

### Question 1

Brokers ...

- 1 are allowed to collect premiums from the insured.
- 2 have a legal obligation to handle claims on behalf of their clients.
- 3 cannot be held legally liable for advice given to clients.
- 4 may not operate in the reinsurance market.

**Brokers are allowed to collect premiums from the insured but have no legal obligation to handle claims on behalf of their clients. They can be held legally liable for advice given to clients. Brokers may operate in the reinsurance market.**

### Question 2

Production flow charts may assist the risk manager in identifying ...

a weaknesses in the organisational structure of an organisation.

b supplier risks.

c process type risks.

d lines of authority.

**Choose the correct combination:**

1 b,c

2 c,d

3 b,c,d

4 a,b,c,d

**Production flow charts may assist the risk manager in identifying supplier risks and process type risks. Weaknesses in the organisational structure of an organisation and lines of authority can be identified by studying the organisational charts of an organisation**

### Question 3

Indicate the **correct** statement:

- 1 An insurer is better able to prevent losses.
- 2 Pooling results in smaller deviations from expectations in terms of possible losses.
- 3 Shoplifting is an uninsurable risk.
- 4 Reinsurance assures the buyer of insurance that all insurers will charge the same premium for the same risk.

Pooling results in smaller deviations from expectations in terms of possible losses. An insurer is not necessarily better able to prevent losses as uncertainty remains. With reference to one risk confronting one individual, the positions of the insurer and insured are virtually identical. Shoplifting is an insurable risk in terms of the characteristics of an insurable risk. Shoplifting cannot however be insured under a theft insurance policy as it does not meet the requirement in terms of the definition of theft as defined in insurance. This aspect will be dealt with later in the prescribed material. Reinsurance cannot assure the buyer of insurance that all insurers will charge the same premium for the same risk. This is not the purpose of reinsurance.

### Question 4

You have insured your house for R2 000 000 with ABC Insurer. You transfer your bond to another bank and take out insurance on the house with DEF Insurer for R1 500 000. You do not cancel your insurance with ABC Insurance company. The actual value of your house is R2 000 000. A fire breaks out in your house causing damages of R500 000.

Choose the **correct** statement:

- 1 Each insurer will pay R250 000 of the loss.
- 2 ABC will pay R285 714,29 and DEF R214 285,71 of the claim.
- 3 ABC will pay R285 714,29 and DEF R160 714,28 of the claim.
- 4 DEF Insurer will not be liable for any losses as the house is underinsured.

It is possible to insure an asset with more than one insurer. In terms of the insurance principle of indemnity the insured will however not be allowed to profit from insurance. The principle of indemnity is enforced by the condition of contribution where more than one policy is in force for a specific asset. In this case each insurer is liable for a rateable portion of the loss. In this particular case, the house is insured for R2 000 000 with ABC Insurer and R1 500 000 with DEF Insurer. The actual value of the house is R2 000 000. A loss of R500 000 is sustained. Although the total amount of insurance amounts to R3 500 000 between the two insurers, each insurer will only be liable for a portion of the loss of R500 000. (In case of a total loss, each insurer will still contribute proportionally to indemnify the insured for the value of the house, being R2 000 000. The insured will not be able to claim the total value insured from each of the insurers as this will breach the principle of indemnity which specifies that the insured will be put back in the financial position he/she was before the loss.)

Portion payable by ABC Insurer:

$$R2\,000\,000/R3\,500\,000 \times R500\,000 = R285\,714,29$$

Portion payable by DEF Insurer:

$$R1\,500\,000/R3\,500\,000 \times R500\,000 = R214\,285,71$$

### Question 5

Indicate which of the following is/are considered as a material fact(s) when taking out a fire policy.

- a The location of the premises.
- b The type of business carried out at the premises.
- c The number of staff operating from the premises.
- d Previous claims experience.

**Choose the correct combination:**

- 1 a,b
- 2 b,c,d
- 3 a,b,d
- 4 a,b,c,d

When taking out a fire policy, material facts to be disclosed will include the location of the premises, the type of business carried out at the premises and any previous claims experience. Although the number of staff working at the premises would be useful information, it will not necessarily be material to assess the risk in terms of a fire.

**Question 6**

Indicate the **correct** statement(s).

- a The breaching of a warranty in an insurance contract by the insured may result in the repudiation of a claim by the insurer.
- b The first amount payable is reflected in the schedule of a policy document.
- c Insurance contracts are based on the premise of *caveat emptor*
- d The reasonable man test is generally applied to test the validity of insurance contracts.

**Choose the correct combination:**

- 1 a,b,c
- 2 b,c,d
- 3 a,c,d
- 4 a,b,d

The breaching of a warranty in an insurance contract by the insured may result in the repudiation of a claim by the insurer, even if the warranty reduces the risk to the insurer (refer to the discussion on page 30 of the Unisa study guide). The first amount payable is reflected in the schedule of a policy document. The reasonable man test is generally applied to test the validity of insurance contracts. Insurance contracts are however based on the premise of *uberrimae fidei* or utmost faith.

### Question 7

An insurer enters into a quota share arrangement with the ceding insurer retaining 60% of any loss. How much will the reinsurer pay if the loss amounts to R40 000 under a R80 000 policy?

- 1 R24 000
- 2 R40 000
- 3 R32 000
- 4 R16 000

An insurer enters into a quota share arrangement with the ceding insurer retaining 60% of any loss. This represents a 60/40% quota share treaty. The cession to treaty is thus 40%. In this case the reinsurer will be liable to pay 40% of the loss of R40 000 calculated as follows:  
 $R40\ 000 \times 40\% = R16\ 000$

### Question 8

In terms of a surplus treaty ...

- 1 the reinsurer is bound to accept a fixed proportion of every risk.
- 2 risk is shared on a non-proportional basis between the cedant and reinsurer.
- 3 the share of the different parties involved in the agreement is expressed as an amount.
- 4 only the amount of excess of the cedant's normal capacity for a particular risk is ceded to the reinsurers.

In terms of a surplus treaty only the amount of excess of the cedant's normal capacity for a particular risk is ceded to the reinsurers. In terms of a quota share treaty the reinsurer is bound to accept a fixed proportion of every risk. A surplus treaty is a proportional reinsurance agreement between the cedant and reinsurer. In the surplus treaty, the reinsurer's retention is expressed as a number of lines.

### Question 9

An underwriter is requested to underwrite a tyre manufacturing plant. The sums insured are:

Fire R35 000 000

Loss of profits R10 000 000

The underwriter has a net line of R3 000 000 and can take an additional 50% if the risk involves Fire and Loss of profit. The underwriter has a nine line surplus treaty.

Under the above scenario ...

- 1 the gross retention is R50 000 000.
- 2 the total net line is R3 000 000.
- 3 facultative reinsurance of R5 000 000 will have to be placed.
- 4 no facultative reinsurance is required.

An underwriter is requested to underwrite a tyre manufacturing plant. The sums insured are for fire and loss of profits of R35 000 000 and R10 000 000 respectively. The underwriter has a net line of R3 000 000 and can take an additional 50% if the risk involves Fire and Loss of profit. The underwriter has a nine line surplus treaty. Under this scenario no facultative reinsurance is required. The gross retention is R45 000 000 and the total net line is R4 500 000. These amounts are calculated as follows:

Net line	R 3 000 000
Plus 50% for loss of profits	R 1 500 000
Total net line	R 4 500 000
Nine lines surplus treaty	R 40 500 000
Gross retention	R 45 000 000
<b>Total sum insured:</b>	
Fire	R 35 000 000
plus Loss of profits	R 10 000 000
	<b>R 45 000 000</b>
Less gross retention	R 45 000 000
<b>Facultative required</b>	<b>R 0</b>

4

### Question 10

A change in consumer preferences is an example of a (n) ... risk to a retailer.

- 1 insurable
- 2 fundamental
- 3 particular
- 4 speculative

A change in consumer preferences is an example of a particular risk to a retailer as it might affect the turnover of the specifically retailer negatively

### Question 11

Choose the **correct** statement.

- 1 In insurance practice, premiums are due on the inception date of a new policy.
- 2 Premiums paid to an intermediary are only considered paid once the amount is paid over to the insurer.
- 3 A 15-day period of grace apply to all short term insurance policies.
- 4 Annual policies are most common to the personal lines market.

In insurance practice, premiums are due on the inception date of a new policy. Premiums paid to an accredited intermediary are deemed to have been received by the insurer. In short term insurance the client has no grace period as he or she has in the long term market. If the policyholder is however a natural person, the insured must be allowed at least 15 day's grace for the payment of renewal premiums. For monthly policies this applies from the second month of the policy. Annual policies are most common to the commercial insurance market

### Question 12

Indicate the **correct** statement(s).

- a Stamp duties are not payable on short-term insurance policies.
- b Consideration in terms of insurance policies is defined as the payment of a claim.
- c The replacement of stolen assets with new assets is considered a violation of the principle of indemnity.
- d The issuance of a policy is not essential for concluding an insurance contract.

**Choose the correct combination:**

- 1 a,c
- 2 a,d
- 3 a,b,c
- 4 a,b,c,d

Stamp duties are not payable on short-term insurance policies. In terms of common law, neither the issuance of a policy nor the payment of a premium is essential for concluding a contract. The insurance contract, like any other contract, comes into force as soon as the parties have agreed to its essential terms. Consideration in terms of insurance policies is defined as the payment of the premium. The replacement of stolen assets with new assets is not considered a violation of the principle of indemnity, since no general principle demands that the loss has to be determined in terms of the market value of the asset.

### Question 13

Indicate the **correct** statement.

- 1 Joint owners of property have an insurable interest in each other's life.
- 2 Neighbours have an insurable interest in each other's life.
- 3 Trustees cannot insure the property for which they are liable for.
- 4 There is no legally recognised relationship between mortgagees and mortgagors.

Insurable interest is the legally recognised relationship between the insured and the financial loss that he or she might suffer after a loss incident. Joint owners of property therefore have an insurable interest in each other's life. Neighbours however do not have an insurable interest in each other's life. Trustees are allowed to insure the property for which they are liable for. There is a legally recognised relationship between mortgagees and mortgagors.

### Question 14

Indicate the **correct** statements:

- a The solvency margin of a company is represented by the capital from shareholders and free reserves of the company.
- b Policyholders usually prefer higher solvency margins.
- c Higher solvency margins indicate a higher utilisation of resources.
- d Shareholders usually prefer higher solvency ratios.

**Choose the correct combination:**

- 1 a,c
- 2 a,b
- 3 a,b,c
- 4 b,c,d

The solvency margin of a company is represented by the capital from shareholders and free reserves of the company. Policyholders usually prefer higher solvency margins because it gives them greater security with the insurer of choice. Higher solvency margins however indicate a lower utilisation of resources and shareholders therefore usually prefer lower solvency ratios. Shareholders wish to see the insurance company write the maximum amount of business and create the maximum utilisation of resources.

### Question 15

Annual policies are ...

- 1 reviewed on a monthly basis.
- 2 quoted annually but paid in monthly instalments.
- 3 immediately affected by changes in the underwriting philosophy of insurer.
- 4 most common to the personal lines markets.

Annual policies are quoted annually but paid in monthly instalments. Monthly policies are reviewed on a monthly basis, immediately affected by changes in the underwriting philosophy of insurer and most common to the personal lines markets.

### Question 1

An excessive claim reserve will result in ...

- 1 a decrease in the share price of the insurance company.
- 2 the loss ratio of the insurer appearing lower than it actually is.
- 3 a lower solvency margin.
- 4 an increase in investments from external sources.

An excessive claim reserve will result in a decrease in the share price of the insurance company and a decrease in investments from external sources. The loss ratio of the insurer appears higher than it actually is because of the higher solvency margin

### Question 2

A House Owners policy covers the buildings and outbuildings of a residence but can also be extended to include ...

1 swimming pool machinery against wear and tear.

2 fixed television antennae against breakage.

3 fixed sanitary ware against chipping and scratching.

4 accidental damage to television sets and video cassette recorders.

A House Owners policy covers the buildings and outbuildings of a residence but can also be extended to include fixed television antennae against breakage, swimming pool machinery against accidental damage, excluding wear and tear and fixed sanitary ware against accidental breakage but not chipping and scratching. Damage to television sets and video cassette recorders will be covered under a Householders policy.

### Question 3

Indicate which of the following is likely to be covered in terms of Personal Accident policy.

1 A man murdered by thugs on his way home from work.

2 A man injured when picking up a heavy box.

3 A woman dying six months after being injured in a car accident.

4 A worker sustaining lung cancer as a result of working in an asbestos plant.

A man murdered by thugs on his way home from work is likely to be covered in terms of a Personal Accident policy. A worker sustaining lung cancer as a result of working in an asbestos plant will not be covered as illness is not covered under this policy. A man injured when picking up a heavy box will not be covered under this policy as there was no violence involved. A woman dying six months after being injured in a car accident will only be paid if her death is directly related to the motorcar accident and her death occurs within the number of months specified in the policy.

### Question 4

The following is/are exceptions in terms of liability covers in a domestic package:

a Liability arising from conduct of business for reward.

b Liability for the death of the policyholder.

c Liability arising from the negligent use of a firearm.

d Liability arising from the consequences of a bad slice at golf.

**Choose the correct combination:**



1 a,d

2 a,b

3 a,b,c

4 a,b,c,d

Exceptions in terms of liability covers in a domestic package include amongst others, liability arising from conduct of business for reward and liability for the death of the policyholder. Liability arising from the negligent use of a firearm or from the consequences of a bad slice at golf will be covered.

### Question 5

Mr A insures his factory in terms of a general fire policy. A worker who was dismissed by the company deliberately sets fire to some flammable material which is stored in the factory. The sprinkler system is activated which extinguishes the fire but causes water damage to the other stock in the factory. Some records of debtors are also destroyed. It is assumed that it will take more or less two months to restore the factory to full production. Based on the aforementioned scenario, indicate the **correct** statement(s).

- a Consequential losses caused by damage to the factory will be covered in terms of the policy.
- b Water damage caused by the sprinkler system will be covered in terms of the policy.
- c The insurer will not be liable for any losses due to the fact that the fire was caused by arson.
- d The water represents both the hazard and peril in this particular case.

**Choose the correct combination.**

1 a,d

2 a,c

3 a,b,c

4 a,b,c,d

**Mr A insures his factory in terms of a general fire policy. A worker who was dismissed by the company deliberately sets fire to some flammable material which is stored in the factory. The sprinkler system is activated which extinguishes the fire but causes water damage to the other stock in the factory. Some records of debtors are also destroyed. It is assumed that it will take more or less two months to restore the factory to full production.**

**Under this scenario consequential losses caused by damage to the factory will not be covered in terms of the policy. The water represents both the hazard and peril in this particular case. Water damage caused by the sprinkler system will be covered in terms of the policy. Arson is not an automatic cause for repudiating a claim. The insurer will not be liable for any losses caused by arson only if the insurer can proof that the fire was set deliberately by the insured.**

### Question 6

Mr Albany is an electrician. Apart from the working tools he carries with him, he also carries wires and pipes and in many cases electrical equipment that needs to be fitted at a clients' premises. In terms of Goods in Transit insurance the following items will be covered:

- 1 The pipes, wire and electrical equipment that needs to be installed.
- 2 The working tools, pipers and wire.
- 3 The working tools, pipes, wire and electrical equipment that needs to be installed.
- 4 The working tools and electrical equipment.

Mr Albany is an electrician. Apart from the working tools he carries with him, he also carries wires and pipes and in many cases electrical equipment that needs to be fitted at a clients' premises. In terms of Goods in Transit insurance only the pipes, wire and electrical equipment that needs to be installed will be covered. His working tools need be insured under a Business All Risk policy.

### Question 7

Indicate the **correct** statement.

- 1 Under third party only cover, cover is only provided for the insured's vehicle.
- 2 The first amount payable under motor insurance is cumulative in the case of windscreen excess.
- 3 Damage to the insured's recovered stolen vehicle will be covered under a Third party, Fire and Theft policy.
- 4 In terms of the "pillion passenger extension" liability cover is provided for injuries to passengers carried in a side-car of a motor cycle.

Under third party only cover, no cover is provided for the insured's vehicle. The first amount payable under motor insurance is cumulative except in the case of windscreen excess. Damage to the insured's recovered stolen vehicle will be covered under a Third party, Fire and Theft policy. In terms of the "pillion passenger extension" liability cover is provided for the motor cycle but not for injuries to passengers carried in a side-car of a motor cycle. A separate liability policy must be taken out to cover passengers traveling on a motor cycle or in a side-car of a motor cycle.

### Question 8

A fire policy can be extended to include damage caused by ...

- a earth tremors.
- b sonic shock waves.

c landslips.

d malfunctioning of sprinkler systems.

**Choose the correct combination.**

1 a,c

2 b,c

3 a,c,d

4 a,b,c,d

A fire policy can be extended to include damage caused by earth tremors, landslips and malfunctioning of sprinkler systems. Damage caused by aircraft, other than aerial devices or articles dropped from an aircraft, may be covered, but damage caused by sonic shock waves is excluded.

### Question 9

Business interruption insurance ...

1 is also referred to as profit and loss insurance.

2 provides cover for bad debts.

3 has an unlimited indemnity period.

4 was developed to reimburse those charges that continue regardless of the reduction in turnover after a loss incident.

**Business interruption insurance is also referred to as Loss of Profits insurance. It was developed to reimburse those charges that continue regardless of the reduction in turnover after a loss incident. It does not provide cover for bad debts, only for irrecoverable debts due to the destruction of records and has a limited indemnity period.**

### Question 10

Indicate the **correct** statement.

1 Shoplifting is covered under theft insurance.

2 The breakage of mirrors in a fitting room of a retailer is covered under glass insurance cover.

3 Money transported to and from the bank is covered under Fidelity insurance.

4 Theft of money by employees is covered under money insurance if discovered within 30 days of its happening.

Shoplifting is not covered under theft insurance as it does not involve forcible and violent entry or exit. The breakage of mirrors in a fitting room of a retailer is covered under Glass insurance cover. Money transported to and from the bank is covered under Money insurance. Theft of money by employees is covered under Money insurance if discovered within 14 days of its happening.

### Question 11

Indicate the **correct** statement:

- 1 Arbitration can be used to resolve all types of claim disputes.
- 2 Litigation can only be used to resolve problems of quantum.
- 3 Repudiation of liability applies where the terms and/or conditions of a policy have not been complied with.
- 4 Arbitration is the most common way of handling disputed claims.

Arbitration can only be used to resolve problems of quantum. Repudiation of liability applies where the terms and/or conditions of a policy have not been complied with. Negotiation is the most common way of handling disputed claims.

### Question 12

Consider a policy with a R5000 deductible and a recapture factor of 5%. Determine the amount that the insurer would pay for a loss of R45 000.

- 1 R40 000
- 2 R42 750
- 3 R42 000
- 4 R44 750

Consider a policy with a R5000 deductible and a recapture factor of 5%. For a loss of R45 000 the insurer would pay R42 000.

Calculation:

$P = (L - D) \times (1 + R) = (R45\ 000 - R5\ 000) \times (1 + 0.05) = R42\ 000$ . The deductible payable by the insured decreased from R5 000 to R3 000.

### Question 13

An insurer enters into a quota share arrangement with the ceding insurer retaining 60% of any loss. How much will the insurer pay if the loss amounts to R40 000 under a R80 000 policy?

1 R16 000

2 R24 000

3 R40 000

4 R32 000

An insurer enters into a quota share arrangement with the ceding insurer retaining 60% of any loss. The insurer will pay R24 000 if the loss amounts to R40 000 while the reinsurer will be liable for R16 000.

Calculation:

$R40\ 000 \times 0.60 = R24\ 000$ . The reinsurer will pay the remainder of the loss, or 40%, amounting to R16 000.

#### Question 14

In terms of the COID Act (130 of 1993) ...

1 employers have less need for Employer's Liability cover.

2 employees can sue their employers for injuries following an accident at work.

3 domestic workers and contractors have a right to compensation from the government for injuries following an accident at work.

4 Permanent Military Force members have no the right to compensation from the government for injuries following an accident at work.

In terms of the COID Act (130 of 1993) employers have less need for Employer's Liability cover as employees can no longer sue their employers for injuries following an accident at work, but receive compensation in terms of the Act. Domestic workers and contractors are not covered by the Act and do not have a right to compensation from the government for injuries following an accident at work. Permanent Military Force members are covered by the Act and have the right to compensation from the government for injuries following an accident at work.

#### Question 15

Indicate the **correct** statement.

1 Risks such as good in transit are covered under a Material Damage coupon in terms of SASRIA cover.

2 SARIA cover is renewable on an annual basis.

3 Insurance companies have the authority to settle claims on behalf of SASRIA.

4 The prescription period in terms of SASRIA motor claims is 6 months.

Risks such as good in transit are covered under a Material Damage coupon in terms of SASRIA cover. SARIA cover is not renewable but members may send out expiry notices to remind clients to request the cover for the new period of insurance. Insurance companies do not have the authority to settle claims on behalf of SASRIA. The prescription period in terms of SASRIA motor claims is 12 months.

#### Question 1

An insurance agent ...

1 sells insurance as his/her main occupation.

2 is allowed to sell other products such as property on a commission basis.

3 does not need to comply to the FAIS Act.

4 does not need to register with the Registrar of Financial Service Providers.

An insurance agent is allowed to sell other products such as property on a commission basis. In the short term insurance market an insurance agent is someone who sells insurance, but it might not be his/her main occupation. Insurance agents are subject to the FAIS Act and need to register with the Registrar of Financial Service Providers

#### Question 2

A farmer insures his crop for R100 000. The value of the crop is R125 000. A loss of R50 000 is sustained. If the principle of special condition applies, an amount of ... will be payable by the insurer.

1 R 33 333,33

2 R 37 500,00

3 R 50 000,00

4 R100 000,00

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 R125 000 at the time of the loss. A loss of R50 000 was sustained. The sum insured amounts to

80% of the value of the crop at the time of the loss. The insurer is thus liable for the full value of the loss while the farmer is liable for the remainder of the loss.

Calculations:

$$100\,000/125\,000 \times 100 = 80\%$$

The insurer will be liable for the full R50 000.

### Question 3

Indicate the correct statements.

- 1 Insurance contracts indemnify the insured in terms of money, services or both.
- 2 Pooling changes the nature of risk and hampers predictions.
- 3 Organisational charts are useful in identifying supplier risk.
- 4 Driver training is an example of post-loss minimisation technique.

Pooling of risk changes the nature of the risk and improves prediction. Although insurance generally involves pooling it is not a prerequisite for insurance. Insurance contracts indemnify the insured in terms of money, services or both. Organisational charts are used to show the basic organisational structure of a company. It is indicative of the business relationship between staff and a study of these charts may point out weaknesses in the structure and particular issues such as key staff dependencies, too much authority etc. Production flow charts on the other hand may be useful in identifying process type risk. Driver training is an example of a pre-loss minimisation technique. The effect of the possible loss due to bad driving skills is anticipated and the necessary steps are taken to prevent or minimise any damage through proper driver training.

### Question 4

Self insurance may result in ...

- a the less effective use of funds for development of the business.
- b lower premiums.
- c less focused risk control programmes.
- d a smaller statistical base for premium calculations.

Choose the correct combination:

- 1 a,b
- 2 b,d
- 3 a,b,c
- 4 a,b,c,d

Self-insurance may result in lower premiums and more focused risk control programmes. Insurance costs are decreased and investment income is earned on loss reserves resulting in the more effective use of funds for business development purposes. On the other hand it requires capital to be tied up to make provision for possible losses which means that these funds are not available for other business developments. Claims statistics, which is used to determine premiums into the reserve fund, comes from a very narrow base.

#### Question 5

In terms of collective insurance ...

- a only one policy document is issued.
- b claims are handled by the broker.
- c the collective share of each insurer is reflected in the policy document.
- d a company which has a share on a collective policy are not allowed to quote against the lead insurer.

Choose the correct combination:

- 1 a,b
- 2 a,c,d
- 3 a,b,c
- 4 a,b,c,d

In terms of collective insurance only one policy document is issued and the collective share of each insurer is reflected in the policy document. A company which has a share on a collective policy are not allowed to quote against the lead insurer. All claims are handled by the lead insurer.

#### Question 6

Adverse selection ...

- 1 can result in higher losses than expected.
- 2 is increased by introducing clauses such as a suicide clause.
- 3 refers to the tendency that people with a lower probability of loss than the average seek insurance.
- 4 is increased by introducing compulsory medical examinations when applying for policies.

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 decreased by introducing clauses such as a suicide clause and introducing compulsory medical examinations when applying for policies.



### Question 7

Indicate the correct statement.

- 1 Wagering contracts are illegal in terms of common law.
- 2 Insolvent people have no capacity to enter into contracts.
- 3 In terms of common law the issuing of a policy document is not essential for the conclusion of an insurance contract.
- 4 In terms of common law the payment of the first premium is essential for the conclusion of an insurance contract.

In common law wagering contracts are not illegal, but are unenforceable. Insolvent people have a limited capacity to enter into contracts. As a rule, no special form is required to conclude a contract and insurance follows the rule. The insurance contract, like other contracts, comes into existence as soon as the parties to the contract have agreed to its essential terms. In terms of common law neither the issuance of the policy document nor the payment of a premium is therefore essential for the concluding of a contract. 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 8

Indicate the correct statement(s).

- a Stamp duties are no longer payable on short-term insurance policies.
- b Consideration in terms of insurance policies is defined as the payment of the premium.
- c The replacement of stolen assets with new assets is a violation of the principle of indemnity.
- d Insurable interest is only required for short-term insurance policies.

Choose the correct combination:

- 1 b,c
- 2 a,d
- 3 a,b
- 4 a,b,c,d

Stamp duties are no longer payable on short-term insurance policies. Consideration in terms of insurance policies is defined as the payment of the premium. The replacement of stolen assets with new assets is not necessarily a violation of the principle of indemnity since no general principle demands that the loss has to be determined in terms of the market value of the asset. Insurable interest is required for all insurance policies.

### Question 9

The policy schedule includes details of the:

- a Period of the insurance.
- b Special terms and conditions.
- c First amount payable.
- d Exceptions.

Choose the correct combination:

- 1 a,b
- 2 a,c,d
- 3 a,b,d
- 4 a,b,c

#### Question 10

Indicate the correct statement:

- 1 The principle of indemnity applies to all insurance contracts.
- 2 Insurable interest enforces the principle of indemnity.
- 3 Insurance contracts are contracts of uberrima fides.
- 4 Insurable interest is not a requirement for taking out a life insurance policy on another person's life.

The principle of indemnity generally applies to most short term insurance policies. Policies such as life, personal accident and health insurance are considered non-indemnity contracts. The amount due to the insured under these policies need not bear any relation to the actual loss the insured suffered. Insurable interest is the legally recognised relationship between the insured and the financial loss that he/she suffers following a loss. It does not however enforce the principle of indemnity as such. Insurable interest is a requirement for all insurance policies, including life insurance policies. Insurance contracts are contracts of uberrima fides.

#### Question 11

Mr A insured his car, valued at R400 000, with Company X for R150 000 and Company Y for R250 000. Mr A is involved in an accident and damage to his car amounts to R25 000. His claim, however, is repudiated due to some technical reasons. Company Y, however, decided to make an ex gratia payment of R15 625 to Mr A.

Based on the aforementioned scenario, indicate the correct statement.

- 1 Ex gratia payments are indemnity payments.
- 2 The principle of contribution does not apply to ex gratia payments.

3 Company X will be liable to pay R9 375 to Mr A

4 Ex gratia payments may affect future claims payments.

Mr A insured his car, valued at R400 000, with Company X for R150 000 and Company Y for R250 000. Mr A is involved in an accident and damage to his car amounts to R25 000. His claim, however, is repudiated due to some technical reasons. Company Y, however, decided to make an ex gratia payment of R15 625 to Mr A.6

Where a claim is not covered for technical reasons, or where there has been a genuine misunderstanding an insurer may decide to pay the claim or a part thereof. This is normally a decision made on management level and is often for business reasons. Ex gratia payments are not indemnity payments and therefore the principle of contribution does not apply. Company X will for this reason not be liable to a share of the payment to Mr A. Ex gratia payments are made without prejudice by insurers and therefore does not affect future claims payments.

#### Question 12

In terms of a quota share treaty ...

1 risk is shared on a non-proportional basis between the cedant and reinsurer.

2 the share of the different parties involved in the agreement is expressed as an amount.

3 the reinsurer is bound to accept a fixed proportion of every risk.

4 only the amount of excess of the cedant's normal capacity for a particular risk is ceded to the reinsurers.

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 13

Unemployment is an example of a (n) ... risk.

1 insurable

2 particular

3 fundamental

4 speculative

Unemployment is an example of a fundamental risk. Fundamental risks affect a 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 14

An underwriter is requested to underwrite a tyre manufacturing plant. The sums insured are:

Fire R50 000 000

Loss of profits R30 000 000

The underwriter has a net line of R2 000 000 and can take an additional 50% if the risk involves Fire and Loss of profit. The underwriter has a nine line surplus treaty.

Under the above scenario ...

1 the gross retention is R27 000 000.

2 the total net line is R2 000 000.

3 no facultative reinsurance is required.

4 facultative reinsurance of R50 000 000 will have to be placed.

An underwriter is requested to underwrite a tyre manufacturing plant. The sums insured are:

Fire	R 50 000 000
Loss of profits	R 30 000 000

The underwriter has a net line of R2 000 000 and can take an additional 50% if the risk involves Fire and Loss of profit. The underwriter has a nine line surplus treaty.

**Suggested solution:**

Net line	R 2 000 000
Plus 50% for loss of profits	R 1 000 000
<b>Total net line</b>	<b>R 3 000 000</b>
Nine lines surplus treaty	R 27 000 000
<b>Gross retention</b>	<b>R 30 000 000</b>

<b>Total sum insured:</b>	
Fire	R 50 000 000
plus Loss of profits	R 30 000 000
	<b>R 80 000 000</b>
Less gross retention	R 30 000 000
<b>Facultative required</b>	<b>R 50 000 000</b>

Question 15

Insurable interest ...

1 must exist at the time a life insurance policy claim is submitted.

2 is a requirement for wagering agreements.

3 must only exist at the time of issuing of a motor policy.

4 must exist at the time of a marine loss.

Insurable interest must exist at the time a life insurance policy is issued but is not required at the claims stage. Insurable interest must exist at the time of a marine loss. Insurable interest is not a requirement for wagering agreements. Insurable interest must exist at the time of issuing of a motor policy, at the time of the loss, and at the renewal of the policy.

#### Question 1

Proximate cause ...

1 refers to the final or last cause of a loss where more than one event contributes to the loss.

2 need not be an insured peril.

3 refers to the first or original cause of a loss where more than one cause/event contributes to the loss.

4 refers to the dominant cause of a loss.

Proximate cause refers to the dominant cause of a loss. It is not necessarily the first or last cause of the loss where more than one cause/event contributes to the loss. The insurer is only liable for losses proximately caused by an insured peril.

#### Question 2

Indicate the correct statement:

1 Fidelity guarantee insurance only provides cover against theft of money by employees.

2 Fidelity guarantee insurance is always issued on a blanket basis.

3 The premium of Fidelity guarantee insurance is based on the sum insured and the number of employees.

4 The level of hazard under Fidelity guarantee insurance is judged by the levels of control and the salaries and wages paid in a business.

Fidelity guarantee insurance is specifically designed to deal with fraud and theft by employees and covers theft of money and of stock and goods. The level of hazard under fidelity guarantee insurance is judged by the levels of control (how easy it would be for staff to steal) and the salaries and wages paid in a business. Fidelity guarantee insurance can be issued on a named persons basis, a positions basis and a blanket basis. The premium of fidelity guarantee insurance is based on the sum insured, the number of employees and the level of controls to prevent theft and how hazardous the risk is.

#### Question 3

Indicate the correct statement.

1 Theft of money by employees is covered under money insurance only if discovered within 30 days of its happening.

2 The breakage of mirrors in a fitting room of a retailer is covered under All Risk insurance.

3 Money transported to and from the bank is covered under Money insurance.

4 Shoplifting is covered under theft insurance.

Money transported to and from the bank is covered under money insurance. Theft of money by employees is covered under money insurance only if discovered within 14 days of its happening. The breakage of mirrors in a fitting room of a retailer is covered under glass insurance. Shoplifting is not covered under theft insurance as there is no forcible or violent entry or exit to or from the premises involved.

#### Question 4

Indicate the correct statement.

1 Personal Accident policies provide cover for accidents and illnesses.

2 Personal Accident policies are policies of compensation.

3 Temporary disablement due to an accident will not be covered under a Personal Accident policy.

4 No age restrictions apply to Personal Accident cover.

Personal accident policies are policies of compensation. Personal accident policies provide no cover for illnesses. Temporary disablement due to an accident is normally payable for 52 to 104 weeks. Cover is normally restricted to persons between the ages of 15 and 70 years old.

#### Question 5

Indicate the correct statement.

1 Exclusions to policies cannot be deleted and always apply.

2 Exceptions to a policy can be deleted and the peril covered for an extra premium.

3 Collusion or theft by employees is a general exception under most accident policies.

4 Loss arising from war is a general exclusion to commercial policies.

Exclusions to policies can be deleted and the peril covered for an extra premium. Exceptions to a policy cannot be deleted and will always apply. Collusion or theft by employees is a general exception under most accident policies. Loss or damage arising from war is a general exception to commercial policies.

#### Question 6

Indicate the correct statement:

- 1 SASRIA cover risks in South Africa and Namibia.
- 2 The government is one of the shareholders of SASRIA.
- 3 The government has an unlimited liability towards SASRIA.

4 Companies authorised to issue SASRIA cover are remunerated by means of commission.

Companies authorised to issue SASRIA cover are remunerated by means of commission. The government is the sole shareholder of SASRIA. The government has a limited liability towards SASRIA of R1b. SASRIA only cover risks in South Africa. A similar arrangement applies in Namibia (NASRIA).

#### Question 7

Indicate the correct statement:

- 1 The solvency margin of a company is the total value of its fixed assets and long-term liabilities.
- 2 Shareholders of a company usually prefer lower solvency margins.
- 3 Lower solvency margins indicate a lower utilisation of resources.
- 4 Policyholders usually prefer lower solvency ratios.

The solvency margin of a company is the difference between the total value of its assets and its outstanding liabilities. Shareholders of a company usually prefer lower solvency margins. Lower solvency margins indicate a higher utilisation of resources. Policyholders usually prefer higher solvency ratios.

#### Question 8

Advanced listing ...

- a entails the listing of policies due for renewal.
- b are done four months before the renewal date of policies.
- c are a long process completed manually by the claims department.
- d enables the underwriter to rate the claims experience for the policy.

Choose the correct combination:

- 1 a,d
- 2 a,b
- 3 b,c,d
- 4 a,b,c,d

Advanced listing entails the listing of policies due for renewal and is done approximately two months before the renewal date of policies. Renewals are listed in advance to enables the underwriter to rate the claims experience for the policy. Advance listing used to be a long process completed

manually by the claims department. With the development of computer technology this process has become shorter and less cumbersome.

#### Question 9

Proportional reinsurance ...

- 1 is arranged on a treaty or facultative basis.
- 2 is arranged on a treaty basis only.
- 3 entails the cedant to underwrite its retention as a form of first-loss insurance.
- 4 have grown in popularity because they are simple to operate.

Proportional reinsurance can be arranged on a facultative or treaty basis. With non-proportional reinsurance the cedant will underwrite its retention as a form of first-loss insurance. Non-proportional reinsurance agreements have grown in popularity because they are simple to operate.

#### Question 10

Indicate the correct statement:

- 1 Ex gratia payments are compensation payments.
- 2 Litigation can only be used to resolve problems of quantum.
- 3 Ex gratia payments might affect future claim payments.
- 4 Contribution and subrogation applies to ex gratia payments.

Arbitration is used to resolve problems of quantum. An ex gratia payment is made without prejudice and therefore does not affect future claim payments. Contribution and subrogation do not apply to ex gratia payments as these are not indemnity payments but are compensation payments.

#### Question 11

A ship has an insurable value of R5 000 000 but is insured for only R4 500 000. The ship is damaged during a storm at sea. Damage amounts to R500 000. The insurer will be liable for ... of the loss.

- 1 the full value
- 2 R250 000
- 3 R450 000
- 4 no part

A ship has an insurable value of R5 000 000 but is insured for only R4 500 000. The ship is damaged during a storm at sea. Damage amounts to R500 000. The insurer will be liable for R450 000 of the loss.



Calculation:

$$\begin{aligned} & R4\,500\,000 / R5\,000\,000 \times R500\,000/1 \\ & = R450\,000 \end{aligned}$$

Question 12

An excessive claim reserve will result in ...

- 1 the loss ratio of the insurer appearing lower than it actually is.
- 2 an increase in the share price of the insurance company.
- 3 a decrease in investments from external sources.
- 4 a lower solvency margin.

An excessive claim reserve will result in the loss ratio of the insurer appearing higher than it actually is, a decrease in the share price of the insurance company, a decrease in investments from external sources and a higher solvency margin.

Question 13

Indicate the correct statement:

- 1 A cricket bat broken during a match will not be covered under the All Risk section of a Personal Lines policy.
- 2 The cover provided by All Risk Insurance is also referred to as property risks.
- 3 A radio system stolen from a locked motor vehicle will not be covered under the All Risk section of a Personal Lines policy.
- 4 Money, cheques and coins are covered under the All Risk section of a Personal Lines policy.

The cover provided by all risk insurance is also referred to as away from premises risks. A cricket bat broken during a match will not be covered under the All Risk section of a Personal Lines policy. A radio system stolen from a locked motor vehicle will be covered under the All Risk section of a personal lines policy. Money, cheques and coins are not covered under the All Risk section of a personal lines policy.

Question 14

Indicate the correct statement:

- 1 The principle of contribution applies to personal accident policies.
- 2 Proof of insurable interest must be submitted when purchasing an annuity.
- 3 Personal Accident policies are life insurance policies.
- 4 Insurable interest enforces the principle of indemnity.

Personal accident policies are policies of compensation because you cannot place a value on the life of someone. The insured cannot be indemnified for his/or her loss of life or disability. The insured however is compensated if injured or killed by violent external and visible means, as a direct result of an accident, to the value of the amounts specified in the personal accident policy. Contribution, subrogation and average only apply to policies of indemnity. Personal accident policies are short-term policies. Insurable interest is a requirement when any insurance policy is purchased. The absence of insurable interest could render the insurance contract illegal, void or unenforceable. The principle of indemnity is not enforced by insurable interest but through principles such as contribution average and subrogation and Annuities are classified as long-term insurance. Insurable interest is required when the annuity is purchased but not at claim stage.

#### Question 15

Motor traders internal policies ...

1 do not cover vehicles temporarily garaged in the course of a journey.

2 covers the insured's vehicles against and vehicles in his/her custody against accidental damage.

3 provides no cover for the insured's own vehicles against accidental damage at the premises of the insured.

4 are rated on a trade plate basis.

Motor traders' internal policies only cover the insured's own vehicles against accidental damage. It is rated on the size of the insured's premises and the wage figure for the company. Vehicles temporarily garaged in the course of a journey are covered under motor traders' external policies.

#### Question 1

ABC Traders, a medium sized retailer, is considering the implementation of a self-insurance programme and approaches you for some assistance in this regard. The following information is supplied by the auditor of the concern to assist you with your final recommendations:

Annual sales	R1 100 000
Net income after tax	R 520 000
Average net income after tax for 5 years	R 580 000
Net income percentage of turnover	33%
Un-mortgaged assets	R400 000
Current ratio	2:1
Asset test ratio	1,1:1

You are required to comment on the aforementioned organisation's ability to absorb losses and to make recommendations with regard to the implementation of a self-insurance programme. All recommendations should be backed by sound theoretical principles. In your answer make reference to the advantages and disadvantages of self-insurance programmes. (10)

ABC Traders, a medium sized retailer, is considering the implementation of a self-insurance programme and approaches you for some assistance in this regard. The following information is supplied by the auditor of the concern to assist you with your final recommendations:

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Net income percentage of turnover	33%
Un-mortgaged assets	R400 000
Current ratio	2:1
Asset test ratio	1.1:1

#### ☒ Working capital:

Working capital reflects the liquidity of the business. A range between 1% and 25% of working capital is considered as guideline when deciding on the amount to be reserved for loss assumption. Where the current assets of a business cannot be easily liquidated or where the liquidity levels fluctuate throughout the financial period, the lower end of the scale should be considered for loss assumption. The higher end of the scale applies to stable and higher liquidity ratios. ✓

#### ☒ Total assets:

The ability to absorb losses may also be determined by taking into consideration the proportion of total assets available for funding. A range between 1% and 5% is considered practical. Where assets are highly leveraged and illiquid the lower end of the scale will be considered. The higher end of the scale applies when the assets of the business is liquid or unencumbered. ✓

#### ☒ Earnings method:

The ability to fund losses can also be determined by considering the current earnings and the previous five years' earnings of the business. The suggested range is between 1% and 3% of current retained earnings plus 1% to 3% of average pre-tax earnings over the preceding 5 years. ✓

#### ☒ Earnings per share:

Earnings per share represent the most tightly constrained measure of loss assumption. It is used as a conservative measure to ensure that self-funding does not over-extend a public entity or company to a point where earnings per share or current budget would be impaired by a large loss in a single reporting financial year. Normal loss assumption is considered 10% of earnings per share of a public company and 10% to 15% of the expected excess of revenue over expenditure in a public entity. The proportion will depend on management discretion and the perception of what is required by investors in a particular industry. ✓

#### ☒ Sales budget:

The final indicator is based on the sales budget with a range of 0,5% to 2% of annual sales or revenue as guideline. It measures the business' ability to generate revenue. The lower end of the scale applies to a high volume, heavy leveraged operation while the higher end of the scale applies to businesses with traditionally higher profit margins. ✓

The above indicators should finally be considered within the constraints of the entity's overall attitude towards risk. Companies with a more risk adverse culture may interpret the variables in a different light than entities with a more risk taking culture.

The next section of the answer may be answered in table format. You need to make a **recommendation** and **motivate** your recommendation. There is really no right or wrong answer as the specific range that you indicate will depend on your own numerical example and attitude towards risk.

NORM	RATIO OF COMPANY	RECOMMENDATIONS AND COMMENTS
Working capital 1-25%	2:1 Current ratio 1.1:1 Asset test ratio ✓	The working capital ratios imply that a higher ratio of working capital may be reserved for self-insurance. Recommended range: 10-15% of working capital. The figure cannot be calculated as the amounts of current assets and liabilities are not supplied. ✓
Total assets 1-5%	Un-mortgaged: R400 000	There is not sufficient information as the total assets and liability figures are not provided. Therefore a lower range of 1% of un-mortgaged assets is recommended. ✓
Earnings 1-3% of current earnings Plus 1-3% of pretax earnings over the past year	The earnings was relative stable for the preceding five years and use higher scale of 2% can be used: $R520\ 000 \times 0,02 = R10\ 400$ $R580\ 000 \times 0,02 = R11\ 600$ ✓	Based on earnings, an amount of R22 000 can be recommended to be reserved for self-funding ✓
Earnings per share	No information supplied.	
Sales Budget 0.5-2% of annual sales or revenues	Sales – R1 100 000 Profit margin – 33% ✓	The profit margin is relative low and the lower end of the scale, 1% of annual sales, is therefore recommended. $R1\ 100\ 000 \times 0,01 = R11\ 000$ ✓

## Question 2

Graphically illustrate and explain the relationship between severity and frequency of losses and the funding decision. In your answer identify and briefly explain the three categories of possible losses in an organisation. (10)

In a database of historical loss experience, we can identify three loss categories defined in terms of their individual impact on the financial integrity of a company.

☐ A range of relatively small losses exist but they have no particularly disturbing effect on a company's finances beyond their direct cost.v

☐ Then there is a cost range in terms of which the loss effects can be reasonably established by adding the direct cost of the loss to the cost of having to borrow the additional funds in the money market.v

☐ In a third range, the cost of extensive losses has a more serious effect on the ability of the company to finance the loss from its regular cash flows and normal credit lines. It may be advisable to transfer this cost to an insurer.v

Losses can also be classified as type 1, II and III losses:

#### Type I losses

The first loss type emanates from risks that produce aggregate yearly costs which are over time considered stable. The stability estimate is usually based on past experiences projected into the future. Year after year this type of loss shows little variation between the aggregate value of predicted losses and the aggregate of actual annual losses.v

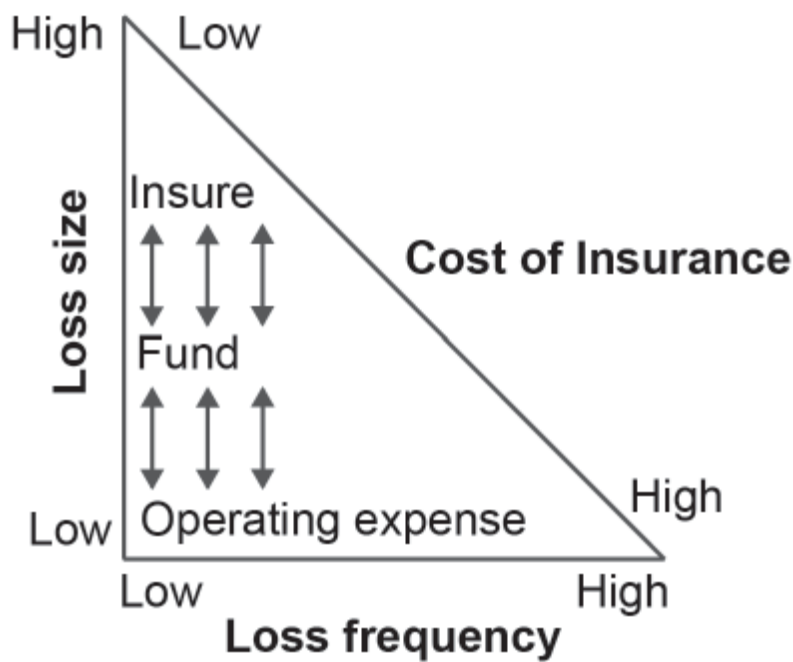
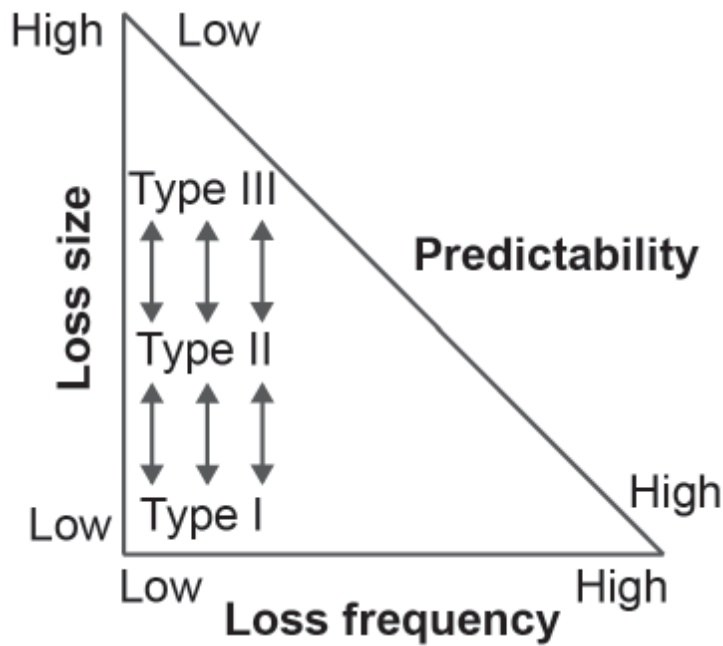
#### Type II losses

The second loss type emanates from risks that produce annual aggregate losses in excess of those associated with the first loss type. However, a company can absorb these losses within one year and remain a going concern. The maximum cost consequence of risk in this class varies according to the company's ability to absorb loss and the risk aversion attitude of its management. Risk aversion is defined as the reluctance of management to subject the company to the possibility of loss costs in excess of a planned or budgeted limit.v

#### Type III losses

The third loss type covers losses which produce aggregate annual costs in excess of those in the first two loss types.v

The relationship between the severity and the frequency of losses and their insurability is depicted in the two diagrams below.



### Loss types and Insurance

The above two diagrams show that the cost of insuring the highly predictable losses (high frequency and low severity) is high. The main reason is the high cost associated with predictable losses. The insurance company has to recover an amount that is at least equal to the size of the loss plus an additional amount for profits and administrative costs. This boils down to what is referred to as “rand swapping” which is quite costly to the insured. By funding these losses from its own resources, the company saves a substantial amount of money. This is especially true if we take into account that these losses can run into millions of Rand to which insurance companies may add as much as 40%.

### Question 3

A worker sustained lung cancer as a result of working in an asbestos plant. Explain whether the worker would have a claim under the personal accident section of a policy. (5)

A worker sustained lung cancer as a result of working in an asbestos plant. Explain whether the worker would have a claim under the Personal Accident Section of a policy.

Suggested solution:

The worker will not be able to claim from a Personal Accident policy in this case. Personal accident insurance compensates the insured, if he or she is injured or killed by violent, external and visible means as a direct result of an accident. There is no cover for illness. The worker will however be able to claim compensation in terms of the Compensation for Occupational Injuries and Diseases Act (COID) (130 OF 1993). Where the illness is a direct result from the negligence of the employer, the worker might also proceed with a liability claim against the employer.

You will note that the solution to this question is relative concise when compared to that of question 4 that carry the same mark allocation. Question 3 is considered an application or insight question and students were required to use the theory and apply it to a practical scenario. The answer must include very specific information that would answer the question posed.

### Question 4

Use a numerical example to illustrate the difference between a straight and disappearing deductible. (5)

A straight deductible applies to each and every loss and is subtracted before a loss payment is made.

Example:

Mr A has a straight deductible of R1 500 for motorcar accidents. Mr A scratches his car while parking. The value of the damage is R1 000. In this case the value of the damage is less than the deductible payment and the insurer will not be liable for any payment.

Mr B has a deductible of R 2 000 for motor vehicle accidents. He is involved in an accident and sustains damages to the value of R10 000. In this case the insurer will be liable for the amount in excess of the deductible (R10 000 – R2 000 = R8 000).

When a disappearing deductible is used, the size of the deductible decreases as the size of the loss increases. At a certain level of loss, the deductible disappears completely. The reduced deductible is calculated in terms of the following formula:

$$P = (L-D) \times (1 + R)$$

Example:

Mr C has a policy with a R5 000 deductible and a recapture factor of 5%. He sustained a loss of R5 000. The insurer will pay  $(R5\ 000 - R5\ 000) \times (1.05) = R47\ 250$ . The deductible is in effect reduced from R5 000 to only R2 250 which is  $R45\ 000 - R47\ 250$ .