Investment: Insurance

INTRODUCTION

Businesses operate in dynamic and risky environment. Insurance indemnifies businesses against certain types of risk. Business owners should have a clear understanding of the financial impact of accidents/disasters on their business operations, so that they can make provision for that in advance.

Insurance is extremely beneficial to businesses and individuals as it provides financial relief in times of unforeseen financial losses. Insurance plays a vital role in ensuring that businesses are sustainable.

Overview

TOPIC	CONTENT	CONTENT DETAILS FOR TEACHING, LEARNING AND ASSESSMENT PURPOSES
Investments: Insurance	• Definition of insurance and assurance with examples. • Differences between insurance and assurance. • Insurable and non-insurable risks and examples. • Importance/advantages of insurance for a business • Principles of insurance • Description of insurance concepts • Calculations of under-insurance • Distinction between compulsory and non- compulsory insurance and examples. • Types of compulsory insurance • Types of benefits paid out by the Unemployment Insurance Fund (UIF). • Rights of workers registered for UIF. • Provisions of the Road Accident Fund (RAF)/ Road Accident Benefit Scheme (RABS). • Rights of road users in terms of the RAF/RABS.	• Explain the difference between insurance and assurance and give examples. • Explain the meaning of insurable and non-insurable risks and give examples. • Outline/Discuss/Explain the advantages of insurance for a business. • Outline/Discuss/Explain principles of insurance for a business. • Explain insurance concepts e.g.: ○ Underinsurance ○ Over insurance ○ Average clause ○ Reinstatement ○ Excess • Calculate under-insurance. • Differentiate/Distinguish between compulsory and non- compulsory insurance and give examples. • Explain/Discuss the types of compulsory insurance: UIF, RAF, Compensation Fund/COIDA • Explain the types of benefits paid out by the UIF.

13.1 Key concepts

These definitions will help you understand the meaning of key insurance concepts that are used in this chapter.

Term	Definition
Insurance	Is a contract between a person/business/insured requiring insurance cover and the insurance company/insurer bearing the financial risk.
Insurance contract	An agreement whereby the insurer undertakes to indemnify the insured in the event of a specified loss in exchange for a premium.
Insurer	An insurance company that will take over specified risks.
Insured	Individual/Business that takes out insurance coverage.
Indemnify	To compensate, protect or re-pay the insured in the event of a loss or damage.
Premium	The payment made by insured to be covered in the event of losses/damages.
Life insurance	It is a long term insurance and is taken out on the life of a human being and cover for the loss of life.
Insurable interest	Is expressed in financial terms and is the interest that the insured stand to lose if there are losses or damages.
Unemployment Insurance Fund (UIF)	This fund provides benefits to workers who have been working and are now unemployed for reasons such as retrenchment.
Road Accident Fund (RAF) Road Accident Benefit Scheme (RABS)	This fund pays compensation when a person is disabled/injured in a road accident and to dependents of the individual if killed in a road accident.
Compensation for Occupational Injuries and Diseases (COIDA)	This fund compensates workers financially for disability that may arise as a result of accidents while performing duties in the workplace.

13.2 Insurance and assurance

Definition

Insurance: The cover for a specified event that MAY happen. e.g. the damage to a building due to a fire.

Assurance: The cover for a specified event that WILL happen, but the time of the event is uncertain. e.g death of a partner/key personnel.

Activity 1

Distinguish between insurance and assurance and give ONE example of each. (8)

Answer to activity 1

INSURANCE	ASSURANCE
• Based on the principle of indemnity.√	• Based on the principle of security/ certainty.√
• The insured transfers the cost of potential loss√ to the insurer at a premium.√	• The insurer undertakes to pay an agreed sum of money√ after a certain period has expired/on the death of the insured person, whichever occurred first.√
• It covers a specified event√ that may occur.√	• Specified event is certain√, but the time of the event is uncertain.√
• Applicable to short term insurance.√	• Applicable to long term insurance.√
Sub max (3)	Sub max (3)
Example: • Property insurance/money in transit/theft/burglary/fire,√ etc.	**Example**: • Life insurance/endowment policies/ retirement annuities,√ etc.
Sub max (1)	Sub max (1)
Max (4)	**Max (4)**

13.3 Insurable and non-insurable risks

INSURABLE RISKS	NON-INSURABLE RISKS
• Businesses are compensated for losses arising from specified risks.	• These risks are not insured by insurance companies they remain the responsibility of the business.
Examples: • Fire • Theft and burglary • Storm/Damage during natural disasters • Life insurance • Vehicle insurance • Unemployment insurance	**Examples**: • Losses caused by war • Risks occurring in the period between placing orders and receiving goods • Changes in fashion • Shoplifting • Losses caused by marketing malpractices • Advancement in technology/new machinery invention

13.4 Importance/advantages and principles of insurance for businesses

Importance/advantages of insurance for businesses

- Transfers the risk from the business/insured to an insurance company/insurer.
- Protects the business against theft/loss of stock/damages caused by natural disasters such as floods.
- The business will be compensated for insurable losses.
- Valuable business assets e.g. vehicles/equipment/buildings need to be insured against damage and/or theft.
- Business is protected against the loss of earnings e.g. strikes.
- Protects the business against deeds of dishonesty by employees.
- Life insurance can be taken against the life of partners in a partnership.
- Protects the business against losses due to the death of a debtor.

Principles of insurance

Security

- Applies to long-term insurance where the insurer/insurance company undertakes to pay out an agreed upon amount in the event of loss of life.
- A pre-determined amount will be paid out when the insured reaches a pre-determined age/or gets injured due to a predetermined event.
- Aim is to provide financial security to the insured at retirement/the dependants of the deceased.

Indemnification/Indemnity

- Usually applies to short term insurance, as the insured is compensated for specified harm/loss.
- Insurer agrees to compensate the insured for damages/losses specified in the insurance contract in return for premiums paid by the insured to the insurer.
- Protects the insured against the specified event that may occur.
- The insured must be placed in the same position as before the occurrence of the loss/damage./The insured may not profit from insurance.

Insurable interest

- Insured must prove that he/she will suffer a financial loss if the insured object is damaged/lost/ceases to exist.
- An insurable must be expressed in financial terms.

Utmost good faith

- Insured has to be honest in supplying details when entering into the insurance contract.
- Both parties must disclose all relevant facts.
- Details/Information supplied when claiming should be accurate/true.

Activity 2

2.1 Identify the principle of insurance that is relevant to each of the statement below.

2.1.1 The insured must prove that he/she stands to lose financially should his/her possession be destroyed.
2.1.2 The insurer has guaranteed to pay the insured a large sum of money for an insured eventuality.
2.1.3 The insured and the insurer are both required to disclose all information that may affect the requirement of a contract.
2.1.4 The insured will be compensated for damages/losses specified in the insurance contract.

(8)

ANSWERS TO ACTIVITY 2

2.1.1 Insurable interest √√
2.1.2 Security √√
2.1.3 Utmost good faith √√
2.1.4 Indemnification/Indemnity √√

(5 x 2) (10)

13.5 Insurance concepts

Description of insurance concepts

Reinstatement

- Insured is restored to almost the same financial position as before the loss occurred.
- The insurer rebuilt/replace the damaged property instead of paying out cash.
- Principle of re-instatement may be applied if the item was over-insured.

Excess

- A clause which states that the insured is responsible for a fixed amount of the claim, when submitting a claim.

Average clause

- The insurer will only pay the average between the actual value and the insured value. This means that the insured will have to carry a part of the risk that is not insured.
- This applies to goods/items that are underinsured.

Over insurance

- Over insurance is when the item is insured for more than the actual market value.
- Businesses/Individuals will not receive a pay-out larger than the value of the loss at market value.
- This means that the extra money paid for the premiums will not be paid out to the insurer.

Insurable risk

- Risk that can be shifted to insurance companies to minimise the financial impact of the losses.
- Risks that can be carried by insurance companies.

Non-Insurable risk

- Risks that cannot be shifted to insurance companies, businesses/individuals must carry such risks themselves.
- Insurance companies cannot work out a premium that the business must pay.

Activity 3

3.1 Identify the insurance concept represented by EACH scenario below:

3.1.1 John has insured his R100 000 business property for R80 000.
3.1.2 KB insurance will only pay John R16 000 if damages to his property amounts to R20 000
3.1.3 KB insurance will rebuild Trevor’s building since the building is insured for more than its value.
3.1.4 A stipulation whereby the insurer may replace lost/damage property/goods instead of reimbursing the insured.
3.1.5 KB requires payment of R4 000 for her car that was involved in an accident before repairs are done.

(10)

3.2 Differentiate between insurable and non-insurable risks and give TWO practical examples of each type of risk.

(8)

Answer to activity 3

3.1.1 Underinsurance√√
3.1.2 Average clause√√
3.1.3. Over insurance√√
3.1.4 Reinstatement√√
3.1.5 Excess√√

3.2 Differentiate between insurable and non-insurable risks

INSURABLE RISKS	**NON-INSURABLE RISKS**
• Risks that cannot be shifted to insurance companies√, businesses/individuals must carry such risks themselves.√	• Insurance companies cannot work out a premium √ that the business must pay.√
Sub max 2	Sub max 2
EXAMPLES OF INSURABLE RISKS	**EXAMPLES OF NON-INSURABLE RISKS**
Theft√ Burglary√ Fidelity insurance√ Money in transit√ Fire√ Storms/Wind/Rain/Hail√ Damage to/Loss of assets/vehicles/ equipment/buildings/premises Injuries on premises√	Nuclear weapons/war√ Changes in fashion√ Improvement in technology√ Irrecoverable debts √ Financial loss due to bad management √ Possible failure of a business √ Shoplifting during business hours√ Loss of income if stock is not received in time Wars√
(2x1) (2)	(2x1) (2)
Max (4)	**Max (4)**

Calculation of under-insurance

Definition: Under-insurance occurs when property or assets are insured for their full market value. It is insured for less than the current/actual value of the property/assets.

FORMULA: (**Amount insured ÷ Market value) x damages**

Remember to always show all your calculations in tests and exams.

Activity 4

Paul owns a factory outside Port Elizabeth. His factory was damaged by a fire. The damage to the factory was estimated at R300 000.
The factory is insured for R780 000 and the current market value is R1,2 million.

Calculate the amount that Paul will receive from the insurance company.

(4)

Answer to activity 4

$$\frac{\text{Amount insured}}{\text{Market value}} \times \text{damages}$$

$$\frac{780\ 000}{1200\ 000\ \surd} \times 300\ 000\ \surd = \text{R}195\ 000\ \surd\surd$$

13.6 Compulsory and Non-compulsory insurance

Differences between compulsory and non-compulsory insurance

COMPULSORY INSURANCE	NON-COMPULSORY INSURANCE
• It is required by law/there are legal obligations for it to be taken out and paid for.	• It is voluntary/the insured has a choice to enter or not, into an insurance contract.
• It is regulated by Government and does not necessarily require insurance contracts/brokers.	• The insured will enter into a legal insurance contract with the insurer, who may be represented by an insurance broker.
• Payment is in the form of a levy/ contribution paid into a common fund from which benefits may be claimed under certain conditions.	• Monthly/Annual payments/premiums must be paid in order to enjoy cover for a nominated risk/insured event.
• Examples: UIF, RAF, COIDA	• Examples: Short term insurance/Multi-peril insurance (theft, fire, etc.)/Long term insurance/Life insurance

Types of compulsory insurance

Unemployment Insurance Fund (UIF)
- The UIF provides benefits to workers who have been working and become unemployed for various reasons.
- Businesses contribute 1% of basic wages towards UIF, therefore reducing the expense of providing UIF benefits themselves.
- Employees contribute 1% of their basic wage to UIF.
- Businesses are compelled to register their employees with the fund and to pay contributions to the fund.

Road Accident Fund (RAF)/Road Accident Benefit Scheme (RABS)
- RAF/RABS insures road-users against the negligence of other road users.
- The RAF/RABS provides compulsory cover for all road users in South Africa, which include South African businesses.
- RAF/RABS is funded by a levy on the sale of fuel/diesel/petrol.
- The next of kin of workers/breadwinners who are injured/killed in road accidents, may claim directly from RAF/RABS.
- Injured parties and negligent drivers are both covered by RAF/RABS.
- RABS enables road accident victims speedy access to medical care as delays due to the investigation into accidents has been minimised.

NOTE: RABS replaced RAF

Compensation Fund/Compensation for Occupational Injuries and Diseases/COIDA

- Compensates employees for injuries and diseases that happen at work.
- The contribution payable is reviewed every few years according to the risk associated with that type of work.
- Compensates employees for injuries and diseases incurred at work.
- Compensation paid is determined by the degree of disablement.
- In the event of the death of an employee as a result of a work-related accident/ disease, his/her dependant(s) will receive financial support.
- Employees do not have to contribute towards this fund.
- Employees receive medical assistance provided there is no other party/medical fund involved.
- In event of the death of an employee as a result of a work related accident/disease, his/her dependant(s) will receive financial support.

NB

Remember: COIDA as an Act benefits both the employer and the employee. COIDA as a type of compulsory insurance only benefits the employee.

ACTIVITY 5

5.1 Read the scenario below and answer the questions that follow:

> Mr Rajah was involved in a car accident on his way to work. He suffered minor injuries and took sick leave for three days. He has lodged a claim with the Road Accident Fund.

5.1.1 Do you think Mr Rajah's claim for compensation is justified? Motivate your answer. (4)

5.1.2 Outline any THREE provisions of the Road Accident Fund. (6)

Answer to activity 5

5.1.1 **Road Accident Fund**

No

- RAF only pays for serious injuries√ that render a person incapable for work. √
- RAF only pays for the injury resulted in 30% or more impairment √ of the whole person.√

Max (4)

5.1.2 **Provisions in terms of the Road Accident Fund**

- Provides cover for all drivers of motor vehicles against claims by persons injured in vehicle accidents. √√
- The next of kin people who are injured/killed in road accidents are compensated from the fund.√√
- Pays approved claims to drivers/passengers/pedestrians injured in an accident due to the negligence of the driver of the vehicle. √√
- The fund does not cover damages to assets/motor vehicles. √√
- The nature of the injury will determine the amount to be paid from the fund. √√

(3x2) (6)

13.7 Unemployment insurance Fund (UIF)

Types of benefits paid out by UIF

Unemployment benefits

- Employees, who become unemployed/retrenched due to restructuring/an expired contract, may claim within six months after becoming unemployed.
- Unemployed employees may only claim, if they contributed to UIF.
- If a worker voluntarily terminates his/her contract, he/she may not claim.

Illness benefits

- Employees may receive these benefits if they are unable to work for more than 14 days without receiving a salary/part of the salary.

Maternity benefits

- Pregnant employees receive these benefits for up to 17 weeks/4 months/121 days.
- If a person had a miscarriage, she can claim for up to six weeks/42 days.

Adoption benefits

- Employees may receive these benefits if they adopt a child younger than two (2) years.
- Employees who take unpaid leave/may receive part of their salary while caring for the child at home.

Dependants' benefits

- Dependants may apply for these benefits if the breadwinner, who has contributed to UIF, dies.
- The spouse of the deceased may claim, whether he/she is employed or not.