ADDRESS TO THE

INSURANCE INSTITUTE OF DUBLIN

"CHANGING TIDES IN LIFE INSURANCE"

W Acton FSA

Canada Life

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CHANGING TIDES

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Thank you and thank you for attending this talk. Unlike a tide, I will not take 6 hours to change nor indeed will I take 6 hours to go down.

I tried to follow the first rule in speech making - that I should have a strong opening, a quick, snappy ending and keep the rest to a minimum.

I failed!

So instead, I will revert to the second rule of speech making - tell them what I am going to say, tell them what I have to say and then tell the sleepy ones what I have said.

So: Changing Tides - more like Crashing Waves - but well spread out - I will talk about and show you a few of my observations on the Irish Life Assurance Market - the big things that have affected it in the past 30 years - share with you my humble opinion why those effects are there, and lastly, to give you my list of the current and coming events that will affect the business for the next 30 years.

My views are those of a person from abroad - I am from Canada. I have worked for Canada Life for 20 years, spending:

3 years in Computer Systems

2 years in US Individual Insurance

3 years in the UK

4 years in US Group Employee Benefits (PHI, Life)

9 years in Canadian Group Life and PHI ??

5 years in Canadian Home and Auto Insurance

6.5 years in and on Irish business

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32 years in total in my 20 years with the company - a lot of double jobbing!!

However about 1/3 of my career has been involved in Irish business dating from 1979 - 1982 and more recently, 1991 until now.

My view - 4 big events or forces have shaped the business in Ireland over the past 30 years:-

1. Inflation - it has changed our products, expectations taxes and much more

2. 1st Life Directive has allowed new competitors and opened the eyes of the old competitors. It was the first taste of Europe.

3. 1989 Insurance Act has and is still changing our sales people

4. Government Tax Policy Change

5. Then I will talk about the factors that I think will affect us in the future.

Let's take them in order:

INFLATION

Inflation is not a normal state of affairs. Indeed during times of peace, inflation up until 1958 on average did not exist. Normal was a gradual drop in prices.

Here is a graph of the Consumer Price Index from 1600 up to 1914. This is taken from a paper presented by Wilkie to the Institute and Faculty of Actuaries. You can see that prices varied from about 30 to 70 and both went up AND down. The major ups occurring during times of famine , war or strife - Plague and great fire of London, Napolianic wars Crimean war etc. The Economist using this same data series made the point that from the time of the great fire in 1666 to 1945 the index value did not rise.

From 1900 to the present hardly fits on the same graph. And I am not here to deceive, I am not using the familiar linear scale, this is a log scale so doubling in prices is represented by uniform increases in the height. Even so, the period from 1958 to 1993 goes from 100 to over 1000!!. 350 years of relative stability followed by 35 years of rapid change. Blame who you want, but inflation is not normal.

It is hard for young people like me and you to understand a time of low inflation but imagine the truths that would exist.

Salary changes were infrequent and occurred with promotion - no annual increase.

Prices were stable - a home purchased at a price could be sold on at about the same price.

Interest rates were low and stable reflecting the income value of an asset, not the loss of purchasing power.

Dividend yields were higher than interest rates because they were a more risky return.

Most businesses were not geared for growth in nominal terms, they grew by business expansion, not price increases.

Now to the Life Insurance business.

Products	-	set premiums that lasted a lifetime - no need for increases to premium rates or to face amounts.
Benefits	-	a constant multiple of a percentage of premium times term implying a zero guaranteed return
Investments	-	predominantly in Equities so that insurance companies could benefit from the higher equity yields and pass this advantage on to policyholders

Product Design - such that the statutory pay back period on a policy was approximately 6 - 7 years. New Business was a fairly constant 12 - 15% of inforce business

Inflation changed the rules of the game. The exact sequence is hard to determine but company finance, investment, policy design, consumer demand all changed.

SLIDE

Between 1945 and 1965 the smoothed ratio of New Business to Revenue Premium in Ireland hovered in the 12 - 15% range. Since 1975 it has not been less than 19% and has peaked at 25% in 1981 and 1987. EXPAND CONCEPT

Companies selling traditional products could not afford to keep selling these products. They had to wither away as they failed to keep pace or weaken themselves financially or develop new products that recouped the initial loss more quickly - the front-end load unit-linked policy was the easy solution to the problem.

Irish Life felt this first in Ireland as they were not only faced with the inflation effect but also their rise in market share from 30% to well over 50%. Irish Life led the way in unit-linked policies in Ireland.

Another view would be that rather than serving themselves - this was market led - customers deserved the immediate reward of investment gains in the year in which they occurred, not spread out, based on some Actuary's whim. Moreover, this had the effect, in a time of rising market values and interest rates, of paying out more - right now. EXPAND CONCEPT SLIDE

It could also be used to bamboozle - such as the good old line - "well sure the Bonus Rate at Standard Life is only 2 1/2% - the fund increase on the Property Fund was 12%"!!. This was comparing apples and oranges but was a part of the rough and tumble of marketing in those days.

In any event, companies and consumers both embraced unit-linked products and the prospect of future investment gains outweighed the obvious costs of front-ended charges.

Indeed inflation did something else! Those front-ended charges of 1.5 times annual premium, or 2 times annual premium paled into insignificance after only a few years so companies quickly realised that they could raise prices (charges) and still sell business. The race for distribution started.

Inflation also drove Stock Market and Real Estate values for about 25 years. Owners of Real Assets benefited greatly - like policyholders, people who borrowed money to buy homes benefited. Who lost? - people who lent money i.e. depositors in Banks and Building Societies, holders of debt instruments like Banks and Building Societies and Pensioners.

So during that bout of inflation lots of things came right for insurance companies:

- Our Investment Strategy of holding Equities for a high yield actually translated into big capital gains.
- We changed product design to allow faster growth of our business.

- Policyholders accepted high early charges and took on the investment risk. Indeed they even took on the risk of expense inflation and mortality as new flexible products were introduced.

- Holders of both old and new policies gained and indeed holders of Endowment Mortgages gained in four ways - Life Assurance Tax Relief, Insurance investments in Equities, Borrowed money to buy House - Tax relief on interest.

- Inflation crippled our principal competitors in the savings market - the deposit institutions.

- Life was good - too good!

  - we forgot about fundamentals of selling insurance - we sold investments - we lost our roots.

  - we allowed high expenses to creep in - we got fat.

  - we started assuming inflation would last forever - we lost the run of ourselves.

INFLATION FUNDAMENTALLY CHANGED OUR BUSINESS

In the middle of that inflation - a simple change in Europe took place - **THE 1ST LIFE DIRECTIVE** - Freedom of Establishment.

From 1936 to 1976, there were no new companies created. There had been 40 life companies - that was crowded

But by 1966 there were 13 active companies - the big 3:

Irish Life	-	34%
New Ireland	-	17%
Royal Liver	-	13%

These are market share of recurring revenue premiums as shown in the "Blue Book" that was really a green book at the time.   Lets see what happened to them. SLIDE> You can see that something happened in the market to the big 3 over the past 30 years. In 1966 the rest of the market was led by Norwich Union at 9.5% and the rest of the market had between 1% and 4% share. Most of the pack ran their companies from the UK and used UK products, UK management and dealings in the Republic were almost an historic accident as much as a business.

SLIDE

So in 1966 the top 5 companies had 80% of the business, there were very few Challengers to the top companies.

By 1977 little had changed really. Irish Life using its special tax status as having 66% tax relief on premiums as opposed to the foreign companies 50% (sour grapes) popular unit linked products, excellent fund management and nationalism had grown to near 50%, the rest went down. There were now some nowhere companies, and a cloud on the horizon one new company Insurance Corporation. But the race was about to begin.

Then the door opens - first Insurance Corporation Life Company (to be Prudential, to become Progressive); then Shield - to become Eagle Star; Abbey Life - to become part of Canada Life; Hibernian. Also the branches of foreign companies noticed that they needed to treat Ireland differently. Life Association Scotland creating an Irish subsidiary. Norwich and Standard and Friends Provident starting to locate decision makers here. This was the time of my first involvement in Ireland and it was exciting to watch.

The winds of change were blowing.

By 1987 the Top 5 companies, who had controlled 80% of the business now only had 70% of the business. The newcomers were changing the rules and challenging the historic leaders.

Unit-Linked products financially removed the barrier to entry, so the product development that had allowed Irish Life to grow so quickly was the product that allowed the new companies to arrive and grow and push Irish Life out of the way.

By 1993 the Top 5 controlled 60% of the business. There was a new order. The "pack" that in 1966 meant that there were 5 companies over 5% and 9 between 1 and 5%. By 1993 there were 9 companies over 5%, only 5 between 1 and 5% and 5 strugglers at less than 1%. Comparisons on New Business even more dramatic.

The new companies and the old companies that had to get sharper in order to survive, became serious life assurance companies - created jobs in Ireland and brought down the stranglehold of the old, established Industrial Branch based companies.

These new companies included the Bank subsidiary companies but that change was not so much a separate Wave but part of that Freedom of Establishment Wave - and a part of that next wave. Before I depart from this movement it is instructive to see if this effect is yet complete -- It is not. In 1966 most companies that operated had a new business market share that more or less matched their revenue premium market share. We all had our slice. Except for Irish Life who swept up all the little bits and had a new business market share that was a bit higher than its market share. I refer to this balance of market shares as momentum -- Is a companies new business share above its revenue share? If so it will inevitably lead to growth in the more stable revenue share. If not, the momentum is in the other direction. Here is a picture of overall share and new business share for Irish Live in the chosen 4 years. There is lots of change still being felt from the first life directive.

Is the market over crowded? Not really - what happened is that the companies that were doormats have fought back.

The 1st Life Directive was a definite shaping influence and a Tide Change and a portend of more European influence and impact.

The next Tide Change was fairly recent so we have not seen its full impact yet but it has made a major change - **THE 1989 INSURANCE ACT**.

The principal effect was the demarcation of Brokers as requiring special obligations, the formal requirements for Agents and Tied Agents. Coupled with the creation of the Bank Subsidiary companies, meant that the situation in the 60's and 70's whereby every bank manager, postman, school teacher and parish priest had an agency, changed. The companies who had come to rely on these sources of business suffered.

Those who had developed full time broker and sales force distribution channels were relatively unaffected.

Unfortunately that sort of information is not available so no names named or market shares revealed.

The aspect of the 1989 Insurance Act that is still running its course, is the fact that broker ranks are thinning and not enough new brokerages are getting started. Why? Because of the interaction between the IIF Commission Agreement and the 1989 Insurance Act.

This saga will be played out in the years to come because a healthy, vibrant, viable, in-depth, broker market is a good thing and a worthy policy objective. Failure to address and correct that interaction will result in the weakening of the Irish Life Insurance Market.

The last of the major Tide Changes has been the gradual **SHIFT IN TAX POLICY** since the mid-1980's.

As I mentioned earlier, inflation was good for life insurance companies and hard on banks. The cry for a level playing field to try to make the two even - in an inflationary environment - has meant that in a low inflation environment, the playing field is tilted in the other direction.

Dropping Life Assurance Tax Relief was to be expected. The social desirability of Life Assurance as a thing to be encouraged had been perverted by greedy "savings" sellers. However there has not been an encouragement to pursue that worthy social policy that replaces the abolition of Life Assurance Tax relief.

BUT the introduction of DIRT tax at standard rates means that risk-free deposit returns are taxed at the same rate as the relatively risky investments of life companies. Coupled with the taxation of unrealised capital gains for life companies the environment of the lifting of exchange controls, the creation of special zones for real estate which instantly drive the value of existing holdings down - the latter two items tending to specifically devalue life insurance investment portfolios -- and the continuation of an incredible period of sustained high real interest rates means a quadruple whammy on life insurers.

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These changes will push insurers to drop our traditional role of long term investors and make us change our investment profile to that of a Bank <u>if</u> we are to compete in the savings market.

Can we compete in the savings market? Can we overcome our tax, expense and infrastructure problems in order to deliver short-term savings products? The answer to this can be seen in the sales statistics and the answer so far has been NO.

This, as much as anything, has made us revert to our "protection" roots.

This raises the question;

If the current tax status and protection of pension business goes, do we have, as an industry, the wherewithal to compete against all-comers?

The answer is of course speculation So that brings me to my time for speculation.

At the outset I promised you my guesses at what comes next - what will be the forces shaping us into the next 10 or 15 years?

I have already alluded to a few of them.

The reduction in **inflation** will have many of the opposite effects of the increase in inflation - it has and it will hurt the industry.

We will go back to a With-Profits environment or at least a more balanced approach to product mix as opposed the almost religious divide on Unit-linked versus With profits that has existed for most of the past 20 years.
We will revert to selling stable protection based products as much due to tax reasons as to do with inflation. And we will or should start to take some of the very expensive administration and flexibility out of our products. That flexibility was put there in response to inflation. By and large inflation ended before the flexibility was created but flexibility drives up our costs of administration and at some point we will go back to more simple products. FOR EXAMPLE monthly allocations and charges were deemed necessary when prices and increases in values were all over the place. Surely now we can do as our forefathers did and use an average assumption in there and get a product people can understand and we can administer without using a supercomputer.

We will be able to finance products with longer break-even points i.e. deliver better early returns. This will push the return on capital down, but the owners of companies have had a pretty good run of it for the past few decades and in the open competition that does exist we must design our products to compete against all alternative products not just other insurance policies.

And the other biggy to tackle with the decline in inflation is our sales costs. They have to go on a diet for a variety of reasons The current charges are too high to hide in a non-inflationary environment. The changes here will require a good deal of power of conviction. Intermediaries don't like to hear that commissions will be dropping in the future -- indeed they tend to associate the bearer of that news with the news itself. However for the intermediaries who accept this message and raise their productivity such that they can survive and prosper in a low commission environment will prosper mightily in the interim and survive into the future. The ones who think that the day could never happen will be lost when the day comes -- as it has in Australia, the US and Canada to name but 3 English speaking markets. Companies must also adapt to this low cost environment and failure to do so will relegate them to the sidelines.

Demographics will play a big part in our world. This impact with respect to pensions was covered at a previous presentation, but the obverse side of those demographic statistics that are so favourable for pensions, is that the need for life insurance will subside. The salespeople who think that they are great salesmen in the 1990's are great with a big help from the fact that the Irish baby boom and bust has created a current demand for such products. This won't last for ever. The companies that have the fundamentals and vision to foresee the next demographic trend and the attendant consumer needs will prosper.

Europe will affect the Irish market in several more ways. The first will be the convergence effect and the ability for new companies to come in. Just as the first life Directive produced a wave of competition, it also had an element of protectionism -- there was a threshold of expense and size to overcome before entering the Irish Market. Some companies indeed many companies failed to overcome that threshold. BUT there were many companies who didn't enter the market because of that threshold and now some of that barrier is gone due to the 3rd Life Directive. Watch out--- our niches will be under attack.

The next element of Europe is that ominous thing concerning European interference and regulation and consumerism and a pull towards regulation of selling practice and policy wordings and disclosure and all that stuff. The camel has its head in the tent and is not going to leave. Inspite of all the talk, the German model of 100% regulation is coming. This is not the end of the world, but it is going to be a fact of life. The companies that can comply with the regulation and yet retain their imagination and flare for marketing will prosper --- the ones who merely comply will be lost.

CHANGING TIDES YES and CRASHING WAVES But like surfers these changes produce energy--- energy that can be harnessed and used to gain market advantage. Looking backwards at the effects of inflation, 1st life directive, 1989

Insurance act and tax changes-- some companies have positioned themselves to take advantage of these changes and **have** prospered. Some have prospered from some and not from others. In the future, companies, sales intermediaries and people employed in and around the industry have the opportunity to ride these new waves to new prosperity. Good luck, hold onto your board and watch out for the rocks.

THE END

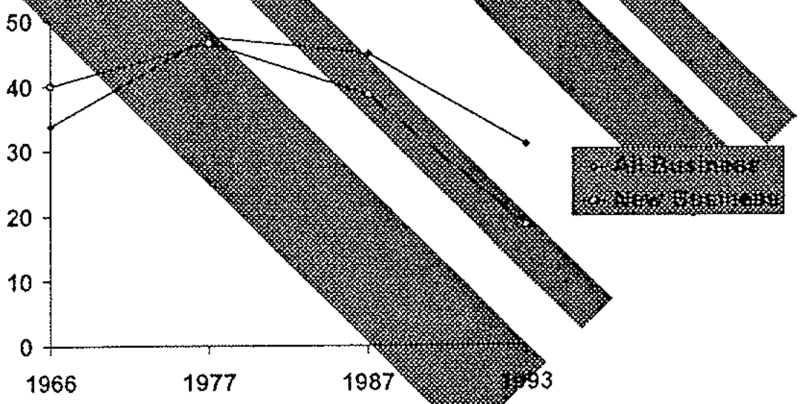
Tax Policy

- Level ⇨ Tilted
- Protection

Next

- No Inflation → Low Inflation
- Demographics
- Europe
  - New competitors
  - Consumer Protection

Irish Life Market Shares



1989 Insurance Act

B16

Historical Market Share

		1966	1977	1987
	% Top 5	80%	82%	71%
Top	# +10%	3	3	1
Challengers	# 5-10%	2	1	6
Tailers	# 1-5%	9	7	8
Not There	# <1%	0	4	5

Historical Market Share

		1966	1977	1987	1993
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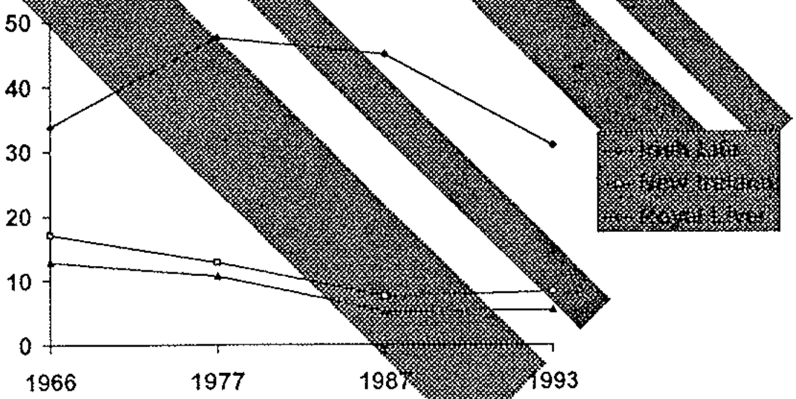
Inflation

1. Pressure on policy design
2. Consumer demand for payout
3. Marketing led
4. Higher charges
5. Relative advantages
6. Life was good

Market Share of AP Income



Inflation

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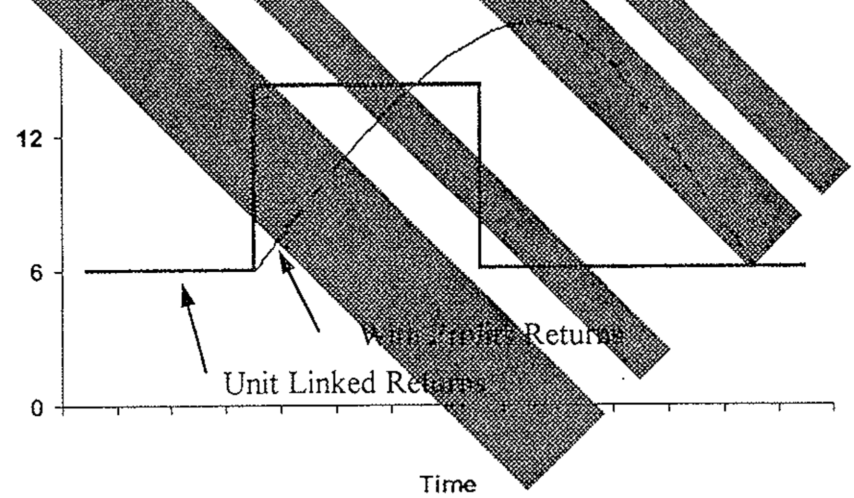
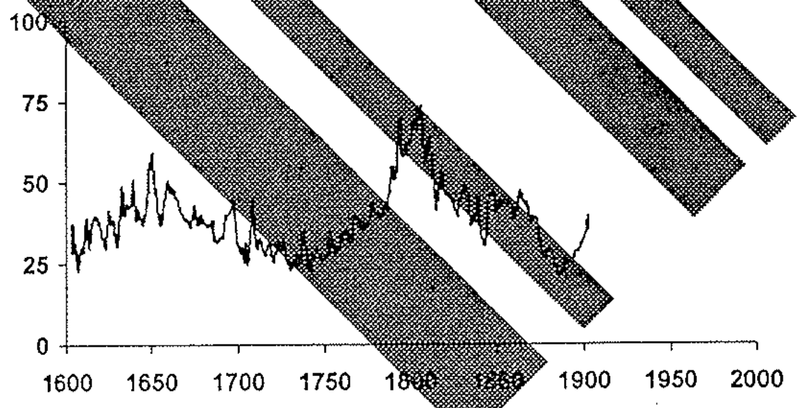
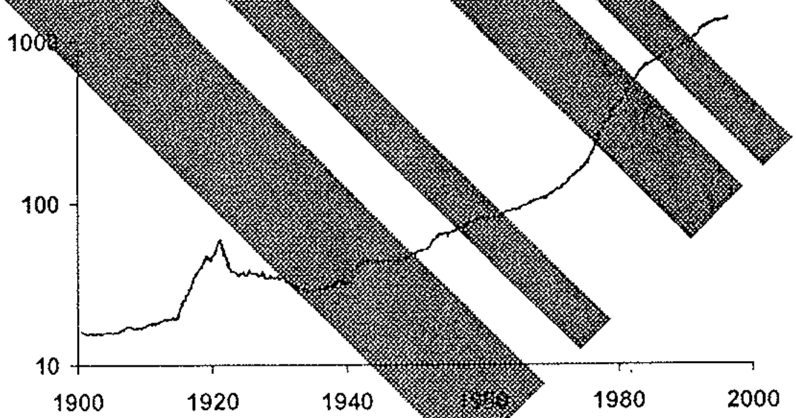


Inflation 1600-1914



Inflation 1900-1994



Changing Tides ?

No, Crashing Waves

Changing Tides

- Inflation
- First Life Directive
- 1989 Insurance Act
- Tax Policy
- What Next ?