



## **IISA Conference 2010 – IGF**

Good afternoon ladies and gentlemen. Seamus has posed some interesting questions and I hope that my presentation will go some way towards answering some of them.

The Intermediaries Guarantee Facility has been serving the South African Short Term industry since it's incorporation in 1990 and is thus 20 years old.

In the 80's, a number of intermediaries went to the wall and insurers were left with no premium and covering the risk. As a result, the FSB wanted to ban the collection of premium by Brokers, unless the industry could come up with a solution to the problem. Hence, the outsourced model was at risk. Barry Scott, who joined SAIA about 16 years ago, remembers that it was a SAIBA Broker, Rod Maitland from Forbes, who devised the Guarantee Facility that was eventually adopted by the industry and the FSB, and S20bis was born.

S20bis was replaced by S45 in the revised Insurance Act and the facility is therefore set up by the industry for the purposes of providing security in terms of Section 45 of the Short Term Insurance Act read together with regulation 4.

A short-term insurer may not authorise a person in writing to act as an independent intermediary, to receive, hold or in any other manner deal with premiums payable to it under short term policies unless that person has provided security in terms of the Regulations Part 4 and Section 45 of the Short Term Insurance Act 1998.

### **Regulation 4, Section 45 of the Short Term Insurance Act, 1998**

4.1 (1) A short-term insurer may, subject to subregulation (2), in writing authorize an independent intermediary to receive, hold or in any other manner deal with premiums payable to it under short-term policies.

(2) A person shall not be authorized, as contemplated in subregulation (1) unless that person has provided security, to the extent and in accordance with the requirements of this Part, in respect of his or her obligation in terms of Regulation (4.3) by means of:

- (a) a guarantee policy issued by a short-term insurer registered to do so in accordance with a guarantee facility created by short-term insurers generally for the purposes of providing such security; or
- (b) a contract which, but for the fact that the undertaking concerned is given by a bank, would be a guarantee policy,

and under which policy benefits are to be provided in the event of the failure of that person to meet those obligations.

### **The terms and conditions of the IGF insurance contract**

The insurance contracts provide indemnity up to a specified limit to the beneficiary in case of the default of the insured broker. The amount of cover provided is stipulated in the Act as an amount being not less than R100k and not exceeding R80m equal to:

- (i) in the financial year in which the person concerned is first authorised to receive, hold or in any other manner deal with premiums and in the immediately following financial year, 30 per cent of a reasonable estimate of the total premiums which that person expects to receive in a full financial year; and
- (ii) in every subsequent financial year of the person concerned, 30 per cent of the total premiums actually received, held or in any other manner dealt with by that person in the previous financial year.

All contracts include the following terms and conditions that impact on the risks to which IGF is exposed:

- The policy is effective only once a deposit premium has been received;
- Higher risk policyholders are required to provide collateral;
- The contracts are underwritten, repriced and renewed annually; and
- The IGF can cancel the contract during the policy term.

### **The responsibilities of the parties to the contract are as follows:**

#### **Insurers**

Each insurer must individually and specifically authorize in writing each of his intermediaries, whom he empowers to collect premiums on his behalf.

The insurer must ensure that the authorized intermediary has a current guarantee issued in terms of Regulation 4, Section 45 of the Short Term Insurance Act, of 1998.

## Intermediaries

Intermediaries who at present receive premiums on behalf of insurers must insist that they are specifically authorized in writing by those insurers.

Intermediaries must be in possession of a guarantee that complies with Regulation 4, Section 45 of the Short Term Insurance Act, of 1998 for an amount equal to 30% of the net premiums received by them in their last financial year (**based on a minimum guarantee of R100 000 and a maximum guarantee of R80,000,000 - as at 01 April 2010. The maximum will increase by R10m per annum until R100m is reached on 01 April 2012.**)

If the intermediary has a collecting agency or a third party receiving premiums on their behalf for insurers, they should ensure that the agency or third party has a guarantee.

Intermediaries are deemed to “receive premiums” where the premium passes through a bank account controlled by the intermediary.

Where the intermediary merely collects cheques issued in favour of the insurer from the client and delivers to the insurer, no authorization or guarantee is required.

### **An Example – not presented**

An intermediary with a Guarantee of **R5m** will incur a cost of **R65k** if they have no PI or FG cover – which is probably unlikely. Should they have PI and FG cover to the value of say **R10m**, then the cost of the guarantee halves from **R65k** to **R33k**. This facilitates the intermediary collecting premium to the value of **R16.7m** ( $R5m / 30 \times 100$ ) which equates to roughly **R1.4m** per month. At **8.75%** and holding the cash for **45** days, the intermediary will earn approximately **R15k** pm which equates to **R180k** per annum. So a guarantee that costs **R33k** produces income of at least **R180k**. Some intermediaries also charge the client an additional broker fee for collecting of the premium.

The rates are reviewed by the Technical Underwriting divisions at Santam, M&F and Zurich on an annual basis.

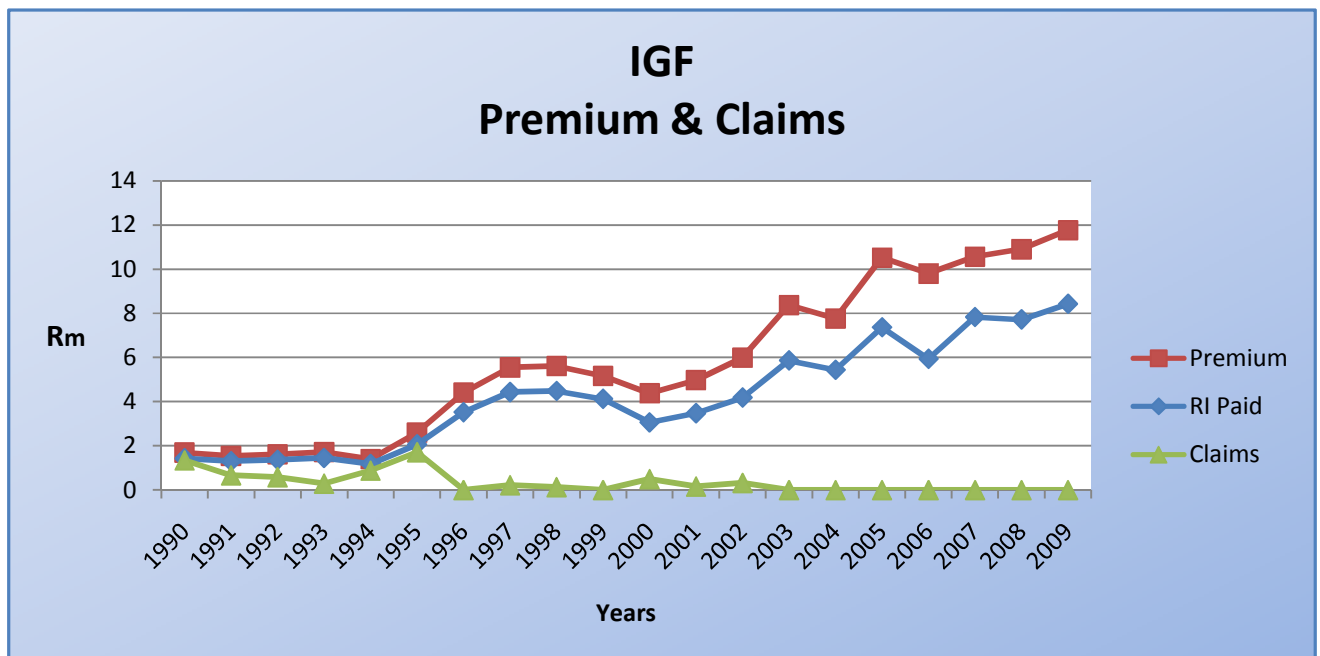
### **The Effect of FAIS**

The Financial Advisory and Intermediary Services (“FAIS”) Act was enacted in 2002 and is applicable to all financial service providers engaged in the rendering of financial advice or acting as intermediaries in respect of a financial product. The Act imposes certain obligations on financial service providers pertaining to the manner in which their business should be

performed, and specifically prescribes rules relating to the introduction of such services to clients, conduct of intermediaries and representatives in dealing with clients, and extensive record-keeping facilities.

In most circumstances, financial service providers are required to appoint a compliance officer, acting with demonstrable independence. The introduction of FAIS has therefore reduced the risk of default in the company's target market.

The introduction of firstly the IGF and secondly FAIS, has resulted in a marked decrease in the number of broker failures. This is evidenced by the fact that the Facility has not had any claims since 2003.



### The Concentration of risk and catastrophes

IGF is exposed to concentrations of risk and catastrophes as there is no diversification across types of risks. A severe downturn in the economy or regulatory changes that put pressure on the business model of insurance brokers could result in a number of brokers failing at a similar time.

The maximum risk per policy is limited to R80 million so there is a risk that the failure of a single broker could adversely impact the company. Past experience however indicates that the larger risk exposures are generally more robust businesses and should have a lower probability of failure.

The following table shows the number of contracts in bands of sum insured size for the twelve months to 31 December 2009

Maximum Sum Insured	Number of Contracts	Average Sum Insured	Total Sum Insured
100,000	94	100,000	9,400,000
250,000	75	165,471	12,410,356
500,000	65	360,382	23,424,873
1,000,000	49	736,980	33,901,102
2,500,000	46	1,675,447	77,070,544
10,000,000	40	5,167,755	206,710,231
25,000,000	20	14,952,442	299,048,841
50,000,000	12	35,592,710	427,112,527
60,000,000	11	58,035,229	638,387,525
70,000,000	4	70,000,000	280,000,000
<b>Total</b>	<b>412</b>	<b>4,872,490</b>	<b>2,007,465,999</b>

The normal 80 / 20 principle applies and the number of contracts greater than or equal to R10m make up 21% of the contracts, which in turn make up 92% of the Total Sum Insured. The risks of several claims from different policyholders or a single large claim are mitigated by the 100% reinsurance arrangements. Given the lack of reserves on IGF's statement of financial position (which I will show you shortly), the failure of any reinsurer in conjunction with a claim on a policy could make the company insolvent. However, given the low frequency of claims, and the low probability of a failure of a reinsurer, this outcome is unlikely. In addition, claims by IGF on its reinsurers will not be large enough to cause financial difficulties for the reinsurers under any but the most extreme conditions.

## **IGF UNDERWRITING RULES**

For an Application Fee of R350, the IGF will process an application for a guarantee.

- 1) The external auditor's opinion on the Financial Statements is always considered. We very seldom receive a qualified set of accounts and only take the qualification into account if the effect of the qualification materially impinges on our ability to come to a decision on the accounts at hand.
- 2) Net income before tax is adjusted for significant directors emoluments and administration fees and a ratio of 10 will be applied to the result. The maximum guarantee allowed will be ten times the income adjusted as noted.
- 3) Five times the Net Assets of the Intermediary must equal the guarantee amount. This is an alternative or additional test as decided by the Underwriting Committee or Board.

- 4) The intermediary should have a Net Current Asset position. In the event of a Net Current Liability position, collateral will be required for the deficit plus 10% of the guarantee amount.
- 5) We examine the quality of the assets and exclude 50% of goodwill, other intangibles and assets of questionable value. The net asset position of the company will be examined after these adjustments and the company will need to be solvent after these adjustments. Should the company be insolvent, collateral will be required for the full amount of the guarantee.

**The following forms of Collateral Security may be utilised:**

- The cession of an Investment Policy
- The cession of a Right of Life Policy
- The cession of a Right to Deposit
- A Deed of Suretyship
- An Insurance Company Guarantee
- A Pledge of Shares and a Cession of Claims
- Bank Guarantees
- A Subordination Agreement

Only 7% of all guarantees are asked to provide any form of collateral. Guarantees may be obtained from any bank. However, the rates from the IGF are normally keener.

**Not Presented**

All guarantees less than R1m are processed by the IGF staff. The Underwriting Committee process all applications greater than or equal to R1m and less than R10m and make recommendations to the Board for guarantees greater than or equal to R10m. The Underwriting Committee is made up of the following individuals:

Chris Kemp	Mutual & Federal (Chairman)
Roy McGrath	Santam
Charles Hitchcock	SAIA
Francis Kingston	Lombard
Lucien Mundie	SGIGA
Neville Kai	Chartis

All guarantees greater than **R10m** are referred to the Board with an Underwriting Committee recommendation.

**The Directors of the board are as follows:**

Chris Kemp	Mutual & Federal (Chairman)
Charles Hitchcock	SAIA
Amit Khilosia	Lloyds

Roy McGrath	Santam
Ken Naidoo	Chartis
Barry Scott	SAIA
Gail Walters	Hollard

No directors Fees are paid to the Directors and the Fiduciary duties of the directors in terms of both the Companies Act and King, preclude them from disclosing any information that they may glean in the performance of their duties to any other party.

Should the intermediary still feel uncomfortable with the review being conducted by the IGF staff, Underwriting Committee or the Board, they may request that the review be conducted by an independent third party. They usually elect to utilise their own external auditors and I can only remember one such case in the recent past. They now submits their accounts normally.

There is a view that the IGF Annual Financial Statements are confidential. This is not the case and they may be viewed at SAIA's offices and the pertinent figures are also part of the FSB statutory returns.

### **Intermediaries Guarantee Facility Limited**

(Registration number: 1989/007489/06)

Annual Financial Statements for the year ended 31 December 2009

#### **Statement of Comprehensive Income**

<b>Figures in Rand</b>	<b>2009</b>	<b>2008</b>
Gross written premiums	11,770,942	10,910,412
Insurance premium ceded to reinsurers	(11,770,942)	(10,910,412)
<b>Net premiums</b>	-	-
Change in provision for unearned premiums	-	-
Gross amount	278,975	219,716
Reinsurers share	(278,975)	(219,716)
Earned premiums net of reinsurance	-	-
Interest income	427,470	524,037
Commission income	3,344,462	3,188,095
Application fee income	174,227	137,150
<b>Net income</b>	<b>3,946,159</b>	<b>3,849,282</b>
Administration fee	2,966,480	2,693,948
Other expenses	206,455	166,717
<b>Expenses</b>	<b>3,172,935</b>	<b>2,860,665</b>
<b>Profit before tax</b>	<b>773,224</b>	<b>988,617</b>

Income tax expense	(216,503)	(272,633)
<b>Total comprehensive income</b>	<b>556,721</b>	<b>715,984</b>

### Statement of Financial Position

<b>Figures in Rand</b>	<b>2009</b>	<b>2008</b>
<b>Assets</b>		
Reinsurers' share of insurance contract provisions	7,568,271	7,229,058
Deferred tax	566,522	543,087
Loans and receivables	1,968,211	1,589,140
Cash and cash equivalents	8,484,012	7,035,790
South African Revenue Service	-	1,096
	<b>18,587,016</b>	<b>16,398,171</b>
<b>Equity and Liabilities</b>		
<b>Equity</b>		
<b>Capital and reserves attributable to the company's equity holders</b>		
Share capital	200,000	200,000
Retained earnings	4,119,992	3,563,271
	<b>4,319,992</b>	<b>3,763,271</b>
<b>Liabilities</b>		
Insurance contract provisions	7,568,271	7,229,058
Deferred revenue	2,023,292	1,939,599
Trade and other payables	4,660,620	3,466,243
South African Revenue Service	14,841	-
<b>Total liabilities</b>	<b>14,267,024</b>	<b>12,634,900</b>
<b>Total equity and liabilities</b>	<b>18,587,016</b>	<b>16,398,171</b>

### Reinsurance strategy and risk management

The most critical risk to the IGF is the credit default of a reinsurer on a valid reinsurance claim. As 100% of the risk accepted by IGF is reinsured, no insurance risk remains with IGF in the normal course of events. The 100% quota share reinsurance policy is thus fundamental to the business of IGF and is not subject to review, although the mix of reinsurers and arrangements for cover in the event of failure of any one reinsurer can be reviewed.

The table below outlines the proportions of business reinsured with each reinsurer and their respective credit rating.

Company	%age	Credit rating
Santam Limited	<b>18.00</b>	AAA+
Mutual & Federal Insurance Company Ltd	<b>15.00</b>	AA+
Zurich Insurance Company SA Ltd	<b>8.00</b>	AA+
Kiln South Africa Proprietary Ltd (Lloyds)	<b>9.00</b>	A+ (standard and poor)
Lombard Insurance Company Ltd	<b>9.00</b>	A+
Constantia Insurance Company Ltd	<b>8.00</b>	A-
Chartis South Africa Ltd	<b>8.00</b>	AA+
Lion of Africa Insurance Company Ltd	<b>9.00</b>	A
The Hollard Insurance Company Ltd	<b>6.00</b>	AA
African Reinsurance Corporation (SA) Ltd	<b>5.00</b>	A- (standard and poor)*
Regent Insurance Company Ltd	<b>4.00</b>	AA-
New National Assurance Company Ltd	<b>1.00</b>	A-
	<b>100.00</b>	

\* - Rating of holding company

All the reinsurance companies are registered in South Africa and are regulated by the Financial Services Board which inter alia includes monitoring of these companies' statutory solvency based on specified admissible assets and policyholder liabilities that complies with the requirements of the Short Term Insurance Act.

All ratings are local ratings by Global Credit Ratings Company except where stated.

The risks of several claims from different policyholders or a single large claim are mitigated by the 100% reinsurance arrangements. Given the lack of reserves on IGF's statement of financial position, the failure of any reinsurer in conjunction with a claim on a policy could make the company insolvent. However, given the low frequency of claims, and the low probability of a failure of a reinsurer, this outcome is unlikely. In addition, claims by IGF on its reinsurers will not be large enough to cause financial difficulties for the reinsurers under any but the most extreme conditions.

**The IGF Team and contact details are as follows:**

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You are also welcome to contact any member of the either the Underwriting Committee or the Board.

THANK YOU