# ISSUE BRIEF 1: THE 'LOW FOR LONG' CHALLENGE

THE GENEVA ASSOCIATION

## How the life insurance industry is tackling a 'manageable headwind'

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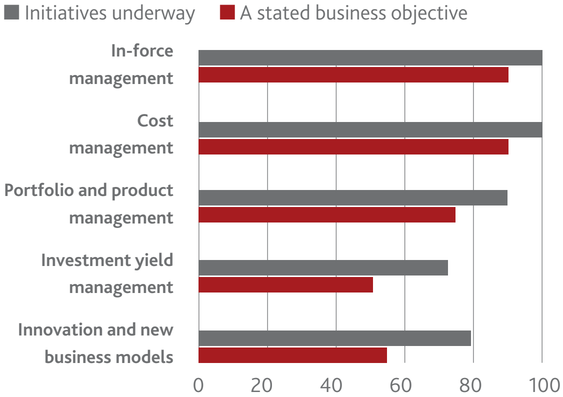
*The role of life insurance in helping individuals achieve peace of mind and financial security is significant. In a low interest rate environment, insurers have an even bigger role to play as individuals may struggle to find investments with appropriate returns. Life insurance can provide investment performance in combination with a secure insurance guarantee and a death benefit for beneficiaries. However, the industry is not immune to low interest rates. This Issue Brief, based on a survey with senior executives of leading life insurers, reports on the industry's response to the challenges created by low interest rates.*[1]

### THE BIG RESET— FOCUS ON IN-FORCE AND COST MANAGEMENT

Low interest rates affect both the demand for and supply of life insurance products. Products that were once popular and profitable for insurers and policyholders have now been repriced to reflect the new environment. Many products were withdrawn and are therefore no longer available to help policyholders plan for their financial needs in old age. A reset of customer expectations is underway and the industry has been busy repositioning.

***Figure 1: Relative importance of adaptation priorities***

*Survey results — initiatives underway or stated priorities grouped into themes (%)*




*Source: The Geneva Association.*

Figure 1 summarises the industry's response to the low interest environment. It reveals equal weight given to cost and in-force management as top priorities. In addition, roughly 90 per cent of companies participating in the survey have embarked on initiatives towards business model adaptation, while only 60 per cent called the development of new business models a stated objective.

**First, in-force management.** It is a fairly new discipline with the objective to create more value by better managing a business that may have been on the books for decades. The value extracted from these activities can accrue to shareholders and customers.

Although all insurers have in-force management initiatives underway, there are significant differences in how they are proceeding and the scope of activities.

- The question of whether in-force customers should be offered alternatives in the form of buy-outs or new products better reflecting the changed macro-financial environment triggered different responses. European insurers especially were concerned about perceptions triggered by in-force products with changed conditions. They perceived such offers as not worth the risk to well-established customer relations.

1 The full report, *The 'Low for Long' Challenge: Socio-economic implications and the life insurance industry's response*, is available at: http://bit.ly/TheGenevaAssoc_LowforLong. The study is based on in-depth interviews with 16 senior executives of large, globally active life insurance companies with operations in North America, Europe and Asia.

- Even more differing responses were received with respect to structural in-force actions which include selling legacy books. Although a number of insurers did such transactions, many voiced strong objections to selling old books, wishing instead to retain in-force customers for the long term. Transaction statistics reveal that the majority of legacy book deals were performed in the U.S. and the U.K., whereas numbers and size of such deals were considerably lower on the European continent.

While in-force management activities are well established, more needs to be done. Slightly less than one-tenth of projects have been completed. And more than half of the projects are considered either underway or still in early stages. It is probably fair to assume that in-force management will be firmly institutionalised even after the current initiatives are done.

**Second, cost reduction.** It ranks at the same priority level as in-force management, but the motives are different. For many executives, cost management is common sense; they perceive the sector as not being as efficient as it could be. Others underlined the importance of cost reductions to mitigate the adverse impact of lower investment returns in order to benefit insurers and/or policyholders. And a third group called for insurers to become more efficient in order to prepare for future competition against InsurTech companies that are not saddled with legacy burdens.

However, achieving cost reductions can be difficult. The devil is in the details. One of the major challenges referred to arises from complicated IT legacy systems built decades ago. They are often not well integrated, creating barriers for speedy efficiency gains. Many executives saw a need for the corporate culture to change towards an even more cost and customer-centric mind set. The survey also revealed that cost work is an ongoing process. Consequently, respondents believed that even more could be done to improve the cost efficiency of life insurers, and particularly so in light of technological progress.

## TOWARDS A NEW BUSINESS MIX

Up to now, insurers have made significant progress with initiatives rebalancing their new business mix towards more sustainable products that are, from both a policyholder and shareholder perspective, better adapted to the current low interest rate environment. Focus areas highlighted by survey participants include:

- Reducing the reliance on savings products (with high interest rate guarantees) and replacing them with unit-linked and hybrid products that feature more sustainable guarantees or no guarantees at all,

- Developing a stronger focus on biometric risk or term protection products,

- Focusing on wealth management for high net worth individuals and, more broadly, on asset management products,

- Focusing on corporate customers by offering unit-linked pensions and corporate protection business.

As interest rates declined, many insurers sought additional investment yield to fund the (high) guarantees promised to policyholders on in-force policies or simply to maintain attractive pricing on new business. However, searching for yield does not seem to be as high a priority as often stated. This could be explained by regulatory considerations and/or simply because the risk adjusted return fails to make the cut. Nearly half of respondents thought that a permanent review of investment management should be 'business as usual'. They made clear that reviews cover a whole range of activities, such as implementing sophisticated IT systems to better match assets and liabilities, and outsourcing investment functions to third party asset managers.

When looking ahead, answers in response to questions about new, innovative business models were a bit reserved. Although executives saw the need to adapt business models to compete against potential high-tech competitors, it was not clear how exactly such business models would apply and how new technologies could better support the business in the future. A tentative conclusion could be that leaders need more information about the potential of new technologies. They appear to believe that it is difficult to see how technology-enabled business models that disrupted competition in other industries could be transformed for insurance. There are also many hurdles that make market entry for non-insurance competitors difficult, rendering the need to face the challenge of new technology competitors less urgent than in other industries. But executives are aware that parts of the value chain are being disrupted and that the potential for new technology challengers should not be neglected.

## REMAINING CHALLENGES

Executives also mentioned a number of other challenges when trying to improve performance metrics. They range from internal obstacles (related to talent pools and the legacy book, for example) to external challenges, such as changing regulatory requirements and customer behaviour. Two key challenges mentioned are:

- **Customer inertia:** Demand for life insurance products has been slow to change in many markets. Customers continue to demand traditional, more familiar products with guarantees, even if they may not be the best choice in the current macro-financial environment. Executives see a need to do a better job in engaging customers and communicating with them on the changing macroeconomic environment.

- **Distribution inertia:** Similar to customer inertia, distribution inertia has made it hard for insurers to proactively rebalance their products and portfolios ahead of the market. There is a fair amount of lead time to teach agents about new offerings, especially if new products are completely different from existing products. Life insurance continues to be seen as something that needs to be sold to, rather than bought by, customers. The question is to what extent digital technologies will change this view.

## ASSESSMENT AND OUTLOOK

Life insurers have come a long way in tackling the structural weaknesses exposed by the current macro-financial environment. The adaptation to the likely 'new normal' of perennially low interest rates is well under way. Survey participants were not discouraged by the short-term challenges, because 'in the short term, we can manage the change.' And they were reasonably confident that life insurers will continue to play an important socio-economic role in the long run.

This requires that customers must see value in the product offerings. Otherwise, the acceptance of the socio-economic role of life insurance may be at risk at a time when ageing societies face a growing need to access sustainable retirement solutions. Through the pooling of longevity risks and a disciplined, liability-driven investment management, life insurers are well positioned to mitigate at least part of the financial risks associated with ageing. It is precisely for these reasons that executives believe that life insurance will continue to have a valid socio-economic role in the future.

The extent to which life insurers will fulfil this role depends on how successfully they can navigate the necessary changes and make the most of the assets at their command today—their in-force customer base, their superior regulatory knowledge, and their access to market and distribution channels. This vision was widely shared. But the key question is, as one executive put it succinctly, 'how do we get from today to the future?'

Although executives agreed on three broad objectives on which the industry has to deliver, it is still open which business models would be most promising. They agreed that the socio-economic role of life insurance would remain central, that insurers need to adopt new technologies more quickly to better realise efficiency gains, and that distribution will have to become even more efficient and customer-engaging while balancing the need for expert advice. But there was dissent as to whether the industry would continue to evolve along a traditional, evolutionary path; follow a disruptive, 'digital first' transformation; or choose to partner with new technology firms in a cooperative approach.

Whichever business models ultimately succeed, it is clear that they need to succeed, and succeed well, on three must dos':

- Deliver on the **socio-economic role** of insurance,

- Deliver **superior customer engagement** and **superior customer value**,

- Deliver effectively against evolving **regulatory requirements**.

Failing to reach these goals would put at risk the business proposition of life insurers and their valued socio-economic role. But the message from senior executives is not one of complacency. To the contrary, they have seen the writing on the wall. They are implementing corrective measures. And they are determined to weather 'manageable headwind.'

## SOME POLICY IMPLICATIONS

However, for the industry to be in a position to fulfil its role, policymakers must also play their part and provide a conducive environment. Building blocks may include:

- A stable macro-financial and regulatory environment that allows for long-term planning reduces the risk of disruptive financial crises and promotes long-term savings. Low interest rates make retirement savings difficult, and many savers have yet to fully recover from the losses incurred during the Great Financial Crisis,

- Regulatory, accounting and risk management frameworks that are viable under many different interest rate scenarios and properly reflect the life insurance business model. It requires in particular acknowledging that life insurance liabilities are illiquid with very long durations. Insurers are therefore well-positioned to hold assets with a liquidity premium, thereby funding long-term investments in support of economic growth,

- The promotion of financial literacy among the general public. For a number of reasons, people tend to underestimate longevity risk, and the actual protection cover of individuals and households tends to be inadequate, as are individual savings for retirement purposes. The deficiencies caused by under-savings are exacerbated by low and ultra-low interest rates. For these reasons, financial literacy programmes should be designed to create a better awareness of retirement financing conditions. Their objective should be to close the gap between actual savings and expected retirement financing needs while paying proper attention to longevity risk.