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INSURANCE

Mammoths may squash sector's empowerment potential

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Starting a short-term insurance company is becoming more difficult, with the rising number of barriers to entry.

Insurance, at its most basic level, operates from a simple premise of sharing risk, whereby the unfortunate few who suffer a loss are compensated through the premiums paid by the many who avoided such a calamity.

The larger the risk pool, the more effective the insurance instrument. But the industry has grown, and new, advanced and sophisticated risk-management techniques are devised every day to deal with new challenges in the new economy.

Stewart Rider, the vice-president of research at Merrill Lynch, the investment bank, says capital – both financial and intellectual – access to distribution networks, and branding are the main obstacles to entrepreneurs hoping to enter the market.

High costs are forcing newcomers to undercut market prices to gain market share, "but this leads to solvency problems when they no longer have the cash to pay claims", he says.

Michael Duncan, the group director at Alexander Forbes risk services, says it is possible in this country, for a predetermined premium rate, to insure nearly everything from loss or damage. Possibilities include insurance or medical aid for pets and insurance against loss or damage caused by politically motivated acts, among others.

"In London, a pub owner went to the extent of taking out insurance to protect his profit in summer, in the event that the average temperature might drop below a certain stated figure, negatively influencing the rate of beer consumption at his

establishment," Duncan says.

And, he adds, a US publisher bought insurance to protect his business in case printing prices increased above a certain figure. The policy would pay the publisher the amount in excess of the price set in the policy.

The more bizarre the risk, the more unique the product to handle that risk. As a result, the premiums tend to be higher.

But the mind-boggling amount of capital required, in part to comply with the 25 percent solvency margin set by the financial services board to protect policyholders, makes the insurance business almost inaccessible for smaller companies.

The larger financial services companies have their fingers in just about every type of insurance product you can think of.

FirstRand, for instance, owns 46 percent of Outsurance, the short-term group; a large interest in Momentum, which recently took over Southern Life; and Discovery, the healthcare financing and life assurance group.

The top five insurers have a stranglehold on the industry. Mergers and acquisitions have created mammoths such as Mutual & Federal/CGU and Santam/Guardian, whose interests stretch across the entire assurance spectrum.

The e-economy might present a chance for wannabe insurers to enter the market by covering all manner of risks in the e-commerce environment.

For example, new risk management instruments will be needed to deal with losses caused by data corruption

caused by cyberhackers.

The opportunities to start an insurance business stretch far and wide, but the capital requirements are keeping at bay many would-be entrepreneurs, particularly black empowerment initiatives.

But Hollard Insurance, the billion-rand-a-year, short-term and life insurance group, is breathing new life into black empowerment. The group has engineered a partnership scheme, assisting several groups to set up underwriting businesses without an insurance licence.

The companies act as intermediaries, or underwriting managers, between Hollard and the broker or the insured party, and are remunerated other than by way of commission.

In turn, Hollard takes a

strategic interest in each company and helps it raise the necessary capital.

Although the general understanding in the industry is that the relationship effectively entails renting a licence to a third party, Hollard says the companies do not rent licences from it.

Instead, it works together with the companies to market and to administer the business. The product development and packaging is left to the underwriting manager, who sells the product to the brokers.

Each partner company, in effect, runs the underwriting operation as if it were an insurer.

The model has so far been relatively successful. Companies such as PetSure, the pet medical aid firm; Zimisele Underwriting Management Company, a black

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empowerment initiative in which Hollard has a 38,5 percent interest; and Legal Wise are involved with Hollard as underwriting managers.

Sometimes the underwriting manager, such as Auto & General, decides to go solo and applies for an insurance licence.

The model's appeal lies in the fact that Hollard not only allows companies to operate under its umbrella, but takes a strategic equity stake and supplies the necessary capital and technical expertise.

There are only three black-owned companies in the short-term insurance industry: Zimisele, First Central Insurance, which is under curatorship, and the Lion of Africa.

Zimisele's gross premium is about a R100 million a year - small change compared with the billions of rands accruing to the Big Five short-term insurers.

It is disturbing to note such little interest in forging black empowerment deals in this sector. If the government is serious about black economic emancipation, this is one avenue where it could empower the masses on a grand scale.

For instance, the government plans to privatise Sasria, its cash-flush political risk insurer with a net asset value of R3 billion.

It would be disastrous for black empowerment if such an opportunity is sold off to the already rich without any benefit to the economically marginalised.

But perhaps the biggest challenge is for established insurance companies to be proactive, to hunt for suitable black empowerment partners and tap into what must surely be the country's biggest source of premiums.