
Tutorial Letter 201/1/2016
Risk Financing and Short Term Insurance

RSK3701

Semester 1

**Department of Finance, Risk Management and
Banking**

This tutorial letter contains the
suggested solution to assignment 01
and examination guidelines.

Bar code

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shared via CourseHero.com

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Please note / important notes:

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Dear Student

The purpose of this tutorial letter is to provide you with guidelines on answering the first assignment, as well as some information on the examination paper. Please refer to the Tutor guideline that was uploaded as an additional resource. This guide will supply you with some additional study guidelines.

Question 1: Correct option 1

Refer to chapter 1 in the prescribed book.

Brokers may have an agency agreement with different insurers. In the short term insurance market an insurance agent is someone who sells insurance, but it might not be his/her main occupation. An insurance agent is allowed to sell other products such as property on a commission basis. Loss adjusters are also sometimes called claims assessors. Loss adjusters are not responsible for the settlement of claims. They can only make recommendations to the insurer on the settlement of claims.

Question 2: Correct option 2

Refer to study unit 2 in the Unisa M0001 guide.

Adverse selection refers to the tendency that people with a **higher** probability of loss than the average seek insurance. **Adverse selection may result in higher losses than expected.** Adverse selection may be **reduced** by introducing clauses such as a suicide clause and introducing compulsory medical examinations when applying for policies.

Question 3: Correct option 3

Refer to chapter 3 in the prescribed book.

A strike in the mining industry in South Africa is an example of a **fundamental** risk. Fundamental risks affect large part of society or even the world and are regarded as commercially uninsurable. These risks are outside the control of a person or a group of people.

Question 4: Correct option 2

Refer to chapter 1 in the prescribed book.

Lloyds has underwritten the voice of Bruce Springsteen. Lloyds is not an insurance company, but in fact an association of underwriters, operating worldwide. The term *underwriting* originated at Lloyds.

Question 5: Correct option 2

Refer to Study unit 4 in the Unisa M0001 guide.

A proposal form is an offer by the **insured to the insurer** to do business. It can be used to advertise other products available from the insurer, elicits a quotation and establishes a warranty.

Question 6: Correct option 1

Refer to Study unit 4 in the Unisa M0001 guide.

Consideration in terms of an insurance policy is not essential for concluding a contract in terms of South Africa law. In some cases policy wording of a particular policy contract may state that payment must be made before the contract will come into force. This modifies the law, but only for that particular contract.

Question 7: Correct option 1

Refer to chapter 3 in the prescribed book.

In an insurance policy the cancellation clause will be reflected under the general conditions. The operating clause is where the insurer agrees to pay a claim when a loss, which is covered in terms of the policy wording, occurs. The recital clause or preamble gives the names of the parties to the contract.

Please note that option 3 of this question has been changed to "general exemptions" as per announcement dated 18 January 2016 on the RSK3701 SITE.

Question 8: Correct option 4

Refer to chapter 5 in the prescribed book.

In terms of a quota share treaty the reinsurer is bound to accept a fixed proportion of every risk. The risk is shared on a **proportional** basis between the cedant and reinsurer. The share of the different parties involved in the agreement is expressed as a **percentage**. The type of reinsurance where only the amount of excess of the cedant's normal capacity for a particular risk is ceded to the reinsurers is referred to as a **surplus treaty**.

Question 9: Correct option 3

Refer to Study unit 6 in the Unisa M0001 guide.

An insurer enters into a quota share arrangement with the ceding insurer retaining 60% of any loss. The reinsurer will pay 40% of the loss of R80 000 under a R100 000 policy:

$$R80\ 000 \times 0,40 = R32\ 000.$$

Question 10: Correct option 3

Refer to chapter 3 in the prescribed book and study unit 4 in the Unisa M0001 guide.

In terms of an insurance policy an insurer may repudiate a claim if a warranty contained in the policy has been breached. The operating clause is where the insurer agrees to pay a claim when a loss, which is covered in terms of the policy wording, occurs. Specific risks in each section are limited by the **specific exceptions** to the policy. The **heading** in the policy contains the name of the insurer and its head office address.

Question 11: Correct option 4

Refer to chapter 2 in the prescribed book.

An organisational chart may assist the risk manager in identifying key staff members. A production flow chart will identify possible bottlenecks in the production process, process type risks and supplier risks.

Question 12: Correct option 2

Refer to chapter 1 in the prescribed book.

In terms of collective insurance only one policy document is issued and claims are handled by the lead insurer. The **broker** is responsible to place cover elsewhere in cases where one of the companies that share in the policy is liquidated. A company who has a share on a collective policy may **NOT** quote against the lead insurer.

Question 13: Correct option 1

Refer to page 68 in the Unisa MO001 guide.

A farmer insures his crop for R100 000. The value of the crop is R150 000. A loss of R50 000 is sustained. If the principle of special condition applies, an amount of R 33 333,33 will be payable by the insurer.

Under the special condition of average, a 75% condition of average is applied. In terms of this special condition, the insured will only share in the loss if the insured sum is less than the stated percentage (i.e. 75%) of the value of the asset at the time of the loss. If the sum insured is 75% or more, the insured will be considered fully insured and the whole amount of the loss will be paid by the insurer. If the sum insured is less than 75% of the value of the asset at the time of the loss, average will be applied and the insured will pay a pro rata percentage of the loss.

In the case stated in the question, the farmer insured his crop for R100 000. The value of the crop was R150 000 at the time of the loss. A loss of R50 000 was sustained. The sum insured amounts to 66,67% of the value of the crop at the time of the loss. The insurer is thus liable for 66,67% of the value of the loss while the farmer is liable for the remainder of the loss.

Calculations:

$$100\,000/150\,000 \times 100 = 66,67\%$$

The insurer will be liable for:

$$66,67/100 \times R50\,000 = R33\,333,33$$

The insured will be liable for:

$$33,33/100 \times R50\,000 = R16\,666,67$$

Question 14: Correct option 2

Refer to chapter 2 in the prescribed book.

Examples of post-loss minimisation of losses include hiring of security guards to protect premises after a fire and activation of sprinkler systems with the outbreak of a fire. Training in the use of dangerous substances and fire drills are examples of pre-loss minimisation techniques.

Question 15: Correct option 3

Refer to chapter 3 in the prescribed book as well as study unit 4 in the Unisa M0001 guide

Indemnity in terms of insurance is enforced through the principles of subrogation, average and contribution. Insurable interest does not enforce the principle of indemnity. Insurable interest is however a requirement of insurance.

A two-hour, 70 marks, partial fill-in paper will be set for both the May/June and October/November examinations. The mark you obtain out of 70 will be converted to a percentage mark.

The examination paper will comprise TWO sections.

SECTION A comprises 20 multiple choice questions of 1 mark each and 10 True/False questions of 2 marks each.

SECTION B comprises essay, paragraph and calculation type questions.

Additional study guidelines:

The following general guidelines apply to both the May/June and October/November examination papers:

- When answering true/false questions you must indicate whether the statement is true or false. This must be followed by a proper motivation which supports your initial answer. **In the exam, no marks will be awarded for a true or false answer without a proper motivation.** A motivation can be approached in two ways. For a false statement, first motivate why the answer is false and then indicate what would be the correct statement or fact(s). For correct statements, emphasise why the answer is considered correct.

- Indicate the answers to the **multiple choice questions** on the **answer book** as well as on the **mark reading sheet**. In case of a query we will be able to revert back to the answers in the book.
- Answer the written questions in **point format**. Underline or highlight the main facts. Make use of headings and subheadings in your answers.
- **Never leave open spaces**. Guess the answer if you have to – you may guess right. Remember if you are a border case we might try to find a mark or two. If there is open spaces this is impossible.

Some of the major problems experienced by students in this paper in previous examinations have been as follows:

- **Not including sufficient facts in an answer**

When a question requires you to “name and discuss for 10 marks” it normally expects you to list at least five facts and give a brief explanation of or elaboration on each fact. When a question asks you to “name and briefly explain **three** factors for 10 marks” it requires you to list the three factors and give a more detailed explanation of each. A discussion question should be answered in point form and facts should be highlighted - in this way you can insure that you include sufficient facts in the answer. Make use of headings and subheadings in your answer.

- **Misinterpretation of questions**

This is normally one of the major problems. When you read a question, make sure that you underline the key words in the question. In the answer itself, ensure that you at least refer to those key words and base your answer on them.

- **Including too much detail in the answers and repeating facts**

Do not write more than two pages for 10 marks. You will run out of time and will not be able to complete the paper. Be careful not to repeat facts - you can prevent this by answering the questions in point form and highlighting key words and concepts.

- **Incomplete facts**

Students tend to include only a certain part of a fact. For example: A characteristic of finite insurance is high premiums. These, however, can be offset by a commutation option which offers a substantial return of premiums to the insured **if the loss experienced under the contract is lower than the expected losses**. Without the part in bold, the fact is incomplete. If you are required to list the disadvantages of self-funding, merely listing “loss prevention services” does not earn any marks. The answer should read: “Loss of insurer services such as loss prevention services”. Although you are only required to list facts, your answer should still make sense and be self-explanatory.

We trust that you are finding this module both interesting and rewarding up to this stage.

We wish you all of the best with Assignment 02. Please do not hesitate to contact us if you have any difficulties with the study material for this module.

Best wishes

MRS CECILE DE SWARDT (AJH 5-115)

MR JETHRO GODI (AJH 5-112)

DEPARTMENT OF FINANCE, RISK MANAGEMENT AND BANKING

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