Module # 1 – Component # 1

Regulatory Examinations Preparation
Sort-term Insurance

Commercial-Lines

Determine the client's need for insurance

Tasks for this Course

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.

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 perentage

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

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 **Component** 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.

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
- ☑ 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 Component # 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 shared 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 Component 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!

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.

Different Types of Cover: Implications & 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 fire causing a building to burn down	The building had a thatch roof
A storm which causes a tree fall on the building	The tree was old and unstable
A crime incident	There were no burglar bars on the windows
A motor accident	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.

1.4.1 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.