Pension Freedoms

The final act of the life insurer

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Pension Freedoms have opened up opportunities yet made life more complicated for consumers, advisers and insurers.

The reform has thrust insurers into a complex landscape with multiple default options, longer investment horizons, greater product diversity and most challenging of all, customers phoning up for help at a time when RDR has exacerbated what was already a significant advice gap.

When considering the impact of the freedoms on insurers' business model, it would be easy to focus on the commercial implications of no longer being able to sell expensive annuities to inert customers, the potential for new decumulation products or buying IFAs to secure distribution channels, but that would miss the wider context of an industry that had already found itself at a historic cross roads.

Life insurers thrived for generations selling the 25 year savings product that only worked if you held it for 25 years. But now the sector is being asked to deliver flexible solutions that can constantly evolve to meet the changing needs of customers, public policy and the latest technological breakthroughs. To do this successfully a whole host of change is needed but at the heart of this lies the need for a much closer alignment between advisers and manufacturers.

An Industry at a cross-roads

The life insurance industry was one of the great innovations of the British Empire that for 200 years has played a key role insuring the nation and helping it save. The sector has helped consumers build strong financial futures and created capital for businesses to invest aided by tax incentives, strong balance sheets and exceptional levels of trust.

The last two decades have brought a tsunami of change and the market has shifted from competing on commission and complexity towards offering simpler products, platforms and services.

The policy framework has seen 15 material changes in the last 17 years headlined by RDR, Auto Enrolment and Pension Freedoms with more to come, especially if LISA proves to be the Trojan horse for a more fundamental shift to TEE that many predict.

Consumer expectations have been re-set as we become increasingly familiar with digital services like Amazon and iTunes. In all aspects of life consumers are increasingly omni-channel wanting to deal with providers on their own terms delegating but not abdicating decisions, living more dynamic lives that require flexible solutions and demanding simplicity.

The insurance sector has notoriously arcane back office technologies which has limited its tech innovation to date, but that will change in the next decade as firms manage their legacy IT issues, personal ownership of data leads to customer aggregation starting with the pensions dashboard and cutting edge innovations such as AI, robo-advice and analytics are fully established.

The day of reckoning

We are rapidly approaching the day of reckoning as it becomes increasingly apparent just how different the actuarial skills and pensions expertise that made insurers successful in the past are to the digital skills and asset management expertise they need to be successful in the future.

So, it is in this context that the pension freedoms have further blurred the boundary between accumulation and decumulation, exacerbating the need for flexible life-time solutions that treat 'retirement' as a beginning not an end.

The services of life insurers will be more important than ever but the shape of the industry will change beyond recognition. We see three distinct models emerging:

1. Platform Asset Administrators

We expect three to five firms to emerge as winners following a period of intense consolidation which will see the minnows taken over or go out of business.

These firms will invest heavily in their technology giving them one underlying admin platform at the back end which will support 'universal accounts' enabling customers to move seamlessly between tax wrappers and other channels.

They will supplement this with sophisticated marketing services (digital front end, analytics, robo-advice, aggregation) to support the delivery of better digital experiences both directly and through intermediaries. Such digital insight will also enable them to develop investment solutions much more closely aligned to client objectives.

Having emerged as the dominant administrative platforms they will seek to vertically integrate to increase revenue by buying distribution and/or strengthening asset management propositions.

They will take proactive steps to manage legacy books by moving customers and assets onto the platform and by running off what is left either by outsourcing IT or customer service or selling to specialists.

Their customers will still need insurance solutions to deal with living too long or not long enough but these will increasingly be sourced from specialists and integrated into funds or platforms.

Critically margins will find a new level with platform administrators needing to operate within 20 or 30 bps not the historic 50 to 100 bps. This will mean a wholesale change in working culture and staff as basic functions are automated and products simplified. They will need half as many people, fewer actuaries and administrators but more customer experience experts and digital scientists.

2. Legacy Back Book Consolidators

We expect a small number of back book consolidators to emerge with the requisite actuarial and operational skills to manage run offs in a cost effective way for the majority of back books in the industry. This will take account of the majority of complex with profits business with their inherent guarantees that cannot easily be migrated to platforms.

The cost of moving to new traditional life platforms will remain prohibitive in many cases so these firms will instead become experts at legal entity rationalisation, process efficiency, outsourcing, off-shoring and work-flow technology to reduce costs.

3. Insurers

We expect insurance to become an increasingly global market with firms with capital and actuarial expertise developing more flexible insurance and longevity solutions often packaged as tradeable securities on the global markets. These will predominantly be 'wholesale' businesses with the customers being owned by the platforms & back book consolidators.

Key ingredients such as the bulk annuity and re-insurance market for term assurance are already well established. The future will see the development of more sophisticated customisable solutions that can be integrated into asset gathering platforms.

What does this mean for advisers?

At one level the future is the same as the past – any successful adviser needs to have a clear picture of the needs of target customers and a clear proposition.

However, the way this is achieved in future will be very different to the past.

It seems likely that the core adviser market will move towards restricted models, in many cases this will see the platforms buying distributors – advisers will need to consider how important independence really is to their customers and why?

Advisers need to accept that customers will increasingly move between advised and direct channels. This will challenge historic industry practices of channel 'ownership' and intermediaries incapable of meeting this constructively, for example by restricting customer's access to digital direct services, will not thrive.

The choice of platform will be ever more critical. As they evolve from pure administration of tax wrappers and assets to offering embedded analytics and AI this will give forward thinking intermediaries the capability to fundamentally transform their own marketing and robo propositions.

Successful intermediaries will recognise the potential for these platforms to transform their businesses.

A different relationship

More than anything, the key for advisers will be to establish fundamentally different relationships with platforms. Too often in the past the relationship with insurers was based on mutual mis-trust, arguments over customer 'ownership', commission dependence and fundamentally different interests.

More mature relationships will be needed based on honest dialogue, shared interests with intermediaries and platforms entering into long-term partnerships as equals.

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