

**SUGGESTED  
ANSWERS**

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**ALL CHAPTERS**

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## CHAPTER 1

1. **You are a short term broker and your client has just asked you to explain the concept of risk management. Write to your client explaining what risk management is.**

You are asked to write a letter, and you should do exactly that.

### Smith Insurance Brokers

40 Smith Street  
Benoni  
1501

17 January 2015  
The Directors  
Perkins Sauce Company Ltd  
P O Box 56  
Westville  
2091

Attention: Mr D Perkins

Dear Dan

I refer to our discussion of last week, when you asked about the concept of risk management. I have spoken to our risk management division and confirm that we would be happy to advise you on the various measures you could take. I have the following information for you which sets out the whole concept and process we would follow.

Firstly it is important to realise that:

- risk management takes a far broader view of the concept of risk than does insurance; and
- insurance can be part of risk management but other areas are taken into account.

There are three steps involved in the risk management process, being:

- identification of risk;
- evaluation of risk; and
- control of risk.

### Identification

There are a number of ways in which this can be done, but before commencing it would be appropriate for our risk manager, Mr Mike Hail, to do a physical inspection of the premises. He would spend two or three days, whichever is convenient for you, inspecting the plant and offices and chatting to the various managers and foremen. This will let him get an overall feel for the processes involved and the type of problems your particular business may face.

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He will then be in a position to complete various diagrams including organisational charts, flow charts and check lists. The one I think you will find most helpful is the flow chart as this will assist us in identifying areas where you are dependent on suppliers and customers. We can also identify plant that may be used as alternatives, in the event of any loss or damage to existing plant.

### **Evaluation**

The next step in the process will be to evaluate the effect any loss will have on the business. We have records of the claims over the last three years, but it would also be helpful if you could let us have details of any accidents there have been which were not claims in terms of your insurance portfolio. One area you may be keen to look at is the possibility of fraud by staff members. This is on the increase in the country as a whole and it may be advisable to look at the checks you have in place to prevent this type of loss.

Once we have completed the evaluation process we can then look at risk control.

### **Risk Control**

It is important to realise that on the whole risk cannot be eliminated, but it can be minimised. It is in this area that Mike Hail will discuss effective methods of risk control with you. There are two areas we can look at, which can both be subdivided. They are:

- Financial Control - here we can decide what risks you wish to retain and which risks you wish to transfer to an insurer.
- Physical Control - here we look at what areas of risk can be eliminated, and which can be minimised.

As I am sure you can see from the description above this is a fairly involved process and needs to be tackled by a professional. Mike Hail has been a risk manager for ten years, has a Degree in Chemistry and was a fire fighter for five years prior to joining us in 1995 as a risk manager.

I would like to organise an appointment with you in the near future and would be grateful if you could telephone me to set up appointments, so that we can get the process started.

Yours sincerely,

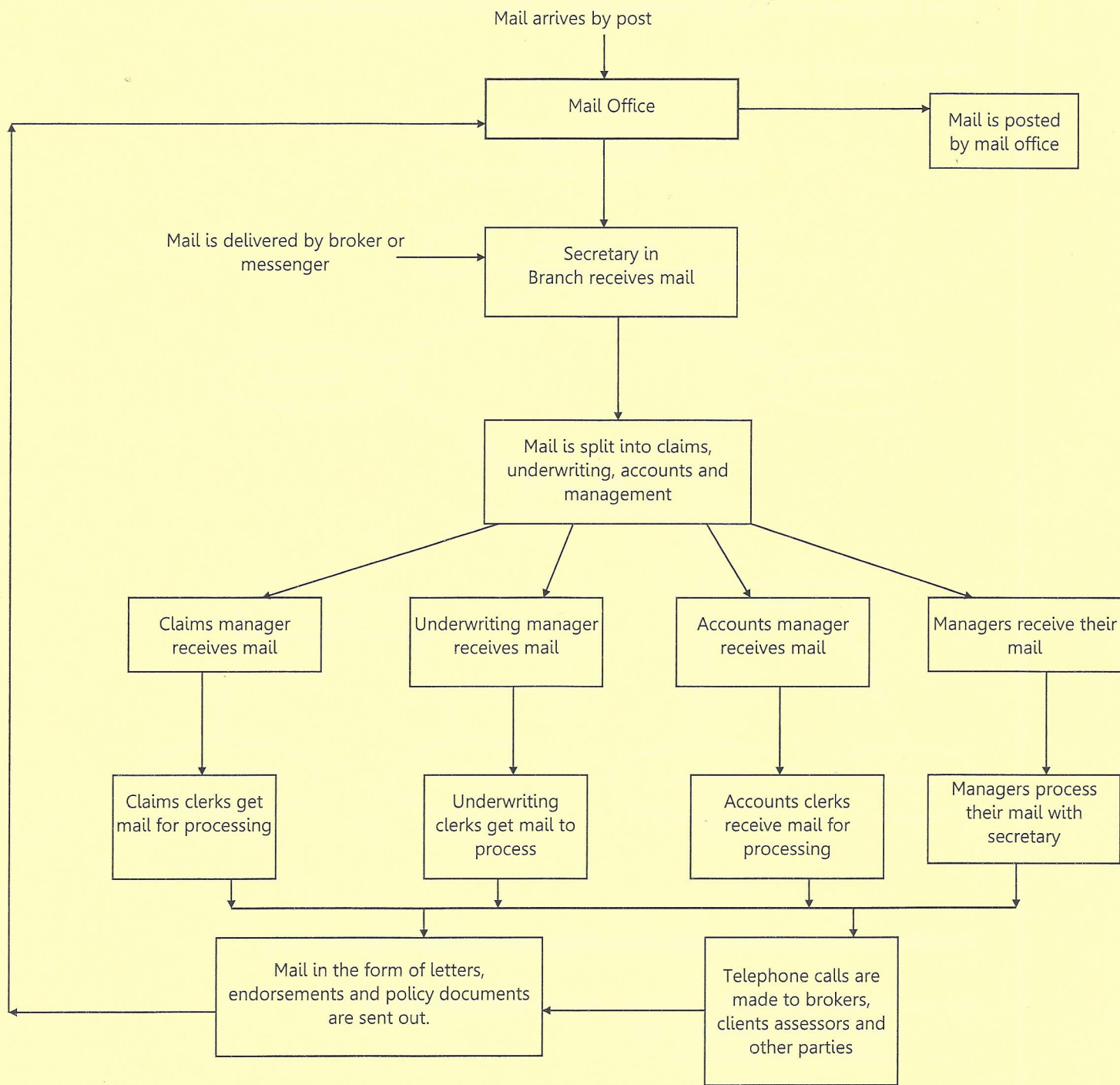
Angela Green FISA  
Accounts Manager

## **2. Explain what a flow chart is and draw one up for the processes in your department or office.**

A flow chart is a diagrammatic aid that can be used in the identification of risk. It is particularly appropriate in risks where processes are involved and where materials flow through different areas of the premises.

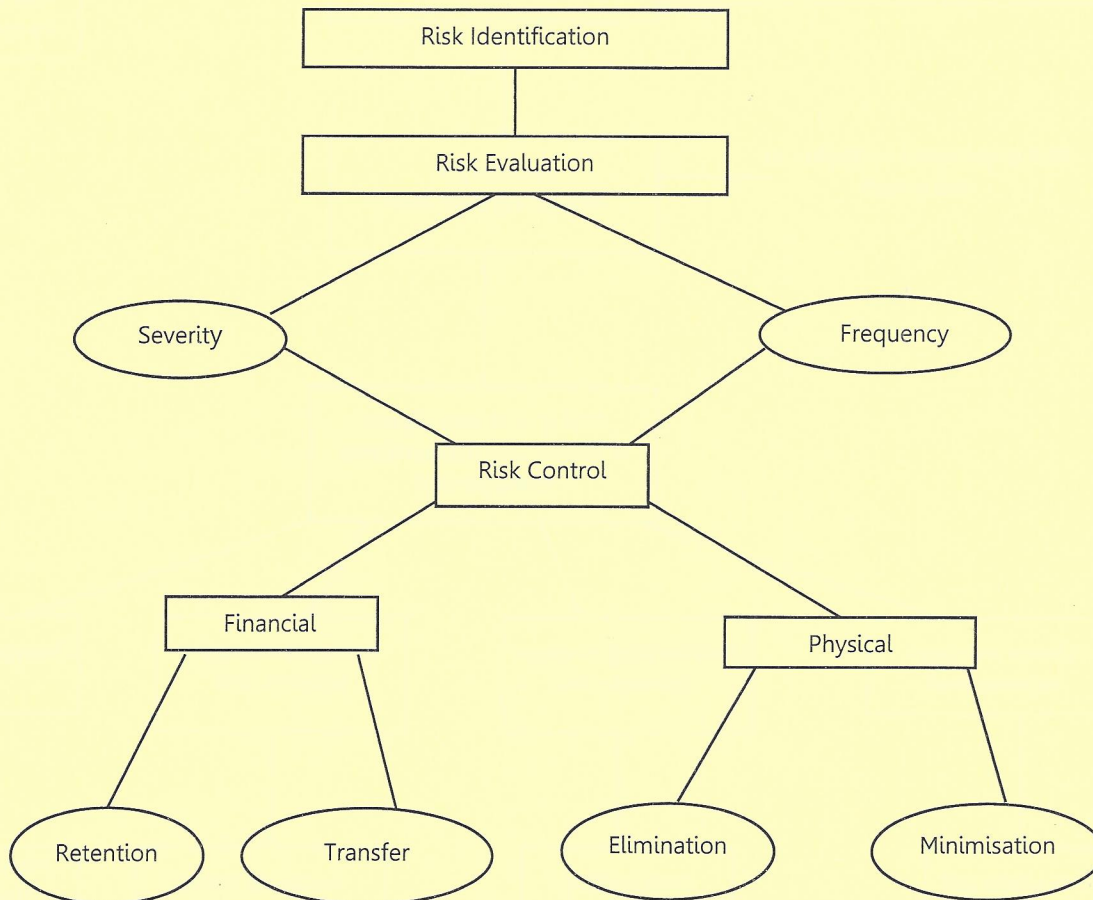
Here is an example in an insurance office:

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3. Draw a diagram showing the various steps in the risk management process.

Risk Management Process



4. Describe the two methods open to the client who decides to transfer risk.

The two methods open to the client who decides to transfer risk are:

- transfer of the whole risk; and
- transfer of part of the risk.

Transfer of the entire risk involves the client obtaining insurance for all those risks that can be transferred.

In transfer of part of the risk the client can decide on:

- how much risk he can afford to keep; and
- how much risk he wants to keep.

He will then try to obtain insurance cover for that part he does not wish to keep.

## CHAPTER 2

### 1. Describe fully the functions of the South African Insurance Association.

The South African Insurance Association:

- represents the interests of the short term insurance industry with government; and
- promotes co-operation between the public and short term insurers.

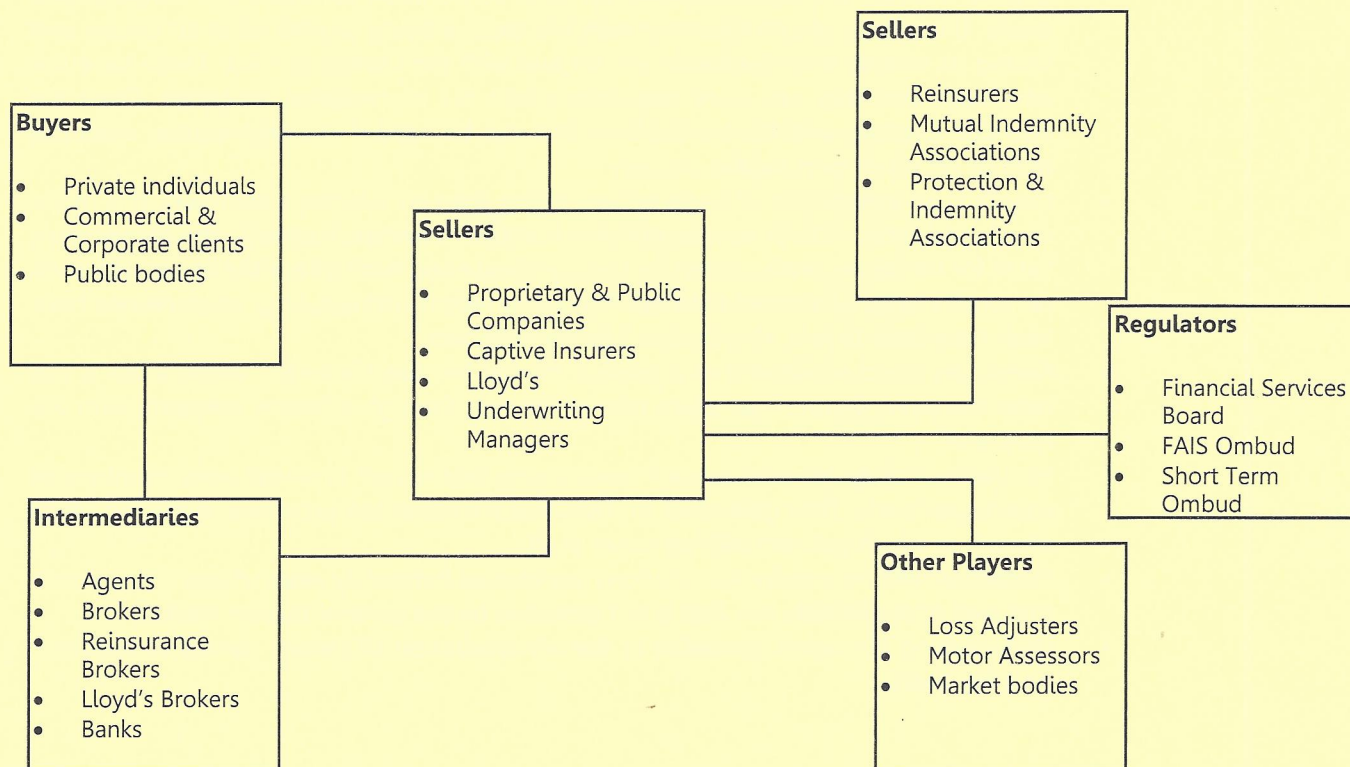
It administers or takes part in

- South African Nuclear Energy Insurance Pool (Home and Foreign);
- Growing Timber Pool;
- Intermediaries Guarantee Facility Limited; and
- Association of Marine Underwriters.

It also oversees various activities aimed at curbing losses due to crime and fraud, such as the fraudline, the Insurance crime bureau and the Insurance Data System.

### 2. Describe the various players in the South African short term market.

The various players in the South African short term market are:



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**Buyers**

- The private individual is the "man in the street", who purchases insurance to cover his home, motor car, all risks and liability which he may incur as an individual.
- Commercial clients are the typical business organisations that require cover for the assets of the business and the liability it may incur.
- The Corporate client is the larger commercial risk that requires commercial cover but, where the assets are larger, it may be suitable to issue Assets All Risks cover.
- Public bodies, including Municipalities and parastatals.

**Intermediaries**

- Agents are people who sell insurance to supplement their income. They are not considered to be full time professionals, as brokers are.
- Brokers are full time insurance professionals. Their income is derived solely from insurance. They owe their client a greater duty of care. Banks often make use of their own in-house brokerages.
- Reinsurance brokers operate between insurers and reinsurers.
- Lloyd's Brokers are the only people who can place business with Lloyd's. They must satisfy the Committee of Lloyd's as to their experience, integrity and financial standing within the market place. There are only Lloyd's agents in South Africa, who are in contact with Lloyd's Brokers in the United Kingdom.

**Sellers**

- Proprietary companies are limited liability companies owned by shareholders. They will have Articles of Association. Mutual companies are owned by the policyholders.
- Captive Insurers are companies set up by a corporation to insure the corporation's assets. It is a form of self-insurance with the captive being registered as an insurer and having to comply with the Insurance Act and with the Companies Act. These have the advantage that they can place reinsurance with the professional reinsurers. There are also Cell Captives and Rent-a-Captives that can be used if the organisation does not wish to set up its own captive insurer.
- Lloyd's is an association of underwriters, rather than an insurance company. It is made up of syndicates, who in turn comprise a number of names. Formerly, the names were liable for the losses underwritten by their syndicate and had to back the losses with their personal assets. (Unlimited liability). Following recent restructuring, corporations have been permitted to join, also limited liability members.
- Reinsurers are companies that provide a market for direct insurers. When a risk is too large the direct insurer may place part of the risk, through different methods, with the reinsurer.
- Mutual Indemnity Associations are associations that accept business from members of a particular trade. They give cover for risks that are either too expensive in the insurance market, or which insurers will not cover at all.
- Protection and Indemnity Associations are mutual indemnity associations. They insure that part of the liability risk that is not provided by the general marine market.
- Underwriting Managers specialise in the administration of certain classes of business, on a fee basis.

**Regulators**

- The FSB regulates the market, while the statutory (FAIS) Ombud and the Short Term Ombud assist with resolving complaints.

**Other Players**

- Loss Adjusters are appointed by insurers to handle mostly non-motor losses on behalf of the insurer. They will liaise with the client, investigate the loss and arrange quotations and replacement of goods among other things. They will send a report to the insurer recommending methods of settlement. They have no authority to settle the loss, but can only give recommendations.
- Motor Assessors inspect damaged vehicles and negotiate prices and repairs with panel-beaters.
- There are various market bodies. They include:
  - SAIA - described in question 1;
  - Financial Intermediaries Association - a consolidation of the South African Financial Services Intermediaries Association, the Insurance Brokers Council and LUASA (the Association of Professional Financial Advisors)
  - The Institute of Risk Managers is an association for risk managers;
  - The Institute of Loss Adjusters is a professional body for loss adjusters. Members can qualify as an Affiliate, Associate, or Fellow of the Institute; and
  - The South African Underwriting Managers Association.

There are also the regulators (the FSB and offices of the Ombud) and the Insurance Institute of South Africa.

**3. Explain the difference between self-insurance and non-insurance.**

Self-insurance is where the insured sets aside funds to meet losses that may occur. There will be certain policy guidelines laid down as to cover details, excesses and the like. In non-insurance, no provisions have been made and the person deals with losses if and when they happen.

**4. Explain the features of a collective policy.**

A collective policy is a policy in which a number of insurers share. It is placed with each insurer by the broker. It is the broker's responsibility to place any shortfall in cover that might occur because of the insolvency of an individual insurer. Features of the policy are:

- each insurer has a share of the risk;
- the lead insurer issues the policy;
- the policy reflects each insurer's share;
- the claims are handled by the lead insurer;
- the other insurers normally follow the lead;
- a collective insurer cannot quote against the lead; and
- the lead insurer receives a handling fee from other insurers, who share the risk.



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**5. Your client owns a corner café and is considering self-insurance. Explain the advantages and disadvantages to him.**

Self-insurance has various advantages and disadvantages. They are

**Advantages:**

- premiums should be lower as there is no commission to be paid and no insurers administrative costs;
- interest from the fund accrues to the self-insured;
- premiums do not increase because of other peoples' claims;
- there is a strong incentive to reduce claims and control losses;
- there is no disagreement over claims settlement; and
- the profits of the fund accrue to the self-insured.

**Disadvantages:**

- a catastrophic loss can wipe the fund out and force the company into liquidation;
- the aggregate of individual losses could have a similar effect;
- capital is tied up instead of being used to grow the company;
- need to employ insurance professionals to handle the fund;
- technical advice from insurance professionals lost;
- claims statistics are from too narrow a base;
- shareholders can criticise the transfer of large sums of money to the fund;
- losses which are not really covered may be paid, because of managerial pressure; and
- basic principle of spreading risk is not adhered to.

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## CHAPTER 3

1. **Short term insurance policies, on the whole, are policies of indemnity. Explain what this means and why contribution and subrogation are linked to this principle.**

Indemnity is the act of putting the insured back in the same financial position he was in prior to the loss. The insured may not profit from a loss. Subrogation and contribution apply to policies of indemnity only. This is because:

- subrogation enables the insurer to recover from a third party who caused the loss or damage. This prevents the insured profiting; and
- contribution is where the insured has more than one policy covering the loss. The contribution clause ensures that each insurer pays its share of the risk and the insured does not profit.

They do not apply to policies of compensation as these are not contracts of indemnity. Benefits are determined at the inception of the policy and the insured's ability to pay helps determine how much compensation he can afford.

2. **Explain how the Short Term Insurance Act regulates the handling of premiums and the amount of intermediary commission.**

In terms of Section 45 and Regulation 4 of the Insurance Act any intermediary who collects premiums on behalf of a short term insurer, must have a guarantee for an amount of 30% of the annual premiums he collects, with a minimum of R100 000 and a maximum of R100 000 000. The Act also regulates how premiums must be paid over once collected. The intermediary:

- must pay over premiums received within 15 days after the end of the month in which they were received;
- must include a statement of payments with the payment; and
- may pay net instead of gross, thereby deducting his commission and any refunds due to clients.

Maximum rates of commission are also stipulated. They are:

- motor - 12,5%;
- all other classes - 20%;

Commission is only payable when the premium has been paid to the insurer, except that the premium may be paid over net of commission.

3. **The short term policy is made up of various sections, one of which is the schedule. Describe what is contained in the schedule.**

The schedule contains all the details that customise the policy for each particular client. It will contain details of:

- the risk;
  - the insured;
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- the period of insurance;
- any excess or first amount payable;
- the policy number; and
- any special terms and conditions that apply.

**4. Explain the difference between a true monthly policy and the annual policy that is paid monthly. How does it affect the client?**

The true monthly policy and the annual policy differ in the following ways.

Area of Difference	Annual Policy	Monthly Policy
Collection of premium	The premium is due annually, but may be spread over 12 months	The premium is a monthly payment due every month
Premium increase and underwriting changes	These are reviewed only once a year	Any increases or underwriting change is effective from the following month, because this is a renewal of the policy
Usual classes of business	This is common in the commercial market	This is common in the domestic market

As per the table, the monthly policy affects the client in that any changes introduced by the insurer usually take effect almost immediately.

**5. Describe the factors which are taken into consideration when underwriting a householders policy.**

Factors that influence the underwriting of a householders policy are:

- sum insured;
- the area;
- the construction; and
- the burglary protections at the risk.

## CHAPTER 4

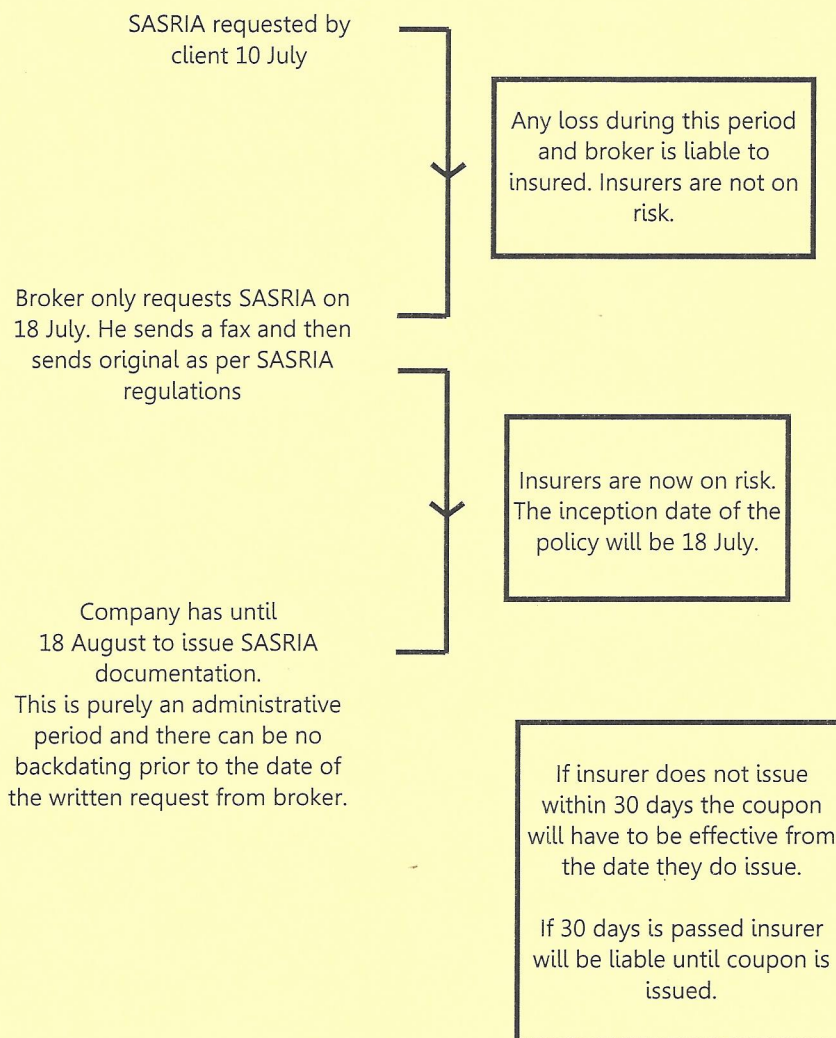
1. **The underwriter tries to review at least three years claims experience. Explain why he does not use one years claims only.**

The underwriter uses three year's experience as this will reflect any trends that are developing. For example, it will show whether the insured:

- claims on a regular basis;
- claims for very small amounts; and
- has had a number of claims for a particular class of business.

2. **Explain the steps necessary for the issuing of SASRIA, with particular reference to the effect late requests, or late issuing may have for the different parties.**

The steps for issuing SASRIA are demonstrated in the following diagram.



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**3. Describe the survey process and what information can be obtained from it.**

If the underwriter decides to call for a survey the undermentioned process will be followed:

- a surveyor from the insurer's office will visit the insured's premises;
- he will take down particulars of the risk, such as housekeeping and protections and he will draw a plan of the risk and may take photographs;
- these allow the underwriter a look at the premises;
- a report will be produced outlining the features of the risk; and
- the underwriter will assess these features and will decide whether to accept or decline the risk. The survey also helps him to decide on the terms, conditions and rates.

## CHAPTER 5

### 1. Explain the difference between facultative and treaty reinsurance.

Facultative reinsurance is a method whereby the underwriter must contact the reinsurer for each and every risk. The reinsurer can decide to accept, or reject the risk and also the terms and conditions required.

Treaty reinsurance is a method whereby treaties are arranged each year and have certain parameters. Within these parameters the underwriter can use the treaty to take the part of a risk which he cannot retain for himself. The reinsurer must accept the risk if it falls within the parameters.

### 2. Explain the advantages of layered reinsurance.

The advantages of layered reinsurance are:

- reinsurers are much happier with a defined limit of exposure;
- cedants are more likely to be able to place cover;
- as the higher layers are more remote from losses, then the premium for these layers is cheaper; and
- for the same reason, reinsurers are happier to take larger amounts in these higher layers.

### 3. An underwriter is asked to underwrite a plastic extrusion plant. The sums insured are:

- Fire R10 000 000
- Loss of Profits R15 000 000

She has a net line of R1 000 000 and can take an additional 50% if the risk involves Fire and Loss of Profits. She has a nine line surplus treaty.

Calculate what her gross retention is and what facultative reinsurance she will have to place, if any.

Net line	R1 000 000
+50% for Loss of Profits	R500 000
Total net Line	R1 500 000
nine lines	R13 500 000
Gross Retention	R15 000 000
Total Sum Insured	R25 000 000
Fire and Loss of Profits	
Facultative required	R10 000 000

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**4. Explain the reasons for using a quota share treaty.**

The reasons for a quota share treaty are:

- a new insurance company needs reinsurance protection until experience and credibility are attained. This may be the only type of reinsurance cover available;
- when an existing insurer branches into another field this could also be the case;
- following significant underwriting losses, this may be the only treaty which can be negotiated; and
- it may be used as an inter-group treaty, within an organisation, to pass business around.

## CHAPTER 6

### 1. Define proximate cause and explain its operation.

A legal definition of proximate cause was given in *Pawsey v Scottish Union and National (1908)* where the judge directed that:

*"Proximate cause means the active, efficient cause that sets in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new and independent source."*

It is not necessarily the first or last cause of the loss, but it is the dominant cause.

### 2. Describe the four methods of settling a claim and give an example of when each is most likely to be used.

The four methods of claims settlement are as follows:

Method	When normally used
Cash Settlement	The claim is settled with a cheque being drawn. This is normal in liability and third party losses.
Replacement	The insurer replaces the lost item with a similar article. This is used where the insurer can obtain a better price, because of the volumes they purchase.  It is the normal way of settling glass claims.
Repair	The insurer pays for the article to be repaired. This is the normal method of settling motor damage.
Reinstatement	In this method the insurer has the item rebuilt. This is normal for buildings that have been burnt out.

### 3. Explain why subrogation and contribution do not apply to an ex-gratia payment.

Subrogation and contribution do not apply to ex-gratia payments as these are not indemnity payments in terms of the contract of insurance. The claim is not covered, but the company pay the claim in the interest of fairness and for business reasons.



**4. Describe the various steps an insurer can take following a loss.**

Following a loss an insurer may take the following steps.

- a post-loss survey;
- a reduction or deletion of the no claims bonus/claim free group;
- reinstatement of the sum insured; and
- deletion of a lost item.

**A post-loss survey**

This will be carried out, perhaps because no survey was conducted when the business was taken on, or because the loss adjuster found an adverse feature. Risk improvements could then be called for.

**Reduction in NCB/CFG**

The insured receives these benefits for not claiming. When a loss occurs the discount must be reduced or removed.

**Reinstate the sum insured**

When a loss occurs, the sum insured is reduced by the amount of the loss. The sum insured must therefore be reinstated and a pro rata premium charged from the date of loss to the next renewal date.

**Deletion of the item**

If an item is lost it must be deleted from the schedule as it is no longer the subject of insurance. This normally only happens to items that are individually specified in the policy.

**5. Explain the concept of average and give an example of how it is applied**

When an insured does not insure for the full value of his property, he is not paying his fair share into the insurance pool. In this instance, when there is a loss, the insured will be considered his own insurer for the portion of the risk that is not insured. The formula for average is:

$$\frac{\text{Sum Insured}}{\text{Value at risk}} \times \text{Loss} = \text{Settlement}$$

Example

$$\frac{\text{R10 000}}{\text{R20 000}} \times \text{R5 000} = \text{R2 500}$$

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## CHAPTER 7

### 1. Briefly list the statements and accounts a short term insurer must submit to the Registrar in terms of the Short Term Insurance Act.

In terms of the Short Term Insurance Act a short term insurer must submit the following:

- within four months of the end of his financial year - an audited annual return, with full details (including statements of assets and liabilities) as provided by the regulations;
- within one month after the expiry of each quarter - a spreadsheet showing gross and net underwriting results for each main class of business - (Property, Transportation, Motor, Accident/Health, Guarantee, Liability, Contractors/Engineering, and Miscellaneous); and
- within six months after the expiry of each financial year - a copy of any duly audited account or balance sheet required to be submitted to shareholders in terms of the Companies Act, or other legislation by which it is incorporated.

#### Statement of Liabilities

This must include:

- the Rand value amount of claims outstanding;
- an estimate of the claims incurred but not reported - in short term insurance provision must be made for claims which have happened, but which the company has not yet been advised of, based on statistics of past experience (the estimates may be net of all recoveries from reinsurers); and
- the estimated liability for taxation.

#### Statement of Assets

Local insurers must present a statement of their assets each year and foreign insurers must present a statement of their assets held in the Republic. The information needed is quite detailed but some of the main points are:

- no amount may be included for goodwill; and
- no premium outstanding for a period of more than two months from due date may be included.

### 2. Describe the solvency requirements of a short term insurer in terms of the Short Term Insurance Act.

In terms of the Insurance Act the solvency margin requirements are:

A domestic insurer carrying on short term business must hold assets with an aggregate value not less than its liabilities plus the greater of:

- (a) R3 000 000; or
-

- (b) the percentage prescribed by regulation (currently 15%) of the greater of:
- the premium income in the previous financial year or
  - the premium income in the previous 12 months before the calculation is made.

This changed in 2010 with the advent of the new Financial Condition Reporting requirements.

**3. Explain how solvency margins are calculated and how incorrect estimates for claims affect these.**

The solvency margin is the difference between its assets and its outstanding liabilities. The higher the amount of assets is over the liabilities the greater the solvency margin.

Incorrect claims estimates impact as follows:

If too high,

- the company is reserving money which could have been invested or used for expansion of the business;
- the liabilities of the company appear worse than they are, which could have an effect on investor confidence (or even the placement of business); and
- the company may have to seek extra funds to maintain its solvency.

If too low,

- then there may not be enough money in the reserves to cover claims;
- the liabilities are too low and create a falsely high solvency margin; and
- at worst, the Registrar could step in and put the company under curatorship because the solvency margin is too low

**4. Explain Value Added Tax in relation to claims payments and recoveries.**

All short term insurance is subject to VAT. With specific regard to claims payments the following applies.

When an insurer makes an indemnity payment he will be entitled to claim an input credit in respect of the VAT portion of the claims, so long as the insurance contract was taxable. This does not apply when:

- payment is in respect of the supply of goods. These payments are excluded where it is restitution to the insured and where the insurer claims an input credit through the supplier's tax invoice;
- the supply of the insurance is zero rated;
- the person indemnified is neither a vendor, nor a resident of the country; and
- the payment is from a supply of goods outside the country, or for services performed outside the country.

The term indemnity is not defined in the Act but it is assumed to mean the settlement of a claim, other than for the supply of goods or services to the insurer, in making good the insured's loss. The insurer is however entitled to an input credit for any VAT charged to him by a vendor, provided he has a tax invoice.

Agreement has been received from the authorities for insurers to combine indemnity payments and payments to suppliers to determine input tax credits. This is subject to insurers having a tax invoice. The credit can only be claimed once the payment has been made.

### **Third Party Vendors**

With regard to third party claims when the insurer pays the third party, who is a vendor, it would not be deemed a service and therefore the vendor cannot claim a tax credit.

The insured vendor who was at fault would however have a constructive receipt and would be liable for output tax. The insurer would therefore have to indemnify the insured by paying him the VAT portion of the claim.

### **Salvage Recoveries**

Any salvage recovered by the insurer is subject to VAT, but the payment need only be made when the insurer has sold the salvage. The insurer must issue a tax invoice for the sale of the salvage.

### **Recoveries from Third Parties**

These are not regarded as a consideration and as such are not subject to VAT.

## **5. List the differences between compulsory insurance and commercial insurance.**

Compulsory insurance differs from commercial insurance in the following ways:

- it is mainly administered by government;
- the rates and contributions may be altered by government;
- the State can supplement, by way of grants, the amount paid in contributions;
- the State guarantees the solvency of the scheme;
- in the case of UIF, COID and Road Accident Fund all persons within the specified categories must join the scheme;
- the rates of contribution vary, but are standard within classes;
- there is no underwriting of the risk;
- often no policies are issued, which reduces costs;
- premiums are frequently deducted at source, for example, earnings and fuel; and
- in the case of COID, claims are handled by a commissioner and not the courts, which also reduces costs.

Commercial insurance, on the other hand, is obtained from insurers at a negotiated commercial rate based on negotiated cover terms and conditions.

## CHAPTER 8

### 1. List the benefits that are available under a Personal Accident policy.

The cover under a personal accident policy provides benefits payable for death or injury following visible violent external means. They are as follows:

Benefit	Details
Death benefit	Death must occur within a certain number of months following the accident.
Permanent disablement	Depends on the degree of disability and is a percentage of the death benefit according to the policy scale of benefits.
Temporary total disablement	This is to compensate the insured with a weekly benefit. It is normally payable for a period of 52 or 104 weeks.  It is usual to try and base this on the earnings of the insured.
Medical expenses	This is to cover medical expenses following an accident.

### 2. Explain the different kinds of liability cover needed by private individuals.

These might include:

- property owner's liability in connection with the ownership of a house;
- tenant's liability, as occupant of the house; and
- personal liability, liability apart from the above, for example, an accident caused by jaywalking. Does not include any business or professional activity, or the ownership or use of most kinds of vehicle. (Although not mentioned at this stage of the course, the insured also needs cover for liability to domestic servants.)

### 3. Explain why the insured requires All Risks insurance, even though he has householders insurance.

The insured needs all risks cover because:

- it provides much wider cover, this is a policy of exclusions - damage not specifically excluded is covered; and
- the cover is on a worldwide basis and is not limited to a premises risk.

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## CHAPTER 9

1. A potential client has requested details of the cover available to him under the standard policy wording. He manufactures bricks. In the form of a report, explain the various covers he may need.

### Smith Insurance Brokers



# Insurance Report

for  
Adobe Bricks (Pty) Ltd

This report has been compiled by J Smith  
for Adobe Bricks (Pty) Ltd  
July 2013

#### Introduction

This report has been compiled at the request of Adobe Bricks (Pty) Ltd and in particular at the request of Mr. K Wise, Managing Director of the company.

#### Purpose

The purpose of this report is to advise Mr. Wise on the cover available to the company under the standard short term insurance policy wording. No recommendations are required, but the report is to be used as the basis for insurance decisions by Adobe Bricks (Pty) Ltd.

#### Validity of This Report

It should be noted that practice within the insurance market may change and therefore this report is valid for three months only.

J Smith  
Accounts Executive  
Smith Insurance Brokers  
July 2013

### **Standard Wording**

For years the industry has used the Multimark III wording, developed by insurers and brokers to offer standard cover for clients. Various covers are available in terms of the policy wording, however not all these will be suitable for the client. The current trend is still to use this wording as a base, although Multimark III does not exist any more as such.

### **Sections Available**

These are:

- fire;
- buildings combined;
- office contents;
- business interruption;
- accounts receivable;
- theft;
- money;
- glass;
- fidelity;
- goods in transit;
- business all risks;
- accidental damage;
- public liability;
- employers' liability;
- stated benefits;
- group personal accident;
- motor; and
- electronic equipment.

As mentioned not all sections of this policy will be suitable for Adobe Bricks (Pty) Ltd. In this report we will focus on those which we believe would be suitable, but should more information be required this can be supplied by the author.

### **Fire Section**

In terms of this section cover is available against loss arising from:

- fire;
- lightning;
- explosion;
- storm, wind, water, hail, snow;
- aircraft and aerial devices;
- impact by animals, trees or vehicles;
- earthquake;

- subsidence and landslip;
- sprinkler leakage; and
- malicious damage.

This policy is designed for industrial, manufacturing and business risks and would therefore be suitable for Adobe Bricks (Pty) Ltd. In terms of malicious damage it must be noted that there would be no cover for damage following any theft or any attempted theft. This will be discussed further under the theft cover.

Cover is in respect of contents and buildings and the sums insured should be calculated as follows:

- any building should be based on the cost of rebuilding;
- stock should be on the cost or purchase price and not the selling price; and
- plant can either be on replacement or reinstatement value conditions. It is the client's decision as to whether the new replacement cost be used, or the plant and machinery be insured on a market value basis.

To reach the appropriate sums insured Smith Insurance Brokers can supply the services of a valuator. This can be discussed when we see Mr. Wise to discuss the insurance portfolio.

The offices in Sandton can be covered under a Buildings Combined policy which we look at next.

### **Buildings Combined**

This policy is specifically designed for the non-hazardous office type risk and it provides wider cover than the fire policy. The perils covered are:

- fire, lightning, explosion and subterranean fire;
- storm, wind, water, hail and snow, excluding
- subsidence and landslip;
- damage to gates posts fences and retaining walls;
- earthquake;
- aircraft and aerial devices;
- bursting or overflowing of water apparatus, including damage to the apparatus;
- impact by animals vehicles or falling trees; and
- theft or any attempt at theft if accompanied by forcible and violent entry or exit.

The policy covers the building and landlords' fixtures and fittings, but not any other contents.

### **Offices Premises**

In terms of this section the following cover is available:

- fire, lightning, explosion and subterranean fire;
- storm, wind, water, hail or snow excluding damage arising from the articles undergoing a process which requires the application of water;
- earthquake;
- theft or any attempt thereat; a choice must be made between full theft cover and theft following forcible and violent entry or exit;
- impact by animals, falling trees or vehicles; and
- aircraft and aerial devices.

The policy also covers loss of rent up to 25% of the sum insured.



This policy would be suitable for the office block in Sandton, which is a totally separate unit. The cover would not be available for the premises situated at the factory in Midrand, as the office forms part of the factory complex.

Computer equipment is not covered by this section, but can be covered in terms of an all risks policy, or of the electronic equipment section. Both of these give wider cover.

The sum insured is based on replacement value conditions and therefore this must reflect the new cost of the articles insured.

### **Business Interruption**

This cover is designed to protect the business should a loss occur in terms of the fire perils insured under the:

- fire policy;
- the building combined policy; and
- the office contents policy.

The cover does not follow any of the other risks discussed later in this report. The major factors to be examined are the calculation of the indemnity period and the Gross Profit figure.

#### ***Indemnity Period***

To establish this Adobe Bricks (Pty) Ltd would have to decide on the following:

- availability of other premises;
- other companies manufacturing similar products;
- the availability of companies to out source work to; and
- how dependant is the market on the product.

The indemnity period is the period it would take Adobe Bricks (Pty) Ltd to recover after a loss and in particular to recover the market share it enjoyed prior to the loss. The stocks could perhaps be built up again very quickly, however the specialised nature of the bricks manufactured by the company may mean that, following a worst case scenario no manufacturing could take place for a number of months. This may mean clients move to a cheaper brick, available elsewhere, and market share would be lost.

#### ***Gross Profit***

There are two methods for calculating this figure. They are:

- Additions Basis - this is the net profit plus standing charges; and
- Difference Basis - this is turnover plus closing stock, less opening stock and uninsured costs.

Standing charges are those charges that would not fall away if there was a loss - an example would be car leases.

Uninsured costs are those charges that vary directly in accordance with the reduced turnover - an example of this would be delivery costs.

The final factor is that the Gross Profit figure must represent the annualised gross profit, even if the indemnity period selected is less than one year. If it is greater than one year then the annual gross profit must be equal to that number of months. For example 18 months indemnity period would require 1,5 times the annual gross profit.

### **Accounts Receivable**

As you have accounts with various builders, who have 90 day accounts, this cover may be advisable, depending on whether or not dual records are kept. If dual records are kept away from the premises then this may be unnecessary. It would however be in the company's interest to discuss the cover as it is relatively inexpensive.

A declaration is required of outstanding debit balances either on a monthly or quarterly basis. It need not be a detailed figure, but rather a total.

The cover is on an all risks basis and therefore if it is not excluded there is cover. The main exclusion under the policy is bad debts as these are a trade risk and uninsurable.

### **Theft**

With the high incidence of crime this is obviously an important area to consider. However the structure of security protections at Adobe Bricks (Pty) Ltd makes the need for this cover very limited.

#### ***Type of Stock***

- Adobe Bricks (Pty) Ltd store the stock of bricks in the open and in terms of the theft policy there is no cover for goods not in securely locked premises.
- The type of stock is fairly unattractive, as it is heavy to transport.
- The manufacturing premises are situated in a fairly isolated spot, with 6 foot high walls and guard dogs which roam freely when the premises are closed.
- There is good security in the form of watchmen and the premises operate on a 24 hour basis.

All these factors combine to make the theft risk very limited at the Midrand premises. One further important point is that there is no cover for goods stolen by employees of the company- a special form of cover is available for this.

#### ***Office in Sandton***

There is wider cover available under the office contents section of the policy and therefore no cover would be required under this section for the Sandton Premises.

#### ***Malicious Damage***

Under the fire section mention was made that there is no malicious damage cover following theft. Under this section theft is restricted to forcible and violent entry or exit to or from the premises. Again the stocks are kept in the open, however for the plant and machinery this cover may be required. If thieves were to gain entry they might cause wilful damage when they find that there is little to steal.

**Main Risk**

The main risk in terms of the Midrand premises appears to be the office area, which cannot be covered under office contents. This area is closed at night, but it has a burglar alarm with armed response.

This section is based on a first loss sum insured. This is the amount the client believes thieves could make off with, before being discovered.

Due to the excellent protections it would be unlikely that thieves could escape with very much, however they could perhaps cause damage to the contents and premises and therefore malicious damage, as discussed above, may be a factor.

**Money**

In terms of the policy there are various levels of cover available. At this point, however, it is worth noting that all salaries and wages are paid electronically by the bank and there is therefore no need for cover for wages and salaries.

The banking is done on a daily basis with Fidelity Guards collecting the deposits and transporting them to the bank. In terms of the contract with Fidelity Guards they are responsible for all losses up to R250 000. As the maximum deposit in the last two years has been R150 000 there is no need for cover for cash in transit to or from the bank.

An amount of R1 500 is kept as petty cash and this is stored in a strongroom in the office at the Midrand premises. At the Sandton premises there is R2 000 petty cash kept in a strongroom.

The cover available is under two headings - a major limit and a minor limit.

**Major Limit**

This is in respect of money in transit to and from the bank and whilst kept in a locked safe overnight. It also covers money at the premises during the day.

Three considerations are therefore necessary.

The first is that there could be an amount of R150 000 sitting at the premises awaiting collection by Fidelity Guards. A hold-up could occur at this time.

Secondly, the amount of money kept overnight and the adequacy of the safe should be looked at. Any money collected after Fidelity Guards have collected the days receipts, will have to be stored overnight. This must be examined.

Thirdly the method of payment by clients must be examined. The preferred method is to have all cheques crossed not transferable. In terms of the policy, if cheques are not crossed, the insured is responsible for the first twenty five percent of any loss.

**Minor Limit**

This covers money

- whilst in the custody and control of directors on business anywhere in the world;
- whilst in the home of any partner or director; and

- whilst outside a locked safe overnight.

The policy also has a limit of R100 000 in respect of crossed cheques automatically written into it.

There is limited cover under this section for theft by employees, but it must be discovered within 14 days of the loss and there must be no Fidelity Guarantee cover. This is discussed next.

### **Fidelity Guarantee**

The cover in terms of this section is for theft by employees. It covers both money and goods.

The cover can be arranged for specific employees, specific jobs, or to cover all employees of the company. Special provisions apply to persons in the electronic data processing area.

#### ***Excess***

In respect of this class of business there is a large excess of

- 2% of the sum insured with a maximum of R60 000, and
- and 10% of the net loss.

#### ***Premium***

The premium is rated on the number of staff covered, the sum insured and the type of controls in place.

### **Public Liability**

The cover under this section is in respect of any legal liability the company may become liable for, following injury or death to any person, or damage to third party property. Any member of the public visiting the business premises could be injured and if the company is found legally liable this section would meet the costs of damages and legal costs.

There is no cover for any liability assumed under contract, which would not normally have applied.

As the risk is a manufacturing risk the two levels of cover required are:

- General Public Liability; and
- Products Liability.

#### ***General Public Liability***

This is cover for injury to persons who visit your premises. An example would be where bricks are incorrectly stacked and they fall on the third party causing injury.

#### ***Products Liability***

This covers liability that may arise because of a defect in products the company supplies.

The courts are awarding higher and higher levels of compensation and this form of cover is extremely important.

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## Group Personal Accident/Stated Benefits

Group personal accident insurance is designed for companies that wish to insure their staff. The company selects the cover required and the premium is usually rated as a percentage of the benefit. A premium is charged for each of the benefits selected.

### *Types of Cover*

- Death benefit - this only applies if the person dies within twenty-four months of the accident and as a result of the accident.
- Permanent disability - for this, a percentage of the death benefit is paid depending on the extent of disability.
- Temporary total disability - this applies when the insured person is unable to work for a period of time. The benefit is normally payable for a period of 52 or 104 weeks but can be for a period elected by the employer.
- Medical expenses - these are the medical expenses incurred following an accident.

There are various options for the issuing of cover. The insured person can either be covered on a:

- 24 hour basis or
- for occupational accidents only.

In addition, the policy can be issued to cover specific employees or a group of employees.

In the event of a loss the benefit is paid to the employer, on behalf of the employee. If the employer has continued to pay wages during the period of disability, the TTD benefit can be used to offset this.

### *Stated Benefits*

Stated Benefits is similar to Group Personal Accident but, instead of the benefit being a fixed amount it is expressed as a percentage of the employees' earnings. Under Stated Benefits the amounts paid for Medical Expenses and Temporary Total Disability are reduced by the amount of any benefit that is paid under the Compensation for Occupational Injury and Diseases Act.

## Conclusion

The cover available in terms of the standard wording have been set out. Sections where it was felt that no cover was required have been omitted, however details are available on request.

It was agreed that the client is to contact the author to set up a meeting to discuss the report within the next ten days.

## 2. Define theft from a legal point of view and from an insurance point of view. What is the difference?

The legal definition of theft is much wider than the definition in the insurance cover. The legal definition is:

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*"the act of taking someone's property with the intention of depriving him of it permanently."*

If this definition was used in insurance it would cover such things as shoplifting. In insurance, theft is the taking of someone's property, but only following forcible and violent entry or exit.

**3. Explain what can be covered in terms of the Business All Risks policy giving examples.**

In terms of the Business All Risks section property owned or used for business purposes can be covered.

This could include such things as:

- travellers' samples;
- doctors' bags;
- cellular telephones belonging to the company;
- car radios belonging to the company; and
- tools.

It is specifically designed for items used or taken out of the insured's premises, but can also give accidental damage for goods that stay at the premises. An example in this case would be a computer.

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## CHAPTER 10

### 1. Explain what is meant by an Aggregate Excess.

Under the motor policies various excesses apply for different criteria. In the event of a loss all the criteria must be examined and the excesses added together depending on the circumstances. For example

Basic excess	R500
Under 25	R150
Licence less than two years	R150
Total excess	R800

### 2. Explain what is meant by first amount payable.

The first amount payable is cumulative, except in the case of windscreen excess. This means that when there is a loss, all the facts have to be looked at and any excesses/first amounts payable that apply are added together.

For only the windscreen excess to apply, there can be no claim for other damage to the vehicle.

### 3. Explain what factors are taken into consideration when rating a commercial vehicle policy. Reference should be made to all factors used including those for heavy trucks.

The following factors are taken into account when rating a commercial vehicle:

- the cover required - comprehensive, third party only, third party fire and theft?
- area in which the vehicle is kept and normally driven - Gauteng as opposed to Graaff Reinet?
- the carrying capacity or gross vehicle mass of the vehicle - 3 ton truck or 3½ LDV?
- the value of the vehicle;
- the use of the vehicle - this is particularly important with large trucks. Compare the frequency with which a truck is used by a removal firms, as opposed to one used by a steel firm which only uses its own lorries occasionally; and
- the No Claim Bonus.

**4. Compare a Motor Traders External and Internal policy with specific reference to factors such as cover, rating, exclusions and restrictions.**

The motor traders internal and external policies are designed to cover motor dealers, whose stock changes continually. They differ from each other in the following ways.

**Where the vehicle is covered**

The external policy covers vehicles while:

- on the road; and
- temporarily garaged in the course of a journey.

The internal policy covers vehicles damaged at the premises.

**Vehicles that are covered**

The external policy covers

- the insured's own vehicles; and
- vehicles in his custody and control.

The internal policy covers only the insured's own vehicles for accidental damage cover.

**Exclusions or restrictions**

Under the external policy there is no cover while vehicles are at the insured's premise.

Under the internal policy

- cover for customer's vehicles, is restricted to:
  - loss or damage arising from negligence of the insured or his employees; and
  - loss or damage caused by a defect in the premises, plant or machinery.

**Methods of rating**

The external policy can be rated in three ways:

- named driver basis - individual drivers are named and a premium charged for each one;
- trade plate basis - the motor dealer has trade plates and the number is given to insurers and a premium charged per plate; and
- wages basis - this is rated on annual wages of all employees and directors.

Internal normally rated by:

- the size of the insured's premises. That is, the amount of floor space. The more space, the more vehicles and the higher the exposure; and
- the wage figure for the company, including an amount for each principal/director.



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## CHAPTER 11

1. **A client has asked you to arrange Employers' Liability cover for him. Explain the position to him with specific reference to the COID Act.**

In terms of the new legislation, the Compensation for Occupational Injuries and Diseases Act (1993), all employees now fall within the scope of the Act.

This means that employees no longer have the right to sue an employer, but must claim in terms of the Act. There are a few categories to which this does not apply and these are:

- people who are undergoing military service or military training (not permanent force members);
- SAPS and defence force members on active service;
- contractors; and
- domestic employees.

Employers Liability cover on a limited basis is still recommended as a kind of fail-safe measure (for example, for when employees may be operating outside of South Africa).

2. **List the different categories of SASRIA coupon and explain which coupons require an underlying policy and which do not.**

There were originally 4 classes of SASRIA coupon available. They were

- material damage - fire, glass, money and goods in transit fall into this category;
- contract works and construction plant - this covers these items which are found under engineering;
- consequential loss coupons - this is for the business interruption cover; and
- motor - this is for all types of motor vehicle covers.

Subsequently two additional covers were added - Mining Risks and Money Risks. The mining risk covers certain mining risks whilst the money risks cover losses pertaining to loss or damage of money or cash as a result of crime.

Marine/Goods in Transit are handled separately because a special scale of rates applies to these.

The only category of coupon that does not require an underlying policy is the motor coupon.

3. **Explain the procedure for handling a SASRIA claim, with specific reference to the documentation required.**

In terms of SASRIA, claims are handled by the direct insurers on behalf of SASRIA. The direct insurer, however, has no authority to settle the claim and must wait for SASRIA to do this. The direct insurer is a liaison between SASRIA and the client.

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### Documentation

Only original documentation should be forwarded to SASRIA. The following are essential when submitting a SASRIA claim:

- a preliminary claims advice form - this must be attached with a covering letter from the insurer;
- a copy of the SASRIA coupon/policy - where the claim is in the name of a subsidiary company the name of the subsidiary must follow the name of the holding company on the claim form;
- the underlying policy schedule - as the terms and conditions of the Material Damages and the Contract Works underlying policy is attached, the underlying policy is required in processing a claim;
- claim forms - in the case of non-motor, a general claims form must be completed. In the case of motor, the motor accident claim form must be completed;
- repair documentation - two quotations, invoices; and
- additional documentation (as required per type of claim) - including any endorsements, specifications, renewal warranties and any other document that may be required in finalising the claim.

### Loss Adjusters

A loss adjuster must be appointed for all claims in excess of R1 500. The adjuster must be appointed by the insurer and not by the intermediary. If the claim exceeds R1m, a loss adjustor cannot be appointed before consulting with SASRIA.

### Other Procedures

- The insurer must treat all SASRIA claims as if they were their own;
- before submitting a claim the insurer must check to see whether it is excluded in terms of any other policy in force at the time of the loss;
- all information must be treated as strictly confidential. If a loss adjuster is appointed, it must be emphasised that no details can be released to the insured, or to the intermediary, without prior consent;
- claims must be reported to SASRIA as soon as reasonably possible; and
- potential claims must be accompanied by sufficient documentation and information to enable SASRIA to open a file.

#### 4. What is the prescription period for the different classes of SASRIA coupons?

The prescription period for SASRIA, other than motor is that of the underlying policy document. For motor the prescription period is 12 months.

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**5. List the cover available under a travel policy for the business traveller.**

The cover available under a travel policy for the business traveller is:

- medical expenses;
- cancellation/curtailment;
- personal liability;
- death/permanent disablement;
- repatriation to country of origin following death;
- hijack;
- hospital cover;
- supply of screened blood;
- travel delay;
- baggage and baggage delay;
- cash and documents.
- replacement personnel;
- trade samples; and
- policies issued to frequent travellers on an annual declaration basis.

In the last instance, instead of booking each time, there will be open cover and the travel undertaken declared at the end of the period of insurance. Benefits and costs vary widely.

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## CHAPTER 12

1. **Explain the relationship between the severity and frequency of losses and the funding decision.**

Losses may be classified as Type I, Type II or Type III, based on their frequency and severity. Type I and Type II losses should be self-funded, and only Type III losses should be insured.

2. **List the advantages of retention.**

In addition to the advantages listed in the study unit, you could have listed the following:

- retention avoids particular expenses associated with the traditional commercial insurance market. These expenses include the insurer's overheads and profit, agents' commissions, and the premium taxes the insurers have to pay;
- the company may believe that its loss experience is significantly better than the average in terms of which rates are determined, or that the rating system does not reflect the hazards associated with exposure accurately;
- some companies want to be able to control the claims process. They argue that insurers sometimes pay claims that should have been contested; and
- some insurance buyers believe that the investment income from loss reserves is not adequately reflected in rates, and decide to capture the investment income insurers earn on their reserves.

3. **From your knowledge of insurance and the claims process, what would you consider disadvantages of retention?**

Potential disadvantages of retention:

- retention can expose the company to catastrophic loss. However, this disadvantage can be eliminated by purchasing reinsurance (as insurers do);
- losses may vary considerably from year to year, meaning the loss of tax deduction when there are no profits from which to deduct the losses;
- adverse employee and public relations may arise from adjusting losses; and
- insurer services are lost (eg loss prevention services and claims handling). This problem may be solved by purchasing these services ("unbundled") from the insurer and by retaining a third-party administrator to handle claims.

4. **Distinguish between a straight and a franchise deductible.**

The straight deductible applies to every loss. It is subtracted before a loss payment is made. The franchise deductible is expressed as a percentage of each value or as an amount in rands. When this amount is exceeded, the insurer is liable for the entire amount.

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**5. Why should a company consider deductibles as the first step to retention?**

A large deductible may offer many of the advantages of retention without increasing the internal expenses associated with other self-funding options. For many companies full retention of losses may be neither advisable nor desirable. Moreover, the deductibles offer cash-flow benefits and cash-flow protection to the insured.

**6. Why is a straight deductible considered the most effective to use?**

A specified amount is deducted from every loss. This eliminates the expense of processing all losses that are less than the deductible. It also forces the insured to absorb part of every claim that is paid and reduces the hazard of fraudulent claims. In contrast, aggregate deductibles are for example not as successful in eliminating the cost of processing small claims, because all losses will be reported to the insurer for credit towards meeting the deductible.

**7. Explain why the term "finite" is used to describe finite insurance.**

The term "finite" is used because the exposure of the insurer is limited to a predetermined amount.

**8. Spread-loss treaties are described by some as a savings account with a credit line. Do you agree with this description? Justify your view.**

Yes, SLTs exhibit the following characteristics: premiums are accumulated over the entire term and losses are distributed over a multi year period. SLTs differ from a savings account because a cost is associated with the use of this facility. The insurer will share in the profits at the end of the period.

**9. Briefly describe the different types of finite cover and outline the advantages of each.**

The following have to be discussed:

- loss portfolio transfers;
- adverse development covers;
- finite quota shares;
- spread-loss treaties;
- the guaranteed cost approach; and
- retrospectively rated programmes.

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**10. Describe the different capital market instruments available to fund losses.**

You must be able to describe the following:

- CAT bonds;
  - insurance derivatives;
  - Catex; and
  - CAT-event-triggered products.
-