Weak rand poses real threat for the insurance industry

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12 May 2016 – The South African insurance industry needs innovative solutions to counteract the negative impact of the dramatic depreciation in the value of the rand since December 2015.

A sustained weak currency poses the real threat to catapult the well-established successful South African insurance industry into a struggling third world industry - with no foreign equity holders, low capacity for reinsurance and unaffordable premiums for consumers.

A major concern is the potential disinvestment by foreign owned insurance and reinsurance companies from South Africa as the continued weakening and volatile currency decimate the return on their investment and capital.

The poor results announced by foreign owned insurance companies already reflect the impact of the weak currency and more and more are looking to sell their South African businesses, with the resultant detrimental impact on the industry as a whole.

Of huge concern for the South African industry is the disinvestment by reinsurance companies, many of whom are operating in South Africa through fully capitalised subsidiary companies with international companies as equity holders. These locally capitalised subsidiary companies offer local insurance companies high credit rated reinsurance balance sheets, a critical requirement in protecting the local insurance company balance sheets and reducing their capital requirements.

If these companies were to close their South African businesses the quality of reinsurance and the capacity for reinsurance will decrease.

Another threat for the industry posed by the weakening currency is consumer resistance to the inevitable increases in insurance premiums.

The weak currency increases the cost of replacing and insuring assets, which are mostly imported. Between 80 per cent and 90 per cent of all consumer goods, including cars, technological devices, electronics and most household appliances, are imported.

Insurance companies are already experiencing an increase in the value of claims due to the higher cost of imported goods and will have no other option than to increase premiums. In an environment where consumers are already under pressure due to a contracting economy and higher inflation, many will opt not to insure their assets. It will not only leave consumers in a position where they are unable to replace their assets in the event of damage or loss, but will have a ripple effect on the economy of the country.

As things stand, short term insurance companies are already under pressure, especially on motor insurance. For many insurance companies the losses on their motor book is currently the most significant contributor to weakening results and extremely slim profit margins. Almost all parts for motor vehicles, even those that are locally assembled, are imported and insurance companies won't be able to absorb the increases in cost for very much longer. This will inevitably result in increased premiums.

In order for South Africa to be part of the global economy and be able to compete, it has to maintain high living standards in order to attract skills and, more importantly, retain skills. Living standards are dependent on Municipalities, firstly, maintaining infrastructure and secondly enhancing these. Insurance plays a critical role in assisting Municipalities maintain infrastructure. With much of the infrastructure being imported in foreign currency, this places a huge strain on the Municipalities and Insurance Companies when the rand depreciates. A depreciating rand will lead to deteriorating infrastructure, lower standards of living and a brain drain over a sustained period of time.

In order to survive and to ensure a viable and successful industry, economy and country, South African insurance companies will need to innovate and diversify as they cannot rely on a sustained appreciation in the value of the rand to secure the future of the industry.