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The Adapting HNW Life Insurance Business in Asia

A year ago, we highlighted in our article "Time to re-think insurance for Asian high net worth clients?" some of the challenges and opportunities facing the HNW life insurance industry in Asia. In this update, we examine some encouraging signs of transition, as the capital market continues to adapt to the increased sophistication of both advisors and clients, driven by the ongoing macro environment changes both market driven and fiscally driven.

A YEAR AGO, WE HIGHLIGHTED IN OUR ARTICLE "Time to re-think insurance for Asian high net worth clients?" some of the challenges and opportunities facing the HNW life insurance industry in Asia. These ranged from the need to continue to improve upon the holistic planning requirements of clients and their actual need for insurance, the changing interest rate environment affecting both financing costs and crediting rates, the need for product adaption, through to the bank balance sheet and client segmentation challenges of premium financing and the potential for mis-selling through a focus on premium financed single premiums with high commission rates.

In this update, we examine some encouraging signs of transition, as the capital market continues to adapt to the increased sophistication of both advisors and clients, driven by the ongoing macro environment changes both market driven and fiscally driven.

An Increasingly Holistic Approach

Whilst HNW life insurance utilization in Asia has for some time focused on important client insurance related needs such as liquidity provision, estate equalization and asset diversification, there are growing signs that with the market adapting to the reality of the Common Reporting Standards (CRS), an increased focus on tax compliant solutions for clients of various target countries is evolving.

The CRS provisions, as they have been adopted and implemented, have led to an evolution in how countries are adapting their fiscal policies in tandem with CRS. The most visible is to commence and implement tax amnesties which are allowing taxpayers to 'normalise' their tax affairs and in most cases the resulting penalties are at a level that should encourage the sensible clients to tidy up their affairs.

The effect of CRS is, and will continue to have, a profound effect on how the international wealth management industry operates. This involves many factors including the provision by custodians of tax reportable information (dividends, coupons, bank interest, realised capital gains etc.), through to the need for investment product manufacturers to be cognizant of the tax treatment of their products in their target client countries, so for example how is a structured product or hedge fund viewed and taxable in China when sold to a Chinese resident with an offshore account. How are mutual funds treated - so for example in some countries accrued income in mutual funds can create an income taxable gain exposure to the tax resident, rather than capital gains taxable gain (i.e. PFICs in the US and non-distributing/non-reporting offshore funds in the UK - so how does each country in Asia address this important anti-deferral issue?).

In the context of this changing environment we are seeing a significant transition in the utilization of insurance as a solution for not only its traditional (in Asia) purposes, but it is increasingly being assessed for its fiscal benefits.

Examples here include the reduction in estate tax in the Philippines to 6%, leading to more clients seeking to utilize insurance solutions as part of their estate tax planning strategy. In Indonesia with the shackles of the tax amnesty out of the way, and with clients now working in a transparent disclosed environment, the utilization of insurance has increased significantly again as the fiscal factors encourage clients to seek tax compliant solutions to their international asset diversification needs.

In Malaysia, the current tax amnesty program is another positive step by governments to align their taxpayers with the new world of transparency. Sensible penalty rates are allowing tax- payers to put their affairs into order which will assist both themselves and their future generations who will not inherit unnecessary problems. For the insurance business this means that as with where Indonesia was, clients are in general in pause mode as they tidy up their affairs. However, looking forward it bodes well for future business as compliant planning becomes the norm. Furthermore, the consistent message coming from more and more countries is that where countries do not have gift and inheritance taxes in place, with the increasing wealth gap, the imposition of such taxes is a more realistic threat, and this is where insurance related planning has significant benefits.

From a more granular perspective, insurance solutions are increasingly being recognised for

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other important benefits. These would include the ability for the policy to act as a "blocker" for US estate tax purposes where the underlying assets include US securities which would otherwise expose the non-resident alien investor to US estate taxes on for example their US stocks. Additionally, with CRS comes the transparency and detail behind the reporting of investments. In a non-insurance account, line by line detail of the investments held in the account are reportable, with the challenge with joint name accounts requiring a double counting of the reports made (e.g. husband and wife reported separately). With an insurance "wrapper", it is simplified to the total cash value of the policy, with no additional detail required.

These benefits are further enhanced by the ability to move the succession planning process from a trust with (typically) an offshore (often a BVI) company as the account holding entity, to an insurance policy solution with leading global names acting as the account holder and undertaking the consolidated reporting as a one line cash value statement. Often this can be achieved with tax advantages and compliance, whilst the policy acts as a simple form of trust, distributing the death benefit to beneficiaries without the need for the public and time-consuming exercise of probate.

Beyond tax related planning, there is still a significant holistic demand from an asset diversification perspective. This is particularly prevalent from the China market, where business continues to flow well, driven to a large extent by the wish to diversify out of the Yuan and into the US Dollar. Recent moves in the trade conflict between the US and China further reinforce this planning need, and the resulting fall in the Yuan against the US Dollar has substantiated this planning motivation. Insurance solutions also represent a fiscally compliant solution for China based clients, so demand should remain strong from this market.

Conversely, whilst Chinese clients are being driven to diversify over a falling currency, the Thai market has been strong as clients are taking advantage of the strong Thai Baht to move assets where possible into USD based product, with life insurance being an attractive option.

So, in conclusion, from a holistic perspective, there is a strong and growing increase in the focus of utilizing life insurance as a fiscal planning tool, whether it be the mitigation of estate taxes or the wrapping of investments into a domestically recogniseable, internationally diversified, compliant wrapper with simplified CRS reporting requirements. This opportunity and "angle" is set to become increasingly important as the international wealth management market adapts to a transpar-

ent fiscal world, and subsequently adapts its product selling approach to an increasingly advised approach to wealth management.

Product Adaption

The adjusting macro environment, both in the context of market driven changes such as the interest rate environment and the fiscal environment is seeing interesting adjustments in the product mix and utilization.

10 years ago, 95% or more of the HNW business was focused on single premium, financed Universal Life (UL) business. 10 years later we are seeing some very interesting adaptions to the product utilization.

In the first instance there has been a significant shift from UL to Whole of Life (WOL). This is being driven by a number of factors including the interest rate environment and the greater security of future returns represented by WOL. Furthermore, the interest rate environment compounded by bank balance sheet and client segmentation efforts are driving a huge shift from single premium policies to multi-pay policies. One leading broker indicates that 45% of their business is now multi-pay, this being a dramatic shift over the last couple of years.

In addition to these changes, we are seeing a proportionate adjustment higher in both Variable Universal Life (VUL) and to Indexed Universal Life (IUL). In the case of VUL, clients are seeing the benefits of transferring and combining segments of their investable assets with high death benefit insurance to provide enhanced benefits and solutions. This may for example be driven by a client looking at their long term, next generation directed portfolio segment, and deciding to combine this with insurance to achieve a better fiscal solution combined with the additional built in death benefit and succession planning advantages.

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The motivation driving VUL is also seeing a continued growth in interest for Private Placement Life Insurance (PPLI) in the form of the low death benefit policies optimizing the fiscal result. The PPLI is more likely to appeal to the fee-based advisors and bankers and is well suited to the smaller clients who can utilize these policies for both their fiscal and succession planning advantages. Nevertheless, there is a strong argument that this product could be placed to be a leading wrapper for offshore investing HNW investors, ensuring a blocker for US securities exposure, a compliant wrapper for many Asia onshore based investors, simplification of CRS reporting, reduced risk and increased flexibility for the private banks and investment product issuers, and a succession structure/trust alternative - ''All in One''.

In the case of IUL there has been a significant increase in take up driven by both good markets, an increased sophistication and understanding of the product, and

concerns over the crediting rate environment driven by low interest rates of the traditional UL and WOL products. With the 12-month floors in IUL built into the indexed portion, advisors are focusing on dollar cost averaging their client's policies into a series of indexed segments (typically 6), so as to achieve a rolling market exposure and floor strikes. The returns have the opportunity to be much higher than the crediting rate characteristic of UL and WOL policies, whilst the inbuilt floors provide protection from poor medium-term market performance. This product is likely to see continued increase in focus due to its unique investment process combined with an uncertain interest rate environment.

Revenue Adaption

As has been briefly touched on, the transition from single pay to multi-pay is an important secular step forward in both the more holistic approach to the utilization of insurance, combined with positive long term revenue impacts and reduced regulatory risk exposure (through the potential for mis-selling claims through premium financed UL).

Whilst in the short term this approach may be difficult to stomach from a revenue point of view, there are considerable longer-term advantages as the lumpy nature of single premium revenue is reduced and annuity style revenue flow is generated. From a management perspective it will also provide a benefit in that it will add to the reasons for relationship managers at wealth managers to stick with their platforms and build a long-term career with their chosen wealth manager.

This transition to multi-pay will also have an important impact on the adjustment overtime of wealth managers in Asia from a transaction driven lumpy deal flow to a less volatile fee based annuity revenue flow, particularly as the revenue streams are adjusted to advisory fee based models overall from the predominantly transaction based commission model that is still prevalent in Asia.

Other Areas of Consideration

In the HNW space which covers distribution principally through the private banks and independent wealth managers, the utilization of other insurance product related areas such as term insurance, critical insurance, mortgage protection, medical insurance and general insurance, still comprises an insignificant proportion of the business (if any).

In most cases this is driven by the cost dynamics of delivering such solutions and is where the private banks with associated retail banks have an opportunity over time to piggy-back off technologically driven solutions in this space.

This factor also illustrates the challenge the private banks face in becoming the sole trusted advisor to the client. The adjustment of dealing with a banker as an investment product provider to a broad advisory and counselling basis to cover other matters such as health insurance and critical illness is still a big challenge, whereas the single and multi-family offices are undoubtedly better placed to engage in this area, and indeed should be considering such solutions for the families with whom they have a fee based holistic engagement. This will be an important differentiator for the Multi-Family Offices.

In the meantime, the focus of the private banks will undoubtedly remain investment linked solutions which remain a more important focus for the HNW client segment when dealing with their wealth management provider at this time.

Conclusion

A little over a year ago we highlighted in our previous article that there was a need for the HNW life insurance industry in Asia to re-think their approach to insurance in Asia. It is clear from our discussions with leading figures in the industry that this transition is taking place.

We have illustrated that this transition is being driven by a number of factors, including the Common Reporting Standards effect on the fiscal planning benefits, tax amnesties and their aftermath, zero interest rate and negative interest rate policies affecting the viability and risk associated with the UL and WOL market, and increased sophistication seeing interest shifting to VUL and IUL products.

The key takeaway for wealth managers is to ensure that they are recognizing these developments, and that a clear understanding of them is being communicated effectively to both their relationship management teams and their clients.

Finally, it is essential that wealth managers in Asia with international clientele are focused on the tax considerations of the products, solutions and reporting that they are delivering, and this is certainly a major attraction for the life insurance industry in Asia going forward.■