SA Media - The University of the Free State

Page: 1

Source: LEADERSHIP SA

Date: 31-Jul-2003

Topic: 08

Ref No: 10245

1

ID: 02970327-01 | Source Page: 57

Businesses, insurers and reinsurers globally have been forced to re-evaluate their options in the wake of the attacks of September 11, 2001, severe acute respiratory syndrome and depressed global markets

Taking the risk out of risk management

The new reality is that companies are very vulnerable to unexpected crises in other parts of the world, and the local market has not been immune to the international trend towards higher premiums and enhanced risk management. If September 11 was the catalyst for a global rethink, then it is the reinsurance business that has had a far greater influence on the South African market than Sars or the war in Iraq. As almost all reinsurance protections are secured directly or indirectly from international markets, the impact has been acute, although big insurers claim they are trying to absorb a percentage of the increases internally. Hendri Nigrini, executive head of risk services at Santam, believes that the competitive environment in non-life insurance has dramatically changed over the last two to three years.

"The US losses in 2001 and the decline in equity markets have reduced the industry's capital base in all major markets," he said. "This initiated price increases, which are necessary for companies to shore up their balance sheets. The South African market cannot escape these global trends."

According to Steffan Gilbert, chief executive for Africa of Munich Re, the global trends include reduced investment opportunity in traditional stocks, a melt-down of capital base of insurers and reinsurers, poor performance of traditional stocks and reduced ratings of insurers and reinsurers. This has resulted in investor nervousness and a need to focus on statistically correct risk pricing. Aside from the severe hardening of reinsurance terms as overseas reinsurers struggle to come to terms with huge losses, the local market has not been substantially affected, as SA insurers have generally not had to fund these overseas losses. The most obvious trickle-down to retailers has been the demand for better quality information from insurers on risk and how it is managed. By

placing greater emphasis on the quality of data, insurers seek to pinpoint risks, especially those arising from interruptions at companies' suppliers or customers' plants. Despite these changes, there are conflicting views on how events of the past few years have affected risk management models.

Chris Fimpel, managing director of Forbes Reinsurance, said: "Risk management models have been 'turned on their heads' and risk managers must consider the potential of the 'impossible' as well as the probable."

Risk management models are now being more carefully assessed and may need to be more imaginative in the future. In general, however, it is difficult to judge how efficiently individual companies are applying risk management models. In the US, where there is far more anxiety about terrorism, some companies are creating the post of chief risk officer (CRO) as part of their in-house risk management upgrade. While this step may be unnecessary for even large multinationals trading in South Africa at the moment, there is certainly opportunity to broaden the corporate risk manager's scope to include new disciplines, ranging from corporate governance to the potential impact of a terrorist strike. Nigrini said he expected to see similar appointments being made locally as part of a "knock-on" effect, but questions the motivation behind such decisions.

"After 9/11, the Americans have become paranoid about terrorism. I think that the appointment of CROs is more about trendy good governance than anything else," he said.

Rod Pearson, managing director of the technical division at Glenrand MIB, disagreed, citing such appointments as symptomatic of the broader view organisations are taking towards risk management. While in-house risk managers, even in the US, do not prioritise terrorism insurance, one lesson learnt from September 11 is that even if a business is not directly affected by terrorism, there are indirect risks such as road closures and evacuations. By actively managing these and other property and business interruption losses, businesses can help insurers identify, assess and handle their risk.

Gilbert agreed that the establishment of CROs in South Africa was likely in the future. "This is an inevitable development," he said. "The aspect of attention to corporate risk can no longer be dealt with in a fragmented manner."

Unlike in the US where legal squabbles have in some cases caused delays, there has been no discernible slowing of claims settlement being made in South Africa over the past two years. According to Nigrini, claims settlement is probably more important than pricing and policy administration.

"This (claims settlement) is the chance where a company delivers on a promise contained in a policy document. The broker fraternity also constantly evaluates claims service. Santam is definitely not delaying claims settlement," he said.

However, opinion is mixed on whether the South African Special Risks Insurance Association (Sasria) was correct in raising its premiums for terrorism coverage by 20 percent. Detractors say the response of the government-owned risk insurer, Sasria, was a knee-jerk reaction to jitters in the global industry following massive reinsurance losses in the US. Sasria has a monopoly in the SA market, providing insurance for terrorism, riots, strikes and political incidents. The body was founded in 1976 to provide cover underwritten by the government, for special risks such as political riots that private insurers were reluctant to touch. Sasria later extended its cover to include nonpolitical public disorder. Glenrand MIB was initially critical of the hike and Pearson says he has seen nothing to make him reconsider, especially following Sasria's large profits and strong assets position.

"Moreover, the increase was combined with an exclusion relating to losses connected with chemical or biological agents," he said. "This did not sit well at the time, considering the anthrax scares."

When viewed in isolation, the 20 percent increase in Sasria premiums may seem excessive, but there were mitigating factors. Nigrini points to the regulator's multi-year reinsurance arrangement (three years), which implies fixed rates, terms and conditions.

"At renewal, this would have required certain increases, further compounded by the losses of September 11 and the hardening market," he said. "Considering this, the rate increase can only be deemed reasonable."

This purchase of substantial additional reinsurance would have been at some cost, given

the state of the global reinsurance market, the increase in the tempo of international terrorism and the possible spillover to South Africa.

Fimpel added that Sasria had been lowering rates over the years and that the government had systematically stripped the body of a substantial portion of its considerable reserves. However, he doubted the increase was justified, given the historical profitability of the company.

Gilbert disagreed, arguing that he thought the regulator had found the right balance.

"It must be remembered that this market has come off many years of discounted capacity," he said. "The price corrections currently being implemented are easily justified on the basis of past performance and the state of the current financial market."

Part of the problem is that reinsurance is a truly global business. South Africa cannot avoid international drivers, whatever the local market perspective may be. The majority of South African reinsurers are subsidiaries of global companies and, according to Fimpel, what parents say, goes.

He said: "The South African reinsurance industry spend constitutes a tiny fraction of the world market and in hard conditions there is a tendency for international players to adopt a 'take it or leave it' attitude."

Consensus is that, while South Africa is part of the global village, any increases or changes in terms and conditions should be balanced and reasonable. This scenario appears highly unlikely while local reinsurers remain dependent on their foreign providers.

Iain Macindoe, the managing director of Reinsurance Consultants, said: "Local reinsurers haven't found the right balance, as they are being dictated to by their overseas parents and therefore there are generally no bespoke solutions for the SA market."

This is, to an extent, an indictment on the local market which has largely ignored the opportunity for innovative products and procedures for specific portfolios or clients.

Not many new products have been launched recently, although there has been a renewed focus on re-packaging existing products to meet the needs of certain market segments.

Fimpel said: "There has been a noticeable increase in the formation of both cell and offshore captives. Many clients are lowering insurance costs by increasing their self-insured limits or deductibles."

Part of the problem is that there are too many reinsurance brokers offering a similar service. According to Nigrini, the real challenge is the value a reinsurance broker can offer, backed by international expertise.

"Some of them focus only on niche business," he said. "At the end of the day, market forces will determine." ▲