Chapter 15

Unit 4

Insurance

Higher Level

Chapter Notes

WHAT IS RISK MANAGEMENT?

Risk Management — Def is a **planned approach** to the handling of the risk that the individual or business is exposed to. It involves: - The **identification of all possible risks/losses** e.g. the risk of fire, employer negligence, personal injury loss, legal liability etc. - **Calculating costs** of protection from loss.

2005 Short Q 2

Risk management involves

1. Identifying risks
2. Reducing the likely hood of the risk occurring
3. Taking out insurance to reduce the risk

METHODS OF RISK MANAGEMENT

Identifying risks can take preventative action to eliminate the risk form happening and can benefit both households and business. This can result in fewer risks and less to insure against. A manager might consider the following to minimise risk within a business.

2018 Question 5 (B)
2015 Question 4 (C)
2012 Question 5 (A)
2011 Question 5 (C)
2008 Question 6 (B)

1. **Insurance**: Transfer the risk to an insurance company for a premium where the company will make good any loss suffered.
2. **Safe procedures**: The manner/act of doing something is strictly laid out and adhered to/ /stringent monitoring procedures/secure procedures for managing cash.
3. **Health and Safety**: Health and Safety statements: Regulations, identification of hazards, Training of personnel in health and safety. Drills, courses of action and medical training. Provision of safety equipment, protective clothing and training in same. Appoint Health and Safety representatives in the work force. Report safety issues.
4. **Regular safety inspections/audits**: Investment in new, replacement, upgraded equipment.
5. **Install Security systems**: Alarms, fire doors, CCTV etc.

Possible risk to a business (and appropriate type of insurance)

1. **The risk of structural damage to the factory** - Buildings Insurance – provides protection against loss or damage to the structure of the building caused by fire, flood or storm.
2. **The risk of damage to stock** - Contents insurance – provides protection against loss or damage to contents caused by burglary, fire or flood.
3. **The risk of being involved in a road traffic accident** - Motor insurance – it is compulsory by law to have third party insurance. Other policies include Third Party Fire and Theft and Comprehensive.
4. **The risk of losing an important member of staff** - Key Person Insurance – protects the business against the loss of a valuable staff member.
5. **The risk of a customer injuring themselves while on premises** - Public Liability Insurance – protects the business against claims made by the public as a result of accidents while on site.
6. **The risk of a worker injuring himself while carrying out his job** - Employer Liability Insurance – Covers the business against claims made by employees as a result of accidents in the workplace.
7. **The risk of having cash or stock being stolen by an employee** - Fidelity Guarantee Insurance – Protects the business against dishonesty or fraud committed by an employee.
8. **The risk of the company's products being harmful to the public** - Product Liability Insurance – Protects the business in the event of a customer making a claim as a result of defective products that may have caused harm.

WHAT IS INSURANCE?

Insurance companies collect premiums from a large number of people. Only a small number of these risk will actually happen causing the insurance company to pay out This allows the insurance company to pay out compensation but also have money left over for a profit

IMPORTANCE OF INSURANCE?

Business	Household
1. Business survival is protected	1. Greater financial security – risks such as fire can be protected against
2. Improves cash flow	2. Greater piece of mind – can provide financial protections for victims of accidents
3. Can save money	3. Saving can be enhanced – life assurance policies can provide payment at a future date
4. Makes exporting easier	
5. May be a legal requirement	

WHAT TYPES OF INSURANCE SHOULD A BUSINESS HAVE?

2020 Question 6 (C)
2018 Question 5 (B)
2012 Question 5 (A)
2007 ABQ
2006 Question 5 A (i)

<u>Assets</u>

Third party fire and theft	Provides third party protection plus loss or damage to your own car from fire or theft
Comprehensive motor insurance	Provides third party, fire and theft cover plus compensation for nay accidental damage that happens to your own vehicle
Motor insurance	A compulsory type of insurance that must be paid by law if the business or individual own a motor vehicle. Protects the business from being at a financial loss as a result of a motor accident. Three types of motor insurance include: third party insurance, third party fire & theft insurance and fully comprehensive insurance

A risk management approach would ensure you have adequate insurance cover and the vehicles are roadworthy.

Product Liability	Insurance Protects the business from financial loss in the event of a customer making a claim as a result of defective products that may have caused harm to a consumer.

A risk management approach would be to ensure all foods have the proper dates, nutritional and instruction of use included in or one the product

Buildings and Contents	This provides the business with protection against any loss caused by damage to the structure of the building caused by fire, flood or storm. You should ensure a smoke alarm is fitted and there are adequate fire extinguishers in the premises.

A risk management approach would be to ensure a smoke alarm is fitted and there are adequate fire extinguishers in the premises.

<u>Insurance on employees</u>

Permanent Health Insurance	provides sick pay for workers unable to work due to illness
Key person Insurance	Protects the business from financial loss as a result of a vital employee (a key scientist/ researcher/football player). Key person insurance is a type of life insurance policy that is taken out by a business on the life of a key employee. It is also possible for the policy to pay out in the event of the key person being diagnosed with a specified serious illness, such as cancer or heart attack.
PRSI	is a compulsory insurance to the state by both employees and employers. It's calculated as a percentage of gross income. It is used to pay for unemployment payments, pensions
Fidelity Guarantee Insurance	Protects the business against financial loss as a result fraud or cash or stock being stolen by an employee.

A risk management approach would be to ensure checks and balances are in place.

Insurance against Liabilities

Public Liability	protects the business against financial loss as a result of claims made by members of the public/consumers as a result of accidents while on the business premises. e.g. Public Liability Insurance protects the business against a claim for damages from a consumer who falls and is injured on the business premises.

A risk management approach would be to ensure that all floors have appropriate warning signs placed on them when they have been washed to avoid any injury.

Employer's Liability	Covers the business against financial loss as a result claims made by employees as a result of accidents in the workplace.

A risk management approach would be to ensure all employees are trained in the use of the company's machinery and equipment

Consequential Loss/goods in transit	Provides financial compensation for loss of income in the event of a risk occurring. Protects the business from financial loss as a result of goods/stock being damaged when they are being transported.

A risk management approach would be to ensure secure procedures are in place.

WHAT TYPE OF INSURANCE SHOULD A HOUSEHOLD HAVE

2006 Question 5 A (i)

<u>Assets</u>

House insurance	cover both building and its contents in the event of fire burglary
Motor insurance	is compulsory for cars

<u>Liabilities</u>

Mortgage Protection insurance	is required by all lenders before approving a loan to buy a house

<u>Personal Health</u>

General Health Insurance	covers the cost of private health care in the event of an illness (VHI, Aviva)
Permanent health insurance	Pays a percentage of your salary if you have to give up work due to an accident or illness
Personal accident insurance	provides compensation if you have a serious accident. The amount paid will depend upon the seriousness of the injury

<u>Life Assurance</u>

Whole life assurance	the insured pays an annual premium for the rest of their life and compensation will be paid out when death occurs
Endowment life assurance	Under this policy compensation is paid out if you reach a certain age or death occurs which ever happens first
Term-Life assurance	this provides cover for an agreed period of time such as 20 years no lump sum is paid unless death occurs within that period

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HOW TO BECOME INSURED

There are 5 steps involved in getting insured

Step 1 – Contact an insurance company

You can contact an insurance company directly or go through a broker or agent

- Broker – They work independently of insurance companies and receive a commission for their work
- Agent – They work for a particular insurance company and receive a wage for their employment

Step 2 – fill in a proposal form

Insurance Proposal forms or application forms are used to apply for insurance cover and the company is given full particulars of the risk against which the insurance protection is desired. Insurance Proposal form helps the insurance company to calculate the premium based on all the potential risks in relation to the insurance policy.

Exposure unit Def This is the object that is being insured and on which insurance is been taken out on

Step 3 – Risk in assessed and premium is calculated

The insurance company will calculate a premium (fee) that is to be paid and a quotation is issued. This will be based on

- The level of risk
- Value
- Loadings – are extra charges that are added to motor insurance to account for the different characteristics (Age, car)
- Profit targets

Step 4 – Policy is issued

If the quotation is accepted a cover note is issued. This is a temporary document that is issued by the insurance company as proof of an insurance contract until the full policy

Is ready. An insurance policy is then set out and included the full contract such as item covered value of compensation and condition

Step 5 – Make a claim if the insured event occurs

If a risk occurs that a person is cover for a claim form must be filled out by the insured. This is a document that must be completed describing what happened and stating the loss suffered. If a risk occurs that a person is cover for a claim form must be filled out by the insured. This is a document that must be completed describing what happened and stating the loss suffered

PRINCIPALS OF INSURANCE

These are the basic rules that must be obeyed before an insurance company will agree to pay out compensation on an insurance claim. They Include the following

1. Insurable Interest
2. Utmost Good Faith
3. Indemnity
4. Contribution
5. Subrogation

2023 Short Q10
Deferred
2016 Short Q4
2015 Q6 (A)
2010 Short Q7
2009 Short Q3
2008 Short Q10
2006 Question 5 A (i)
2005 Short Q7
2002 Question 5 (B)

1. *Insurable Interest*

This means that the person looking for insurance must benefit for the existence of exposure unit and suffer from the loss. For example, you can't insure your neighbor's house. In essence you can't insure something unless you have a vested interest in it.

Also, you can only claim compensation on something for which you have taken out insurance. This is known as Proximate clause. For example, if you insure a business equipment against fire and it is then stolen the business cannot claim insurance.

2. *Utmost Good Faith*

This is also known as Uberrima Fidei. It means that all **material facts** must be revealed. A material fact is anything that could influence the insurer's decision to take on the risk or what premium or charge. The person taking out the insurance must answer all the questions truthful.

Failure to do so can make the insurance cover worthless. If the insurance contract is obtained by way of fraud or misrepresentation it is void e.g. a driver should declare truthfully the number of penalty points on their license.

3. <u>Indemnity</u>

This means that the insurer agrees to compensate for the actual financial loss. The insured can't make a profit from an insurance claim and no compensation is paid for sentimental loss.
i.e. insurance can put an insured person in the same financial position as they were prior to a loss occurring. If a car is written off in an accident the insured receives its replacement value and not the original sum paid for it.

Life assurance is an exception to the principal of insurance. This principal also affects business and households who over/under insure items. Over insurance – is when you insure and item more than it is actually worth. Under insurance – Is where an item is insures for less than it is actually worth (Average clause)

4. <u>Contribution</u>

This principle states that if you hold more than one insurer liable for your losses, they have to share the
loss. If you take out two polices on your car, you can't collect from both insurers. One company would pay you and then collect from the second, or both companies would share the compensation payment between them. Fundamentally the principle is linked to indemnity ensuring that a person doesn't profit from insurance

For example, you have a phone insured for €200. This is covered by phone insurance and Home contents insurance. Your phone breaks and you claim off your insurance. You don't receive €400 (because this would mean you are making a profit and this goes against the indemnity principle). What would happen is as follows

•Company A will pay 50%	€100
•Company B will pay 50%	<u>€100</u>
	€200

5. *Subrogation*

Subrogation says when you accept an insurance settlement, the insurer gets your right to sue the third party. This prevents you collecting twice for the same damage and gives your insurer a way to recoup its losses. Fundamentally the principle is linked to indemnity ensuring that a person doesn't profit from insurance.

UNDER INSURED

Underinsured

2014 Question 5 (C)

Def This means the business has inadequate insurance cover. The insured fails to insure for the full value of the policy. In the event of a claim for total loss or partial loss underinsurance may result in economic losses to the policy holder, since the claim would exceed the maximum amount that can be paid out by the insurance policy.

The reason for being underinsured is the lower premiums paid by the policy holder, however, the losses arising from a claim will far outweigh savings experienced in reduced insurance premiums as a consequence of the inadequate insurance.

2023 Question 6 (A)
2014 Question 5 (C)

Possible effect of being underinsured on a business.

1. Serious financial crisis - in a business depending on the asset that is insured. For example if a building is insured for €300,000 and is subsequently destroyed in a fire and the cost to replace the building is €500,000 the business will have to make up the difference of €200,000 from its own resources.
2. The lower premiums - will reduce the business costs and thereby increase profits. This could be intentional with the full knowledge of the risk.

However, the losses arising from a claim may far exceed any marginal savings in insurance premiums. It may not be intentional. Businesses should review and update cover annually (e.g. stock may have increased in value due to inflation).

AVERAGE CLAUSE

Underinsured means the business has inadequate insurance cover. The insured fails to insure for the full value of the policy. In the event of a claim for total loss or partial loss underinsurance may result in economic losses to the policy holder, since the claim would exceed the maximum amount that can be paid out by the insurance policy.

This rule applies to partial loss when a loss is suffered. For example
If you insure your house for 25% of the value of the house then insurance company will only pay you 25% of the loss suffered

A house is worth €300,000 but is only insured for €150,000. A fire caused €40,000 worth of Damage how much compensation will they receive. As the house is only half insured - they will only receive have the damages.

2020 Short Q10

$$\frac{\text{Amount insured for}}{\text{Value of the item}} \times \text{Damages} \qquad \frac{€150,000}{€300,000} \times €40000$$

$$= €20,000$$

HOW CAN AN INSURANCE COMPANY SETTLE A CLAIM

Insurance companies can settle compensation claim in the following ways

1. Pay cash compensation (this is the most common method
2. Replacement of the asset – if the item is lost or completely destroyed
3. Repair or reinstatement – where partial loss or damage occurs to the asset

SIMILARITIES AND DIFFERENCES BETWEEN HOUSE AND BUSINESS INSURANCE

Similarities	Differences
1. Identify and manage possible risks	1. Business have more risks to insure
2. Insure against all reasonable risks	2. Businesses can suffer far greater financial losses
3. Fill out insurance forms (proposal and claim)	3. House holds only pay PRSI on their own income business have to pay PRSI for all employees
4. Keep insurance forms safe	4. Business can treat insurance payments as business expense

Chapter 15

Managing business and household finance

Higher Level

Past Exam questions (For this chapter)

SHORT QUESTIONS

2023 - Short Question 10 (Deferred)

Identify the correct insurance principle which corresponds with the explanation below

Explanation	Insurance Principle
The policy holder must benefit by the continued existence of the item and suffer financially from its loss.	
The insured must declare all material facts about the item they wish to insure when completing the application form.	
A policy holder cannot make a profit from insurance.	
The insured cannot take out two policies for the same risk and collect from both insurers.	

2021 - Short Question 4

Circle the correct option in the case of each of the following statements.

(i) A larger policy excess will result in a higher / lower insurance premium.

(ii) The person who calculates the amount of compensation to be paid to a claimant is known as an Assessor.

(iii) Indemnity / utmost good faith means you cannot make a profit from an insurance claim.

(iv) Loadings on an insurance policy result in an increase / decrease in the premium.

(v) An insurance company who tries to reclaim any losses against a third party is using the principle of contribution / subrogation.

(10)

2020 – Short Question 10

Henry Winters insured his home for €200,000 with Allianz

The market value of the house is €250,000

A chimney fire casued €36,000 worth of damange

(i) Calcualte the amount of compensation Henry will receive frim Allianz shouw yor workings

Workings	**Compensation**
	€ ________________

Explain why Henery receives this amoutn of compenation

2016 – Short Question 4

Column 1 is a list of insurance terms. Column 2 is a list of explanations for these terms. (One explanation does not refer to any of these terms.) Match the two lists by placing the letter of the correct explanation under the relevant number below.

1	2	3	4	5

Column 1: Terms	Column 2: Explanations
1. Insurable Interest	A. Applies if item is insured against the same risk with more than one insurance company.
2. Average Clause	B. The insured person cannot make a profit from insurance.
3. Subrogation	C. The insured person must gain from the item’s existence and suffer financially from its loss.
4. Contribution	D. Applies if an item is under-insured and there is a partial loss.

5. Indemnity	E. The insured person must declare all material facts about the item being insured.
	F. Once compensation has been paid any legal right to the item recovered passes to the insurer.

2010 – Short Question 7

Illustrate the difference between the insurance principles 'Insurable Interest' and 'Indemnity'

(a) Insurable Interest is :
(b) Indemnity is :

2009 – Short Question 3

Distinguish between public liability and fidelity guarantee as type of insurance

(a) Public liability Insurance is:
(b) Fidelity Guarantee Insurance is:

2008 – Short Question 10

(a) John O'Neil owed a house worth €350,000 and had Insured if for €300,000 when a fire caused a partial loss Of €63,000. Calculate the amount the insurance company Will pay (Show your workings)

Workings

(b) Name the principle of insurance that applies in (a) above

2005 – Question 2

Risk management requires managers to

2005 – Question 7

Distinguish between the insurance principles (i) Utmost good faith and (ii) indemnity

(i)

(ii)

LONG QUESTIONS

2023 – Question 6

Due to major increases in utility bills, business owners may cancel insurance premiums or under insure their risks

(A) (i) Explain one implication of underinsurance

(ii) Discuss two types of business insurances that you would recommend a hotel business should have (15)

2020 – Question 6

(C) (i) Explain the term public liability insurance.

(ii) Outline three types of insurance, other than public liability, that a business might have. (20)

2018 – Question 5

(B) Draft a business letter, using today's date, from Phoenix Risk Management Ltd to Ricardo's Burgers Ltd, a fast food retailer. In your letter identify the main types of insurance Ricardo's Burgers Ltd should have and outline ways in which it could minimise business risks. Use fictitious names and addresses. (25)

2015 – Question 6

(A) Read the information supplied and answer the questions which follow.

PRIVATE MOTOR INSURANCE PROPOSAL FORM

DECLARATION

I/We declare to the best of my/our knowledge and belief that the information given on this form is true and complete in every respect.

(i) Outline the function of an insurance proposal form.

(ii) Explain the principle of insurance referred to in the extract from the above private motor Insurance proposal form.

(iii) Outline two other principles of insurance that apply to insurance contracts.

(20)

2014 – Question 5

(C) Explain what it means to be under insured and outline one possible effect of being underinsured on a business (15)

2012 – Question 5

Read the information supplied and answer the questions which follow.

Bianua Ltd, a medium size company, operating in the agrifood sector, supplies quality prepared food products in Ireland and in the UK market.

(A) Draft a business letter from EXON Insurance PLC to Bianua Ltd, using today's date, identifying the possible business risks and the appropriate types of insurance for Bianua Ltd. Use fictitious names and addresses. (20)

2011 – Question 5

(C) (i) Illustrate your understanding of the term 'risk management'.

(ii) Describe three methods a manager might consider to minimise risk within a business.

(20)

2008 – Question 6

(B) (i) Explain the term 'risk management'.

(ii) Illustrate three methods that can be used to reduce risk in a business (20)

2007 - ABQ

(B) Describe the types of insurance appropriate to the context described above (20)

2006 – Question 5

(A) Differentiate between indemnity and insurable interest. Illustrate your answer

(B) Distinguish between insurance for a household and for business (20)