Diversifying life insurance choice for Asia's HNW

Changes in UK tax laws and anticipated hikes in interest rates are key reasons for the value proposition of variable universal life insurance (VUL) to gain ground as a planning solution for HNW clients in Asia, says Steve Lawless of Old Mutual Wealth.

A mix of factors from regulation to the macro-economic landscape are leading to greater diversification and choice in insurance solutions for HNW clients in Asia.

Already, demand for death cover in the HNW segment in Asia is significant, in a bid to create extra liquid assets to enhance the size of a personal estate.

"[Changes in UK laws] are going to have huge impact in the global HNW arena. And this makes planning for overseas clients who own UK property vital."

STEVE LAWLESS
Old Mutual Wealth

VUL, in particular, looks set to start to resonate more loudly within the market – both from the perspective of those in need of cover as well as private banks and high-end independent advisory firms themselves, explains Steve Lawless, global head of banking distribution at Old Mutual Wealth.

But the US Federal Reserve's decision to start to increase interest rates, as a potential sign of things to come, requires consideration for a new type of product, explains Lawless.

In addition, changes in UK laws will mean that all corporate or trust structures which hold UK property are to be caught in the UK inheritance tax net from April 2017. (The UK government is introducing legislation that creates a look-through for all tax structures which previously would have sheltered overseas clients owning UK property from UK inheritance tax.)

"These changes are going to have huge impact in the global HNW arena," explains Lawless. "And this makes planning for overseas clients who own UK property vital."

Given that this asset class is popular in a lot of HNW portfolios in Asia, this development provides further impetus to the need for these individuals to increase liquidity upon death.

CREATING MORE CHOICE

Key to Old Mutual International's strategy has been its desire to avoid bringing yet another Universal Life (UL) policy to Asian HNW clients.

"First, premium financing will come under some strain if interest rates rise. Secondly, a lot of clients don't want to use cash or sell existing assets or shares to access jumbo death cover via ULI; they may prefer to use their own private company shares to create the liquid assets upon their death."

In fact, it's an extremely valuable planning tool for clients who are asset rich but cash poor, and it activates inactive assets such as family business shares to buy life insurance. More specifically, one of the reasons for UL potentially becoming a riskier and more expensive proposition for clients, is that they often take loans to pay premiums.

This is referred to as premium financing. If the cost of financing those loans rise during the lifetime of the policies, but the regular payments from the insurers do not rise accordingly (and the two are not necessarily linked), then the clients can find themselves having to fund the extra cost of that borrowing from other assets which may not have been anticipated at outset.

For the insurance companies, meanwhile, rising interest rates makes things harder to ensure the bond fund(s) they run can offer competitive levels of future income payments in order to keep pace with the need to pay for the

"A lot of clients don't want to use cash or sell existing assets or shares to access jumbo death cover via ULI."

ULI, although an incredibly popular and worthwhile product in the region, is an offering potentially better suited to an environment where interest rates stay low. And it is that low interest rate environment that has been key for private banks, brokers and insurers alike in being able to offer clients gearing and premium financing to drive the UL market to where it is today.

There is, though, now potential for a shift in the market, for two main reasons, says Lawless.

A good match?

While VUL doesn't suit every HNW individual or scenario, the mounting pressures on way UL is structured makes its benefits clearer for clients to see.

For example, a business owner with a long-term commitment to an employee can buy a VUL policy and structure an executive bonus or a deferred compensation plan, as part of an employee retention programme. In this case, the cash value is the equity portion of that policy and can be used 10 years later to create a supplemental retirement income stream.

Part of determining what suits customer is knowing their asset position, given that many wealthy Asians are asset rich with limited liquid capital.

Control is perhaps the most important aspect of the decision over what is the most appropriate policy. For example, with the investment aspect of VUL, it gives flexibility to the customer to select the bank with which they want to custodise the assets left from the premium once the charges are taken out.

As a result, they can use an investment platform they are familiar with, and work with their banker to select the fund managers to invest with.

By contrast, with UL the insurer maintains custody. It typically invests the assets in a bond portfolio, although some consider equities. Customers also need to fully understand the upside and downside of each product – including more volatility, depending on their investments.

higher borrowing costs, such that the clients face on the other side of the premium financing trade.

When interest rates rise, typically short-term yields (borrowing costs) rise more than long-term borrowing costs; this drives the crediting rate driven from the underlying bond fund.

> **"When we looked at the Asia market we looked at our strengths globally in terms of VUL offerings elsewhere."**

The yield curve is steeper at the short end and therefore there is usually a lag for the longer term bond funds to keep pace with the short term interest rate movements.

Old Mutual has certainly been patient in waiting to seize the opportunity for VUL to emerge as a more viable alternative.

It launched its innovative new life cover solution, the Silk Life Plan, around 18 months ago, to provide more depth and range than any product it had launched to date in Asia.

And the firm is confident that Silk is both competitive and unique in its field, standing out due to key factors such as its flexibility of cover types, high death benefit sum assured, its joint life option, and further flexibility around the diversity of the underlying assets. These are features which lend the product an angle that traditional whole-of-life products might not always have. "When we looked at the Asia market we looked at our strengths globally in terms of VUL offerings elsewhere," says Lawless. "When we considered the market dynamics at play, it looked clear that we could, with not insignificant effort, get traction in Asia with the VUL.

"In the short term, we need to look at specific client needs that the traditional markets could not necessarily solve, and in the longer term get more comprehensive market coverage due to the higher interest rates and changing macro-economic situation. We wanted to be an early mover in this space in Asia."

> **"With the addition of new channels, we will get quicker traction with VUL than has been the case in the past."**

The past 18 months has seen the firm do a lot of the "heavy lifting" required in terms of training the various distributors on the VUL product and how to sell it.

A BROADER ENGAGEMENT

At the same time, Lawless is looking to widen the firm's current distribution base in Asia.

Previously, he explains, the plan was to sell Silk exclusively through the largest brokers and big private banks.

But applying his experience with VUL in other markets, especially Switzerland, Lawless has been focused on carving out new market segments.

He has been approaching independent external asset management firms and multi-family offices, as well as lawyers, accountants and trust companies as sources of referrals to brokers where appropriate.

He is also looking at developing relationships with some smaller brokers, IFAs, as well as specialist HNW consultants.

"With the addition of these new channels, we will get quicker traction with VUL than has been the case in the past," he explains.

"We are seeing strong evidence of this already, which is hugely exciting." ■