Household and business manager: Insurance

10

Learning objectives

In this chapter you will learn about:

1 Insurance and how it works

2 Management of risk

3 The principles of insurance

Insurance

How insurance works

Households and businesses pay insurance companies to carry the risks that they do not want to carry themselves. The money paid to the insurance company is called a **premium**.

- **Proposal:** When households or businesses want insurance, they fill out an application form for the insurance company, called a proposal.
- **Quotation:** The insurance company will quote a premium, i.e. the amount that must be paid to cover the risk(s) in the proposal. The amount of the premium depends on the degree of risk, loading, no-claims bonus and value of the item.
- **Policy:** If the customer accepts and pays the premium quoted, a policy document will be drawn up by the insurance company (the **insurer**) and sent to the **insured** (the customer). The policy sets out the terms of the contract between the insurer and the insured. This is a very important legal document.
- **Insurance claim:** If a risk that is covered by the policy actually happens, the insured will fill out a claim form describing what happened and stating the amount of money claimed. The insurance company may use an **assessor** to inspect the claim and to decide on the amount of money it will offer to pay.

Principles of insurance

- Insurable interest
- Utmost good faith (*uberrimae fidei*)
- Indemnity
- Contribution
- Subrogation

Insurable interest

You can insure something only if you **would suffer a financial loss** if the thing insured was lost or damaged.

Example: A person can insure their own house but not someone else's house.

Utmost good faith (*uberrimae fidei*)

An insured person must give **accurate and full information** to the insurance company when applying for insurance. They must keep the company informed of any change in **material facts** which affect the **level of risk** being insured.

Example: A person insuring their life must inform the insurance company if they regularly go sky-diving.

Indemnity

Insurance is intended to compensate for the actual financial loss suffered and a claim should **not give a profit to the insured person.**

Example: A person **overinsures** their house, worth €200,000, for €300,000. If a fire destroys the house, they will be paid only €200,000.

Example: A person **underinsures** their car, worth €16,000, for €8,000 to keep down their premium. If the car is crashed and sustains €4,000 in damage, the company will only pay €2,000. That is half the damage because the car was insured only for half its value. This calculation is based on the **average clause.**

Contribution

An item is **insured under two different insurance policies** with different companies. If a loss occurs, the insured person can claim for the loss only once. The insurance **companies** will arrange to **pay half** the amount claimed each.

Example: Mary's golf clubs were insured on her household insurance and also on her holiday insurance policy. When her golf clubs were lost in transit she claimed from her house insurance. The two insurance companies each contributed half of the claim amount.

Subrogation

If an insurance company pays **full compensation** in response to a claim, they have the right to:

1 **Take possession of the item insured**

Example: If the insurer pays out €8,000 to cover the full value of a crashed car, it can take the wreck and sell it off to recoup some of its money.

2 **Sue any person who is responsible for causing the loss to recover the cost.**

Example: A building is damaged by falling materials dropped by a crane working on an adjoining building. The insurance company will pay the owner of the damaged building and then has the right to sue the operators of the crane to try to recover some of the money paid out.

Average clause

Besides the five principles above, there is another important rule in insurance, called the **average clause**. This states that if something is insured for only a proportion of its value (e.g. half its actual value) the insurer is only liable for the same proportion of the loss (i.e. half) when a claim is made.

Example: Jason Morgan insured his house, worth €300,000, for only €200,000 in order to reduce the premium he had to pay. A fire in the kitchen caused €9,000 worth of damage. When he claimed €9,000 from the insurance company they refused to pay the full amount. They applied the average clause and paid out only €6,000.

Top Tip!

Make sure that you can apply the average clause and calculate the compensation payable when a claim is made.

Calculation of Average Clause	
• Actual value of house	€300,000
• House insured for	€200,000
• Proportion/average insured is	€200,000 ÷ €300,000 = ⅔
• Amount of claim	€9,000
• Compensation paid is	€9,000 x ⅔ = €6,000

Types of insurance businesses should have

- Buildings and contents insurance
- Motor insurance (third-party insurance; third-party, fire and theft insurance; comprehensive insurance)
- Product liability insurance
- Employers' liability insurance
- Public liability insurance
- Consequential loss insurance
- Fidelity guarantee insurance
- Pay Related Social Insurance (PRSI)
- Key person insurance
- Cash insurance
- Goods in transit insurance

Types of insurance households should have

- Building and contents insurance
- Motor insurance (third-party insurance; third-party, fire and theft insurance; comprehensive insurance)
- Health insurance
- Whole of life assurance
- Term life assurance
- Endowment assurance
- Pay Related Social Insurance (PRSI)
- Permanent health insurance

Top Tip!

You should be able to list some examples of both household and business insurances and compare the need for each one. In a given situation, you should be able to suggest the insurances required by a household or a business.

Risk management

Risk management involves the business **identifying the risks** it faces and then putting in place methods to reduce each of the risks. **Eliminating or reducing the risk** will reduce the need for insurance or the amount of insurance needed and the amount of losses incurred.

How to minimise/reduce risks for a business

- Install **fire prevention devices**, e.g. alarms and sprinkler systems.
- Put in place **security devices** to prevent burglaries (e.g. CCTV) or a safe to hold cash.
- Use **security procedures** to prevent loss of cash, e.g. security vans to collect cash.
- **Train staff** to avoid risks, e.g. training in fire prevention/how to use fire extinguishers.
- **Minimise the value of cash and materials held** in the business to reduce any potential loss.
- Fit **safety devices** to machinery to reduce risk of injuries to staff.

Exam question

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

Draft a business letter from EXON Insurance PLC to Bianua Ltd. Using today's date, identify the possible business risks and the appropriate types of insurance for Bianua Ltd. Use fictitious names and addresses. *(2012, 20 marks)*

Sample answer

EXON Insurance PLC
10 Top Street
Longford

Tel: 999 9999
Email: info@exon.exon

Your ref: 110799
Our ref: 998011
Date: 12/06/2012

Bianua Ltd
Main Street
Offaly

RE: Business risks and the appropriate types of insurance policy for the company

Dear Mr Murphy,

The following is a list of possible business risks and the appropriate types of insurance policy for your company.

Risk of structural damage to the factory, warehouse or office building

Buildings insurance – provides protection against loss or damage to the structure of the building caused by fire, flood or storm.

Risk of damage to stock, raw materials, components, etc.

Contents insurance – provides protection against loss or damage to contents caused by burglary, fire or flood.

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.

Risk of losing an important member of staff

Key person insurance – protects the business against the loss of a valuable staff member.

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 in the workplace.

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.

Risk of having cash or stock stolen by an employee

Fidelity guarantee insurance – protects the business against dishonesty or fraud committed by an employee.

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.

Others: *Goods in transit/Consequential loss.*

I look forward to hearing from you.

Yours faithfully,

Bríd Bryson

Bríd Bryson

Senior Risk Assessor

Marking scheme

- Layout of letter: 8 marks
  - Letterhead (1 mark), date (2 marks), RE (1 mark), name and address (1 mark), salutation (1 mark), closing salutation (1 mark) and signature (1 mark)
- Four risks: 4 x 2 marks
- Four types of insurance: 4 x 1 mark

Questions

Higher Level long questions

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

(ii) Describe three methods a manager might consider to minimise risk within a business. *(2011, 20 marks)*

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

(ii) Distinguish between insurance for a household and for a business. *(2006, 20 marks)*

3 Explain three important principles of insurance. Illustrate each principle with an example.

4 Explain the average clause as it applies to insurance. Illustrate how the average clause is applied using a numerical example. Supply your own figures.

Key-points!

- Insurance
- Management of risk
- Principles of insurance

Key-definitions!

average clause: Applies in insurance where something is underinsured. Only a proportion (average) of any claim will be paid out.

employers' liability insurance: An insurance to protect employers from claims by employees who suffer injury in the workplace.

indemnity: A principle of insurance that states that the insured person should not be able to make a profit on an insurance claim.

policy: In insurance, a policy is a document setting out the details of the contract of insurance.

premium: In insurance, the money paid to the insurer for covering a risk is called the premium.

product liability insurance: Protects a business from claims from its customers who suffer injury or loss resulting from faulty goods produced by the firm.

public liability insurance: Insurance which protects a firm against claims from members of the general public who suffer injury or loss as a result of visiting the premises of the firm.

risk management: Eliminating and reducing risks so as to reduce the amount of insurance required and the cost of paying for insurance cover, e.g. install smoke alarms to reduce the risk of fire.

subrogation: A principle of insurance which states that if the insurer pays a claim in full the insurer then has the right to salvage any remaining part of the insured item or to sue any party responsible for the loss.

third-party insurance: A type of motor insurance that provides protection against claims by parties other than the insured for injuries caused by the insured person's car.

utmost good faith: A principle of insurance that requires an applicant for insurance to be truthful in the information provided to the insurer.