LEARNER GUIDE

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Underwrite a standard risk in Short Term Personal Insurance

Introduction

At the end of this module, you would be able to:

- Investigate the circumstances of the proposer.
- Analyse assets and liabilities of a personal proposal.
- Investigate the loss and claims history of a proposer.
- Make an underwriting decision for a short term personal standard risk

During the process of insurance, a proposer offers their assets, also called the subject matter of insurance, to an insurer who through the process of underwriting decides whether they are willing to accept the risk, at what premium and whether they want to impose certain terms and conditions. This decision is based on their experience and underwriting rules and retention limits.
It is necessary to try and establish how soon the insured will claim, how frequently and how severe the claims will be – based on this a premium is determined. This is possible based on the statistical information that the insurer uses as well as the loss history of the proposer.
In insurance, a person would have a claims trend, meaning the way things are going, and if nothing significant happens, the trend will continue as it has in the past. That is why it is imperative that the insurer knows the claims history of the proposer and this will usually be checked at claims stage with the previous insurer.

Some risks are higher than others which refers to the fact that on some items (subject matter of insurance) or under certain circumstances, a risk will be higher, meaning the probability of an incident happening is increased. The higher the probability, the higher the risk, and therefore, the higher the premium that will be charged. In this module we look at all of the above aspects in great detail, but it is also advisable that the unit standard on Insurable Risk, being 120124 is studied with this module.

Module 1

Investigate the circumstances of the proposer

This Module deals with:

- The concept of the insured with reference to items to be insured
- The concept of a risk with examples
- The criteria used to underwrite a personal risk with reference to how each could influence the risk
- A proposal analysed and elements that could indicate a higher than usual risk identified and investigated further
- The basic purpose of underwriting risk with particular reference to short term personal insurance
- The use of a central database in investigating the loss history of a proposer and an indication of when such a data base is used by an insurer

Who is the "Proposer"?

The proposer is the person, company, business or other body who requires insurance cover for their assets.
This party seeking insurance cover must have a financial interest (insurable interest) in the assets to be insured (the subject matter.)
The Proposer, by law, must be over the age of 18 years.

Under what circumstances will an individual be classified as a proposer?

The main criterion for an individual to be a proposer is that he/she must have a financial interest in the assets to be insured. In insurance terms this is known as "insurable interest." In other words the proposer must suffer a financial loss when the assets (insured subject matter) are lost or damaged. It is therefore obvious that one party cannot insure the assets belonging to another party unless the insuring party has a direct financial interest in the insured assets and where the insuring party would financially loose if the assets were to be lost or destroyed. It is important to note though that not all insurers apply the concept of insurable interest.

Where an individual has purchased goods on hire-purchase or by means of a personal loan the company providing the goods, the finance company or individual providing the funds to purchase the goods will require the buyer insure such goods. Reason being, that in the event of the goods being lost or damaged, their outstanding balance will be recoverable minimising or negating the effects of a loss.

In the case where the residence has been purchased by way of a housing loan the bondholder will in all cases require a policy to be taken out on the property. The policy will be in the name of the person taking out the loan and a cession will be endorsed on the policy in favour of the bondholder to safe guard their financial interest. It is worth noting that in the event of a total loss of the goods insured where a company or individual has provided a hire purchase, surety or a cash loan this company or individual will be paid out first for the outstanding balance at the time of the loss. The proposer (Insured) will only be paid the residual amount if any at the end.

To summarise, an individual cannot financially gain from the misfortune of another in terms of an insurance policy. The third party must be able to prove a financial loss in the event of a loss to someone else's goods or assets.

1.1 The concept of the insured with reference to items to be insured

As stated, the insured person must have a direct financial interest in the insured assets to enter into a contract of insurance. There are certain persons who do not have full contractual capacity to enter into a contract of insurance as discussed in the unit standard on Law of Contract (unit standard 120128).

Once the proposer offers their “risks” (subject matter of insurance) and the insurer has accepted the risks, communicated and premium, and if applicable, any terms and conditions, the proposer now has the opportunity to accept the offer.
If the insurer and proposer agrees on the terms and conditions, premium, cover, start date and debit order date, and the fist premium/pro-rate is successfully paid, the proposer now becomes the insured.
The insured refers to the person who has taken out insurance and their name will appear on the schedule detailing the cover.

1.2 The concept of a risk with examples

Risk refers to the possibility of an incident happening. To be more specific, it refers to the severity (size of loss) and frequency (how often) of an incident occurring.

When underwriting a risk the insurer will attempt to predict the severity and frequency of loss occurring and if they are willing to accept the risk, they will communicate the terms and conditions of cover, as well as the premium.

When the probability is increased, this is referred to as a higher than usual risk, and the higher the probability of an incident happening, the higher the premium to be charged. A usual risk in insurance would refer to a standard risk.

- **What is a standard risk?**

A standard risk in insurance is a residence built of stone, brick, or the like, roofed with IBR, tiles or concrete. A thatched roofed house would not be a standard constructed house. Likewise a residence constructed wholly from timber is not a standard risk.

Where the risk of fire is high, the insurance company will not accept the risk at standard type risk terms or premium.

1.3 The criteria used to underwrite a personal risk with reference to how each could influence the risk

The questions that are asked to clients will give the insurer the information to be used during underwriting. This information is also called the "**criteria**" that is used during underwriting. These might include (most insurers use more or less the same criteria but there are a few insurers that use more criteria) but is not limited to:

- Age
- Driving history and driving ability (vehicle insurance)
- Model and make of the vehicle (vehicle insurance)
- Financial background (looking at sequestrations, liquidations, judgements etc.)
- Previous losses (claims history)
- Risk address (vehicle, buildings, contents and all risks insurance)
- Occupation (all cover at some insurers, especially personal accident cover)
- Value of the items
- Security devices

As previously mentioned, the criteria assists the insurer to determine the probability of an incident happening (the risk). This in turn will help the insurer decide whether the risk is acceptable and what terms, conditions and premium must apply.

Underwriting Criteria:

- **Age:**

  Usually younger people would need to pay a higher premium than older people. The reasons differ depending on the item that insurance is sought on. Let's look at the most obvious one – vehicle insurance. Younger people would have received their licenses more recently resulting in less driving experience. This has a direct impact on their driving ability and their capability of avoiding accidents. It has been proven that older people have what is called "instinctive avoidance" based on their years of driving experience that assist them in avoiding accidents. Another aspect is young people's *need for speed.* Younger persons usually drive faster and a little more reckless – usually when there are other people looking – which increases the probability of an accident. Young people usually go out more frequently. They might also go to unfamiliar places and park their cars in the street when clubbing until the early hours of the morning. This increases the probability of theft and hijackings and driving in the early hours (due to drinking and fatigue) might increase the probability of accidents happening.

- **Driving ability and driving history:** (see above)

- **Model and make of the vehicle:**
  A few aspects are important here – a new vehicle might mean availability of parts but these parts might come at a price. If a vehicle has a "high performance engine" or it has been modified to increase the performance of the vehicle it will cause an increased premium as it increases the probability of an accident happening. The model and make also has a direct impact on the value which will also increase the premium.

- **Financial background:**
  Some insurers will ask the client about their financial background and some even perform ITC checks at underwriting stage. The reason for this is that a client with an adverse credit record *might* pose a moral risk to the insurer and *might* be more probable to claim. This is a generalisation; however it does happen that clients that are in dire financial situations might institute a fraudulent claim in order to assist with their financial responsibilities. The other aspect is that clients that don't have enough money or clients with a bad payment record might not pay the premium which negatively affects the insurer. Even though a claim will not be paid if the insurer has not received the premium (notwithstanding the 15 day grace period according to the policyholder protection rules governing Short Term Insurers), the insurer still wants to receive premiums every month as it influences the loss ratio and

profitability of the company… remember the concept of pooling as discussed in the Insurable Risk unit standard.

- **Previous losses:**
  As mentioned earlier, it is used to determine the probability of incidents happening with specific reference to the severity and frequency of such losses.

- **Risk address:**
  The location of where the subject matter of insurance will be kept will be used to determine the probability of an incident happening. Insurers use (as with most underwriting criteria) scientific information to determine this. The insurer might use its own data that it has (based on its own experience with claims) and data from the police (crime statistics), and even information on acts of nature (lightning, storms etc), type of ground (will influence sinkholes (subsidence), heave and landslip), mining activities in the area (will influence earthquakes) etc.

- **Occupation:**
  Very few insurers use the client's occupation to assist in determining the premium, but all insurers will look at the occupation when a Personal Accident policy is underwritten. Some occupations are excluded. The client might be able to get cover if he has an "excluded" occupation but the policy will not pay if the accident occurred as a result of the occupation. For instance, police officers can obtain Personal Accident cover. If they are at home and fall off a ladder while changing a light bulb, and die as a result of this accident, the policy will pay out. However, if he is shot during an armed robbery at the bank while he is performing his duties, the policy will not pay out as this is excluded from cover.

- **Value of the items:** It goes without saying that the higher the value the higher the premium. It is expected that a client that enjoys R1 million cover will pay more for this cover than a client that enjoys R100 000 cover. The same applies to vehicles for instance. A client that drives a SL55 AMG will pay more for the cover than a client that drives an Opel Corsa Lite. This factor, however, as with most other criteria, should not be seen in isolation. It is possible that a young driver with an Opel Corsa Lite could pay a considerably higher premium than an older, more experienced driver driving a SL55 AMG. At companies where cross subsidisation occurs this is less likely than at companies that do not cross subsidise between risks and classes of insurance.

- **Security devices:**

  The more security the client has that protects the items, the lower the premium should be. A client that lives in a high security estate whose house is protected by high walls, electrified fencing, infra red beams, an alarm linked to armed response; security gates and burglar bars will pay less for household contents cover than a client living in a house in a residential suburb with security gates and burglar bars. The same goes for vehicles – if a client has an approved tracking device on the vehicle and parks it inside a locked garage, he should pay less than a client with the same car that only has the factory fitted immobiliser and parks his car outside in his driveway.

  Again, this is looking at items in isolation, and as you would have realised at this stage is that insurers never do – during the process of underwriting they take all aspects relevant to them into consideration when determining whether they will accept the risk, and if they do, under which terms and conditions, and at what premium.

A client that lives in a security estate but only received his license last year *might* have a lower premium than someone that has his license for 3 years but lives in a "high risk" area and drives a high performance vehicle.

1.4 Analysing a proposal looking at factors that could indicate a higher than usual risk

A proposal for insurance is made up of different sections:

(a) The proposer;

(b) The subject matter to be insured;

(c) The declaration; And in most cases

(d) The debit order authority.

A proposal is a questionnaire designed to seek as much information as possible about the proposer and the subject matter of the proposed insurance to enable the underwriter to decide on the terms and conditions of the contract.

A proposal form is the basis of the insurance contract between the proposer and the insurance company providing the insurance cover.

The following are the usual questions contained in a proposal form, which would illicit information regarding the proposer:

- Full names;
- Postal and residential addresses;
- Identity number;
- Date of birth;
- Married or single;
- Occupation.

The financial standing of the proposer is questioned:

- Has the proposer ever been declared insolvent or been liquidated?

Elements that could indicate a higher than usual risk could be:

- Where the proposer and the insured are different individuals.

If this is found the full reasons for the difference must be investigated. It can happen that the registered owner of the assets could differ to the one who has use of the assets. An example would be a parent purchasing a motor vehicle for the child's specific use.

In the case where a house is registered in the owner's name but a child or relative has the use of the house for the purpose of subletting the property to reside in. It can occur where an insolvent person gets someone else to insure assets on his behalf.

This practice might not be acceptable to an insurance company. Where the name of the proposer differs from that of the individual's name signing the debit order from which premium for the policy will be deducted. Full reasons for this difference must be obtained and investigated as to the legality of such an arrangement, depending on the insurer. Some insurers would not have an issue with this.

1.5 The basic purpose of underwriting risk with particular reference to short term personal insurance

The basic purpose to underwrite any risk is to evaluate all risks on a similar basis and then to limit the insurance company's exposure to unacceptable risks by way of claims made against it. As mentioned earlier, the process of underwriting entails the following:
A series of questions that assists to assess a risk scientifically in order to determine:

- Whether to **accept** the risk or not. If the risk is accepted it determines the
- **Terms and conditions** as well as the
- **Premium**

Insurance is based on good faith therefore the insurer trusts that the insured is supplying full and honest facts, and vice versa. Once the proposer accepts the above and the two parties agree on the premium, terms and conditions, start date, premium debit order date and cover, the proposer is now the insured.

1.6 The use of a central database in investigating the loss history of a proposer

The Insurance Data System, managed by TransUnion, is a centralised database of claims and policy information to help you achieve a single, integrated view of policyholders, their previous performance and their assets. Currently the system holds 4, 5 million claim records and 1, 8 million policies.

The Insurance Data System contains the following shared information:

- Claims information

The claims system provides a comprehensive claims history on line as well as pro-active alerts on suspicious claims element to enable the prioritisation of the investigation process.

Claims data elements include personal details around the claimant, insured and driver, claims details, service provider details, personal liability, claim items, risk address, vehicle details and third party details.

Participants are alerted on suspicious claim elements by way of a Claims Fraud Model which enable users to detect which claims are most likely to require review and are therefore worth prioritising for investigation. Alerts are also available on suspicious information around residential address, telephone details or identity number irregularities (as verified by Home Affairs).

By using the Insurance Data System at the claims stage, the insurance industry is managing risk more effectively and cutting down on fraudulent claims that are costing the industry an estimated R1, 4 billion annually.

Most, if not all insurers will also check ITC or Experian in the event of a claim which will provide the insurer with financial information relating to the insured. This is helpful to cut down on fraudulent claims, for instance if the client is 3 months behind on her vehicle repayment, and her car is all of a sudden reported stolen, an insurer will investigate this more closely.

Module 2

The assets and liabilities of a personal proposal

This Module deals with:

- The concept of subject matter of insurance with reference to a personal proposal
- The concept of insurable interest and indemnity with reference to the relationship between the proposer and the subject matter
- Six different personal assets and reasons as to why each would be classified as a high, medium or low risk for the insured and the insurer
- Potential business risks in a personal proposal to determine acceptability under a personal policy (covered in the assessment)

2.1 The concept of subject matter of insurance with reference to a personal proposal

The subject matter of insurance is the actual item (asset) or person on cover (being insured), such as the building, car, contents, etc. Short Term Insurance could also cover the person under personal accident cover.

Multi-peril policies allow the subject matter of insurance to be insured under specified sections called classes of insurance in order for specific risks and exclusions to be grouped together.

On a proposal form there will be separate sections for householders, all risks, motor, house owners, personal accident, motor cycle, trailers and pleasure craft in order to gather specific information and questions regarding the different risks.

Each section will ask for values or indemnity limits to be insured. This will include replacement value of house contents, replacement values of jewellery and other specified all risk items. Either a market or trade value for motor vehicles, motorcycles, trailers or caravans. The replacement value of pleasure craft caravans. A specific sum insured for personal accident.

Essential information required to underwrite each section is requested in the proposal form.

2.2 The concept of insurable interest and indemnity with reference to the relationship between the proposer and the subject matter

A contract of insurance is only valid if the insured has a legally recognised financial relationship with the subject matter of the insurance whereby he benefits from its safety, will be prejudiced by its loss or can incur a liability arising there from – this is what is meant by insurable interest. In property insurance, insurable interest arises mainly through ownership of the subject matter while persons such as executors and trustees also have an interest in property for which they are legally responsible.

Mortgagors, usually banks and building societies, have an insurable interest up to the extent of their loan. In short term insurance the insurable interest must exist both at the time the policy is taken out and when the loss occurs. A person has an insurable interest in any potential liability which he/she may incur and as such can arrange insurance to provide the necessary indemnity. Indemnity for the purpose of insurance means restoring the insured to the same financial position after a loss as he/she was immediately before its occurrence.

This is in line with the basic concept of insurance, which is to compensate the insured for the loss sustained but not to provide any measure of profit arising from the misfortune. It is therefore obvious that a person who has no financial interest in the subject matter cannot profit from the misfortune of another. The legal owner of the subject matter can only expect to receive the market value or the physical replacement of the item lost or damaged in the case of a claim.

2.3 Six different personal assets and reasons as to why each would be classified as a high, medium or low risk for the insured and the insurer

Herewith follows a table with assets in the left hand column followed by its description in the second column and finally in the third column, the type of risk that it would be prone to.

Thereafter follows a discussion of information requested in the proposal form, followed by more assets and whether they would constitute a low, medium or high risk.

Asset	Description	Risk
Building of private residence	On the banks of the Vaal River	Flooding
Private contents of a residence of standard construction	On a plot or smallholding 40 km's from Pretoria	Theft Depending on area, increased risk of fire
A cell phone insured under all risks	Cover applies for accidental loss or damage as well as theft	Accidental loss or damage such as dropping, forgetting, theft, water damage etc.
A diamond engagement ring insured under all risks	As above, cover applies for accidental loss or damage as well as theft	Accidental loss or damage such as the diamond falling out or losing/forgetting the ring etc.
A private motor car	Loss or damage to the insured motor car	Accidents, intentional damage, theft of the vehicle, fire damage to the vehicle etc.
A pleasure boat and motor	Loss of or accidental damage to the boat and motor	Hitting submerged objects Theft of the boat and motor. Dropping off into the water Damage whilst in transit etc.

Under each section of the proposal form specific questions are asked regarding the subject matter:

- Householders (contents of residence)
- House, flat, townhouse in or out of a security complex.
- Construction of the residence.
- Plot, farm of smallholding.
- Protections fitted to the premises and perimeter protections in place.
- Unoccupied in the future and if so for what periods.
- Motor insurance
- The make, model and year of manufacture.
- The usual use of the vehicle.
- The usual driver of the vehicle and casual drivers who may sometimes drive the vehicle.
- Details of driving licenses of the usual drivers.
- Any prior convictions or if license has been endorsed.
- Where vehicles are parked overnight.
- If vehicles are fitted with anti-theft devices.
- If the vehicle's engine has been modified, if the vehicle is a rebuilt vehicle.
- Details and values of all accessories fitted to the vehicle e.g. radios, air conditioners and crash bars.
- Details regarding the registered owner of the vehicle. This could differ from the usual driver of the vehicle.

The proposal follows a standard format but certain insurance companies require more information regarding the risks than others. On receipt of the completed proposal form the insurance company underwriter will peruse the answers provided. This will provide the underwriter with a picture of the risk so as to enable him to pick out the good and bad features of the various risks to be insured. It is also from the proposal form that the policy will be loaded on the insurance company's computer. It is therefore obvious that the information provided in the proposal form must be correct so that the policy is issued with the correct insured items. This does form the basis of the contract between the insurer and insured, and in the event of direct insurers that do everything telephonically, that recorded conversation will replace the proposal as the basis of the contract. The other two documents would be the schedule which is issued as a result of the underwriting process, and the policy wording.

Ten domestic assets and reasons as to why each would be classified as a high, medium or low risk:

Asset description	Classification	Reason
Private residence roofed with thatch	High	Increased risk of fire if struck by lightning or fire caused by any means
Private residence roofed with tiles or IBR roof sheets	Medium	Under normal circumstances the risk of fire is reduced from lightning. Tiles and IBR roof sheets are not vulnerable to lightning and do not burn that easily. There is however still a risk for theft and other damages, so not low.
A residential flat on the second floor of a housing complex	Low	The flat roof would be built of concrete. There would be no chance of a fire arising from outside sources such as lightning. Theft also lower due to accessibility and on other risks, medium. From the 3 above, this is the lowest risk.
A residential building and the contents thereof on the banks of a river or sea shore.	High	The chances of flooding from the river or sea are high in the cases of very heavy rains or a freak wave occurring.
The contents of a townhouse within a security complex	Low	The security complex would make it difficult to remove the contents from the residence seeing that the access point would be guarded 24 hours a day.
Electrical items such	High	These items are highly sort after and

Asset description	Classification	Reason
as Hi-fi Televisions, video machines and DVD players.		there is a large black market in which to dispose of these articles. In the event of a house break in these are usually the first items stolen.
Cell phones	High	Not only the risk of accidental loss or damage if dropped, but the very high theft incidence fuelled by black market demand for stolen phones.
Heavy furniture within a residence	Low	Weight and size reduce the attractiveness to thieves due to transport difficulties.
An old model motor car	High	Part prices increase and so does the demand for second hand parts. Consequently theft and hi-jack risks increase.
An imported, uncommon high valued sports car	Medium to low	If this vehicle is stolen it would stand out on the road and would be very easily recognisable. It would be difficult to sell in this country, as it would not be a common asset that everyone would be able to own. The risk of theft is thus low. However, scarce local spares and high cost of repairs need consideration.

Further examples of adverse features found on a proposal form are described and explained below.

- **Standard Construction:**

The proposal form will specify the construction of the residence. If the roof is of thatch automatically there will be a substantial premium loading because of the increased likelihood and severity of fire. This fact will also increase the likelihood of the insurance company requiring reinsurance on the risk. This will depend on the values for household contents, the value of the building (if also insured) and the total value of all the all risk items to be insured.

It is usual for non-standard risks to be surveyed by an official in the insurance company's employ before or shortly after accepting the risk. There will be standard minimum requirements to be confirmed before insurance cover will attach to the risk e.g. lightning conductors, distance from the nearest fire brigade and the availability of water on the premises.
The same criteria may follow for a standard construction residence.
The risk could be situated in areas where heavy seasonal lightning strikes occur or where heavy flooding by rains is experienced. Likewise the exceptionally high risk could be excluded or high excesses imposed. It is however unusual that an insurer would request a site survey on a domestic risk. The insured value would have to be very high in order to justify this expense on the part of the insurer.

A new type of risk has arisen where individuals own residential houses on game farms. The house could be roofed with thatch that could be attractive to monkeys and birds. Damage to the roof could also increase the risk of water leaks and this should be closely monitored. Domestic residential houses are sometimes used for business activities that use the whole or a partial section of the dwelling.

This aspect obviously enhances the chance of burglary and perhaps fire, depending on the type of goods being stored by the business. The domestic policy will in most cases exclude goods stored for business purposes as these items are to be insured under a commercial type policy. This aspect must be brought to the proposer's attention.

- **Unoccupied Risk:**

These risks could be permanently unoccupied or temporarily unoccupied as a result of extended overseas travels, permanent December holidays or holiday homes only occupied in December. As a rule the insurance companies will not accept permanently unoccupied risks because of the high risk of burglary, malicious damage, fire and storm damage. Where the proposal indicates such risks exposures, the policy will be refused.

Where risks are temporarily unoccupied the period of unoccupancy per year will be required. Usually companies exclude theft cover after a period of 30 or 60 days unoccupancy. This exclusion will also depend on whether someone is looking after the premises during the proposer's absence, or if a radio/siren alarm linked to an armed response company is in place. Similar criteria will be considered for risks situated on plots, farms or smallholdings. The essential concern would be to find out about the security measures in place to safeguard the goods and to deter entry into the property.

In most cases security companies do not service far outlying areas. If they do, it could take some time before the armed response unit would arrive at the premises. By then the burglars would have made off with the expensive electrical items, firearms and jewellery and a costly claim could be submitted. No matter what physical protections are installed, with time a burglar can overcome any amount of protection.

- **Security complexes:**

With the increase in crime in the country security complexes have become very popular. A typical security complex is an area where residential houses have been erected. The whole area is surrounded by at least a 1, 8 metre high wall or electrified fence or both.

There will be a 24-hour access control point at the only entrance point to the complex. There will, in most cases, be a 24 hour armed patrol within the complex. For this type of risk most insurance companies will provide substantial discounts off the householders (contents) section of the policy.

It can be noted here that stand alone houses can also enjoy substantial discounts if there are electronic access gates installed, where a radio/siren alarm with armed reaction is in place, and the whole property is surrounded by at least a 1, 8 metre wall. The minimum requirement of burglar bars at all opening windows and strong security gates at all exit doors must, in the first instance, be in place for these discounts to apply.

ALL RISK INSURANCE

Even though the cover provided under this section is very wide, there are however some special underwriting requirements that could be imposed.

- **Valuation certificates:**

It is generally accepted that where an item is unique, e.g. an item of jewellery, an original painting or other work of art, a Persian carpet, a valuation certificate issued by a specialist in that specific field of expertise is obtained.

As previously stated the reasons for a valuation certificate are:

- It proves the existence of and describes the item in detail.
- It confirms ownership of the item.
- It can, if prepared in detail, be used to reconstruct or repair the item.
- It establishes value at the time of valuation.

Ideally either the intermediary introducing the business to the company or a senior official of the insurance company should view the original valuation certificate. With the advent of very sophisticated Photostat machines a valuation certificate can be tampered with and copied. It will be very difficult to notice where the tampering has taken place. The valuation certificate copy should be certified as being a true, correct copy of the original and must be attached to the proposal form.

- **High valued jewellery:**

Depending on the insurance company any one single item of jewellery exceeding R100 000 in value will be required to be locked away in an SABS approved safe that has been bolted to the floor and wall inside the residence when not in use.

A further condition to be imposed could be that the item must be inspected by a competent jeweller at least once a year and a certificate to be issued confirming that the claws holding the stone are secure and that any safety chains and clasps have been inspected and are in place and secure.

It must be remembered at all times that the full replacement value of a jewellery item must be insured and not only the replacement value of the stone. This enquiry does crop up from time to time from a cautious proposer.

It is normally the case that a diamond will fall out of a ring, so the proposer is selecting against the insurance company by insuring only the highest risk attaching to the item. Also by insuring a lesser value the proposer will be saving on premium. Under no circumstances will the insurance companies allow this.

Certain extremely high valued items of jewellery will only be insured if permanently stored in a security box in a bank vault when not worn. The reason for this is obvious, however losses have over the years occurred from bank vaults, but they are few and far between.

- **Motor, motor cycle, caravans and trailers**

Where motorcars and motorcycles are driven or ridden by young inexperienced drivers and riders the chances of an accident is increased thus the need for higher premium loadings and higher compulsory excesses on a policy. High valued motor cars and motor cycles may be in excess of the insurance company's maximum retention so the need for re-insurance occurs. This need would increase the premium, as the re-insurers must also be paid.

Imported motor cars and motor cycles might pose a problem in the case of repairs where the spare parts and body panels are not readily available in this country. Increased costs for these spares would inflate a claim, which would be costly to the insurance company. With the advent of 4 x 4 type vehicles on the market these vehicles are highly sought after in neighbouring African states, so the likelihood of theft and hijacking has become very high. Most companies would not insure these vehicles if not fitted with sophisticated anti-theft or anti-hijacking deterrents including satellite tracking so as to safeguard the vehicle.

The main risk to caravans and trailers would be the accidental damage risk. A further risk to caravans is the theft of contents, so where the caravan is housed when not in use becomes a problem. A caravan permanently parked in a caravan park but

only rarely occupied would pose a high risk for theft of contents and even malicious damage to the caravan itself. Most insurance companies would not insure such a risk.
It must be remembered that each insurance company would view risks differently so it is very important to get to know the different views of the insurance companies in the market.

The materials used in the construction has been dealt with in the adverse sections previously explained. However the importance thereof cannot be underestimated. A residential house roofed with thatch increases the risk of fire to the building as well as the contents.

It must be remembered that when thatch burns it will fall inside the residence thereby setting the contents alight especially if there are wall-to-wall carpets within the premises. The same risk attaches to a house constructed from wood. It is obvious that this type of residence carries a very high risk of fire to the structure as well as the contents. The risk is increased when built close to or within plantations or close to bush undergrowth and firebreaks are not maintained between the surroundings and the house. In the case of a bush fire the residence will also be destroyed along with the contents.

The opposite is the case where a house is built of brick and roofed with IBR roof sheets or tiles. This residence, under normal circumstances, will not catch alight from lightning. The main cause of fires stems from electrical short circuits or ignition - a fire starting within the premises such as cooking oil overheating or an electric blanket setting the bedding alight. It must be remembered that if the house is not regularly maintained the risk of storm damage will be high in any of the three examples provided. In a heavy storm leaks will occur in a poorly maintained residence and these types of claims can be costly. However if neglected maintenance can be proven the claim will certainly not be paid.

- **Conducting a Survey**

The main reason for a survey to be conducted at the insured premises is to provide the underwriter with a clear description of what the risk looks like. One of the main risks that would be surveyed is a thatch type risk. It has been stated that the availability of water would be an underwriting feature. If the risk is situated on a farm or smallholding what would the water supply be like in the dry season?

Are there strong boreholes from which water could be pumped to fight the fire? Is there a large swimming pool on the property from which water could be used to extinguish the fire? How far away is the nearest municipal fire brigade? Would they attend to a fire on a farm or plot?

What is the size of firebreaks between the bush and the residence? The wider the fire breaks the less chance of a bush fire jumping the firebreak and setting the residence on fire. Are there lighting conductors in place next to the residence? This requirement would be very necessary in high, rocky areas as lightning is specifically prevalent in rocky areas.

In the case of old houses being insured, a survey could be conducted to ascertain the condition and maintenance applied to the residence. If it is found that the residence is in a poor state of repair the underwriter could refuse to insure the premises or at best apply a large excess for storm damage or exclude the storm risk from the insurance cover provided.

2.4 Business risks

Personal lines short-term insurance is also called domestic insurance. This refers to personal items that belong to “natural persons” (meaning a person like you and me). All your personal items, your car, your house, your contents, your personal accident cover etc. will be covered under this class of insurance.

It is also possible to cover items that are used for business purposes under this section.

External sales advisors, estate agents, medicals reps etc. will be using their vehicles for business purposes (the moment your vehicle forms an essential part of any work function it needs to be insured for business purposes). It will make no sense for a person to take a commercial policy just to insure a car on business purposes, and therefore all insurers allow these types of vehicles to be covered under a domestic policy. (There are exceptions of course).

This has also been extended to contents cover. It is becoming more and more popular for people to start working from home. They will have items like computers, printers, copiers, scanners, a desk and chairs etc. that they are using for business purposes (in their own personal capacity) to earn an income. Therefore most insurers allow a certain amount or a percentage of the total value of the contents for the purpose of “Goods used for business purposes”. There will be certain terms and conditions attached to this cover in that it will maybe not allow for other employees to be on the premises or for clients to visit.

This is the perfect cover for the graphic designer or material-developer, for instance that works on their own from their study at home.

If, however, you run a fully fledged registered business from home, especially if you are trading with commodities, manufacturing items or delivering a service (like a home spa/beauty salon/hairdresser etc.), or you have clients seeing you, you would need to take a separate policy for your business and this would be a commercial lines short-term insurance policy.

All businesses that trade in a business name would also take a business (commercial) policy. Think of Spar, Standard Bank, Speedy, Chips Away etc. They (should) have commercial insurance.

Module 3

The loss and claims history of a proposer

This Module deals with:

- Verification of the information on the proposal form
- Previous insurance loss history and corrective measures taken to reduce risk
  The financial implications of the size and frequency of previous losses

3.1 The information on the proposal form verified from an appropriate source

It is normal when a new proposal form is received at the insurance company's office for an official to telephone the previous insurer to verify the claims history as stated by the proposer in the proposal form.

Normally a policy number and the name of the previous insurance company must be stated in the proposal form. If not stated this information must immediately be obtained from the proposer.

If the previous insurance company confirms that the information regarding previous losses is correct, the underwriter can proceed further to underwrite the risk. If the loss history does not coincide with the previous insurance company's records further action must be suspended. The proposer could be hiding the fact that he has suffered many claims.

This action is serious, as it constitutes the withholding of material facts that would influence the acceptance of the new business. In a few circumstances it could happen that the proposer genuinely forgot about the losses. This however is not normal so the underwriter may believe that the proposer is withholding material facts regarding the risk and thus decline the risk.

Some insurers only check this at claims stage.

3.2 Information relating to previous insurance loss history and corrective measures taken to reduce risk

If it is found that the claims history as provided by the proposer does not agree with the loss history provided by the previous insurer, the new insurance company must immediately contact the proposer before any risk attaches to the new business. An explanation for the discrepancy must be obtained. An opinion is made regarding the probable truth of the explanation and a view taken on the trustworthiness of the proposer.

If it was a probable intention to withhold the information most companies will refuse to issue a new policy. If the proposer is lying at the inception of the policy it is acceptable to assume that he will falsify claims information when a claim arises. If it is ascertained that the discrepancy is a genuine error on the part of the proposer the proposal can be processed after acceptance of all other issues.

Other additional information relating to previous losses could be responses to questions regarding the remedial action taken after past losses to safeguard and prevent future occurrences. This could be that a radio/siren alarm was fitted to the premises, security gates have been installed, the roof of the residence has been waterproofed after a previous storm etc. It could happen that the insurance company would send out a surveyor to check that the remedial action has in fact been taken before accepting the risk.

If it has not been carried out this fact would also be seen as misguiding or trying to adversely influence the underwriter. On perusing the new proposal the underwriter might require higher excess levels or a loading in premium before accepting the risk. These additional requirements must first be relayed to the proposer and agreed to before the policy is issued, the additional requirements might not be acceptable to the proposer.

He must be given a chance to either accept or reject the additional requirements. If he rejects them then he will most probably take his business to another insurance company who may accept the business at less demanding terms.

3.3 The financial implications of the size and frequency of previous losses and an indication of the previous claims

In any insurance company the size (severity) and frequency (how often) of claims is very important as this information affects the company's profit margin. Any insurance company will try to limit amounts paid out in claims during any one year. The lower the amounts paid the higher the company's profit should be and the less likely premium increases are.

This fact obviously filters down to each risk that is underwritten, as all the individual risks underwritten will contribute towards the company's overall year-end profit margin. The size of claims relates to the amount physically paid to the insured or the cost involved in repairing or replacing the asset that has been the subject of a claim.

Historically fire claims were always the highest value paid out for claims. Today a large burglary can be just as high as a medium fire claim. The frequency of claims relate to how many claims an insured has suffered in say a 12-month period. As an example an insured could have five cell phones stolen in a 12-month period. This would constitute a high frequency of claims. The frequency can also relate to a high number of different types of claims in a 12-month period.

Loss histories vary from client to client. A proposal form can reflect two claims in one year but the amounts claimed are high. The proposer could have had a fire at his residence. The cost to reinstate the building could have been expensive. A few months later his brand new motor car could have been stolen. The maximum indemnity on the motor car could also have been expensive.

In another case the proposer could have sustained ten different claims but the amount paid for each claim is small. In both these cases the insurance company could view the losses as extreme. The acid test would be to divide the value paid out in claims by the total premium paid for 12 months. This calculation provides a loss ratio over the 12-month period. A loss ratio under 70% would be viewed by most insurance companies as acceptable. Over this percentage the loss ratio is viewed as high and the new business at similar terms would be found unacceptable.

A further check on the proposer's claims history would be to look at the type of claims during the past period and repetitive claims cycles. If there have been numerous storm claims over a period of two years this would indicate either that the premises have not been well maintained or that the area in which the proposer resides is a high storm area. The company may send a surveyor out to assess the general condition of the building. If the building is in a bad state of repair the new business proposal could be turned down.

The surveyor may suggest that certain maintenance be carried out to limit or prevent any further storm claims arising. The underwriter could then accept the business but might impose compulsory excess for any future storm claims for at least the first year of insurance.

To sum up the claims history of a proposer is very important to the new insurance company. They do not want to inherit a multi-claimant who has been refused further insurance cover from his existing or previous insurer. The new insurer wants to show a profit on the insurance of a new client so must know what they can reasonably expect from the proposer by way of his previous claims history.

This might sound surprising, but when faced with a loss history indicating high severity, low frequency versus a high frequency low severity, the insurer would prefer the high severity, low frequency.
The reason being, the probability that a severe claim will repeat itself, is very low.
However, if a client is a frequent claimant, s/he will most probably remain so, and the probability that the frequent claims will become more severe, is very high.
And as soon as a client is a high severity high frequency claimant, the insurance company will most probably cancel the insurance and a new insurer would most probably decline insurance in that instance.

Module 4

Make an underwriting decision for a short term personal standard risk

This Module deals with:

- Gathering and analysing information to determine whether to accept or decline the proposal
- Factors that warrant a loading or reduction in terms of reducing perils, applying deductions, excesses and physical protection of assets
- The premiums, terms and conditions applicable to a policy

4.1 Gathering and analysing information to determine whether to accept or decline the proposal

The insurance company underwriter must follow all the following procedures in reaching an acceptance decision:

- The proposal (plus debit order) has been correctly completed and signed by the proposer.
- All the required information has been provided and analysed.
- The proposer's previous insurance company has confirmed that the claims history on the proposal is correct.
- There are no adverse aspects regarding the various sections / risks for which the proposer requires insurance. This includes re-insurance considerations.
- The underwriter will then confirm that the new business can be processed at normal standard terms.
- As stated in the previous specific outcomes, where adverse aspects regarding the various risks are found remedial action will be taken and the policy will be issued with the additional excesses, deletion of certain covers where numerous claims have been made or a loaded premium imposed on certain sections.

The premium rate is determined for the gross cost of risk.

In most, if not all, insurance companies today the rates applicable to the various sections of the policy have been loaded on the company's underwriting computer system.

These rates will cater for the various areas in the country, the construction of the residence, the make and model of all the different motor vehicles on the market in South Africa.

For every given set of circumstances that is input to the computer system the system will generate a rate for the risk.

All the different sections' premiums are then added together within the system and a monthly or annual premium is generated plus any bank charges or debit order loadings that the insurance company may charge.

These total premiums per section of the policy will be reflected on a schedule that will be attached to the company's policy wording booklet.

Manual rate books are available and the learner should attempt to obtain such a rating guide so that various rating calculations can be performed to complete activity 4.2. in the formative assessment.
Rating requests, provided by the facilitator, require your calculation of an appropriate premium. These calculations must be retained in your portfolio.

4.2 Factors that warrant a loading or reduction in terms of reducing perils, applying deductions, excesses and physical protection of assets

These factors have been covered in some depth in the previous specific outcomes but they are again summarised because of the importance thereof:

Premium loading

Premium loadings are not the preferred way of reducing the risk. Additional excesses result in the proposer having a greater financial interest in reducing the risk and are thus preferred. However where the underwriter has noted adverse features of a risk, a premium loading could be imposed.

The main reason for a premium loading is usually for young inexperienced drivers of motor vehicles. The age limit could be for all drivers under the age of 21 or 25 years. Residences built with highly flammable building materials, e.g. thatch or wood, would also all qualify for a premium loading.

Reduction in premium

Where the risk is found to be lower than normal, premium discounts could be allowed.

Examples of such discounts are:

- Security complexes
- An electronic alarm system connected to an armed response
- All risk items kept permanently in a bank vault
- Where the insured elected to pay a substantial excess towards claims reported
- Pensioners' discounts

Where very high sums insured are in place. A standard rate would apply to a certain value, e.g. R500 000, 00 and a reduced rate would apply to the balance of the sum insured.

Applying Deductions and Excesses

It has been stated that young drivers qualify for additional excesses over and above the basic excess. In the case where the claims history reveals many claims under a specific section or over many sections of a policy, similar excesses could be imposed in addition to the standard excesses stated in the policy wording.

Physical Protection of Assets

Most insurance companies impose minimum physical protections such as burglar bars at all opening windows and security gates at all exit doors although with some insurers it would depend on the risk address and would not always be necessary. In high crime areas the company could insist on a radio/siren alarm with armed response. High valued jewellery items when not in use must be locked away in a SABS approved safe fixed to the residence. Motor vehicles within a high crime risk area to be securely locked within a garage overnight for theft of vehicle to apply. No theft covers for pleasure craft or motors if left unattended. No cover for theft of goods from unattached outbuildings if the said buildings are not securely locked.

The concepts of excess, deductibles and self-insurance are explained with reference to a particular policy document.
As previously stated, excesses and deductibles are used:

- To limit the insurers' loss in the event of a claim.
- To prevent the insured from claiming for small amounts. To pay out small amounts on claims increases the Insurance Company's administration costs.
- To impose a financial interest on the insured, that in the event of a loss, they bear a part of the loss themselves. This obligation will hopefully make the insured vigilant and improve their safeguarding of their property.

All insurance companies impose standard excesses to sections of the policy. These would include the All Risks and Motor sections, the Pleasure craft section and in some cases the Householders (contents) and House owners (building) sections. These various section excesses will be printed on the policy schedule or included in the policy wording.

Self-insurance means that the insured elects to carry the whole or certain sections of cover himself.

The insured could elect to carry the storm damage to his building and contents himself. The cover would be deleted from the policy and the insurance company could provide a discount on the premium. The same could be the case for burglary cover, where the insured does not deem burglary to be a high risk to his assets.

By electing to carry a voluntary excess (in addition to the standard excess) the insured also is his “own insurer” for that amount of the claim.
This means that by carrying an increased share of the claim he is self-insuring that share of the claim.

4.3 The premiums, terms and conditions applicable to a policy

After all the underwriting requirements have been checked and found acceptable and in some cases a survey completed, the insurance company will produce a quotation. This quotation sets out the terms and conditions under which the assets will be insured. These terms and conditions will include the excess applicable to the various sections of cover provided, it will include any restrictions in the cover and all requirements that have to be met for insurance cover to be in force.

The quotation sets out the various monthly and/or annual premiums applicable to each section of the policy. These premiums are totalled up at the end so as to provide a total annual and/or monthly premium payable.
On receipt of the quotation the proposer must decide whether they will accept the terms and conditions as well as the premium payable. The proposer can either accept or reject the quotation.

If the quotation is rejected the insurer files their papers marked “not taken up” or NTU. If the proposer accepts the quotation and all its terms the insurer must be advised and placed on risk. Policy documents are issued and sent to the proposer who now becomes the insured.

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