general insurance and financial brokers

Table 1.1 Other industry and professional bodies (contd)

Organisation	Membership and function
Insurance Europe	A European federation of national insurance industry associations (such as Insurance Ireland), providing a forum at European Union (EU) level for its 37 member associations.
Bureau International des Producteurs d'Assurances et de Reassurances (BIPAR – European Federation of Insurance Intermediaries)	A European federation for national insurance intermediaries associations (such as BI), providing a forum at EU level for its 47 member organisations from 30 countries.
Global Federation of Insurance Associations	A global federation of national insurance industry associations (such as Insurance Ireland), providing a forum at a global level for its 40 member associations.
European Insurance and Occupational Pensions Authority (EIOPA)	A European supervisory authority safeguarding the stability of the insurance and occupational pensions sector, with the overall aim of early identification of potential risks and vulnerabilities.

Useful resources

Compliance Institute website: www.compliance.ie/

Brokers Ireland website: www.brokersireland.ie

Bureau International des Producteurs d'Assurances et de Reassurances website: www.bipar.eu

European Insurance and Occupational Pensions Authority website: www.eiopa.europa.eu

Global Federation of Insurance Associations website: www.gfiainsurance.org

Insurance Europe website: www.insuranceireland.eu

Insurance Ireland website: www.insuranceireland.eu

Life Insurance Association website: www.lia.ie

Motor Insurer's Bureau of Ireland website: www.mibi.ie

The Insurance Institute of Ireland website: www.iii.ie

Quick question 6

During the night, John's parked car was struck by a car. There were no witnesses. The impact sent John's car through the front wall of his house causing €120,000 worth of damage. How much compensation can John expect to receive from the MIBI?

H Summary

In this chapter we looked at some of the key features of the Irish insurance market. We also learned about the interaction between the various players in the marketplace and the different distribution channels used for the sale and purchase of insurance.

You should now have a good sense of the structure and operation of the market, as well as the main industry and professional bodies associated with it.

H1 What's next?

The Irish market is influenced and shaped by many factors and practices that we will look at as we move through the textbook. Chapter 2 introduces the concept of risk, which is at the heart of the insurance market.

H2 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

H3 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and study tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

Completing online mock exams and reviewing the personalised feedback that follows, is a great way of testing your knowledge and preparing for exam day.

To access these online learning supports, just log into your Member Area on www.iii.ie and click on the **Connect** logo.

End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 1.

1. State the four main groups in the insurance market.

2. List the four main types of insurance buyers.

3. Explain the term 'affinity group'.

4. State the difference between specialist and composite insurers.

5. Outline the main incentive for creating a captive insurance company in Ireland.

6. Outline the primary function of the State Claims Agency.

7. Outline the key advantages, from an insurer's perspective, of selling insurance directly to the customer.

8. List the main reasons why customers purchase private health insurance.

9. Identify the main types of reinsurer.

10. Outline the main role of Insurance Ireland.

11. Explain the purpose of the Declined Cases Agreement.

12. Explain the main function of MIBI.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. The four main groups in the insurance market are:
   - insurance buyers (customers)
   - insurance providers (sellers, i.e. insurers)
   - distribution channels (the channels that bring buyers and sellers together)
   - reinsurers (insurers or specialist reinsurance companies).

2. Insurance buyers can be divided into four main types:
   - private individuals
   - commercial concerns
   - public bodies
   - associations and clubs.

3. Affinity groups are groups of people with a common interest or connection, who work together to achieve a common goal, e.g. to obtain discounted premium rates or exclusive insurance schemes. Trade unions are examples of affinity groups.

4. Composite insurers accept several classes of insurance business but specialist insurers only accept a specific class(es) of business.

5. The main incentive for creating a captive insurance company in Ireland is that it provides a favourable corporate tax system.

6. The State Claims Agency manages personal injury claims (injuries to both employees and members of the public), property damage and clinical negligence claims brought against certain State authorities.

7. The key advantages, from an insurer's perspective, of selling directly to the customer are:
   - Reduced costs – no intermediary commission or fees
   - Efficiency – ease and speed of selling insurance is improved as immediate cover can be granted over the phone and internet.

8. Customers purchase private health insurance for the following reasons:
   - the high cost of medical treatment and accommodation
   - long waiting lists or a perceived lack of access to public health services
   - the belief that public health services are of an inadequate standard
   - the offer of fully or partially paid insurance by an employer.

9. The main types of reinsurer are:
   - specialist reinsurers that do not sell insurance, only reinsurance
   - Lloyd's syndicates
   - insurance companies that also act as reinsurers.

10. The role of Insurance Ireland is to represent and advocate on behalf of its members to Government, state agencies, regulatory bodies, public representatives, other national interest groups, the media and the general public. Insurance Ireland also represents its members on a European and global level and keeps them up-to-date on relevant policy and regulatory developments. It provides a forum for member debate and policy formulation on such issues.

11. The purpose of the Declined Cases Agreement is to assist those who are finding it difficult to obtain insurance quotes for compulsory third party motor insurance.

12. The main function of MIBI is to compensate victims of road traffic accidents caused by uninsured or unidentified vehicles.

Answers to quick questions

1. Sarah is categorised as a commercial concern as she is providing a business service and the insurance she is purchasing is for business purposes rather than private purposes. However, as you will learn later in your studies, Sarah would be classed as a consumer by the Central Bank and consumer protection legislation as her revenue would likely be under €3 million.

2. The owner of a captive insurer is always a non-insurance parent company and the captive insurer only insures the risks of that particular parent company.

3. One disadvantage is the tendency to focus on price rather than cover, key product features and wordings; another is the inability to easily obtain answers to questions that may arise in the purchasing process.

4. Reinsurers can be:
   - specialist reinsurers
   - Lloyd's syndicates
   - insurance companies.

5. Employee benefit consultants deal mainly with private health insurance.

6. John will not be able to claim from the MIBI as the damage to John's property was caused by an unidentified vehicle. However, if the vehicle is comprehensively insured and the house is also insured, he can claim from his insurers without his no claims discount being affected.

Sample multiple-choice questions

Note: In your exam you will be awarded +3 marks for every question answered correctly, -1 mark for every question answered incorrectly, and 0 marks for every question you choose not to attempt. On the answer form you complete in the exam, you will be required to choose from options A, B, C, D or E. Options A–D correspond with a possible answer to the question, while selecting Option E confirms you are choosing not to attempt the question. When you attempt the mini-mock and full mock exam papers available in your Member Area, this marking system is applied to allow you to prepare for your exam.

Question 1

In terms of gross premium income per class of business, which of the following is the **largest** class of non-life business:

A. property

B. motor

C. accident and health

D. liability

Your answer:

☐

Question 2

Which of the following is a private individual **most likely** to approach for a household insurance policy?

A. A captive insurance company.

B. An insurance intermediary.

C. An employee benefit consultant.

D. A reinsurance company.

Your answer:

☐

Question 3

A member of the public has submitted a claim against a public hospital for a fall they suffered. This claim would be managed by:

A. the Personal Injuries Assessment Board

B. IPB Insurance CLG

C. the State Claims Agency

D. the Health Insurance Authority

Your answer:

☐

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 1A1

Question type: K

Correct response: B

Learning outcome: Explain the structure and operation of the general and private health insurance markets.

Question 2

Chapter reference: Chapter 1D

Question type: U

Correct response: B

Learning outcome: Explain the structure and operation of the general and private health insurance markets.

Question 3

Chapter reference: Chapter 1C4

Question type: U

Correct response: C

Learning outcome: Explain the structure and operation of the general and private health insurance markets.

The Insurance Institute

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Quitch

Chapter

2

Risk and risk management

What to expect in this chapter

Now that you know more about the structure and operation of the industry you're working or hope to work in, it's time to start looking at what makes this industry tick. If there were no such thing as risk there would be no need for insurance. However, only certain types of risk can be insured. In this chapter we look at the different classifications of risk and how we determine whether or not a risk can be insured.

This chapter sets the scene for Chapter 3, which introduces us to the insurable risks that people and organisations face and how insurance helps them to manage those risks.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**The concept of risk**	Explain and apply these key insurance terms – risk, uncertainty, frequency, severity, peril and hazard.
B	**Components of risk**	
C	**Risk management**	Recognise the interaction between risk management and insurance and identify the risk management techniques that can protect customers and their businesses (physically and financially).
D	**Risk classifications**	Classify risks to determine whether they are capable of being insured.
E	**Requirements for insurable risks**	

A The concept of risk

Insurance is the main way for individuals and businesses to reduce the financial impact of a risk occurring. There is no single definition of risk and people interpret the term in many different ways. Some people might describe it as uncertainty or danger, while others might think of it as the potential consequences of unwanted events, such as damage to property or a serious injury.

We all face some degree of risk in our everyday lives. For an individual, this can be something as simple as deciding whether it is safe to cross a road; for a business, it could be about evaluating the pros and cons of launching a new product. Normally, however, we tend to consider risk in terms of potentially catastrophic events and we often try to protect ourselves against the consequences of such events through the purchase of insurance.

Risk is widely defined as a situation involving exposure to danger. This definition is helpful, but we must also look at other uses of the term. These include:

- the possibility of an unfortunate occurrence
- doubt concerning the outcome of a situation
- unpredictability
- the possibility of loss.

We can see that there are two key elements common to all types of risk – uncertainty and unpredictability.

Think about the risks associated with owning and using a car. They include the risk of:

- car theft
- damage caused by an accident
- injury to the driver
- injury to others
- damage to property
- prosecution for a motoring offence.

Just think

What other risks do you face as an individual? Think about the risks to your person and to what you own, within your living and work environment and in the wider world.

You may have thought about your car, your home and other possessions – all tangible assets. Any one of them could be lost, damaged or stolen. Your environment, on the other hand, includes less tangible risks, such as to your health and finances. Various social risks may also arise, e.g. through joining clubs and organisations. Then there is the possibility of unemployment, recession, government instability and legislative change. As we consider more and more aspects of our environment, we can see that risk is inherent in most of what we do. External influences can combine to bring about unexpected and unwanted results. Many of these are not within our control but we may be able to manage their effects. Through the purchase of insurance, the financial consequences of a risk are transferred from the insured person to the insurer.

Although we are considering risk in its generic sense, there are three other ways in which the word is used in the insurance marketplace, as shown in Table 2.1.

Table 2.1 Other uses of the term 'risk'

1. The source of the possible loss or exposure, e.g. fire, theft or liability risk
2. The thing (or liability) insured, e.g. a factory, house, public liability, motor car or individual
3. A combination of 1 and 2, where an insurer will refer to insuring a 'risk', which means the thing itself and the cause of the possible loss.

Point 3 may not be familiar to you, so let us consider Example 2.1.

Example 2.1

An insurer is considering a household risk for a house in an area where there has been a series of floods in the past. The insurer is asked: 'Will you insure this risk?'

In this situation, the insurer is being asked to consider both the physical bricks and mortar of the house and the likelihood of future flood damage (both the thing and the cause of loss). This is what is referred to as the 'risk'.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

B Components of risk

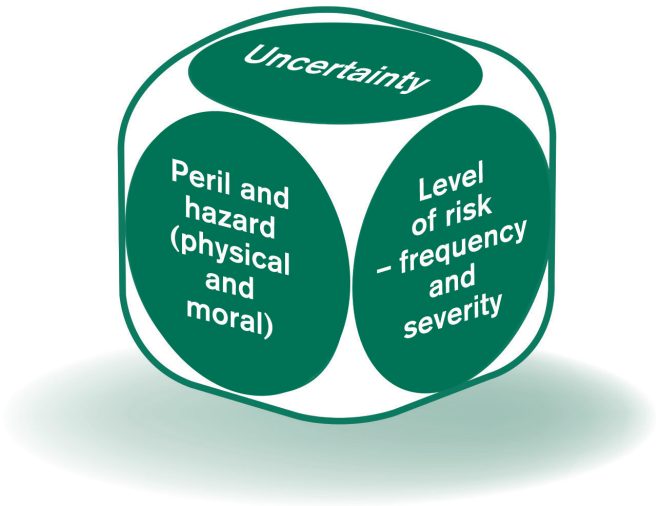
Risk also has a positive side, e.g. the 'risk' of a favourable financial outcome when setting up a business. However, in the context of insurance, risk is viewed from a negative perspective, i.e. the possibility of loss rather than gain.

When we consider risk in this way there are three aspects that are important for our studies:

- Uncertainty – 'Will it ever happen?' or, as in life insurance, 'When will it happen?'
- Level of risk – 'How often will the loss occur and how severe will it be?'
- Peril and hazard – 'What **peril** is involved and what are the relevant **hazards**?'

Figure 2.1 illustrates these three aspects of risk, which are explained further in the following sections.

Figure 2.1: Aspects of risk



B1 Uncertainty

Uncertainty is at the core of the concept of risk. If we know what's going to happen and when, then there is no element of risk. If you know that your house will burn down at 4pm tomorrow, or that on the way home you will have a car accident, the event is a certainty rather than a possibility.

B2 Level of risk

This relates to how risk is measured. There is a greater likelihood of some events happening than others. We know that some events will cost more than others. The level of risk is normally assessed by insurers in terms of **frequency** and **severity** as establishing the level of risk is vital for an insurer when trying to determine whether to accept the risk and the appropriate premium to charge.

peril

event or occurrence that gives rise to a loss or liability

hazard

any feature that influences the operation of a peril, either in its likelihood of occurrence (frequency) or its severity

Quick question 1

What is the element of uncertainty in relation to life insurance?

The answer is at the end of this chapter.

frequency

how often an event will (or is likely to) happen

severity

the seriousness (size/consequences) of an event (also referred to as 'impact')

B2a Frequency

Insurers try to gauge the frequency or likelihood of an event occurring based on past experience. Before we consider how they do this, read through Example 2.2.

Example 2.2

Imagine a house situated beside a river that is prone to overflowing. Past experience (i.e. the known history of the river overflowing) increases the likelihood of this house suffering flood damage.

Now imagine a second house that is 100 metres away from the river bank and on a slight hill. This house is less likely to be flooded because of its position and altitude.

In both cases, we are considering how often flooding might occur (the frequency or likelihood). This is an important aspect of risk assessment.

Just think

Think of other risks, both personal and commercial. In the case of each of these risks, think about what factors would influence the frequency of loss?

Other risks with factors impacting on the possible frequency of loss include:

- Motor insurance – age and type of vehicle, driving experience of driver (likelihood of risky activities)
- Property insurance – industrial processes (likelihood of fire or explosions)
- Employers liability insurance – unguarded machinery (likelihood of worker injury)
- Bicycle insurance – inadequate security when unattended (likelihood of theft)
- Personal accident insurance – general carelessness about personal health and safety (likelihood of accident or injury).

So far, in each scenario we have only considered the risk that a loss, injury or damage may actually occur (frequency). We also need to consider the potential size of any loss.

B2b Severity

If we factor in the potential amount of loss, damage or destruction, the overall level of risk may change. In other words, as well as frequency, we must also consider the severity (impact in terms of scale or seriousness) of the loss that might occur.

To return to our earlier example of the two riverside houses, what if the house closest to the river is valued at €100,000 and the second house further away is valued at €500,000? While the €100,000 house more likely to be flooded, the potential loss is €100,000. On the other hand, the €500,000 house is less likely to be flooded but, if this happens, the potential loss is €500,000.

This illustrates the importance of considering both frequency and severity when assessing the level of risk.

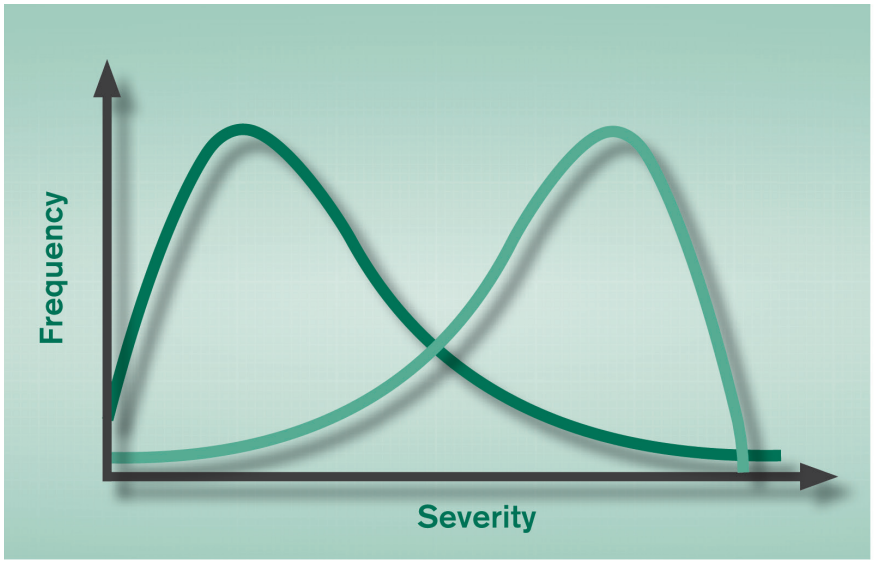
Quick question 2

When considering 'severity', what are we trying to determine?

B2c Relationship between frequency and severity

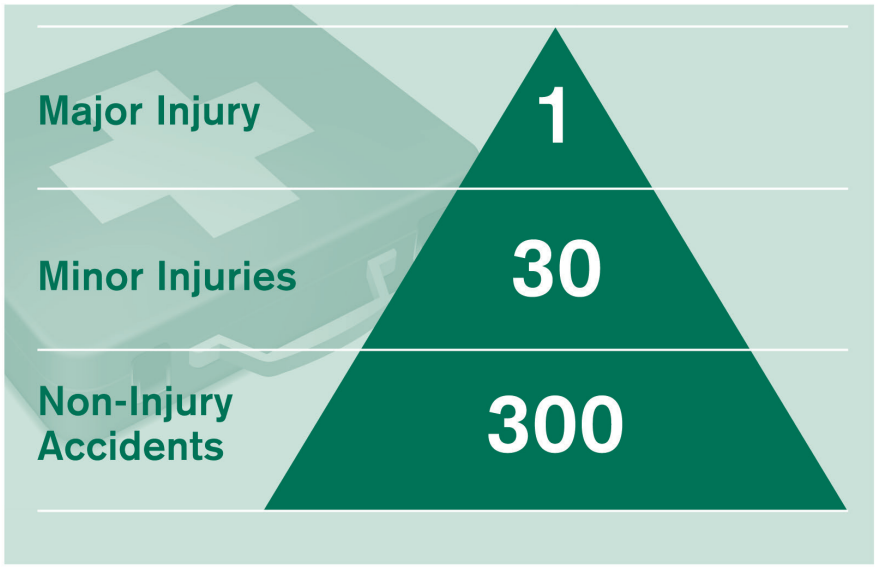
In many risk situations, we see a standard relationship between frequency and severity. There is a high frequency of low-severity losses and a low frequency of high-severity losses. These relationships are illustrated in Figure 2.2.

Figure 2.2: Frequency-severity relationship



The Heinrich Triangle in Figure 2.3 shows that, for every one major injury at work, there are 30 minor ones and 300 non-injury accidents. The triangle was the result of analysing several thousand work incidents and these figures have been confirmed by later studies. The pattern shows that there are few serious incidents (low frequency-high severity) and many minor ones (high frequency-low severity).

Figure 2.3: The Heinrich Triangle



The relationship of 'high frequency/low severity' and 'low frequency/high severity' has also been shown to exist for other areas of risk, including motor accident and property damage.

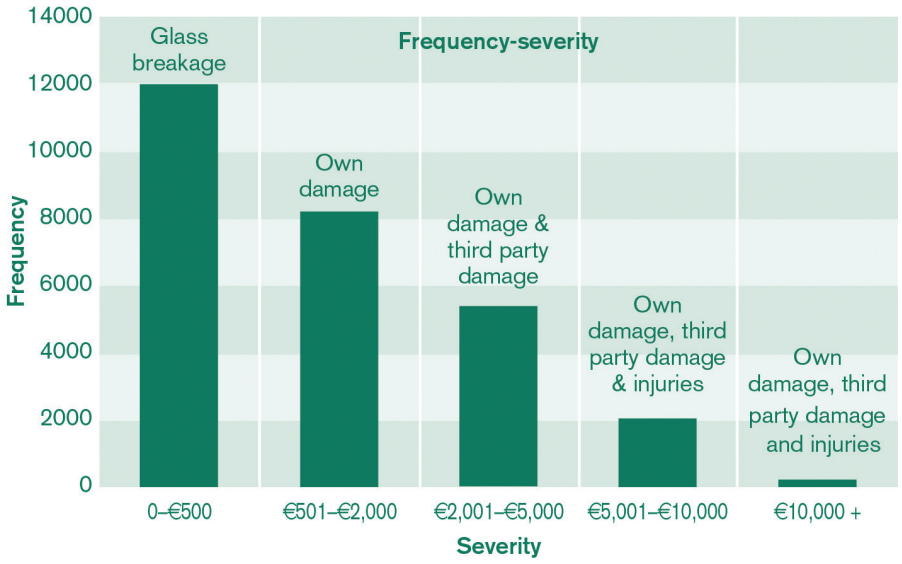
Table 2.2 illustrates some common examples of this relationship in different types (classes) of insurance. It reflects the typical experience of a busy claims department in an insurance company.

Table 2.2 Classes of insurance

Business class	Type of incident	Frequency	Severity
Motor	Windscreen	High	Low
Motor	Multiple fatalities	Low	High
Household	Accidental breakage	High	Low
Household	Subsidence	Low	High
Travel	Baggage claim	High	Low
Travel	Death overseas	Low	High
Private health insurance	Broken arm/leg	High	Low
Private health insurance	Critical illness diagnosis	Low	High

Motor claims handlers deal with large numbers of claims for minor damage to vehicles but, thankfully, fewer claims involving serious or fatal injuries. In other words, they see a high frequency of low severity claims and a low frequency of high severity claims. Figure 2.4 illustrates the frequency-severity relationship in terms of different types of motor claims.

Figure 2.4: Illustration of frequency-severity relationship in motor claims



Quick question 3

According to the Heinrich Triangle, if a large industrial company sustains 1,500 non-injury accidents in a given year, how many minor and major injury accidents would you expect it to suffer?

The different profiles of frequency (number of claims) and severity (cost of each claim) help insurers to predict the overall cost of claims likely to arise for a particular class of business. This enables them to set appropriate premiums and to decide on the level of risk they are prepared to accept.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

B3 Peril and hazard

Peril and hazard are important aspects of risk as they relate to the cause of a loss.

- A peril can be defined as the event or occurrence that gives rise to a loss or liability (the main cause of the loss).
- A hazard can be defined as any feature that increases the frequency or severity of a peril.

Example 2.3 outlines the distinction between a peril and a hazard.

Example 2.3

A timber-framed house is insured against fire. Fire is therefore the peril, because it is the insured risk, the primary cause of loss named in the policy. However, the timber frame has the potential to encourage a fire to spread quickly and result in greater loss if a fire occurs. The timber frame is therefore a hazard.

Other examples of perils are:

- If household contents are damaged because of an overflow from a water tank, the peril is escape of water.
- If a window is broken in the course of a burglary in which an expensive necklace is stolen, the peril is theft.
- If a vehicle is damaged following a collision with another motorist, the peril is collision.
- If a restaurant is flooded due to a nearby river bursting its banks, the peril is flood.

Other examples of hazards are:

- A safari holiday – The presence of local diseases and the likelihood of injury while engaging in safari activities all increase the possible extent of loss and are hazards in travel insurance.
- A high number of motoring convictions – This increases the likelihood of poor quality driving or reckless driving and is a hazard for motor insurance.
- An area with a high crime rate – This increases the likelihood of car thefts, vandalism and burglary and is a hazard for motor or property insurances.
- A building or home regularly left unoccupied – This increases the likelihood of break-ins and is a hazard for household or property insurances.

Just think

Did you notice any difference between the types of hazards we have just considered?

There is an important distinction between the types of hazards presented by different risks. Hazards can be physical or moral.

B3a Physical hazard

Examples of a **physical hazard** are:

- Security protection at a shop – the absence of a quality security system can increase the physical hazard presented, as the premises will be more vulnerable to an attempted break in.
- Construction of a property – the lower the standard of building construction, the poorer the physical hazard for fire and similar risks, as the building will be less resistant to damage.

Example 2.4 provides a case study demonstrating both positive **discrimination factors** and physical hazards.

physical hazard

the physical aspects of a risk that increase the likelihood or probability of a loss occurring and which directly impact on the risk's insurability or on the terms, conditions and exceptions on which insurance may be provided

discrimination factor

a feature of a risk that presents a poorer or better hazard

Example 2.4

BuzzMe is a company that produces mobile phones. It recently purchased a new business unit in an area with a high crime rate. Due to inadequate lighting in the surrounding area, the company installed a camera surveillance system and their vehicles are garaged overnight. As it makes deliveries nationwide, the garage (part of the business unit) stores 50 litres of petrol on a continual basis. The company provides regular health and safety training to staff.

Physical hazards

- Attractiveness of stock, small in size relative to value and not easily traced – high risk of theft loss
- High crime-rate area – increase likelihood of theft loss
- Poor lighting – further increased likelihood of theft loss
- Gasoline in garage – increased likelihood of fire loss with catastrophic potential.

Positive discrimination factors

- Camera surveillance system – deterrent to would-be thieves and therefore reduced likelihood of theft loss
- Vehicles garaged overnight – reduced likelihood of motor theft loss
- Regular staff health and safety training – reduced likelihood of employers liability loss.

Underwriters pay close attention to positive discrimination factors in all classes of business. For example, driver experience, low mileage, burglar alarm and mortice deadlocks are positive discrimination factors, which may result in premium discounts for the **insured/policyholder**.

insured/policyholder

a person or firm that has arranged a contract of insurance with an insurer

Quick question 4

List other examples of positive discrimination factors.

B3b Moral hazard

Examples of a **moral hazard** include:

- Carelessness – A driver's lack of care can increase the chance of an accident happening and its severity.
- Dishonesty – A person who has previously been open and upright in their dealings with insurers represents a better moral hazard than one who has made, or is suspected of making, fraudulent or exaggerated claims.
- Social attitudes – Some individuals do not regard cheating insurers as immoral.

Example 2.5 outlines a situation that demonstrates a moral hazard.

moral hazard

factors concerned with the attitude and conduct of people (in insurance, usually the person insured but also the insured's employees and that of society as a whole)

Example 2.5

George's car is a standard model with no unusual features. However, George has had two insurance claims in the past and two motoring convictions.

The first claim involved car theft. George told his insurer that the car was recovered in a damaged state after a theft. On investigation, the insurer suspected that the car had not been stolen, but was reported to the Gardaí as a theft because George had only third party, fire and theft cover. Therefore, his policy covered damage to the car due to theft, but did not include damage resulting from an accident.

The second incident involved a household insurance claim. Following what the insurer believed to be a genuine theft, there were suspicions that extra 'stolen' items had been added to the list. There were no receipts available.

His motoring convictions involved driving through a red light and failing to stop when required to do so by a Garda.

Moral hazards

a. Suspicion of fraud – Faking an incident and falsely including non-stolen items in a theft claim are very serious matters.

b. Motoring convictions – While insurers may be prepared to take a generous view of a minor parking offence, the type of offences George had committed demonstrates an irresponsible and careless attitude.

B3c Distinguishing between physical and moral hazards

Sometimes, it can be difficult to distinguish between a physical and a moral hazard. This is because a moral hazard is often accompanied by some poor physical aspect to the risk. Take the examples of the physical hazard of unguarded machinery in a factory or a poorly controlled smoking environment. These physical hazards clearly arise from the attitude and behaviour of those in charge, which encourages a careless approach to safety (moral hazard).

However, we must not assume that a poor physical hazard is automatically accompanied by an adverse moral hazard. For example, a fireworks factory represents a very poor fire risk but it does not follow that there is a poor moral hazard to the risk. Equally, a young driver who is driving a high-performance car will not necessarily drive irresponsibly. However, statistics do show that a disproportionately high number of accidents are caused by young drivers. In addition, the car itself will be in a high-rating category because of its value and performance. These two aspects comprise a physical hazard because they are measurable; so too would a poor claims history, serious motoring convictions or numerous penalty points.

The significance of these aspects of hazard is that they will influence insurers' decisions as to the acceptability of risks and the pricing of policies. These factors will also influence decisions by insurers regarding how much of a risk they should accept, and the degree to which the risk should be shared with other insurers or reinsurers.

Quick question 5

Why is it sometimes difficult to distinguish between a physical and a moral hazard?

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

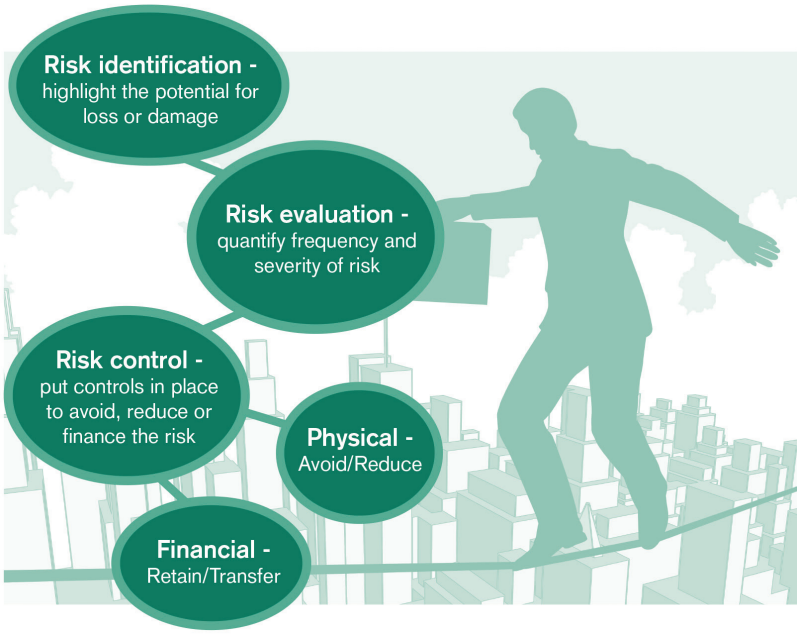
C Risk management

Everyone's attitude to risk is different and everyone responds to it in different ways. Some people can be described as **risk-seeking** while others can be described as **risk-averse**.

Regardless of our attitude to risk and without even realising it, as individuals we all engage in risk management every day. We look before we cross the road; we set the house alarm and install fire alarms; we eat healthily and exercise; we use safety equipment at work.

Businesses approach the issue of risk management in a far more structured way. They tend to adopt a more formalised and strategic approach and may employ a risk manager to oversee the process. Regardless of the formality of the process undertaken, the basic steps are the same and these are outlined in Figure 2.5.

Figure 2.5: Risk management process



Risk management is important because it:

- reduces the potential for financial and physical loss by identifying and managing hazards
- gives stakeholders in a business (e.g. employees, shareholders, suppliers and customers) a greater degree of confidence in the company, and gives individuals some peace of mind
- provides a disciplined approach to quantifying risks.

All risk can be managed using a simple step by step process:

- Risk identification – highlight the potential for loss or damage
- Risk evaluation - quantify frequency and severity of risk
- Risk control – put controls in place to avoid, reduce or finance the risk.

risk-seeking

a willingness on the part of an individual or company to accept certain risks

risk-averse

a desire on the part of an individual or company to minimise the risks to which they are exposed, either through risk management or insurance

As can be seen from Figure 2.5, the focus of risk management is the treatment of identified risks. Risk management should be a continuous and evolving process. In the case of an organisation, it should address methodically all the risks surrounding the organisation's activities – past, present and, in particular, future. We will now briefly explain each step of this risk management process.

C1 Risk identification

Risk identification establishes current and future threats. The risk identification process will often involve the following activities:

- carrying out detailed or general physical inspections of premises
- detailing the processes and business activities involved
- face-to-face discussions with those involved
- completion of questionnaires/checklists
- flow charts of processes or product manufacture
- inspection of records of accidents or other incidents
- understanding precisely the causes of previous claims/losses
- accessing current health and safety statements and comparing these with best practice guides regarding hazards
- an examination of the business' accounts
- an assessment of the business' future plans for expansion or contraction.

As mentioned previously, individuals do not need to carry out such a comprehensive risk identification process. However, everyone should give some thought to identifying the risks they are exposed to in relation to issues such as their health, car, home, personal belongings and employment.

C2 Risk evaluation

Each risk identified must be assessed in terms of how likely it is to happen (frequency) and the consequences if it does happen (severity). Past data, such as patterns of workplace accidents, can be used in this evaluation. The actions taken following the evaluation will depend on whether the organisation or individual is risk-seeking or risk-averse. Each risk will then be managed using one of the risk control options outlined in Section C3.

C3 Risk control

Risk control can be divided into categories – **physical risk control** and **financial risk control**.

C3a Physical risk control

Risks can be physically controlled in one of two ways – by avoiding them, or by reducing them.

For example, if a manufacturer carries out a highly hazardous paint-spraying activity, it may decide to outsource the process and therefore avoid that particular element of the risk. However, in many situations the only way that a business could eliminate or avoid risk completely would be to stop trading. Risk is implicit in every aspect of personal and commercial life and, in most situations, cannot be avoided.

There are, however, methods by which risks may be substantially reduced. Using the example of the paint-spraying activity, the manufacturer could install powerful extraction fans to remove toxic fumes. All staff engaged in this activity or working in that particular area could be provided with protective masks, goggles and health and safety training.

In Section B3 we identified physical and moral hazards and how they can be reduced. Best practice guides (e.g. Health and Safety Authority guides), online risk management facilities (e.g. BeSMART), and legislation (e.g. **Safety, Health and Welfare at Work Acts and Regulations** which specify safety measures, e.g. manual handling requirements in the workplace) are good sources of information and advice on measures that can be used to reduce risks. For example, with regard to property insurances, enhanced security measures or fire-prevention devices are often part of a cost-effective, risk-reduction strategy. Motor risks can be reduced by complying with the relevant legal requirements, e.g. completing the National Car Test (NCT) or Commercial Vehicle Roadworthiness Test (CVRT), observing speed limits and wearing a safety belt.

Just think

Can you remember the two ways in which risks can be physically controlled?

If a risk cannot be completely avoided or substantially reduced, the individual or organisation will need to control it financially.

Useful resources

Health and Safety Authority website: www.hsa.ie

physical risk control

physical measures undertaken to eliminate or reduce risks faced by a firm or individual

financial risk control

a mechanism for either retaining risk (self-insurance) or transferring it by contract or insurance

C3b Financial risk control mechanisms

The two mechanisms for financial risk control are:

- **risk retention** – where the risk is retained by the person or organisation exposed to it
- risk-transfer – where the risk is transferred to a third party contractor or an insurer.

If insurance is unobtainable (or only available at what is considered an uneconomic cost) and the risk cannot be transferred to another party by contract, the risk will be retained. This may be done in one of the following ways:

- as a regular business cost, i.e. costs relating to risks (e.g. fire damage, injury claim) are treated in the same way as items such as rent, light, and heating
- setting aside resources (self-insurance)
- setting up a captive insurance company (see Chapter 1C3)
- ignoring the risk (non-insurance)
- agreeing with insurers to increase the **deductible/excess** for certain property or liability covers.

When selecting a **risk-transfer mechanism**, individuals and organisations have various options, e.g. hiring a security firm to carry money rather than using company staff. However, in most cases, the transfer of risk is done through the purchase of insurance and this is examined in detail in Chapter 3.

risk retention

when an individual or organisation takes responsibility for a particular risk (or part of a risk) it faces. Instead of transferring that risk to a third party (by means of a contract) or to an insurer (by purchasing insurance), the losses or liabilities will be borne by the individual or organisation themselves.

deductible/excess

first part of each and every loss that is the responsibility of the insured; these terms are interchangeable in some sectors of the market

risk-transfer mechanism

acceptance of unknown future liabilities by an insurer and the transfer of the uncertainty of potential future claims by the insured for an agreed premium

C4 Risk management and the link with insurance

The decision to insure is generally the final element in the risk management process. With the exception of situations where insurance is compulsory, i.e. third party motor insurance and insurances for specific occupations (e.g. professional indemnity for solicitors), the decision to insure should be taken at the end of the process. Ideally, at that stage, affordable risk improvements and the reduction or elimination of serious risks should be already completed or in progress.

You will probably have noticed that the risk improvements that arise during the risk management process are of benefit to both the insurer and the insured. Both parties have a common interest in seeking to minimise risk and they undertake a similar process in order to identify and measure potential risk. However, each approaches their common goal from a different perspective.

Quick question 6

If a small business wishes to retain a share of its risks, is it a viable option to set up a captive insurer?

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

D Risk classifications

As mentioned earlier, it is important to note that not all risks identified are automatically insurable.

We will now look at how risks are categorised to identify those that are insurable and those that are not. The groupings we will look at are:

- financial and non-financial
- pure and speculative
- particular and fundamental.

D1 Financial and non-financial risks

For a risk to be insurable, the outcome of adverse events must be measurable in financial terms. This is not always possible.

Consider, for example, the prospect of a holiday with the intention of experiencing happiness and enjoyment for a period of time. While we may be able to insure certain aspects, e.g. the delayed departure of an aircraft, we cannot insure the 'enjoyment' factor, as this cannot be measured in financial terms. In the same way, the value we might place on an heirloom that has been in the family for years may be far beyond its market value. The heirloom could be insured for its market value but not for its sentimental value. Insurance is not appropriate for such 'unquantifiable' risks.

Most general insurances are compensatory in nature. This implies that there is some external, independent measure that may be used to assess actual value. However, personal accident and sickness policies are important exceptions. These are known as **benefit policies** because there is no way of valuing precisely the loss of a life, the loss of a limb or the loss of sight. Similar considerations apply to life insurance policies.

Table 2.3 shows examples of financial and non-financial risks in different types (classes) of insurance.

benefit policy

a policy that provides stated pre-agreed amounts/ benefits rather than exact financial compensation

Table 2.3 Financial and non-financial risks

Item/issue	Financial	Non-financial
Motor	Damage, theft – market value or repair cost	Selection of an unreliable car
Household	Damage, theft – '**new for old**' cover	Sentimental value
Business	Loss of earnings following named perils	Poor or inappropriate choice of company logo
Legal liability towards others	Loss of earnings, pain and suffering of third party as awarded by a court or the **Personal Injuries Assessment Board (PIAB)**	An award of a **prohibitory injunction**

'new for old'
cover providing replacement of lost or damaged items with new equivalent versions

Personal Injuries Assessment Board (PIAB)
independent statutory body set up to assess compensation due to an injured party when someone else is to blame for the injury

prohibitory injunction
a court order to refrain from doing a particular act

pure risk
a risk where there is the possibility of a loss but not a gain, where the best that can be achieved is a break-even situation

damages
financial compensation fixed by the court according to the seriousness of the injury or damage caused

negligence
failure to take reasonable care in certain circumstances

D2 Pure and speculative risks

D2a Pure risk

Travelling in a car is a good example of a **pure risk**. The best we can hope for is a safe arrival. However, the possibility exists that an accident will occur and the car will be damaged or someone injured. These types of risks are generally insurable. Other pure risks are shown in Example 2.6.

Example 2.6

Pure risks include:

- fire, which could damage or destroy property or cause an interruption to the running of a business
- machinery breakdown, which could lead to actual damage or business interruption
- injury to employees, in which a court may award **damages** and costs if such injury is caused by the **negligence** of a company
- paying for hospital accommodation and associated medical expenses following accident or illness.

D2b Speculative risk

In contrast, speculative risks involve situations where we take a risk with a view to making some kind of gain. Examples include playing the Lotto, gambling, investing in the stock market, starting up a new business and making pricing and marketing decisions.

So, while some aspects of business activity can be insured, these do not include the risk of incurring losses as a result of misreading the market or inaccurately anticipating the competition. Insurance does not apply to **speculative risks**.

speculative risk

a risk where there is a possibility of a loss, break-even or a gain

Just think

Why do you think that speculative risks are uninsurable?

There are two main reasons why speculative risks are uninsurable:

- Speculative risks are voluntarily assumed and the upside and downside should be taken into account when deciding whether to accept the risk.
- It would not be in the public interest for risks to be undertaken knowing that the only two possible outcomes are a win or break-even (propped up by insurance), with no downside.

D3 Particular and fundamental risks

D3a Particular risk

Many risks are localised or even personal in their cause and effect. These are categorised as **particular risks**. Sometimes the cause may be more widespread (a storm over a whole region), but the effect is still localised or related to an individual. Not all properties in the region will have been damaged. Example 2.7 lists typical particular risks.

particular risk

a risk that is localised or even personal in its cause and effect

Example 2.7

Particular risks include:

- a factory fire, which causes localised damage, perhaps spreading to nearby premises but not affecting the whole community
- serious illness, which affects an individual and requires medical treatment
- a car collision, which damages vehicles and involves third party liability but is localised and affects relatively few individuals
- theft of personal possessions from a home, which affects only the family concerned.

D3b Fundamental risk

fundamental risk

a risk that arises from social, economic, political or (sometimes) natural causes and is widespread in its effects

Fundamental risks are risks that are so large, unquantifiable and potentially widespread, as to make them immeasurable. For this reason, they are basically uninsurable in the mainstream insurance market as insurers will recognise these risks as being in excess of what they can reasonably cover as the resultant loses are catastrophic.

We noted earlier that the reason why non-financial and speculative risks are uninsurable is a matter of principle. However, this does not apply to fundamental risks, which are uninsurable due to a lack of willingness or capacity (financial ability) on the part of insurers.

Risks affecting whole countries, regions and/or communities are classified as fundamental and are therefore generally uninsurable. The following is a list of risks treated as fundamental in most insurance policies:

- war (and related risks)
- nuclear assemblies and devices
- sonic bangs (caused by aircraft travelling at sonic or super-sonic speeds).

Example 2.8

The potential for losses resulting from war in any given territory or country are so vast that prudent insurers will not be willing to carry the risk. It is fair to say that no reasonable premium could be calculated to compensate for the extent or cost of the resulting damage.

Over time previously described 'fundamental' risks may become insurable. This is due to a greater understanding of the loss potentials posed by the risks, due to the availability of increased historical loss data to insurers enabling them to quantify potential future losses or due to a perceived decrease in exposure by the insurance industry. Such examples include:

- cyber risks e.g. losses from internet hacking of businesses
- terrorism e.g. loss or damage to business properties due to a terrorist act by a prescribed terror organisation.

Quick question 7

Can you distinguish between particular and fundamental risks?

E Requirements for insurable risks

So far we have established that a risk is only capable of being insured if it is:

- financial
- pure
- particular.

These are our basic risk classifications. However, certain other characteristics must also be present if risks are to be underwritten by an insurer:

- The event insured against must be fortuitous (unexpected).
- There must be **insurable interest** (for non-consumer insurance contracts).
- Insuring the risk must not be against public policy.
- The risk exposure should be homogeneous.

We will briefly consider each of these.

E1 Fortuitous

To be insurable, the event must be accidental and unexpected and it must not be within the control of the insured. An example of a non-fortuitous loss is an insured who deliberately damages their car or sets fire to their home, while a car accident is an example of a fortuitous event.

E2 Insurable interest

This is a key principle of insurance and means that the insured person must have a financial interest in the subject matter being insured. You can insure against the possibility of theft of stock from your warehouse, because you suffer financial loss if it is stolen. On the other hand, you cannot decide to insure the stock of a neighbouring business, because you will suffer no financial loss if that stock is stolen; you have no legally recognised insurable interest. For non-consumer contracts, insurable interest must be in place at the time an insurance policy is taken out (incepted) and must continue for the duration of that policy. For example, a business cannot incept its commercial property insurance policy if it hasn't yet purchased the property it wishes to insure, as it does not yet have an insurable interest in the property.

Other financial interests are also recognised, as we will see in Chapter 5D. In Chapter 5D9, we see how the application of this principle in relation to insurance **consumers** has been impacted on by the **Consumer Insurance Contracts Act 2019.**

insurable interest

the legal right to insure arising out of a financial relationship recognised at law between the insured and the subject matter of insurance

consumers

any of the following:

c. a person or group of persons, but not an incorporated body with an annual turnover in excess of €3 million in the previous financial year (includes partnerships and other unincorporated bodies such as clubs, charities and trusts)

d. incorporated bodies with an annual turnover of €3 million or less in the previous financial year (provided the body is not part of a group with a combined turnover of more than €3 million).

… and includes a potential consumer.

E3 Public policy

It is commonly recognised in law that contracts must not be contrary to what society considers to be the right and moral thing to do. The measure tends to be a negative one, i.e. insurers should not cover risks that are against public policy.

For example, it would not be in the public interest to insure the risk of incurring a fine for a motoring offence. Insuring such a risk might encourage people to break the law or at least be ambivalent about it.

E4 Homogeneous risks

homogeneous risks (exposures)

the existence of a number of risks with similar profiles or characteristics, e.g. in terms of frequency and severity patterns

Insurers accept many different types of risks – financial, pure, particular and unexpected events – as long as they are not against public policy and the insured has a valid insurable interest. However, **homogeneous risks (exposures)** represent the ideal risk profile for insurers.

A sufficient number of exposures to similar risk, historical patterns and trends will allow an insurer to forecast the expected extent of future losses. In the absence of a large number of homogeneous exposures, the task of predicting claims patterns, and therefore being able to create adequate premiums, becomes more difficult.

Some markets, such as the London insurance market, are renowned for their willingness to insure 'almost any risk'. Examples of such unique risks are insuring a pianist's fingers or a footballer's legs. Similarly, insurance is available for satellite launches even though their occurrence is infrequent. However, as a general rule, an insurer looks for homogeneous exposures in order to benefit from the law of large numbers. Motor and household insurances fall into this category. We will talk about the law of large numbers in Chapter 3.

F Summary

Now you know about risk, and the various options for managing it. You've also learned how different types of risks are classified and the reasons why some risks are uninsurable.

F1 What's next?

In Chapter 3, we'll look at the relationship between insurance and risk in more detail. We'll also consider the risks that individuals and businesses are exposed to and which insurance products provide protection from these risks.

F2 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

F3 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and study tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

Completing online mock exams and reviewing the personalised feedback that follows, is a great way of testing your knowledge and preparing for exam day.

To access these online learning supports, just log into your Member Area on www.iii.ie and click on the **Connect** logo.

End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 2.

1. Name and define the two terms used to describe the level of risk in insurance terms.

2. Briefly describe the usual relationship between frequency and severity.

3. Provide an example of an aspect of insurable risk that is likely to affect the frequency of loss.

4. Define 'peril' and 'hazard'.

5. Define the terms 'moral hazard' and 'physical hazard'.

6. State the three main steps of the risk management process.

7. Identify the two types of risk control.

8. Explain the term 'non-financial risks'.

9. Explain the term 'pure risk'.

10. Identify two reasons as to why speculative risks are uninsurable.

11. List six characteristics that determine whether risks are insurable.

12. State why homogeneous exposures (risks) are more attractive to insurers than risks with a less predictable profile.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. The level of risk in insurance terms is how often an event happens (frequency) and the extent of the damage when it does (severity).

2. In many risk situations, we see a standard relationship between frequency and severity. There is a high frequency of low-severity losses and a low frequency of high-severity losses.

3. Any one of the following:
   - motor insurance – age and type of vehicle, driving experience of the driver (reflecting the likely number of risky activities)
   - property insurance – industrial processes (making fire or explosion a more likely occurrence)
   - employers liability insurance (for injury to employees) – unguarded machinery (making the risk of injury more likely)
   - bicycle insurance – inadequate security when unattended (making the risk of theft more likely)
   - personal accident insurance – general carelessness about personal health and safety (making the risk of accident or injury more likely).

4. The definitions are:
   - peril – an event or occurrence that gives rise to a loss or liability
   - hazard – any feature that influences the operation of the peril, either in its likelihood of occurrence or its severity.

5. The term 'moral hazard' refers to the attitude and conduct of people. Physical hazard relates to the physical aspects of a risk that increase the likelihood or probability of a loss occurring and which directly impact on the risk's insurability or on the terms, conditions and exceptions on which insurance may be provided.

6. The three main steps of the risk management process are risk identification, risk evaluation and risk control.

7. The two types of risk control are physical risk control and financial risk control.

8. Non-financial risks are risks that are not capable of financial measurement. (The possible outcome of adverse events must be measurable in financial terms for the risk to be insurable).

9. A pure risk has the possibility of a loss but not a gain. The best that can be achieved is a break-even situation.

10. The two main reasons are:
    - Speculative risks are voluntarily assumed and the upside and downside should be taken into account when deciding whether to accept the risk.
    - It would not be in the public interest to undertake a risk, knowing that the only two possible outcomes are a win or a break-even (propped up by insurance) with no downside.

11. There are three basic characteristics. These are that the risks must be:
    - financial
    - pure
    - particular.

    However, there are three further characteristics:
    - The event insured against must be fortuitous (unexpected).
    - There must be an insurable interest (for non-consumer insurance contracts).
    - Insuring the risk must not be against public policy.
    - The risk exposure should be homogeneous.

12. A sufficient number of exposures to similar risk, historical patterns and trends will allow an insurer to forecast the expected extent of future losses, and benefit from the law of large numbers. Examples are motor and household insurances. In the absence of a large number of homogeneous exposures, the task of predicting claims patterns, and therefore being able to create adequate premiums, becomes more difficult.

Answers to quick questions

1. Although we know that we will all die at some time, the uncertainty relates to the timing of our death.

2. In considering severity, we are trying to determine the maximum cost of an incident that may occur.

3. You would expect the company to suffer 150 minor injury accidents and 5 major injury accidents.

4. The following are examples of positive discrimination factors:
   - motor – fitting of an alarm/immobiliser
   - household – installing a fire extinguisher/smoke alarm/fire blanket
   - commercial theft – use of a commercial firm to provide overnight surveillance.

5. Quite often, a poor moral hazard will be accompanied by a poor physical aspect to the risk (i.e. a physical hazard), and this can cause confusion.

6. The costs involved in setting up and running the captive insurer means that a small business is highly unlikely to find this an attractive proposition. Equally, the likely size of risk to be placed by the captive insurer is unlikely to achieve beneficial terms from reinsurers.

7. Particular risks are those that are localised or personal in their cause and effect. Fundamental risks arise from social, economic, political and sometimes natural causes, with widespread effect.

Sample multiple-choice questions

Question 1

The terms 'physical' and 'moral' **usually** describe:

A. hazards

B. perils

C. accidents

D. injuries

Your answer:

☐

Question 2

In terms of frequency and severity, how is the risk of subsidence under a household insurance policy most likely to be classed?

A. Low frequency, low severity.

B. High frequency, low severity.

C. High frequency, high severity.

D. Low frequency, high severity.

Your answer:

☐

Question 3

Backspace DAC has employed a risk manager to analyse its accident record. During a typical year it has recorded accidents leading to one major injury and 16 minor injuries. According to the Heinrich Triangle, how many **additional** minor injuries can it expect to have before another major injury occurs?

A. 4

B. 9

C. 14

D. 284

Your answer:

☐

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 2B3

Question type: K

Correct response: A

Learning outcome: Explain and apply these key insurance terms – risk, uncertainty, frequency, severity, peril and hazard.

Question 2

Chapter reference: Chapter 2B2c (Figure 2.2)

Question type: U

Correct response: D

Learning outcome: Explain and apply these key insurance terms – risk, uncertainty, frequency, severity, peril and hazard.

Question 3

Chapter reference: Chapter 2B2c

Question type: A

Correct response: C

Learning outcome: Explain and apply these key insurance terms – risk, uncertainty, frequency, severity, peril and hazard.

Chapter

3

Insurable risks and their insurance solutions

What to expect in this chapter

From Chapter 2, we know that insurance is one of the ways we can manage and control the risks we face. We learned that a risk can only be insured it if is financial, pure and particular. We also know that certain other characteristics must also be present if a risk is to be underwritten by an insurer.

In this chapter, we look at the role and scope of insurance in more detail and consider the benefits that it brings. Now we're going to match the risks faced by individuals, businesses and organisations to the insurance products that have been developed to provide protection from those risks.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**Insurance and its benefits**	Explain the role of insurance as a risk transfer mechanism, its benefits and how risks are pooled and shared.
B	**Risk pooling and sharing**	
C	**Risks faced by customers**	Identify the risks faced by general insurance customers and the appropriate insurance solutions to meet these needs.

A Insurance and its benefits

Do we really need insurance? This is a question that is frequently asked, particularly when an insurance renewal notice drops through the letter-box.

In Chapter 2, we described insurance as a risk-transfer mechanism. Transferring the risk to an insurer does not prevent losses from occurring. It simply means that the insured transfers the uncertainty of a potentially large claim to the insurer and replaces it with the certainty of the much smaller and certain cost of the premium.

This gives valuable protection and peace of mind to the person insured. The insurer's side of the bargain is a promise, outlined in the policy wording, that it will pay for loss, damage or liability incurred.

A1 Benefits of insurance

Insurance brings benefits to individuals, businesses, organisations and society as a whole. These benefits include:

- It gives peace of mind to the person insured, because the future unknown cost of the insured risk (e.g. a house fire) has been replaced by the certainty of a known amount (the premium).
- It releases money, for both individuals and organisations that would otherwise have to be built up and set aside to cater for unforeseen events such as fire, flood or liabilities. This money can instead be used to purchase cars, undertake home improvements, set up, develop or expand commercial businesses.
- It reduces the financial pressure on other systems. For example, private health insurance reduces the pressure on the finances of the public health service.
- It supports businesses and employees in times of crisis. If an explosion occurs at a factory, causing considerable physical damage, the premises may need to be closed until the rebuilding is complete. Insurance, properly arranged, is an effective means of paying for rebuilding, wages, salaries and loss of trading profit while the business is recovering.

- It reduces the size and number of losses due to the focus on risk identification and risk management. Every fire prevented represents a claim that is not made, a business that can continue trading without disruption and a family that is not displaced.
- Insurers support the growth and stability of the national economy. They invest premium income from personal and commercial general insurance policies in a wide range of businesses, including property and equities.

Just think

If insurance did not exist, how would a business cater for a large unexpected loss?

As we learned in Chapter 2C3b large, successful businesses could set aside substantial sums to deal with such a loss (self-insurance). Alternatively, they could set up a captive insurer (see Chapter 1C3). However, neither of these would be an option for smaller enterprises. If small businesses did not have access to insurance, they would be less likely to invest heavily in assets that would be exposed to substantial risks, knowing that one relatively large loss could wipe out the business entirely. The knock-on effect of this would be to slow down economic growth, limit employment opportunities and depress the property market. This highlights the importance of insurance not only to individuals and businesses, but to the economy as a whole.

B Risk pooling and sharing

This section looks at the practice of risk pooling and risk sharing.

B1 Risk pooling

Risk pooling is the fundamental basis of insurance. An insurance company collects relatively small sums of money (premiums) from large numbers of people who want financial protection against similar kinds of perils. These premiums go into a common pool, managed by the insurer, from which claims payments are made to compensate the losses of the few. Figure 3.1 illustrates the concept of risk pooling.

The total value of the premiums must be large enough to meet the total losses (claims) incurred in any one year. It must also cover the costs of operating the pool and provide an element of **profit** for the insurer.

Figure 3.1 Risk pooling

Example 3.1 provides a very basic illustration of risk pooling.

Example 3.1

Risk pooling

Millbrook Insurance Company (MIC) is a newly established insurer specialising in providing household insurance for apartments. MIC expects to sell 10,000 policies, and the net cost of claims is estimated at €1,250,000. The estimated costs of running the company (commission, salaries, rent, promotion, taxation and cost of reinsurance) are €1,500,000. The stakeholders are expecting a 5% return (dividend) on their €10,000,000 investment.

Net cost of claims €1,250,000 + expenses €1,500,000 + dividend €500,000 = Total €3,250,000

Contribution by each of the 10,000 policyholders (premium) = €325

risk pooling

basic concept of insurance – that the losses of the few are met by the contributions of many

profit

the difference between the total income (revenue) of the business and the total running costs (operating expenses) associated with the continued operation of the business

Example 3.1 presumes that each policyholder brings the same level of risk to the pool. However, this is not the case. Different members of the pool present different levels of risk to the pool itself. Therefore, there has to be a direct relationship between the likelihood of someone taking something out of the pool (probability of claiming) and the amount they should contribute (their premium).

To operate a pooling system successfully, a number of pools must be established, one for each main group of risks e.g. one pool for motor insurance, another for household insurance and another for private health insurance. One reason for this is the law of large numbers, which is examined next.

B1a Law of large numbers

law of large numbers

the larger the number of similar-type events that occur, the more likely the outcome will match the expected result

In operating the pool, insurers benefit from the **law of large numbers**. This can be illustrated by considering the flip of a coin, which has only two possible outcomes – heads or tails. As the chance of getting either outcome is 50%, simple mathematics would suggest that if we flip a coin 20 times we should expect to get 10 heads and 10 tails. However, flipping a coin 20 times may result in any combination of heads and tails, because the sample is too small to be reliable. If we flip the coin 10,000 times, the law of large numbers will operate to give a result more in keeping with the underlying probability of 50% each – or 5,000 heads and 5,000 tails.

Applying the law of large numbers to insurance claims data enables the insurer to predict, with some degree of confidence, the future total cost of claims in any one year. This is because insurers provide cover against a large number of similar (homogeneous) risks.

The final number of actual loss events tends to be very close to the expected number (based on past measured experience). This means that the insurer can calculate likely losses and charge a fixed premium, knowing that it will cover the anticipated losses. The benefit for the insured/policyholder is a fixed financial outlay for the year, irrespective of the number or size of claims that may occur in that period.

Quick question 1

Why not set up a single pool so that the greatest possible number of risks can be included?

The answer is at the end of this chapter.

B1b Equitable premiums

proposer

person or firm applying for insurance

equitable premium

the rule that each person wishing to join an insurance pool must be prepared to make a fair contribution

When deciding on a fair premium, insurers will, for most classes of insurance, take into account the different elements (the risk itself and its associated hazards) brought into the pool by each of the **proposers**. The process of arriving at a fair premium, and one that will produce a fair profit, is complex and the correct assessment of risk is extremely important. This is a significant element in the insurance underwriting process, which is explored in Chapter 4.

In Ireland, however, the system of **equitable premiums** cannot be applied to private health insurance. We'll talk more about this in Chapter 4D.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

B2 Risk sharing

Managing the pool of money from which claims are to be paid is a significant part of an insurer's role. Each insurer has a range of criteria for the risks it will accept. These criteria are based on both the size and the nature of a risk. For example, insurers are usually more willing to cover an office risk than a factory where plastics are manufactured. The office would be deemed lower risk, even if its **sum insured** is the same as, or higher than the factory. A plastics factory will have expensive specialised equipment, the loss or damage of which will increase the severity of a claim. There is also a higher risk of injury when using such equipment. Furthermore, plastic burns quickly and easily resulting in a greater chance of a fire claim.

sum insured

maximum amount the insurer will pay out in the event of a total loss claim

Just think

What happens when a risk is offered to an insurer where the amounts at risk are greater than the sum the insurer is willing to accept for that category?

The most obvious response might be for the insurer to decline to insure the risk. However, the insurer will not wish to do this if the only issue is one of size, and the risk is of good quality in all other respects. The insurer must therefore find a way to share the risk with others or to insure only part of the risk. One way of doing this is through reinsurance where the insurer purchases insurance from one or more other (re)insurance companies to limit the total loss they will experience from that risk, in the event of a large claim. This will be discussed in greater detail in Chapter 4E. The other way an insurer might share the risk is through co-insurance, which we will look at now.

For commercial risks and property insurances in particular, an insurer may opt for **co-insurance**. Insurers use co-insurance to expand their capacity (ability to take on larger risks) while reducing their exposure. Co-insurance involves sharing the risk with other insurers and issuing a single policy (known as a co-insurance policy). Each insurer receives a stated proportion of the premium and pays the same proportion of any losses that occur. The insurer holding the largest share of the risk is referred to as the lead insurer, which is responsible for issuing the documentation, surveying the risk and pricing renewal business. However, the rating and terms to be applied must be agreed with the co-insurers before this information is conveyed to the policyholder. The lead insurer is also responsible for reviewing and commenting on claims prior to notification of co-insurers.

co-insurance

proportional risk-sharing between insurers

Each insurer is separately liable to the insured for its proportion of any claim that becomes payable, as the insured has a direct contractual relationship with each individual co-insurer (as if each had issued a policy for its own share). For administrative convenience, the lead insurer may pay out on small losses (e.g. less than €50,000) and recoup the other insurers' shares of the claims payment afterwards.

Co-insurance is an effective method of risk sharing and is used throughout the general insurance market (although rarely for individual personal insurances such as household or motor).

Quick question 2

What exactly do we mean by the term 'equitable premium'?

Quick question 3

If three insurers co-insure a risk in proportions of 40%, 30% and 30%, which insurer is responsible for issuing the policy documentation?

C Risks faced by customers

We will now consider, in general terms, the risks faced by individuals and organisations and the types of insurance solutions that may be appropriate.

C1 Individuals and their insurance needs

First, we will look at the various categories of risks that individuals face.

C1a Health and related risks

Individuals and family members may face a wide variety of health-related costs – from regular visits to a general practitioner to hospital admissions for acute medical conditions. Some risks arise only at certain times (such as pregnancy and childbirth).

Private health insurers offer a wide choice of product types. This type of insurance is heavily prescribed by legislation in terms of the minimum range of benefits provided and the pricing models permitted.

C1b Motor risks

The **Road Traffic Act 1961** (as amended) makes it compulsory to insure third party liabilities arising from the use of a motor vehicle. Ownership or use of a motor vehicle gives an individual the right to insure the vehicle itself. The scope of different levels of cover will be explored in later modules.

C1c Household and related risks

Ownership or use of a house gives an individual the right to insure. Anyone who has a mortgage (mortgagor) will be required to take out insurance and ensure that the financial interest of the lender (mortgagee) is noted on the policy. People renting a property may want to insure their personal possessions. Property owners and occupiers face certain liability risks (e.g. damage caused by branches falling from trees on their property, injury suffered by a **visitor** to their house). Cover for all of these risks is packaged together in a household policy.

C1c1 Specialist

Certain individuals may have different, or more specific, insurance needs if they own:

- high-value items such as art, bicycles, IT equipment, jewellery
- caravans and mobile homes
- yachts and motor boats
- horses and other pets.

Road Traffic Act 1961

The 1961 Road Traffic Act introduced the compulsory third party motor insurance in order to protect the innocent victims of road accidents against death, injury and damage to their property. Subsequent Road Traffic Acts outline where exemptions apply to the compulsory insurance requirement and also outline the minimum cover required in Ireland and throughout the EU

visitor

a person who is lawfully on the occupier's premises either by invitation of, or with the permission of, the occupier or a member of their family

Each may give rise to potential legal liabilities as well as the physical risk of loss, injury or damage.

C1c2 Legal expenses

Individuals face the additional risk of legal costs incurred in defending or pursuing a legal action related to their ownership of property, an employment contract, or rights in relation to goods purchased. Some legal costs are covered by a household or motor policy if they relate to defending a claim under that insurance policy. However, other legal costs must be catered for under a specialist legal expenses policy.

Just think

Why do insurers bundle together a variety of different insurances under a household policy?

Ownership or use of a house involves potential exposure to various types of risks, e.g. damage to the property, loss of contents, liability for third party injury and property damage, indemnity to financial institutions (e.g. the bank who provided the mortgage for the property), and legal defence costs. Due to the number of risks involved, it makes sense for insurers to combine the different covers provided in a single policy, for the purposes of administration and risk management.

C1d Travel risks

When an individual travels, certain risks arise such as:

- accident or illness
- delay of personal baggage
- flight delay
- theft and loss of baggage, passport or money
- repatriation (e.g. getting an insured person home) if seriously injured.

There is a long list of possible risks and many different package policies have been developed to meet them.

Quick question 4

Aside from those already mentioned, what other risks are associated with travel insurance?

C2 Personal insurance policies

There is a wide range of insurance products available to meet the diverse needs discussed in the previous section. The most common types of policy are shown in Table 3.1, along with a brief description of the perils that may be covered.

Table 3.1 Personal insurance policies

Policy type	Summary of cover provided
Health and related	
Private health	Medical treatment outside standard entitlements and facilities of the public health system; can include a wide range of additional benefits and facilities
Permanent health	An income provided up to normal retirement age when unable to work due to illness
Critical illness	Lump-sum benefits when named, serious conditions are diagnosed
Dental plans	Non-routine dental treatment
Healthcare cash plans	Fixed sums for medical treatment involving hospitalisation
Personal accident	Fixed-sum or weekly benefits (payable for up to 104 weeks) in the event of accidental death or bodily injury
Sickness	Weekly benefit (up to 104 weeks) for inability to work due to illness
Motor	
Guaranteed Asset Protection (GAP)	GAP insurance is designed to provide cover against financial loss that can arise when a total loss damage (or 'write off') claim falls short of either the amount of any loan/finance outstanding or the actual purchase price of the vehicle
Motor car	Insurance of motor cars and liabilities arising out of their use, plus a range of extra benefits including breakdown assistance, personal accident and personal effects
Motorcycle	Insurance of motorcycles and liabilities arising out of their use, with a limited range of extra benefits
Motor legal expenses	Expenses incurred in defending or prosecuting specified categories of claim related to motor insurance; helplines often provided by the insurer or specialist provider
Household and related	
Household	Package policy that covers: buildings and/or contents (usually on a 'new for old' basis) against a wide range of perils, including fire and theft, valuables and personal effects, public liability and a number of optional extensions including accidental damage
Bicycle	Loss or damage to bicycles within or away from the home
Caravans and mobile homes	Loss or damage to caravans and contents, and liability arising from a non-towing risk (covered under a motor policy)
Yachts, small crafts and motor boats	Loss or damage to yachts, small craft and motor boats, including contents and outboard motors, and public liability arising from their use
Pet	Veterinary fees and other benefits (such as death, theft and loss) for cats, dogs and certain other pets as well as associated public liability
Gadget	Cover for owners of small electronic or electric items, e.g. smartphones, tablets, e-readers, laptops, covering accidental loss or damage, theft, water damage, breakdown, worldwide cover and unauthorised calls

Table 3.1 Personal insurance policies (contd)

Policy type	Summary of cover provided
Family legal expenses	Expenses incurred in defending or prosecuting specified categories of claim related to household insurance; helplines often provided by the insurer or specialist provider
Travel	
Travel	Wide range of insurance covers, e.g. injury, death, medical expenses, loss of baggage/personal possessions/money and cancellation charges for individuals travelling within Ireland or abroad, for a period of time that can range from a few days to a year

Just think

Can you think of any other recently developed personal general insurances?

New personal general insurances are continuously being developed, e.g. car hire excess, wedding and backpacker insurance.

Quick question 5

What is the difference between critical illness cover and sickness cover?

C3 Organisations and their insurance needs

We now turn our attention to the insurance needs of organisations and businesses.

C3a Vehicle risks

As previously noted, the ownership or use of vehicles of all kinds gives an organisation the right to insure them. For example, the **Road Traffic Act 1961** (as amended) imposes a legal obligation to insure third party liabilities arising from the use of a motor vehicle.

C3b Property and related risks

An organisation can insure against risks relating to the loss of, or damage to, property. The scope of perils to be insured (including fire, theft and other perils) depends on the organisation's specific needs. Buildings, stock and other contents are at risk.

C3c Business interruption risks

Property insurances cover physical damage to a building or to other items. However, a major incident such as a fire, flood or explosion can have other significant effects on a business.

Just think

Aside from the damage to property, what other losses might a business suffer after a major fire?

After a major fire, there is usually an interruption to the insured's business activities. The business having to close for a period of time would probably result in a drop in income while wages and bills would still need to be paid. Most businesses cannot absorb the impact of these adverse events without the benefit of insurance. Business interruption insurance protects against this interruption to the earning capacity of a business.

C3d Financial and specialist risks

Businesses and organisations are exposed to a range of financial risks:

- employee dishonesty leading to internal theft or misappropriation of goods
- theft or loss of money
- legal expenses to pursue or defend claims
- specific contractual arrangements entered into
- customer credit risks.

An example of a specialist risk is that posed by cyber attacks, data and security breaches which can have significant financial and reputational repercussions for an organisation or business.

C3e Liability risks

Legal liabilities can have expensive consequences for businesses and may arise in several ways:

- liability towards employees relating to health, safety and welfare at work
- general liability to the public from the business' activities or premises
- liability arising from products sold or services performed
- liability arising from advice that has been given (covered under a professional indemnity policy).

Although certain insurance products contain many restrictions, all the liabilities we have discussed are normally insurable. If a business or organisation voluntarily assumes additional liability under the terms of a contract, insurance cover is available but it is a limited market. An example of voluntarily assuming liability under the terms of a contract would be where the insured accepted liability for an incident and perhaps even made an offer of payment to the injured party, without the insurer having confirmed that liability actually existed. In most cases this would only be covered if the insured would have, in any event, been legally liable or where it is found that the voluntary assumption of liability had reduced the overall final cost of the claim. This is known as contractual liability.

Just think

What do you think is meant by customer credit risks?

A customer credit risk is the risk that a customer may not pay a business what it is owed. For example, a business that supplies goods or services to a customer, on a credit basis, is exposed to the risk that the customer may refuse to pay, or may be unable to pay.

C3f Goods in transit

Businesses also face the risk of loss or damage to goods in transit. Internationally recognised terms of trade allocate responsibility for goods between buyers and sellers. These terms determine the extent of liability for loss and damage at different stages of transit.

C3g Engineering/breakdown risks

These include risks that arise from boilers exploding, moving machinery breaking down, goods being dropped from lifting equipment, among many other perils. For these types of risks there is a range of specialist solutions, often coupled with inspection contracts for specified equipment (e.g. boilers and lifting machinery). These must be regularly inspected under the terms of the **Safety, Health and Welfare at Work (General Application) Regulations 2007-2016**.

C4 Commercial insurance policies

Tables 3.2 – 3.5 list the products designed to meet these commercial insurance needs. In practice, many of the policies shown will be combined in package arrangements. Some of these will offer limited options or scope for tailoring; others will allow the business to select from a range of different components and build its own customised package.

Table 3.2 Commercial insurance policies

Policy type	Summary of cover provided
Vehicle policies	
Motor car and motorcycle	• Motor cars and liabilities arising out of their use, often with fewer extra benefits than those for personal insurances • Motorcycles and liabilities arising out of their use with a very limited range of extra benefits
Commercial vehicle	Vehicles designed primarily for the carriage of goods, against damage and liabilities arising from their business use, e.g. cars used by sales reps, large haulage vehicles, motor fleets, vans
Vehicles of special construction	Vehicles not designed for normal road use (e.g. forklifts, cement mixers, cranes, dump trucks) can be insured for associated road use
Agricultural and forestry vehicles	A range of defined specialist vehicles (including tractors), many of which are designed for a specific purpose, and includes liability risks, e.g. crop spraying or road use
Motor trade road risks	Liability for vehicles in the custody or control of a motor trader, arising out of their use on public roads
Motor trade internal risks	Premises and liability cover which may be extended to include other associated liabilities such as defective workmanship

material damage

the physical loss or damage to property

Table 3.3 Commercial insurance policies	
Policy type	**Summary of cover provided**
Property and related policies	
Property (material) damage	Loss or damage caused by fire, lightning, explosion and other named perils; cover may extend to accidental loss, destruction of, or damage to, property
Theft	Loss or damage caused by theft associated with forcible entry or exit
Glass	Glass breakage and damage to lettering, signs and shop fronts
Farm	Loss, damage or liability relating to the private dwelling house, its contents, farm outbuildings, farm machinery, equipment and stock
Contractors 'all risk'	Loss or damage to property during the course of a building contract
Business interruption policies	
Business interruption (**material damage**)	Losses due to interruption to business occurring as a result of material damage to property
Business interruption (engineering)	Losses due to interruption to business occurring as a result of mechanical breakdown of machinery or other defined risks

Table 3.4 Commercial insurance policies	
Policy type	**Summary of cover provided**
Pecuniary (financial) and specialist policies	
Fidelity guarantee	Financial results of dishonesty/disloyalty of employee(s) resulting in financial loss to the business
Money	Theft or accidental loss or damage to money, including an assault benefit for hold-ups
Legal expenses	Costs of seeking legal advice or pursuing/defending civil actions not otherwise included in liability policies
Credit	Non-payment of debts owed to the business
Cyber	Cover designed to provide protection from cyber-attacks, data breaches, security breaches (including hacking and transmission of viruses), accidental loss or interruption of data, or damage to IT systems and/or networks
Aircraft (aviation)	Aircraft including airplanes, helicopters, hot air balloons, sea planes and drones. Coverage is for the hull (the craft itself), third party legal liability and passenger liability.
Liability policies	
Employers liability	Legal liability and costs for illness, injury or death of an employee arising from the operation of the insured's business
Public liability	Legal liability and costs for illness, injury or death of a third party or damage to their property arising from the business
Products liability	Legal liability and costs for illness, injury or death of a third party or damage to their property arising from goods sold or services supplied
Professional indemnity	Legal liability and costs for third party costs arising from advice given in connection with the business

Table 3.5 Commercial insurance policies

Policy type	Summary of cover provided
Goods in transit policies	
Marine cargo, hull and freight and liabilities	Covers theft, loss and liability arising from vessels and goods in transit (cargo) whether by road, rail, sea or air including while in storage in the ordinary course of transit (long-term storage and delay are not covered). Covers range from 'all risks' to limited perils.
Aviation cargo, hull and liabilities	As per marine policies
Engineering/breakdown policies	
Engineering/ breakdown policies	This cover is commonly referred to as a statutory inspection policy. The serious hazards associated with boilers and pressure plant, engine plant, electrical plant, lifting machinery, miscellaneous plant, and computers have resulted in statutory requirements regarding compulsory, periodic safety inspections of such equipment. This policy provides inspection services and covers a wide range of risks (e.g. material damage, breakdown, third party liability and business interruption).

Just think

Can you think of any other commercial general insurances that do not appear in Tables 3.2 – 3.5?

Examples of other commercial general insurances include directors' and officers' liability, computer, and environmental impairment liability insurances.

D Summary

In this chapter we explained why individuals and organisations need insurance and the range of benefits it provides. We also looked at the concepts of risk pooling and risk sharing and how insurers use these when considering risks and deciding whether to accept them.

We finished by outlining the risks that individuals and organisations are exposed to and listed the products available to meet those risks.

The concepts and material explored in all of the chapters studied to date will be developed further later in this textbook. It is very important that you fully understand this material before you move on to the next chapters.

D1 What's next?

In Chapter 4 we'll deal with the underwriting process including premium setting, underwriter's options and reinsurance.

D2 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

D3 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and study tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

Completing online mock exams and reviewing the personalised feedback that follows, is a great way of testing your knowledge and preparing for exam day.

To access these online learning supports, just log into your Member Area on www.iii.ie and click on the **Connect** logo.

End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 3.

1. State what it means to say that insurance is a 'risk-transfer' mechanism.

2. State the name of the mechanism whereby an insurer collects premiums from a large number of insureds/policyholders to pay the claims of a smaller number of insureds.

3. State what is needed for risk pooling to operate effectively.

4. List the two main ways in which insurers share risks.

5. Explain how the law of large numbers assists insurers.

6. Explain 'co-insurance'.

7. Identify the differences between private health insurance and permanent health insurance.

8. State the maximum number of weeks that a personal accident/sickness policy normally pays a benefit.

9. List three risks faced by a private individual when travelling abroad.

10. Outline what is covered by a products liability policy.

11. Outline what is covered by a business interruption (material damage) policy.

12. State two items that are often subject to inspection contracts under government regulations.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. Insurance is referred to as a risk-transfer mechanism because an insurer accepts unknown future liabilities when the insured transfers the uncertainty of potential future claims to that insurer for an agreed premium.
2. When an insurer collects premiums from a large number of insureds/policyholders to pay the claims of a smaller number of insureds, this is known as risk pooling.
3. For risk pooling to operate effectively, a pool of risks with similar kinds of perils (homogeneous risks, properly classified) is required so that the law of large numbers can operate.
4. The two main ways in which insurers share risks are co-insurance and reinsurance.
5. Applying the law of large numbers to insurance claims data allows insurers to predict the future total cost of claims in any one year. This is because insurers provide cover against a large number of similar risks.
6. Co-insurance is where an insurer agrees to share a risk with other insurers, they jointly agree on the rating and terms to be applied to a risk and issue a single policy; known as a co-insurance policy. Each insurer receives a stated proportion of the premium and pays the same proportion of any losses that occur.
7. Private health insurance is concerned with medical treatment for individuals, outside the standard entitlements and facilities of the public health system, and can include a wide range of additional benefits and facilities. Permanent health insurance, on the other hand, provides an income up to normal retirement age when unable to work through illness.
8. Personal accident/sickness policy normally pays a benefit for a maximum of 104 weeks.
9. Any three of the following:
   - accident or illness
   - delay of personal baggage, passport or money
   - flight delay
   - theft and loss of personal baggage
   - repatriation if seriously injured.
10. Products liability policies cover the insured's legal liability for illness, injury or death of a third party or damage to their property arising from goods sold or services supplied.
11. Business interruption policies cover the insured's losses due to interruption to business occurring as a result of material damage to property.
12. Boilers and lifting machinery are often subject to inspection contracts under government regulations.

Answers to quick questions

1. The law of large numbers only works effectively when there is homogeneity of risk, i.e. when the risks grouped together in a pool all have similar characteristics.

2. An equitable premium is a fair price based on a specific risk. It relates to the rule that each person wishing to join an insurance pool must be prepared to make a fair contribution that reflects the risk they bring to the pool.

3. The insurer holding the 40% share of the risk is the lead insurer and is responsible for issuing the documentation, surveying the risk and pricing renewal business.

4. Other risks associated with travel insurance are cancellation or curtailment of the flight, missed departure and hospitalisation due to illness or injury.

5. Critical illness cover gives the policyholder a lump-sum, one-off payment in the event that they are diagnosed with a serious illness or condition specified under the policy. Sickness cover provides for weekly payments, for a maximum of 104 weeks, if a policyholder is unable to work due to an illness.

Sample multiple-choice questions

Question 1

Which of the following insurance policies would provide the insured with an income up to normal retirement age when unable to work, through illness?

A. Healthcare cash plans.

B. Personal accident and sickness insurance.

C. Permanent health insurance.

D. Critical illness insurance.

Your answer:

☐

Question 2

Which of the following policies would be purchased **only** by commercial policyholders?

A. Legal expenses insurance.

B. Professional indemnity insurance.

C. Healthcare cash plans.

D. Yacht insurance.

Your answer:

☐

Question 3

An insurer is able to predict the future total cost of claims in any one year with relative accuracy by:

A. applying the law of large numbers

B. using figures supplied by the Central Bank

C. applying the principle of community rating to claims data

D. using figures supplied by Insurance Ireland.

Your answer:

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 3C2 (Table 3.1)

Question type: K

Correct response: C

Learning outcome: Identify the risks faced by general insurance customers and the appropriate insurance solutions to meet these needs.

Question 2

Chapter reference: Chapter 3C4 (Table 3.4)

Question type: K

Correct response: B

Learning outcome: Identify the risks faced by general insurance customers and the appropriate insurance solutions to meet these needs.

Question 3

Chapter reference: Chapter 3B1a

Question type: U

Correct response: A

Learning outcome: Explain the role of insurance as a risk-transfer mechanism, its benefits and how risks are pooled and shared.

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Chapter

4

Underwriting: people & processes

What to expect in this chapter

In Chapter 3, we learned about risk pooling, equitable premiums, homogeneous risks (exposures) and the law of large numbers. In this chapter, we'll find out how these concepts are applied in practice throughout the underwriting process.

We'll also look at the professionals involved in the underwriting process and the different roles they play. In doing this, we'll consider the following issues:

- What options are available to an underwriter when faced with a risk proposal?
- If the underwriter does accept the risk, how is the premium calculated?
- What factors impact on premium setting for a whole class of business, as opposed to for a single policy?
- How does reinsurance fit into the underwriting process?

Finally, we'll learn about the unique regulatory and legislative requirements that apply to private health insurance.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**People involved in the underwriting process**	Outline the role of the professionals involved in the general insurance underwriting process.
B	**Premium setting**	Demonstrate the relationship between underwriting and the premiums charged for general insurance policies.
C	**Underwriting**	Describe the typical underwriting measures available to an underwriter when considering a general insurance proposal.
D	**Underwriting private health insurance**	Demonstrate the impact of private health insurance principles on the underwriting of this class of insurance.
E	**Reinsurance**	Define reinsurance, state what prompts its use and outline the main types of reinsurance.

A People involved in the underwriting process

From an insurer's perspective, effective **underwriting** is the key to business success. The financial stability and profitability of an insurer is based on the ability to distinguish between better and poorer risks and to price risks correctly.

This is achieved by combining the expertise and experience of a number of key professionals. We will now look at the role of each of these in turn.

A1 The role of the actuary

An actuary is a professionally qualified person who analyses the financial consequences of risk. They use mathematics, analytics and statistical theory to study uncertain future events. They apply techniques aimed at estimating the probability of losses (frequency) and predicting claim numbers and future values (severity). Actuaries play an important role in risk pricing and calculating how much money should be set aside to cover future claims (**claims reserves**).

The actuary's role in claims reserving also has a regulatory dimension. The Central Bank pays close attention to claims reserves and requires an Actuarial Certification of an insurer's **technical provisions/reserves**. Under the **Solvency II Directive**, insurers must appoint a Head of Actuarial Function (HoAF). This is a very senior role which is responsible for providing an annual Actuarial Opinion on Technical Provisions (AOTPs) to the board of the insurer.

A2 The role of the underwriter

Insurance underwriters assess the risks and exposures of potential policyholders and decide the category into which each customer falls, based on the guidelines or matrix provided by the actuary. They also decide what premium and level of cover to apply to each risk.

In the insurance industry, the term 'underwriter' is used to refer to:

- a person employed by an insurance company, whose job is to make decisions on risk acceptance and premiums
- an insurer who takes on the risk and is liable for the insured losses.

underwriting

process of risk pooling, risk selection (choosing who and what to insure) and assessment of individual risks that meet the insurer's risk criteria

claims reserves

funds set aside by an insurer to meet the cost of present and future claim payments

technical provisions/ reserves

reserves held so that assets are matched with known and estimated future claims liabilities and associated expenses

When looking at individual risks, the role of the underwriter is to:

- assess the risk that people bring to the pool
- decide whether or not to accept the risk, at what price, or how much of the risk to accept
- determine the terms, conditions and scope of cover to be offered
- calculate an appropriate premium to cover expected claims, provide a reserve, meet all expenses and provide a profit.

For non-risk rated classes of business, such as private health insurance, the underwriter does not consider each risk individually. Instead, they look at the potential claims and costs of the whole group of risks in the pool to assess whether the law of large numbers can operate effectively for the insurer's benefit.

Quick question 1

Why does a private health insurance underwriter have a different role from, say a motor insurance underwriter?

The answer is at the end of this chapter.

A3 The role of the risk surveyor

Risk surveyors are often involved in risks that are large and/or complex. As we will see in Section C, insurers may have a risk surveyor conduct a physical inspection of the premises to be insured. Based on the information provided by the risk surveyor the underwriter will decide whether to accept the risk and on what terms.

The main functions of the risk surveyor are to:

- decide whether the risk meets the insurer's minimum standards
- identify risk improvements that are needed or desirable and indicate timescales for their implementation
- identify additional risks which should be insured
- contribute to the assessment of the estimated maximum loss (EML) or probable maximum loss (PML) in respect of property damage or business interruption insurances
- check that the sums insured are adequate.

We will now look at the underwriting process and the options available to underwriters when presented with a risk.

B Premium setting

As mentioned in Section A2, one of the key tasks of the underwriter is to calculate a suitable premium or price for a risk. The premium paid by an insured/policyholder represents their contribution to the 'common pool'. This contribution must be fair, i.e. it should reflect the degree of risk the insured brings to the pool (see Chapter 3B1).

B1 Premium assessment

Premiums are often calculated by applying a premium rate to an exposure measure.

B1a Exposure measure

When working out the premium for a particular risk, the **exposure measure** is the underwriter's starting point. It is an expression of the size of the risk and is usually based on one overriding element, e.g. the sum insured for a household insurance policy or the wage roll for an employers liability insurance policy.
Table 4.1 lists some commonly used exposure measures.

exposure measure
the basis to which rates are applied to determine premium

Table 4.1 Commonly used exposure measures

Class of business	Exposure measure
• Household • 'All risks', caravan, mobile home, small craft • Commercial property • Business interruption	Sum insured
• Products liability • Directors and officers liability	Turnover
Motor	Flat rated, with a number of loads/discounts included for certain factors e.g. age, area, driving licence type
Personal accident	Benefit level selected
Employers liability	Wage roll (or number of employees)
Public liability	Turnover or flat rated (e.g. based on number of customers (supermarket), capacity (cinema/ conference centre), rooms (hotel/hospital))
Personal liability	Flat rated
Fidelity guarantee	Chosen loss limit
Professional indemnity	Fee income
Money	Estimated annual carryings

premium rate

a rate (usually expressed per €100 or €1,000) applied by the insurer to the value of the exposure measure when calculating the premium to be quoted

B1b Premium rate

The next step in calculating a premium is applying the **premium rate** (usually expressed as a rate per €100 or per €1,000) to the value of the exposure measure, as in Example 4.1.

Example 4.1

Property insurance calculation

Let us assume a building's sum insured of €1,000,000 and a rate of 0.25% (in other words 25 cents for each €100 sum insured). Our calculation is as follows:

Exposure measure (sum insured) x premium rate = premium

€1,000,000 × 0.25% = €2,500

The premium rate is typically set by the insurer's actuary. It is based on previous claims patterns and must also allow for future trends. The aim is to charge premiums that will be high enough to exceed potential future claims and expenses, thus creating a profit for the insurer, while still remaining competitive and retaining market share.

In practice, the premium rate applied in a particular case will reflect the hazards associated with that risk. As explored in Section C2, an underwriter may adjust the standard premium rate to reflect the particular risk's discrimination factors, based on information gathered about the risk at the proposal stage. Examples 4.2 and 4.3 illustrate this in the case of household and motor insurance respectively.

Example 4.2

Household insurance

Patrick and Eimear	John and Niamh	Tom and Mary
3 bedroom, brick-built house	3 bedroom, brick-built house	3 bedroom, brick-built house
Tiled roof	Tiled roof	Tiled roof
Mullingar	Kerry	Dublin
Sum insured : €300,000	Sum insured : €285,000	Sum insured: €425,000
	New build	One room used by Mary, a music teacher, to offer private lessons
	2km from river	High crime rate in area

Patrick and Eimear will attract the lowest rate since the risk has no negative features and the occupation is normal for such a building. Whilst the sum insured is higher than John and Niamh's, their premium includes a discount for the location of the house, which has been established as a 'low risk' through the use of '**geocoding**'.

John and Niamh have a lower sum insured but may be viewed as uninsurable due to the flood risk. They might still be able to obtain insurance but it will most likely exclude any cover for flood damage.

Tom and Mary will attract a higher rate than Patrick and Eimear as the sum insured is higher and their premium will likely be loaded due to the crime rate in the area. Some insurers may consider the risk uninsurable because Mary is operating her business (music lessons) from the house. They may insist on domestic use only and be unwilling to offer an extension to cover the commercial use. Insurers will cover home offices under a household insurance policy as long as there are no customers or colleagues visiting the house and as long as no work-related stock is kept in the house. However, a room used for business purposes and with customers visiting the house (such as Mary's music students) presents a higher public liability risk.

geocoding

compiled geographical information relating to a particular area for use in decision making

Example 4.3

Motor insurance

Niall	Emma	Eric
51 years old	46 years old	19 years old
5-year old Ford Fiesta 1300cc	5-year old Ford Fiesta 1300cc	5-year old Ford Fiesta 1300cc
5 years no claims bonus	3 years no claims bonus	No previous insurance
Full Irish licence	Full Irish licence	Provisional Irish licence
Vehicle has alarm	4 penalty points (from 2 years ago)	Travels 20,000km annually

As you can see all three policyholders are insuring the exact same vehicle, but they will all pay very different premiums.

Niall will attract the lowest rate since the risk has no adverse features and his premium will be discounted due to his 5 years no claims bonus, his driving licence and for the security device fitted to the vehicle.

Whilst Emma is a similar age to Niall and also has a full Irish licence, she only has 3 years no claims bonus so the discount for her will be lower than Niall's. She also has 4 penalty points from 2 years ago, which will potentially incur a loading.

Eric will pay the highest rate as there are many adverse factors to consider. He has no previous driving experience and only holds a provisional licence. His mileage is also quite high. All of these factors will likely incur loadings on Eric's premium.

There have been significant data-enrichment developments in recent years, e.g. Insurance Ireland's Integrated Information Data Service (IIDS), a shared members' database that, by arrangement with the Department of Transport, allows its users to confirm the accuracy of penalty point and no-claims discount information provided by customers when they are seeking to renew existing or taking out new motor policies. This assists insurance companies in premium setting or in deciding whether to decline risks. As mentioned in relation to Example 4.2, Geocoding is used by insurers to establish the proposer's proximity to rivers, i.e. for potential flood risk. Other examples include:

- claims databases (to highlight risks with higher claims frequencies and aid the detection of fraud)
- vehicle information databases (usage history, tax and NCT status, technical data, etc.)
- credit rating databases (establish the insured's financial situation).

As we saw in Chapter 2E4, insurers find pricing easiest when dealing with a large number of similar exposures to risk, whether houses, commercial buildings or cars. The law of large numbers (see Chapter 3B1a) helps insurers to calculate more accurate premium rates than if their experience was limited to a few risks.

B1c Minimum premiums

For smaller risks, many insurers apply a minimum premium regardless of the premium produced by applying the rate to the exposure measure. Insurers will have determined the costs, such as those of issuing the policy, servicing the customer and potentially settling claims. This will require a certain minimum level of premium if a suitable contribution is to be made to the common pool.

B1d Adjustable premiums

In some cases, the exposure measure cannot be accurately established at the start of the period of insurance.

Just think

Take another look at the list in Table 4.1 and decide which of these might not be exactly quantifiable in advance of the period of insurance.

For some types of insurance, it may only be possible to provide an estimate of the amount of the exposure measure. For example, in employers liability insurance the insured/proposer must estimate the total wage bill for the coming year. However, the actual wage bill may turn out to be higher or lower than this estimated figure. In such cases, an **adjustable premium** is charged. At the end of the year, the insured submits a declaration showing the actual wages paid and the premium is adjusted up or down as appropriate.

Adjustable premiums may also be used in motor fleet, public liability, products liability and business interruption insurances. In property insurances, they may be used for stock risks.

B1e Flat premiums

Sometimes, insurers charge a flat premium rather than applying a rate to an exposure measure. This is done in motor insurance. The flat premium is used as a base against which various loadings and discounts are applied for different risk factors. For example, the driver's age and experience, type and use of vehicle, area where vehicle is kept, claims history and type of cover required. This is why mature drivers pay less than inexperienced drivers and high-performance cars attract higher premiums than family saloon cars.

B1f Insurance premium levies

The **insurance premium government levy** and the **Insurance Compensation Fund** (ICF) levy apply to most non-life general insurances, where the insured risk is located in Ireland. The levies are paid by the insured through their premium. These levies are 3% and 2% respectively totalling 5% of premiums collected. An additional 2% levy is applicable to all motor insurance policies. A stamp duty charge of €1 also applies to every new non-life insurance policy.

Reinsurance contracts, private health insurance policies, export credit insurance, aviation and transit insurance and certain marine and dental insurance policies are not subject to the insurance premium government or the ICF levies.[4] Other levies apply to specific types of insurance – these will be explored more in later modules.

Once the premium quotation has been accepted, the insurance policy (contract) is issued. Chapter 5C outlines the typical structure of an insurance policy. The Compliance and Advice module explores the legal and regulatory requirements that apply to the documentation.

adjustable premium

the premium rate is applied to the estimated exposure measure at the start of the period of insurance and then adjusted appropriately at the end of the period when the actual exposure measure is known

insurance premium government levy

tax applying to most general insurances, where the insured risk is located in Ireland, but does not apply to reinsurance contracts, private health insurance policies, export credit insurance, aviation and transit insurance and certain marine and dental insurance policies

Insurance Compensation Fund

Irish insurance guarantee fund (financed by a levy on most non-life insurance policies) designed to protect consumers of authorised non-life insurers that go into liquidation and are unable to pay insurance claims

Quick question 2

If a building's sum insured is €450,000 and the premium rate is 0.3% (per €100), calculate the premium.

[4] For more information, see Revenue's website on www.revenue.ie

C Underwriting

Now we look at the options available to underwriters when faced with a proposal for insurance.

proposal form

type of questionnaire, asking questions about subject matter of insurance

statement of fact

document generated by an insurer, recording the answers given by a proposer to a telesales operator or insurance intermediary or on a website in response to specific questions asked in response to an enquiry for a quotation

questionnaire

specially constructed form used by insurers to deal with commonly encountered hazards for groups of risks

material fact

a fact that would influence the judgement of a prudent insurer in fixing the premium or determining whether to take the risk

Underwriters need a variety of information to enable them to assess risks accurately and price them appropriately. They gather this information from a variety of sources including **proposal forms**, **statements of fact, questionnaires**, submissions by intermediaries, and risk surveys.

Non-consumer insurance proposers must disclose all **material facts** relating to the risk, irrespective of whether or not they are requested. Consumer insurance proposers need only answer (honestly and with reasonable care) the specific questions asked by the insurer.

The underwriter uses all of the information gathered to review the risk and understand the hazards it presents. When the risk assessment is completed, the underwriter has several options to choose from and we will look at these now.

C1 Accept the risk at normal terms

Where a risk presents the expected hazards and risk factors, the underwriter will apply standard rates and terms. A combination of positive and negative features may be seen as balancing each other out.

C2 Increase or reduce the premium

The underwriter may take the view that the risk, while acceptable, presents extra hazards. In this case, the premium may include a loading (increase) to reflect any negative features or hazards. Examples of negative features include a high risk of a fire spreading due to poor fire separation within a building or an unusually high number of previous claims. Example 4.4 lists some others.

Example 4.4

For household insurance risks, additional premium may be charged for:

- the carrying out of business activities from the home
- areas prone to flooding
- an increase in the **inner limits** for jewellery and other valuables
- areas with a high crime rate
- 'non-standard' construction.

inner limit

an indicator of the largest payment that will be made under a specific insurance policy heading (expressed either as a monetary amount or a percentage of another limit)

On the other hand, some risks may exceed the insurer's minimum standards. In this case the insurer may allow a reduction in premium to reflect the beneficial features.

Just think

Can you think of situations in which an insurer might apply a premium reduction?

Situations where insurers may apply a premium reduction include:

- an introductory no claims discount (NCD) for a first-time motor insurance customer who has been driving claim-free under another policy as a named driver
- installation of a burglar alarm for theft risk or installation of smoke detectors or fire extinguishing appliances for fire risk under a household or property insurance policy
- the policyholder's age (some insurers offer discounts to policyholders aged over 55 years)
- acceptance of a level of self-insurance by the policyholder (e.g. a higher voluntary excess – Chapter 8C1e).

C3 Reduce or limit the cover

Where risks are generally acceptable but present one or more features that are unacceptable or less attractive from the insurer's viewpoint, the insurer may offer a reduced level of cover either overall or for the less desirable element(s) of the risk.

Examples of a reduction in cover are:

- specific **exclusions**, e.g. exclusion of a named person as a driver on a motor insurance policy, limiting of cover provided to certain drivers (e.g. exclude **own damage** cover for a young driver on a high-powered car), exclusion of flood cover on a property insurance policy in an area known to be prone to flooding
- exclusion of cover for a period (until an action has been taken), e.g. limited cash cover is provided to a business until a recommended safe is installed
- application of an excess/deductible, e.g. an increased compulsory excess for flood claims
- exclusion of specific elements of cover in certain circumstances, e.g. exclusion of theft or vandalism when a property is unoccupied for more than a specified period of time.

exclusions
policy provision that defines circumstances or types of loss that are not

own damage
damage done to the insured vehicle/ property

Quick question 3
An insurer is offered a household risk with a large sum insured and a high proportion of valuables in an area known to have a frequent rate of thefts.

An insurer is offered a theft risk with highly attractive stock coupled with a poor claims history.

What do you think the insurer's likely response would be to these two risks?

C4 Manage the risk

In many classes of insurance, the insurer will want to ensure that certain aspects of the risk remain constant or are improved. The risk surveyor plays an important role in this by providing insurers with the information they need to allow them to manage the risk in a proactive manner. The options available will depend on the particular class of insurance but may include:

- Property – improved housekeeping, better storage, installation of an alarm system, review of electrics, better risk separation, either as requirements (necessary before risk acceptance) or as recommendations
- Employers liability – installation of machinery guards, health and safety training, use of personal protective clothing and equipment
- Motor – defensive driving/advanced driver training courses/blackbox technology (**telematics**)
- Public liability – installation of handrails, non-slip surfacing, and removal of trip hazards such as exposed wires and cables.

telematics
driving related information (e.g. speed, distance, braking patterns, time of driving etc.) which is transmitted to the insurer and used to assess and price the motor risk

Generally, insurers will allow a reasonable time limit to implement **risk improvement requirements**.

risk improvement requirement
requirement insisted on by the insurer as a condition for accepting the risk

Sometimes, certain aspects of a risk are so critical from the insurer's point of view that insurance is only provided if certain things happen (or don't happen). To manage these circumstances, the insurer may apply a condition or warranty to the policy. Let's examine each of these, how and when they can be used and their impact on the insurer's management of the risk.

C4a Warranties and 'basis of contract' clauses

Non-consumer insurance contracts

Non-consumer insurance contracts may contain **warranties**. A warranty always appears in the policy documentation and must be strictly and literally complied with. It is essentially a promise made by the insured/proposer, relating to facts or performance concerning the risk. In other words, a warranty is an undertaking by the insured/proposer that:

- something will or will not be done
- a certain state of affairs exists or does not exist.

A basis of contract clause may also be found in non-consumer insurance contracts and has the effect of turning all statements made by the insured into warranties.

Another way of describing a warranty is as a 'condition precedent to liability'. This means that if the insured does not comply with the warranty, the insurer has the right to refuse the claim.

Typical examples of warranties include:

- Fire insurance – Rubbish must be put into metal bins daily and be removed from the premises at least once a week.
- Public liability – Very detailed requirements are put in place for carrying out any hot work (e.g. welding) away from the insured's premises.
- Money – In relation to cash in transit an insurer will require a minimum number of people to escort it depending on the amount of money being transported – **custodian warranty**.
- Employers liability – Correct manual handling procedures must be used.

Just think

What is the effect of a breach of warranty?

If the insured/policyholder breaches (does not comply with) a warranty, then, depending on the date of the breach and the type of warranty, the whole of the insurance policy may be automatically set aside by the insurer either from inception (ab initio) or from the date of the breach.

If the warranty relates to facts (e.g. that the insured had no claims on their commercial property policy in the previous 5 years), rather than performance, the contract is set aside *ab initio* (from the beginning) as the breach existed from the start of the contract. In this instance, the insurer will issue a letter indicating that the policy is void (rather than cancelling the policy) and return the premium in full.

If the contract is set aside from the date of the breach, the contract between the insurer and the insured no longer exists. However, the insurer is still responsible (liable) for losses occurring before the breach. If the insured later complies with the warranty (e.g. employs the correct manual handling procedures), this does not reinstate the insurer's liability.

Warranty

term (in a non-consumer insurance contract) that, if breached, permits the insurer to automatically void the contract as a whole

basis of contract clause

a declaration on an insurance proposal form or insurance contract stating that representations made by the policyholder (insured) are true and accurate

custodian warranty

a requirement by insurers that a certain number of able-bodied adults accompany money in transit (under a money insurance policy)

An insurer may decide to waive (overlook) the breach and consider the policy to remain in effect. However, if an insurer acts as if it has waived the breach, it may still be liable for losses incurred as a consequence of the breach. If, for example, after a breach of warranty, an insurer issues a letter of cancellation in accordance with the policy terms, this would imply that the insurer is treating the policy as having been in force at the time of the loss. The same would be true if the insurer offers renewal of the contract.

The insurer cannot avoid (refuse to pay) a particular claim and allow the contract to continue. It must either end the contract or waive the breach. Example 4.5 illustrates this point.

Example 4.5

Following a risk survey of a small manufacturing premises an insurer is concerned about a build-up of flammable waste material immediately outside the premises, which presents a fire hazard. The insurer accepts the risk only on the basis of a warranty stating that waste material will be removed daily and placed in metal bins and cleared from the site at least once a week.

If it was established that, 7 months into the insurance contract, the insured ceased placing the waste in metal bins and clearing it from the property, the insurer would treat this as a breach of warranty and cancel the contract from the time of the breach. The insurer would only be liable for claims up to month 7 – the time of the breach.

The absolute nature of the obligations under warranties is such that the insured must be fully aware of the wording of any warranty and the impact of not complying with it. Explaining warranties and their possible consequences to the policyholder is an important part of an insurance adviser's role as highlighted in Example 4.6.

Example 4.6

An insurer issues a property insurance policy to the insured, a factory owner, via an insurance intermediary. The policy includes a warranty stating that each floor in the factory must have a fire alarm and sprinklers installed. This warranty is not highlighted by the intermediary at the time of inception and the insured does not read the policy documentation provided, so is unaware of this warranty. A couple of months later a fire breaks out in the factory and spreads rapidly through the entire property, resulting in a total loss of €500,000. The factory owner attempts to claim from the insurer but they refuse the claim due to the breach of warranty. The insured is left with no income and cannot afford to rebuild the property.

If the inclusion of this warranty had been highlighted by the intermediary at inception the insured could have installed the fire alarms in advance of purchasing the policy and would have been in a position to make a successful claim when the subsequent fire damage occurred.

Consumer insurance contracts

Under the **Consumer Insurance Contracts Act 2019**, warranties are no longer permitted in consumer insurance contracts. Neither is any term which converts a statement or representation made by a consumer prior to entering into the insurance contract into a warranty ('basis of contract clause').[5]

C4b Conditions

Conditions can apply in both consumer and non-consumer insurance contracts but following the **Consumer Insurance Contracts Act 2019**, any clause that imposes a continuing restrictive condition on a consumer is treated as a **suspensive condition**.

If a suspensive condition is breached, the insurer's liability is suspended for the duration of the breach, but only if the breach increased the risk of loss occurring. If the breach has been remedied by the time the loss occurs, the insurer shall not be entitled to deny the claim on this ground alone.

Typical examples of suspensive conditions include:

- Motor insurance – Where a condition of the policy states that the vehicle must be parked overnight in a locked garage, theft cover will not apply if the vehicle is stolen while parked out in the open overnight e.g. on a street.
- Theft insurance – Where a condition of the policy states that a properly maintained and working burglar alarm must be installed and activated each evening/when the property is left empty, theft cover will not apply if the alarm is not on when a theft occurs.

condition

a provision or obligation in a policy that must be complied with

suspensive condition

condition that, if breached, suspends the insurer's liability for the period of the breach (from the date of the breach up until it has been remedied)

C5 Combined measures

Insurers often use a combination of underwriting measures, e.g. increased premium combined with the application of a warranty. It is also possible that an insurer may not insist upon a risk improvement measure (a **risk improvement recommendation**) but may offer a premium reduction if the measure is carried out.

risk improvement recommendation

a recommendation to improve the standard of the risk which, if completed, may lead to a premium discount

Just think

Can you think of other examples of underwriting measures available to an insurer?

Other examples of underwriting measures available to an insurer include:

- the storage of high-value jewellery in a safe for a household insurance risk
- the installation of a tracker for a motor insurance risk
- an increased premium combined with a reduction in cover, e.g. a higher excess than normal, for flood cover coupled with an increased rate
- a reduction in cover, e.g. fire cover only for an unoccupied building.

[5] Section 19, **Consumer Insurance Contracts Act 2019**.

C6 Decline the risk

Certain types of risks are unacceptable to insurers, because they are high risk or sub-standard in some significant way and cannot be improved to an acceptable level. They exist across all classes of business, as shown in Examples 4.7 and 4.8.

Example 4.7

Class of insurance	High risk or sub-standard features
Household/property insurances	non-standard construction (e.g. thatched roof) or issues that relate to location (the fire risk and the flood risk)
Motor insurance	the combination of a young inexperienced driver and a high-performance car, or proposers with unacceptably high numbers of claims or convictions in the past (the accident/personal injury risk)
Property insurance	a fireworks manufacturer (the fire and explosion risks)
Property insurance	jewellery shops (the theft risk)
Liability insurance	products that are exported to the United States and Canada (due to the fact that people are more likely to take a company to court in these countries and the high damages awarded by their courts)

Quick question 4

An insurer is considering a commercial motor insurance risk where there is a poor claims record, mainly due to a number of claims that have arisen while spouses and other family members have been driving. What options might the insurer consider in underwriting this risk?

Example 4.8

Austin wants to effect (take out) a household policy. The house has a thatched roof and is in a remote location. The physical security is poor and there have been several thefts from the property over the past 3 years. The house is frequently left unattended for 2 or 3 weeks at a time.

The insurer may take the view that no matter what measures Austin takes, the ongoing risk will be unacceptable because of the quantity and variety of poor hazards it presents.

A category of risk may also be identified as 'unacceptable' if the insurer cannot access reinsurance support, or if the insurer's business management strategy means that it restricts acceptance to certain categories.

D Underwriting private health insurance

Underwriting private health insurance differs considerably from underwriting most general insurances. This is primarily due to the unique principles that apply to this class of insurance.

Under the **Health Insurance Acts 1994–2022**, private health insurance is governed by the following four principles:

- **community rating**
- **open enrolment**
- **lifetime cover**
- minimum benefits.

As we will see in the following sections, private health insurance price distinctions are made solely in relation to different levels of cover (the policy's benefit structure). The underwriting process is confined to calculating the costs required to run the pool as a whole and not the degree of hazard as in other personal general insurances.

D1 Community rating

Community rating means that a health insurer in Ireland must charge the same premium for the same health insurance contract, regardless of the age, gender, health status or past claims record of the individual. In other words, the insurer cannot use any of these **discrimination factors** to differentiate between risks when pricing the policy.

Community rating is designed to spread the cost of private health insurance, between young and old and, to some degree, male and female. This means that younger people subsidise the claims cost of older people. The **Health Insurance (Amendment) Act 2014** modified this principle and permitted a number of exceptions to the equal premium rule when it introduced a system of **Lifetime Community Rating** (see Personal General Insurance or Health Insurance and Associated Insurances modules).

community rating

private health insurance principle that cross-subsidises the cost of private health insurance from young to old and, to some degree, male to female

open enrolment

in private health insurance there must be no discrimination on grounds of age, sex or state of health, with the exception of waiting periods in respect of pre-existing conditions

lifetime cover

private health insurance principle stating that subscribers have a statutory right to change insurer and not be refused cover

discrimination factor

a feature of a risk that presents a poorer or better hazard

lifetime community rating

the older a person is when they take out private health insurance, the higher the premium they will pay; however, the premium may not subsequently be increased to reflect the person's advancing age

D2 Open enrolment

Open enrolment obliges insurers to accept all individuals who wish to enrol in a health insurance scheme. Insurers can, however, refuse to provide cover to a person who has previously made a fraudulent claim that resulted in a loss for the insurer.

Insurers can also apply **waiting periods** and exclusion periods to health insurance contracts. These can be applied both to new customers and to those upgrading their cover. The purpose of these is to prevent customers from only purchasing cover when they become ill. Waiting periods play an important role in supporting the principles of open enrolment and lifetime community rating.

waiting periods

specified periods of time following the start of a private health insurance policy during which particular policy benefits are not available to the insured

Quick question 5

What is the effect of community rating on premium levels?

D3 Lifetime cover

Lifetime cover means that, once an individual has been accepted for cover, a health insurer may not cancel or refuse renewal, except in very limited circumstances, i.e. non-payment of premium, fraud leading to economic loss by the insurer, or where the insurer ceases to write private health insurance business in Ireland or no longer offers health insurance contracts of that type.

Individuals have a statutory right to change insurer and not be refused cover. Provided they renew their cover within 13 weeks, benefits will not be subject to additional waiting periods (unless they opt for higher benefits).

D4 Minimum benefits

Under the **Health Insurance Act 1994 (Minimum Benefit) (Amendment) Regulations 2015**, all policies offered by private health insurers must provide cover for a statutory minimum schedule of benefits. The exception are those policies that cover public hospital daily charges only or certain health services only (e.g. out-patient services). The entry-level policies available from the different health insurers tend to correspond to the minimum schedule of cover and are broadly similar, although many tend to exceed the minimum benefit requirements.

Minimum benefit requirements are restricted to treatment that is 'medically necessary'. The regulations also list the permitted exclusions in private health insurance. We will consider the Minimum Benefit Regulations in more detail in the Personal General Insurance and Health Insurance and Associated Insurances modules.

D5 Risk equalisation

Risk equalisation is a common mechanism in countries with community rated health insurance systems. Without an effective risk equalisation system, a community rated market, with significant differences in risk profiles between competing insurers, cannot survive. Extract 4.1 shows the 2015 market shares of the private health insurers in the Irish market. It highlights the differences in the insurers' risk profiles and it is data such as this that supported the introduction of the risk equalisation in the Irish private health insurance market.

risk equalisation

a process that aims to equitably neutralise differences in insurers' costs that arise from variations in the age profile of the individuals they insure

4.1

Extract

Health insurance claims costs increase with age. The average prescribed claims cost for people aged 70-79 in 2015 was €3,204 compared to €311 for those aged 18-29. Vhi Healthcare has a much higher proportion of older lives than the other health insurers in the market. For instance, Vhi Healthcare, at December 2015, has a 49% market share in the 0-49 age group and an 83% market share of the over-80s age group. This contributes to Vhi Healthcare having a higher average claim cost per member than its competitors.[6]

The **Health Insurance (Amendment) Act 2012** is the basis for the Risk Equalisation Scheme (RES).

The risk equalisation process involves transfer payments between health insurers. This helps to spread some of the claims cost of the high-risk, older and less healthy members among all the private health insurers in the market, in proportion to their market share. The process works through a system of levies (money collected from insurers) and credits (money paid back to insurers). The HIA administers the Risk Equalisation Fund.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

[6] The Health Insurance Authority (2018), *Health Insurance Levy/Risk Equalisation – Guide to Risk Equalisation 2018*, pdf, www.hia.ie. Note that this HIA material contains references to health insurers that are no longer active in the Irish market. For example, GloHealth is now Irish Life Health and, in August 2023, AXA Insurance acquired Laya Healthcare.

E Reinsurance

Reinsurance is the process by which an insurer, having accepted a risk, passes (cedes) that risk to another insurer. The insurer that purchases the reinsurance is known as either the 'cedant' or the 'reinsured' – these terms are interchangeable. The reinsurance company that accepts the risk from the original insurer is known as the 'reinsurer' (or specialist reinsurer).

Reinsurance protects the common pool and supports the underwriting process. We will study this topic in greater depth in the Practice of Risk Control and Underwriting module. For now, we will briefly consider the function of reinsurance and the main ways in which it can be arranged.

E1 Aims of reinsurance

The main aim of reinsurance is to remove uncertainty by sharing the risk. This allows insurers to:

- smooth peaks and troughs in their claims experience, replacing the uncertainty of losses with the stability of a predictable reinsurance cost
- have the confidence to expand their business
- accept a larger and wider range of risks
- protect the portfolio (in effect, the balance sheet)
- access expertise provided by reinsurers.

treaty reinsurance

a pre-negotiated agreement between the primary insurer and the reinsurer, whereby the primary insurer agrees to cede all risks within a defined class or classes to a reinsurer and in return, the reinsurer agrees to provide reinsurance on all risks ceded without individual underwriting

E2 Types of reinsurance

There are two main types of reinsurance: treaty and facultative. These are explained in the following sections.

E2a Treaty reinsurance

Treaty reinsurance is the most common form of reinsurance. It is used to protect a portfolio of risks (e.g. all of the risks of a particular class of insurance such as an insurer's household account) rather than individual policies. The treaty is the underlying agreement that outlines the business ceded to the reinsurer, and the precise terms of the arrangement.

E2b Facultative reinsurance

In **facultative reinsurance** the insurer has a separate reinsurance contract for a particular risk. The term 'facultative' means optional, in that both the insurer and reinsurer have the option to decide whether or not to enter into the contract.

When we considered risk sharing in Chapter 3B2, we noted that an individual risk may sometimes exceed an insurer's normal acceptance limits. In these circumstances, the insurer may seek a means of sharing the risk by co-insurance or by reinsurance. Facultative reinsurance is a common way of providing cover for large and unusual risks.

Example 4.9 illustrates the administrative impact of facultative versus treaty reinsurance.

facultative reinsurance

a type of reinsurance cover for individually large or unusual risks that are typically excluded from standard reinsurance treaties

Example 4.9

Facultative vs. treaty reinsurance

ABC Insurance insures 200,000 commercial properties. If it were to reinsure them on a facultative basis, it would have to individually negotiate and arrange 200,000 separate reinsurance contracts.

In contrast, under treaty reinsurance it will only need to arrange one contract.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

F Summary

In this chapter, we looked at the professionals involved in the underwriting process and at the role of the underwriter, in particular. We saw the options available to underwriters when they're presented with a risk, and how exposure measures and premium rates influence the pricing of a risk. We considered the unique features that impact on the underwriting of private health insurance. Finally, we learned about the role of reinsurance in the underwriting process.

F1 What's next?

Now we're going to consider the legal relationship between the policyholder and the insurer. The insurance policy forms the basis of the contract between them so we're going to take a look at the law of contract and its relevance to insurance policies.

F2 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

F3 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and study tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

Completing online mock exams and reviewing the personalised feedback that follows, is a great way of testing your knowledge and preparing for exam day.

To access these online learning supports, just log into your Member Area on www.iii.ie and click on the **Connect** logo.

End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 4.

1. Identify the role of the underwriter when considering individual risks.

2. Explain how property insurance premiums are usually calculated.

3. State the usual exposure measure for household insurance.

4. Explain why some policies have adjustable premiums.

5. Identify the range of options available to an underwriter when dealing with an insurance risk.

6. Provide an example of how an underwriter may reduce or limit policy cover when presented with a risk that contains a less attractive feature.

7. Explain the term 'warranty', with reference to a non-consumer insurance contract.

8. State the four principles on which private health insurance is based.

9. Explain the principle of lifetime cover found in private health insurance.

10. List the benefits of reinsurance to an insurer.

11. State the two main ways in which reinsurance can be arranged.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. The role of the underwriter is to:
   - assess the risk that people bring to the pool
   - decide whether or not to accept the risk, at what price, or how much of the risk to accept
   - determine the terms, conditions and scope of cover to be offered
   - calculate an appropriate premium to cover expected claims, provide a reserve, meet all expenses and provide a profit.

2. For property insurances, premiums are usually arrived at by applying a premium rate to an exposure measure (usually the sum insured).

3. The usual exposure measure for household insurance is the sum insured on buildings or contents.

4. In some cases it may only be possible to provide an estimate of the amount of the exposure measure. The provisional premium will need to be adjusted once actual figures are known.

5. Options available to an underwriter when dealing with an insurance risk could include:
   - accepting the risk at normal terms
   - increasing or reducing the premium
   - reducing or limiting the cover
   - managing the risk
   - a combination of measures
   - declining the risk.

6. Example measures to reduce or limit the cover could include:
   - For a young, named driver coupled with a high-powered car, the insurer may be willing to cover other more experienced drivers on a comprehensive basis but exclude own damage cover for the young driver.
   - In an area known to be prone to flooding, the insurer may exclude flood cover.

7. A warranty is a promise made by the non-consumer insured concerning the risk, and relates to facts or performance. It is an undertaking by the insured that something will or will not be done or that a certain state of affairs does or does not exist. If breached, it permits the insurer to automatically void the contract as a whole.

8. The four principles, (enshrined in legislation), on which private health insurance is based are:
   - community rating
   - open enrolment
   - lifetime cover
   - minimum benefits.

9. Lifetime cover means that, once an individual has been accepted for cover, a health insurer may not cancel or refuse to renew their cover, except in very limited circumstances, i.e. non-payment of premium, fraud leading to economic loss by the insurer, or where the insurer ceases to write private health insurance business or no longer offers health insurance contracts of that type.

10. The benefits of reinsurance include: smoothing results, i.e. smoothing peaks and troughs, providing confidence for expansion or extra capacity for individual risks, protecting the portfolio and providing access to the reinsurer's expertise.

11. Reinsurance can be arranged either by facultative reinsurance or treaty reinsurance.

Answers to quick questions

1. A private health insurance underwriter is concerned with the effective operation of the common pool but not with individual risk rating (as this is not permitted by law). A motor insurance underwriter will seek to achieve the effective management of the common pool by means of individual risk rating.

2. Exposure measure (sum insured) x premium rate = premium. So the premium is €250,000 (exposure measure) x 0.3% (premium rate) = €1,350.

3. It is possible that an insurer would offer reduced cover for these two risks. It is likely that an increased excess and improved security features would be applied; probably coupled with a premium rate increase. However, the insurer might decline the risks altogether.

4. The insurer could:
   - decline the risk if it seems that profitability is unlikely
   - impose a higher level of excess while non-employees are driving (or exclude own damage cover/ social domestic and pleasure use (business use only))
   - increase the premium to take account of the unusual frequency of losses
   - combine the options, imposing both a premium loading and restriction in cover.

5. The principle of community rating means that a health insurer in Ireland must charge the same premium for the same health insurance contract, regardless of the age, gender, health status or past claims record of the individual. This spreads the cost of private health insurance, from young to old and, to some degree, from male to female. There are some exceptions to this requirement, most notably lifetime community rating.

Sample multiple-choice questions

Question 1

What percentage is applied to all household insurance premiums (in addition to a €1 stamp duty charge) to reflect the insurance premium levies?

A. 2%

B. 3%

C. 5%

D. 7%

Your answer:

☐

Question 2

How will an insurer **usually** set a premium rate for a class of business?

A. By reviewing previous claims patterns and adjusting these for future trends.

B. By assessing the sums insured for the entire class of business and spreading these across the pool of risks.

C. By forecasting their projected profits for the year and calculating a rate that will generate these profits across the class of business.

D. By assessing each individual risk and charging a separate rate per risk, which will generate a profit at the end of the year.

Your answer:

☐

Question 3

Eddie has a private health insurance policy and his renewal date was two weeks ago. He has decided to switch providers but does not want to have to go through a waiting period again. Within what **maximum** number of weeks must Eddie effect a new policy, in order to avoid additional waiting periods?

A. 8

B. 10

C. 11

D. 13

Your answer:

☐

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 4B1f

Question type: K

Correct response: C

Learning outcome: Demonstrate the relationship between underwriting and the premiums charged for general insurance policies.

Question 2

Chapter reference: Chapter 4B1b

Question type: U

Correct response: A

Learning outcome: Demonstrate the relationship between underwriting and the premiums charged for general insurance policies.

Question 3

Chapter reference: Chapter 4D3

Question type: A

Correct response: C

Learning outcome: Demonstrate the impact of private health insurance principles on the underwriting of this class of insurance.

Chapter

5

The insurance contract and policy

What to expect in this chapter

An insurance policy is a legal contract between the insured and insurer. In this chapter we're going to look at how the law of contract applies to insurance policies.

The formation of an insurance contract is traditionally governed by two key legal principles – insurable interest and utmost good faith. Insurable interest relates to whether someone has the right to insure something. Utmost good faith concerns the relationship of trust and honesty that must exist between the insured and the insurer.

We will consider these principles in detail including how they have been amended in relation to insurance consumers by the **Consumer Insurance Contracts Act 2019**. This Act reforms the law applicable to insurance contracts and aims to:

- address the perceived imbalances in consumer contract law identified in the Law Reform Commission's 2015 *Report on Consumer Insurance Contracts*, and
- consolidate the various laws and regulations applicable to consumer insurance contracts.

We will also look at:

- the elements of a valid contract
- how a contract is discharged or fulfilled
- the format of a typical insurance policy.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**A valid contract**	Describe the main elements of a valid contract of insurance, how a contract is discharged and remedies for breach of contract.
B	**Discharge of a contract (termination)**	
C	**The insurance policy**	Outline the structure of a general insurance policy and explain the impact of a breach of policy condition.
D	**Insurable interest**	Explain the scope and impact of the legal principles of insurable interest and utmost good faith in general insurance and outline how they have been impacted on by the **Consumer Insurance Contracts Act 2019**.
E	**Utmost good faith**	

A A valid contract

The law of contract is concerned with the relationship between two parties, both of whom agree to carry out a certain task or accept an obligation. Insurance contracts follow the same rules as other contracts, but also have special rules of their own. In this section we will consider the elements necessary to form a valid contract.

A1 Offer and acceptance

A contract comes into existence when one party makes an offer that the other party accepts unconditionally. If there is a condition attached to the acceptance, this amounts to a rejection of the original offer and a further offer being made, as shown in Example 5.1.

Example 5.1

Conditional acceptance

- **Insurer**: I will insure your house under the terms of a household policy but I want to impose a €1,000 excess because of the theft risk for the area in which you live. (This is an offer.)
- **Proposer**: I accept the premium but will you remove the excess if I fit security bolts to all my windows? (This represents a rejection of the first offer and the making of a new offer.)
- **Insurer**: Yes, provided you also fit a five-lever or tumbler deadlock to your front door. (This represents a rejection of the second offer and the making of a new offer.)
- **Proposer**: I agree. (This represents unconditional/unqualified acceptance.)

We can see in the example that each stage represented a rejection of the offer as it stood and it was not until the final statement that agreement was reached. Each counter-offer meant that the original offer was no longer available for acceptance.

consideration

what each party agrees to do to support their side of the contractual agreement

A2 Consideration

The offer and acceptance process described relies on promises made by the parties. These promises refer to each party's side of the bargain, known as **consideration** in contract law.

The payment of money is a common form of consideration for many contracts. For insurance contracts the consideration is more complex. The proposer's consideration is usually the promise to pay the premium and abide by the policy terms. The insurer's consideration is a promise to pay benefits or compensation should the defined event(s) occur.

A3 Legal relationship

There must be an intention to create legal relations. For example, a promise to meet a friend for a meal on a certain day is an informal arrangement with no intention to create legal relations. In contrast, in insurance situations, the parties come together with the clear intention of creating an insurance contract.

contractual capacity

freedom of a company or individual to enter into a contract

capacity

(in this context) the ability to understand when a decision is made and the nature and consequences of the decision in the context of the available choices.

A4 Capacity to contract

Most individuals who have reached the age of majority (18 years) have full **contractual capacity**. The same is true of companies. However, there are those whose legal capacity is limited e.g. minors, intoxicated persons or persons who lack **capacity**.

A5 Legality of purpose

Any contract that purports to support an illegal act or is itself unlawful will be void.

A6 Certainty of terms

The terms of a contract must be certain, and no contract is formed if a vital term is missing or if the meaning of an essential term is uncertain. It should also be noted that some terms will be set aside (in consumer contracts) if they are considered unfair (i.e. create an imbalance in the positions of the parties to the detriment of the customer). Minor terms do affect the substance of a contract and are generally not set aside.

Quick question 1

What is the consideration on the part of the insurer and the insured in an insurance contract?

The answer is at the end of this chapter.

A7 Good faith

The parties to a contract must act in good faith and not deliberately deceive each other. As we will see in Section E, non-consumer insurance contracts are subject to the more demanding requirement of utmost good faith.

B Discharge of a contract (termination)

In this section we consider how the rights and obligations of the parties may come to an end.

A contract may be discharged in a number of different ways. We will now look at each of these in turn.

B1 By performance

In order to discharge the contract, performance must usually be precise and exact. For example, when an insurer pays out a total loss claim for a diamond ring (the only item covered under the policy). The exceptions to this general rule are as follows:

- Where the principle of partial performance is accepted by one party, they have the choice to accept or reject the other party's partial performance.
- A genuine tender (offer) of performance is made by one party and refused by the other party. The other party prevents performance in this case.
- Where performance is substantially complete, each case would be decided on its merits.

B2 By breach

This is a failure to perform. For example, if an insurer refuses to pay for a claim that arises from an event which was explicitly covered under the insurance policy. If one party gives advance warning that they do not intend to honour the contract, this will amount to anticipatory breach and action can be taken straight away.

If a contract is breached without advance warning, the following **remedies** or actions are available to the injured party:

- A legal action for damages can be taken by the injured party.
- An **injunction** can be put in place.
- The contract can be rescinded (i.e. both parties are returned to their pre-contract position).
- There can be a court action for specific performance (i.e. the court requires that the contract be performed as agreed).
- There can be a rectification (i.e. contract corrected to show actual intention of the parties).

remedies

the ways in which a wrongful act can be addressed and rectified/ compensated for, on behalf of the injured/ affected party

injunction

court order requiring that a person act in a particular way (mandatory or prohibitive)

B3 By frustration

This occurs when an event makes a previously possible contract now impossible to perform, e.g. the destruction of the **subject matter of the contract** or non-occurrence of the event on which the contract depends. In such instances, both parties are released from their obligations.

Examples include:

- A motor insurance contract is discharged because the insured has suffered a disability which brings to an end their ability to continue driving.
- A public liability contract of insurance is discharged as the contract was taken out to cover specific building works being carried out by the insured but the insured business has since ceased operating and those works cannot commence.

subject matter (of the contract)

the financial interest a person has in the item or event insured

B4 By agreement

If neither party has performed their consideration, the contract will automatically be discharged. For example, an insured person requests cancellation of their dental insurance policy, as they no longer wish to have this cover, and the insurer agrees to this request.

B5 By operation of law

A contract may be discharged by the operation of the law. The following are examples:

- Death will discharge a contract for personal services. Rights and duties under other contracts survive for the benefit, or otherwise, of the estate of the deceased party.
- Bankruptcy will discharge a contract, whereby a trustee in bankruptcy may be appointed and rights of action possessed by the debtor relating to their property will pass to the trustee.

In the course of a contract, breaches of conditions or warranties may occur. In general contract law, a warranty has to be complied with in general terms, but a condition goes to the heart of the contract.

In insurance law, this is reversed. A warranty goes to the very heart of the contract (see Chapter 4C4a) and conditions vary in their effect according to type (see Section C2). The remedies for breaches of conditions and warranties are explained in the referenced sections.

Quick question 2

What term is used when an event makes the contract impossible to perform?

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

C The insurance policy

The insurance policy is evidence of the contract between the insurer and the insured. It documents the parties involved, the premium, the scope of the cover provided and any special terms, conditions or exclusions that apply.

While each insurer has its own particular style of policy wording, some elements are common to all policies. As you work through this section, you might find it helpful to look at some policy wordings. If you work in an insurance company, you can study some of your own company's policies. Alternatively, you could refer to your own personal insurance policies (e.g. motor or home) or look at the policy wordings on insurers' websites.

C1 Policy structure

Most personal general insurance policies are now issued in what is known as a scheduled form. The policy wording is pre-printed, often in a booklet, which can be in hard or soft copy format, with a **schedule** (usually a single page) included to tailor it to the policyholder. However, for commercial insurances, most insurers issue a tailor-made, computer-generated policy, which only includes clauses and sections relevant to the insured.

It is important that the insured reads the policy documentation carefully at the start of cover to ensure they are fully protected. A common mistake is to assume there is cover for everything that is listed in a policy booklet.

Although policy booklets vary considerably in both style and length, all general insurance policies contain certain basic elements. These are shown in Table 5.1.

schedule

tailored section (of a policy) that provides the policy number and all variable information about the policyholder, period, premium and subject matter, and highlights any special terms, conditions or exclusions that apply

recital clause

scene-setting clause that refers to the parties to the contract, premium, indemnity and (in non-consumer insurance contracts) may confirm the proposal (if any) as the basis of the contract

operative clause

clause(s) that describes the standard scope of cover of each section of an insurance policy

endorsement

a written document, usually incorporated within a policy wording, and referenced on the schedule, which modifies the policy in terms of the cover being afforded by the insurer

exclusion (exception)

policy provision that defines circumstances or types of loss that are not covered

implied conditions

terms that are assumed to be part of an insurance policy even though they may not have been written into the policy

subject matter of insurance

item or event insured (e.g. car, house, valuables, factory stock, or liability for acts of negligence)

Table 5.1 Policy structure

Policy section	Content
Heading	Name of insurer, company logo and usually the address and other contact details
Recital clause/preamble	A scene-setting clause referring to the parties to the contract, premium payment, indemnity and (in non-consumer insurance contracts) may confirm the proposal (if any) as the basis of the contract
Definitions	Frequently used terms or words with a particular meaning
Signature	Officer of the insurer (pre-printed), e.g. Chief Executive Officer, Managing Director
Operative clause (s)/ Insuring Agreement(s)	A clause (or clauses) that describes the standard scope of cover of each section of an insurance policy
Policy schedule	Tailored to give the policy number and provide all the variable information about the policyholder, policy period, premium subject matter and cover applicable and to highlight any special terms, conditions, **endorsements** or exclusions that apply
Information and facilities	Not usually part of the contract itself; information may be provided on customer helplines, service standards and complaints and claims procedures
General conditions	These can be either standard conditions applied by all insurers to policies of a given type or bespoke conditions applied by an insurer to an individual risk.
General **exclusions/ exceptions**	These can either be standard exclusions applied by all insurers to policies of a given type or bespoke exclusions applied by an insurer to an individual risk.

C2 Policy conditions

Policy conditions give details of the behaviour expected by the parties to the contract. There are two types of conditions – implied and express – and they apply to all insurance contracts.

Implied conditions relate to what is expected of the insured. Examples relating to non-consumer insurance contracts include:

- Insurable interest – the insured must have an insurable interest in the **subject matter of the insurance** (see Section D1).
- Utmost good faith – the insured must comply with the requirements of disclosure required in contracts of utmost good faith (see Section E).

Insurable interest and utmost good faith are long standing principles in Irish insurance law which apply to all non-consumer insurance contracts. However, the **Consumer Insurance Contracts Act 2019** has amended the application of these principles to consumer insurance contracts (see Sections D9 and E2b).

Express conditions relate to specific requirements that must be complied with, either by the policyholder, the insurer, or both. Examples include:

- Due observance – All terms and conditions of the policy must be fulfilled for a claim to be payable.
- Reasonable precautions – The insured must take all reasonable care/precautions to minimise the risk of loss or damage or of incurring liability.
- Alteration – This condition requires the insured to notify the insurer of any changes that may increase the risk of damage during the life of the policy. The effect is to extend the duty of disclosure (see Section E3a) so that it becomes a continuing one.
- Cancellation – This provides for cancellation during the life of the policy, usually by the insurer. Where an insurer cancels the insurance policy, it must notify the insured in writing and refund the premium for the unexpired period of insurance. The insured also has the right to cancel the policy mid-term. If so, this is stated in the condition. Under the **Consumer Insurance Contracts Act 2019**, the insured has the right to a 14 business day 'cooling off' period and the insurer cannot charge an administrative fee for cancelling the policy.[7]
- Claims – One of these conditions is the requirement for the insured to notify claims promptly and to cooperate with the insurer. We will deal with claims conditions in greater detail in Chapter 7A2.
- Dispute resolution – This is a condition that binds both insurer and insured to refer disputes to **arbitration** or **mediation** in the event of a dispute. However, this does not override the right of the insured to refer their complaint to the **Financial Services and Pensions Ombudsman (FSPO)**, if eligible to do so.

C3 Breaches of policy conditions

A breach of either type of condition (express or implied) is serious, although the effect of a breach varies according to the category of condition. Policy conditions are divided into three distinct categories, which are explained next.

C3a Conditions precedent to the contract

Conditions precedent to the contract must be fulfilled prior to the formation of the contract (e.g. for non-consumer insurance contracts these would be insurable interest, utmost good faith). There may also be ongoing conditions (e.g. suspensive conditions (see Chapter 4C4b)). If such conditions are not complied with, the validity of the entire contract is in doubt. For example, in a non-consumer insurance contract, if there is no valid insurable interest there is not an effective insurance contract; meaning that the contract is void.

Just think

What is the effect of a policy being treated as void?

If a policy is declared void, it is as if the contract never existed. It cannot be enforced by either of the parties.

Breach of other conditions precedent to the contract may allow an insurer to avoid the policy (see Section E5). This would include issues such as a fraudulent **misrepresentation** by a consumer.

express conditions
terms that are set out in the wording of an insurance policy

arbitration
a legally binding alternative dispute resolution process, whereby cases are heard by an arbitrator rather than a judge in court

mediation
process of settling a dispute between an insurer and an insured arising from certain types of insurance claims

Financial Services and Pensions Ombudsman (FSPO)
statutory body for insurance customers to refer complaints about the conduct of a regulated financial service provider

condition precedent to the contract
condition that, if not complied with, can allow the insurer to void the policy as a whole

misrepresentation
untrue statement of fact, either innocent, negligent or fraudulent, made during negotiations

Quick question 3
In non-consumer insurance contracts, is utmost good faith an implied or express condition?

[7] Sections 11 and 13, **Consumer Insurance Contracts Act 2019**.

condition precedent to liability

condition that allows the insurer to avoid liability for a claim in the event of a breach

C3b Conditions precedent to liability (or to recovery)

Non-consumer insurance contracts

In non-consumer insurance contracts, conditions precedent to liability are conditions that must be complied with for a claim to be valid. The term 'liability' in this context refers to the insurer's liability to pay a claim. If a **condition precedent to liability** (or to recovery) is not observed, the insurer may avoid liability for a particular loss. The materiality of the breach is irrelevant. However, the insurer may not repudiate (reject) the contract as a whole (see Example 5.2). If a subsequent loss occurs, the insurer must pay, provided the insured complies with the condition in the later instance.

Example 5.2

The policy of insurance requires the payment of an excess of €1,000 in the event of a claim. Following a claim, the insurer may insist upon the payment of the excess prior to dealing with the particular claim, but it may not cancel the policy if the excess is not paid.

Consumer insurance contracts

Under the **Consumer Insurance Contracts Act 2019**, an insurer can only decline a claim based on a breach of a condition precedent to liability if that breach increased the risk of the loss that occurred. For example, if the use of a burglar alarm is a condition precedent to liability, the insurer cannot decline a flood claim because the burglar alarm was not activated. This is because the burglar alarm being on or not has no impact on the likelihood or severity of the flood claim. So basically, in consumer insurance contracts, a condition precedent to liability is generally treated as a suspensive condition.

C3c General conditions

Some conditions do not fit into any of the previous categories. General conditions can be applied by insurers to policies of a given type (such as the cancellation condition or premium adjustment condition) or be specific to the particular risk in question. These conditions are not fundamental to the operation of the contract and do not carry the severe consequences arising from a breach of the other conditions. Instead, the remedy for a breach of these conditions depends on the extent to which the insurer was prejudiced by the breach; this means a claim may be avoided altogether or it may merely be reduced.

Under the **Consumer Insurance Contracts Act 2019** (see Chapter 4C4b), any clause that imposes a continuing restrictive condition on a consumer is treated as a suspensive condition. This means that the insurer's liability is only suspended for the duration of the breach i.e. if a breach existed but was remedied before the loss occurred, then the breach is immaterial.

Table 5.2 summarises examples of breaches and the effects and remedies for breach of each category of condition.

Table 5.2 Breach of conditions

Cause	Example of breach	Effect
Breach of condition precedent to the contract	Michael approaches an insurer for a buildings insurance policy and fails to disclose the fact that the property is suffering from subsidence. A few months later, Michael puts in a claim for damage caused to the property by subsidence. Following some investigation, the insurer refuses the claim and voids the policy.	• If a condition precedent to the contract is never fulfilled the contract is void *ab initio* ('from the beginning') (non-consumer insurance contract). • If Michael is a consumer and presuming that the insurer asked a specific question about subsidence during the proposal process, Michael's actions constitute fraudulent misrepresentation. As a result, the contract is void *ab initio*.
Breach of condition precedent to liability (non-consumer insurance contracts only)	Alex leaves the keys in his van while he goes into the local shop. His vehicle is promptly stolen. Alex attempts to claim from his insurer for the theft. His insurer refuses the claim as Alex has breached a 'claims condition' noted in his policy regarding the care of the vehicle. However, the policy is not cancelled.	• The insurer may avoid the claim. • The insurer must show that it has been prejudiced by the breach of condition, e.g. the keys were left in the van and it was stolen. • The policy as a whole is not avoided and remains in force.
Breach of general condition	One of the general policy conditions on Barbara's home insurance contract states that the property must be fitted with specified security standards. Barbara's house is broken into and it is determined that the required security standards were not in place. The insurer settles the claim but the settlement amount is reduced to reflect the fact that the security condition was not adhered to.	The remedy for the breach depends on the extent to which the insurer was prejudiced and on what the outcome would have been if the condition had been complied with. This means that the claim can be avoided or merely reduced.

D Insurable interest

Insurable interest is defined as 'the legal right to insure arising out of a financial relationship recognised at law, between the insured and the subject matter of insurance'.

In Section A, we identified the elements of a valid contract. For a non-consumer insurance contract to be valid, there is a requirement of 'insurable interest'. However, the requirement for insurable interest in consumer insurance contracts was amended by the **Consumer Insurance Contract Act 2019**.

The principle of insurable interest, as it applies to non-consumer insurance contracts, contains a number of elements, which are discussed in Sections D1-D8. How this principle applies to consumer insurance contracts is examined in Section D9.

D1 Subject matter of insurance

This is the item, event or liability being insured. Some obvious examples are vehicles, property, valuables, factory stock, or liability for acts of negligence. For example, the subject matter of insurance under a household policy can be the building, furniture and other contents, or the creation of liability (e.g. when a tile that should have been secured falls from a roof and injures a passer-by).

subject matter (of the contract)

the financial interest a person has in the item or event insured

D2 Subject matter of the contract

In the case of ***Castellain v Preston*** (1883), in an attempt to explain the phrase **subject matter of the contract**, the following question was asked: 'What is it that is insured in a fire policy?' The answer was: 'Not the bricks and materials used in building the house, but the interest of the insured in the subject matter of insurance.'

D3 Financial value

The interest referred to in the ***Castellain v Preston*** (1883) case is the financial interest in the subject matter of the insurance – in this instance, the cost of rebuilding the house. Insurable interest in the subject matter of insurance must have a financial value. The measure of value will differ according to the type of insurance.

D4 Legally recognised relationships

The relationship between the insured and the subject matter of the insurance must be recognised in law (e.g. owner, mortgagee).

If there is no legal relationship, there is no insurable interest. For example, a thief can have no insurable interest in stolen goods. Nor can an individual have an insurable interest in a friend's possessions, unless they have been given the goods for safekeeping and they are legally responsible for them.

Legal spouses and civil partners are deemed to have an insurable interest in each other's possessions but this is not currently the case for co-habiting couples or partners. Although some insurers may accept that there is insurable interest in these situations, others may not and will deem the contract invalid.

D5 Insurer's insurable interest

As we saw in Chapter 1, insurers share risks with reinsurers. They are able to do this because they have an insurable interest in the risks they have assumed. The subject matter of the reinsurance contract is the insurer's financial interest in the original insurance (the possibility of financial loss to the insurer if there is insured liability, loss or damage).

Quick question 4

What is the difference between the subject matter of insurance and the subject matter of the contract?

D6 Timing of insurable interest

An important question that needs to be asked is: 'When must insurable interest exist?' The answer to this question varies according to the class of insurance business involved.

- For commercial (non-consumer) indemnity insurance contracts, insurable interest must exist at inception and throughout the contract. It will therefore exist at the time of any loss.
- For marine insurance contracts, insurable interest must exist at the time of loss only (though there must be a reasonable expectation of a future interest when the policy is effected).
- For commercial (non-consumer) life insurance contracts, insurable interest must exist at inception. It does not need to exist at the time of a loss. An example would be when a business purchases keyperson life insurance.

As Example 5.3 shows, the expectation of acquiring insurable interest at some time in the future, however certain, will not be enough to create insurable interest in general non-marine insurances.

Example 5.3

Rental Giants Ltd. is in the late stages of negotiations to purchase a large apartment complex. In anticipation of the sale going through, a suggestion is made that Rental Giants Ltd. insures the property. However, Rental Giants Ltd. cannot do this because up until it owns the property (or pays a deposit), it does not have an insurable interest. Until that happens, Rental Giants Ltd. has nothing more than a mere expectation and this is insufficient for the purposes of insuring the property.

D7 Sources of insurable interest

Insurable interest in the subject matter of an insurance policy may arise in three ways:

1. At common law

Many duties and rights under common law give rise to insurable interest. For example, we have already considered ownership. Equally, if we injure someone through our negligence, there is a financial aspect to that responsibility that gives us an insurable interest.

2. Under contract

There are situations in which we accept greater liabilities than those imposed by common law. They occur when we enter into a contract that gives us greater responsibilities. For example, a landlord is normally liable for the maintenance of the property they own. However, the landlord may make the tenant liable under the terms of the lease.

3. Under statute

Many statutes (Acts of Oireachtas) give rise to an insurable interest, by imposing a particular duty on, or granting a benefit to, certain groups of people. Examples of statutes imposing duties are the **Hotel Proprietors Act 1963,** the **Safety, Health and Welfare at Work Acts 2005 and 2010**, the **Trustee Acts 1893 and 1989**.

D8 Requirements of insurable interest

Table 5.3 summarises the main requirements of insurable interest.

Table 5.3 Main requirements of insurable interest

- There must be some property, right, liability, interest, life or limb that is exposed to loss and capable of being insured.
- This must be the subject matter of the insurance.
- The subject matter of the insurance must have a measurable financial value.
- There must be a relationship between the insured and the subject matter of the insurance such that the insured stands to benefit by its safety or be prejudiced by its loss.
- This relationship must be recognised at law.
- The relationship must be current – the mere hope of acquiring an interest is not enough.

D9 Consumer Insurance Contracts Act 2019

As already outlined, insurable interest is an element of a valid insurance contract. However, the application of this concept in relation to most consumer insurances was abolished by the **Consumer Insurance Contracts Act 2019**.

This means that an otherwise valid claim made by a consumer cannot be rejected by an insurer on the grounds that the claimant did not have a valid insurable interest in the subject matter of the insurance at the time that the policy was entered into or at the time of the loss. The reasoning is that an insurer is responsible for assessing a risk before it is underwritten and if, at that point, the insurer determines that a proposer does not have sufficient interest in a matter, the insurer does not have to provide them with the insurance policy cover. As a result, an insurer cannot later seek to avoid a claim because the claimant does not have an 'insurable interest' which they were not concerned about when they sold the policy.

The exception to the abolition of this principle in the case of consumer insurances is a contract of indemnity (e.g. fire, public liability, employers liability). Under a contract of indemnity for consumers, the concept of insurable interest is satisfied by the claimant having an economic benefit in the preservation of the subject-matter or suffering an economic loss following its loss or destruction.

Example 5.4 illustrates this amended concept of insurable interest.

Example 5.4

Denis is his Uncle Tom's only living relative. He has been told that he will inherit Tom's house on his uncle's death. Denis discovers that his uncle's house is not insured.

Given that Denis has the expectation of an economic benefit (from his inheritance of the house), it is therefore reasonable for him to insure his uncle's house. It is likely to be a joint policy and the insurer would have to be satisfied that Denis had a factual expectation of insurable interest in the house.

While Denis would pay the premium, his Uncle Tom would be the beneficiary under the policy during his lifetime. This would mean that, in the event of a loss occurring while Uncle Tom was alive, the insurer will settle any claim with Tom as he would be the only one suffering an economic loss. Denis would not have any proof of economic loss as he is not yet the owner of the house. However, if a loss occurred after Denis had inherited the house or while ownership of the house was being transferred to Denis, the insurer will settle any claim with Denis.

This amended concept of insurable interest (applicable to contracts of indemnity for consumers) need only be present at the time of loss and not at the inception of the contract.[8]

[8] Section 7, **Consumer Insurance Contracts Act 2019**.

E Utmost good faith

Prior to the **Consumer Insurance Contracts Act 2019**, insurance contracts for both **consumers** and non-consumers were contracts of utmost good faith (uberrimae fidei). This meant that the parties to a contract must voluntarily disclose, accurately and fully, information relevant to the risk (known as 'material facts') whether requested or not, before the contract is entered into by the parties and comes into effect. For example, a failure to disclose on a property insurance proposal that chemical processes (which clearly have a higher risk of fire-related damage) are undertaken on the premises is a breach of the principle of utmost good faith. A good rule of thumb is: 'If in doubt – disclose.'

For non-consumer contracts, the principle of utmost good faith continues to apply equally to the proposer and the insurer.

consumers

any of the following:

c. a person or group of persons, but not an incorporated body with an annual turnover in excess of €3 million in the previous financial year (includes partnerships and other unincorporated bodies such as clubs, charities and trusts)

d. incorporated bodies with an annual turnover of €3 million or less in the previous financial year (provided the body is not part of a group with a combined turnover of more than €3 million).

… and includes a potential consumer.

E1 Material facts

We have referred several times to material facts and have seen how important they are to insurance contracts. The current legal definition of a material fact is contained in the **Marine Insurance Act 1906**:

> Every circumstance is material, which would influence the judgement of a prudent insurer, in fixing the premium, or determining whether he will take the risk.

Just think

Suppose an insurer sends a surveyor to inspect a proposer's business premises. The surveyor fails to notice an industrial process conducted on the premises that would have generated a much higher premium. If there is a claim, could the insurer refuse it on the basis that the proposer had failed to specifically disclose this material fact?

We instinctively sense that this is not reasonable, provided the proposer did not try to hide the process.

Some facts that are material do not need to be disclosed, as their non-disclosure does not affect the insurance contract. Examples include:

- Facts of law – Everyone is deemed to know the law. It follows that those actions the proposer needs to take in order to comply with the law do not need to be specifically declared. For example, a manufacturing company that operates dangerous machinery does not need to disclose that its machines are fitted with protective guards, as these are necessary to comply with health and safety legislation.
- Facts of public knowledge – This includes knowledge that a state of war exists or that a particular area is subject to natural catastrophes such as subsidence, or hurricane. It also extends to include issues such as industrial processes used in manufacturing (where these are standard for the trade).
- Facts that lessen the risk – These are almost invariably stated by the insured in the hope of gaining better terms from the insurer. Nevertheless, there is no requirement to disclose them. The fitting of a burglar alarm is an example of an improvement to a theft risk that will not affect the validity of the policy if undisclosed.
- Facts where the insurer has waived information – These would include partially completed answers, or unanswered questions, on a proposal form (see Section E4).
- Facts that a survey should have revealed – This only applies in circumstances where an insurer has carried out a survey. Provided the proposer has not concealed anything from the surveyor, if the surveyor overlooks something of importance (i.e. a material fact), the insurer cannot subsequently claim non-disclosure.
- Facts the insured does not know.

Next we examine how the **duty of disclosure** applies to, consumers, non-consumers and insurers, when this duty exists and the consequences of a breach of this duty.

duty of disclosure

obligation to truthfully reveal all material facts about the risk

E2 Duty of disclosure

E2a Pre-contractual duty of disclosure for non-consumers

A non-consumer proposer has a duty to disclose all material facts about the risk to the insurer. The details of the subject matter of the insurance and the circumstances surrounding it are known mainly (sometimes solely) by the insured. The insurers are not generally aware of these facts. In the UK case of *Rozanes v Bowen* (1928), the judge described it as follows:

> 'As the underwriter knows nothing and the man who comes to him to ask him to insure knows everything, it is the duty of the assured, to make a full disclosure to the underwriter, without being asked of all the material circumstances. This is expressed by saying it is a contract of the utmost good faith.'

E2b Pre-contractual duty of disclosure for consumers

For consumers (as defined in the **Consumer Insurance Contracts Act 2019**), the rules are very different. As a result of this Act, an insurance consumer's pre-contractual duty of disclosure is confined to answering specific questions posed by the insurer honestly and with reasonable care. To date, there is no Irish legal judgment defining honesty or reasonable care with regards to the **Consumer Insurance Contracts Act 2019**. The consumer is not under any duty to volunteer information over and above that sought by the insurer's questions. For example, if an insurer asks for details of all claims that occurred in the last 3 years, there is no obligation to reveal claims that occurred more than 3 years ago.[9]

It is assumed that the consumer knows that any matter about which an insurer asks a question is material to the risk.

E2c Pre-contractual duties of the insurer

The insurer must also be entirely open with the proposer. The insurer cannot introduce new non-standard terms into the contract that were not discussed during negotiations; nor can it withhold information about discounts that are available for certain measures that improve a risk (e.g. the fitting of a burglar alarm for household contents insurance).

Under the **Consumer Insurance Contracts Act 2019**, the insurer's questions must be specific and written in plain and intelligible language. General questions are not allowed. Under this Act, before entering or renewing a contract of insurance, the insurer must inform the consumer in writing of the general nature and effect of the pre-contractual duty of disclosure.[10]

E3 Timing of the duty of disclosure

The duty to disclose is implicit in all insurance negotiations. As we saw in Section E2, this is particularly important at the proposal stage, before the contract comes into existence. At common law, once the policy is in force, the duty of disclosure is revived at each renewal date (in the negotiations leading up to renewal).

Just think

Would an insurer accept only being advised of material changes to the risk at inception and at renewal?

The simple answer to this question is 'no'. In practice, the common-law duty of disclosure is often changed by the policy wording. Insurers use different conditions to create a continuing duty of disclosure.

They want to be kept up to date with material changes to risks and, in some cases, may wish to renegotiate terms as a result. Example 5.5 illustrates some of the approaches taken by insurers to create a continuing duty of disclosure.

[9] Section 8, **Consumer Insurance Contracts Act 2019**.

[10] Section 8, **Consumer Insurance Contracts Act 2019**.

Example 5.5

- **Commercial (non-consumer) property insurance** – requires continuing disclosure of the removal of property or goods to another location or of circumstances that increase the risk of damage
- **Motor insurance** – requires continuing disclosure of all material changes by the insured during the life of the policy (e.g. if an insured gets penalty points during the year they must tell their insurer)
- **Public and employers liability insurance** – insurers tightly define the 'business description' of the insured and require continuing disclosure of any extension of activities, sometimes coupled with a condition requiring continuing disclosure of material facts.

Quick question 5

What is the definition of utmost good faith?

E3a Mid-term material alterations

If, during the life of a general insurance contract, the insured needs to change the terms of the policy (e.g. increase the sum insured, change the description of the property, add another driver to a motor policy or extend a business definition), the duty of disclosure is revived, as a new contract is effectively being formed.

If any change necessitates an endorsement to the policy, it must be disclosed immediately and new terms agreed for continuance. Insurers have the right to refuse what could, in effect, be a new contract. In practice, the trend is to accommodate the majority of amendments.

In relation to mid-term alterations, under the **Consumer Insurance Contracts Act 2019**, an insurer can refuse a claim where there was a change in the subject matter of the contract of insurance (including as described in an 'alteration of risk' clause) to the extent that circumstances have changed so much that the new risk is something which the insurer did not agree to cover.[11]

E3b Renewal

For non-consumer insurance contracts, the policyholder must disclose to the insurer at renewal any changes in the material facts about the risk.

Under the **Consumer Insurance Contracts Act 2019**, the policyholder (consumer) is not under any obligation to provide the insurer with any additional information at renewal unless the insurer expressly requires them to do so by asking them a specific question or requesting them to update information previously provided concerning a specific matter. The policyholder must respond honestly and with reasonable care. If they do not provide any new information in response to the insurer's request and continue to pay the renewal premium, it is presumed that the information previously provided has not changed.[12]

[11] Section 15, **Consumer Insurance Contracts Act 2019**.

[12] Section 14, **Consumer Insurance Contracts Act 2019**.

Table 5.4 summarises the duties of a consumer and insurer at the various stages of the insurance contract.

Table 5.4 Duties of consumer and insurer

	Consumer	Insurer
Pre-contractual	Must answer specific questions asked by the insurer honestly and with reasonable care. Has no duty to volunteer information over and above that specifically requested by the insurer.	Must draft questions in plain English. Is deemed to have waived any further duty of disclosure on the part of the consumer if it fails to investigate absent, incomplete or ambiguous answers, unless the non-disclosure arises from fraudulent, intentional or reckless concealment. Where a proposal form is completed, the insurer must return a copy of it to the insured within 5 days of inception. Must inform the consumer on a durable medium of the general nature and effect of the pre-contractual duty of disclosure.
Mid-term alterations	Only needs to notify the insurer of alterations that take the risk outside of what was in the reasonable contemplation of the contracting parties when the contract was effected.	Can only reject a claim if the undisclosed alteration was so significant that the insurer would not have written the risk or would have applied substantially different terms and conditions.
Renewal	Must answer any specific questions asked by the insurer, honestly and with reasonable care. If requested by the insurer, must update information previously provided.	Can expressly ask the insured to answer specific questions or to update information previously provided but cannot go beyond that in the new presentation of the risk at renewal. Must notify the consumer, at least **20 business days** in advance, of any alteration to the policy's terms and conditions. This does not include changes to the premium. Must inform the consumer in writing of the general nature and effect of the pre-contractual duty of disclosure.

E4 Insurer's waiver of rights

In many cases, insurance is effected following completion of a proposal form by the proposer. The proposal form is designed by the insurer to elicit all information relevant to the risk.

If, in reply to an insurer's question, the proposer provides only partial or vague information, or fails to answer the question at all, the onus is on the insurer to seek further details. If the insurer does not do this, it is deemed to have forfeited its right to that information (**waiver of rights**). This is reinforced by the **Consumer Insurance Contracts Act 2019** which deems an insurer that does not investigate an absent or obviously incomplete answer to a question to have waived any further duty of disclosure by the consumer.[13]

Also, if an insurer words a question in a limited way, it is not entitled to information that lies outside the scope of the question. For example, a question that asks for the proposer's claims experience of the past 5 years does not entitle the insurer to information about a claim that occurred 6 years earlier.

waiver of rights

an insurer's loss of rights to information as material facts, having been alerted to a possible problem and failed to follow it up

Example 5.6[14]

Life Safe Assurance Company's proposal form asked whether the proposer had sought medical treatment in the 6-month period prior to the date of the proposal. Mark answered 'no' to that specific question, but he had, in fact, sought treatment for illness on several occasions prior to the 6-month period, and these facts were not disclosed. Mark subsequently died from the underlying medical condition. A court decision said that Life Safe Assurance Company had significantly limited the disclosure required and Mark's **non-disclosure** did not entitle the insurer to repudiate (reject) the claim.

non-disclosure

failure to volunteer information (in a non-consumer insurance context, material facts)

Just think

What do you think the insurer is entitled to do if there is non-disclosure of a material fact?

[13] Section 8, **Consumer Insurance Contracts Act 2019**.

[14] Example based on the case of ***Kelleher v Irish Life Assurance Co. Ltd*** (1993).

E5 Consequences of non-disclosure

Non-consumer insurance

The general rule is that if the insured is in breach of the duty of disclosure (by non-disclosure or misrepresentation), the insurer may void the contract entirely ***ab initio*** ('from the beginning') and return the premium. Therefore, no claims are payable. The insurer can set the whole contract aside. If the non-disclosure is fraudulent (often referred to as 'concealment'), and if a claim has been paid under the policy before the discovery of the non-disclosure, the insurer may keep the premium and sue for the recovery of any amounts paid out.

In either case it has serious consequences for the insured in trying to obtain subsequent policies of insurance, as full disclosure of previous enforced cancellations or voids are a requirement of all insurers and can influence the insurer's decision in whether or not to offer terms.

Just think

Can an insurer refuse a non-consumer's claim payment but leave the policy in force?

The insurer cannot refuse payment of a claim and leave the policy in force as the non-disclosure is fundamental to the whole contract. The insurer has the right to ignore the breach, but must pay the claim and leave the policy in force.

Consumer insurance

Under the **Consumer Insurance Contracts Act 2019**, the remedies available to insurers for pre-contractual misrepresentation by a consumer vary depending on whether the misrepresentation was innocent, negligent or fraudulent. Where a claim is made following:

- an innocent misrepresentation, the insurer must pay the claim and cannot avoid the contract on the ground of the innocent misrepresentation
- a negligent misrepresentation (one that is neither innocent nor fraudulent), the remedy reflects what the insurer would have done had it been aware of the full facts
- a fraudulent misrepresentation, or where any conduct by the consumer, relative to the insurance contract or steps leading to its formation, involves fraud, the insurer can avoid the contract.[15]

As we saw in Chapter 2B3b, dishonesty is a moral hazard and this is something insurers take into account when establishing the level of risk involved, and the appropriate premium to be applied, if they agree to take on the risk.

Quick question 6

Which categories of material fact, if undisclosed, will not affect the validity of a non-consumer insurance policy?

[15] Section 9, **Consumer Insurance Contracts Act 2019**.

E5a Compulsory third party motor insurance

Motor insurance cover for third party personal injury and third party property damage is compulsory under the terms of the **Road Traffic Act 1961** (as amended).

The same rules of disclosure apply to motor insurance contracts as to other non-life classes of insurance. However, third party motor insurance is compulsory as the law is primarily concerned that innocent victims of road accidents are adequately compensated. This aim would be defeated if an insurer could avoid paying third party claims on grounds of non-disclosure.

Just think

Get There, a haulage company with an annual turnover of €3.75 million, is insured by ABC insurers. ABC have discovered that Get There failed to disclose drink-driving convictions held by a number of its drivers. What is ABC entitled to do regarding this non-disclosure?

ABC is entitled to avoid claims that relate to non-compulsory areas (e.g. 'own damage'). However, the breach of utmost good faith would not limit or restrict ABC's liability in respect of their obligations to third parties under the **Road Traffic Act 1961** (as amended). ABC would be obliged to meet third party claims for personal injury to an unlimited value, and property damage up to a maximum of value €1.22 million.

Just think

Why should the insurer bear the cost of a claim if the insurance has been obtained under false pretences by non-disclosure or misrepresentation?

The insurer must bear the cost initially, in order to protect the innocent victim of the motor accident. However, having done so, the insurer then has a right of recovery against the insured for the whole of its outlay. In such circumstances, the insurer will seek to recover as much as it can.

F Summary

In this chapter we considered the elements needed to form a valid contract, including those specific to insurance contracts – insurable interest and utmost good faith. We outlined the impact of the **Consumer Insurance Contracts Act 2019** on both of these longstanding insurance principles.

We learned about the structure of general insurance policies and the common exclusions and conditions they contain. We also looked at breaches of policy conditions and the serious consequences they can have.

F1 What's next?

In Chapter 6, we'll continue our focus on the legal environment with our study of the law of torts. This has enormous relevance to insurance, as it deals with issues such as personal injury, negligence, and defamation.

F2 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

F3 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and study tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

Completing online mock exams and reviewing the personalised feedback that follows, is a great way of testing your knowledge and preparing for exam day.

To access these online learning supports, just log into your Member Area on www.iii.ie and click on the **Connect** logo.

End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 5.

1. Explain 'conditional acceptance', in relation to the law of contract.

2. Identify the groups of individuals that have limited contractual capacity.

3. State the five ways by which a contract may be discharged.

4. State the two types of policy conditions.

5. State three distinct categories of conditions in an insurance policy.

6. Identify the action an insurer is entitled to take if there is a breach of a condition precedent to liability in a non-consumer insurance contract.

7. Explain what is meant by the term 'subject matter of the contract' in an insurance contract.

8. Identify when insurable interest must exist for commercial (non-consumer) indemnity insurance contracts.

9. Outline the insurer's options when discovering that there had been non-disclosure when a non-consumer insurance policy was set up.

10. Outline the insurer's options when discovering a fraudulent misrepresentation was made when a consumer insurance policy was set up.

11. Explain the main consequences of non-disclosure for a non-consumer insured.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. ‘Conditional acceptance’ represents a rejection of the offer as it stood and replaces it with a new offer.
2. Most individuals who have reached the age of majority have full contractual capacity. Legal capacity is limited in the case of minors, those who lack capacity or intoxicated persons.
3. A contract may be discharged by performance, breach, frustration, agreement or operation of law.
4. The two types of conditions are implied and express.
5. The three distinct categories of conditions in an insurance contract are:
   - conditions precedent to the contract
   - conditions precedent to liability (or recovery)
   - general conditions.
6. A condition precedent to liability is a claims condition. If it is not observed in a non-consumer insurance contract, an insurer may avoid liability for a particular loss, but may not repudiate the contract as a whole.
7. In an insurance contract, the subject matter of the contract is the financial interest a person has in the subject matter of insurance (i.e. the item, event or liability being insured).
8. For commercial (non-consumer) indemnity insurance contracts, insurable interest must exist at inception and throughout the contract. It will therefore exist at the time of any loss.
9. The non-disclosure is fundamental to the whole contract and so the insurer may void the contract entirely. The insurer cannot refuse payment of a particular claim and then leave the policy in force for the future. The insurer has the right to ignore the breach, but must pay the claim and leave the policy in force.
10. If a claim is made following a fraudulent misrepresentation, the insurer can avoid the contract.
11. Non-disclosure has serious consequences for a non-consumer insured when trying to obtain subsequent policies of insurance, as there is a duty to disclose previous enforced cancellations or voids to any potential new insurer and this will influence the insurer’s decision on whether to accept the risk or not. The insured will be seen as a moral hazard by the insurer and therefore, if the insurer is prepared to offer terms, this hazard will be reflected in the premium offered to the insured.

Answers to quick questions

1. The insured's consideration is usually the promise to pay the premium and to abide by the policy terms. The insurer's consideration is a promise to pay benefits or compensation in the event of defined events occurring.

2. When an event makes a contract impossible to perform, that is called 'breach by frustration'.

3. In non-consumer insurance contracts, utmost good faith is an implied condition.

4. The subject matter of insurance is the item or event insured (e.g. car, house, valuables, factory stock, or liability for acts of negligence); the subject matter of the contract is the name given to the financial interest a person has in the subject matter of insurance.

5. 'Utmost good faith' is the positive duty to voluntarily disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not.

6. There are some facts that are material, but do not affect the non-consumer insurance contract if they are not disclosed. These are facts:
   - of law
   - of public knowledge
   - that lessen the risk
   - where the insurer has waived information
   - that a survey should have revealed
   - the insured does not know.

Sample multiple-choice questions

Question 1

For marine insurance contracts, insurable interest **must** exist:

A. at inception only

B. at the time of loss only

C. both at inception and at the time of loss

D. throughout the contract

Your answer:

☐

Question 2

What legal effect will the rejection of a counter-offer have on the formation of a contract of insurance?

A. It will now make it impossible to form the contract.

B. The original offer no longer needs to be honoured but the contract may still be formed.

C. It will place an onus on the insurer to prove that the counter-offer was unreasonable.

D. The original offer still needs to be honoured and the contract can be formed.

Your answer:

☐

Question 3

Which of the following is deemed to have full contractual capacity?

A. A person under the age of 18.

B. A person who lacks capacity.

C. An intoxicated person.

D. A person over the age of 18.

Your answer:

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 5D6

Question type: K

Correct response: B

Learning outcome: Explain the scope and impact of the legal principles of insurable interest and utmost good faith in general insurance and outline how they have been impacted on by the **Consumer Insurance Contracts Act 2019**.

Question 2

Chapter reference: Chapter 5A1

Question type: U

Correct response: B

Learning outcome: Describe the main elements of a valid contract of insurance, how a contract is discharged and remedies for breach of contract.

Question 3

Chapter reference: Chapter 5A4

Question type: K

Correct response: D

Learning outcome: Describe the main elements of a valid contract of insurance, how a contract is discharged and remedies for breach of contract.

Chapter

6

The legal environment

What to expect in this chapter

We've already explored the relationship between risk and insurance. Now we're going to look at a particular area of risk – that of incurring a legal liability.

In this chapter we'll focus on the law of torts, which relates to the duties we owe one another, and explain how it applies to insurance.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**The law of torts**	Outline the torts of negligence, trespass, nuisance, strict liability, defamation and breach of statutory duty as they apply to insurance.
B	**Negligence**	
C	**Trespass**	
D	**Nuisance**	
E	**Strict liability**	
F	**Defamation**	
G	**Breach of statutory duty**	
H	**Time limitations for civil actions**	Demonstrate the relevant time limitations applicable in tort.

A The law of torts

The law of torts regulates the conduct of individuals and society by providing that anyone whose rights are interfered with by another can seek a legal remedy. A tort is an act or omission that gives rise to injury or harm to another and amounts to a civil wrong for which courts impose liability.

A **tort** occurs when one person breaches a general duty they owe to another person. This breach can give rise to a legal liability, which usually involves the obligation to pay financial compensation to the other party, for loss or injury, in the form of **damages**. This potential liability is often insured under an insurance policy.

The relationship between the law of torts and insurance is very close. Most people who are sued in tort are covered by insurance. This means that the real defendant in the vast majority of tort claims is an insurance company. For example, a toy manufacturer owes a duty of care to the children who buy its toys. If a toy is defective and a child is injured, the toy manufacturer could be found to have been negligent and therefore, responsible and legally liable. The financial settlement with the child for their injuries, the associated legal costs and negative publicity could put the toy manufacturer out of business. To protect it against the consequences of a situation such as this, the toy manufacturer would have purchased product liability insurance. This highlights the relationship between a duty of care, legal liability and insurance.

It should be noted that a **breach of contract** is not a tort. If one party is in breach of the terms that both agreed to when setting up the contract, the other party has an automatic right to seek damages (see Chapter 5). There is no such automatic right under the law of tort. For damages to be awarded, some degree of fault or blame usually needs to be proven against the other party.

tort

a civil wrong remedied by the award of damages or other appropriate legal remedy, as opposed to a criminal act penalised by punishing the offender

damages

financial compensation fixed by the court according to the seriousness of the injury or damage caused

breach of contract

failure to perform the duties and obligations required by a contract

A1 Classification of torts

The law of torts protects people's rights by allowing them to sue if their interests are invaded, threatened or harmed. Different classes of tort protect different interests, as shown in Table 6.1.

Quick question 1

What is the main difference between a tort and a crime?

The answer is at the end of this chapter.

Table 6.1 Definitions of torts

Negligence	Protection of a person against injury, loss or damage caused by another's careless act(s)
Trespass to the person	Protection of a person against deliberate or reckless physical harm or restraint
Trespass to goods	Protection of a person against direct interference with the things they own or are responsible for
Trespass to land (private nuisance)	Protection of a person's interest in the land they own/occupy
Defamation	Protection of a person's interest in their reputation

We will examine these areas of tort in more detail in the sections that follow.

B Negligence

Negligence is the most commonly encountered tort in insurance claims. The majority of third party motor, employer liability and public liability claims are caused by acts of negligence.

Definition

Definition of negligence

'The omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate human affairs would do or doing something which a prudent and reasonable man would not do'.

Blyth v Birmingham Waterworks Company (1856)

In other words, negligence is the failure to take reasonable care in a situation where care should be taken.

If an injured party (plaintiff) wishes to sue another person (defendant) for negligence, they will have to show that their injury, loss or damage was caused by the defendant's failure to exercise reasonable care.

To succeed in an action in negligence, the plaintiff must prove all of the following:

- a **duty of care** was owed by the defendant
- the defendant was in breach of the duty of care
- the plaintiff suffered actual loss or damage
- the cause of the loss or damage is not too **remote**.

B1 Duty of care

In order to establish whether a defendant is in breach of their duty of care, we must first establish to whom they owe a duty of care. This was answered in the United Kingdom case of ***Donoghue v Stevenson*** (1932) when the judge decided that in law, 'you must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour.'

Just think

In this context who do you think a **neighbour** would be?

The judge defined 'neighbour' as: 'Any person who is, or ought to be, within the contemplation of the person committing the tort at the time it is committed.' Essentially, this case established the principle that we all owe a duty of care to any person who may be affected by our actions.

duty of care

a moral or legal obligation to ensure the safety or well-being of others

remote cause

a cause that only makes a minor contribution to the loss or is not considered to have been significant in arriving at the loss

neighbour

in the context of tort, a person that we should have been thinking about or bearing in mind when considering a course of action

B2 Breach of duty

For negligence to be proven, a duty of care must be breached. In other words, it must be shown that the person in question did not behave like the 'reasonable man' mentioned in the definition of negligence.

Under Irish law, the standard by which the defendant's behaviour is judged is an **objective test of reasonableness**. However, a defendant who professes to have a particular skill or ability will be expected to exercise that skill in a competent fashion. For example, a doctor who helps a person in distress will be judged by the standards prevailing in the medical profession, rather than by those that would apply to the average 'reasonable man' in a similar situation.

objective test of reasonableness

a test in which the conduct of the defendant is compared to that of a reasonable person under similar circumstances

Just think

As an objective test, what measures do you think would be used to determine whether a duty has been breached?

In examining whether a duty has been breached, the courts take into account a number of factors including:

- the magnitude of the risk involved
- how easily the risk could have been eliminated or reduced, and the cost of these measures
- the current state of scientific or technical knowledge.

Just think

An oil pan catches fire, resulting in severe fire damage to a property and its neighbouring property. In this case, do you think the neighbour has a right to claim for damage to their property due to negligence?

The answer is 'no', unless the neighbour can prove negligence against the responsible parties.

B3 Actual loss or damage

Any degree of damage, unless it is absolutely trivial, gives sufficient reason to take legal action for negligence. Damage can include death, bodily injury, damage to property or a recognised psychiatric injury.

There are normally three requirements for damages in tort.

1. It must be shown that the defendant caused the damage.
2. It must be shown that the damage is not too remote.
3. If the first and second requirements are satisfied, the damage must be measured.

B4 Remoteness of damage

For a legal action to be successful, the plaintiff must show that their injury, loss or damage is a direct result of the defendant's failure to exercise reasonable care. The action will not succeed if the damage is too remote. In other words, the damage must be reasonably foreseeable by the defendant when they commit the act in question. The law attempts to place a reasonable limit on the defendant's responsibilities, to ensure that the defendant is not liable in negligence for every loss that may have some connection (however remote) with their wrongful act.

trespass

intentional interference with people, goods or land

C Trespass

The tort of **trespass** has three main forms:

- trespass to the person
- trespass to land
- trespass to goods.

All three forms of trespass share the following characteristics:

- The act of the defendant must be direct – the resulting injury or damage being directly attributable.
- The act of the defendant must be intentional – not purely accidental.
- The tort is actionable *per se* ('in itself') – no proof of actual loss or damage is required.

C1 Trespass to the person

This normally consists of assault, battery and/or false imprisonment. In civil law, assault is to attempt or threaten to do bodily harm to another person, whereas battery is to physically inflict the harmful act. Brandishing a knife within reach of a person is an assault; stabbing a person with the knife is battery. False imprisonment is to unlawfully restrict someone's freedom without their consent. This Just think illustrates how some liability policies cover the 'false imprisonment' aspect of this form of trespass.

Just think

Consider the situation where a customer is detained by a member of staff on suspicion of shoplifting. How might the shop's liability policy cover this situation?

In this situation, if the suspicion cannot be proven, the customer might sue for false imprisonment. In this case, the shop owner's liability policy may cover the damages (compensation) and legal costs arising from this incident.

C2 Trespass to land

Trespass to land means the direct interference with another person's possession of land. It takes three forms:

- unlawful entry onto the land of another
- unlawfully remaining on the land of another (having entered the land lawfully but refusing to leave when permission to be there has expired)
- unlawfully placing or throwing any material object (such as rubbish, unwanted goods, or even a person) on the land of another.

Quick question 2

After a night out, Claire decides to take a short cut home through her neighbour's back garden. While on her neighbour's property, she drops a used tissue. Do you think Claire has committed an act of trespass to land?

C3 Trespass to goods

This occurs where the defendant directly and intentionally interferes with goods that are in the possession of another, without lawful authority. It would not normally have insurance implications due to the deliberate nature of the tort.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

D Nuisance

We are all familiar with the word 'nuisance', as used in everyday language. In the context of tort, however, **nuisance** has a very specific meaning. A legal definition of nuisance can be found in the case of ***Connolly v South of Ireland Asphalt Company*** (1977).

> 'An act or omission which amounts to an unreasonable interference with, disturbance of, or annoyance to another person in the exercise of his rights. If the rights so interfered with belong to the person as a member of the public, the act or omission is a public nuisance. If these rights relate to the ownership or occupation of land ... then the acts or omissions amount to a private nuisance.'

nuisance

unreasonable interference with, disturbance of, or annoyance to another person in the exercise of their rights

Just think

Can you give examples of the tort of nuisance?

Think about a homeowner who consistently plays music at a high volume, or who owns a dog that barks all night keeping the neighbours awake. Both are examples of the tort of nuisance.

As stated in the definition, nuisance can be public or private.

Public nuisance is treated as a crime, because it affects the public at large. Blocking or obstructing a motorway is a good example. However, an individual who is specifically affected by a public nuisance may bring a civil action against the perpetrator of the nuisance. For example, digging a hole in the road might amount to a public nuisance (inconveniencing the public as a whole), but an individual who suffers injury as a result of falling down the hole can bring an action in tort.

Private nuisance involves an interference with a person's enjoyment of their land, or the exercising of a common right. The interference on the part of the defendant may take one of two forms:

- wrongfully allowing noxious or harmful things to escape from their own property, so as to interfere with the claimant's land (such as, noise, smoke, smells, vibration, damp or vermin)
- wrongful interference with rights attaching to the claimant's land (such as rights of way, rights to light, or rights of support to land or buildings).

public nuisance

the carrying on of an activity, which is likely to cause inconvenience or annoyance, to the public or a section of the public, or interference with a right common to all

private nuisance

nuisance in relation to the ownership or occupation of land

D1 Unreasonable interference

The 'objective test of reasonableness' used in the tort of negligence (see Section B2) also applies to the tort of nuisance. For nuisance to be actionable, the interference must be unreasonable. Effectively this involves balancing what it is reasonable for the defendant to do with what it is reasonable for the plaintiff to accommodate.

D2 Insurance implications

The tort of nuisance has insurance implications only in limited situations. It may apply, for example, where a builder carrying out work on a property causes vibration damage to a nearby property, or carries out work that weakens the support of a nearby property.

Many liability policies simply refer to 'legal liability' and do not specify how the liability must arise. In effect, this means that they include actions in nuisance as standard. However, the remedies available for actions in nuisance include injunctions. Clearly, a liability policy can only respond to financial damages awarded and legal costs specified, as this is the basis of the insurance contract.

Quick question 3

What is the difference between a public and a private nuisance?

E Strict liability

Some types of liability are known as '**strict liabilities**'. This means that there is no requirement to prove negligence or intention to harm.

strict liability

liability held by a person even though their actions are neither intentional nor negligent

***Rylands v Fletcher* (1868)**

a legal principle whereby somebody is strictly liable for the non-natural use of land resulting in the escape of something that causes damage or harm to another

prima facie

refers to how a thing looks on its first appearance

The common-law rule is derived from the English case of ***Rylands v Fletcher* (1868)**. The case concerned water that had been collected in a reservoir. Its escape, even though there was no negligence on the part of the defendant, was held to be the defendant's responsibility.

The ruling in this case has since been held to apply to wild and domestic animals, yew branches (which are poisonous), electricity, gas stored in bulk, fire, sewage, explosives, a flagpole, a 'chair-o-plane', and even caravan dwellers.

The ***Rylands v Fletcher* (1868)** legal rule states that:

> 'a person who, for his own purposes, brings on his lands and collects and keeps there anything likely to cause mischief if it escapes, must keep it at his peril, and if he does not do so, is ***prima facie*** ('on the face of it') answerable for all the damage which is the natural consequence of its escape'.

For the rule to apply there must be an unnatural use of land and 'anything likely to cause mischief' must escape. Something naturally occurring will not result in this type of strict liability.

Other examples of strict liability are damage caused by straying livestock, injury to livestock caused by dogs, and injury or damage generally caused by animals, which had a '*mischievous propensity*' (that is, vicious tendencies) of which the keeper was aware. These rules are now contained in the **Animals Act 1985** and the **Control of Dogs Act 1986** and the **Control of Dogs (Amendment) Act 1992**.

Although we use the term 'strict liability' (because there is no need to prove negligence) it does not follow that there are no defences to such an action.

Quick question 4

What does the term 'strict liability' mean?

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

F Defamation

This tort protects a person's interest in their reputation.

A person is guilty of **defamation** if they publish, by any means, a defamatory statement about someone to one or more persons. A defamatory statement is one that tends to injure a person's reputation in the eyes of reasonable members of society.

Libel and slander are both forms of defamation. Historically, libel was the written form of defamation (considered permanent), while slander was the spoken form (considered non-permanent). However, with the advent of modern technology, the distinction between the two has become increasingly blurred. The **Defamation Act 2009** abolished the separate torts of libel and slander and replaced them with the tort of defamation.

defamation

a false statement about a person that causes injury to that person's reputation

Example 6.1

In 2013, businessman Denis O'Brien was awarded damages of €150,000 against the *Irish Daily Mail* after it published an article that accused him of being a hypocrite.

A jury found that the article was defamatory and he was entitled to damages. Although they agreed that it was the author's honest opinion, they said it was not based on fact and was not in the public interest.

Quick question 5

Which tort is encountered most often in insurance claims?

In addition to awarding damages, courts can now order the defendant to apologise for the action, correct the action, or admit the action was wrong – through a 'correction order'. Courts can also prevent the continuance of the offending publication (or *'continuing publication of the offending material'*) by means of a 'prohibition order'.

For an action in defamation to succeed the following elements must be present:

- publication (includes newspapers, books, internet, blogs, radio and TV, among others)
- a defamatory statement
- injury to a person's reputation in the eyes of reasonable members of society.

Just think

What criteria do you think a statement would need to fulfil for an action in defamation to be successful?

To be successful in an action for defamation the statement must be communicated to at least one other third party. Innuendoes or false impressions will also count as defamatory. It is not usually necessary to prove that the plaintiff has suffered actual loss.

G Breach of statutory duty

So far, we have focused on the general duties people owe to each other, which form the basis of most legal actions in tort.

In this section we will look at statutory duties and how a breach of such a duty relates to insurance.

Over the years, a number of statutes have been enacted to consolidate or extend the general duty of care owed in particular situations.

In an insurance context, statutory duties relating to occupiers' liability, and health and safety at work are of particular importance. Legal actions based on these areas of law will normally allege both negligence and breach of statutory duty.

Table 6.2 shows examples of statutes that impose civil duties, and the areas of insurance to which they may apply.

Table 6.2 Statutes imposing civil duties

Employers liability	Factories Act 1955
	Safety, Health and Welfare at Work Acts 2005 and 2010
	Safety, Health and Welfare at Work (General Application) Regulations 2007–2016
	Safety, Health and Welfare at Work (Construction) Regulations 2006–2013
Public liability	Occupiers' Liability Act 1995
Products liability	Sale of Goods Acts 1893 and 1980
	Liability for Defective Products Act 1991

It is important to note that the breach of duty must be the cause of the damage for which the claim is made.

Quick question 6

CoverIt Insurance DAC is developing a new products liability policy. The research department knows that legislation creates statutory duties in this area and that the policy needs to include cover for these duties. Name two pieces of legislation the insurer would need to consider when developing this policy.

H Time limitations for civil actions

Court actions for tort must be taken within a specified timeframe. This is based on the principle that cases should be heard promptly, or not at all.

The more time that elapses between the occurrence of the alleged tort and the court action, the less clear and less easily available the evidence becomes. This makes it more difficult to conduct a fair hearing. It is therefore considered unfair to maintain open-ended timings for bringing an action in tort.

H1 Time limitations

The **Statute of Limitations Act 1957** (as amended by the **Statute of Limitations (Amendment) Act (1991)**) and the **Civil Liability and Courts Act 2004** limit the time allowed for a plaintiff to commence legal proceedings.

Under the **Civil Liability and Courts Act 2004**, in actions involving personal bodily injury or death, the alleged wrongdoer must be advised that a claim is being made against them within 1 month or as soon as practicable from the date of the cause of action. This can be a brief, informal written note giving details of the 'wrong'. This puts the possible defendant on notice of a possible action and it is essential that all such letters are sent to insurers as soon as possible. Insurers take a strong view on late notification, as it prejudices their position in defending the claim.

The time limitations most relevant to insurers are shown in Table 6.3.

Table 6.3 Time limitations

Nature of cause	From the date of the injury, damage or alleged wrongful act, the time limitation is:
Personal injury and fatal injury actions	2 years
Property damage	6 years
Liability arising from defective vehicles	2 years
Liability arising from defective products	3 years
Defamation	1 year

H2 Exceptions to time limitations on civil actions

There are exceptions to the time limitation in personal injury cases. The most significant of these relates to cases involving a minor (i.e. a person under 18 years of age). Although a minor may sue through a 'next friend', the 2-year time limitation does not start until the minor has reached their 18th birthday.

It should be noted that when a case is brought under the Personal Injuries Assessment Board process, the time limitation stops on referral to the Board and does not recommence until 6 months after the Board has finished dealing with the claim. It is recognised that once a claimant has applied to the Board, any further delays, or indeed the passage of time generally, are outside of their control.

Quick question 7

On 1 April 2022, Mia is celebrating her 15th birthday when she suffers personal injuries as a result of an accident. Presuming the case was not referred to Personal Injuries Assessment Board, what is the latest date on which Mia could issue proceedings against the negligent party before the time limitation expires?

Useful resources

Personal Injuries Assessment Board website: www.piab.ie

I Summary

In this chapter we considered the torts most likely to be encountered in insurance situations. We also learned about some of the ways that a legal liability may arise and the general principles involved in civil actions.

I1 What's next?

Now we'll move on to look at the duties and responsibilities of the people involved in the claims process.

I2 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

I3 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and study tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

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End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 6.

1. Name the legal remedy usually sought by someone whose rights have been interfered with by another.

2. Define negligence.

3. Outline three factors that are taken into account by a court to determine whether there has been a breach of the duty of care.

4. To succeed in an action in negligence, identify what the plaintiff will need to show.

5. List three forms of trespass and briefly explain each one.

6. State which tort is concerned with protecting a person's interest in the land they occupy.

7. State the legal rule that was established in the case of ***Rylands v Fletcher*** (1886).

8. List the three elements that must be present for an action in defamation to succeed.

9. List the main time limitation for bringing a civil action.

10. State the most significant exception to the time limitation in a personal injury case.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. The legal remedy usually sought by someone whose rights have been interfered with by another is an award of damages, i.e. financial compensation for loss or injury.

2. Negligence is a failure to take reasonable care in certain circumstances. It was defined in ***Blyth v Birmingham Waterworks Company*** (1856) as 'The omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate human affairs would do or doing something which a prudent and reasonable man would not do.'

3. The courts take into account the following three factors:
   - the magnitude of the risk involved
   - how easily the risk could have been eliminated or reduced, and the cost of these measures
   - the current state of scientific or technical knowledge.

4. To succeed in an action in negligence, a plaintiff must show that their injury, loss or damage is a direct result of the defendant's failure to exercise reasonable care. The action will not succeed if the damage is too remote.

5. The three forms of trespass are as follows:
   - Trespass to the person – this would normally consist of assault, battery and/or false imprisonment
   - Trespass to land – the direct interference with another's possession of land
   - Trespass to goods – direct and intentional interference with goods belonging to another.

6. Private nuisance is the tort concerned with protecting a person's interest in the land they own or occupy.

7. The rule established in ***Rylands v Fletcher*** (1868) states that a person who, for his own purposes, brings on his lands and collects and keeps there anything likely to cause mischief if it escapes, must keep it at his peril, and if he does not do so, is *prima facie* ('on the face of it') answerable for all the damage which is the natural consequence of its escape.

8. For a defamation action to succeed the following elements must be present:
   - publication
   - a defamatory statement
   - injury to a person's reputation.

9. The time limitations for the main types of civil actions are:

- In actions involving personal bodily injury or death, the time limitation is 2 years from the date of the alleged wrongful act. However, the alleged wrongdoer must be advised that a claim is being made against them within 1 month or 'as soon as practicable thereafter' from the date of 'the cause of action.'
- In actions involving defamation, the time limitation is 1 year from the date of the alleged wrongful act.
- For claims involving damage to property, the time limitation is 6 years from the date of the alleged wrongful act.
- For actions arising from defective products, the time limitation is 3 years from the date of the alleged wrongful act.
- For actions arising from defective vehicles, the time limitation is 2 years from the date of the alleged wrongful act.

10. The most significant exception to the time limitation in a personal injury case relates to cases that involve a minor (a person under 18 years of age). Although a minor may sue through a 'next friend' the 2-year time limitation does not start until the day the minor reaches their 18th birthday.

Answers to quick questions

1. A tort is a civil wrong as opposed to a criminal act. A tort is remedied by the award of damages or other appropriate legal remedy. A crime is penalised by punishing the offender (usually done by the State).

2. Claire has actually committed two acts of trespass to land: 1) unlawfully entering onto the land of another and 2) unlawfully placing a material object onto the land of another.

3. A public nuisance is an activity that affects the public in general or interferes with a right that is common to all. A private nuisance interferes with an individual's enjoyment of their land or the exercising of a common right.

4. 'Strict liability' means that negligence or the intention to harm do not need to be proved. However, it does not follow that there are no defences to such an action.

5. Negligence is the tort most commonly encountered in insurance claims.

6. CoverIt Insurance DAC would need to consider the **Sale of Goods Acts 1893 and 1980** and the **Liability for Defective Products Act 1991** when developing its product liability policy.

7. Presuming the case was not referred to the Personal Injuries Assessment Board, the latest date on which Mia could issue proceedings against the negligent party would be 1 April 2027; the time limitation would expire on that date.

Sample multiple-choice questions

Question 1

Trespass to the person includes:

A. malicious interference with a person's goods

B. unlawful entry onto the land of another person

C. false imprisonment

D. interference with a person's enjoyment of their land

Your answer:

☐

Question 2

XYZ Insurance is developing a new public liability policy. Which of the following pieces of legislation that creates a statutory duty in this area, would the company need to consider?

A. Sale of Goods Acts 1893–1980.

B. Factories Act 1955.

C. Occupiers' Liability Act 1995.

D. Safety, Health and Welfare at Work Acts 2005 and 2010.

Your answer:

☐

Question 3

On 28 August 2020, an employee of Secure Scaffolders Ltd carelessly dropped a timber plank, smashing John's glasshouse in the adjacent garden. By what date at the **latest** must John issue proceedings against Secure Scaffolders Ltd before the time limitation expires?

A. 28 August 2022

B. 28 August 2023

C. 28 August 2025

D. 28 August 2026

Your answer:

☐

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 6C1

Question type: K

Correct response: C

Learning outcome: Outline the torts of negligence, trespass, nuisance, strict liability, defamation and breach of statutory duty as they apply to insurance.

Question 2

Chapter reference: Chapter 6G

Question type: U

Correct response: C

Learning outcome: Outline the torts of negligence, trespass, nuisance, strict liability, defamation and breach of statutory duty as they apply to insurance.

Question 3

Chapter reference: Chapter 6H1

Question type: A

Correct response: D

Learning outcome: Demonstrate the relevant time limitations applicable in tort.

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Chapter

7

Duties and responsibilities in the claims process

What to expect in this chapter

A policyholder only discovers the true value of their insurance policy when they come to make a claim. They've kept their side of the bargain by paying their premium and now it's time for the insurer to deliver on its promise. For this reason, the claims department is often known as the shop window of the insurer.

In this chapter we're going to look at what's expected of the policyholder, the adviser and the insurer in the course of the claims process. This will provide a foundation for the material in later textbooks, where we'll consider the various steps in the claims process in detail.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**What are a policyholder's duties after a loss?**	Explain the responsibilities of the insured after a loss.
B	**Proximate cause**	Explain the principle of proximate cause and illustrate its operation in the claims process.
C	**Regulatory responsibilities after a loss**	Demonstrate the regulatory responsibilities of the insurer and the adviser during the claims process.

A What are a policyholder's duties after a loss?

Most of the policyholder's duties in relation to their **claim** are explicitly stated in the insurance policy (contractual duties).

claim

an application for compensation under the terms of an insurance policy following a loss

A1 Implied duties

Implied duties apply to all insurance contracts and cover what is expected of the insured after the loss. The insured:

- should act as if they were not insured and take all reasonable steps to minimise the loss
- should advise the appropriate authorities in the event of loss or damage, e.g. the fire service (fire) or the Gardaí (theft)

- must take all steps necessary to prevent a loss from spreading, e.g. fire
- must not hinder the insurer in the claims investigation process.

implied duties

duties imposed on the policyholder at common law, whether or not they are actually found in the policy wording

Just think

If these duties are implied, why do you think insurers actually express them in their policies?

Insurers include specific claims conditions in their policies that reinforce these implied duties because they:

- may wish to vary the common-law position and clarify exactly what is needed
- may wish to emphasise the importance of the matters being specified
- cannot assume that policyholders will be aware of the full extent of their responsibilities.

A2 Express duties

Express duties are those written into the insurance contract. As noted in the 'Just think', some of these simply reinforce the implied duties outlined in Section A1. These express duties are usually identified as the 'claims conditions'.

A2a Notification condition

notification condition

claims condition that sets out the duties of the insured with regard to notifying the insurer on the occurrence of the event insured against

fraud condition

claims condition stating that all policy benefit is forfeited if a claim is in any way fraudulent or if fraudulent means are used to obtain a benefit, or if wilful damage is caused

The **notification condition** is usually included within the policy under the headings of 'claims conditions', 'claims procedures' or 'action by the insured'. They outline the duties of the insured in terms of reporting an accident/loss or any incident that could give rise to a potential claim. Notification conditions vary according to the policy requirements. Some require the insured to notify the insurer within a specific timeframe, while others require the insured to notify the insurer as soon as possible or within a reasonable time after the event has occurred. Notification conditions may require that this notice be either in writing, by telephone or by calling at the local branch office. Sometimes, this initial notification may need to be followed up by full written particulars of the claim within a period specified in the policy, e.g. 7, 15 or 30 days.

Under the **Consumer Insurance Contracts Act 2019**, if a consumer does not make a claim within the specified notification period but the insurer is not prejudiced, the insurer cannot refuse liability on the grounds of the late notification alone. The insurer would have to show that its position was prejudiced by the delay.[16]

Just think

Why do you think insurers insist on speedy notification?

Any delay (e.g. contacting witnesses, protecting what remains of the subject matter of insurance, or determining the origin of a fire) can significantly hamper an investigation and possibly prejudice the insurer's position. The more time that passes, the more difficult it may be to determine the cause of the loss. For large losses, insurers may need to tell their reinsurers at an early stage.

Quick question 1

After a night out, Ian returned to discover that thieves had broken into his apartment. They caused damage to the external door and stole jewellery and electronic equipment worth €4,000. When making his claim for the stolen items, Ian decides to include a laptop that was not actually taken by the thieves. Consider whether the insurer is liable for the damage and losses caused by the thieves and/or the laptop.

The answer is at the end of this chapter.

A2b Fraud condition

The **fraud condition** gives the insurer the right to repudiate the entire claim if any aspect of the claim is found to be fraudulent.

Example 7.1 addresses the question: 'Can a claim be partly fraudulent?'

Example 7.1[17]

A fire damaged Elizabeth's house and contents. Her claim included rent paid for alternative accommodation, allegedly paid to a friend. In reality, Elizabeth owned the alternative accommodation and produced forged documents in support of that part of the claim. The rent was reimbursed by her insurer, as well as payment for the reinstatement of the property and replacement of the contents.

When her insurer discovered the fraud, it successfully recovered not only the rental item but all other sums paid under the policy related to the fire. In effect, the fraudulent element tainted the whole claim.

Chapter 7

[16] Section 16, **Consumer Insurance Contracts Act 2019**.

[17] Example is based on the case of ***Direct Line v Khan*** (2001), Court of Appeal, England.

Any falsified statement produced with the intention to defraud (or grossly exaggerate the amount) will be sufficient grounds for an insurer to refuse any payment, regardless of whether there are non-fraudulent elements.

Under the **Consumer Insurance Contracts Act 2019**, the insurer has the right to refuse to pay a claim and terminate the contract if the claim contains information that is false or misleading in any material respect. A valid claim made under a policy is not affected where a subsequent fraudulent claim is made under the same policy. Once an insurer becomes aware that a fraudulent claim has been made, it may notify the consumer that it is avoiding the insurance contract and the contract will be terminated from the date on which the fraudulent claim was submitted. Once this notice is provided, the insurer may refuse all liability under the insurance contract in respect of any claim made after the date of the fraudulent act and does not need to return any of the premiums paid under the insurance contract. However, an insurer cannot claim against the consumer for the cost of investigating a fraudulent claim.[18]

control of claims condition

condition that ensures a policyholder does not prejudice their own claim (e.g. no action taken prior to insurer's investigation and insurer to be kept informed of all third party proceedings)

consent

defence that applies when the plaintiff agrees to a deliberate act by the defendant that would be a tort if no consent had been given

A2c Control of claims conditions

The key elements of the **control of claims conditions** are as follows:

- The policyholder must not admit liability without the insurer's written **consent**.
- There must be no repairs undertaken until the insurer has had the opportunity to investigate the circumstances.
- The policyholder must immediately inform the insurer of any impending prosecution, inquest or civil proceedings.
- The policyholder must immediately send to the insurer every legal document (e.g. letter, claim, writ, summons) relevant to the claim, preferably unanswered.

Just think

What is the problem with an admission of liability if this seems reasonable to the policyholder in the circumstances?

An admission of liability could prejudice the insurer's position, particularly in any court proceedings where it may carry considerable weight in determining or apportioning liability.

A2d Observance of conditions

The obligation of the insurer to make any payment under an insurance contract is usually conditional on:

- the answers in any proposal and declaration for this insurance being true and complete to the best of the knowledge and belief of the insured
- the proposal and declaration being considered the basis of the contract (only in non-consumer insurance contracts)
- the insured, or any other person on whose behalf payment is claimed, observing the terms and conditions of the policy so far as they can apply.

This express condition reminds the policyholder that if they do not comply with the policy terms and conditions, the insurer may be entitled to turn down the claim.

[18] Section 18, **Consumer Insurance Contracts Act 2019**.

A3 Onus of proof

When a potential claim arises, the initial onus of proof falls on the insured. This is an automatic responsibility, regardless of whether it appears in the policy (implied condition).

The policyholder is responsible for proving their loss and must demonstrate:

- the amount of the loss
- that an **insured peril** arose (or event occurred).

insured peril

a potential cause of loss or damage that is listed in the policy as being covered

proximate cause

main or dominant cause of the loss or the cause that is most powerful in its effect

A3a Amount of loss

The insured must produce evidence to quantify the financial loss suffered.

Just think

In property insurance claims, what evidence might be relevant in terms of proving ownership and the amount of the loss suffered?

For property insurance, suitable proof might be a purchase receipt, a repair account or a valuation. The precise documentation required will depend on the type of claim and the nature of the subject matter.

A3b Occurrence of insured peril

The insured must show that their loss was 'proximately' caused by a peril that is insured by the policy. We will discuss the principle of **proximate cause** and how it operates in Section B.

Just think

Why is it important for the proximate cause of a loss to be established?

The main cause of a loss must be identified in order to establish whether that loss is covered under the insurance policy, and whether the insurer is liable for the loss.

If an insurer wishes to decline to pay a claim on the basis of an exception in the policy wording, the onus of proof is reversed. In this case, the insurer must prove that the exception applies, as outlined in Example 7.2.

Quick question 2

In what circumstances does an insurer have to prove what caused a loss under an insurance policy?

Example 7.2

BeThere Insurance is dealing with a theft claim under a household policy and it suspects that the property was unoccupied at the time of the break-in. The household policy contains a policy exclusion whereby theft cover is excluded if the home is unoccupied for longer than the permitted time limit (usually between 30 and 60 days). If the insurer wishes to turn down the claim, it must prove that the property was unoccupied for longer than the permitted time limit. If it cannot do so, the insured is entitled to be paid.

B Proximate cause

Insurance law has always assumed that, no matter how complicated the situation, one factor can be identified as the most powerful in bringing about the loss – this being the proximate cause.

B1 The principle of proximate cause

When a loss occurs and the policyholder makes a claim, the proximate cause must be identified in order to establish whether it is covered under the insurance policy and therefore if the claim will be paid. There must always be a direct link between the cause of the loss and the resulting damage or loss.

Most cases are straightforward, with one clearly identifiable cause of loss that is covered under the policy. In these situations, identifying the proximate cause of a loss is simply a case of looking at cause and effect. For example, there can be little dispute about the proximate cause of the loss when thieves break into a shop and steal electrical goods (theft), or when slates are stripped from a roof in a violent storm (storm damage). However, when two or more independent perils operate at the same time and result in a loss, all possible causes and the relationships between them must be examined in order to establish the proximate cause of the loss.

A useful definition of proximate cause was put forward in ***Pawsey v Scottish Union and National*** (1907).

> 'The active, efficient cause that sets in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new and independent source'.

A good way to picture this 'chain of events' relationship between cause and effect is to imagine a row of dominoes, all standing. Imagine the first domino is pushed over, knocking the second, which in turn knocks over the third and so on, until they have all fallen down. If we take the fall of the last domino to represent a loss, the push of the first domino is the proximate cause of the loss. Figure 7.1 shows a simple 'domino' loss scenario.

Figure 7.1: Simple 'domino' loss scenario

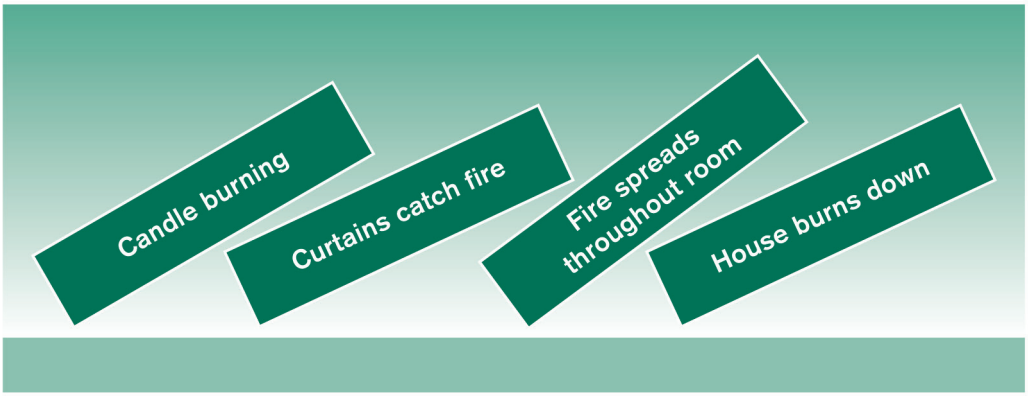
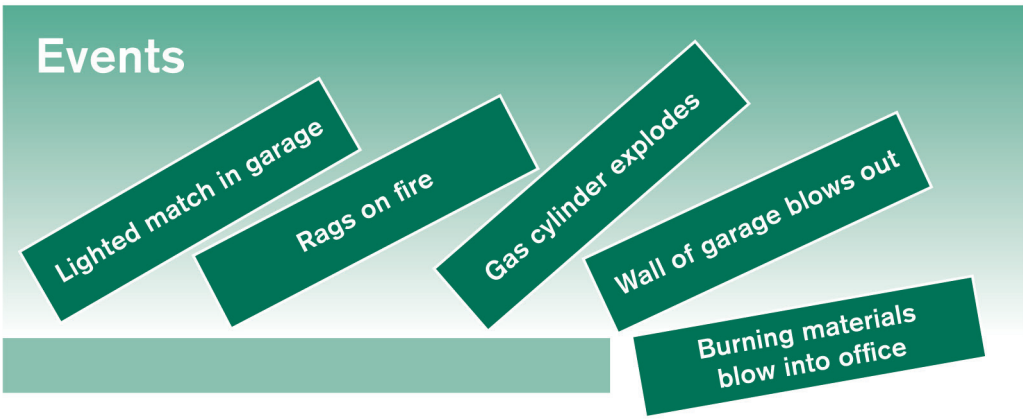


Figure 7.2 illustrates a more complex 'domino' loss scenario.

Figure 7.2: Complex 'domino' loss scenario



new intervening act or cause *(novus actus interveniens)*

refers to a situation where the sequence of causation is broken and something entirely new happens to bring about the loss

However, imagine if one of the dominoes does not fall as a result of the first domino falling, but is pushed by an onlooker. The chain has been broken by events that were not natural or probable results of what happened before. The chain of events has stopped and there is a **new intervening act or cause** (*novus actus interveniens*). This new force becomes the cause of the fall of the last domino and is therefore the new proximate cause of the loss. Example 7.3 illustrates this point.

Example 7.3

A fire caused a mob to gather near Jacob's shop. A riot started, the mob began plundering and his shop's front window was broken. Jacob's insurance policy covered breakage of glass, but excluded glass breakage by fire.

The riot and the mob's conduct was not an inevitable or probable result of the fire. The mob and their actions broke the chain of events. It was the riot and not the fire that was the proximate cause of the glass being broken. The policy exception (glass breakage by fire) did not apply. The proximate cause was riot and Jacob's loss was covered.[19]

Quick question 3

George has a fire policy. Some coal falls from the fire and sets the house ablaze.

What is the proximate cause?

In Appendix 1 to this chapter, there are a number of scenarios illustrating how these 'chains of events' – those that are treated as unbroken and those where a new cause becomes the effective agent of loss – have been interpreted to determine the proximate cause. Read through them and try to anticipate what the proximate cause was in each scenario.

B2 Nature of perils

Once the insurer has established the proximate cause of the loss, it must check whether that particular peril is covered by the policy. Perils can be classified as follows:

- **Insured perils** – those named in the policy as covered
- **Excluded (excepted) perils** – those named in the policy as specifically not covered
- **Unnamed perils** – those perils not mentioned in the policy (as it is not possible for every imaginable peril to be listed in a policy). Unnamed perils operate

[19] Example based on the case of ***Marsden v City & County Insurance*** (1865).

differently depending on how the policy is constructed. They could be termed **uninsured perils** in policies which list all of the perils covered ('named-perils policies'). In 'all risks' type policies (which cover all risks but list exclusions), these unnamed perils are covered simply because they are not excluded.

Insurers will decide whether or not a claim is valid by considering the peril that was the proximate cause of the loss and establishing which of these categories it fits into. It is only necessary to find the proximate cause of a loss where the events before the loss are not all insured perils. If they are all insured, the loss is covered.

uninsured perils

a peril/cause not mentioned in a policy that is structured as a named contingency policy

Just think

Can you think of a situation in which an insurer would want to determine the proximate cause even if all events in the chain are named perils in the policy?

It will be necessary to determine which peril caused a loss if different levels of excess, differing limits of **indemnity** and, possibly, inner limits apply to different perils in the chain. For example, suppose there is a different level of excess for theft of a motor vehicle compared with that for own damage. If damage is caused to the vehicle it will be necessary to establish whether this was or was not theft-related in order to apply the correct excess to the claim.

The distinction between an excluded (excepted) peril and an uninsured peril becomes important when two such perils operate together. These scenarios are explored in Section B2a.

indemnity

financial compensation sufficient to place the insured in the same financial position after a loss as they enjoyed immediately before the loss occurred

concurrent causes

two or more perils operating at the same time (to bring about a loss)

B2a Concurrent causes

Occasionally, two or more perils operate concurrently (at the same time or very closely together) to bring about a loss. For example, a building might be damaged by a fire that was raging and a storm that was battering it at the same time.

It is important to note that if both perils are insured (or indeed excluded), there is no problem; it is either all covered or not covered at all. Careful examination of the **concurrent causes** and their effects is only important if, for example, one is insured and the other is excluded or not mentioned in the policy. Examples of these situations, and the rules that apply, are summarised in Table 7.1.

Quick question 4

Why can we not always refer to unnamed perils as 'uninsured perils'?

Table 7.1 Proximate cause and concurrent perils

Cause	Policy coverage	Example
Independent perils combine to cause a loss – each can be shown to have caused clearly definable damage.	Insurers pay for the loss attributable to the insured peril only.	Overnight damage to a building is caused by a small fire arising from a short circuit and, independently, a storm causes damage (a peril not covered by the policy). The insurer is liable only for the separately identifiable fire damage.
Independent but **interdependent perils** combine to cause a loss – neither would have caused the loss on its own.	• If one cause is an insured peril and the other is clearly excluded by the policy, the insurer will have no liability for the loss.	• ABC installs a tank in XYZ's premises. It is set alight one night because of two independent causes – the defective nature of the tank (an exclusion under ABC's liability policy) and the negligence of an employee of XYZ (an insured peril) who switched on equipment so that it ran overnight. The insurer is not liable.
	• If one cause is an insured peril and the other is either not mentioned or is not specifically excluded, the insurer is liable for the full loss.	• A fire (insured peril) occurs in an outbuilding of a home caused by sparks from a barbecue. It burns down completely because of storage of timber in the building (not excluded). The insurer is liable in full.

independent perils

unlinked causes that arise separately without one inevitably leading to the other

interdependent perils

linked causes, in that neither peril operating on its own would have caused the damage

Quick question 5

An aircraft suffers damage caused by two concurrent proximate causes – stormy weather (an insured peril) and defective design (an excepted/excluded peril). If neither cause brought about the loss on its own, would the insured be able to recover anything in respect of this loss?

Would it make a difference if defective design is simply not mentioned in the policy?

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

C Regulatory responsibilities after a loss

So far we have focused on the policyholder's duties, but what about the responsibilities of the insurer and the adviser? The Central Bank **Consumer Protection Code (CPC)** sets out what is required of insurers and advisers at this point in the insurance process.[20]

Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

C1 Intermediaries

In practice, most intermediaries' involvement in the claims process is limited to passing information to the insurer. Where an intermediary does provide assistance in the making of a claim, they must transmit it to the relevant insurer within 1 business day from receipt of the completed claims documentation.[21] Even if there is no general intention for an intermediary to assist with a claim, they may become involved if any dispute or difficulty arises. However, if an intermediary operates a **delegated authority** scheme on behalf of an insurer, which includes authority to settle claims, they must satisfy all of the requirements outlined in Section C4 in relation to procedures and timings.

C2 Private health insurers

It should be noted that the claims processing provisions of the CPC do not apply where a method of **direct settlement** is used by private health insurers.

Just think

Why would the provisions of the CPC, in respect of claims processing, not apply where direct settlement is used by private health insurers?

A direct settlement agreement with hospitals and other health centres will include a list of covered procedures/benefits including the relevant limits and excesses. The hospital or health centre will simply record the procedures performed on/for the policyholder, and send the bill to the insurer. Therefore, the policyholder does not have to go through the 'normal' claims process (e.g. completing **claim forms**, and submitting evidence of payments) and does not therefore need the protection of the CPC.

[20] Central Bank of Ireland, 'Consumer Protection Code 2012', 2015, pdf, www.centralbank.ie. The CPC is regularly amended and the Central Bank expect to finalise a substantial review in 2024. Students should stay up to date with developments in this area, while remembering that only the content of this textbook is examinable.

[21] Provision 7.8, CPC.

Consumer Protection Code (CPC)

Code issued by the Central Bank of Ireland setting out requirements that regulated firms must comply with in order to ensure a minimum level of protection for consumers

delegated authority

authority granted to the agent of an insurer, usually in the context of a scheme arrangement, to issue policy documentation and possibly carry out limited underwriting and claims functions

direct settlement

claims method by which the medical provider and insurer directly process claims, whereby the insurer makes periodic payments to the medical provider by incorporating multiple claims approved for payment against the provider's record

claim form

document designed to elicit from the policyholder all relevant information surrounding the circumstances of a loss caused by an insured event

loss adjuster

independent expert in processing claims from start to finish

loss assessor

expert in dealing with insurance claims, appointed by the insured to prepare and negotiate a claim on their behalf

C3 Loss adjusters and assessors[22]

The role of the **loss adjuster** is to investigate claims on behalf of the insurer. Their function is to establish the cause of the loss, ensure that the loss is covered under the policy and negotiate a settlement that is fair to both the insurer and the insured. Although the loss adjuster is appointed by the insurer, they must act impartially to ensure an outcome based on the terms and conditions of the policy.

If an insurer employs a loss adjuster and/or expert appraiser, it must inform the claimant of their contact details and the fact that the loss adjuster/appraiser acts in the interest of the insurer. It must also keep a record of this notification.

In the case of motor insurance and property insurance claims (and other claims where relevant), the insurer must tell the claimant that they (the claimant) may appoint a **loss assessor** to act in their interests, but this is at their own expense and is not recoverable from the insurer. The role of the loss assessor is to support the insured during the claims process and negotiate, on the insured's behalf, to ensure the best possible settlement for them.

Again, the insurer must keep a record of the notification. If the claimant does employ a loss assessor, an insurer must engage with them at the claimant's written request.

An insurer must be available to discuss all aspects of the claim with the claimant, including assessment of liability and damages, during normal office hours or outside of these hours if agreed with the claimant.

Quick question 6

Why might a claimant decide to appoint a loss assessor, at their own expense, to act in their interest?

C4 Insurers

C4a Written procedures

Insurers must have a written procedure for the effective and proper handling of claims as required by the CPC. The written procedure must, at least, include the following:

a. Where an accident has occurred and a personal injury has been suffered, a copy of the Personal Injuries Assessment Board 'Claimant Guide' is issued to the claimant as soon as notification occurs.[23]

b. If a motor accident involves an uninsured or unidentified vehicle, or a foreign registered vehicle, the firm must advise the potential claimant to contact the Motor Insurers' Bureau of Ireland (see Chapter 1G2).

c. A claim form (where required) is issued within 5 business days of notification.

d. The insurer must offer to assist in the process of making a claim and alert the claimant to policy terms and conditions that may be to their benefit.

e. A record must be maintained of all conversations with the claimant in relation to the claim.

f. While the claim is ongoing, the insurer must provide the claimant with updates of any developments affecting the outcome of the claim within 10 business days of the development. For example, where further investigation is underway prior to a decision on liability being made the insurer is obliged to advise the insured of this development within 10 business days. Any additional documentation or clarification must be requested as soon as required and, if necessary, the claimant issued with a reminder in writing.[24]

[22] Provision 7.9-7.12, CPC.

[23] Personal Injuries Assessment Board, *PIAB Claimant Guide*, pdf, www.piab.ie

[24] Provision 7.7, CPC.

Note: A business day (also known as 'working day') is as any day from Monday to Friday and does not include Saturday, Sunday or public holidays. See Example 7.4.

Example 7.4

Laura calls CoverAll Insurance DAC on Monday March 6th to notify them of a break-in at her home and to tell them that she wants to claim under her household insurance policy for the damage to the house and the property stolen. Under CPC guidelines, the insurer has 5 business days to issue a claim form. Therefore, CoverAll will have to send Laura a claim form by Monday March 13th at the latest (5 business days later).

If Laura notified CoverAll Insurance DAC on Monday March 13th, the insurer would have until Tuesday March 21st to send Laura a claim form as St Patricks Day (a public holiday) is not a 'business day'.

C4b Consumer Insurance Contracts Act 2019

An insurer has a number of duties under this Act, many of which overlap with the insurer's claims processing duties under the CPC. Under this Act, and without prejudice to an insurer's right to make decisions in relation to a claim, an insurer has a duty to:

- handle claims promptly and fairly
- where a claim is not made by the consumer themselves, notify them of the claim as soon as practicable
- engage with the consumer including allowing the consumer to submit evidence relevant to the insurer's determination of the claim
- inform the consumer of the amount for which the claim has been settled (or otherwise disposed of) and the reason(s) for its settlement (or disposal).[25]

C4c Claims settlement methods[26]

If an insurer appoints a third party to undertake repair/restoration work in respect of a claim, e.g. a builder or repairer, it must provide the claimant with written details of the scope of the approved work and the cost in advance.

Effectively, the CPC places the onus on the insurer to ensure that any work it asks a third party to carry out is satisfactory. Where the insurer uses a method of direct settlement, e.g. an approved repairer for motor insurance claims, it must not ask the claimant to sign off on any work carried out. The insurer must certify, in writing, that the work carried out by the third party has restored the claimant's property to the standard that existed prior to the insured event.

Just think

Can you remember from Chapter 5 what kind of interest the policyholder must have in the item or event insured before they can receive payment under their policy?

In Chapter 5D, we learned about situations in which the insured must have an 'insurable interest' in the subject matter of the insurance.

[25] Section 16, **Consumer Insurance Contracts Act 2019**.

[26] Provision 7.13-7, 14, CPC.

C4d Settlement decisions and offers

An important requirement, central to the CPC, is that an insurer must try to verify that a claim is valid before making a decision on its outcome.[27]

The insurer has the responsibility to ensure that any claim settlement offer made to a claimant is fair, taking into account all relevant factors, and that this represents the insurer's best estimate of the claimant's reasonable entitlement under the policy.[28] If the case is later referred to the Financial Services and Pensions Ombudsman (FSPO), the insurer's actions in relation to this requirement would be taken into account.

There is a prescribed order of events for claim settlement and a related timescale. Before making a settlement the insurer must ensure that:

1. the insured event has been proven, or accepted by the insurer
2. all specified documentation has been received from the claimant
3. the entitlement of the claimant to receive payment under the policy has been established.

Within 10 business days of making a decision in respect of a claim, the insurer must inform the claimant, in writing, of the outcome of the investigation, explaining the terms of any offer of settlement. Following this, the claimant must be allowed at least 10 business days to accept or reject the offer. If the claimant waives this right and accepts the settlement offer within this timeframe, the insurer must record this decision.

Where a claimant has accepted the insurer's offer, the insurer must pay the claim within 10 business days from the date of acceptance (subject to finalisation of legal costs where applicable). Where a method of direct settlement applies, the insurer must discharge the claim without delay. Under the **Consumer Insurance Contracts Act 2019**, where it is not possible to quantify the total value of the claim within a reasonable time but where part of the total value has been quantified, the insurer shall pay that part to the consumer within a reasonable time.[29]

If the insurer decides to decline the claim, the reasons for that decision must be provided to the claimant in writing. In addition, an insurer must provide a claimant with written details of any internal appeal mechanisms available (i.e. the insurer's complaints procedure).

Chapter 7

[27] Provision 7.6, CPC.

[28] Provision 7.15, CPC.

[29] Section 16, **Consumer Insurance Contracts Act 2019**.

There is a specific process which must be followed by those involved in handling complaints and this is covered in the Compliance and Advice Module.

Special rules apply to settlements to other parties (such as to an employee for employers liability claim or to a third party for repair costs to a motor vehicle). Where the policyholder is not the beneficiary of the settlement, the insurer must advise the policyholder in writing, at the time settlement is made, of the final outcome of the claim and details of the settlement. Where applicable, the policyholder must be informed that the settlement of the claim will affect future insurance contracts of that type.[30]

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

Useful resources

Financial Services and Pensions Ombudsman website: www.fspo.ie

Quick question 7

Using the material you have studied in this and in previous chapters, give three examples as to why an insurer might decline a claim.

[30] Provision 7.16-7.21, CPC.

D Summary

In this chapter we looked at the obligations and responsibilities of the different parties involved in the claims process. We also talked about the importance of identifying the proximate cause of the loss and establishing whether it's covered under the claimant's insurance policy.

D1 What's next?

Now we're going to look at the process whereby the policyholder is compensated for their loss, in accordance with the terms of their insurance policy.

D2 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

D3 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and learning tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

Completing online mock exams and reviewing the personalised feedback that follows, is a great way of testing your knowledge and preparing for exam day.

To access these online learning supports, just log into your Member Area on www.iii.ie and click on the **Connect** logo.

Appendix 1: Proximate cause scenarios

Can you determine the proximate cause?

These scenarios describe losses caused by 'chains of events'. Some involve situations where the chain is unbroken; others involve situations where a new force becomes the cause of the loss. Read through them and try to figure out what the proximate cause was in each instance.

Scenario 7.1[31]

The Mary Jane was a ship insured under a policy that covered perils of the seas, but excluded war risks. It was hit by an enemy torpedo and, despite being badly holed and in danger of sinking, reached the port of Rosslare, where repair work was started. When a storm started to blow, the harbour master ordered the ship to an outer berth to save the harbour from being blocked if it sank. When the ship did sink after leaving port, the ship owners argued that the 'last cause' (storm damage) should be regarded as the proximate cause. The insurers argued that the effective cause of the ship being lost was the damage caused by the enemy torpedo. This was an excluded war risk. Which was the dominant or proximate cause?

Scenario 7.2[32]

Norris fell from his horse and suffered some injuries that forced him to lie in cold and damp conditions. He contracted pneumonia and was taken to hospital, where he eventually died. Which was the dominant or proximate cause?

Scenario 7.3[33]

An earthquake caused an oil stove to overturn. Spilt oil was ignited by the wick and the building caught fire. The fire spread from one building to another by radiated heat and sparks and embers carried on the breeze until the insured premises, some 500 yards away, caught fire. SparkFree (the insurer) maintained that the loss stemmed directly from the earthquake (an excluded peril). The question is whether the original cause has become so remote as to be irrelevant. Which was the dominant or proximate cause?

31 Scenario is based on the case of *Leyland Shipping v Norwich Union Fire Insurance Society Ltd* (1918).

32 Scenario is based on the case of *Etherington v Lancashire and Yorkshire Accident Insurance Company* (1909).

33 Scenario is based on the case of *Tootal Broadhurst Lee Company v London and Lancashire Fire Insurance Company* (1908).

Answers to 'Can you determine the proximate cause?' scenarios

Scenario 7.1

The proximate cause of the loss was the torpedo (a war risk, which was excluded), because the damage it caused had been effective throughout. The chain of events had not been broken.

Scenario 7.2

Although Norris died of pneumonia, the proximate cause of his death was the original accident – falling from the horse. The personal accident policy therefore paid out. The disease (not stated as an insured event in the policy) did not represent a new and intervening cause. It was deemed that the accident, not the disease, was responsible for his death.

Scenario 7.3

The proximate cause was the earthquake. The loss was not payable because the policy excluded fire caused by earthquake and the chain of causation between this excluded peril and the loss was unbroken.

End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 7.

1. Identify the two key implied conditions with regard to the insured's onus of proof in relation to a claim.

2. List three reasons why insurers will include specific conditions in a policy, even though there may be equivalent implied conditions.

3. Briefly explain the likely outcome of a claim, if the claimant falsifies any statements made in respect of any element of that claim.

4. Define 'proximate cause'.

5. Identify what the insurer must do once it has established the proximate cause of the loss.

6. Explain the difference between an unnamed peril and an excluded (excepted) peril.

7. Outline what the insurer is liable for where the perils are independent (in the sense that one did not lead to the other) and either one would have caused some loss without the other.

8. State in what type of circumstance, and under what type of policy, the provisions of the CPC in respect of claims processing do not apply.

9. State the time limit for an intermediary to submit a customer's claims documentation to the insurer.

10. Explain the difference between a loss adjuster and a loss assessor.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. In relation to a claim, the insured must prove:
   - that an insured peril arose (or event occurred)
   - the amount of the loss.

2. Insurers include specific conditions in a policy for the following reasons:
   - Insurers may wish to vary the common-law position and clarify exactly what is needed.
   - Insurers may wish to emphasise the importance of these matters relevant to the conditions.
   - It cannot be assumed that customers will be aware of the full extent of their responsibilities.

3. If it is established that a claimant made any false or fraudulent statements, in respect of any element of the claim, in an attempt to defraud or exaggerate the loss, the insurer can refuse to make any payments regardless of whether there are also non-fraudulent elements to the claim.

4. 'The active, efficient cause that sets in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new and independent source.' (***Pawsey v Scottish Union and National*** (1907))

5. Once the insurer has established the proximate cause of the loss, it must check whether that particular peril is covered by the policy and the nature and scope of any relevant exclusions.

6. An unnamed peril is a peril that is not mentioned in the policy wording. For 'all risks' policies these perils will be covered simply because they are not excluded. An excluded peril is a peril that is specifically not covered in the policy wording.

7. Where the perils are independent and either one would have caused some loss without the other, the insurers are only liable for that part of the loss attributable to whichever peril is insured.

8. The provisions of the CPC, in respect of claims handling, do not apply where the policy is a private health insurance policy and the method of payment is 'direct settlement'.

9. Where an intermediary assists in the making of a claim they must, on receipt of the completed claims documentation, transmit it to the relevant insurer within 1 business day.

10. A loss adjuster is employed by the insurer to establish the cause of the loss, ensure cover is in place for the loss and negotiate a settlement which is fair to both the insurer and the insured. The loss adjuster must act impartially at all times. A loss assessor is employed by the insured, at the insured's own expense, to support them through the claims process and negotiate on their behalf to ensure the best possible settlement terms for them. The loss assessor's duty is to the insured only.

Answers to quick questions

1. The insurer is certainly not liable for the laptop. The bigger question is whether that fraudulent element of the claim taints the validity of the whole claim. The short answer is that it does, so the insurers will not be liable for the other (genuine) aspects of the claim (***Direct Line v Khan*** (2001)).

2. The burden of proof falls to the insurer when it contends that the cause of the loss is an excepted or excluded peril.

3. Fire is the proximate cause and this is typical of most cases dealt with by insurers.

4. They can only be termed 'uninsured perils' for those policies constructed as named perils policies. For 'all risks' type policies they will be covered simply because they are not excluded.

5. The loss is not payable at all because one cause is an insured peril and the other is clearly excluded by the policy. However, had this been an unnamed peril, the whole of the loss would have been payable.

6. A claimant may feel that they do not know enough about insurance, claim valuation or claims processing to represent themselves properly with their insurer or the insurer's loss adjuster. They may wish to engage the professional support of a loss assessor.

7. An insurer might decline a claim if they establish that:
   - the proximate cause of the loss was an excluded (excepted) peril under the policy; e.g. a property was damaged as a result of a nearby river bursting its banks and flooding the premises, but flood cover is specifically excluded under the property policy
   - the claimant was in breach of an express duty (claims condition) and this allows the insurer to repudiate the particular claim; e.g. if the claimant didn't call the fire brigade when their house was on fire
   - the claimant has attempted to fraudulently claim for additional losses that they did not in fact suffer.

Sample multiple-choice questions

Question 1

Who is responsible for paying for the services of a loss assessor?

A. The insured only.

B. The insurer only.

C. The insurer and the insured between them.

D. The insurer or the insured, depending on who appoints the loss assessor.

Your answer:

☐

Question 2

Which of the following statements is **correct** regarding proximate cause where two concurrent perils are involved?

A. If independent perils combine to cause a loss where each would have caused some damage on its own, if one is an insured peril and one an excluded peril, the insurer is liable for the loss caused by the insured peril.

B. If independent perils combine to cause a loss where each would have caused some damage on its own, if one is an insured peril and one an excluded peril, the insurer has full liability for the loss.

C. If independent perils combine to cause a loss where neither would have caused damage on its own, if one is an insured peril and the other excluded, the insurer is liable for the loss caused by the insured peril.

D. If independent perils combine to cause a loss where neither would have caused damage on its own, if one is an insured peril and the other unnamed in the policy, the insurer has no liability for the loss.

Your answer:

☐

Question 3

Because of an earthquake, the gas main to a factory is ruptured and the gas is ignited by a portable heater. The resulting explosion causes a fire in the factory. What is the proximate cause of any resulting loss?

A. The earthquake.

B. The explosion.

C. The fire.

D. The rupture of the gas main.

Your answer:

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 7C3

Question type: K

Correct response: A

Learning outcome: Demonstrate the regulatory responsibilities of the insurer and the adviser during the claims process

Question 2

Chapter reference: Chapter 7B2/B2a

Question type: U

Correct response: A

Learning outcome: Explain the principle of proximate cause and illustrate its operation in the claims process.

Question 3

Chapter reference: Chapter 7B/B1

Question type: A

Correct response: A

Learning outcome: Explain the principle of proximate cause and illustrate its operation in the claims process.

Chapter

8

Calculating the claim payment: who should pay and how much?

What to expect in this chapter

We're now at the stage where the policyholder's claim has been deemed valid and the insurer must compensate them appropriately.

In determining the 'appropriate' compensation, the insurer must consider a number of factors, such as:

- What is the financial value of the policyholder's loss?
- Does the policyholder have another source of compensation?
- Was the damage to their property due to another person's carelessness?
- Do they have another insurance policy that covers some or all of the loss?

To ensure that the policyholder receives fair compensation, but cannot make multiple claims for the same loss, or profit from the situation, claims payments are governed by three key principles: indemnity, subrogation, and contribution.

These principles go to the heart of what most insurance policies try to do – to provide a fair claims settlement for the policyholder. A policy should compensate, but not overcompensate, a policyholder for the loss they have suffered.

Now we're going to look at the theory and practical application of each of these in turn.

Learning outcomes for this chapter

Section	Title	At the end of each section you should be able to:
A	**What is indemnity?**	Outline the concept of indemnity and identify an insurer's settlement options when providing indemnity to a policyholder.
B	**How is indemnity provided?**	
C	**Factors limiting and extending the principle of indemnity**	Demonstrate the application of indemnity to a policy of insurance.
D	**Subrogation**	Explain the principle of subrogation and apply it in situations where recovery rights may be exercised.
E	**Applying the principle of subrogation**	
F	**Contribution**	Explain the principle of contribution and apply it in situations where dual insurance exists.
G	**Applying the principle of contribution**	

A What is indemnity?

Indemnity basically means that, following a loss, the insured receives enough financial compensation to return them to the position they enjoyed immediately prior to the loss – no better, no worse. This principle is the basis for determining the amount of the compensation.

Virtually all property, financial and liability insurances are contracts of indemnity. However, some general insurance policies provide fixed benefits, mainly for accident and sickness. As it is impossible to place a figure on the loss of a limb or loss of sight, the principle of indemnity cannot apply.

Examples of **hybrid policies** include motor and household policies, which are treated as indemnity policies with added personal benefit sections. Travel insurance and private health insurance also contain elements of both indemnity and benefit cover.

hybrid policy

policy that contains elements of both indemnity and benefit cover

B How is indemnity provided?

Unless the policy defines the means of calculating the loss, indemnity is the value at the time and place of loss. In practice, the method by which indemnity is to be measured depends on the type of insurance involved. This is explored in more detail in the Personal and Commercial General Insurance modules.

When providing compensation under indemnity policies, an insurer has a number of settlement options. These are:

- cash payment
- repair
- replacement
- reinstatement.

The options available will be stated in the policy. If they are not stated, then the insured has a legal right to financial compensation.

B1 Cash payment

In most cases, insurance claims are settled by payment of money (cheque or credit transfer) by the insurer directly to the insured. Claims for certain types of insurance always involve settlement by payment of money. Examples include money insurance, fidelity guarantee, business interruption and liability insurance claims. In the case of liability insurances, payment is made to the injured party, not to the insured.

B2 Repair

Where possible, insurers may choose to repair the damage to an insured item. In this way, they can often provide indemnity at a lower cost to themselves, because of their relationships with service providers. For example, many motor insurers make arrangements with approved repairers, who allow a price reduction on both parts and labour, in return for a guaranteed amount of work. A motor insurer will want to ensure that repairs are done to a high standard, are fairly priced and that long-distance tows and unnecessary storage costs are avoided wherever possible.

Approved repairer schemes can also make the claims process easier for the policyholder. While each insurer's scheme has its own particular features, they typically include some or all of these benefits:

- collection and delivery of the vehicle
- no requirement to obtain repair estimates
- provision of a loan car while repairs are carried out.

If an insurer settles claims by arranging for repairs, they must tell the consumer this at the quotation stage. They must also tell them about any financial penalties (e.g. an increased excess or no courtesy car) if they do not use the insurer's approved repairers.

B3 Replacement

Replacement as a means of providing indemnity relates most commonly to glass and contents insurance. Similar to the approved motor repairers, insurers have nominated retailers that they use where items have been lost, stolen or damaged beyond economic repair.

The benefits to the insurers include:

- minimising further losses, e.g. looting of stock if broken shop windows are not repaired
- using their bulk-buying power to obtain discounts, which leads to lower claims costs
- minimising fraudulent claims as, in most cases, fraudsters will be looking for cash rather than replacement goods
- improved customer service, e.g. by having a quality retailer replace and deliver an item such as a TV, with the bill (less any excess) paid directly by the insurer.

B4 Reinstatement

Reinstatement involves an insurer undertaking to restore or rebuild a building (or piece of machinery) that has been damaged by an insured peril.

Reinstatement is the least popular method of claims settlement. Where insurers opt for reinstatement, they must do the following:

- reinstate to substantially the same as the pre-loss condition
- reinstate within a reasonable time
- be their own insurers of the risk during the period of reinstatement (so either insure it themselves or carry the risk)
- ensure that the sum insured is adequate, or they will lose the protection of the sum insured as the maximum sum payable.

Quick question 1

For property insurance, what four options do insurers write into their policy wordings to give themselves flexibility in providing indemnity?

The answer is at the end of this chapter.

C Factors limiting and extending the principle of indemnity

Indemnity is a contractual principle of insurance, which can be amended if the parties to the insurance contract wish. In practical terms, this means that the policy may provide either more or less than a strict indemnity. We will now consider the limitations and extensions that may be applied to an indemnity settlement.

Quick question 2

What is the significance of indemnity being a contractual principle?

Just think

Before studying this section think about the restrictions that might apply to policies.

We have already learned about some of the factors that limit the principle of indemnity. For example, fraud (see Chapter 7A2b), misrepresentation (see Chapter 5E5) and breach of policy conditions (see Chapter 5C3). Section C1 explores more factors which restrict policies and limit the principle of indemnity.

C1 Factors limiting the principle of indemnity

Factors that limit the principle of indemnity are:

- Sum insured or limit of indemnity
- Market value
- First loss sum insured
- Item/inner limits
- Policy excess/franchise
- Underinsurance.

C1a Sum insured or limit of indemnity

The insurance policy sums insured, or the **limit of indemnity** (also termed the limit of liability), represent maximum limits. This means that the insured cannot recover more than this amount even where the loss, measured by the indemnity principle, is a higher figure. Only in limited circumstances, and depending on policy wording, will the limit of indemnity be breached. For example, in a liability case, the award to an injured party may be within the limit of indemnity but the legal costs may exceed this limit of indemnity.

An exception to this general rule is the requirement under the **Road Traffic Acts** for motor insurers to grant unlimited cover for liability in respect of third party death or bodily injury arising from the use of motor vehicles.

limit of indemnity

insurer's maximum liability for any one incident (usually) under the terms of a liability policy or section of a policy

C1b Market value

Some motor insurers ask the insured for an estimate of the current market value of the vehicle. The market value is the value of the vehicle at the time of a loss, irrespective of what the sum insured had been placed on the vehicle by the policyholder. This estimate effectively operates as a maximum sum insured in the event of a claim for loss or damage to the insured's own vehicle.

C1c First loss sum insured

A proposer may say that there is no possibility of a total loss of their property, and may request a sum insured that is less than the full value of the property. If the insurer agrees, the policy will be issued on a first loss basis as illustrated in Example 8.1. The premium for **first loss cover** may not be substantially lower than the premium for a full value sum insured because insurers already consider the maximum amount at risk when calculating rates and premiums.

first loss cover

insurance cover in which the insurer agrees to insure property for a lesser sum than its replacement cost

Example 8.1

First loss cover

ABC, a manufacturer, has stock valued at €20 million in a warehouse. The stock consists of large plastic pipes – bulky items of no great individual worth. In ABC's opinion, an absolute maximum of two lorry loads could be taken in a single theft, as it would not be possible for someone to steal all of the stock in a single robbery. The combined value of two lorry loads is estimated at €1 million. Therefore, ABC wishes to insure only for this lesser sum of €1 million. If the insurer agrees to this first loss cover, it will restrict its maximum liability to the €1 million limit and provide a premium discount.

C1d Item/inner limits

Within the overall sum insured or limit of indemnity, there may be further separate limits for particular types of loss or types of property. Example 8.2 illustrates these different limits for different classes of insurance.

Example 8.2

Sarah's **household contents policy** has a sum insured of €60,000 but restricts cover on individual valuables (defined as gold or silver items, jewellery, antiques, art) to 5% of the total sum insured. So, when a picture valued at €7,000 is destroyed in a household fire, she receives no more than €3,000. Another example is where the limit might apply to the total of such valuables as a percentage of the contents sum insured. ('All risks' policies are not subject to this limitation.)

Raymond's **money insurance policy** places a limit of €350 on money claims relating to money not kept in a locked safe outside of business hours.

Kathy's Stop 'n' Shop **theft insurance policy** divides the stock sum insured between different categories, with each category having its own maximum sum insured. For example, cigarette stocks (because of their attractiveness to thieves) are valued separately and a higher premium is charged.

Example 8.2 (contd)

Daire's **motor policy** has separate limits for items such as personal effects, the cost of parts if needed from a far distant country (e.g. Japan), and a time limit for roadside assistance cover where provided.

Blaster Ltd's **public liability policy** has a reduced limit of indemnity for liability arising from certain processes, such as welding, piling or demolition.

Quick question 3

What categories of limits are typically found in a household contents policy?

C1e Policy excess/franchise

A policy excess (deductible) means that the insured must bear the first amount of any loss. It can be expressed either as a sum of money (e.g. €250) or a percentage of the loss (e.g. 5%). Deductibles are very large excesses and usually apply to commercial policies. Excesses may either be compulsory or voluntary (to reduce the premium).

The effect of these clauses is to make the insured their own insurer for the amount of the excess or deductible and reduce the size of claim payments from an insurer's perspective. In the case of small claims, the presence of an excess clause relieves insurers from having to deal with numerous small and frivolous claims.

A **franchise** is similar to an excess, but there is an important distinction between them. This is illustrated in Example 8.3.

franchise

a minimum amount of loss that must be incurred before insurance coverage applies. Similar to an excess except that once the amount of the franchise is exceeded, the whole of the claim is paid

Example 8.3 Comparison between excess and franchise

	Loss of €950	Loss of €1,045
Policy subject to €1,000 excess	Insurers pay nothing	Insurers pay €45
Policy subject to €1,000 franchise	Insurers pay nothing	Insurers pay €1,045

A franchise may also be a period of time. Time franchises apply to some insurances, including business interruption or sickness policies. This means that, instead of a financial amount needing to be exceeded, a specified number of days must pass before a claim is eligible for payment. For example, a sickness policy with a 7-day franchise will not pay any benefits for a period of illness lasting less than 7 days. However, claims for illnesses lasting longer than 7 days will be paid in full.

C1f Underinsurance

Underinsurance refers to a situation where a policyholder has not declared the full value of the risk to be insured. This means that, from the insurer's perspective, the risk is underinsured and an insufficient premium has been received. Therefore, at the time of a claim, the insurer will (depending on the policy terms) reduce its payments for the loss or damage in proportion to the underinsurance.

When underinsurance exists and the **average** clause/condition is applied, the insured is deemed to be their own insurer for the uninsured proportion of the loss.

For commercial insurances, the pro rata condition of average (usually referred to as the policy being 'subject to average') is applied. This states that, if a lesser premium has been paid than would have been due for full value insurance (i.e. if there was underinsurance), the insured should be their own insurer for that proportion and share losses accordingly.

The formula that is used is:

$$\frac{\text{Sum insured at time of loss}}{\text{Value of risk at time of loss}} \times \text{Amount of loss} = \text{Amount of claim payable (liability of insurer)}$$

Household insurers can apply the pro rata average condition on the settlement of claims if full values are not maintained.

The pro rata condition of average measures the complete cost, as new, of all items in order to see what level of underinsurance exists (applying the formula). Example 8.4 illustrates this.

Example 8.4

Bill's household insurance policy is 'subject to average'. The sum insured for contents is €20,000 but has a value of €40,000. A theft occurs and contents to the value of €5,000 are taken. The pro rata condition of average is applied and his insurer pays €2,500 in settlement of claim.

underinsurance

where the declared value on a risk is less than the full value required as the basis for cover and policy limits are insufficient to cover the full value of future potential claims

average

principle that if a sum insured is less than the full insured value, the insured should be their own insurer for that proportion and share the losses accordingly

Quick question 4

A commercial fire policy is 'subject to average'. The sum insured is €100,000 but has a value of €120,000. If, in the event of a fire, a loss of €60,000 occurs, how much will insurers have to pay?

C2 Factors extending the principle of indemnity

The following factors extend the concept of indemnity:

C2a Betterment

Betterment, in relation to buildings and machinery, refers to improvements to buildings/machinery as a result of repairs carried out following a loss. The term is not found in an insurance policy; it is an implied right for insurers when paying indemnity loss settlements. For example, a wall is knocked down by a negligent third party and the liable insurer instructs a building contractor to carry out the repairs. When rebuilding the wall the contractor has to use a different, much stronger brick, because the original brick is now discontinued. Betterment cannot apply in circumstances where the policy is insured on a 'new for old' or reinstatement basis.

C2b Reinstatement conditions

This refers to conditions within a policy (for commercial buildings and contents, but not stock), which seek to provide payment for full reinstatement to damaged, destroyed or lost items. For example, a warehouse has been insured on a reinstatement basis in respect of the buildings, fixtures, fittings and machinery for the past five years. A fire breaks out and the warehouse burns to the ground. The insurer is liable to rebuild the building and replace all fixtures, fittings and machinery with new versions. As the machinery was five years old at the time of the loss, the reinstatement of new machinery inevitably puts the insured in a better position after the loss, if only because the new machinery is likely to have a longer 'shelf life' than the machinery in place prior to the loss.

C2c 'New for old'

'New for old' cover is mainly found in household policies for contents and aims to replace items lost or destroyed with new items of similar functionality; buildings cover is normally on the same basis as for commercial policies.

C2d Agreed value

Agreed value policies (sometimes known as 'valued' policies), is where the sum insured for a total loss is fixed at the outset of the insurance; an independent and verifiable valuation is provided by the insured prior to inception of the policy, and this sum will be paid, regardless of the actual value of the property at the time.

agreed value

insurance arrangement in which the value of an item insured is agreed in advance and (usually) a formula agreed for partial losses

Just think

What types of property do you think would be suitable for agreed value policies?

This form of cover is often used where the property is unique, or of a type for which there is a limited market. In such instances, the question of value is likely to be more subjective than normal and therefore more likely to give rise to a dispute. For this reason, works of art, antiques and vintage cars are frequently insured on an agreed value basis.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

D Subrogation

subrogation

the right of an insurer, following payment of a claim, to take over the rights of the insured to recover payment from a third party responsible for the loss

Subrogation deals with the right of an insurer to recover its claim payments from another source. It is defined as:

> The right of one person, having indemnified another under a legal obligation to do so, to stand in the place of that other and avail himself of all the rights and remedies of that other, whether already enforced or not.
>
> ***Burnand v Rodocanachi*** (1882)

Simply put, subrogation allows one party to stand in the place of another.

D1a Common law

Subrogation is a common-law right. The insured cannot claim an indemnity payment from an insurer and then also acquire a further payment from a negligent third party. This would result in a profit for the insured, which is contrary to the principle of indemnity. Consider Example 8.5.

Example 8.5

Recovery from two sources

John employed a Jobs-R-Us local contractor to paint the outside of his house. The preparation consists of burning off the old paintwork. Unfortunately, the contractor did not take adequate precautions and the process created a localised fire, which spread rapidly and burned the house down. John pursues Jobs-R-Us and also claims from its insurer, receiving a payment from both. John has therefore 'recovered for the same loss twice'. In this situation, where there is potential for double recovery, the insurer can call on John to repay the indemnity he received from them. If John did not reimburse the insurer, he would profit from the situation and be guilty of unfair conduct.

Just think

What is the problem with John collecting the payment from both Jobs-R-Us and its insurers?

As you will recall, the principle of indemnity aims to place the insured in the same financial position they were in immediately before the loss – no better, no worse. If John had retained both payments, he would have received more than a full indemnity.

The common law right of subrogation requires an insurer to indemnify the insured before it can pursue subrogation rights.

D1b Subrogation condition

The requirement for an insurer to indemnify the insured before pursuing subrogation rights can sometimes lead to difficulties. In Example 8.4, if the rebuilding period for John's house was 12 months, the insurer would have to wait until the end of that period to pursue Jobs-R-Us. If Jobs-R-Us were wound up, ceased trading or went bankrupt during that year, the insurer would be out of pocket.

To avoid this situation, insurers usually include a subrogation condition in the policy that gives them the right to pursue subrogation rights before the claim is paid.

In keeping with the principle of indemnity, insurers cannot recover more than they have paid out, as shown in Example 8.6.

Example 8.6[34]

Pembroke Insurance paid the insured (LongHaul Shipping) £72,000 for the total loss of their ship following a collision. LongHaul Shipping sued the owners of the ship that caused the collision and damages were recovered in Canadian dollars. However, by the time of the recovery payment, the pound had been devalued and, when converted back to sterling, the recovery exceeded the original £72,000 payment by £55,000. It was held that, once the insured reimbursed Pembroke Insurance in full, they were entitled to retain all surplus funds.

Quick question 5

In the absence of a subrogation condition in the insurance policy, when may an insurer begin to pursue recovery rights against a culpable third party?

D1c Consumers and subrogation

The **Consumer Insurance Contracts Act 2019** provides that an insurer cannot exercise its subrogation rights in certain situations e.g. an uninsured family member, the employee of an insured employer (see Example 8.7). The reason for these restrictions on an insurer's subrogation rights is that an insured might be discouraged from pursuing a claim for fear that a family member (responsible for the damage) might be pursued by the insurer in order to recover the claim cost. This restriction does not apply where the misconduct of the person that gave rise to the loss was serious or wilful (family/personal relationships) or intentional or reckless and with knowledge that the loss would probably occur (employment situation).

Example 8.7

Tom is Noel's adult son. Tom lives in the family home but is not the home insurance policyholder and has no insurance of his own. Tom leaves a tap running in the bathroom and the escaped water causes damage. Noel (the policyholder) claims under the home insurance policy. Provided Tom did not act recklessly or intentionally, the insurer cannot exercise its subrogation rights against him.

Quick question 6

While your car is parked, Kieran collides with it, causing damage. You claim under your own comprehensive motor insurance policy and also contact Kieran's insurer to claim damages. You receive two settlement cheques. Can you keep both cheques and, if so, why?

An insurer cannot impose a subrogation condition on a consumer requiring them to assign subrogation rights to the insurer for the consumer to be entitled to a claim payment in respect of their loss.

The Act also sets out how funds generated from the exercise of subrogation rights should be distributed between an insurer and the consumer so that the consumer is not prejudiced.[35]

[34] Example based on the case of ***Yorkshire Insurance Co. v Nisbet Shipping Co. Ltd*** (1961).

[35] Sections 23 and 24, **Consumer Insurance Contracts Act 2019**.

E Applying the principle of subrogation

We now look at how subrogation rights arise and how they are relevant to insurance claims.

E1 How do subrogation rights arise?

Subrogation rights may arise in one of three ways:

- tort
- contract
- subject matter of insurance.

E1a Tort

As we know from Chapter 6, everyone has a duty to act in a reasonable way towards others, and a breach of this duty is called a tort. The person who has suffered damage or injury is entitled to compensation. Example 8.8 outlines how subrogation can arise in a case involving tort.

Example 8.8

Jenny's house was damaged by tree roots that encroach from a neighbour's garden, causing subsidence. If Jenny makes a claim under her household buildings policy, her insurer may have subrogation rights against the neighbour.

A lorry driver negligently loses control of their truck and crashes through Paul's kitchen wall. If Paul makes a claim under his household buildings policy, his insurer may have subrogation rights against the lorry driver's insurers.

A plumber doesn't properly seal the waste water pipes in Ralph's house. If Ralph makes a claim under his home insurance policy for damage caused by leaking water, his insurer may have subrogation rights against the plumber.

E1b Contract

Subrogation may arise from a contract entered into by the insured (i.e. the policy purchased and the terms and conditions within), as illustrated by Example 8.9.

Example 8.9

Under Trevor's tenancy agreement with his landlord, he is responsible for damage to the property. After a fire, a claim is made to the landlord's insurers (HouseProof Insurers). HouseProof Insurers pays the claim to the landlord but then exercises its subrogation rights and recovers its losses from Trevor.

E1c Subject matter of insurance

Sometimes, a situation arises where an insured has been indemnified by the insurer and the subject matter of the insurance has been treated as a total loss. Once this has happened, the insured cannot retain ownership of the salvage as this would over-indemnify them.

Just think

Having paid the claim, what is the insurer's relationship to the salvage?

If an insurer pays for a total loss, it becomes the owner of the salvage. The insured's claim has been fully satisfied and they have no further right to the salvage. In fact, whereas subrogation allows the insurer to recover no more than its own payment, the insurer could possibly make a profit on the salvage. If, for example, an insurer pays a total loss for a stock of copper piping damaged by fire, and the goods are subsequently sold as scrap, any greater sum received (e.g. if the value of copper increased in the meantime) will benefit the insurer. This scenario is extremely rare and the more common outcome is that the insurer uses the sale of the salvage to offset the total cost of the claim.

Where the insured retains the salvage, a suitable deduction is made from the claim payment to take its value into account.

It should also be noted that subrogation operates automatically as a result of the principle of indemnity, whereas salvage does not have to be accepted by the insurer. The insured does not have a legal right to force the insurer to take possession of the salvage.

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

Quick question 7

What is the most common way in which subrogation rights arise?

Quick question 8

An insurer pays €10,000 and allows the insured to retain the salvage, valued at €1,000, in settlement of a claim for damage caused by a negligent third party. How much can the insurer claim from that third party when exercising its subrogation rights?

Quick question 9

Why do insurers have greater rights arising out of the subject matter of the contract (salvage) than those arising from subrogation rights generally?

contribution

the right of an insurer to share the cost of an indemnity payment among similarly (but not necessarily equally) liable parties

F Contribution

Contribution is concerned with how insurers share the cost of a claim when there is more than one policy in force.

Contribution differs from subrogation in that, while subrogation passes on the insured's rights to the insurer, contribution is an equitable method of sharing losses between insurers. However, both contribution and subrogation support the principle of indemnity, as the insured should not recover more than the financial loss suffered.

The insured can take out as many insurance policies as they wish, provided there is no fraudulent intent. Example 8.10 lists a number of possible instances.

Example 8.10 Examples of dual (double) insurance

Cover required	Policies providing cover	
Mobile phone	Household contents policy	Travel insurance policy
Camera	'All risks' policy	Travel insurance policy
Laptop	Household insurance policy	Gadget policy
Hospital costs abroad	Private health insurance policy	Travel insurance policy

So what happens when there is double (or dual) insurance, with more than one valid policy in force? Can an insured recover under both policies?

Applying the principle of indemnity, we know that an insured should not be able to recover in total more than the amount lost. The insured can only recover the total amount of a loss sustained, regardless of the number of policies held.

If the insured holds two policies, but receives indemnity from only one of the insurers, then the other insurer has avoided its financial responsibility and the insurer that paid the claim has taken full financial responsibility for the loss. For this reason, the principle of contribution tries to share the burden of the loss fairly among all insurers covering the loss.

F1 Contribution condition

Because it supports the principle of indemnity, the insurer's right to contribution exists, whether stated in a policy document or not. Where insurers are aware of dual insurance they do not want to pay the whole claim and then have to recover part of it from another insurer, although this is the only right they have under common law. They would prefer to pay only the share for which they are liable.

Rather than paying the whole loss and recovering part later, insurers usually include a 'contribution condition' in their policies. A typical contribution condition states that 'if, at the time of any loss, damage or liability there is any other insurance covering such an incident, the insurer will pay only its **rateable proportion**'.

When completing a claim declaration, the insured is asked to give details of other insurances. On receipt of the declaration, the insurer will then notify the other insurer(s) of the claim to seek recovery following settlement with the policyholder. See Example 8.11.

Example 8.11

Two household insurance policies are identical cover in terms of policy coverage, sums insured and excesses. There is a water damage claim of €5,000 (excluding the policy excesses).

Insurer A learns that there is dual insurance (i.e. another policy is in force), contacts Insurer B and enforces the contribution condition of the policy.

Insurer A's rateable proportion would be €2,500 (i.e. 50% of the loss) and Insurer B would also cover 50% of the loss (i.e. the remaining €2,500).

Quick question 10

While both subrogation and contribution support the principle of indemnity, what is the key distinction between the two types of rights?

rateable proportion

where there is more than one insurance policy liable for a loss and the insurers concerned only pay their share of the loss

G Applying the principle of contribution

We now look at how contribution arises and how it is applied to insurance claims.

G1 How does contribution arise?

Table 8.1 shows the common law requirements that must be satisfied before contribution arises.

Table 8.1 Common law contribution requirements

Two or more policies of indemnity: The policies must be indemnity contracts and not life or other non-indemnity insurances (benefit policies).

A common insurable interest: The policies cover the same financial (insurable) interest in the subject matter.

A common peril giving rise to the loss: There is overlap between the range of perils covered under the policies and the overlapping peril (contingency) must give rise to the claim.

A common subject matter: The subject matter affected by the loss must be common to both policies, but the policies need not cover only the same subject matter.

Each liable for the loss: Insurers are liable under their policies (i.e. neither has the right to avoid the contract, e.g. for breach of condition).

Neither policy containing a non-contribution clause: See Section 8G2.

Quick question 11

What key tests are there to check whether contribution arises when there is dual insurance?

As can be seen, the policies do not need to be identical, as long as they have the elements of interest, peril and subject matter in common.

G2 Modifications to the principle of contribution

There are some situations in which the principle of contribution operates differently because of the wording of an insurance policy.

1. Non-contribution clause – Some policies have what is known as a **non-contribution clause**. A typical clause is shown in Example 8.12.

non-contribution clause

generic term for a variety of clauses that restrict the operation of a rateable sharing of losses

Example 8.12

Non-contribution clause

'There shall be no liability under this policy in respect of any loss for which the insured is entitled to indemnity under any other policy.'

This means that the policy will not contribute if there is another insurance in force. However, if a similar clause applies to both (or all) policies, they are treated as cancelling each other out and each insurer reverts to paying its rateable proportion.

2. **More specific insurance** – Some policies include a clause that restricts cover if a more specific insurance policy has been arranged. The term 'more specific' may or may not be defined in the policy. However, a policy is likely to be regarded as more specific if it describes or identifies the subject matter more precisely, as shown in Example 8.13.

more specific insurance clause

exclusion of cover where a loss is covered by another, more specific, insurance policy

Just think

Can you think of a situation where there may be two policies, one of which is more specific?

Example 8.13

More specific insurance

- a specific warehouse stock policy and a 'floating' policy covering stock over several warehouses, both covering the same stock
- a household contents policy and the personal effects section of a motor policy, both covering personal effects while in a motor vehicle.

G3 Sharing the loss

How do insurers apportion losses where contribution applies? In practice, there are two main methods of calculating the proportions: maximum liability and independent liability.

G3a Maximum liability method

maximum liability method

means of apportioning losses where the contribution applies in proportion to the maximum amount of cover available under each policy

Under the **maximum liability method**, the loss is shared by the insurers in proportion to the sums insured under each policy. This approach means that each insurer's payment is likely to reflect the proportion of premium paid to them. This method is only used where neither policy is subject to average. It is therefore appropriate for many household, 'all risks', travel and motor (own damage) claims. The formula used to calculate each insurer's contribution is:

$$\frac{\text{Policy sum insured}}{\text{Total sum insured under all policies}} \times \text{loss}$$

Examples 8.14 and 8.15 demonstrate the maximum liability method.

Example 8.14

Maximum liability method

XYZ Ltd has two fire policies with different insurers. Neither policy is subject to average.

Policy A sum insured is **€100,000**. Policy B sum insured is **€200,000**.

In the event of a loss amounting to €60,000, how much will each insurer pay?

Policy A will pay $\frac{€100,000}{€300,000} \times €60,000 = €20,000$

Policy B will pay $\frac{€200,000}{€300,000} \times €60,000 = €40,000$

Quick question 12

Under the maximum liability method of apportioning losses, if a property is insured for €20,000 with Insurer A and for €30,000 with Insurer B, what will each insurer pay for a loss of €10,000?

Chapter 8

Example 8.15

Maximum liability method

QRS Ltd has two fire policies with different insurers. Neither policy is subject to average.

Policy A sum insured is €**75,000**.

Policy B sum insured is €**175,000**.

In the event of a loss amounting to €50,000, how much will each insurer pay?

Policy A will pay

$$\frac{€75,000}{€250,000} \times €50,000 \quad = \quad €15,000$$

Policy B will pay

$$\frac{€175,000}{€250,000} \times €50,000 = €35,000$$

G3b Independent liability method

The **independent liability method** is typically used:

- where one or more of the policies is subject to average (underinsured)
- when the terms of the policies are different (e.g. different excesses or limits)
- to apportion losses between liability insurers.

Example 8.16 demonstrates the steps involved in this method.

independent liability method

means of apportioning losses where the contribution applies in proportion to the independent liability under each policy

Example 8.16

Independent liability method

ABC Ltd has two fire policies with different insurers.

Policy A sum insured: **€200,000**

Policy B sum insured: **€400,000**

Total value at risk: **€800,000**

Neither policy is subject to an excess

Loss incurred: **€100,000**

How much will each insurer contribute to this loss?

In this situation, we need to calculate each insurer's **independent liability**.

When the total value at risk exceeds the total sum insured by all policies, each policy will pay:

$$\frac{\text{Policy sum insured}}{\text{Total value at risk}} \times \text{loss}$$

Policy A will pay $\frac{€200,000}{€800,000} \times €100,000 = €25,000$

Policy B will pay $\frac{€400,000}{€800,000} \times €100,000 = €50,000$

The total payment by the two insurers is €75,000. The balance of the loss (€25,000) is borne by the insured. This is because of underinsurance, i.e. the total sum insured (€600,000) was considerably lower than the value at risk (€800,000).

If the total of the individual sums insured exceeds the total value at risk, if an excess applies, or if the conditions are not the same for both policies, further steps are required to apportion the loss. These calculations require a different formula and are beyond the scope of this textbook. They will be explored in more detail in the Practice of Claims and Loss Adjusting module.

Quick question 13

A property is insured for €150,000 with Insurer A and for €200,000 with Insurer B. Neither policy is subject to an excess. The total value at risk is €450,000. The insured suffers a loss of €45,000. Under the independent liability method of apportioning losses, what will each insurer pay and will the insured be liable for any of the loss?'

Microlearning

In the Member Area of www.iii.ie, via the Connect logo and in Your Learning Centre, select the microlearning section of this chapter to access a resource specifically developed to help you better understand this topic.

H Summary

In this chapter we learned that indemnity is the core principle of general insurance. It is designed to deliver the insurer's promise of financial compensation to the insured, while ensuring that the policyholder does not profit from their loss.

We also considered the principles of subrogation and contribution, which go hand in hand with indemnity. These two principles underpin the rights of an insurer when seeking recovery of a claim payment or a contribution to the cost of a claim.

H1 Study tips

It's important to remember that this textbook is the primary information source for this module. All the questions in your exam will relate directly to information featured in the textbook. Use the 'End of chapter questions', 'Quick questions' and the 'Sample multiple-choice questions' to quickly test what you've learned so far. Make a note of any topics/areas you need to improve in and keep it to hand so you can refer to it when you revise this chapter again before your exam.

In addition to the textbook, your Member Area has many online learning supports that can help you as you study this module.

H2 Online learning supports

Your Member Area includes a guide to success, an automated study planner, an exam countdown timer and learning tips guide. These learning supports are invaluable in reinforcing what you have learned from the textbook so far. The webinars, chapter-by-chapter key points and other supports will help you to break down the chapter content when revising.

Completing online mock exams and reviewing the personalised feedback that follows, is a great way of testing your knowledge and preparing for exam day.

To access these online learning supports, just log into your Member Area on www.iii.ie and click on the **Connect** logo.

End of chapter questions

Use these questions to test your understanding of what we've covered in Chapter 8.

1. Define 'indemnity'.

2. Outline the benefits of approved repairer schemes for the motor policyholder.

3. Outline why insurers often use nominated retailers (rather than make a cash payment) where items have been lost, stolen or damaged beyond economic repair.

4. Outline the measure of indemnity if a policy does not define the means of calculating a loss.

5. List the settlement options available to an insurer (once stated in the policy), when providing compensation under indemnity policies.

6. Explain the difference between a policy excess and a franchise.

7. Explain the aim of an agreed value policy and the type of subject matter to which it is best suited.

8. Distinguish between subrogation and contribution.

9. Provide a working definition of 'subrogation'.

10. State how insurers deal with the fact that their common-law right to subrogation begins after claim payment.

11. Define contribution.

12. Explain how non-contribution clauses operate.

13. State when the independent liability method might be used to calculate insurers' contributions to a loss.

Answers to end of chapter questions

Check your answers against those below and make a note of any points you left out. This will highlight the sections you may need to look at more closely during your revision.

1. Indemnity refers to financial compensation sufficient to place the insured in the same financial position after a loss as they enjoyed immediately before the loss occurred.

2. The benefits include the following:
   - collection and delivery of the vehicle
   - no requirement to obtain repair estimates
   - provision of a loan car while repairs are carried out
   - lack of a penalty excess for non-use of an approved repairer.

3. Where items have been lost, stolen or damaged beyond economic repair, insurers increasingly use nominated retailers (rather than making cash payments) as this benefits them in a number of ways, as follows:
   - Retailer discounts achieved mean lower claims costs.
   - Using the replacement option can prevent or at least minimise fraudulent claims. In most cases, a fraudster will be looking for cash rather than goods.
   - Customer service is improved through use of quality retailers.

4. In the absence of a policy definition, indemnity represents the value at the time and place of loss.

5. The settlement options available to an insurer when providing compensation are:
   - cash payment
   - repair
   - replacement
   - reinstatement.

6. A policy excess is the first amount of any loss which the insured must pay themselves, with the balance of the loss being paid by the insurer. A franchise is an amount of loss (in time or money) that must be exceeded before a claim is eligible for payment by the insurer. If this amount of loss is exceeded then the insurer will pay the full cost of the claim.

7. The aim of an agreed value policy is to avoid disputes as to the value of the property at the time a loss occurs. This form of cover is often used where the property is unique or of a type for which there is a limited market, e.g. antiques, vintage cars and paintings.

8. Subrogation concerns the insurer's right to recover its payments from another source. Contribution arises when there is more than one policy in force and gives an insurer rights in relation to other liable insurers.

9. Subrogation is the right of an insurer, following payment of a claim, to take over the insured's rights to recover payment from a third party responsible for the loss.

10. In order to gain control over claims situations early in the process, insurers invariably include a condition in the policy giving them power to pursue subrogation rights before the claim is paid. (The only limitation is that the insurer cannot make a recovery from a third party before it has settled the insured's claim.)

11. Contribution is the right of an insurer to call on others similarly, but not necessarily equally, liable to share the cost of an indemnity payment.

12. Non-contribution clauses transfer the whole of any such loss onto the other insurer. However, there is the possibility that both contracts will have a similar clause, so that the insured appears to have no cover at all. In this case, the clauses cancel each other out and each insurer reverts to paying its rateable proportion.

13. The independent liability method is typically used:

- where one or more of the policies is subject to average
- when the terms of the policies are different (e.g. different excesses or limits)
- to apportion losses between liability insurers.

Answers to quick questions

1. The four options are:
   - cash payment
   - repair
   - replacement
   - reinstatement.

2. The significance is that the indemnity can be varied if the parties to the insurance contract wish to vary it.

3. Individual valuables, at a percentage of the total sum insured (say, 5%). A limit might also apply to the total of such valuables as a percentage of the contents sum insured.

4. The formula used is:

$$\frac{\text{Sum insured at time of loss}}{\text{Value of risk at time of loss}} \times \text{Amount of loss} = \text{Amount of claim payable (liability of insurer)}$$

   The insurer therefore pays:

$$\frac{€100{,}000}{€120{,}000} \times €60{,}000 = €50{,}000$$

5. In the absence of a subrogation condition in the policy, the insurer must already have indemnified the insured before pursuing subrogation rights.

6. No, accepting both settlement cheques would allow you to make a profit from this situation, which is in breach of the principle of indemnity. Therefore, the settlement from Kieran's insurers should, by right of subrogation, go to your motor insurer to minimise its loss. However, you are only obliged to reimburse your own insurer the amount it actually paid. You can keep the balance, which may include an excess or other uninsured losses.

7. Although subrogation rights may arise from a contract entered into by the insured, they mostly arise in cases involving tort.

8. The insurer settled the claim by a payment of €10,000 and allowed the insured to keep the salvage valued at €1,000. The insurer can only subrogate for its loss, which is €10,000.

9. Having paid for a total loss, the insurer becomes the owner of the salvage. This puts the insurer in a different position in relation to the goods. With other subrogation situations, the insurer is pursuing the rights of the insured.

10. Contribution differs from subrogation in that, while subrogation passes on the insured's rights to the insurer, contribution is an equitable method of sharing losses between insurers.

11. The following requirements must be satisfied before contribution arises:
    - There must be two or more policies of indemnity.
    - The policies must cover a common interest.
    - The policies must cover a common peril (or event) that gives rise to the loss.
    - The policies must cover a common subject matter.
    - Each policy must be liable for the loss.
    - There must be no non-contribution clause(s).

12. Under the maximum liability method, if a property is insured for €20,000 with Insurer A and for €30,000 with Insurer B, A will pay two-fifths of any loss and B will pay three-fifths. In the event of a loss amounting to €10,000:

Insurer A pays: $\frac{€20,000}{€50,000} \times €10,000 = €4,000$

Insurer B pays: $\frac{€30,000}{€50,000} \times €10,000 = €6,000$

13. A property is insured for €150,000 with Insurer A and for €200,000 with Insurer B, but the total value at risk is €450,000. As the total value at risk exceeds the total sum insured by all policies, under the independent liability method, the following will be each insurer's independent liability.

Policy A will pay

$\frac{€150,000}{€450,000} \times €45,000 = €15,000$

Policy B will pay

$\frac{€200,000}{€450,000} \times €45,000 = €20,000$

The total payment by the two insurers is €35,000. The balance of the loss (€10,000) is borne by the insured. This is because of underinsurance, i.e. the total sum insured (€350,000) was lower than the value at risk (€450,000).

Sample multiple-choice questions

Question 1

Which of the following policy types would generally have characteristics of **both** indemnity and benefit policy arrangements?

A. Public liability.

B. Personal accident and sickness.

C. Professional indemnity.

D. Private health.

Your answer:

☐

Question 2

Brian discovers one morning that someone has damaged his car while parked overnight outside his house. He claims for the damage from his insurer. The loss is settled subject to a €100 excess. Brian then receives a letter from Gillian explaining that she caused the damage and offering to pay the cost of the repairs. What should Brian do?

A. Obtain payment from Gillian for the full amount of the repairs and keep the money.

B. Tell Gillian that she does not need to pay as his insurer has already settled the loss.

C. Advise his insurer, who can claim the payment from Gillian and refund Brian the €100 excess he has paid.

D. Tell Gillian that he only wishes to recover the amount of his excess.

Your answer:

☐

Question 3

Shane has a comprehensive motor policy with ABC Insurance DAC. He has a compulsory excess of €200 and a voluntary excess of €300. He is involved in an accident, which was his fault, causing €3,500 worth of damage to his car. Assuming the peril is covered, how much will Shane receive from his insurer?

A. €3,000

B. €3,200

C. €3,300

D. €3,500

Your answer:

☐

Answers to sample multiple-choice questions

Question 1

Chapter reference: Chapter 8A

Question type: K

Correct response: D

Learning outcome: Outline the concept of indemnity and identify an insurer's settlement options when providing indemnity to a policyholder.

Question 2

Chapter reference: Chapter 8D

Question type: U

Correct response: C

Learning outcome: Explain the principle of subrogation and apply it in situations where recovery rights may be exercised.

Question 3

Chapter reference: Chapter 8C1e

Question type: A

Correct response: A

Learning outcome: Demonstrate the application of indemnity to a policy of insurance.

Referenced legal cases and legislation

Legal cases

Blyth v Birmingham Waterworks Company (1856)

Burnand v Rodocanachi (1882)

Castellain v Preston (1883)

Connolly v South of Ireland Asphalt Company (1977)

Direct Line v Khan (2001)

Donoghue v Stevenson (1932)

Etherington v Lancashire and Yorkshire Accident Insurance Company (1909)

Kelleher v Irish Life Assurance Co. Ltd (1993)

Leyland Shipping v Norwich Union Fire Insurance Society Ltd (1918)

Marsden v City & County Insurance (1865)

Pawsey v Scottish Union and National (1907)

Rozanes v Bowen (1928)

Rylands v Fletcher (1868)

Tootal Broadhurst Less Company v London and Lancashire Fire Insurance Company (1908)

Yorkshire Insurance Co. v Nisbet Shipping Co. Ltd (1961)

Legislation

Animals Act 1985

Assisted Decision-Making (Capacity) Act 2015

Central Bank Consumer Protection Code 2012

Civil Liability and Courts Act 2004

Consumer Insurance Contracts Act 2019

Control of Dogs Act 1986

Control of Dogs (Amendment) Act 1992

Defamation Act 2009

Factories Act 1955

Health Insurance Act 1994 (Minimum Benefit) (Amendment) Regulations 2015

Health Insurance (Amendment) Act 2012

Health Insurance (Amendment) Act 2014

Health Insurance Acts 1994-2022

Hotel Proprietors Act 1963

Insurance Acts and Regulations 1909-2000

Insurance and Reinsurance (Solvency II) Directive 2009

Insurance Distribution Regulations 2018

Liability for Defective Products Act 1991

Marine Insurance Act 1906

Occupiers Liability Act 1995

Personal Injuries Resolution Board Act 2022

Road Traffic Act 1961

Safety, Health and Welfare at Work (General Application) Regulations 2007-2016

Safety, Health and Welfare at Work (Construction) Regulations 2006-2013

Safety, Health and Welfare at Work Acts 2005 and 2010

Sale of Goods Acts 1893 and 1980

Statute of Limitations Act 1957

Statute of Limitations (Amendment) Act 1991

Trustee Acts 1893 and 1989

Acronyms

Organisations/bodies/regions	
Brokers Ireland	BI
Bureau International des Producteurs d'Assurances et de Reassurances (European Federation of Insurance Intermediaries)	BIPAR
European Insurance and Occupational Pensions Authority	EIOPA
European Union	EU
Financial Services and Pensions Ombudsman	FSPO
Health Insurance Authority	HIA
Health Service Executive	HSE
Hospital Saturday Fund	HSF
Insurance Information Service	IIS
Integrated Information Data Service	IIDS
Life Insurance Association	LIA
Motor Insurers' Bureau of Ireland	MIBI
Personal Injuries Assessment Board	PIAB
State Claims Agency	SCA

Terminology	
Actuarial Opinion on Technical Provisions	AOTPs
Commercial Vehicle Roadworthiness Test	CVRT
Consumer Protection Code	CPC
Declined Cases Agreement	DCA
estimated maximum loss	EML
Guaranteed Asset Protection	GAP
Head of Actuarial Function	HoAF
Insurance Compensation Fund	ICF
National Car Test	NCT
no claims discount	NCD
probable maximum loss	PML
Risk Equalisation Scheme	RES

Glossary of Key Terms

adjustable premium	the premium rate is applied to the estimated exposure measure at the start of the period of insurance and then adjusted appropriately at the end of the period when the actual exposure measure is known
adviser (advisor)	an individual involved in the advising process
affinity group	a group of people with a common interest or connection, who work together to achieve a common goal, e.g. to obtain discounted premium rates or exclusive insurance schemes
agreed value	insurance arrangement in which the value of an item insured is agreed in advance and (usually) a formula agreed for partial losses
arbitration	a legally binding alternative dispute resolution process, whereby cases are heard by an arbitrator rather than a judge in court
average	principle that if a sum insured is less than the full insured value, the insured should be their own insurer for that proportion and share the losses accordingly
basis of contract clause	a declaration on an insurance proposal form or insurance contract stating that representations made by the policyholder (insured) are true and accurate
benefit policy	a policy that provides stated pre-agreed amounts/benefits rather than exact financial compensation
breach of contract	failure to perform the duties and obligations required by a contract
broker	an intermediary that provides their regulated activities on the basis of a fair analysis of the market
Brokers Ireland	an industry body representing Irish general insurance and financial brokers
capacity	(in this context) the ability to understand when a decision is made and the nature and consequences of the decision in the context of the available choices. **Assisted Decision-Making (Capacity) Act 2015**
captive	an authorised insurer that has been formed as a subsidiary of a non-insurance parent company
Central Bank of Ireland	financial regulatory body in Ireland, responsible for the authorisation and supervision of all financial service providers
claim	an application for compensation under the terms of an insurance policy following a loss
claimant	person or firm making a claim
claim form	document designed to elicit from the policyholder all relevant information surrounding the circumstances of a loss caused by an insured event
claims reserves	funds set aside by an insurer to meet the cost of present and future claim payments
co-insurance	proportional risk-sharing between insurers
community rating	private health insurance principle that cross-subsidises the cost of private health insurance from young to old and, to some degree, male to female

composite insurer	insurer that accepts several types of insurance business (called classes or lines of business)
concurrent causes	two or more perils operating at the same time (to bring about a loss)
condition	a provision or obligation in a policy that must be complied with
condition precedent to liability	condition that allows the insurer to avoid liability for a claim in the event of a breach
condition precedent to the contract	condition that, if not complied with, can allow the insurer to void the policy as a whole
consent	defence that applies when the plaintiff agrees to a deliberate act by the defendant that would be a tort if no consent had been given
consideration	what each party agrees to do to support their side of the contractual agreement
consumer	any of the following: c. a person or group of persons, but not an incorporated body with an annual turnover in excess of €3 million in the previous financial year (includes partnerships and other unincorporated bodies such as clubs, charities and trusts) d. incorporated bodies with an annual turnover of €3 million or less in the previous financial year (provided the body is not part of a group with a combined turnover of more than €3 million). … and includes a potential consumer.
Consumer Protection Code	code issued by the Central Bank of Ireland setting out requirements that regulated firms must comply with in order to ensure a minimum level of protection for consumers
contractual capacity	freedom of a company or individual to enter into a contract
contribution	the right of an insurer to share the cost of an indemnity payment among similarly (but not necessarily equally) liable parties
control of claims condition	condition that ensures a policyholder does not prejudice their own claim (e.g. no action taken prior to insurer's investigation and insurer to be kept informed of all third party proceedings)
custodian warranty	a requirement by insurers that a certain number of able-bodied adults accompany money in transit (under a money insurance policy)
customer	a person (natural or legal/individual or firm) to whom an insurer or intermediary provides, or offers to provide, an insurance product or service, and any person who requests such a product or service; for an intermediary, the terms 'client' and 'customer' are interchangeable
damages	financial compensation fixed by the court according to the seriousness of the injury or damage caused
Declined Cases Agreement	an agreement that ensures a designated insurer will provide cover to a motorist seeking insurance if the customer has approached and been declined by at least three insurers
Declined Cases Committee	the committee that administers the operation of the Declined Cases Agreement

deductible/excess	first part of each and every loss that is the responsibility of the insured; these terms are interchangeable in some sectors of the market
defamation	a false statement about a person that causes injury to that person's reputation
delegated authority	authority granted to the agent of an insurer, usually in the context of a scheme arrangement, to issue policy documentation and possibly carry out limited underwriting and claims functions
direct insurance	insurance sold by insurers where there is no intermediary in the selling or advising chain
direct settlement	claims method by which the medical provider and insurer directly process claims, whereby the insurer makes periodic payments to the medical provider by incorporating multiple claims approved for payment against the provider's record
discrimination factor	a feature of a risk that presents a poorer or better hazard
distribution channel	the chain of individuals and organisations involved in getting a product or service from the producer to the customer
duty of care	a moral or legal obligation to ensure the safety or well-being of others
duty of disclosure	obligation to truthfully reveal all material facts about the risk
employee benefit consultant	intermediary employed to advise on and help place mainly health insurance business at a corporate level
endorsement	a written document, usually incorporated within a policy wording, and referenced on the schedule, which modifies the policy in terms of the cover being afforded by the insurer
equitable premium	the rule that each person wishing to join an insurance pool must be prepared to make a fair contribution
excess/deductible	first part of each and every loss that is the responsibility of the insured; these terms are interchangeable in some sectors of the market
excluded (excepted) peril	a cause specifically listed in the policy as not being covered
exclusion (exception)	policy provision that defines circumstances or types of loss that are not covered
exposure measure	the basis to which rates are applied to determine premium
express conditions	terms that are set out in the wording of an insurance policy
facultative reinsurance	a type of reinsurance cover for individually large or unusual risks that are typically excluded from standard reinsurance treaties
financial risk control	a mechanism for either retaining risk (self-insurance) or transferring it by contract or insurance
Financial Services and Pensions Ombudsman	statutory body for insurance customers to refer complaints about the conduct of a regulated financial service provider
first loss cover	insurance cover in which the insurer agrees to insure property for a lesser sum than its replacement cost
franchise	a minimum amount of loss that must be incurred before insurance coverage applies. Similar to an excess except that once the amount of the franchise is exceeded, the whole of the claim is paid

fraud condition	claims condition stating that all policy benefit is forfeited if a claim is in any way fraudulent or if fraudulent means are used to obtain a benefit, or if wilful damage is caused
frequency	how often an event will (or is likely to) happen
fundamental risk	a risk that arises from social, economic, political or (sometimes) natural causes and is widespread in its effects
general insurance	any type of insurance other than life insurance; across the EU this is commonly known as 'non-life insurance'
geocoding	compiled geographical information relating to a particular area for use in decision making
hazard	any feature that influences the operation of a peril, either in its likelihood of occurrence (frequency) or its severity
Health Insurance Authority	a statutory regulator of the private health insurance market; established in 2001 under the **Health Insurance Acts**
homogeneous risks (exposures)	the existence of a number of risks with similar profiles or characteristics, e.g. in terms of frequency and severity patterns
hybrid policy	policy that contains elements of both indemnity and benefit cover
implied conditions	terms that are assumed to be part of an insurance policy even though they may not have been written into the policy
implied duties	duties imposed on the policyholder at common law, whether or not they are actually found in the policy wording
indemnity	financial compensation sufficient to place the insured in the same financial position after a loss as they enjoyed immediately before the loss occurred
independent liability method	means of apportioning losses where the contribution applies in proportion to the independent liability under each policy
independent perils	unlinked causes that arise separately without one inevitably leading to the other
injunction	court order requiring that a person act in a particular way (mandatory or prohibitive)
inner limit	an indicator of the largest payment that will be made under a specific insurance policy heading (expressed either as a monetary amount or a percentage of another limit)
insurable interest	the legal right to insure arising out of a financial relationship recognised at law between the insured and the subject matter of insurance
insurance intermediary (intermediary)	any person or firm, other than an insurer/reinsurer or their employees but including an ancillary insurance intermediary, which, for remuneration, takes up or pursues the activity of insurance distribution and is subject to the **Insurance Distribution Regulations 2018**
Insurance Ireland	an industry body that represents Irish life and non-life insurers
insurance premium government levy	tax applying to most general insurances, where the insured risk is located in Ireland, but does not apply to reinsurance contracts, private health insurance policies, export credit insurance, aviation and transit insurance and certain marine and dental insurance policies

Insurance Compensation Fund	Irish insurance guarantee fund (financed by a levy on most non-life insurance policies) designed to protect consumers of authorised non-life insurers that go into liquidation and are unable to pay insurance claims
insured peril	a potential cause of loss or damage that is listed in the policy as being covered
insured/policyholder	a person or firm that has arranged a contract of insurance with an insurer
insurer	a regulated, risk-carrying entity (provider of insurance products)
interdependent perils	linked causes, in that neither peril operating on its own would have caused the damage
law of large numbers	the larger the number of similar-type events that occur, the more likely the outcome will match the expected result
liability	being legally responsible for something, e.g. an accident or an injury to a third party
lifetime community rating	the older a person is when they take out private health insurance, the higher the premium they will pay; however, the premium may not subsequently be increased to reflect the person's advancing age
lifetime cover	private health insurance principle stating that subscribers have a statutory right to change insurer and not be refused cover
limit of indemnity	insurer's maximum liability for any one incident (usually) under the terms of a liability policy or section of a policy
Lloyd's syndicates	a syndicate made up of one or more members of the Lloyd's market, who join together as a group to accept insurance/reinsurance risks. Each syndicate tends to specialise in a particular type of insurance and is staffed by expert underwriters/insurance professionals
loss adjuster	independent expert in processing claims from start to finish
loss assessor	expert in dealing with insurance claims, appointed by the insured to prepare and negotiate a claim on their behalf
material damage	the physical loss or damage to property
material fact	a fact that would influence the judgement of a prudent insurer in fixing the premium or determining whether to take the risk
maximum liability method	means of apportioning losses where the contribution applies in proportion to the maximum amount of cover available under each policy
misrepresentation	untrue statement of fact, either innocent, negligent or fraudulent, made during negotiations
mediation	process of settling a dispute between an insurer and an insured arising from certain types of insurance claims
moral hazard	factors concerned with the attitude and conduct of people (in insurance, usually the person insured but also the insured's employees and that of society as a whole)
more specific insurance clause	exclusion of cover where a loss is covered by another, more specific, insurance policy
Motor Insurers' Bureau of Ireland	body set up between motor insurers and the Government, which aims to ensure that innocent victims of road accidents are properly compensated in circumstances where no effective motor insurance is in force

negligence	failure to take reasonable care in certain circumstances
neighbour	in the context of tort, a person that we should have been thinking about or bearing in mind when considering a course of action
'new for old'	cover providing replacement of lost or damaged items with new equivalent versions
new intervening act or cause *(novus actus interveniens)*	refers to a situation where the sequence of causation is broken and something entirely new happens to bring about the loss
no claims discount	a reduction of premium for successive claim-free years, which increases each year up to a maximum of (usually) 5 years, held in consumer's own name
non-contribution clause	generic term for a variety of clauses that restrict the operation of a rateable sharing of losses
non-disclosure	failure to volunteer information (in a non-consumer insurance context, material facts)
notification condition	claims condition that sets out the duties of the insured with regard to notifying the insurer on the occurrence of the event insured against
nuisance	unreasonable interference with, disturbance of, or annoyance to another person in the exercise of their rights
objective test of reasonableness	a test in which the conduct of the defendant is compared to that of a reasonable person under similar circumstances
open enrolment	in private health insurance there must be no discrimination on grounds of age, sex or state of health, with the exception of waiting periods in respect of pre-existing conditions
open membership undertaking	a private health insurer that must accept any customer who seeks to take out cover
operative clause	clause(s) that describes the standard scope of cover of each section of an insurance policy
own damage	damage done to the insured vehicle/property
particular risk	a risk that is localised or even personal in its cause and effect
peril	event or occurrence that gives rise to a loss or liability
Personal Injuries Assessment Board	independent statutory body set up to assess compensation due to an injured party when someone else is to blame for the injury. To be renamed the Personal Injuries Resolution Board under the **Personal Injuries Resolution Board Act 2022**.
physical hazard	the physical aspects of a risk that increase the likelihood or probability of a loss occurring and which directly impact on the risk's insurability or on the terms, conditions and exceptions on which insurance may be provided
physical risk control	physical measures undertaken to eliminate or reduce risks faced by a firm or individual
premium rate	a rate (usually expressed per €100 or €1,000) applied by the insurer to the value of the exposure measure when calculating the premium to be quoted
prima facie	refers to how a thing looks on its first appearance
private nuisance	nuisance in relation to the ownership or occupation of land

profit	the difference between the total income (revenue) of the business and the total running costs (operating expenses) associated with the continued operation of the business
prohibitory injunction	a court order to refrain from doing a particular act
proposal form	type of questionnaire, asking questions about subject matter of insurance
proposer	person or firm applying for insurance
proximate cause	main or dominant cause of the loss or the cause that is most powerful in its effect
public nuisance	the carrying on of an activity, which is likely to cause inconvenience or annoyance, to the public or a section of the public, or interference with a right common to all
pure risk	a risk where there is the possibility of a loss but not a gain, where the best that can be achieved is a break-even situation
questionnaire	specially constructed form used by insurers to deal with commonly encountered hazards for groups of risks
rateable proportion	where there is more than one insurance policy liable for a loss and the insurers concerned only pay their share of the loss
recital clause (preamble)	scene-setting clause that refers to the parties to the contract, premium, indemnity and (in non-consumer insurance contracts) may confirm the proposal (if any) as the basis of the contract
reinsurance	insurance of an insurance company, e.g. against large insurance losses
reinsurer	a firm that takes on all or part of the risk covered under a policy issued by a primary insurer in return for a premium
remedies	the ways in which a wrongful act can be addressed and rectified/ compensated for, on behalf of the injured/affected party
remote cause	a cause that only makes a minor contribution to the loss or is not considered to have been significant in arriving at the loss
risk	uncertainty of future events and their outcome
risk-averse	a desire on the part of an individual or company to minimise the risks to which they are exposed, either through risk management or insurance
risk equalisation	a process that aims to equitably neutralise differences in insurers' costs that arise from variations in the age profile of the individuals they insure
risk improvement recommendation	a recommendation to improve the standard of the risk which, if completed, may lead to a premium discount
risk improvement requirement	requirement insisted on by the insurer as a condition for accepting the risk
risk pooling	basic concept of insurance – that the losses of the few are met by the contributions of many
risk retention	when an individual or organisation takes responsibility for a particular risk (or part of a risk) it faces. Instead of transferring that risk to a third party (by means of a contract) or to an insurer (by purchasing insurance), the losses or liabilities will be borne by the individual or organisation themselves.

risk-seeking	a willingness on the part of an individual or company to accept certain risks
risk-transfer mechanism	acceptance of unknown future liabilities by an insurer and the transfer of the uncertainty of potential future claims by the insured for an agreed premium
Road Traffic Act 1961	The 1961 Road Traffic Act introduced the compulsory third party motor insurance in order to protect the innocent victims of road accidents against death, injury and damage to their property. Subsequent Road Traffic Acts outline where exemptions apply to the compulsory insurance requirement and also outline the minimum cover required in Ireland and throughout the EU
***Rylands v Fletcher* (1868)**	a legal principle whereby somebody is strictly liable for the non-natural use of land resulting in the escape of something that causes damage or harm to another
schedule	tailored section (of a policy) that provides the policy number and all variable information about the policyholder, period, premium and subject matter, and highlights any special terms, conditions or exclusions that apply
severity	the seriousness (size/consequences) of an event (also referred to as 'impact')
specialist insurer	an insurer that offers a specific type(s) of insurance business not commonly offered in the wider insurance market
speculative risk	a risk where there is a possibility of a loss, break-even or a gain
statement of fact	document generated by an insurer, recording the answers given by a proposer to a telesales operator or insurance intermediary or on a website in response to specific questions asked in response to an enquiry for a quotation
strict liability	liability held by a person even though their actions are neither intentional nor negligent
subject matter (of the contract)	the financial interest a person has in the item, liability or event insured
subject matter (of the insurance)	item or event insured (e.g. car, house, valuables, factory stock, or liability for acts of negligence)
subrogation	the right of an insurer, following payment of a claim, to take over the rights of the insured to recover payment from a third party responsible for the loss
sum insured	maximum amount the insurer will pay out in the event of a total loss claim
suspensive condition	condition that, if breached, suspends the insurer's liability for the period of the breach (from the date of the breach up until it has been remedied)
technical provisions/ reserves	reserves held so that assets are matched with known and estimated future claims liabilities and associated expenses
telematics	driving related information (e.g. speed, distance, braking patterns, time of driving etc.) which is transmitted to the insurer and used to assess and price the motor risk
tort	a civil wrong remedied by the award of damages or other appropriate legal remedy, as opposed to a criminal act penalised by punishing the offender
treaty reinsurance	a pre-negotiated agreement between the primary insurer and the reinsurer, whereby the primary insurer agrees to cede all risks within a defined class or classes to a reinsurer and in return, the reinsurer agrees to provide reinsurance on all risks ceded without individual underwriting

trespass	intentional interference with people, goods or land
underinsurance	where the declared value on a risk is less than the full value required as the basis for cover and policy limits are insufficient to cover the full value of future potential claims
underwriting	process of risk pooling, risk selection (choosing who and what to insure) and assessment of individual risks that meet the insurer's risk criteria
uninsured peril	a peril/cause not mentioned in a policy that is structured as a named contingency policy
unnamed peril	a cause not mentioned in the policy
utmost good faith	concept in non-consumer insurance contracts that consists of the positive duty to voluntarily disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not
visitor	a person who is lawfully on the occupier's premises either by invitation of, or with the permission of, the occupier or a member of their family
waiting periods	specified periods of time following the start of a private health insurance policy during which particular policy benefits are not available to the insured
waiver of rights	an insurer's loss of rights to information as material facts, having been alerted to a possible problem and failed to follow it up
warranty	term (in a non-consumer insurance contract) that, if breached, permits the insurer to automatically void the contract as a whole
white labelling	insurance products underwritten by an insurer but marketed to a retailer's customers as its own product

Formulas

Chapter 4B1: Premium calculation

The formula used to calculate the premium is:

Exposure measure (sum insured) × premium rate

Chapter 8C1f: Pro rata condition of average

The formula used to calculate the claim payable (the liability of the insurer) in the event of underinsurance is:

$$\frac{\text{Sum insured at time of loss}}{\text{Value of risk at time of loss}} \times \text{Amount of loss}$$

Chapter 8G3a: Maximum liability method of contribution calculation

The formula used to calculate each insurer's contribution is:

$$\frac{\text{Policy sum insured}}{\text{Total sum insured (under all policies)}} \times \text{loss}$$

Chapter 8G3b: Independent liability method of contribution calculation (simplified version)

The formula used to calculate each insurer's contribution is:

$$\frac{\text{Policy sum insured}}{\text{Total value at risk}} \times \text{loss}$$