



inseta

**INSURANCE SECTOR EDUCATION
AND TRAINING AUTHORITY**

FSB REGULATORY EXAMINATION PREPARATION

Section 11:

Second Level Regulatory
Examination: Short-term Insurance:
Commercial Lines

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Tasks

The material provided in this guide is based on the following tasks, as published in Board Notice 105 of 2008:

1	Determine the client's need for insurance.
2	Match the client's need to the relevant product/s.
3	Apply underwriting criteria.
4	Draft/request a quotation for insurance.
5	Agree to terms and conditions of cover.
6	Issue policy/fulfilment document.
7	Provide a service to the client/maintain the policy/client retention.
8	Process a claim.
9	Recovery/mitigation of losses.

Please note that any reference to:

- masculine gender implies also the feminine
- singular indicates also the plural, and vice-versa.

Glossary of terms

Accident: an unforeseen and unintended event or occurrence resulting in an undesired consequence such as loss, damage and liability.

Accountable: liable to being called to account; answerable.

Amend: to change

Ascertain: to make certain

Assessment: the act of appraisal; the valuation of property or damage to property

Asset: valuable item that is owned by an individual person or company. It can include personal possessions, stocks cash, fixed property, vehicles and investments.

Average: this is a principle of insurance that has the effect of reducing a claim payment where underinsurance has been shown.

Bankrupt: when liabilities exceed assets

Betterment: the added value of the improvement to an insured property when it has been repaired, replaced or rebuilt following loss or damage.

Bordereau: a detailed schedule, that lists risks, values and premiums

Capacity: the maximum amount that can be retained on a risk; the legal status of persons to enter into a contract

Catastrophe: an event causing losses of insured property above a specific monetary limit and affecting a substantial number of policyholders and insurers

Common Law: the body of law developed as a result of custom and judicial decisions, as distinct from the law laid down by legislative assemblies

Compensate: to pay for something lost or damaged

Compliance: readiness to conform or agree to do something

Comprehensive policy: a policy covering a wide variety of perils

Consent: to agree

Consequence: something that logically or naturally follows from an action or condition; the relation of a result to its cause

Consequential loss: a loss directly arising from another loss. The term is used to describe the class of business also known as loss of profits or business interruption insurance.

Contribution: a payment for a special purpose; payment to a common fund as by an insured to the risk pool; the principle whereby two or more insurers covering the same risk contribute proportionately to any losses

Damages: an amount of money awarded by a court as compensation for injury or loss

Disclosure: revealing all the facts relevant to an insurance contract to the insurer or intermediary, and as required by FAIS

Endorsement: written evidence of some alteration to a policy of insurance

Exposure: the possibility of loss or damage

Excess: that first part of a loss for which the insured is liable

Finance house: a business enterprise that loans money to individual people or to companies against collateral, especially to buy items on hire purchase

Fortuitous: happening by chance

Fraud: deception intended to benefit those deceiving

Frequency: how often something happens

In lieu: instead of or as a substitute

Incident: a definite occurrence or event; an occurrence or event that interrupts normal procedure

Indemnity: the placing of the insured, in the same financial position after a loss that he was in, immediately prior to the occurrence

Insurable interest: a demonstrable interest in something covered by an insurance policy, the loss of which would cause deprivation or financial loss. Insurable interest must be shown whenever somebody takes out an insurance policy or makes a claim; the principle that requires an insured to have a legally recognised relationship with the item to be insured

Insurance cover: an arrangement by which a company gives customers financial protection against loss or harm such as theft in return for payment of premium

Instalment: one of a number of successive payments

Insurance policy: a document that is evidence of a contract of insurance

Insured: the insured is a person who has insurance

Insure: a person or company licensed to provide insurance to the public

Intermediary: a person who arranges insurance on behalf of another

Landlord: one that owns and rents out land or buildings

Liability: legal responsibility for financial obligation, such as damages

Limits of acceptance/liability: the maximum amount accepted by an insurer in respect of a specific risk

Litigation: legal proceeding in a court to determine and enforce legal rights

Loading: those elements added to a premium to allow for additional risk exposure

Loss: an undesired event or the amount of a claim made by an insurance policyholder

Loss adjustor: an independent, qualified person who assess the size, or value of a loss, on behalf of the insurer, but who may also be employed by an insured to look after his interest in a loss settlement

Market value: the price at which an asset can be sold or bought at any specific time

Material facts: anything that would affect the judgement of an underwriter in accepting or deciding the terms of risk

Misrepresentation: a false statement of a material fact that can be innocent or fraudulent

Negligence: a civil wrong causing injury or harm to another person or to property as the result of failing to provide a proper or reasonable level of care

New for old: insurance where the replacement value of the property that has been lost or damaged is payable without deduction for depreciation (is replaced at current purchase price)

Non-disclosure: the failure to disclose a material fact or circumstance

Nuclear fission: nuclear reaction in which a nucleus splits into smaller parts with a simultaneous release of energy

Offer: the communication of the proposed terms of a contract by one party to another

Peril: a peril is the possible cause of a loss

Policy schedule: the list of personal details of the insured and the subject matter of the insurance in a policy

Premium: the money paid by the insured to the insurer for cover as specified in the insurance policy. It may also contain terms and conditions additional to the policy wording.

Premium rate: the price per unit of insurance, based on a percentage of value

Pro rata premium: the premium based on the length of time for which the insurer was actually on risk

Probability: the chance of an event occurring

Proximate cause: a direct cause of a loss which is uninterrupted by any other event

Rate: the sum charged per unit at risk by which the premium is calculated, often shown as a percentage

Regulation: a principle, rule or law designed to control or govern conduct

Reinstatement: the making good of damaged property; the restoration of the sum insured after settlement of loss on payment of an additional premium

Reinsurance: when an insurance company purchases insurance for the risks they cover in order to share the financial burden or loss

Renewal: the process of continuing insurance for a further period after the first or current period of cover has ended

Replacement cost: the value of property as indicated by the current new purchase price of a similar article

Representative: an individual who represents a licensed Financial Services Provider in providing either advice or an intermediary service to the public

Retention limit: the maximum liability that an insurer wishes to keep for his own account in respect of a particular risk

Risk: the subject matter of an insurance contract; the possibility of a loss against which insurance is taken out

Risk management: the business discipline applied by large commercial and industrial organisations to manage those risks that can cause losses

Risk transfer mechanism: risk is taken away from one person (the insured) and given to another (the insurer)

Salvage: whatever is recovered of an insured item, or part thereof, on which a claim has been made

Self-insurance: insurance that a business organisation finances internally by establishing a fund to meet losses

Severity: how serious something will be when it does happen

Short-term Insurance: insurance that operates on an annual basis, and which may be terminated by the insurer or the insured

Speculative: a financial asset or group of assets, or risks, with uncertain returns. The greater the degree of uncertainty the more speculative the asset or risk (such as betting on a racehorse in the stock exchange)

Standard construction: a building erected on foundations, constructed of bricks, stone, steel, with a concrete, tile or steel roof

Statutory: enacted, regulated or authorised by statute

Subrogation: the right of one party to stand in the place of another and assume the legal rights against a third party

Sum insured: the monetary limit of the insurer's liability under a policy; or the insured value of an item or group of items

Tenant: one that pays rent to use or occupy property owned by another

Third party: a person who is not a party to a contract of insurance

Turnover: the income received or business transacted during a given period of time

Underinsurance: insurance for a sum insured less than the value of the risk

Underwriter: a person who makes decisions on whether or not to accept insurance risks, and if so, on what terms

Valuation: the act of determining the value or price of an item

Void contract: a contract that cannot be enforced by either party

Voidable contract: a contract that either party can choose not to enforce

Warranty: a condition that must literally be complied with, literally and completely

Chapter

1

Determine the client's need for insurance

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain the principles of insurance, including the concepts of insurable interest, insurable risk, duty of disclosure, indemnity, average, compensation, subrogation, proximate cause and contribution.

Explain the different lines of insurance.

Describe the different types of cover (including self-insurance/funding, e.g. aggregate excesses) available, and the implications and benefits thereof.

Basic knowledge and understanding of financial statements.

Describe what a niche market is.

Explain when to refer to a niche specialist.

SKILLS CRITERIA

Determine the client's need for insurance by asking relevant questions relating to product offering.

Conduct a needs analysis by asking relevant questions and gathering relevant information.

Complete relevant records.

Identify the areas of risk to which the client is exposed.

Interpret basic financial statements in order to determine a client's financial risk.

Establish the client's limitations and restrictions, including affordability.

Apply principles of insurance.

Establish the insurable interest, previous claims loss history, previous insurance and financial status of the client.

Purpose

This chapter provides the individual with fundamental insurance principles, the different lines of insurance and types of cover available, financial statements and niche markets. It also outlines the process by which a representative would determine the short-term insurance needs of a client.

1.1 EXPLAIN THE PRINCIPLES OF INSURANCE

Before one can begin to determine the insurance needs of a client, there are some basic insurance principles that need to be understood. These principles are outlined below.

1.1.1 Insurable interest

Insurable interest is the legally recognised financial relationship between the insured and the financial loss that he suffers following a loss. One can insure only those things with which one has a legally recognised financial relationship, for example, one can insure one's house against fire because if it burns down one will suffer a financial loss.

Legally recognised relationships are:

- owners and joint owners of property;
 - mortgagees and mortgagors;
 - bailees (a person holding another's goods and having a duty of care for those goods);
 - agents;
 - executors and trustees who can insure the property for which they are legally responsible;
 - the relationship with your spouse. Husbands and wives have unlimited insurable interest in each other's lives. (Other examples exist for long-term insurance.)
-

1.1.2 Insurable risk

In order for a risk to be insured, there are certain basic requirements that must be met. These requirements are as follows:

- The cause of the loss must be accidental or fortuitous;
- There must be insurable interest; and
- The loss must not be intended for personal gain by fraudulent means.

1.1.3 Duty of disclosure

Disclosure means to make known, reveal or expose to view, all of the information that the client needs to know about the financial product and the terms and conditions of the product he is purchasing. The obligation to disclose begins as soon as the negotiation for the insurance contract begins. The client must be in a position to make an informed decision.

It is therefore legislated, through the Financial Advisory and Intermediary Services (FAIS) Act, that various aspects of financial arrangements be made known to clients by Representatives who sell them financial products.

In addition, the client also has a duty to disclose all factors that might influence the risk for which they are seeking insurance.

1.1.4 Indemnity

Indemnity is when a person's financial position is restored, as a result of insurance, back to what it was immediately before the person experienced a loss. Indemnity and insurable interest are closely linked, as the principle of indemnity means that the insured cannot recover any amount exceeding the extent of his insurable interest.

1.1.5 Average

Average is a concept used by insurers to deal with underinsurance. If a policyholder is under-insured, he will not be paid in full when a loss occurs. The amount of any loss will be divided between the insurer and the insured, based on the full value of the property. Underinsurance occurs when an item is insured for less than its intended insurance replacement value the basis of settlement should be either market or replacement value.

It is important that the insured should not select against the insurer by understating the value at risk and must therefore pay his full share into the insurance pool. The premium that he pays should be based on the amount of financial value at risk and not part thereof.

If the insured understates the insured value, he will be paying an incorrect amount of premium and therefore be underinsured. Should he then have a claim, the principle of average will be applied.

1.1.6 Compensation

In short-term insurance personal accident and liability are examples of compensation policies. In the event of a loss the insured is paid an agreed amount of money. This differs from indemnity policies, where insured items are restored, repaired or replaced or the monetary value thereof is paid.

1.1.7 Subrogation

Subrogation is the legal provision under common law by which one party, usually an insurer, stands in the place of the insured, so as to have the benefit of the insured's rights and remedies against a third party. More detail on how subrogation is applied is dealt with in Chapter 9.

Subrogation therefore means the right of one person to take over, or assume, the legal rights of another person.

Example:

Elias is aware of how important insurance is. He has thus taken out insurance to cover his new car.

One morning on his way to work, a car collides with his car. As a result of the collision, caused by the negligence of the other driver, Elias's car is badly damaged. There is R50 000 worth of damage to the car.

Elias' insurer arranges for the repair of his car. The insurer now has the right, through a process of subrogation, to recover the monies paid from the other driver's insurer or the driver himself where the driver is uninsured.

The subrogation clause states that insurers have the right to assume the insured's right to claim against the third party. This means that:

- the insurer may act as though they were the insured; and
- the insurer may begin acting before they pay out the money for repairing the damages to Elias's car.

(See Sec. 9.2.1)

1.1.8 Proximate cause

In an insurance contract, it is necessary to state the perils that are covered or excluded, so that all parties to the contract know exactly what perils are covered.

It is necessary, therefore, to examine the cause of loss in some detail because the insurer is only liable for losses "proximately" caused by an insured peril.

Definition:

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

Examples:

- Damage is caused by smoke resulting from a fire, the fire is the proximate cause of the damage caused by the smoke;
- Damage caused by water used to extinguish a fire is proximately caused by fire;
- A person sustains accidental injury and is taken to hospital, where he contracts a disease from a patient in the next bed and dies from the disease, the accident is not the proximate cause of death;
- a wall is weakened by a motorcar that collides with it and the wall in its weakened state is subsequently blown down by a high wind, the proximate cause of the collapse of the wall is the wind (and not the impact of the motor car).

1.1.9 Contribution

Where the same risk is insured by two different insurers, contribution will apply in the event of a claim, in respect of that particular occurrence.

The definition of contribution is:

"... the right of an insurer to call upon other insurers similarly (though not necessarily equally) liable to the same insured to share the cost of an indemnity payment."

Insurance is intended to indemnify the insured in the event of a loss. However, if there is more than one policy covering the same item, the policy's condition of contribution is applied. The formula applied for contribution is discussed in more detail in Chapter 8.

Contribution in many instances could arise from clients not clearly understanding or being unaware of what they are covered for, which results in them acquiring duplicate cover.

The representative needs to be very careful in such instances to check for these types of situations as more often than not, insurers are tending to state that where more than one policy exists for the same risk, such insurer will not pay in the event of a claim. If both insurers adopt this policy, then this could result in there being no cover!

1.2 EXPLAIN THE DIFFERENT LINES OF INSURANCE

1.2.1 Personal lines

Personal lines insurance policies are standard, general policies bought by individuals to cover their personal assets.

These policies cover:

- house owners insurance (buildings);
 - householders insurance (contents);
 - personal motor;
 - all risks insurance;
 - personal computers;
 - small craft;
 - personal accident insurance; and
 - personal liability insurance.
-

It is usual for these policies to provide different types of cover under a single policy, usually with a single combined premium for all of the sections (payable annually or monthly). This is known as a personal lines “multi-peril” policy.

It must be emphasised that each insurer has different personal lines wordings with varying limits, and the insurance technician must be able to use and interpret each insurer’s policy wording. This is even more important for intermediaries, who may deal with several insurance companies.

1.2.2 Commercial lines

Commercial insurance policies cover business and commercial risks of businesses.

These policies cover the classes of:

- fire and perils;
 - accident;
 - theft;
 - loss of money
 - goods in transit – damage or loss to goods being transported on a conveyance
 - personal accident
 - business all risks
 - fidelity – fraudulent actions by employees
 - liability;
 - accidental damage;
 - motor, including motor traders internal and external risks;
 - business interruption;
 - machinery breakdown;
 - contractors all risks;
 - fidelity guarantee and guarantees and bonds;
- and money, plate glass and other minor classes.

There is a further undefined segmentation that exists in the commercial lines market between commercial entities, corporate entities and industrial entities.

Corporate entities: the types of firms whose shareholding may be listed on the Johannesburg Stock Exchange. They often comprise of diverse businesses/entities with a multitude of complex risk scenarios for which a normal multi-peril policy cannot apply. A special policy known as an Assets All Risks Policy could be used in these cases.

Industrial entities: are those involved in the manufacturing segment of the economy, and could range from the large corporate to a small entity. Industrial risks include manufacturers, engineering works, panel beaters, and other small private enterprises.

Commercial entities: those entities involved in commerce such as banks, insurance companies, department and retail stores.

Because of the great differential between businesses as outlined above, it is essential that a representative understands the business of the client in order to fully understand the risks to which each client may be exposed and to offer the appropriate solutions.

1.2.3 Niche or specialist markets

Niche markets are those for which certain insurers provide cover for limited specialised risks.

In the commercial lines environment, particular niche markets would be:

- marine;
- aviation;
- agriculture;
- livestock;
- bloodstock;
- construction;
- computer fraud;
- director's and officer's; and
- engineering

Marine

Marine insurance as a specialist market specifically refers to cover to the hulls of watercraft. Hull damage relates to the vessel and associated machinery of the vessel. It also includes loss caused by pirates at sea.

In addition, cargo on ships is covered by a marine cargo policy.

Aviation

All aspects of aviation, including the airfields, aircraft, damage and liabilities, are handled in the aviation segment of the insurance industry. This may also include commercial airliners, small aircraft, gliders, micro-lights, hang gliders and para gliders owned by individuals.

It should be emphasised that personal accident cover in relation those participating (crewing) in the above is specifically excluded in the multi-peril and standard personal accident policies and can only be covered in the aviation market.

Agriculture

This mainly concerns damage to growing crops and plantations. The buildings and equipment of a farm are normally insured by a farmer's multi-peril policy. Therefore, the average crop farmer will have two policies. The growing crops themselves will be covered for disease, fire, hail and storm damage to the crop under the agricultural policy.

Livestock

Specialist Livestock insurers will offer cover on livestock (cattle, sheep or goats) for death, specified disease, infertility or impotence of bulls for registered breeding herds. For commercial herds cover is usually provided for catastrophes such as fire and lightning.

Bloodstock

This is cover exclusively for thoroughbred breeding and racing horses. This provides cover for death resulting from "all risks of mortality" including accidents to racing and breeding stock as well as death by humane destruction as a result of injury to an animal.

Cover is also available for infertility of stallions, the insurance of unborn foetuses and foals.

Insurance is also available on horse-related risks relating to leisure horse cover such as show jumpers and dressage horses.

Conclusion

It is important to note that there are a host of insurers and underwriting managers who design and sell specialist products not included in the above for specialist risks such as the hospitality industry, specialist classes of liabilities, bonds and guarantees and it is important for the representative to have a good working knowledge of the market.

1.3 EXPLAIN THE DIFFERENT TYPES OF COVER, AND THE IMPLICATIONS AND BENEFITS THEREOF

1.3.1 Types of perils, hazards and risks

Peril vs. hazards

A peril is something that causes a loss and a hazard is something that influences the damage caused by a peril, for example, accident damage to your car is a peril, but the heavy traffic and dangerous road conditions are hazards.

Examples:

Peril	Hazard
A <i>fire</i> causing a building to burn down	The building had a thatch roof
A <i>storm</i> which causes a tree fall on the building	The tree was old and unstable
A <i>crime</i> incident	There were no burglar bars on the windows
A <i>motor accident</i>	Dense traffic on wet roads

Moral and physical hazards

Hazards can either be physical or moral. Physical hazards relate to the physical environment, for example, keeping flammable liquids in a building, and, as explained above, heavy traffic and dangerous road conditions.

Moral hazards relate to attitudes and behaviour of people, especially the tendency of individuals to alter their behaviour because they are insured.

Examples of moral hazards are:

- dishonesty - a person who claims fraudulently;
 - people who inflate claims in the belief that it will result in a fair settlement by insurers;
 - people who misrepresent the true facts of the risk;
 - carelessness - a driver who drives under the influence of alcohol increases the chances of an accident.
-

It can be difficult to separate moral and physical hazards, such as the manner in which the car is driven or maintained and not the car itself.

Fundamental risk

Risks can further be divided into particular and fundamental risks. Fundamental risks are generally impersonal in origin and affect large parts of society or even the population of the world, and are regarded as commercially uninsurable.

However, in some cases insurance is available for risks that are outside the control of a person or a group of people. These risks normally affect a large number of people and the loss is often catastrophic.

Examples of catastrophic events:

Earthquake, tsunami, war, riot, drought/famines, economic recession and the resulting unemployment

Fundamental risks can be caused by social, political or natural factors.

Suppose, for example, that a family is planning a holiday to Egypt and a few days prior to their departure there is a terrorist attack at the Pyramids just outside of Cairo. There is nothing they can do to prevent a civil unrest or war in the country, but they must take into account the risk of this happening and ruining their holiday. Whilst there is an impact on the family's trip, the severity of the impact would differ depending on whether they are in Egypt at the time, or still in South Africa awaiting their departure to Egypt.

Particular risk

A particular risk is one which affects individuals and which arises from individual causes that can be identified.

Particular risks are personal in origin and affect individuals or small groups, for example, fire, theft, or vehicle accidents.

Example:

Thieves break into your home and goods are stolen. This is a particular risk because it affects only you and your family and not society as a whole.

In general, risks which are not particular fall into the fundamental class.

Speculative risk

Speculative risks, on the other hand, are normally taken in the hope of some gain. For example, it is not possible to insure the possible winnings that one hopes to receive from gambling.

It is however difficult to be dogmatic about this, as practice is changing and the division between pure and speculative are becoming more blurred as time passes. Take the case of the credit risk that can be seen as a speculative risk.

The goods have been sold on credit in the hope that a gain will result, but a form of credit insurance is available which will meet some of the consequences should the debtor default. Very strict underwriting criteria are applied to this type of risk, because of the nature of the risk.

However, insurance is not normally available for those risks where the outcome can be a gain. Speculative risks are entered into voluntarily, in the hope that there will be gain. There would be very little incentive to work towards achieving that gain if it was known that an insurance company would pay up, regardless of any effort by the individual. Using the terminology of hazard, we could say that there would be a very high risk of moral hazard.

We should, however, be clear that the *pure risk consequences of speculative risks* can be insured against and insurers are being asked to handle the results of speculative risks.

An example of a speculative risk that becomes a pure risk as a consequence, is bad debt. Profit is made on a venture or sale, which is a speculative risk. The subsequent collection of the debt or the non-collection can result in a loss, thus fitting the definition of pure risk.

The pure risk consequences of speculative risks are certainly insurable, but not the speculative risk itself. Take as an example the marketing of a new line in clothing. The risk of the new line selling is clearly speculative. It is a risk knowingly entered into in the hope of financial gain. This, after all, is the very essence of business activity.

However, the risk that the line will not sell is not the only risk to which the enterprise is exposed; the factory in which the garments are to be made could be damaged, designs could be stolen, and suppliers of essential

materials could have fires or other damage resulting in them being unable to supply the raw material. All of these risks are pure risks, which are insurable, but they arose directly from the decision to take the speculative risk of making the new line of clothing in the first place.

Pure risk

Pure risks arise due to human “error” or actions, or natural phenomena. These are risks that may or may not happen, for example theft, liability, motor accident or an electrical short circuit and are generally insurable.

Example:

When you drive to work in the morning you either have a car accident or you don't.

A lightning strike occurs that impacts all the electrical appliances in your house, but not the house next door.

Insurance is mainly concerned with pure risks –with an undesirable result that can only result in loss or prejudice.

Conclusion

In general an insurable risk must be financially quantifiable in monetary terms.

1.3.2 Fire

The fire section of a commercial policy covers damage to property caused by fire and associated perils.

Associated perils include:

- storm, wind, water, hail or snow;
- explosion;
- lightning;
- earthquake;
- impact of vehicles, animals and falling trees;
- leakage of fire extinguishing appliances;
- subsidence and landslip;

- aircraft or aerial devices; and
- malicious damage.

1.3.3 Accident

An accident is an unforeseen or fortuitous act that affects the insured resulting in loss.

Accident covers the following sections:

- Theft
- Loss of money
- Goods in transit – damage or loss to goods being transported on a conveyance
- Personal accident
- Business all risks
- Fidelity – fraudulent actions by employees

1.3.4 Liability

Liability covers legal liability for negligent acts of the insured, which cause loss or damage to property or people. The liability section can also include:

- product liability, guarantee, recall and inefficacy;
- defective workmanship;
- defamation and wrongful arrest;
- cost of defence of criminal action under certain statutes (legal expenses);

There is a specific exclusion for products exported to North America and an extension for products exported to the European Economic Community.

1.3.5 Accidental damage

Accidental damage provides cover for accidental damage to property on the premises, which is not insured, nor is insurable, by other sections of the commercial policy.

Accidental damage may include damage caused to goods on a shelf when it collapses.

1.3.6 Motor

The motor section of a commercial policy covers loss of or damage to and liability in connection with a motor vehicle owned by the business. This could include motor fleets, motor traders or delivery or business-owned vehicles defined in the policy.

1.3.7 Business interruption

Business interruption is designed to compensate an insured for financial losses to the business as a consequence of losses incurred resulting from an insured peril on the fire and machinery breakdown policies. Some insurers will extend this to losses insured by the burglary and other asset policies.

1.3.8 Engineering (machinery breakdown)

Engineering covers loss, damage and consequential loss caused by the breakdown of machinery, such as:

- a boiler explosion; or
- an electric motor burns out on a printing press.

1.3.9 Contractors All Risks (CAR)

This section covers damage to the works, plant and materials on contract sites. The CAR policy will also extend to cover Public Liability Insurance.

Examples of these could include:

- Dam wall, roads, buildings, bridges under construction
- Cement mixers;
- Scaffolding;
- Mobile crane on a contractor's site.

1.3.10 Guarantees and bonds

A number of different types of bonds and guarantees are underwritten in the short-term insurance market, viz;

- performance bonds – in the event of failure of a contractor to perform
- court and estate duty bonds – insisted on by the Master of the Supreme Court for performance of liquidators on insolvent estates and deceased estates.

1.3.11 Self-insurance

Self-insurance occurs in those instances where the insured elects to bear the costs of any damage or loss to his assets himself.

A common example of an individual opting for self-insurance would be by way of an additional voluntary excess. Note that self-insurance is a conscious decision rather than simply neglecting to take out cover. It often involves creating a specific fund out of which to pay losses and has tax benefits.

Consequences of self-insurance:

- Accumulating a substantial savings fund, which may not be relative to the amount of premium saved
- The loss, or accumulated losses could exceed the amount saved in the fund; therefore requiring the loss to be funded from "cash flow"
- A substantial loss could occur before adequate funds are accumulated.

Advantages of self-insurance:

- Premiums should reflect an appropriate discount for the self-insured proportion which can be "invested" to cover future losses. As this fund grows, so the percentage of self-insurance can be increased, resulting in further premium discounts.
- Run-of-the-mill claims can be paid out of a self-insured (emergency) fund, without the necessity of paying premium for these. This has the advantage of protecting the claims experience resulting in better premiums.
- Tax advantage

Disadvantages of self-insurance:

Funds allocated to the insurance fund could be required for other purposes.

Aggregate excesses

An aggregate excess is a form of self-insurance whereby the insured agrees to accept for his own account an agreed amount on losses from defined risks. The insurer resumes its normal responsibilities when that limit is exceeded.

1.4 BASIC KNOWLEDGE AND UNDERSTANDING OF FINANCIAL STATEMENTS

1.4.1 Assets

This is the total value of property owned by the insured, including money.

An asset is anything tangible or intangible that is capable of being owned or controlled to produce value and that which is held to have positive economic value is considered an asset. The balance sheet of an entity records the monetary value of the assets owned by the entity consisting of money and other valuables.

Assets can be divided into:

- current assets – which are cash and other assets expected to be converted to cash.
- long-term investments – which are investments in fixed assets not used in operations (such as equity investments).
- fixed assets – property, plant and equipment used to earn profit in an entity.
- intangible assets – such as patents, copyrights and goodwill.

All of these assets have a monetary value, and can, if required, be converted into money.

1.4.2 Liabilities

Liabilities are what an entity owes to people or businesses outside of itself. These can include:

- loans from the bank;
 - credit from vendors;
 - vehicle leases or loans;
-

- loans from shareholders.

1.4.3 Operating costs

Operating costs are the costs incurred in running an entity, such as:

- wages or salaries;
- purchase of raw materials;
- costs of public utilities; and
- rentals.

1.4.4 Profit and loss

Profit and loss is the amount earned or lost by an entity in a financial year before the deduction of tax. This can be found on a company's balance sheet and trading accounts.

1.4.5 Determining the client's financial risk

A representative would need to confirm the value of a client's financial risk by evaluating the balance sheet and trade account of an entity.

If liabilities exceed assets the company is technically insolvent.

For the purposes of establishing a business interruption sum insured, it is necessary to analyse the trading accounts, as the balance sheet does not provide all the information required. By looking at and applying the definitions stated in the business interruption policy, it is a relatively simple act to extract the information required from the accounts. It is essential that this process is understood and followed, as the definitions in the financial statements do not necessarily match with those in the business interruption policy. Furthermore it is prudent to involve the client's financial director or accountant in this exercise.

Business interruption cover is either based on an additions or difference basis (explained in Section 1.6.2), whichever method is used, the resultant sum insured is identical.

1.5 NICHE (SPECIALIST) MARKETS

1.5.1 What are niche markets?

Niche markets are underwriters who specialise in specific and unique risks for example, marine hull insurance.

1.5.2 When should one refer to a niche specialist?

A referral to a niche specialist is required when one has need of the specialist service for an expert in a certain area of cover.

Often the representative, intermediary or company, may feel that they are specialists in the area of commercial or corporate insurance because they have been in the industry for many years, however, there may be instances when a risk particularly falls outside of the expertise of an individual or company and a niche specialist is required.

1.6 DETERMINE THE CLIENT'S NEED FOR INSURANCE

With all of the above concepts understood and explained, one can now start applying these concepts in order to determine a client's need for insurance.

1.6.1 Gather information from the client by asking relevant questions

Each insurance company or intermediary has a different form or format in which the relevant information is gathered from a prospective client. This can either be a paper-based form or on an electronic system, however these forms generally contain all of the information required from a prospective client for quotation purposes.

Information that is relevant to an insurance quote includes information regarding the:

- policyholder;
 - value, identity, security, use and location of the property being insured; and
 - current insurance cover, previous claims experience, current benefits of insurance cover, whether a previous insurer has cancelled insurance, or an application has been declined.
-

Understand your client's business

Familiarise yourself with the business your potential client is involved in and the strengths, weaknesses, opportunities and threats to which it is exposed.

Important too, is background information of the company's history, structure and existence, including achievements and downfalls, as this indicates the stability of the company.

By survey

A survey is a physical examination of the property, noting the defects, risks and hazards that may influence an underwriter's decision. On larger risks a scale plan of the property is often created.

A survey is normally required before the risk is assumed by the underwriter. Size, complexity and hazards determine the need for a survey to ensure that the risks are adequately identified.

It has become standard practice to survey all business premises, which identifies the underwriting criteria for that risk and aids in simplifying the claims process in the event of a dispute.

As the analysis of the survey is crucial to the underwriting process, some insurers may require the survey to be completed by a professional insurance surveyor.

1.6.2 Establish insurable interest, previous claims loss history, previous insurance information

From the above information, one now needs to establish whether there is an insurable interest. Insurable interest exists either, by means of the person owning the insurable item, or if they have a vested financial interest in the insurable item. If there is no insurable interest, the insurer will reject a claim for that item, and any premiums paid for that insurance would be wasted, and at the discretion of the insurer, may be refunded. The insurer would have the option to "void" the policy.

Previous claims history can be established by obtaining details regarding previous claims or losses and damage over a historical period. This period may vary between three (3) and five (5) years. It will indicate the prospective

insured's attitude and moral risk profile for insurance purposes, which in turn allows the underwriter to price the risk adequately.

Previous insurance information allows the proposed insurer to verify the risk profile for the prospective insured, with the relevant previous insurers.

1.6.3 Identify the areas of risk to which the commercial entity is exposed

Based on the survey report completed, one can identify the financial and physical risks to which the commercial entity is exposed.

This would include analysing the information regarding the items or assets to be insured, such as values of:

- buildings;
- stock;
- plant and machinery;
- stock of completed goods;
- other contents such as office equipment, documents and records; and
- turnover for the identification of business interruption risk.

The hazards are also analysed in terms of the insurance cover required and the limitations thereof. These covers are as listed above in Section 1.2.2.

Business interruption cover – the INSURED's gross profit can be formulated on either the *additions* or *difference* basis. Whilst it is essential to follow the definitions in the policy wording the under mentioned will give the representative an overview of what is required.

The **additions basis** is the net profit plus the specified standing charges. Specified standing charges are the charges that do not vary proportionately to the turnover.

The **difference basis** is the turnover plus closing stock less the opening stock, purchases and those costs that will reduce in proportion to turnover. This information is extracted from the trading account of the company.

1.6.4 Establish client's limitations and restrictions

When entering into a contract of insurance there are certain limitations and restrictions a client may have, which need to be taken into consideration when determining their insurance needs. These limitations and restrictions could relate to the following:

- Descriptions of use on the motor policy – the motor section of the policy outlines specific uses of vehicles. Use outside of these limits may not be covered;
- Conditions regarding claims – adherence to the claims procedures and processes of the general conditions of the policy;
- Territorial restrictions – a client needs to be aware of territorial restrictions relating to each section of the policy to ensure that all risks are considered;
- Warranties – are required in specific areas such as theft in terms of the alarm being set during times that the building is not occupied;
- Security requirements – for theft of motor vehicles or burglary of contents;
- Physical security and risk prevention mention measures such as fire-fighting equipment, etc.
- Special conditions applicable to cheques – the money section of a policy outlines a specific procedure that should be followed with cheques. If this procedure is not adhered to the claim will not be paid.
- Age limits – personal accident only applies to individuals between the ages of 16 and 70 years of age;
- Computer viruses – the electronic equipment section specifically excludes cover, placing requirements on the internet firewalls used by the company, ensuring that these are contained.

Municipalities and other para-statal organisations are restricted in terms of the requirements imposed by law, such as the Public Finance Management Act, which states that three quotes are required and above a certain threshold limit has to go to tender.

Subsidiary companies are often restricted in their authority by the parent company in providing authorisation on a particular supplier such as an insurer or intermediary service provider.

1.6.5 Record-keeping

It is imperative that the representative documents all relevant information obtained from a client during this process and that all subsequent documentation obtained on behalf of, and presented to the client are kept on file. This enables the representative to accurately reflect on the recommendations made to the client in the event of a dispute.

It is recommended that a comprehensive “checklist” be used.

Summary

In summary one needs to understand:

- the basic principles of insurance;
- the terms and conditions of policies;
- the types and classes of cover available; and
- how to determine the financial risk exposure of a client.

Only once the above are fully understood can one start analysing the risks to which the client is exposed and determine the client's insurance need.

Self-Assessment Questions

1. Which of the following demonstrates the principle of insurable interest?
 - a) An employer on the life of a client
 - b) An uncle on the life of his niece
 - c) A mortgagor in the property mortgaged
 - d) An 18-year-old on his father's car

 2. Which of the following demonstrates the principle of indemnity?
 - a) A client's building is repaired after a fire
 - b) An employee receives payment for loss of a limb
 - c) An employee's family receives payment on the death of the employee
 - d) An expensive camera is replaced by a cheap camera

 3. When is the principle of average applicable?
 - a) In all claims settlements
 - b) In the event of underinsurance
 - c) When the replaced item has a better performance than the original item
 - d) In compensation claims

 4. The lines of insurance include:
 - a) A fire policy
 - b) A reinsurance policy
 - c) Motor, contents and all risks
 - d) Personal, commercial and specialist markets

 5. Types of cover would include:
 - a) An aggregate excess
 - b) Motor, office contents and all risks
 - c) Specialist markets
 - d) Multi-peril policies and standalone policies

 6. When is a company technically insolvent?
 - a) When assets exceed liabilities
 - b) On a difference basis
 - c) When liabilities exceed assets
 - d) When the rates are not paid
-

7. An example of a specialist market is:
 - a) A motor insurer
 - b) An aviation underwriter
 - c) A fire surveyor
 - d) A manufacturing plant

8. When should one refer to a specialist?
 - a) When a survey is needed
 - b) One does not need to refer to a niche specialist
 - c) All representatives are niche specialists
 - d) When cover for a special risk is required

9. Areas of risk to be considered when determining the needs of a client include:
 - a) Speculative risks
 - b) Moral and physical hazards
 - c) Pure risks only
 - d) Fundamental risks

10. What limitations and restrictions would one need to consider when determining the client's insurance need?
 - a) The description of use of the motor vehicle
 - b) The construction of the building
 - c) The items kept in the safe
 - d) The value of the client's turnover per year

Self-Assessment Answers

1. Which of the following demonstrates the principle of insurable interest?
 - a) An employer on the life of a client
 - b) An uncle on the life of his niece
 - c) A mortgagor in the property mortgaged**
 - d) An 18-year-old on his father's car

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Chapter

2

Match the client's need to the relevant products

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain the terms and conditions of various products available.

Describe the benefits offered by relevant products.

SKILLS CRITERIA

Analyse the data gathered from the client in order to establish the insurable interest and need of the client.

Conduct a comparison of types of cover available to the client.

Purpose

This chapter provides an understanding of the terms and conditions of a multi-peril policy.

2.1 EXPLAIN THE TERMS AND CONDITIONS OF VARIOUS PRODUCTS AVAILABLE

2.1.1 What are the terms and conditions of commercial insurance products?

The following are standard wordings to a normal commercial insurance product. Some specialist markets may use wordings that are more applicable to their particular product.

General exceptions

Grouping together the exceptions and conditions applicable to most sections of the policy saves repetition, but you must remember these when studying the rest of the policy wording.

Riots

This refers to loss or damage to property related to or caused by any of a long list of events, mainly related to riot, strike, public disorder, and warlike operations of any kind. War is a national concern, where Government becomes involved, but for other kinds of disorder, political or non-political, cover is usually available from SASRIA (South Africa) or NASRIA (Namibia), and in other ways (not discussed at this stage).

War

The policy also excludes loss or damage caused directly or indirectly by any occurrence for which a fund has been established in terms of the South African War Damage and Compensation Act (no. 85 of 1976), or similar Acts in other territories.

Nuclear

Except for the Fidelity, Stated Benefits and Group Personal Accident Sections, the policy does not cover any loss of, or destruction or damage to property, any consequential loss, or any legal liability arising from ionising radiations or radiation contamination by nuclear fuel, nuclear waste from the combustion of nuclear fuel, or nuclear weapons material. This is because no one insurer could carry such a large risk.

Remember that other sources of radiation, such as radioisotopes, particle accelerators, X-ray apparatus and lasers, are in use in industry, medicine and research. The exclusion does not apply to these. Such risks must be carefully considered, but can be underwritten in the ordinary material damage and liability policies.

Computer losses

There is also a general exception for losses arising because of computer malfunction caused by incorrect programming, etc., for example, incorrect date formatting, or as a result of viruses, etc.

General conditions

Many of these modify or reinforce the position at common law, so that there is less chance of disputes developing.

Misrepresentation, misdescription and non-disclosure of material particulars render the particular section or item voidable at the insurer's discretion.

Other insurance: the policy will pay only its rateable share of the loss, in other words, the insured himself must also claim from each of the other policies, (rather than claim from only one, and then leave the insurers to sort out contribution between themselves). Also provides for the "importation" of average, where this does not already apply to both policies.

- a) **Cancellation** - immediately, by the insured (normal short period or minimum premium may be charged) or on 30 days' notice by the insurer, subject to a pro rata refund.
- b) **Continuation of cover** - if the premium is paid by debit order, the insurance automatically lapses if the debit order is not met, unless it can be shown that this was due to an error by the bank. The

condition makes provision for monthly, quarterly, half-yearly or annual premium payments.

Premium adjustment: annual adjustment of premium on some sections of the policy, based on the insured's declarations.

Prevention of loss: the insured cannot be expected to prevent all losses (there would be no point in having the insurance), but the precautions and action taken must be reasonable in the circumstances. The insured should always adopt the philosophy of acting as if not insured.

Claims

- a) As soon as reasonably possible, the insured must give notice of any event that may result in a claim. This is especially important in connection with liability risks, or where the insurer might want to insist on extra precautions.

If a claim then results, the insured must, as soon as possible:

- submit full details in writing;
- provide the required proof and documentation, and immediately forward any third party claim or summons to the insurer to deal with;
- in case of theft, notify the police, and cooperate in trying to recover the stolen property.

- b) Insurers cannot allow an unlimited time between the event, and a claim being made. Unless they agree specially, the maximum allowed is 24 months. This limit does not apply to business interruption, fidelity, personal accident/stated benefits, third party liability and where there is pending legal action, but some sections of the policy have their own special requirements.

- c) If the claim is rejected, the insured has only six months, (prescription) from the date of repudiation, to start legal action against the insurer. It is not enough to give notice of legal action; the insured must also pursue this to finality.

- d) The insured, if asked to do so, has to assist the insurer in the recovery of lost or stolen property.

Company's rights after an event

- a) The insured cannot abandon property to the insurer, but the insurer can take possession of damaged property. They must deal with the property in a reasonable manner, otherwise they can be liable for any further damage that results from their actions.
- b) The insurer can take over the rights of the insured immediately and recover against third parties¹. Subrogation proceedings will be at the insurer's expense, but the insured must cooperate.
- c) Liability to third parties. This might exceed the limit under the policy, so the insurer has the option of paying the insured the limit of indemnity and withdrawing from the claim.

Fraudulent claims: any fraudulent claim is forfeited. This includes those insured who, for example, intentionally set fire to their own property, or arrange to have it set fire to or be stolen.

Reinstatement after loss: insureds, and even some brokers, do not always understand that payment of a loss generally reduces the available cover. For example, if contents are insured for R60 000 and R20 000 is then lost, only R40 000 is left for later claims during the same period of insurance. If replacement property is bought, the original sum needs to be reinstated. This condition makes this plain, and provides for reinstatement to take place automatically, so that the client is not left with insufficient cover. Normally, an additional premium is due, but insurers often reinstate small losses free of charge.

Note:

This condition does not apply to personal accident/stated benefits. Stock declaration conditions under the Fire Section, and the Fidelity Insurance Section have special provisions for reinstatement.

Breach of conditions: a breach of conditions affects only the particular section, not the policy as a whole.

¹ In common law, they could do this only after payment of the insured's claim.

No rights to other persons: emphasises that the contract of insurance is between the insurer and the insured. No rights are given to any third parties.

Collective insurances: some large policies are issued by a panel of insurers, each of them named in the policy together with their percentage. One insurer takes responsibility for the issue and administration of the policy, and is called the "lead insurer". The condition makes provision for this.

General provisions

Claims preparation costs

This provides cover of a percentage, normally 10% of the sum insured or limit of indemnity or a specified amount on the item affected, whichever is the lesser amount. This is in addition to any amounts specifically shown in the various sections.

Payments on account

At the insurer's discretion, interim payments may be made to the insured, pending finalisation of a claim.

First amount payable

The policy excess, as it features in some sections of the policy.

Members

If the insured is a close corporation, rather than a company, "member" is used instead of "director".

Liability under more than one section

This is to guard against accumulation of cover under the different liability sections, but is not meant to penalise an insured who may have insured the same risk under two policy sections, for example, rent under Fire as well as under Business Interruption.

Meaning of words

Policy wordings, schedules and endorsements must be read together with one another, and any specific meaning applied throughout².

Premium payment

Premium is payable on or before the inception date or renewal date. Insurers do not have to accept late payments; this is at their choice.

Holding cover

To form a valid contract, the terms including the premium must be agreed. If insurers are holding cover, they will not reject a claim merely because the premium has not yet been agreed.

Schedule sums insured blank

This makes it very clear that if the sum insured/limit of indemnity is left blank, or shown as "nil" or "not applicable", this means no cover, not "no limit to the cover".

Security firms

This does not mean that the policy now covers the security firm, but that:

- the insured's rights under the policy are not prejudiced by entering into a contract required by the security service; and
- if this contract prevents the insured from claiming against the security firm for loss or damage caused by its employees, the insurers will, likewise, not exercise their rights of recourse against this firm.

² People who draw up policies have to take care that this does not result in a meaning they did not intend.

2.2 DESCRIBE THE BENEFITS OFFERED BY RELEVANT PRODUCTS

2.2.1 Commercial multi-peril policies

Each client's policy should be tailored specifically to that client's risk exposure and needs.

2.2.2 Specialist products

These are products specifically designed to cover specialised risks.

2.3 ANALYSE THE INSURABLE INTEREST AND CONDUCT A COMPARISON OF COVER

2.3.1 Analyse the insurable interest

The extent of the interest of the insured, for all items for which insurance is required, must be established.

2.3.2 Price, excesses and loadings

The major difference between insurers is their underwriting practices commercial risks. This is evidenced by the rates they apply and terms and conditions they impose.

2.3.3 Comparison of cover

In commercial insurance the cover provided between insurers has minor differences, which should be identified by the representative. The main differences to be compared are in the prices offered by the insurer, the excesses or loadings applied and any specific warranties that may be imposed.

It is in this area that the representative should be aware of the FAIS General Code of Conduct, Conflict of Interest regulations, as it becomes vitally important that a representative may not recommend an insurer for which the premium charged is higher, where the cover is identical, for the sole reason that they would earn a greater commission.

Summary

For an insurance representative to properly propose insurance solutions to a client, it is required for the representative to consider all the options best suited to the client's needs.

This can only be done through a thorough "needs analysis" and comparison of cover and quotations offered by the different insurers. Each quote should be considered in terms of the client's insurance exposure and prioritisation of needs.

Self-Assessment Questions

1. Which one of the following is a general exception to a multi-peril policy?
 - a) War
 - b) Flood
 - c) Landslip
 - d) Earthquake

2. Which of the following is a general condition of a multi-peril policy?
 - a) First amount payable
 - b) Warranties
 - c) Premiums are paid
 - d) All material facts are disclosed by both parties

3. Which of the following is a general provision in the multi-peril policy?
 - a) Computer losses
 - b) Prevention of loss
 - c) Claims preparation costs
 - d) Lightning

4. How does one establish insurable interest?
 - a) From the previous insurance policy
 - b) Producing proof of ownership
 - c) Valuation certificates
 - d) By taking ownership of the maintenance of the asset

5. What should a representative consider in the comparison of quotes?
 - a) The general provision in the cover offered
 - b) The general exceptions
 - c) The terminology used in the quote
 - d) The price offered for cover

 6. What should a representative check for in a quote comparison?
 - a) That the description of the risk is correct
 - b) That the general terms and conditions offered are the same
 - c) That loadings have not been applied
 - d) That the client gets the cheapest price

 7. A benefit of the policy is:
 - a) That all claims will be paid
 - b) That the terms and conditions are unique
 - c) That the client is indemnified in the event of an insured loss
 - d) That every possible risk is covered

 8. When comparing a quote, a representative needs to keep records of:
 - a) Proof of ownership certificates, banking details of the client and registration of vehicle
 - b) The survey completed, the quotes compared and the analysis of the client's needs
 - c) The client's financials, an inventory of assets, and the client's ID documents
 - d) Registration documents for the company, their VAT certificate and list of employees
-

Self-Assessment Answers

1. Which one of the following is a general exception to a multi-peril policy?
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 - d) Registration documents for the company, their VAT certificate and list of employees

Chapter

3

Apply underwriting criteria

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain the concept and types of reinsurance (with applicability) and limits of retention of the company.

Explain how to apply the underwriting criteria and when surveys are required.

Explain the policy wording, including the concept of excess, underwriting criteria and types of perils and hazards.

Describe how severity and frequency of a risk could impact on acceptance of a risk or the premium.

SKILLS CRITERIA

Determine the factors and hazards that will influence risk in terms of severity and frequency.

Purpose

In this chapter the various factors affecting underwriters' decisions are discussed in terms of how they influence premium, and accurately rate each client for their respective risk exposure. They also impact on the terms and conditions of a policy in some cases, or result in the underwriter deciding which risks he may not accept.

3.1 REINSURANCE

3.1.1 The concept of reinsurance

Reinsurance is a means by which an insurance company can financially protect itself together with other insurance company(ies) against the risk of losses, which are larger than it wishes to carry for its own account.

Individuals and corporations obtain insurance policies to provide protection for various risks such as hurricanes, earthquakes, lawsuits or collisions. Reinsurers, in turn, provide insurance to the insurance companies.

3.1.2 Retention limits

The retention limit is the maximum liability in respect of any loss that an insurer wishes to retain for its own account in respect of a particular risk.

There are various limits that are agreed upon between insurers and reinsurers. These limits are also applicable to various classes and the nature of risks for each class.

From a business point of view it is poor practice for an insurer to be financially over-exposed in respect of any one risk.

3.1.3 Types of reinsurance

There are two kinds of reinsurance, which are Treaties and Facultative.

Treaties

Treaty reinsurance is an arrangement whereby an agreed proportion of a risk is automatically ceded to a reinsurer who has to accept the risk in terms of the treaty agreement. Treaties are divided into proportional and non-proportional arrangements.

In proportional arrangements, (quota share and surplus treaties) the ceding company retains a fixed proportion of a risk or a series of risks and cedes the balance to reinsurers. Premiums and claims are paid and accepted in the same proportions. For example the insurer retains 20% of a risk and cedes (passes on) 80% to the reinsurer. 80% of the original premium is paid to the reinsurer and the reinsurer will pay 80% of any claim.

In non-proportional arrangements (excess of loss) the ceding company (insurer) retains a fixed amount of the risk and cedes the balance to reinsurers. For example the insurer retains the first R100 000 of a risk with a total limit of R500 000 and passes on the balance of R400 000 to the reinsurer. The reinsurer will charge a premium for accepting the R400 000, which bears no relation to the original premium. The insurer will pay the first R100 000 of any claim and the reinsurer picks up the balance.

Treaty reinsurance normally applies to the insurer's portfolio of risks and is an annual agreement. Once signed, it is obligatory on the insurer to cede and the reinsurer to accept.

Facultative

Facultative Reinsurance is an arrangement whereby a proportion of an individual risk is offered to a reinsurer on a proportional or non-proportional basis, which has the opportunity to accept or decline the risk.

3.2 EXPLAIN HOW TO APPLY UNDERWRITING CRITERIA, AND WHEN A SURVEY IS REQUIRED

3.2.1 How is underwriting criteria applied?

When preparing and calculating a quotation for insurance purposes, each additional risk to which the client is exposed as well as the nature thereof,

needs to be factored in terms of the underwriting criteria, to ensure that the client is paying the correct premium for their risk exposure.

3.2.2 What are surveys?

Surveys are recorded descriptions of the risk and hazards to which it is exposed. These are used to apply underwriting criteria to quote on the risk. The survey gives the underwriter the information required to make a judgement on acceptance, terms and premiums of a risk. It also assists the client in that it highlights areas of potential loss and which should be remedied in order to mitigate risk and therefore premium, through risk management.

3.2.3 When are surveys needed?

Although it has become standard practice with some insurers to do a survey report for each new client or risk, surveys are generally required at inception of a risk, as required by underwriters at renewal, or after a loss.

It is imperative to obtain a survey when the risk or hazards are complex and may require the expertise of a professional insurance surveyor to analyse the premises and risk exposure.

3.3 EXPLAIN POLICY WORDING

3.3.1 What is contained in policy wording?

The policy wording consists of a number of sections, each serving a different purpose.

These sections are:

- the **Heading**
the description of the policy provided;
 - the **Preamble**
this details the basic essentials and components of the contract. This clause usually states the payment terms of the agreed premium to be paid by the insured, and acknowledgement that the details supplied in the proposal form constitute the basis of, and are incorporated in the contract;
-

- the **Operative Clause** (these are standard printed clauses) details the hazards and perils for which cover is provided and for which losses, the insurer is prepared to make payment to the insured;
- the **Exceptions** details the risks or losses that are not covered by the terms and conditions of the policy;
- the **General Conditions** which are rules governing the application and interpretation of the contractual conditions as a whole (for example a claim will only be processed if all the premium payments are up to date; or time limits for notification of claims are met);
- the **Policy Schedule** (this is the part that differs in each policy and contains the client's details) this groups together the various features that are unique to the particular insurance relating to:
 - details of the insured;
 - the description of the risks insured
 - the amount and nature of cover required;
 - the premium to be paid by the insured; and
 - the applicable excesses;
- the **Specification** this applies to risks which are not specifically covered by the operative clause, such as the business all risks section of the multi-peril policy;
- the **Endorsement** these are clauses attached to a policy which may either restrict or extend the general terms and conditions of the cover or which may reflect changes in circumstances or the nature of the risks, such as additional security measures to reduce risk, or the acquisition of additional assets which increases the sum insured.

Warranties

A warranty is a compulsory requirement of the policy, which details what the insured must comply with in order for cover to be effective. An example of a warranty is an *alarm warranty* on the theft section of the policy; an example of a pre-condition would be a warranty to the effect that there have been no claims prior to inception.

3.3.2 Underwriting criteria

Underwriting criteria refers to the basic requirements, as well as additional requirements or financial loadings or discounts that an underwriter will consider in order to correctly, evaluate and rate the risk. In addition to these, other factors are also considered when setting the underwriting criteria.

In doing so the underwriting criteria may result in the following:

A **loading** is a percentage of premium rate, which is added to the standard rate to cover the additional risk exposure in the event of a claim.

A **discount** is a percentage of premium/rate, which may be deducted from the standard rate for the reduction of risk.

A **co-insurance** clause is a requirement that the insured must undertake to carry a specified percentage of the sum insured as a self-insured proportion of the risk.

Additional requirements may be in the form of:

- valuation certificates to prove the value of the insured item; or
- security certificates to prove the measures of security taken to reduce the risk exposure.

3.3.3 Excesses

Excesses or first amounts payable are imposed by underwriters to firstly reduce the liability of the insurer in respect of a claim, and secondly to create a sense of responsibility in the insured to take due care.

Voluntary excesses are also requested in some instances where the insured may opt to pay a higher voluntary excess to reduce the premium.

3.3.4 Franchises

A franchise is a type of excess which is a specified amount that any loss must exceed before the underwriter is liable to pay a claim. When a loss exceeds the amount of the franchise, the underwriter would normally be obliged to pay for the entire loss without any deduction. (If the loss exceeds the amount of the franchise, there is no excess payable by the insured.)

Example:

Personal accident – temporary total disability benefits have a seven-day (7-day) franchise applied.

If the disability exceeds seven (7) days, the benefit will be payable from the first day of the disability. If the disability is less than seven (7) days, there is no benefit payable.

Fire – the underwriter requires a R10 000 franchise. A fire occurs and the loss is assessed at R5 000. The insured receives no claim settlement. If the fire damaged was assessed at R12 000, the insured would receive a claim settlement of the entire loss of R12 000 with no excess deduction.

3.3.5 Types of perils

Referring to Section 1.2.2 where the types of cover were described, the perils are defined as follows:

Fire

- Storm, wind, water, hail or snow;
- Explosion;
- Lightning;
- Earthquake;
- Impact of vehicles, animals and falling trees;
- Leakage of fire-extinguishing appliances, including sprinkler and drencher systems;
- Subsidence and landslip;
- Aircraft or aerial devices; and
- Malicious damage

Accident

- Theft – including fraud
- Breakage
- Loss or damage

Liability

- Negligence of the insured

Accidental damage

- Breakage and damage

Motor

- Damage to vehicles
- Third party liability
- Theft

Business interruption

- Loss of profit following a reduction in turnover following the perils insured in terms of the underlying material damage policies (fire/machinery breakdown)

Engineering

- Machinery breakdown

Contractors

- Liability
- Contractors all risks - for everything on site

Guarantees and bonds

- Insolvency
- Performance of obligations

3.4 DESCRIBE HOW SEVERITY AND FREQUENCY OF A RISK COULD IMPACT ON ACCEPTANCE OR A RISK OF THE PREMIUM

3.4.1 What is severity of a risk?

Severity is the magnitude of the consequences of a loss. The severity of a risk is used in calculating the retention of an insurer before the use of reinsurance. For this there are three (3) definitions:

1. Estimated maximum loss (EML);
2. Probable maximum loss (PML); and
3. Maximum possible loss (MPL).

Estimated maximum loss

The estimated maximum loss is the estimated amount of a loss that could occur as the result of an insured peril. An example could be a total failure of the sprinkler system.

Probable maximum loss

The probable maximum loss is the maximum loss that is possible to happen as a result of an insured peril, such as a factory in several buildings - it is probable that one building can be destroyed but not all, as a result of an insured peril.

Maximum possible loss

The maximum possible loss is the total loss of property as a result of an insured peril, such as a factory in several buildings and all the buildings are destroyed as a result of an insured peril.

3.4.2 What is frequency of a risk?

The frequency of risk is the average number of losses of a particular type that may occur in a year. This frequency is extracted from statistics and trends of the particular peril. Such as how many burglaries occur in a particular area in a year.

3.4.3 Determine the factors or hazards that will influence risk in terms of severity and frequency

This would include unpacking the information regarding the items or assets to be insured, such as:

Buildings:

The value of the property and its structure(s):

- The location of the property. Its proximity to open fields, rivers/water lines and adjacent properties which may pose additional risk;
- Details of the building structure, such as standard construction material or a thatched roof;
- Additional structures on the property such as the outbuildings;
- Occupation of the building and the processes carried on in those buildings;
- The general state of repair of the building/s.

Contents:

The value of the contents:

- Office contents;
- Stock of raw materials and finished goods;
- Plant and machinery;
- Security arrangements of the property: precautionary measures such as burglar proofing, alarms linked to 24-hour armed response, electric fencing and secured walls around the perimeter of the property;
- Hazardous materials or processes;
- Fire extinguishing equipment such as automatic sprinklers, fire hoses and handheld extinguishers;
- Construction of the building in terms of soundness of the structure of the building and the material of which the building is made;
- Electrical supplies or outlets and the condition thereof, such as wall and floor plugs and cables being secure and in good repair;
- The general state of housekeeping within the premises.

All Risks:

Business All Risks: The identity of each specified item, its value, and the use thereof should be detailed. The terms and conditions for these items are often dependent on the precautionary measures practiced by the insured.

These items can include copy machines, switchboard systems and electronic equipment.

Motor:

The identity, value, use and security arrangements of each vehicle and any additional modifications or enhancements made to a vehicle should be detailed. Modifications or enhanced items that are not factory fitted and should be specified on a vehicle which may include:

sound systems or speakers;

- magwheels;
- spoilers; or
- performance system;
- tools of trade such as hoists and winches permanently attached to the vehicle.

Security arrangements may be factory fitted and can include:

- tracking devices;
- approved immobilisers;
- gear lock;
- alarm systems; and
- smash and grab film on the windows of the vehicle.

Fleet management procedures relating to:

- maintenance of the vehicles;
- driver training;
- accident prevention; and
- driver register per vehicle.

Use of the vehicle is classified as:

- use for social, domestic and pleasure purposes and use for the business or occupation of the insured.

The limitations to the use of the vehicle are:

- carriage of fare paying passengers;
- carrying any load or passengers exceeding the capacity of the vehicle;
- use in connection with the motor trade; or
- carriage of explosives.

Details of each driver per vehicle must be noted on the schedule to prevent disputes in respect of claims. These details will include, but not be restricted to:

- whether or not any of the named drivers have had endorsements to their driver's license;
- the age of each driver; and
- the claims history of each driver.

Electronic equipment:

- Identity and value of computer equipment
- This is covered as a separate section of the policy as the advancement of technology and value of such items requires these items to be specified separately.

Group Personal Accident/Stated Benefits

- Description of the various occupations of the employees
- Age of employees

Liability:

- Access by the public;
- Products manufactured;
- Manufacturing processes – risk of explosion;
- Sign boards – risk of collapse;
- State of building – risk of a person being injured by a defect in the building
- Cleaning processes – risk of a person slipping on wet floors
- The final destination of goods in particular to overseas destinations such as the USA & UK.

Client's risk exposure

With the information gathered regarding the nature of the assets to be insured, their relevant security and usage information, as well the location of the assets, one is able to identify the risks to which the client may be exposed.

Summary

Underwriting criteria is critical to ensuring that the client pays the correct premium for the risk for which the correct cover is provided. In order to ensure this balance one needs to understand how such criteria are applied to ensure that the client:

- pays the appropriate amount of premium;
 - understands the additional restrictions or limits of cover; and
 - provides all the relevant documentation or information;
- for the risk to which he is exposed.

It is further important to understand that every insurer has a different way of evaluating such risks and therefore the imposed loadings or restrictions should also be compared before making a recommendation to the client.

Self-Assessment Questions

1. What is reinsurance?
 - a) It is a means of avoiding claims costs
 - b) It is a financial means by which an insurer can insure against the risk of losses
 - c) It is a means of co-insurance
 - d) A guarantee for an insurer to guard against the risk of loss
2. The types of reinsurance include:
 - a) Co-insurance and aggregate excess
 - b) Self-insurance and voluntary excesses
 - c) Facultative and treaty agreements
 - d) Dual insurance and surety bonds

3. What is a retention limit?
 - a) The limit of insurance that a client accepts before the normal insurance policy is effective
 - b) The financial limit of cover retained by an insurer on a specific loss
 - c) The possible limit of liability retained by an insurer before reinsurance is required
 - d) The maximum liability that an insurer retains before reinsurance is required

 4. What is the purpose of underwriting criteria?
 - a) To establish the premium rate for a risk
 - b) To lay down security requirements
 - c) To establish the value of the risk
 - d) To ensure the client pays the premium

 5. Why are surveys required?
 - a) To establish the value of complex risks only
 - b) To ensure a client does not commit any fraudulent activity
 - c) To establish the physical hazards of a risk proposed by a client
 - d) To ensure that the client does disclose all material facts

 6. When are surveys required?
 - a) When risks are complex
 - b) For large companies with many properties
 - c) Only when a loss has occurred
 - d) At inception or renewal of a policy

 7. When is a loading of premium required?
 - a) For a regular risk
 - b) For a substandard risk
 - c) For a company with a high turnover
 - d) For a complex risk

 8. What is the severity of a risk?
 - a) Severity refers to the magnitude of the consequences of a loss
 - b) Severity is how often a loss may occur
 - c) Severity is how many sections of a multi-peril policy a loss may affect
 - d) Severity is only used in premium calculation
-

9. The abbreviation PML stands for:
- a) Possible Maximum Loss
 - b) Particular Maximum Loss
 - c) Premium Maximum Loss
 - d) Probable Maximum Loss
10. What could the perils specific to the Liability Section of a policy be?
- a) Negligence of the public
 - b) Negligence of the insured or employees
 - c) Negligence of the independent contractors of an insured
 - d) Negligence of the driver of the company vehicle

Self-Assessment Answers

1. What is reinsurance?
- a) It is a means of avoiding claims costs
 - b) **It is a financial means by which an insurer can insure against the risk of losses**
 - c) It is a means of co-insurance
 - d) A guarantee for an insurer to guard against the risk of loss
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 - c) **Facultative and treaty agreements**
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 - b) **For a substandard risk**
 - c) For a company with a high turnover
 - d) For a complex risk
8. What is the severity of a risk?
- a) **Severity refers to the magnitude of the consequences of a loss**
 - b) Severity is how often a loss may occur
 - c) Severity is how many sections of a multi-peril policy a loss may affect
 - d) Severity is only used in premium calculation
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 - d) **Probable Maximum Loss**

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- a) Negligence of the public
 - b) Negligence of the insured or employees**
 - c) Negligence of the independent contractors of an insured
 - d) Negligence of the driver of the company vehicle

Chapter

4

Draft/request a quotation for insurance

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain the applicability of rate structures.

Explain the use of applicable formulas.

Explain the concept of SASRIA/NASRIA, VAT (cross border), reinsurance and fees, as they apply to premium.

SKILLS CRITERIA

Identify additional requirements, loadings, discounts and excesses which may need to be applied.

Use the formulas.

Prepare a quotation for a commercial short-term insurance policy.

Apply, calculate and disclose applicable rates including fees, SASRIA and reinsurance where applicable.

Calculate the premium, including reinsurance, where applicable.

Purpose

This chapter describes how rate structures are applied in determining the amount of premium quoted and also describes how SASRIA/NASRIA affects premium. It further details the required disclosures that need to be made regarding the premium quoted.

4.1 EXPLAIN THE APPLICABILITY OF RATE STRUCTURES

Rating structures indicate the applicable premium rate for the value of the asset to be insured.

Without the correct rate structure, one would not be able to advise on the premium payable for the cover required.

4.1.1 Underwriting guide

Each insurer compiles a unique underwriting guide with their applicable rates, which express their underwriting philosophy. The underwriting guide will list rating structures for the majority of commercial or industrial risks, covering all classes of business within the normal multi-peril policy.

4.1.2 Fidelity rates

Fidelity insurance provides cover for theft or fraud committed by an employee against his employer.

As a guide, underwriters use a premium rating charge issued by one of the South African Reinsurers. The premium rates are based on number of people insured, the turnover of the business and the amount of fidelity cover required.

4.1.3 Loadings

A **loading** is a percentage that is added to the standard rate to cover the additional risk exposure perceived by the insurers.

For example, the storage of flammable liquids could result in a loading being applied to the rate of premium for buildings and contents and also affects the business interruption rate.

Another example is a fleet of motor vehicles that has a bad claims experience.

4.1.4 Discounts

A **discount** is a percentage that may be deducted from the standard rate for the reduction of risk.

For example, a tracking device fitted to a vehicle could result in a discount on the motor premium charged.

Another example could be an approved sprinkler installation in a factory, which could result in a discount being applied to the building and contents fire premium.

4.1.5 Excesses

Excesses are used:

- to eliminate the costs of small claims;
- to make the insured a self insurer for part of the risk;
- a voluntary excess is used to reduce the premium payable.

Excesses will only have an impact on premium in the event of a client accepting a higher excess to reduce the premium charged.

4.1.6 Additional requirements

Additional requirements may be in the form of:

- valuation certificates to prove the value of the insured item; or
- security certificates to prove the measures of security taken to reduce the risk exposure.

An example of such would be an Automatic Sprinkler Bureau certificate for a commercial/industrial building. Although these certificates or valuations do not have a direct impact on the premium charge, they are required to calculate the correct rate of premium.

4.2 EXPLAIN THE USE OF APPLICABLE FORMULAE

4.2.1 Applicable formulae to determine business interruption sum insured

Within the commercial quotation process the underwriting guide stipulates the rate of premium that is charged per section of the policy based on the value of the assets to be insured.

However, business interruption cover stipulates two optional formulae that may be applied in calculating the sum insured upon which the premium is to be charged.

These formulae are the additions basis and difference basis.

The **additions basis** is:

Net profit + the specified standing charges = sum insured (insured gross profit)

The **difference basis** is:

Turnover + closing stock - the opening stock, purchases and those costs that will reduce in direct proportion to turnover (uninsured working expenses) = sum insured

The above amounts are extracted from a company's trading account.

Example:

Stock at beginning of year (opening stock)	R13 000	Sales	R100 000
Purchases	R60 000	Stock at end of year	R18 000
Variable charges (other than purchases): i.e. uninsured costs	R15 000		
Standing charges	R20 000		
Net Profit	R10 000		
	R118 000		R118 000
Additions Basis	Net profit + standing charges = R30 000 gross profit		
Difference basis	Sales + closing stock R118 000 less		
	Opening stock, purchases and uninsured costs R13 000 + R60 000 + R15 000 = R88 000		

4.3 EXPLAIN THE CONCEPT OF SASRIA/NASRIA, VAT, REINSURANCE AND FEES AS THEY APPLY TO PREMIUMS

4.3.1 What is SASRIA/NASRIA?

It is important to note that in South Africa insurance is available against the fundamental risk of riot (or unrest), strikes and the like. This cover is provided by the South African Special Risks Insurance Association (SASRIA) who are owned by the Government. It is important to note that this cover does not include acts of war.

NASRIA provides the same cover as SASRIA, however is applied in Namibia.

4.3.2 How does SASRIA/NASRIA affect premium?

This is a specific premium for cover relating to riot, strikes and unrest. There are varying classes of cover, each with its own applicable rate or cost.

SASRIA applies to fire, specified working expenses, motor and contractors and Plant All Risks section of a policy.

It is necessary to disclose the SASRIA/NASRIA portion of the premium to the client.

SASRIA/NASRIA cover is not automatically renewable, however is generally dealt with during the renewal process.

4.3.3 VAT and how it affects premium

VAT is a tax applied to the total premium including the debit order charge and SASRIA.

4.3.4 Reinsurance and premium

Reinsurance has no impact on the premium payable by the insured. This is an internal arrangement between the insurer and reinsurer.

4.3.5 Fees and premium

Fees generally have no relation to the premium, as they are amounts charged by an intermediary or insurer for services rendered and should be separately disclosed to the client. In the case of a large number of corporate businesses, the intermediary invoices the customer for a fee for the services they will provide. In this instance commission is not paid by the insurer.

4.4 PREPARE A QUOTE FOR RECOMMENDATION

4.4.1 Case Study – The Widget Engineering Supplies Company

Using the information below, list the additional information one would need to consider before a quote can be prepared.

QUOTATION	
Client:	The Widget Company (Pty) Ltd
Address:	Metal Street, Alberton
Occupation:	Manufacturers and distributors of engineering supplies
Construction:	Brick, metal with metal roof
Turnover:	R7 500 000
Cover required	
1. Fire	
Buildings	R12 500 000
Plant & machinery	R 8 000 000
Stock & materials in trade	R 4 000 000
All other contents	R 2 500 000
Additional claims preparation costs	R 100 000
Extensions	
Earthquake	
Special perils	
Malicious damage	
Stock declaration conditions	
Escalation 10%	

2. Office contents

Contents	R 500 000
Documents	R 100 000
Additional claims preparation costs	R 10 000

Extensions

Theft

3. Business interruption

Gross profit	R 6 500 000
Additional increase cost of working	R 1 000 000
Additional claims preparation costs	R 100 000
Difference basis	
Indemnity period	24 months

Extensions

Suppliers 100%
Prevention of access – extended cover
Public telecommunications – extended cover
Public utilities – extended cover
Accidental damage

Uninsured costs

Purchases
Bad debts
Discounts received

4. Theft

First loss	R 50 000
Additional claims preparation costs	R 10 000
Radio alarm installed, armed response	

Extensions

Malicious damage to buildings as a result of theft or attempted theft

5. Money

Major limit R 75 000
Increase to R150 000 for Christmas period

Extensions

Receptacles R 10 000
Additional CPC (in full) R 10 000
Personal accident assault R 100 000 D & PTD
(in full)
R 1 000 TTD
R 25 000 medical
expenses

6. Fidelity

All office staff (10) R 250 000
Additional claims prep, costs R 50 000

Extensions

Retroactive cover period
Superceded policy – three (3) years
Reinstatement of sums insured

7. Goods in transit

Annual carry R3 000 000
Limit per vehicle R 350 000
Additional claims preparation costs R 50 000

Means of conveyance – own and contractors' vehicles

Cover required – All Risks

Extensions

Debris removal
Fire extinguishing charges

8. Business All Risks

Telephone system	R 50 000
Copier	R 10 000

Extensions

Replacement value conditions	
Increase in cost of Working	
Additional claims preparation costs	R 15 000

9. Accidental damage

First loss	R750 000
------------	----------

Extensions

Leakage of oils/chemicals/fumes	
Additional claims preparation cost	R 25 000

10. Public liability

Losses occurring basis

Limit of indemnity	R5 000 000
--------------------	------------

Extensions

Products liability
Defective workmanship
Wrongful arrest

11. Employers liability

Limit of indemnity	R1 000 000
--------------------	------------

12. Stated benefits

All employees

Death & PTD three (3) times annual earnings
TTD 100% for 104 weeks
Medical expenses R25 000

Extensions

Burns disfigurement

13. Group Personal Accident

Mr Joe Bloggs

D & PTD

R1 000 000

TTD

R 5 000 104 weeks

Medical expenses

R 100 000

Extensions

Burns disfigurement

14. Motor

All vehicles comprehensively insured

Isuzu 5 ton truck
Isuzu 10 ton enclosed truck
Nissan LDV
Mercedes 500SEC car
Hyundai Getz car

Extensions

Contingent liability
Passenger liability
Unauthorised passenger liability
Windscreen
Loss of keys
Radios and tape players
Credit shortfall
Wreckage removal
Loss of use

15. Electronic equipment

2 x Computerised metal working lathes at R1 500 000 each
6 x IBM computers, with server and all accessories R30 000 each

Extensions

Additional increased cost of working
Indemnity period 24 months

16. Machinery breakdown

Computerised metal working lathes	R3 000 000
Bench presses and drills	R1 000 000
Forming press (10 ton)	R 750 000

Extensions

Claims preparation costs

17. Machinery breakdown – Loss of profits

Sum insured	R6 500 000
Indemnity period 24 months	
Additional claims preparation cost	R 100 000

Missing information to be considered:

A survey is required for this client, to facilitate a quotation.

Claims experience for each section of the quote

Overall information regarding the business required

- Fire
 - Fire extinguishing appliances automatic and manual and service dates
 - Hazardous processes conducted on the premises
 - Proximity and exposure of neighbouring property
- Office contents
 - Separate office block or contained in factory
 - Security precautions against theft
- Business interruption
 - What costs are to be noted for the difference basis
 - Names of suppliers
- Theft
 - Name of security firm
 - Are watchmen employed?
- Money
 - Is a security firm used for the transit of money?
- Public liability
 - Does the public have access to the premises?
 - Are any goods exported to North America or the European Economic Community
 - Description of products

- Limit of indemnity for defective workmanship and products liability
- Stated benefits (Personal accident)
 - Number of employees in each category
 - Wages applicable for each employee category
- Motor
 - Year of manufacture and value of each vehicle
 - Registration details per vehicle
 - Value of radio/tape/CD players per vehicle
 - Name of finance house involved for credit shortfall
 - Details of SASRIA covers required
 - Hire required
 - Locks and keys
 - Waiver of excess

Once all of the above information has been established the representative will request insurers to quote based on information given to provide a quote comparison.

4.4.2 Fees and premium - DISCLOSURE

It is a FAIS requirement that at the time of quotation or at renewal, all aspects making up the premium the client pays are disclosed. This disclosure includes:

- premium charged per section, and excesses applicable thereto;
- SASRIA/NASRIA premium charged per section;
- Administration fees;
- Broker fees;
- Debit order charge;
- VAT; and
- Percentage of commission payable to broker.

At any time that the premium may change, it is necessary to disclose all of the above, apart from during quotation or at renewal.

Summary

It is required by the FAIS legislation that all necessary figures are disclosed that make up the insurance premium, including:

- SASRIA cover;
- administration fees;
- rate of broker commission; and
- any other applicable amounts.

Self-Assessment Questions

1. What is the purpose of a rate structure?
 - a) To show that the underwriter considered the cost of a risk
 - b) To indicate the applicable premium for the value of the asset insured
 - c) To ensure that the broker charges the correct commission per section of the policy
 - d) To ensure that the correct admin fees are levied on a quote
2. Why are excesses used?
 - a) To ensure a lower premium
 - b) To guarantee a claim will be paid
 - c) To eliminate the cost of small claims
 - d) To act as a deposit on a claim settlement
3. In which section of a multi-peril policy is there a stipulated formula for calculating the sum insured?
 - a) Fire
 - b) Office contents
 - c) Personal accident
 - d) Business interruption
4. What does SASRIA provide cover for?
 - a) Riot, civil unrest and strikes
 - b) Nuclear fission
 - c) War, piracy and terrorism
 - d) Nuclear explosion, and dangerous goods

5. What is the difference between SASRIA and NASRIA?
 - a) The cover offered by the two
 - b) The territorial limits of cover offered
 - c) The premium payable between the two countries
 - d) There is no difference

 6. How does VAT apply to premium?
 - a) 14% VAT is charged on each section of the policy
 - b) VAT does not apply
 - c) SASRIA/NASRIA is not vatable
 - d) 14% VAT is charged on the overall premium

 7. What is the applicability of reinsurance to the premium charged?
 - a) The insured bears a percentage cost of the reinsurance premium
 - b) The premium is increased by the amount charged by the reinsurer
 - c) There is no applicability of reinsurance on the premium charged
 - d) The insured pays the insurer a fee for reinsurance cover

 8. What items of the premium should a representative disclose to the client?
 - a) All aspects making up the premium charged must be disclosed
 - b) The admin charges
 - c) The broker commission
 - d) The premium per section of the policy

 9. How would one calculate a quotation for a commercial multi-peril risk?
 - a) By requesting the insurer to produce a quote
 - b) By copying the previous insurers rates
 - c) By using the underwriting criteria and guides of respective insurers for each class of risk
 - d) The survey provides the recommended rates of insurance

 10. What is the purpose of an insurer's underwriting guide?
 - a) To stipulate the underwriting requirements needed for a quote
 - b) To stipulate the physical securities required
 - c) To regulate broker commission
 - d) To provide the correct rate of premium per class of risk on which a representative may quote
-

Self-Assessment Answers

1. What is the purpose of a rate structure?
 - a) To show that the underwriter considered the cost of a risk
 - b) To indicate the applicable premium for the value of the asset insured**
 - c) To ensure that the broker charges the correct commission per section of the policy
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- a) By requesting the insurer to produce a quote
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 - c) **By using the underwriting criteria and guides of respective insurers for each class of risk**
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 - d) **To provide the correct rate of premium per class of risk on which a representative may quote**

Chapter

5

Agree on terms and conditions of cover

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain how to apply the law of contract to insurance policies.

SKILLS CRITERIA

Present and explain the terms and conditions to the client.

Verify that the quote meets the client's needs.

Ensure that a survey is conducted where applicable.

Make recommendations of measures that can be put in place to reduce losses or improve risk.

Explain financial options for managing risk with reference of transferring the risk and self-funding.

Present any changes to terms and conditions where applicable.

Obtain acceptance from the client.

Follow up on outstanding requirements such as valuation certificates and security requirement certificates and financial statements.

Purpose

This chapter outlines the purpose and description of the terms and conditions of cover, and any changes or negotiations made thereto.

5.1 EXPLAIN HOW THE LAW OF CONTRACT APPLIES TO INSURANCE POLICIES

5.1.1 Law of Contract

An insurance policy is a contract or agreement between two or more parties, which is legally binding.

The essential elements of such a contract are:

- agreement – there must be agreement to the terms and conditions of the policy wording. The insurer and insured must agree on details such as price, the extent and nature of cover and the period of cover.
- offer and acceptance – an offer is a quotation provided by the insurer, the acceptance is the agreement of the proposer to that offer. The contract is only valid once the offer has been unconditionally accepted.
- capacity – all parties to the contract must have legal capacity to enter into the contract.
- legality – the contract must not be illegal. The contract will be invalid and void if the contract is forbidden by statute or against public policy.
- It must be capable of being fulfilled

5.2 AGREE ON TERMS AND CONDITIONS OF COVER

Once the proposed insured has agreed to a certain quotation it is important that one explains the terms and conditions of the cover to the client to ensure that the client fully understands what is covered and what is not.

A contract of insurance could not exist unless the terms of the contract are fully understood and agreed by the parties.

It is important to remember that the policy document that the insured receives from an insurance company is not the actual contract, but is the evidence of

the contract's existence. The contract is the original proposal form, which gives details of the risk that has been given to insurers on which a quotation has been offered and accepted by the insured.

The terms and conditions are contained in the policy wording and include endorsements, restrictions, exclusions, warranties and conditions of insurance.

5.2.1 Endorsements

Endorsements are clauses appended to the policy which may either restrict or extend the normal policy cover, or which may record changes in circumstances.

When an amendment to a policy is required, it is usually done by means of the issuing of an endorsement. An endorsement is a document, which amends and overrides the original terms and conditions with regard to those areas that have been changed.

Typical endorsements that would be issued include a change in the terms and conditions in the premium, in the nature of the risk, the addition or deletion of an asset, changing of the premium payment frequency.

Neither of the parties, insured nor insurer, may change the terms without the other's consent. The following points apply to changes to an insurance contract:

- Changes mutually agreed upon must be recorded by endorsement;
- If the parties cannot agree on a change, the policy may have to be cancelled;
- Each renewal of a short-term policy is regarded as a fresh contract - terms can be amended.

5.2.2 Exclusions and restrictions

Exclusion clauses have the effect of relieving one party to the contract of insurance, of liabilities that he might otherwise incur towards the other party in terms of the contract. Clauses excluding one party to the contract from responsibility for any liabilities arising in connection with that contract, no matter how induced, are called exclusions and occasionally restrictions.

Exclusions, which may appear in the terms and conditions, may be as follows:

- Any losses arising from nuclear fission, war, riot and civil unrest in South Africa; or

- Use other than the description of use as stated in the policy;
both of the above examples will result in the insurer not accepting liability in the event of a claim.

Restrictions are generally clauses that place conditions of cover on a particular insured asset, or the limit of cover provided for a specified item. Such clauses may include:

- limitation of cover (such as working hours only for personal accident);
or
- vehicle to be kept in locked garage overnight;

Any restriction, if not adhered to, may create a dispute in the event of a claim.

Any endorsement, suspension or cancellation of a driver's licence must be advised as soon as possible to insurers. This applies to anyone who drives the vehicle. Driver's Licence endorsements are material facts for motor insurance, and can give rise to a dispute in the event of a claim.

5.2.3 Conditions of insurance

Conditions are rules governing the application and interpretation of the contract as a whole.

Conditions may be found relating to each section of the policy, but cover very similar points. Some common conditions may be:

- a condition stating that the policy is only in effect if the insured complies with all the terms of the policy, including the payment of the premium;
- the requirement that the insured notify the insurer if there are any changes in risk;
- procedures to be followed in the event of a claim. This may vary from cover to cover but will include timeframes for notifying the insurer of a claim;
- the consequences of fraudulent acts;
- reference to the fact that the insured should take all reasonable steps to avoid and minimise risk of loss or damage or incurring liability;
- an outline of what is to happen if there are other policies in force covering the same loss and same subject matter, as this will concern the principle of contribution; and

- conditions under which an insurer or insured may cancel a policy and the procedure thereof.

5.2.4 Application of terms and conditions as applied in the quotation

The insurer's quotation is regarded as the legal offer. The quote should set out terms, such as excess and any warranties to apply, so that the proposer can make an informed decision.

It is a general and overriding principle that the intentions of the insurer and the insured should prevail and that these are set out in the terms and conditions of the policy – that is that the policy should accurately reflect what they meant to say. It should be based on the thorough needs analysis, which has led to the identified and recorded needs of the proposer.

If any information has been misconstrued, this should be dealt with immediately and brought to the attention of the other party at the earliest possible opportunity.

This would prevent any possible dispute arising in the event of a claim.

The acceptance of this offer by the insured creates the contract. This contract will be evidenced by the policy wording which the insured must read carefully and bring to the attention of the insurer any anomalies or omissions.

5.3 MAKE RECOMMENDATIONS OF MEASURES THAT CAN BE PUT IN PLACE TO REDUCE LOSSES OR IMPROVE RISK

5.3.1 The application of a risk management programme

An effective risk management programme identifies the risks to which an insured may be exposed and proposes measures to counter the exposure.

There are many risk management principles that can be implemented to reduce losses.

Risk management is a specialist profession offered by trained professionals for a commensurate fee. Where a representative is not equipped to deal with risk management issues, he is required to undertake a needs analysis and obtain comprehensive quotations for the provision of adequate insurance. If the terms

of the insurance require specified risk improvements then the intermediary is obliged to convey these requirements to the insured.

For example, a survey may identify the use of flammable liquids and the representative or risk manager may recommend appropriate storage and ventilation to reduce the risk of fire. An insurer may then recommend appropriate measures that need to be taken.

5.3.2 Improve physical aspects of the property

A risk management process will recognise the risk of flooding and the risk manager may recommend to improve drainage measures, or install additional drainage systems.

Other physical aspects may include burglar alarms, fire extinguishing equipment or tracking devices.

5.3.3 Employee risks

The Occupational Health and Safety Act no 85 of 1993 imposes health and safety requirements on all employers. This requires an employer to conduct its own risk assessment of its property, work processes and any other possible risk, to ensure the health and safety of its employees and their property.

Employee risk assessments would include internal audits and personnel procedures.

Internal audits such as:

- health and safety compliance requirements to prevent liability claims;
- finances - to ensure compliance with the internal regulations and also the statutory requirements imposed on a company to prevent fraud and theft by employees; and
- stock - to ensure compliance with internal regulations of the company to prevent fraud and theft by employees.

Personnel procedures would include:

- codes of conduct;
- disciplinary;
- appropriate training; and
- compliance with the labour laws.

5.4 EXPLAIN FINANCIAL OPTIONS FOR MANAGING RISK WITH REFERENCE TO TRANSFERRING THE RISK AND SELF-FUNDING

5.4.1 Transferring of risk

The transfer of risk can be done by self-insurance, risk transfer or alternative risk transfer.

Risk Transfer refers to the shifting of the responsibility, for paying for losses through insurance, from the client to the insurer.

5.4.2 Creating a cell captive (alternative risk transfer)

A cell captive only applies to very large commercial companies, which create an "in house" insurance entity that exists solely to underwrite the insurances of the parent company. Premiums are based on the experience of the parent company and not the general market. Reinsurance protection is usually purchased.

The advantages therefore are retention of the premium within the organisation, lower premiums and special cover that might not be available elsewhere.

5.4.3 Self-funding

Self-funding works on a planned retention of risk based on sufficient capital resources of the client, and must be accompanied by a risk management strategy.

The advantage of self-funding is that the fund, if not utilised, accumulates an amount which can then be utilised to take on a larger self-insured proportion in the following insurance year. It also creates greater risk management awareness.

The disadvantages are the same as those listed under self-insurance.

For commercial risks, insurance cover is needed against catastrophes.

5.5 PRESENT A RECOMMENDATION TO A CLIENT

5.5.1 FAIS requirements

In the ambit of the FAIS requirements, it is imperative that the client be furnished with all the relevant information to make an informed decision.

An insurance quotation for the client, therefore must include, in a language the insured understands:

- a covering letter;
- the comparison of cover proposed, which includes all relevant quotes received, and their comparison to the client's current cover;
- a recommendation of cover proposed;
- awareness of risk exposure and possible solutions in which these risks can be addressed; and
- full details of the intermediary, product supplier(s) and any other relevant party to the recommendation proposed.

In presenting the above to the client, the representative must highlight all of the proposed changes in cover and benefits, as well as the applicable exclusions/restrictions as detailed in the terms and conditions.

5.5.2 Obtaining additional requirements or information

Upon the client's acceptance of the recommendation or of a specific quotation, it may be necessary to obtain additional information or documentation, from the client, to conclude the transaction.

It is necessary to take note of specific time limits in respect of these requirements, as the failure to obtain such information or documentation may result in a delay of cover being granted to the client.

5.5.3 Obtaining acceptance

The recording of the client's acceptance is critical to the validity of the policy. This can be done in various manners, such as a recorded telephone call between the client and representative, or in writing by the signing of an acceptance form with the intermediary.

Without such acceptance from the client, the contract will be null and void.

5.5.4 Record-keeping

As per the FAIS requirements it is vital that the intermediary or representative keep a record for each client, which should reflect the following:

- A copy of the record on which the insured items were recorded;
- A copy of all quotations considered;
- A copy of the recommendation made to the client;
- A copy of the client's acceptance of the recommendation or alternative quote;
- Copies of all additional documentation and information required; and
- A copy of the policy schedule with the terms and conditions of the policy wording.

Summary

Without a client's consent to the terms and conditions, underwriting loadings and restrictions imposed, as well as the premium charged with the relevant excesses, the insurance contract is null and void.

Self-Assessment Questions

1. How does the law of contract apply to insurance policies?
 - a) There needs only to be consensus for a contract to exist
 - b) An insurance policy is a contract and therefore the law of contract applies to insurance policies as it does to any other contract
 - c) There needs only to be an offer and acceptance
 - d) It does not apply to insurance policies
2. In presenting the terms and conditions to a client, a representative needs to consider:
 - a) All limitations, restrictions and exclusions imposed and endorsements required
 - b) Anything that limits the cover of the policy
 - c) Ensuring that the client understands only what is excluded from the policy
 - d) Any conditions under which a claim will be accepted

3. What measures can a client implement to reduce risk?
 - a) A client need not worry about risk management once he is insured
 - b) Employ a risk manager
 - c) Consider risk transfer options
 - d) A risk management programme including internal audits and policies and procedures

 4. What is self-funding?
 - a) A fund to deal with catastrophe claims only
 - b) A fund to pay the excesses due on claims before insurance is effective
 - c) A fund established by the insured to deal with claims
 - d) It is the same as self-insurance

 5. What is one of the risk transfer options that a company can consider?
 - a) Creating a cell captive
 - b) Buying an insurance company
 - c) Avoiding all risks
 - d) Creating an in-house insurance broking company

 6. What documents need to be kept by the representative in having presented a policy to a client?
 - a) Once the policy is issued, the representative need not keep any further records thereof
 - b) A copy of the survey report, needs identified, quotes compared, policy issued, policy schedule, endorsements required
 - c) Copies of all ownership certificates, bank accounts, guarantees and bonds
 - d) A PowerPoint presentation with all his notes and recommendations

 7. What steps need to be taken once the client agrees to the quotation recommended?
 - a) Re-quote in case premium changes
 - b) Send all needs analysis documents to the insurer
 - c) Obtain second opinion on survey
 - d) Obtain a written acceptance and follow up on valuation and security certificates
-

Self-Assessment Answers

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Chapter

6

Issue policy/fulfilment document

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain the procedure for issuing policies/fulfilment documents.

SKILLS CRITERIA

Submit/receipt of closings/acceptance of quote

Ensure accuracy of closing/acceptance to the quote

Issue policy/fulfilment document

Quality assurance of policy document/contract to quote/proposal or closings

Purpose

It is imperative that representatives ensure that the policies issued coincide with the quotation the client accepted.

6.1 EXPLAIN THE PROCEDURE FOR ISSUING POLICY DOCUMENTS

Upon the client accepting the quotation, the representative confirms the receipt of the closings or acceptance form and follows the steps as outlined below.

6.1.1 Confirm that the quotation given is that which has been accepted

It is necessary for the insurer to confirm that the quote issued is the same as the quote accepted by the client. This is critical, as in some instances the premium value quoted might change slightly, or the risk address might change.

6.1.2 The policy document

The policy document may now be issued in accordance with the insurer's procedures.

6.1.3 Ensuring that the policy is issued on the quotation provided

The representative of the insurer and the intermediary, is responsible for checking that once the policy documents are received, the policy schedule accurately reflects the sums insured for the various sections of the policy, and that the premium, stated benefits and exclusions are in agreement with the quotation.

For quality assurance, one needs to ensure that all of the following are in agreement:

- Premiums quoted and premiums charged;
 - Benefits offered and benefits provided;
 - Loadings, restrictions and exclusions applied;
 - Excesses applied and excesses quoted; and
 - Insured property provided and insured property stated in the policy schedule.
-

6.1.4 Regulatory requirements for issuing policies

Section 47 of the Short-term Insurance Act places a specific requirement on insurers to issue a policy (or at least a document embodying the contract, with access to a copy of the full policy) within 30 days after entering into or changing such a policy.

A policy must be issued within a prescribed period to ensure that the relevant parties are aware of their rights and obligations in terms of the policy.

Section 52 of the Act states that an individual (minor) who has reached 18 years of age, may enter into a short-term insurance contract, without the consent of his guardian.

This client will be held responsible for the payment of premium and terms and conditions of the policy as if he were an adult, for as long as he benefits from the policy.

The client would also have the power to negotiate changes in the terms of the policy, as long as these changes are in the individual's interest as if he has attained his majority (reached the age of 21 years).

Summary

Besides the regulatory requirements for issuing policy documents, it is best practice to ensure that the policy document issued matches the quotation provided and the proposal accepted.

Self-Assessment Questions

1. Which one of the following is required for quality assuring a policy that is issued?
 - a) Agreement between the proposal, quotation and the policy itself
 - b) That the administrator issuing the policy has a relevant qualification
 - c) That the policy schedule has similar amounts to those quoted
 - d) That the sums insured are inflated by 10% for inflation purposes

2. What is the minimum age stipulated in Section 52 of the Short-term Insurance Act with regards to issuing policies to minors?
 - a) 21
 - b) 17
 - c) 18
 - d) 24

3. What is the regulated time period stipulated in Section 47 of the Short-term Insurance Act for policies to be issued to clients?
 - a) 15 days
 - b) 45 days
 - c) 60 days
 - d) 30 days

4. Which items in a policy must be checked against the quotation for quality assurance purposes?
 - a) The banking details of the client
 - b) Claims history, age of insured, property owner
 - c) Premiums, conditions, excesses and details of insured property
 - d) The consistency of the policy wording

Self-Assessment Answers

1. Which one of the following is required for quality assuring a policy that is issued?
 - a) **Agreement between the proposal, quotation and the policy itself**
 - b) That the administrator issuing the policy has a relevant qualification
 - c) That the policy schedule has similar amounts to those quoted
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 - c) **Premiums, conditions, excesses and details of insured property**
 - d) The consistency of the policy wording
-

Chapter

7

Provide a service to the client/maintain policy/client retention

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain the concept and process of renewal/review of policies.

Explain the procedures for making additions of changes to policies and the implications thereof.

Explain the conditions of collection and payment of premiums.

Explain the replacement policy concept.

SKILLS CRITERIA

Analyse the performance of the policy and establish whether the policy still meets the need of the client.

Renegotiate the terms and conditions of the policy as appropriate.

Communicate and confirm all changes to policies with all relevant parties.

Obtain supporting documentation for changes where required.

Make amendments to policies and issue endorsements.

Ensure collection/payment or refund of premium.

Purpose

It is imperative that policies are reviewed each year to ensure that the cover provided in the policy is still adequate for the requirements of the insured. There are various aspects to consider in this process, as outlined in this chapter.

7.1 EXPLAIN THE CONCEPT AND PROCESS OF REVIEW/RENEWAL OF POLICIES

7.1.1 Analyse and review the policy

Is the policy still adequate for the cover that the insured requires?

Many things happen within a year in terms of an insured's assets. People acquire assets such as machinery, vehicles or IT hardware, which increase the overall value of the property insured.

It is therefore imperative to re-confirm this information each year with the client to ensure that the client remains adequately covered. In the short-term environment this confirmation happens on an annual basis during a renewal process.

In addition to the above, inflation also has a role to play and gives rise to problems both for the policyholder and the insurer:

- It may result in underinsurance for the policyholder, with the result that average may be applied in the event of a loss; and
- The effect for the insurer is that the company is not receiving the amount of premium actually required to cover the insured risks, while the cost of claims continue to increase.

The manner in which insurers deal with the effect of inflation, is to build in an inflation index to the sum insured, which gives rise to an equivalent premium increase for cover provided.

7.1.2 Renewal of policies

In cases where insurers would like to retain a client, it is a standard procedure that the insurers will send out renewal policy schedules (notices) for policies that are due for renewal. These could be sent out to the client directly or to the intermediary concerned who in turn will refer and discuss the renewal notice with the client. There is no obligation for an insurer to invite renewal.

The purpose of renewal notices is to communicate a change in rate of premium if applicable and to remind the client to ensure that the values of his assets have been adjusted in line with the inflation factor, to ensure that he remains adequately covered for the next year. During the renewal process it is necessary to review the terms and conditions of cover as well as the values of the assets covered.

A renewal notice may even impose restrictions or conditions of proposed continued cover to a client, so that they can adequately manage the risk.

Again in the renewal process disclosures come into the forefront. These disclosures would include:

- any increase in premium, if applicable.
- where applicable, any variations in cover or limits, as well as any changes to the terms and conditions of the policy.

The intermediary will evaluate all the rates, terms and conditions to see that they are fair and will re-negotiate with the insurer, if necessary. When satisfied, the intermediary will contact the client to discuss the renewal.

Documentation required for disclosures in the event of a review or renewal would include any additional valuation certificates that may apply, and details of variations in the policy schedule or terms and conditions.

In the event of a renewal, the intermediary needs to keep record of the negotiations between the intermediary and client, as well as any changes in policy schedule or terms and conditions agreed. The revised schedule replaces the schedule in the policy document and details the cover for the next period of insurance.

In addition, ensure that the client fully understands his rights and obligations to obtain copies of any of the above-mentioned documentation.

The client must be fully informed of the implications, including:

- all fees and charges applicable;
- special terms and conditions, including loadings, excesses and restrictions; and
- the implications on vested rights in terms of no claim bonuses.

The intermediary should advise the client of comparative products and cover available and the premium thereof. This information must be discussed with the client.

If the current cover is to continue, the renewal premium should be paid by the client on, or before, the renewal date of the policy.

Once the insurer has been advised of the changes in the risk details, and the policy has been amended, a revised schedule can be sent to the client.

There are some exceptional cases in the renewal process in which the insurer will not send out a renewal notice to a client because of a high moral hazard, or claims experience, but will notify the intermediary that they will not be renewing the policy.

7.1.3 Changes to the contract

Changes to the contract can be made at the time of issue of the policy, or subsequent to the policy being issued.

An endorsement to a policy overrides the terms and conditions of the original policy and therefore amends the contract itself. It is very important that these changes are correctly recorded.

Endorsements can affect the following sections of a policy:

- The amounts insured;
- The details of the subject matter of the insurance, for example, a new risk address or a different vehicle;
- Addition or deletion of sections insured for;
- Increase in the premium payable as a result of a general premium increase, or higher premiums for a single insured as a result of the loss history;
- Change of payment methods and banking details; or
- Additional premiums as a result of amendments to the policy.

Changes to policies must be recorded, as these changes could have an impact on the potential severity of losses, and could leave the insured without appropriate cover if they are not recorded.

7.2 EXPLAIN THE CONDITIONS OF COLLECTION AND PAYMENT OF PREMIUMS

7.2.1 Collection of premiums

Where the intermediary is handling premium collections, he must:

- be authorised by the insurer in writing; and
- furnish a guarantee representing a regulatory portion of the estimated annual premiums handled in the year, with the limits of the regulatory requirements.
- include a statement of premiums being paid with the payment.

This guarantee is usually effected through the IGF facility administered by the South African Insurance Association (SAIA), as per Part 4 of the Regulations referring to Section 45 of the Short-term Insurance Act, although other forms of secure guarantee can also be arranged, such as bank guarantees. This is a protection for the client in the event of the intermediary not paying over the premium.

The Regulations also require that all premiums, net of refunds due and the amounts due to the intermediary for services provided, are paid over to the insurers:

- for renewals, within 15 days after the end of the month in which they are collected; or
- for new business, within 15 days after the end of the month in which the policy incepted.

When is premium due?

In insurance practice, "due date" means:

- in the case of a new policy, the inception date of the policy;
-

- in the case of the renewal premium , this is the same as new business; the premium is therefore due on or before the renewal date.

Methods of payment

Premium for a policy can be paid in the following ways:

- The premium can be paid annually, half-yearly or quarterly. This method is still used by businesses and personal lines clients. However, because of economic reasons, it is becoming less popular;
- Monthly payment by debit order.

Non-payment of premium

The premium is due on a certain date and must be paid by that date.

Insurers may not automatically cancel or reverse the cover because payment to the intermediary is deemed to be payment to the insurer, if the premium has been paid to the intermediary by the insured, and the intermediary does not submit the insured's payment during the required period of time.

One of the conditions applicable to admitting claims is whether or not the premium payments received are up to date.

When cover ceases - debit order policies

The policy wording and/or the debit order form that the client signs, tells the client when premium is due. It is practice for insurers to resubmit unpaid debit orders to the bank for processing. However, if the debit order is returned as "payment stopped", the policy is cancelled immediately.

The effective date of the cancellation will be the due date of the first returned debit order.

Example:

- Premium is payable on the 28th March.
- This premium is in respect of April as the policy is payable in advance.
- Date of cancellation if debit order returned after the re-submission - 1st of April

Conclusion

The collection of premium in the short-term marketplace has wide-ranging consequences. The type of collection can affect the terms of the insured's policy.

The collection of annual premiums paid over by intermediaries can be an administrative nightmare, with accounts departments within the insurance company receiving monthly bordereaux, which must be reconciled with outstanding premiums. It is very important for these statements to be monitored as premiums may become overdue.

Therefore the credit control function of the accounting department in an insurance company requires effective control.

7.3 EXPLAIN THE CONCEPT OF A REPLACEMENT POLICY

7.3.1 Replacement policies

Should it become apparent to the intermediary during the renewal process, that more favourable terms and conditions are available in the market, the intermediary should present the client with the option to renew the current policy, as well as quotations and recommendations on the alternative covers available.

The insurer of the existing policy, being replaced, needs to be notified of the intention not to renew the policy in terms of the conditions of the current policy.

Example:

Mr Jones, who is insured with ABC Insurers, is informed by his intermediary that his current policy is up for renewal. During the review of the renewal terms and conditions his intermediary advises him that more affordable cover is available.

He arranges to meet with his intermediary who presents him with the terms and conditions of the current renewal, as well as the terms and conditions of an alternative product.

Upon consideration of the intermediary's presentation, it would appear that there is very little difference in the terms and conditions of the two policies, and that Mr Jones would in fact benefit from a lower premium charge for a higher value of cover.

Mr Jones accepts the new quotation and requests his intermediary to cancel his current cover and to transfer his portfolio to the new insurer.

Summary

The review and renewal process is as important as the original inception of the policy. It is often by omissions, or oversight, in renewals that the insured finds himself underinsured, unless the representative follows the FAIS process for each client.

It is imperative to note that a review process may result in a replacement policy in which case the FAIS process needs to be carefully monitored in terms of disclosures.

Self-Assessment Questions

1. What is the purpose of analysing and reviewing a policy?
 - a) To ensure the representative has received the commission due
 - b) To determine how much additional premium the insurer could charge
 - c) To determine that the policy still meets the insured insurance needs
 - d) To ensure that all the security conditions are met in terms of the terms and conditions of the policy

2. What is the purpose of a renewal?
 - a) To re-evaluate the excesses and loadings of the policy
 - b) To confirm or amend sums insured and obtain acceptance should the premium increase
 - c) To ensure continuity of insurance cover
 - d) To check that the insured is still paying his premium

3. Name one aspect that an endorsement might affect on a policy?
 - a) The security arrangements of the insured
 - b) The name of the landlord
 - c) The bank account from which the debit order is deducted
 - d) The increase or decrease in the sums insured

 4. In order for an intermediary to collect premiums, he must comply with the following conditions:
 - a) Have a separate bank account for premium collection
 - b) Be a qualified accountant
 - c) Be authorised by the insurer in writing
 - d) Be a professional member of a professional body

 5. During which stage of an insurance policy lifecycle is a replacement policy possible?
 - a) At renewal of a policy
 - b) At inception of cover
 - c) Ad hoc when the insured requests it
 - d) Upon an insurer cancelling cover

 6. What is the concept of a replacement policy?
 - a) It is when an insured replaces one asset with another on his policy
 - b) An addition of another vehicle or building to the policy
 - c) An alternative finance arrangement to pay his premiums
 - d) When alternative and more favourable terms and conditions of cover are recommended and accepted at the time of renewal

 7. During the process of renewal of policies, what is the representative's role?
 - a) To confirm his qualification and commission with the insured
 - b) To communicate and confirm all changes with the insured
 - c) To communicate to the insured that he has updated his professional status
 - d) To keep contact with the insured on a regular basis

 8. With one of the conditions of insurance being the payment of premium, what are the implications of returned debit orders?
 - a) Cancellation of cover
 - b) Cover continues indefinitely
 - c) Claims will be reduced by the amount of premium owed
 - d) The insurer will repossess the insured's assets
-

9. What should be checked in regard to premiums in the event of a claim?
- a) That the insured at least pays some premiums
 - b) That the premium payments are up to date
 - c) That the premium will escalate by the rate of inflation
 - d) There is no issue regarding the premium in the event of a claim
10. Why is it important to record changes to policies?
- a) Because the FAIS Act requires it
 - b) For the representative to show that he has contacted his client
 - c) For the insurer to have an accurate policy record in the event of a claim
 - d) To check that the client operates in the terms and conditions of the policy

Self-Assessment Answers

1. What is the purpose of analysing and reviewing a policy?
 - a) To ensure the representative has received the commission due
 - b) To determine how much additional premium the insurer could charge
 - c) To determine that the policy still meets the insured insurance needs**
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Chapter

8

Process a claim

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Identify whether the loss is an insured peril in terms of the policy/fulfilment.

Explain the terms and conditions of the policy.

Explain the claims procedure and criteria for claims of the insurer.

Explain the concept and applicability of third party insurance and the procedure for third party insurance claims.

Describe the role of the relevant parties involved in a claim.

Describe the process for review and appeals of rejected claims.

Explain the types of compulsory legislative insurance.

Explain what the applicable formulas are (e.g. average, betterment and contribution) and how they should be used.

SKILLS CRITERIA

Gather relevant information relating to the claim from the client.

Advise the client on the claims procedure.

Record the details of the incident or loss for record-keeping.

Notify the relevant parties of the potential loss.

Obtain all relevant documentation regarding the claim.

Validate the documents/information and the legitimacy of the claim.

Establish liability in terms of the policy (Appoint a loss adjustor/assessor and/or investigator if necessary).

Establish the value (quantum) of the claim.

Notify relevant parties of the claims outcome (settle/reject) internally and externally.

Settle the claim if admitted.

Record the finalisation of the claim.

Purpose

Short-term insurance claims are the shop window of the insurance industry. It is therefore necessary to carefully communicate procedures and administrative requirements, and ensure that the client fulfils all the terms and conditions of the policy, to facilitate a speedier claims process.

8.1 IDENTIFY WHETHER THE LOSS IS AN INSURED PERIL IN TERMS OF THE POLICY

8.1.1 The claims process

In the event of the insured suffering a loss or damage as a result of an insured peril, and if that loss is covered by the terms of the policy, the insured may submit a claim to his insurer.

This claim is an application by the insured for the repair of damage or indemnity for the loss in terms of the insurance contract between the insured and the insurer.

Therefore one needs to ask the following:

- Is there a policy in force that covers the item lost or damaged?
- Is the proximate cause an insured peril?
- Have the policy terms and conditions been complied with?
- Are premiums up to date?

Certain conditions must be satisfied, such as:

- an insured event must occur resulting in a loss or damage to an insured asset or a liability of the insured;
 - the insurer must be advised of such loss or damage within the time stated in the policy;
 - it must be confirmed that the policy covers the appropriate type and cause of loss;
 - the insurance contract must be enforceable, specific to the disclosure on behalf of the insured;
 - the claims must be legal in that the insured cannot gain financially from his own illegal actions;
-

- the claims process for different categories of assets are dealt with in different ways, therefore upon notifying the insurer of the claim and the above confirmations, the relevant requirements will be communicated to the insured; and
- where an insurer provides a claim form which requires additional supporting documentation to be submitted, it is the responsibility of the insured to complete the form and submit all the relevant details requested.

8.1.2 Insured perils

An insured peril relates to an insured event. As discussed in Chapter 1 a peril is the cause of the damage or loss, such as a flood, fire or accident.

It is however possible that certain perils are not insured, such as war, civil unrest or riot, or the consequence of a criminal act committed by the insured, whether intentional or not.

The exclusions to the insured perils however, would be detailed in the terms and conditions of the policy wording. Therefore, when a claim is submitted, the peril needs to be confirmed in terms of the policy wording as an insured peril, for the claim to be accepted or processed.

8.2 EXPLAIN THE TERMS AND CONDITIONS OF THE POLICY

8.2.1 General claims procedure

As soon as reasonably possible, the insured must give notice of any event that may result in a claim. This is especially important in connection with liability risks, or where the insurer might want to insist on extra precautions.

If a claim then results, the insured must, as soon as possible:

- submit full details in writing;
 - provide the required proof and documentation, and immediately forward any third party claim or summons to the insurer to deal with;
 - in case of theft, notify the police, and cooperate in trying to recover the stolen property.
 - for the loss of property, notify the police, or requested to do so by the insurer.
-

Insurers cannot allow an unlimited time between the reporting of the event to the insurer (usually within 30 days), and a full claim being made. Unless they agree specially, the maximum allowed is 24 months. This limit does not apply to business interruption, fidelity, personal accident/stated benefits, third party liability and where there is pending legal action, but some sections of the policy have their own special requirements.

The insured, if asked to do so, has to assist the insurer in the recovery of lost or stolen property. If he does not do so, he must refund the claim settlement, if required by the policy.

8.2.2 Company's rights after an event

The insured cannot abandon property to the insurer, but the insurer can take possession of damaged property. They must deal with the property in a reasonable manner; otherwise they can be liable for any further damage that results from their actions.

The insurer can take over the rights of the insured immediately and recover against third parties³. Subrogation proceedings will be at the insurer's expense, but the insured must cooperate.

Liability to third parties - This might exceed the limit under the policy, so the insurer has the option of paying the insured the limit of indemnity and withdrawing from the claim.

8.2.3 Fraudulent claims

Any fraudulent claim is forfeited. This includes insureds who, for example, intentionally set fire to their own property, or arrange to have it set fire to or stolen.

8.3 EXPLAIN THE RELEVANT INSURER'S CLAIMS PROCEDURE AND CRITERIA

It is imperative to note that each insurer has their own particular claims procedure with their relevant requirements.

³ In common law, they could do this only after payment of the insured's claim.

As noted earlier this may differ further between the different classes of business insured by the same insurer.

It is therefore very important that once a potential claim has been communicated to the relevant insurer, that the claims process for that claim is confirmed and communicated to the client.

8.3.1 Enforceable insurance contracts

The claims technician/negotiator will further evaluate the terms and conditions and excesses that apply.

Compliance with the terms and conditions of the policy can be checked as follows:

- When a claim is submitted to insurers, it is unlikely that all of the relevant details will be available, but as much information as possible should be obtained;
- The insurer will probably appoint a loss adjuster and this person will be able to investigate further;
- The loss adjuster will require details of the cover under the policy and it is likely that he will advise the insurance company as to whether the terms and conditions have been complied with.

If no loss adjuster is appointed, it is the claims technician/negotiator's job to check the claim form that is to be completed by the insured to ensure that all terms and conditions have been complied with and that all documentation and information is complete.

The claims technician/negotiator will then, depending on the size of the loss, appoint a claims assessor or loss adjuster and/or call for a fully completed claim form and supporting documentation.

Burden of proof

- The insured must prove the loss;
- The insured must further prove insurable interest in the loss or damage incurred;
- If the insurer wishes to claim that an exception operates then it is up to the insurer to supply the proof thereof.

8.4 EXPLAIN THE CONCEPT AND APPLICABILITY OF THIRD PARTY INSURANCE, AND THE PROCEDURE FOR THIRD PARTY CLAIMS

8.4.1 What is third party insurance?

Third party insurance covers injury to other parties and damage to their property.

Third party insurance

Third party insurance is contained in the liability and motor sections of a multi-peril policy of insurance to indemnify the insured party for liabilities that may arise in consequence of –

- accidental death of or injury to third parties, i.e. persons other than the insured;
- accidental loss or damage to a third party's property.

This is the most basic form of cover, which provides no cover for the policyholder's own loss or damage. There are a number of important exclusions to this cover. Such exclusions may include:

- death or injury to members of the insured's household;
- death or injury to people who are employed by the insured;
- loss or damage to property belonging to the insured or which is in his custody or control
- losses which are already covered by the Road Accident Fund Act
- insured persons cannot sue the negligent driver

8.4.2 How does third party insurance work?

Scenario 1:

A defective wall on a company's property collapses and damages a visitor's car. The insurers of the car accept damage to the vehicle, and in subrogation claim against the liability section of the company's multi-peril policy.

Scenario 2:

A product is incorrectly labelled and as a result of the use of that product by a third party, injury is caused to the user. The products liability extension of the multi-peril policy will cover this loss.

8.5 DESCRIBE THE ROLE OF THE RELEVANT PARTIES TO A CLAIM

When a claim is reported to the insurer, a claims assessor or loss adjuster is sent to establish the circumstances and extent of the damage or loss.

Instead of authorising repairs, the claims assessor or loss adjuster may report back to the insurance company, which will authorise the repairs when all of the necessary documentation has been received and checked or call for further investigation.

8.5.1 The insured

In the event of a loss or damage to an insured item, it is the responsibility of the insured to make every effort to notify the intermediary or insurer of the incident as soon as possible.

In many instances it will be required that the insured reports the incident to the police and obtain a case number for the incident. It is critical that the insured provides accurate and detailed information regarding the incident in the police report. This would be necessary in cases of attempted theft, theft or a motor vehicle accident.

The insured must obtain quotations for repairs or valuations for the items lost when required by the insurer. This documentation is often then required as supporting documents to the claim form submitted.

The insured may then be contacted by relevant parties appointed by the insurer to assess and facilitate the claims process. It is then the insured's responsibility to co-operate to the best of his ability to ensure a smooth and speedy resolution.

8.5.2 The intermediary

Where an intermediary is involved in a claims process, it is his responsibility to assist the client in:

- confirming the relevant claims processes and all the insurer's requirements;
- being the communication link between the insured and insurer;
- provide assistance to the insured in completing claim forms, but not completing them himself, and wherever necessary;
- submitting the claim forms to the insurer on the insured's behalf; and
- to keep the insured informed of the claims process throughout the investigation and resolution thereof.

8.5.3 The insurer

Upon receipt of the advice of the incident, the insurer provides a nominated individual to deal with the claim. This person is often referred to as a claims technician/negotiator. It is the responsibility of the claims technician/negotiator to evaluate the liability of the insurer in respect of the claim submitted.

Where necessary the claims technician/negotiator will appoint a claims assessor or loss adjuster to further investigate the reported claim and to provide recommendations to the insurer regarding their liability.

Upon receipt of the assessor or loss adjuster's report, the claims technician/negotiator will analyse the report and determine the necessary action from the insurer's office and facilitate such action as is deemed appropriate. The following actions could arise:

- Accept and facilitate the settlement of the claim;
- Reject the claim by sending a rejection notice to the intermediary or client; or
- Escalate the claim for further investigation, legal advice or management decision, whichever is applicable.

8.5.4 Claims assessor

A claims assessor evaluates a situation and assesses the damage caused by the incident.

Claims in which an assessor's report may be required:

Burglary:

An office was burgled and a quantity of goods taken. The assessor would be sent to examine the circumstances and assess the nature and value of the goods stolen. He reports to the insurer whether the terms and conditions of the policy have been followed, and may in addition record any suspicious circumstances.

Fire:

There is a fire in a warehouse. An assessor is sent out to investigate and report on the cause of the fire and the extent of the damage. Any implications to other sections of the multi-peril policy must also be reported on, such as business interruption.

Motor accident:

Assessors employed by some insurers are situated at Motor Assessment Centres. In addition they travel to where the undrivable damaged vehicle may be stored.

8.5.5 Loss adjuster

The insurer will appoint a loss adjuster at their discretion. Loss adjusters would typically be appointed for claims arising from non-motor losses or damage. Normally the designation Loss Adjuster is reserved for those who are members of the Institute of Loss Adjusters.

When a loss adjuster is appointed he will:

- require full details of the cover under the policy;
- then contact the client and arrange to meet;
- investigate the circumstances of the loss and it is here that he will ensure that the terms and conditions of the policy have been complied with;
- organise quotations and liaise with repairers;
- send a final report to the insurer, who will then accept, or reject liability for the damage or loss.

If no loss adjuster is appointed, then the claims technician/negotiator must check all the documentation to ensure that he has enough information to decide or recommend on the insurer's liability.

Loss adjusters' reports

When a loss adjuster, or any investigator for that matter, sends in his report, there will be information in it which could be sensitive and could upset the client, even lead to his suing the company.

It is, therefore, very important that claims technicians at insurance companies do not give copies of these reports to anyone, who may in all innocence give it to the client, nor should they be given to the client direct.

These reports are paid for by the insurer and at no time are they for the consumption of the intermediary or client.

8.5.6 Legal adviser

A legal adviser may be called upon to provide advice:

- of the legal liability or otherwise of the insurer;
- on other legal implications from the information received by the insurer;
- and guidance to the claims department in the recovery of monies or salvage process once a claim has been finalised; or
- where litigation may be considered.

8.6 DESCRIBE THE PROCESS FOR REVIEW AND APPEALS OF REJECTED CLAIMS

8.6.1 Appeal of rejected claims

All insurers have a system of reviewing all claims, to ensure that all procedures have been correctly followed.

In the event of a claim being rejected, the insured has the right to appeal.

The first appeal would be directed to the insurer concerned, and in the event of the claim still being rejected, the insured has six (6) months (prescription

period) (unless stated otherwise in the term and conditions of the policy), from the date of rejection, to start legal action against the insurer. It is not enough to give notice of legal action; the insured must also pursue this to finality.

The alternative option is for the insured to appeal to the Short-term Ombudsman, who will call for all necessary documents and make a decision thereon.

8.7 EXPLAIN THE TYPES OF COMPULSORY LEGISLATIVE INSURANCE

8.7.1 The Road Accident Fund Act (56 of 1996)

The legislation that governs compulsory motor insurance in South Africa is the Road Accident Fund Act No 56 of 1996 (RAF) and the considerable amendments to the Act, which came about in 2008.

Swaziland, Botswana, Namibia and Lesotho have similar fuel-funded systems, however for Zimbabwe and Mozambique, one is required to take similar cover at the border.

Premium

The premium for this class of insurance is collected by means of a fuel levy. Every litre of fuel purchase includes an amount that goes towards the fund.

What is covered?

The fund will compensate any third party for loss or damage he may suffer as a result, caused by the negligence, or other unlawful act, of the driver of a motor vehicle, or of the vehicle owner.

In terms of the Act, there is cover only for death or injury to people, whether they are in a vehicle or as pedestrians. The identity of the negligent driver need not be established for a claim to be valid.

Limit of liability

The Road Accident Fund Act (RAF) does not include any form of property damage.

Cover is limited to the following:

- (i) Persons not in the insured vehicle, such as a pedestrian
- (ii) Passengers being transported for a fee
- (iii) Persons being transported in the course of the owner's business
- (iv) Employees being transported in the course of their employment
- (v) Persons being transported in a motorcar for the purpose of a lift club.

A cap was placed on payments for general injury, pain and suffering and disability that the fund makes to compensate third party victims of motor accidents.

A cap was introduced in respect of loss of income (disability) or support (death of a breadwinner). Payments for future loss of income to a third party will cease on the death of the third party or when he turns 65.

Payments for general injury will be paid only in the event of "serious injury". The Act defines this as a permanent injury which leads to total disablement or paralysis, or dysfunction of a vital organ based on the American Medical Association Guides but leaving some discretion in the scope of the definition to the Minister supported by approved medical experts to "make the call".

Payment for immediate emergency medical treatment is made based on the National Health Reference Price List, as negotiated with medical service providers. However, other treatment is recompensed at the public service provider rate.

Exception

In terms of the Act, there is one exception to this rule. If you are undergoing military service, the benefit payable is not limited, regardless of:

- the use of the vehicle (unless it is a military vehicle);
- the purpose for which you are travelling in the vehicle.

The motor policy

Third Parties may claim against the RAF for injuries, or their estate may claim for death, however, the benefits are limited and this in no way compensates for the loss of a breadwinner or a family member in most cases.

The negligent driver may no longer be sued for medical expenses, loss of earnings, or pain and suffering.

When does cover not apply?

There is no cover in terms of the Act for:

- emotional shock from witnessing an accident; or
- property that is damaged.

Administration

A claim in respect of the Road Accident Fund can be submitted to the Fund itself by the claimant or through his legal representative.

8.7.2 Compensation for Occupational, Injury and Diseases Act 130 of 1993 (COIDA)

This Act replaced the Workmen's Compensation Act and all the amendments thereto.

COIDA provides compensation for work-related death or injuries and specified work-related diseases to or for all employees. The benefits are based on a maximum of an amount stated in the Regulations.

The premium for COIDA is a percentage of the employer's wage roll paid to the Department of Labour.

8.8 EXPLAIN WHAT THE APPLICABLE FORMULAE ARE AND HOW THEY SHOULD BE USED

8.8.1 Average

Average is a concept used by insurers to deal with underinsurance. Underinsurance occurs when an item is insured for less than its actual value.

It is important that the insured must pay his share into the insurance pool. The premium that the insured pays is based on the amount of financial risk or value at risk.

What happens if the insured does not advise the insurer of the correct value at risk? If the insured says that it is lower than it should be, he will not be paying sufficient premium. When this happens we say that the insured is underinsured. If there is a loss then we apply what is called "average".

Average will apply where the client is underinsured, whether deliberately or accidentally. If the damage results in a total loss, the sum insured will be paid out, which amount will be insufficient for the client to replace the lost or damaged item.

If the insurance is on replacement value conditions, the basis for average is:

$$\frac{\text{Sum insured}}{\text{Cost of replacement of the whole property insured}} \times \text{loss}$$

Average applied to fire

Example:

A company owns a factory. The cost to rebuild the factory would be R1 000 000. The company says that it could only sell the factory for R500 000.

The company, therefore, only insures it for R500 000. The factory gets damaged in a storm and the damage is R100 000.

Would it be fair to pay the company the full R100 000? No, because the company has only paid premiums on R500 000 whereas the insurer has been on risk for a potential R1m. It has therefore not paid its fair share into the pool. To work out indemnity, you must apply the formula for average.

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

So, for our example above:

$$\frac{\text{R500 000}}{\text{R1 000 000}} \times \text{R100 000} = \text{R50 000}$$

Average and personal accident/liability policies

Average is not applicable to personal accident and liability policies, which are not policies of indemnity.

Average and motor

It is also rare to find average applying in motor insurance, where it is usually relatively easy to ascertain the value of the vehicle using a published vehicle value index, but should someone end up being underinsured, the principle needs to be used in order to ensure indemnity.

Consequences of underinsurance

An insurance policy, having a sum insured or limit of indemnity will not pay out more than that amount in any one claim. In fact, under many insurances the sum insured or limit of indemnity represents the maximum amount that can be claimed in any period of insurance.

Therefore, a consequence of underinsurance is that no claim will be paid for an amount greater than the sum insured or limit of indemnity.

Example:

Suppose, for example, that a factory is insured for R8 000 000.00 (the sum insured), and has been burnt to the ground. The compensation payable cannot exceed the sum insured, so that even if the factory was valued at R10 000 000 at the time of the fire, the company can receive no more than R8 000 000. The average formula has applied and the insured bears a R2m loss.

However, if the value of the destroyed factory had been assessed at R5 000 000, the insurer would have paid the full R5 000 000.

It is essential to insure for the full replacement cost.

Policies of compensation

Average applies only to policies of indemnity as does subrogation and contribution. It is important to note that these do not apply to policies of compensation. For example, the death and disablement sections of a personal accident policy.

8.8.2 Betterment

The amount payable is the cost of replacing property of the same kind or type, or repairing it in as good as new, but not better than new, condition. If the performance or value of the replaced item is greater than the original, the insured bears the cost of the difference in price (betterment) of the item. This is particularly the case of computer and technological equipment.

Replacement value conditions

The replacement value conditions apply when property is insured for its replacement value and in the event of loss (notwithstanding its condition) is replaced by a new item.

8.8.3 Contribution (dual insurance)

In the event of the same risk being insured by two different insurers, contribution will apply in the event of a claim in respect of that particular risk.

It has been established that insurance is intended to indemnify the insured in the case of a loss. However, what happens if there is more than one policy covering the same item? Can the insured claim from both? This is where the policy's condition of contribution is applied.

The definition of contribution is: *"... where two or more policies are in force each pays its rateable proportion of any loss"*.

Example:

Blogg's (Pty) Ltd has a warehouse, which is bonded to ABC Bank.

Blogg's (Pty) Ltd forgot that when the bond was incepted, a policy was issued to cover the warehouse against fire and flood.

Blogg's (Pty) Ltd wants to insure the warehouse, so they acquire a policy through XYZ Insurance Company.

The policy through the bank has a sum insured of R1 000 000.

The one through XYZ has a sum insured of R1 500 000.

There is a fire at the warehouse that causes R100 000 worth of damage.

How will the claim be settled? Is it fair for Blogg's (Pty) Ltd to claim under both policies?

If they do claim under both, they would get R200 000, but this is not indemnity, as they will have made a profit.

What do the insurers do to ensure that this does not happen? Below, you will find an example, showing how contribution is applied.

How contribution is applied

Blogg's (Pty) Ltd submits a claim to XYZ Insurers for the damages. They send out a loss adjuster, who finds out that there is another policy through the bank. Based on this finding, the insurer uses the contribution clause in the policy wording to settle Blogg's claim. This clause states that "if there are two or more policies covering the loss, each policy will pay its proportional share of the claim".

In the case above, they would work out the amounts as follows:

Policy through ABC Bank	R1 000 000
Policy through XYZ Insurer	R1 500 000
Total sum insured	R2 500 000

The formula for adjusting the loss is:

$$\frac{\text{Sum insured Company A}}{\text{Total sum of all policies}} \times \text{Loss}$$

Therefore, the insurance through ABC Bank would pay:

$$\frac{R1\ 000\ 000}{R2\ 500\ 000} \times R100\ 000 = R40\ 000$$

Therefore, the insurance through XYZ Insurance would pay:

$$\frac{R1\ 500\ 000}{R2\ 500\ 000} \times R100\ 000 = R60\ 000$$

Contribution can also be applied where it is difficult to establish blame, such as in the case of a motor vehicle collision in an intersection where both parties carry some degree of negligence. In this instance contribution would be applied in establishing how much of the damage each party would bear. This is known as contributory negligence. In every case the amount of contributory negligence is decided on the facts in each individual case.

8.9 ENDORSEMENTS AND CLAIMS

8.9.1 Endorsements after a claim

After a loss has occurred and the claim is settled there are various actions the insurer is required to take by means of an endorsement. These include:

- deletion of the item, if it is specified on the policy;
- an endorsement may be needed to add on the replacement item;
- reinstatement of the sum insured, with additional premium when applicable; and
- sometimes the insurer may need to restrict cover.

In cases where insureds become repetitive claimants, or where fraud has been attempted, the insurer is entitled to give the client notice of cancellation.

8.10 CALCULATING THE VALUE OF A CLAIM

8.10.1 Case study

In multi-peril policies a claim is normally calculated by a claims assessor or loss adjuster, as each case is dependent on its own circumstances.

You are informed of a fire that has occurred at the Widget Company causing considerable damage. The fire was caused by independent contractors carrying out welding work and failing to follow the requirements of the "HotWork" permit issued. You instruct a loss adjuster to investigate and report on the loss.

1. In this case study, which sections of a multi-peril policy could be affected?
 - Fire
 - Business interruption
 - Office contents
 - Account receivable
 - Machinery breakdown
 - Machinery breakdown loss of profits
 - Electronic equipment

2. What information should the loss adjuster obtain? He will:
 - require a full copy of the policy wording.
 - ascertain that the loss is covered by the policy wording.
 - then evaluate the loss and obtain estimates for the repair/reinstatement of the damaged property.
 - investigate the possibility of recovering the loss from the independent contractors.
 - recommend settlement of the material damage loss.
 - also investigate the reduction in turnover resultant from the damage applying the policy formula for any business interruption loss.
 - recommend settlement of the business interruption loss.

3. Actions by the insurer:
 - Notify reinsurers of the loss.
 - Decide on settlement as suggested by the loss adjuster.
 - Decide on recovery of the loss from the independent contractor.

4. Actions by the intermediary:
 - Act on behalf of the client in all matters.
 - Assist the client in formulating his claim.
 - Assist in submitting the claim.
 - Ensuring that a fair settlement is reached.

Summary

The claims process is the ultimate test to the insurer, intermediary and client to ensure that the purpose of the insurance policy has been met.

Not only is it the requirements, terms and conditions of which one should be cautious, but also the calculations and formulae to be applied, and the appropriateness thereof.

Self-Assessment Questions

1. What are the requirements in terms of an insured peril in relation to a claim? That the:
 - a) loss or damage is a result of any peril.
 - b) loss or damage must be as a result of an insured peril as stated in the policy.
 - c) proximate cause is a hazard and an accident.
 - d) loss or damage must be a deliberate act in relation to the peril.

2. What are the criteria to be considered in the event of a claim being submitted to an insurer? Whether the:
 - a) person was injured and how many people were hurt in the incident.
 - b) person took all the necessary precautions to prevent such an accident from happening.
 - c) vehicle was safely towed to a secure yard.
 - d) proximate cause is an insured peril and that the terms and conditions of the policy have been complied with.

3. Describe the concept of third party insurance. Third party insurance covers:
 - a) injury to persons and damage to property other than that belonging to the insured.
 - b) the injury caused to other people by the insured.
 - c) damage and injury caused to the insured and his property by other parties.
 - d) the damage of a third party if he has paid his premiums.

4. What is the responsibility of the insured in the event of a claim?
 - a) To admit blame for causing the accident
 - b) To ensure that the insurer understands that the insured did not cause the accident
 - c) To notify the insurer of the incident, submit all relevant details and documents to the insurer
 - d) To use forceful measures with the insurer to achieve a settlement for the claim

 5. What is one of the requirements to be fulfilled in terms of the insured's burden of proof?
 - a) The insured must prove insurable interest in the insured item for which the claim has been submitted.
 - b) There is no burden of proof on the insured at all.
 - c) The insured must prove that the item was properly maintained.
 - d) The insured must prove that he put up a fight in preventing an accident.

 6. Which one of the following is a form of compulsory legislative insurance in South Africa?
 - a) The Short-term Insurance Act
 - b) The FAIS Act
 - c) The Insurance Laws Amendment Act
 - d) The Road Accident Fund Act

 7. How do insurers try to prevent the application of average in the event of a fire claim?
 - a) Onsite surveys and valuations by professional valuers
 - b) Insist that the price tag remains on the contents of the buildings
 - c) Request a video tour of the insured property
 - d) Request receipts of payment for each item

 8. When is the principle of betterment applied? When the:
 - a) insured wants a better asset than the one he had.
 - b) cost of the new item is similar to that of the original insured item.
 - c) cost of replacing and performance of an insured item is greater than the replacement cost of the original item.
 - d) cost of replacing an insured item is cheaper than the one lost or damaged.
-

9. When does contribution (dual insurance) apply?
- a) When the same risk and causes in the event of a claim is insured by two different insurers
 - b) In the case of a stokvel, when each person pays a part of the claim
 - c) When an insured pays for a portion of the claim himself
 - d) When there are two combined causes that resulted in damage or loss
10. Under which circumstances is an endorsement required after settling a claim?
- a) When the insured submits the valuation certificate for the item
 - b) The deletion of a lost item if it is specified on the policy
 - c) When the item is found by the police
 - d) When the claim was caused by a drunk third party and his driver's license is suspended

Self-Assessment Answers

1. What are the requirements in terms of an insured peril in relation to a claim? That the:
 - a) loss or damage is a result of any peril.
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 - d) Request receipts of payment for each item
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Chapter

9

Recovery/mitigation of losses

This chapter covers the following criteria:

KNOWLEDGE CRITERIA

Explain the process of salvage of goods and recovery of money.

Explain the legal rights of recourse (i.e. subrogation) available to the relevant parties.

Explain the implications of VAT.

SKILLS CRITERIA

Determine available recourse/recovery actions.

Determine the involvement of the client in this process.

Advise the client of actions/process to be taken and implement recovery action where appropriate.

Establish the relative interest of the parties in any recovery achieved.

Settle between the parties involved.

Record finalisation of recovery/mitigation settlement.

Purpose

An insurance claim seldom ends at the claim being settled with the client. There are additional processes that insurers practice to recover their cost of claims.

9.1 EXPLAIN THE PROCESS OF SALVAGE OF GOODS AND RECOVERY OF MONEY

9.1.1 Recoveries

Recoveries is a means of controlling the cost of claims by an insurer in recovering some of its expenses.

When a claim is reported, consideration is given to the following:

- Salvage – is there any salvage available and is it economical to recover?
- Policyholder – is there any excess payable by the policyholder?
- Dual insurance – is there any other insurance on the same risk?
- Subrogation – is there a third party from whom recovery is possible?
And
- Co-insurance or Reinsurance – are there co-insurers to the risk and is reinsurance applicable?

It may happen that more than one recovery option exists, such as subrogation and salvage, in which case the processes need to happen simultaneously.

In assessing the recovery prospects the following should be considered:

- Probability of making a recovery
 - Based on the merits of the claim and potential responsibility, issues arising, bearing in mind that the third party may have a counter claim
- Economical viability of the recovery -
 - Consider the amount to be recovered
 - Is it cost-effective to pursue the recovery?

- Potential value of salvage
 - Consideration must be given to whether the salvage has any value, and whether the amount of the potential recovery exceeds the cost of disposal
- Dual insurance
 - Possibility of any other insurance cover in full or in part
 - Assess the potential amount to be recovered taking economical viability into account, and
- Recoveries from co-insurers and reinsurers
 - Establish the amount of contribution from co-insurers and/or reinsurers.

A recovery agent in an insurer's office is responsible for:

- identification of recovery opportunities;
- assessing recovery prospects;
- contacting the recovery source; and
- pursuing the recovery.

All recovery actions taken must be documented and communicated to the client, where appropriate.

9.1.2 Salvage of goods

The issue of salvage arises when the insurer has accepted a claim in respect of a loss of an insured asset including those that are beyond repair. Such assets become the property of the insurer. Motor salvage is probably the most common example, but there can also be salvage under the fire and accident classes under the multi-peril policy.

Examples of these can include:

- partially-damaged machinery;
- office contents such as furniture or equipment;
- stock; or
- stolen vehicles and other articles recovered through police intervention.

Average and salvage

If there is underinsurance and there is salvage, the client is entitled to his rateable share of the salvage recovery. Such an example could be water damage to furniture:

- A total loss of R50 000;
- The sum insured is R25 000;
- There is therefore 50% underinsurance;
- Sale of the salvage realises R10 000;
- The client would be entitled to R5 000 of the salvage monies.

Vehicle a "write-off"

When the vehicle is damaged beyond economical repair, usually to the extent of 70% of the market value of the vehicle, the insurers treat the vehicle as a "write-off" and will pay the insured (or finance house if its interests are noted in the policy), the reasonable market or retail value of the vehicle in its pre-accident state.

The excess will be deducted from the settlement. Insurers will then take over the salvage to sell for their own account and ideally they should cancel the registration.

Cash in lieu

It does happen that an insured specifically requests cash in lieu of a write-off, in which case the insured may keep the salvage and the settlement is adjusted accordingly. Insurers are reluctant to do this because they normally have salvage contracts with salvage contractors who are bound by the agreement to accept all wrecks no matter their condition.

In some instances, the insured prefers to keep the "reasonably good wreck", which is without too much damage, as they may be able to repair the vehicle with second-hand parts.

The insurer would then reduce the settlement figure by the amount or percentage that they would receive from their salvage contractors. This may happen where the insured owes more than the market value to a finance house and believes that he can in fact have the vehicle restored to a roadworthy condition. This is why finance houses and insurers often offer "credit shortfall" cover.

In this case the cover in terms of the policy - both own and third party damage - should be suspended until such time that an engineer's report is received confirming that the repairs are complete and the vehicle is roadworthy.

9.1.3 Subrogation

The principle of subrogation has been discussed and applied in previous chapters. However, the subrogation process in a recovery would be as follows:

- Notification – the insured must be notified of the insurer’s intention to take over the rights of the insured in claiming against the third party;
- Investigation – regarding the circumstances and to determine the economic viability of proceeding with the legal process;
- Evaluation and negotiation – to determine whether a legal case exists, or to negotiate a settlement arrangement with the third party;
- Settlement – requesting reimbursement upon the third party accepting responsibility, or legal liability is proven in court.

It is imperative for the insurer to keep the insured informed throughout the above process and to document any decisions made or settlements reached.

9.1.4 Contribution (dual insurance)

Once the involvement of another insurer has been identified, the following steps are taken:

- Notification – the insurer approaches the dual insurer to confirm interest and policy cover provided;
- Investigation – establishing that the policies provide substantially the same cover, and that the subject matter and insurable interest are the same under both policies;
- Evaluation and negotiation – to determine the amount each insurer is liable for in terms of the claim;
- Settlement – each insurer pays their portion to the insured.

It is imperative for the insurer to keep the insured informed throughout the above process and to document any decisions made or settlements reached.

9.1.5 Recovery of money

When an insurer has accepted and paid for the repair of the damage of an insured’s vehicle, and the accident was caused by the negligence of a third party, the insurer may recover their financial expense, and the excess paid by the insured, from the third party. This course of action is available to the insurer in terms of the principle of subrogation. The excess if recovered by the insurer will be reimbursed to the insured.

Reminder (Chapter 1)

The principle of subrogation entitles the insurer to claim against the insurer of a third party, (not only the insurer but the third party himself) to recover their costs paid as if they are the insured.

9.1.6 Reinsurance

The loss may be reinsured, in which case the reinsured portion of the loss is recovered from the reinsurer. This does not affect the contract of insurance with the insured unless it is made a condition of the insured's contract – this is what is called the "cut through or pay as paid clause".

9.2 EXPLAIN THE LEGAL RIGHTS OF RECOURSE AVAILABLE TO THE RELEVANT PARTIES

9.2.1 Who has a legal right of recourse?

Any person who suffers loss or damage has a legal right of recourse; however, as an insured individual, the insurer, having paid for the repair of damage or loss, would be able to recover their outlay through the principle of subrogation, as if they were the insured.

If the person is not insured, and is the victim of an occurrence they may claim against the other party by:

- sending a letter of demand; and
- threatening to institute a civil action at law in the small claims, magistrate or high court.

9.2.2 What legal right of recourse is available to the relevant parties?

There are various actions of recourse available to the insurer including:

- subrogation;
- recovery/salvage of goods; and/or
- legal process.

The right of recourse to the insured is to report the incident to the FAIS or Short-term Ombuds or to follow a legal process through the courts.

9.3 EXPLAIN THE IMPLICATIONS OF VAT

9.3.1 VAT and recoveries

One first needs to understand the concepts of input and output tax, to understand the VAT implications on recoveries.

Output tax is the VAT payable by a supplier. For example the VAT charged on an item purchased.

Input tax is the recovery of the VAT paid in respect of goods and services. In other words any VAT vendor may claim back the VAT amount they pay, for goods and services purchased.

Therefore, when an insurer settles a claim, in which the settlement figure includes VAT, the insurer is entitled to claim back the VAT portion paid as input tax.

If a supplier is not in South Africa, the insurer is required to pay VAT on the goods or item received when it is imported and arrives in the country, as well as import duty tax. As a VAT vendor, the insurer can then recover the VAT amount paid from SARS.

When a service is acquired from a supplier who is not resident in South Africa, VAT is not applicable as the vendor (supplier) is not a VAT vendor.

Summary

Effective recovery procedures are essential to the profitability of an insurer.

Such recoveries may include:

- recovery of money;
- salvage of goods; or
- litigation processes through the courts.

Self-Assessment Questions

1. What does the process of recovery aim to achieve?
 - a) For the insurer to gain a profit
 - b) Recovery of expenses of insurer for the costs of claims
 - c) To ensure the least possible payment is made by the insurer
 - d) To prolong the settlement of claims

 2. If a speedy settlement of recovery is not reached, what other form of recourse is available to the insurer?
 - a) To follow a legal process
 - b) To abandon the settlement of a claim
 - c) To sell all salvage items of the insured before the claim is settled
 - d) To report the case to the Ombudsman

 3. What recourse action is available to the insured if settlement is not reached?
 - a) To request a second opinion from another insurer
 - b) To demand interest on his premiums paid
 - c) To report the case to the Short-term Ombud
 - d) To fraudulently amend the claim form

 4. The legal rights of recourse available to the insurer include:
 - a) Applying aggregate excess
 - b) Imposing voluntary excesses
 - c) Rejecting the claim
 - d) Subrogation

 5. When is VAT output tax payable?
 - a) When goods are sold
 - b) On importation and collection of goods
 - c) When goods are repaired
 - d) When settling a claim

 6. When is it necessary for a recovery agent to communicate with a client during a recovery process?
 - a) It is not required to communicate with the client
 - b) Only if the client is involved in the process
 - c) At each step of the recovery process
 - d) Only if recovery is not achieved
-

7. When can the insurer dispose of salvage?
- a) Only when the claim is settled
 - b) When the damage occurs
 - c) When the claim is lodged
 - d) When the claim is subject to average
8. What is the effect of average in the application of the recovery process?
- a) Average has no effect in recoveries
 - b) The insured will receive an equivalent of the proportion of underinsurance
 - c) Average is applied when the insurer retains salvage
 - d) Average is applied in the contribution of dual insurance

Self-Assessment Answers

1. What does the process of recovery aim to achieve?
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