Topic 5: Understand the issues surrounding the provision of insurance

After completing this topic, you will be able to:

- explain the purpose of insurance and the different types of insurance;
- define some key words and phrases used in insurance;
- understand the difference between 'life assurance' and 'general insurance';
- explain how whole-of-life assurance and endowment assurance work;
- explain how the following types of general insurance work:
  - buildings insurance;
  - contents insurance;
  - motor insurance;
  - pet insurance;
  - health insurance;
  - payments protection insurance; and
  - travel insurance;
- understand what 'insurance premium tax' is;
- list the different providers of insurance and assurance, including:
  - brokers;
  - insurance companies;
  - financial advisers;
  - banks;
  - supermarkets; and
  - motoring organisations;
- recognise the rights and responsibilities of both parties to an insurance contract, including:
  - material facts;
  - utmost good faith;
  - good faith; and
  - indemnity.

What is insurance?

Insurance is used to reduce the financial effects of a loss, whether it is the loss of an asset, or a person, or your income. There is always a risk of something happening that will mean a financial loss; insurance tries to spread this risk. You pay a 'premium' to an insurance company and if a financial loss arises as the result of the insured event, you may receive a sum of money that can help.

Insurance is a way of sharing risks. When people insure their possessions, they pay premiums, which are collected into a pool out of which the unlucky ones are paid compensation when something goes wrong.

Insurance companies are willing to cover you against loss should certain events occur because they are able to make a profit out of doing so. By looking at past loss figures, they are able to calculate how likely that event is to happen.

How insurance works

When you apply for insurance, you are trying to protect yourself against risk by asking the insurance company to pay you if an event happens. You will give the company the information that it requests. Depending on the type of insurance for which you are asking, this will include information such as your age, whether you smoke, where your car is usually parked (that is, on a driveway or in the street), what experience any drivers have or the age of your pet.

On the basis of this information, the insurance company calculates the chances of that event happening and works out a price for the insurance based on how much it would cost the company if the event were to happen. The insurance company is said to be 'underwriting' the risk and an insurance company can be referred to as an 'underwriter'.

The insurance company will give a 'quotation' – that is, a summary of the terms of the cover and its price. The price is called a 'premium'. The insurance company agrees to pay out if the event against which you are insuring happens, in which case you will make a claim on your insurance.

When you have agreed the quotation and paid the premium, the insurance company will issue a 'policy'. The policy states the type of insurance, the items covered and the circumstances under which the insurers will pay a claim.

Key words and phrases

Certificate of insurance	This is a document proving that you are insured, stating your name, address, the amount of the cover, the premium, and the dates on which the insurance starts and ends.
Claim	If the event does happen, you make a 'claim' to the insurance company, which will then pay out.
Cover	This is the amount that the insurance company agrees to pay out to the customer if the event insured happens. So, for example, if your house is covered for £120,000 in the event of a fire, this is the maximum that the insurance company will pay out to rebuild the house.
Cover note	This is a certificate issued by an insurance company stating that a policy is operative. It is used as a temporary measure between the commencement of cover and the issue of the policy. The cover note is important for car insurance, because you must, at all times, have evidence that your insurance meets the legal requirements for driving a car.
Excess	This is a proportion of any claim that the customer will pay themselves. It is usually paid on car insurance policies: for example, if you have an accident and the repairs to your car will cost £1,000, an excess of £100 will mean that you will pay £100 and the insurance company will pay the other £900. The higher the excess, the cheaper the premium because the insurance company has to pay out less if the event occurs.
No-claims bonus	This is often a feature of car insurance, although it can also be given for other types of general insurance. The no-claims bonus is a reduction in the premium that the company gives you because you have not made a claim in a certain period of time. No-claims bonuses can be quite valuable and be worth as much as 75 per cent for five years' claim-free driving.
Policy	This is the name of the insurance that you buy. You might say, for example, 'I have a house insurance policy' or 'This is my car insurance policy'.
Premium	This is the price quoted by the insurance company for the insurance. This can be paid as one lump sum, or the insurance company may accept it in instalments, eg monthly, by direct debit or standing order.

Schedule	This is a list of items that are insured and for what they are insured. So, for example, if your home contents are insured, the schedule might include your freezer and might state that the insurance company will pay out to replace the items in the freezer in the case of a power cut, during which the freezer is turned off and everything in it is ruined.
Sum assured	This is the amount of cover when referring to a life assurance policy.
Sum insured	This is another way of saying the amount of cover.

There are two main types of insurance:

- life assurance; and
- general insurance.

The two words 'insurance' and 'assurance' have slightly different meanings.

- **Insurance** is for an event that *might* happen, such as a fire or an item being stolen.
- **Assurance** is for an event that *will* happen, the only such event being death.

In this world, nothing can be said to be certain, except death and taxes.

Benjamin Franklin (1706–90)

Life assurance

Life assurance pays out if you die. We choose to take out life assurance (also called 'life cover') to protect people who depend on us financially. Life assurance pays out a lump sum to the people left behind.

In order to take out life assurance on another person, you must have an 'insurable interest' in their life. Married people or partners have an insurable interest in each other, but you cannot insure the life of a stranger, because you have nothing to lose from this person's death.

The life of the person being covered is known as the 'life assured'.

There are different types of life assurance:

- whole-of-life; and
- endowment.

Whole-of-life

Whole-of-life assurance pays out an agreed sum when you die, whenever that may be. This type of cover will pay an amount of money that could be used to repay borrowings, such as a mortgage, if the person who has died was the main wage-earner, or to pay for funeral costs.

Endowment

An endowment is a policy that pays out if you die – and also if you do not die.

The endowment policy will pay a sum of money if death occurs before an agreed date. The life company will invest part of each month's premium and use the rest to provide the life cover. If the policy reaches the agreed date and the life assured has not died, the insurance company will pay a sum of money. This is calculated on how much the investments have increased in value.

An endowment policy therefore allows you to save, as well as provides you with life assurance. You do not feel that your premiums are being wasted – especially when the chances of death for someone who is of working age are quite low.

General insurance

General insurance refers to all of those types of insurance that are *not* life assurance. As long as the insurance is not for paying out on death, it is called 'general insurance'.

So this definition covers just about all of the other types of insurance that are available, including the following.

House insurance

Our houses are a very expensive possession and we also keep a lot of valuable items inside them. The cost of damage to our houses can be high and so this is an important financial risk that should be insured.

Buildings insurance

Buildings insurance usually pays out if fire, floods or subsidence destroy your property.

You may have read about floods in the UK and seen the damage that can be done to properties. We also know that a fire in a house can cause a lot of damage to the contents and to the buildings themselves.

Although you are not required by law to have buildings insurance, many houses are used as security for loans – especially mortgages. In this case, the lender will insist on buildings insurance.

Did you know?

Figures published by the Association of British Insurers (ABI) in 2010 showed a 200 per cent increase in claims resulting from flood damage since 2000. Between 2000 and 2010, insurers paid out £4.5bn to customers whose homes or businesses were hit by flooding. The widespread floods of summer 2007 alone cost £3bn.

Source: www.abi.org.uk

Home contents insurance

Home contents insurance covers the loss or damage to the contents of your home, and can include your furniture, electrical goods and valuables. You can also, for an extra premium, get cover for items that are taken outside the home, such as jewellery, cameras and laptops.

While different policies offer different types of cover, common to all will be cover against fire and theft. For an additional premium, you will usually be able to insure contents for damage caused by accidents, such as paint being spilled on a carpet, or damage caused by dropping your phone or MP3 player.

Motor insurance

The law says that you must have basic motor insurance if you own or drive a motor vehicle. You can also choose to have a higher level of cover, such as one of the following.

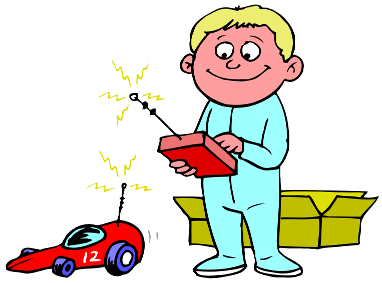
- **Third-party, fire and theft**

  The basic cover that you have to have by law is insurance to cover you against liability for injury and damage to third parties – that is, people other than yourself, such as other drivers and pedestrians. Most insurance companies do, however, offer more than the legal minimum, adding fire and theft to the cover.

- **Fully comprehensive**

  This is a voluntary type of insurance and covers accidental damage to your vehicle, even if it caused by your own driving. Premiums for this type of cover are much more expensive, but are well worth considering if your car is an expensive model and you cannot afford the financial costs of an accident.

At the beginning of this topic, we considered the process of obtaining a quotation from the insurance company. Car insurance quotations can vary quite a bit, depending on the age and driving experience of the policyholder, and the town in which the car is kept. The make and model of car also affects the premium: cars with quick acceleration, for example, are more expensive.



Did you know?

Direct Line demands a compulsory excess of up to £450 for young or inexperienced drivers under the age of 21.

Source: www.directline.com

Pet insurance

Pet insurance can cover you against the cost of vet's bills for your pet. The types of bill covered are those for an accident to your pet or for a serious illness. Pet insurance does not cover routine vaccinations and other items, such as nail clipping.

Did you know?

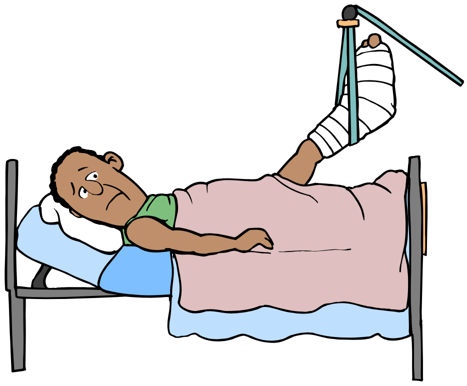
Fixing a cat's broken leg can cost £825. Surgery for a dog that has eaten something dangerous can cost £1,500.

Source: www.moneysavingexpert.com

Health insurance

You can insure yourself for private health treatment, to reduce the financial effects of an injury or the need for an operation. You can pay to visit a doctor or consultant at a time of your choosing and the insurance company will pay all or part of the bill. This depends on the amount of premiums that you have paid.

If you have to go to hospital, you can also choose the date of your operation and not have to take the dates offered by your local National Health Service (NHS) hospital.



The financial effects of an injury or the need to have an operation could result from loss of earnings if you cannot work while waiting for an operation, or the inconvenience of having to take a particular date for a doctor's appointment.

Payment protection insurance (PPI)

Payment protection insurance (PPI) can cover your monthly loan repayments if your salary drops as a result of accident, sickness or unemployment. The policies will pay out for only a fixed period of time, such as 12 months.

The insurance is linked to the repayments of a particular lending product and may be offered at the same time as the lender agrees to make the credit available.

For example, you may want to protect the payments on a personal loan. You will need to think carefully about the extra premium that is being paid and whether the risk of losing your job or being so ill that you cannot work is worth the extra payments.

Payment protection insurance can be extremely useful, although many PPI policies have been mis-sold alongside loans, credit cards and mortgages over the years to people who did not need them, were ineligible to claim the benefits for one reason or another, or did not even realise that the policy had been included as part of the loan repayments. Some lenders developed sales scripts for their customer service advisers to follow that included a statement that the loan was 'protected', without explaining that this protection was provided in the form of an insurance policy – a policy that the customer should have been given the opportunity to opt out of taking.

Several companies have been fined for mis-selling this product and many customers are being encouraged (through advertising campaigns and telephone calls) to make a claim against their lender if they feel that they may have been wrongly sold this product. Those whose claims are successful are not only given back the insurance premiums, but are also able to claim the interest that this money would have earned had it been in a savings account.

Travel insurance

Taking out travel insurance can help you to get financial and practical help if something goes wrong on your trip. Unfortunately, illness, theft or accidents can happen anywhere.

For example, a travel insurance policy should cover:

- medical and health cover in the event of an injury or sudden illness while you are abroad;
- the cost of replacing lost or stolen possessions;
- the costs of cancellation and curtailment (that is, cutting your trip short).

Dangerous or risky activities, such as jet skiing, are commonly excluded from policies.

Did you know?

Holiday Extras quotes an excess of £75 for lost or stolen baggage in its travel insurance policy.

Source: www.holidayextras.co.uk

Activity 5a

Discuss all of the things that could go wrong when you are travelling abroad. Think about those that you would have to pay to sort out.

Insurance premium tax (IPT)

All insurance premiums are taxed. This means that, on top of the premium payable to the insurance company, the customer has to pay an additional amount of money, which is collected by the insurance company and passed to the government. This makes the premiums more expensive, but it has to be paid.

Did you know?

There are two rates of IPT:

- a standard rate of 6 per cent (which applies to most insurance policies); and
- a higher rate of 20 per cent for travel insurance.

Providers of insurance

There are many providers of insurance products, a few of which we will look at below. Others are covered elsewhere in the unit.

All of these providers have to be regulated by the Financial Conduct Authority (FCA). The FCA ensures that all companies offering insurance advice have trained staff, and that information given websites and in leaflets, for example, is accurate and clear.

Insurance companies

An insurance company is the company that takes on the risk, accepts your premium and ultimately pays out if the insured event happens. Insurance companies are the 'underwriters' of the insurance. They assess the risk and work out a premium based on the amount of money that they would need to pay you if the insured event were to happen.

Insurance companies take premiums from thousands of customers every year, but only a few unlucky ones have to make a claim.

Activity 5b

List as many insurance companies as you can. It might help you to think about some of the adverts that you see.

Visit www.find.co.uk and see how your list compares with that offered under the heading 'A–Z lists of insurance companies'.

Insurance broker

An insurance broker finds suitable general insurance for their customers. They have good knowledge of the market and can find the best product.

A broker will be paid a fee, either by the customer or by the insurance company. The broker has to tell you how the fee will be earned and at what rate.

Financial adviser

Financial advisers are people who give advice to customers on financial services, such as savings, investments, pensions and insurance policies. They can be independent or they can work for a single company or group of companies.

Financial advisers are no longer allowed to receive commission if someone buys a new service through them and must instead agree a fee with the customer.

Banks and building societies

You will already be familiar with the main providers in this market. They will all offer insurance products – especially if they are lending to you as well. For example, if you apply for a mortgage, the lender will send you information about its house insurance. You do not, however, have to buy your insurance from the lender.

Supermarkets

Some supermarkets offer insurance; you will have seen the leaflets. If you look carefully at the back of the leaflet, you will usually see that a well-known insurance company or bank is also involved in providing this insurance.

Motoring organisations

Motoring organisation are groups that look after the interests of motorists. You will be familiar with them because they provide, for a fee, roadside breakdown and recovery services. The two largest of these are the AA and RAC. Both have traditionally offered car insurance and also sell other insurance products.

Activity 5c

Visit either www.theaa.com or www.rac.co.uk and look at the range of insurance products available. You will quickly see that neither organisation is restricted to motor insurance.

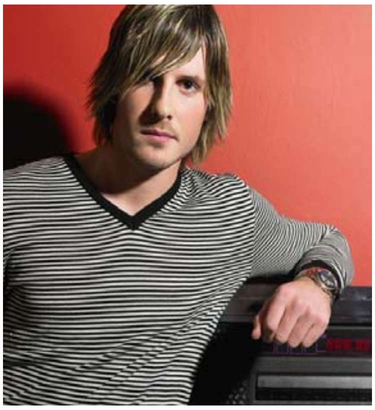
Rights and responsibilities of the parties to an insurance contract

When you are arranging a quotation with an insurance company, it will quote you a price based on its assessment of risk. This decision is made using the information that you have given to it. The insurance company is entitled to protection from your telling lies, or simply not quite telling the truth.

This protection involves some special phrases that we need to define, as follows.

'Material facts'

The 'material facts' are anything that an insurance company should expect to be told. For example, if you are asking for insurance for fire cover, you should tell the insurance company if your premises are next to a fireworks shop.



Case study

Liam has received an automatic renewal notice for his moped insurance. At the bottom of the notice, he spots a note that asks him to tell his insurer about any events during the year that might have changed the insurer's risk.

It is a material fact that Liam was caught by a speed camera doing 70 mph down a hill in a 60 mph speed area and now has three points on his licence.

'Utmost good faith'

'Utmost good faith' is the principle of insurance that applied to contracts of insurance until April 2013. Utmost good faith required customers to 'disclose accurately, honestly and completely any information that might influence the insurer's decision to enter into the contract'. This information is called 'material facts' and the insurer would rely on the facts provided by the individual to underwrite the policy. The trouble was that most customers had no idea what information would 'influence' an insurer, and so if they failed to disclose something that the insurer considered to be relevant, a claim under the policy would be rejected.

In April 2013, the Consumer (Disclosure and Representations) Act 2013 came into force, removing the requirement to 'disclose all material facts' and replacing it with a duty to 'take reasonable care not to make a misrepresentation' – in other words, to answer all questions fully and honestly, and to take care not to mislead,

'In good faith'

'In good faith' means not knowingly keeping information from the insurer. If, for example, you honestly did not know that the shop next door had fireworks in the stockroom and if there were no notices up to say that the shop sold fireworks, the insurance company would have to pay out for the damage to your house caused by an explosion of those fireworks.

In the case of a speeding fine, for example, if the camera flashed, but you have not yet had the fine notice, then this is not material and does not have to be declared. In good faith, you had not yet been fined (and perhaps there was no film in the camera).

Indemnity

The principle of 'indemnity' means that you cannot make a profit out of insurance. If you suffer a loss, the insurance payment should put you only in the same position in which you were before the event happened.

For example, if you insure a new car for £12,000, the value of the car will fall over the years for which you use it. If you have an accident after three years and the car is written off (that is, damaged beyond repair), you will receive its market value on that date and not the £12,000 that you paid for it.

Review questions

1. Explain in your own words how insurance works, using the terms ‘risk’, ‘quotation’, ‘premium’ and ‘underwriter’.

2. What are the main risks to a house and its contents?

3. What are the main risks to someone while on holiday?

4. Does insuring a risk makes the event less likely to happen?

5. Is it true that the higher the risk of someone suffering a loss, the higher will be the premium charged by an insurance company?

6. What do you call the legal principles described below?
   a) You can insure something only if it belongs to you.
   b) You cannot make a profit out of claiming on an insurance policy.

Learning activities

Internet

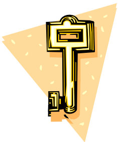
- Visit www.environment-agency.gov.uk and look at 'At home and leisure'; click on the link called 'Flood'. Read the information under the headings 'Managing flood risk' and 'Prepare for flooding' Are there any properties in your area at risk of flooding?
- Visit www.tescobank.com. Choose 'Insurance', then 'Home insurance' and then 'Policy documents'. Look at the key policy information booklet for existing customers with policies started on or after 14 September 2013.
  - What does Tesco's home contents insurance cover?
  - Is my PC covered?
  - In what cases do I need to tell Tesco about the individual value of my contents?
  - What measures does Tesco Insurance take to prevent fraud?
- Visit www.directline.com and choose 'Pet insurance'. Click on 'Get a quote' and you will be transferred to a secure connection. You will then be asked to enter some personal details – for example, your postcode and address, and your age. Type in that you are '18 or over' (it does not matter if it is not true, because you are not going to buy the insurance). You will then be asked questions about the pet that you want to insure (you can put in details of your own pet or make it up). Click on 'Continue' and see what monthly quote you are given.
- Visit a comparison website such as www.moneysupermarket.com and look at the range of types of holiday insurance. You may wish to get a quotation for yourself: look at the details of one policy, and look at the excesses and the special clauses about sports. You may find it easier to answer the questions as though you are over the age of 18.

Group

Choose several providers of insurance. Get quotations for buildings insurance. Use the same postcode and value of the buildings, and compare the premiums and terms of insurance.

Individual

When you are next standing in the queue at a supermarket, look at and read some of its leaflets about insurance.



Key points for Topic 5

You should now understand:

- the purpose of insurance and the different types of insurance;
- the following terms and be able to give an example of each one – 'material facts', 'insurable interest', 'insurance premium tax', 'premium', 'policy', 'assurance', 'excess', 'schedule', 'certificate', 'cover note', 'no-claims bonus' and 'indemnity';
- what 'life assurance' is and the two types of cover (whole-of-life and endowment);
- the following types of general insurance – house, contents, motor, pet, health, payment protection and travel;
- the following insurance providers – brokers, insurance companies, financial advisers, banks, supermarkets and motoring organisations.