GAUTENG PROVINCE
EDUCATION
REPUBLIC OF SOUTH AFRICA

BUSINESS STUDIES

GRADE 12

TERM 3

CHAPTER 13

NOTES ON INVESTMENT: INSURANCE

2019

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CONTENT DETAILS FOR TEACHING, LEARNING AND ASSESSMENT PURPOSES

Learners must be able to:

- 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.

Terms and definitions

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.

Meaning of insurance

- Insurance refers to cover for a possible event that may cause a specified loss/ damage.
- An agreement whereby the insurer undertakes to indemnify the insured in the event of a specified loss/damage.
- The insured has to pay a premium for specified losses/damages covered.
- A contract between a person/business/insured requiring insurance cover and the insurance company/insurer bearing the financial risk.

NON-COMPULSORY INSURANCE

The meaning of non-compulsory insurance

- Non-compulsory insurance is voluntary/the insured has a choice whether to enter into an insurance contract.
- Insured will enter into a legal insurance contract with the insurer, who may be represented by an insurance broker.

Description of insurance concepts

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.

Under-insurance

- Occurs when property or assets are insured for their full market value.
- The property/asset is insured for less than the current/actual value of the property/assets.

Average clause

- A stipulation set by the insurer which is applicable when property/goods is under insured/insured for less than its market value.
- The insurer will pay for insured loss/damages in proportion to the insured value.
- This means that the insured is responsible for a part of the risk that is not insured.

NOTE: The average clause applies when goods/assets are under insured.

Calculations of average clause

- The insured amount is divided by the market value of the insured item and multiplied by the total value/amount of the damages/loss.
- Insurance companies apply the following formula to determine the amount to be paid out to the insured:

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

$$\frac{\text{Amount insured}}{\text{Value of insured item}} \times \text{Amount of damages/loss}$$

Example of calculating the average clause

Peter owns a thatched house valued at R100000. He insured his house with Pro-Cover Insurers for R800000. Afire in the kitchen caused damages of R30000.

1. Calculate the amount that Pro-Cover Insurers will pay Peter to cover damages. Show ALL calculations.
2. Explain to Peter the reason why he did not qualify for the full amount of damages sustained.

$$\frac{R800000}{R1000000} \times R30000$$

=R24000

Reasons for not qualifying for the full amount of damages

- Peter insured his house for less (R800 000) than the market value (R1 000 000).
- He was underinsured so the average clause had to be activated.
- He will only receive R24 000 for damages, and not the full amount of the claim (R30 000).

Reinstatement

- It is a stipulation whereby the insurer may replace lost/damaged property/goods instead of reimbursing.
- This stipulation is applicable when property/goods are over insured.
- The re-instatement value will not be higher than the market value of the loss.
- Insured is restored to almost the same financial position as before the loss occurred.
  Example: A business property that has been insured for R300 000 but the market value for the property is R200 000. If it is destroyed by fire/storm etc., the insurer will rebuild the property instead of paying cash.
  NOTE:. 1 Reinstatement applies when goods/assets are over-insured.
  2 There is no formula for calculating over insurance. Therefore you will not be asked to calculate over insurance.

Excess

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

Differences between insurance and assurance

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 certainty, but the time of the event is uncertain
Applicable to short term insurance	Applicable to long term insurance
Examples	**Examples**
Property insurance/money in transit/theft/burglary/fire	Life insurance/endowment policies/ retirement annuities,

Advantages/Importance of insurance for businesses

- Transfers the risk from the business/insured to an insurance company/insurer.
- Transfer of risk is subject to the terms and conditions of the insurance contract.
- Protects the business against theft/loss of stock and/or damages caused by natural disasters such as floods, storm damage, etc.
- Businesses will be compensated for insurable losses, e.g. destruction of property through fire.
- Businesses assets, e.g. vehicles/equipment/buildings need to be insured against damage and/or theft.
- Businesses are protected against the loss of earnings, e.g. strikes by employees which result in losses worth millions.
- Protects businesses against dishonest employees.
- Life insurance can be taken on the life of partners in a partnership to prevent unexpected loss of capital.
- Should the services of key personnel be lost due to accidents/death, the proceeds of an insurance policy can be paid out to the business/beneficiaries.
- Replacement costs for damaged machinery/equipment are very high, therefore insurance can reduce/cover such costs.
- Protects businesses from claims made by members of the public for damages that the business is responsible for.
- Protects businesses against losses due to death of a debtor.

Examples of insurable and non- insurable risks

INSURABLE RISKS	NON-INSURABLE RISKS
These risks are insured by insurance companies.	These risks are not insured by insurance companies as insurance cost/risks are too high/remains the responsibility of the business.
Examples • Theft • Fidelity insurance • Burglary • Money in transit • Fire • Natural disaster/Storms/Wind/Rain/Hail • Damage to/Loss of assets/vehicles/ equipment/buildings/premises • Injuries on premises	**Examples** • Losses caused by war. • Most risks occurring between placing orders and receiving goods. • Changes in fashion. • Losses caused by marketing malpractices by the business. • Advancement in technology/new machinery invention.

Examples of short term and long term insurance

SHORT TERM INSURANCE	LONG TERM INSURANCE
• Property insurance • money in transit • theft • burglary • fire	• Endowment policy • Life cover policy/Life insurance • Retirement annuity/Pension fund/Provident fund • Disability policy • Trauma insurance • Funeral insurance • Health insurance/Medical aid

Principles of insurance

Indemnification/Indemnity

- Usually applies to short term insurance, as the insured is compensated for specified/proven 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.
- Pay-outs from insurance companies/insurer will only be made; if there is proof that the specified event took place/if the insured can prove the amount of the loss/ damage.
- The amount of indemnification/compensation is limited to the amount of provable loss/damage, even if the amount in the policy/insurance contract is higher.
- The insured must be placed in the same position as before the occurrence of the loss/damage/The insured may not profit from insurance.

Security/Certainty

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

Utmost good faith

- Insured has to be honest in supplying details when entering in an insurance contract.
- Both parties/insurer and insured must disclose all relevant facts.
- Insured must disclose everything that may affect the extent of the risk.
- Details/Information supplied when claiming should be accurate/true.

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 interest must be expressed in financial terms.
- Insured must have a legal relationship with the insured object in the contract.

NOTE: The average clause is not one of the principles of insurance.

DIFFERENCES BETWEEN INDEMNIFICATION AND SECURITY

INDEMNIFICATION	SECURITY
A possible loss is insured.	The insured event is certain, but not always the time/date of the event.
Applied to short term insurance on property/assets to cover for fire, theft, etc.	Applied to long term insurance, e.g. life insurance, endowment policy, funeral policy, etc.
Insured must be put in the same financial position as before the loss./Insured may not profit/gain from insurance.	It provides financial peace of mind for the future/dependants of the insured.
An amount may be paid out to cover the loss partially/in full	Ensure that his dependants will receive the nominated amount when the event occurs.
The amount paid out will usually be determined by the real value of the loss.	The amount paid out will not reinstate loss of life.

The viability and relevance of insurance for individuals & businesses

- This is the ability of the insurer to pay out when it is necessary.
- It is important to select a reputable and well established insurance company.
- Insurance must make financial sense as insurance cost can be high and they are often based on risk factors.
- The individual or business must be certain that there is a real risk that needs to be covered.
- The insurance must not cost more than what it would to cost to replace the goods insured.
- The insured must take all reasonable steps to reduce the risk themselves and to inform the insurance company of the depreciation of their assets over time.
- **Example**: A small business will pay less to insure its office equipment if it has good security and an alarm. It must also remember to adjust the value of its equipment each year as it depreciates.

Compulsory insurance

Types of compulsory insurance
- Unemployment Insurance Fund (UIF)
- Road Accident Fund (RAF)/Road Accident Benefit Scheme (RABS)
- Compensation Fund/Compensation for Occupational Injuries and Diseases/COIDA

NOTE: Do not confuse compulsory insurance with examples of long term insurance.

Detailed description of 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%v of their basic wage to UIF.
- The contribution of businesses towards UIF increases the amount paid out to employees that become unemployed.
- All employees who work at least 24 hours per month are required to be registered for UIF/contribute to the UIF.
- It is an affordable contribution that makes it possible for businesses to appoint substitute workers in some instances.
- The business cannot be held responsible for unemployment cover as the UIF pays out to contributors directly/dependants of deceased contributors.
- Businesses are compelled to register their employees with the fund and to pay contributions to the fund.

NOTE: You will be penalised for using the word "workman's compensation fund" instead of UIF.

Benefits of 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.
- Unemployed employees enjoy these benefits until the allocated funds are exhausted.
- If a worker voluntarily terminates his/her contract, he/she may not claim.
- No tax is payable on unemployment benefits.

Illness benefits/ Sickness/ Disability
- Employees may receive these benefits if they are unable to work for more than 14 days without receiving a salary/part of the salary.
- Employees may not claim these benefits if they refuse medical treatment.

Maternity benefits
- Pregnant employees receive these benefits for up to 4 consecutive months.
- If an employee 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 years.
- Employees who take unpaid leave/may receive part of their salary while caring for the child at home.
- Only one parent/partner may claim.

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.
  NOTE: Do not confuse the benefits of UIF with types of leaves

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.
- Drivers of business vehicles are indemnified against claims by persons injured in vehicle accidents.
- RAF/RABS is funded by a levy on the sale of fuel/diesel/petrol.
- The amount that can be claimed for loss of income is limited by legislation.
- 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.
- The injured party will be compensated, irrespective of whether the negligent driver is rich/poor/insured/uninsured.
- RABS aims to provide a benefit scheme that is reasonable/equitable/affordable/ sustainable, etc.
- RABS aims to simplify/speed up the claims process as victims of road accidents no longer have to prove who caused the accident.
- RABS enables road accident victims speedy access to medical care as delays due to the investigation into accidents has been minimised.
  NOTE: You will be penalised if you use the word "third party" instead of RAF.

Compensation Fund/Compensation for Occupational Injuries and Diseases/COIDA

- The fund covers occupational diseases and workplace injuries.
- Compensates employees for injuries and diseases incurred at work.
- Compensation paid is determined by the degree of disablement.
- The contribution payable is reviewed every few years according to the risk associated with that type of work.
- All employers are obliged to register with the compensation fund so that employees may be compensated for accidents and diseases sustained in the workplace.
- The fund covers employers for any legal claim that workers may bring against them.
- Employers are required to report all accidents within 7 days and occupational diseases within 14 days to the Compensation Commissioner.
- Employers are responsible for contributing towards the fund and may not claim money back from employees/deduct contributions from wages.
- 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.

Differences between compulsory and non-compulsory insurance

Compulsory insurance	**Non-compulsory insurance**
Is required by Law/there are legal obligations for it to be taken out and paid for.	Is voluntary/the insured has a choice whether to enter into an insurance contract.
It is regulated by Government and does not require insurance contracts/brokers	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 that must be paid in order to enjoy cover for a nominated risk.
Examples UIF, RAF and Compensation Fund/COIDA	**Examples** Short term insurance/Multi-peril insurance (theft, fire, etc.) Long term insurance/Life insurance