

Indemnity: not worse, not better, but similar

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It is a well-known truism that like income tax, paying premium for insurance of property is considered a grudge payment; paying for something and not receiving anything in return.

There is often a perception, normally following an isolated negative claims experience, that claimants are being “ripped off”. In return for a premium, insurance provides a promise to compensate an insured following certain defined events which may occur. Very often it provides only peace of mind if the loss does not occur; in the event of a loss occurring, the policy terms and conditions come into play and it is at this stage misunderstandings and disputes are most likely to arise. It is only at this critical stage that the promise is really tested.

Failure to restore to the pre-loss position has often resulted in dissatisfied and disgruntled claimants. Treating Customers Fairly (TCF) has been introduced by the regulatory authorities and service

providers have been “reined in” with the focus on ensuring that fairness prevails; this is an attempt to codify the behaviour and responsibilities of insurers to ensure that clients are not unfairly prejudiced. In the light of TCF regulation it is important that one of the fundamental principles of insurance, indemnity, is revisited so that practitioners are aware of its application and how it can assist in achieving fairness.

Indemnity is a cornerstone of insurance practice and is well known in the industry and features prominently following loss of or damage to property and claimants need to be fairly compensated for losses they have suffered. Through the principle of indemnity, claimants are placed in the same position enjoyed prior to the loss. Indemnity is referred to in the preamble of policy wordings and cites the circumstances in which the policy will operate incorporating the terms, exceptions and conditions that are applicable. This is achieved in one of the following ways:

- 1) By cash payment, or at the option of the Insurer by
- 2) Replacement
- 3) Reinstatement
- 4) Repair

Although this appears fairly straightforward it is not always easy to achieve indemnity as there are other factors that must be taken into account. The sum insured value, for example must be adequate and represent the current replacement cost of the insured property. It is obvious that if the insured value is understated true indemnity cannot be achieved leading to unhappy and disgruntled clients.

Other factors that must be taken into consideration when indemnifying claimants are the principles of

Contribution and Subrogation. Bearing in mind that a claimant must be placed in the same position enjoyed prior to incurring the loss or damage if Contribution / Subrogation is ignored, the claimant could benefit from the loss which goes against the principle of indemnity.

Contribution following dual insurance, occurs when more than one policy exists covering the same subject matter (property) and the principle is that a claimant cannot benefit by claiming under both policies for the same loss. In practice, the claim is normally dealt with under one policy and the additional policy(ies) are called to contribute to the loss – all things being equal it means that each policy contributes its fair share of the loss and indemnity is achieved – the claimant is in neither a worse nor better position than before the loss occurred.

Subrogation, also following a loss, is the right embodied in the policy wording, accruing to the company after indemnifying the claimant. If a third party was responsible for the loss or damage, then the right of recourse is transferred to the insurer and exercised by the company against that third party. The insurer, having indemnified the insured, now tries to recover its outlay from the negligent party. In the absence of subrogation, a claimant could recover from the company and then claim from the responsible party too, ending up better off than prior the loss – the principle of indemnity would therefore be compromised.

By applying the principle of indemnity regardless of the method chosen by the Insurer it seeks as far as possible to place claimants in the same or similar position enjoyed prior to incurring the loss or damage – NOT WORSE OR BETTER.