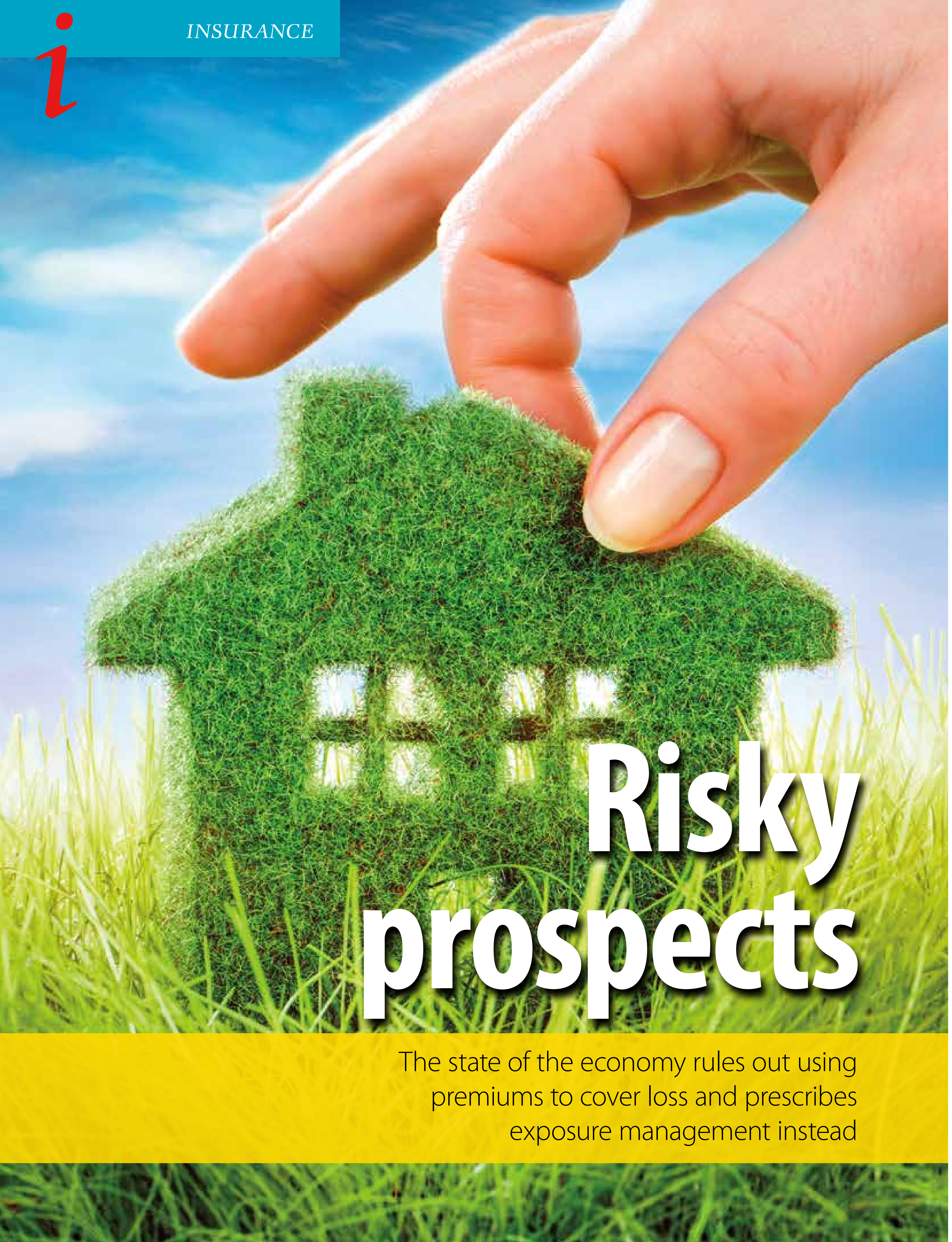

Risky prospects

The state of the economy rules out using premiums to cover loss and prescribes exposure management instead

INSURANCE

Prospects for meaningful growth in the South African economy are weak in the short to medium term, and short term. Insurers will remain under considerable pressure to maintain profitable underwriting results. While there are some positive indications that premium rates could creep up in certain lines of business, generalised rates increases will be difficult to sustain, especially in the highly competitive personal and commercial lines space.

What this means is that insurers cannot rely on increased premiums to cover a greater frequency and extent of losses. Rather, they will have to concentrate on and redouble their efforts on the management of the exposures contained in their individual risk pools.

Bluntly put, those insurers that get it right will be profitable, and those that don't, simply won't be.

For policy holders in turn, there is the potential for a win-win solution. The incentive to practise proactive risk management is that they will receive the best product and price.

When talking about risk management from an insurance perspective, one is essentially talking about the assumption of a risk by an insurer of the type, or extent that the policy holder is unable or unwilling to retain for itself.

In accepting the transfer of the risk, the insurer must satisfy itself that the policy holder, in determining which part of the risk to retain, and which to transfer, has taken all, or all of the reasonable steps available to avoid or reduce the risk.

Of course, therein lies the rub for the insurer: To what extent can the insurer make an assumption about the steps taken by the policy holder; and/or to what extent must the insurer investigate those steps itself?

To my mind, insurance risk management has to start and end with the correct understanding and measurement of the risk, and that understanding can only come from the insurer obtaining all relevant information from all sources, having discussions with intermediaries, experts and the policy holder, and then doing an in-depth assessment of the risk.

But having said that, it must be emphasised that the environment in which the insurer operates can be a very difficult one to navigate.

> The key lies in understanding the risk and in recognising that this is an ever evolving process

So, by way of some examples:

Particularly, as in the case of present-day South Africa, where we have an economy that is sluggish, individuals have their disposable incomes reduced, and corporates come under pressure to grow but to remain profitable. Where that happens, there is a very real risk that living and operating expenses are the first to be reduced and that this leads to a cut in spending on risk management. Unfortunately, this often only manifests after a period of time and, in the interim, insurers may find themselves potentially faced with a substandard risk pool.

Often as well, policy holders will follow a rules-based system of risk management as opposed to a value-based system. In effect, policy holders may do the minimum to ensure laws and regulations are not broken, rather than to ensure the risk itself is avoided or reduced. Examples of this abound in the transport industry where minimum roadworthy requirements are implemented rather than proper care and maintenance; or in the construction industry where minimum construction and health and safety standards are followed as opposed to standards that ensure the safety of workers and the public.

This position is exacerbated in emerging markets where there are many challenges facing central and local government, with considerable constraints on finance and on the human resources necessary to enforce compliance with standards. Political imperatives may overshadow practical risk management implementation in State and Parastatal infrastructure, thereby further undermining the integrity of systems and in turn increasing systemic risk.

The weather patterns are likely to remain volatile and more frequent, and severe weather events will clutter the risk environment and make risk management less certain.

It bears repeating that the key to this whole issue lies in understanding the risk and in recognising that this is an ever evolving process. Some of the fundamental factors that insurers may be able to influence follow.

It goes without saying that underwriters and risk engineers must be skilled and experienced in understanding and measuring risk. Where skill and experience is missing, insurers must commit to training and upskilling their underwriting staff. A holistic view must be taken of the whole risk acceptance protocol, realising that claims, reinsurance, accurate accounting and administration processes are essential.

Data collection and management has become vital, and insurers should ensure a wide spectrum of pertinent and appropriate information is made available to risk acceptance areas.

Policies and procedures must be established which assist underwriters in understanding and accepting risk. In general terms, this involves a greater degree of peer collaboration and adherence to protocol, bearing in mind, though, that in order to remain commercially viable, there has to be a balance between strict adherence to protocol only on the one hand, and individual flexibility that lends itself to client-centric practices on the other.

Long-term relationships between insurers, intermediaries and policy holders must be fostered. Information sharing is fundamental and it is critical to engender a trust relationship between the parties which will allow a free flow of that information. The most successful relationships are those where insurers can obtain as much information as possible about a risk and the policy holder's risk management philosophy, because underwriters will be more comfortable with accepting risk and, in return, policy holders receive a better product in terms of cover and price.

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