

Tutorial Letter 201/2/2017

Long Term Insurance

RSK 3702

Semester 2

Department of Finance, Risk Management and Banking

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

Bar code

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1 INTRODUCTION

Dear Student

The purpose of this tutorial letter is to provide you with guidelines on answering the assignment questions, as well as some information on the examination paper.

2 GUIDELINES FOR ANSWERING ASSIGNMENT 01

Question 1: Correct answer is option 4

Refer to par 5.7.3 Chapter 5 in the IISA prescribed book.

Various devices have been designed and implemented in an attempt to curb the escalating cost of health care, such as medical savings accounts, capitation, service bundling and co-payments.

Question 2: Correct answer is option 4

Refer to par. 11.7 of Chapter 11 in the IISA prescribed text.

Adopted children have no claim against the intestate estate of their natural parents. An adopted parent will be considered to be an ancestor of the child he adopted and will be in a position to inherit from the intestate estate of the adopted child. Where a polygamous man dies intestate, each of his wives would be able to inherit. A minor or mentally ill descendant is not able to renounce his/her right to inherit.

Question 3: Correct answer is option 4

Refer to par 8.5.3 Chapter 8 in the IISA prescribed book.

Mr Calvin applied for a life policy on 1 January 2015. The policy included a suicide clause excluding death by suicide within one year of inception of the policy. On 1 June 2015 the policy lapsed due to non-payment of premiums. Mr Calvin applied for the reinstatement of the policy and it was reinstated on 1 February 2016, **with proof of good health**. Mr Calvin died on 6 October 2016 as a result of an overdose of prescribed sleeping pills. Suicide is expected.

If suicide is proven, the insurer will not be liable for any claims as the suicide clause is still

in force. Policies that are reinstated with proof of good health, is again made subject to a suicide clause from the date of reinstatement.

Question 4: Correct answer is option 4

(Students were given a free mark as this topic is not covered in the prescribed study material)

In order to qualify for social grants by government, the applicant must pass a means test. As part of the means test all the applicants' assets, excluding his/her house, is taken into account at market value. Money earned from growing crops and /or livestock is also taken into account when calculating whether a person is entitled to a full or partial grant. Money earned from any kind of work, **after contributions** to unemployment insurance, medical aid, a staff retirement fund and tax is taken off, will also be taken into account. Where the income of the applicant's spouse is a pension or other grant, that pension or grant **will not be counted** as income received by the applicant.

Question 5: Correct answer is option 4

Refer to par 6.2 Chapter 6 in the IISA prescribed book.

The factors that influence the assessment of the risk the proposer's age and gender; physical condition; medical history; family medical history; occupation and hobbies and leisure activities of a hazardous nature.

Question 6: Correct answer is option 3

Refer to par 10.7 Chapter 10 in the prescribed book.

Indicate the **incorrect** statement regarding contingent liability. It is a written agreement between the business and the director.

Question 7: Correct answer is option 1

Refer to par 3.3.1 Chapter 3 in the IISA prescribed book.

The main purpose of doing an actuarial valuation of a life insurance company is to test the solvency of the life office. Other reasons are to:

- Determine the amount of surplus funds available for distribution in the forms of bonuses and dividends and reserve funds for contingencies.
- Test the effect of new premiums or products had on the profit of the insurer.
- Settle the terms under which a merger or transfer between two or more insurers should take place.

Question 8: Correct answer is option 1

Refer to par 7.2.2 and 7.2.3 in the IISA prescribed text.

The cash value of the policy is the current value of the investment account of the policy. The policy holder will receive the **surrender value** if he/she decides to cancel the policy. The cash value is not a guaranteed amount. Where expenses are upfront recovered by a life insurer, there will be **little** difference between the cash and surrender value of the policy compared to where an aggregated charging for expenses is used where there will be quite a **large** difference between the cash and surrender value of the policy.

Question 9: Correct answer is option 2

Refer to par 8.5.3 Chapters 8 in the IISA prescribed text.

Most life insurers incorporate a 'suicide clause' in the policy. This clause applies when the policy lapsed and has been reinstated. It normally applies when a claim occurs during the **first one or two years** of a policy. The suicide clause **does not apply** to an assistance insurance policy.

Question 10: Correct answer is option 3

Refer to par. 2.3.2 of Chapter 2 in the IISA prescribed text.

The principle of '*uberrima fides*' (utmost good faith) applies to any proposal for insurance, but the test of the validity of the contract will be determined by the 'reasonable man test'. This includes the divulgence of material facts/information. In life insurance material facts would include, amongst others, the declination of a policy application by another life insurer. The lapsing of a previous policy due to non-payment of premiums, retrenchment by a former employer and the fact that the proposer is going bald are not considered material facts.

Question 11: Correct answer option 4

(Students were given a free mark because this question has two correct answers)

Refer to par 3.3.5 Chapter 3 in the IISA prescribed book.

A waiver-of-premium clause the premium payment cease and the policy is maintained in force free of charge.

Question 12: Correct answer option 3

Refer to par 3.3.5 Chapter 3 in the IISA prescribed book.

The guaranteed insurability benefit allow allows purchase of additional insurance without proof of insurability.

Question 13: Correct answer is option 3

Refer to par 5.2.2 Chapter 5 in the IISA prescribed book.

Indicate **incorrect** statement regarding Hospital cash plans exclusion the normally applies where the period of hospitalization is less than three days.

Question 14: Correct answer is option 3

Refer to par 9.1.1 Chapter 9 in the IISA prescribed text.

An incorrect statement: a pension fund may pay the total value of the accumulated benefits due to the member as a single lump sum.

Question 15: Correct answer is option 3

Refer to par 2.8.1 Chapter 2 in the IISA prescribed book.

An absolute cession of a life insurance policy is used where a policy with a cash value is sold to an investor. It is also used where a policy is given as a gift to a family member or where a policy ceded as part of an ante nuptial agreement. A security cession will apply where a policy is given as security for a loan.

3 GUIDELINES FOR ANSWERING ASSIGNMENT 02

Question 1 (10 marks)

Refer to par 2.9 Chapter 2 in the IISA prescribed book.

Mr. Rodgers took out a life insurance policy while married to Wife Mercy. He nominated her as sole beneficiary of the policy. They divorced and he remarries Wife Noko. Three years after the marriage he dies in a car accident. In his last will he leaves his estate, including the life policy, to Wife Noko. He however neglected to change the beneficiary of his life policy. Under this scenario, Wife Mercy will be able to claim the proceeds of the policy despite the conditions of the will. Where there is a difference between the stipulations of a will and the nomination of a beneficiary on a life policy, the courts will favour the beneficiary

nomination on a long term policy.

1.1 In the light of the abovementioned scenario describe the beneficiaries applicable and also indicate whether you agree or disagree with the statement and motivate why.

Suggested answer

Refer to par 5.4.4. Chapter 5 in the IISA prescribed book.

Agree ✓

- In South African law one person in a contract can promise the other person that he will award some benefit to a third person who is not part of the contract. ✓
- The contract between the insurer and insured does not give any rights to the third person, she gets those rights only by accepting the benefit when it is offered to her. ✓
- The beneficiary under life policy is only nominated to receive the proceeds of the policy when they become due. ✓
- Rodgers may be either the insured himself or his estate, or third person who was not included in the insured's contract with the insurer. ✓
- We cannot presume that married person who takes out a policy, intends to benefit his spouse and/or children, where there is no nomination of the beneficiary, the proceeds will not be paid to a surviving spouse and/or child. The proceeds will have to go into the estate. ✓
- The insured is alive a policy payable to himself or to his estate is an asset owned by him, it is his right to dispose of it as a legacy in his will. ✓
- The policy can be taken by creditors and will become the property of his trustees if he were to declare insolvent. ✓

Any 5

1.2 Based on the scenario, name the beneficiaries favoured by the court and argue why there may be differences between stipulation of a will and the nomination of the beneficiary and motivate? (5)

Suggested answers

- Mercy is a beneficiary favoured by court ✓
- In this situation, the court usually favoured the person (Mercy) who has been named as a beneficiary. ✓
- Where there is a difference between the stipulations of a will and the nomination of a beneficiary on a life policy, the courts will favour the beneficiary nomination on a long-term policy. ✓
- A nominated beneficiary (mercy) does not have to be clearly identified at the time that the nomination made ✓
- It is possible for a policy owner to simply nominate future children ✓
- In South African law one person in a contract can promise the other person that will award some benefit to a third party who is not part of the contract. ✓

Any 5

Question 2

2.1 Briefly explain 5 points under the demarcation guidelines between health insurance and medical schemes. (5)

Suggested answers

Refer to par 5.4.4. Chapter 5 in the IISA prescribed book.

- Medical schemes indemnify individuals against incurred medical care expenses while health insurance provides indemnity against unforeseen health events. ✓✓
- Medical schemes are before tax while hospital insurance is post tax. ✓✓
- Medical schemes fall under the Medical Schemes Act and the hospital insurance falls under the Long term and Short Term Insurance Acts. ✓✓
- If a policy assists in defraying medical expenses, then that policy falls under medical schemes. ✓✓
- Hospitalisation and or payment of medical costs will make a policy fall under the

medical schemes. ✓ ✓

- Health insurer pays the insured directly and may not offer cessions to service providers. ✓ ✓
- Health Insurance cannot be offered on condition that the individual has medical aid cover. ✓ ✓
- Both parties will monitor the upholding of these demarcations. ✓

2.2 Explain whether a claim submitted 20 months after the reinstatement of a policy will be considered if the cause of death was suicide. (5)

Suggested answer

Refer to par 2.6.3 Chapter 2; par 8.5.3 Chapter 8 in the IISA prescribed book.

- The non-permanent suicide clause stipulate that no claim will be admitted if suicide is committed within the set period of months of the date of the letter in which notice is given that the policy has been accepted or reinstated. ✓
- Policies that are reinstated without proof of good health, with or without the exclusion of claims, will be subjected to the suicide clause only to the extent to which the original period still applies. ✓
- Policies that are reinstated with proof of good health, are again made subject to a suicide clause from the date of reinstatement (date later). ✓
- In order to ensure uniformity, most life offices work with calendar months, where a calendar month begins on the date of the above mentioned letter and ends on the same day on the day of the following month. (weekends, public holidays and leap years therefore do not affect the period of the month) ✓
- Most life insurers used to impose a suicide clause as a results of which a death claim as a results of suicide during the first 24 months of the contract will automatically be repudiated. ✓
- It is widely believed that it is a fundamental principle of insurance law that an insured cannot receive a benefit if, by his own deliberate act, he causes the event insured against.(supported by the Judgement of lord Atkin and Lord MacMillan in the leading

case of *Beresford vs Royal Insurance Co. Ltd* (1938). These judges considered that the ruler preventing payment was not that of public policy, but a fundamental implied term of the contract “a man cannot by his own act cause the event on which the insurance money is payable”. ✓

- The above principle does not apply if the life insured commits suicide whilst insane, as it can be said he does not have the mental capacity to appreciate what s/he is doing. ✓
- If the policy contains a suicide clause then the position depends on the wording of the clause. Many offices include a clause such as:
“If the suicide life insured shall commit suicide within twelve months from the date of the policy all benefits which otherwise have become payable shall be forfeited and belong to the insurer”. ✓

Any 5

4 GUIDELINES FOR ANSWERING ASSIGNMENT 03

Question 1

Discuss insurable interest, setting out the fundamental concept (**definition**) thereof, give the **differences** between the required presence of insurable interest under short term and life insurance policies and also provide brief notes on at **least three examples** of insurable interest.

(5)

Suggested answer:

Refer to par 2.2 Chapter 2 in the IISA prescribed book

Before you attempt any question make sure you analyse the question properly. Highlight the core parts of the question and make sure you address each part in your answer. This question comprises three parts – a definition, the difference between short and long term applicability and three examples.

For an insurable interest to be present the person taking out the policy must be able to provide tangible evidence that s/he will **suffer a pecuniary loss** in the event of the insured event happening.√ This evidence must be provided at the **inception of the policy as well as at the claim stage** for a **short term insurance** policy, but only at the **inception of a life insurance policy**.√

In the case of *Commercial Insurance Co. vs Kern* the court decided that - “The fundamental principle is that once the insured is deprived of his insurable interest in the insured car, the policy ceases to have any validity”. This means that in a claim under a **short term contract** the insurable interest must be established, **both at the time that the contract is taken out and also at the claim stage**. (√)

In the case of *Rixom vs Southern Life Association of Africa & Collins & Bain* the court decided that - “Insurable interest must be in **existence at the beginning of the contract**”. As this decision was about a life insurance policy it is now accepted as applying to all life policies. In a **life insurance contract** one must therefore prove insurable interest at **commencement only**. There is no need to prove insurable interest at the claim stage. (√)

Max 2 marks

In the above section of the solution many of the facts are repeated. We therefore awarded alternative marks – in brackets – and capped the allocation of marks at a maximum of 2.

Examples of insurable interest

Any three of the following x 1 mark:

On the insured's own life

Everyone has an unlimited insurable interest in their own lives.

On the life of a spouse

There is an unlimited insurable interest between spouses.

On the life of a fiancée/fiancé

A person has some right to expect a financial advantage from the continued well-being of a fiancée/fiancé.

On the life of a relative

A person has a legal right to claim support from a relative and so an insurable interest exists.

Creditor on the life of a debtor

A creditor has an interest in the continued health of a person who owes him money.

Partners

Partners create an insurable interest in each other's lives when they sign an agreement to pay money to the estate of a partner that dies.

Employers on their employees

An employer has an insurable interest on the life of an employee if it can be established that the earnings of the company rely on the employee's skill or services.

Question 2

Policy servicing in a life office involves a variety of functions and aspects. Briefly discuss the following issues:

- | | |
|----------------------------|-----|
| 1. Cash values | (1) |
| 2. Surrender values | (1) |
| 3. Automatic premium loans | (1) |
| 4. Revival conditions | (1) |
| 5. Policy loans | (1) |

Suggested answer:

Refer to chapter 7 in the IISA prescribed book.

1. Cash values

A policy owner can ask the life insurer at any time what the cash value of his/her policy is. The cash value will be the **current value of the investment account** of the policy.√

2. Surrender values

The surrender value of a policy is that **amount of money** that a policy owner will receive **out of the investment account** if s/he decides to **cancel the policy**.√

3. Automatic premium loans

Where a policy has acquired a surrender value, the insurer will use this to keep the benefits going for as long as possible **if the premiums are unpaid.**√ (This is known as an Automatic Policy Loan [APL] or a Non-Forfeiture Allocation [NFA].) This will help the policy owner as s/he will be able to **submit a claim even if the premiums are in arrears.** √ However, when the surrender value of the policy “runs out” the policy will lapse and all benefits will be lost.

4. Revival conditions

If the policy **has lapsed the policy owner will have to re-apply** for the insurance cover. Any **medical evidence** that the underwriters might ask for will have to be given to them by the life insured. **Conditions** such as the suicide clause will recommence from the date of revival. The life insurer also has the right to refuse to renew the policy.√

5. Policy loans

To help policy owners through tough times insurers offer **loans against the security of most** policies. The value of the loan will be limited to a percentage between 80% and 95% of the surrender value of the policy. √The **loan and any interest** that has been added to its value will be **subtracted** from the value of any claim that is due when the policy matures or becomes a claim.√

(5 marks)

Question 3

It may happen that a person dies without having drawn up a will, while it is also possible that the Master of the Supreme Court may rule that certain conditions set out in a person’s will do not conform to criteria acceptable to him and he can then declare the will (or part thereof) to be invalid. When this occurs the “deceased” is said to have died *intestate* and the Intestate Succession Act no 81 of 1987 (as amended) will determine who will inherit the estate, once the estate has been finally wound up.

Briefly set out the distribution basis of the estate under the following conditions, when the deceased is:

- 3.1 Survived by a spouse, but not by a descendant
- 3.2 Not survived by a spouse or a descendant, but by parents, or one parent
- 3.3 Survived by a spouse and three children
- 3.4 Only survived by an adopted child
- 3.5 A man who was in a polygamous (religious) marriage, with multiple wives

(5 x 2 = 10)

Suggested solution:

Refer to Chapter 11, par.11.7 in the IISA prescribed book.

3.1 Survived by a spouse, but not by a descendant

Where a person is survived by a spouse, but not by a descendant, the surviving spouse will inherit the entire estate. ✓✓

3.2 Not survived by a spouse or a descendant, but by parents, or one parent

Where a person is survived by both parents, the parents will inherit the intestate estate in equal shares. ✓ Where a person is survived by one parent, the surviving parent will inherit one half of the intestate estate and the descendants of the deceased parent will share the other half of the estate. ✓ Should the deceased parent not have any descendants, the surviving parent will inherit the entire estate. ✓

max 2**3.3 Survived by a spouse and three children**

Where a person is survived by a spouse and descendants, the spouse will inherit an amount equal to the greater of a child's share of the intestate estate or an amount which is fixed from time to time by the Minister of Justice in the Government Gazette. ✓ Where more than 1 child is involved the value of the children's portions will be determined by dividing the monetary value of the estate by the number of children plus one. The plus one is for the surviving spouse's share. ✓ Where the amount set down is greater than a child's share the descendant will inherit the residue, if any, of the intestate estate. ✓

max 2**3.4 Only survived by an adopted child**

An adopted child is deemed to be a descendant of his/her adopted parents. ✓ Where a person is survived by an adopted child and no spouse, the adopted child will inherit the entire estate. ✓

3.5 A man who was in a polygamous (religious) marriage, with multiple wives

Where a man in a polygamous marriage dies intestate, each of his wives will inherit in equal shares ✓✓.

5 GUIDELINES FOR THE EXAMINATION

A two-hour, 70 marks, 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 paper comprises three sections:

SECTION A comprises 10 multiple choice questions of 1 mark each and 10 True/False questions of 2 marks each. The True/False questions must be motivated – no marks will be allocated to a True/False answer that does not include a proper motivation.

SECTION B comprises of question that count a total of 40 marks. **All the questions in this section must be answered.**

General guidelines

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

- Section A must be answered in the examination script as instructed. You will not have to complete a mark reading card for this section.
- Answer the questions in Section B 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.

- **Include 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.

- **Make sure you interpret the questions correctly**

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.

- **Do not include too much detail in the answers and repeat 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.

- **Make sure the facts included are complete**

Students tend to include only a certain part of a fact. For example: Where a policy has acquired a surrender value the insurer will use this to keep the benefits going for as long as possible, **if the premiums are unpaid**. Without the part in bold, the fact is incomplete. Where you are required to list facts, your answer should still be complete, make sense and be self-explanatory.

6 CONCLUDING REMARKS

We trust that you have found the study of this module both interesting and rewarding up to this stage. We wish you all of the best with your preparation for the examination. Please do not hesitate to contact us if you have any difficulties with the study material for this module.

Best wishes

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DEPARTMENT OF FINANCE, RISK MANAGEMENT AND BANKING

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