

**FIRST LOSS POLICY ON NON-LIFE INSURANCE CONTRACT:
COMPARATIVE STUDY OF NEW ZEALAND, JAPAN AND THAILAND**

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Abstract

According to the proportion of under-insurance products has been demanded and provided in the present market. In case of partial loss, the compensation will be sensitively deducted upon the components of the Average Clause. The compensation will be decreased once there is any alteration upon the formula. The actual value of the insured asset is the most problematic fact in accordance with the failures of the insured and insurer, and also other relevant issues. These factors currently lead a number of insufficient compensation claims in Thailand.

This article presents the First Loss methodology that make the insured accurately understand and simply access the coverage. As it is the most suitable tool in order to raise the sustainable awareness of sharing risks amongst the people. For raising certainty to the people, Thailand should enact concrete regulations as same as in New Zealand. In the same way of Japan, the laws have been altered to be fit into the current situation. Additionally, an effective enforcement is another factor to support the insurance market in the country.

Keywords: Insurance, Compensation, Indemnity, First Loss, Under-Insurance

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1. Introduction

The under-insurance has been applied into the various types of insurance on the ground of the decline of financial situation and the downgrade of the total loss occurrence. It has a low premium compared to the full valued insurance; however, there are many concerned issues due to the application of Average Clause when the partial loss occurred. The application of the formula of average in under-insurance consisted of many factors which may cause to the insureds not to receive the sufficient amount of compensation.

It could be additionally clarified in the fact that: Mr. A owns the insured asset values at THB 1,000,000 at the commencement of contract, in the meantime of the insurance there is the actual loss from flood at THB 300,000. The compensation upon the under-insurance will be calculated following the Average Clause formula. Although the maximum sum for flood loss in the policy is set at THB 300,000, but he will receive the compensation in the amount of less than that. The calculation of $\left(\text{Loss} \times \frac{\text{Amount of Sum Insured}}{\text{Actual insurable value at risk}} \right)^1$ as $300,000 \times \frac{300,000}{1,000,000}$ equals at only 90,000. Therefore, Mr. A will receive the compensation of the loss is at THB 90,000 due to the application of Average Clause and in accordance with the burden of THB 210,000 for self-indemnity of the loss.

The actual value of subject matter is the easiest factor to be altered when the loss occurred. The inflation or deflation of the amount of the value will impact to the compensation. The more actual value has changed, the more compensation will be reduced. The point is that

¹ Financial Ombudsman Service, 'Under Insurance in household insurance complaints' <https://www.financialombudsman.org.uk/publications/technical_notes/under-insurance-household.html> accessed 3 March 2018

there are a number of insureds who do not understand this unique concept of under-insurance. As a result of the claims, many complaints had been brought into the dispute procedures on the matter that they did not receive enough amount of compensation as they should receive.

In Thailand, many problems have continually occurred in the present such as the claim of the inadequacy of compensation due to the under-insurance policy, ranked one of top 5 in 2015 through the Office of Insurance Commission of Thailand (OIC). However, there is an alternative methodology to deal with this concern which called First Loss.

2. What is First Loss?

First Loss is an insurance condition that the policyholder and the insurer agree to receive the insured coverage being lower than the actual value of the insured property by accepting a maximum Sum Insured per a loss for a certain module of an insurance. The essence is that the calculation of compensation under the First Loss policy will be excluded an Average Clause when the loss occurred. To explain clearly about the difference of compensation between the First Loss policy and the normal under-insurance policy could be clarified upon the same partial loss fact of Mr. A prior. If Mr. A has an insurance under First Loss for flood loss at THB 300,000, he will be compensated at the amount of THB 300,000 explicitly without any applications of Average Clause. If damages overs the Sum Insured, Mr. A has to bear for the exceeded amount by himself.

3. Status of First Loss and Under-insurance under Thai Laws

The scheme of insurance has presented in the narrow aspects due to the insufficient knowledge and loop hole of laws. A number of

consumers as being insureds have claimed for the unfair compensation though the Office of Insurance Commission of Thailand. The occurrence of this issue has shown as it is one of the most claims of non-life insurance in 2015.² Besides, the notable flood disaster in 2011 in Thailand, the study³ shows that there was only 7% of 600 interviewees from the disaster area, had the insurance for the loss. Surprisingly, although they believe that the severe disaster will reoccur in 5 years, there was only less than 50% of each, they would be willingly to purchase an insurance for disaster.

4. Directory of First Loss and Under-insurance

In regard to the complicated technical terms and applications of insurance, the exclusion of Average Clause in First Loss policy will help the insureds be able to easily understand the coverage and the amount of compensation that they will exact receive when the loss occurred. To support this benefit, it has shown in Section 15 of the Insurance Law Reform Act 1985 of New Zealand that stipulates the prohibition on inclusion of condition of average in contract of insurance relating to dwelling.

In the terms of First Loss policy, the insured is also the self-insurer to himself in some proportion of the sum insureds. The more actual loss occurred the more amount, the insured has to self-indemnify, the maintenance of the insured subject is the method to

² The Office of Insurance Commission, 'News' (2015) <www.oic.or.th/th/consumer/news/releases/85268> accessed 26 April, 2018

³ Orapan Nabangchang, Hermi Francisco and Aini Zakaria, 'Thailand's 2011 Flood: Household Damages, Compensation and Natural Catastrophe Insurance' (2014) Vol. 13 CUBR <<http://www.davidpublisher.org/Public/uploads/Contribute/5508ef6ba38d2.pdf>>

manage the risk. This interaction of the insureds will therefore support the insurer to control the loss not to be severe.

In the fact that the premium cost of First Loss policy is not expensive as full value insurance, this product will help the pool of insurance to be strengthened by providing the alternative coverage to the consumers especially for the low and middle population who earn limit income. Furthermore, the cost of survey in order to calculate the actual loss will be more easily handled than the other insurance due to the simple and exact amount compensation scheme of First Loss per se. The insurer limits the expenses in order to hire the adjuster within the shorten time. The compensation will therefore indemnify to the insureds in the fair period and get rid of the claims of the delayed compensation afterwards.

5. Analysis of First Loss Application

According to the study, it could be concluded that the Average Clause is not a taint by itself; instead, the lack of the information and misunderstanding of the insureds are the issues to be concerned. It could be said that the communication and the access of the information in the present between the parties are considerably impaired. The Theory of Contract by Oliver Hart and Bengt Holmström emphasizes that the most problematic factor that raises a number of disputes on unfair contracts caused by the asymmetric information amongst the parties. There is none of the equal reciprocal contracts in this modern era since the well-designed contracts are exposed to be as the credit agreement that specify the payment and decisive rights by prejudicial protecting the

lenders, Likewise, the insurance contracts have forcedly pushed the deduction to the insureds in order to undertake the risk.⁴

The application of First Loss condition in the policy will support the insureds in order to access the protection and receive the impartial compensation. The amount of the compensation will be explicitly stated at the first time of making a contract. The potentiality to improve the insureds understanding could raise by enforcing of scheme as to prohibit the Average Clause into the household dwellings insurance and promote the First Loss condition into the policy instead of the aforementioned normal under-insurance.

Regarding to the provisions of Thai law relating to non-life insurance and enforcement do not adequacy protect the insureds; the authority of the Office of Insurance Commission of Thailand (OIC) should be liable to enact the regulation to enforce the determent of Average Clause upon the household premises. Likewise, in New Zealand, Section 15 of Insurance Law Reform 1985 is the prohibition on pro rata condition or the Average Clause into every household's policy in order to control the calculation of compensation not to be injustice to the people in majority. The policy that against the provision shall be voidable automatically afterwards.

The OIC shall proclaim this concept upon the Non-Life Insurance Act B.E. 2535 according to the authority on Chapter 2 Supervision of the Company, Section 29 in accordance with Section 4 in references to control the condition into the non-motor policies and the scope of authority of the registrar. The prohibition should be firstly enforced to the dwellings upon the natural disaster insurances as the Japan has

⁴ Oliver Hart and Bengt Holmström, 'Contract Theory' (10 October 2016) KVA <<https://www.nobelprize.org/uploads/2018/06/advanced-economicsciences2016-1.pdf>> accessed 3 March 2018

applied the First Loss concept into the earthquake insurances to support and improve the protection of loss i.e. windstorm and flood according to the disaster of flood in 2011 and the monsoon catastrophe in Thailand.

6. Conclusion

As being an alternative choice to the customers in the market rather than the normal under-insurance, First Loss insurance has an uncomplicated and understandable concept that will strengthen the pool of risk for people in majority by persuading more people to involve into the insurance market. When the damages occurred, the power of the pool has the potential to partially insure the risks to the insureds in order to receive the full amount of agreed compensation without the Average Clause basis, with the proper premium rate which subsequently cheaper than full-valued insurance price. The aforesaid basis depends on the benefits of both of parties as the reasonable premium for the reasonable advantage under the reasonable agreement.

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