retender

LIFE INSURANCE AS AN INVESTMENT

THE STORY

During World War 2, Abraham Wald was a member of a statistical group trying to help the US military reduce aircraft casualties. The military researched damage to their planes and found, when mapping bullet holes, that the majority was clustered around the wings and the tail. Their conclusion was simple: more armour was needed on these areas. Abraham's conclusion however was different: more armour was needed on the engines instead. His reasoning was that the military was only focusing on the planes that had returned and not the ones which had been lost and so, a more logical conclusion was to increase the armour in all areas other than the ones observed.

We tend to focus on 'survivors' but sometimes there is a story from those that didn't make it. Sometimes stepping out of the problem in front of us and rather focusing on the system as a whole, including what we can't see, yields a different approach that in hindsight seemed obvious.

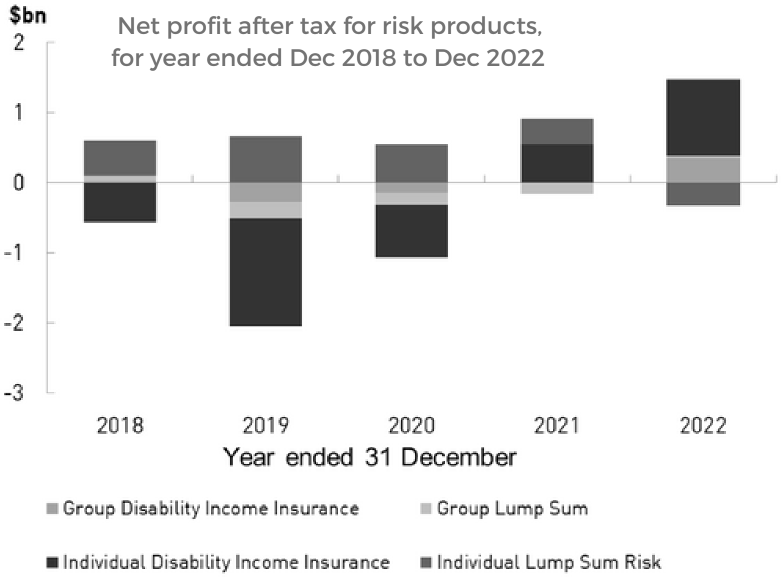
Life insurance, as being sold today, has a collection of legacy problems that have culminated in significant premium increases beyond what consumers and advisers expected. In the current economic environment, with affordability forcing consumers to reconsider their need for life insurance protection, these premium increases are just adding 'armour' in the wrong place.

This paper explores how we might approach life insurance if it were considered as an asset class (an investment) rather than risk protection (a cost). How could the tried and tested concepts of indices, diversification, volatility, rebalancing, switching managers and timing apply to life insurance? The paper proposes a different lens to assess life insurance performance, along similar lines to that used when assessing an investment manager's performance, which calls for active portfolio management. Ultimately, it calls for advisers to ensure that their customers are in the risk pools that maximise their future returns.

Past performance

The cost of life insurance has been rising fast and is predicted to continue increasing in coming years under a challenging economic environment. Insurance, being a discretionary spend, is likely to be one of the first areas to be re-assessed in households' budgets.

The driver for these increases has been losses made by insurers (now running into billions in recent years), the underlying reasons primarily relate to the rising cost of claims (in particular for Income Protection (IDII) business), along with expense pressures and the impact of changes in interest rates on reserves. In the last 5 years, net profit after tax for the four main risk lines has been $12m on net policy revenue of $117bn, implying a 0.01% profit margin.


Net profit after tax for risk products, for year ended Dec 2018 to Dec 2022

Source: APRA Quarterly Life insurance performance statistics, Dec 2022

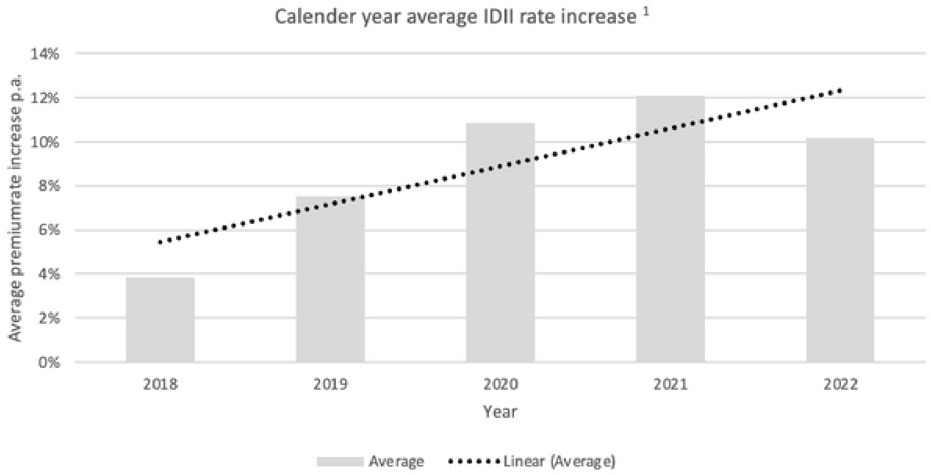
The most recent APRA data has shown a $1.1bn turnaround in profitability in the year to December 2022 for IDII, likely partly a reversal of previous loss recognition, increased yield curve impact on reserves and potentially an improvement in claims termination rates through earlier return to work than anticipated. Primarily, these are one-off in nature, due to the accounting treatment of life insurance, where profits are slowly recognised over time, but losses are capitalised. This means that if an insurer moves from loss making to breakeven, a large positive will flow through in that period, not representing a strong profit, but merely the recovery of the loss.

The industry is still far from solving its profitability issues of the last decade (and losses are now emerging on group insurance) so this profit reversal will not translate into reductions to the same extent they led to increases.

Akin to the role of the RBA with regards to general inflation, APRA and ASIC play an important role in managing 'insurance inflation', by creating an environment of consumer confidence. Wild swings in prices or profitability shake confidence and whilst there aren't many levers at their disposal, perhaps continued use of the word 'sustainability' is now creating an unintended consequence, providing license for participants to recoup losses.

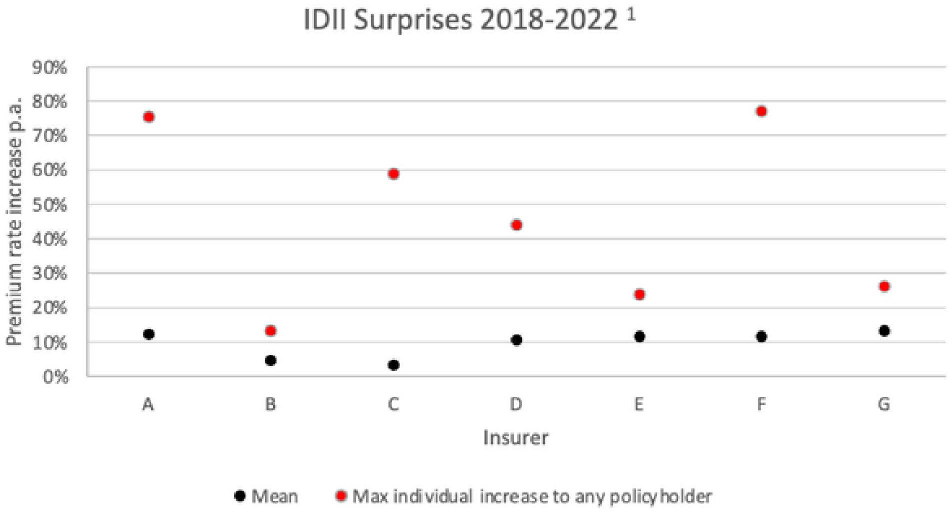
With an asset management lens, we would want to investigate past price changes which, although not a guide to the future, is the best available information to form a starting point.

For IDII as one benefit example, the last 5 years have resulted in a continued series of premium rate increases for IDII cohorts, starting at an average of c4% in 2018 and increasing to an average of c12% in 2022 (before Age and/or CPI increases). Note that this does not necessarily suggest that any one individual customer has had all these rate increases applied.



Source: Retender estimates based on APRA data.

At an insurer level, there is a fairly wide distribution.



Source: Retender estimates based on APRA data.

As examples, Insurer's A, E, F and G all had similar magnitude averages p.a., however Insurer's A and F 'shocked' customers in terms of the maximum that any single customer experienced. Insurer's E and G in contrast had a steady consistent stream of increases p.a. but lower variability with regard to any one customer, and had to weigh up cross subsidies and the slow bleed of customer premiums increasing in the future.

[1] Note there are a number of data limitations, primarily related to discrepancies that cannot be verified with each insurer. Averages are only for those customers who had an increase.

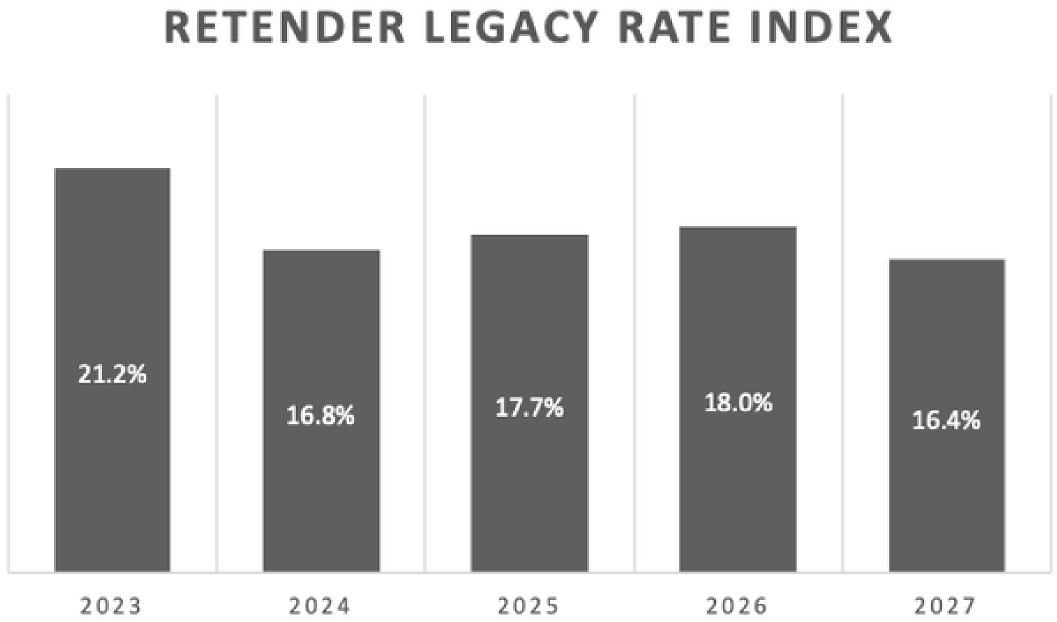
Measuring insurer performance should start with a benchmark but what are they measured against? Arguably, the benchmark should be a 0% change over the term. But what emerged in practice? Unfortunately on this product line it's all about degrees of underperformance as all insurer's missed the benchmark.

The degrees are magnified even further when you break down these increases by segments where customers are 'more trapped'. For example, agreed value policies (which are no longer available) had an 11% p.a. average increase compared to indemnity policies which had an 8% p.a. average increase. Similarly, level premium policies (where customers have paid more at outset and shouldn't theoretically be able to find a cheaper similar structure product elsewhere) had an 11% p.a. average increase compared to stepped policies which had a 9% p.a. average increase.

Note that these increases are before CPI (applied automatically unless opted out) and age (for stepped premiums) meaning that from an end customer point of view, these above numbers are understating the cost impact which may add a further c10% or more in cost.

The real question is where are we heading?

In terms of the direction, the authors believe that the life industry hasn’t seen the last of life insurance cost pressure. The Retender Legacy Rate Index is based on a weighted portfolio of life insurance akin to the basket of goods used as the basis for the RBA’s consumer price index (CPI). After making allowance for market participant views of trends, past experience and anti-selective lapsation rates, it predicts aggregate legacy costs will increase in the order of c21% next year and on average c17% p.a. over the coming years, including for age and indexation which is how customers see their premiums . If broken down further, this Index would be higher for disability benefits (IDII, Trauma and TPD) and lower for mortality (Death) and may not emerge uniformly.



Source: Retender Legacy Rate Index, 2022

These expectations also reflect a trend APRA called out in 2015, where a typical portfolio of life insurance business accumulates risk and uncertainty over time, which, unless actively addressed, “is likely to continue, eating away at sustainability like a rat gnawing on an electric cable. In other words, the quality of the insurance portfolio of an insurer in this position will steadily deteriorate, with a consequent effect on claims, and then reserving and pricing. Customers pay the price in higher and more volatile premiums.”[2]

An Actuaries Institute Taskforce has developed a sustainability guide (December 2022) to help insurers improve the sustainability of their long term IDII business. This may help going forward for new tranches of business, but is unlikely to stem the increases coming through on the legacy portfolio or provide practical guidance to consumers bearing the brunt of insurer's sustainability challenges.

Caveat emptor

These losses culminated in an unprecedented response by the regulator, where after seeing no movement or ability of insurers to address the challenges in a meaningful future-proof way, specified product measures which banned features which contributed to rising prices, such that new customers from October 2021 could only access more restrictive products. Following this up, in March 2022, APRA made its expectations of life insurers clear by imploring insurers to “take steps to support policyholders in unsustainable IDII products transitioning to newer, more sustainable products, where appropriate”[3].

Changes in community expectations may also increase claims acceptance rates and payments of claims outside of policy terms, or even limit the ability for management action such as implementing premium reviewability. A number of such level premium rate changes have been challenged recently which, although too early to conclude, raises risks around ability to change historic premiums. These risks were highlighted in a Retender paper in 2018 titled 'The Cost of Consumer Expectations' where, in response to concerns raised by the UK Ombudsman in 2003 around whether reviewable-rate policies complied with the Unfair Terms in Consumer Regulation Act 1999, the FSA and ABI undertook an investigation into how reviewability was being applied. We commented that 'It’s reasonable to assume, therefore, that the ability of Australian insurers to recoup losses or change expense assumptions within pricing will no longer be allowed in the future. At an unlikely but extreme scenario, community expectations may not support reviewability under any circumstances.'

In addition, other legal, regulatory and reputational risks may also crystalise, such as AFCA systemic issues, ASIC enforceable undertakings or class actions. These have the potential to require significant remediation, raising the insurer’s cost ratio, and will need to be recouped by raising premiums for a specific cohort or over the broader customer base, either as a one-off jump or multiple increases over future years.

[2] APRA Deputy Chairman Ian Laughlin, Life Risk Insurance – a challenge to the life industry: managing for long term portfolio health, Insights Session at Actuaries Institute, Sydney, 3 March 2015

[3] APRA Deputy Chair Helen Rowell, Letter to life insurers and friendly societies: Individual disability income insurance: Suspension of policy contract term measure, 24 March 2022

One recent example is that of Resolution Life Australasia v N.M. Superannuation [4], where the defendant (the Trustee of AMP Super Fund) won against an injunction seeking to stop a RFP process for the Super component of the life insurance. In effect, the insurer (Resolution) purchased a book of business in 2020, with the expectation of being able to charge future premiums to those policyholders until expiry of the policies which would recoup the initial funding costs. The Trustees (AMP Super) however have a different legal obligation under the SIS Act to assess the best financial interests of their members for the component within Super, and initiated a RFP process to explore their options. Whilst still ongoing at the time of writing and subject to further appeals, one potential outcome is that these Super policies could all move from Resolution en masse which would have knock on impacts (and potential cost) for remaining Resolution policyholders and for advisers currently receiving ongoing commission for recommending this cover.

By implication this could set a precedent for other similar Super fund trustees offering Individual policies within Super (estimated in the vicinity of a quarter of Retail insurance sales) but also suggests that Superfunds offering Individual policies may have broader obligations and risk exposures than originally understood at the time of providing their Superfund capacity. The Trustees, as policy owner, may only be notified of all premium increases, but not required to approve them. They may no longer be satisfied that the policy continues to meet their best financial interests duty to members, due to the erosion of retirement savings by the premium increases.

This case also raises an interesting question about how the various best interests tests interact with each other. Superfund Trustees, for example, have to apply their test to the group whereas financial advisers have to apply their test to the individual. But what happens where a policy is written in Super (governed by Trustees) by a financial adviser? What is good for the individual might not be good for the group, or vice versa. Who 'owns' the customer where there is an insurer, Trustee and adviser?

Diversification

A robust asset management strategy is typically predicated on diversification and setting up a portfolio of multiple asset classes, sometimes spread over multiple managers. Ideally some of these assets are uncorrelated with each other, providing a hedge where one asset performs and another underperforms.

In contrast, the traditional approach to life insurance tends to place all the benefits with one provider to reduce the administrative burden and to cater for the linkage between rider benefits. There is a liquidity catch though by placing business with one provider who may be subject to its very own unique challenges. By underwriting life insurance customers only at application, customers with deteriorating health, as a consequence, can become trapped in their existing policy. The reason is that customers in poorer health have a higher chance of claim, and hence their yield from holding onto the insurance is higher. They cannot easily move to another insurer as they would not pass a new underwriting process, and so have to pay whatever premiums are charged to maintain their cover. As an implication though, to the extent healthy lives no longer keep their cover as they are able to move to a new insurer, the pool is left with deteriorating risks over time creating continued increasing pricing pressure.

[4] Resolution Life Australasia Ltd v N. M. Superannuation Pty Ltd [2023] NSWSC 98

It is critical advisers ascertain whether the client has any reason to believe that their health may have changed. Richard Neil Swansson v Russell Alan Harrison & Ors is an important case, which highlights that moving policies is not appropriate if there is any suspicion of a change in health, even when the move is driven by significant premium increases. There is an onus on advisers to follow up on any suggestion of changes in their clients' medical conditions, even beyond application for the new cover through to policy issuance. It also highlights that existing policies of more than 3 years duration have particular value, given under section 29(3) of the Insurance Contracts Act 1984 (Cth), a policy can no longer be avoided for innocent non-disclosure.

Along with health changes, the premium structure of life insurance can also create a trap for some cohorts of customers. Unlike Stepped Premium policies which increase with age in line with rising claims costs, Level Premium policies are designed to remain more stable by effectively charging more in the early years when you are younger and less in the later years when you are older. Level Premium customers only benefit from their initial investment in this policy structure, with higher premiums in early years, after having held their policy for a long time. In almost all cases, the savings from moving to a cheaper provider will never be enough to offset the costs already incurred from these higher premiums – hence the trap.

The conflicts of interest here are significant too, with no disadvantage for insurers to ratchet up Level Premiums. Not only do Level Premium customers have no better option, if they do lapse it's at the benefit of the insurer who no longer has to fund future claims as the customer ages. The insurers' reputations might be protected by the industry collectively following a similar approach, but now that confidence link for advisers is broken for selling Level Premium policies, which may have been the best structure to maintain affordability over the long run. The question remains though, if there is that element of being stuck, akin to investing in non liquid assets, why put all your eggs in one providers basket?

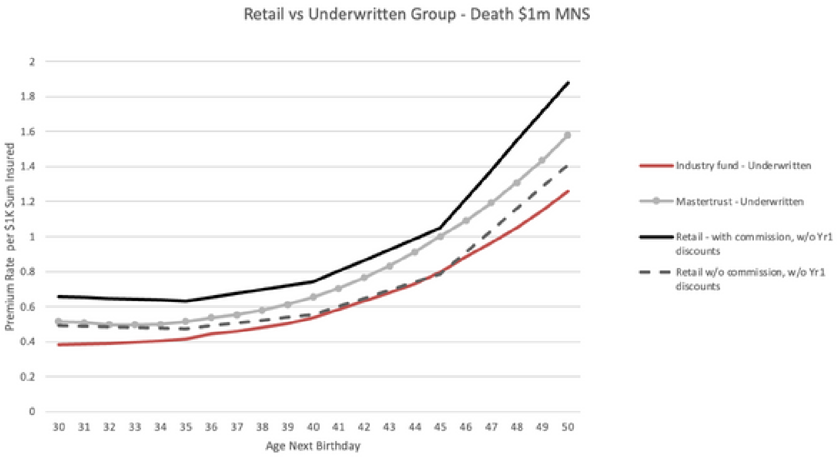
Different classes

The life insurance industry requires heavy reliance on advisers to guide consumers in assessing trade-offs between risk and cost. And all these dislocations of the risk pools means that consumers will need to reconsider their options. To avoid losing protection altogether, there are several options available for customers facing rising life insurance costs to avoid cancelling cover altogether. AFCA's advice for those complaining of price increases is to save money by tweaking existing policy cover such as "the sum insured amount, the waiting period, duration of the payment term and the indexation option"[5].

From a customer perspective though, consideration should be given to all segments where cover is available, akin to an investment adviser's consideration of all the asset classes available and the relative risk return trade-offs. With the tightening of product conditions for example, there is now greater alignment between Retail and Group insurance product offerings, making it more enticing to broaden the field of reference when assessing alternatives across the system to manage rising legacy costs. There is indeed an anecdotal view in the market that the impact of these overlaps are much bigger than we think, where as the individual advice sector has shrunk in recent years, the volumes lost have been more than offset by the growth in voluntary group insurance written via the superfunds.

[5] AFCA Factsheet – Insurance premium increases

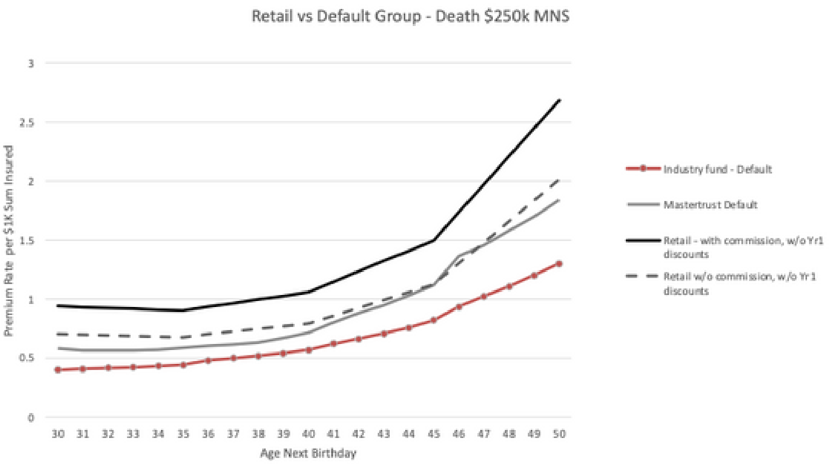
The following graph compares Death cover (which has minimal product variance across channels), based on a popular level of underwritten cover of $1 million, for a Male Non-Smoker Professional, across Retail, underwritten Mastertrust and underwritten Industry Funds. As Group insurance typically offers a unit-based pricing structure with varying default cover levels across funds, a per mille basis (i.e. premiums per $1,000 of cover) has been used in all comparisons



Source: Retender estimates as at July 2022

After allowing for full commission dial down in Retail, given commissions are outlawed in Group, on average Retail costs were similar to Industry Funds but cheaper compared to Mastertrusts. Include commission however and Retail becomes, on average, similar to Mastertrusts and more expensive than Industry Funds. So the questions for consumers is really whether they want advice and if they do, how best to fund it (i.e. through separate advice fees or included within the life insurance policy)? With consumer demand to remove conflicts, advice education standards solidifying the advice profession and commission rates at an all-time low, fee for service is becoming an increasingly appealing approach for advisers.

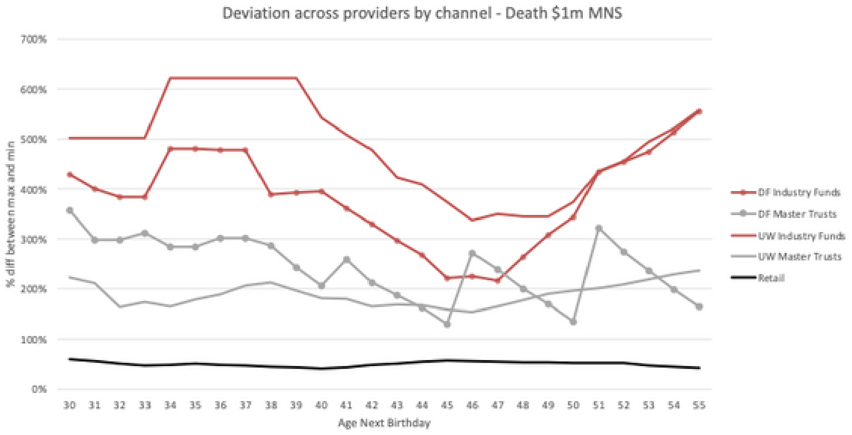
The following graph is similar to the comparison above but instead of $1 million of cover the typical level of default Death cover in industry funds of $250,000 is assumed. This shows the clear advantage default group insurance has over Retail at this lower cover level.



Source: Retender estimates as at July 2022

Volatility

It is dangerous to draw conclusions only from averages. We might instead focus on the range in price across the segments, from lowest to highest. This shows a staggering range in pricing of up to 600%, with the largest variance occurring for Industry Funds and the smallest for Retail. Bear in mind, this is for Death cover – the theoretically most stable and predictable of the risks covered in life insurance – morbidity risks will have greater variances.

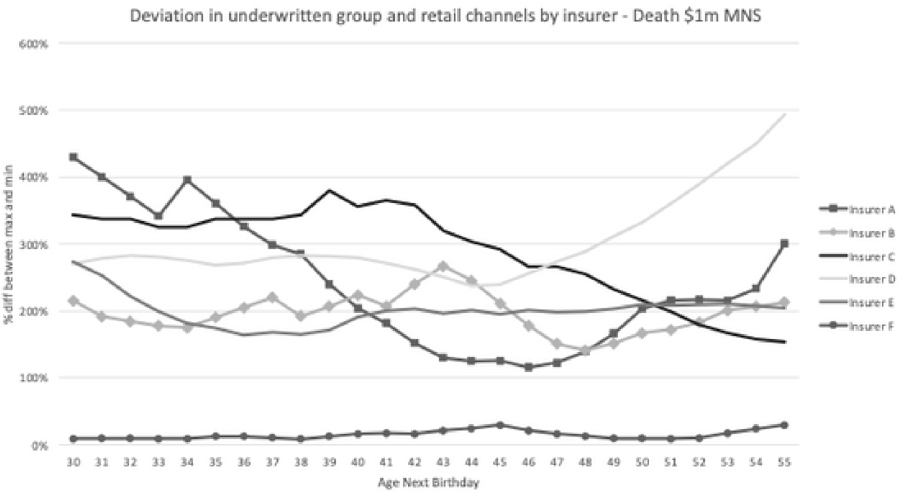


Source: Retender estimates as at July 2022

As an example, for a 40-year-old professional male non-smoker for Death cover, there is a 400% difference between the cheapest and most expensive default Industry Fund available – said another way, pick the wrong Fund and you could be paying 4 times the premium. Intuitively this makes sense given Funds are priced based on their members' mix of occupations, where cross subsidies are still prevalent given limited occupational categories, compared to a Retail cover where pricing is tailored to the individual's occupation specifically.

However, it does raise the question of whether some Funds should even be offering insurance for certain occupation groups – if a professional seeking life insurance is sourcing death cover that is 400% more expensive than the best Fund available, are there any obligations on the Trustees around their retirement objectives that would lead to removing those covers altogether from their proposition? What's fascinating is that it is even worse for underwritten cover in Industry Funds – for the same 40-year-old male the range is almost 550%. The newly introduced Target Market Determinations could be valuable to clarify where cover may not be appropriate for certain individuals. And as with investment advice, one needs to consider the structure under which the assets can be optimally sourced.

Taking this one step further, we can also look at these same differentials at an insurer level, for those insurers offering both underwritten Group insurance and Retail insurance.



Source: Retender estimates as at July 2022

There is no equivalent best interest test on insurers or reinsurers. The outworking of actuarial pricing based on various pools of risk means that insurer and reinsurer pricing varies significantly by channel, even for underwritten business by the same insurer. This is likely to be based on a different claims experience profile of the customer cohorts, together with different allowances for expenses, lapses, capital and even profit expectations depending on the scale and certainty of the assumptions underpinning the pricing. The level of competition in each channel will also influence the final price. Customers must beware that one offer in the market from an insurer may be vastly different from another and this is true within the same insurer too.

Rebalancing

Implicitly, an adviser listed against their client’s policy is year on year tacitly supporting their customer continue in their current policy, and the adviser continues to receive a renewal commission for this 'recommendation'.

One might therefore argue that not giving advice is still giving advice but technically the best interest duty only arises at the time explicit advice is provided. Despite an ongoing trail being payable for over 90% of all advised policies, there is no obligation on the adviser (except those imposed by Licensees), to review a customer’s cover over time to ensure it continues to meet the objectives, financial situation and needs of the client. Even where an adviser has been made aware of significant increases on the customers policies, still no obligation arises to review whether it is continues to be the best option. Advice may still stand in terms of recommended benefit types and cover levels, but an opportunity remains to update the cover to create value for the policyholder, akin to the investment approach towards regular rebalancing of the portfolio.

No fear of hindsight

With all these dislocations and pressures on risk pools, how should advisers respond on behalf of their clients? No matter what adjective ultimately sits in front of the word 'advice', nothing is stopping advisers from switching their customers to more sustainable risk pools. A less feature rich offer can be recommended when it achieves an overall cost saving and aligns to the needs of the client.

Best interest duties were enshrined in the Corporations Act as part of the government's Future of Financial Advice (FOFA) reform package. ASIC's Regulatory Guide 175 details how ASIC will administer this law, including specifying that 'advice will often be appropriate under s961G (of the Corporations Act) if there are overall cost savings for the client and it would be reasonable to conclude these are likely to override the loss of benefits that are of value to the client.' In one example set out in RG175 around insurance, they comment that 'The adviser is required to balance … insurance needs realistically with the cost of premiums that increase with age, and the need … to save for their retirement.' The same guide also makes it clear that there is no retrospective testing, using an example of a recommended investment option turning out to be loss making.

What does that mean? There are two important conclusions:

1. Future cost matters: it may not just be this year's premium cost to consider, nor a projection of future premiums, but also the likelihood of an unexpected rate rise.
2. Hindsight isn't a constraint: there is no hindsight test of whether a claim not payable under a new policy, or payable at a lower amount, would have been payable under the more feature rich original policy.

There is a similarity with investment advice:

- Should advisers ignore future fees in their recommendations?
- Would advisers be liable if an investor made less money after switching assets compared to the prior investment vehicle?

Michelle Levy acknowledges, in her August 2022 "Treasury consultation paper – Proposals for Reform" for the Quality of Advice Review, that advisers demonstrate more risk averse behaviour due to their misinterpretation of ASIC's guidance as the law and related concerns that ASIC would commence proceedings for 'minor infractions of the law'. Her primary draft proposal is around the provision of "good advice", which deals more to the substance of the advice rather than the adviser's process, which will hopefully more clearly support recommendations balancing cost savings against less feature rich products and free advisers from acting out of fear.

So, what are some of the other barriers at play?

- Perhaps it is the time and cost of replacing old policies, all to end up with a lower ongoing trail commission? The adviser will potentially see the same hit to revenue if they take no action, as rising premiums prompt clients to amend their cover to reduce premiums. Worse still, if the client cancels altogether, the adviser may lose more than just their risk relationship. This doesn't change the burden on the adviser when suggesting a change in insurer. Licensees often see this as a trigger for an onerous Statement of Advice, which is a costly exercise.

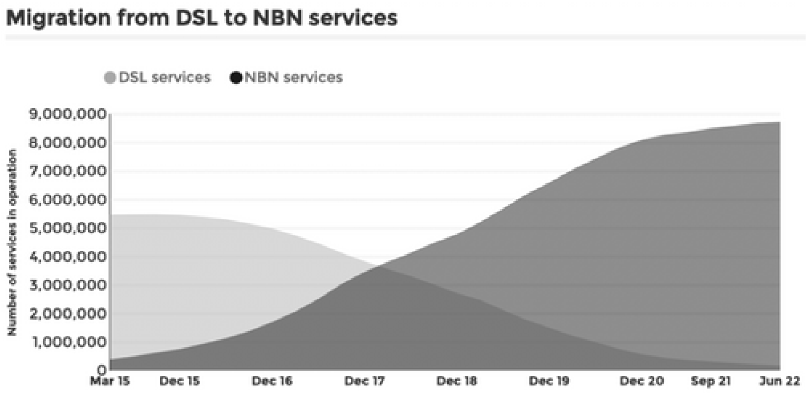
- Is the price differential insufficient to justify the new underwriting application and medicals for the client and reduction in benefits for the newer disability income products? It would be difficult for an adviser to assess any expectation of future changes in premium over time and hence quantify the benefit of undertaking these additional steps. Furthermore, insurers have priced to reduce movement from their existing portfolio to newer products, meaning it may be difficult to attach a reasonable saving to the move, opening it to be dubbed as “churn” by the Licensee compliance team or ASIC’s file reviews.
- Is there fear that revising the recommendation of which insurer will provide the optimal return creates doubt in their clients about previous advice? Surely the client will see the value in proactive management of this cost disruption and actually place greater value on the adviser’s approach? “Changes to brand loyalty and a willingness or even expectation to regularly and readily change product supplier” was called out by APRA back in 2015[6].
- Could it be an adviser’s worst nightmare to switch a client and not be paid the claim at the new provider? In Retender’s paper, the ‘Thanksgiving Turkey’, we explore how almost 1 in 8 morbidity claims are declined anyway, with this number higher for closed compared to new business books. Staying in a risk pool that is underperforming and will continue to underperform, with no reputation constraints, surely increases this risk.
- Lastly, advisers are heavily reliant on tools that reduce their administration burden, critical to an efficient and cost-effective business model. The issue with this is these tools often rely on inbuilt research by a rating house that places value on bells and whistles. The top rated products will pop out and then the most cost effective of the 'top few' can be recommended. But does a customer need that top product? Could that actually be over-insuring for a windfall at an unsustainable price? Despite insurers offering a spectrum of products from premium to basic, adviser behaviour maybe hasn’t adapted. They recommend what rating houses place on top because it is an independent indicator of meeting their ‘best interests’ obligations. But is it best?

Regardless of whether we move to ‘good’ advice, regulatory and legal hurdles are not a current barrier to switching risk pools.

Active change

TPG Telecom define churn on their website as 'a transfer of a Customer's ADSL/ADSL2+ broadband connection from a participating ISP to TPG. The turnaround time is less than a new installation'. They have a list of 77 participating providers and have a streamlined approach to transitioning customers, or “takeover terms”. For healthy competition there should be no impediment to customers moving from an existing provider to one that offers greater value. No different to mortgage exit fees, or ability to switch energy providers (and list goes on). One author just received a prompt from the state government (Service NSW) to compare and save on energy plans, so switching is generally encouraged, but why not for life insurance? This is also applied at a product level. When a better product was introduced in the form of the NBN, all customers were migrated, either with their existing provider or to a new provider, to the better quality product.

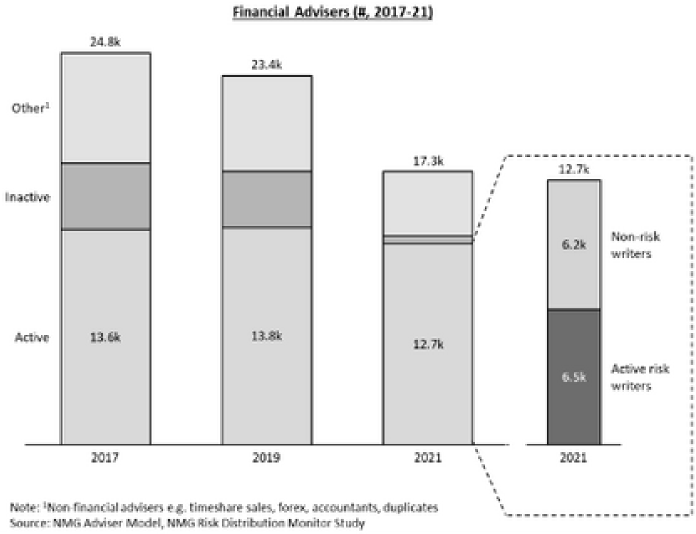
[6] APRA Deputy Chairman Ian Laughlin, Life Risk Insurance – a challenge to the life industry: managing for long term portfolio health, Insights Session at Actuaries Institute, Sydney, 3 March 2015



Source: NBN Wholesale Market Indicators Report, June quarter 2022 report

In 2014, ASIC undertook a review into retail insurance advice, with the resulting report 413 identifying high lapse rates and evidence of poor advice, linked to the more dominant upfront remuneration model. The Life Insurance Framework (LIF) was subsequently introduced to address these findings by reducing conflicts and misaligned incentives. On 1 January 2020 the final phase of LIF reforms became effective, taking the maximum upfront commission to 60%, subject to a 2 year clawback period. Before 2018, it was standard business practice to provide 110% upfront commission, subject to a 1 year clawback period, and an ongoing 10% trail.

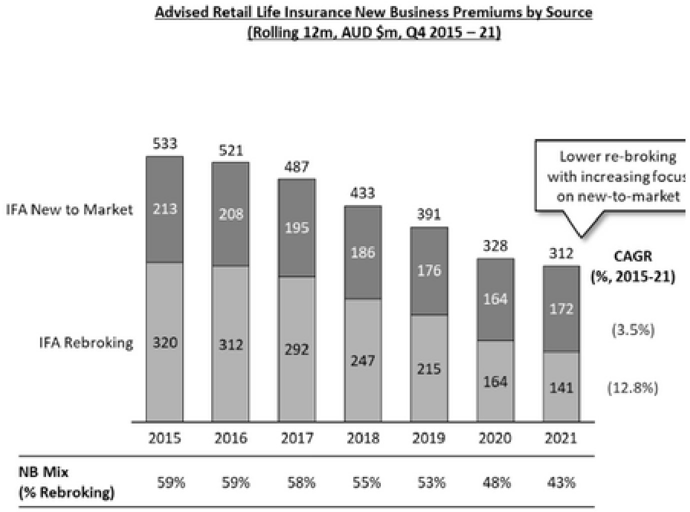
The capping of commissions aligns consumer interests with advisers by removing any potential perceived conflict of interest. While commissions provide consumers with a valuable option to pay for access to life risk advice, the time, cost, and complexity of producing risk advice, along with increased educational and professional requirements, have contributed to advisers departing the market, with those remaining tending to focus on fewer, high-net-worth consumers.



Note: [1]Non-financial advisers e.g. timeshare sales, forex, accountants, duplicates
Source: NMG Adviser Model, NMG Risk Distribution Monitor Study

In turn, this has led to a reduction in the number of consumers who can access advice despite having a need for life insurance, because there are fewer advisers providing it and those who do are advising fewer consumers given the regulatory requirements. So, a simple flow – LIF pays less, leads to less supply which leads to less advice being given.

The LIF reforms have achieved their desired impact, removing the spike in lapses after the clawback period and increasing the average policy duration, whilst also reducing the amount of replacement business. Despite this suggesting a refocus to new customers, this cohort has also declined at 3.5% p.a.


Advised Retail Life Insurance New Business Premiums by Source
(Rolling 12m, AUD $m, Q4 2015 – 21)

Source: FSC submission to the Quality of Advice Review, July 2022

The above may highlight a reduction in rebroking by more than 50% over the last 6 years. More so when you consider that premium rates have been increasing recently (say on average 50%), so on a like for like basis with 2015, rebroking (as a proportion of existing policies) may have fallen by as much as 75% rather than the 50% observed.

With rebroking representing only around 2% of the advised inforce premiums now, does it seem reasonable that 98% of all policyholders ever written have the best insurance in place for them after all these dislocations, costs and premium rate increases? Consider if new Telco's or banks selling mortgages were limited to only 2% of existing customers? In fact, external refinancing of loans to a new provider is at about 13% of household debt in the year to July 2022 according to ABS, with internal refinancing making up another 8%. There are many factors that drive rates of refinancing, including the purchase of a new home or the end of a fixed interest period, but this does highlight that 2% in life insurance may not be achieving the best outcome for customers.

Interestingly new to market policies are 57% of all new life insurance policies, in line with 54% of household loans being new, rather than refinanced. This highlights that there is room for more activity in both rebroking and new policies being written in life insurance, likely due to the more limited adviser capacity to service the market, resulting in additional underinsurance.

Churn as a word has negative connotations but it's fuelled by incumbency. Any advisor with a high lapse rate is considered 'bad business' even if the advice is in the best interests of those customers. But the prior insurer has no idea about what the advice was that moved their customer to another player. Perhaps perceived connotations of 'churn' may vanish if advisers move to a fee for service model and conflicts of interest are no longer a consideration. Or perhaps they simply vanish if we apply the same thinking to life insurance that is applied by an investment advisor where movement is actively encouraged. Regardless, the word should be 'switch' and not 'churn' and there should be little tolerance for poor servicing and pricing of old products, and little safety in the inability to move.

Timing

Investment advice typically spreads the placement of assets across multiple providers and multiple asset classes. And even within those assets classes, we don't bet it all on one share or bond. Prices going up and down over time also introduces a timing dimension, where a reasonable strategy might be to not try second guess when to buy or sell, but rather take advantage of dollar cost averaging to spread the average cost of purchase and take advantage of partial withdrawals to spread the average cost of sale.

New entrants with new strategies emerge all the time. In retail life insurance, with consolidation of the bancassurers into the big players, smaller players such as Neos, PPS, Metlife and Integrity are gaining traction. Whilst the existing players may have scale on their side, they also have costly legacy infrastructure, across both technology and risk pools. Multiple acquisitions see the need to support multiple systems, some nearing end of life, the dial-up equivalent, and requiring expenditure to rationalise. Their risk pools have seen years of anti-selective lapsation. In contrast, new players have invested well in agile technology that gives them a competitive advantage in servicing advisers and customers alike, whilst also being able to attract new, healthy lives to build their risk pools. Similar to a dollar cost averaging strategy, should advisers be considering how to take advantage of 'the average cost of the life insurance purchase' when reviewing life insurance portfolios?

When policyholders replace their existing cover their previous insurer loses out to the benefit of their new insurer. An insurer with a large legacy portfolio and little sales will only lose when healthy lives leave and unhealthy customers remain. It’s easy to see why one of these insurers would be against switching. But those insurers with a focus on growth will obtain a significant portion of their new customers from a competitor insurer and as such benefit from switching. And they refine their product, pricing and service offering to attract these new customers, so really, is everyone better off with an appropriate level of switching?

The challenge is with supporting unhealthy lives. Whilst healthy lives have the flexibility to move to a more attractive offer, unhealthy lives are not afforded this luxury, and they are the ones that need the cover the most. It is in their best interest to maintain their cover, with a higher return on continuing to pay their premium, given the real prospect of claim. Where affordability bites, these customers have little option but to reduce their cover to the maximum affordable amount. A new market participant, iExtend, has also seen an opportunity to support these customers supporting the payment of premiums where a customer with deteriorating health is considering cancellation. They co-own the policy, pay all the premiums and the insured shares in a portion of any claim.

So what?

Prices of IDII and Trauma are rising and potentially there is a contagion that might follow with other subjective benefit lines such as TPD. With no end to price rises in sight and purely from the lens of consumers, changing risk pools where good health remains seems one response. But what pool? To answer this, what if we took the traditional investment asset management approach to insurance?

Investment asset management requires decision making about asset allocation and the asset manager for your investment portfolio. The life insurance equivalent to asset allocation could be considered the benefit types and sums insured appropriate for the client, and the chosen insurer is akin to the asset manager which can be assessed against a performance benchmark.

Ongoing, the asset manager’s performance in picking stocks is actively monitored, measured and rebalanced to a different asset manager over time to meet the investors objectives. Similarly, life insurance should involve changing insurer based on their performance in managing the risk pools and as propositions evolve to meet the customers objectives. The choices by the adviser as to where and how they invest $100 premium need to be considered just as carefully as passing that $100 to an equity manager. There is a subtle difference of course with life insurance - you pay a premium but you may not get a payment back. But this is akin to an options contract which by its nature is also a form of insurance if this story were to be reversed.

Selecting an insurer goes beyond the premium and product components rated by research houses and relied upon by advisers to make recommendations. Re-assessment of insurer risk pool management, performance against the index and active rebalancing to alternative offers is key to portfolio performance. The original recommendation of an insurer with the cheapest premiums will mean very little for policyholders if these premiums increase beyond expectation, increase above their competitors or are costed above the price of new policies. This represents a reducing return on investment, and is likely to trigger a worsening risk pool with healthy lives opting out.

There is no silver bullet to fix the legacy challenges. But life insurance is a valuable commodity and meets an important consumer need. One go forward option is to start with a different lens to the problem, trying to think about life insurance as an asset which will lead to a focus on maximising returns for customers. This can be achieved through assessing an individual's health circumstances to determine if passive management is the best (and only) approach. If active management is a viable option however, their current portfolio performance should be assessed against a past index, future expectations, available asset classes and options for the choice of asset manager.

Past performance has shown us that increases in life insurance cost are possible and that no benefit line, even mortality, is therefore sacred. Customers can only benefit by applying an investment management approach to life insurance.

If you would like to discuss or have any feedback on this paper, we'd love to hear from you.

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