

Risk insurance – the \$7 billion market

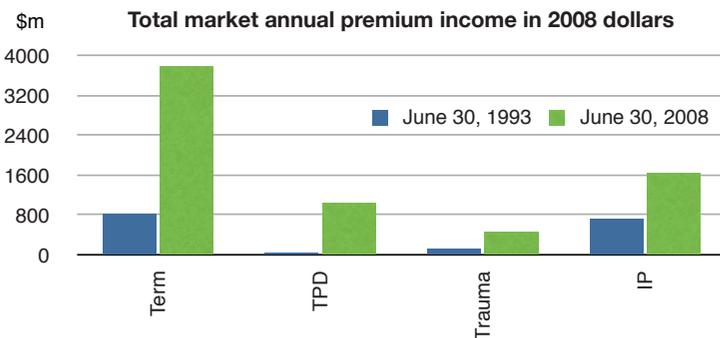
Richard Weatherhead assesses the outlook for Australia's risk insurance market

The global financial crisis has focused the public attention on financial security with many retirement plans being thrown into chaos, or at least put on hold, as retirement savings have seemingly evaporated over the past year.

In economic downturns, people turn their attention to the need for risk insurance cover – life, disability and trauma benefits. For many financial advisers, with clients unwilling to commit substantial additional funds to superannuation, risk insurance has been a key focus for maintaining and developing client relationships. Insurance needs often increase as overall wealth reduces.

SIZE OF MARKET

The chart below compares the annual premium income in the risk insurance market in 1993 and 2008. All the figures are expressed in 2008 dollars to remove the impact of inflation.



Source: Rice Warner Actuaries

The overall risk insurance market in Australia has grown by 9.6 per cent per annum in real terms over the past 15 years and is expected to grow by 6.2 per cent per annum in real terms, or 9.4 per cent per annum in nominal terms over the next 15 years.

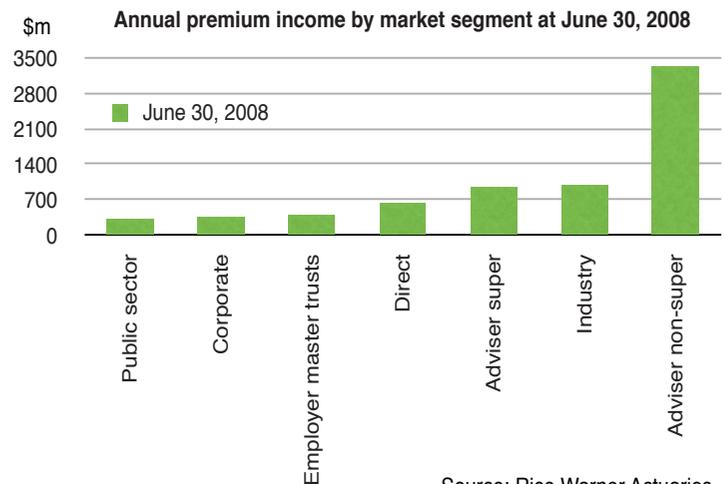
The chart below shows the breakdown of the current market by segment.

Wholesale business - which includes risk insurance sold within industry funds, employer master trusts, stand-alone corporate superannuation funds and public sector superannuation funds - has grown dramatically, in line with the growth of superannuation itself. The introduction of default insurance and its gradual increase over the years has extended cover to virtually all members of superannuation funds, at least while they are actively making contributions.

Conversely, trauma cover is not available within superannuation and only a few funds have default income protection (or salary continuance) cover.

Growth in the retail sector has also been driven by the growth of superannuation, particularly for the self-employed and those working for small businesses. However, it has also been driven by the shift from packaged investment and risk products, common in the 1970s and 1980s, to unbundled products - with risk sold in its own right, supported by comprehensive financial needs analysis by advisers and product designs that have the flexibility to be tailored to meet specific client needs.

In the past few years, we have seen a growth in direct sales using a variety of media including print, web and call centres. These sales are usually generated from existing customers and are often linked to other products. For example, selling life insurance together with home mortgages.



Source: Rice Warner Actuaries

PRODUCT TRENDS

There is now a wide range of different definitions of total and permanent disablement; guaranteed insurability for future increases on cover; automatic indexation of cover; and cover for an ever-increasing range of trauma events, with a trend towards severity-based cover levels.

Continuation options - enabling clients to maintain cover as they move from one provider to another or one superannuation fund to another - are now almost universal in the retail sector and are becoming more common in

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industry superannuation funds. In the income protection market, although overall growth has been lower than for other products, some growth has also resulted from price increases, reflecting underpricing of risk in the late 1980s and early 1990s and subsequent price corrections.

Competition has intensified significantly over the years, particularly in the wholesale market where the buying power of the large superannuation funds has enabled them to secure significant price reductions combined with benefit improvements. The benefits of risk pooling within superannuation funds that have large numbers of members have enabled significant levels of cover to be provided without underwriting. In the retail sector, competition has driven price reductions for death and total and permanent disability business.

Change in price for \$500,000 cover over 10 years – male non-smoker

IP outside super	Change in price 1999 to 2009
Death cover	-3.7%
Death and TPD cover	-6.0%
Trauma cover	+7.4%

However, even allowing for improvements in benefits and features, the cost of trauma cover has increased, primarily as a result of higher claim costs.

Insurers have invested heavily in streamlining the underwriting process, and innovations such as initial periods of accident-only cover and pre-existing conditions exclusions have been used to enable products to be offered without any underwriting. These products have often been designed for direct distribution but have also become common, either with or without advice, in the mortgage and loan markets where risk insurance is sold to pay off the loan if the borrower dies.

The management of risk insurance business within adviser practices has been transformed over recent years. The FSR requirement for formal financial needs analysis and a Statement of Advice have added great complexity, even when the need is relatively simple to establish. However, back office processes have been streamlined significantly through the introduction of electronic quotation

systems, product comparators such as ProPlanner and COIN, electronic application forms and, more recently, automatic underwriting, with clients in full health being accepted on the spot.

Client relationship management has become more efficient with the widespread use of customer relationship management (CRM) tools, both in-house and via on-line access to insurer records and CRM systems. Advisers have been able to reduce their paperwork significantly with many transactions becoming virtually paperless.

THE FUTURE

The drive towards automation will continue and intense price competition will continue. However, the key points of differentiation are likely to be in distribution and service. Advisers will increasingly develop tiered services for their clients, including limited advice to those with relatively simple and homogeneous needs, supported by simple, relatively low-featured products.

For the more complex circumstances, tailoring of products to individual needs will increasingly become a value adding service provided by advisers and a point of differentiation between insurers. This happens today through tailoring of financial advice and the selection of products and options and the introduction of “lifestyle” products where the components of cover change with age, marital status and family circumstances.

However, ultimately the current standard product with multiple options could be replaced by individually tailored products for each client, supported by tailored product disclosure, recognising the client’s unique personal and family circumstances. This personalised offer, supported by a personalised and streamlined PDS and marketing material, will enable advisers to demonstrate more clearly the value they add through recommending the particular tailored product most suitable for their clients – and to deliver it in a simpler form.

The debate about commissions versus fee for service has grown louder in recent weeks with the announcement of a parliamentary inquiry into financial products and services, which will look at

the role of financial advisers, the general regulatory environment and the role played by commission arrangements.

Barring any legislative change in this area, there is likely to be a shift towards fee for service in the risk insurance market, but there will continue to be a mix of charging methods. We expect a continuing shift from upfront to ongoing commission to align with the servicing of clients. The needs of many clients with relatively simple insurance needs will be met more efficiently with the support of technology so that costs can remain low while standards of advice remain high. Web-based “insurance needs” calculators will have an increasing role in this area of the market. Automatic underwriting will become the norm.

Competition from industry funds and employer master trust providers will intensify. Unless the legislation or tax rules change, we can expect a further shift towards risk insurance within superannuation.

The costs of advice through those channels will increase so that well-managed and professional advisers and dealer groups will still be able to compete effectively based on the quality of their advice, their ability to advise on complex family and business risks and the ancillary services they can provide, either directly or indirectly, such as accounting, legal and tax advice.

Underinsurance remains a significant issue in the Australian market. For example, the average level of death cover across the working population currently represents about 2.9 years’ earnings compared with a reasonable benchmark of around 10 years’ earnings. Even with expected growth over the next 15 years, the level of cover will only reach around 5.2 years’ earnings, so the risk insurance market is nowhere near saturated and will not become so over the next 15 years.

For advisers with the right business processes and marketing and distribution strategies, the opportunities in the risk insurance market remain considerable. ■

Richard Weatherhead is a director of Rice Warner Actuaries.



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We're all in this together

Emma Grainge explains an industry campaign aimed at addressing Australians' woeful underinsurance

Most of us wouldn't think twice about getting the right level of motor insurance to ensure we could repair or replace our car in the event of an accident. Yet too few people ensure they have the right level of cover to replace their income (arguably their greatest asset) in the event of the same accident. Surely Australians value their ability to earn an income more than their car?

This is the conundrum at the heart of Lifewise, an industry campaign that hopes to reduce the personal, social and economic costs associated with the fact that a majority of Australians are significantly exposed to financial hardship in the event of accident, sickness or death.

Picture this: Tim enjoyed the boom times. He really stretched his finances and took out a large mortgage to purchase a family home that is now worth 15 per cent less than it was three years ago. A car accident means that he needs to take six to 12 months off work to focus on treatment and recovery. There's no equity in the home to fund the time he needs off and the value of his small investment portfolio has also fallen significantly. He has life cover and income protection cover in his corporate super fund, but only at the default levels. While this provides some support, it leaves a significant shortfall which means he, and his family, must make significant adjustments to their lifestyle at great personal cost.

Unfortunately, this scenario is all too common. The 2005-2006 Australian Institute of Health & Welfare report into serious land transport accidents showed that more than 17,000 men were seriously injured in a road accident in that year.

Research commissioned by the Investment and Financial Services Association (IFSA) in 2005 found that 60 per cent of Australians with dependents do not have enough life insurance cover

'Cost is often cited as a barrier - and undoubtedly some household budgets are stretched'

to replace their income for more than 12 months. Research by the Australian Institute of Superannuation Trustees (AIST) and Industry Funds Forum (IFF) in 2008 revealed that one in two super fund members have significantly less death cover than they need and three in four have significantly less total and permanent disability (TPD) cover.

That's not to say super funds haven't been making a valuable contribution to address this issue - they have. Many funds have increased the level of cover automatically provided to their members and are actively promoting the value of this benefit. Increasing the default cover is a move very much supported, but in reality the only way someone can ensure they have adequate protection from financial hardship is to take an active interest in the issue, consider their own risks and how they should manage those risks.

Not having the right level of cover means that many Australians are facing severe financial difficulty while also dealing with the emotional and physical stress associated with having an accident, becoming sick or losing a loved one. Having the right level of cover gives people the financial free-

dom to focus on what's important - their health, lifestyle or the family.

SHE'LL BE RIGHT, MATE

In good times, Australians' trademark optimism makes it easy for people to ignore life's risks. Research conducted by AXA in 2007 compared how the citizens of 11 countries view various risks. It revealed that Australians were among the least likely to consider they'll have an accident in the work place, have a serious car accident or suffer from a serious illness.

Similar research conducted by ING in 2008 showed that only 20 per cent of Australians aged 25 to 65 think they're likely to have a serious illness in the next 20 years. The reality is around 77 per cent of Australians will be diagnosed with a serious illness in their working lives. Worryingly, two-thirds of Australians surveyed by ING said they had "a plan" in the event of major misfortune, but most of these arrangements relied on global economic prosperity.

While this optimism undoubtedly serves us well in some aspects of our lives, the ING research shows it can mean we ignore risks that can be easily managed - either through having adequate savings or the right levels of insurance cover.

Cost is often cited as a barrier for many people - and undoubtedly some household budgets are stretched. However, the perception that life insurance is prohibitively expensive is in many cases untrue, especially when compared to other types of insurance.

According to AXA, a 40-year-old, non-smoking male can take out \$500,000 of life insurance for \$7.85 a week and for a female it is only \$6.36. For a home valued at \$600,000, insurance can cost between \$17.30 and \$24.00 per week while insuring

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Emma Grainge

a standard new vehicle costs between \$12.10 and \$26.90 per week.

But it's not just apathy, cost concerns and misplaced optimism that prevent Australians from approaching life insurance as just another one of those financial decisions you need to make. The industry recognises it has much to do to improve the customer experience and demonstrate the value of insurance.

Life insurers acknowledge that product complexity, and approval times and processes have been an issue and many companies have invested considerably in simplifying products and implementing new technologies. With the industry paying out more than \$6 million every day in claims, more could certainly be done to explain the improvements the industry has made and the value the industry gives back.

Having identified the issue in 2005, superannuation funds, insurers and planners have already done much to improve the situation for Australians. But a co-ordinated effort is required if we're going to shift Australians' attitudes towards the

life risks they face and the various ways they can protect themselves.

Through the Lifewise website, Australians will be able to access general information that will help them feel confident approaching life insurance decisions in the same way they do other insurance matters. The website will have user-friendly tools, such as a basic insurance needs calculator, Q&A, budget planner, testimonials and case studies. It is hoped that this information will enable them to feel comfortable assessing their risks and thinking about how to manage them.

Lifewise is being coordinated by IFSA and has first-year funding via special contributions made by IFSA's life insurance and reinsurance members. Lifewise will be supported and used by many in the industry community – insurers, superannuation funds and advisers. Lifewise will also be developing partnerships in the broader community via the media and community groups.

To be officially launched at a luncheon in Sydney on May 1, 2009, the campaign will start with a website and "how much is enough" calculator to

educate consumers about the risks they face, how they can protect themselves and how much protection is likely to be required, along with estimated costs.

Financial planners are encouraged to use the site and consumer tools to educate clients about how life insurance works and the benefits.

Through Lifewise we hope that all Australians will get wise on life insurance and make sure they have the right level of insurance cover. Not only will this give them peace of mind now, it will secure their long-term financial wellbeing, no matter what life throws their way. ■

The life insurance industry launches Lifewise on May 1, 2009, to encourage Australians to make conscious and informed decisions about their life insurance needs. To attend the launch, register at the IFSA website: www.ifsa.com.au

Emma Grainge is IFSA's senior policy manager.



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We deliver where it matters to you and are proud to announce the launch of Zurich LifeXpress. This software delivers a streamlined end-to-end new business solution for life risk. Quotations are now fast and easy. The LifeXpress advanced application and automated underwriting system provides flexible data entry and delivers underwriting decisions to your desktop. You'll spend less time on admin and more time with your clients. To find out more, talk to your Zurich risk specialist BDM or visit www.zurich.com.au/zurichupdates. **Here to help your world.**



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