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THE END OF THE UMA?

We spoke to some insurers and underwriting management agencies about the sustainability of the UMA model in an increasingly tough operating environment.

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We don't know what the future holds. We can make predictions and imagine scenarios, but professing certainty beyond a doubt is simply out of our reach. The barrage of regulation coming at the insurance industry has led to a host of predictions about potential impacts on niche and smaller insurers, who may lack the necessary resources to comply and thrive.

With quoted figures sitting between 200 and 300, South Africa is almost unique in the prolific number of UMAs in our market. Providing brokers and insurers with an innovative and specialist servicing model, protecting these niche businesses seems to be a top priority for many insurers. In fact, insurers such as Mutual & Federal are planning to spearhead growth initiatives through UMAs, while a new marine insurer underwritten by Infiniti Insurance, Tri-Marine Acceptances, entered the market at the beginning of August. If this was all the information you were given on the subject, you would be forgiven for thinking that things are rosy in the UMA space.

But the truth is that some serious difficulties face the future sustainability of this model.

The cost of regulation.

An increasing legislative and compliance burden is a stretch for the small guys when it comes to time, money and resources. Increased levels of competition in the market, impacting on rating levels and profit margins; global financial uncertainty and the pinching effects it has on the pockets of consumers and corporates; and skills scarcity, leading to fierce competition for the limited skills available in the market, are some of the major challenges that industry commentators highlight as facing insurers and UMAs. Large insurers are more able to withstand these assaults, but what of UMAs?

"We are seeing more UMAs consolidating to create bigger businesses, which tend to have more capacity and collective ability to deal with these challenges. There is a strong business case for larger UMAs, which can deliver products and services of a superior quality to their brokers when run as efficient and excellent businesses," says Lireas MD, Valerie Hayter. Lireas is currently invested in 17 UMAs and has been involved in two mergers in the past 18 months, expecting this trend to continue.

Solvency Assessment and Management (SAM) is just one of many regulatory measures facing the industry. Although insurers and not UMAs are required to hold the capital stipulated under SAM, UMAs will have to provide data, such as claims exposures, to insurers so that they can do the necessary capital management. This will require extra work and management attention for UMAs, potentially detracting from entrepreneurial endeavours. Further, those insurers required to hold more capital may require greater underwriting margins from UMAs, forcing them to underwrite more strictly. Tighter margins may lead insurers to look at reducing the outsource fee paid to UMAs or changing the profit-sharing model altogether.

"The financial model where UMAs are charging fees on top of the management fee paid by the insurer will face greater scrutiny, both from a compliance perspective and from a sustainability point," says Quinten Matthew, executive head of specialist business at Santam. The fact that intermediaries are now able to charge binder fees could further cut into the UMA's outsourced relationship with its insurer. "If the UMA is fulfilling a purely administrative function, similar to what an intermediary would be fulfilling in terms of the binder agreement, the duplication of services will be questioned. However, for most UMAs, this is not the core advantage, which lies in their ability to provide agility, flexibility and solutions second to none," he adds. If the UMA is involved in product design, then legislation like Treating Customers Fairly will affect it too, but usually products and pricing are designed by insurers.

Chairman of the South African Underwriting Managers Association (SAUMA), Rory Gainsford, thinks that consolidation is more likely to be driven by the rate war and recession, which has seen expenses grow faster than premiums, than it is by regulation. This is not necessarily negative. "Consolidation of UMAs that have complementary business models can only improve their talent pool,

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align and reduce expenses and create critical premium mass, which allows access to larger retention limits and makes them more meaningful players within the markets they operate," he explains.

However, the UMA's capacity to adapt to an ever-changing environment, due to greater flexibility and fluidity as a result of their small size and systems, is a distinct advantage. In this sense, says Matthew, UMAs have carved a niche that only they are now profitably able to fill. "Their sustainability is vital and must be maintained for the health and competitive edge of the insurance industry as a whole," he notes. While Matthew believes that consolidation will occur where there is an over-supply, a lack of differentiation and competitiveness based purely on price, he thinks this may open things up for new UMAs. "We will continue to see new UMAs entering the market that can offer unique solutions, together with service and skills that are in short supply or not offered in the market."

But executive head of underwriting at Mutual & Federal, Karen Miller, believes it is far more onerous to start a new UMA now than it was some 10 years ago. Nonetheless, she notes that the servicing model of UMAs is unique and difficult for insurers to replicate. "One of the charms of UMAs is the servicing that they offer brokers, who can access specialists at a high level." Insurers could perhaps emulate this if they rethought their operating models, but this would almost certainly increase the costs of delivery on certain products.

At any rate, access to specialist skills remains a key differentiator of UMAs, as well as their key challenge should they wish to look forward to a bright future.

The struggle for skills

That the end of UMAs would lead to an exit of scarce skills from the industry, something which it can ill afford, is a very real risk. Succession challenges and talent shortages plague the industry and UMAs tend to attract more specialist skills, which is something that bigger insurance companies battle with. "Traditional insurers are unlikely to create an environment that will attract and retain the best specialist underwriting talent," says Bertus Visser, head of distribution and business development at Natsure. But if a plethora of UMAs exit the market, some of these skills could plausibly be absorbed by insurance companies. "If UMAs were to disappear completely, some or most of the business would probably find its way back into the general insurance market, depending on where the skills migrated to," says MD of Compass Insurance, Paul Carragher. "In some instances, where for whatever reason skills could not be retained, the products themselves may be discontinued if the insurer felt they could not adequately service those products."

Those insurance companies that are dominated by UMAs would certainly be challenged. "Some insurance companies deal only through UMAs and do not have the internal resources to absorb these UMAs back into a conventional branch structure. Even those companies that do have their own in-house capabilities for certain classes and use UMAs for others, do not have the resources to absorb the fallout," notes Gainsford.

"Lireas does not foresee a flight of skills from the industry due to the challenges it faces, but rather an opportunity to support this model and ensure fresh, young talent is attracted into the industry. This will ensure that critical skills are passed down to the younger generation and fused with technological advancements," says Hayter. Client manager at Centriq Insurance, Sydney James, says that South African insurers' overall lack of investment when it comes to training individuals in specialist lines of insurance is a cause for concern. "The industry is very unbalanced at the moment, with highly experienced people with no formal qualifications on the one side of the scale; and highly qualified people with little experience on the other end," he adds.

The struggle for skills, on top of regulation and market forces, has led some insurers to keep specialist lines of business in-house. Etana Insurance took this decision four years ago, replacing UMAs with in-house centres of excellence (CoE), so controlling its access to category specialist delivery by absorbing UMA-style expertise into its business.

In-house vs out-sourced

"While our CoEs are not separate legal entities, they nevertheless have their own independent board and MD," says Etana chairman, Paolo Cavalieri. "From a broker perspective, regarding the delivery of expertise and experience, they function as UMAs but without the stresses burdening UMAs today, which frees them to centre their energies and attention on their most important responsibility: delivering expertise to our brokers." Cavalieri notes that Etana's loyalty to brokers means it cannot take chances with its commitment to deliver specialist underwriting and business products. "Brokers need to be 100 per cent confident that they will receive uninterrupted and continuous backup of the highest quality. Having our CoEs protected from today's stresses makes that guarantee."

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Indeed, while brokers enjoy and appreciate the servicing model of UMAs and having direct access to some of the best brains in the business, Miller notes that there is often an underlying concern that the UMAs will not pay claims. She says that brokers often have significant buying power with insurers, while UMAs may take a stricter view to paying claims. In a bid to secure client or broker loyalty, insurers may opt to pay claims that contain grey areas, whereas UMAs may adopt a more black and white approach to claims payment.

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Nevertheless, the industry response to the in-house approach is mixed. "It is unlikely that the in-house UMA model is more cost-effective than the traditional UMA model," says Visser. "Both models could work, but we feel strongly that the UMA model plays a key role in maintaining the standards of specialist markets." Similarly, James points out that establishing an in-house resource should insurers lose the specialist skills of a UMA due to the tough operating environment would be a significant cost burden on the insurer.

Gainsford says that the decision to keep specialist lines of business in-house must come from the insurer but that very often individual specialists do not want to work in a corporate environment and like to have a shareholding in their own business. According to Matthew, the following factors should be considered when deciding whether to keep a specialist line of business in-house or not: the ability to attract and retain the right skills and people; agility and solution capability; and a sustainable competitive advantage to stay ahead of the pack.

Securing success in an uncertain future

To prepare for what may come, UMAs should, according to Visser, partner with insurers that have the best long-term interests of the UMAs and the UMA industry at heart. "Stay abreast of regulatory and market changes and ensure that succession challenges are addressed," he adds. Miller agrees that insurer support is vital. "We will have to see to what extent insurers will provide support to UMAs with regard to compliance requirements. The more support insurers give to UMAs, the more they are likely to thrive."

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"Expense management is also vital and during this time, staff should be made aware of the need to stretch themselves as never before within a tightly controlled budget," continues Hayter. "When it comes to attracting and retaining skills, UMAs should be more actively involved as an industry to attract young talent and to ensure skills and knowledge are imparted to the younger and upcoming practitioners in order to safeguard the continued existence and specialisation so critical to the industry."

"As is the case in any business, the UMA must be in a position to adapt to changes in the industry, be it legislative, market or otherwise. Aspects such as training, succession planning and understanding consumer needs are crucial," says Carragher. "Service excellence is a key factor for the UMA and having the right skill, competency and professionalism is essential." Gainsford warns that next year is likely to be a tough year for the industry, unless the recession recedes and rates start to harden. "While underwriting results have stood up surprisingly well, I believe there has been a large element of luck. The rates being charged in the market are inadequate and will at some point in time need to move upwards," he explains.

Hard rates or soft, to remain competitive and relevant; UMAs need to stay on top of a changing landscape. "Continuous professional development (CPD) will maintain, develop and increase technical and professional knowledge in the industry and the UMA environment," adds James. In addition to maintaining high standards, UMAs need to continue bringing something unique to the table. "UMAs will need to clearly define their competitive advantage versus traditional insurers. If you are playing in a cluttered space then this becomes more of a challenge, but there is opportunity if a UMA can differentiate itself and ensure that it is sustainable," concludes Matthew.