The Dialogue

Leading the conversation

The Future of Life Insurance

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Actuaries Institute

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Ilan is the Chair of the Life Insurance and Wealth Management Practice Committee and Managing Director of Retender. He has worked in South Africa, the UK and Australia in a variety of roles that have included strategy, marketing, pricing and distribution and is passionate about the role that actuaries can play in driving change.

The author would like to acknowledge the contributions from various industry participants for providing input and views that have helped shape this paper.

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The Future of Life Insurance

Ilan Leas

Life Insurance is an important financial thread that binds our social and economic fabric.

Executive Summary – Key Points

1. **Life insurance is important, providing $5.2[1] trillion dollars of peace of mind to Australians. Despite this, there are areas of life insurance that have not kept up with rapid societal changes or met community expectations.**

2 **Life insurance will only remain relevant if it takes some significant steps towards a future model that centres around the consumer. Some have been taken but the shift needs to happen quickly.**

3. **Life insurance's value proposition must be more understandable, easier to access, modernised and fairer.**

Background

Life Insurance is an important financial thread that binds our social and economic fabric. It supports individuals and families during difficult times. It is a centuries-old industry but is now facing gales of change – demographic, technological and societal.

Recently, life insurance (wealth and risk protection) in Australia has been subject to intense public scrutiny by customers, media, regulators and investors. There are clear signs that the industry has not met changing community expectations and the regulatory framework has not evolved sufficiently quickly to meet new challenges.

This paper sets out a range of ideas for government and industry that suggest how life insurance could adapt to meet increasingly demanding consumer needs and expectations of the future.

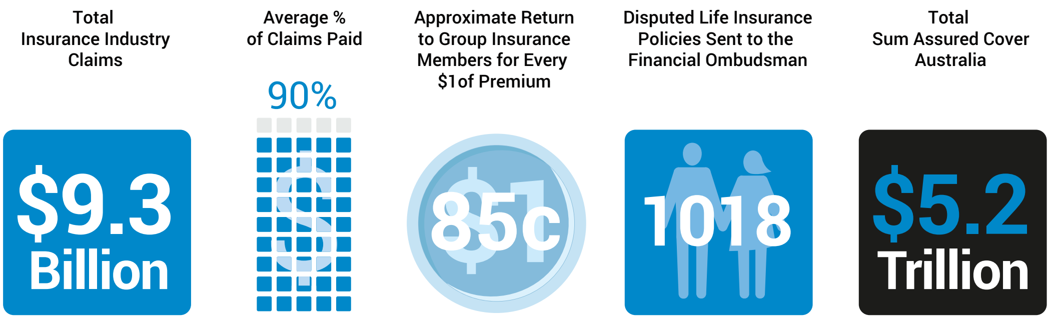
Insurance provides consumers with peace of mind and financial protection in times of greatest need. Expectations are that life insurance is trusted, fair value, convenient, flexible, understandable, and sustainable.

The need for life insurance?

The financial consequences of death, loss of health or outliving retirement savings require protection as they are inherently unpredictable and expensive, for the individual and the community. In the absence of government absorbing those costs, individuals self-insuring or community charity, life insurance provides an effective vehicle to manage these financial risks.

The societal licence to operate has been clear and unambiguous; insurance provides consumers with peace of mind and financial protection in time of greatest need. As part of this delivery, community expectations are that life insurance provided by insurers is trusted, fair value, convenient, flexible, understood, and sustainable.

How does the Australian life insurance industry score?



The industry is delivering in many respects. In Australia, for the 12 months to March 2017, the life insurance industry paid out $9.3bn[2] to the community in death and disability claims. Nearly all working Australians have a basic level of death and disability cover due to mandatory insurance within Superannuation which returns to members between 80-85c on every dollar along with providing cover to groups of consumers that would individually struggle to source affordable insurance. On average 90%[3] of all claims are paid, there are fairly low numbers of disputes sent to the Financial Ombudsman (1,018 for 2016-2017[4]) and the poor profitability of the sector[2] partly highlights the extent to which consumer premiums have been subsidised at an aggregate level by the life insurers.

At a more macro level, when you consider the amount of actual dollar coverage across **all policyholders** in Australia, there is $5.2 trillion[1] in Sum Assured cover that insurers provided as at 2016. This should be described as $5.2 trillion of peace of mind that the private sector is funding.

Despite these metrics, the industry is performing poorly when it comes to consumer needs and expectations. Whilst there is momentum to review and improve all areas of the customer benefit proposition, it isn't happening quickly enough. There remains an inherent disconnect between the product that life insurers sell and consumer outcomes; for example:

- the premium cost increases (i.e. affordability decreases) where there is more awareness, earlier diagnosis of certain conditions, increased coverage of high risk groups of consumers or reduced declinatures; or

- while the life insurance industry believes they offer a long-term product, after five years, on a typical retail product, only around 50%[5] of policies sold would be still in force.

Other 'cracks' in the sector include:

- concerns over sustainability of the industry due to low profit levels and return on capital in certain areas;
- financial advisor scandals linked with the traditional advisor distribution system;
- significant costs due to lack of ability to rationalise legacy products;
- there are high claim declinature rates for certain products and several claimant case studies with poor experiences and outcomes;
- data quality, systems and analytics have suffered from low investment;
- risk selection areas such as genetics and mental health have failed to keep up with changing consumer expectations and technology;
- inappropriate erosion of retirement savings for younger consumers or where super is split across multiple funds; and
- more than half of the industry, particularly bank-owned insurers, has been put up for sale.

Regardless of who is directly impacted, the issues are a concern for all participants – when your neighbour's house is on fire, it's in your interests to help.

Consumer groups and the media have highlighted the extent of these disconnects, including pockets of poor customer experience and various scandals, which has evolved over the last few years into increased government and regulatory scrutiny, culminating in 2018 in the Parliamentary Joint Committee Review and the Royal Commission which includes life Insurance within its scope.

Drivers of Change

Consumers want a fair deal, convenience, simplicity, automation and speed.

Consumers want a fair deal, convenience, simplicity, automation and speed. Attitudes to risk are changing and trust, corporate responsibility, lifestyle enrichment and cost are starting to dictate choice of suppliers and engagement.

Consumers are living longer and living healthier[6] lives. Older age consumers are working longer, marriage and home purchases are happening later, children are living at home longer[7] and the working age population is shifting towards millennials. There are historic highs in mortgage debt[8]. Part time employment and automation, supported by technology, is expected to lead to productivity gains, a changing workplace[9] and potential to make many jobs obsolete.

Medical and technological advances continue apace especially in areas such as non-invasive screenings, personalised medicine, preventative medicine, nanotechnology, immunotherapy, vaccinations and new understanding of diseases. The world of identifying and proactively treating certain genetic diseases, regeneration of body parts or removing mutated genes is promising as part of the ground-breaking changes seen in genomics. Wearable technology that can detect and monitor health is expanding.

The amount of data collected and available for analysis and use is expanding as technology develops in new fields such as artificial intelligence, blockchain, neural networks and new data techniques previously the domain of other industries.

One view of the future

Trust will be increasingly important, where consumers will demand certainty that in their time of need, their claim will be paid.

Consumer needs will be driven by life enrichment and convenience, with automation, speed and ease becoming critical for insurer engagement. Trust too will be increasingly important, where consumers will demand certainty that in their time of need, their claim will be paid. Spending on insurance will likely reduce as a greater proportion of insurance spend will be directed towards savings, particularly for younger lives and as unnecessary default cover is reduced. The need for death cover will reduce whilst disability cover may need to increase.

In **distribution**, group insurance is likely to remain the most efficient mechanism in terms of consumer value and convenience, with an increased focus by superannuation funds on addressing the needs of different consumer groups along with growth of voluntary purchase of insurance above default levels. Advisors are likely to start shifting focus towards the older age segment ('following the money') and technology will enhance the advice process along with reducing full advice requirements for some segments, in line with consumer demands for speed and convenience. Trusted and tailored brands, with data on lifestyle behaviours and health, will emerge to compete for new business against more traditional insurer brands.

The best interests of consumers in **product design** will become the primary test against community expectations but this will have a cost as insurers pay a higher proportion of claims or pay-out outside historical terms and conditions. Coverage for consumers with relatively lower insurance needs or where there is duplication will reduce.

Legacy **product changes** will get legislative permission to offer modern coverage that is balanced against pricing sustainability. Insurers will move away from selling reviewable stepped policies, favouring level premiums or decreasing sum assured policies. Similarly, lump sum only disability products will be replaced by hybrid designs, sum insureds will vary over the term of the policy and standardised critical illness policies will emerge with new players able to take advantage.

In terms of **risk selection**, the emerging field of genetics and other sources of asymmetric information will lead to a breakdown of the risk pool for some insurers. Ease of transition between risk pools, both within and between insurers and superannuation funds, will accelerate as consumers will be easily able to switch cover between insurers without additional underwriting. Use of pre-existing conditions as a risk selection tool will disappear in favour of upfront underwriting.

The industry and government will need to debate the issues of privacy, discrimination, the right to underwrite and the risk pool principles behind insurance.

Claims management will encourage the health benefits of work, offering wellness, rehabilitation and mental health services. There will be a focus on those who suffer significant loss ('impact rather than diagnosis') and a movement towards increasing standardisation of conditions, contracts and transparency.

Increased **data** and ability to distil insights will help deliver products to better suit consumers' needs. Unencumbered insurers and big data owners will utilise data from electronic health records, smart devices and new rating factors to target healthier lives, increasing industry anti-selection risk and anti-selective lapses. The industry and government will debate privacy, discrimination, the right to underwrite and the risk pool principles behind insurance along with whether moving towards a health insurance community rating model is appropriate.

Superannuation funds, insurers and reinsurers will move into other parts of the **value chain** in a bid to continue growth in a consolidated market. The industry will continue to advance to multiple carriers of the risk rather than single company exposure. The intense spotlight on life insurance will disappear, other than from regulators, as the industry focuses on implementing consumer led change.

Life insurance needs to adapt to the drivers of change and successfully identify and fulfil the needs of an increasingly diverse, informed and tech-savvy demographic.

Where to start?

Life insurance will only continue to be relevant if it adapts to the drivers of change and successfully identifies and fulfils the needs of an increasingly diverse, informed and tech-savvy demographic. Any transition to the future state requires a review of current attitudes and policies. Industry, government and consumer groups should be working together to enhance consumer outcomes and sustain an efficient, safe and stable industry.

As with setting out one view of the future, again, this is just one view of the top 4 areas that require strong consideration for industry, government and consumer bodies to work together to optimise consumer outcomes. The key focus and starting point is the consumer lens.

The top four priorities proposed are:

1. Help me understand

Whilst encouraging innovation, certain areas of the manufacturing process such as definitions, processes, complaints and contracts are not currently standardised, leaving consumers exposed to unknown outcomes.

Policy development areas:

- **Encouraging opportunities for simplicity and education:**
  - Industry shifting approach, where applicable, towards simplicity of conditions, definitions, contracts and information requirements, potentially through increased standardisation.
  - Increased and aligned communication, with industry, distribution and consumer groups joining together to increase awareness and understanding of life insurance.

Help me understand – target examples

Standardised industry forms across all product types and distribution channels:

- a common electronic standardised set of underwriting questions;
- a standardised industry set of product definitions; and
- a common electronic standardised claims form.

2. Make it easier for me

Consumers want options for portability of insurance, with solutions that allow them increased flexibility.

There is a strong push towards increased regulation across the value chain to lift the bar but in some cases, consumers want a simplified, light-touch, convenient process to purchase cover without full advice.

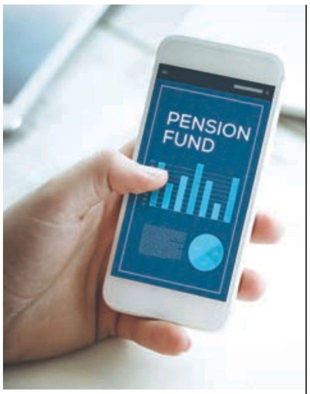
Policy development areas:

- **Streamlining consumer processes and access:**
  - An industry and regulatory review of which consumer sub-groups (and distribution channels) would benefit from a simplified disclosure requirement to support convenience and ease of purchase.
  - Industry utilising technology to simplify back-end processes and customer interactions.
  - Industry review of options for portability of insurance, particularly risk assessment, with solutions that allow consumers increased flexibility.

Make it easier for me – target examples

A process and use of data that allows:

- all medical decisions to be made within 10 days of application and fixed timelines for providing a provisional claims assessment where information required is not forthcoming;
- underwriting and claims automation for more than 75% of applications and claims assessments;
- use of a central data repository for insurance information that can allow consumers to download their data and pre-populate all future insurance forms; and
- online and immediate transfer of cover between insurance providers for the same levels of benefit.



3. Modernise my products

The industry is still managing products designed 20 years ago because legislation doesn't allow inusrers to amend benefits unless all consumers have the same outcome or are better off. This applies to outdated trauma cover (stage 1 cancers don't have the same financial impact anymore), lump sum disability (TPD cover levels encourage low return to work rates and worse outcomes) and stepped premium patterns (encouraging churn and healthy lives leaving the system).

Policy development areas:

- **Barriers to modernising products removed:**
    - Industry to propose a legislative solution to move to modern definitions and benefit structures for outdated products. This should necessitate a reduction in benefits no longer needed but also lead to a reduction in price.
    - Industry to build support from government, regulators and consumer groups for a framework and criteria to be applied to introduce changes, consistent with terms already available to other sectors.

Modernise my products – target example

A one-off industry Transfer Period where all consumers are defaulted onto modern standardised product definitions with a commensurate reduction in certain benefits (and price).

4. I want fair treatment

Data usage needs to be appropriate and fair whilst balancing the need for innovation.

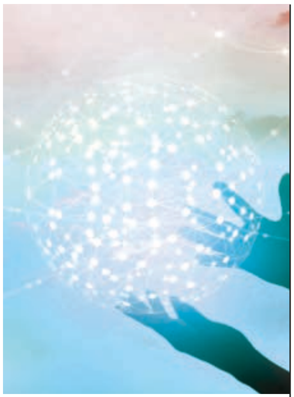
Consumers will be able to access asymmetric information about their health, through increased private testing or genetics. Life insurance relies on pooling of risk but the use of asymmetric information by a few (anti-selection) impacts the sustainability for the many. Data usage needs to be appropriate and fair whilst balancing the need for innovation.

Policy development areas:

- **Balancing sustainability:**
    - Legislation to require disclosure by consumers of genetic tests only above a certain threshold cover level.
    - Regulators to review what constitutes the appropriate and fair use of personal data and what industry information can be shared.

I want fair treatment – target example

Insurers support consumers accessing any genetic or additional medical information, with disclosure required only above a $500,000 cover level.



The Way Forward

There is a balance to be struck between a customer's personal interest in their own insurance policies and the public's common interest in maintaining an affordable and sustainable life insurance industry. Key social areas include adherence to insurance terms and conditions, discrimination, investment by the industry in social good and encouraging consumers awareness.

It's easy to call for consumer change but affordability will be affected by the cost of these reforms and needs to be factored into the decision. In support of this debate, a clear understanding on where that balance lies and how it can best be maintained should be investigated. Although the industry has begun this journey, more can be done.

Recommendations

To satisfy anticipated consumer needs and thereby sustain the life insurance industry, insurers need to recognise and respond to the following themes:

1. **'Help me understand'** – Industry will have to simplify terms, conditions, definitions, contracts and information requirements.

2. **'Make it easier for me'** – Industry and regulators will need to identify groups that will benefit from reduced disclosure requirements. Customer interaction to be streamlined with use of technology. Options will need to be explored to allow greater portability of insurance.

3. **'Modernise my products'** – Industry and government must act to rationalise outdated products and build regulatory, government and consumer support for an appropriate replacement framework.

4. **'I want fair treatment'** – Industry will need to reconsider its current approach to dealing with genetic test results. Government should review what constitutes the appropriate use of personal data along with opportunities to share data to drive innovation.

References

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In the future there will need to be a workable balance struck between a customer's personal interest in their own insurance policies and the public's common interest in maintaining an affordable and sustainable life insurance industry.

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