

INSURANCE

Claims and Catalogues

Pacific & Orient's Big Comeback — and New Moves

In the insurance business, guarding against false claims is the key to survival. But what should an insurance firm do when its agents are the ones perpetrating fraud? In 1988, Malaysian entrepreneur Ong Sing Hwa and his family were agonizing over just such a question. At that time, Ong owned the loss-ridden Pacific & Orient Insurance Co. On top of making huge commissions, P&O's authorized agents were defrauding it. So Ong tried to sell his firm, which began as an underwriter for Lloyd's of London, to a

first day of trading. Last week the stock hit RM 9. With some 800,000 policy holders, it ranks third in net premium among Malaysia's 53 general insurers, after Malaysian National Reinsurance and Kurnia, the leader in passenger vehicles.

P&O's highly successful listing caught industry watchers by surprise. Auto insurance, which contributes over 90% of its premiums, is highly risky. It is subject to claims ranging from minor car damage

How did P&O climb back? Luck, says Chan, 38. But he quickly points to other factors: "Meticulous house keeping and circumstances of the time. The first thing we did was to turn around our name, which had long been dragged around in the mud." Chan brought in a new management team and worked closely with it. The strategy: "We found that the only way to revive the company was to forget about how insurance was done in the past."

Until the 1990s, agents enjoyed up to 40% commissions. As they mostly operated far from head office, it was difficult for their bosses to keep track of them. Many agents pocketed premiums and gave paying clients forged preliminary insurance contracts or cover notes. "We had no way to compel agents to hand over premiums," says Chan. "That had to stop. The bleeding was too severe."

Bank Negara, Malaysia's central bank, applied the first tourniquet. It stepped in as the insurance industry's regulatory body in 1988 and slashed agents' commissions to a maximum of 10%. "That in itself led to our turnaround," says Chan. "If it were not for the central bank, the stage would not have been set for the whole industry to be resuscitated."

The bank also identified a host of other problems, including loose management procedures, inadequate capital and too small a scale of operations. Claims were not properly assessed and reinsurance arrangements, by which a company shares risks and premiums with others, were inefficient, draining revenues. Bank Negara urged mergers and the raising of capital in the stock market. Regulators also accorded high priority to computerization, vastly improving accounting in insurance firms. P&O has invested some \$2.8 million in technology. The company developed an exclusive on-line network called the Issuing Office Computerized System, which dealt a death blow to its agents' scams.

The IOCS links P&O's three branches and nearly 60% of its 350 agents with the head office in Kuala Lumpur. The system has built-in underwriting guidelines, which make it easier to control credit and monitor agents. "Unwanted and unsuitable risks are rejected at the point of sale," says general manager Peggie Lim. The system also enables the head office to collect premiums within 48 hours of the Issuance of cover notes. Another advantage: Managers can negotiate with agents for lower commissions, which now average 8.5% of P&O's gross premiums — down from 9.1% in 1993 and below the current industry average of 9.3%.



Randy Lagerway

BACK FROM THE CRASH

Malaysian auto insurers Kurnia and P&O have been rivals at the top since leader Mercantile went bust last year. Kurnia is now No. 1, but at a price. As a portion of premiums, commissions and management costs exceed P&O's. But P&O has to digest the risks it took in the fraud-ridden late 1980s. Claims from 1988 to 1992 reached 72.9% of P&O's 1993 premiums. Its underwriting margin, a measure of how much insurance earnings exceed costs, was a thin 5.9%.

INDUSTRY LEADERS

Percent of gross premiums	Kurnia	P&O	SEA*	Industry
Financial Year Ended	June '93	Sept. '93	Dec. '93	—
Underwriting Margin	12.4%	5.9%	15.2%	11.9%
Claims Ratio	58.2%	72.9%	88.0%	68.9%
Commissions Ratio	13.5%	9.1%	8.1%	13.0%
Management Expenses	15.9%	12.1%	19.1%	15.3%
Vehicle Insurance	90.6%	92.6%	77.8%	54.0%
Market Share in Autos	12.0%	9.9%	6.8%	—

Source: TA Securities

*South East Asia Insurance is No. 3 in vehicles

Asiaweek Table

local consortium. But the deal fell through and Ong then handed over P&O to his nephew Chan Thye Seng, a corporate lawyer, offering him a 40% stake.

In two years, Chan had pulled P&O out of the red, posting a net premium of \$23 million and a pre-tax profit of \$6 million in 1990. He bought out Ong and last year lifted net premium to \$85 million and pre-tax profits to \$15 million. In mid-May P&O became the sixth general insurance firm to trade on the Kuala Lumpur Stock Exchange main board — and the only listed firm insuring cars and motorcycles. It topped the most active list in terms of volume traded, gaining a hefty 125% premium over its 3-ringgit issue price on the

to death and disability payments for accident victims. But investors seem impressed by P&O's high growth rate of nearly 40% a year for net premiums, and local and foreign fund managers continue to invest in its stock. Says an analyst: "The bigger the size, the better P&O can withstand the risks associated with intermittent, adverse underwriting results." It currently has the lion's share of the used-car segment and is gradually moving into new autos. Further growth is virtually guaranteed. Like those of other vehicle insurers, P&O's earnings depend upon the number and prices of registered cars — both on the rise. "The strong yen," adds an analyst, "will also translate into higher prices."

Another Bank Negara reform was a 1993 rule to set aside assets for "incurred but not reported claims" or IBNR, a kind of provision against likely claims based on historical patterns, but not actually made. It is based on premiums collected for the past six years, the time limit for insurance claims to be made. IBNR provisions ensure that insurance companies do not let their assets fall below a certain prudent level. To comply with the central bank's IBNR directive, P&O set aside \$54 million in fiscal 1993-1994. That trimmed profits despite higher revenues from premiums and gains in the company's investments.

While IBNR provisions have kept many top insurers in the money, analysts say they are the biggest hurdle for less profitable firms. For general insurance companies, the net assets should be at least \$2 million or 20% of net premiums of the preceding fiscal year, whichever is higher. One analyst estimates P&O's surplus at the end of 1994 was a comfortable \$64 million. But many other firms have been unable to meet the solvency requirement. These have either folded or may soon do so. The largest to close shop is Mercantile Insurance — the top vehicle insurer until it went bust last year.

With P&O's cash reserves in excess of \$106 million, Chan is looking to diversify by using agents to sell more than insurance — consumer goods, for example. The scheme is as simple as it is lucrative. While clients wait for insurance paperwork, they can peruse catalogues full of merchandise to order. Agents will then key

To diversify, P&O plans to offer clients waiting for papers a catalogue of goods to order

orders into the computer and the product is delivered by mail or courier. P&O is currently negotiating with several manufacturers to get the project underway. "Moving into trading will be the icing on our cake," the boss says. "And what's more exciting, this venture is almost risk-free, unlike our insurance business."

But insuring cars and motorcycles will remain P&O's main calling. Says Wilhem Lee, head of corporate finance at Smith Zain Securities: "Insurance is a probability business — and like gaming the house always wins. So the bigger you are, the closer you get to that long-term probability." P&O investors, bidding its stock higher and higher, evidently agree. •