Module # 1 Component 1

Current Affairs in Short Term Insurance

Knowledge Criteria

Significant or controversial issues related to Short Term Insurance
Articles on Legislation that could change the Short Term insurance sector and suggestions as to the potential impact on the sub sector
Current events in the socio political environment interpreted and indication of their possible impact on Short Term insurance.
International socio political events that could impact on reinsurance is analysed to identify the potential effect on the South African Short Term insurance sub sector.

Introduction

This Component is intended to promote general knowledge and understanding of current affairs in the field of Short Term Insurance in order to ensure knowledgeable and informed workers in the industry.

It addresses a broad base of Short Term and risk management related knowledge and requires the analysis of current affairs as they could impact on premiums and risk.

It requires learners to make connections between the Short Term insurance sector and current events that could impact on the industry. The focus is on prediction and anticipation of events rather than on historical research after the event.

Insurance and Society

As events in the Social Environment occur, the insurance industry is faced with a need to act positively to deal with the outcomes of such events. New underwriting criteria are set, reinsurance needs are more closely realised, risk control becomes more important, and product offerings are amended to provide cover that relies on the principles of insurance in terms of potential exposure.

Faced with events in the social environment, the insurance industry will be affected as follows:

- ☑ The financial requirements of insured losses would need to be met, often at great expense and effort by insurers.
- ☑ Reinsurance protection would be reassessed, perhaps reduced. Acceptance criteria are tightened, and there is a closer watch on rating, risk assessment and the risk management requirements on the part of the insured.
- ☑ More intense statistics collection and investigation is implemented.
- ☑ Emergency operational requirements are implemented to perform the additional tasks e.g. temporary staff, mobile claims settling units, customer service lines.
- ☑ Survey activities are more closely scrutinised and more rigorously followed.
- ☑ Claims history becomes more important to insurers at the risk offering stage.
- ☑ Product offerings may be altered; resulting in reduced cover, or even excluded cover.
- ☑ Greater market networking takes place, as unified and effective procedures for dealing with future events are implemented.
- ☑ More intensive research results, to plan and prepare for future events, and to lessen their impact wherever possible.

The Environment, Society and the Economy

The economic cycle has been closely associated with various social phenomena. Marriage and divorce rates and the consumption of luxuries vary more or less closely with the economic cycle at the time. Church activities vary somewhat in reverse order. In other words in a down cycle in the economy, more divorces are reported, but more people attend church.

Crime rates also respond to the cycle, but in several different ways, depending on the nature of the crime. There is a measurable relationship between economic cycles and the cycle's observable in nature, particularly the more severe ones such as weather and sunspots. Weather cycles with alternations stressing favourable and unfavourable crop years, extending over periods ranging from a decade to a generation, have been noted.

Economic Cycles:

Economic cycles are alternations of business activity from peaks of prosperity or booms, to the low points of depressions. Business activity in booms, measured chiefly by productive activity commonly rises as high as 15% above the general average of current business. Depressions sink to 20% and more below. Economic cycles generally last for an average of five years, but generally vary from one to twelve years. An economic cycle is closely related to the expansion and contraction of money, and its substitute, credit. During the nineteenth century under the leadership of Britain, gold became the sole monetary standard of leading nations. In effect, the dollar, pound, franc and mark were merely comparable weights of gold.

The Great Depression:

The most outstanding characteristic of the boom that had preceded the depression of 1929 to 1939 had been an intensification of business activity marked by rises in production and prices. The initiative had been taken by heavy industries related to investments, the stimulus being the anticipation of profits. With the outlook favourable, banks extended credit to finance expansion. Companies then increased production, and created surplus jobs, thus increasing costs. The excess of bank credit jeopardised reserves, and high prices caused an outflow of gold, as businesses bought cheaper goods elsewhere. Consequently, banks were forced to restrict credit. Businesses contracted and failed, and millions of people became unemployed. The effects of this economic depression were felt throughout the world. It had a major impact on all sectors of the insurance industry, as people were out of work and therefore not earning.

They therefore had nothing to spend, and one of the first areas they cut back on was insurance.

Inflation:

Whenever credit is restricted because it has grown to too large a position, inflation ensues. This manifests itself in rising costs associated with manufacturing and production, transportation, wholesale and retail prices and the general costs of living. While South Africa is rich in mineral reserves, it is a net importer in areas of textiles, manufacture, luxury consumer goods, and industrial machinery.

This means that we are influenced by rising costs overseas, and by the devaluation of the Rand against other currencies, as these imports are payable in the currency of the supplier. This affects the financial stability of companies and individuals, and they look to cut costs. The insurance industry is among the first to feel these effects, as there is an ever-increasing trend for consumers to seek cover chiefly based on the price of the product sought. When inflation rates are low, and the Rand is strong against other currencies, the insurance industry benefits as consumers have more ready cash available. Companies seek the fullest cover available to protect their assets, and individuals spend more on investments to maintain their living standards in the event of economic changes occurring in the future.

Retrenchment, restructuring and downsizing:

Statistics show that companies that exercise the option of retrenchment of staff as a result of rising costs and reductions in profit and turnover never achieve the levels of profit and income that they hoped for. This is because retrenchment is merely one option of dealing with symptoms of a worsening economic cycle. Often service levels have dropped, staff is not adequately trained, prices are set too high, the core business has been diluted by and the company is operating on borrowed money. The effects on the insurance industry are that more people are unemployed, and therefore not financially satisfied, and so less money is available. Fewer purchases are made in the retail, wholesale and manufacturing sectors, so less money is flowing into the economy. Then less is spent, as a knock-on effect, on insurance. In addition, more people out of work are then eligible for unemployment benefits, placing a heavier burden on the State. The cost of services provided by the State is recovered by way of additional taxation, which adds to the cost spiral. One possibly positive feature is that more retrenchment-related products become available for sale, offering support to unemployed people. Such products include lump sum payments to the insured for a limited period following their retrenchment.

War, Terrorism and Conflict:

These events impact on all sub-sectors of the insurance industry. When soldiers are away fighting and trying to survive, and civilians are in shelters or refugee camps they have no ability to make payments or purchase insurance. War risks to property are excluded other than under Life, and Personal Accident polices, and have been severely restricted under Marine and Aviation covers since the attack on the World Trade Centre in September 2001. War in itself obviously has a negative influence on the insurance industry, but during and after the event, there is always much expansion or rebuilding to be done. This releases money back into the economy, where it is spent on factory works, manufacturing and new and important processes needed for the war or reconstruction effort. In many circumstances, governments fund these projects, but often grants are made or private financing used. These activities lead to an upsurge in the need for insurance risk protection, and consequently more is spent on insurance products.

The effects of terrorism are profound on the insurance industry. In the wake of the attack on the World Trade Centre (WTC):

- ☑ Insurance covers previously available, such as terrorism, kidnap and ransom cover were restricted, and premium was increased for this limited cover;
- ☑ Previously where ambiguity existed in wordings, these have been refined to be more precise;
- ☑ Reinsurance capacities have been reduced, and the costs of reinsurance have risen;
- ☑ A greater focus has been placed on the risk assessment process, with acceptance limits and retentions more clearly defined;
- ☑ Many companies have been made to pay out vast sums of money as claims, across many lines of business – fire, combined, business interruption and office contents for those companies with offices in WTC; Life, Pensions and Personal Accident for those that lost their lives; motor in respect of vehicles damaged; aviation covers for the aircraft and liability;
- ☑ Some insurance companies will not have enough funds to pay, and will be forced into liquidation;
- ☑ In addition, the attacks have a marked effect on global travel, with fewer people willing to take risks;
- ☑ This has caused a crisis within the travel and associated industries, with carriers forced to close or cut back on operations, and individuals not needing to have travel insurance cover. The risks available to insure have reduced – BA have cut back their fleet, Swissair and Sabena have closed, and other airlines remain in financial difficulty, faced with mounting costs and reduced customer levels;
- ☑ The Great Depression and World War II stimulated the demands for economic reform. Laws were implemented to stabilise stock markets, and economic leadership openly assumed responsibility the supply of money with a view to stabilising market economies. The laws were also put into effect that governed such industries as insurance and Financial Services.

Political Environment:

Political events are those that affect the State, or its government, and these events have a wide impact on the insurance industry. Often the insurance industry is nationalised by government, which means that the government acts as the risk carrier, under the name of a national insurer. Countries in Southern Africa that have nationalised the industry include Lesotho and Swaziland. All countries have legislated regulations that govern the insurance industry; such the Short Term and Long Term Insurance Acts in South Africa.

Political disagreements often lead to wars (see above) but in many instances also lead to the imposition of economic sanctions on a nation that is deemed to follow political ideals that conflict with more powerful nation's ideology. In recent years, these sanctions have affected South Africa and Zimbabwe, Cuba, Iraq, Taiwan, China and others to varying degrees. The impact on the economic environment and particularly insurance, is that trade curtailments reduce the need for insurance cover, particularly for Marine cover and export and import risks. Conversely, insurance needs are enlarged, when carriers are refused overfly rights and had to make longer journeys to reach destinations.

Sanctions also affect the economy of the country they are imposed on as a whole. Without international trade opportunities being available, gross revenues are reduced, and these impacts again include the knock-on effect to insurance. Mostly, however the people of the nations are the ones who suffer most. Deprivation, poverty and suffering are increased by these factors.