Australia: Market overview 2015

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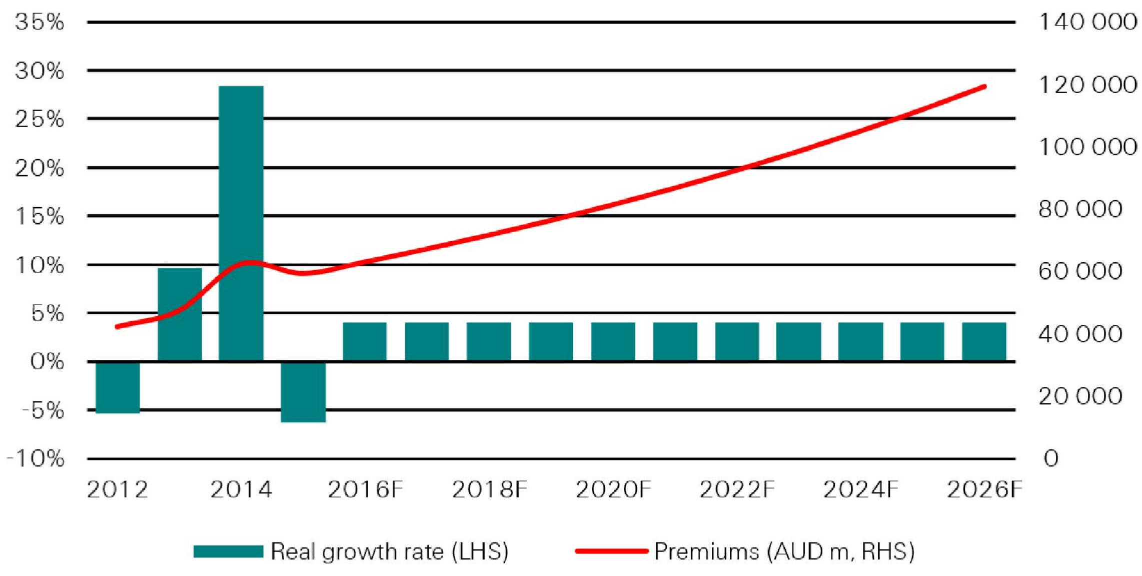
Overview

Total premiums written by Australian life insurers decreased by 4.9% in the first six months of 2015, mainly due to a double-digit decline in investment-linked business amidst slowing GDP growth and rising financial volatility, according to data from Australian Prudential Regulation Authority (APRA). The non-investment linked life insurance business continues to report solid growth, with inforce premiums projected to grow by 5.6% to AUD 15.7 billion in 2015.

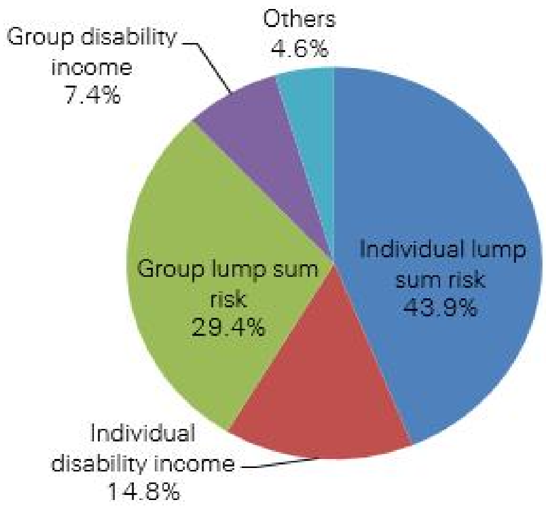
With a much anticipated improvement in Australian economic performance in 2016, growth in both inforce and new business premiums is expected. Overall, life premiums are projected to grow by a real 4% in 2016, and growth will average around 4% per annum between 2016 and 2026. There are some challenges to this forecast, however, primarily in the form of the jobless rate (remains high on an ongoing basis) and the limitations on household budgets – both of which may contribute to increased lapse rates and affordability concerns by life insurance purchasers.

Life Insurance Premiums Australia



Source: Australian Prudential Regulation Authority, Swiss Re Economic Research & Consulting

Australia Life Insurance Risk Premiums by lines of business, 2015*



Note: * Twelve months ending June 2015
Source: Australian Prudential Regulation Authority, Swiss Re ER&C.

While life insurance inforce business continued to experience solid growth overall in the first six months of 2015, major insurers reported substantially lower new business for the group sector. Group premium rates were raised sharply due to poor claims experience for total and permanent disability (TPD) and income protection products. In 2014, rates for death, TPD and income protection products increased by 15%, 26% and 19% respectively, on average, according to Rice Warner. Insurers also tightened the eligibility criteria and related benefits under death and disability policies. The increasing awareness of TPD benefits and the changing community attitudes to mental health led to a higher prevalence of stress-related illness claims.

The life industry reported an after-tax profit of AUD 1.6 billion in the first six months of 2015, up 26% from the same year-earlier period, after the aggressive pricing in 2014. In 2015, major insurers further raised rates of income protection products by about 5-10%. Profitability in individual disability segment improved sharply then dropped sharply again in Q3.

Group insurance

The group risk channel represents more than AUD 6 billion of annual premium, or close to 40% of the Australian life insurance market.

The group channel is made up of three key segments – industry/super funds (dominant share), master trusts and corporate – all providing life cover, TPD and income protection benefits.

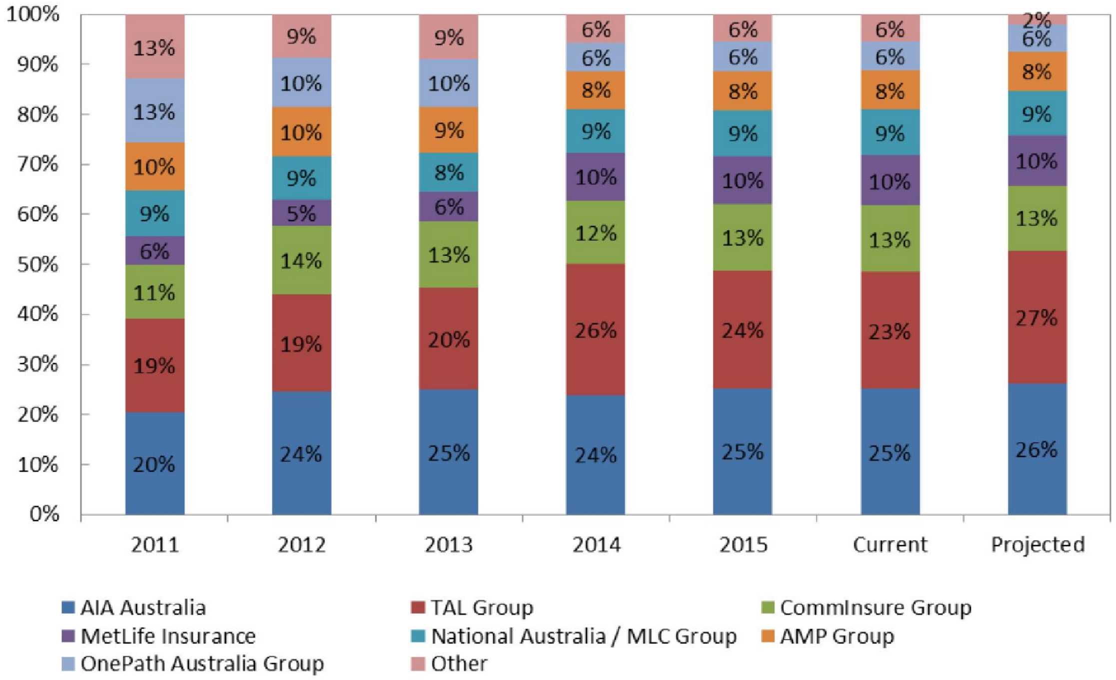
- **Industry funds (super)** – large default arrangements typically catering for employees from particular industries. This channel represents 67% of the Australian group risk market.

- **Master trusts (super)** – tailored arrangements targeting employers through intermediaries (financial brokers/advisers). This channel represents 19% of the Australian group risk market.

•	**Corporate standalone (super and non-super)** – employee benefit arrangements driven from the employer, heavily tailored for the needs of the respective workforce. This channel represents 14% of the Australian group risk market.

While new business growth is slowing, inforce premiums are projected to rise by 15% across the market in 2015, mainly driven by industry funds significantly increasing premiums in response to a market-wide deterioration in claims experience. Going forward, organic growth of inforce policies will be the primary growth driver, with increases in real wages and default cover levels driving up premium revenue.

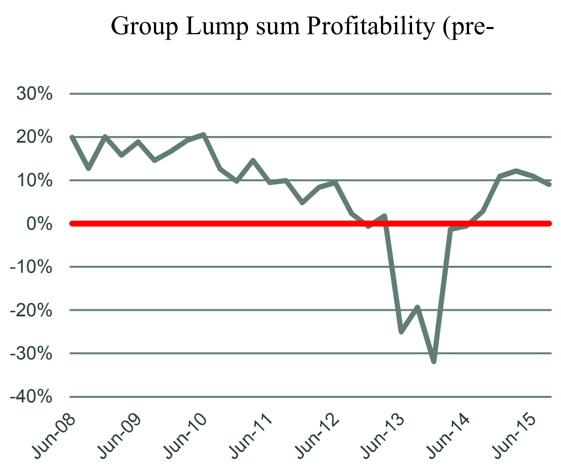
Group Insurance Market Share Distribution

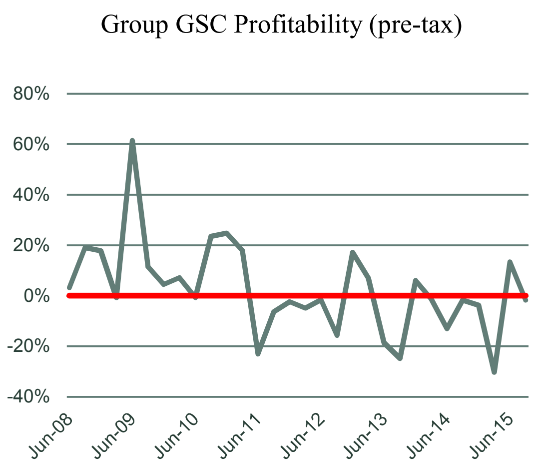


Source: Plan For Life Jun 2015

The challenges around profitability of the Australian group risk market are well documented and although progress has been made to address the underlying causes (heightened member awareness, mispricing, product design, claims management), to return the segment to acceptable profitability levels, this remains a key focus for all market stakeholders.

While the impact of recent premium increases is starting to address profitability issues, premium rates are likely to continue to rise driven by respective fund TPD and group salary continuance (GSC) experience (albeit not as significant as previous two years). There are still signs of experience deterioration (TPD and GSC), particularly in the industry fund segment.





Source: Australian Prudential Regulation Authority Quarterly Financial Results 2008 - 2015

The focus on product design also continues, particularly around sustainability, with product tightening occurring across key eligibility conditions, features and disability definitions. Lower automatic acceptance (AAL) levels and tighter entry criteria for rollovers and guarantee insurability options are consistent trends across insurer propositions. TPD has undergone a significant metamorphosis with a progressive move away from 'unlikely to be able to' to 'unable to' definitions with mandatory rehabilitation requirements.

A growing focus for fund trustees is the affordability of insurance within the respective funds. The concern (shared by the regulator) is the negative impact recent premium increases is having on member superannuation balances (a deterioration in retirement savings). To combat this impact, funds are now contemplating simplified product options to provide a lower price point to the existing offerings.

The trend of increased member awareness of benefits coupled with lawyer involvement continues, placing pressure on the claims management process and experience of insurers and superannuation funds. Insurers and funds continue to invest in their claims management capability to ensure more efficient process with a greater focus on technology.

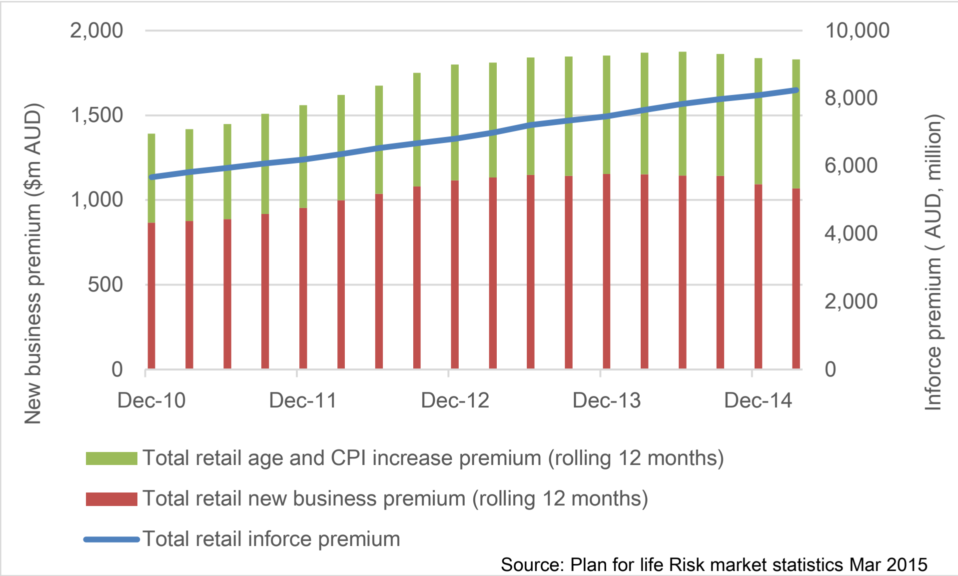
While an appetite for growth still exists, it does so on a selective basis. Most insurers and reinsurers are still adopting a cautious new business approach, focused on sustainable margins. However, there are signs of increasing competition and aggressive acquisition of low risk schemes as overall profitability improves in the market (with pricing levels and designs more sustainable). Some fund consolidation is expected in the coming period, and with select insurers' exit from the group risk segment there will be a number of new business opportunities for those remaining insurers to seize.

Retail

Retail business in Australia is generated through the sale of individual insurance products via intermediaries, the latter taking many different business models from vertically integrated, tied, aligned and IFA with many permutations of each.

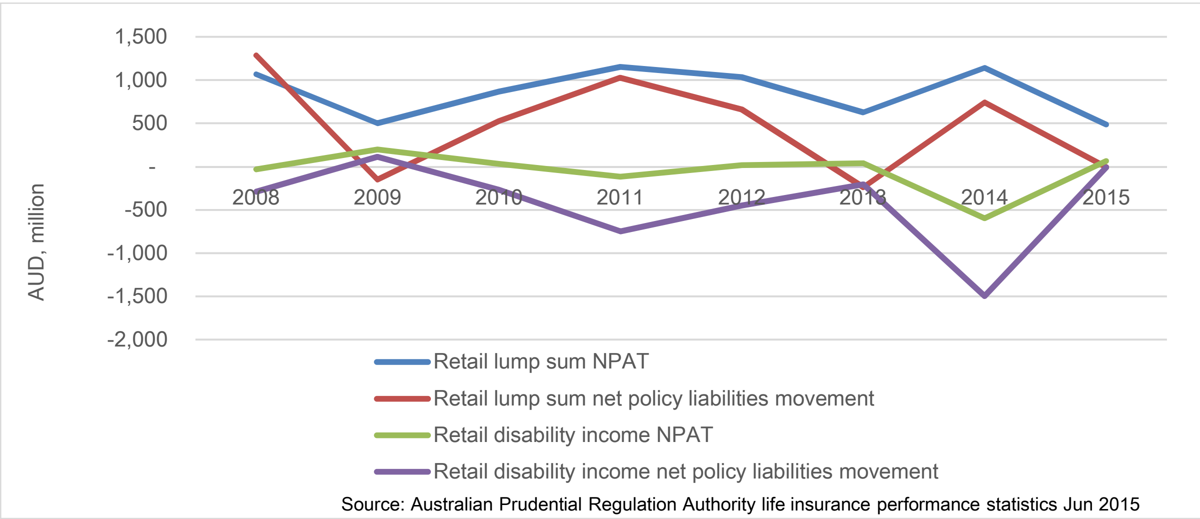
The halcyon days of 2010-2013, where retail new business grew more than 10% year on year, are now a distant memory, with retail insurers reporting negative annual growth for the past four quarters (March 2014 to March 2015). Despite declines in new business growth, the actual volume of new business during this period remained relatively stable and combined with the steady growth in CPI/age increases (indication of persistency improvements, as greater number of policies are continuing beyond policy anniversary), retail market inforce premium recorded annual growth rate of around 9%.

Australian retail market performance 2010 - 2014



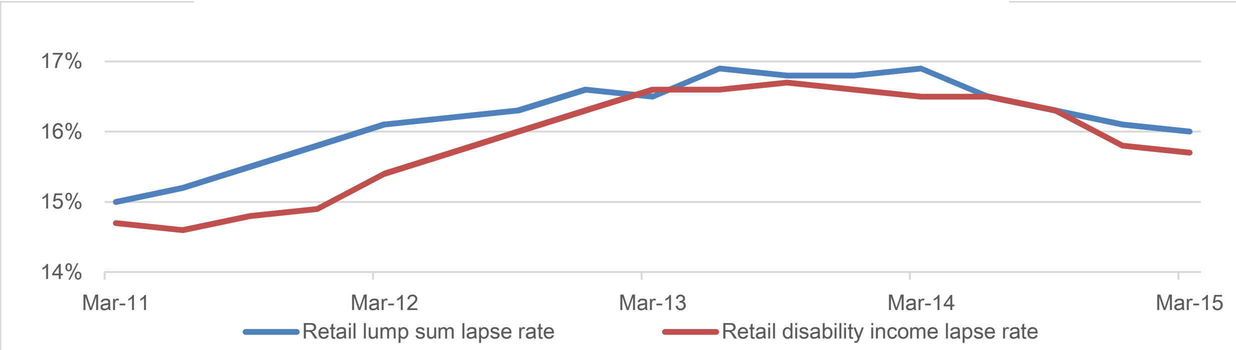
The profitability of retail life insurers has been somewhat volatile in recent years. Since reporting significant profit in 2011, aided by the release of lump sum reserves relating to improvements in mortality experience, both lump sum and disability products have reported deterioration in lapse and claims experience driving a 36.8% decline in industry profits between 2012 and 2013.

Australian retail market profitability and reserve movements



The recent adjustments to experience assumptions and fluctuation in profits have led to industry experts questioning the sustainability of the retail life insurance market. In response to these questions, insurers have marshalled resources to focus on creating a more sustainable retail channel deferring investment away product innovation to instead focus on pricing adjustments, claims management, sustainable advice models and a concerted effort to enhance retention initiatives. The introduction of initiatives such as welcome calls, cancellation follow up calls, review of customer communications (wording, frequency, medium) and improved flexibility and system capabilities for policy alterations are becoming standard for all retail insurers.

Australian retail market lapsation



Source: Plan For Life Jun 2015

Retail product design is somewhat homogenous with four key benefits – life, CI, TPD and IP – being broadly undifferentiated and commoditised in the eyes of distribution. That said, there are many subtle differences in benefits and diverse pricing strategies at play from the insurers. This has led to distribution abdicating product search and selection to product comparison software providers whose rating methodologies can significantly impact the success or failure of a retail insurer's proposition.

As market conditions soften and the impact from regulatory changes take effect, bank owned insurers are increasingly interested and willing to develop simplified retail products to stimulate lacklustre new business volumes. This development is still in its infancy and insurers have indicated the need for reinsurer assistance in data extraction, data analytics, proposition design and project management, to ensure this development is successful.

Direct

The direct insurance channel represents 10% the Australian life insurance market, with zero/modest growth forecast over the next five years, coming mainly from age and CPI increases. Average market lapse rates continue to sit higher than other market segments at approximately 31%. Though lapse rates are influenced by sales channel and method, with outbound telesales and direct marketing (DM) mail outs reporting lapse rates in the region of 45-50% in year one. With minimal growth, a much greater focus on retention and protecting inforce is anticipated.

The Australian direct channel distributes similar propositions as the retail channel, with the addition of funeral plans (30% of all new business) though insurers and distributors are awakening to the need for more innovation if they are to achieve any success in the direct channel moving forward.

Direct distribution is still heavily focused on direct response television marketing with very few insurers delivering a compelling online proposition. General insurers such as Suncorp are currently providing online transacting for their GI products and will foreseeably make the leap to the same for their life propositions as the customer acquisition cost continues to challenge profitability of the direct channel.

Moving into 2016 and beyond, the key focus areas for direct are centred on retention of inforce, creating a sustainable direct business model under new regulations and perhaps most crucially – innovating new propositions that meet identified consumer needs

Regulatory developments

The final report of the Financial System Inquiry (FSI) was released in December 2014, with consultation on the recommendations concluding in 31 March 2015. It contained 44 recommendations on matters such as amending and restricting upfront insurance commissions, improving operating efficiency in superannuation, transparency on the ownership structure of financial planning licenses, and monitoring how financial regulators have implemented their mandates. On 25 June 2015, the Australian Government gave its response to FSI recommendations and supported a majority of the proposals.

The Life Insurance Framework released by then Assistant Treasurer Josh Frydenberg (and as subsequently amended) follows a controversial debate surrounding the release of ASIC's Review of Retail Life Insurance Advice (ASIC Report 413) in October 2014, and the subsequent recommendations handed down by John Trowbridge earlier this year, in response to that report.

The framework provides a 14-point plan that addresses:

- Adviser and licensee remuneration.
- Transitional arrangements.
- Quality of advice and insurer practices.
- Better enforcement and monitoring.
- Industry efficiency.

Life Insurance Framework Changes – Effective 1 July 2016
Maximum upfront commission of 60% of first year premium from 2018
Maximum ongoing commission of 20% of annual premium from 2016
Transition arrangement for commission: • Maximum upfront commission of 80% of first year premium from 2016 • Maximum upfront commission of 70% of first year premium from 2017 • Maximum upfront commission of 60% of first year premium from 2018
Two-year clawback period on first year commission from 2016: • 100% of first year commission in year 1 • 60% of first year commission in year 2
Ban on volume based payment from July 2016
Life insurers to provide fee for service products
Increasing AFSL's approval product list
Introduce code of conduct from July 2016
Ongoing reporting of policy replacement data to ASIC from 2016
Government to review these measures in 2018
ASIC to review and consider simplifying disclosure requirements
Government to consider developing mechanism to rationalise legacy product (as outlined in FSI)

Although supported by most insurers, the framework has been the centre of considerable intermediary lobbying and debate, with many needing to significantly adjust their business model in order to operate within the new remuneration terms. Much discussion continues oscillating between the negative – predicting an industry dominated by aligned advisers, the emergence of 'The

Great Last Churn' before the changes are effected in 2016, decreases to new business volumes, and selective lapsation, through to the more positive – increased consumer trust, a raising of professional standards, adviser business models that create better economic value. While distribution grapples with how to organise itself prior to 1 July 2016, major insurers are already announcing premium freeze guarantees and other enhanced benefits to comfort advisers that they are willing to support them through their transition to the world of a longer clawback period and hybrid commission.

Adjustment to regulatory changes such as the Future of Financial Advice (FoFA) and Stronger Super reforms remain a key area of focus as life insurers are becoming increasingly integrated with financial/wealth management businesses.

Spotlight: The wellness race is on

Although wellness related insurance propositions are not brand new to Australia (AIA introduced Vitality to Australia around two years ago) the level of insurer interest has noticeably increased over the past six months whereby now almost all major insurers are contemplating wellness-related proposition benefits for one or more of their target channels.

Two recent launches showcase the application of wellness in an insurance proposition in two different channels – retail and direct.

MLC On Track, launched on 23 November 2015, provides qualifying new customers with a Basis Peak wearable device (also a watch). Manufactured by Intel and used widely in the US healthcare system by clinicians, the device provides MLC with 72,000 wellness-related data points per day on each policyholder. The customer engagement strategy encourages the customer to achieve a target wellness score by taking a minimum number of steps, wearing the watch for a minimum number of hours, getting a number of hours of sleep and maintaining a healthy resting heart rate. If they achieve their target wellness score they receive a 10% premium discount guaranteed over the life of the policy. The wellness proposition is part of the overall retail product range manufactured by MLC and sold through their extensive intermediated distribution network.

The launch was picked up by Australian media with television coverage *Seven Network*'s evening news available here:

https://lnkd.in/b6qJH2S

Just two days later, Qantas announced the launch of Qantas Assure, a new financial services vertical for the Qantas Loyalty business (a subsidiary of the Qantas group).

Leveraging the asset that is a ten million strong Qantas loyalty membership base, Qantas Assure has teamed up with local medical insurer NIB to develop a medical insurance proposition centred on wellness. In exchange for purchasing the Qantas Assure medical insurance product and providing wellness data, Qantas will reward the customer with frequent flyer points. While details around the type, frequency and means of supplying the wellness data are not yet clear, the strength of the Qantas brand coupled with the desirability of the frequent flyer points suggests this will be a new distribution force to watch.

While these are the two newest propositions to hit the Australian market, the feverous levels of conversation around wellness, wearables, health data and insurance continues and will inevitably result in further launches in 2016 and beyond.

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Protection Review