



Institute of Actuaries of Australia

4th Financial Services Forum

Innovation in Financial Markets

19 and 20 May 2008 – Melbourne

4th Financial Services Conference

Value of a GI Business in a Financial Services Business

**Presentation by Andy Cohen and
Estelle Pearson
20 May 2008**



Today's presentation

- The GI Value Chain
- Relevant GI Products and Overview of Market
- Business Models Available
- Assessing the Opportunity



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Why are we here?



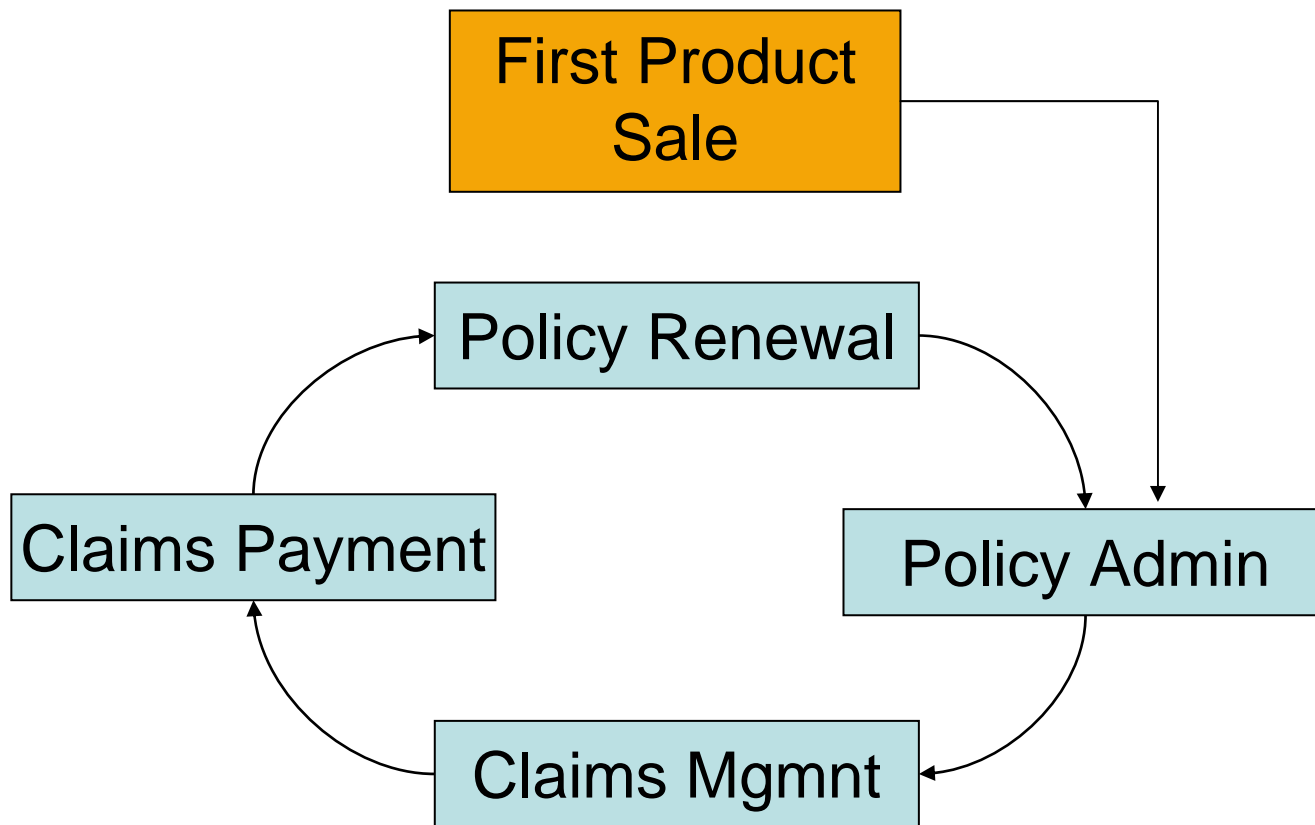
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The GI value chain

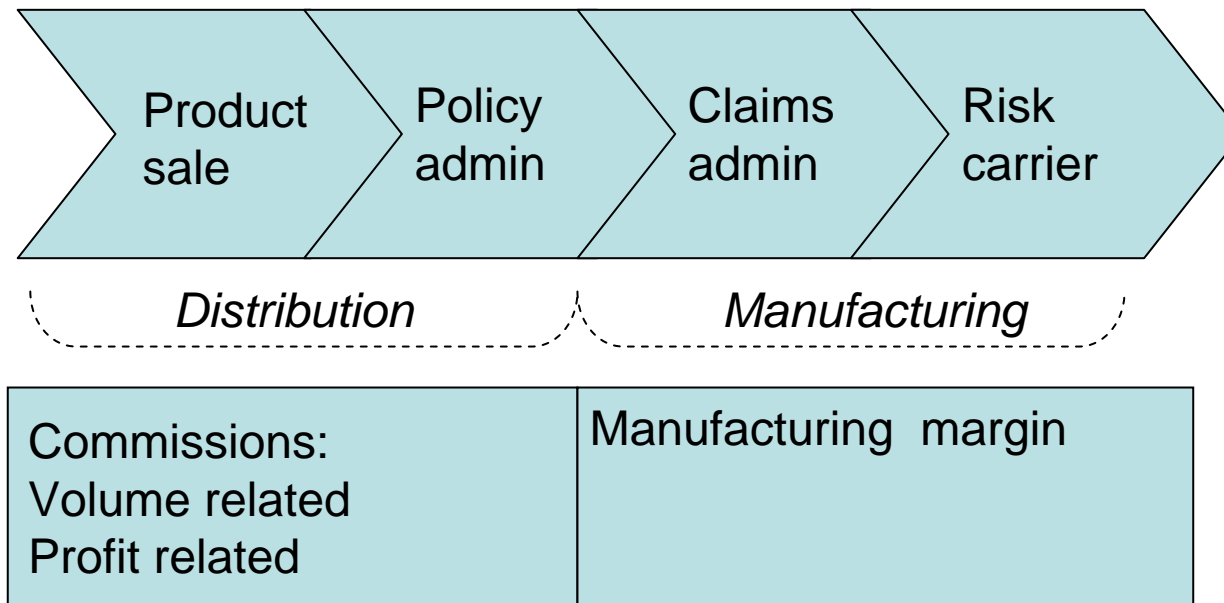


The product lifecycle





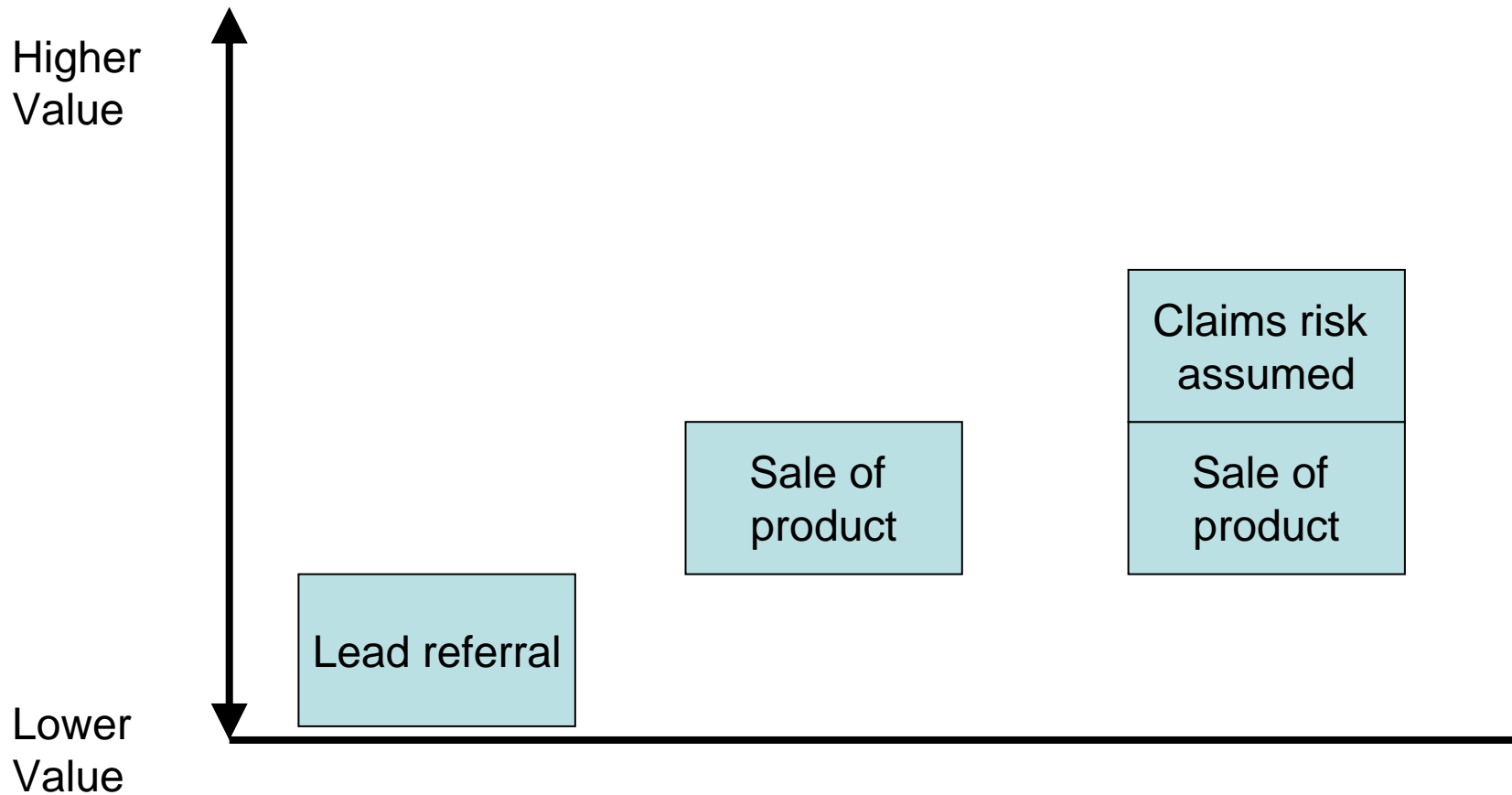
The GI value chain



- Total value:
 - 15% to 25% pre-tax ROC
 - Targeted average over the insurance cycle

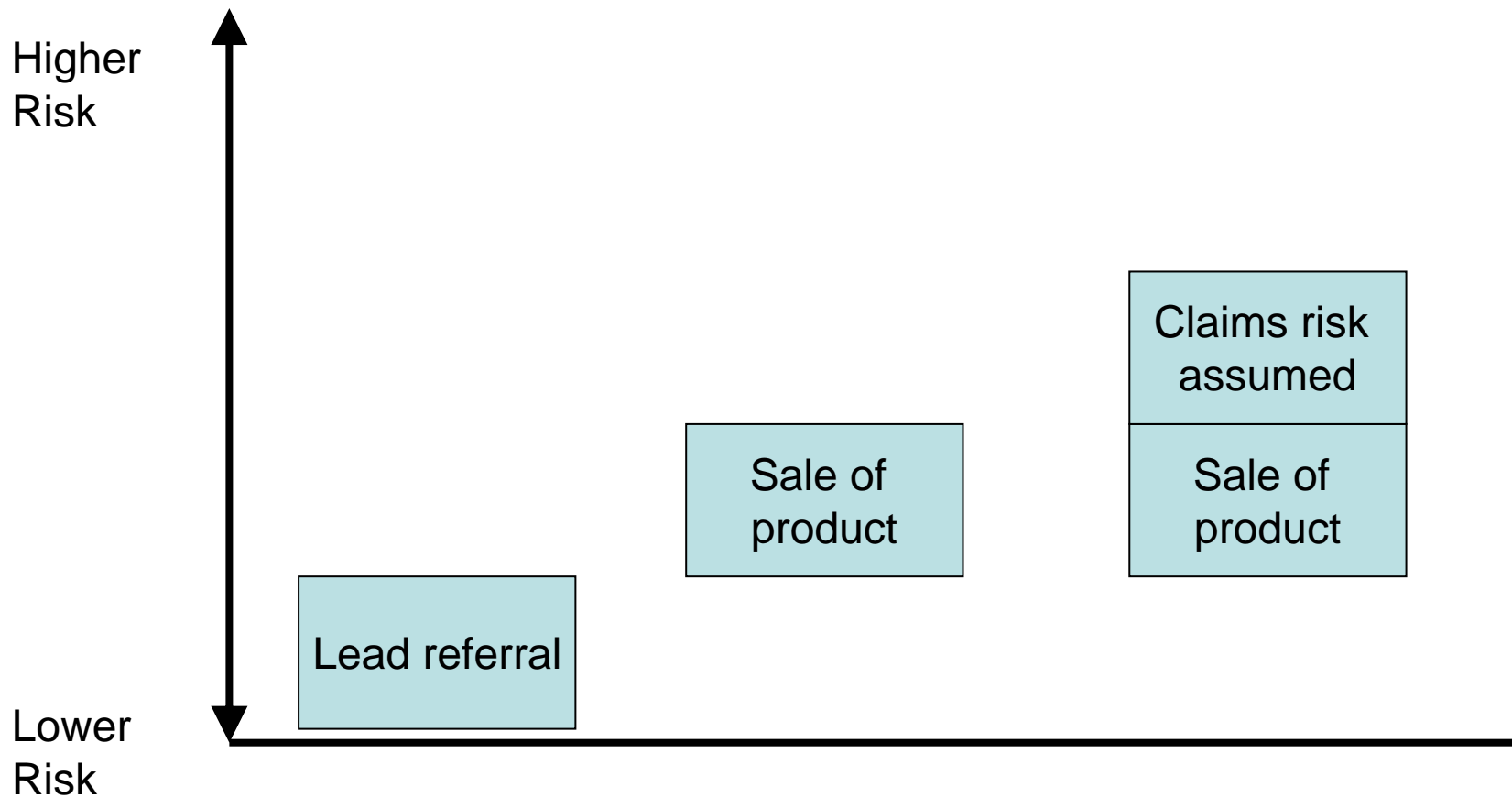


The building blocks of value





The building blocks of risk





What's in it for the FSO

Pluses	Minuses
Capture value	Risks need capital
Profit diversification	Lower ROCs/more volatility
Maximise cross-sell (leverage customer base)	Small market potential (at least for some products)

- + > - = Manufacture
- + < - = Distributor/Don't bother



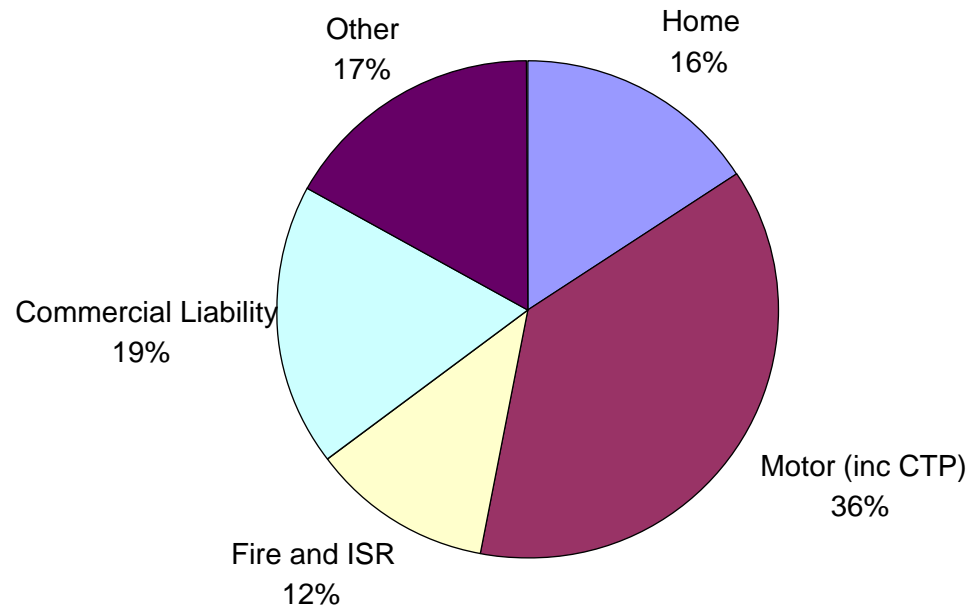
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Relevant GI Products



GI Market Overview



- \$25 billion annual premium (excl reinsurance)
- 2.5% of GDP



GI Market Overview

- Wide product range - mix of Personal and Commercial Lines
- Range of distribution channels
– direct, intermediated
- APRA is the regulator – since HIH collapse, regulatory environment has changed significantly
- 130 APRA regulated companies - top 4 or 5 dominate market



FS business considerations for GI participation

Customer Base	FS Product Offered	Distribution Method
Large or small	Natural connection with GI products	Strong direct customer relationship
Broad-based or niche		Brand well known and trusted
Demographics & socio-economics		Potential GI point of sale at FS point of sale



“Candidate” GI products

- Commercial lines
- Consumer credit
- Home
- Lenders mortgage
- Motor
- Personal accident
- Travel

Which to choose?

- Consider existing FS business (previous slide)
- PLUS characteristics of the particular GI product

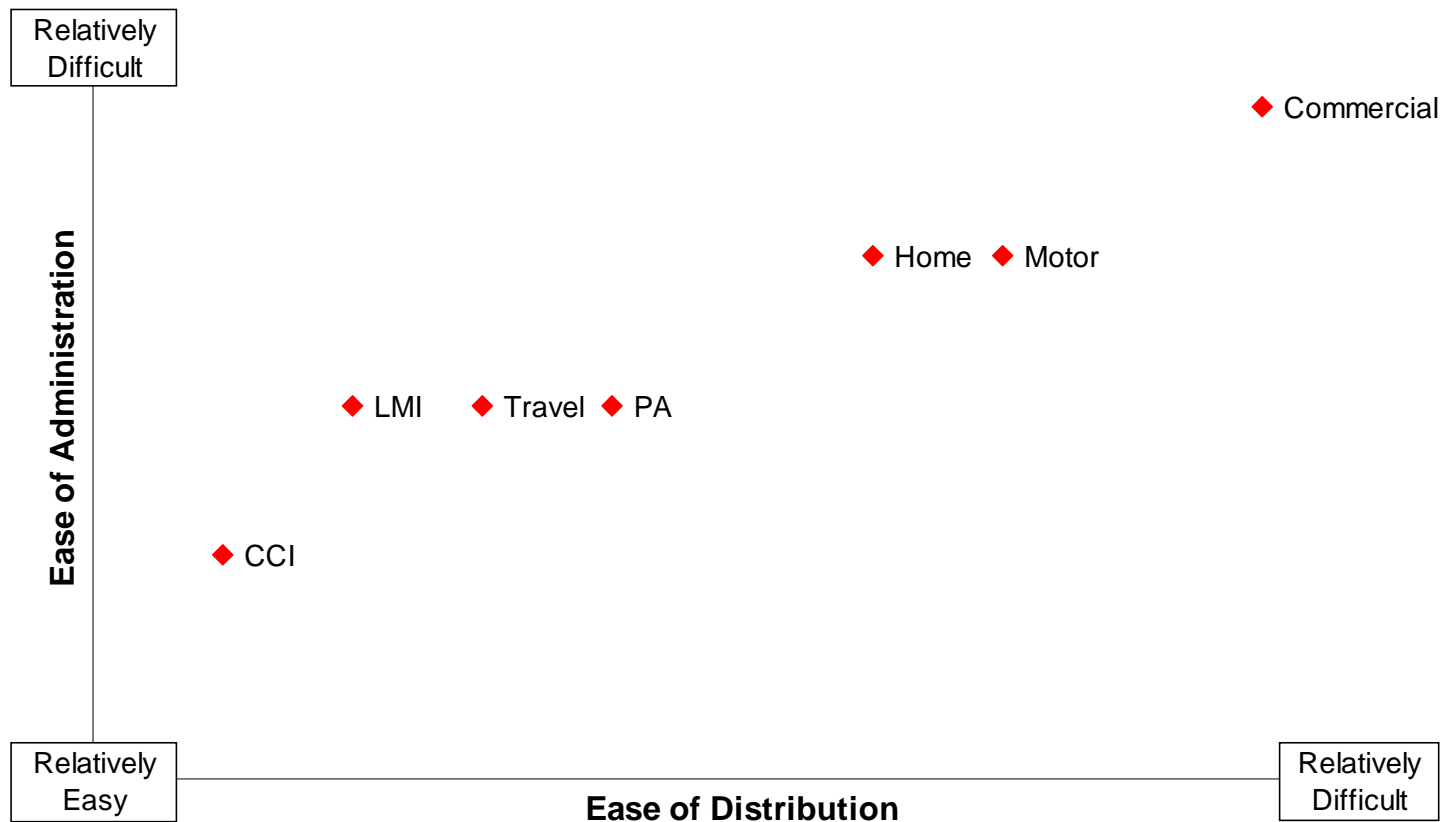


Initial investigations

	Motor	Product 2	Product 3	Commercial
Market	\$5 bn	:	:	\$8.5 bn
Claim Freq	High freq	:	:	Low
Claim Size	Low	:	:	High
Catastrophes	Yes	:	:	Yes
Duration	Short	:	:	Med/long
Cycle	No	:	:	Yes
Profitability	0-5% PM	:	:	100%/88% COR
Distribution	Direct	:	:	Intermediated
Point of sale	Loan	:	:	Relationship
Rating factors	Many	:	:	Large (incl qualitative)
Underwriting	Limited	:	:	Yes



How easy to distribute and administer





How easy to distribute and manufacture





Ranking of GI products

- 1) Consumer credit
- 2) Personal accident, Travel and Lenders mortgage
- 3) Home
- 4) Motor
- 5) Commercial lines
 - wide range of LOBs available
 - probably focus on SMEs only



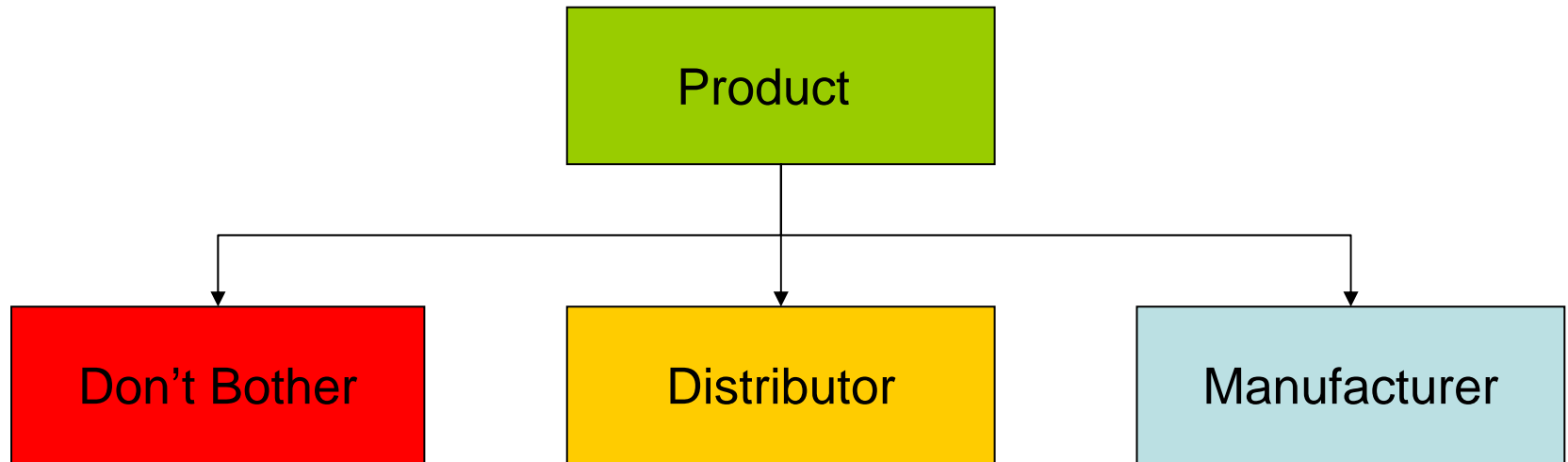
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Business Models Available



Three courses of action



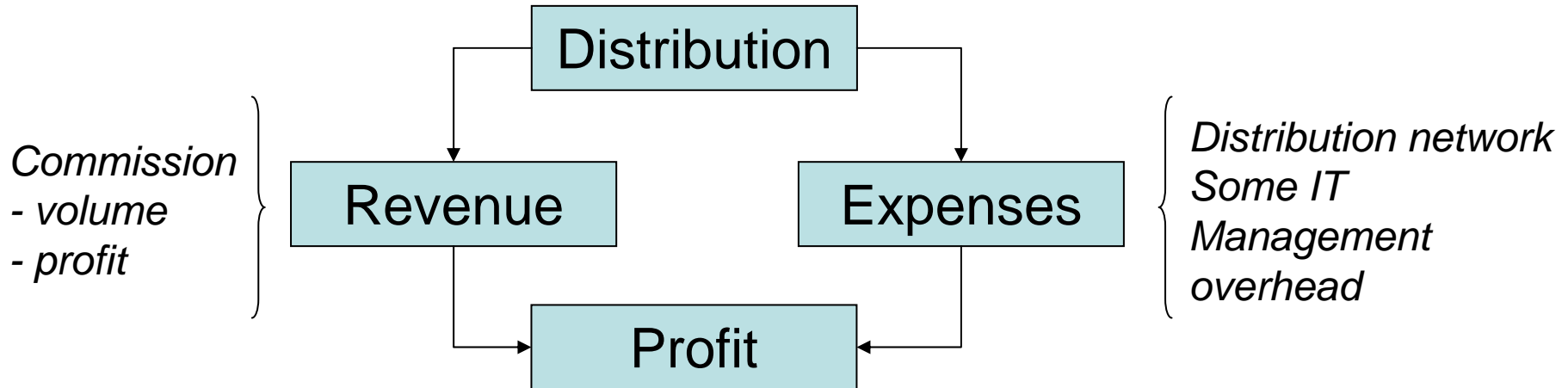


Business model features

	Distribution	Manufacturing
Characteristics		
Remuneration/reward		
Degree of risk		
Capital needs		
Regulatory implications		
Control (product & customer)		
Operational needs		

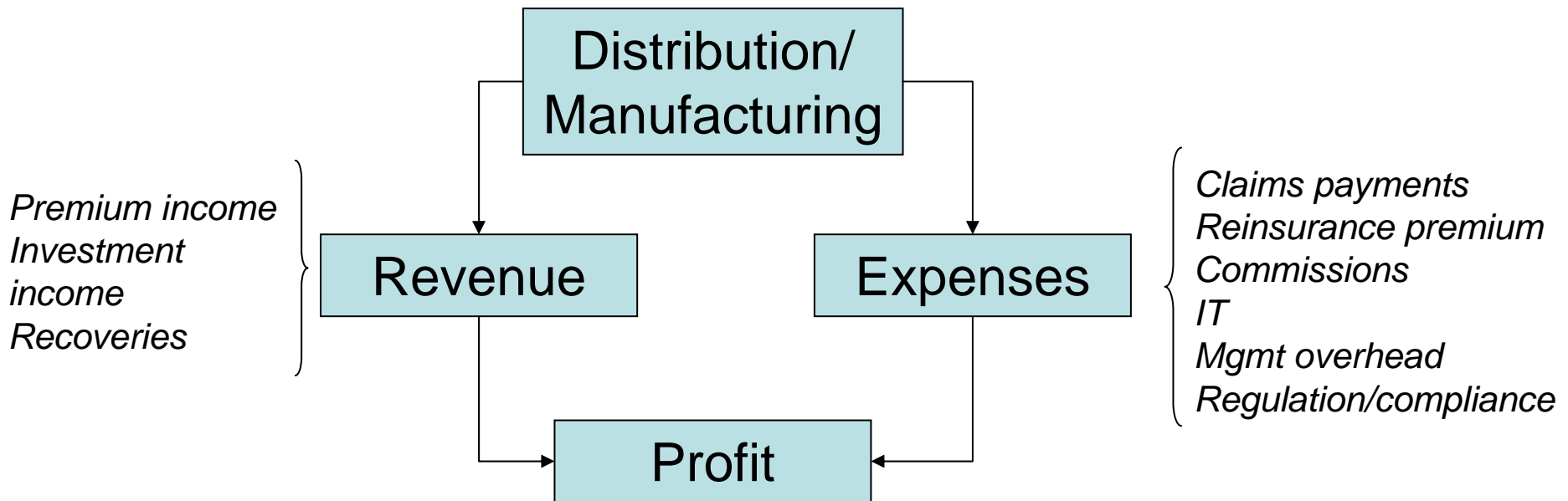


Distribution margin



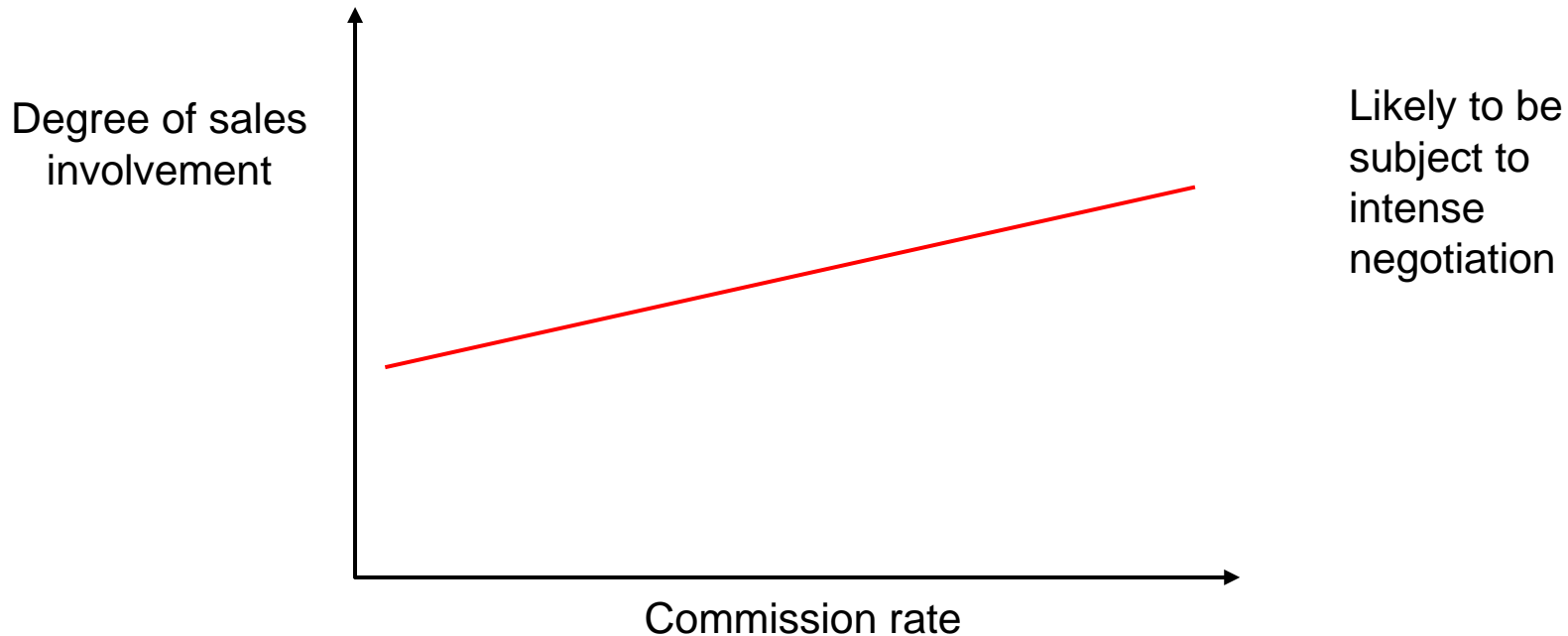


Distribution + Manufacturing margin



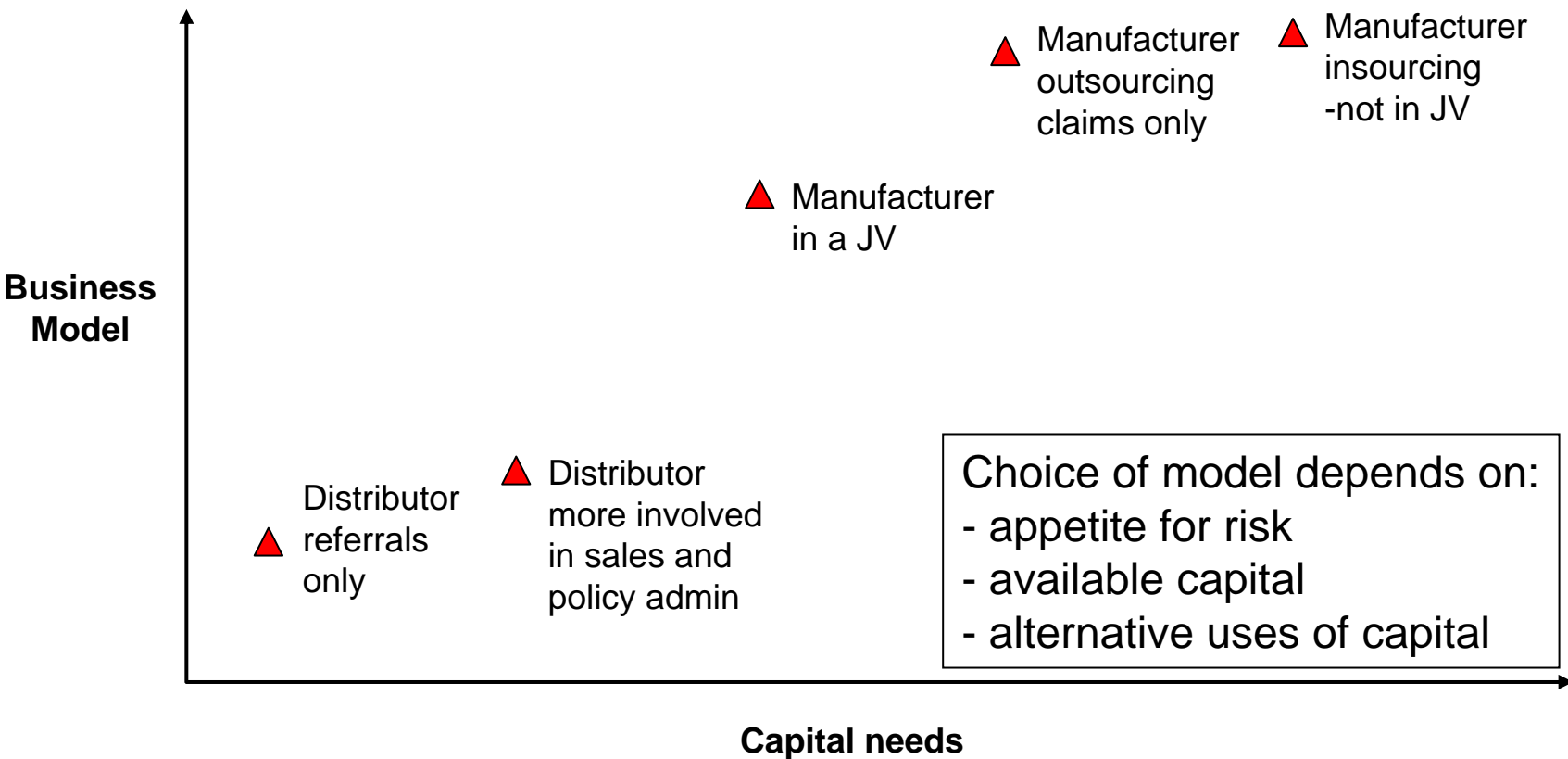


Commission depends on sales process involvement



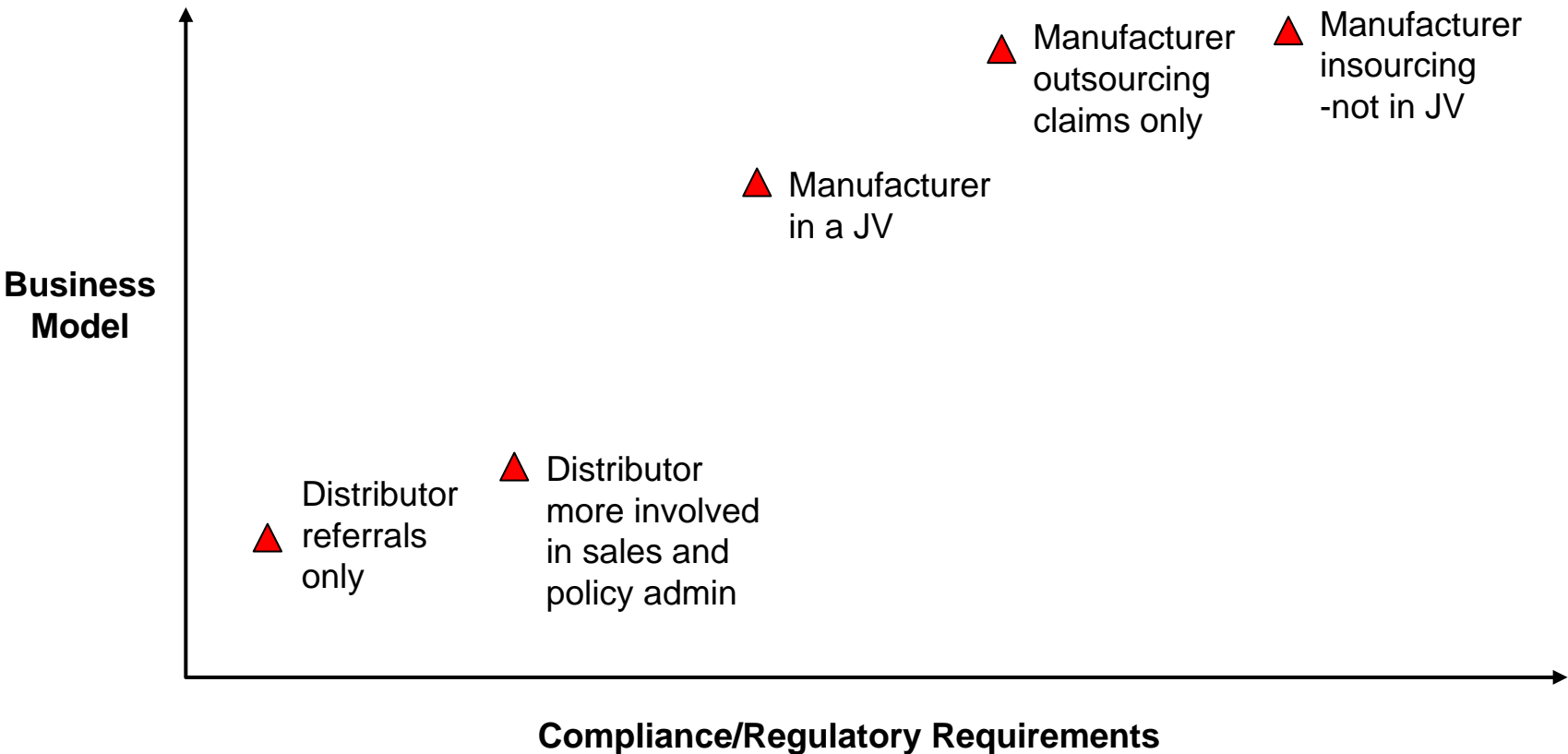


Capital needs increase if manufacturing model chosen



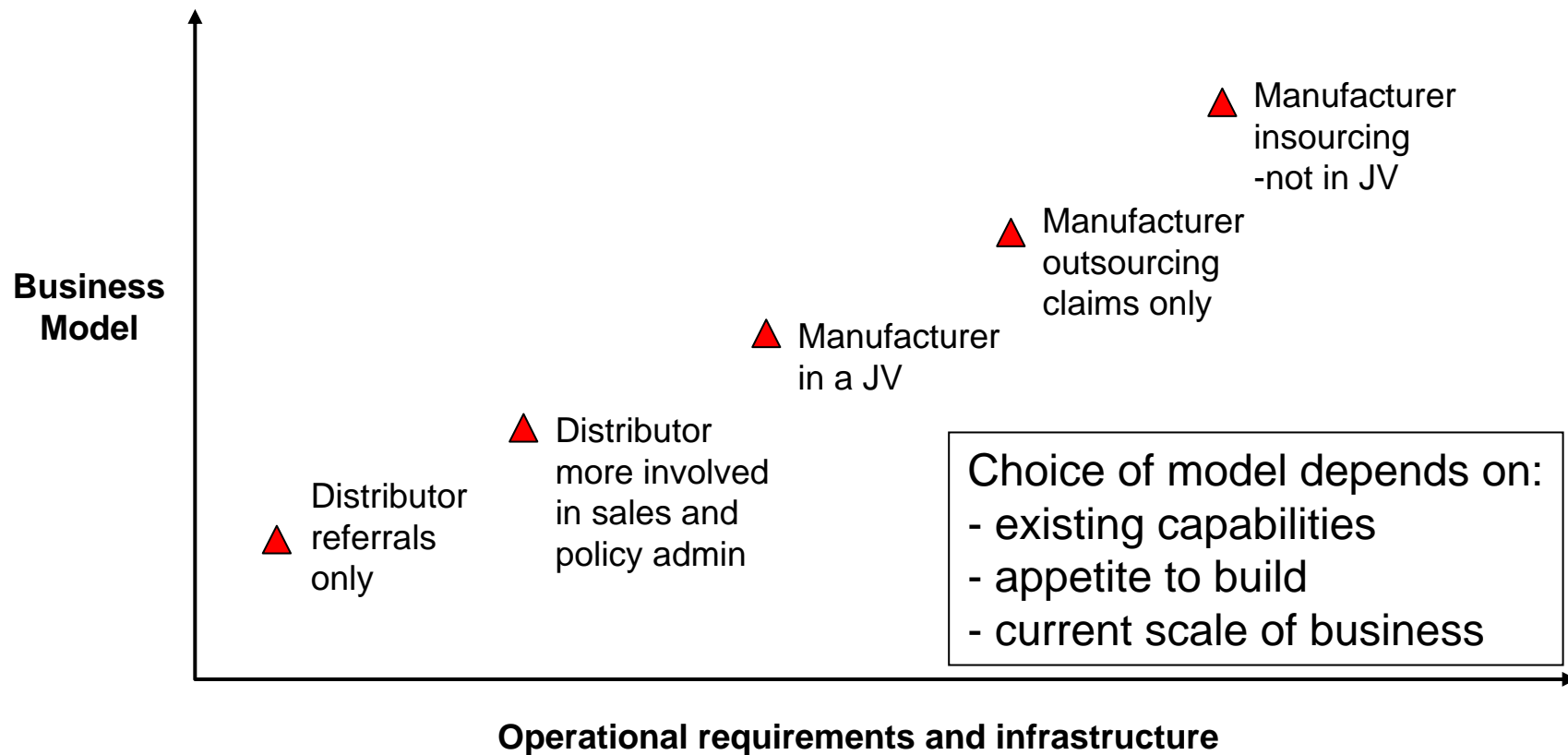


Regulatory/compliance burden much higher for a manufacturer



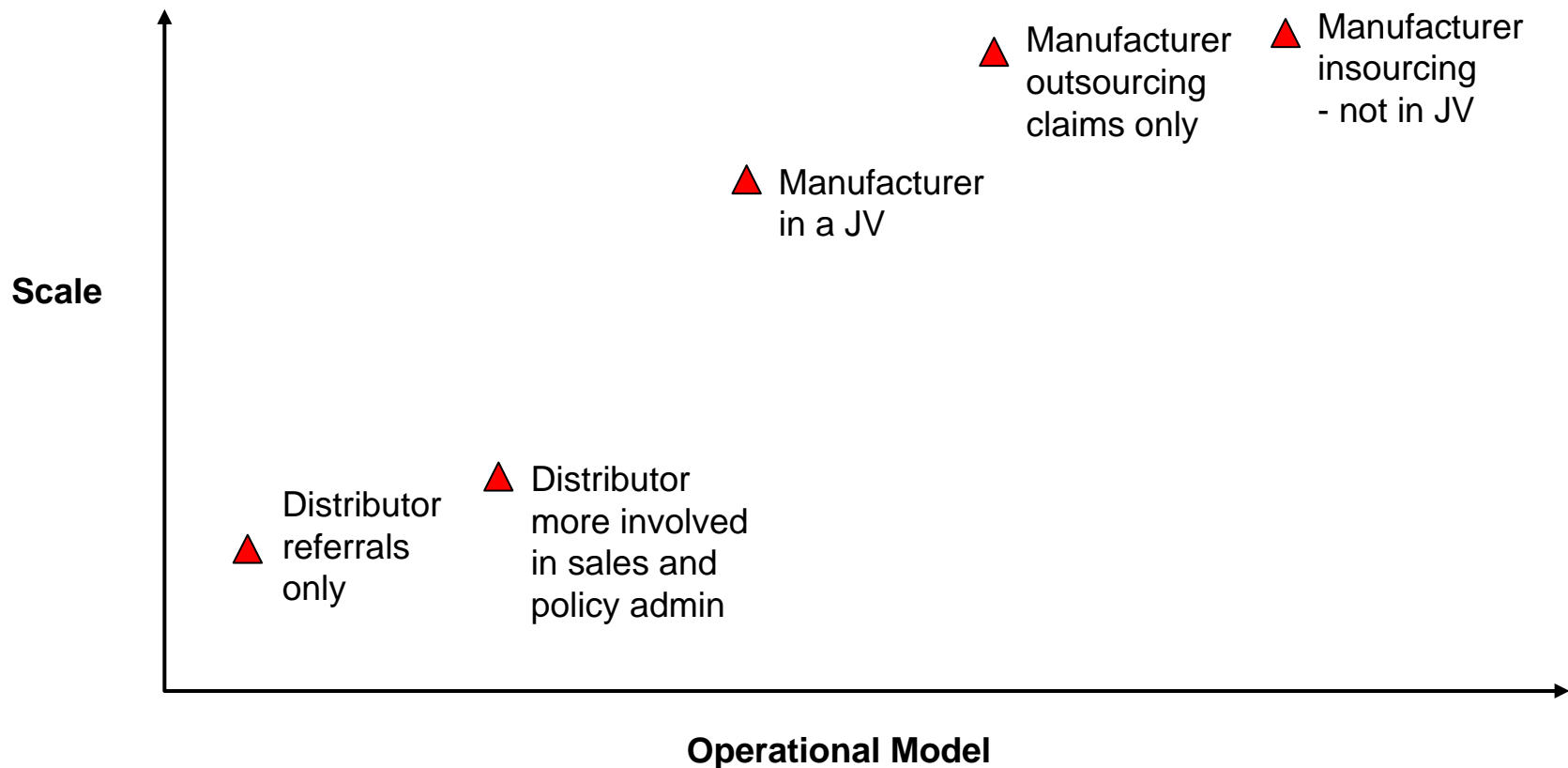


Choice of model impacts infrastructure requirements



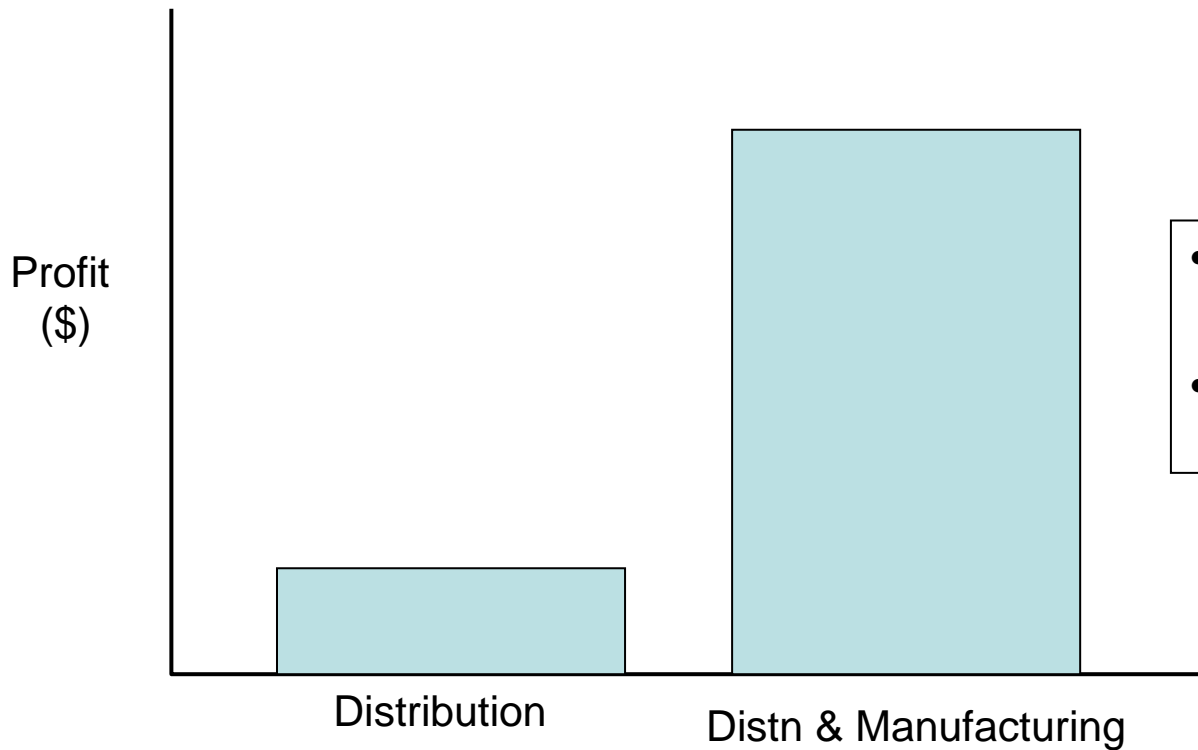


Selected model might change as business builds scale





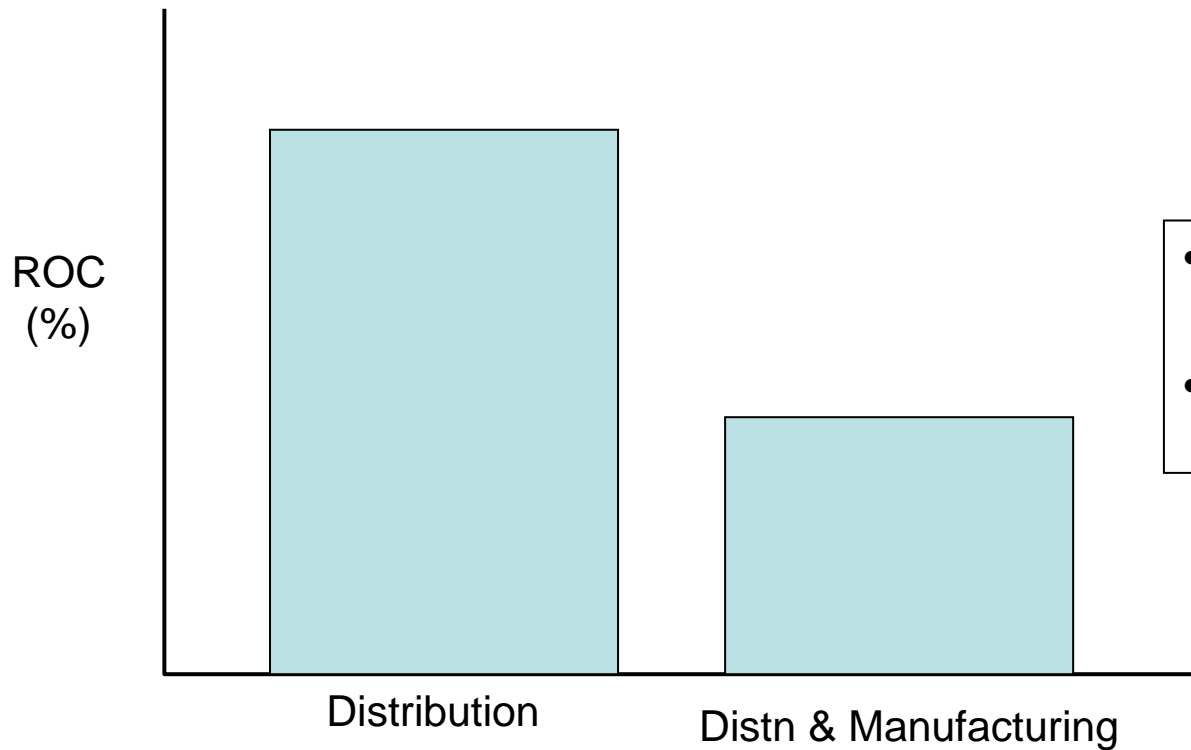
How much value is there?



- More “dollar value” to capture, if a manufacturer
- But note greater profit volatility also



ROCs percentages are deceptive?



- Distributor – lower \$ profits but higher ROCs
- Due to much lower capital requirements



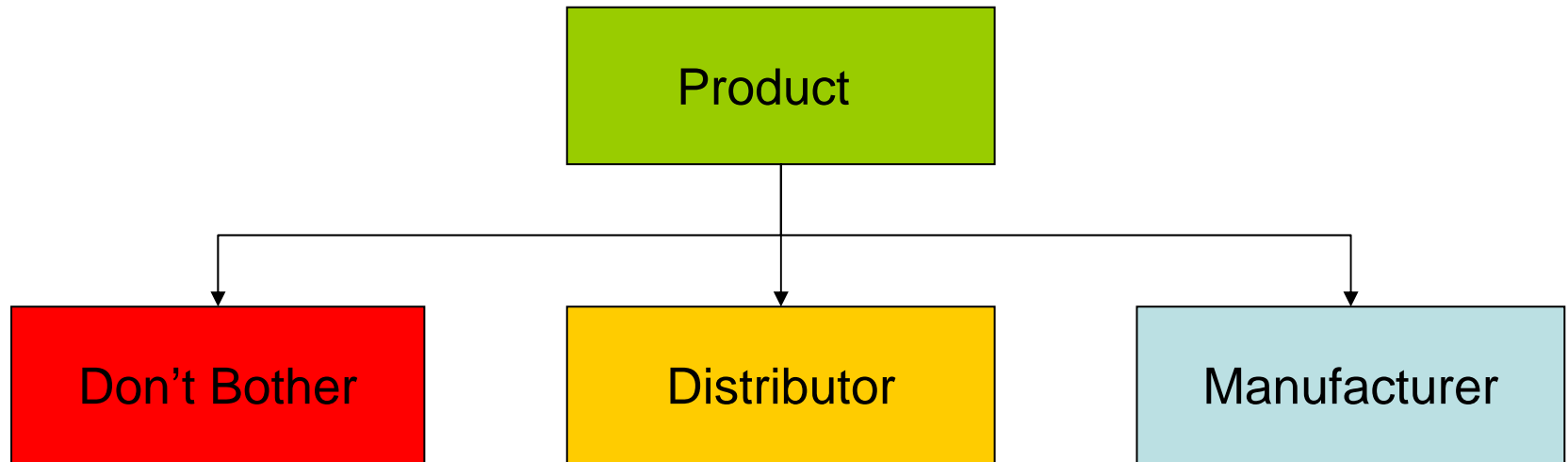
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Assessing the Opportunity



Product by product consideration





Summary of key issues to consider

Operational	Financial	Organisational
Complexity of product: <ul style="list-style-type: none">- Sales- Pricing/underwriting- Administration- Claims handling	Profitability: <ul style="list-style-type: none">- Distribution margin- Manufacturer margin Volatility of profits Catastrophe exposure Price/claims cycles Capital requirements	Capital deployment Risk appetite Diversification benefit Customer retention Synergies with other BUs

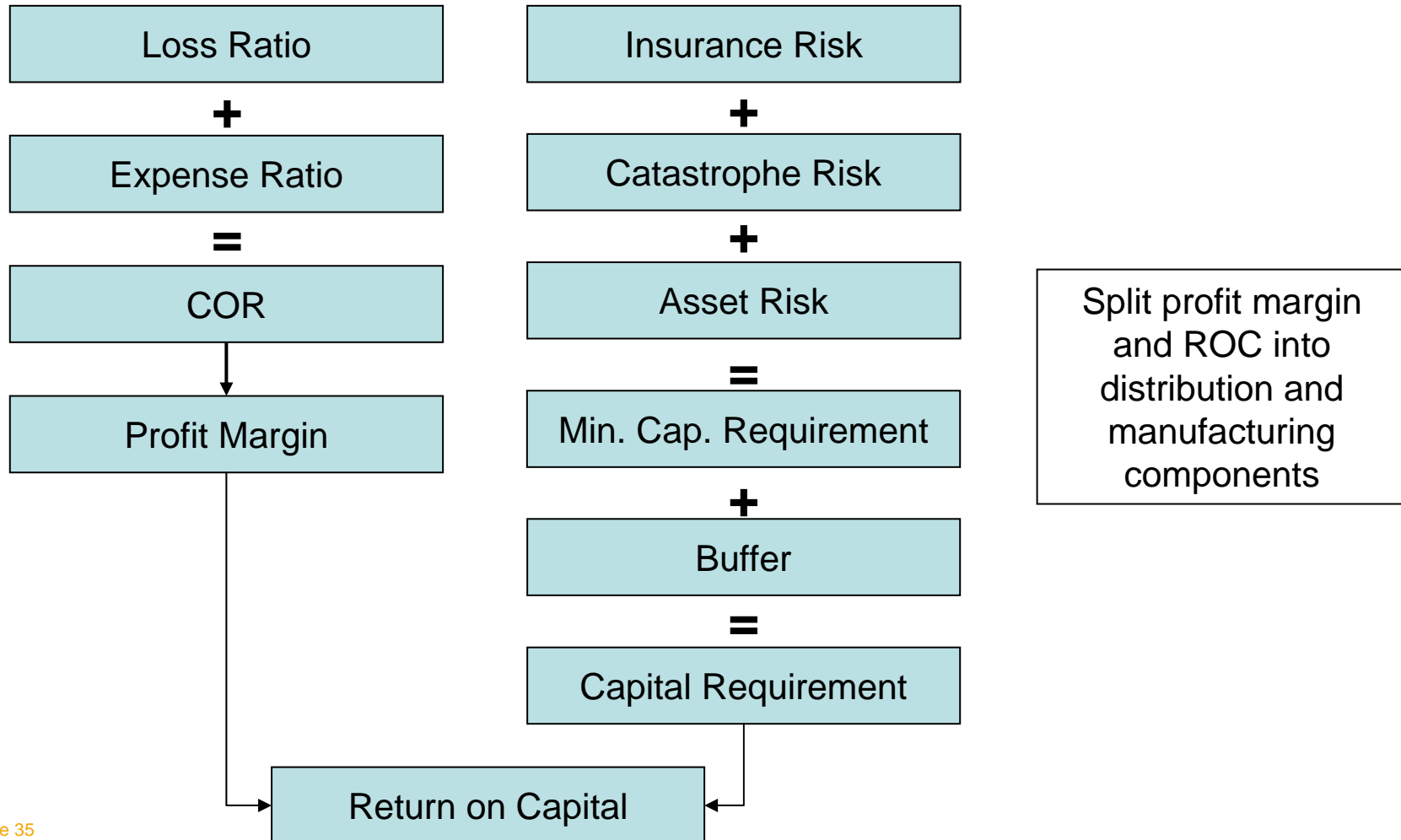


Key metrics (product by product)

- Market environment
 - size, competition, growth prospects
 - FSO penetration rate
 - Can the sales force be incentivised?
 - historical experience, variability, catastrophe exposure

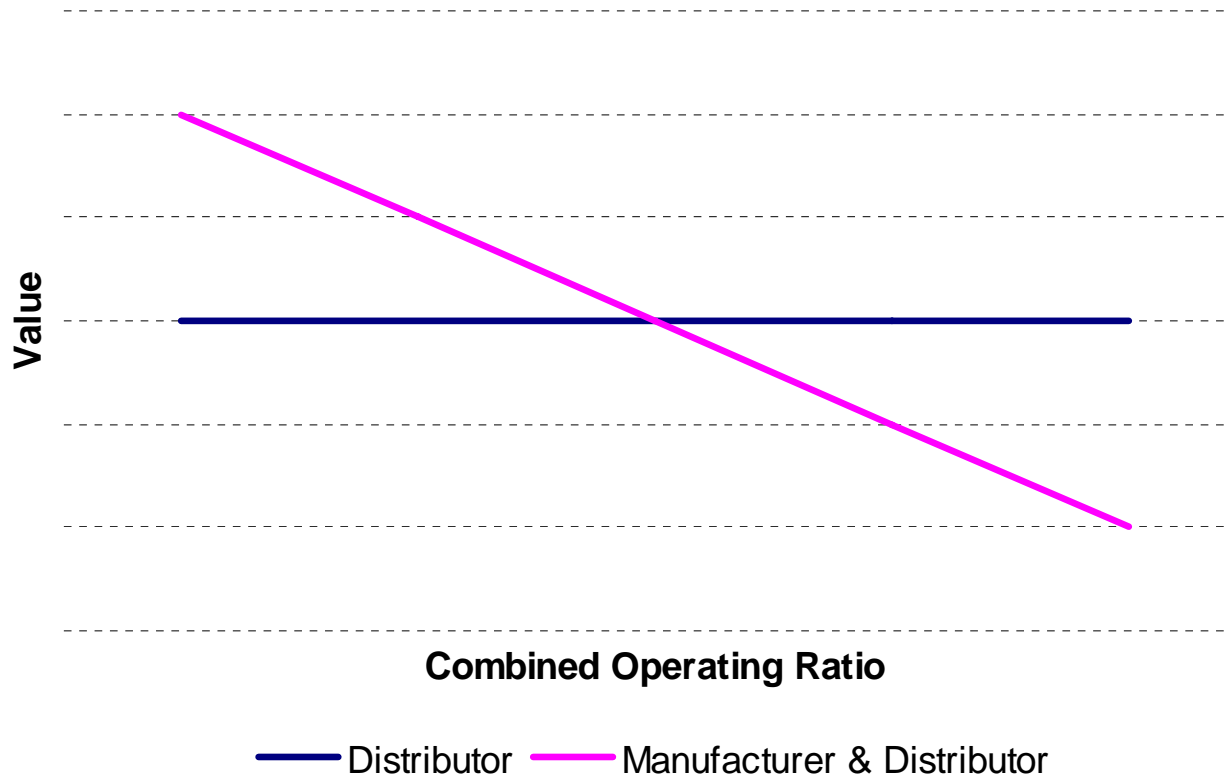


Key metrics (product by product)





Decision may depend on profit margins





Does it have legs?

- Additional metrics might include:
 - Full financial models – P&Ls/ Balance Sheets
 - Appraisal value
- Consider separately and then compare:
 - Distribution model
 - Different forms of the Manufacturing model
 - JV
 - Outsourcing
 - Quota share R/I
 - Stand-alone



Summary (1)

- Value to be captured in GI - but +s and –s
- Depends not only on characteristics of GI products but also existing FS business
- Ranking of GI products possible



Summary (2)

- Which model? Depends on a wide range of issues – quantitative and qualitative
 - Product complexity
 - Capital
 - Risk and risk appetite
 - Diversification benefits
 - Customer retention
 - Scale achievable
 - Profit potential
 - Operational issues
 - Control
 - Regulation