BASIC PRINCIPLES OF TRAVEL INSURANCE

After reading this document on basic Principles of Travel Insurance you will be able to -

- explain the purpose of insurance
- list the elements of risk
- differentiate between peril and hazard
- summarise the cycle of insurance
- recall the key insurance principles

1. Purpose of Insurance

What is insurance? Have you ever asked yourself that question? You may have travel insurance, car insurance and home insurance but have you ever thought about what insurance really is?

For example, if we have to cancel our holiday/trip the insurance will reimburse us for any financial loss. Insurance is there to indemify us if we suffer a loss due to an unforeseen event.

2. Definition of Insurance

An agreement by which one party promises to reimburse another party in the event of a loss, theft or damage to property, personal injury or death. A service that offers financial reimbursement for something that may or may not happen.

Insurance replaces the unknown risk or loss with a known cost. This known cost is called 'the insurance premium'. Insurance companies are professional risk takers and insurance is a risk transfer mechanism.

3. Insurance Premiums

The insurance company as a professional risk taker will gather together premiums from people all wanting to be protected against the same or similar risks. The insurer retains these premiums and will pay any claims made by people who have paid the premium. All policies must have a Statement of Price confirming the total amount payable by the Insured including any applicable government tax. The government tax applicable to retail holiday travel insurance is known as Insurance Premium Tax and is currently 20% of the cost of the policy paid by your customers.

4. Risk Factors

The insurance company will calculate the premium and cover levels dependent upon the risk.
So, how does an insurance company decide what risks they should and should not take? Insurance companies divide risks into three components. Those three components are –

- Uncertainty
- Level of risk
- Peril and hazard

5. Uncertainty

If we knew what was going to happen then there would be no element of risk involved and therefore we would have no need for insurance.

6. Level of Risk

For each risk that is covered by a travel insurance product there is a different level of risk rating involved. Some risks are more likely to happen than others and are rated accordingly.

7. Peril and Hazard

A peril will give rise to any loss, for example, medical emergency or loss of gagge.

A hazard will influence the operation of that peril. A hazard can increase or decrease the effect of that peril.

8. The Insurance Principles

When we think about travel insurance policies we should think about them as legal contracts. In simple terms a contract is an agreement between two parties, one of whom agrees to perform a certain act if and when the other party performs a certain act. If we look at them in terms of insurance the agreement is between the insurer and the insured. The insured agrees to pay a premium to the insurer. The insurer agrees to pay a sum of money on the occurrence of a specific event to the insured, subject to the terms of the Policy. As well as the agreement for the contract to be valid there must be an offer, an acceptance and consideration. Offer and acceptance is when one party makes an offer which the other party accept. There are certain conditions under which an offer may be accepted on a contract. There are –

- Unconditional – the acceptance is final and without further conditions
- Conditional – the acceptance is subject to specific conditions which must be agreed before signing.

9. Consideration

Not only does there have to be an offer of acceptance but there also has to be consideration for the contract to be valid. Consideration can be described as each person's side of the agreement which supports the contract. Money is the most common form of consideration and in insurance we refer to the insurance premium as the insured's consideration.

10. Insurable Interest

Insurable interest is an element necessary to create a valid insurance contract. A definition of insurable interest is –

In order for a risk to be insurable the applicant must have an insurable interest in the item or event to be insured and suffer a financial loss as a result of the risk occurring. For example, if you own a digital camera you would have an insurable interest in the camera as you would consequently suffer a financial loss if it was stolen. However, if your best friend has a camera which he or she owns outright which you have borrowed to use on your holiday/trip, you do not have an insurable interest in it as you would not suffer a financial loss if it was stolen.

11. Material Facts

The parties to an insurance contract have a duty of honesty to disclose any material facts that may influence the insurer’s decision to decide whether they wish to accept the risk and at what terms and conditions should be applied. For example –

- Pre-existing medical condition
- Occupation eg: members of the Armed Forces

This principle applies equally to both the insured and the insurer throughout the contract negotiations. People selling travel insurance policies must give full and correct information to the applicant. Nothing said should be incorrect or misleading.

12. If a claim is made

If a claim occurs the insurance company has to determine if the proximate cause of the claim is insured under the policy. The proximate cause is the first event in a chain of events that gives rise to a claim.

For example – if we look at a baggage claim and your baggage is lost or stolen whilst in the hands of the airline this would be the proximate cause of the loss. If, however, you left your baggage unattended in the lobby of the hotel, the proximate cause of this claim may be deemed to be your negligence, as you may not be complying with the terms and conditions of your policy.

13. Indemnity

Indemnity means that the insured must be placed back in the same financial position they were in immediately prior to the loss. Therefore, when a loss is settled and the claim is paid the insured cannot recover more than the financial loss they have actually suffered.

14. Subrogation

Subrogation is when an insurance company has the right to stand in the place of the insured to recover any payment from the responsible third party that the insurer has paid to their insured.

For example – if you are admitted to a hospital for medical treatment after an accident on your holiday/trip solely caused by the responsible third party which results in a claim, Subrogation allows your insurer to try and recover costs from any third parties involved in your accident. E.g. non fault vehicle accident.

15. Contribution

Contribution arises when there is more than one policy covering the same risk.

For example – an insured may have some travel insurance which will cover him whilst on holiday. However, his household insurance may also provide some cover whilst away from home for the same items. As we’ve already discussed, the principle of Indemnity states that the insured cannot recover more than the financial loss he has actually suffered. He can therefore only recover the total value of the loss sustained, no more.

Contribution allows each insurer to share the cost of the loss fairly, whereby each insurer only pays for their rateable proportion.