Evolving Distribution Models in Life Insurance (Australia)
Author: Young Goh

Abstract
This paper intends to look at the life insurance industry over the past 10 years in Australia and how distribution models have changed over this time.

How have distribution models changed in response to changes in societal perceptions and understanding of their need for insurance?

What are the implications for the industry of these changes in general, and on the different functions within the industry in particular i.e. distribution, underwriting, claims, product design and pricing.

Whilst the focus on models in Australia, developments in different worldwide regions (North America, Europe, South Asia and East Asia) have been provided for context.

Preamble
As is often the case in life, things don’t always turn out as expected. As I embarked on the writing of this paper chronicling the evolution of distribution, little did I expect the twists and turns that would emerge along the journey.

Whilst there are many possible pictures or angles I could take in telling this story; the one I prefer the most is to think of distribution like a river finding its way to the sea. Trickling, twisting, turning through rocks and other obstacles, it finds its way through to its destination.

Also, I did not find the Australian history of life insurance readily available. For some of us, this retelling of the story will be old news. For other readers, I hope this will serve as a brief introduction.

Disclaimer
Whilst every endeavor has been made to verify the information that is being presented here through the process of research and peer-review, the anecdotal nature of my interview based research on the historical elements means there is a degree of subjectivity and I anticipate that some readers will have a perspective of such events. Should this occur, my commitment will be to re-verify the new data presented and to update this paper at a later stage.
1. Introduction

The life insurance industry in Australia today is approximately $10b\textsuperscript{1} in annual premiums in force. The market includes 17 major life insurers, 5 major reinsurers and a number of Lloyds agencies\textsuperscript{2}.

Insurance plays a vital part of Australia’s financial sector with strong prospects in light of relatively high levels of underinsurance\textsuperscript{3} remaining in spite of progress over the past decade or so. Significant opportunities therefore still exist for growth. In this regard, the Australian market, though mature, is similar to her Asian neighbors.

Distribution remains key for life insurance as life insurance continues to be a product that needs to be sold not bought.

The purpose for this paper is to provide a brief history of the changes\textsuperscript{4} within the distribution of life insurance in Australia. This includes a summary of the characteristics of different channels and their appropriateness for different market segments, which are factors that should be considered during strategic planning.

This paper is targeted to younger Australian actuaries and others involved in life insurance that may not otherwise be familiar with the historical development of life insurance distribution in Australia. Australian actuaries may also find the comparison with the overseas markets useful.

On the subject of distribution, entire books can be written. Therefore the scope of this paper is limited to providing a high level narrative, a brief history, to set the Australian story in the context of her neighbours and to consider some of the causes/reasons behind the evolution of distribution.

The research methodology adopted for this paper was mainly via interviews with senior executives with significant experience in the distribution of life insurance, supplemented by relevant material I managed to find.

The rest of this paper is structured as follows:
- A brief history of life insurance distribution in Australia
- Commentary on the key channels – i.e. Retail, Group and Direct
- Trends that have driven change in the past and that might drive change in the future
- Opportunities going forward

The value of history must lie in part in its ability to teach us how to avoid past mistakes and how to do things better in the future. To the extent that trends can be observed, they also open themselves to be exploited. This paper will conclude with an exploration of some observed trends and their implications.

The key trends that have been observed are:
- Regulation
- Technology
- The Consumer

The companies that can foresee and take advantage of these changes can potentially stay ahead of the curve and come out the winners.
2. The Distribution of Life Insurance in Australia

The original intention in writing this paper was to describe the history of life insurance over the past 10 years or so. However since a ‘tectonic’ shift in the life insurance industry took place in the early ‘80’s, it was felt worthwhile to begin there.

Like our Asian neighbours, life insurance in Australia to the ‘80’s was distributed via tied agents, a model with origins from the United Kingdom (UK) and the United States of America (USA).

As we look at how this changed over time, it is helpful to keep in perspective broader market changes (for example how products being offered were evolving also) to provide a context.

The premise presented in this paper is that the three most significant forces have helped shape the market are changes or advances in:

- Government regulation (including taxation legislation)
- Technology and
- Consumer attitudes and preferences.

These forces will be explored further in Section 4 of this paper.

2.1 Changes in Product Offerings

The ‘era’ before (pre ‘80’s) was characterized by traditional/conventional products and distribution models, i.e. whole of life (WOL) and Endowment style contracts distributed by tied agencies fully managed by the life insurers of the time. The scene was dominated by the big four mutual – the AMP, National Mutual, Colonial Mutual and City Mutual. (Today of these mutuals only the AMP remains, and it too has demutualized becoming a listed company).

Then in the early ‘80’s a UK company called ‘Occidental Life’ introduced the concept of unbundled products with the slogan ‘Buy term, invest the difference’ – the idea being that doing so gave the policyholder more control over the investment aspect of their policy.

This gave rise (or at least greater prominence) to term insurance products as well as investment account/investment linked products for the savings or investment elements of the policy which were once ‘bundled’ in with the protection in the old WOL/endowment contracts.

This also gave rise to the unit trust industry in Australia and to the rise of a whole range of medium sized life insurance companies such as Australian Eagle who sought to capitalize on these changes in the landscape to gain market share.

In his best-selling book ‘The Tipping Point’, journalist turned author Malcolm Gladwell explored the question of what causes some ideas to really take off (‘tip’) and others not to. His thesis was that tipping points occurred when there was a serendipitous confluence of connectors, salespeople and mavens.

In the same way, I believe the change that took place in the ‘80s occurred because of a confluence of two to three supporting factors which I think may be rather neatly expressed by the following equation:
In other words, the continual desire by customers for greater personalization (which continues to be a force today) intersecting with the innovations by the manufacturer (life insurer) and distributors (agents and advisors) in their attempt to gain competitive advantage gave rise to the changes which would lead to the demise (in Australia) of traditional products and distribution channels.

These changes were only possible because of the technological advances of the day, which enabled the administration of these unbundled contracts.

It is interesting to note that despite having common roots, the subsequent evolution of distribution has turned out differently in Australia from say her Asian neighbours. This may perhaps be attributed to differences in culture, which itself is often shaped by surrounding environmental factors and government regulation.

‘Buy term invest the rest’ did not take root in either the USA nor Asian markets, where more traditional products with their bundled savings elements have continued to dominate. Why is this so? A few possible reasons come to mind:
- The lack of investment choices in Asian markets making the ‘buy term invest the rest’ unattractive as a proposition
- The desire to ‘get something back’ hence the savings component which is probably a cultural aspect.

We will look at the US story in its own section later in this paper.

2.2 Changes in Distribution

Life insurance products used to be sold by tied agents, who were essentially product salespersons ‘tied’ to a product manufacturer. The usual method of remuneration would be a (higher) upfront and a stream of trail commissions (usually lower).

Whilst providing agents with the incentives to sell product, this remuneration structure creates at least two challenges for the product manufacturer:
- Firstly, writing business with up-front commission consumes significant amounts of capital.
- Secondly, high upfront capital also incentivizes the switching of consumers from one company to another (a practice referred to as churning).

The rise of the unit trust industry – and the unbundling of the investment and protection components that were hitherto all bound within the traditional whole of life (WOL) or endowment policies in the ‘80’s – had the effect of requiring agents to provide investment advice also, especially as the number of alternative investment options grew.

The increasing sophistication of their product offering gave rise to the need for more holistic financial advice, not just product information – this played a key part in the growth of the advice industry. The passing of the legislation the Insurance Agents and Broker’s Act (1984) also opened the door for many hitherto tied agents to become multi-agents, which many did.
Similar to the US, groups of these multi-agents banded together to form their own distribution companies, aggregating their sales in order to negotiate better commission terms from the product manufacturer. This has given rise to the existence of these distribution agencies which are still in existence today, with one such being the RI Advice Group, which is one of Australia’s largest and longest established financial advisory groups, with over 200 advisors.

In summary:

**Diagram 1: The Evolution of Distribution in Context**

```
<table>
<thead>
<tr>
<th>PRODUCT CHANGES</th>
<th>'TRADITIONAL' DISTRIBUTION</th>
<th>EMERGENCE OF OTHER CHANNELS</th>
</tr>
</thead>
<tbody>
<tr>
<td>WOL/ Bundled</td>
<td>Unbundled</td>
<td></td>
</tr>
<tr>
<td>Tied Agents</td>
<td>Multi Agents</td>
<td>Financial Advisers</td>
</tr>
<tr>
<td>No advice</td>
<td>Full Advice</td>
<td>Scaled Advice</td>
</tr>
</tbody>
</table>

REGULATORY CHANGE
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### 2.3 Market Participants

It is also worthwhile noting the different parties/stake holders involved in the life insurance market and their different interests:

<table>
<thead>
<tr>
<th>Participant</th>
<th>Interest/Role</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consumers</strong></td>
<td>Provide the demand for insurance and investment products and advice.</td>
</tr>
<tr>
<td><strong>Consumer Protection Groups</strong> – Financial Ombudsman Service (FOS), Superannuation Complaints Tribunal (SCT), Department of Fair Trade</td>
<td>Protect the interests of consumers at an individual level.</td>
</tr>
<tr>
<td><strong>Distributors</strong> – i.e. independent financial advisors, brokers, Internet aggregators</td>
<td>Provide broking and advice (varying degrees) to consumers.</td>
</tr>
<tr>
<td><strong>Government (and Opposition)</strong></td>
<td>Provide policy direction and structure for the industry through legislation.</td>
</tr>
<tr>
<td><strong>Product Manufacturers</strong> (i.e. Insurance companies)</td>
<td>Provide the insurance products and services demanded by the market.</td>
</tr>
<tr>
<td><strong>Professional industry associations</strong> such as the Financial Services Council (FSC)(^{10}) and Financial Planning Association (FPA), Association of Financial Advisers (AFA)</td>
<td>Protect and advance the causes of the various industries represented (i.e. the insurance industry, the financial planning industry etc.)</td>
</tr>
<tr>
<td><strong>Regulator i.e. the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA)</strong></td>
<td>Ensure business is conducted in a sustainable and ethical manner in order to protect the interests of consumers, at a systemic level.</td>
</tr>
<tr>
<td><strong>Reinsurers</strong></td>
<td>Provide support to insurers as a source of risk transfer, capital and product expertise.</td>
</tr>
<tr>
<td><strong>Ratings/Research houses</strong> – for e.g. Plan for Life, SuperRatings, the Heron Partnership, ChantWest and DEXXR.</td>
<td>Provide independent product comparisons.</td>
</tr>
<tr>
<td><strong>Superannuation Funds</strong> – Master Trusts, Industry Funds</td>
<td>Provide services in relation to managing the superannuation funds of Australians - has enabled super-based group insurance.</td>
</tr>
<tr>
<td><strong>Unions</strong></td>
<td>Advocate for minimum insurances for their employee members through industrial relations i.e. Enterprise Bargaining Agreements (EBA’s)</td>
</tr>
<tr>
<td><strong>Workers Compensation</strong></td>
<td>State based public insurance/compensation schemes for work related injuries.</td>
</tr>
</tbody>
</table>

The above is not exhaustive but may be useful in describing some of the key participants.
3. Key Distribution Channels in Australia

In this section we look (briefly) at each of the key distribution channels in operation in Australia today.

The following table presents a snapshot of the market currently and where its expected to be in 15 years time. Based on an expected nominal growth rate of 8.4% p.a., the total risk insurance market is projected to reach $33.6B p.a., compared to $10.0B at 30 June 2011. When adjusted to 2011 dollars, this equates to a real growth of 5.3% p.a. with an annual premium of $21.6B p.a.\(^1\)

<table>
<thead>
<tr>
<th>Market Segment</th>
<th>Today (30/06/11) (SM)</th>
<th>(%)</th>
<th>In 15 years (30/06/2026) (SM)</th>
<th>(%)</th>
<th>Real growth rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Funds</td>
<td>122</td>
<td>1%</td>
<td>204</td>
<td>1%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Corporate Stand Alone</td>
<td>346</td>
<td>3%</td>
<td>807</td>
<td>4%</td>
<td>5.5%</td>
</tr>
<tr>
<td>Industry Funds</td>
<td>1,496</td>
<td>15%</td>
<td>4,008</td>
<td>19%</td>
<td>6.8%</td>
</tr>
<tr>
<td>Public Sector Funds</td>
<td>442</td>
<td>4%</td>
<td>561</td>
<td>3%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Employer Master Trusts</td>
<td>660</td>
<td>7%</td>
<td>1,748</td>
<td>8%</td>
<td>6.7%</td>
</tr>
<tr>
<td>Total Wholesale</td>
<td>3,066</td>
<td>31%</td>
<td>7,328</td>
<td>34%</td>
<td>6%</td>
</tr>
<tr>
<td>Retail</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adviser Superannuation</td>
<td>1,475</td>
<td>15%</td>
<td>1,616</td>
<td>7%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Adviser Non Super</td>
<td>4,552</td>
<td>46%</td>
<td>10,393</td>
<td>48%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Direct</td>
<td>909</td>
<td>9%</td>
<td>2,257</td>
<td>10%</td>
<td>6.2%</td>
</tr>
<tr>
<td>Total Retail</td>
<td>6,937</td>
<td>69%</td>
<td>14,266</td>
<td>66%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Total Market</td>
<td>10,002</td>
<td>100%</td>
<td>21,594</td>
<td>100%</td>
<td>5.3%</td>
</tr>
</tbody>
</table>

The following table sets this out by type of cover\(^2\):

<table>
<thead>
<tr>
<th>Year to 30 June</th>
<th>Term</th>
<th>TPD</th>
<th>Trauma</th>
<th>Income Protection</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>4,844</td>
<td>1,622</td>
<td>866</td>
<td>2,670</td>
<td>10,002</td>
</tr>
<tr>
<td>2026</td>
<td>14,849</td>
<td>5,047</td>
<td>3,646</td>
<td>10,101</td>
<td>33,643</td>
</tr>
<tr>
<td>Growth rate</td>
<td>7.8%</td>
<td>7.9%</td>
<td>10.1%</td>
<td>9.3%</td>
<td>8.4%</td>
</tr>
</tbody>
</table>

3.1 Retail (Intermediated)

The advised or intermediated Retail segment is the largest segment within the Australian market, with a market share of approximately 61% of annual premiums in force largely unchanged from 15 years ago despite the enormous strides the group risk market has taken with the advent of default cover within superannuation.
Within the segment, insurance outside superannuation dominates accounting for approximately 76% of premiums in force.

There are around 12,000 financial advisers in Australia, most of whom belong to one of the two largest associations for financial advisers/planners the Financial Planners Association (FPA) and the Association of Financial Advisors (AFA).

The following table and chart shows the new business written by the top 5 dealer groups in the Independent Financial Advisor (IFA) segment Australia for the 12 months ending 31 December 2011:

<table>
<thead>
<tr>
<th></th>
<th>Lump Sum</th>
<th>Income Protection</th>
<th>Master Trust</th>
<th>Total Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMPFP</td>
<td>17.2</td>
<td>9.2</td>
<td>27.6</td>
<td>53.2</td>
</tr>
<tr>
<td>Millenium3</td>
<td>18.7</td>
<td>11.2</td>
<td>1</td>
<td>30.9</td>
</tr>
<tr>
<td>Garvan</td>
<td>13.3</td>
<td>7.6</td>
<td>4.8</td>
<td>25.5</td>
</tr>
<tr>
<td>PIS</td>
<td>14.7</td>
<td>9</td>
<td>1.6</td>
<td>25.3</td>
</tr>
<tr>
<td>Financial Wisdom</td>
<td>12.6</td>
<td>6.8</td>
<td>1.5</td>
<td>10.9</td>
</tr>
</tbody>
</table>

Source: NMG Risk Distribution Monitor, NMG Consulting, February 2012.

It is interesting to note that whilst these are classified within the IFA space, Millenium3, Garvan FP and Financial Wisdom are owned by the Australia New Zealand Bank (ANZ), National Australia Bank (NAB) and the Commonwealth Bank of Australia (CBA) respectively. Total new sales were $532 million, meaning the top five writers counted for 29% of new sales.

How the Retail space develops over the next few years will be interesting with the latest round of legislative reforms under the Future of Financial Advice (FOFA) banner expected to make a significant impact.

3.2 Group Insurance

After Retail, group insurance is the next largest segment in Australia with approximately $3b in annual premiums. It may be offered either outside superannuation (often as a stand-alone corporate arrangement or linked with a union negotiated enterprise bargaining arrangement (EBA), as part of a retail master trust or an industry superannuation fund.

One of the key differences between group and retail is the ownership of the policy. In retail, the ownership lies with individuals whereas with group, the policy owner is usually the superannuation fund trustees in the case of super arrangements or the employer (for stand-alone corporate arrangements).
The Australian superannuation industry has grown because of government mandated minimum contributions resulting in the creation of an industry with over $1 trillion in funds under management, the largest in Asia and one of the largest around the world.

Whilst group life insurance is certainly not unique to Australia, offering it via superannuation is. Offering compulsory (default) cover within group is also unique (worldwide) and has grown to its current size as it has ridden on the coat tails of government mandated compulsory superannuation.

Whilst the US and UK group markets are larger in total, they are almost entirely composed of employer sponsored arrangements.

The introduction of default cover is the single most important factor that has reduced (and is continuing to reduce) the subsistence level underinsurance gap from $1 trillion in 2005 to around $670 billion today although credit in raising awareness about insurance must also be given to Lifewise, an industry sponsored non-profit group with the charter of raising awareness about the importance of insurance.

Furthermore, the group insurance market in Australia is extremely competitive. In this sense it represents great value for money for the consumer.

One of the themes prevalent today is the blurring of distinction between distribution channels. An easy example of this within the group space might be observed with the increasing ability of superannuation fund members to manage their own insurance arrangements available via their superannuation fund on-line by themselves. Should this be classified as group, or is this direct? Where advisors are involved in group, is it still group or retail?

**3.3 Direct**

The direct channel refers to all forms of non-intermediated selling, such as but not limited to direct mail, TV and the Internet.

Direct mail has been prevalent for a long time, with banks often offering insurance when mailing out credit card or bank statements.

However where this channel has really taken off is in relation to funeral plans which are sold via TV advertising which generates the awareness and demand which is then fulfilled via inbound call centers. Funeral plans have become of late symbolic of a hotly contested market space and representative of a whole range of other direct, non-intermediated approaches.

TAL is a market leader in the direct insurance space and has been since its acquisition of InsuranceLine which was started by South Africans who imported the concept from there. Their success has not gone unnoticed but has drawn others, such as Real Insurance, into the market.

Despite the strong growth of direct and group in recent times, Rice Warner Actuaries in their Risk Projections report 2011 does not anticipate a strong change in the overall mix of business by channel over the next 15 years, where the market is expected to grow by around 8.4% p.a. in real terms.
3.4 Alliances

Apart from superannuation funds, insurers have also formed partnerships and alliances with other organisations offering white-label insurance products.

A noteworthy and recent example of this is the partnership between TAL and Virgin. The Virgin brand proposition worldwide is great customer experience built by excellent customer service. Virgin are well-known for entering into established oligopolistic markets and upsetting the status quo, and irreverently challenging the establishment by offering to give more back to the consumer (shifting the balance of power to the consumer away from the establishment). In Australia, Virgin Money offers life insurance with no underwriting sold via advertising on free-to-air television.

Life insurance is still perceived by a large number of Australians to be unnecessary, or at least not important enough for them to overcome personal inertia. Perhaps it will take a brand like Virgin to shake people up.

3.5 Bancassurance

Bancassurance (in its pure form i.e. sales of products through branches) has not taken off in Australia\(^\text{18}\) with the cultural differences (bank vs. insurer) probably being the biggest issue even though three out of the four largest insurers are bank owned\(^\text{19}\). Australians do not associate going into a bank branch as the place to go for purchasing insurance or for making decisions about their investments – the bank relationship is still primarily very transactional, and about their mortgage (and other forms of debt such as credit cards).

For another example, consider Consumer Credit Insurance (CCI). Although the biggest single liability the average consumer will have is probably their home mortgage and insurance is available for this as Consumer Credit Insurance (CCI), only a small part of the market here. Why does insurance sell better as CCI in some cultures/geographic locales but as ‘life insurance’ in others? There was a time when insurance was sold (in Australia) when the mortgage was written, but issues with third line enforcing brought a change to industry practice.
3.6 Business Mix and Channel Convergence

Bringing this all together, the following table summarizes some of the differences between distribution channels:

<table>
<thead>
<tr>
<th>Market Segment</th>
<th>Retail</th>
<th>Group</th>
<th>Direct</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree of consumer engagement or “touch”</td>
<td>High. Cover is sold after advice is provided. Underwritten.</td>
<td>Low – none. Cover is provided as default. Not underwritten – under Automatic Acceptance Limits.</td>
<td>Medium. Cover is bought after consumer call Call Centre in response to TV advertising.</td>
</tr>
<tr>
<td>Market Segment suited</td>
<td>Self-employed or individuals from higher socio-economic class who have specific tailored needs.</td>
<td>Provides good value for broad-based society.</td>
<td>May be only source of insurance for those with special needs – i.e. funeral plan.</td>
</tr>
<tr>
<td>Policy ownership</td>
<td>Individual</td>
<td>Trustee</td>
<td>Individual</td>
</tr>
<tr>
<td>Capital intensity</td>
<td>High</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Profitability</td>
<td>13.4%</td>
<td>7.6%</td>
<td>13.4%</td>
</tr>
<tr>
<td>Lapse rate</td>
<td>11%-15% p.a.</td>
<td>~15% p.a.</td>
<td>~15% p.a.</td>
</tr>
</tbody>
</table>

Although this section has focused on characteristics of the different channels as though they were mutually exclusive,

there has been an observed trend in channel convergence, with consumers using multiple channels for information gathering through to fulfillment.

Insurers should invest in the ability to have a single customer point of view across these channels and to perhaps incentivize referrals across channels.
4. The Trends/Forces Driving Change

This section aims to highlight and summarize some forces that have shaped the evolution of distribution over the years.

4.1 Historic/Overseas Influences

“No man is an island”²⁰. In the same way, the Australian market had and continues to be influenced from abroad, especially from the USA, UK and South Africa. We owe the tied agency model to the USA. Many products such as whole of life (WOL) and Endowments have come from the UK. Innovations in direct insurance have come from South Africa.

Developments in overseas markets will no doubt continue to have an influence in Australia.

4.2 Regulation

The major pieces of legislation in Australia that have impacted life insurance and its distribution are as follows:

<table>
<thead>
<tr>
<th>Legislation</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Life Insurance Act (1995)</td>
<td>Provides the legal framework for the operation of life insurance companies in Australia, and covers such matters as the registration of Life companies, the powers of APRA in prudential supervision.</td>
</tr>
<tr>
<td>The Insurance Contracts Act (1984)</td>
<td>This act sets out important contractual aspects between the policyholder and the insurer.</td>
</tr>
<tr>
<td>Agents and Brokers Act (1984)</td>
<td>Instrumental in the development of multi-agents from tied agents. By being able to offer products from multiple product providers, agents were able to take a step closer to providing advice (and products) that are in the best interests of their clients.</td>
</tr>
<tr>
<td>Financial Services Reform Act (2001)</td>
<td>Played a key part in upgrading the quality of disclosures required to being made to the public.</td>
</tr>
<tr>
<td>Future of Financial Advice (FOFA)²¹</td>
<td>This proposed legislation, due to be implemented from July 2013, places a best-interest obligation on financial advisors as well as banning conflicted remuneration (commissions)²².</td>
</tr>
</tbody>
</table>
These legislative pieces have provided the legal framework for the establishment and running of life insurance companies and their intermediaries or distribution networks; they are ultimately concerned about protecting the rights and interests of consumers/policyholders.

The primary impact of legislation has been to shape the structure of the life insurance industry. For example, the non-tax deductibility for life insurance as well as the absence of estate taxes are probably among the most significant factors in the level of underinsurance prevalent today. On the flip-side, the rise of the superannuation industry has played a significant role in the growth of the group insurance market here in Australia.

The second domain of legislation has been to protect consumer rights in the sale and purchase of financial products; the FOFA reforms alluded to above fall in this second camp, following on from the Financial Services Reform Act which commenced in March 2002.

The two most significant aspects of FOFA are:
- A best-interests obligation for financial advisors
- A ban on conflicted remuneration.

The ban on conflicted remuneration is effectively a ban on commissions. From July 1 next year, all licensed financial service companies and their representatives will be banned from receiving any benefit that might have influenced financial product advice given to retail clients. The exceptions include life insurance, general insurance and sharebroking services. One win the financial planning industry had in relation to the reforms was the compulsory opt-in requirements. Originally all advisers would have had to obtain their clients' permission every two years to continue to charge a fee for ongoing financial advice.

The opt-in requirement was included, as Bill Shorten put it, "to ensure clients do not pay open-ended ongoing fees while receiving little or no service". As a result of the changes advisers can be exempted from the opt-in provisions if they are bound by a professional code of conduct. The exemption must be in writing and will be issued by the Australian Securities and Investments Commission if it is satisfied that the code of conduct means the opt-in requirement need not apply.

The FOFA regulations will apply to contracts after July 1 next year, effectively creating new-money investors. Anyone who invested before then will need to review their investments, including superannuation, to ensure their returns are not subject to commissions, specifically trailing commissions, which are often embedded in financial products.

Those with old-money investments can either change the investment product they are in after July 1, 2013, or they can change to an adviser now that has always been fee-for-service and will rebate in full the trailing commission.

The important message is people must make the effort to review their investments to see if they need to change.

As in any debate, good arguments can be found and made for either side. However, the point is, the river of distribution is once again coming across some obstacles. If the past can be relied on as a guide, then there is no doubt in my mind the advice industry will successfully adapt and continue to survive. Hopefully so, since these debates are happening against the backdrop of a nation needing advice and still not getting enough of it.

The first key implication for insurers when it comes to regulation is to continue to invest in resources required to keep abreast of and understand the regulatory environment. And secondly, to be nimble and agile enough to be able to respond quickly and effectively to opportunities that open up from time to time due to legislative change.
### 4.3 Technology

As in other industries, advances in technology are having a profound impact on the way insurance is distributed. Three we will look at are:

- The Internet as source of information used in the purchasing decision
- Technology as enabler in simplifying and speeding up underwriting
- Data mining leading to better customer understanding and more targeted direct marketing
- The increasing prominence of social media is dramatically transforming what “word of mouth” means, with increased reputational risk implications for product manufacturers and distributors alike.

Firstly, the availability of information on the Internet via comparator/aggregator websites mean advisors are no longer the gatekeepers to information they perhaps once were.

This is probably a key factor behind the observed trend in channel convergence, with consumers using multiple channels for information gathering through to fulfillment.

Insurers should invest in the ability to have a single customer point of view across these channels and to perhaps incentivize referrals across channels.

This is not to say that advisors no longer have a place to play in today’s tech-dominated world: theirs is still a very valid role in the interpretation and application of the information.

Furthermore, the opportunity for advisors is to provide more sophisticated advice, moving up the value-chain as it were, tailoring and structuring solutions to cater for their client’s needs.

However, the economics of this new environment, especially in an increasingly fee for service environment, will probably mean that advisors will focus on the upper end of the market, leaving the middle to lower markets open to and needing different distribution models to reach them.

The second area technology has played a big part in the distribution of life insurance has been in underwriting which has been one of the traditional barriers to sale (the difficulty in filling in forms, supplying relevant health information and getting medical reports and blood tests where necessary).

Expert on-line paper-less underwriting systems with reflexive questioning have cut down significantly on the paperwork and effort required to get cover – this is a big step in the simplification of (obtaining) insurance for consumers.

Thirdly, the increasing use of data mining is enabling far more efficient targeted direct marketing. The banks with their enormous customer bases, coupled with information on their spending history via their credit cards, are potentially in a strong place to leverage off this.

Other entities with large customer bases, for example health funds and super funds, will probably follow suite as each entity looks to increasingly extract value from their customer bases.

Finally, the dramatic ramp up in the use of social media such as Facebook and Twitter is transforming how people connect with each other and with the companies they will buy from. The incredible power of social media is highlighted by the up and coming float of Facebook which is estimated to value the company from $75 billion to $100 billion given its audience of 800 million users.23
A simple way to understand the impact of social media is to see it as “accelerated word of mouth”. Technology has enabled the conversations that used to be held between individuals to be forwarded to thousands upon thousands of individuals in a very short space in time.

The widespread take-up of online discussions via blogs and forums, including the opportunity for persons reading online news articles to post their comments, provide tangible evidence of the desire of people to connect and be connected.

There are two key implications I see arising out of social media:

- Insurers and distributors need to think about how they can truly connect with their constituents and gain their trust. This may mean thinking more deeply about values and integrating internal values and external behavior – i.e. it’s not going to be just about the product, but “who you are, what you stand for, and do you live out who you say you are.”
- Reputation risk increases dramatically in impact in a social media world.

Insurers and distributors who wish to capitalize on this need to understand that having a social media strategy is not the same as having a digital strategy.

4.4 The consumer

Finally, the third significant factor driving change is the consumer themselves. There are three key factors to consider here:

- Demographic changes
- Increasing importance of trust
- Increasing self determination of Australian consumers

Firstly, changes from a demographic perspective. Some key changes observed are:

- Australia is experiencing above average population growth mainly due to overseas immigration to help meet our labour shortage needs. This represents a growth opportunity for life insurance.
- Counterbalancing this growth is Australia’s aging population which reduces the need for some forms of life insurance (although opening up other needs such as longevity insurance).
- The gender mix of the workforce is also changing with the proportion of females increasing.

Secondly, trust continues to be a pre-requisite for advice or sale for the customer.

In some ways, this has been eroded somewhat by the Global Financial Crisis (GFC) where Australians despite being under advice saw the level of their superannuation decline, for some just about to retire with adverse consequences.

Insurance companies and distributors need to think about how they will regain the trust of Australian consumers.

Finally, there is also an increasing level of sophistication and self-determination amongst consumers. We are a nation that likes to do things ourselves – hence the significance of DIY or “Do It Yourself”, whether it be home renovations or will kits – Australians like to do things themselves.
This has been facilitated by the internet – people able to shop and transact online and even manage their banking and other affairs increasingly online.

Another evidence supporting this trend is the rise of Self Managed Super Funds that make up approximately 30% of market share and expected to increase in the future. In response to this, several industry superannuation funds are investing in the technology to enable members to self-service their insurance – for example with online insurance needs calculators, and the ability to add or change your insurance online.

5. Industry Challenges

The forces and trends making their impact felt do not have an equal impact across all distribution channels.

Group and direct will probably be impacted the least; the channel which will probably face the most challenge in the years ahead are independent financial advisors who are facing a reduction in contestable market due to competitive and consumer pressures.

The competitive pressures will arise as the banks implement vertical integration and Approved Product Listing lockouts to strengthen their market position.

Legislative reform (FOFA) also threatens to challenge traditional advisor remuneration structures and economics causing some to exit the industry.

Pressures from consumers will come from those who either do not need full advice, or are unwilling to pay for this, particularly as superannuation funds begin to provide ‘scaled advice’ to their members.

Consumers’ trust in financial advisors, probably still damaged from the GFC, have resulted in accountants and super funds having a new role to play in the intermediated space.

Efficient, professional businesses that embrace technology and can present a well articulated consumer proposition will be in a position to thrive and win. Those who don’t will fall by the wayside.

6. Conclusion

The life insurance market in Australia is alive and well with levels of underinsurance in Asia (ex Japan) and Australia indicating opportunities for further growth in the years ahead.

Sophisticated and mature, the Australian life insurance market presents numerous challenges for insurers and distributors– to cope, adapt and thrive in rapidly changing market spaces.

The landscape continues to evolve at “warp speed” with the onslaught of regulatory reform, technology and changing consumer dynamics.

To re-cap some key findings and recommendations in order to successfully manage these changes:

- The impact of FOFA will be significant for advisors and super fund trustees.
- Advisors will join professional bodies to avoid opt-in requirements – this should benefit the industry as the skill and reputation of advisors continue to grow.
• However revenue pressures in a post FOFA environment may result in the reduction of advisors. The resulting advice gap will probably be covered partly by an increase in scaled advice provided by superannuation funds to their fund members.
• Super fund trustees will need to become more engaged with insurance as they execute their responsibilities for setting the insurance strategy for their funds.
• The emergence of online insurance product comparators and calculators means consumers are able to self-research and self-service to a much higher degree than before. Some websites even provide the ability for consumers to apply for insurance and be underwritten and accepted online.
• The challenge and opportunity for advisors in this new world is to move up the advice value-chain, providing more sophisticated structuring of advice.
• In a social media savvy world, insurance companies and distributors need

In this environment, the ability to adapt in ever shortening time-spans seems to be a prerequisite to survival (let alone thriving). Manufacturers and distributors that don’t adapt quickly enough are likely to face extinction. Those who cannot produce or distribute efficiently are likely to face consolidation.

Yet for those who can rise to the challenge, opportunity awaits. Exciting times ahead.

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Finally, I would like to acknowledge the support of my family, particularly my wife who endured my long hours doing the research, interviews and writing of this paper.
Appendix 1. The History of Life Insurance Distribution In Other Markets

North America25

The life insurance market in the US still represents the largest market in the world. The Canadian/US story is important because distribution models prevalent in Asia today have their roots based on the USA particularly AIA (USA) and Prudential (UK).

The primary distribution model in the USA used to be the tied agency model26. Agents are recruited out of college and given modest stipends during their training. There tends to be a high drop off rate but if they were still around by year three, they would then typically go on for a long time. This model has been around for a long time, perhaps the ‘20’s or so.

The predominant products sold were WOL. These tended to offer better commissions 80% - 110% of first year premiums as opposed to 35% - 55% for Term.

The ‘80s saw the rise of the independent broker breaking out of the ranks of tied agency forces as they tried to negotiate higher margins for themselves.

Agents formed groups (agencies) as they tried to gain scale for greater negotiating leverage. These would negotiate agreements with a handful of insurance companies, including commission write backs etc.

There was also product differentiation - there was the entry of Preferred Term, Universal Life and Variable Universal Life. Preferred Term = blood tests, underwriting, 5 occupational categories - sharper pricing.

In the UK and Canada, provision of estate tax has been a selling point for insurance. Not sure that this is the case here.

South East Asia (SEA)27

Distribution models in South East Asia (SEA, i.e. excluding China and India) were initially largely modeled off the USA and UK from where the multi-national insurers with a current presence once came.

However, unlike the USA and UK, bancassurance is perhaps the dominant distribution channel in SEA with many successful joint ventures between the large multi-national insurers and banks. Within each country in this region, cultural and regulatory differences shape not only the products offered but how they are sold.

In Hong Kong, one of the most commercialized markets in the world, insurance is marketed aggressively through tele-marketing and bancassurance. There is very little direct mail selling. What is sold are simple, guaranteed issue products with very low sums insured. Agents will concentrate on the more complex and higher underwriting levels of sums insured products.

Further south in Singapore, distribution is still agency driven but bancassurance plays a part, with partnerships between insurers and banks with insurers pay banks a distribution fee for the privilege of accessing their customer networks. Unlike Hong Kong, telemarketing is not as prolific in Singapore due to regulatory constraints which require proper financial needs analysis to be provided over the phone. This regulatory change has also recently come to Hong Kong, thus reducing the effectiveness of telemarketing of life insurance products there.
Perhaps surprisingly, Thailand – though perhaps lagging in product development relative to its Southeast Asian neighbours – is more advanced in its marketing techniques, which is beyond simply product distribution. There are in existence a large number of tied agencies. Unfortunately many of these are not professionally run, with history existing of some absconding with their clients’ money. In such an environment, a bank is often more trusted than a life insurance agent and hence bancassurance distribution flourished.

Life insurance is also sold through direct television advertising, where interested persons are given a phone number to call and then undergo simple underwriting over the phone. Also through bancassurance yet another market is flourishing for credit protection insurance - for borrowers to purchase Mortgage Reducing Term Assurance for their home loans, personal loans and small business loans. This is facilitated through a integrated process through the bank loan officer. Deposit replacement products such as simple endowments are also sold through the bank branches. Third line forcing regulation does not exist in Thailand.

To round off the remaining countries in SEA, Malaysia is, unsurprisingly, not dissimilar to Singapore. The life insurance market in the Philippines is still very small.

The market in Indonesia seems to be moving to Singapore with a growing number of bank/insurer partnerships. There is regulation-mandated credit insurance. However, to avoid issues of third line forcing, banks have to offer three alternatives of insurers.

It is still early days for fledging Vietnam where the agency model predominates. Bancassurance there appears to not be having much success.

**South Africa**

Apart from the US and UK, another geographic region that has impacted the Australian market has been South Africa. Given the number of similarities between the two nations (for example their common colonial heritage), it is perhaps unsurprising that the innovations that have been successful in South Africa should also be successful in Australia.

The South African influence is clearly seen in group insurance and direct insurance.

**South Asia (India)**

Life insurance in India, like the USA, continues to be sold mainly through life agents. What makes the Indian story unique is the fascinating nationalization of life insurance in India in 1956, when by an act of parliament the government operated Life Insurance Corporation was established which absorbed some 154 Indian, 16 foreign and 75 provident societies.

For the government, this provided access to long term funds for the building of essential infrastructure. For insured members, insurance was a form of savings.

In the early ‘90’s, change came as economic woes brought the nation of India to the brink of default. With the help and intervention of the International Monetary Fund (IMF) that resulted in a restructuring of the industry with it being open once again to the private sector. However, to avoid the ghosts of the past, foreign ownership in joint ventures is restricted to a maximum of 26% by legislation.

There are currently approximately 24 players, mostly international majors. Things have re-started reasonably well. Bancassurance plays an important part but, unlike SEA, accounts for
less than 25% of distribution. Examples of bancassurance JV’s include HDFC bank and Standard Life (UK), and Prudential (UK) with ICICI bank.

Joint ventures between large industrials and foreign insurers are notable, with Birla/Sun Life and TATA/AIG being two prominent examples that come to mind.

It was fascinating to learn of the large part-time agency forces that have been recruited as companies in their pursuit of top-line growth have perhaps focused on quantity rather than quality.

This has not been an issue when markets have been performing (given the large volume of unit linked business sold, sometimes with insurance ‘wrap-a-rounds’).

However, following several years of 40%-50% growth, there was a drop in new business of 30% last year amongst the private players.

Unsurprisingly, the industry is experiencing some pain at present as it restructures and adapts itself. Even the product mix being sold is coming full circle. Where once unit-linked products dominated sales (~ 90% to 95%) this has now fallen to ~40% to 45%. The regulator undoubtedly had a hand in that, driving behavior by restricting allowable allowances from certain products.

In developing countries such as India, the rise of micro-finance as a force for positive social change has truly been a good news story. Tagging along the journey has been its cousin – micro-insurance. However, anecdotal reports are that the success that micro-finance has enjoyed are yet to be replicated in micro-insurance, which is still loss making.

**Japan**

The Japanese life insurance market is extremely large and significant with around $20.4 trillion JPY in annual in-force premium ($231 billion). The largest market by far is individual insurance, followed by group, then individual and group annuities.

This has mainly been sold mainly through a tied-agency channel, and unlike say the USA, an agency force of predominantly women.

**UK/Europe/China**

Regrettably, due to time constraints, we weren’t able to look into these markets. We hope to do so in an update to this paper.
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End Notes

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3 Rice Warner Actuaries Underinsurance Report 2011 is a useful report for those seeking more information.
4 A presentation entitled “Widening the Distribution Channel” prepared by James Hickey and Eric McNamara was given at the 2006 Financial Services Forum organized by the Institute of Actuaries of Australia but it did not cover the historical development as this paper does.
5 Information in this section was kindly provided by interviews with Terry Bell, Owner, Business Health Pty Ltd and Geoff Black, CEO Investments, TAL Life Limited.
6 National Mutual was eventually purchased by AXA, which itself was recently purchased by AMP. Colonial Mutual is now owned by the Commonwealth Bank of Australia (CBA) and City Mutual purchased initially by MLC, which is now owned by the National Australia Bank (NAB).
7 Wikipedia attributes this concept to Arthur L. Williams, an American life insurance agent who eventually went on to found Primerica, one of the largest life insurance distribution companies in the US with around 2,000 employees and a market capitalization of USD1.7 billion.
9 Started in 1979 as RetireInvest, the RI Advice Group is now wholly owned by the ANZ Bank.
10 formerly the Investment and Financial Services Association (or IFSA).
12 Risk Market Projections, RWA, 2011, page 46
13 Statistics from Risk Distribution Monitor published by NMG Consulting, February 2012.
14 CALPERS in the US offers group health insurance but not life insurance.
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16 www.lifewise.org.au
17 Helpful information is contained within the Rice Warner Actuaries Direct Insurance Report 2011. Research for this section was also provided via an interview with Frank Dyer, Direct and Alliances, TAL Life Limited.
18 Only in the pure sense of branch sales as the largest insurers are bank-owned.
Australia’s “big four” banks all have an exposure to life insurance through the acquisition of an insurer/wealth manager, (Westpac/BT Life, CBA/CommInsure, NAB/MLC and ANZ/One Path).

At the time of writing is still a Bill of parliament.


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