Department of Finance, Risk Management and Banking

LONG TERM INSURANCE

Only study guide for

RSK3702

Semester 1 and 2

University of South Africa, Pretoria

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CONTENTS

INTRODUCTION

We wish to extend a warm welcome to all students registered for the RSK3702 module in Long-Term Insurance.

This module is offered primarily in an online format. For those students who have difficulty following the online method of studying, hard copies of the study material will be made available as in the past. Your online study material is uploaded under Learning Units on the RSK3702 module site on myUnisa.

Please note that this module requires – and it is so designed – that you must dedicate at least 120 hours per semester to mastering the content and learning outcomes of this module. You may find the assignments and examination paper very difficult if you have not invested the required time in the subject.

AIM OF THIS MODULE

The aim of this module is to enable students to study the principles and nature of long-term insurance, and the structure and regulation of the industry from a risk management perspective.

MODULE OUTCOMES

At the end of the module, you should be able to

- demonstrate sufficient knowledge of long-term insurance products, retirement annuities, health-care products, and their pricing in order to relate personal needs to the most appropriate product
- demonstrate a basic understanding of the operation of and interrelationships in the long-term insurance markets by
  - illustrating these relationships
  - identifying industry bodies and explaining their role
  - providing arguments for and against regulating the long-term insurance industry and the duties of long-term insurers, subject to insurance legislation
- demonstrate a basic understanding of legal and tax issues related to life insurance by providing examples and general explanations, and performing basic calculations
- demonstrate effective administrative skills in the life insurance industry by explaining and applying the principles of underwriting, policy servicing and claims management
- In addition to teaching you technical skills, this module also aims to achieve the following general goals of a broad-based education:
- to encourage critical thinking, including moral and ethical reasoning (This module examines a number of logical, alternative choices that require critical thinking. A study of insurance invariably deals with a number of moral and ethical issues, ranging from the question of whether the insurance industry should be regulated to how the Aids problem should be handled.)
- to aid the understanding of human behaviour (The insurance transaction is the result of human interaction. Many risk management questions have psychological explanations such as what role human behaviour plays in preventing and causing losses.)

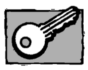
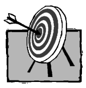
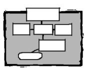
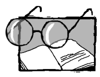
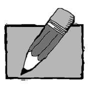
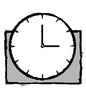
- to integrate knowledge across various disciplines (The study of risk management and insurance not only requires an understanding of business management, but also requires the application of some of the principles of economics, law and mathematics.)

We hope that you will enjoy the module.

Lecturer: Long-Term Insurance

THE USE OF ICONS

The icons that will be used in this study guide are as follows:

Icon	Description
	**Key concepts.** The key concepts icon draws your attention to certain keywords or concepts that you will come across in the topic or study unit.
	**Learning outcomes**. The learning outcomes indicate what aspects of the particular topic or study unit you have to master and be able to demonstrate.
	**Mind map**. Mind maps are provided to help you to see the relationships between various parts of the learning material.
	**Study**. This icon indicates which sections of the prescribed book or the study guide you need to study and internalise.
	**Read.** This icon will direct you to read certain sections of the prescribed book for background information.
	**Activity.** This icon refers to activities that you must do in order to develop a deeper understanding of the learning material.
	**Reflection**. This icon requires you to reflect on the important issues or problems dealt with in the study unit.
	**Assessment**. When you see this icon, you will be required to test your knowledge, understanding and application of the material you have just studied.
	**Feedback**. This icon indicates feedback on the questions asked in the self-assessment activities.
	**Multimedia.** The multimedia icon indicates that you have to refer to any audio, video, or DVD material that may be included in your study material. These will be placed on *my*Unisa website.
	**Time-out**. This icon indicates that you should take a rest, as you have reached the end of a study unit or topic.

TOPIC 1

The life insurance industry

This topic comprises learning units 1 and 2 as well as the self-assessment questions and answers for these learning units.

Learning unit 1

Long-term industry bodies that affect the life insurance intermediary

Contents

Learning outcomes

After you have worked through this learning unit, you should be able to

- list the industry bodies that affect the life insurance intermediary
- describe how the industry bodies, which affect the life insurance intermediary, are structured
- explain the main purpose of each of the industry bodies that affect the life insurance intermediary

Key concepts

— Financial Services Board (FSB)
— Association for Savings and Investment South Africa (ASISA)
— Life Insurance Ombudsman
— Financial Planning Institute (FPI)
— Insurance Institute of South Africa (IISA)
— Institute of Retirement Funds (IRF)

GETTING AN OVERVIEW

This learning unit deals with the first outcome of topic 1.

Insurance, like other commodities, is sold in a market place. People (the buyers) buy the insurance and companies (the sellers) sell the insurance. The insurance market has "middlemen" known as *intermediaries*. The buyers of life insurance are people, businesses and corporations. Life insurance companies, reinsurers and Lloyd's are the main suppliers of life insurance. This learning unit deals with the bodies that influence life insurance intermediaries in the industry.

1.1 FINANCIAL SERVICES BOARD

Study this section in chapter 1 of your prescribed book.

1.2 LIFE INSURANCE OMBUDSMAN

Study this section in chapter 1 of your prescribed book.

1.3 ASSOCIATION FOR SAVINGS AND INVESTMENT SOUTH AFRICA

Study this section in chapter 1 of your prescribed book.

1.4 INSURANCE INSTITUTE OF SOUTH AFRICA

Study this section in chapter 1 of your prescribed book.

1.5 FINANCIAL PLANNING INSTITUTE

Study this section in chapter 1 of your prescribed book.

1.6 FINANCIAL INTERMEDIARIES ASSOCIATION

Study this section in chapter 1 of your prescribed book.

1.7 ASSOCIATION OF BLACK BROKERS

Study this section in chapter 1 of your prescribed book.

1.8 INSTITUTE OF RETIREMENT FUNDS

Study this section in chapter 1 of your prescribed book.

1.9 PENSION LAWYERS ASSOCIATION

Study this section in chapter 1 of your prescribed book.

1.10 OTHER INTERMEDIARY GROUPS

Study the following section in chapter 1 of your prescribed book:

- Agency bodies

1.11 OTHER RELATED BODIES

Study the following sections in chapter 1 of your prescribed book:

- South African Reinsurance Offices Association
- South African Society of Insurance Medical Underwriters
- Association of Insurance Medical Officers of South Africa
- Pension Fund Adjudicator
- Ombud for Financial Services Providers
- Board of Healthcare Funders
- Council for Medical Schemes
- Insurance Sector Education and Training Authority

SUMMARY

This learning unit described the bodies operating in the long-term insurance market. The legal and tax issues related to the long-term insurance intermediary will be discussed in the next learning unit.

Assessment

(1) Answer revision questions at the end of chapter 1 of the prescribed book.
(2) Answer the written questions on chapter 1 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.

Feedback

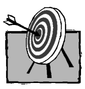
Answers to questions on chapter 1:

(1) The Financial Services Board is an independent statutory body established by government to oversee the financial services sector in South Africa.
(2) The subsectors include short-term and long-term insurance, pension funding, risk management, unit trusts, health-care benefits, funeral benefits, and reinsurance.

Learning unit 2

Legal and tax issues

Contents



Learning outcomes

After you have worked through this learning unit, you should be able to

- explain the concept "contractual capacity" and list parties who have no or a limited contractual capacity
- explain the amendments to the common law principle of contractual capacity brought about by the Long-term Insurance Act
- explain when insurable interest must be present
- provide examples of insurable interest applicable to life assurance policies
- explain the difference between caveat emptor and uberrima fides
- discuss the implications of the "reasonable man test" as it applies to life insurance policies
- explain how a lost policy document can be replaced
- briefly describe the legislative protection afforded to life insurance policies
- explain, in general terms, the miscellaneous restrictions and prohibitions that apply to life insurance policies and the marketing thereof (including maximum commission scales)
- discuss how the cause of death of a life insured may affect the payment of a claim
- explain, in some detail, the restrictions that apply when a new policy is issued
- describe a cession and how it applies to a life insurance policy
- explain the difference between an absolute cession and a security cession

- explain the rights of a beneficiary appointed in a life insurance policy
- discuss, in some detail, the unique position of a beneficiary nominated in a retirement annuity and the rights of this beneficiary
- explain the effect of the Income Tax Act 58 of 1962 on the employer and the employee if the employer owns a life insurance policy on the life of the employee
- list and provide a general description of other taxation issues that apply to a life insurer

Key concepts

— Beneficiary
— Capital gains tax (CGT)
— Caveat emptor
— Absolute cession
— Contractual capacity
— Insurable interest
— Mutual agreement
— Reasonable person test
— Security cession
— Uberrima fides

GETTING AN OVERVIEW

This learning unit deals with the second outcome of topic 1. The first part of this learning unit describes the legal issues relating to life insurance, and the second part specifies certain tax issues.

2.1 CONTRACTUAL CAPACITY

Study this section in chapter 2 of your prescribed book.

- Persons who have no contractual capacity
- Persons with limited contractual capacity

2.2 INSURABLE INTEREST

Study this section in chapter 2 of your prescribed book.

- When must insurable interest be present?
- Examples of insurable interest

2.3 PRINCIPLES OF AGREEMENT

Study this section in chapter 2 of your prescribed book.

- Mutual agreement
- Caveat emptor vs uberrima fides

2.4 LONG-TERM INSURANCE ACT 53 OF 1998

Study this section in chapter 2 of your prescribed book.

- Days of grace
- Protection of certain life policies
- Protection against creditors

2.5 MISCELLANEOUS RESTRICTIONS AND PROHIBITIONS

Study this section in chapter 2 of your prescribed book.

- Restricted insurance on children under 14
- Limited relief for misstatement of age
- Only the rate table given to the registrar may be used
- No discrimination
- No inducements
- No credit for the first year's premium
- Conditional selling
- Maximum commission scales

2.6 CAUSES AND CIRCUMSTANCES OF DEATH

Study this section in chapter 2 of your prescribed book.

- Death at the hands of the law
- Murder
- Suicide
- War service

2.7 RESTRICTIONS APPLICABLE TO NEW BUSINESS

Study the whole section in chapter 2 of your prescribed book.

2.8 CESSIONS

Study the section in chapter 2 of your prescribed book.

- Absolute cessions
- Security cessions
- Formalities attached to a cession

2.9 BENEFICIARIES

Study the section in chapter 2 of your prescribed book.

- Third party as a beneficiary
- Revocable nominations of beneficiaries
- Irrevocable nominations of beneficiaries

2.10 BENEFICIARIES AND RETIREMENT ANNUITIES

Study the whole section in chapter 2 of your prescribed book.

2.11 INCOME TAX ACT AND INSURANCE

Study the following sections in chapter 2 of your prescribed book:

- Employer
- Employee

2.12 OTHER GENERAL TAXATION ISSUES

Study the following sections in chapter 2 of your prescribed book:

- General overview
- Personal income tax
- Corporate tax
- Taxation of retirement funds
- Average and marginal tax rates
- Taxation of life insurance policies
- Donations tax
- Capital gains tax

2.13 POLICYHOLDER PROTECTION RULES

Study the following sections in chapter 2 of your prescribed book:

- Basic rules for direct marketers
- Cancellation of a policy by the insured
- Other rules and duties
- Assistance business group schemes
- Other requirements of the policy protection rules

2.14 FINANCIAL INTELLIGENCE CENTRE

Study the whole section in chapter 2 of your prescribed book.

- General

SUMMARY

The legal and tax implications related to long-term insurance were discussed in this learning unit. Topic 2 will introduce the most generally used life insurance products.

Assessment

(1) Answer revision questions on chapter 2 in the prescribed book.
(2) Answer the written questions on chapter 2 in the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.

Feedback

Answers to the questions on chapter 2:

(1) The following people have no contractual capacity:

- *people who are mentally ill*
- *people who are intoxicated*
- *minor children*

(2) In the case of short-term insurance, insurable interest must be present at the time the contract is agreed upon and when the claim is lodged. In the case of life insurance, the insurable interest only has to exist at the time that the contract is signed.
(3) No person is allowed to lend money or to provide credit and then insist that the loan or credit will be granted only if the borrower buys an insurance policy. However, it is acceptable to insist that some form of security for the loan or credit be provided. When a person borrows money or is granted credit, the following conditions apply:

a. The debtor can be required to provide security for the debt, taking the following into account:

i. his/her creditworthiness

ii. that the debtor is allowed to choose his/her own insurer and use his/her own agent
iii. all other relevant information (e.g. a guarantor)

b. When a new policy must be taken out, the following applies:

i. The policy must be reasonable in relation to the debt.
ii. The debtor must be allowed to choose his/her own insurer and use his/her own agent.

The type of policy may be limited to a policy that only pays a benefit on the death or disability of the life insured. If the borrower uses an existing policy, he/she must be allowed to use his/her own intermediary to arrange the security cession of the policy and to make changes that have to be effected to the policy (so that adequate security on death or disability is included).

To ensure that the above conditions are complied with the policyholder must confirm, in writing and before a security cession can be lodged with the insurer, that he/she

- *was given prior written notice of his/her freedom of choice as explained above*
- *exercised that freedom of choice*
- *was not subjected to coercion or inducement as to the manner in which that freedom of choice was exercised*

(4) Cessions for value received as a free gift and in accordance with an agreement.

TOPIC 2

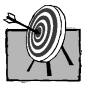
Life Insurance products

This topic comprises learning units 3 to 5 as well as the self-assessment questions and answers for these learning units.

Learning unit 3

Life insurance – a product introduction

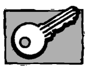
Contents



Learning outcomes

After you have worked through this learning unit, you should be able to

- explain the concept of probabilities and its impact on establishing a usable mortality table, and describe how a life insurance premium is calculated
- discuss the effect of Aids on future mortality rates
- identify the main expenses to keep in mind when a life insurance premium is determined
- explain the purpose of a valuation, and briefly describe the two valuation methods
- list and briefly describe the possible sources of a surplus when a valuation is undertaken
- describe how "with profit" policy owners can share in the surplus established after a valuation
- briefly describe how the owners of "linked" policies share in the investment returns of an insurer
- describe, in detail, how the "universal" concept works
- discuss the implications of a possibly negative review to the owner of a universal policy
- list and briefly describe other main types of policies that are still part of the portfolios of most life insurers



Key concepts

— Mortality tables
— Morbidity
— Prospective method
— Retrospective method
— "With profits" policy
— "Linked" policies
— The "universal" concept
— Decreasing term insurance
— Credit life insurance
— Whole life insurance
— Endowment insurance

GETTING AN OVERVIEW

This learning unit deals with the first outcome of topic 2.

Life insurance is based on a risk-pooling plan to handle the financial implications of premature death, transferring the risk from individuals to a group. Life insurance contracts differ from other insurance contracts in that the event against which insurance is taken out is an eventual certainty. However, this type of contract does not violate the requirements for an insurable risk because it is not the possibility of death that is insured, but premature or untimely death. This learning unit first looks at the principles of life insurance, and then at specific life insurance products.

3.1 PRINCIPLES OF LIFE INSURANCE

Study the following sections in chapter 3 of your prescribed book:

- Understanding insurance
- Types of life insurance

3.2 HOW A PREMIUM IS DETERMINED

Study the following sections in chapter 3 of your prescribed book:

- Application of mortality tables
- Impact of Aids on mortality rates
- Expenses
- Investments

3.3 VALUATIONS

Study the following sections in chapter 3 of your prescribed book:

- Purpose of a valuation
- Reserves
- Surplus
- Distribution to policy owners
- Supplementary or risk benefit policies

SUMMARY

This learning unit described life insurance products. We will now proceed to a discussion of retirement annuities in learning unit 4.

Assessment

(1) Answer revision questions at the end of chapter 3 of the prescribed book.
(2) Answer the written questions at the end of chapter 3 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.

Feedback

Answers to questions 1 to 6 in chapter 3:

(1) Aids will cause mortality rates to rise.
(2) The investment account is the account into which all premiums are paid.
(3) The "guaranteed period" is the period during which the premium rate for life cover will remain unchanged.
(4) A pure endowment policy provides a stipulated sum (with or without profits) at a future date if the policyholder is still alive at that date. The policy does not include life cover.

Learning unit 4

Retirement annuities, annuities and supplementary benefits

Contents

Learning outcomes

After you have worked through this learning unit, you should be able to

- list the rules that apply to a retirement annuity for approval by the Commissioner for Inland Revenue
- explain how to establish the maximum tax deduction permitted by an individual for contributions to a retirement annuity
- discuss the differences between a "voluntary" and a "compulsory" annuity purchase
- list and explain the different types of immediate annuities

Key concepts

— Retirement annuities
— Voluntary annuity
— Compulsory annuity
— Annuities certain
— Immediate single-life annuities
— Guaranteed annuities

GETTING AN OVERVIEW

This learning unit deals with the second outcome of topic 2.

Annuities are also called "upside-down life insurance". This refers to the reverse application of the law of large numbers in annuities compared to the application of this law in life insurance. According to the annuity principle, the law of averages operates to permit a lifetime guaranteed income to each holder of an annuity. Some people who reach age 65 will die before they reach 66. Others will live to be 100 years of age. Those who live longer than the average age will offset those who live for a shorter period, and those who die early will forfeit money to those who die later. Every payment the annuity holder receives is part interest and part principal. In addition, each payment is part survivor benefit in that it includes part of the funds of group members who have died.

Annuities may be classified in the following categories:

- voluntary annuity
- compulsory annuity
- annuities certain
- immediate single-life annuities
- guaranteed annuities

The distinctions among these classes of annuities are discussed in chapter 4 of the prescribed book.

4.1 INTRODUCTION TO RETIREMENT ANNUITIES

Study the whole section in chapter 4 of your prescribed book.

4.2 RETIREMENT ANNUITY FUNDS

Study the following sections in chapter 4 of your prescribed book:

- Definition and rules
- Deduction of contributions

4.3 ANNUITIES

Study the following sections in chapter 4 of the prescribed book:

- The difference between a "voluntary" and a "compulsory" purchase annuity
- Annuities certain
- Immediate single-life annuities
- Guaranteed annuities
- Examples of plans involving annuities

SUMMARY

Annuities, disability, dread disease benefit and permanent health care were discussed in this learning unit. Health care in South Africa will be discussed in the next learning unit.

Assessment

(1) Answer revision questions at the end of chapter 4 of the prescribed book.
(2) Answer the written questions on chapter 4 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.

Feedback

Answers to the questions in chapter 4:

(1) No more than one third of the total value may be commuted for a single payment.

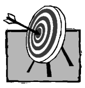
- *No person shall become entitled to the payment of an annuity after the age of 70 years, except disabled people.*
- *In case of death, before the member becomes entitled to the proceeds, the amount payable will be limited to the amount contributed.*

(2) An annuity paid by a pension fund is a compulsory annuity. A voluntary annuity is purchased by a person who is under no obligation to do so.

Learning unit 5

Health care and funding in South Africa

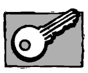
Contents



Learning outcomes

After you have worked through this learning unit, you should be able to

- list and briefly describe the role of private health-care providers
- describe current key issues facing the provision of health care in South Africa
- explain existing legal controls in the health-care industry
- explain the tax aspects that apply to the provision of health care
- list and describe the available health-care products
- describe the administration of health-care schemes in South Africa
- briefly explain key financial aspects of health-care schemes
- explain the concept of managed care in some detail
- list and describe the vehicles used in health-care management
- explain the concept of disease management



Key concepts

— Health care
— Health insurance plans
— Managed health care
— Managed care
— Co-payments
— Utilisation reviews
— Capitation
— Service bundling
— Networks
— Disease management

GETTING AN OVERVIEW

This learning unit deals with the third outcome of topic 2.

The health-care environment, and in particular key issues in this environment, is discussed in this learning unit. The discussion then proceeds to the regulation of health care and the products on offer, and then to two very important developments, namely managed care and disease management.

5.1 THE HEALTH-CARE ENVIRONMENT

Study the whole section in chapter 5 of your prescribed book.

5.2 FUNDING OF HEALTH CARE

Study the following sections in chapter 5 of your prescribed book:

- Covering medical costs
- Hospital cash plans
- Role of the government
- Private providers
- Key issues

5.3 LEGAL CONTROLS IN THE HEALTH-CARE ENVIRONMENT

Study the following sections in chapter 5 of your prescribed book:

- Legislative outline
- Medical Schemes Act, 1998
- Taxation
- Inspection of Financial Institutions Act and the FSB

5.4 HEALTH-CARE PRODUCTS

Study the following sections in chapter 5 of your prescribed book:

- Traditional medical aids
- Health insurance products
- Managed health-care systems
- Demarcation of health insurance and medical schemes

5.5 ADMINISTRATION OF MEDICAL SCHEMES

Study the following sections in chapter 5 of your prescribed book:

- Underwriting issues
- Administration of medical schemes
- Administration of health insurance plans

5.6 FINANCIAL ASPECTS OF HEALTH-CARE SCHEMES

Study the following sections in chapter 5 of your prescribed book:

- Costing principles
- Handling cross-subsidisation
- Prefunding

5.7 MANAGED CARE CONCEPTS

Study the following sections in chapter 5 of your prescribed book:

- Principles and issues
- Physician/provider behaviour models
- Vehicles in health-care management
- The "lifestyle management" concept

SUMMARY

The health-care environment was discussed in this learning unit. We will now proceed to topic 3 and a discussion of the administrative principles related to life insurance, annuities, hospital cash plans and medical cover.

Assessment

(1) Answer the revision questions at the end of chapter 5 of the prescribed book (ignore question 6).
(2) Answer the written questions at the end of chapter 5 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.
(3) Health insurance schemes are trying to eliminate cross-subsidisation. Briefly discuss each of the four main components of this attempt.

Feedback

Answers to the questions in chapter 5:

(1) *The government plans to create a countrywide state-assisted scheme for primary health care, with selected facilities, to provide more advanced, specialist health services at affordable rates.*
(2) *"Primary health care" means basic health care (inoculations, assistance with childbirth, fundamental hygiene, and the treatment of minor ailments).*
(3) *Over-prescription, charging for services not rendered, fictitious medical bills, patient abuse of the system, which include discussions of the following:*

   a. *underwriting, applying risk-related premiums*
   b. *class groupings (age, gender, occupation)*
   c. *use of medical savings account*
   d. *allowing good risks to drift into lower-premium categories*

(4) *Increasing pensions*

- *withdrawal of subsidy*
- *reducing benefits*
- *funding for benefits*
- *paying of a lump sum to settle liability*
- *offering a defined rand benefit*
- *agreeing on defined contributions*

(5) *Blindness*

- *deafness*
- *requiring a wheelchair, calliper or crutch to move from one place to another because of a permanent disability*
- *requiring an artificial limb*

(6) *Sickness, disability and accident cover*
- *a savings element*
- *group life assurance*
- *hospital benefits*
- *pension provisions*
- *medical aid scheme*

Answer to assessment question 3:

In your answer, refer to the following aspects:

- *underwriting; applying risk-related premiums*
- *class groupings (age, gender, occupation)*
- *use of medical savings account*
- *allowing good risks to drift into lower-premium categories*

TOPIC 3

Administrative principles

This topic comprises learning units 6 to 8 as well as the self-assessment questions and answers for these learning units.

Learning unit 6

Introduction to underwriting

Contents

Learning outcomes

After you have worked through this learning unit, you should be able to

- explain the needs for underwriting in life insurance
- describe the objectives of the life underwriter
- list the different risk classes according to which the underwriter has to classify prospective life insurance clients
- explain the need for and the process of risk selection
- discuss the underwriting guidelines that the average life underwriter has to follow
- profile a life underwriter
- identify the more common medical terms that are used in medical underwriting
- discuss the concept of reinsurance applicable to life insurance

Key concepts

— Risk classes
— Risk selection
— Numerical rating system
— Retention
— Treaty reinsurance
— Facultative reinsurance

GETTING AN OVERVIEW

This learning unit deals with the first outcome of topic 3.

Underwriting is the process of selecting and classifying risk exposures. It is an essential element of the insurance programme, because unless the company makes the selections from among its applicants, the inevitable result would be adverse selection – and the primary objective of underwriting is to guard against adverse selection. There must be the same mix of good and bad risks in the insured group as there were in the group from which the rates derive. The tendency to seek insurance of poorer-than-average risks must be avoided. Note that underwriting does not aim to select risks that will not lead to losses; its purpose is to avoid a disproportionate number of bad risks, thereby equalising actual losses and expected losses.

6.1 WHAT IS UNDERWRITING?

Study the following sections in chapter 6 of your prescribed book:

- Definition
- The basis of sound underwriting

6.2 INTRODUCTION TO UNDERWRITING

Study this section in chapter 6 of your prescribed book.

6.3 OBJECTIVES OF UNDERWRITING

Study the following sections in chapter 6 of your prescribed book:

- Equitable to the client
- Deliverable by the intermediary
- Profitable to the insurer
- Service and speed

6.4 SELECTION OF RISKS

Study the following sections in chapter 6 of your prescribed book:

- Establishing risk classes
- The need for selection
- Risk selection

6.5 UNDERWRITING GUIDELINES

Study the following sections in chapter 6 of your prescribed book:

- The numerical rating system
- The underwriting manual
- Underwriting policy and company objectives
- The ASISA HIV-testing protocol

6.6 PROFILE OF AN UNDERWRITER

Study the following sections in chapter 6 of your prescribed book:

- Functions of the experienced underwriter
- Queries
- Relationship with the claims department

6.7 MEDICAL TERMS

Study this section in chapter 6 of your prescribed book.

6.8 REINSURANCE

Study the following sections in chapter 6 of your prescribed book:

- Retention
- Main types of reinsurance

SUMMARY

The nature and the importance of the underwriting process and the role of the underwriter were discussed in this learning unit. The servicing of policies will be discussed in the next learning unit.

Assessment

(1) Answer the revision questions in chapter 6 of the prescribed book.
(2) Answer the written questions at the end of chapter 6 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.
(3) List and briefly explain the steps in the underwriting process.
(4) Explain why prompt application approval and policy delivery are vital. Describe why the objectives of the underwriter are to approve and issue policies that are equitable to the client, deliverable by the intermediary, and profitable to the insurer.

Feedback

Answers to the questions in chapter 6:

(1) *A careful selection of lives to ensure an equitable basis for the provision of cover, and an expected mortality profit.*

(2) *Risks are assessed on the following basis:*

- *mortality in life insurance*
- *morbidity in permanent health insurance*
- *occupation and medical condition in personal accident insurance*
- *medical condition, medical history in hospital, and medical insurance*

(3) *Approve and issue a policy that is*

- *equitable to the client*
- *deliverable by the intermediary*
- *profitable to the insurer*

(4) *Competition will ensure that*

- *the policy is equitable*
- *the policy provides benefits that meet the buyer's needs*
- *the premium is competitive*
- *application approval and policy delivery are prompt*

(5) *It is important to follow a consistent policy and practice in handling claims. If claims investigations are not done properly and poor claims are not refused, the public will not bother to make true and proper declarations when they apply for cover.*

(6) *SA Society of Medical Underwriters*

(7) *Institute of Life Underwriters*

Answer to assessment question 3:

The desk underwriter receives applications for insurance and decides on whether to accept or reject the applicants. When these decisions are made, the desk underwriter relies on information from a variety of sources (listed in the prescribed book).

These sources include the information in the application or the information submitted by the agent, credit reports, information bureaux, and physical inspections or examinations. The importance of each source varies, depending on the type of insurance, but all these sources are important for different reasons. Multiple sources are necessary because losses may have a wide variety of causes and no single source of information would suffice.

Answer to assessment questions 4:

The following points are relevant:

- *The insured should pay a premium that is proportionate to the risk.*
- *The insurer has to determine the degree of risk and charge a fair premium for the risk.*
- *Analysis of a group of individuals of a particular age and gender indicates a wide variation in physical health, occupation and vocation.*
- *Understanding how various factors influence mortality enables the underwriter to identify applicants who present comparable mortality risks and to classify them accordingly.*
- *Classification in this way allows the insurer to charge each individual policy owner an equitable premium that is proportionate to the degree of mortality risk.*
- *The buyer ultimately decides whether the policy is acceptable.*
- *The buyer may choose not to accept the policy when it is delivered by an intermediary.*

- *An unfavourable underwriting decision results in higher premiums.*
- *For a policy to be acceptable to the buyer, the following must apply:*
  - *It must provide benefits that meet the buyer's needs.*
  - *The cost of cover must be within the buyer's financial means.*
  - *The premium must be competitive in the market.*
- *All insurers require sound underwriting for favourable financial results.*
- *The profitability for the insurer is built into the rate structure.*
- *The underwriter is not directly involved in determining the premium structure.*
- *The underwriter's decision is very important to producing actual mortality results that coincide with mortality projections.*
- *A delay in approval and delivery gives the buyer an opportunity to reconsider the decision to buy.*
- *Lagging behind the competition could lead to lost business.*
- *Underwriters must balance the demand for prompt turnaround times with appropriate analysis of risk information.*
- *Electronic links with the laboratories for blood and urine results speed up assessments.*

Learning unit 7

Policy servicing

Contents

Learning outcomes

After you have worked through this learning unit, you should be able to

- explain the reason that an efficient policy-servicing department is a vital component of a life insurer's operations
- list and explain the duties that every life insurer's policy-servicing department has to deal with
- explain the importance of the policy document and the procedures to be followed if this document is lost or destroyed
- list and describe the different components of a policy document
- discuss the potential problems when the premium payments on a life insurance policy cease, and how these problems are handled in different circumstances
- describe the method the average insurer uses to grant a loan against a policy
- explain ASISA's code of practice regarding the replacement of policies

Key concepts

— Up-front recovery
— Aggregated charging
— Surrender values
— Paid-up policies

GETTING AN OVERVIEW

This learning unit deals with the second outcome of topic 3.

The policy-servicing department is responsible for maintaining policies and keeping in contact with the policy owners. Servicing departments perform duties related to

- policy changes such as beneficiaries policy amendments
- record maintenance regarding the handling of queries from policy owners
- premium collection and collection procedures

7.1 THE POLICY DOCUMENT

Study the following section in chapter 7 of your prescribed book:

- The details of the policy document

Note: *In terms of the Long-term Insurance Act, 1998, it is no longer necessary for an insurer to issue a policy document to every policy owner. Instead, a detailed summary is printed and mailed to the policy owner. However, if a policy owner asks for a policy document, the document must be printed and sent to the owner.*

7.2 WHEN PREMIUMS STOP

Study the following sections in chapter 7 of your prescribed book:

- Initial expenses
- Cash values
- Surrender values
- Minimum values for long-term policies
- Lapses
- Automatic premium loans
- Paid-up policies
- Revival conditions

7.3 POLICY LOANS

Study this section in chapter 7 of your prescribed book.

7.4 THE CODE OF CONDUCT OF THE ASSOCIATION FOR SAVINGS AND INVESTMENT SA (ASISA)

Study this section on the code of conduct of the Association for Savings and Investment SA (ASISA) in chapter 7 of your prescribed book:

- Code on policy quotations

7.5 THE STANDARDS OF ASISA

Study the following sections on the standards of the Association for Savings and Investment SA (ASISA) in chapter 7 of your prescribed book:

- ASISA standard on complaints resolution
- ASISA statistics standard
- HIV-testing protocol
- ASISA standard on replacement

SUMMARY

The nature and the importance of the policy-servicing department were discussed in this learning unit. The next learning unit will present a general overview and the principles of claims.

Assessment

(1) Answer the revision questions at the end of chapter 7 of the prescribed book.
(2) Answer the written questions at the end of chapter 7 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.

Feedback

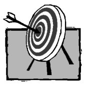
Answers to questions in chapter 7:

(1) To ensure that the change is allowed in accordance with the terms and conditions outlined in the policy document.
(2) The consensus is that a cession cancels a beneficiary nomination. If the cession were cancelled, the proceeds are to be paid to the estate if the policy owner nominates another beneficiary.
(3) No – only questions for which answers are readily available in the company system.
(4) The policy document is proof of the contract entered into.
(5) A person working for the insurance company who is authorised to agree to issuing the policy – usually the managing director, the chief executive officer or the company secretary.
(6) This depends on the term of the policy. If the term is 10 years, the policy will have a surrender value after one year. If the term is between 10 and 20 years, it will have a surrender value after two years, and if the term is more than 20 years, the policy will have a surrender value after three years.

Learning unit 8

General overview and principles of claims

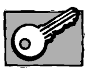
Contents



Learning outcomes

After you have worked through this learning unit, you should be able to

- explain the general aims of an insurer's claims department
- list and briefly describe the information that is needed to verify the policy details at the claim stage
- explain why the claims department has to verify the policy details at the claim stage
- discuss the effect on a claim if it is discovered that information has been withheld from the life insurer's underwriter at inception of the policy
- explain how the validity of a claim may be established
- describe how the average life insurer deals with early claims
- explain the general policy of life insurers when dealing with a claim where death was due to the suicide of the insured



Key concepts

— Retrospective underwriting
— Early claims
— Immediate cover

GETTING AN OVERVIEW

This learning unit deals with the third outcome of topic 3.

The aims and objectives of the claims department of a life insurer are to deal with claims as efficiently and speedily as possible.

8.1 VERIFICATION OF INFORMATION

Study the following sections in chapter 8 of your prescribed book:

- Insurable interest
- Personal particulars

8.2 EFFECT OF NON-DISCLOSURE

Study the following section in chapter 8 of your prescribed book:

- Proof of non-disclosure

8.3 ESTABLISHING THE VALIDITY OF A CLAIM

Study this section in chapter 8 of your prescribed book.

8.4 OTHER UNLAWFUL ACTS

Study this section in chapter 8 of your prescribed book.

8.5 "EARLY" CLAIMS

Study the following sections in chapter 8 of your prescribed book:

- Claims before cover commences
- Reinstated policies
- Death by suicide

SUMMARY

This learning unit provided an overview of the claims procedure for life policies. The claims verification process was highlighted as an important aspect of this procedure.

Assessment

(1) Answer the questions, at the end of chapter 8 of the prescribed book.

(2) Answer the written questions at the end of chapter 8 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.

Feedback

Answers to the questions in chapter 8:

(1) *Retrospective underwriting refers to the verification of information relevant to a policy contract. Verification includes calling for the file and checking the information that was provided at the inception of the contract. The aim is to verify this information and to check whether a material fact that could affect the risk had been withheld.*
(2) *Insurable interest has to exist in the case of a life policy at the inception of the contract.*
(3) *When a policy has been in force for longer than 10 years, the claim is paid on the assumption that the deceased was HIV-negative during the claims stage.*
(4) *A fact is of material importance if, in the opinion of the reasonable person, it would have influenced the reasonable insurer's initial decision.*
(5) *Since the underwriting process is time-consuming, immediate cover is granted automatically on receipt of the proposal form, together with the first premium.*
(6) *The suicide clause states that no claim will be admitted if suicide is committed within 24 months of the date of the letter in which is stated that the policy has been accepted or reinstated. Policies that are reinstated without proof of good health will be subject to the suicide clause only to the extent to which the original 24 months still apply. Policies that are reinstated with proof of good health are again made subject to a suicide clause from the date of reinstatement. Whether the policy will respond to the claim therefore depends on the specific circumstances of the reinstatement.*

TOPIC 4

Life insurance applications

This topic comprises learning units 9 to 11 as well as the self-assessment questions and answers for these learning units.

Learning unit 9

An introduction to retirement funds

Contents

Learning outcomes

After you have worked through this learning unit, you should be able to

- explain what a retirement fund is
- give a brief overview of the history of the development of retirement funds
- explain why an employer is usually quite easily convinced to introduce a retirement fund for employees
- discuss the need for negotiations with staff representatives when an employer decides to introduce a retirement fund
- explain the differences between a defined benefit fund and a defined contribution fund and how these funds work
- explain why there has been a major shift in membership from pension funds to provident funds in South Africa
- describe the structure, purpose and advantages of a preservation fund
- explain, in some detail, the eligibility criteria stipulated in Social Assistance Act 59 of 1992 and the benefits provided to persons who qualify

Key concepts

— Pension funds
— Preservation funds
— Social security benefits
— Provident fund

9.1 ORIGINS AND HISTORY OF RETIREMENT FUNDS

Study the following sections in chapter 9 of your prescribed book:

- A definition of a retirement fund
- The history behind the development of retirement funds

9.2 NEGOTIATIONS WITH STAFF REPRESENTATIVES

Study this section in chapter 9 of your prescribed book.

9.3 EMPLOYER CONTRIBUTION OPTIONS

Study the following sections in chapter 9 of your prescribed book:

- Defined benefit funds
- Defined contribution funds
- Defined contribution versus defined benefit
- Employer and socioeconomic pressures

9.4 PRESERVATION FUNDS

Study this section in chapter 9 of your prescribed book.

9.5 BENEFITS PROVIDED BY THE STATE

Study the following section in chapter 9 of your prescribed book:

- Kinds of grants

SUMMARY

This learning unit provided an overview of group pension funds, the benefits provided by the state, and the planned government pension scheme. The different benefits were highlighted as an important aspect of group life insurance and employee benefit markets.

Assessment

(1) Answer the revision questions at the end of chapter 9 of the prescribed book.
(2) Answer the written questions at the end of chapter 9 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book

Feedback

Answers to the questions in chapter 9:

(1) A retirement fund is a systematic plan set up for a group of people, usually employees, to provide a retirement benefit, either as a lump sum or as a regular monthly payment, to a member who has reached retirement age. It often also provides a lump-sum payment or monthly income to people who can no longer be actively employed, and provides for the dependants of an employee who might die before he/she reaches retirement age.

(2) The structure of the fund and the extent of the benefits to be provided should be discussed with, and accepted by, both the employer and the representatives of the employees. The best way is to set up a body that will ultimately become the management board of the fund and to negotiate with them.

(3) There is no hard and fast rule, but most employers have realised that when their organisations reach the point where the work force is becoming substantial (usually between 20 and 50) and they can no longer provide retirement benefits from their own resources, a retirement fund will be the most logical solution.

(4) A substantial part of the traditional work force came from rural communities and a lump-sum payment was preferred, as it would enable these members to return with the means to purchase livestock, to build a house, or to farm a tract of land.

(5) An employee had the option to remain as a paid-up member of the employer's fund, to take the benefit in cash, or to transfer the benefit to a retirement annuity fund with no tax consequences.

(6) If an applicant's assets exceed the prescribed threshold in terms of the means test, he/she is automatically disqualified from receiving a benefit. The thresholds are

- *R547 200 for single persons*
- *R1 094 400 for married persons*

In terms of the means test, all the applicant's assets, other than his/her house, are taken into account at market value.

(7) People who served in the military, the navy or the air force during wars, in which South Africans had been involved, could apply for a war veteran's grant when they reach the age of 60 years or older. They could also apply if they can no longer support themselves because of a physical or mental disability acquired during or because of these wars. The war veteran's grant is slightly larger than a normal social grant.

Learning unit 10

The use of insurance in the business environment

Contents

Learning outcomes

After you have worked through this learning unit, you should be able to

- define a key person in an organisation
- explain what a "deferred compensation" plan is
- explain the benefits of structuring an employer-owned policy in accordance with the concessions in terms of the Income Tax Act of 1962
- explain the estate duty implications of a "key-person" policy
- explain what a "preferred compensation" plan is and why it is sometimes used instead of a deferred compensation plan
- briefly describe what a "sinking fund" is
- explain the importance of a buy-and-sell agreement in a business environment, and briefly describe how these agreements work
- explain how a preference share capital redemption plan works
- explain what "contingent liability" insurance is and how the plan works

Key concepts

— Key-person insurance
— Deferred compensation
— Preferred compensation
— Buy-and-sell agreements
— Contingent liability

10.1 KEY-PERSON INSURANCE

Study the following sections in chapter 10 of your prescribed book:

- Establishing the value of the key person
- Key person and deferred compensation
- The Income Tax Act
- The Estate Duty Act

10.2 DEFERRED COMPENSATION

Study the following sections in chapter 10 of your prescribed book:

- The employer's position
- The employee's position
- Preferred compensation (restraint of trade)

10.3 PREFERRED COMPENSATION (RESTRAINT OF TRADE)

Study the following sections in chapter 10 of your prescribed book:

- The employer's position
- The employee's position

10.4 SINKING FUNDS (CAPITAL ASSETS REPLACEMENT PLAN)

Study the following section in chapter 10 of your prescribed book:

- How is it done?

10.5 BUY-AND-SELL AGREEMENTS

Study the following sections in chapter 10 of your prescribed book:

- The sole proprietor
- Partners, members and shareholders

10.6 PREFERENCE SHARE CAPITAL REDEMPTION PLANS

Study the following section in chapter 10 of your prescribed book:

- How is it done?

10.7 CONTINGENT LIABILITY INSURANCE

Study the following section in chapter 10 of your prescribed book:

- How is it done?

10.8 THE EFFECT OF CAPITAL GAINS TAX (CGT) ON BUSINESS INSURANCE SOLUTIONS

Study this section in chapter 10 of your prescribed book.

10.9 RECOMMENDED ADDITIONAL READING

Study this section in chapter 10 of your prescribed book.

SUMMARY

This learning unit provided an overview of how life insurance can be used to the benefit of a business. The various types of application of business life insurance were described. The effects of taxation and the benefits of correctly structured agreements were highlighted as an important aspect of this type of insurance

Assessment

(1) Answer the revision questions at the end of chapter 10 of the prescribed book.
(2) Answer the written questions at the end of chapter 10 of the prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book

Feedback

Answers to the questions in chapter 10:

(1) The key people in an organisation are usually those who, should they die or leave, would be difficult to replace

- *affect the profits of the organisation*
- *cause a reduction in sales*
- *mean costly training of a replacement*
- *possibly require a change in management*

(2) When the services of a key person were suddenly terminated, it could mean a major loss to an organisation.

That became clear in the previous section dealing with key-person insurance.

Services can be unexpectedly terminated in two ways, namely premature death (the reason for key-person insurance), or resignation of the key person. No employer is able *to retain the services of an employee who wishes to leave. What the employer can do, however, is to provide incentives to persuade the employee to stay.*

The development of deferred compensation packages (funded by life insurance) has evolved because of certain tax concessions that are available to the employer and the employee. It is possible to fund a deferred compensation scheme from other sources (e.g. profits in the year of retirement or share investments), but these other avenues would not be able to compete with life insurance because of the Section 11(w) deductions that are available. Employees are also happier knowing that their benefits are based on the returns of life insurance and not on the fluctuations of the business market.

(3) *Deferred compensation schemes have been set up at several different employers, specifically to encourage the employees to stay until normal retirement age. Although this scheme has proven to be very attractive to both the employer and the employee, a deferred compensation scheme is not always the best option under circumstances such as the following:*

- *In some industries, it is normal for employees to move from one employer to another.*
- *The employer may be a tax-exempt institution (a Section 21 company).*
- *The age of the employee may be such that the period to normal retirement age could be considered too long.*

(4) *The most likely purchaser of a sole proprietor's business is a key employee who knows the customers, is familiar with the operation, and has established credibility in the community.*

The problem would be to raise finances for the purchase price. The solution is a purchasing (commonly known as a buy-and-sell) agreement, funded by life insurance that matures at the retirement age of the sole proprietor and has sufficient life cover to cater for prior death.

The other option is a buy-and-sell agreement with a competitor in a similar line of business. The two parties can agree that the business of the first person who is dying will be purchased by the survivor, who can then, sell the business at its true value when the time is right. The survivor could also appoint a competent manager and retain the business.

(5) *Preference shares are used to raise money. Although preference shareholders obtain certain rights against the assets of the company, they usually have no voting rights. Holders of preference shares are entitled to share in the profits of the company before a dividend is declared to ordinary shareholders. Preference shares can be either cumulative or noncumulative. Preference shareholders have a prior claim to the repayment of capital upon the winding-up of a company.*

Preference shares have either a redemption date, at which stage the company will repay the capital at a specified price, or a conversion clause that allows the preference shares to be converted into ordinary shares.

(6) *The director (directors) agrees (agree) that the business may take out an insurance policy on the life of the director, on condition that*

- *the business pays all premiums*
- *the proceeds of the policy are used to settle outstanding amounts to creditors who hold personal guarantees that the director may have signed*
- *the business may retain any surplus remaining after settlement of the secured debts*
- *a written agreement is entered into between the business and the director, compelling the business to use the proceeds of the policy to settle amounts owed to creditors*
- *creditors accept the plan and provide a written undertaking to cancel the personal surety provided by the director on repayment of the debt*

Learning unit 11

Estate planning

Contents

Learning outcomes

After you have worked through this learning unit, you should be able to

- briefly explain some of the more commonly used definitions in the Estate Duty Act 45 of 1955
- list and briefly describe the property and deemed property of an individual that forms part of this person's estate
- list and briefly describe some of the more common deductions allowed against the value of an estate when liability for estate duty is determined
- explain the importance of having a valid will
- list and describe the formalities required for executing a will
- explain the effects of a divorce on a will
- explain who is competent to execute a will
- explain the procedure for distributing the estate of a person who died intestate
- explain the implications of the Maintenance of Surviving Spouses Act 27 of 1990 for an estate
- explain the implications of intestate succession
- explain how claims against an estate are handled
- discuss the testamentary trust as an estate-planning instrument
- explain donations, intra vires trusts and private companies as estate-planning instruments

Key concepts

— Estate Duty Act, 1955
— Property
— Last will and testament

— Intestate succession
— Intra vires trusts

11.1 ESTATE DUTY

Study the following sections in chapter 11 of your prescribed book:

- Dutiable amount of an estate
- Who is liable for the payment of estate duty?
- Rebate in respect of death in rapid succession

11.2 CAPITAL GAINS TAX

Study this section in chapter 11 of your prescribed book.

11.3 DONATIONS TAX

Study this section in chapter 11 of your prescribed book.

11.4 MATRIMONIAL REGIMES

Study the following sections in chapter 11 of your prescribed book:

- Marriages in community of property
- Marriages in terms of an antenuptial contract
- Marriages in terms of an antenuptial contract including accrual

11.5 DIVORCE ACT 70 OF 1979

Study this section in chapter 11 of your prescribed book.

11.6 LAST WILL AND TESTAMENT

Study the following sections in chapter 11 of your prescribed book:

- Formalities required in the execution of a will
- Effect of divorce or annulment of marriage on a will
- The Maintenance of Surviving Spouses Act 27 of 1990

- Entitlement of a surviving spouse and descendants
- Interpretation of wills
- Competency to make a will
- Competency of persons involved in the execution of a will
- Wills drawn up in a foreign country
- Summary of the will-signing procedure

11.7 INTESTATE SUCCESSION

Study this section in chapter 11 of your prescribed book,

11.8 FURTHER FACTORS THAT AFFECT ESTATE PLANNING

Study the following sections in chapter 11 of your prescribed book:

- Claims against the estate
- Creation of a testamentary trust
- Estate planning instruments

SUMMARY

This learning unit provided an overview of estate duty, the procedures to be followed for a last will and testament, the execution of a will, and intestate succession. Having a valid will was highlighted as an important aspect of estate planning.

Assessment

(1) Answer revision questions at the end of chapter 11 of the prescribed book.
(2) Answer the written questions on chapter 11 of your prescribed book. The answers to these questions are provided in the Annexure at the end of the prescribed book.

Feedback

Answers to the questions in chapter 11:

(1) Every person of 16 years or older may make a will unless, at the time of making the will, he/she is mentally incapable of appreciating the nature and effect of his/her act. The burden of proof that he/she was in fact mentally incapable rests with the person making the allegation.

(2) The following people are disqualified from receiving a benefit from the will:

a. a person who attests and signs the will as a witness
b. a person who signs the will on behalf of the testator
c. a person who writes the will (or any part thereof) in his/her own handwriting
d. a person who is the spouse of such person as mentioned in a, b or c above

(3) *It is possible, however, to set aside the disqualification. The person will then be permitted to receive the benefit.*

These special cases include the following:

- *A court may declare a person or his/her spouse competent to receive a benefit from a will.*
- *A person or his/her spouse who, in terms of the law regulating intestate succession, would have been entitled to inherit from the testator if there had been no will, shall not be disqualified to receive a benefit from the will.*
- *A person or his/her spouse who attested to or who signed a will as a witness shall not be disqualified if the will had been attested and signed by at least two other competent witnesses who will, however, not benefit from the will.*

(4) *When a child has been adopted, the adopted child is deemed a descendant of his/her adoptive parent(s) and not of his/her natural parent(s). An adopted child will therefore have no claim against the intestate estate of a natural parent, unless the natural parent is also an adoptive parent or was, at the time of adoption, married to the adoptive parent.*