

**THE DEVELOPMENT OF PROFESSIONAL SHORT TERM  
REINSURANCE IN SOUTH AFRICA 1950 - 1985**

by

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## **ABSTRACT**

This thesis covers the history of short term reinsurance in South Africa from 1950 to 1985 and shows how it developed from a very limited market in which insurers generally relied on British and European professional reinsurers to a viable local market albeit with strong foreign support.

The study demonstrates that the local reinsurance market grew in parallel with the development of the South African economy and the consequent need for extensive cover arising from the country's industrial expansion. It considers the different problems of the two waves of locally established reinsurers and the different circumstances prevailing in the two distinct eras of South African short term reinsurance.

The conclusion reached is that, notwithstanding the varied results of individual reinsurers and the collapse of two local reinsurance companies, the market performed well and succeeded in meeting the needs of the South African short term insurance market.

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## CHAPTER 1

# THE ECONOMIC CONTEXT OF THE DEVELOPMENT OF PROFESSIONAL SHORT TERM REINSURANCE IN SOUTH AFRICA.

### I: INTRODUCTION

In the four decades following the Second World War the South African economy underwent massive growth and change, with this being particularly rapid from the 1950s through to the mid 1970s. Perhaps the most important feature of this development was not so much the growth of the economy, spectacular though this was, but rather its increasing sophistication. In this regard the financial sector has possibly experienced the greatest transformation, having been revolutionized from the late 1940s in terms of the scale and range of operations as well as degree of specialization. The insurance market proved to be no exception. Indeed these years were the crucial period in the development of insurance in South Africa in that they saw the emergence of a domestic South African insurance sector, in both short term and life business. At the heart of this process was the decline in the importance of branch offices of foreign insurers and the concomitant rise in the importance of South African companies. Undoubtedly one of the most important developments, at least for the short term insurance market, was the creation of a local reinsurance market. Central to this development was the emergence of a number of locally registered professional reinsurance companies. Prior to this the local reinsurance market had been extremely small, consisting only of the limited reinsurance facilities provided by the direct companies. This in turn forced the direct companies to rely almost totally for their reinsurance needs on the reinsurance markets of Britain and Europe where the professional reinsurers provided the necessary capacity. Consequently in examining the emergence and subsequent development of professional short term reinsurance companies in South Africa one is effectively considering the development of a highly specialized component of the insurance sector, from its hesitant beginnings to its maturity.

Before examining the development of the short term reinsurance market in detail it is helpful, given the highly technical and specialized nature of reinsurance, to consider the role of reinsurance in the economy. Coupled with this it is important to consider the economic context of the development of reinsurance internationally and within the South African economy. This in turn will provide a frame of reference against which to judge the development of the reinsurance market in South Africa.

## **II: ROLE OF REINSURANCE IN THE ECONOMY**

Before examining the development of reinsurance in South Africa, it is important to outline some of the basic principles and functions of reinsurance, particularly the position of the South African short term insurance sector in the economic structure.

In general terms the role of reinsurance can be summarized as follows:

- (1) To provide the widest possible spread of risk.
- (2) To give insurers the capacity that enables them to provide cover for larger sums than otherwise could be written.
- (3) To protect insurers against the accumulation of losses arising out of natural catastrophes
- (4) To share the financial burden of the additional insurances needed to fund the growth of Gross Premium Income.
- (5) To reduce insurers net liability to amounts considered appropriate to their financial resources.
- (6) To allow small insurance companies to write more business than their capital can safely afford.(1)

The fundamental principle which underpins both short term insurance and short term reinsurance is the spreading of risk amongst as great a number of risk carriers as possible, so that the burden of a major loss does not fall too heavily on any one insurer.(2) Reinsurance plays a crucial role in facilitating this spreading of risks in that the direct companies place a percentage of their business with a number of reinsurers in return for a relative percentage of the premium. (For a definition of the various forms of reinsurance see Appendix I) At the same time reinsurers, by accepting part of the direct companies risks, can offer these companies some protection against the danger of insolvency arising out of major losses, although this is not always successful, as shown by the collapse of the AA Mutual.(3) Reinsurance is particularly important for new and small insurance companies lacking a strong overseas parent, for it allows them to write a gross portfolio far in excess of their capital base thereby bringing their net retention into line with their financial resources. Indeed it can hardly be coincidental that the 'domestication' of short term insurance in South Africa, involving as it did the proliferation of small and weak insurers, occurred only after the local reinsurance market was well established. Thus reinsurance offices can be seen as playing a role in the development of local direct insurance companies.(4) In this process both insurance companies directly, and hence reinsurance companies indirectly, provide the means by which business can minimize the impact of the loss of, or damage to assets and income. The overall importance of insurance and thus of reinsurance lies in the fact that by removing some of the risks facing companies and consequently their shareholders it encourages industrial development and expansion. Investors would be less willing to expose their funds to the risks inherent in industrial development if adequate insurance cover was not available to protect their investments against loss or damage.(5) However, while the basic function of both insurance and reinsurance companies is the carrying of risks, reinsurance constitutes a separate and distinct branch of insurance. Reinsurance provides the insurance needed by the direct insurance companies to meet the world's requirements of capacity and spread of risk, which is essential in an industrial economy. It should now be clear that a key feature of reinsurance, is that reinsurance companies do not deal directly with the public, the ultimate purchasers of insurance, but exclusively with the direct companies.(6)

In theory, though at times difficult in practice, reinsurance is geared to providing assistance to insurance companies in two specific instances. First reinsurance assists the direct companies in providing the high level of cover needed for the large risks which the individual insurers or consortiums of insurers would not be able to bear. One of the consequences of the intense competition that has occurred within the direct market world-wide since the 1950s, is that cover for massive risks could not be provided through the practice of co-insurance, that is a consortium of insurers. In such

an environment it was only through reliance on reinsurance facilities that direct insurers were able to provide the level of cover needed for massive industrial undertakings.(7) Secondly, reinsurance facilities also offer the direct companies 'portfolio-wide' protection against the serious and damaging accumulation of losses over a broad range of policies that may arise from the destruction caused by major natural catastrophes such as earthquake or flood.(8) In South Africa, where there is a very great regional concentration of industry, coupled to a very considerable exposure to floods and general storm damage, reinsurance plays a crucial role in spreading and ameliorating the impact of natural catastrophes. This reinsurance spread is not merely domestic but also international with support coming from Europe, USA and Japan. Some idea of the importance of the role of reinsurance can be seen from the following statistics of net claims from natural catastrophes.

**TABLE 1.1**

**CATASTROPHE CLAIMS 1968-1984 (9)\***

<b>Year</b>	<b>Event</b>	<b>Claims (R)</b>	<b>Percent of Total Premium</b>
1968	Port Elizabeth Storm	6 176 862	24.3%
1969/70	Boland Earthquakes	4 470 431	14.8%
1979	Pretoria Hailstorm	11 736 956	5.3%
1981	Cape Floods	47 648 860	15.5%
1984	Cyclones	33 418 402	7.8%
	Cape Storms	26 031 798	6.1%
	PWV Storms	49 689 789	11.6%

\* These results are the combined net results of the direct companies and serve to indicate that the burden of these losses, large though they were, would have been far greater had local as well as international reinsurance facilities not been available.

Reinsurance plays a crucial role both in enabling the insurer to write larger individual risks than would normally be possible, and reduces the overall burden of losses on an insurer in any one year. Although these two benefits form the basic role played by reinsurance in the insurance market, there has been a tendency in recent years for the direct market to seek reinsurance cover for those forms and levels of risks which have conventionally fallen within the net retention of the direct com-

panies such as low individual risk exposure business. In particular there has been a marked rise during the 1980s in the degree to which insurers seek reinsurance cover for personal accident and motor business. This is a reflection of the potential collective losses involved in such forms of insurance rather than the size of these risks per se.(10)

The process of the spreading of risks does not end with the acceptance by the reinsurers of business from the direct companies. Reinsurance companies themselves seek to reduce their own exposure on certain risks or classes of risks via further reinsurance, that is through retrocession to other reinsurance companies. The process of retrocession allows the subdivision of risks to the point that even the largest of risks which have been accepted by the reinsurance company form only a small part of that company's total exposure.(11) Retrocession in turn rests on the existence of a large number of reinsurers amongst whom the various risks can be spread. In the case of the relatively small reinsurance market in South Africa, this of necessity entails dependence on foreign reinsurance companies for retrocession, as indicated by Table 1.2.

**TABLE 1.2**

**RETROCESSION PATTERN IN SOUTH AFRICA 1971-1983.(12)**

<b>Year</b>	<b>Percentage Placed Locally</b>	<b>Percentage Placed Overseas</b>
1971	6.0%	84.0%
1973	8.6%	91.4%
1975	3.9%	96.1%
1977	5.2%	94.8%
1979	5.8%	94.2%
1981	6.0%	94.0%
1983	3.5%	96.5%

These figures highlight a further important feature and principle of reinsurance, namely that it is a business which transcends national boundaries. Indeed it can be argued that the central principle on which reinsurance is based is the spreading of risks as widely as possible, not just within the economy of one country but internationally. Reinsurance, by channeling part of the aforementioned catastrophic losses overseas, effectively serves to reduce the impact of an accumulation

of natural disasters such as occurred in 1984 and 1987 on the domestic economy. In particular reinsurance led to a very substantial inflow of foreign capital into South Africa in the form of claims payments. As such "international reinsurance is not only an insurance against large losses but also against a lack of foreign currency at short notice."<sup>(13)</sup> For a country such as South Africa, with a geographically concentrated industrial sector, the cost of reconstruction after a major natural catastrophe if borne locally could constitute a substantial part of the country's national income. However, where a large part of these losses are borne by foreign reinsurers via retrocession, the cost of reconstruction is vastly reduced. Indeed an international spread of business via retrocession overseas is necessary to protect a country against a domestic catastrophe where the total market premium income would be insufficient to absorb the total claims. This is graphically illustrated by the case of Guatemala where the country's total premium income for 1976 was around US \$ 18 million while the claims arising from the earthquake of that year totaled US \$ 75 million.<sup>(14)</sup> This brings up one fairly contentious issue, namely that reinsurance via retrocession, leads to a large outflow of capital from South Africa. It is, however, incorrect to measure the cost of reinsurance in terms of retrocession premiums ceded overseas and what is crucial is the profitability of the business. Ultimately it is the difference between premiums on one hand and losses on the other which determines the direction of the capital flow into and out of the country. Consequently capital leaves the country when insurance business is profitable and enters the country when the direct insurance market makes a loss. However, in many instances the outflow of premium is offset by the obtaining of reciprocal business. The key point to note is that while a large and concentrated inflow of capital occurs when the market is in a period of difficulty, the outflow of capital to foreign reinsurers when the market is enjoying a period of prosperity is insignificant both in terms of the absolute level of that outflow and in terms of a percentage of overall premium income.<sup>(15)</sup>

### **III: ECONOMIC CONTEXT OF THE DEVELOPMENT OF REINSURANCE.**

#### **INTERNATIONAL BACKGROUND**

Although the earliest records of insurance transactions come from the trading entrepôts of Northern Italy during the Middle Ages, it was only with the Commercial Revolution of the 16th and 17th centuries, centred on Amsterdam and London, that insurance began to develop along formal lines.<sup>(16)</sup> With the rapid expansion of trade, both in terms of volume and geographic spread, the institutional basis of the Dutch, and subsequently the English, economies underwent rapid and far reaching changes. In particular the increasing complexity of trade gave rise to commercial and financial

specialization. It was in this environment of economic growth and financial experimentation that insurance came to be organized on a formal basis. At this time insurance was overwhelmingly, if not exclusively, marine insurance, though by the end of the 17th century fire insurance had begun to emerge as an important component of the insurance market. In view of the nature of the European economies up to this time with shipping constituting the main form of large scale commercial capital investment, it was inevitable that insurance would be orientated towards the provision of marine cover. Certainly marine insurance was essential for the smooth and orderly development of worldwide trade because it enabled the risks inherent in ship-owning to be spread, thus facilitating and encouraging further investment in shipping.(17) However, this period also saw the growth of a rudimentary manufacturing base in both Britain and the Netherlands, but more importantly there was a rapid increase in the storing and linked processing of colonial raw materials for re-export from the entrepôts of Amsterdam and London. There followed a very significant growth in the demand for insurance cover for property, laying the basis for the emergence of fire insurance. This was particularly important in England following the Great Fire of London in 1666, because this conflagration awoke property owners, particularly the owners of commercial property, to the vulnerability of fixed property to destruction by fire.(18) The essential feature which must be recognized is that the emergence of insurance was a result of the increasing level of capital investment in both trade and production. This increasing tendency towards large scale concentrated capital investment exposed the investor to the danger of a catastrophic loss and possible bankruptcy should his investment be destroyed or lost.(19) In very general terms it was the need to guard against such losses and the consequent demand of investors for such a facility which led to the emergence of the direct insurance market from the 16th and 17th centuries.

Just as it was the growth in the scale of capital investment in commerce and industry, and the consequent growth in risks, during and after the Commercial Revolution which was responsible for the emergence of professional insurers, so too was it the continuing growth of industrial and commercial risks in the late 18th and more particularly the 19th century which led to the development of reinsurance.(20) However, in direct contrast to insurance, reinsurance developed most rapidly on the continent, particularly in Germany, rather than in Britain. In part this was a result of various legal restrictions on reinsurance in Britain, where marine reinsurance, for instance, was prohibited from 1746 to 1864. More importantly the structure and strength of the British insurance market was such that it was able to provide the level and spread of the cover needed by the industrializing economy without recourse to reinsurance facilities, at least until the late 19th century.(21) On the one hand this was a product of the size and financial strength of British insurance companies by the

late 18th century as well as the large number of insurance companies. On the other it stemmed from the unique success of Lloyds as a means for primary risk sharing via co-insurance which facilitated the insurance of even the largest risks, thereby obviating the need for reinsurance.(22) A further possible reason why reinsurance failed to develop in Britain was that industrial concerns, thus industrial risks, tended to be smaller than was the case in Germany in the later 19th century where a high degree of industrial concentration occurred.(23) By contrast on the continent it rapidly became apparent following the initial development of joint stock insurance companies, that there was a great need for reinsurance facilities to allow the direct insurance companies to provide the cover needed by the rapidly industrializing economies. This was because of the continuing increases in insured values brought about by rapid industrialization. Not only were insurance companies on the continent generally smaller and less secure than in Britain but the competition between these rapidly growing young insurance companies was fiercer than in Britain, thus limiting the possibility of the practice of co-insurance. Moreover in contrast to Britain there were generally far fewer insurance companies in continental countries, making it still more difficult to achieve an effective co-insurance of risks. Consequently there was a need for an alternative means of achieving the necessary capacity and spread of risks, and continental insurers found it could best be provided by reinsurance.(24) This growing demand for reinsurance cover which accompanied the industrial development of Europe in the second half of the 19th century was met initially via reinsurance contracts between direct insurers themselves. It became apparent, however, that these arrangements were unable to meet the need for cover, both in terms of the level of capacity and the spread of risks, as well as in terms of the confidentiality of information. As a consequence, from the mid 19th century a number of specialized, or professional, reinsurance companies emerged. The first was the Cologne Reinsurance Company which was founded in 1846 but only commenced operations in 1852 owing to numerous business difficulties they faced and the political upheavals of 1848/9.(25) The example of the Kolnische Ruck was promptly followed by the Aachener Ruck in 1853, the Frankfurter Ruck in 1857 and the Magdeburger Ruck in 1862. This rapid development of professional reinsurance facilities in Germany was remarkable in that these early companies were successful and survived the initial difficulties.(26)

Subsequently the two most important international reinsurance groups today, the Swiss Reinsurance Company and the Munich Reinsurance Company were founded in 1864 and 1880 respectively.(27) The development in Britain was very different with the first professional reinsurer,

The Reinsurance Company Ltd, being founded in 1867 and going into liquidation in 1871.(28) This early failure did not discourage the formation of other reinsurance companies which ultimately were equally unsuccessful, as Table 1.3 shows.

**TABLE 1.3**

**EARLY BRITISH REINSURERS 1867-1900.(29)**

<b>Formed</b>	<b>Name</b>	<b>Liquidated</b>
1867	Reinsurance Company Ltd.	1871
1873	London General Re.	1874
1874	Fire Reinsurance Corporation	1882
1875	Fire Guarantee Association.	1876
1877	Four Reinsurance Companies, the last being liquidated in 1893.	

In the following three decades there was a succession of other unsuccessful formations, and the first successful British reinsurer, Mercantile and General did not come into being until 1907. Consequently German reinsurers enjoyed a leading role in the international reinsurance market prior to the outbreak of the First World War, a position which they have managed to maintain to the present day.(30) The trend towards specialization within the overall insurance sector was reinforced by the practice of insurance companies of setting up "in house" reinsurance companies, totally or largely owned by the founder which handled all or at least a major part of their parent company's reinsurance business. A variation of this theme was the practice of a number of direct companies combining to set up a reinsurance company to meet the direct market's need for reinsurance. It is clear that it was the growth of industry and the rapid increase in the size of individual and combined risks, coupled with the inability of the direct companies to provide the necessary insurance cover by themselves, which led to the development of professional reinsurance companies in Europe in the second half of the 19th century.(31)

Within this overall development of short term reinsurance, the various classes of business and forms of cover emerged at different times and under very different circumstances. As with insurance the first branch of reinsurance to develop was marine reinsurance, which emerged on a formal basis

during the 17th and 18th centuries. During that period references to the use and transaction of marine reinsurance occurred in commercial regulations and ordinances dealing with maritime law in France, Germany, Spain and Britain. Arguably marine reinsurance emerged at this early date because of the considerable capital employed in ships and their cargoes and the very great risks involved in shipping in those days.(32) Fire reinsurance developed much later than marine reinsurance, emerging only in the 1820s and as might be expected from the points noted already, it developed as a regular practice considerably earlier on the continent than in Britain. Right up to the end of the last quarter of the 19th century the bulk of fire reinsurance business, both in Britain and on the continent was conducted on a facultative basis. It was only from the early 20th century that the practice of treaty reinsurance became the normal procedure in fire reinsurance, with facultative business being used for those particularly large risks which lay outside treaty limits.(33) The 1890s also saw one other important development in reinsurance, namely the introduction, by Cuthbert Heath, of the concept of excess of loss reinsurance, for up to this point all business had been conducted on a proportional basis. However, it was only from the end of the Second World War that excess of loss reinsurance has really come of age.(34) This was largely a result of the general extension of fire policies to include catastrophic hazards such as earthquakes and windstorm. The final branch of reinsurance to develop was accident reinsurance which emerged in parallel with accident insurance in the 19th century and even more strongly in the early 20th century as accident insurance grew.(35)

Although the six decades between the emergence of the Cologne Reinsurance Company in 1852 and the outbreak of the First World War in 1914 saw the growth of professional reinsurance, it was only in the three to four decades following the end of the Second World War that a truly international professional reinsurance market came into being for the developed and developing world. Essentially the post-war decades have seen two distinct but interlinked processes at work. These were first a rapid increase in the level of reinsurance cover sought world-wide, with the total volume of reinsurance business increasing disproportionately to the extremely rapid growth of the world economy.(36) Secondly there was a rapid expansion in the number of reinsurance companies world-wide, with it being estimated that of the approximately 420 reinsurance companies operating throughout the world in the early 1980s, some 75% had emerged since the 1950s. An allied development at this time was new forms of reinsurance organizations to meet or manipulate the growing need for reinsurance cover, particularly in the Third World. (37)

Four main factors lie behind the growth of international reinsurance.(38) First the scale of modern industrial and commercial operations has increased so much over the past 30 to 40 years that the proportion of risks requiring reinsurance has increased dramatically. Secondly inflation has eroded the real value of insurance companies retentions and while insurers retention levels have increased, the increase has not been proportionate to the increase in insured values consequently increasing the proportion of business requiring reinsurance. Thirdly the extension of fire policies to include windstorm and earthquake has given rise to very great accumulations of risks exposed to a single event generating a significant increase in the demand for catastrophe reinsurance protection, which hardly existed twenty to thirty years previously. Lastly the development of the insurance sector within the Third World led to the formation of hundreds of local companies which wrote an increasing proportion of the direct business available in that country. The retention levels of these companies were inevitably much lower than of the foreign insurers which had previously dominated the market, thus creating a greater demand for reinsurance cover. This final point leads on to the second major development which has occurred within the international reinsurance market since the Second World War, namely the explosion in the number of reinsurance companies operating world-wide.

While some growth has occurred within the established markets of Western Europe and North America, the bulk of the expansion occurred in the Third World where reinsurance facilities had previously not been available.(39) Broadly speaking this was a product of both the expansion of "core" reinsurers into the markets of the "periphery", and a result of local initiative from within the developing countries.(40) With the economic boom in the United States and much of Western Europe following the end of the Second World War, there was a massive and rapid expansion in the volume of business written by the major European and American reinsurers. As this growth emanated almost exclusively from European and/or American business, many reinsurers found themselves with increasingly imbalanced portfolios. Because this constituted a potentially serious weakness some reinsurers, most notably the Swiss Reinsurance Company, expanded their operations and hence representation into the "new" markets of the developing world. From these developing markets large international reinsurers were able to secure the additional volume and spread of business necessary to achieve a balanced portfolio.(41) Moreover, in the aftermath of the economic dislocation caused by the Second World War there was also a very real desire on the part of many of the European reinsurers to diversify geographically. This was because exclusively European reinsurance companies had lost everything in terms of business and assets during the war. Their expansion into non European markets was undertaken so that in the event of another major European

conflict the operations of these companies would not be completely disrupted, or all their assets lost.(42) Lastly from the mid 1950s the opportunities for growth in the reinsurance markets of North America and Europe were increasingly limited in spite of the rising demand for reinsurance cover. This was particularly so for the German reinsurers who had lost their traditional and important markets of Eastern Europe giving another reason for "core" reinsurers to expand into new markets, especially in view of the mounting competition between these reinsurers from the 1960s. In addition the growing and unsatisfied demand for reinsurance cover attracted these reinsurers to certain markets in the Third World. Consequently it was not merely conditions in the core which pushed reinsurers into the developing world, but also the potential of these markets which pulled reinsurers into them.(43)

Not all of the initiatives which led to the development of reinsurance facilities in the Third World were a product of an impulse coming from the core economies of North America and Western Europe, and a degree of initiative also came from the periphery. It was not so much private enterprise which played the crucial role, but rather the direct or indirect intervention of governments in the insurance sector.(44) In the post colonial era there has been large scale state intervention in the economies of most developing countries inspired by the socialist inclinations and Third World economic nationalism. The insurance sector has not escaped such intervention with many governments trying to establish local insurance and reinsurance markets. Usually two general paths have been followed, with the degree and form of intervention being determined by the extent to which the insurance sector has self-evolved. The first form of intervention essentially involved governments drafting legislation which forced foreign insurers and reinsurers to register their operations as nominally independent local companies if they wished to write business in that country. Generally this has been the pattern in those developing countries with a relatively advanced, but foreign dominated insurance sector. This in turn goes a long way in explaining the expansion in the number of reinsurance companies world-wide, so that what could have been branch operations were forced by legislation to be registered as independent reinsurance companies.(45) The second form of government intervention is participation in the insurance sector by establishing national reinsurance companies. This has been aimed primarily at meeting the needs of the local insurance market for reinsurance cover while reducing the country's dependence on foreign reinsurers and thus limiting the outflow of foreign exchange.(46) Although in certain South American countries national reinsurance companies were established as early as the 1920s, direct government intervention in the reinsurance market has been an essentially recent development, with the trend having been most conspicuous in the past twenty years. This highlights the fact that such intervention has

primarily been a feature of the post independence economic development which has occurred in Africa and Asia, where there has been a perceived need to "force" the development of the insurance sector. Generally these national reinsurance companies have been established on the basis of the company receiving compulsory cessions from all the local direct insurers, fixed as a percentage of their gross or surplus business. In addition many of these national reinsurance companies actively seek non compulsory reinsurance business as well. While these national reinsurance companies in many ways assist the development of local insurance they have serious weaknesses and are arguably fundamentally flawed, because they do not achieve the ideal broad spread of risks having an imbalanced portfolio from focusing almost exclusively on local business, and the difficulty of attracting good quality foreign business.(47) Partly in response to this, from the late 1970s a further form of government intervention emerged with the establishment of regional reinsurance corporations through the activities of the United Nations Conference on Trade and Development. "The most significant of these regional reinsurance corporations to date have been the Asian Reinsurance Corporation and the African Reinsurance Corporation. The latter is the most comprehensive with a 5% compulsory cession of all the reinsurances of all the insurance companies in forty two countries in Africa."(48)

Overall this highlights the fact that the development of reinsurance in the Third World in the past twenty to thirty years was both a product of foreign private initiative and local government intervention. South Africa was to prove no exception to this, and when considering the development of reinsurance in South Africa it is crucial to recognize that this occurred within the context of the worldwide growth of reinsurance. Many of those factors which caused the initial emergence and subsequent evolution of the South African reinsurance market were the same as those which had led to such developments in other parts of the world.

#### **IV: ECONOMIC CONTEXT OF THE DEVELOPMENT OF REINSURANCE:**

##### **SOUTH AFRICAN BACKGROUND.**

Essentially those factors which were responsible for the initial development of reinsurance in Europe in the mid 19th century also lay at the heart of the development of reinsurance in South Africa a century later, when the emergence of a short term reinsurance market occurred in line with the growth of the economy. Individual insurance companies had generally been able to bear the

risks associated with the agricultural and even the mining sectors which had dominated the South African economy up to the Second World War. With the diversification into secondary industry from the interwar years, and the larger and larger factories which emerged as a result of this, individual insurance companies were increasingly less able to bear these industrial risks. Moreover because of this, there was also a need for a wider spread of risks than could be provided by the direct market alone.(49) It is important to place the development of reinsurance in the specific context of development of secondary industry and the linked growth of the financial sector in South Africa.

South Africa's industrial development began during the First World War, but particularly during the interwar years as a result of the measures adopted by Herzog's Pact government from 1924. The scale of this industrial growth is indicated by Table 1.4.

**TABLE 1.4**

**DEVELOPMENT OF SECONDARY INDUSTRY IN SOUTH AFRICA  
1915-1939.(50)**

	<b>Gross Value of Output (R'000)</b>	<b>Level of Employment ('000)</b>	<b>No. of Industrial Concerns</b>
1915-6	71 398	89	3 638
1919-20	153 698	125	5 961
1924-5	114 608	115	6 009
1929-30	156 850	142	6 472
1934-5	190 746	182	7 636
1938-9	281 174	236	8 614

From this it is evident that the growth of secondary industry between the outbreak of the First World War and the outbreak of the Second World War was, in percentage terms, very rapid. Indeed the annual industrial growth rate was in the region of 12-13% per annum during this period, albeit from an extremely small base. However, in spite of this rapid growth the industrial sector in South Africa remained essentially small and vulnerable, being of only minor importance to the economy. In considering the industrial development in South Africa between the wars, as it im-

pinged on the development of the short term insurance and reinsurance markets, a number of factors are of particular note. While the development of import replacing industries during the First World War was undoubtedly important in expanding South Africa's industrial base, much of the apparent increase in gross output was a result of inflationary pressures in the international economy, and the expansion of the industrial sector was considerably slower than these figures suggest. Although the First World War and subsequent post war boom had stimulated remarkable industrial expansion, at least in nominal terms, much of this growth was economically unsound, being a product of the artificial prosperity generated by the war. That this was so is indicated by the effect which the post war depression had on local industry during the early 1920s, with gross industrial output declining from R 159 million in 1920 to R 116 million in 1922.(51) The coming to power of the Pact government in 1924 caused something of a recovery, and with increased government assistance the industrial sector continued to grow throughout the interwar period, though the rate of growth fluctuated markedly. In terms of the demand for insurance cover what was important was not so much the scale of the expansion but rather the nature of this industrial growth. Two factors are of particular importance. First the greatest part of this expansion occurred in light and relatively basic industries such as the processing of agricultural and timber products, clothing, textiles and paper products, rather than in heavy, sophisticated industries.(52) Secondly the size of the individual factories were generally small and not particularly capital intensive, an inevitable result of the nature of the industrial expansion.(53) What this meant was that the demand for insurance cover from the industrial sector did not increase rapidly because while the number of industrial risks increased rapidly the insured values of individual risks did not increase proportionally. Because of this the direct companies could easily bear the increased demand for insurance. This was particularly so as in the absence of high rates of inflation during the interwar years the financial bases of these insurers generally grew in line with insured values. While substantial industrial progress had been made during these years the fact remains that in a very real sense South Africa still possessed a narrowly based economy in which secondary industry played only a minimal role in comparison to mining and agriculture. The scale and more importantly the nature of this growth was such that it did not provide a major stimulus to the direct insurance market, and certainly did not create a need and hence demand for reinsurance.(54)

While the industrial growth of the interwar years laid the basis of the modern South African industrial sector it was the Second World War which effectively signalled South Africa's industrial take off. The process of industrial development occurring from the moves towards import substitution undertaken during the Second World War marked the beginning of a period of nearly con-

tinuous and extremely rapid industrial growth which was to last until the late 1970s. During the Second World War and in the post war decades the industrial sector came to be the dominant driving force behind the growth of the South African economy. Indeed it was in this period that secondary industry eclipsed mining as the most important sector of the economy. Moreover 1965 saw the share of manufacturing in the Gross Domestic Product exceed the combined contribution of mining and agriculture.(55) While the period 1951 to 1975 witnessed an average industrial growth rate of well over 5% per annum, this was not a period of even growth, with there being two main bursts of expansion. In 1960-1, after more than a decade of continuous growth and industrial diversification the economy experienced a sharp downturn as a result of the political crisis generated by Sharpeville and the declaration of the Republic leading to a massive outflow of capital.(56) In spite of this, from 1962, an upswing occurred leading to an industrial boom in the first half of the 1960s with the industrial growth rate touching 6% per annum. The rate of growth declined marginally from the late 1960s, but industrial growth continued at a high level until the mid-1970s. Consequently by 1976 the contribution of manufacturing to the gross domestic product had reached 24.5%.(57) Some idea of the extent of this growth is provided by Table 1.5.

**TABLE 1.5**

**DEVELOPMENT OF SECONDARY INDUSTRY IN SOUTH AFRICA  
1950-1976.(58)**

	<b>Gross Value of Output (R'000)</b>	<b>Level of Employment</b>	<b>No of Industrial Concerns *</b>
1940-1	379 698	273 779	8 599
1945-6	669 108	379 022	9 642
1950-1	1 583 208	543 252	12 983
1955-6	2 333 905	639 935	10 378
1960-1	3 023 986	688 843	11 885
1966	5 104 399	941 848	12 727
1970	7 404 219	1 073 689	11 833
1976	20 239 729	1 349 485	15 222

\* Basis of calculation changed between 1950-1 and 1955-6.

Rapid though the industrial expansion was, what was probably more significant was that this was accompanied by a major structural transformation of the secondary sector. Prior to the Second World War, processed agricultural products, clothing and textiles, as well as wood and paper products constituted around 60% of South Africa's total industrial production. The dislocation of trade during the Second World War caused this to change. From the 1950s the industries engaged in the production of transport equipment, machinery, paper and printing products, chemicals, and base metals surged far ahead of the previous main industries in terms of growth.(59) Consequently the three and a half decades from the end of the Second World War through to the 1980s saw the industrial sector shift from having an overwhelming concentration on consumer goods to the production of a wide range of intermediate and capital goods. As a direct result of this the scale of individual factories increased massively while the value and sophistication of the capital equipment within such factories also increased sharply.(60) Because of this there was a huge increase in the insured values of individual factories as well as in the total insured value of the industrial sector. This industrial development was accompanied by a concentration into progressively larger units, causing the insured values of individual industrial risks to rise still further, to far beyond the limit which could be carried by individual insurance companies. That industrial development in South Africa in this period was characterized by concentration and the emergence of larger risks is indicated by the fact that while industrial output grew by some 760% between 1955-6 and 1976, the number of industrial concerns in the same period increased by only 46.7%.(61)

This was in contrast to the inter war years where industrial output increased by 294% between 1915 and 1939 while the number of industrial concerns increased by 137%. In the thirty years following the end of the Second World War the industrial sector in South Africa underwent far greater concentration than had occurred previously. The central point to recognize was that the expansion saw the emergence of larger and larger industrial plants with more and more complex equipment, leading to a massive increase in the value of individual risks. This when coupled to the increasing concentration of ownership of industries into fewer and fewer hands meant that the provision of insurance cover for the large mining and industrial corporations that dominated the South African economy came to constitute enormous risks involving billions of rands. Moreover there was a tendency for many of these emerging industries to be concentrated in a few centres, in particular the Witwatersrand, which meant that there was a very great exposure to natural catastrophes such as flooding, earthquake, hail and windstorm all of which create potential for massive losses.(62) By the 1950s it became increasingly apparent that individual insurers could not possibly carry the in-

surances of these corporations on their own. The one possible solution to this was the practice of co-insurance whereby a number of direct companies would combine to provide the level of cover required, with each accepting different shares of the business. However, with the increasing competition in the direct market, and from the 1960s the rapid reduction in the number of direct companies through mergers co-insurance was unable to provide an adequate solution to the problem of "carrying" major risks.(63) This inability provided the major impulse for the development of reinsurance in South Africa and made reinsurance capacity vital to the local direct market's ability to provide the cover needed by industry. Essentially the rapid development of South Africa's industrial base far outstripped the growth in the ability of the direct insurance companies to provide the necessary cover. This industrial development can be viewed as the catalyst for the emergence of professional reinsurance companies in South Africa.

The emergence of professional reinsurance companies as part of the evolution of the short term insurance sector from the early 1950s also formed part of the development of the financial sector as a whole. The growth of the short term reinsurance market mirrored many of the developments which occurred in other parts of the financial sector, particularly banking and the money market. Indeed the key point is that the same basic forces which had moulded the reinsurance market were also responsible for shaping the evolving banking sector. In the period up to the late 1940s the financial sector had generally been characterized by a fairly low level of development and a marked lack of specialization. The banking sector in the interwar years had been dominated by the two big imperial banks, the Standard Bank of South Africa and Barclay's Bank (DC+O), with the Netherlands Bank of South Africa being too small to offer a serious challenge.(64) It was from the early 1940s with the creation of Volkskas that this duopoly began to be broken down. Volkskas grew very rapidly because of the tendency of Afrikaner interests to deal with an Afrikaans bank rather than with an 'English' bank at a time when nationalism was running high in South Africa. In 1955 another Afrikaner controlled bank, Trust Bank emerged and caused something of a revolution in South African banking by its dynamism and 'hard sell' marketing, against the very conservative approach of the existing banks. Its approach attracted vast custom, particularly because of its far more liberal approach to personal loans and finance. During the 1960s and 1970s further banking institutions entered the field, changing the face of the market to a much more open market with fierce competition between banks, which ultimately benefited the customers.(65) In this there were a number of very noticeable parallels with the development of the professional reinsurance market in South Africa. First and most notably there was a move from a period of limited competition in the

1950s and 1960s, when the market was totally dominated by the Swiss-SA Reinsurance Company, to the intense competition of the 1970s and 1980s following the emergence of strong new reinsurers such as the Munich Reinsurance Company of South Africa (MRSA). Secondly the MRSA has in many ways acted as a parallel of the Trust Bank in that it revolutionized the reinsurance market by breaking down the 'old' conservatism through offering new products rejected by the older reinsurers. Lastly the 1960s and 1970s saw the growing Afrikaner role in the banking sector reflected in the increasing Afrikaner involvement in reinsurance. This occurred first directly through Santam being registered as a professional reinsurer and subsequently through Santam Bank's 50% share in the Central Reinsurance Corporation. Both of these were efforts to establish a South African owned reinsurance company in line with the economic nationalism prevalent among Afrikaner business interests during this period.

Not only did the banking sector become far more competitive from the 1940s, but it also became far more sophisticated. Up until the late 1940s the functions of the local banking sector were essentially limited to the provision of commercial banking services, with other services only being available overseas. A particular weakness was the absence of a domestic money market which meant that there was a continual outflow of "idle" funds from South Africa, something which the country could ill afford. Specific weaknesses of the financial sector up to the 1950s were:(66)

- No organized outlet for temporary surplus funds.
- Absence of specialized dealers in short term securities.
- Lack of accepting houses providing bills of high quality.

From this it is evident that by the late 1940s the banking sector was in a position broadly analogous to the insurance sector, in so far as the growth of the industrial sector and its demands for financial services created the need for specialized financial institutions to fulfil these demands, either directly or more commonly indirectly. The emergence of professional reinsurers marked a move to increased specialization within the insurance sector, a move which was mirrored by developments in the banking sector. The creation of the National Finance Corporation in 1949 to provide a repository for short-term call or notice deposit funds reduced the outflow of these funds to the London money market and laid the basis for a local money market. In 1955 South Africa's first merchant bank, Union Acceptances Limited was established, while 1957 saw the creation of the first local discount house, The Discount House of South Africa. Further merchant banks and discount

houses followed in the 1960s and 1970s, so that by the 1980s the South African banking sector and money market had, like the reinsurance market, achieved a degree of maturity and had come to constitute an integral and important component of their respective sectors.(67) According to Solomon, the main developments which have occurred in the South African banking sector since the Second World War have been:(68)

- Decreasing degree of concentration.
- Domestication of foreign banks.
- Increasing diversification.

In general terms these have also been the main themes which have characterized the development of the South African short term insurance sector during the same period. It is clear therefore that the emergence of short term reinsurance offices in South Africa in the period 1950 to 1975 was part of larger and more far reaching changes that were taking place in the financial sector as a whole.(69)

While the emergence of the reinsurance market was ultimately a product of the growth of local industry, the immediate stimulus came from the growth of the direct insurance market. In the quarter of a century between the early 1950s and the mid- 1970s the direct insurance market in South Africa underwent a radical transformation. Not only did the scale of operations increase dramatically but there was also a significant change in the nature of the direct companies operating in the market. Both of these developments impinged directly on, and indeed were responsible for, the emergence of the reinsurance market. The two most noticeable features of the direct market during these years were the massive growth in the level of insurance business conducted in South Africa and the trend towards the 'domestication' of the insurance sector. The growth in the level of insurance business conducted in South Africa is shown in Table 1.6.

**TABLE 1.6**

**GROWTH OF THE DIRECT INSURANCE MARKET  
1955-1975 (R'000)\* (70)**

	<b>Gross Premium Income</b>	<b>Net Premium Income</b>	<b>Reinsurance Premiums</b>	<b>Reinsurance PI as a % of GPI+</b>	<b>Assets</b>
1955		50 142			66 700
1956		54 898			73 354
1957		58 522			80 643
1958		65 296			78 204
1959		N/A			93 688
1960		N/A			N/A
1961		77 136			99 372
1962		76 749			108 292
1963	N/A	84 765	N/A	N/A	122 354
1964	111 941	92 602	19 339	17.3%	132 529
1965	119 972	97 855	22 117	18.4%	139 560
1966	146 143	96 853	49 290	33.7%	181 103
1967	158 206	106 821	51 385	33.5%	198 507
1968	177 666	119 418	58 248	33.8%	239 797
1969	198 914	135 779	63 135	31.7%	275 523
1970	235 135	160 447	74 688	31.8%	N/A
1971	286 534	195 589	90 945	31.7%	301 891
1972	343 229	229 006	114 223	33.3%	372 663
1973	399 756	269 587	130 169	37.9%	431 293
1974	435 344	287 278	148 066	34.0%	473 596
1975	521 367	343 700	177 677	34.1%	521 164

\* Compiled in pounds-sterling converted into rands at a rate of 1 Pound to R 2. This rate of conversion is used throughout with all subsequent figures being in rands.

+ Refers to total percentage of GPI reinsured - does not differentiate between reinsurances placed in South-Africa and overseas.

From this it is apparent that the level of premium income of insurers, both gross and net, grew extremely rapidly with net premium income increasing by over 940% in the 25 years under review. While gross income grew by some 335% during the decade 1965 to 1975 in the same period net premium income increased by only around 251% indicating that the growth in capacity of the direct market was not keeping pace with the demand for cover. As a result the direct companies became increasingly dependent on reinsurance capacity to meet the demand of industry for insurance protection. This is evident from the increase in reinsurance premiums which effectively doubled as a percentage of the direct market's gross premium income between 1964 and 1975. The reason for this dramatic increase in the reliance of direct insurers on reinsurance was that the assets of these insurance companies did not grow in line with the demand for cover. Assets increased by 273% between 1965 and 1975 while gross premium income, the best available reflection of demand for insurance rose by around 335% in the same period. That the growth of the combined financial base of the direct market did not keep pace with the growth of gross premium income is further indicated by the fact that in 1965 assets totalled 116.3% of GPI while in 1975 this had declined to 100.0% of GPI. Not only was the insurance sector characterized by very rapid growth but the nature of the insurance companies operating in South Africa also changed. At the heart of this change was the move towards the 'domestication' of insurance companies and the concomitant rationalization of the market into a smaller number of larger companies via takeovers and mergers.(71) This trend is clearly indicated in Table 1.7, which shows that the number of insurance companies declined by over half between the mid-1950s and the mid-1970s.

**TABLE 1.7**  
**SHORT TERM INSURANCE COMPANIES REGISTERED IN SOUTH AFRICA \*(72)1951 - 1975**

	Union/Republic Insurers	Non Union/Republic Insurers	Total
1951	29	78	107
1955	34	86	120
1961	42	82	124
1965	40	71	111
1971	61	15	76
1975	50	7	57

\* Union/Republic insurers refers to companies registered in South Africa, both independent and subsidiaries, while Non Union/Republic insurers refers to foreign insurance companies having branches in South Africa writing business on their behalf.

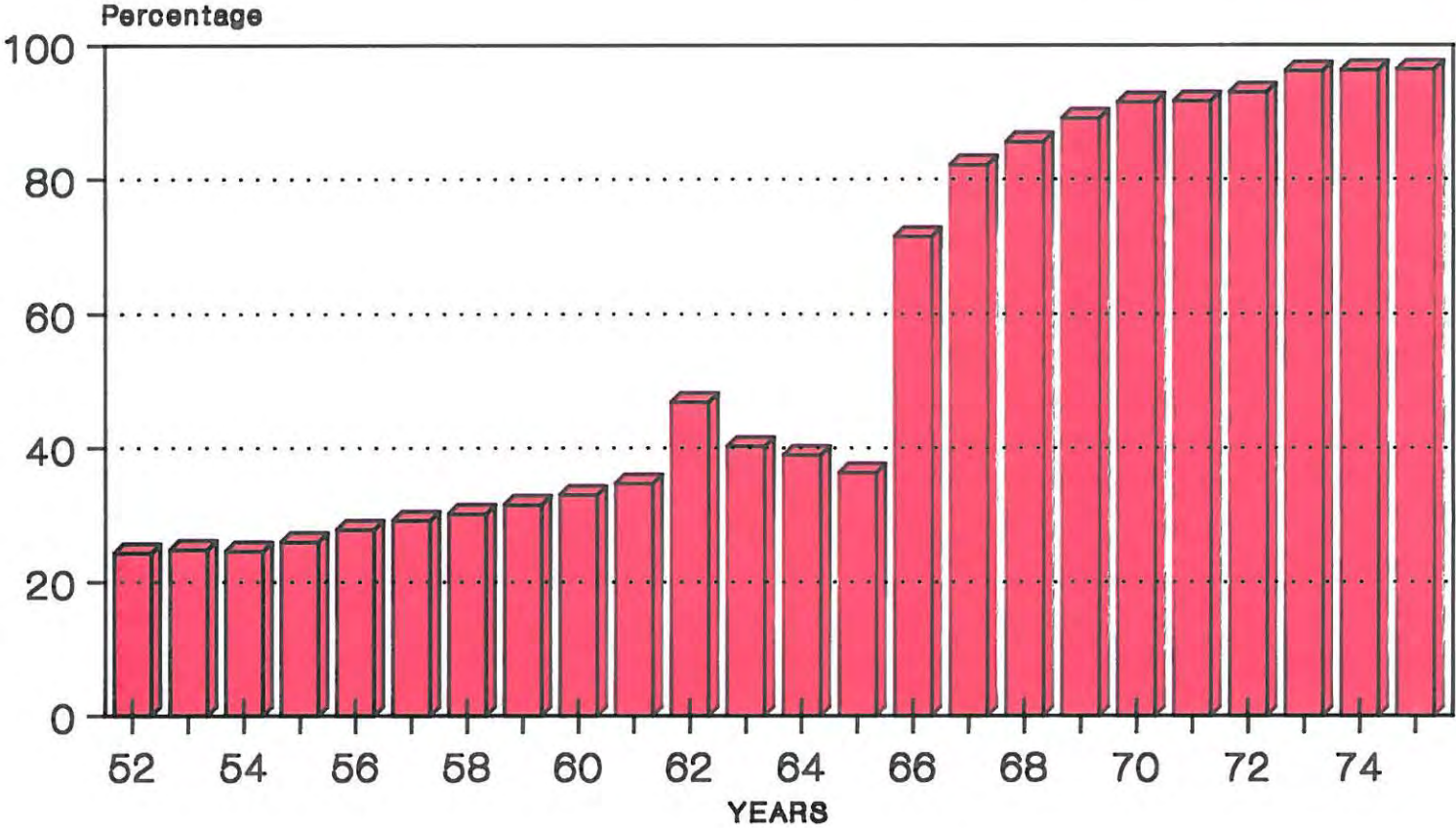
In this overall reduction of just under 50%, the decline in the number of foreign insurance companies registered in South Africa was the most important factor. These companies either withdrew from the market and sold their interests to local insurers or registered their operations as local companies in line with government efforts to domesticate the insurance market. The process of rationalization, given that it involved the establishment of larger and more secure insurance companies was also linked to the instability of the short term insurance market in the late 1950s which arose from the multitude of small, weak and financially insecure companies. Such was the degree of instability that the early 1960s saw the enforced closure of many of these companies, so that by 1964 seven short term insurers had gone into liquidation. These were:

- Union Guarantee Insurance Co. Ltd.
- Provident Insurance Corporation of Africa Ltd.
- Auto Protection Insurance Co. Ltd.
- Johannesburg Insurance Co. Ltd.
- British Overseas Insurance Co. Ltd.
- Parity Insurance Co.Ltd.
- African Horizon Insurance Co. Ltd.(73)

Their main problem was that they made totally inadequate provision for claims and in many cases disguised the claims intimated from their auditors and Registrar of Insurance. The income which should have been used to build claims reserves was instead used for other financial ventures and to pay "huge" dividends to the shareholders, with the main shareholders often being the senior managers of the company. This reflected both the speculative nature of many of these companies as well as the failure or inability of the Registrar to exercise adequate control over them, explaining why the late 1960s saw a considerable tightening in the financial control exercised by the Registrar.(74) In particular the inadequate provision for claims was a problem which affected motor insurance because this class of business was characterized by particularly poor claims experience and reinsurance cover was essential if insurers were to supply motor insurance on a sound basis.

The impact of the move towards the 'domestication' of insurance companies operating in South Africa is evident from Figure 1 which shows the share of net premium income held by local as opposed to foreign insurance companies. Figure 1 clearly illustrates the dramatic turn around in the division of net premium income between local and foreign insurers in 1965-6 as a result of government pressure. This in turn explains the virtual doubling of the percentage of gross premium in

# UNION/REPUBLIC INSURERS SHARE OF SHORT TERM NET PREMIUM INCOME



PREM. INCOME

Figure 1

come that was reinsured from these years. This process continued, albeit at a slower rate, until the mid 1970s, by which time the role of foreign insurers was negligible. Thus the period 1955 to 1975 was the crucial period in the evolution of the direct insurance market in South Africa and the development of local professional short term reinsurance was an integral component of the development of the short term insurance sector.

The growth and increasing sophistication of the direct market provided the immediate stimulus for the creation of local reinsurance facilities. In considering the development of the direct market in relation to the emergence of local reinsurance facilities it is apparent that both the 'domestication' of the insurance sector and the very rapid growth of premium income were important in this process. While for the purpose of analysis it is helpful to consider the role of these two factors separately, it must be recognized that to separate them is artificial because both are inextricably linked. Turning first to the effect of the 'domestication' of the insurance companies in South Africa at this time, it is apparent that this led to a dramatic increase in the percentage of gross premium income which was being reinsured. This did not arise from a sudden increase in the level of gross premium income being written by the direct market, but was a product of the change in the nature of the insurance companies. Up to 1965-6 the bulk of the insurance business written in South Africa was in the hands of non Union/Republic insurers, that is branches of foreign insurance companies. These foreign insurance groups had the necessary financial resources to retain the bulk of the gross premium written in South Africa for their own account. Moreover when these companies did reinsure part of their South African business, it was invariably done through their head offices in Europe.<sup>(75)</sup> As a result before the mid-1960s the need for local reinsurance facilities was limited to the demands of domestic Union/Republic insurers, who wrote only a small percentage of the local business. This is borne out by the doubt expressed by the Swiss Reinsurance Company in 1951, when they were considering opening an office in South Africa, as to whether the direct market could support a third professional reinsurer.<sup>(76)</sup> Certainly this goes a long way to explain the comparatively slow growth of the reinsurance market up to the mid-1960s in spite of the rapid growth of the direct insurers premium income and the fact that there were relatively few locally registered reinsurers in the market at that time.

From 1965 with the wholesale 'domestication' of insurance companies, which saw branch offices being converted into locally registered insurance companies, the demand for reinsurance cover rose dramatically. These new 'independent' insurance companies lacked the financial resources of their parent companies and were forced to rely increasingly on reinsurers in order to be able to write the

level of business that they had written previously.(77) This increased reliance on reinsurance facilities was also a product of the tightened solvency margin requirements for insurers which were promulgated in the late 1960 in reaction to the instability of the direct market. While the necessary reinsurance facilities could have been provided by foreign reinsurers, both within the republic and overseas, the efforts undertaken by the government to build a strong domestic insurance sector ultimately also came to encompass the establishment of domestic reinsurance facilities.(78) This served to reduce the reliance of the local insurance sector on foreign reinsurers, although the extent of this should not be exaggerated. In turn this highlights one of the main aims of the government in 'domesticating' the insurance sector, namely the attempt to retain an increasing percentage of insurance, and reinsurance, premiums in South Africa. The various government efforts to reduce the outflow of premium income, given substance by the tightened solvency margin requirements, stimulated the growth of reinsurance facilities in South Africa with a second wave of reinsurance companies being established between 1968 and 1974. The growth of the professional short term reinsurance market consequently was in many ways a product of the government's determination to establish a domestic short term insurance sector in South Africa.(79)

With the rapid industrial growth from the 1950s through to the 1970s, there was an equally rapid growth in the demand for insurance cover, particularly for large industrial risks. The product of this industrial development was that the gross premium income of the direct companies increased very rapidly, as indicated by Table 1.6. What is of particular importance when considering the development of reinsurance facilities is the fact that while the gross premium income of the direct market increased at an annual average of 33.5% in the period 1965-1975, the net premium income of the direct market in the same period grew at an average of only 25.1% per annum. From this it is evident that although the direct market was ostensibly able to meet the growing demand for insurance, the direct companies were in fact becoming increasingly dependent on reinsurance facilities to provide the level of cover demanded. The decline in the net retention of the direct market was the result of the gross premium income of the direct market growing faster than its financial resources. The combined assets of the direct market grew at an average of 27.3% per annum between 1965 and 1975 in comparison with the 33.5% per annum growth in gross premium income. This was ultimately the reason for the direct market coming to rely increasingly on reinsurance facilities. Had assets grown in line with the demand for insurance, and thus gross premium income, the direct companies would have sought to retain a similar percentage of gross premium income as previously for their own account in order to boost their net income. Consequently by the late 1960s the insurance companies were being forced to retain a smaller percentage of their gross premium income

than hitherto, thus providing an important stimulus for the development of local reinsurance facilities. Although the 'domestication' of the insurance companies played an important role in this trend, it was ultimately the growing demand for insurance which was the driving force behind the development of reinsurance facilities. Certainly the growing level of reinsurance business from the mid-to-late 1960s encouraged some of the major European reinsurance companies to begin operating in South Africa. Because of government legislation aimed at 'domesticating' the insurance sector, these operations took the form of locally registered subsidiary companies, whereas in other circumstances only branch offices might have been established.(80)

## **V: LEGAL FRAMEWORK OF REINSURANCE IN SOUTH AFRICA.**

A final issue which should be considered in examining the background to the development of reinsurance in South Africa is the legal position of reinsurance companies in this country. While the South African government has been relatively restrained in its intervention in insurance, it has hardly interfered in reinsurance at all. What intervention has occurred has largely been incidental, a result of reinsurers being subject to the same rules as the direct insurance companies.(81) The basis of government legislation in regard to the insurance sector as a whole is the South African Insurance Act of 1943 which was largely derived from English insurance law, although the principles of Roman Dutch law have impinged on this and helped to shape its development. The Insurance Act of 1943 and its various amendments has provided the legal basis for the development of reinsurance right through until 1985 although amendments have frequently been promulgated which repealed and consolidated all previous insurance legislation.(82) By the 1980s insurance law in South Africa was well entrenched with the many amendments implemented in the preceding forty years facilitating close supervision of the insurance sector, but it was mainly during the 1960s that the government tightened its supervision. This was in response to the instability which plagued the insurance market in the late 1950s and early 1960s, and the consequent desire of the government to place it on a sounder footing so as to protect policyholders.(83) In spite of this the tradition of non interference in the insurance sector has been maintained with legislation essentially being geared to protect the public. This non intervention was arguably a result of the success of the insurance sector in private hands, having been able to meet an increasing percentage of the economy's growing need for insurance.(84) In considering the main features of insurance legislation as it has affected the development of reinsurance in South Africa the focus will be on the Insurance Act of 1943 as amended. However, other pieces of legislation also have had a significant impact on the develop-

ment of reinsurance and as such deserve attention. The Financial Institutions Act and its various amendments was one of the most notable of these, concerning as it did the registration of reinsurance companies operating in South Africa.

South African insurance legislation in comparison to that affecting the operation of reinsurers in other parts of the developing world is very limited, with the individual companies being free to pursue their own interests within very broad parameters. This is a reflection of the fact that insurance legislation per se was primarily developed for the protection of policyholders, rather than as part of an attempt to stimulate the growth of the insurance and reinsurance markets. This is borne out by existing legislation, and the main elements of the amended South African Insurance Act of 1943 relating to short term reinsurers are outlined below:(85)

- Registration: All reinsurers must be registered with the Registrar Insurance who in turn exercises certain judicial control over these companies and their activities.
  
- Accounts and Statements: Each registered reinsurer must, within six months of the end of its financial year, submit accounts and financial statements to the Registrar.
  
- Prohibitions: The registrar is empowered to prohibit reinsurers taking actions which are undesirable or irregular, and issuing policies should the company fail to comply with provisions of the Act.
  
- Amalgamation, Transfer of Insurance Business: Approval of the Registrar must be secured for the amalgamation of reinsurance companies and/or the transfer of their business in the event of a reinsurer withdrawing from the market.
  
- Judicial Management/  
Winding Up: Registrar in Conjunction with the Minister of Finance, or the reinsurer itself, may apply for a company to be placed under judicial management or liquidated.

- Solvency Margin: Solvency requirements are that assets, valued in accordance with the Act, provide a sufficient margin over liabilities. For a short term reinsurer the requirement is that they hold assets with an aggregate value of its liabilities, plus "such a percentage as may from time to time be prescribed by regulation, of its premium income of the previous financial year after deducting certain categories of approved reinsurances", namely business reinsured with another South African registered insurance/re- insurance company or Lloyds.

- Holding of Pre-

scribed Assets: Short term reinsurers in terms of the financial requirement of the Act are obliged to hold assets having an aggregate value of not less than the amount of their net liabilities, of which 33% of these assets must be invested in prescribed assets, that is in various classes of government stock within the Republic. These are as follows:

Government of the Republic.

Local Authorities of the Republic.

Administration Boards.

Rand Water Board and Escom.

Any institution approved by the Registrar.

Government or Local Authority other than the Republic which is approved by the Registrar.

Broadly speaking South Africa insurance legislation would appear to have provided sufficient latitude to reinsurers for them to be able successfully to pursue their own interests. Even those parts of the Act relating to the holding of prescribed assets have generally not hampered reinsurers in terms of maximizing their return on investment funds, while retaining immediate access to these funds.<sup>(86)</sup> Perhaps the most important general feature of the Insurance Act is that it fails to differentiate between direct insurers and reinsurers.

Although the Insurance Act has generally not retarded the performance of the reinsurance companies, there have been certain specific problems with the Act. For the reinsurers the most impor-

tant, and indeed most contentious, element of the Act relates to the solvency margin. In terms of the Act the solvency margin is defined as the free reserves of the company, that is the difference between its assets and liabilities, as a percentage of the net premium income.<sup>(87)</sup> The current 10% solvency margin is calculated on the basis of gross premiums less approved reinsurances, approved reinsurances being reinsurances, or in the case of reinsurers retrocessions, placed with locally registered insurers and reinsurers. It is in this that the failure of the Act to differentiate between insurers and reinsurers is a major problem for the reinsurers. Because of the small local reinsurance market, which lacks the capacity to provide the necessary retrocession facilities, reinsurers are forced to retrocede business overseas. For reinsurers the solvency margin is thus, in de facto terms, based on gross premiums.<sup>(88)</sup> This has been seen as the one element of the insurance legislation presently in force which has had a negative impact on the performance of reinsurers. However, at the same time it can be argued that this has ensured the strength of South African reinsurance companies, meaning that they have the financial strength needed to provide the reinsurance cover sought by the direct market.<sup>(89)</sup> It has also been argued that the existence of approved reinsurances has stimulated the development of professional reinsurance in South Africa in that it encouraged insurers operating in South Africa to place their reinsurances locally in order to strengthen their statutory solvency margin. This has at least partially protected local professional reinsurers against severe price competition from foreign reinsurers, although it has failed to keep out the so called 'suitcase brigade'. This view, however, is not universally held with the argument being put forward that the existence of approved reinsurances in the Insurance Act has not had much impact on the placing of reinsurance locally because the solvency margins of the main local insurers are such that they do not need to use approved reinsurances to ensure that they meet the statutory solvency requirements.<sup>(90)</sup> This is a view which is shared by some of the direct companies with the Guardian National Insurance Company for example, placing much of its reinsurance overseas through the Guardian Royal Exchange.<sup>(91)</sup>

Although it is evident from this that the South African government has adopted an essentially laissez-faire approach to the insurance sector, there have been various moves towards, and pressures for, the State to play a greater role. While this has led to certain indirect intervention in the insurance sector, the government has resisted temptation to increase the extent of control over the insurance sector. For the insurance sector as a whole, both life and short term, the Financial Institutions Act has been the most important means by which the government has intervened in the operations of this sector. During the course of the 1960s this Act was amended to promote what may be termed the 'domestication' of the financial sector. As already indicated government involvement

was crucial in leading to the 'domestication' of the short term insurance sector and stimulated the development of the second wave of reinsurance companies from the late 1960s. This effort to 'domesticate' local insurance via the Financial Institutions Act was the only time the government actively intervened to promote the development of the insurance sector. As with many other developing countries this was motivated by a sense of economic nationalism and a desire to reduce the outflow of foreign exchange. This latter point has been a continuing theme in the relationship between the insurance sector and the government, but has not led to any further intervention.<sup>(92)</sup> From the mid 1960s, the curbs placed on foreign insurers and reinsurers aimed at domesticating the insurance sector was also motivated by the desire "To localize institutions which might otherwise be used as instruments in a possible sanctions war against South Africa as had happened in Rhodesia."<sup>(93)</sup> This reflects the continuing preoccupation of South African legislators with the prospect of economic isolation, making the limited direct intervention in the short term insurance sector all the more remarkable. While the government could have taken further steps to retain reinsurance premium in the country to stimulate the expansion of the local reinsurance market this would have been likely to have had the counter productive effect of retaining losses in South Africa. Indeed most of the reinsurers in South Africa had no wish to see legislation tightened, in spite of the fact that this would have increased the volume of their business. This is borne out by the following view of E.F. Kahle, Managing Director of MRSA.

"When considering the need to retain as much business as possible in South Africa, any possible governmental restriction should be avoided and the market allowed to regulate itself. An example of the failure of government restrictions with regard to insurance and reinsurance cessions abroad is that of the Phillipines. After more that 10 years of very positive experience in the Phillipines, six major fires involving an overall loss in the region of R 85 million occurred in the first nine weeks of 1978 alone. As a result, Phillipine fire business inevitably showed negative results in 1978. With the reinsurance cessions abroad being subject to restriction, a very large share of these losses had to be borne by the Phillipine Insurance Industry."<sup>(94)</sup>

This was written in January 1984, the very year in which the South African insurance industry was to be hit by a series of catastrophic losses, in response to suggestions that the government should tighten its control of the short term insurance sector. Had the direct market been forced to rely on local reinsurers because of government legislation restricting the outflow of reinsurance premiums, the South African insurance sector in 1984 would have experienced even worse losses than it did.

Overall perhaps the most notable feature of the relationship between the State and the short term insurance sector, and particularly the reinsurance market, has been that the government has not sought to establish a state reinsurance corporation as has happened in many other parts of the developing world. Once again this reflects not so much the unwillingness of the government to involve itself in the affairs of the short term insurance and reinsurance markets, but rather the success of the private sector in providing the necessary services, making government intervention to promote such developments unnecessary. Certainly in view of all this it can be argued that in very general terms South African insurance legislation, if not necessarily playing a major role in stimulating the development of reinsurance, by the same token has not seriously retarded its development.

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## CHAPTER 2

### THE LAYING OF THE FOUNDATIONS OF PROFESSIONAL REINSURANCE 1950-1966

The foundations of professional short term reinsurance in South Africa were laid during 1950-51, a development which was noted by the then Registrar of Insurance Mr I.T. Meyer, when he wrote that, "a new and interesting development in the field of insurance arose with the registration of the undermentioned so called professional reinsurers, of whom three are Union insurers and one a non Union insurer."(1)\*

South African Reinsurance Corporation Ltd: Reg. 3rd May 1950.

Reinsurance Union of South Africa Ltd: Reg. 29th December 1950.

Swiss-SA Reinsurance Company Ltd: Reg. 24th January 1951.

Mercantile and General Reinsurance Co.Ltd: Reg. 5th April 1952.

While the registration of the first three of these companies as locally registered reinsurance companies undoubtedly marked a major development within the insurance sector, a degree of caution should be exercised in evaluating the significance of this development. It has to be recognized that although professional reinsurance cover was for the first time available locally, adequate reinsurance cover to meet the needs of the direct market had been available prior to this development. These limited needs were met through accepting agencies for foreign reinsurers and brokers, but more importantly through the in-house reinsurance arrangements of the direct companies which were predominantly branches of foreign insurance offices and relied on their parents for reinsurance. None the less the development of locally registered reinsurers marked an important step in the overall development of the insurance sector. In considering the initial development of reinsurance in South Africa it is important to consider not only the formation of the first three local reinsurers in 1950-1, but also the subsequent registration of the three other professional reinsurers which had occurred by 1961. These were the Hollandia Reinsurance Company of South Africa Limited (1953), the Swedish Atlas Reinsurance Company of South Africa Limited (1956) and the Suid Afrikanse Nationale Trust en Assurantie Maatskappy (1960).(2) Together the six reinsurers constituted the first wave of reinsurance companies developed in South Africa, as distinct from the second wave that emerged in the late 1960s and early 1970s.

\* Because of the lack of available statistics for branch or non Union reinsurers, such as the Mercantile and General, this study of the development of professional reinsurance in South Africa is restricted to locally registered reinsurers.

**TABLE 2.1****OWNERSHIP OF LOCALLY REGISTERED REINSURERS.(3)**

<b>Company</b>	<b>Parent</b>	<b>Nationality</b>
(1) South African Reinsurance Corporation Ltd.	Societe Nord Africaine de Reassurances	French (From 1958 it was South African owned)
(2) Reinsurance Union of South Africa Ltd.	Various	British/South African
(3) Swiss-SA Reinsurance Company Limited	Swiss Reinsurance Company	Swiss
(4) Hollandia Reinsurance Company of South Africa Limited	Algemeene Herverzekering Maatschappij	Dutch
(5) Swedish Atlas Reinsurance Company of South Africa Limited: Became:	Swedish Atlas Reinsurance Company	Swedish
Gerling Global Reinsurance Company of South Africa Limited in 1961.	Gerling-Konzern Weltversicherungspool AG.	German
(6) Suid Afrikanse Nasionale Trust en Assurantie Maatskappy	Santam/Sanlam*	South African

\* In 1960 Santam registered as a "professional reinsurer" so as to write reinsurance business. However, it did not establish a separate company, rather conducting limited reinsurance business as an adjunct to its direct short term business.

The period from 1950 to the mid 1960s, which saw the first tentative steps in the development of a local reinsurance market was one of experimentation and instability as evidenced by the cessation of trading by South African Reinsurance Corporation and the reinsurance arm of Santam by the end of 1966. The distinctive feature of these companies was that they were essentially local reinsurers as distinct from the others which were subsidiaries of strong overseas reinsurance groups, as shown in Table 2.1. Although the South African Reinsurance Corporation was a subsidiary of the Société Nord Africainè de Reassurances, up until 1958, it was to all intents and purposes a local reinsurer for its short life because of the weakness of its parent company and the relationship between the two organisations.

In spite of this instability, by the close of this initial period of development in 1966, locally registered professional reinsurers had become a permanent feature of the South African insurance scene. Moreover many of the teething troubles experienced by these early professional reinsurance companies had been overcome by the mid-to late 1960s.

Although it has been argued in general terms that the development of professional reinsurance in South Africa was closely linked to the growth of secondary industry in this country as well as the world-wide expansion of reinsurance, it is worthwhile before going into the details of the early development of the reinsurance companies to consider some of the specific reasons behind the sudden emergence of a number of local reinsurance offices in the early 1950s for which 1948 and 1949 appear to be the crucial years. There is no information on the creation of the South African Reinsurance Corporation, but details of the motivation behind the formation of both the Reinsurance Union of South Africa and the Swiss-SA Reinsurance Company provide some indication of the reasons which led to the initial moves. In the case of the Reinsurance Union, during the late 1940s the British broking firm of Matthews Wrightson became aware of the very considerable volume of facultative reinsurance business being written by their agent in South Africa. Together with a number of British and South African insurance companies they considered the idea of setting up a South African reinsurance company with a joint British/South African shareholding. This was seen as a sensible move as there was at that time an increasing tendency to retain a greater part of the short term business written in South Africa within the Union and a reinsurance company would be needed to cope with the reinsurance implications of such a trend in the direct market.(4) The creation of the Reinsurance Union was thus essentially motivated by the recognition of the need for local reinsurance capacity to meet the growing needs of the direct market. This in turn was a reflection of the interests of the promoters of the Reinsurance Union, who were insurers with a major in-

terest in the South African market. The formation of this company because of the growth of the direct market was ultimately expected to be a profitable investment for the founders. The initial capital base of Pds250 000 was subscribed as shown in Table 2.2.(5)

**TABLE 2.2**

**INITIAL SHARE HOLDING OF THE REINSURANCE UNION OF S.A. LTD.**

**South African Companies:**

	Shares at 1 Pound each
African Guarantee and Indemnity Co. Ltd.	10 000
Federated Employers Fire and General Insurance Co.Ltd	10 000
Santam.	10 000
Stafford Meyer Co.(S.A.) Ltd.	5 000
S.A. Fire and Accident Insurance Co. Ltd.	5 000
S.A. Mutual Life Assurance Society.	15 000
Southern Insurance Association.	<u>15 000</u>
<b>Total South African Shareholding:</b>	<b>70 000</b>

**British Companies:**

Alliance Insurance Co. Ltd.	20 000
Atlas Insurance Co. Ltd.	20 000
Commercial Union Assurance Co. Ltd.	20 000
London and Lancashire Insurance Co. Ltd.	20 000
Northern Assurance Co. Ltd.	20 000
North British and Mercantile Insurance Co. Ltd.	20 000
Phoenix Assurance Co. Ltd.	20 000
Royal Exchange Assurance Co. Ltd.	20 000
Matthews Wrightson Holdings Ltd.	10 000
United Standard Insurance Co. Ltd.	<u>10 000</u>
<b>Total British Shareholding:</b>	<b>180 000</b>

<b>Total Shares Issued:</b>	<b>250 000</b>
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While the underlying reasons behind the growth of the Swiss-SA Reinsurance Company were the same as those which led to the creation of the Reinsurance Union, the specific factors which led to its formation were somewhat different. The Swiss Reinsurance Company, based in Zurich, sent a delegation to South Africa in 1949-50 to consider the possibilities of extending the company's operations through the creation of a local company. However, no definite decision was reached following this visit, although it would seem that some doubt had been expressed about whether there was sufficient business for a third reinsurance company in South Africa. None the less a second delegation came to South Africa later in 1950 and registered a local company, the Swiss-South African Reinsurance Company Ltd, in which the Swiss Reinsurance Company had a 100% shareholding.(6) In contrast to the Reinsurance Union, the establishment of the Swiss-SA Reinsurance Company was motivated less by a specific recognition of the need for reinsurance facilities in South Africa and was rather part of the Swiss Re's general world-wide expansion which during the post war decade had seen a thrust into the main Commonwealth markets of Australia and Canada. Of the other reinsurance companies which emerged during the initial period, the formation of both the Hollandia Reinsurance Company of South Africa Ltd and the Swedish Atlas Reinsurance Company of South Africa Ltd, was motivated by the desire of their respective European parents for a share of the potential profits of the South African market and by their desire to secure sufficient non European business to provide a balanced portfolio.

The registration of Santam, a long established Afrikaner controlled short-term insurer, as a professional reinsurer in 1960, was apparently motivated by a patriotic feeling in so far as there was a perceived need for a local reinsurance company to counter the possibility of South Africa facing increased economic isolation in the aftermath of the Sharpeville riots and the creation of a Republic. This was not an unrealistic fear for in 1961 the Swedish Atlas sold off its South African operation as part of the general Swedish withdrawal from South Africa which also saw the Aequitas Reinsurance Company selling off its 20% share in the Hollandia Re. The fact that Santam ultimately played virtually no role at all in the reinsurance market and ceased operating in 1966 shows that the South African insurance sector did not suffer a loss of reinsurance capacity following the political turmoil of 1960-1 and that there was thus no need for the essentially autarkic orientated reinsurance facilities provided by Santam. With the exception of the Swedish Atlas Reinsurance Company of South Africa Ltd, which took over the existing business of the South African branch office of its parent, all the other reinsurance companies which were formed in this period were developed from scratch having had no earlier branch or agency representation in South Africa.(7)

When looking at the performance of these reinsurance companies in the initial stage of the development of professional reinsurance in South Africa, two linked features stand out. In the first place these companies experienced very rapid growth in terms of the level of business underwritten, although admittedly from small bases. Secondly in spite of this growth, they remained very small, both in absolute terms and in comparison with the direct companies. Indeed one of the most notable features of these reinsurance companies was their extremely small capital bases; none having share capital exceeding half a million rand, (see Table 2.3.). The bulk of the working capital required by reinsurance companies, however, normally comes from accumulated premium income rather than subscribed share capital, although during their early life, share capital formed the greater part of their working capital as they had not yet built up substantial reserves of accumulated premium income.

**TABLE 2.3**

**PAID-UP SHARE CAPITAL OF REINSURANCE COMPANIES  
1951- 1966\* (R'000) (8)**

	<b>Reinsurance Union</b>	<b>Swiss-SA Re</b>	<b>Hollandia Re</b>	<b>Gerling Global</b>
1951	500 000	360 000		
1954			200 000	
1957				
1959		372 000		180 000
1961				200 000
1964				500 000
1966	500 000	372 000	200 000	500 000

\* Compiled in pounds-sterling converted into rands at a rate of 1 to R 2. This rate of conversion is used throughout with all subsequent figures in rands.

In view of the limited size of these reinsurance companies, in terms of share capital, it is important to consider whether they justified their shareholders investments during this initial stage in the development of reinsurance in South Africa. This issue has to be considered not only on their results and thus their return on capital, but also in the light of their rates and levels of growth. Coupled with this one further worthwhile measure of their performance was the degree to which they were able to meet the needs of the direct market for reinsurance cover and provide sound and competent service to their clients.

Turning first to these companies' performance in terms of growth, the most important and accurate measure of the growth of the reinsurance market in South Africa, and its members is provided by their net premium income. At the same time this also gives an indication of growth in the reinsurance market's capacity, that is the ability of these reinsurers to meet the demand of the direct market for reinsurance. The varying growth rates of the four reinsurers which survived the difficulties of the initial period, namely the Reinsurance Union, the Swiss-SA Re, the Hollandia Re and the Gerling Global are shown in Figure 2. All four companies generally experienced rapid and continuous growth so that the net premium income of the reinsurance market as a whole rose by some 1500% from R 44 424 in 1951 to R 7 184941 in 1966/7.<sup>(9)</sup> This massive expansion in the volume of reinsurance business written in South Africa occurred both as a result of the increase in the number of direct companies operating in the country and more importantly as a result of the growth of individual direct insurers.<sup>(10)</sup> Not only did the market as a whole experience considerable growth of premium income, but there was also a fairly rapid extension of reinsurance facilities throughout Southern Africa. During this period the main reinsurance companies opened branches, or more commonly appointed agents, in the main commercial centers of South Africa and Rhodesia. By the 1960s reinsurance facilities were readily available to all direct insurance companies in Southern Africa no matter where their offices were located. This expansion is demonstrated by the growth of the Reinsurance Union which with its head office in Cape Town and a branch office in Johannesburg appointed agents in Durban and Port Elizabeth in 1951, and in Salisbury and London in 1952. With the exception of the London office which was a product of the Reinsurance Union's position as an independent South African reinsurer, this was a pattern of expansion typical of other reinsurers in South Africa.<sup>(11)</sup>

## GROWTH OF NET PREMIUM INCOME 1951 - 1966

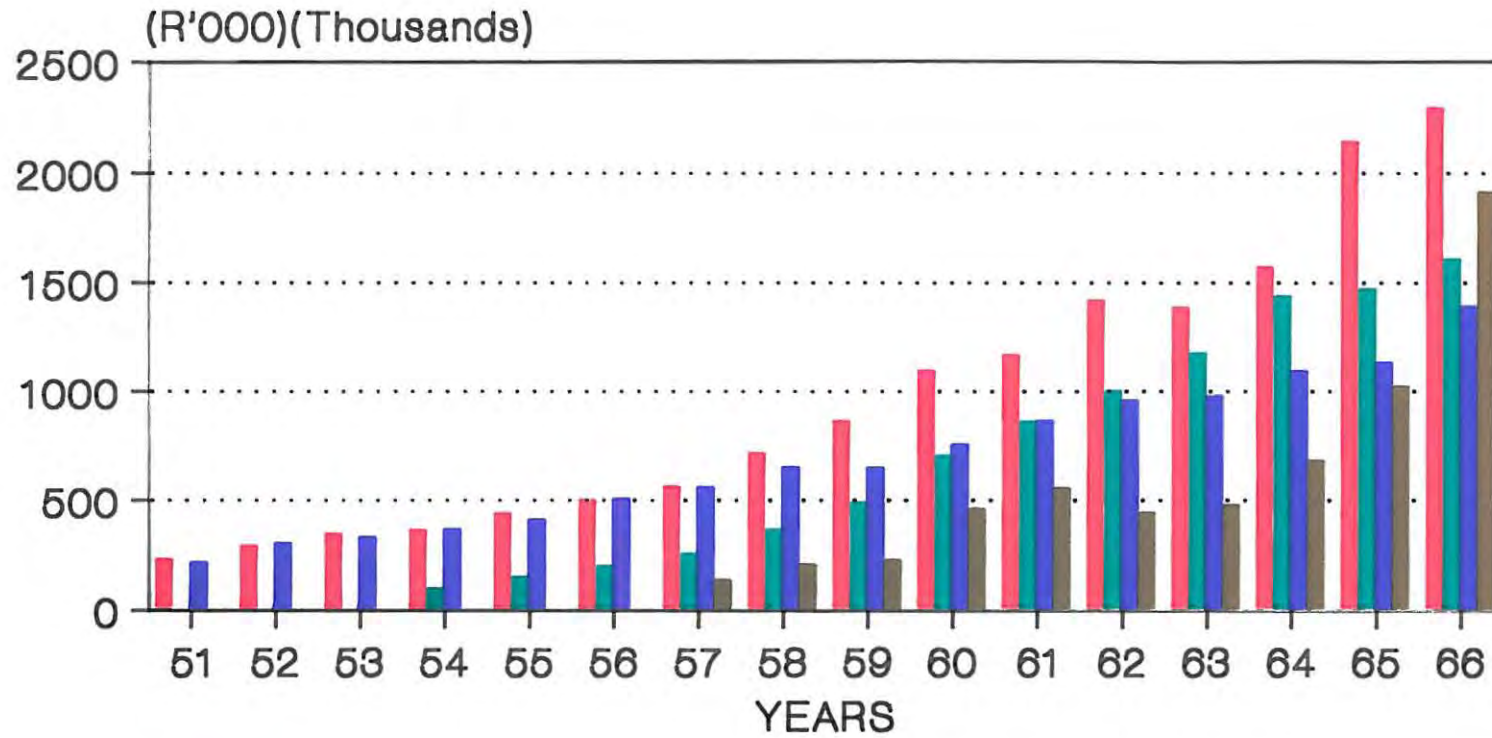


Figure 2a

# CLAIMS EXPERIENCE 1951 - 1966

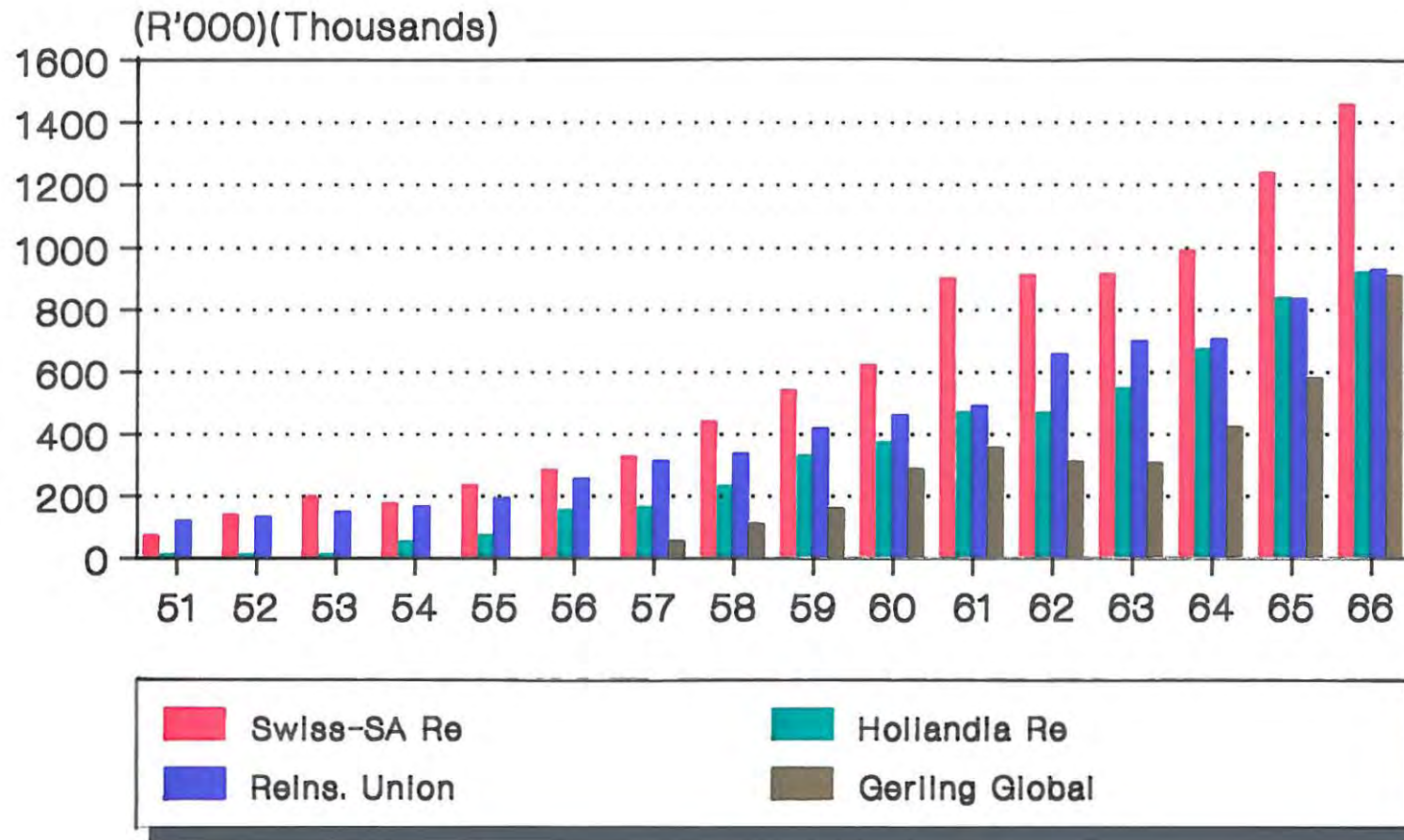


Figure 2b

Within the overall growth of the market the performance of the individual companies varied considerably, the most notable being that of the Swiss-SA Re which totally outstripped the others in terms of growth. Indeed such was the growth of the Swiss-SA Re at this time, and its consequent dominance of the market, that it is reasonable to claim that the history of reinsurance in South Africa up to the mid-1960s was effectively the history of the Swiss-SA Re.(12) Table 2.4 clearly illustrates their dominance of the local reinsurance market up to the mid-1960s. For the Hollandia Re this whole period, but particularly the early 1960s, was a time of reasonably solid if unspectacular growth. Certainly by the mid-1960s the Hollandia Re had outwardly at least built a sound base for future growth but it must be noted that the greater part of their income came from foreign business ceded to it by its parent company and thus in reality they had little penetration of the local market as is shown in Table 2.4. However, owing to a number of fundamental weaknesses the Hollandia was not able to capitalise on its position and in the late 1960s and 1970s was to fall increasingly behind the rest of the market. For the Swedish Atlas cum Gerling Global this was a time of markedly fluctuating fortunes which saw the company shift from a period of very slow and limited growth to a period of spectacular growth, so that by 1966 it appeared to be posing a threat to the dominance of the Swiss-SA Re. Between 1963 and 1966 the net premium income of the Gerling Global rose from R 473 738 to R 1 906 948 or from 5% of local net premium income to over 40%, a growth rate of some 300% in three years which was particularly notable as inflation at that time was running at an annual average of only 2.8%. This rapid growth and the preceding slight decline in the net premium income of the Gerling Global was a result of them buying out the South African business of the Swedish Atlas in 1961. Following this the existing business was pruned back and radically restructured in light of the poor performance of the Swedish Atlas.(13)

The final feature worth noting was the below average growth of the Reinsurance Union, particularly in the years 1958 to 1964 when it lagged far behind the rest of the market, especially in local business. This slow growth in terms of local business was surprising given that the shareholders of the company were local and foreign insurers operating in South Africa. It could have been expected that they would have ceded a large part of their reinsurances in South Africa to their 'own' reinsurer. Indeed at the time of the company's formation it was asserted that, "the company has already been assured of a substantial volume of reinsurance business both locally and from overseas."(14) However, this slow growth should be seen as an inevitable and indeed necessary result of the local

nature of the Reinsurance Union. Their relatively slow growth and consequent limited importance to the South African market is once again indicated by the following breakdown of domestic reinsurance business.(Table 2.4)

**TABLE 2.4**

**BREAKDOWN OF LOCAL NPI INTO COMPANY SHARES. 1951-1966.\* (15)**

	<b>Reinsurance Union</b>	<b>Swiss-SA Re</b>	<b>Hollandia Re</b>	<b>Gerling Global</b>
1952	9.3%	90.6%		
1955	8.3%	90.9%	0.7%	
1956	7.2%	91.3%	1.5%	
1957	4.8%	74.9%	3.4%	18.9%
1958	5.4%	86.5%	2.3%	5.7%
1959	5.9%	85.4%	2.2%	6.5%
1961	8.3%	73.2%	2.9%	15.6%
1963	10.2%	81.4%	2.6%	5.8%
1964	17.7%	51.7%	2.5%	28.1%
1965	17.0%	57.0%	2.4%	23.5%
1966	9.8%	45.7%	2.5%	42.0%

\* Discrepancies between these company shares and Fig 2 arise from the fact that this table excludes foreign business while foreign business is included in Fig 2.

It is evident from Figure 2 that not only did the reinsurers generally experience considerable growth during this period, although in absolute terms the companies remained small, but from the outset they enjoyed a healthy margin between premium income and claims. That the performance of these early reinsurers in terms of results was good is borne out by the loss ratios of these companies which are shown in Table 2.5

**TABLE 2.5**

**LOSS RATIOS OF REINSURERS 1951-1966.(% of NPI) (16)**

	<b>Reinsurance Union</b>	<b>Swiss-SA Re</b>	<b>Hollandia Re</b>	<b>Gerling Global</b>	<b>Average</b>
1951	55.5	30.5			43.0
1952	43.4	47.3			45.4
1953	44.9	57.3			51.1
1954	45.0	48.1	53.6		48.9
1955	47.1	53.5	48.6		49.6
1956	50.4	56.8	76.5		61.2
1957	56.2	58.4	64.0	39.7	59.5
1958	51.7	61.4	63.1	53.1	57.4
1959	64.6	62.9	67.6	71.0	66.4
1960	61.2	56.9	52.9	62.4	58.3
1961	56.8	77.3	54.5	63.8	63.1
1962	68.5	64.5	46.9	70.2	62.5
1963	71.5	66.3	46.7	64.4	62.2
1964	64.6	63.2	46.8	62.1	59.2
1965	73.9	57.8	57.0	56.8	61.4
1966	66.9	63.5	57.4	47.7	58.9

The first and most striking feature to emerge from this is that although loss ratios throughout this period remained low by then current standards, from the mid-1950s there was a marked upswing in the loss ratios of reinsurers. This was probably a result of the direct companies tightening up their terms for local reinsurers once it became apparent that they were enjoying abnormally good results. In turn this reflected the inexperience of both the direct companies and reinsurers in the conducting of South African reinsurance business.<sup>(17)</sup> Within this relatively good experience the Reinsurance Union from the early 1960s experienced a disastrous downturn in its results with the company's loss ratio being on average 8.1% above the market norm between 1962 and 1966. At the other end of the scale was the Hollandia Re which after some initial difficulties came to enjoy a consistently lower than average loss ratio during the 1960s, reflecting the high quality of the foreign business ceded to the company by its parent office.

Although the loss ratio is the main determinant of the operating results of a reinsurer, the commission and expense ratio is also of considerable significance in shaping results, particularly when the company experiences an unduly high loss ratio. Table 2.6 provides an indication of the commission and expense ratios of the four locally registered reinsurers.

**TABLE 2.6**

**COMMISSION AND EXPENSE RATIOS 1951-1966 (%of NPI) (18)**

	<b>Reinsurance Union</b>	<b>Swiss-SA Re.</b>	<b>Hollandia Re.</b>	<b>Gerling Global</b>	<b>Average</b>
1951	41.0	39.8			40.4
1952	36.7	36.5			36.5
1953	35.5	32.0			33.7
1954	36.3	33.7	25.7		31.9
1955	38.4	31.9	24.7		31.6
1956	35.7	32.5	31.2		33.1
1957	35.6	31.7	33.4	30.0	32.7
1958	34.9	29.5	34.5	31.2	32.5
1959	34.8	35.9	34.4	26.1	32.8
1960	34.4	37.2	22.1	22.9	29.1
1961	35.7	31.9	21.9	26.1	28.9
1962	34.4	30.2	29.3	29.3	30.8
1963	35.7	36.1	25.5	32.5	32.4
1964	34.8	34.2	23.6	32.5	31.3
1965	35.7	34.0	21.6	34.2	31.4
1966	34.0	37.5	25.3	33.9	32.7

Other than in 1951 and 1952, the average commission and expense ratios of these local reinsurers were very much in line with what was to be the norm during the subsequent two decades. Within this average, inevitably there were considerable differences between the individual companies. On the one hand there was the Hollandia Re which with the exception of the period 1957-1959 exhibited a far lower cost structure than any of the other reinsurers. This reflected its willingness to sacrifice technical skill and efficiency in return for keeping the costs of writing business down with the 'high'costs of 1957-9 being a result of the company's entry to life reinsurance business.(19) In contrast to the Hollandia Re the Swiss-SA Re had a much higher cost structure which was a product of both the technical skill of the company and its more "up market" image.(20) While the

Reinsurance Union also had a relatively high cost structure this was a result of its large scale involvement in foreign inwards reinsurance business, which unlike the Hollandia Re it wrote for itself, and thus had to bear the high costs associated with writing such business.(21)

Taken together, the loss ratios as well as the commission and expense ratios provide a fairly accurate indication of the operating margins enjoyed by reinsurers during this initial stage of the development. These operating results are outlined in Table 2.7.

**TABLE 2.7**  
**OPERATING MARGINS OF REINSURERS 1951-1966**  
**(% of NPI) (22)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Average
1951	3.5	29.7			16.6
1952	19.9	16.2			18.0
1953	19.6	10.7			15.2
1954	18.7	8.2	20.7		19.2
1955	14.4	14.8	26.7		18.8
1956	13.9	10.7	-7.7		5.7
1957	8.2	9.9	2.6	30.3	7.8
1958	13.4	8.3	2.4	15.7	10.1
1959	0.6	1.2	-2.0	2.9	0.7
1960	4.4	5.9	25.0	14.7	12.6
1961	7.5	-9.2	23.6	10.1	8.0
1962	-2.9	5.3	23.8	0.5	6.7
1963	-7.2	-2.4	27.8	3.4	5.4
1964	0.6	2.6	29.6	5.4	9.5
1965	-9.6	8.4	21.4	9.0	7.2
1966	-0.9	-1.1	17.3	18.4	8.4

The period 1957-1966 was one of general prosperity for the reinsurance market, particularly in comparison with the future experience of the local reinsurers. What was it about the reinsurance market at this time which caused such good results, particularly as later the market failed to exhibit the same positive operating results? While a number of factors such as the increasing incidence of natural disasters and the growing inflationary pressures present in the economy, among others affected the results, the main reason for the market's shape was the lack of intense competition between the reinsurers. During the initial stage in the development of reinsurance in South Africa reinsurers experienced considerable structural difficulties, especially reluctance on the part of many of the direct companies to cede their business to the new local reinsurers. This led to the emergence of a common identity and sense of solidarity among the reinsurers. This sense of mutual self interest and self preservation acted as an effective damper on competition thereby eliminating the threat of cut throat competition.(23) Subsequently when the second wave of reinsurers emerged in the far more favourable environment of the late 1960s and early 1970s the situation changed radically in that the actions of the new companies were not shaped by the same sense of mutual interdependence and self preservation. In turn this led to a rapid increase in the level and intensity of competition and was in a large part responsible for the deterioration of results after 1966.(24)

While the market consistently showed an underwriting profit this should not obscure the fact that the fortunes of the individual companies differed sharply, contrast the results of the Reinsurance Union and Hollandia Re as shown in Table 2.7. From the early 1960s the Reinsurance Union experienced a dramatic deterioration in its operating results which was a product of its deteriorating claims experience, which was in line with the market and the slide in the exchange value of the South African currency which was of particular effect on the Reinsurance Union with its large foreign portfolios. The experience of the Reinsurance Union also illustrates the necessity of a reinsurer keeping its rates of commission and more importantly expenses within reasonable bounds, lest they compromise the company's results.(25) By contrast the experience of the Hollandia Re during the 1960s was remarkable with its strongly positive results being the product of a low loss ratio coupled to a low commission and expense ratio. However, the results of the Hollandia Re were in many ways a result of good fortune in that it was the generally positive operating environment of this period which enabled the company to produce a profit without any technical expertise. Moreover, this profitability was at least partly achieved at the expense of building up the company's reserves.

The final factor which impinges on the annual operating results of a reinsurance company is its investment income, that is the return derived from accumulated reserves. The investment income of the reinsurers operating in South Africa between 1951 and 1966 is shown in Table 2.8, with the returns being expressed as a percentage of net premium income.

**TABLE 2.8**  
**INVESTMENT INCOME OF SOUTH AFRICAN REINSURERS**  
**1951-1961 (26)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Average	
	Amount(R)	% of NPI	Amount(R)	% of NPI	Amount(R)	% of NPI	Amount(R)	% of NPI	% of NPI	% of NPI
1951	18228	8.5	24100	10.6						9.5
1952	21794	7.2	35860	12.4						9.8
1953	26272	8.0	37806	11.5						9.7
1954	32236	8.8	39250	10.5	6544	6.7				8.7
1955	39146	9.6	49556	11.4	70904	4.8				8.6
1956	44808	8.9	58560	11.8	8350	4.2				8.3
1957	51612	9.3	60034	10.8	11484	4.5	5300	4.0		7.1
1958	59064	9.1	65918	9.3	11614	3.2	7416	3.6		6.3
1959	55718	8.6	71728	8.4	14540	3.0	10576	4.7		6.2
1960	59070	7.9	65056	6.0	21458	3.1	15352	3.4		5.1
1961	70931	8.2	83831	7.2	31742	3.7	22723	4.1		5.8
1962	84739	8.9	107568	7.6	30073	3.0	32363	7.3		6.7
1963	89308	9.1	123599	8.9	30147	2.6	61742	13.0		8.4
1964	93402	8.7	148405	9.5	35247	2.5	87675	12.9		8.4
1965	102013	9.0	159044	7.4	38213	2.6	67967	6.7		6.4
1966	119738	8.6	207034	9.0	53833	3.4	96078	5.0		8.5

The most striking feature of the investment income of these local insurers was that the sums involved were extremely low, with the combined investment income of the four not even amounting to half a million rand in 1966. Not only was this investment income low in absolute terms but, measured as a percentage of net premium income, it was far lower than what was to be the norm in the 1970s and 1980s. This bears out the often expressed contention that the emergence of cash flow underwriting was a product of the 1970s and that prior to this the very idea of practicing cash-flow underwriting was an anathema to any respectable reinsurer.<sup>(27)</sup> However, as is indicated by Table 2.9 even during these years investment income played a not insignificant role in ensuring the profitability of the reinsurers by canceling out most of the operating losses. The unusually low investment income of the Hollandia Re stemmed from its very limited reserves which in turn were a product of the Algemeene Herverzekering Maatschappij "milking" the Hollandia Re.<sup>(28)</sup> The Swedish Atlas also suffered from being exploited by its parent company until it was bought out by the Gerling-Konzern Weltversicherungspool AG in 1961. None the less it is evident that generally the investment income of the early reinsurers ensured their profitability, see Table 2.9 showing the combined operating and investment results of these companies.

**TABLE 2.9**

**COMBINED OPERATING AND INVESTMENT RESULTS  
OF REINSURERS.\*1951-1966.(% of NPI) (29)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Average
1951	12.0	40.3			26.1
1952	27.1	28.6			27.8
1953	27.6	22.2			24.9
1954	27.5	28.7	27.4		27.8
1955	24.0	26.2	31.5		27.2
1956	22.8	22.5	-3.5		13.9
1957	17.5	20.7	7.1	34.3	19.9
1958	22.5	17.6	5.6	19.3	16.2
1959	9.2	9.6	1.0	7.6	6.8
1960	12.3	11.9	28.1	18.1	17.6
1961	15.7	-2.0	27.3	14.2	13.8
1962	6.0	12.9	26.8	7.8	13.4
1963	1.9	6.5	30.4	16.4	13.8
1964	9.3	12.1	32.1	17.3	17.7
1965	-0.6	15.8	24.0	15.7	13.7
1966	7.7	7.9	20.7	23.4	14.9

\* Differences between these two sets of figures (Tables 2.7 and 2.9) and the figures of underwriting results produced in Annual Reports arise from the fact that these figures are based merely on the results of year to year operations and do not take account of transfers to and from insurance funds and reserves. For the growth of these reserves see Table 2.12.

It is clear from the above that the reinsurance companies operating in South Africa at this time enjoyed a very substantial margin on net premium income, particularly during the 1950s. Indeed the overall results achieved by short term reinsurers during these years were almost on a par with those achieved by reinsurers during what may be termed the Golden Years of reinsurance in South Africa, that is 1968 to 1978. There can be little doubt that these companies generally justified their

shareholder's investments in terms of results. Perhaps one exception to this is the Reinsurance Union which experienced unusually poor results from the early 1960s. Having made these observations it has to be noted that the dividends paid by these reinsurers and the returns on share capital cannot be used as measures of their performance in short term reinsurance because with the exception of the Reinsurance Union, they were also involved in life reinsurance business.

While it is evident that these reinsurers were, from the perspective of their shareholders, generally successful in terms of results and growth, in evaluating their performance it is necessary to go further and consider the issue from another angle, namely the extent to which they met the needs of the local direct insurance market. The simplest measure of their success in supplying the direct market is the volume of reinsurance placed with them. However, owing to the nature of the Annual Reports of the Registrar of Insurance up to 1965/6, figures of the gross premium income of insurers and reinsurers are not available, with the Reports only providing figures of net premium income.<sup>(30)</sup> Thus it is impossible to calculate the degree to which local professional reinsurers met the needs of the direct market from 1951 to 1965. Consequently in considering this matter it is necessary to rely on much more impressionistic evidence. Taking all factors into account it is reasonable to argue that the early local professional reinsurers met only a very small, though rapidly growing part of the direct market's need for reinsurance. Accepting that up to 1951 no local professional reinsurance facilities had been available and by 1968 34.4% of the direct market's need for reinsurance cover was provided by these reinsurers, these companies must have increased their share of the direct market's reinsurances by around 2% per annum. In view of this it is evident that the share of the local direct market's reinsurance business held by these companies grew more rapidly than in any subsequent period. Indeed in the following 18 years the share of the reinsurance business of the local direct market held by these professional reinsurers only increased by around 10%. It should also be recognized that their rapid growth took place in spite of the very considerable difficulties experienced by them.

Thus not only did the market enjoy generally satisfactory results during this period but its performance was also satisfactory in so far as it was able to meet at least part of the needs of the direct market, either directly or through providing access to the facilities offered by their parent companies. There was, however, more to the issue of the local reinsurance market's ability to meet the needs of the direct market than merely the offer of partial capacity because in addition reinsurers also need to offer secure cover and sound technical service. That South Africa's early professional reinsurers were able to provide these is indicated by the fire at Maydon Wharf in Durban in 1953.

Following the Indian government's breaking of trade links with South Africa the government stock-piled jute at Maydon Wharf. As a quasi-government risk it was co-insured via a fire pool facility, but such were the hazards inherent in the risk that many of the direct companies sought considerable local reinsurance protection. The fire resulted in the total destruction of both the wharf and the jute stock pile, and reinsurers provided invaluable support to the direct companies who would otherwise have been hard pressed by the very large loss.(31) This in turn demonstrated the importance to the local market of the financial strength and the services of the newly emerged local reinsurers. In this the position of the majority of these reinsurers as subsidiaries of foreign reinsurance groups was crucial as this meant that they were able to draw on both the financial strength and technical expertise of their parents.

Another facet of the issue of whether the reinsurers were able to meet the need of the direct companies was the degree to which these reinsurers were accepted by the direct market. Generally these first reinsurers were welcomed, particularly by the Union/Republic insurers as this removed the necessity for them to seek reinsurance in foreign markets, thus reducing the cost of reinsurance. However, at the same time these reinsurers other than the Swiss Re were treated with a degree of suspicion by a large section of the direct market. There was in many cases a reluctance to cede much business to them because of doubts over their financial strength and technical competence. Certainly questions were raised about the viability of these reinsurance companies, reflecting the scepticism of the direct market about the likelihood of their survival.(32) Such reservations were not totally without foundation as the collapse of the South African Reinsurance Corporation well illustrates. Also many of the direct companies had come to establish good contacts with overseas reinsurers and were understandably reluctant to break these ties in view of the generally high standard of service which they received. This was especially so as there was no guarantee they would obtain the same standard of service and security from small local reinsurers. In very general terms this was the situation in the 1950s. Once, however, the local reinsurers had proved themselves, as they had by the early 1960s, there was a greater willingness to make use of their facilities and accept them as reinsurers of first, rather than last, resort.(33)

It is evident that one important consideration when evaluating the performance of South Africa's early reinsurers is their financial strength, because this ultimately determined their ability to provide a satisfactory service to the direct market. Perhaps the most important measure of their financial strength was their assets and liabilities which are shown in Figures 3a and 3b.\* The assets and liabilities not only indicate the generally rapid growth of these companies, especially during the economic boom of the early 1960s, but also the radically different performances of individual companies. Once again the small size of the reinsurance companies operating in South Africa is highlighted, with only two companies, the Swiss-SA Re and the Reinsurance Union, having assets in excess of R 2 million by 1966. Within this what is striking is not so much the differing performances of these companies per se, but the fact that the growth in assets did not always correspond with the rate of growth of net premium income. At the one end of the scale were the Swiss-SA Re and the Reinsurance Union, whose assets generally grew in line with their net premium income. During the period 1957 to 1960 the premium income of the Swiss-SA Re increased by some 900% and its assets by around 700%, while for the Reinsurance Union the respective figures were 550% and 400%. In the case of the Swiss-SA Re the net premium income never amounted to more than 56% of its short term assets being 32.5% in 1952 and 38.2% in 1966.(34) At the other end of the scale was the Gerling Global, and to a lesser degree the Hollandia Re, whose net premium income grew at a considerably faster rate than their assets as indicated in Table 2.10.

\* These figures refer to the short term assets and liabilities of these companies, not the overall assets and liabilities which would include life business.

# SHORT TERM ASSETS OF REINSURERS 1951 - 1966

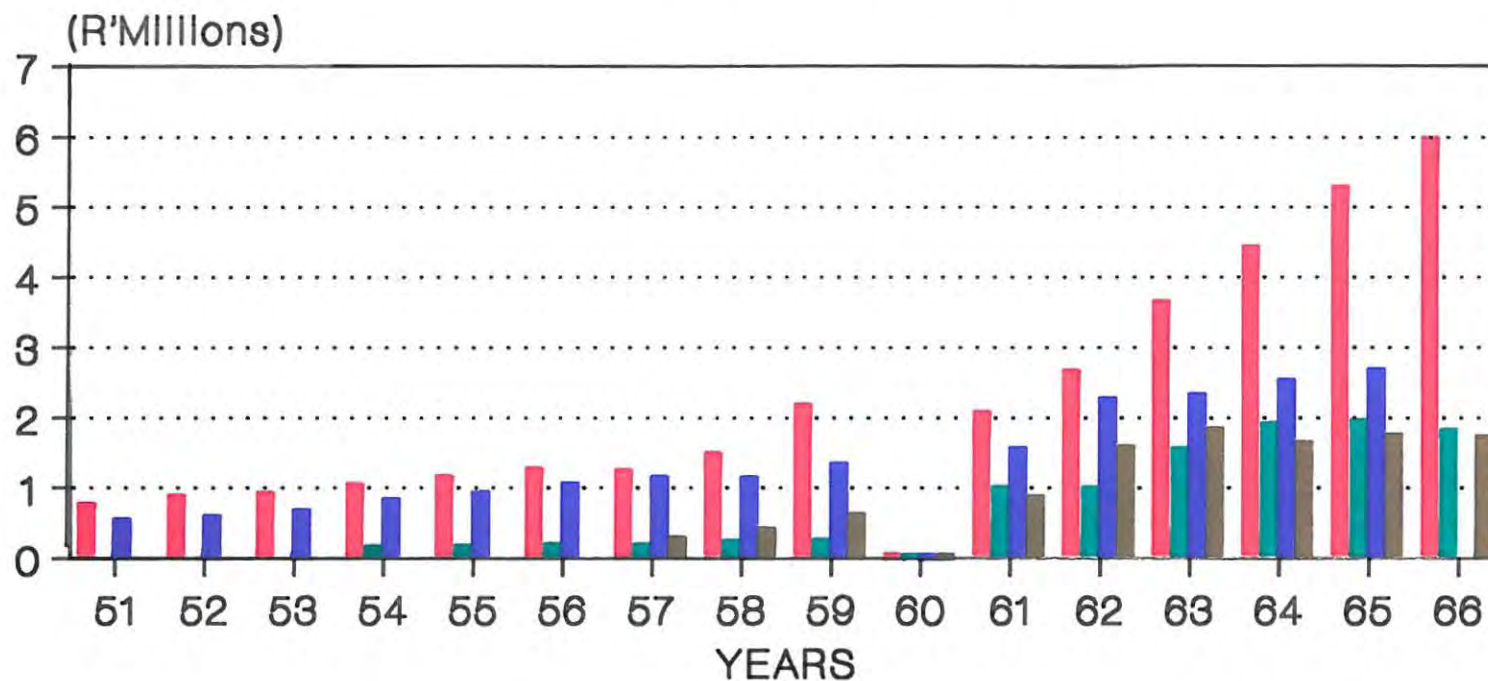


Figure 3a

# SHORT TERM LIABILITIES OF REINSURERS 1951 - 1966

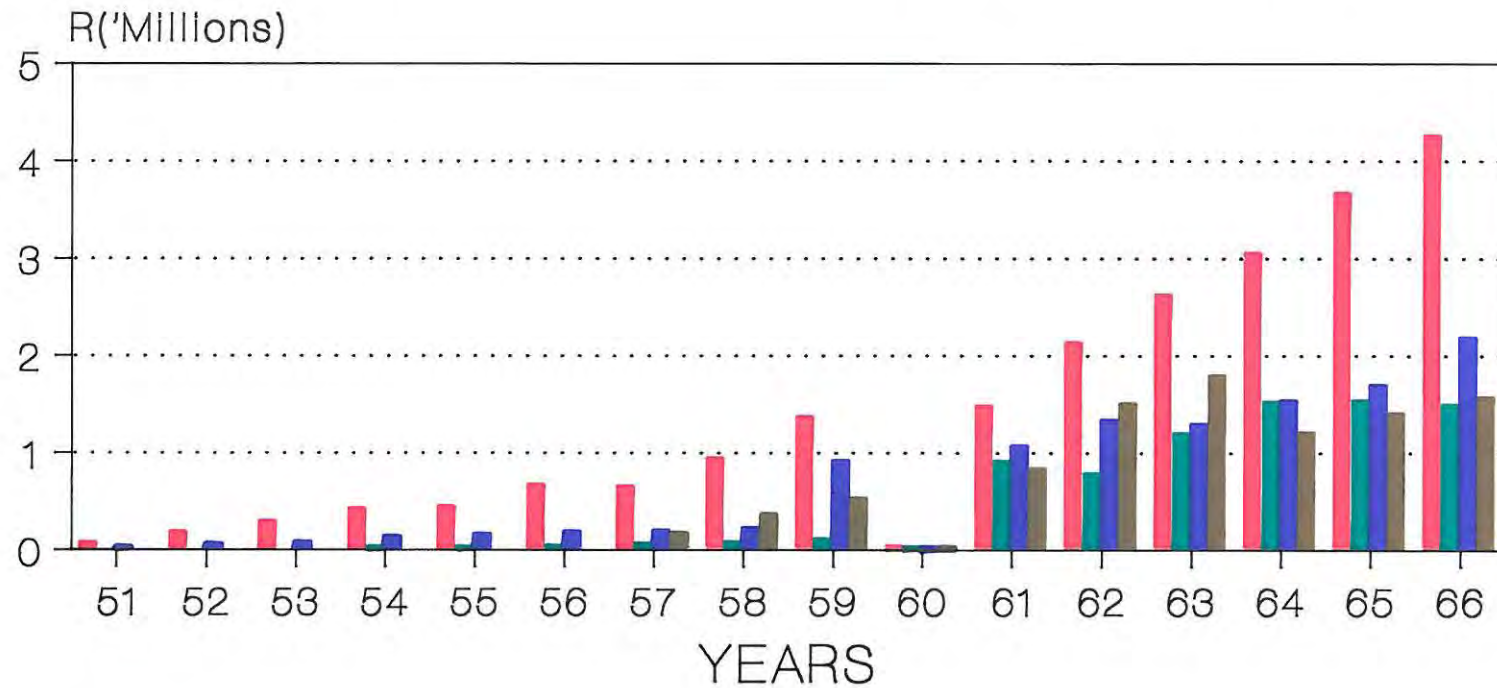


Figure 3b

**TABLE 2.10**

**GROWTH OF NPI AND ASSETS 1954/7 TO 1966.(35)**

	<b>Gerling Global</b>	<b>Hollandia Re</b>
NPI	1 323%	1 551%
Assets	495%	975%

By the close of this period the net premium income of these two companies constituted an unhealthily high percentage of their assets. None the less in the case of the four reinsurers which survived this period, the assets of all these companies were considerably greater than their liabilities, though once again the specific margins varied considerably as is indicated by their solvency margins, that is their free reserve or difference between assets and liabilities, calculated as a percentage of net premium income. Table 2.11 demonstrates this, and in the case of the Swiss-SA Re and the Hollandia Re figures of the technical reserves or insurance funds of these companies are also provided, once again calculated as a percentage of net premium income.

**TABLE 2.11**

**FREE AND TECHNICAL RESERVES OF REINSURERS  
1951-1966 ( % OF NPI) (36)**

	Reinsurance	Swiss-/SA		Hollandia		Gerling
	Union	Re		Re		Global
	Solvency Margin	Solvency Margin	Insurance Funds	Solvency Margin	Insurance Funds	Solvency Margin
1951	252.3%	309.4%	49.1%			
1952	176.2%	245.3%	60.9%			
1953	182.9%	187.1%	73.7%			
1954	191.8%	172.1%	78.9%	160.8%	49.7%	
1955	190.7%	161.7%	79.0%	112.7%	74.5%	
1956	173.0%	122.6%	82.8%	80.4%	72.0%	
1957	172.3%	107.2%	91.3%	49.4%	74.4%	86.6%
1958	142.8%	77.4%	88.5%	46.7%	72.7%	25.4%
1959	65.6%	96.0%	90.2%	29.6%	64.5%	42.0%
1960	N/A.	N/A.	73.7%	N/A.	73.1%	N/A.
1961	57.8%	51.9%	85.5%	11.7%	51.0%	9.7%
1962	98.3%	33.7%	115.1%	22.5%	77.4%	20.9%
1963	106.6%	74.8%	119.2%	31.0%	85.8%	12.7%
1964	92.5%	88.7%	120.7%	28.1%	80.0%	65.8%
1965	87.9%	75.6%	108.1%	29.2%	88.2%	35.2%
1966	N/A.	75.3%	94.3%	20.6%	83.8%	8.4%

A number of factors of particular note emerge from these figures. In the first place there was a very marked difference in the financial position of the Swiss-SA Re and the Reinsurance Union on the one hand, and of the Gerling Global and Hollandia Re on the other, in terms of solvency margins. The solvency margins of the Swiss-SA Re and the Reinsurance Union were consistently in excess of 50%, while in the case of the Hollandia Re and Gerling Global these were normally considerably

below that level. Indeed in the case of the Gerling Global the solvency margin on two occasions fell below the present statutory requirement of 10% of net premium income. This highlights the fact that during the 1950s and even during the 1960s the degree of control exercised by the Registrar of Insurance over both the direct and reinsurance markets was very low in comparison with that exercised since the mid 1970s.(37) Certainly all this supports the contention that the rapid growth of these latter two companies in this period to a degree compromised their financial position. In the case of the Hollandia Re this situation arose primarily as a result of the unwillingness of their parent company to allow them to build up reserves, choosing rather to repatriate funds to the Netherlands.(38) Overall it would seem that there was a direct connection between the level of these reinsurers free and technical reserves and their rate of growth in terms of premium income. Having said this it would none the less appear that all these companies, when both free and technical reserves were taken into account, enjoyed adequate financial strength to be able to provide the level and security of cover demanded by the direct market. The one possible exception to this was the Gerling Global. However, the particular financial weakness of this company at specific times was a result of first the change in its shareholding in 1961 and secondly its exceptionally rapid growth of premium income in 1966, rather than any fundamental financial weakness.(39) Of the early reinsurers it was only the South African Reinsurance Corporation which can be adjudged to have been financially unsound. During its lifetime, that is from 1950 to 1962, its assets were only marginally in excess of its liabilities and on two occasions, in 1954 and 1962 its assets were actually less than its liabilities and the company was the one element of instability within the South African reinsurance market during its early years.

Undoubtedly the single most notable and indeed disreputable event which occurred in the South African reinsurance market in the period 1950 to 1966 was the demise of the first professional reinsurer registered in South Africa, the South African Reinsurance Corporation (SARC). This company which was registered as a professional reinsurer on the 3rd May 1950 was until 1958 a subsidiary of the French controlled Société Nord Africaine de Reassurances (SNAR).(40) Unlike the other reinsurance companies established in South Africa, the SARC was created not as a result of the strength and expansionist tendencies of its parent company but rather was a product of the difficulties being experienced by the SNAR. Essentially the SNAR was a speculative financial company rather than a genuine reinsurer. This company had originally been based in Paris but was forced to move to Algeria in the aftermath of the Second World War because of its doubtful financial position. By the late 1940s the SNAR was experiencing considerable difficulties with poor operating

results further undermining its already tenuous financial position, leading to the French authorities investigating its affairs. SNAR decided to attempt to resolve its problems by establishing a subsidiary in another country and handing over much of the business on the SNAR's books to it, thereby reducing the strain on their financial resources.(41) It would appear that the general belief was that if a subsidiary could be established in a country like South Africa where there was a large latent demand for local reinsurance facilities, the volume and quality of the new business acquired by the subsidiary would offset the burden of the bad business ceded to it by its parent. In the event this scheme did not work, with the SNAR collapsing in 1958 and the SARC experiencing the same fate just four years later.

Following its decision to establish a subsidiary in South Africa, the Société Nord Africaine de Réassurances in 1948 sent out one of its senior officials, Edmond Panigel, to register and establish what was to become the South African Reinsurance Corporation. To this end Panigel was given an effective carte blanche to establish the SARC and to ensure the company's complete independence from the the SNAR group. This freedom was to a degree hamstrung by the inadequate finance available to Panigel stemming from the financial difficulties of SNAR. In these circumstances the authorized share capital of the SARC amounted to Pounds 250 000, while the issued and paid up capital initially stood at only Pounds 48 000, rising to a maximum of Pounds 62 500 by 1954.(42) Such share capital was totally inadequate for any reinsurer operating in South Africa at this time, particularly one which was unable to trade on the basis of the reputation and financial strength of its parent company. (For comparison see Table 2.3) In spite of these financial difficulties Panigel in the space of a few years established for the SARC, on the surface at least, a considerable financial empire in the form of a network of subsidiary companies, as outlined in Table 2.12

**TABLE 2.12**

**SUBSIDIARIES OF THE SOUTH AFRICAN REINSURANCE CORPORATION  
(43)**

**Insurance Companies:**

- Provident Assurance Corporation of Africa Ltd.
- South African Mortgage Insurance Corporation Ltd. (SAVVM)
- South African Machine and Engineering Insurance Corporation Ltd  
(Samagic)
- Insurance Corporation of Rhodesia Ltd.
- Sentrakas

**Property Companies:**

- Reinsurance House and Garage (Pty) Ltd.
- Reinsurance House (Durban) (Pty) Ltd.
- New Clewer House (Pty) Ltd.
- Espoir Investments (Pty) Ltd.
- Sasolburg Estates (Pty) Ltd
- Mobeni Construction Company (Pty) Ltd.

This establishment of a network of subsidiaries was the single most important feature of the SARC Group and one which distinguished it from the other reinsurers in South Africa. While it could normally be expected that this would be a reflection of the financial strength of a company, in the case of the SARC it was rather symptomatic of its weakness.

By the time the South African Reinsurance Corporation commenced business in 1951 it had been joined by two other reinsurers; the Reinsurance Union of South Africa and the Swiss-SA Reinsurance Company. In the face of the competition posed by these other two reinsurers, both of which had strong and reputable shareholders, the SARC found it difficult to break into the market owing to the dubious reputation of the SNAR(44) Indeed the other reinsurers generally sought to dis-

tance themselves from the SARC because of its reputation. Consequently the SARC found it difficult to build up a portfolio of South African business. This posed a very serious problem for the SARC particularly as its parent company had, as already indicated, handed over a considerable portfolio of poor quality French and continental business to its South African subsidiary. If the SARC was to survive it was imperative that it acquire new business to balance out the losses which could be expected from the business ceded by its parent. Because the large established direct companies in South Africa, which were the seekers of the greatest volume of reinsurance, would have nothing to do with the SARC this forced the company into two specific and doubtful courses of action. Firstly SARC used the contacts established by the SNAR on the continent and in French territories to build up a further portfolio of foreign business.(45) It is worth noting that the foreign business of the SARC up to the end of the SNAR's ownership in 1958 constituted almost as great a percentage of its business as was the case with the Reinsurance Union. (See Table 2.15) This constituted a very considerable weakness for the company as the business acquired through the SNAR's contacts was generally poor. Also the slide in the exchange value of the South African currency from 1960/1 further exacerbated this situation. However ultimately it was to be the second of the two efforts to secure additional business which was eventually to bring about the collapse of the company. The solution proposed by Panigel was both simple and ingenious, though ultimately flawed. If the established direct companies would not cede business to the SARC, and given that the demand for insurance cover was growing, the SARC would purchase and establish a number of direct companies in Southern Africa to provide the business it needed.(46) Particular focus was placed on the establishing of specialist insurance companies to provide forms of cover not normally provided by the direct companies in South Africa, for example hail insurance through Sentrakas. To this end Panigel assiduously courted government officials to get permission to extend the SARC's operations into new fields and it can be hardly coincidental that a large part of this new activity was aimed at the Afrikaner market. For instance Panigel via the SARC was responsible for creating Sentrakas, the forerunner of Sentraoer and Sentraoes and its life arm the Suid Afrikaanse Verband Versekerings Maatskappy, which was later taken over by the Land Bank.(47) Thus the network of subsidiaries established by the SARC, at least in the insurance sector, were a reflection of the company's weakness rather than a result of its strength.

The perceived weakness of the South African Reinsurance Corporation, both in terms of its financial and operational position, is confirmed by an examination of the performance and results of the company between 1951 and 1960. While the company remained in operation until 1962, 1960 was the

last year for which accounts were prepared. Moreover the draft annual accounts for both 1959 and 1960 were rejected by the auditors, Alex Aitken and Carter in 1959 and Price Waterhouse in 1960. It follows that the accuracy of the figures for these two years cannot be confirmed.(48) For details of the performance of the SARC see Table 2.13.

**TABLE 2.13**

**SARC: GROWTH AND PERFORMANCE 1951-1966 (R) (49)**

	GPI	NPI	Local NPI as a % of Total NPI	Claims	Loss Ratio (% of NPI)	Assets	Liabilities	Dividends	Solvency Margin (%ofNPI)
1951	67 634	29 822	-	9 231	30.9	52 000	11 000	-	137.5
1952	195 861	68 639	31.3	32 057	46.7	45 000	17 000	5%	40.8
1953	265 025	101 160	25.7	66 155	65.4	68 000	38 000	5%	29.6
1954	331 358	127 574	-	89 328	70.1	57 000	51 000	5%	4.7
1955	520 360	215 890	21.8	141 019	65.3	82 000	68 000	5%	6.5
1956	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1957	731 666	238 852	28.4	202 276	84.7	88 000	79 000	5%	3.8
1958	1 071 161	469 226	52.4	311 045	66.3	308 000	170 000	-	29.4
1959	N/A	270 243	45.8	190 937	70.6	308 000	298 000	-	3.7
1960	N/A	373 364	-	250 705	67.1	716 000	695 000	-	5.6

On the surface it would appear that the performance of the SARC measured in terms of the growth of premium income, both gross and net, was very satisfactory. Indeed the growth of this company was at worst in line with the average growth rate of the market. However, beyond this basic measure of performance it readily becomes apparent that the performance of the SARC was extremely poor. In the first place the loss ratio of the company was considerably higher than the market average meaning that the overall results were probably below the average for the market. This was true for both the period up to 1958 when as a subsidiary of SNAR the company wrote a book consisting overwhelmingly of foreign business, as well as for the period after 1958 when as a locally owned company it wrote a larger book of local business.(50) On the face of things there was

little difference in the quality of local and foreign business held by the company, both portfolio's generally being poor. Owing to the paucity of information, in particular the failure of the annual financial statements to provide consistent details of short term investment returns, levels of commission and management expenses, it is impossible to produce accurate figures of the operating margin. It can, however, be deduced with a fair degree of certainty that the management expenses of the SARC were much higher than the norm because of its high acquisition costs of both local and foreign business and the high level of personal spending of the Chief Executive. This coupled with the fact that the investment income of the SARC was likely to be minimal as a result of the low level of the company's reserves suggests that the overall results of the SARC were likely to be very poor.(51) That this was the case is confirmed by J. Kristella who served as Deputy General Manager of this company from March 1960 to June 1961, and who stressed that "the results of the company were appalling, with the company continually running at a loss."(52) Having said this perhaps the one outstanding feature of the SARC during the 1950s was that until 1958 it consistently paid a dividend of 5% per annum to its shareholder, the Société Nord Africaine de Reassurances. These dividends were paid at the request of the SNAR with the approval of the Chief Executive of the SARC in spite of the continual losses. This was particularly damaging as the 1950s and 1960s were the period of unlimited liability proportional treaty business, where it would take years before the profitability of a treaty could be determined.(53) The ultimate reason behind this paying of dividends was twofold. First the SNAR needed the dividends to strengthen its financial position and secondly the idea soon arose that the SARC should be sold off to South African interests, but to attract local shareholders the company had to appear profitable. While this latter move was successful with Norman Herber of Greatermans leading a consortium which was to purchase a 50% share in the company, the paying of dividends seriously weakened its financial position. Essentially the payment of dividends was achieved at the expense of building up adequate claims and premium reserves.(54) Moreover the income derived from the company's net account was largely used to establish the subsidiary network of the SARC rather than the necessary liquid reserves. While it could be, and in fact was, argued that the investment in these subsidiaries effectively constituted the company's reserves, these 'reserves' were only as strong as the subsidiary companies.(55) Ultimately it was to be the failure of one of these subsidiaries, the Provident Assurance Corporation of Africa, which was to cause the collapse of the SARC. The failure to build up the liquid reserves of the SARC is manifested by the solvency margin. In terms of the current statutory solvency margin requirements, the license of the SARC would have been suspended by the Registrar, and the company forced to stop writing business on five occasions between 1951 and 1960. This failure to ensure the financial soundness of the SARC is probably the single most damning feature of the perfor-

mance of the company and of its management in that this was ultimately responsible for the company's demise in 1962. Overall the performance of the company was truly catastrophic, not merely in comparison with other reinsurers but also in absolute terms. However, from 1957/8 onwards the results were not disclosed or balance sheets submitted to the Registrar and the auditors ultimately refused to approve the annual accounts.(56)

Before going from this general focus on the main problems of the SARC to considering the specific reasons for the company's demise in 1961/2 it is necessary to outline the main events which led up to the company's collapse. At this point it should be stressed that the SARC was as much a holding company as it was a reinsurer and consequently the demise of the SARC was bound up with the difficulties experienced by its subsidiaries.(57) While it would be true to claim that the company was inherently flawed right from the outset, the beginning of its demise can be traced to 1957/8 when the company ceased to be a wholly owned subsidiary of the SNAR, and came to be jointly owned by Panigel and Norman Herber through SARC Holdings Ltd. This change in ownership was a result of the financial difficulties of SNAR and indeed it was only because the SNAR sold the SARC that the latter company 'survived' for otherwise it would have collapsed along with the rest of the SNAR Group. That the mounting financial difficulties of the SNAR posed a threat to the position of the SARC is indicated by the following view expressed in April 1957, "Another source of speculation in the South African insurance market is the effect which the difficulties of a large North African reinsurer may have on the fate of its South African subsidiary and allied interests."(58) The shares of the SNAR in the SARC were purchased by Herber and Panigel on a 50/50 split and ceded to SARC Holding Ltd. While Herber paid the SNAR for his 50% shareholding in the SARC on receiving the shares it was agreed that Panigel would pay off the Pounds 31 250 for his 50% of the shares in annual installments out of the management fees which SARC Holdings received from the group.(59) In reality this meant that Panigel never actually paid up his 50% of the share capital of the SARC group. This change in ownership effectively marked the first stage in the demise of the SARC, for it had the effect of undermining still further the reputation of, and confidence in, the SARC on the part of the direct market as Panigel was not highly regarded within the local insurance market. Furthermore the change in ownership compromised the already doubtful financial position of the SARC yet further as neither of the new owners had the financial resources to put the company on a sound footing.(60) In other words it was even better for the SARC to have a weak parent company of dubious reputation than to be owned by Herber and Panigel, the former knowing nothing about reinsurance and the latter being regarded as something of a rogue and a speculator.

From this point on the SARC deteriorated markedly in the administration of business and organization of the company as well as in financial strength. In particular it became evident that the organization of the company was totally inadequate to support its growth over the previous years, with the result that the entire management structure broke down and there was loss of managerial control. That the company was facing a catastrophic state of affairs is also indicated by its increasingly perilous financial position. The June 1958 annual accounts were the last published, and as late as March 1960 the 1959 balance sheet had still not been completed. To compound this sad state of affairs the auditors refused to sign the accounts for both 1959 and 1960. More importantly in the latter year the auditors expressed the opinion that the main subsidiary of the SARC, the Provident Assurance Corporation of Africa was effectively insolvent. At this point the auditors of the SARC had discussions on the financial position of the SARC and its subsidiaries with the Registrar of Insurance who had become extremely concerned about the position of the group.<sup>(61)</sup> The effect of this on the SARC is eloquently summed up by the following statement, "If, as intimated, the Provident was insolvent the shares valued at Pounds 70 000 of the Provident belonging to the South African Reinsurance Corporation would have to be written down to Pounds 1 thereby reducing the assets of the South African Reinsurance Corporation by Pounds 70 000, making the company virtually insolvent."<sup>(62)</sup> As this assessment of the Provident was ultimately accurate, this effectively constituted the final nail in the coffin of the SARC and its collapse was inevitable.

As these events were unfolding during the course of 1960s the board of the SARC, particularly the nominated members, became increasingly concerned and sought ways of remedying the situation, so they and the Registrar of Insurance tried to secure the financial support of an overseas insurer or reinsurers to prevent the company going into liquidation.<sup>(63)</sup> Previously when the SNAR was looking at selling off its shareholding in the SARC, the Munich Reinsurance Company had expressed an interest in buying the company in order to gain a representation in the South African reinsurance market. This, however, fell through when Panigel was able to secure Herber's support. In the face of the growing doubts about the company's future the board approached the Munich Reinsurance Group and requested it to investigate and reconsider the possibility of purchasing the SARC. After an in depth examination the delegation sent to South Africa by the Munich Re expressed the view that around Pounds 1 million in additional capital would be required to put the company on a sound footing and therefore declined the offer.<sup>(64)</sup> Once the Munich Re had expressed its unwillingness to purchase, strenuous efforts were made to interest other overseas reinsurance companies as purchasers. Up to this point the Registrar had not intervened directly in the affairs of the SARC as he hoped that either an overseas insurance or reinsurance company would

purchase the SARC or that Herber would invest an additional Pounds 200 000 in the company.(65) When it became apparent that the losses and outstanding liabilities of the SARC were such that neither of these two proposed solutions was going to be implemented, the Registrar became more actively involved and approached local insurers to rescue the SARC. As this met with no more success than the previous attempts to resolve the crisis the Registrar was eventually compelled to institute liquidation proceedings. However, at this juncture the so called "non-conformist of South African insurance", Aubrey M.Cramer of the Auto Protection Insurance Company expressed an interest in purchasing the SARC group.(66) This was an offer which the Registrar readily accepted in order to avoid a liquidation, in spite of the arguably doubtful financial strength of the Auto Protection Insurance Company. Consequently in late 1961 the Registrar was able to inform the board of the SARC that the Auto Protection would be prepared to purchase the Provident Assurance Corporation and its holding company the SARC, as well as a number of the other subsidiaries in the group. This effectively marked the end of the road for the SARC for Cramer saw the SARC essentially as a holding company which it was necessary to buy to secure control over the subsidiaries and consequently halted the reinsurance activities of the SARC. The final chapter in this sorry tale came in 1964 when Cramer's Auto Protection group went insolvent, an event which can in part be attributed to the burden the SARC and its subsidiaries placed on the financial resources of the group.(67)

While the reasons for the collapse of the SARC were many and varied, five factors stand out as being of particular importance. These were firstly the ownership of the SARC, secondly its continual financial weakness, thirdly the breakdown of effective managerial control, fourthly the large foreign portfolio written by the company and lastly the generally poor quality of all the business on its books. The first of these issues has been dealt with in a fair degree of detail and essentially related to the support available to the company from its shareholders. There is little doubt that in comparison with the other reinsurers in South Africa at this time, the SARC had the weakest parentage. This was not only in terms of the level of financial and technical support but also in terms of reputation, which was a very important asset for the early reinsurers. This was the case both before and after the change in ownership in 1958, although from this point on the situation deteriorated still further. The second factor, financial strength is at least partially linked to this and once again has been considered in detail. It is reasonable to suggest that ultimately it was the fundamental financial weakness of this company which was responsible for its collapse. In this emphasis must not only be placed on the problems caused by the shareholding of the SARC but also on the role played by the management of the company. As the management of the SARC was effec-

tively given a free hand in the running of the company by the SNAR, the management must bear the brunt of the responsibility for its financial weakness. This weakness was largely a product of the investment and reserving policies adopted by the SARC. In turn this raises the third factor behind the collapse of the SARC and one which has not been considered in much detail, namely the lack of sound managerial control. At the heart of this lay the absence of a sound organizational and hierarchical structure. The effect of this on the company is best illustrated by the following statement, "The group did not have an organization capable of facilitating the smooth operation of the company. No decision could be made by the appointed senior officials as all decisions were made by the managing director who was often unavailable due to other work. There was a general state of uncertainty, frustration and confusion throughout the company. The technical departments reported directly to the managing director. The departments which provided the accounts data and had to arrange for the financial requirements were dealt with directly by the managing director in collaboration with the General Manager Mr G.M.Zaia who received direct instructions from the managing director and who was autonomous from all other officials.\* It was quite obvious that this was arranged so that one did not become aware of the financial transactions which were arranged every month with a view to having cash available to pay the necessary accounts."(68) The key point which emerges from this is that Panigel exercised total dominance over the company with its management effectively resting in his hands. Not only did Panigel take all decisions on both the technical and financial matters but he also "received all the letters from the actuaries and auditors and did not entrust these to the board."(69) From this it becomes apparent that there was a total breakdown in the management and administration of the company and there is no question that this was central to the underwriting and more importantly the financial, difficulties of the SARC. The two final factors relating to the collapse of the SARC, were the standard of business written by the company and the dominance of foreign business in the company's portfolio, and have been considered in detail. In the first instance the large portfolio of foreign business written by the SARC constituted a fundamental weakness of the company and the problem caused by the writing of a large book of foreign business is considered in detail in the next section. Secondly it is evident that the greater part of the business written by the SARC, both local and foreign was generally of a poor quality. In the case of local business this was a result of the SARC being forced to rely on its subsidiaries to provide it with business. As these companies tended to operate in high risk fields or at the lower end of the market, writing business rejected by the large and reputable direct companies, the quality of the business secured by the SARC was poor. Much the same held true for foreign business as the

\* It is worth noting that Guido Zaia was an acquaintance of Panigel, who prior to being appointed General Manager of the SARC had been head chef at the old Carlton Hotel in Johannesburg.

SARC relied on its contact with the SNAR to secure this and unfortunately SNAR's business was also towards the lower end of the market. Taken together these factors combined to form a fatal blend of difficulties which ultimately were to be responsible for the collapse of the SARC.

The initial stage in the development of professional reinsurance in South Africa, saw a number of distinctive features coming to characterize the reinsurance market. The most important of these was the overwhelming European ownership of the reinsurance companies registered in South Africa. While there had been various attempts to establish exclusively South African reinsurance companies, only one, the Reinsurance Union survived for any length of time. Of the other two independent South African reinsurers established in the 1950s, both Santam and the South African Reinsurance Corporation soon dropped out of the reinsurance market. This, when linked to the eventual collapse of the Reinsurance Union in 1985, raises a number of important issues. In particular whether an exclusively South African reinsurance company was a viable proposition in view of the essentially international nature of reinsurance. Linked to this is the issue of whether the creation of independent South African reinsurance companies was primarily a response to the desperate need for local reinsurance facilities and also a result of ignorance about the underlying requirements for successful reinsurance operations. Certainly there have been no subsequent attempts to float any other independent South African reinsurance companies. Lastly it has to be inquired what effect the dominance of foreign owned reinsurance offices in South Africa has had on the development of the South African reinsurance market. In other words has this been a positive or negative factor within the overall development not only of reinsurance but of the insurance sector as a whole. W.A.Stricker argues that independent South African reinsurance companies are inherently unable to survive for two reasons: first the international nature of reinsurance and secondly the fundamental weakness of South Africa's position in the international economy.<sup>(70)</sup> This view is not, however, universally accepted. In some quarters it is seen as too rigid and determinist in that it does not take the specific circumstances of the individual companies into account. None the less it would seem that there is a general consensus that independent South African reinsurers face considerable difficulties in terms of their operating position. In so far as the essence of reinsurance lies in the spreading of risks world-wide it is necessary for any reinsurance company, if it is to be successful, to engage in international reinsurance business, not merely via retrocession but through accepting foreign inwards business. Consequently for an independent South African reinsurer to operate successfully that company requires to become involved in large scale foreign business to secure the necessary spread of risk.

However, because international reinsurance business involves a flow of capital between countries, international reinsurance operations can only be conducted successfully from countries with strong and stable currencies and without exchange control regulations. Since the imposition of exchange controls by the South African government in the early 1960s, but particularly from the early 1980s when this coincided with a sharp slide in the exchange value of the rand, this effectively eliminated the possibility of conducting foreign inwards business from South Africa. This in turn put the position of independent South African reinsurers in jeopardy. Moreover, the fact that South Africa is a small and unimportant reinsurance market has meant that the foreign business offered on the South African market was normally of poor quality, being the business which could not be successfully placed on other more important markets. Certainly this was borne out by the experience of the Gerling Global which engaged briefly in foreign business on its own behalf in the late 1970s and early 1980s. This company only accepted around 5% of all foreign business which it was offered because of its poor quality.(71) Further key features behind the weak position of independent South African reinsurers are first the lack of expert knowledge of international reinsurance markets and secondly the high costs of securing this expertise which would have to be imported. Essentially South African management has not had the technical or financial expertise to be able to run a viable reinsurance operation in the main financial centres of the world. This is the basis of the argument put forward by W.A.Stricker that independent South African reinsurance companies inherently cannot survive owing to their weak position vis-a-vis the international reinsurance market and their concomitant need to write foreign reinsurance business.

It has, however, been argued that while independent South African reinsurance companies do face significant difficulties in terms of conducting such international business, they could survive, though not necessarily flourish, in spite of these difficulties. If these independent South African reinsurers had been prepared to limit their foreign activities and consequently grow slowly, as would seem to have been the case with the Reinsurance Union in its early years, they could have survived. However, they would have had a very limited capacity and would only have had a minimal impact on the local market. Such companies because of shareholder pressure and the ambitions of management were generally unwilling to limit their growth to such a degree and consequently ran into major difficulties from their large scale involvement in foreign business.(72) Thus although it was in theory feasible for independent South African reinsurers to survive, it was in reality unlikely with the experience of such companies since the 1950s bearing out this contention.

In light of all this it would seem reasonable to argue that foreign owned reinsurance companies operating in South Africa, must have played a crucial role in the development of reinsurance facilities in this country. Certainly such reinsurers did not experience the difficulties faced by independent South African reinsurers. Not only did they have the access to the technical and financial resources which the independent reinsurers lacked, but more importantly they did not have to become directly involved in the writing of foreign business. During the period 1950 to 1966 the Swiss-SA Re, the Hollandia Re and the Swedish Atlas/Gerling Global were all wholly owned subsidiaries of their respective European parent companies. Essentially they operated as their parent group's representative in South Africa and in the last analysis wrote business within this region on behalf of their parent companies.<sup>(73)</sup> While this is a generally accurate assessment of the operations of foreign owned insurers trading in the South African market both in this initial period and in the subsequent periods, the degree of 'independence' of these subsidiary companies varied considerably. On the one hand the Swiss-SA Re enjoyed a relatively high degree of freedom in its operations, in that it did not merely act as a branch of its parent company, but rather acted independently within the very broad guidelines set down by its parent.<sup>(74)</sup> On the other extreme companies such as the Hollandia Re were very closely supervised by their parent offices and acted essentially as the marketing arm of their parent. All these reinsurers enjoyed the total backing of their parent companies, and the South African reinsurance market gained the benefits of access to the vast technical and financial resources of these international reinsurance groups.

Undoubtedly one of the main benefits which the South African reinsurance market has derived from the very close relationship between these international reinsurers and their South African subsidiaries is that the subsidiaries have generally been able to draw on the vast financial resources of their parent companies. The availability of such financial support has played an important role in ensuring the strength and stability of the South African reinsurance market in the face of the periodic difficulties and crises which have affected it in the past thirty five years. Essentially this support allowed these reinsurers to ride out temporary crises, such as those of the early 1960s and early 1980s, which caused the collapse of independent South African reinsurers. These foreign reinsurers played a role broadly analogous to that played by the so-called 'Imperial Banks' in South Africa by providing an important element of strength and stability in their respective sectors. This financial support has generally taken two main forms. In the first instance capital has been available both to strengthen the financial base of these companies should this be necessary and to facilitate the expansion of premium income. Secondly this financial support has involved the effective guaranteeing of retrocession facilities for the subsidiaries. Unlike the independent South African reinsurers, these

subsidiaries are not at the mercy of foreign retrocessionaires and adequate retrocession facilities are always available. Moreover the cost of this retrocession cover has generally been considerably below what would have to have been paid by an independent South African reinsurer on the open market for equivalent cover.

Turning first to the issue of the availability of capital it is clear that all the subsidiaries of European reinsurance companies operating in South Africa, with the exception of the Hollandia Re from the late 1970s, have been able to rely on their parent companies to provide the capital necessary to strengthen their financial base. Such financial support has been available both to support the company in times of difficulties and to facilitate the rapid expansion of business. Of the major reinsurance groups operating in South Africa through subsidiaries, it has only been the Netherlands Reinsurance Group which has been forced to reduce its involvement in the South African market as a result of anti-apartheid pressure. Mr. E.J. Slager then Deputy Chairman of the Hollandia Re advised in 1982 that, "it was impossible for the NRG to provide an increase in capital on account of the anti-apartheid policy of the Netherlands government which inhibits increased investment in South Africa and the distinct danger of politically motivated public repercussions."<sup>(75)</sup> Certainly during this initial period of the development of reinsurance in South Africa those reinsurance companies which were subsidiaries of major European reinsurance groups were able to secure the capital necessary for expansion from their parent companies. Thus these international reinsurance groups played an important role in ensuring the growth of local reinsurance capacity to meet the growing needs of the direct market.

Similarly in terms of access to retrocession facilities the subsidiary operations enjoyed great benefits over the independent South African reinsurers in that retrocession facilities were virtually guaranteed by their parents. As in the case of the availability of capital all the subsidiaries of foreign reinsurers operating in South Africa have been able to rely totally on their parent offices for the provision of retrocession facilities. Because these subsidiaries effectively wrote business not so much for their own account, but primarily on behalf of their parent companies, they would write up to the maximum capacity for their own account and beyond this retrocede the balance of their gross premium income to their parent companies. Through this these subsidiaries were able to provide, albeit indirectly, a large part of the reinsurance capacity needed by the direct companies, thereby reducing their dependence on overseas capacity and thus strengthening their statutory solvency margin. The easy access of the subsidiaries to retrocession facilities via their parent offices was particularly important during periods when the market was experiencing poor underwriting conditions.

These companies were then ensured adequate retrocession facilities at rates normally considerably below the price they would have had to pay on the open market.(76) By contrast independent South African reinsurers during these periods generally had to pay far higher rates for their retrocession cover, at the very time when their results were such that they were least able to afford to pay for it, thus seriously weakening their position. However, in the light of the apparent ability of the Reinsurance Union to secure adequate reinsurance facilities at reasonable rates, even during poor underwriting periods, this factor should not be overemphasized.(77) In general it is clear that in terms of financial support, both in the availability of capital and through the guaranteeing of retrocession facilities, those companies which were subsidiaries of major European reinsurers were in a far stronger position than the independent South African reinsurers. This in turn had an important stabilizing effect on the South African reinsurance market, particularly during its early formative years.

Perhaps the most notable feature of the South African reinsurance market which emerged right from the initial stage of its development was the division which has existed between those companies which wrote a large foreign portfolio and those which concentrated solely on business emanating from Southern Africa. Somewhat inevitably this division corresponded to the division between the independent South African reinsurers and the subsidiaries of foreign groups operating in South Africa. The independent South African reinsurers, as indicated already, were obliged to write foreign business while the subsidiary offices did not have to write such business. This in turn had a considerable bearing on the performance of these various elements of the reinsurance market. Those companies which had to write foreign business faced considerably greater problems than those offices which did not have to attempt to write this business, inevitably weakening their operating position. This almost exclusive focus on business from within Southern Africa by subsidiary companies was a result of the fact that many of the parent groups, the Swiss Reinsurance Company in particular, had subsidiaries and branches throughout the world, each of which wrote business either directly or indirectly for their parent company from that particular region.(78) In the case of South African operations this generally involved Southern Africa and the Indian Ocean islands. There was little call for these reinsurers to get involved in foreign business, that is business outside this region, as this would be likely to come into conflict with the overall interests of the group. Thus unlike the independent South African reinsurers these companies did not face the potentially destabilizing problem of the need to write foreign business to achieve a balanced portfolio. If foreign business was sought by the local subsidiary it was normally done through the agency of the parent company, as was the case with the Swiss-SA Re. Because the parent company

had the necessary expertise to underwrite such business thus ensuring that only good quality business was written and also reducing the acquisition cost to a bearable level. Indeed the strength of the subsidiaries in part lies in their lower underwriting costs, stemming from their ability to draw on the expertise of their parent offices.(79) Nonetheless some of these subsidiary operations, notably the Gerling Global, have at various times written a fairly profitable portfolio directly on their own behalf although this has invariably been a minor part of their total business. By contrast independent South African reinsurers, most importantly the Reinsurance Union, have been heavily involved in writing foreign business. This was also true of the Central Reinsurance Corporation during the 1970s, when owing to Santam Bank having a 50% stake in the company and being largely responsible for its creation and operation the company effectively operated as an independent South African reinsurer. In the case of the Reinsurance Union it seems that the main focus of this company's activities was on the foreign rather than local insurance market. This was in spite of the fact that it was originally established by some of the direct companies to provide the reinsurance capacity needed by the direct market. However a large part of this foreign business was based on reciprocity, involving the trading of local business for an equivalent amount of overseas business in order to spread the risks and achieve a secure income base. Thus the company did write, though not retain, a considerable amount of local business. Some idea of the predominance of foreign business in the Reinsurance Union's portfolio in the 1950s and 1960s is provided by Table 2.14.

**TABLE 2.14**

**FOREIGN BUSINESS OF THE RIU  
AS A PERCENTAGE OF NET PREMIUM INCOME 1952 - 1966(80)**

Year	Percentage	Year	Percentage
1952	91.4%	1961	88.1%
1955	82.3%	1963	83.0%
1956	84.9%	1964	87.4%
1957	87.4%	1965	83.7%
1958	87.0%	1966	89.4%
1959	85.1%		

From this table, as well as the examination of the performance of the South African Reinsurance Corporation, it appears that independent local reinsurers generally wrote large foreign portfolios. In view of the difficulties associated with writing foreign business from a South African base a crucial factor behind the greater strength and stability of the subsidiaries of European reinsurance groups as opposed to the independent South African reinsurers, was that they did not have to engage in writing large amounts of foreign business.

In retrospect to describe the period 1950 to 1966 merely as the formative period of professional reinsurance in South Africa is hardly an adequate description of the overall development in this period. Not only did it see the formation of the first professional reinsurance companies and hence the emergence of a local reinsurance market, but subsequently it also saw a massive expansion in the capacity of that market. This was both a result of the registration of further professional reinsurers as well as the rapid growth experienced by most of these original companies, particularly the Swiss-SA Re. Moreover in spite of the fact that the period saw the demise of one of the original three reinsurers, the market as a whole experienced remarkably few teething troubles. That this was the case was all the more notable in view of the very considerable difficulties faced by the early reinsurers. The performance of all these reinsurers was generally satisfactory with both rapid growth and good underwriting results being combined with generally more than adequate financial strength. The good underwriting results were arguably a result of the small number of reinsurers operating in the market and the fact that competition between the companies was kept within bounds. The period was also crucial for the development of a number of key features, which were later to characterize and shape the South African reinsurance market. The most important of these was the important role played by the subsidiaries of major European reinsurance groups in the development of reinsurance in South Africa. Ultimately it appears that the developments in the reinsurance market between 1950 and 1966 laid the foundations on which its prosperity and phenomenal growth in the late 1960s and 1970s was to be based.

## NOTES

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- (2) Ibid. 1953 to 1960
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- (4) Bisset, N. Reinsurance Union of South Africa - A Quarter of a Century, Unpublished. 1975. p 2.
- (5) Ibid. p 4.
- (6) Swiss South African Reinsurance Company Ltd.: A Short History, Anonymous, 1971. p 1.
- (7) Interview with W.A.Stricker of the Swiss-SA Reinsurance Company Ltd.
- (8) Annual Reports, op cit.
- (9) Ibid.
- (10) Ibid.
- (11) Bisset,N. op cit. p 6.
- (12) Swiss-SA Reinsurance: A Short History. op cit. p 12.
- (13) Interview with T.Gentles and A.Peters of the Gerling Global. Reinsurance Company of South Africa Ltd.
- (14) Bisset,N. op cit. p 6.
- (15) Registrar of Insurance. op cit. 1952-1966. From Tables of Short Term Premium Income.
- (16) Annual Reports. op cit.
- (17) W.A.Stricker. op cit.
- (18) Annual Reports. op cit.
- (19) Interview with J.A.Brandma of Incorporated General Insurances Ltd.
- (20) W.A.Stricker. op cit.
- (21) Interview with R.Hefler of the Reinsurance Union Ltd.
- (22) Annual Reports. op cit.
- (23) Interview with T.Hvidsten of the Hollandia Reinsurance Company Ltd.
- (24) Ibid.
- (25) W.A.Stricker. op cit.
- (26) Annual Reports. op cit.
- (27) Interview with J.Kristella of Greig Fester.
- (28) Interview with S.Murphy of the Hollandia Reinsurance Company Ltd.
- (29) Annual Reports. op cit.

- (30) Registrar of Insurance. op cit. 1951-1966. From Tables of Short Term Premium Income.
- (31) Swiss-SA Reinsurance: A Short History. op cit. p 5.
- (32) J.Kristella. op cit.
- (33) W.A.Stricker. op cit.
- (34) Annual Reports. op cit.
- (35) Ibid.
- (36) Ibid and Registrar of Insurance. op cit. From Tables of Short Term Assets and Liabilities.
- (37) J.Kristella. op cit.
- (38) Minute Books of the Hollandia Reinsurance Company Ltd. 1953-1979.
- (39) Annual Reports of the Gerling Global Reinsurance Company of South Africa Ltd. 1957-1966.
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- (42) South African Financial Year Book 1951-1957. R.Beerman Publishers (Pty) Ltd.
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- (48) Sammel,H.B. "Letter to the Minister of Finance" 6th December 1961.
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- (52) Ibid.
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- (59) Note on the SARC. op cit.
- (60) Ibid.
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- (64) Note on the SARC. op cit.
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- (66) Ibid.
- (67) Note on the SARC. op cit.
- (68) H.B.Sammel. op cit.
- (69) Ibid.
- (70) W.A.Stricker. op cit.
- (71) T.Gentles and A.Peters. op cit.
- (72) Interviews with: (1) L. Keel of the Swiss-SA Reinsurance Company Ltd.
- (2) P.A. Hudson of the Cologne Reinsurance Company of South Africa Ltd.
- (73) Interview with D. Bridge of the Mercantile and General Reinsurance Company of South Africa Ltd.
- (74) L.Keel. op cit.
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## CHAPTER 3

### TOWARDS MATURITY:

#### THE GOLDEN YEARS OF THE REINSURANCE MARKET 1967-1978

The years 1967 through to 1978 were the period during which the South African reinsurance market achieved maturity. The teething troubles and instability of the earlier period were something of the past and the future of reinsurance in South Africa looked increasingly secure and profitable. Although the period 1967 to 1978 constituted a distinct stage in the development of reinsurance in South Africa, many of the trends which had emerged during the initial stages continued to shape the performance of the reinsurance market. Certainly those factors which had underpinned the initial development of reinsurance continued to be of paramount importance. New trends and features, not all of which were beneficial, also emerged. Within this overall development three features stand out. First these years saw the second wave of reinsurance companies being established, so that by 1975 the market had achieved its maximum complement of eight locally registered reinsurers. Secondly this was a boom period for reinsurance not only in South Africa but world-wide, and the market experienced very rapid growth, particularly in capacity. This was coupled with high profit margins and the increasing sophistication of reinsurance operations. Finally a number of specific developments occurred which undermined the market's strength and technical soundness. These features were ultimately responsible for the difficulties experienced in the late 1970s and early 1980s. The key factor to note about "The Golden Years" was that while there was a decline in underwriting standards, the market did not experience the difficulties caused by the increase in the number of catastrophic losses after 1978-9.

Between 1967 and 1975 four new reinsurance companies were registered in South Africa. This was a development comparable to the initial emergence of five professional reinsurers between 1950 and 1957 and highlights the fact that the development of reinsurance companies in South Africa occurred in two distinct waves. The first new reinsurer to emerge was the Cologne Reinsurance Company of South Africa Ltd. founded in 1967 with a share capital of R 500 000 as a wholly owned subsidiary by the Kolnische Ruckversicherungs Gesellschaft AG, the oldest professional reinsurance

company in the world.(1) If the impact of this company on the local reinsurance market was limited, the impact of the second reinsurer to emerge at this time, was to be enormous. This was the Munich Reinsurance Company of South Africa Ltd. established in 1968 as a wholly owned subsidiary of the Münchener Rückversicherungs Gesellschaft AG, which like the Kölnische Rückversicherungs Gesellschaft was incorporated in the Federal Republic of Germany. In both cases neither of the parent companies had any prior representation in the South African market, either through a branch office or agency.(2) Also in 1968, the Hollandia Re became part of the Nederlandse Reassurantie Groep as a result of the merging of its original parent company, the Algemeene Herverzekering Maatschappij, with another Dutch reinsurer the Universeele Reassurantie Maatschappij.(3) This development had a detrimental effect on the growth of the Hollandia Re because the NRG continued the practice, begun by the Algemeene Herverzekering Maatschappij, of exploiting Hollandia Re without making any investment in return.

In direct contrast to the Cologne Re and the MRSA the two new reinsurance companies established in the early 1970s developed out of earlier branch operations. The first of these, the Central Reinsurance Corporation Ltd. which was registered in August 1972 and started trading in January 1973 grew out of the branch operation of the British registered Reinsurance Corporation. This company had only very limited market penetration, having a gross premium income of only R 20 000 or 0.1% of total gross premium income in 1971.(4) The Central Reinsurance Corporation Ltd was floated on the basis of establishing a nominally South African reinsurance company and had an initial share capital of one million rand, of which Santam Bank put up R 500 000 with the remaining 50% being held by the Reinsurance Corporation. This partnership between the Reinsurance Corporation and Santam Bank was based on the desire of both parties to secure a meaningful stake in the South African reinsurance market and the realization that neither party could achieve this independently. For while Santam, through Santam Bank, had the capital and management expertise it lacked the technical knowledge and international contacts of the Reinsurance Corporation, which in turn lacked the capital to create a viable company.(5) In 1976 the Reinsurance Corporation became part of the Norwich Winterthur Reinsurance Corporation following the merging of the reinsurance interests of the Norwich Union Group (British), the Winterthur Insurance Company (Swiss) and the Chiyoda Insurance Company (Japanese). Following Santam Bank selling its 50% share to this group in 1982, the Central Reinsurance Corporation became a wholly owned subsidiary of this group and constituted its most important investment outside of Britain, Switzerland and Japan.(6) It is important to recognize that until 1982 the Central Reinsurance Corporation effectively func-

tioned as an independent South African reinsurer, with the Reinsurance Corporation/Norwich Winterthur Reinsurance Corporation essentially being a sleeping partner, leaving the running of the company to the South African shareholders(7). The Mercantile and General Reinsurance Company of South Africa Ltd. commenced business in January 1975, completing the full complement of eight locally registered reinsurers. Unlike the Reinsurance Corporation, the Mercantile and General (UK) had operated a large and successful branch office in South Africa, enjoying a 16% share of locally placed gross premium in 1971.(8) It was the government's policy of "domesticating" the insurance sector rather than any growth in reinsurance business which led to the Mercantile and General (UK) converting its branch office into a locally registered company in 1974/5. There was also, however, a realization that in the increasingly competitive market the only way for the Mercantile and General Group to secure its position was through establishing a local subsidiary.(9) The establishment of the Mercantile and General Reinsurance Company of South Africa Ltd. differed from that of the other reinsurers in that the initial capital base of R3 million, did not constitute an injection of foreign capital into South Africa, but rather came from the accumulated reserves of the earlier branch operation.(10) Thus the period 1967 to 1978 saw a doubling of the number of locally registered reinsurance companies, a factor of great importance in the rapid expansion in market capacity as well as in the performance of the individual companies. In particular this expansion gave rise to a markedly more competitive situation.

The doubling of the number of reinsurance companies operating in South Africa between 1967 and 1975 inevitably had a major effect on the market's growth and performance. The most accurate and important indicator of the rate of growth of the reinsurance market as a whole, as well as the differing performances of the companies, is the growth of the net premium income. The rapid growth is shown in Figures 4a and 4b, with Figure 4a outlining the performance of the companies which emerged during the 1950s, while Figure 4b shows the performance of the companies which emerged during the period under review. The salient features of the performance of the market as a whole are shown in Table 3.1.

# GROWTH OF NET PREMIUM INCOME 1967 - 1978

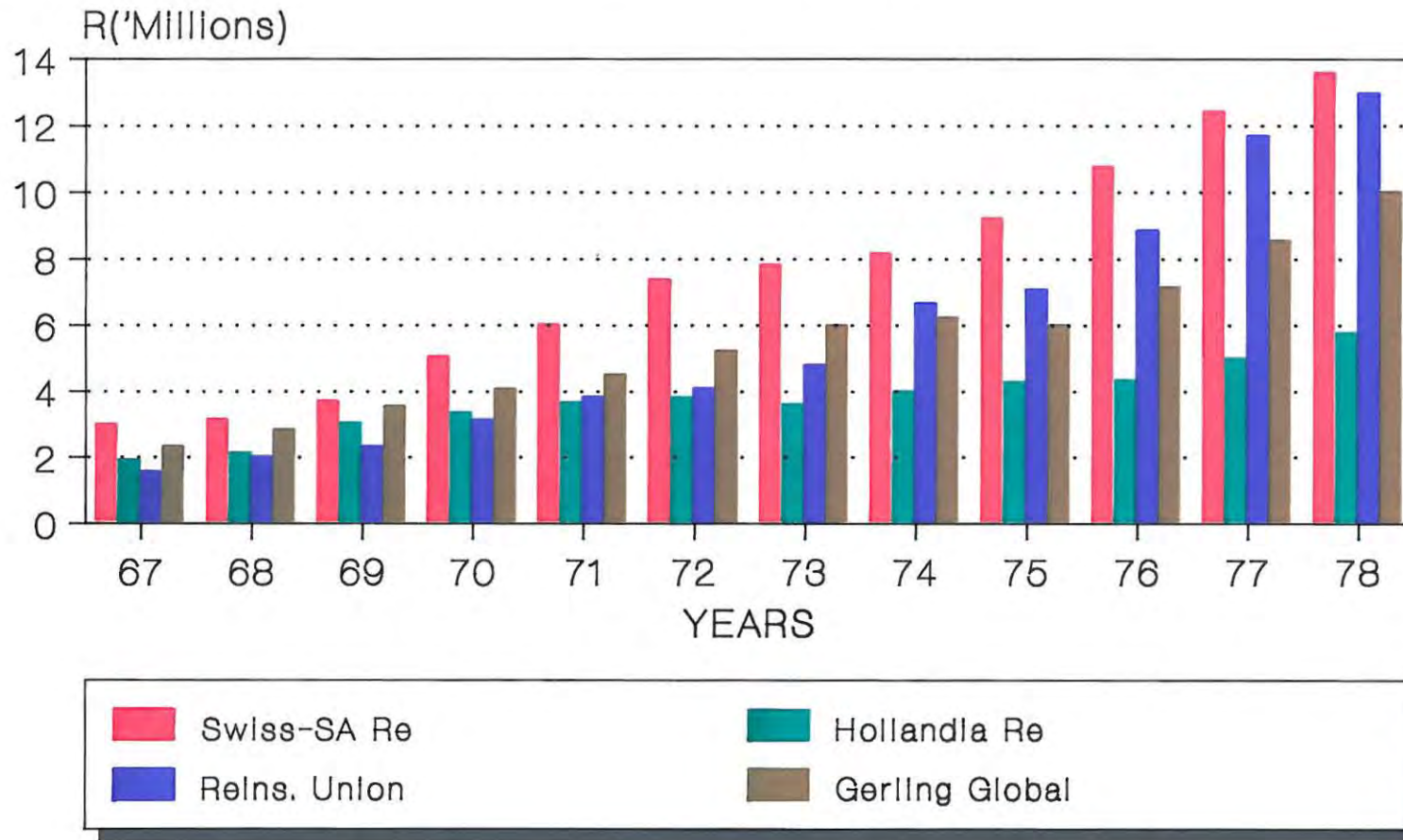


Figure 4a(i)

# NET CLAIMS EXPERIENCE 1967 - 1978

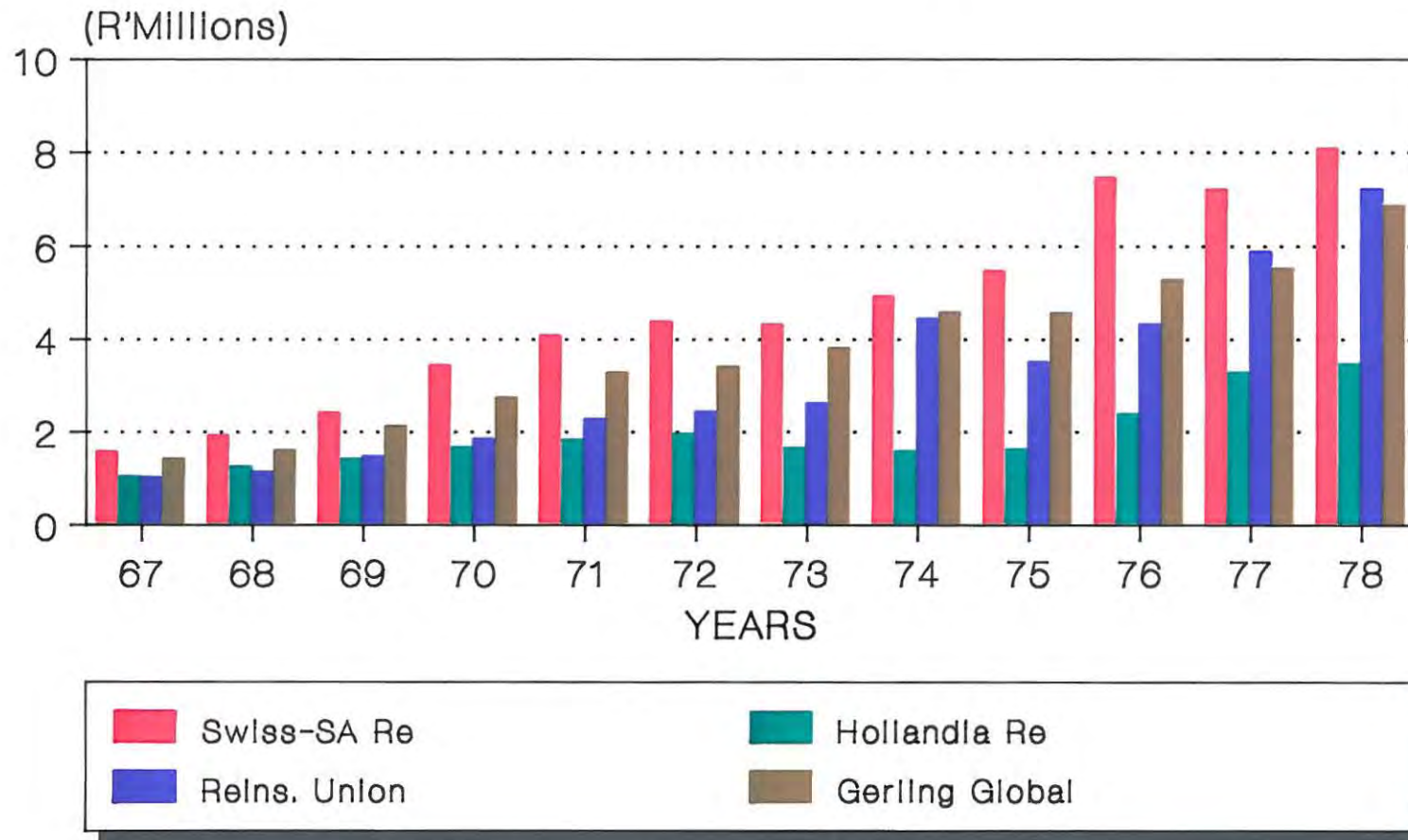


Figure 4a(ii)

# GROWTH OF NET PREMIUM INCOME 1967 - 1978

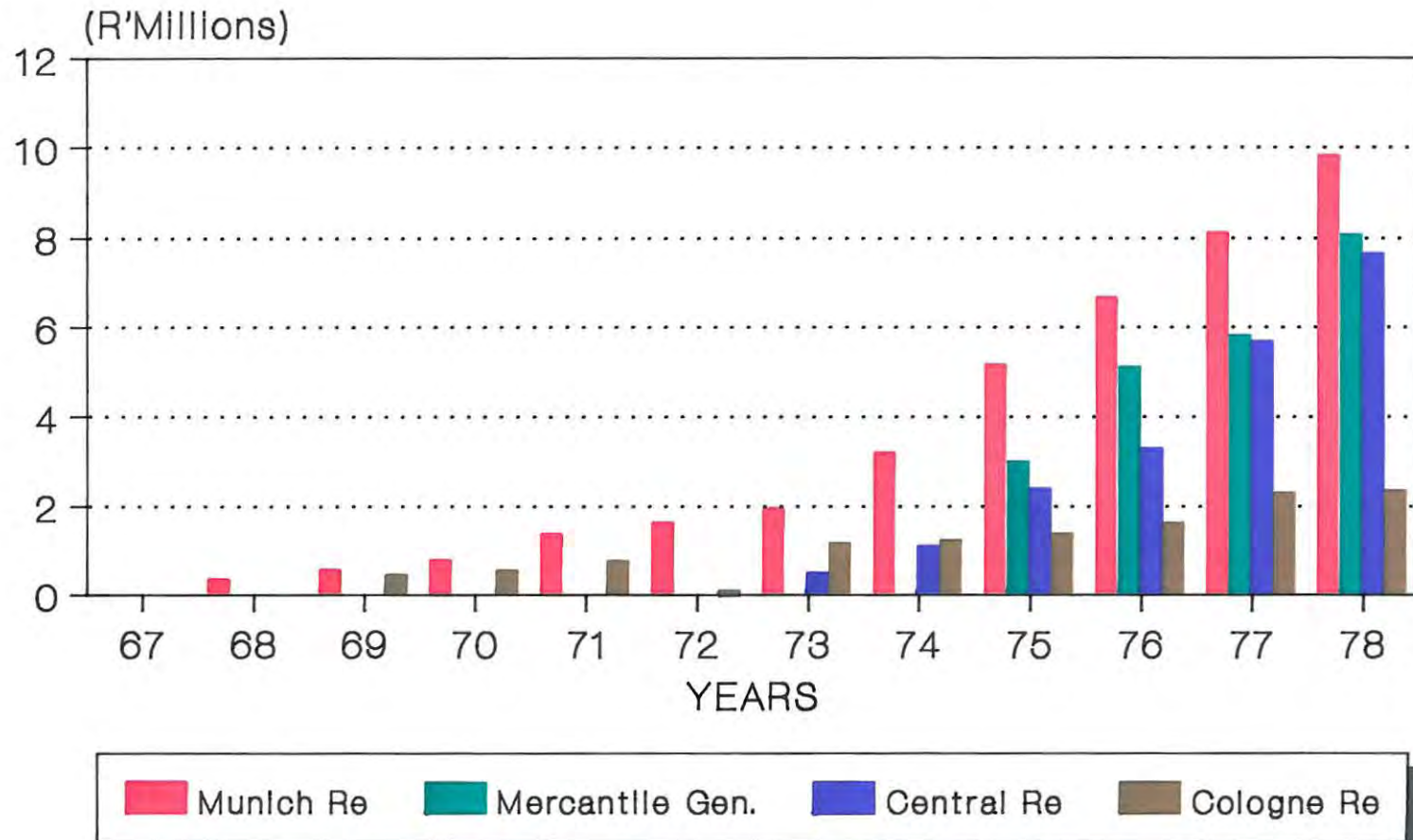


Figure 4b(i)

# NET CLAIMS EXPERIENCE 1967 - 1978

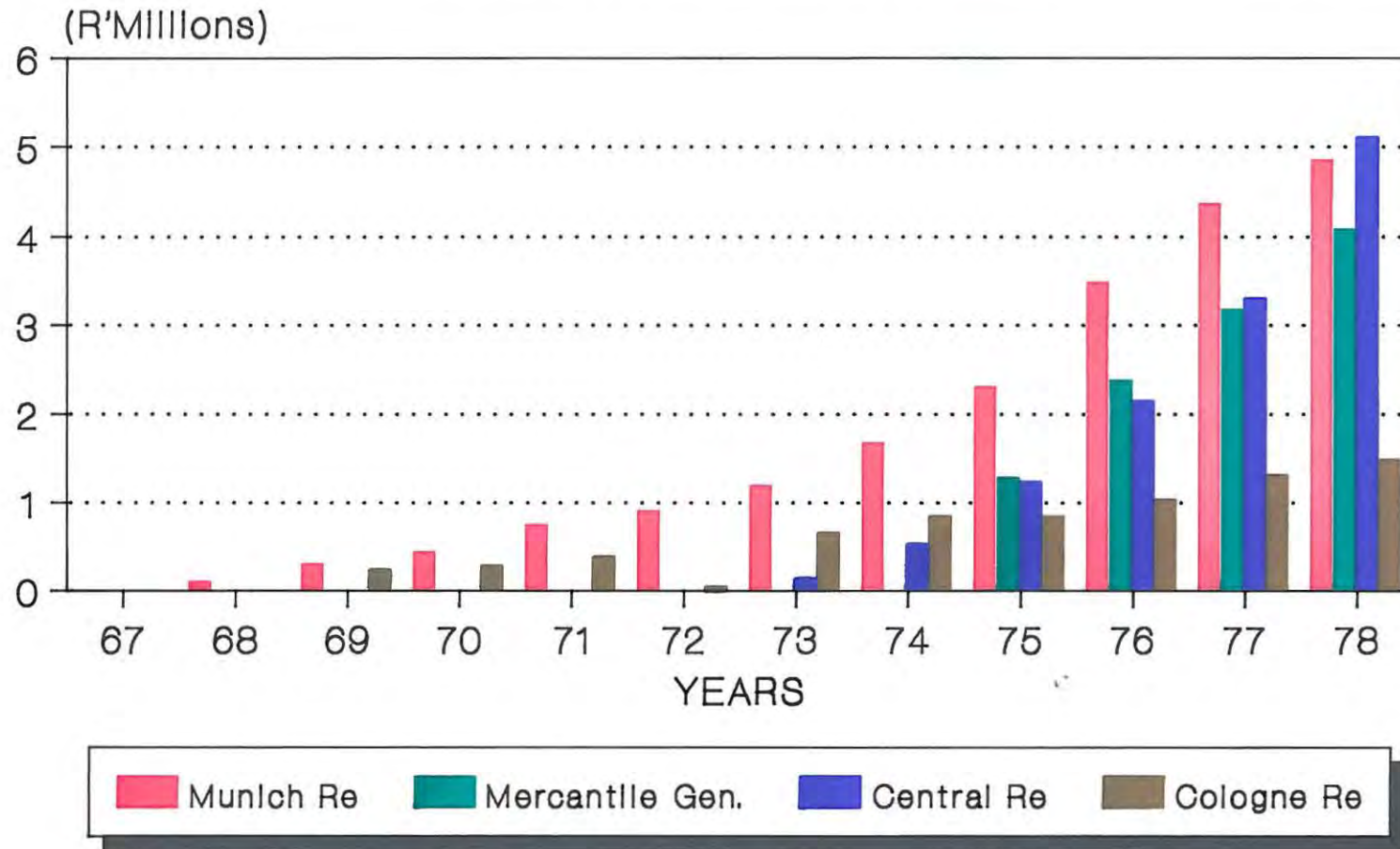


Fig 4b(II)

**TABLE 3.1****PERFORMANCE OF THE REINSURANCE MARKET 1967-1978 (R'000)(11)**

	<b>Total NPI</b>	<b>Domestic NPI.</b>	<b>Domestic NPI as a % of Total</b>	<b>Total Claims</b>	<b>Loss Ratio</b>
1967	8 757	6 912	78.9%	4 993	57.0%
1978	70 125	43 897	62.5%	41 047	58.8%

Three factors in particular stand out. First the massive growth in net premium income, with total net premium income rising marginally over eight fold while domestic net premium income rose six fold in the same period. This highlights the second overall feature of this period, namely the growing importance of foreign business to the market. Foreign business increased from 21.1% of total net premium income in 1967 to 37.5% in 1978. In a large part this was a result of the extremely rapid growth of the Reinsurance Union and the Central Reinsurance Corporation, both of which wrote large amounts of foreign business. Although the Central Reinsurance Corporation in 1978 had only a 5.3% share of the domestic business written by locally registered reinsurers, it had an 11.8% share of the total business that was written by these reinsurers, while in the case of the Reinsurance Union the figures were 5.3% and 8.5% respectively. (12) The third point to be noted is that while claims rose over eight fold in the period under review there was an increase of only 1.8% in the loss ratio of the reinsurance market between 1967 and 1978, clearly showing that reinsurers in South Africa enjoyed good results during this period, both in terms of growth and profitability.

The performance of the individual reinsurance companies during this period, however, differed markedly, not merely in growth but also in results. Those companies which emerged during the 1950s and had achieved a degree of maturity, experienced a measure of continuity in performance. The earlier rapid growth of the Swiss-SA Re continued during this period, although its rate of growth slowed significantly during two separate periods in line with the market as a whole. The first was from 1967 through to 1968/9 and the second from 1972 to 1974. From the mid 1970s the growth of the Swiss-SA Re though rapid was in fact marginally slower than that of the market. This was in direct contrast to the preceding period when the Swiss-SA Re had consistently outperformed the rest of the market. The Gerling Global continued to perform fairly well although it lost its position as the second largest reinsurer in South Africa, in terms of net premium income, because of the

rapid growth of the Reinsurance Union. It was also increasingly under threat from the phenomenal expansion of the MRSA whose net premium income overtook the Gerling Global's in 1979. In contrast to the performance of these companies, this decade was a dismal period for the Hollandia Re which failed to capitalize on its fairly rapid growth in the 1950s and 1960s. The company's growth increasingly fell behind the rest of the market so that by 1978 it ranked seventh out of the eight reinsurers in South Africa. However, during the 1970s this was partially compensated for by the fact that the Hollandia Re generally recorded better than average underwriting results. The slow growth of the Hollandia Re was largely a result of the unwillingness of the NRG to provide its subsidiary with adequate financial support.<sup>(13)</sup> The Reinsurance Union by contrast experienced very rapid growth, being in excess of the growth rate of the market. This was all the more remarkable in comparison with its performance in the 1950s and 1960s when its growth was the market's, slowest. A large part of this growth was, however, based on the company's foreign portfolio, which was a potentially destabilizing factor. Consequently while in terms of total premium income the growth of the company was phenomenal, in terms of locally generated premium income it performed very poorly and its market share actually declined.<sup>(14)</sup>

The growth of the new reinsurance companies which emerged during this period was, with one exception, nothing short of astonishing. This was particularly so as they combined rapid growth with an average loss ratio only marginally higher than that experienced by the older companies.<sup>(15)</sup> The odd one out was the Cologne Re whose growth rate lagged markedly behind the the market, especially in comparison with the other new reinsurers. This was largely a result of its very conservative underwriting policies and its limited financial resources.<sup>(16)</sup> The performance of both, the Cologne Re and the Hollandia Re at this time was a case of missed opportunities, for during these years the potential for growth was greater than at any other time in history of South African reinsurance market. The outstanding feature of this period was undoubtedly the emergence and subsequent rapid growth of the MRSA, particularly from 1972. However, while the growth of the MRSA was exceptionally rapid, there has been a tendency to exaggerate its performance during this early period of its development. At the same time the rapid growth achieved by both the Central Re and the Mercantile and General, both of which generally kept pace with the growth of the MRSA at this time, has been overlooked. This raises the question of whether the growth of the MRSA, at least during this early period of its development, had as damaging an effect on the market as it is often alleged to have had.<sup>(17)</sup>

It is important at this point to consider the effect of the rising rate of inflation on the overall performance of the reinsurance market, with particular focus on the effect this had on the real growth rate of reinsurers. Some idea of the growing divergence between the apparent growth rates of these companies and the actual growth rates is provided by Table 3.2.

While all these companies apparently continued to enjoy rapid growth in many cases it was substantially lower in real terms than that which had occurred in the preceding period because of the steadily escalating rate of inflation. Whereas during the period 1951 to 1966 the rate of inflation never rose above 3.7% per annum, in the period under review, that is 1967 to 1978, it rose as high as 17.9% and from 1972/3 was consistently in excess of 10% per annum.<sup>(18)</sup>(See Appendix IV) In view of this it was hardly surprising that in certain instances the net premium income in real terms of some of these companies actually declined. In many instances the growth of premium income was a result of the inflation of insured values rather than any growth in the volume of business written. Given that this occurred during a period when the reinsurance market has conventionally been seen as expanding, this divergence between real and apparent rates of growth is important in evaluating the performance of the reinsurance market. Moreover this directly affected the real level of reinsurance capacity available to the direct companies from the local reinsurance market.

The rising rate of inflation, however, not only impinged on the growth rates of the reinsurers, but also affected their results. The main problem for reinsurers was that while the average cost of claims rose because of inflationary pressures, premiums did not rise in line with the rate of inflation.<sup>(19)</sup> That rates did not keep pace with inflation was largely a result of the high level of competition within both the direct and reinsurance markets which led to severe rate cutting and even rate wars in certain classes of business, with the strife being compounded by the growing role of brokers in the determining of rates.<sup>(20)</sup> Reinsurers were consequently caught in a scissors trap of declining premiums and rising claims which forced them into a greater reliance on their investment income in order to return a profit. However, inflation increasingly eroded their investment income, and through the return on investments rose the increase did not keep pace with inflation.<sup>(21)</sup> As a result not only were the operating results of reinsurers under pressure but their combined operating and investment results were also affected. Having said this a degree of caution must be exercised in attributing the incipient difficulties of the reinsurance market to inflation. In considering the emerging problems of the reinsurance market in the late 1970s, emphasis should rather be placed on those factors which caused a decline in rating and underwriting standards. None the less there is no doubt that the rising rate of inflation seriously affected the rate of growth of



reinsurers and more importantly the expansion in the capacity of the local reinsurance market. In particular in the prevailing inflationary environment there was a tendency for insured values to rise more rapidly than the asset bases of the reinsurers, forcing them to retain less premium income for their own account and into greater dependence on their retrocessionaires.

A further indication of the very differing rates of growth experienced by individual reinsurers is provided by the following breakdown of domestically generated reinsurance business into company shares. At the same time this also provides some idea of the changing relative importance of these companies in the South African reinsurance market. The figures are based on premiums emanating from South Africa and thus exclude foreign inwards business. The salient figures are outlined in Table 3.3.

**TABLE 3.3**

**COMPANY SHARES OF LOCAL REINSURANCE BUSINESS.  
1967-1978 (% OF PI.) (23)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central Re		Mercantile+ General	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
1967	12.0	6.7	43.0	36.8	5.9	11.5	19.3	23.5	2.9	5.3						
1968	12.0	7.3	38.4	31.5	5.5	9.5	19.9	25.2	2.7	3.9	5.2	3.7				
1969	11.0	4.3	38.8	30.7	4.6	6.3	20.5	25.0	3.2	4.2	6.2	4.8				
1970	11.7	5.6	41.5	36.8	4.2	6.3	20.3	24.4	3.4	4.3	7.5	5.7				
1971	11.0	5.0	37.6	35.9	4.7	4.5	19.2	21.3	4.5	4.6	9.2	7.9				
1972	12.4	4.9	35.3	36.1	5.1	5.6	17.4	17.5	4.9	5.3	10.9	7.4				
1973	12.3	6.7	35.3	34.2	5.8	5.8	16.6	19.2	4.1	4.1	12.8	7.9		N/A		
1974	8.7	3.8	30.9	30.7	4.7	4.8	16.3	17.3	4.3	4.4	14.8	11.1	6.6	2.6		
1975	10.1	6.3	29.1	33.5	5.0	5.2	12.8	15.4	4.0	4.9	21.3	19.8	8.0	4.0	9.6	10.8
1976	8.9	6.4	26.9	26.8	5.0	4.9	13.6	19.7	4.1	3.9	21.3	17.9	7.7	3.4	12.4	13.5
1977	9.1	8.9	27.3	27.7	5.3	6.3	13.0	17.3	4.1	4.9	22.1	18.5	8.5	4.3	10.6	12.1
1978	8.0	5.3	26.9	26.0	6.0	7.0	12.2	17.0	3.8	4.0	21.8	19.6	9.4	5.3	11.9	15.4

The single most striking feature to emerge from this table is that the market share of the Swiss-SA Re declined very significantly during this period, particularly in terms of gross premium income, supporting the contention that the Swiss-SA Re experienced below average growth during these years. The decline in the market share of the Swiss-SA Re was largely a result of the spectacular growth of the MRSA in the period 1968 to 1978 and it is evident that the greater part of this growth was achieved at the expense of the old established reinsurers, particularly the Swiss-SA Re and the Gerling Global. The Hollandia Re and Cologne Re growth was particularly poor as is shown by the above figures and it is evident that both of these companies, for different reasons, failed to capitalize on the opportunities for expansion present during this period. What growth these two companies experienced resulted from the inflation of insured values, the expansion of the direct market and their ability to retain their limited market share.(24) However, some of the other companies, most notably the MRSA but also the Mercantile and General, enjoyed rapid growth and a increase in market share because of their efforts in providing the type of cover and service sought by the direct companies. It is clear that during this period great opportunities existed for reinsurers to achieve rapid growth and what ultimately determined the performance of individual reinsurers was their willingness and ability to seize these opportunities.

One other notable feature which emerges from this table is that certain companies had a markedly greater share of the total gross premium income than of the total net premium income of the market and vice versa. From this it is apparent that the net retention levels and hence underwriting policies of these companies must have differed very considerably, as shown in Table 3.4.

**TABLE 3.4**

**NET PREMIUMS AS A PERCENTAGE OF GROSS PREMIUMS 1967-1978(25)  
(LOCAL BUSINESS ONLY)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Mercantile+ General	Average
1967	24.8	37.7	86.1	54.0	81.7				56.8
1968	28.1	37.7	79.7	58.3	67.5	32.4			50.6
1969	19.1	38.3	67.9	59.1	62.0	37.1			47.2
1970	21.3	39.8	68.2	54.0	56.9	34.0			45.7
1971	19.0	42.1	41.9	48.9	45.5	37.6			39.2
1972	16.4	42.0	45.0	41.2	44.6	27.7			36.1
1973	23.1	41.1	42.5	48.9	42.6	26.3	N/A		37.4
1974	18.6	41.8	43.3	44.7	43.2	31.7	16.9		34.3
1975	22.1	48.9	37.2	42.7	43.8	33.2	17.7	48.3	34.7
1976	28.6	39.6	38.5	57.5	38.1	33.3	17.4	43.5	37.0
1977	35.9	37.0	43.2	48.5	42.8	30.4	18.6	41.8	37.3
1978	26.2	35.0	42.4	50.4	38.3	32.5	20.3	46.6	36.5

The most significant feature of the different retention levels of these reinsurers was the fact that the companies with the lowest net retention were the independent South African reinsurers, with the subsidiaries of overseas reinsurance groups generally having markedly higher retention levels. This was the opposite of what might reasonably have been expected to be the case because subsidiaries, effectively being branch operations, would have been expected to have had relatively low retention levels with business being written primarily on behalf of their parents. By the same token the independent South African reinsurers would have been expected to have had relatively high retention levels in that they were writing business purely for themselves. This reverse situation was primarily a result of the limited amount of business which the independent reinsurers could write for their own account as a result of their limited financial resources.(26) Moreover, because it was imperative for the independent reinsurers to achieve a balanced portfolio, they were unable to retain a large percentage of the local business they wrote, because this would lead to an unhealthy dominance of South African business in their net portfolio.(27) By contrast the great financial strength enjoyed by the subsidiary offices, enabled them to retain a large proportion of their gross premium income and

they were also not constrained by the need to achieve a balanced portfolio. None the less even among these subsidiary companies there were considerable differences in retention levels, reflecting among other things the differing philosophies of the parent offices and their relationships with their subsidiaries.

At the one end of the scale were companies such as the Gerling Global and Mercantile and General which were characterized by relatively high retention levels. Indeed the net premium income of these companies never constituted less than 40% of their gross premium income. At the other end of the scale was the MRSA which continually had significantly lower than average net retentions. The other subsidiary companies fell somewhere between these two poles. As suggested already this was a reflection of the differing position of these subsidiaries vis-a-vis their parent offices. For instance the MRSA was essentially a conduit through which business could be channeled to the parent office in Germany. Some of the other companies such as the Mercantile and General operated with a greater degree of freedom, although once again their interests were subordinate to those of the whole group. Essentially the differing retention levels reflect the divergent opinions held by the European reinsurers represented in South Africa as to how their South African offices could provide the greatest benefit for the group.(28)

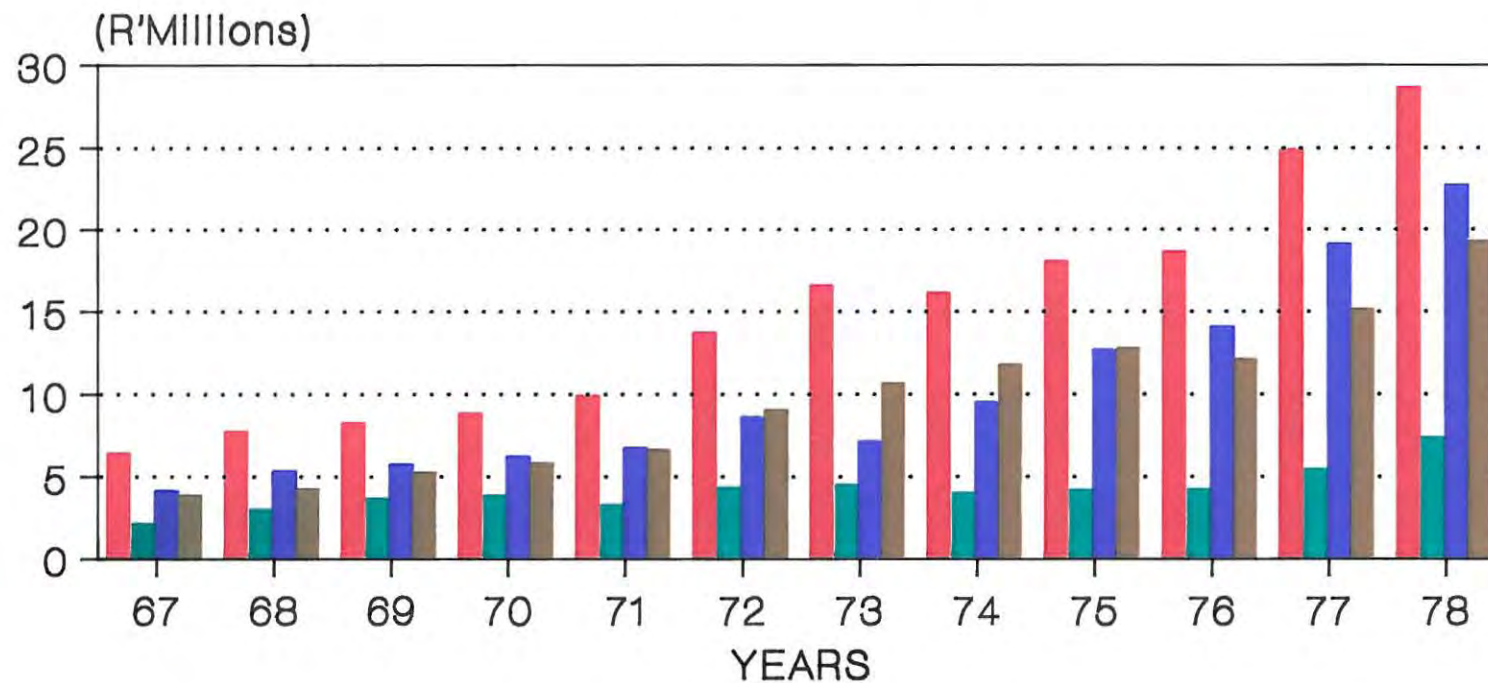
There was, however, a general tendency for the average level of net retention to decline during this period, from a market average of 56.9% of gross domestic premium in 1967 to 36.5% in 1978.(29) This reflects the massive growth of gross premium during this period which rose from R 15 580 000 in 1967 to R 121 215 000 in 1978 and the failure, albeit inevitable, of the financial resources of the local reinsurance market to grow at a similar rate.(30) This forced these reinsurers to retain a declining percentage of gross premium and to retrocede a growing part of this gross premium to their parent offices. That they were able to channel a growing percentage of gross premium income to their parent companies indicates that the local reinsurance market was, indirectly at least, able to ensure that adequate capacity was available to meet the growing needs of South African insurers.

It was in providing this indirect access to the financial resources and capacity of some of the major European reinsurance groups that these subsidiary reinsurers had the greatest impact on the insurance sector in South Africa. While the direct companies could, and in many cases did, place a

large part of their reinsurance cover directly with foreign reinsurers, this was to come into conflict with the statutory solvency margin requirements introduced by the Registrar of Insurance. These new requirements stipulated that the solvency margin was no longer to be based on net premium income, but was to be calculated on the basis of gross premium income less approved reinsurances. Approved reinsurances as defined by the Registrar referred to reinsurances placed with reinsurers registered in South Africa. This meant that if a direct company chose to, or had to, place its reinsurances outside of South Africa its solvency margin for legal purposes would effectively be based on its gross premium income.(31) Inevitably this placed many direct companies in considerable difficulties as their own financial resources were inadequate to support the gross premium income which they wrote. Those reinsurers which were subsidiaries of overseas reinsurance groups were able to place the financial resources and hence capacity of their parent group indirectly at the disposal of the direct companies. By placing their reinsurances with locally registered subsidiary offices, the direct companies not only acquired the security and large scale cover they needed but were also effectively able to calculate their solvency margin on the basis of net premium income. In turn the reinsurers were able to accept this business because as they ultimately wrote on behalf of their parents they were able to pass everything they could not retain to their parent company. These reinsurers in spite of their generally low retention levels were able to provide a substantial proportion of the reinsurance needed by the direct companies and thus ease their position vis-a-vis the statutory solvency margin requirements.(32)

As one of the crucial determinants of the performance of reinsurance companies is their financial strength, in that this impinges on their ability to provide cover, it is necessary to consider in detail the financial strength of the reinsurers operating in South Africa at this time. The first and most basic measure of their financial strength relates to the assets and liabilities of these companies, and the comparative figures are outlined in Figures 5a and 5b. It is readily apparent from these figures that the growth in the asset bases of all these companies generally mirrored their growth in net premium income far more closely than in the previous period. This was in spite of the very rapid expansion in the premium income of these companies. In other words the reinsurers were able to increase the size of their net accounts without jeopardizing their financial position. However, it should be noted once again that their financial resources did not expand at the same rate, and to the same level as their gross premium income and they were forced to retain a declining percentage of the gross business they wrote. Within this the performance of the individual companies varied very considerably. Again it was the performance of the MRSA which was truly outstanding

# SHORT TERM ASSETS OF REINSURERS 1967 - 1978



Swiss-SA Re

Hollandia Re

ReIns. Union

Gerling Global

Figure 5a(I)

# SHORT TERM LIABILITIES OF REINSURERS 1967 - 1978

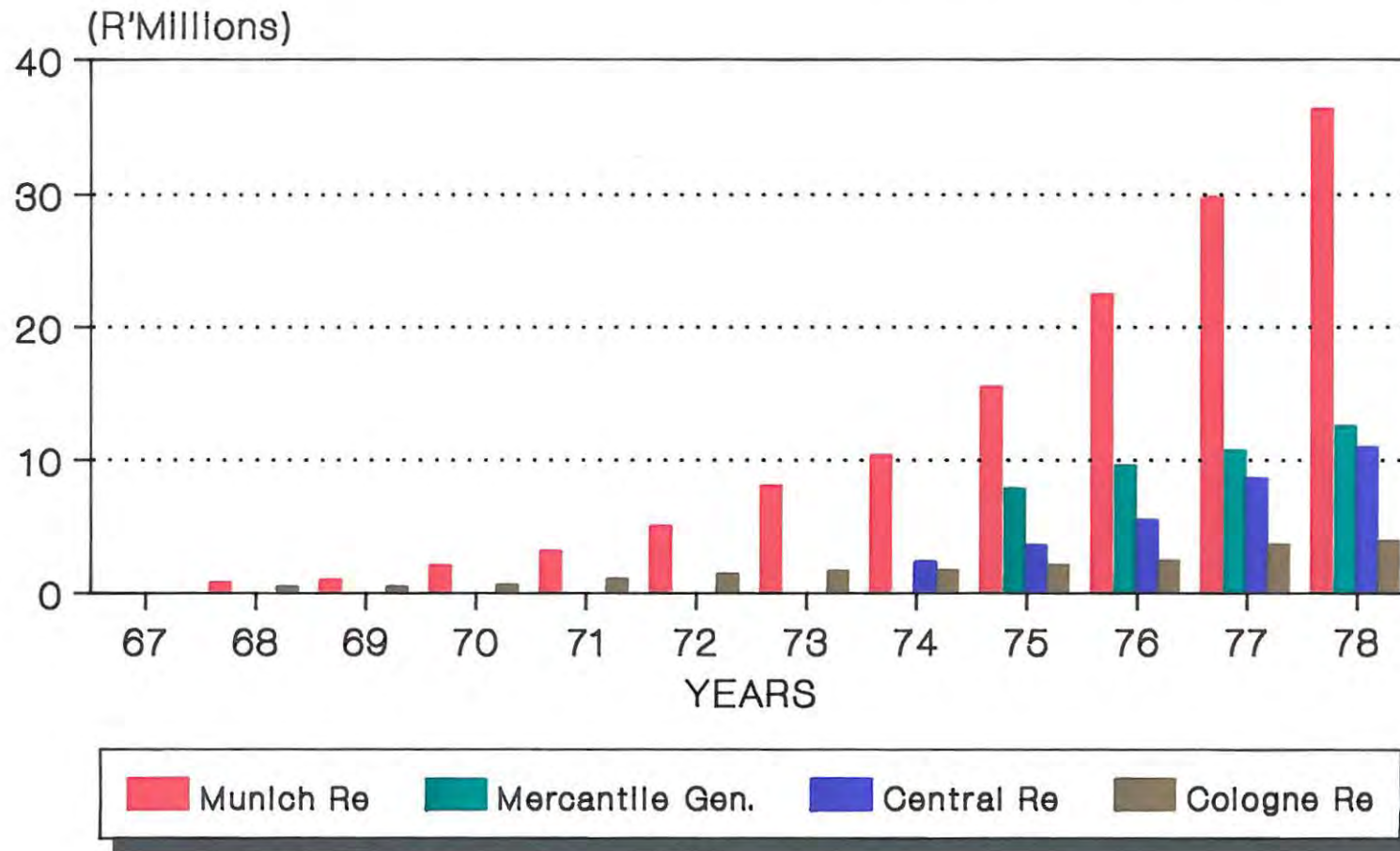
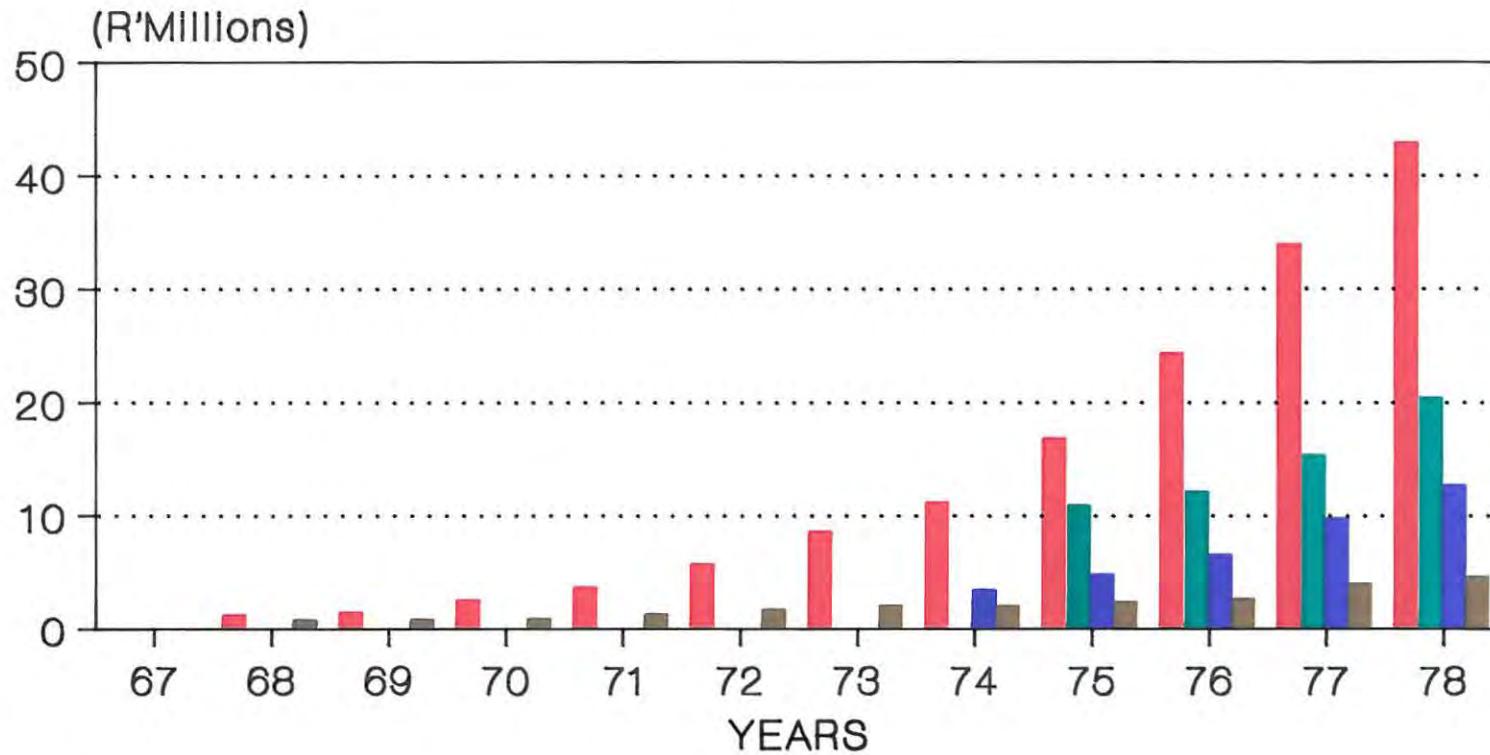


Figure 5b(ii)

# SHORT TERM ASSETS OF REINSURERS 1967 - 1978



Munich Re    Mercantile Gen.    Central Re    Cologne Re

Figure 5b(I)

# SHORT TERM LIABILITIES OF REINSURERS 1967 - 1978

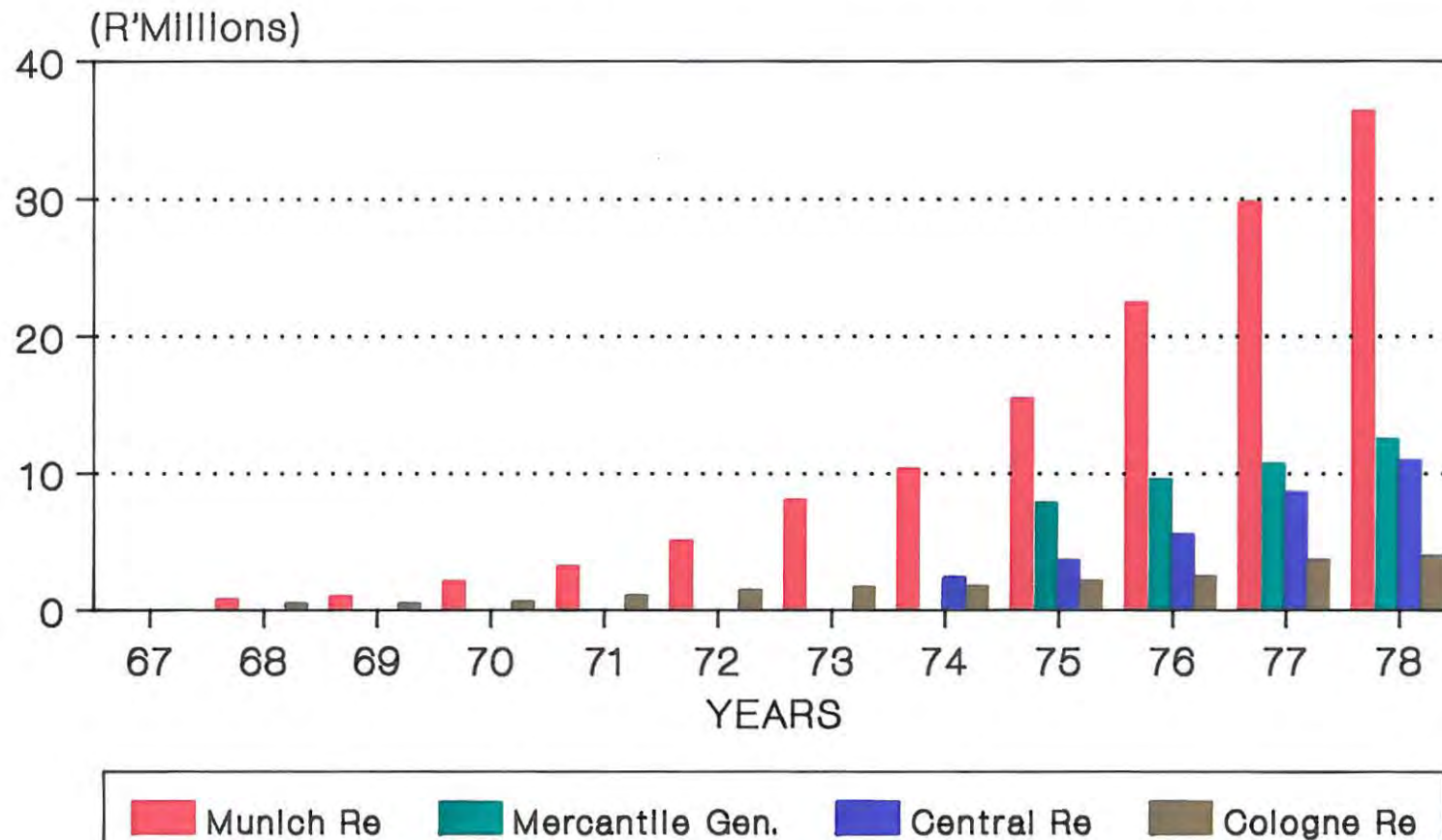


Figure 5b(ii)

with the assets of this company increasing from R 1 127 000 in 1968 to R 42 809 000 ten years later, with the growth being particularly rapid from 1974.(33) This was vital in facilitating the phenomenal expansion of the MRSA's net premium income. If the performance of the MRSA was outstanding, it was inevitable that as the expansion in financial resources reflected the growth in premium income, the growth of the financial bases of the Hollandia Re and the Cologne Re lagged far behind the rest of market. However, the very considerable differences between the performance of these two companies is not clearly indicated by these graphs because of their low asset bases.

**TABLE 3.5**

**INFLATION ADJUSTED GROWTH OF ASSETS 1969-1978 (%) (34)**

	<b>Hollandia Re</b>		<b>Cologne Re</b>	
	Nominal	Actual	Nominal	Actual
1969	22.3	20.0	0.7	-1.6
1970	5.1	1.9	10.8	7.6
1971	-15.3	-20.0	56.8	52.1
1972	32.6	24.5	33.1	25.0
1973	4.3	-8.9	19.0	14.8
1974	-11.1	-29.0	-1.8	-19.7
1975	4.8	-12.5	20.0	2.7
1976	0.8	-15.3	11.6	4.2
1977	29.2	16.1	50.7	37.6
1978	35.1	25.1	15.6	5.6

While the assets of the Cologne Re, in line with all the other reinsurers, generally expanded at a rate considerably in excess of inflation, the growth of the Hollandia Re in the early 1970s lagged far behind the rate of inflation. Consequently by 1976, the asset base of the Hollandia was lower in real terms than it had been in 1970. This was in spite of the quadrupling of the share capital between 1970 and 1974 as is indicated by Table 3.6.

**TABLE 3.6**

**INCREASES IN ISSUED SHARE CAPITAL 1967-1978 (35)**

	<b>Reinsurance Union</b>	<b>Swiss-SA Re</b>	<b>Hollandia Re</b>	<b>Gerling Global</b>	<b>Cologne Re</b>	<b>Munich Re</b>
1967	500 000	372 000	200 000	500 000	500 000	500 000
1969		744 000				
1971			300 000			
1972	1 000 000	1 000 000				
1973			500 000			
1974			1 000 000		625 000	1 000 000
1977				1 000 000		
1978					750 000	

Only the Central Re and the Mercantile and General did not experience an increase in share capital during this period, arguably because both had only recently been established and had relatively high initial share capitals of one and two million rand respectively.(36) As six out of the eight reinsurers operating by 1977 had the same share capital, namely one million rand, yet totally different asset bases, it is necessary to consider what was the prime determinant of the growth in their asset bases. Essentially the financial base of reinsurers is composed of accumulated premium income in the

form of loss and premium reserves as well as the shareholders funds. This in turn is shaped by the philosophy of the company and its parent group, the volume of business written and the profitability of that business. For instance the low asset base of the Hollandia Re was primarily a result of the desire of the NRG to keep the minimum amount of funds in South Africa, repatriating the greater part to the Netherlands or Switzerland. Conversely the financial strength of the MRSA was largely a reflection of the large reserves which it built up in South Africa with the active encouragement of its parent group. This was also linked to the fact that while the NRG insisted that the Hollandia Re pay regular dividends, which it did throughout the period under review, no pressure was exerted on the MRSA to make such payments.(37) At the same time while an adequate financial base was needed to write a growing volume of business, so too did the growth of net premium income cause an expansion of the company's asset base in that it led to an expansion in the company's reserves. As a final point in looking at the growth of the assets of these reinsurers it is important to recognize that the financial strength of those companies which were wholly owned subsidiaries of overseas reinsurance groups was ultimately the financial strength of the parent group. In spite of the differing relationship between these companies and their parents, none of these international groups would have let their South African subsidiaries fail.(38) In other words the parents constituted their reserves of a last resort. This in turn explains the small share capital of these companies which were nothing more than tokens to meet South African legal requirements.

In considering the financial strength of these reinsurers it is important to go beyond this and examine their performance in terms of their free and technical reserves. The free reserves, that is the difference between the assets and the liabilities, constitutes their solvency margin which is the single most important determinant of their financial strength. Coupled with this the technical reserves or insurance funds, being composed of liquid assets, determines the ability of the reinsurers to meet unexpired risks arising from the business written by them. Once again these are calculated as a percentage of net premium income as it is not the actual scale of these reserves but the degree to which they cover the net account of the company which is important. These figures are outlined in Table 3.7. It is clear that all these companies generally maintained high levels of technical reserves in relation to their net premium income. Thus in this period they were in a position to meet even the largest of claims or series of claims without undue strain on their financial resources. Certainly the high level of technical reserves achieved during the formative years of the reinsurance market were maintained in spite of the rapid growth in the net premium income of these companies. In direct

**TABLE 3.7**  
**FREE AND TECHNICAL RESERVES OF REINSURERS (%OF NPI) (43)**

	REINSURANCE UNION		SWISS-SA RE		HOLLANDIA RE		GERLING GLOBAL		COLOGNE RE		MUNICH RE		CENTRAL RE		MERCANTILE+ GENERAL	
	Margin	Fund	Margin	Fund	Margin	Fund	Margin	Fund	Margin	Fund	Margin	Fund	Margin	Fund	Margin	Fund
1967	N/A	132.8	N/A	82.3	N/A	82.0	N/A		N/A	N/A						
1968	80.8	122.1	81.2	83.3	13.4	86.5	11.9		N/A	N/A	126.2	80.0				
1969	63.7	124.1	42.9	87.0	12.4	77.6	16.3		71.5	63.1	80.3	62.7				
1970	29.4	110.9	11.5	80.5	11.0	82.5	9.3		44.5	73.4	57.7	71.2				
1971	21.3	102.7	14.2	79.8	16.1	69.4	9.7	N/A	32.0	74.1	34.6	69.8				
1972	48.7	105.1	33.5	82.3	22.3	69.6	16.7		N/A	N/A	39.7	87.1				
1973	N/A	102.0	32.2	90.4	23.0	77.5	16.2		31.8	73.1	25.6	84.6	N/A	62.3		
1974	20.3	80.3	24.3	96.2	16.7	77.7	10.0		22.2	71.2	24.3	78.0	96.9	70.9		
1975	28.9	89.2	41.8	91.7	24.9	70.9	15.2		18.1	83.1	24.8	73.0	49.3	70.9	101.2	123.9
1976	25.6	86.0	21.9	92.0	14.5	67.8	8.9		13.2	85.3	28.0	76.4	31.6	82.2	48.7	91.8
1977	21.7	82.6	33.4	89.8	13.7	73.9	22.1		14.0	81.6	50.1	82.5	21.0	78.9	79.0	97.2
1978	33.1	87.7	46.9	88.6	16.6	86.6	32.1		27.1	91.3	66.8	84.3	22.1	83.3	97.4	90.2

In these figures of the Reinsurance Funds of the Gerling, Global are not available owing to the fact that the claims or loss reserves of these companies are not separated into short term and life business.

contrast there was a marked decline in the solvency margins of all these companies compared with the preceding period. This was primarily a result of the massive growth in premium income rather than any deterioration in the ratio of assets to liabilities. This general decline in the individual solvency margins did not indicate a fall in absolute financial strength but rather that with the growth in demand for reinsurance cover, all these reinsurers were prepared to write business up to the maximum limit that their financial resources would allow. This was something which had not occurred in the previous period,(39) and is borne out by the significant decline in the average net to gross ratio. In turn this implies that these companies, though increasing their net lines and writing business up to the maximum of their underwriting limits, were faced with such a demand for cover that they were forced to retrocede a growing percentage of this gross business(40) In terms of financial strength the single most notable performance was that of the Mercantile and General whose free and technical reserves, during this period, were consistently far in excess of the market average. Consequently it was hardly surprising that the Mercantile and General came to have a reputation for financial strength and security second to none, something which it has assiduously maintained ever since.(41) What was all the more remarkable was that it was able to combine this with a faster than average growth of net premium income. Overall it is apparent that all the reinsurers in South Africa during this decade were financially sound and generally able to meet the needs of the direct market without jeopardizing their financial position. Perhaps the key point to note is that their financial strength and ability to meet the needs of the direct market was ultimately based on the strength of their respective parent companies, and the parents willingness to support its South African subsidiary.(42) For this reason it is reasonable to contend that the Reinsurance Union, in spite of what may appear from the figures, was the weakest reinsurer in South Africa in terms of financial strength.

Accepting that all these reinsurance companies generally experienced fairly rapid growth while maintaining their financial strength, it is important to consider the profitability of their operations during this period. The following three tables (3.8, 3.9 and 3.10) and linked analysis provide an indication of their comparative operating results.

**TABLE 3.8**

**LOSS RATIOS OF REINSURERS 1967-1978. (% of NPI) (43)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Mercantile+ General	Average
1967	64.9%	52.1%	53.9%	60.7%	N/A				57.9%
1968	56.6%	61.0%	58.5%	56.1%	N/A	28.8%			58.1%
1969	63.2%	64.9%	46.8%	59.6%	53.3%	54.9%			57.6%
1970	59.0%	68.2%	49.7%	67.0%	51.9%	56.8%			59.2%
1971	59.3%	67.7%	49.9%	72.9%	50.8%	55.0%			59.3%
1972	59.5%	59.2%	51.4%	65.1%	56.5%	56.4%			58.0%
1973	54.5%	55.0%	54.9%	63.5%	56.5%	61.6%	27.2%		58.2%
1974	66.6%	60.1%	39.5%	73.3%	68.3%	52.7%	47.9%		61.9%
1975	49.5%	59.3%	37.9%	75.9%	61.0%	44.9%	51.7%	42.8%	52.9%
1977	50.3%	57.9%	65.6%	64.6%	57.3%	53.9%	58.0%	54.5%	57.8%

Between 1967 and 1978 the loss ratio of the market as a whole though rising, was very much in line with that experienced in the preceding period, reflecting the market's continuing profitability. This was in spite of reinsurers growing concern about the rising costs of claims, and on the surface at least, would seem to indicate that premiums generally kept pace with inflation.(44) However, in view of the rate cutting which was becoming prevalent in the direct market from the mid-1970s this would arguably seem unlikely. A more plausible and indeed generally accepted explanation for the low loss ratios was that they were, at least in part, a result of a fortuitous lack of any major natural catastrophes or accumulation of major losses. Within this generally good performance a number of features stand out. Perhaps the most notable being the very much higher than average loss ratio of the Gerling Global. What makes this particularly noteworthy was that the Gerling Global during this period had developed a reputation in the direct market as a company which generally wrote "high quality fire business."(45) The fact that this coincided with the company having a higher than average loss ratio supports the often expressed contention that there was a particularly noticeable deterioration in the rating of fire business during these years. In contrast to this the loss experience of the Reinsurance Union improved very significantly in comparison with the preceding period, in spite of a substantial increase in its rate of growth. The good performance of the Mercantile and General during its first years as a local reinsurer, in terms of financial strength and rate of growth,

was mirrored in its loss experience which was consistently below the market average. Both the MRSA and the Hollandia Re, though experiencing very different rates of growth, had better than average loss ratios. However for the Hollandia Re the writing of foreign business from 1978 caused a deterioration in its loss experience.

The second determinant of the operating results of the reinsurance companies was their joint commission and expense ratios which when combined with their loss ratio produce the operating margin. Table 3.9 provides a good indication of the comparative commission and expense ratios, and as the level of commission paid by reinsurers was generally uniform, the one factor which can explain the differing ratios is the individual management expenses.

**TABLE 3.9**

**COMMISSION AND EXPENSE RATIOS OF REINSURERS 1967-1978(46)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Mercantile+ General	Average
1967	35.0%	37.8%	28.2%	32.9%	N/A				33.5%
1968	35.1%	36.8%	33.4%	35.1%	N/A	18.9%			34.9%
1969	36.1%	36.5%	30.5%	34.2%	45.6%	35.4%			36.6%
1970	34.9%	34.2%	27.5%	35.1%	44.6%	31.6%			35.3%
1971	35.8%	34.6%	29.0%	32.2%	43.6%	29.5%			34.0%
1972	35.6%	35.5%	28.5%	32.4%	40.9%	35.9%			34.8%
1973	34.7%	37.3%	30.0%	31.2%	41.6%	31.5%	31.8%		34.7%
1974	34.8%	38.1%	33.8%	33.8%	43.1%	34.0%	30.7%		35.7%
1975	36.3%	36.5%	31.3%	36.1%	40.5%	35.9%	28.5%	36.2%	35.2%
1976	35.4%	36.5%	40.6%	32.9%	41.3%	37.8%	29.7%	36.5%	36.3%
1977	34.6%	36.5%	29.9%	32.2%	38.9%	37.2%	30.3%	36.3%	34.5%
1978	33.5%	36.8%	35.9%	32.8%	41.3%	37.1%	29.2%	33.9%	35.1%

Throughout this period there was little change in the market average commission and expense ratios, although there had been a significant rise from the preceding period. However, within this the experience of the individual companies varied considerably. At opposite ends of the scale were the Hollandia Re and the Cologne Re. The low management expenses of the Hollandia Re were a result of the pressure exerted by the parent company and the board on the company's management to keep the costs of administration as low as possible. These efforts, although meaning that the company did not have the same level of technical expertise as, for example the Swiss-SA Re, did not prevent the writing of a fairly profitable book of business. By contrast the experience of the Cologne Re suggests that the small reinsurer with very narrow underwriting limits can face the problem of having to pay higher than average rates of commission to secure the small amount of business which it seeks. More importantly the cost of managing and administering a small portfolio is relatively high because it requires the same resources, human and material, as it would to write a much larger portfolio. On a more general level it is reasonable to argue that in this period there was little correlation between the rates of commission paid by reinsurers and the quality business, measured in terms of losses. This is borne out by the subsequent attempts of the reinsurers in the early 1980s to institute a sliding scale of commission in which the commission paid was directly related to the loss ratio. The introduction of sliding commission scales was one of the most important changes wrought by the South African Reinsurance Offices Association in the early 1980s and did much to restore market profitability.(47)

From both the above sets of figures it is possible to establish the operating margins of the individual reinsurers and of the market as a whole. This provides a good indication of the underwriting conditions facing the reinsurers and the salient figures are outlined in Table 3.10.

**TABLE 3.10**

**OPERATING MARGINS ON NPI 1967-1978\* (48)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Mercantile+ General	Average
1967	8.1%	10.1%	17.9%	6.4%	N/A	(a)			8.6%
1968	8.3%	3.0%	7.8%	8.8%	N/A	52.3%			7.8%
1969	0.7%	-1.4%	22.7%	6.2%	1.1%	9.7%			5.8%
1970	6.1%	-2.4%	22.8%	-3.1%	3.5%	11.6%			5.5%
1971	5.7%	-2.3%	21.1%	-5.1%	5.6%	15.5%			6.7%
1972	4.9%	5.3%	20.1%	2.5%	2.6%	7.7%			7.2%
1973	10.9%	7.7%	24.1%	5.3%	1.9%	6.9%	40.9%		7.1%
1974	-4.1%	1.8%	26.7%	-7.1%	-11.4%	13.3%	21.4%		2.8%
1975	14.2%	4.2%	30.8%	-12.0%	-1.5%	19.2%	21.0%		11.9%
1976	15.9%	-5.8%	4.4%	-6.8%	-5.5%	9.9%	5.1%	17.0%	4.3%
1977	5.1%	5.6%	4.5%	3.2%	3.8%	8.9%	11.7%	9.2%	7.7%
1978	11.0%	3.9%	4.1%	-1.3%	9.2%	15.4%	4.0%	15.6%	5.4%

(a) Munich Re only operating from the second half of 1968.

\* Operating margin calculated on basis of Loss Ratio added to Commission + Expense Ratio subtracted from Net Premium Income with margin expressed as a percentage of NPI.

While the period was one in which the market enjoyed positive operating results, there was a tendency for these to deteriorate slightly from the mid-1970s. In part this stemmed from the the ending of the Fire Tariff in 1974 which resulted in considerable competitive rate cutting in the direct market.(49) The effects of this rate cutting began to impinge on the reinsurance market from the mid- 1970s, although until the late 1970s this was mitigated by the absence of major losses. Moreover from the mid-1970s rates in marine and particularly accident business began to decline fairly sharply, once again as a result of the increasing competition in the direct market and the growing influence exerted by brokers over rating. None the less on the whole the market during this

period continued to enjoy positive operating results with the downturn becoming significant from 1979. Once again there was considerable divergence in the performance of the individual reinsurers. For the Hollandia Re the early to mid-1970s though being a period of minimal real growth was also a period of prosperity with operating margins never dropping below 20% of net premium income. These good results were the single most damning feature of the management and shareholders of the Hollandia Re in that these profits were 'wasted away' in the payment of dividends and the transfer funds to the Netherlands and Switzerland, instead of being used to build up reserves.<sup>(50)</sup> It would be a mistake to infer from this that slow growth and profitability went hand in hand, as the MRSA was one of the most consistently profitable reinsurers in South Africa yet it experienced an unprecedented rate of growth. At the other end of the scale was the Gerling Global with its higher than average loss ratio causing the company to experience frequent operating losses, forcing it to rely increasingly on its investment income to return a profit.

Linked to the individual and combined performance of these reinsurers were a number of developments which impinged directly on market performance and as such deserve closer attention. These are, first whether there was any specialization or noticeable trends in the writing of business. Secondly how the capacity of the local professional reinsurance market changed, to meet the local insurers growing demand for cover. Lastly and possibly most importantly is the issue of the decline which occurred in rating during this period as well as the emergence of cash flow underwriting, both of which fundamentally affected the profitability of the reinsurance market.

The first issue which deserves attention is whether there were any noticeable trends in class of business written and specialization among the reinsurers. As a starting point some indication of the breakdown of reinsurance business into classes for the market as a whole is provided in Table 3.11.

**TABLE 3.11**

**BREAKDOWN OF REINSURANCE BUSINESS INTO CLASSES  
AS A PERCENTAGE OF PREMIUM INCOME 1967-1978 (51)**

	Fire Business		Miscellaneous Business		Marine Business	
	Net	Gross	Net	Gross	Net	Gross
1967	44.1%	35.3%	51.8%	60.4%	3.9%	3.5%
1968	45.6%	38.5%	49.1%	56.6%	5.3%	4.9%
1969	44.4%	35.1%	50.5%	59.4%	5.1%	5.3%
1970	44.8%	35.6%	49.5%	58.6%	5.6%	5.5%
1971	46.9%	36.1%	48.0%	58.2%	5.1%	5.5%
1972	51.2%	41.8%	43.3%	52.0%	5.6%	6.3%
1973	53.2%	44.6%	41.8%	49.6%	5.0%	5.8%
1974	54.1%	48.4%	40.5%	46.0%	5.3%	5.6%
1975	52.5%	46.0%	42.0%	47.9%	5.6%	6.1%
1976	54.3%	46.4%	40.1%	47.0%	5.6%	6.6%
1977	54.3%	49.0%	40.4%	44.5%	5.3%	6.5%
1978	51.5%	44.3%	43.5%	49.5%	5.2%	6.2%

The period 1967 to 1978 saw a significant shift in the balance of business written with the share of gross and net fire business rising while miscellaneous business declined. Although this shift saw fire business becoming the dominant element in the gross premium of the local reinsurance market, miscellaneous business still remained the main component of the net premium of the reinsurance market. The share of marine business in the total premium income of South African reinsurance remained very small and exhibited only very minimal growth.

It is evident that these trends inevitably mirrored the developments and shifts in the direct market. The overall growth of fire business relative to accident business was not merely a reflection of the growth in the volume of fire business coming onto the local direct market but also the increasing risks. Both these factors were a product of the industrial expansion during these years which was accompanied by a massive rise in the value and complexity of industrial equipment as well as a greater concentration of risks in the main industrial centres. Consequently the exposure of direct insurers on industrial fire risks not only increased in number but there was also a large increase in the

scale and hence cost of any one loss. When coupled to the growing demand for consequential loss insurance, this meant that the direct insurers sought greatly increased reinsurance cover for their fire portfolios to reduce their exposure to manageable proportions.(52)

The small amount of marine reinsurance business was a reflection of the traditionally small amount of direct marine insurance placed in South Africa. This was a result of three factors, first the small size of the South African merchant marine, secondly the practice of placing much marine cargo business overseas and lastly the limited expertise and higher costs of the local insurance market. Direct marine business was composed primarily of fishing vessels and pleasure craft, neither of which constituted the same level of exposure as merchant ships, and thus the need for marine reinsurance was minimal.(53)

Turning to the issue of specialization, it is apparent that the market was too small, both in the number of companies and the volume business, for there to be any noticeable specialization in the writing of business.(54) Moreover it should be recognized that as the spreading of risks is the basis of reinsurance, the degree of specialization which occurs in reinsurance is inevitably limited. Too high a degree of concentration in a specific class of business could lead to a dangerous exposure for a reinsurance company causing a sharp deterioration in operating results and the concentration of the Gerling Global on large scale fire business is a case in point. However, this does not hold true in terms of specialization in the form of reinsurance business, that is in the various types of proportional and non proportional reinsurance business. Generally all companies in the South African market have tended to write all classes of business though at the same time certain companies have sought to develop a specific market niche where they seek to write a particularly large share of the available business, with such business in turn composing a larger than normal percentage of their portfolio. This is normally in classes of business, or forms of reinsurance, where they enjoy competitive advantages, most notably a high level of technical expertise.(55) Around this, however, they build a balanced portfolio of other classes of business to achieve the necessary spread of risk. In engineering for example it has only been the MRSA and the Swiss-SA Re which have written this class of business, as they have been the only two companies with the resources to be able to write the large type of risk associated with engineering insurance. The MRSA because of their technical expertise in engineering insurance have, however, dominated this field.(56) It is also perceived by many of the direct companies that the Hollandia Re has tended to focus on what can be described as the "less desirable classes of business" such as liability, professional indemnity and personal accident business on an excess of loss basis.(57) In this the company has been able to benefit from

achieving a disproportionate element of market domination, relative to its size, given the comparative reluctance of other reinsurers to write this type of business on a large scale and so has had some control over ratings.(58) For the Hollandia Re specialization has also involved the writing of non proportional, that is excess of loss, business to far greater degree than was normal in the South African reinsurance market, while downplaying proportional business. Although this was an area of specialization of the NRG and had been developed by the Hollandia Re from the early 1970s, it was only from the mid-1980s that this came to be the dominant form of business written by them. In this instance specialization was not so important in leading to the company achieving market dominance as it was in reducing the company's dependence on foreign retrocessionaires, at a time when it was no longer guaranteed retrocession facilities by the NRG.(59) Overall, however, the South African reinsurance market has not been characterized by any specialization, perhaps an inevitable development in light of the need to achieve the maximum spread and diversification of risks within a relatively small market.

The second issue to be considered is to what degree the South African reinsurance market, and particularly the professional reinsurers, were able to meet the growing needs of the direct market. In particular it is necessary to try to determine whether the capacity of the reinsurance market increased or decreased relative to the size of the direct market, and especially whether its growth kept pace with the growth of the direct market. Linked to this, it is important to examine the changing nature of the relationship between the reinsurers and the direct companies with particular reference to the rating structure of reinsurance in South Africa. It is useful to begin such a study by considering those statistics which relate to the demand for, and availability of, reinsurance capacity in South Africa. These figures are outlined in Table 3.12, and a number of features arising from them deserve closer examination. Perhaps the most notable was that while the amount of reinsurance business placed within South Africa relative to that ceded to foreign reinsurers remained fairly constant, there was a marked increase in the share of this locally placed reinsurance being accepted by professional reinsurers. This suggests that from the late 1960s through to the late 1970s there was a substantial increase in the reinsurance capacity provided by local professional reinsurers. The reasons for this were the increase in the number of reinsurers and the rapidly growing capacity of those which were subsidiaries of large international reinsurance groups. The increased reinsurance capacity provided by the professional reinsurers was to a large degree facilitated by the easy access of the subsidiary companies to overseas retrocession facilities. That this was so is shown by the considerable increase in the percentage of the locally reinsured business which was retroceded.(61)

**TABLE 3.12**  
**REINSURANCE AND RETROCESSION PATTERNS IN SOUTH AFRICA**  
**1967 -1978 (R'000)(24)**

	GPI of Insurers	NPI of Insurers	Percentage Reinsured	Percentage Reinsured		GPI of Professional Reinsurers	NPI of Professional Reinsurers Total	Percentage Retroceded		
				Total	Locally with professional reinsurers			Placed Locally	Placed Overseas	
1968	148 723	102 043	31.4	63.8	32.9	15 362	6 857	55.4	12.2	87.8
1969	175 319	120 897	31.0	64.2	32.9	17 919	7 734	56.8	26.0	74.0
1970	213 070	146 619	31.2	67.4	36.3	24 144	10 162	57.9	23.3	76.7
1971	260 488	179 165	31.2	67.0	36.1	29 383	11 810	59.8	16.0	84.0
1972	318 231	212 732	33.1	62.4	36.5	38 518	14 110	63.4	24.2	75.8
1973	380 950	258 999	31.1	59.3	35.5	42 123	16 015	62.0	8.6	91.4
1974	417 404	276 328	33.8	59.9	33.0	46 596	17 033	63.4	6.4	93.6
1975	500 610	331 059	33.9	60.9	37.3	63 360	22 556	64.4	3.9	96.1
1976	621 670	411 542	33.8	61.8	39.2	82 406	31 621	61.6	27.2	72.8
1977	731 866	473 994	35.2	66.6	40.3	104 020	37 920	63.5	5.2	94.8
1978	826 660	539 969	34.7	65.3	42.3	121 215	43 897	63.8	10.3	89.7

Moreover there was also an increase in the percentage of this retroceded business which was placed with foreign reinsurers which rose from an average of 81.6% per annum between 1968 and 1973, to 89.7% between 1973 and 1978.

Taken together, both these trends indicate that it was the ability of the subsidiaries of international reinsurance groups to write on behalf of their parents and thus on the basis of the group's financial strength, which allowed the local reinsurance market to meet such a high percentage of the direct companies needs for reinsurance.(62) In other words these reinsurers were not only able to write up to the maximum limit of their own financial resources, but beyond this wrote as much business as they could secure on their own terms, with this being passed directly to their parents. Perhaps the best example of this was the MRSA which wrote a disproportionately large gross line in comparison to the size of its net account. As such one could, and many people did, condemn most of the South Africa reinsurers for being nothing more than conduits through which premiums were generated for their parent offices, rather than being independent reinsurers.(63) However, such condemnation was unjustified in that this was the only way in which such a large percentage of the cover needed by the direct market could be met by the local reinsurance market. Certainly in view of the very limited market share of the two nominally independent South African reinsurers, that is the Central Re and the Reinsurance Union, there can be little doubt that independent South African reinsurance companies on their own could not have provided anything like a comparable capacity.(64) Furthermore this trend towards placing a greater percentage of retrocession business outside South Africa was to be expected in that not only was the South African reinsurance market far too small to provide the necessary capacity, but more importantly it was too small to provide the required spread of risks. Overall local reinsurance capacity, at least in gross terms, kept pace with the demand for reinsurance from the direct market. However, a large amount of reinsurance business continued to be placed overseas because local rates were generally higher than those of foreign reinsurers and the statutory solvency margin requirements introduced by the Registrar of Insurance proved to be incapable of preventing reinsurance business being placed outside South Africa.(65) This was because the financial strength of the main direct companies, which wrote the bulk of the insurance business in South Africa, was such that they could meet the statutory solvency requirements even on their gross premium income and thus did not need to place their reinsurances locally to take advantage of the "approved reinsurances."(66)

The ready and growing availability of reinsurance capacity from local professional reinsurers during the late 1960s and 1970s reflected the general profitability of the market and the consequent desire of reinsurers to secure as large a slice of the potential profit as possible. In part this expansion of capacity was also a result of the trend towards cash flow underwriting which was gaining momentum, in that reinsurers sought to maximize their investment funds by accepting larger and larger cessions.(67) This practice of providing capacity in line with the demand from the direct companies did, however, lay the basis of the difficulties experienced from the late 1970s. In particular it was at least partly responsible for the decline in the underwriting standards of the direct companies in that it encouraged them to accept poor risks at low rates, the bulk of which could be passed on to the avaricious reinsurers. This was because the reinsurers in their desire to secure the maximum possible amount of business paid such high rates of commission that it was profitable for the direct insurers to write large amounts of poor quality business which they in turn sold to the reinsurers. By the same token the direct insurers were able to cut rates to secure market share, knowing that a profit could still be made by passing this business on to the reinsurers.(68) This oversupply of reinsurance capacity offered the direct market the opportunity of increasing its gross portfolio and profit without an increase in net exposure. It should, however, be noted that the rapid growth of reinsurance capacity in the 1970s was a world-wide trend with the situation in South Africa being just one part of the overall picture.(69) As already indicated it was the international reinsurance groups in South Africa which were at least partly responsible for the increase in the capacity of the local reinsurance market. These groups competed to achieve market dominance just as they did in other third world markets; an aspect of the fierce international competition between these groups at this time.(70) Thus the growth in the capacity of the professional reinsurance market in South Africa was not always as positive a development as might initially be expected in that it was a major contributory factor in the softening of underwriting and rating standards, and fundamentally affected the relationship between reinsurers and insurers.

It is this issue of the decline in rating that it is now necessary to consider in detail. In the ideal market the rating of business would be determined on the basis of the potential losses likely to arise from any particular risk. This had in fact generally been the case in South Africa for reinsurers and direct writers during the 1950s and 1960s but the main determinant of rates within the South African reinsurance market during the late 1960s and early 1970s was the availability of reinsurance cover.(71) In line with world-wide trends, this reflected the very considerable increase in the level and intensity of competition among the local reinsurers. The general consensus was that while the

rating of reinsurance business was generally sound and at adequate levels up to the early 1970s, from then on rating became ill disciplined in both the direct and reinsurance markets, reaching a nadir during the early 1980s. In looking for the cause of this deterioration in rating three factors would seem to be of particular importance. First as already mentioned the expansion in the capacity of the reinsurance market, leading to the supply of reinsurance cover growing more rapidly than the growth in demand which in turn inevitably forced rates down. As this issue has already been considered in some detail, no further examination will be made at this point.

Secondly there was a marked increase in the level and intensity of competition among reinsurers. During the formative years of the South African reinsurance market the degree and intensity of competition between the reinsurers had been restrained by a sense of mutual self interest which sprang from the difficulties faced by the early reinsurers.(72) With the emergence of new reinsurers from the late 1960s the level of competition intensified. This stemmed not only from the increase in the available capacity and the doubling of the number of companies but also from the aggression of some of these new companies, most notably the MRSA. This was because these companies did not share the same sense of mutual self preservation, which characterized the earlier companies, reflecting the far greater security enjoyed by this second wave of reinsurers. (73) Moreover within this increasingly competitive situation the "suitcase brigade", that is the marketers or salesmen of foreign reinsurers, who came to South Africa when business was good, were seen as having a particularly disrupting effect on the market. The fact that these reinsurers did not have the same overheads as locally registered reinsurance companies, and could withdraw when the market deteriorated, meant that they were able to cut rates even further thus intensifying the rate war. (74) The damaging effect of the "suitcase brigade" on the reinsurance market can perhaps best be compared to the disruptive impact of tramp steamers on regular steamship lines in the days before the emergence of the conference system. The rise in competition within both the direct and reinsurance markets also caused the collapse of the Fire Tariff in the early 1970s and this in turn had a serious effect on rating in the direct market. This led to instability, and indeed a fire business rate war in the direct market, the effect of which was inevitably transmitted to the reinsurance market. Moreover this meant that brokers, both in the direct market and in the reinsurance market, were increasingly able to become the main determiners of rates.(75) The increase in the power of brokers in the direct market in turn led to growing pressure from the direct companies for cheap reinsurance cover, thus pushing rates down even further. In spite of all this the reinsurance market continued to enjoy a fair degree of prosperity right through until the late 1970s. Two reasons can

be seen for this apparent anomaly. In the first place during the greater part of the 1970s there were remarkably few catastrophic losses, unlike the situation from the late 1970s. Secondly the rising investment income of all the reinsurers became increasingly important in cancelling out their underwriting losses. Consequently the rise in the level of competition and its various related effects is commonly seen as one of the important factors, if not the key factor, behind the deterioration in rates and other difficulties experienced by the market from the late 1970s.

The third and final factor behind the deterioration in rates was the rise of what has been termed cash flow underwriting of which it is true to say its rise was also a response to the decline in rating. Thus the emergence of cash flow underwriting must be seen as both a cause and an effect of the deterioration in rates in the reinsurance market. With the intensification of competition and the deterioration of rates, investment income became of extreme importance in determining the overall results of short term reinsurance operations. Investment income also became of increasing importance because of the growth of long tail liability business, with reinsurers having to build up considerable reserves to cover such risks, given that they were the ultimate risk carriers.<sup>(76)</sup> Taken together these were the main causes of the growth of cash flow underwriting which essentially involved the writing of business in which a large lump premium paid at the outset was invested, while claims only started coming in very much later. This allowed the insurers or reinsurers to secure a substantial income from these investments and which it was believed would pay for claims. Consequently there was a tendency, in the increasingly inflationary environment of this period, to write the maximum possible business in order to maximize investments, the combined return of which would be used to pay the claims incurred. While this balancing act was generally successful during the 1970s owing to the high rate of return on investments and the absence of major catastrophes, the practice of cash flow underwriting in the long run contributed to the decline in underwriting and rating standards. This was because cash flow underwriting inherently involved the accepting of the maximum possible amount of business at any price regardless of the risks involved, merely to secure the investment funds to generate the necessary income.<sup>(77)</sup> Consequently it is important to examine the investment performance of the South African professional reinsurers which is outlined in Table 3.13.

**TABLE 3.13**

**INVESTMENT INCOME OF SOUTH AFRICAN REINSURERS  
1967-1978\* (78)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central Re	
	%of		%of		%of		%of		%of		%of		%of	
	Amount	NPI	Amount	NPI	Amount	NPI	Amount	NPI	Amount	NPI	Amount	NPI	Amount	NPI
1967	137 645	8.8	164 954	5.5	N/A		150 334	6.5	N/A					
1968	170 872	8.5	195 365	6.3	N/A		202 261	7.2	N/A		16 487	5.1		
1969	170 671	7.4	302 990	8.2	78 975	2.6	207 727	5.9	39 533	6.9	72 622	13.5		
1970	195 657	6.3	242 277	4.8	91 527	2.7	263 023	6.5	32 420	6.2	845 559	11.2		
1971	208 755	5.4	338 539	5.7	97 881	2.7	326 586	7.3	39 881	5.4	168 479	12.5		
1972	263 089	6.5	422 188	5.7	108 118	2.8	413 360	7.9	N/A		226 152	14.1		
1973	359 347	7.5	598 777	7.7	121 096	3.4	547 607	9.2	83 397	7.3	363 311	18.9	91 260	19.4
1974	472 259	7.1	806 967	9.9	140 833	3.5	710 059	11.4	134 433	11.0	547 409	17.3	172 728	15.9
1975	564 750	8.0	840 043	9.1	149 308	3.5	892 559	14.9	155 872	11.4	751 970	14.6	249 394	10.5
1976	683 942	7.7	1067 475	9.9	195 326	4.5	796 240	11.2	178 610	11.2	1411 481	21.2	347 692	10.6
1977	840 673	7.2	1226 730	9.9	204 852	4.1	878 198	10.3	214 167	9.4	1944 243	24.0	582 749	9.3
1978	990 653	7.6	1465 678	10.8	296 033	5.1	1261 365	12.6	31 877	13.7	2657 256	27.1	656 353	8.6

\* Figures are based on the interest, dividends and rents from investments of accumulated short term premiums.  
Investment income of the Mercantile and General is not used as it is not broken down into life and short term components.

It is apparent from this that investment returns grew in importance relative to net premium income during this period, increasing on average from 6.2% of net premium income in 1967 to 14.2% in 1978. The greater part of this growth occurred from 1971/2, indicative of the general shift towards cash flow underwriting. Within this general trend perhaps the most notable feature was the above average importance of investment income to the MRSA. The reason for this was the policy of their parent group in leaving the investment funds from gross premium income in South Africa, rather than repatriating a percentage in line with the retrocession level of the MRSA. This in turn gave a

far larger than average investment income to the MRSA which helped to fund their rapid growth. By contrast the performance of the Hollandia Re measured in terms of investment income was very poor, reflecting both the unwillingness of the NRG to leave more than the legal minimum of funds in South Africa and the company's conservative investment policy.(79) In considering the comparative investment results it is possible to identify two broad patterns of investment. First those companies which focused exclusively on fixed interest investments and secondly those which sought to achieve more of a balance between fixed interest investments and equities. The underlying investment philosophy within the reinsurance market would, however, seem to be one of caution and limiting the exposure to risks because of the large risks taken on by reinsurers in the course of their business.(80) Companies such as the Hollandia Re which focused exclusively on fixed interest bearing stock and deposits with banks and building societies experienced relatively poor investment results in the 1970s because of the fairly high rate of inflation.(81) In the case of the Hollandia Re it must, however, be recognized that this focus on fixed interest stock and deposits with financial institutions was a product of the small investment funds at the company's disposal. What funds that were available for the Hollandia Re to invest had to be invested in the so called "Part 1 Assets", that is fixed interest bearing investments, in order to maintain the company's solvency margin. Consequently the Hollandia Re was in a position which effectively prevented the pursuit of a successful investment policy.(82) For this reason it was imperative that the company achieve positive operating results, as its investment income was too small to be able to offset an operating loss, and certainly was totally inadequate to facilitate the expansion of its short term business. By contrast companies such as the Swiss-SA Re and the Mercantile and General which invested a large part, often over 50%, of their short term investment funds in equities generally enjoyed very high rates of return during the 1970s. In the case the Mercantile and General, and the MRSA in particular, this was important in financing the rapid expansion of their short term business.(83)

Undoubtedly the most important effect of investment income, however, was to offset the operating losses experienced by certain reinsurers. While investment income was important in that it acted as a cushion against the impact of operating losses, in so doing it removed one stimulus to the improvement of underwriting standards in both the direct and reinsurance markets. At the same time, such investment income by strengthening reinsurers financially allowed them to write more business. The importance of investment income to the reinsurers short term results is shown in Table 3.14 which lists their combined operating and investment margins.

**TABLE 3.14**

**COMBINED OPERATING AND INVESTMENT MARGINS  
OF SHORT TERM REINSURERS 1967-1978 (% OF NPI) \* + (84)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Average
1967	8.9%	15.6%	N/A	12.9%	N/A	(a)		12.5%
1968	16.8%	9.3%	N/A	16.0%	N/A	57.4%		24.8%
1969	8.1%	6.8%	25.3%	12.1%	8.0%	23.2%		13.9%
1970	12.4%	2.4%	22.5%	3.4%	9.7%	22.8%		12.2%
1971	11.1%	3.4%	23.8%	2.2%	11.0%	28.0%		13.2%
1972	11.4%	11.0%	22.9%	10.4%	N/A	21.8%		15.5%
1973	18.4%	15.4%	27.5%	14.5%	9.2%	25.8%	60.3%	23.9%
1974	5.7%	11.7%	30.2%	4.3%	-0.4%	30.6%	37.3%	14.9%
1975	22.2%	13.3%	34.3%	2.9%	9.9%	33.8%	30.3%	20.9%
1976	23.6%	4.1%	8.9%	4.4%	5.7%	31.3%	15.7%	13.4%
1977	22.3%	15.5%	8.6%	13.5%	14.1%	32.9%	21.0%	18.3%
1978	18.6%	14.7%	9.2%	11.3%	21.8%	45.5%	12.6%	18.7%

(a) Munich only operating from the second half of 1968.

\* Figures calculated on the basis of investment income as a percentage of NPI from Table 3.13 being added to figures of the operating margin as a percentage of NPI from Table 3.10 with the final results being measured as a percentage of NPI.

+ Differences between these two sets of figures (Table 3.10 and 3.14) and the figures of underwriting results produced in Annual Reports and by Quest Insurance Advisory Service, arises from the fact that these figures are based on the results of year to year operations and do not take account of transfers to and from insurance funds and reserves. For the growth of these reserves see Table 3.7.

It is clear from this that investment income was of considerable importance in ensuring that the period between 1967 and 1978 was one of uninterrupted prosperity for the short term reinsurance market. Within this perhaps the most notable performance was that of the MRSA. Not only did they grow extremely rapidly but it was also by far the most successful company in terms of profitability. This was a product of both their good operating results as well as their exceptionally large investment income. While the Gerling Global frequently experienced an operating loss, sometimes of considerable magnitude, its investment income effectively served to offset these losses so that the company's short term business ran profitably throughout this period. As a final

point it is worth noting that the statutory investment requirements laid down for insurers and reinsurers by the Insurance Act, (See Chapter 1), did not have a restricting effect on the investment patterns of reinsurers and allowed sufficient latitude for them to be able to maximize their investment returns.(85)

The years between 1967 and 1978 can reasonably be described as the period during which the South African reinsurance market achieved maturity. However, within this period lay the seeds of many of the difficulties which were to plague it during the 1980s. While the emergence of the second wave of reinsurance companies gave the South African reinsurance market its maximum complement of eight professional reinsurers and increased the availability of local reinsurance cover, this also had a disruptive effect on the market. The formation of these new reinsurers, particularly the MRSA, broke down many of the old conventions and caused a massive upsurge in the level of competition. While this may have been beneficial for the direct market in that it led to an increased supply of reinsurance cover at reduced rates, it had a destabilizing and damaging effect on the reinsurance market and thus in the long term on the direct market. In spite of these difficulties, for most of the reinsurers this was generally a period of rapid growth and prosperity. Although this situation began to change from the late 1970s this period did undoubtedly constitute the golden era of reinsurance in South Africa. From the late 1970s onward the reinsurance market was to experience a period of very considerable difficulties, which highlighted the prosperity of the late 1960s and early 1970s. Undoubtedly one of the main developments of this period was the rapid growth of the MRSA following its establishment in 1968, a development which has been viewed in certain quarters as one of the main reasons for the difficulties experienced by the reinsurance market in the 1980s.

## NOTES

- (1) Cologne Reinsurance Company of SA Ltd: Annual Report. 1969.
- (2) Munich Reinsurance Company of SA. Ltd: Annual Report. 1968.
- (3) Hollandia Reinsurance Company of SA. Ltd: Annual Report.1968.
- (4) "Supplement on Insurance"Financial Mail 8th October 1971. p 61.
- (5) Interview with S.P.Overbeek and C.MacFarlane of the Central Reinsurance Corporation Ltd.
- (6) Ibid.
- (7) Ibid.
- (8) Financial Mail. op cit. p 61
- (9) Interview with D.Bridge of the Mercantile and General Reinsurance Company of South Africa Ltd.
- (10) Ibid.
- (11) Registrar of Insurance: Annual Reports. 1967-1978. From Tables of Short Term Premium Income and Reinsurance Business.
- (12) Ibid.
- (13) Hollandia Reinsurance Company of SA Ltd: Minute Books. 1968-1978.
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- (23) Registrar of Insurance. op cit. From Tables of Short Term Premium Income and Reinsurance Business.
- (24) Interview with S.Murphy of the Hollandia Reinsurance Company Ltd.
- (25) Registrar of Insurance. op cit. From Tables of Short Term Premium Income and Reinsurance Business.

- (26) Interview with W.A.Stricker of the Swiss-SA Reinsurance Company Ltd.
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## CHAPTER 4

### THE YEARS OF CRISIS

#### THE REINSURANCE MARKET 1979 TO 1986

Insurance being essentially a cyclical business it was somewhat inevitable that the reinsurance market should move into a period of slump from the late 1970s, given that the market had enjoyed boom conditions since the late 1960's. This is not to suggest, however, that the market experienced a dramatic collapse in the late 1970s, but rather that these years saw the culmination of the problems which started in the mid-1970s. By the late 1970s these negative trends, particularly the decline in rates, had reached the point where they were threatening the underwriting results of the reinsurance companies. That the reinsurance market had in fact remained profitable during the second half of the 1970s in the face of such trends was primarily due to the lack of any major natural catastrophes and consequent accumulation of losses. Indeed it can be argued that it was the lack of major losses during the 1970s which had led to the softening of terms in the reinsurance market in the first place. Such a situation could not last and from the late 1970s there was a marked upswing in the incidence of major catastrophes, involving both weather and fire related losses. When coupled with the poor underwriting conditions prevailing in the market, it was inevitable that the reinsurance companies came to experience massive underwriting losses.(1) Indeed these were of such magnitude that reinsurers investment incomes were generally inadequate to offset their losses. However, just as the preceding period of prosperity had seen the emergence of those factors which underpinned the difficulties experienced by the market in the 1980s, so this period of depression saw the laying of the basis of a new equilibrium in the reinsurance market. To some extent this was inevitable because of the cyclical nature of reinsurance, the general pattern of which can be summarized as follows.(2)

1. Profitable Business - 2. Rate Cutting - 3. Losses Rise
4. Rates Rise - 5. Return to Profitability.

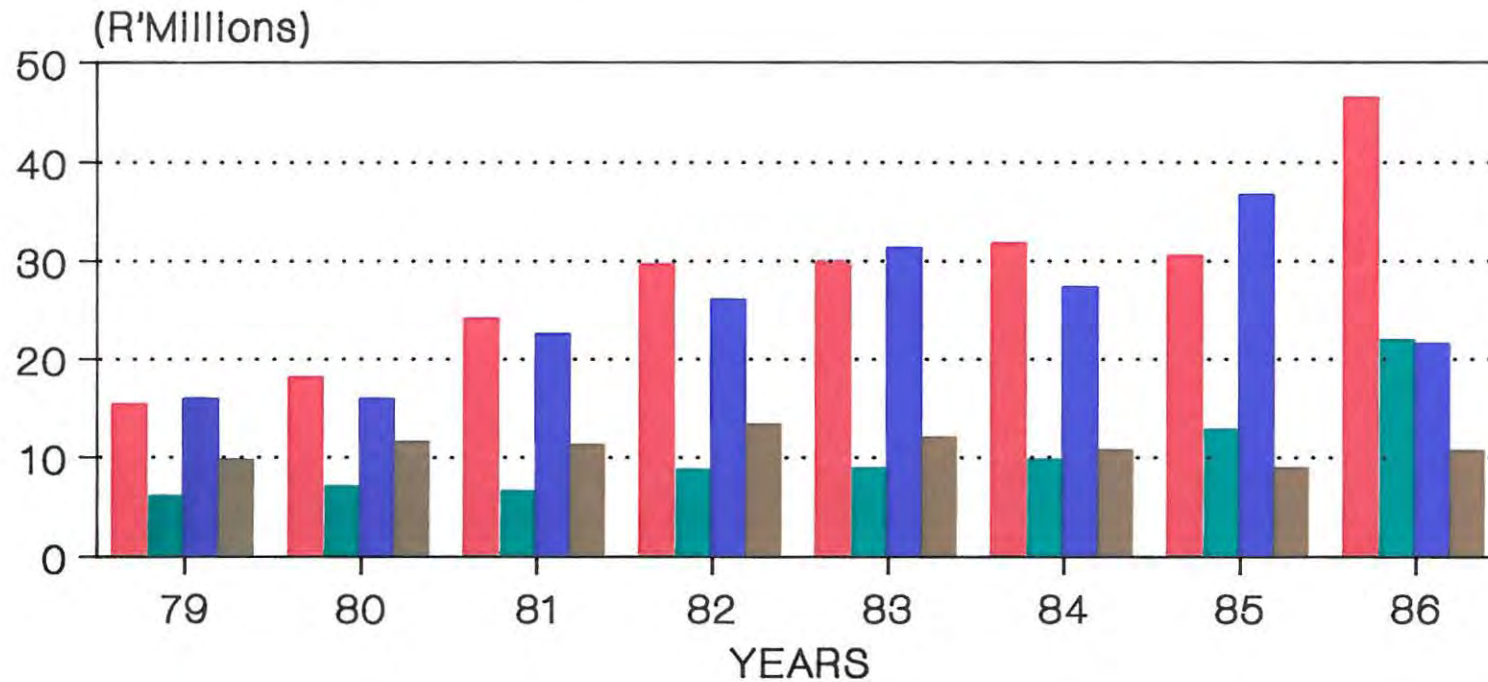
This is essentially a simplistic representation of the dynamics of the reinsurance market in that it ignores factors such as fluctuations in interest rates, inflation and the impact of natural catastrophes. It does, however, serve to illustrate the general pattern of the reinsurance market. Indeed the experience from the late 1970s to the mid 1980s, even allowing for the impact of outside variables, corresponds very closely to this pattern. In considering the experience of the reinsurance market in

this period, it is important to consider not only its general overall performance and that of the individual companies, but also to examine two other developments which resulted from the prevailing market conditions. These were first, the creation of the South African Reinsurance Offices Association (SAROA) in 1981, and secondly the demise in 1985 of the Reinsurance Union.

When describing the years from the late 1970s through to the mid- 1980s as the years of crisis for the reinsurance market, one is primarily referring to the results of the reinsurers and not their rate of growth. While the period was undoubtedly one of very poor results for all the reinsurers, most continued to grow, though slower than previously, while some experienced a marked decline in both gross and net premium income. In most cases this was a result of a deliberate decision on their part to reduce portfolios in light of the serious losses they had been experiencing.(3) Indeed one of the key characteristics of the period 1983 to 1986 was the large scale restructuring of business undertaken by the reinsurers. Essentially this took the form of reinsurers attempting to force rates up, reducing commission paid and limiting their exposure under certain types of policies. This was an attempt on the part of the the individual reinsurers to restore some semblance of the previous stability and prosperity to the market. Such efforts to restructure business took many forms, most notably the companies rewriting their own portfolios and throwing out unprofitable business, as well as undertaking concerted and organized action to press for the interests of reinsurers against the direct companies.(4) An integral, though particularly notable element of this process was the decision taken in 1984 by the shareholders of the Reinsurance Union to withdraw temporarily from the South African and international reinsurance markets in view of the massive losses experienced by the company. This subsequently led in 1985 to the Reinsurance Union withdrawing permanently from both the South African and international reinsurance markets.(5) This did not have an unduly disruptive effect on the market because of the very small book of South African business written by the Reinsurance Union. It is in this context that the creation of the South African Reinsurance Offices Association (SAROA) has to be considered as this formed an integral, and probably the single most important, part of the attempt to place the market on a sound footing.

Having made these preliminary observations it is important to consider the performance of the reinsurance market as a whole and of the individual companies in some detail. Figures 6a and 6b provide a good indication of the nominal growth and comparative standing of the reinsurers in the late 1970s and early 1980s in terms of net premium income, while Table 4.1 outlines the growth of the gross premium income of the market.

# GROWTH OF NET PREMIUM INCOME 1979 - 1986



 Swiss-SA Re	 Hollandia Re
 ReIns. Union	 Gerling Global

Fig 6a(i)

# NET CLAIMS EXPERIENCE 1979 - 1986

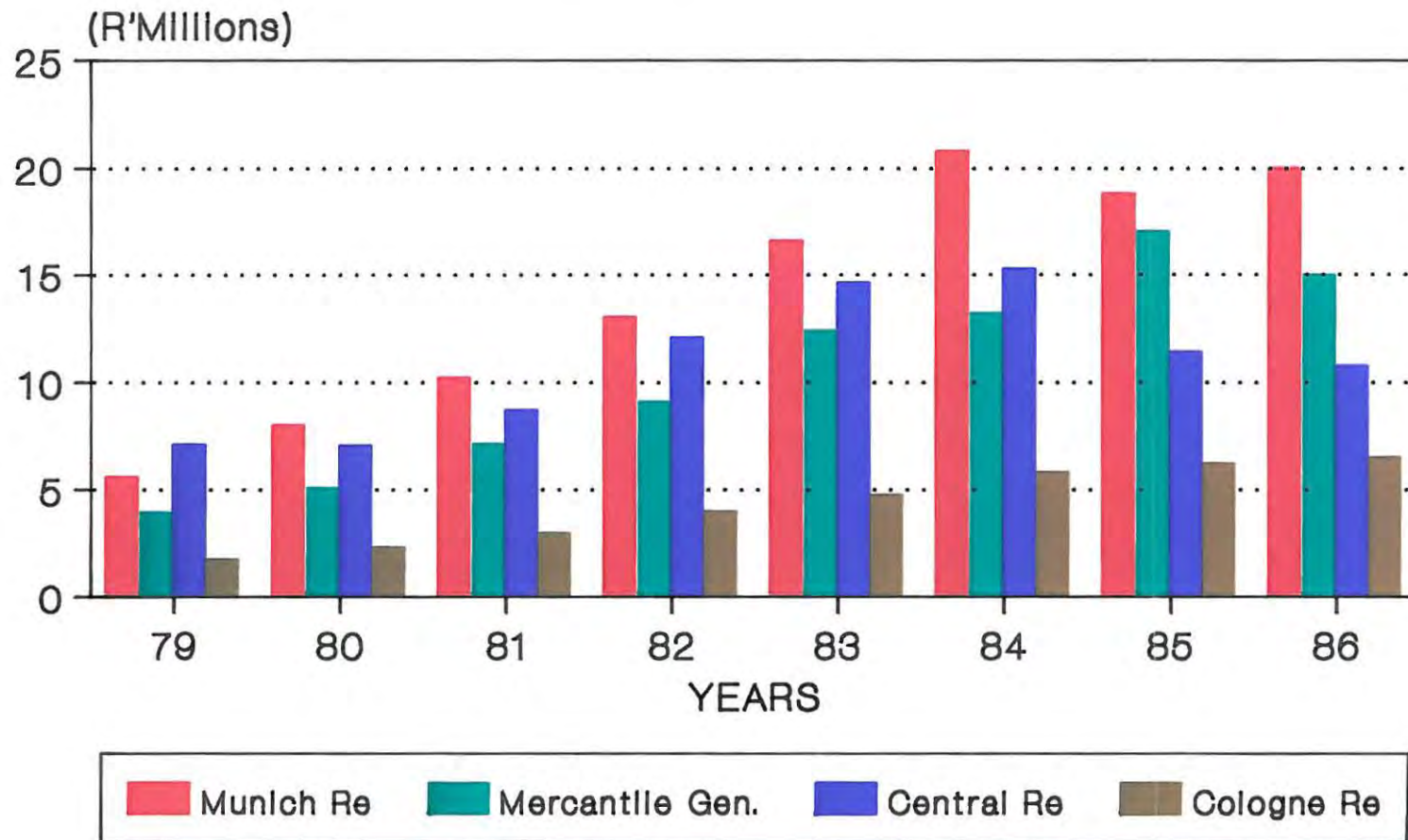


Figure 6b(II)

# GROWTH OF NET PREMIUM INCOME 1979 - 1986

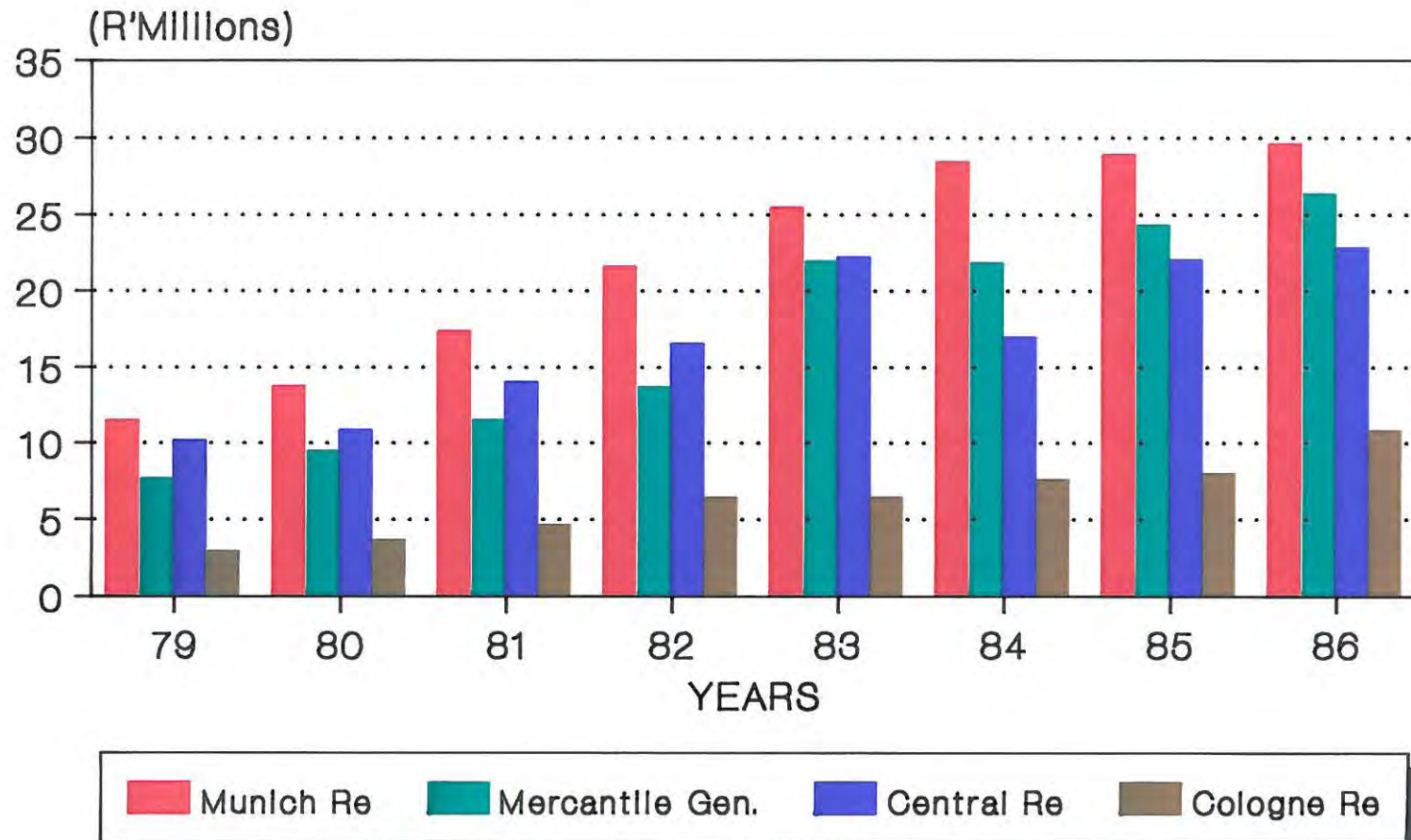


Figure 6b(l)

# NET CLAIMS EXPERIENCE 1979 - 1986

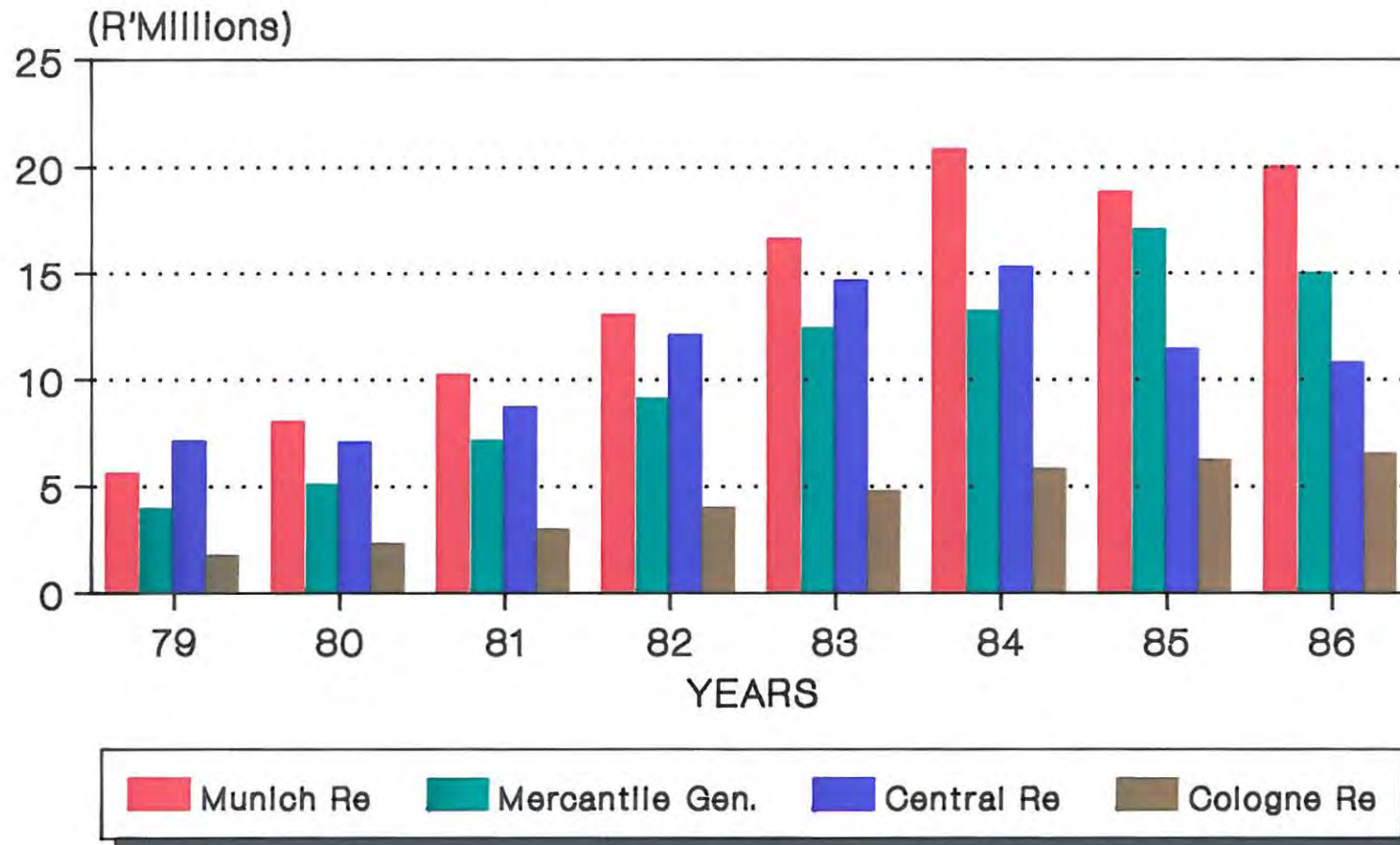


Figure 6b(II)

**TABLE 4.1**  
**GROWTH OF GROSS PREMIUM INCOME 1979-1986 (R'000) (6)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Mercantile+ General
1979	10 471	37 245	9 926	14 537	5 374	37 920	12 069	13 697
1980	11 385	42 586	9 628	18 275	6 997	46 840	14 639	14 989
1981	12 287	60 371	11 272	19 243	8 176	57 870	18 797	18 928
1982	17 116	71 901	16 069	26 396	11 456	69 171	31 372	23 697
1983	19 349	75 691	20 500	24 714	13 388	68 978	39 506	31 616
1984	9 961	65 380	24 940	19 387	12 456	79 109	31 286	35 244
1985	15 673	63 299	27 516	18 229	13 941	91 007	35 834	34 072
1986	N/A	94 531	30 885	22 477	20 038	121 099	38 447	39 067

It is necessary, however, when considering the growth rate of these companies to do so against the annual rate of inflation, in order to get a true picture of the growth of the market and the real level of cover provided.(see Table 4.2)

Perhaps the most striking feature of this period was that while the nominal growth rates of these companies generally remained fairly high, their real growth rates were very low and some, most notably the Gerling Global, experienced a negative real growth rate. What also emerges very clearly from this is the very sharp slow down in the growth of the MRSA in the aftermath of the pounding the market took in 1984. From having a real annual growth rate of well in excess of the market as a whole between 1979 and 1984 the growth of the MRSA in terms of net premium income effectively ground to a halt in 1985 and 1986. None the less the gross premium income of the MRSA continued to expand rapidly rising in nominal terms by 15.1% in 1985 and 33.2% in 1986. This continuing growth in gross terms is apparent from Table 4.1 and highlights once again the distinctive net to gross split of the MRSA. Whereas in the preceding period the highest average real growth rate of a reinsurer had been 64.2% and the lowest 6.0% in the period under review the respective growth rates were 7.4% and -12.7%. While a slightly different result is achieved if the performances of these companies is measured over the seven year period 1978 to 1985, that is excluding the partial recovery of 1986, the basic trend was the same, although the decline in growth rates was even more marked. It should be noted that the efforts of reinsurers to restructure the business on their books, which inherently involved the discarding of varying amounts of business, coincided with the rise in

**TABLE 4.2**  
**INFLATION ADJUSTED GROWTH OF NPI 1979-1986 (% pa)(7)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central Re		Mercantile + General		Average	
	Nominal	Actual	Nom.	Actual	Nom.	Actual	Nominal	Actual	Nominal	Actual	Nominal	Actual	Nominal	Actual	Nominal	Actual	Nominal	Actual
1979	21.4	6.1	12.1	-3.0	4.8	-10.3	-3.9	-19.0	23.6	8.5	16.6	1.5	32.2	17.1	-5.3	-20.4	12.7	-2.6
1980	0.1	-16.6	18.3	1.6	16.2	-0.5	19.0	2.3	25.4	8.7	19.9	3.2	6.7	-10.0	23.3	6.6	16.1	-0.6
1981	42.8	29.2	33.5	19.9	-6.8	-20.4	-2.6	-16.2	26.9	13.3	26.2	12.6	29.6	16.0	21.8	8.2	21.4	7.8
1982	15.4	1.5	23.0	9.1	32.7	18.8	18.7	4.8	38.4	24.5	24.5	10.6	18.2	4.3	19.2	5.3	23.8	9.9
1983	20.3	9.7	1.1	-9.5	2.1	-8.5	-10.0	-20.6	0.4	-10.2	17.9	7.3	34.3	23.7	60.7	50.1	15.8	5.2
1984	-12.8	-21.1	5.9	-2.4	9.8	1.5	-10.8	-19.3	18.1	9.8	11.6	3.3	-23.6	-31.9	-0.6	-8.9	-0.3	-8.6
1985	34.6	17.7	-4.0	-20.9	30.5	13.6	-16.5	-33.4	5.6	-11.3	1.7	-15.2	36.0	19.1	11.3	-5.6	12.4	-4.5
1986	<u>-41.5</u>	<u>-61.1</u>	<u>52.4</u>	<u>32.8</u>	<u>71.8</u>	<u>52.2</u>	<u>19.4</u>	<u>-0.2</u>	<u>35.7</u>	<u>16.1</u>	<u>2.5</u>	<u>-17.1</u>	<u>1.0</u>	<u>-20.6</u>	<u>8.3</u>	<u>-11.3</u>	<u>18.7</u>	<u>-0.9</u>
Average																		
per Company	10.0	-2.6	17.8	3.5	20.1	5.8	13.3	-12.7	21.8	7.4	15.1	0.8	16.8	2.2	17.3	3.0		

the rate of inflation to new highs, leading to a particularly rapid decline in growth rates. The single exception to this overall trend was the Reinsurance Union which exhibited an above average growth rate up to its collapse in 1985. Similarly for the market as a whole the real annual average growth rate of the market had fluctuated between a high of 31.4% and a low of 1.6% in the period 1967 to 1978, during the following eight years the highest rate of growth achieved was only 9.9% and the lowest -8.6%.

Not only did this period see a general slowing down in the rate of growth of the market, but these years, as already mentioned, also saw the performance of the individual companies vary considerably. Thus by 1985/6 the market had been radically altered. The fluctuating fortunes of the various reinsurers are graphically illustrated by Figures 6a and 6b, while the changes in the split of total premium income, as well as locally generated premium income, between these companies are outlined in Tables 4.3a and 4.3b.

**TABLE 4.3a**

**COMPANY SHARES OF TOTAL REINSURANCE BUSINESS  
1979 - 1986 (8)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central Re		Mercantile+ General	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
1979	7.4%	20.0%	26.4%	19.4%	7.0%	7.7%	10.3%	12.2%	3.8%	3.7%	26.8%	14.5%	8.6%	12.8%	9.7%	9.7%
1982	6.4%	19.2%	26.9%	21.8%	6.0%	6.4%	9.9%	9.8%	4.3%	4.7%	25.9%	15.9%	11.7%	12.2%	8.9%	10.1%
1986	N/A	11.3%	25.8%	24.4%	8.4%	11.5%	6.1%	5.6%	5.5%	5.7%	33.0%	15.6%	10.5%	12.0%	10.7%	13.9%

\* Premium in 1986 emanates from business being run off - not writing any new premium therefore will be a continually declining figure.

**TABLE 4.3b**

**COMPANY SHARES OF LOCAL REINSURANCE BUSINESS 1979-1984 (9)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central Re		Mercantile+ General	
	Gross Net		Gross Net		Gross Net		Gross Net		Gross Net		Gross Net		Gross Net		Gross Net	
1979	7.4%	7.1%	26.3%	26.9%	7.0%	7.8%	10.3%	13.8%	3.8%	4.6%	26.8%	21.4%	8.5%	5.4%	9.7%	12.9%
1980	6.9%	7.8%	25.7%	26.3%	5.8%	6.2%	11.0%	15.0%	4.2%	5.0%	28.3%	21.3%	8.8%	5.2%	9.1%	13.1%
1981	5.9%	6.8%	29.2%	29.4%	5.4%	6.1%	9.3%	11.5%	3.9%	4.9%	27.9%	22.1%	9.1%	5.5%	9.1%	13.7%
1982	6.3%	6.4%	26.9%	28.6%	6.0%	6.7%	9.9%	11.5%	4.3%	5.4%	25.9%	20.7%	11.7%	7.0%	8.9%	13.7%
1983	6.4%	6.4%	25.8%	24.3%	7.0%	5.4%	8.4%	10.6%	4.6%	5.3%	23.5%	21.0%	13.3%	11.2%	10.8%	15.6%
1984	6.9%	6.7%	22.7%	24.3%	8.7%	6.5%	6.7%	8.5%	4.3%	5.9%	27.5%	22.5%	10.9%	10.4%	12.2%	15.0%

The one element of constancy in the market during these years of turmoil was the dominance of the Swiss-SA Re in terms of net premium income which though briefly challenged by the Reinsurance Union in the early 1980s, was successfully retained throughout this period. None the less the growth of certain other reinsurers caused its share of locally generated net premium income to drop by around 3% between 1979 and 1984. By contrast the company had by 1986 established its dominance in terms of total net premium income more securely than ever before. While the Swiss-SA Re retained this overall dominance the period saw the MRSA secure its dominance as the largest reinsurer in South Africa in terms of gross premium income. Once more this highlights the massive differences between these two company's retention levels, and more importantly in their whole approach to the writing of business. Thus while it is evident that the Swiss-SA Re and the MRSA remained the two dominant reinsurers throughout this period, among the other companies in the market the status quo was broken down during these years. This was particularly so in the aftermath of the battering taken by the market in 1984. Certainly little change occurred in the ranking of the reinsurers up until 1983, it rather being in the three years following this that the main changes occurred and new trends emerged.(10)

The single most dramatic and important development during this period, and one which shook the reinsurance market, was the demise of the Reinsurance Union. This was especially so in view of its rapid growth up to 1983 by which time it had become the largest reinsurer in South Africa in terms of total net premium income. However, its demise was of such importance in the development of reinsurance in South Africa that the issue needs to be considered separately. Apart from the Reinsurance Union, the company which suffered the most as a result of the adverse market conditions of these years was the Gerling Global whose net premium income increased by less than a million rand from R 9 606 500 in 1979 to R 10 582 210 in 1986, having dropped to a low of R 8 860 387 in 1985. In real terms this meant that the Gerling Global experienced an actual average decline of 12.7% per annum in net premium income between 1979 and 1986. Consequently the Gerling Global's market share declined from 12.2% in 1979 to 5.4% in 1986, so that by then it was the smallest of the seven reinsurance companies trading in South Africa. This also affected its gross income although its decline was not as rapid or spectacular as the net income. However, this decline in the position of the Gerling Global was not solely a result of competition from the other reinsurers, but to a large degree stemmed from a deliberate attempt to cut back the company's portfolio to improve its bottom line results.<sup>(11)</sup> This was in part a result of pressure on some of the smaller reinsurers, by their parent offices, to "put their house in order", failing which the parent group would consider withdrawing from the South African market.<sup>(12)</sup> Certainly the Gerling Global with its above average loss ratio and generally poor operating results can be seen as having been forced to take such action. Indeed according to T.Gentles, the Managing Director of the Gerling Global, in 1981 the company believed the market was unstable, and in view of the poor short term prospects a decision was taken to cut back on business. This deliberate pruning it was argued, while leading to a decline in market share, meant that the Gerling Global did not experience the same losses as the rest of the market during the mid-1980s.<sup>(13)</sup> This will be considered when examining the market results. The performance of the Central Re during this period was also interesting with its generally rapid growth being interrupted in 1983 by a sharp downturn in premium income. As with the Gerling Global this reflected an attempt to restructure the company's business, though their actions was based on different factors. Up to 1983/4 the Central Re operated essentially as an independent South African reinsurer because of Santam Bank's 50% shareholding, and thus wrote a large foreign portfolio. However, following Santam Bank's sale of its 50% share in the Central Re to the other shareholder, the Norwich Winterthur Reinsurance Corporation, in 1982/3 the company became a wholly owned subsidiary and stopped writing foreign business.<sup>(14)</sup> (For the reasons behind this see Chapter 2) While this led to a marked reduction in premium income in 1983, in the medium term this was compensated for by the rapid growth in the amount of local business written

during 1984. Consequently its share of domestically generated net premium income rose from 7.0% in 1982 to 11.2% in the following year. This radical restructuring of the Central Re's business was assisted by the substantial increase in their share capital between 1982 and 1984. A final significant development in this period was the very rapid growth of the Hollandia Re, and to a lesser degree of the Cologne Re, from 1984/5. Both companies can be seen as having broken out of the pattern of slow growth which had characterized their earlier development. Indeed they emerged during this period as the two "up and coming" reinsurers, particularly the Hollandia Re. In part this was a result of the decline in the amount of business written by of the Gerling Global and the demise of the Reinsurance Union. However, in both cases new management, either locally or within the parent group, was arguably more important in causing this growth. In addition in the case of the Hollandia Re the changes in the shareholding of the company during this period ensured that for the first time the company had sufficient capital for meaningful expansion.(15)

Inextricably linked to the performance of the individual companies and of the market as a whole was the issue of local reinsurance capacity. The first point which deserves consideration in examining the changing local capacity is the net retention levels of individual reinsurers, which is outlined in Table 4.4.

**TABLE 4.4**

**NET PREMIUM AS A PERCENTAGE OF GROSS PREMIUM  
1979-1984 (16)  
(Local Business Only)**

	<b>Reinsurance Union</b>	<b>Swiss-SA Re</b>	<b>Hollandia Re</b>	<b>Gerling Global</b>	<b>Cologne Re</b>	<b>Munich Re</b>	<b>Central Re</b>	<b>Mercantile+ General</b>	<b>Average</b>
1979	32.2	34.0	37.2	44.8	40.4	26.5	20.9	44.5	33.4
1980	39.0	35.7	37.1	47.5	41.0	26.3	20.7	50.5	34.9
1981	38.1	33.6	37.4	41.2	41.1	26.2	20.2	49.7	33.3
1982	34.0	35.3	36.9	38.8	41.8	26.6	19.9	51.3	33.3
1983	36.4	34.1	27.8	45.5	42.4	32.1	30.5	52.0	36.3
1984	36.1	40.0	27.9	47.2	51.3	30.6	35.8	45.8	39.3

At the beginning of this period the existing trend of a decline in the average level of net retention continued, lasting through until 1981/2. From 1982/3, however, the average retention levels of these reinsurers increased fairly substantially. The only exception to this trend was the Hollandia Re which experienced a sharp decline in the percentage of business retained for its net account, largely as a result of the rapid growth of the company from 1983 onwards. Perhaps the most notable performance was that of the Central Re which dramatically increased its net retention level following its becoming a wholly owned subsidiary of the Norwich Winterthur Reinsurance Group. This was a result of both the substantial increase in the company's share capital and the fact that it ceased writing foreign business. Thus there would appear to have been some overall increase in the ability of the local reinsurance market to meet the needs of the direct market on its own account. Arguably this reflected both the reluctance of retrocessionaires to accept such a percentage of South African reinsurers business because of the results and the fact that these companies were no longer writing such a large volume of business relative to their assets because of their changing relationship with the direct market.(17)

In view of the much slower growth of these reinsurance companies during this period, it is necessary to consider whether or not the local reinsurers were able to meet the growing need of the direct companies,(see Table 4.5) It is evident from this that at least up to 1983 the local professional reinsurers were able to meet the growing need of the direct companies. First there was a not insignificant growth in the percentage of reinsurance business which was placed on the local market rather than placed overseas. This is noteworthy in that it occurred during a decline in the percentage of the gross reinsured premium income of the direct companies. Secondly not only was there a considerable increase in the proportion of reinsurance business placed on the local market but within this there was also a tendency for professional reinsurers to accept a slowly increasing share of this business. This demonstrates the steady growth in the importance of professional reinsurers to the insurance market. However, while this was true up to 1983, 1984 witnessed something of a turn around, with the percentage of reinsurance business placed in South Africa declining significantly and the share being written by local professional reinsurers falling particularly sharply. This was part of a general attempt by the professional reinsurers to secure a greater say in the writing of short term insurance business in view of the unprofitable state of the market, through reducing the capacity they offered to the direct market and raising their rates. Thus from 1983/4 the direct insurance companies increasingly went directly to foreign reinsurers, particularly the London market in view of the 'hard' approach to business adopted by the local reinsurers. This in turn explains the shrinkage of the gross premium income of the reinsurance market from 1983.(19)

**TABLE 4.5**  
**REINSURANCE AND RETROCESSION PATTERNS IN SOUTH AFRICA (R '000)**  
**1979 - 1984 (18)**

	GPI of Insurers	NPI of Insurers	Percentage Reinsured	Percentage reinsured locally		GPI of Professional Reinsurers	NPI of Professional Reinsurers	Percentage Retroceded		
				Total	with Professional Reinsurers			Total	Placed Locally	Placed Overseas
1979	938 425	612 579	34.7%	65.1%	43.4%	141 549	47 428	66.4%	5.8%	94.2%
1980	1 176 661	785 826	33.2%	67.1%	42.5%	165 905	58 179	64.9%	6.3%	93.7%
1981	1 445 724	970 903	32.8%	70.2%	43.6%	206 946	68 865	66.7%	6.0%	94.0%
1982	1 754 044	1 167 063	33.5%	73.3%	45.5%	266 900	88 937	66.7%	21.1%	78.9%
1983	2 206 634	1 539 992	30.2%	66.8%	43.9%	292 892	106 269	63.7%	3.5%	96.5%
1984	2 628 055	1 881 932	28.4%	62.3%	38.5%	287 695	107 445	62.6%	9.3%	90.7%

In evaluating the performance of these companies it is important, especially in view of the difficult underwriting conditions at this time, to consider their financial strength. One of the striking features of this period was the large scale increases in share capital experienced by many of them. Indeed six out of the eight South African reinsurers experienced increases in their share capital. The two companies which did not receive an increase were the Mercantile and General and the Gerling Global. It is evident that the financial strength of the Mercantile and General was such, that even with the difficult underwriting conditions of this period, it did not require an increase in share capital. The same cannot be said of the Gerling Global which to have retained its market share would have found it necessary to substantially strengthen its financial base. However, their parent company was unwilling to provide further capital in view of the Gerlings historically poor performance in South Africa. This failure to secure additional share capital was one of the main reasons behind the Gerling Global having to cut back and restructure its portfolio of business.(20) These increases in share capital were largely a result of the difficulties faced by the reinsurers and the consequent need to strengthen their financial reserves. In turn this suggests that prior to this period the reinsurers capitalization had generally been far too low to support the level of business they were writing.(21) This has been suggested as one of the weaknesses of the Reinsurance Union up to 1983/4, and thus one of the reasons for its demise.(22) The salient features are outlined in Table 4.6.

**TABLE 4.6**

**INCREASES IN ISSUED SHARE CAPITAL 1979 - 1986.(23)**

	<b>Reinsurance Union</b>	<b>Swiss-SA Re</b>	<b>Hollandia Re</b>	<b>Cologne Re</b>	<b>Munich Re</b>	<b>Central Re</b>
1979		2 000 000		875 000		2 000 000
1980				1 000 000		
1981			2 000 000			
1982					3 000 000	3 000 000
1983	3 921 000					4 000 000
1984		4 000 000	3 000 000			5 000 000
1985	8 921 000					
1986			3 500 500			

In the case of the Reinsurance Union it is evident that the massive injection of capital, with share capital which rose by close on R 8 000 000 between 1982/3 and 1985, came too late to save the company. However, it did ensure that it did not collapse and enabled it to withdraw from the market in an orderly fashion and meet its commitments and liabilities in South Africa and abroad.(24) Of the other reinsurance companies the most notable developments occurred in respect of the Central Re and the Hollandia Re. For both these companies the increase in share capital was accompanied by changes in ownership and control. The rapid increase in the share capital of the Central Re was linked to their becoming a wholly owned subsidiary of the Norwich Winterthur Reinsurance Corporation following the sale by Santam Bank of its 50% share holding.(25) By contrast the increases in the share capital of the Hollandia Re saw that company loosening its ties with its former parent company. This was a result of the political pressure being placed on the NRG by both the Dutch government and trade unions to withdraw from South Africa.(26) The NRG's shareholding in the Hollandia declined from a 100% in 1980 to 50.9% in 1981 and to 40.2% by 1984. This was accompanied by a steady growth in the share holding of the Hannover Ruckversicherungs AG which increased from 25.1% in 1981 to 31.6% in 1984.(27) Following the massive increase in share capital of the Hollandia Re to R 10.3 million in June 1987 the Hannover Ruckversicherungs AG with a 53% stake in the company has become the majority shareholder. This process of change also saw the Hollandia Re acquiring South African shareholders, albeit as minority shareholders. The first was the AA Mutual Insurance Company which held a 20% stake in the company from 1981 until its demise in 1986. From June 1987 the Rand Merchant Bank acquired an 18.9% holding in the company, with the AA Mutual Insurance Company's stake then amounting to 10.3% being held by its liquidators.(28) In this the Hollandia Re was running very much counter to the general trend which saw the wholly owned subsidiaries of foreign reinsurance groups dominating the market. While these changes gave the company greater freedom of action and in the short term greater financial strength, in the long run it arguably constituted a weakness for the company (See Chapter2)

It would appear that most of the reinsurers in South Africa emerged from the difficulties of this period considerably strengthened from injections of share capital. This once again highlights the importance of having the backing of a strong parent group which is willing to provide capital even where it appears that there is little prospect of an immediate return on that investment. In this regard the decline in the exchange value of the rand relative to the major European currencies meant that the cost of these capital injections to the shareholders were minimal. By contrast the cost of such injections for local shareholders would have been very much higher.(29)

One of the most important measures of the financial strength of a reinsurance company relates to the size of its free and technical reserves measured as a percentage of net premium income. However, before looking at the solvency margins and insurance funds of the South African reinsurance companies it is important to establish some picture of the size of their asset base and hence of their liabilities. This not only provides an indication of their financial strength but is also a further measure of their rate of growth. (see Table 4.7) On average the asset bases of all these companies, and thus of the market as a whole, did not expand as rapidly as had been the case during the decade to 1978. At the same time their liabilities on average grew far more rapidly than in the previous period. Consequently there was a very considerable narrowing in the average gap between the assets and liabilities of most of these reinsurers, indicating the generally poor operating conditions faced by the insurance sector as a whole. Obviously within this the performance of the individual reinsurers varied considerably both in terms of growth and financial strength. In terms of growth at the one end of the scale were the Reinsurance Union and the Gerling Global both of which experienced only minimal increases in their nominal asset base and hence an actual decline in real terms. At the other end of the scale were the MRSA and the Hollandia Re both of which experienced considerable real growth in their asset base. The one factor which unites all these companies, with the exception of the Mercantile and General, was that whatever their rate of growth, there was a very substantial reduction in their financial strength. As such when taken together with the figures in Table 4.8, a number of significant points emerge in respect of the financial strength of these companies. In the first place it is evident from the solvency margin of the Reinsurance Union in 1983, standing at only 1.4% above the minimum statutory level, why the company's shareholders decided to withdraw, at least temporarily, from the market in 1984. The decline in the financial reserves of the Reinsurance Union was primarily a result of the massive growth of premium income of the company which occurred at the very time the market was in a severe loss making cycle.<sup>(32)</sup> This was coupled to a failure on the part of the shareholders in the late 1970s to recognize the need to provide substantial additional share capital to increase the company's financial base to support the large amount of business, particularly foreign business, written and its position as an independent South African reinsurer. This sharp decline in the Reinsurance Union's solvency margin and the need to rectify this was the main reason behind the quadrupling of the company's share capital in 1983. Ultimately this proved futile because it came too late, and in addition the continuing high level of losses further undermined the company's already weak financial base. One of the notable features of the financial strength of all the reinsurers at this time was the generally low free reserves and hence solvency margins of the Central Re, the Cologne Re and increasingly also

**TABLE 4.7**  
**ASSETS AND LIABILITIES OF REINSURERS 1979-1984 (R'000)(30)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central R		Mercantile + General	
	Assets	Liabil.	Assets	Liabil.	Assets	Liabil.	Assets	Liabil.	Assets	Liabil.	Assets	Liabil.	Assets	Liabil.	Assets	Liabil.
1979	26 767	19 343	38 367	27 564	7 401	1 618	22 235	17 597	6 656	5 555	52 901	46 291	16 979	14 733	28 600	14 733
1980	28 350	19 999	44 996	30 818	9 440	7 338	23 195	19 348	7 562	6 709	66 820	59 856	19 257	16 967	34 215	17 641
1981	32 805	24 457	50 809	39 989	11 687	8 391	26 484	23 569	8 348	7 316	78 914	73 217	22 983	19 930	32 698	16 218
1982	31 479	24 476	55 107	42 537	13 994	11 198	29 520	26 225	10 429	8 887	95 512	83 931	31 760	27 398	39 373	19 353
1983	36 164	32 594	67 712	53 335	20 101	17 100	28 868	25 585	13 162	11 557	101 341	90 534	44 164	39 213	43 788	23 831
1984	39 719	39 556	75 341	66 921	24 265	20 122	29 147	26 447	13 972	12 327	114 296	104 758	N/A		49 496	31 464

**TABLE 4.8**  
**FREE AND TECHNICAL RESERVES OF REINSURERS 1979-1986 (%) (31)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central Re		Mercantile+ General	
	Margin	Funds	Margin	Funds	Margin	Funds	Margin	Funds	Margin	Funds	Margin	Funds	Margin	Funds	Margin	Funds
1979	47.2	80.4	71.0	99.5	20.4	82.8	48.3		38.2	95.5	57.9	82.8	22.3	83.7	181.8	103.5
1980	53.0	76.9	78.8	104.7	29.9	91.7	33.6		23.6	98.6	50.9	83.6	21.3	81.8	176.2	88.6
1981	37.1	60.3	45.0	94.7	50.3	100.5	26.2	N/A	22.5	94.0	33.0	75.8	21.9	75.5	143.8	80.0
1982	27.0	61.5	42.5	95.1	32.1	88.2	24.9		24.3	81.3	53.8	75.9	26.4	60.9	146.5	72.2
1983	11.4	69.1	48.1	100.2	33.8	115.5	27.6		25.2	93.5	42.6	76.9	22.3	83.1	90.9	73.4
1984	N/A															
1985	15.0	82.8	71.4	137.5	36.2	112.7	35.7	144.7	36.8	95.4	41.8	104.1	25.6	125.3	115.1	84.1
1986	N/A		82.3	120.8	21.5	99.2	48.2	142.6	43.3	93.7	131.3	111.8	53.0	159.6	159.4	97.2

the Gerling Global. However, the financial base of all these reinsurers was generally reasonably strong in that they all had substantial technical reserves to offset their relatively weak free reserves. Moreover unlike the Reinsurance Union they were not growing at a dangerously rapid rate and thus they did not face the same overall decline in their financial base as had affected the Reinsurance Union from 1980. Indeed the declining financial strength of the Gerling Global was one of the main reasons for the company cutting back on the level of business written. This was in line with pressures from the parent company which was unwilling to provide an injection of capital to remedy the company's financial difficulties, as evidenced by the fact that the Gerling Global was one of the two reinsurers not to experience an increase in share capital during these years. Thus while the performance of the Gerling Global in terms of the rate of growth may have appeared very poor, at least it acted pragmatically and restructured its business in line with its resources. If it had failed to do so and embarked on a course of rapid growth, as did the Reinsurance Union, there is a reasonable degree of certainty that it would have suffered a similar fate.<sup>(33)</sup> In direct contrast to the performance of these companies was that of the Mercantile and General which consistently possessed very large free reserves, a solvency margin more than double than that of the rest of the market, as well as very substantial technical reserves. It is important having made these observations to emphasize once again that ultimately the strength of these local reinsurance companies, was not based solely on their own resources, but also on the willingness of their shareholders to provide additional capital should this be necessary. This was also important in determining the willingness of the direct companies to place their reinsurances with these local reinsurers rather than place it overseas, as the shareholders in effect constitute the reinsurers 'reserves of last resort'. In this regard the Guardian National Insurance Company, following a review of the Hollandia Re's financial base and the perceived risk of shareholders not being able, or willing, to assist the company financially, imposed a limit of R 250 000 on individual risks ceded to this company.<sup>(34)</sup>

Generally there has been little correlation between the rate of growth and the financial strength of reinsurers in South Africa. Rapid growth has not normally led to a decline in the financial strength of a company and vice versa, with it rather being the quality of that business which was crucial. This is clearly borne out by the performance of many of the reinsurers operating between the 1950s and the 1980s. Ultimately, even in the case of the Reinsurance Union, it was the poor quality of the business written, rather than its volume which jeopardized the company's financial position. Thus when considering the factors which shaped the financial strength of these reinsurers it is their underwriting results and the prevailing underwriting conditions in the market, rather than their rates of growth which deserves attention. This arguably constitutes something of a vicious circle in that it

is those companies which have enjoyed the greatest financial strength that have attracted the better quality business while the financially weaker companies of necessity accepted the poorer quality business thus perpetuating their weak financial position. Generally during the period 1979 to 1984 the financial base of all these companies declined as a percentage of their net premium income because of their poor operating results and the poor underwriting conditions prevailing in the insurance market. That it was the underwriting results which determined the financial strength of these reinsurers is confirmed by the experience of the Mercantile and General, with its better than average performance in terms of financial strength corresponding with its very much better than average operating results.

Having outlined the growth and financial strength of the reinsurance companies in South Africa during the years from 1979 to 1986, the acid test of their performance is their operating results. The logical starting point for such an examination is a consideration of their loss ratios which give a good indication of the underwriting conditions facing reinsurers in the South African market (see Table 4.9)

**TABLE 4.9**

**LOSS RATIOS OF REINSURERS 1979 - 1986.(35)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Mercantile+ General	Average
1979	53.2%	64.7%	61.5%	74.0%	58.9%	48.7%	70.3%	51.5%	60.3%
1980	68.8%	65.6%	67.5%	64.8%	63.0%	58.4%	65.3%	53.9%	63.4%
1981	66.0%	69.4%	68.6%	81.9%	64.1%	58.9%	62.1%	62.3%	66.7%
1982	74.8%	75.8%	75.2%	79.5%	62.5%	60.3%	72.9%	66.6%	71.0%
1983	68.5%	78.1%	92.8%	78.8%	74.3%	65.3%	66.0%	56.3%	72.5%
1984	93.3%	92.1%	77.6%	100.9%	76.9%	73.3%	90.1%	60.4%	83.1%
1985	86.3%	77.5%	81.3%	96.1%	78.0%	65.2%	49.5%	70.2%	75.5%
1986	139.7%	51.3%	71.1%	67.7%	60.3%	67.6%	47.1%	56.9%	60.3%*

\* Average for 1986 excludes Reinsurance Union as this company was in a run-off situation and its loss ratio was thus artificially high.

It is evident from these figures why the years 1979 through to 1986 were a period of crisis for the South African reinsurance market. The loss ratio rose from an average of 58.5% in the 1970s to slightly over 72% in the 1980s with 1984 producing the worst results in the history of the South African reinsurance market. While Cyclone Demoina and the Reef hailstorms of that year were an important factor, there was also an overall increase in the level of other claims.<sup>(36)</sup> With the exception of the Mercantile and General all these reinsurers from the early 1980s consistently experienced extremely high loss ratios, although most had a few good years either at the beginning or end of this period. The Reinsurance Union and the Gerling Global in particular suffered extremely serious losses causing both companies considerable difficulties. For the Reinsurance Union this was coupled with exceptionally rapid growth and led to the company's ultimate collapse, while the Gerling Global were forced to cut back drastically on the volume of business written. This loss situation arose not because of the catastrophic losses but because of the totally inadequate rating structure within both the direct and reinsurance markets.<sup>(37)</sup> Had sound underwriting standards been maintained it is reasonable to assert that the reinsurers would have been able to bear these catastrophic losses without undue difficulty. Instead many reinsurers were forced into very real financial difficulties by them. Indeed during the first half of the 1980s the general trend was one of negative underwriting conditions, particularly in fire and other property classes, with fierce competition, depressed rating levels and widened terms of cover being the norm. This move away from sound underwriting principles can in a large part be attributed to the actions and growing power of brokers. As a result of the collapse of the direct companies' agency network and the intense competition in the market, brokers increasingly possessed the power to dictate the price and level of cover provided by direct companies, leading to a general decline in rates and softening in terms.<sup>(38)</sup> This situation was exacerbated by the continuing high rates of commission paid by the reinsurers to the direct companies. The relevant figures of commission and expense levels are outlined in Table 4.10.

**TABLE 4.10**

**COMMISSION AND EXPENSE RATIOS OF REINSURERS 1979 - 1986 (39)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Mercantile+ General	Average
1979	36.8%	37.0%	35.5%	35.1%	39.8%	37.9%	32.3%	37.2%	36.4%
1980	36.2%	33.8%	34.4%	33.3%	40.4%	39.6%	32.4%	37.4%	35.9%
1981	33.1%	37.4%	35.4%	36.5%	39.1%	40.7%	31.1%	37.8%	36.4%
1982	31.1%	34.6%	33.2%	32.3%	35.7%	37.5%	34.2%	37.4%	34.5%
1983	30.7%	33.7%	35.3%	36.0%	37.7%	38.5%	32.1%	34.5%	34.8%
1984	29.5%	35.7%	32.8%	33.2%	38.2%	37.1%	35.8%	35.6%	34.7%
1985	31.5%	33.1%	31.1%	32.0%	35.8%	37.3%	30.3%	35.6%	33.3%
1986	38.0%	30.5%	32.5%	37.8%	35.7%	39.7%	31.9%	32.1%	34.3%*

\* Average for 1986 excludes the Reinsurance Union as this company was in a run-off situation and thus its commission and expense ratio was artificially high.

The combined level of commission and management expenses did not rise markedly during this period because there was an effort on the part of the reinsurers to try to resolve their difficulties by cutting both management expenses and rates of commission. This was born of a realization that even through SAROA the reinsurers could do little, directly anyway, to alter the rating of business in the direct market. One of the most important developments in the rates of commission paid by reinsurers was the introduction of a sliding scale.(40) As this issue will be examined in detail when considering the development of SAROA it is sufficient at present to note that the introduction of the sliding scale in 1982/3 led to a significant decline in the levels of commission paid by reinsurers. Such were the perceived problems posed by the high levels of commission and management expenses at a time of low profits that various ideas were put forward to resolve the difficulties these posed for reinsurers. Probably the most revolutionary proposal but one which was ultimately not put into practice was the idea advanced in 1981/2 that the Central Re and the Hollandia Re, while maintaining their separate underwriting identities and thus independence, would create a "joint

management company" in order to achieve an economy of scale in the administration of business, in line with similar developments on the London reinsurance market. This it was argued would strengthen the position of the two companies and allow each to compete more effectively with the larger companies in the market.(41) How seriously this idea was pursued is not clear although discussions were conducted at senior management level apparently with the blessing of the respective parent companies.(42) However, the fact that negotiations occurred at this time arguably reflected the changing relationships of both the respective parent offices with their South African operations. Moreover given the weak position of the Hollandia Re this could in reality be seen as an attempt by the Central Re to take over the Hollandia Re, rather than merely an attempt to resolve the problems posed by high administration costs.(43) Ultimately, however, this idea fell away during 1983 probably as a result of the strengthening of the Hollandia Re's position and because of the growing commitment on the part of the Hannover Ruckversicherungs AG to them. Within the market as a whole it would seem that during this period it was the Cologne Re and the Swiss-SA Re which succeeded best in reducing their commission and expense ratios, thus considerably strengthening their competitive position. By contrast the MRSA continued to experience a high and rising level of commission and particularly management expenses so that by 1986 its management expenses exceeded its level of commission, the first time this had happened in the South African reinsurance market. However, such a high commission and expense ratio was a result of the massive gross premium income written by the MRSA and in reality reflected the cost of purchasing and administering this gross business.(44)

From these two sets of figures it is possible to establish the operating margins of the individual reinsurance companies and for the market as a whole, which in turn provides a fairly accurate indication of the overall conditions facing the market during this period.

**TABLE 4.11**

**OPERATING MARGINS ON NPI 1979 - 1986\* (45)**

	Reinsurance	Swiss-SA	Hollandia	Gerling	Cologne	Munich	Central	Mercantile+	Average
	Union	Re	Re	Global	Re	Re	Re	General	
1979	10.0%	-1.7%	3.0%	-9.1%	1.3%	13.3%	-2.6%	11.3%	11.3%
1980	-5.0%	0.6%	-1.9%	1.9%	-3.4%	2.0%	2.3%	8.7%	0.7%
1981	0.9%	-6.4%	-4.0%	-18.4%	-3.2%	0.4%	6.8%	-0.1%	-3.1%
1982	-5.9%	-10.4%	-8.4%	-11.8%	1.8%	2.2%	-7.1%	-4.0%	-5.5%
1983	0.8%	-11.8%	-28.1%	-14.8%	-12.0%	-3.9%	1.9%	9.2%	-7.3%
1984	-22.8%	-27.8%	-10.4%	-34.1%	-15.1%	-10.5%	-25.9%	4.0%	-17.8%
1985	-17.8%	-10.6%	-12.4%	-28.1%	-13.8%	-2.5%	20.2%	-5.8%	-8.8%
1986	-77.7%	18.2%	-3.6%	-5.5%	4.0%	-7.3%	21.0%	11.0%	5.4%

\* Operating margin calculated on the basis of Loss Ratio added to Commission and Expense Ratio, subtracted from NPI, and expressed as a percentage of NPI.

The sharp downturn experienced by the reinsurance market in the early 1980s is well illustrated by these statistics. While during the 1970s the highest average annual margin was 11.9% and the lowest 2.8%, in the first half of the 1980s these results were 0.7% and -17.8% respectively. Within this, however, the performance of the individual companies varied considerably. On the one hand there were the Central Re and the Mercantile General, which experienced generally good results contrary to the general market trend, while on the other companies such as the Gerling Global and Hollandia Re experienced particularly poor operating results. In the case of the Gerling Global this was part of a trend which had emerged during the 1970s. Perhaps the most notable performance was that of the Central Re which although experiencing an above average loss ratio up to 1985, was by virtue its very low level of commission and management expenses, able to return fairly good operating results. Moreover when the Central Re restructured its portfolio in 1983 with the ending of its writing of foreign business, at the very time when the market was beginning to harden, their low commission and management expenses meant that they were able to return better than average results in 1985/6. By contrast both the MRSA and the Mercantile General, while showing better than average loss ratios, were unable to avoid the general difficulties of this period because of their

relatively high levels of commission and management expenses. These two factors are, however, inextricably linked in that high management expenses generally reflected a high level of technical expertise which arguably enabled these companies to secure better quality business at more realistic rates than those companies which did not have such expertise, leading to them having a better than average loss ratio.(46) Similarly with the introduction of the sliding scale of commission the general trend was for the better quality business to command high levels of commission and vice versa. Perhaps the interaction of these factors can best be summed up by the old dictum, "what you make on the swings you lose on the roundabouts." One notable feature of these years was the relatively poor performance of the Swiss-SA Re, which in spite of having a highly competent technical team generally experienced a higher than average loss ratio. The most likely reason for this was their attempt to compete head on with the MRSA in order to preserve their market share. However, unlike many of the other reinsurers the Swiss-SA Re could bear the losses from such competition without imposing an undue strain on its financial strength.

The final factor which shaped the results of these reinsurers was their investment income which is outlined in Table 4.12.

**TABLE 4.12**

**INVESTMENT INCOME OF REINSURERS 1979 - 1986\* (R'000) (47)**

	Reinsurance Union		Swiss-SA Re		Hollandia Re		Gerling Global		Cologne Re		Munich Re		Central Re	
	%of		%o		%of		%of		%of		%of		%of	
	NPI		NPI		NPI		NPI		NPI		NPI		NPI	
1979	1 113	7.1	1 819	11.9	309	5.1	1 333	13.9	374	13.0	2 819	24.7	827	8.2
1980	1 317	8.4	2 138	11.9	355	5.0	1 569	13.7	476	13.2	3 183	23.2	1 118	10.4
1981	1 505	6.7	2 959	12.3	467	7.1	1 886	16.9	637	13.9	688	4.0	1 275	9.3
1982	1 538	5.9	3 465	11.7	770	8.8	2 253	17.0	727	11.5	94	0.4	2 099	12.7
1983	1 757	5.6	5 482	18.3	1 086	12.2	2 424	20.4	896	14.1	1 489	5.9	2 578	11.6
1984	2 421	8.9	5 114	16.2	1 503	15.4	2 952	27.8	1 220	16.2	2 401	8.5	2 921	17.2
1985	2 493	6.8	6 621	21.8	1 792	14.1	3 319	37.4	1 501	18.9	3 920	13.6	2 892	12.6
1986	2 640	12.3	6 676	14.4	2 487	11.4	3 454	32.6	N/A	N/A	6 743	22.8	3 593	15.8

\* Figures of the investment income of the Mercantile and General are not included as the annual reports of this company do not distinguish between short term and life investment income.

A number of points emerge from these figures which are worth further mention. In the first place the importance of investment income to the Gerling Global increased dramatically rising from around 13% of NPI in 1979 to over 35% in 1985. This, however, was primarily a result of the decline in their premium income rather than any particularly spectacular growth in investment income. Secondly the early to mid-1980s saw the investment income of the Hollandia Re rise very substantially, in fact trebling as a percentage of net premium income in the five years 1980 to 1984. This was a result of both the increase in the investment funds at the disposal of the company and the fact that the return on such investments increased because of the move into the equity market and the rise in interest rates.(48) Of all the reinsurance companies in the South African market, it was only the Reinsurance Union and the MRSA which did not experience an overall increase in the importance of their investment income during this period.

Although it is apparent from this that investment income as in the preceding period was of considerable importance, reflecting the continuing practice of cash flow underwriting, such were the operating losses of these reinsurers that investment income was on a number of occasions unable to offset losses. None the less, as is indicated by Table 4.13, investment income cushioned the effect of the large operating losses.

**TABLE 4.13**

**COMBINED OPERATING AND INVESTMENT RESULTS  
OF SHORT TERM REINSURANCE BUSINESS 1979-1986.  
( % of NPI)\* + (49)**

	Reinsurance Union	Swiss-SA Re	Hollandia Re	Gerling Global	Cologne Re	Munich Re	Central Re	Average
1979	17.1%	10.2%	8.1%	4.8%	14.3%	38.3%	10.4%	14.7%
1980	3.4%	12.5%	3.1%	15.6%	9.8%	25.3%	12.7%	11.8%
1981	7.6%	5.5%	3.1%	-1.5%	10.7%	4.3%	15.9%	6.5%
1982	0.0%	1.3%	0.4%	5.2%	13.3%	2.6%	5.6%	4.1%
1983	6.4%	6.5%	-15.9%	5.6%	2.1%	2.0%	13.5%	2.9%
1984	-13.9%	-11.6%	5.0%	-6.3%	1.1%	-1.9%	-8.6%	-5.2%
1985	-11.0%	11.2%	1.7%	9.4%	5.1%	11.1%	32.8%	8.6%
1986	-65.4%	32.6%	7.8%	27.1%	17.9%	15.5%	36.8%	22.9%

\* Figures calculated on the basis of investment income as a percentage of NPI from Annual Reports (Table 4.12) being added to figures of the operating margin as a percentage of NPI from Table 4.11 with the final results being measured as a percentage of NPI.

+ Differences between these two sets of figures (Tables 4.11 and 4.13) and the figures of underwriting results produced in Annual Reports and by Quest Advisory Service arises from the fact that these figures are based merely on the results of year to year operations and do not take account of transfers to and from insurance funds and reserves. For the growth of these insurance funds see Table 4.8.

Indeed it would be reasonable to suggest that investment income actually became of greater relative importance in these years than in the preceding period. While in the 1970s investment income had merely boosted the operating margins of the reinsurers, in the early 1980s it frequently made the difference between a profit or loss. In this regard the position of the Gerling Global is of particular note and at the same time serves as a good case study of the experience of the market. The Gerling Global consistently returned an operating loss in excess of the market average during the early 1980s, but when their investment income was taken into account they generally fared better than the market average. This was largely because while their premium income declined their short term in-

vestment income continued to expand. In other words the Gerling Global was becoming increasingly dependent on investment income in order to return a profit, even though not pursuing a deliberate policy of cash flow underwriting.<sup>(50)</sup> With such an unhealthy dependence on investment income it is reasonable to argue that the efforts of the Gerling Global to improve the quality of business by pruning their portfolio generally failed. This is not to suggest that the solution to such difficulties was a rapid expansion of premium income for the two companies which demonstrated the most rapid growth in the aftermath of the the 1984 slump, that is the Hollandia Re and the Cologne Re, experienced below average results. In other words there is little correlation between the rate of growth and a company's operating results, it rather being the underwriting practices of the company which are crucial, although these were often allowed to deteriorate to achieve rapid growth. The experience of the Reinsurance Union in this period bears this out. The general improvement in the overall underwriting results of the market which occurred from 1985, but particularly from 1986, was largely a result of the hardening of the reinsurance market. In this the growing strength of the South African Reinsurance Offices Association was of particular importance in allowing reinsurers to have a greater say in the rating of business and restoring some of the equilibrium between the direct companies and the reinsurers.

One of the most important developments in the reinsurance market between 1979 and 1986 was the creation of the South African Reinsurance Offices Association (SAROA). Established in 1981 along the lines of the Reinsurance Offices Association in Britain, SAROA developed out of the earlier informal meetings which had been held on an ad hoc basis between South African reinsurers.<sup>(51)</sup> The creation of SAROA in 1981 while reflecting the difficulties which were plaguing the market, did not so much arise out of a need or desire of the reinsurers to act in concert to overcome these difficulties, but was rather formed at the request of the Registrar of Insurance who looked on SAROA as a body through which he could discuss issues of mutual concern with the reinsurance market as a whole. SAROA can thus be seen as the reinsurance market's counter-part of the South African Insurance Association, which is the representative body for the entire market.<sup>(52)</sup> During the early 1970s the Registrar of Insurance had in fact pressed for the creation of such a body but had encountered resistance from the reinsurers who, in view of the high level of competition in the market and the concomitant lack of mutual trust, felt they should maintain maximum independence. The difficulties of the late 1970s and early 1980s removed the bulk of these objections, facilitating the belated establishment of SAROA.<sup>(53)</sup> The willingness of the reinsurers to co-operate and the belief in the benefits of concerted action was largely determined by the condition of the market; it being very much a case of "co-operation increasing with adversity."<sup>(54)</sup> This

was not merely true of the 1980s, for in the difficulties and uncertainties of the early years of the reinsurance market there was a tendency for reinsurers to co-operate, while in the subsequent boom years such co-operation and mutual restraint was replaced by cut-throat competition. While it is clear that SAROA was not formed by the reinsurers to advance their own interests, the creation of such a body was ultimately facilitated by the recognition that it would play a significant role in resolving some of the difficulties facing the market. In other words the reinsurers soon looked on SAROA as being more than merely their representative body and saw it also as a body through which they could exert some influence over the direct insurers.

Having said this it is important to consider what role the reinsurers themselves believed SAROA should play and whether it fulfilled these aims. In general the reinsurers looked to SAROA as a body which would provide them with the unified voice necessary to stand up to the concerted pressure being exerted by the direct companies and the brokers through their respective representative bodies. Essentially the creation of SAROA meant that reinsurers and insurers met on a more equal footing, with the dominance of the direct insurers over the reinsurers in the 1970s being replaced by a far more egalitarian relationship. Certainly SAROA produced greater unity within the reinsurance market and while not eliminating competition brought it within more manageable and sensible parameters. This unity has been particularly important in that it meant that the reinsurers no longer acted in isolation and ignorance of the other companies decisions and reduced the ability of the direct companies to play one reinsurer off against another.(55) It has been argued in some quarters that the emergence of SAROA has caused the relationship between the reinsurers and the direct market to swing to the other extreme, with the reinsurers increasingly able to dictate terms to the direct market.(56) That SAROA was able to achieve this turn around in the relationship between the direct market and reinsurance market was a result of the determination of the reinsurers to put the market on a sound footing, and this was particularly so following the disastrous results of 1984. The success of the SAROA was also based on the relative ease of achieving concerted action in the face of such poor results, given the small number of reinsurers in the South African market.(57) This shift in the relationship between the reinsurers and the direct companies would seem justified in that the reinsurers were the ultimate risk carriers and as such should have a major say in the writing of business.(58)

Having outlined the reasons behind the creation of SAROA as well as its basic aims, it is important to consider how it fulfilled these roles. At the most basic level SAROA has been a forum where the reinsurers have been able to meet and discuss issues of mutual interest and importance, with par-

ticular emphasis being placed on their technical problems.(59) SAROA has sought to achieve uniformity on technical matters pertaining to the writing of business as well as the introduction of measures aimed at curbing those self destructive actions which had seriously weakened the market from the late 1970s.(60) A wide range of measures were introduced by SAROA in an effort to put the reinsurance market on a sounder footing and to strengthen the hand of the reinsurers in the overall writing of business. Within this it is possible to identify two main areas of activity. In the first place the reinsurers have sought to tighten the terms and scope of cover being offered. For instance reinsurers via SAROA refused to write Assets All Risk business because such policies were not only technically unsound but could contain an "unknown and unknowable collection of risks."(61) Similarly reinsurers have sought to limit the length of the claims tail of liability business by only accepting such business on a 'claims made' as opposed to the earlier 'losses occurring' basis. Although this saw the brokers, via SAIBA, taking the reinsurers to the Competitions Board, this attempt to prevent SAROA changing the basis of liability policies in South Africa failed and the reinsurers through SAROA have generally been successful in imposing their terms on the direct market.(62) The key point is that the success of the reinsurers in imposing their terms on the direct market has been dependent on their presenting a unified front been facilitated by SAROA.

The other main focus of SAROA's activities was in respect of the levels of commission paid by the reinsurers to the direct companies for business. Up to the early 1980s the tendency had been for reinsurers to pay higher and higher levels of commission to secure business. Moreover the rates of commission bore little relation to the quality of the business. Such high levels of commission had a seriously debilitating effect on the reinsurance companies in that they coincided with a sharp increase in the reinsurer's loss ratios. Consequently from the early 1980s the reinsurers, through SAROA, moved away from the practice of paying a flat rate of commission and adopted a sliding scale for calculating rates of commission to be paid. Within this sliding scale the rate of commission was based on the profitability of the business, measured in terms of the loss ratio.(63) This provided an important incentive to the direct companies to improve their underwriting standards. In particular with the rate of commission being tied to the quality of the business it was no longer possible for the direct companies to make a profit merely by ceding any business, irrespective of quality because the rates of commission no longer automatically guaranteed a profit. Indeed the reinsurers in some cases even went as far as paying the direct companies less than their acquisition costs for really poor quality business.(64) This was particularly important because of the tendency of the direct companies to cede only their loss making business, retaining the profitable business for their net account. The introduction of the sliding scale was the most important product of the co-

operation between the reinsurers engendered by SAROA in that it gave the reinsurers an element of control over the underwriting standards and practices of the direct companies. Once again it was only through presenting a united front that the reinsurers were able to exercise some control over the quality of business ceded to them. SAROA thus played an important role in the hardening of the reinsurance market from the early 1980s.

While SAROA has not concerned itself directly with issue of the rating of business it has been crucial in the tightening of terms and the general effort to secure a return to sound underwriting practices. In pursuing these technical issues the activities of SAROA may, however, have come to impinge on the rating of business. The key point is that SAROA has not concerned itself directly with the issue of the rating of business and consequently must be seen as a technical and advisory body and not a tariff agreement in that it has never attempted to impose a market wide rating structure.<sup>(65)</sup> While it has sought to promote co-operation between the reinsurers on technical matters it has not attempted to eliminate the competition between them through the curbing of price competition. In some circumstances, however, it has sought to place such competition within mutually acceptable limits. This restriction of competition was not merely for the good of the reinsurers but ultimately in the long term also for the good of the direct companies which purchased reinsurance cover. Overall SAROA while not eliminating competition in the reinsurance market has, by virtue of facilitating concerted action in respect of technical matters, improved the underwriting position of the reinsurers and strengthened their standing vis-à-vis the direct market. These improvements in the conditions facing the reinsurers in the South African market, however, came too late to prevent the demise of the Reinsurance Union.

The decision taken by the shareholders of the Reinsurance Union in July 1985 that the company should close its doors signaled the end of an era in the South African reinsurance market. The demise of the Reinsurance Union meant that of the first three reinsurance companies established in South Africa in 1950/1, only the Swiss-SA Re had managed to survive these three and a half turbulent decades. More importantly the collapse of the Reinsurance Union marked the end of an era in which independent South African reinsurers had played a role in the shaping of the reinsurance market.<sup>(66)</sup> Although this role had declined over the preceding years, reflecting the growing dominance of foreign owned reinsurers, nominally independent South African reinsurers had continued to play a part in shaping the market until the early 1980s. In spite of the historical significance of this move, the decision by the Reinsurance Union to close its doors had a surprisingly limited impact on the market. There were two reasons for this, in the first place, as indicated by

Figure 7, the Reinsurance Union in spite of its very large net premium income had very little penetration in the South African market, the focus of its activities having been on foreign business. This was surprising given that of the twelve shareholders eleven were major South African short term insurers.(67) Secondly the collapse of the Reinsurance Union was not as dramatic or sudden as might be expected, because its difficulties were recognized from early in 1983. Although the attempt to rectify the situation by quadrupling the share capital of the company in 1983 came too late to save it, this did serve to give notice of the possibility of the company having to cease operations in the not too distant future. Thus the decision taken in 1984 to withdraw temporarily from both the South African and international reinsurance markets in view of the catastrophic losses of that year did not come as a great shock. This decision followed the failure of efforts in 1983 to reduce the company's capacity and to cancel much of its business. Subsequently it became apparent that the Reinsurance Union was in such a weak position that in mid 1985 it was decided to cease operations permanently, and the capital injection of that year was aimed not at saving the company but to ensure that it would be able to pay off its commitments rather than be forced into liquidation.(68) This "futile" investment on the part of the shareholders was largely a result of the pressure exerted on them by the Registrar of Insurance who did not want a South African owned international reinsurer going insolvent. It is evident from this that the manner of the collapse of the only two South African reinsurers to fail, namely the Reinsurance Union and the South African Reinsurance Corporation, were completely different. On the one hand the collapse of the SARC was dramatic and disorderly while on the other the demise of the Reinsurance Union occurred in an orderly and un-spectacular manner with only a minimal impact on the market.

The key issue which needs to be considered in looking at the development of professional reinsurance in South Africa is why the Reinsurance Union, after being in existence for over 30 years, found itself in such a situation. Its most notable feature was its massive foreign portfolio and it was this large scale involvement in foreign business which was seen as responsible for its collapse. (For the problems caused by the writing of a large foreign portfolio see the general discussion of this issue in Chapter 2) This overwhelming dominance of foreign business in the company's net premium income is clearly shown in Figure 7. It is apparent that the level of foreign business written by the Reinsurance Union was far in excess of what was necessary to achieve a balanced portfolio even allowing for their position as an independent South African reinsurer. For a number of reasons it was highly likely that a company such as the Reinsurance Union would be in an inherently weak position in respect of foreign business because being a small company based in South Africa they were generally offered only the poor quality business which had been rejected by the

# NET PREMIUM INCOME of the Reinsurance Union 1970 - 1984

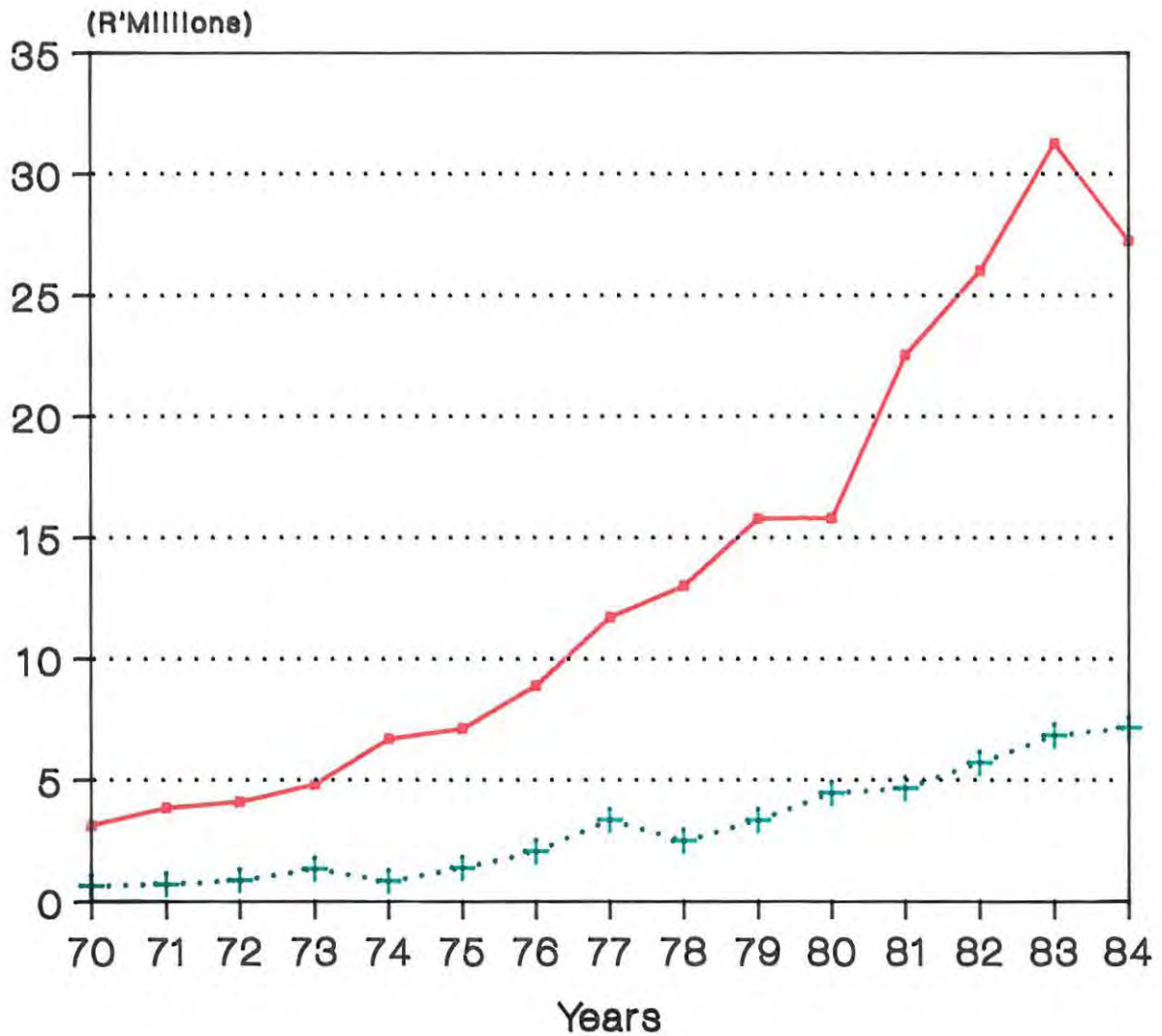


Figure 7

larger and better known companies based in the larger, more important European and North American markets.(69) Consequently the results of this foreign business were generally poor and this was exacerbated by the lack of knowledge of the international reinsurance markets on the part of the Reinsurance Union's underwriters. The company did have an office in London from 1972 which went some way to resolving the problem posed by their lack of knowledge of international markets at least in terms of the European market. However, the company in expanding its foreign business became involved on a large scale in the markets of South America and the Far East in which they had no knowledge what so ever of local conditions, the quality of business or rating levels. It was in business emanating from such regions that the Reinsurance Union inevitably took something of a pounding suffering huge losses. (70) This was not improved by the decline in the quality of their management under T.N.Peace and during the late 1970s the company experienced an inordinately high staff turnover meaning that the general level of competence and efficiency of the company inevitably declined.(71) Moreover the attempt to maintain a reasonably competent staff to write and administer such a large portfolio of foreign business substantially raised the company's management expenses, further contributing to a weakening of its financial position and results. Coupled with this from the late 1970s the international reinsurance market experienced a very sharp deterioration in results.(72) This general deterioration in the results of reinsurance business internationally compounded the problems caused by the Reinsurance Union's disproportionately large foreign portfolio. From 1984 this was further exacerbated by the slide in the exchange value of the rand, although the worst effects of the foreign exchange problems only really hit the company from mid 1985. As such the importance of the decline in the value of the rand should not be overemphasized, given that the company was effectively in an untenable position from 1984.(73) However, the failure of the Reinsurance Union to maintain adequate claim and premium reserves in the countries where business was written, choosing rather to send premiums back to South Africa, while not causing problems when the rand was strong, proved to be fatal to the company when the rand collapsed.(74) Overall there can be little doubt that the Reinsurance Union's large scale writing of foreign business had a seriously damaging effect on the company and was to a very large degree responsible for its ultimate demise. This is not to suggest, however, that this was the only factor behind the company's difficulties.

A further important source of weakness for the Reinsurance Union which emerged from the mid 1970s was the rapid growth of their marine portfolio which at this time grew considerably faster than either fire or miscellaneous business, while at the same time experiencing a far worse than average loss ratio.

**TABLE 4.14**  
**MARINE ACCOUNT OF THE REINSURANCE UNION**  
**1975 - 1984 (R'000)(75)**

	Premium	Total % of NPI	Claims	Marine Loss Ratio	Average Loss Ratio (Excluding Marine)
1975	473	6.7%	318	67.2%	49.5%
1976	548	6.2%	356	65.0%	8.7%
1977	986	8.4%	540	54.8%	50.3%
1978	1 605	12.4%	1 142	71.1%	55.5%
1979	1 641	10.4%	1 225	74.6%	53.2%
1980	2 011	12.8%	2 676	133.1%	68.8%
1981	4 094	18.2%	4 007	97.8%	66.0%
1982	6 071	22.4%	6 616	109.0%	74.8%
1983	5 786	18.5%	6 180	106.8%	68.5%
1984	5 140	18.9%	6 846	133.2%	93.3%

It is evident from this that the growing marine portfolio of the Reinsurance Union must have played a significant role in the company's demise in view of the appalling loss ratio of this business which averaged an astronomical 116% during the early 1980s. Inevitably this put a massive strain on the financial resources of the company which were already stretched by its large volume of net business. This marine portfolio was largely built up at the insistence of the then managing director, T.N.Peace, even though the company's marine underwriter was opposed to such expansion, justifiably so in view of the results.(76) A strong case can be made for the contention that while losses from fire and miscellaneous business, both foreign and local, could probably have been borne it was ultimately this marine business with the strain imposed on the company's limited financial resources which sank the Reinsurance Union.(77) That this is a reasonable assessment is borne out by the fact that between 1982 and 1984 when the loss ratio of the marine portfolio was between 107% and 133%, marine business composed not less than 18.5% of the company's total business. That the marine portfolio of the Reinsurance Union was inordinately large is indicated by the fact

that on average marine business composed only some 5% of the total short term business written by the reinsurance market during this period, compared to 18.5% in the case of Reinsurance Union. In considering the reasons behind the demise of the Reinsurance Union it is insufficient to look merely at the operating results of the company, and it is also necessary to look at its financial strength. In particular the operating results have to be considered in relation to financial strength as this ultimately determines the ability to bear the losses which are inevitably incurred. As indicated in Table 4.8 both the free and technical reserves of the Reinsurance Union were considerably below the market average from 1979 onwards. This was particularly so in terms of the company's free reserves, the crucial determinant of a reinsurer's solvency margin. During the late 1970s and the early 1980s the growth of net premium income of the Reinsurance Union was far too rapid for their reserves, with the growth of premium income far exceeding the growth of its financial base.<sup>(78)</sup> In this the company's disproportionately small share capital can be seen as a particular problem, especially in view of the level of foreign business being conducted by the company. While it was one thing for the subsidiary of a foreign reinsurance group, which wrote business exclusively from Southern Africa to operate on a relatively small share capital, it was another thing for an independent South African reinsurer writing a large foreign portfolio to do so, in view of the greater risks facing it. Of particular importance was the fact that the Reinsurance Union did not have a strong parent company to provide the necessary large scale financial support should they experience difficulties. For these reasons it was necessary for the Reinsurance Union to have a larger than average share capital, but more importantly that it maintained especially strong claim and premium reserves.<sup>(79)</sup> The failure of the management of the Reinsurance Union to ensure that the company possessed adequate reserves to support its growing net retention, was in fact one of the main factors behind its collapse. Ultimately it was the total inadequacy of the company's financial reserves in the face of serious, though only slightly worse than average, losses which caused the demise of the Reinsurance Union. The failure of the management to ensure that the company had adequate reserves was a result of two main factors. In the first place joint ownership by a number of local insurers was not viewed by them as a long term 'strategic' investment, as was the case with many of those companies which were subsidiaries of overseas reinsurance groups. Rather it was seen as a profit making investment by its shareholders who consequently demanded a regular and substantial return on their capital. As a result there was far greater pressure on the Reinsurance Union than on the other reinsurers to declare a dividend.<sup>(80)</sup> Consequently a dividend between 10.0% and 22.5% was declared each year between 1975 and 1982 in spite of the fact that operating results never justified these. In the eight years between 1975 and 1982 the Reinsurance Union distributed dividends amounting to R 1 460 000, an amount which would have significantly bolstered the company's

reserves had these funds been retained.(81) This in turn was a very important factor in the failure of the Reinsurance Union to build up its reserves in line with the growth of its net premium income. However, it should be noted that the rapidity of the company's growth in the late 1970s and early 1980s was such that any company would have found it difficult to build adequate reserves to cover such growth of net premium income.(82) Secondly, improbable though it may seem, the failure to build up adequate reserves to cope with the growth of net premium income in part arose from the total inadequacy of the statistical information at the disposal of the management. Indeed it has been alleged that the actual extent of the company's growth and hence the growing inadequacy of its reserves was not fully realized by management.(83) In the last analysis this failure to ensure the company's financial strength was crucial in causing its collapse and in turn was a reflection of both the position of the Reinsurance Union as an independent South African reinsurer and the failure of management to control its operations.

If there is any one unifying theme which permeates the whole issue of the reasons for the collapse of the Reinsurance Union, it was the poor quality of managerial control.(84) The management of the Reinsurance Union must ultimately accept the greater part of the responsibility for the demise of the company because those factors which specifically caused the collapse were either not rectified by management once they became evident, or in many cases, such as the writing of marine business, can be traced back to decisions taken by management. While the final collapse was in a large part a result of the lack of tight and effective managerial control at a time of general underwriting difficulties (not a new phenomenon in the late 1970s), but was rather a problem which had plagued the company right from the late 1960s.(85) Underwriting was weak with no effective control over the accepting of business, either on the original acceptance or at renewal and there was no "follow-up system" for the renewal of facultative business on an annual basis. There was also a sloppy approach to the handling of treaty business, which led to very considerable problems for the company, especially in respect of foreign treaties,(86) with the loss experience and hence terms of treaties being neither reviewed nor revised. At the same time the control over the receipt of premium for both treaty and facultative business was very poor. This problem of a lack of effective control over business was in a large part a result of the lack of adequate statistical records and was a major source of difficulty for the company in that it led to a dangerous accumulation of risks, with shares of the same risk being accepted from a number of insurers.(87) The lack of tight managerial control would appear to have been directly linked to the lower than average management expenses of the Reinsurance Union. It could be argued that the lack of close managerial control was the result of a deliberate decision in which the poor management and administration of business was accepted in

that it allowed management expenses to be kept down, thus strengthening the operating results of the company. In reality, however, this was unlikely to have been the case, especially in view of the lax control over management costs exerted by the then Managing Director, T.N.Peace. Thus the lack of effective control over business must be attributed to the generally poor management of the company.(88) The ultimate blame for this management failure and consequently the overall difficulties of the Reinsurance Union must rest with T.N.Peace, who was managing director between 1968 and 1983 and exerted total dominance over the company and its management team. Finally it should be mentioned that the management and operations of the Reinsurance Union were also hamstrung by the structure of the board of directors, with all twelve shareholders having a seat on the board. In the first place this meant that the board was of such a size that it was difficult to achieve consensus on any issue, making the taking of decisions very difficult. Secondly the fact that each wanted the Reinsurance Union to act in line with their company's own philosophy meant that there was a considerable likelihood of varying pressures being exerted on the management, so that in effect there was no coherent company policy coming from the board.(89) This further exacerbated the problem caused by poor management. Taking all of the above into account it would appear that the collapse of the Reinsurance Union was ultimately a product of two factors which encompassed all the issues that have been considered. In the first place its demise was a result of the nature of the company's shareholding and hence its position as an independent South African reinsurer. Secondly there was the 'failure' of the management of the company, both in terms of decisions concerning the writing of business as well as reserving policies and in respect of the administration of the business on the company's books.

For the reinsurance companies in South Africa, the years from the late 1970s through to the mid 1980s were a bleak period. Growth in real terms slowed very markedly, with some companies actually experiencing a decline in their real net premium income. At the same time the operating results deteriorated sharply with the nadir being reached in 1984. While these losses were in most cases offset by investment income all reinsurers showed losses after tax, even those with large life portfolios. Indeed such were the results of the reinsurers that the financial reserves of all, with the single exception of the Mercantile and General, were substantially reduced. In the case of the Reinsurance Union this decline in reserves was, when coupled to the prevailing poor results, in part responsible for its closure. Yet even in the face of these problems the foundations of a new period of prosperity were laid. The reinsurers for the first time sought to take concerted action and resolve many of the technical and underwriting problems which undermined the market from the late 1970s. Consequently this period was to witness one of the most important developments in the rein-

insurance market during the three and a half decades of its existence, namely the creation of SAROA. For the first time the reinsurers through SAROA had the strength to influence the direct market and thus had some control over their own destiny. However, there can be no escaping the fact that these years were a period of very considerable difficulties for the reinsurance market and which had, at least in the short-term, a seriously damaging effect on the financial strength of all of South Africa's reinsurance companies.

## NOTES

- (1) South African Insurance Association: Market Information. 1986
- (2) Interview with D.Bridge of the Mercantile and General Reinsurance Company of South Africa Ltd.
- (3) Interview with T.Gentles and A.Peters of the Gerling Global Reinsurance Company of South Africa Ltd.
- (4) Ibid.
- (5) Interview with R.Hefler of the Reinsurance Union Ltd.
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- (13) T. Gentles and A.Peters. op cit.

- (14) Interview with S.P. Overbeek and C. MacFarlane of the Central Reinsurance Corporation Ltd.
- (15) Interview with T.L.Ternent of Greig Fester.
- (16) Registrar of Insurance, op cit. From Tables of Short Term Reinsurance Business.
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- (37) Interview with S.I.Kotane of the Munich Reinsurance Company of South Africa Ltd.
- (38) W.A.Stricker. op cit.
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- (42) T..Ternent. op cit.
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- (44) Interview with E.F.Kahle of the Munich Reinsurance Company of South Africa Ltd. and S.I.Kotane. op cit.
- (45) Annual Reports. op cit.
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- (47) Annual Reports. op cit.
- (48) T.L.Ternent. op cit.
- (49) Annual Reports. op cit.
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- (51) D.Bridge. op cit.
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- (62) W.A.Stricker. op cit.
- (63) Interview with P.A.Hudson of the Cologne Reinsurance Company of South Africa Ltd.
- (64) S.P.Overbeek and C.MacFarlane. op cit.
- (65) L.Keel. op cit.
- (66) Interview with J.Kristella of Greig Fester.
- (67) P.A.Hudson. op cit.
- (68) R.Hefler. op cit.
- (69) S.Murphy. op cit.
- (70) R.Hefler. op cit.
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- (83) Ibid.
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- (85) Ibid.
- (86) S.Murphy. op cit.
- (87) W.A.Stricker. op cit.
- (88) P.A.Hudson. op cit.
- (89) S.Murphy. op cit.

## CHAPTER 5

### CONCLUSION: THIRTY FIVE YEARS OF PROFESSIONAL REINSURANCE.

In examining the emergence and subsequent development of professional short term reinsurance in South Africa, essentially what is being considered is the development of a highly specialized component of the insurance sector, from its hesitant beginnings in the 1950s through to its achieving of maturity in the 1970s. The development of the professional reinsurance market in South Africa was not, however, a smooth and steady process. While growth and progress have undoubtedly been the dominant themes within the emerging reinsurance market in South Africa, it has also faced its share of difficulties and interruptions. This has been as true of the 1980s as it was of the 1950s.

The development of professional reinsurance in South Africa formed an integral, if little recognized, part of the growth which occurred in the South African economy during the post war era and formed part of the growth of both the financial sector and the industrial sectors. Thus the emerging reinsurance sector occupied something of a unique position in that it embraced both the main elements of South Africa's post war economic development. The massive industrial growth between the 1950s and the 1970s with its increase in the number and size of industrial risks caused a rapid and sustained growth in the demand for insurance. For insurers this resulted in a huge increase in exposure levels and individual insurers were not able to carry these on their own. However, owing to the highly competitive nature of the direct market and the reduction in the number of insurers the level of cover demanded by industry could only be met through the use of reinsurance capacity. Such a growing demand for insurance was unlikely, in its own right, to lead to the development of a domestic reinsurance market. However, the growing demand coincided with government efforts to promote economic self sufficiency and this provided the necessary impulse for the creation of a local reinsurance market which formed an integral part of the development of the financial sector, and more specifically of the short term insurance market. The 1950s saw the foundations of the modern South African financial sector laid, with the emergence of a rudimentary local money market as well as the development of a sophisticated banking sector. Within the general development of the insurance market in South Africa, the emergence of locally registered professional reinsurers occupied a prominent position. Perhaps the most important point in this context was that this development meant that the short term insurance sector was coming to be in a position where it

was able to meet all the insurance requirements of a modern economy. In particular the emergence of professional reinsurers facilitated greater specialization in short term insurance with all the benefits which such specialization brought. Overall the increasing sophistication of the insurance sector in terms of specialization meant that the South African short term insurance market was increasingly able to meet the level of services and capacity demanded by local commerce and industry. This in turn ensured that a greater percentage of the insurance and reinsurance business written in South Africa was retained in the country. However, the development of professional reinsurance in South Africa did not take place in isolation and was part of a world-wide explosion in the number of reinsurance companies particularly those operating in the developing world. Moreover the factors which stimulated these developments in South Africa were very much the same as those promoting this development in the rest of the third world, that is a desire for economic self sufficiency and a linked effort to limit the outflow of foreign currency.

The emergence of professional short term reinsurers in South Africa occurred in two distinct and separate waves, the first from 1950 to 1957 and the second between 1967 and 1975. Somewhat obviously the circumstances facing the reinsurers which emerged as a part of the second wave were very different from those faced by the first reinsurance companies established in South Africa. The companies of the 1950s faced a multiplicity of problems which ranged from a shortage of adequately trained staff through to a high degree of suspicion on the part of many of the direct companies, who continued to rely on established overseas reinsurers. By the time the second wave of reinsurance companies came along the worst of these problems had been overcome with the local reinsurance market being accepted as the primary source of reinsurance cover for the local direct market. Consequently these new companies approach to business was not shaped by the same sense of mutual interdependence which had characterized the early reinsurers, in that these later companies initial experience was one of prosperity rather than of difficulty. Thus it was hardly surprising that the approach of some of these companies, most notably the MRSA, was very different to that of the original reinsurers, and thus aroused much hostility. The MRSA has been viewed with particular hostility and many of the woes of the market were attributed to its actions. While there is little doubt that the MRSA had a tremendous impact on the market, this did not necessarily mean that it had a damaging effect. Indeed a convincing case can be made that the MRSA had a positive impact and the hostility of the older reinsurers was engendered by their inability to counter the successful expansion of MRSA. There was also a failure on the part of the older reinsurers to recognize that the circumstances of the South African reinsurance market by the early 1970s were in fact very different from those of the 1950s.

That the circumstances faced by reinsurers in the early 1970s were very different from those of the 1950s was evidence of the considerable changes which occurred in the emerging market. Figures 8 and 9 clearly illustrate the trends that have occurred in the South African reinsurance market during the 35 years of its existence, with Figure 8 focusing on the results of the market and Figure 9 on its financial strength. Though these trends have been considered in detail in the course of this study, in concluding it is worth noting certain pertinent points. Perhaps the most important point to be recognized is that the South African reinsurance market as a whole has generally performed satisfactorily during these years, by whatever measure one uses. In particular the market grew rapidly, thereby meeting an increasing part of the direct insurer's need for reinsurance, while at the same time retaining its financial strength and, up until the 1980s, returning fairly good results. Within this general trend there were obviously short term fluctuations. Undoubtedly the single most notable shift was the dramatic rise in loss ratios and hence deterioration in operating margins from the late 1970s. Even this slump was part of a slow deterioration in the operating position of the reinsurers from the early 1970s, although up to the late 1970s this had largely been disguised by investment income. However, throughout this period the market generally enjoyed adequate levels of financial strength. This was particularly so in terms of technical reserves, reflecting the sound reserving policies of the majority of these companies. Although the free reserves and hence solvency margins fluctuated with a particular drop occurring during the 1970s, this was essentially a product of the rate of growth of the reinsurers at various periods, and the degree to which they wrote to the limit of their capacity.

While it is evident that the local professional reinsurance market as a whole performed well, both in terms of results and financial strength, it is equally apparent that the performance of the individual companies varied considerably. Although the majority generally performed well, the performance of two companies ran counter to the general trend, with the collapse of these companies casting a shadow over the performance of the market as a whole. The collapse of the South African Reinsurance Corporation in the early 1960s and that of the Reinsurance Union in the mid-1980s, though very different in manner were essentially caused by similar factors. In general terms the ultimate collapse and preceding poor performance of these companies were a product of both the failure of their management and their position as independent South African reinsurers. Little need be said about the management of either of these companies other than that in both cases it was autocratic, inefficient and given to making unwise business decisions. However, it was the circumstances of both companies, being independent South African reinsurers, which was crucial and from which a number of important lessons can be learnt. Because they lacked the massive financial strength of

## RESULTS OF THE REINSURANCE MARKET 1951 - 1970 (% of NPI)

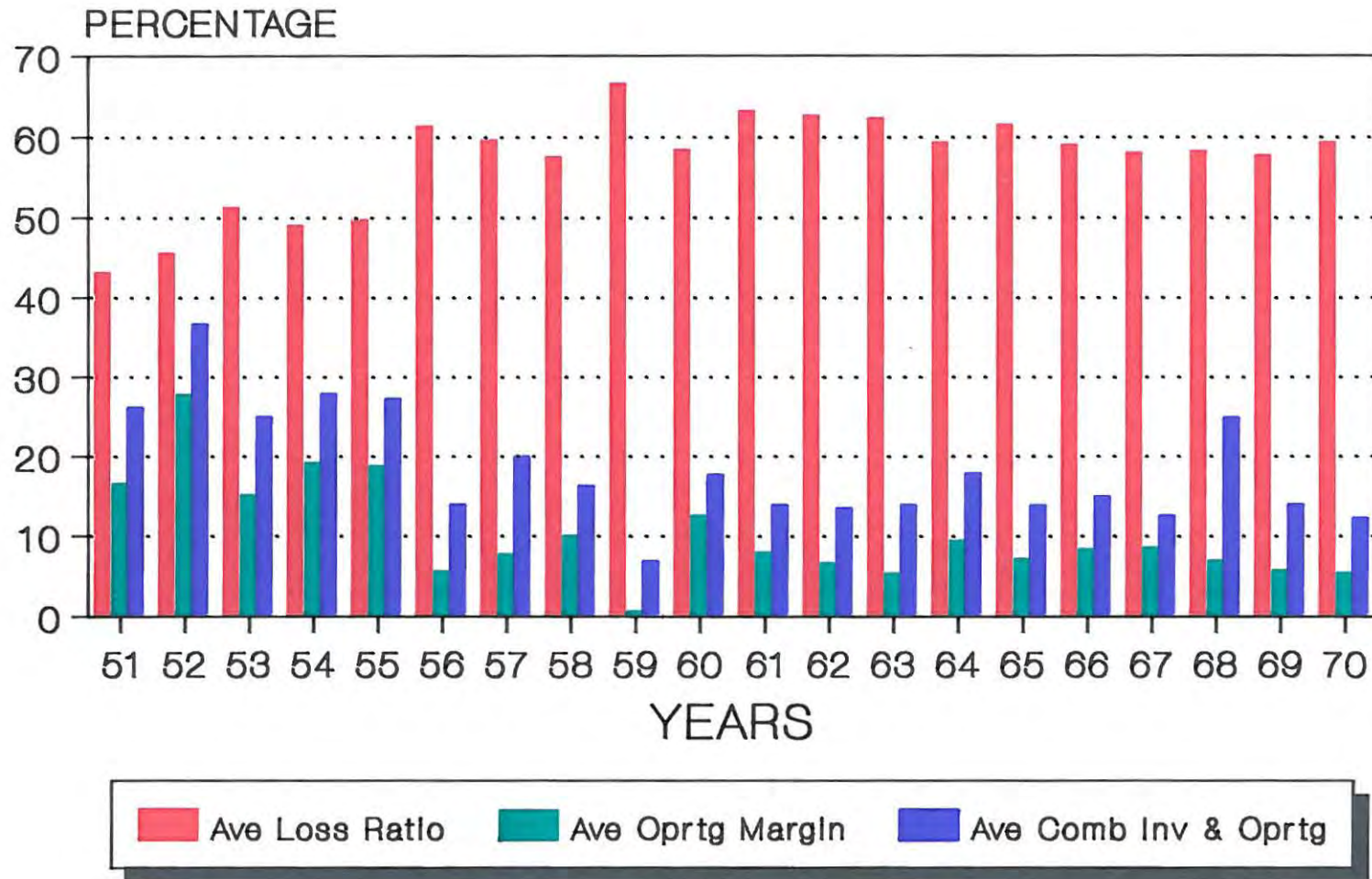
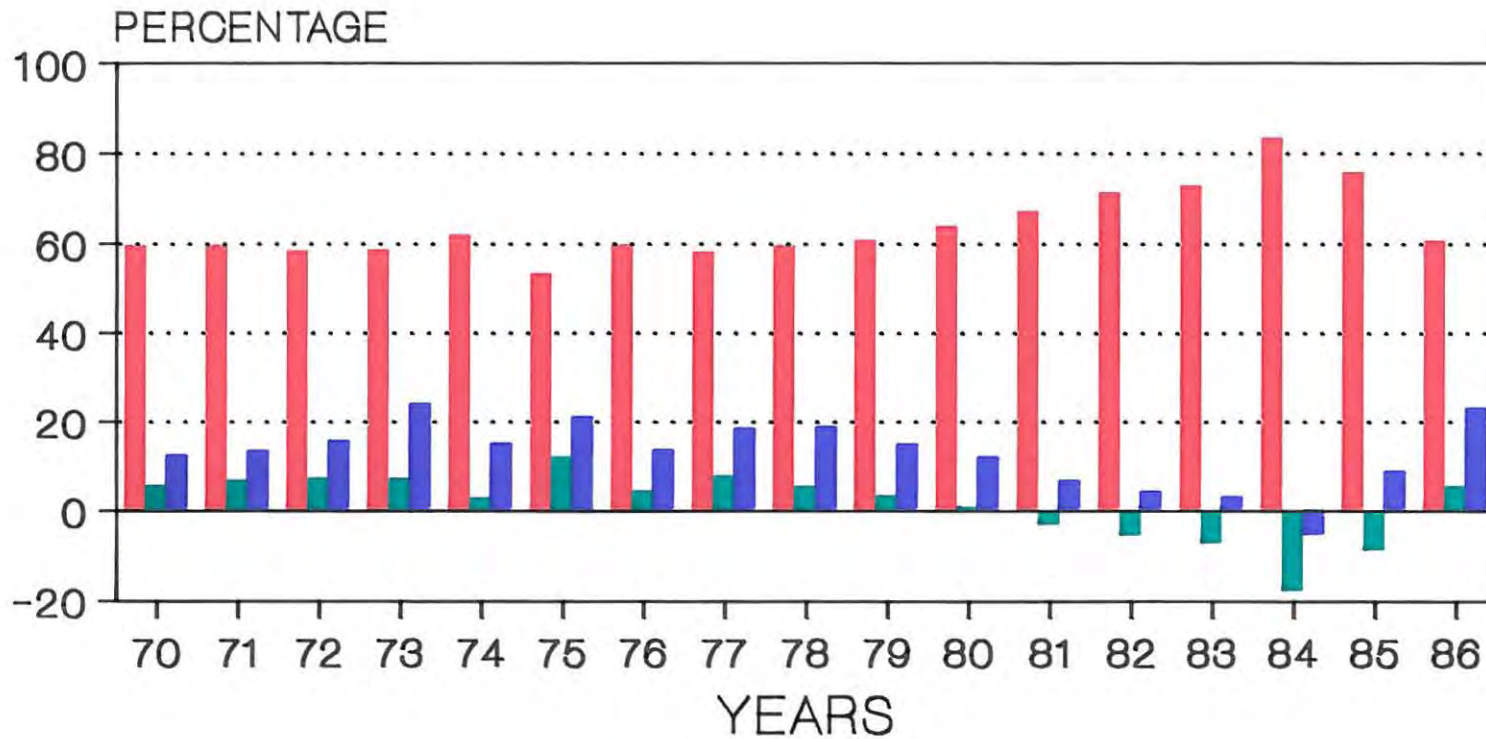


Figure 8a

# RESULTS OF THE REINSURANCE MARKET 1970 - 1986 (% of NPI)



■ Ave Loss Ratio    
 ■ Ave Oprtg Margin    
 ■ Ave Comb Inv & Oprtg

Figure 8(b)

# FINANCIAL STRENGTH OF THE REINSURANCE MARKET 1951 - 1983 (% of NPI)

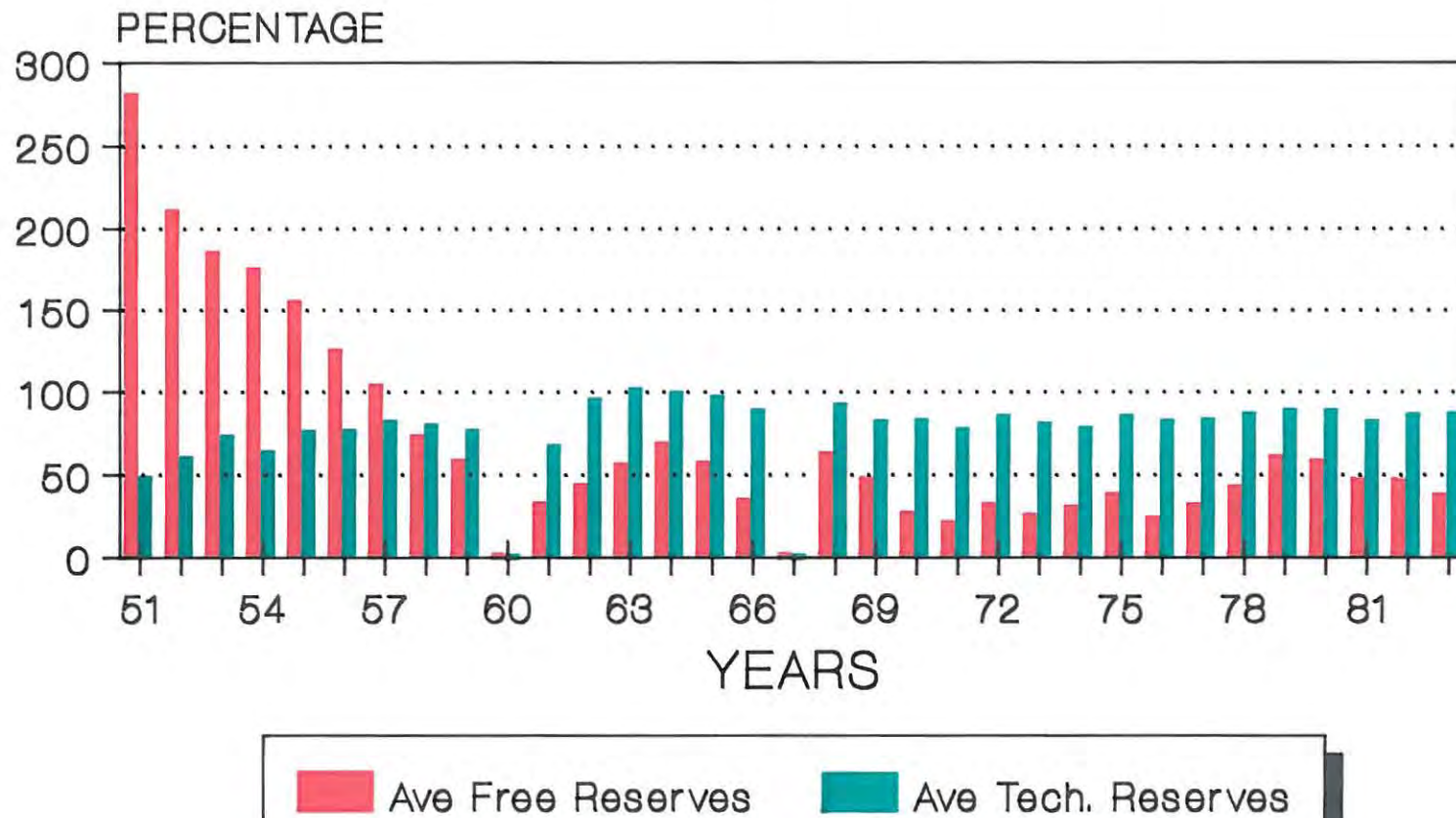


Figure 9

those reinsurers which were subsidiaries of foreign reinsurance groups, and given that they had to write foreign business, the SARC and Reinsurance Union were in an inherently weak position. Consequently their collapse, or at least poor performance, was to a degree inevitable.

The experience of the SARC and Reinsurance Union in comparison with the other South African reinsurers highlights one important feature of the market. This is that the development of a professional reinsurance market, as in other parts of the developing world, has been dominated by foreign owned reinsurance companies. This has had undoubted benefits for the development of the reinsurance market in South Africa in that it facilitated an inflow of capital as well as technical knowledge and skills from abroad. Most importantly, the dominance of subsidiaries of overseas reinsurance groups in the South African market has been a vital stabilizing factor, because of the inherent financial strength of such companies compared to independent South African reinsurers. Moreover companies such as the Swiss-SA Re and the MRSA have been able, by virtue of the large scale retrocession of business to their parent offices, to write a very large gross portfolio, and thus have made an important contribution to the growth in the capacity of the local reinsurance market. By comparison the independent South African reinsurers have played only a minimal role in increasing the market owing to their limited financial strength and their need to write a balanced portfolio including foreign business. That such foreign reinsurers had a stabilizing effect on the market has been borne out by the fact that independent South African reinsurers have been forced to withdraw from the market. It is worth noting that the collapse of the independent South African reinsurers, has meant that the importance of foreign reinsurers has in fact increased and with the demise of the Reinsurance Union in 1985 marked the end of an era in which independent South African reinsurers played a significant role in the development of local reinsurance. In this the reinsurance market has run counter to the general trend in the insurance sector, and indeed in the economy as a whole, of a strong move towards increasing South African control of the financial sector. This, however, must be seen in the context of the international nature of reinsurance and the importance of strong links between the reinsurance markets in countries such as South Africa and the major European or American reinsurance groups. Thus when considering the development of the South African reinsurance market essentially what is being examined is the expansion of international reinsurance groups within the context of a specific economic structure.

The second main feature of the South African reinsurance market was the massive shift which occurred in underwriting standards and practices from the early 1970s. During the 1950s and 1960s the market was characterized by sound underwriting practices and sensible rating of business. In a large part this was a result of the absence of intense competition between the early reinsurers and hence their willingness to act in concert to secure their interests. From the early 1970s, however, there was a marked decline in underwriting standards and rating in the reinsurance market which was a result of three interlinked factors. These were, first the increase in the capacity of the local reinsurance market, secondly the increase in the level of competition within the market and lastly the apparent ease of making profits. An integral part of this decline was the rise of cash flow underwriting, which was probably the single worst manifestation of the decline in underwriting standards. Although this deterioration in underwriting practices and rates had initially reflected the prosperity of the reinsurance market, ultimately this was to be the principle cause of the difficulties of the early 1980s. Such was the deterioration in underwriting standards, and thus rating levels, that the early 1980s saw the reinsurance market as a whole, for the first time in its 35 year history, experiencing large operating losses. These losses led to all the reinsurers in South Africa acting in a more restrained manner by the mid 1980s, suggesting that they had come to achieve a uniform perception of market conditions. In this the creation of the South African Reinsurance Offices Association was the most notable manifestation of the unity which had for so long been lacking. In spite of this development it remains doubtful whether the market has in fact regained the equilibrium, in terms of underwriting and rating standards, which it lost in the early 1970s. Certainly doubt has been expressed in the market about how long this new prosperity will last and more importantly how soundly based it is, implying that there has not been a complete return to prudent underwriting practices.

The development of a professional short term reinsurance market in South Africa formed a significant, if small scale and somewhat obscure element of South Africa's post war economic transformation. As such the emerging reinsurance market has effectively been a microcosm of the development which was occurring in the South African economy as a whole, and particularly in the financial sector. At the same time the emergence of the South African reinsurance market also constituted an integral component of the world-wide expansion of reinsurance facilities. This dual heritage is clearly reflected in the nature and performance of the market and explains many of its developments. Perhaps the most notable result of this was that while it was ultimately the growth of the South African economy which stimulated the development of the local reinsurance market, like many other sectors, the establishment of reinsurance facilities was ultimately not a product of

South African but rather of foreign initiative. Indeed it is reasonable to contend that without this foreign initiative the South African reinsurance market would probably have been stillborn, in spite of the growing need for domestic reinsurance facilities. However, the emergence and growth of local professional reinsurance also owed much to government intervention. Consequently the emergence and subsequent development of the local reinsurance market between the 1950s and the mid-1980s was shaped by the same general factors that were responsible for the development of much of the financial sector. These were first, growing demand from the expanding industrial sector for financial services, secondly the availability of foreign capital, expertise and initiative, and lastly government support and intervention. Taken together these three factors shaped the development of the short term professional reinsurance market in South Africa between 1951 and 1986, just as they shaped the development of the rest of the financial sector.

## APPENDIX I: GLOSSARY

- (1) Co-insurance: The sharing of any particular risk by two or more insurers, normally on account of the scale of the risk involved.
- (2) Combined Operating and Investment Margin/Results: Calculated on the basis of operating results coupled to investment income, but does not include transfers to and from insurance funds as it is geared to measuring the year to year performance of reinsurers. Must be noted that this is not calculated on the same basis as underwriting Profit (Loss).
- (3) Commission and Expense Ratio: Based on the commission paid by the reinsurer to the direct companies for business and the cost of administering this business. Expressed as a percentage of net premium income.
- (4) Direct Company/Market: Another term for an insurance company and the insurance market. Reflects the direct dealing of the insurance company with the purchaser of insurance, or their broker. In contrast to the reinsurer who has no contact with the ultimate purchaser of cover.

- (5) Excess of Loss Reinsurance: A non proportional contract where the reinsurer agrees to pay a share of losses for sums in excess of a stipulated figure up to an agreed maximum.
- (6) Facultative Reinsurance: Transactions where risks are offered separately with the reinsurer having the freedom to accept or reject risks depending on the merits of each case - is relatively expensive to administer.
- (7) Fire Tariff: Basis of rating agreed to by an association of insurers for specific fire risks, so as to secure adequate rates and reducing the damage of price competition.
- (8) Free Reserves: Difference between the total assets and total liabilities of an insurance or reinsurance company.
- (9) Gross Premium Income: Total premium written by an insurer or reinsurer prior to reinsurances.
- (10) Loss Ratio: Based on claims paid and outstanding expressed as a percentage of written net premium income.
- (11) Miscellaneous Business: For reinsurance companies includes: Motor, Personal Accident, Liability and Guarantee business.
- (12) Net Premium Income: That portion of Premium Income which an insurer or reinsurer retains for their own account, also termed net retention. Is Gross Premium Income less reinsurances.
- (13) Non Proportional Reinsurance: Transactions where the reinsurers share of the premium is not in direct proportion to its share of the risk - commonly associated with excess of loss reinsurance.
- (14) Operating Margin/Results: Results of the reinsurers on a year to year basis. Calculated as written net premium income less claims and commission + expenses. Does not include investment income. Can be expressed either in rands or as a percentage of NPI.

- (15) Professional Reinsurer: A specialist insurance company whose business is confined to reinsurance alone i.e. it does not write direct insurance business.
- (16) Proportional Reinsurance: Any reinsurance transaction where the reinsurer's share of the premium is in direct proportion to its share of the risk.
- (17) Reciprocal Business: The exchange of business between reinsurers in different countries in order to secure a balanced portfolio, with the specific exchange being calculated in terms of the profitability of the business.
- (18) Reinsurance Funds/Insurance Funds: Consists of the premium reserves and claims/loss reserves of the reinsurance companies maintained to cover unexpired risks.
- (19) Reinsurance Market: All facilities offering reinsurance cover and capacity, most importantly the locally registered professional reinsurers.
- (20) Republic Insurers/Reinsurers: see under Union Insurers/Reinsurers.
- (21) Retrocession: The transfer of a share of a risk from one reinsurer to another to achieve the maximum possible spread of risks, and to bring the reinsurers net retention in line with their financial resources.
- (22) Solvency Margin: Free reserves of an insurance or reinsurance company expressed as a percentage of net premium income. In the case of the statutory solvency margin requirement of the Registrar of Insurance, net premium income is calculated as GPI less approved, i.e. locally placed reinsurances, meaning that for reinsurers the solvency margin is effectively calculated on gross premium income. This is an artificial measure of the company's financial strength, so calculations used throughout have been based on net premium income.
- (23) 'Suitcase Brigade': Salesmen of foreign reinsurance companies which are not locally registered reinsurers but which seek business from South Africa when local underwriting results are good but withdraw when conditions deteriorate.

- (24) Stop Loss Facilities: Form of Excess of Loss reinsurance where the reinsurer or retrocessionaire agrees to provide cover when the aggregate of all losses of a specific nature during an agreed period, normally one year, exceeds an agreed limit, such as the loss ratio rising above a certain percentage point. Is important to reinsurers during periods of generally poor underwriting results.
- (25) Technical Reserves: See Reinsurance Funds.
- (26) Treaty Reinsurance: An arrangement whereby a reinsurer agrees to accept a certain share of any risk of a specified nature ceded by the original insurer without considering the individual merits of any particular risk.
- (27) Union Reinsurers/Insurers: Insurers or reinsurers operating in South Africa which were locally registered companies with their own share capital. Branch offices of foreign companies were classified as Non Union or Non Republic Insurers/Reinsurers as they were not individual locally registered companies.

## APPENDIX II: ABBREVIATIONS USED IN TEXT

- (1) Central Re: Central Reinsurance Corporation Limited.
- (2) Cologne Re: Cologne Reinsurance Company of South Africa Limited.
- (3) Gerling Global: Gerling Global Reinsurance Company of South Africa Limited.
- (4) GPI: Gross Premium Income.
- (5) Hollandia Re: Hollandia Reinsurance Company Limited.
- (6) Mercantile and General: Mercantile and General Reinsurance Company of South Africa Limited.
- (7) MRSA: Munich Reinsurance Company of South Africa Limited.
- (8) NPI: Net Premium Income.
- (9) NRG: Netherlands Reinsurance Group.
- (10) PI: Premium Income.
- (11) Reinsurance Union: Reinsurance Union Limited.
- (12) RIC: Reinsurance Corporation Limited (UK)
- (13) RIU: Reinsurance Union Ltd.
- (14) SAROA: South African Reinsurance Offices Association.
- (15) SARC: South African Reinsurance Corporation Limited.
- (16) SNAR: Société Nord Africainhede Reassurances.
- (17) Swedish Atlas: Swedish Atlas Reinsurance Company of South Africa Limited.
- (18) Swiss-SA Re:Swiss-South African Reinsurance Company Limited.

### APPENDIX III: STAFF LEVELS\*

	Swiss-SA Re	Hollandia Re	Gerling Global	MRSA	Central Re	Mercantile + General
1951	3					
1956	22					
1961	52					
1966	62					
1969				10		
1970				18		
1971	100			28		
1972				38		
1973				53		
1974				72	8	82
1975				77	11	82
1976	122			93	15	85
1977	118			112	21	84
1978	133			123	25	92
1979	134			139	27	92
1980	149		57	148	27	107
1981	177		59	182	27	113
1982	178		60	188	31	121
1983	177	66	58	190	32	135
1984	177	62	55	195	35	152
1985	165	73	53	195	34	163
1986	168	79	53	198	35	163

\* (1) Figures are for **Total Staff** and thus include life staff in addition to short term staff, except the Central Re.

(2) No comparative functional or racial structure of staff complements is available.

(3) For the above mentioned reasons it is impossible to come to any conclusion about the comparative productivity of staff and whether there was a diminishing return on an increase in staff. Also the nature of short term reinsurance itself makes such calculations problematic, eg the costs of writing of facultative as opposed to treaty business.

#### APPENDIX IV: RATE OF INFLATION (% pa)

1955 = 3.1%	1971 = 4.3%
1956 = 1.4%	1972 = 8.1%
1957 = 1.5%	1973 = 13.2%
1958 = 0.2%	1974 = 17.9%
1959 = -0.1%	1975 = 17.3%
1960 = 1.3%	1976 = 15.8%
1961 = 1.6%	1977 = 13.1%
1962 = 0.7%	1978 = 10.0%
1963 = 0.8%	1979 = 15.1%
1964 = 2.4%	1980 = 16.7%
1965 = 3.1%	1981 = 13.6%
1966 = 3.7%	1982 = 13.9%
1967 = 2.4%	1983 = 10.6%
1968 = 1.3%	1984 = 8.3%
1970 = 3.2%	1985 = 16.9%
	1986 = 19.6%

\* Based on wholesale/producer price index in the 4th Quarter Volume of the Reserve Bank Quarterly Bulletins

The problems caused for reinsurers by the rising rate of inflation can be appreciated from the above figures. The main problem was essentially one of the level of rates declining due to pressure from the direct market while the cost of claims were rising because of inflationary pressures. Reinsurers were thus caught in a scissors trap of declining premiums and rising claims. This was in part responsible for the deterioration in the results of the reinsurers from the mid 1970s when inflation began to emerge as a major problem. Inflation also had a damaging effect on the investment income of the reinsurers at the very time when inflation was forcing them to become increasingly dependent on their investment income. Reinsurers did, however, derive some benefit from those inflationary pressures in that this caused a rapid rise in insured values which was not mirrored in the financial resources of the direct companies, forcing the direct insurers to secure greater reinsurance capacity.

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  - Mercantile and General 1975-1986.
  - MRSA 1968-1986.
  - Reinsurance Union 1951-1986.
  - SARC 1958-1986.
  - Swiss-SA Re. 1951-1986.

(42) Interviews with the following:

Central Re: S.P.Overbeek (Company Secretary) and C.McFarlane (Assistant General Manager)

Cologne Re: P.A.Hudson (Assistant General Manager)

Gerling Global: T.Gentles (Managing Director) and A.Peters (Assistant General Manager)

Hollandia Re: S.Murphy (General Manger) and S.H.Henstra (Chairman)

MRSA: E.F.Kahle (Managing Director) and S.I.Kotane (Deputy Manager)

Mercantile and General: D.R.Bridge (Deputy General Manager)

Reinsurance Union: R.Hefler (Managing Director)

Swiss-SA Re: W.A.Stricker (Chairman) and L.Keel (Managing Director)

Commercial Union Assurance Company: W.A.Rutherford  
(Managing Director)

Guardian National Insurance Company: J.Fitzgerald (Reinsurance Manager)

Greig Fester (SA) (Pty) Ltd: J.Kristella (Deputy Chairman) and L.Ternent  
(Managing Director)