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Life Assurance Or Financial Services?

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One of the more important developments of the last fifteen years has been the growth in the scope and importance of financial services. Indeed I doubt even ten years ago if we used the term financial services. In those days we all knew our place. Banks did banking. Building Societies lent money to buy houses. Life assurance companies sold life assurance with a smattering of pensions.

Even if the occasional bank manager was involved in the odd life sale we recognised it for what it was - a minor deviation from the natural order. Anyhow the actual sale was usually handled by the life office - bank managers were not expected to sell.

Have these good old days gone for ever? Is there really a financial services revolution and do we have to take part? Will there be any separate life companies left or are we all in financial services?

Clearly any industry is continually evolving and there is always change. The view underlying this paper is that the pace of change in financial services is now such that we are in a revolutionary rather than an evolutionary phase. Accordingly the extent and scope of new developments in the next few years will be much much greater than anything we have seen in the past. This poses major challenges for the management in all financial services companies. There are many options - which ones will be the winners?

I propose to approach the subject of this paper "Life Assurance or Financial Services" from the perspective of a life office concerned about its future role in the wider financial services world. Can it maintain an independent existence, either totally on its own or in an alliance with other, complimentary, institutions? Would it be better as an integral part of a more broadly based financial services group?

Initially, as a background, I will look at the success of our industry in recent years. Then I want to introduce the factors that will impact most on our business. From this I will suggest a number of alternative strategies and what these imply. Finally, I want to say something about what I will call the industry infrastructure, including supervision.

The first thing to be emphasised is that the last fifteen years have been very good years. Personal savings, of which life products are a key part, grew by 17% per annum compared with growth in GNP of 13.7%. Thus personal savings grew significantly faster than the economy as a whole.

More interestingly, during this period the life industry dramatically increased our share of the personal savings market, largely at the expense of the banks, as the Table shows.

MARKET SHARE

	1974 %	1988 %
Banks	79	30
Building Societies	8	7
Life offices	4	46
Others	9	17
	100	100

Of course these figures slightly distort the picture since some of the life business, especially in the lump sum investment areas, was sold by the banks.

Nevertheless the table clearly shows why the banks have gone into the life market. For me the surprise is that it has taken them so long to do so.

Why have the life offices done so well? I can offer a number of reasons. Firstly, life offices had a sales culture. Unlike the banks and building societies, we were prepared to go out and sell our products and to reward our distribution for doing so. Of course it helped that we had attractive products to sell!

Secondly life offices were focused on the customers needs. In contrast, the banks were unable or unwilling to treat their account holders fairly, especially in periods of high inflation. Instead they used the income they earned from such deposits to subsidise their money transmission services. This made the money lying in the bank accounts vulnerable to the more attractive returns which life offices could demonstrate.

The building societies had a similar problem. They were constrained politically on the rate they could charge for mortgages. This in turn limited the rate they could offer to attract and retain deposits. While they had the advantages of simplicity and total security of capital it was not too difficult over time to show that the price for these, in terms of lower returns, was unacceptably high.

By comparison life offices did not have to serve two masters. We could buy and sell investments freely with the sole objective of maximising the return to our policyholders. This is especially true with unit linked policies where the greater the return on the fund the better both we and the investor do.

Greater customer knowledge also played a part in our success. For the first time, as a result of both increased advertising and general media coverage, the customer was aware that there were alternatives to bank and building society deposits.

The recent past, therefore, is one of considerable success for life offices. How do we stand as we enter the 1990's?

Firstly banks and buildings societies are fighting back to retain their share of the savings market. It is significant that they are doing so by getting into selling life assurance. Naturally there is some concern among established players in the market, both offices and intermediaries, at the impact of such activity. And we have to recognise that the Bank of Ireland have had a lot of initial success with Lifetime. This then is probably the appropriate time to introduce what I hope will become known as Duncan's Law of Marketing Success.

> "It has to be better to be established in a market that everyone is trying hard to get into rather than one that everyone wants to get out of".

Did the life industry also enjoy a more favourable tax environment for its products? This is a complex area and comparisons are difficult. Any advantage was slight and has been well eroded by the Insurance Levy. The other factors were much more important!

Cross selling has also become the in-approach to the marketing of financial services. The idea is superficially seductive. We have a satisfied client for product A - it should be simple to sell products B,C and D also. This approach is particularly seen in the mortgage area. Give a customer a mortgage. Treat him (or her) well and he will come to you for all his other financial needs. Huge investments are being made to support cross selling and some of these must succeed.

The success or otherwise of cross selling is at the core of the challenges faced by financial services companies. If cross selling is the way of the future then companies with a narrow product range and/or poor customer relationships are vulnerable. Clearly the considerable interest in Ireland and elsewhere in mergers, acquisitions and joint ventures suggests that many believe it is the way of the future. I will come back to this.

The Single European Market will also have an impact. Once AIB get their life operation under way I think in normal circumstances that all the future serious competition in the Irish market is already here. I cannot see our market being attractive to many new entrants although a few will, no doubt, defy my prediction. Also, despite the possibilities on paper, I cannot see many of our customers applying to foreign companies to purchase life assurance or to make lump sum investments unless there are significant tax advantages to doing so.

Unfortunately the Single Market does offer the possibility of such tax advantages unless action is taken. Currently, in Ireland and the U.K., tax is payable within the life fund but there is generally no tax liability when benefits are paid out. In mainland Europe, in contrast, life funds accumulate tax free but tax is payable when benefits are paid out. Over time it is difficult to see any alternative to Ireland and the UK changing our approach - otherwise there will be significant tax advantages in doing business with a non-resident company which the proposed approach of the EC Commission for a single licence will allow.

A change to gross build up would have a major impact on product design. It would also make it easier to implement a genuine level playing field. However moving from the present system would also have huge transitional problems, both for the industry and for the Revenue.

Will we also be operating on the proverbial level playing field? I assume this is the intention of our regulators and the Revenue. It is difficult to achieve in practice although I think it is fair to expect that the playing field will be a little less bumpy! I do not see this causing any problems.

It is, frankly, difficult to assess the long term strategic effect of the Insurance Act, especially on the position of intermediaries. Initially there was some concern that there would be a move towards more tied agencies. I now feel this is much less likely.

A strong, independent, broker market is important in providing an alternative to the distribution capabilities of the banks and building societies for two reasons. Firstly independence, the ability to search the market, has a value that customers should appreciate - it can be the competitive advantage that we all seek. Secondly competition between different offices serving the independent brokers produces both better products and better services. The reason I am so committed to maintaining a comprehensive commission agreement is that it focuses competition on products and service which are to the benefit of the ultimate customer. In contrast a commission free for all does little in the long term to expand the total business.

In summary, therefore, the prospect is one of much change, more competition and lots of experimenting as the industry tests the value of cross-selling. For individual companies there are a number of possible strategies:

1. Be a product manufacturer or producer selling through somebody else's distribution.

2. Be both a producer and a distributor, distributing either through a captive sales force or independent brokers.

3. Some mixture of the above.

To illustrate the options it is helpful to consider a model which highlights the three elements in the sales process - the customer, the distributor and the products. The strategy of an individual office is largely determined by where among these three elements it puts most emphasis.

Take, for example, the institution that puts its main emphasis on the customer. Such an institution aims to sell a range of financial products to a "warm" customer base. Each individual sale will be made, not because the product is the best on the market, but because the customer has a satisfactory long term relationship. This is the approach the two main banks are using.

Institutions with this strategy are into cross-selling in a big way. They will have a strong marketing emphasis, will commit the resources to develop customer based computer systems and will offer a range of products. Some of these products they will manufacture themselves whereas others they will buy in. No more than a handful of institutions will have the resources to pursue this strategy - for most offices the prospect is to be the supplier of the life products (other investment type products such as unit trusts are also possible).

Initially this strategy of focusing on the customer with a strong emphasis on cross selling looks attractive. Personally, however, I still have a very open mind. Cross selling clearly appeals to the financial services company. How about the customer?

While it is early days yet there is already some evidence that customers do not want, as it were, to put all their eggs in one basket. They recognise that no institution can be best at everything. Also it is difficult to manage a long-term relationship - there are always plenty of opportunities for things to go wrong.

The second strategy is to focus on the distributor. Institutions pursuing this strategy, which are most likely to be life offices, rely on selling skills to overcome the disadvantage of not having established customer relationships. They will have a strong emphasis on managing and motivating their salesforce - plenty of competitions and lots of photographs of the leading salesmen (or indeed saleswomen). They are likely to promote a limited range of products and are unlikely to be among the most competitive offices in terms of value.

This is inevitably the strategy pursued by newly established life offices since they do not have any established customers. It can be reasonably successful in the short term but tends to lead to poor quality business. Ultimately the better salesmen want to establish customer relationships and this leads to tensions within the office. This is one reason why the better salesmen usually migrate into brokerage. I have some concerns about the longer term viability of this strategy and I think increasingly such companies will move towards developing better client relationships.

Finally there is the strategy of focusing on products. Such companies could be expected to offer a range of products and to put a lot of emphasis on product development and innovation. They tend to be run by actuaries with a marketing bent and generally are aimed at the independent broker sector. In the first instance product innovation is used to get a bigger share of the brokers business. However such innovation has also been very successful, for example, in expanding the brokers share of the lump sum savings market at the expense of other institutions.

It is likely that offices in this category will be suitable manufacturers of life products for institutions who want to pursue the customer relationship approach. Of course this can lead to conflicts with their broker relationships although it is not obvious that this has an adverse impact on sales.

One conclusion from considering the model is that it is difficult to mix strategies. Thus a company with a strong presence in the independent broker market will find it difficult to set up a captive sales force and vice versa.

The model equally applies to brokers except that the product company is replaced by the specialist broker i.e. the broker who concentrates on a specific market section such as pensions or lump sum investments. It also helps explain why such brokers have difficulty in developing into different product areas.

Overall, therefore, offices have three broad strategies which they can pursue. Which ones will be the winner?

As with most things in the real world there is no simple answer. There is no single right strategy. In principle the winners will be the offices who select the appropriate strategy for their resources and who then implement this strategy successfully. Implementation, coupled with an ability to focus on the appropriate objectives, will be as critical as picking the right strategy.

How will life offices do in comparison with banks and building societies? Again I believe it has to do with "how" rather than "what". Most of the institutions which are pursuing the customer relationship approach are involved in a high risk strategy. While there will be a limited number of successes there will be some big failures.

It is interesting to look at the experience elsewhere. In the U.S., which has been down this road for a number of years, the evidence is that there has been little success in banks widening their range of products to include life assurance. Notwithstanding this there are lots of "alliances" between banks and life companies in both Continental Europe and Australia. If such "alliances" are to succeed then large financial institutions will have to become increasingly successful at selling a wider range of products to their customer base. If this happens - and it is a big if - then it will be more difficult for smaller players, whether they be banks, building societies or life offices, to compete unless they find a niche to which they can bring some special advantage. I am confident, however, this can be done.

Will we see a reduction in the number of life offices?

It has become common place to forecast the contracting of the financial service sector worldwide into an ever smaller number of larger players. The reasons why this should happen are obvious. And yet this has not been the recent experience. In the U.S., for example, there were 1900 life offices in 1980. Everyone agreed this was too many. Today, ten years later there are 2600, an increase of 35% during the decade. There has also been growth in the U.K. and in Ireland.

Let me stick my neck out, therefore, and forecast that there will be a small increase in the number of life offices in Ireland at the turn of the century. Some of these will be product manufacturers, linked in to external distribution system. Some will have very different shareholders.

As banks, building societies and life offices expand their businesses there is an inevitable blurring of the distinctions between the different institutions. This in turn has major implications for what I will call our industry infrastructure.

Firstly take supervision. Insurance, life and general, is currently regulated by the Dept. of Industry and Commerce. The banks and building societies are regulated in the main by the Central Bank. Unit trusts are regulated partly by the Central Bank and partly by the Dept.of Industry and Commerce. The Dept. of Finance and the Revenue have the responsibility for taxation which has a big impact on products.

This does not look like a logical structure with which to deal with an increasingly complex financial services sector. Instead there must be a strong case for a single regulatory authority which has total responsibility for all financial services activities. It would be essential that such an authority should embrace the developed expertise and resources of both the Dept. of Industry and Commerce and the Central Bank. I recognise that a case can be made for leaving general insurance unchanged.

Then there are the appropriate industry representative bodies. The Irish Insurance Federation represents the interests of insurers, both life and general. Does it extend its brief to cover subsidiary activities of insurers such as unit trusts? How does it represent the interest of an insurer who is a subsidiary of a bank? Who rules on the inevitable conflicts? What are the implications in the Single Market where foreign companies are marketing into Ireland? To date the staff of the Federation have done a great job in reconciling the different issues so, hopefully, they will be able to continue doing so.

I expect the broker bodies are also looking at their options. And indeed one of the bodies has already added "investment" to "insurance" in its name.

Finally there is the Insurance Institute. Historically life and general insurance go together but nowadays life offices have far more in common with other providers of financial services. Can the Institute continue to provide relevant education or do we need alternatives? When I come back in ten years time to explain why I got all my predictions wrong will it be to the Insurance Institute or to the Institute of Personal Financial Services?

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