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# The Principles of Insurance & Why They Are Important

5 minute read

FCA Compliance



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The insurance industry is built upon seven principles. We examine the principles of insurance and why they are crucial for a robust and reliable insurance sector.

The seven principles of insurance govern the relationship between insurers and policyholders. These guidelines ensure fairness, transparency, and the proper functioning of the insurance market.

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## What are the principles of insurance?

The seven core principles underpinning the insurance industry are:

1. [Utmost good faith](#)
2. [Insurable interest](#)
3. [Proximate cause](#)
4. [Indemnity](#)
5. [Subrogation](#)
6. [Contribution](#)
7. [Loss minimisation](#)

They have evolved over the years, with some dating back centuries. However, they were formalised and codified into modern insurance law through various legal developments. Many of these principles were established through English common law case precedents dating back to the 18th and 19th centuries.

However, more recently, specific legislation - such as the [UK Insurance Act 2015](#) - codified and updated these principles to reflect contemporary legal and market conditions.

They have become integral to the insurance industry and are now considered fundamental to the operation of insurance contracts. Learn more about each of them in more detail below.

### 1. Utmost good faith

A mandate of the highest degree of honesty and fair dealing between the insurer and the insured. Both parties are expected to disclose all material facts relevant to the insurance contract. Any [misrepresentation or concealment of information](#) can lead to the voiding of

the policy.

This principle ensures that the insurer has a clear understanding of the risks involved and can accurately assess the appropriate premium.

## 2. Insurable interest

The insured party must have a financial stake in the property or life being insured. This means that the insured would suffer a direct financial loss if the property were damaged or the life was lost. Insurable interest **prevents fraudulent claims** and ensures that the insurance is being used for its intended purpose.

## 3. Proximate cause

This establishes the direct link between the insured event and the loss suffered. The loss must be a natural and foreseeable consequence of the insured event. If there are intervening factors that break the chain of causation, the insurer may not be liable for the loss.

## 4. Indemnity

Indemnity aims to put the insured in the same financial position as they were before the loss occurred. This means that the insurer will compensate the insured for the actual loss suffered up to the policy limit. The insurer will not make a profit from the loss, and the insured will not be overcompensated.

## 5. Subrogation

This allows the insurer to step into the shoes of the insured and pursue legal action against a **third party who caused the loss**. This helps to recover the amount paid out to the insured and prevents the insured from receiving double compensation.

## 6. Contribution

If an insured item is covered by multiple policies, each insurer is liable for a proportionate share of the loss based on the coverage amount they provided. This prevents the insured from profiting from their loss by claiming more than the actual value of the damaged property.

## 7. Loss minimisation

The insured party must take reasonable steps to prevent or minimise the loss after an insured event occurs. This includes actions like contacting emergency services, securing the property,

and preventing further damage. Failure to do so may result in reduced coverage or denied claims by the insurer.

## Why are the principles of insurance important?

The **principles of insurance** play a vital role in ensuring the stability and fairness of the insurance market. They provide a framework for the relationship between insurers and policyholders, protecting the rights of both parties.

By adhering to these principles, the insurance industry can maintain public trust and confidence. This knowledge is essential for:

- **Fair and transparent insurance contracts** - The principles of insurance ensure that contracts are clear, unambiguous, and free from unfair terms.
- **Accurate risk assessment** - By understanding the principles of insurable interest and duty of disclosure, insurers can accurately assess the risks involved and set appropriate premiums.
- **Prevention of fraudulent claims** - The principles of utmost good faith and insurable interest help to prevent fraudulent claims and ensure that insurance is used for its intended purpose.
- **Effective dispute resolution** - In the event of a dispute, the principles of insurance provide a clear framework for resolving claims and ensuring that both parties are treated fairly.

## Understanding the UK Insurance Act 2015

The UK Insurance Act 2015 **modernised insurance law**, bringing greater clarity and fairness. Key changes include:

### Representations

Replaced warranties, allowing for more flexibility in contract terms. This shift recognises that not all statements made by an insured need to be strictly true to be valid.

### Materiality

Established a clearer test for determining the **significance of undisclosed information**. This test helps to ensure that insurers only consider information that is truly relevant to the risk

being insured.

### Claims payment

Clarified insurers' obligations and insureds' rights regarding claim settlement. This provides greater certainty for both parties and aims to streamline the claims process.

### Contract termination

Provided clearer rules for the [termination of insurance contracts](#). This helps to protect the interests of both insurers and insureds by ensuring that termination can only occur in specific circumstances and under fair conditions.

### Remedies

Introduced new proportionate remedies for both insurers and insureds in case of disputes. This allows for more flexible and equitable solutions to disputes, avoiding disproportionate penalties.

## What is duty of disclosure: UK Insurance Act 2015?

The duty of disclosure compels both the insurer and the insured to [reveal all relevant information](#) about the insurance contract. This includes details about the property being insured, the insured's health, and any prior claims or convictions. Failure to disclose material information can result in the insurer voiding the policy.

These reforms have streamlined insurance practices, fostering better relationships between insurers and policyholders.

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