



BUSINESS STUDIES

GRADE 12

TERM 2

CHAPTER 7

NOTES ON INVESTMENT: INSURANCE

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This chapter consists of 12 pages

CONTENT DETAILS FOR TEACHING, LEARNING AND ASSESSMENT PURPOSES

Learners must be able to:

- **Define/Elaborate on the meaning of insurance**

NON-COMPULSORY INSURANCE

- Explain/Elaborate on the meaning of non-compulsory insurance
- Explain/Elaborate on the meaning of the following insurance concepts:
 - Over-insurance
 - Under-insurance
 - Average clause
 - Reinstatement
- Explain the differences between over and under insurance
- Differentiate/Distinguish between insurance and assurance. Give examples.
- Name/Give examples of short term and long term insurance.
- Name/Mention/Explain/ Discuss the following principles of insurance:
 - Indemnification/Indemnity
 - Security/Certainty
 - Utmost good faith
 - Insurable interest
- Apply the average clause to calculate the compensation in the case of under-insurance.
- Discuss/Explain the advantages/importance of insurance.
- Explain the meaning of insurable and non-insurable risks.
- Outline/Mention/Give examples of insurable and non-insurable risks

COMPULSORY INSURANCE

- Explain/Elaborate on the meaning of compulsory insurance.
- Discuss/Explain types of compulsory insurance e.g. Unemployment Insurance Fund (UIF), Road Accident Fund (RAF)/Road Accident Benefit Scheme (RABS)/ Compensation for Occupational Injuries and Diseases Fund (COIDA).
- Explain the types of benefits paid out by the UIF
- Identify types of compulsory insurance from given scenarios/statements.
- Explain/Differentiate/Distinguish between compulsory and non- compulsory insurance and give examples.
- Keep abreast of the changes in legislation from time to time e.g. the RAF is currently changing to the RABS (Road Accident Beneficiary Scheme).

TERMS AND DEFINITIONS

Term	Definition
Insurance	It 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.
Insured value	The amount of money agreed to by the insured and insurer to insure assets/life of a person when the contract is signed.
Book value	The purchase price of an asset , less depreciation
Risk	Possibility of losses/damages
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.
Public liability	Damage caused by business operations to the public
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.

1 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.

2 NON-COMPULSORY INSURANCE

2.1 The meaning of non-compulsory insurance

- Non-compulsory insurance is voluntary/the insured has a choice whether to enter into an insurance contract.
- It is not required by law, but it can provide protection for businesses and individuals.
- It is taken out in order to transfer the risk of something happening onto the insurance company.
- These risks include theft, damaged cars, damaged buildings/ premises/injuries on premises etc.
- Non-compulsory can be divided into:
 - Short-term insurance e.g. fire, theft etc.
 - Long-term insurance e.g. retirement/death etc.

2.2 Meaning of insurance concepts

2.2.1 Over insurance

- Over insurance is when the item is insured for more than the actual market value.
- Businesses 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 if there is a claim for a loss.

2.2.2 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
- If a business is insured for an amount that is under the actual market value of goods or service, the insured/business will only be paid out for the amount that the goods/assets are insured for.
- The insurer usually applies the average clause to calculate the amount of money that must be compensated to the insured if the goods/assets are under insured.

2.2.3 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.

Formula for calculating the 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. A fire 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).

2.2.4 Reinstatement

- It is a stipulation whereby the insurer may replace lost/damaged property/goods instead of reimbursing the insured.
- This stipulation is applicable when property/goods are over insured.
- The re-insatement value will not be higher than the market value of the loss.
- Insured is returned 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.**

3 Differences between over and under-insurance

OVER-INSURANCE	UNDER-INSURANCE
Property/Assets that are insured for more than their value.	Property/Assets that are not insured for their full market value.
The insurer can choose to reinstate the insured.	The insurer will implement the average clause to determine the amount that will be paid.
Businesses will not receive a pay-out larger than the value of the loss at market value	Businesses will only be paid out for the amount that the goods/assets are insured for.

4 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,

NOTE: Both insurance and assurance form part of non-compulsory insurance

5 Examples of short term and long term insurance

SHORT TERM INSURANCE	LONG TERM INSURANCE
<ul style="list-style-type: none"> • Property insurance • Money in transit • Theft • Burglary • Fire 	<ul style="list-style-type: none"> • Endowment policy • Life cover policy/Life insurance • Retirement annuity/Pension fund/Provident fund • Disability policy • Trauma insurance • Funeral insurance • Health insurance/Medical aid

6 Principles of insurance

6.1 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.

6.2 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.

6.3 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.

6.4 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 principles of insurance form the basis of an insurance contract between the insurer and the insured.

7 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 businesses against dishonest employees.
- Protects businesses against losses due to death of a debtor.
- Protects the business against theft/loss of stock and/or damages caused by natural disasters such as floods, storm damage, etc.
- Protects businesses from claims made by members of the public for damages that the business is responsible for.
- 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.
- 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.

8 Meaning of insurable and non-insurable risks

8.1 Meaning of insurable risks

- These risks are insured by insurance companies.
- Insurance companies decide on the likelihood of an event and then decide if they want to insure the risk

8.2 Meaning of non-insurable risks

- These risks are not insured by insurance companies as insurance cost/risks are too high/remains the responsibility of the business.
- The insurance company cannot calculate the profitability of the risk and therefore they cannot work out a premium that the business must pay.

8.3 Examples of insurable and non- insurable risks

INSURABLE RISKS	NON-INSURABLE RISKS
<p>Examples</p> <ul style="list-style-type: none"> • 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 	<p>Examples</p> <ul style="list-style-type: none"> • Nuclear weapons/war • Changes in fashion • Improvement/changes 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/Time that elapses between the ordering and delivery of goods.

9 Compulsory insurance

9.1 Meaning of compulsory insurance

- Compulsory insurance is insurance that is required by law before /businesses/individuals may engage in certain activities.
- Compulsory insurance is intended to safeguard the welfare of everyone concerned.
- It is regulated by Government and does not require insurance contracts/brokers.
- Payment is in the form of a levy/contribution paid into a common fund from which benefits may be claimed under certain conditions

9.2 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 the examples of compulsory insurance with the examples of long term insurance.

9.2.1 Unemployment Insurance Fund (UIF)

- The UIF provides benefits to workers who have been working and become unemployed for various reasons.
- Employees contribute 1% of their basic wage to UIF.
- Businesses contribute 1% of basic wages towards UIF, therefore reducing the expense of providing UIF benefits themselves.
- 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 not be awarded marks writing “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

9.2.2 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 not be awarded a mark if you write the word “third party” instead of RAF.

9.1.3 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.

10 Differences between compulsory and non-compulsory insurance

Compulsory insurance	Non-compulsory insurance
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