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Time to re-think insurance for Asian high net worth clients?

There is a widespread creed that life insurance is integral to any holistic wealth planning process in Asia. Life insurance is to this day the most commonly used and most successful vehicle for wealth transfer between generations. But are wealth managers and the life insurers selling what Asia's HNW clients need, or foisting on those clients what the industry prefers to sell? Is broker expertise lacking? And, is now the time to end fat commissions paid up-front and replace them with rational economics over the life of the product?

THE LANDSCAPE FOR HNW INSURANCE products in Asia in the past five or more years has become intensely competitive. Naturally, the rapid growth of wealth in Asia has drawn more international companies to Asia, as has deregulation as authorities in Asia gradually permit greater competition for homegrown insurers.

To date, Universal Life (UL) policies have dominated the landscape in Asia. However, the evolving requirements of clients' needs for protection, as well as changing financial market conditions - the trough for interest rates after more than 30 years of decline - means that greater diversification in insurance solutions for HNW clients in Asia is not just valuable, it is necessary.

UL school report – good, but could do better

This view is supported by the clear mismatch between the HNW insurance opportunity in Asia and the levels of take-up that brokers, carriers, agents and banks have achieved to date - mainly via the UL policies. This is despite rapid growth in HNW numbers and assets, and their improving sophistication and growing focus on succession planning as well as other facets of their estate.

That perspective was certainly borne out by a White Paper on the HNW insurance sector released by Hubbis earlier this year. Over 90% of the senior practitioners representing all types of players from across the industry said the take-up was only 3% to 5%, which all agreed is far out of kilter with the region's ability to create new millionaires every year.

Turning this round depends to a large degree on client-facing advisers and a far more intense and focused 'client first' mentality.

However, the greater competition amongst insurers has not, many experts contend, been matched by the greater sophistication of the brokers and the wealth management industry at large.

For example, many clients may only need term insurance but it is very difficult to find a broker who is doing a proper job of doing term insurance. Accordingly, the pendulum needs to swing back towards giving the right advice to clients, to assess exactly what the client has, what they might need and what they might not have even considered.

While single-premium UL is currently the most common product and perhaps the most relevant in today's super low-interest rate conditions, a greater variety of products should be expected, especially in anticipation of higher rates.

For example, it is not possible in Asia to get premium financing on multi-pay UL, whereas it is possible in the United States. Multi-pay will be more attractive to clients who anticipate higher interest rates in the future.

More solutions for a new financial landscape

UL came into effect in the early 1980s when whole life policies had significant problems due to the poor performance of equity markets in the 1970's (and hence the underlying investment performance was not good enough to sustain the cash values). Accordingly, insurance companies became very conservative, switching to bonds from other investments that were potentially volatile such as equities. Luckily, this happened at a nearly ideal time in the early '80s when interest rates peaked, in the US for example at around 15%. Now we are in a very different era, at the back end of more than 30 years of falling interest rates.

With interest rates so low they cannot go lower, and indeed market conditions indicate they will move higher, positioning the clients correctly is vital at this inflexion point.

Broker education is a vital factor for change to be affected. One industry veteran we interviewed added "If in five years' time 95% of business is Universal Life, I think we can admit as an industry we have failed. It might not be as low as 40% or below but I would like to think there will be a much better spread between Universal Life, both high and low life cover, single pay whole of life, critical illness, medical term, and so

DO YOU CONSIDER THAT UPFRONT FEES ON THE SALE OF INSURANCE SHOULD BE DISCONTINUED IMMEDIATELY?

Yes

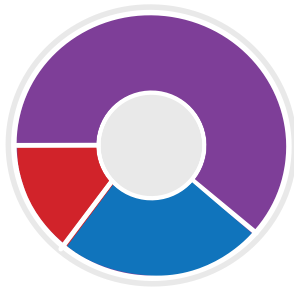
44%

No

56%

Source: Hubbis Asian Wealth Solutions Forum November 2017 - Singapore

HAVING HAD A CONVERSATION ABOUT INSURANCE WITH A CLIENT AND THEN REFERRED THEM TO A BROKER, HOW OFTEN DO THEY ACTUALLY PROCEED WITH THE PURCHASE OF INSURANCE?



Less than 25 percent of the time

More than 25 but less than 50 percent

More than 50 percent

Source: Hubbis Asian Wealth Solutions Forum November 2017 - Singapore

forth. Education of the industry and the brokers will enhance this diversification process."

UL has in some cases been sold more as an investment product, rather than a focus on the life cover as the most important aspect of the policy.

Regulation across Asia is evolving and that is also having a positive effect on the product quality and diversification. Some of the newer products that have the potential to emerge today in the context of the Asian HNW segment include variable universal life (VUL), private placement life insurance (PPLI), whole-of-life products, jumbo term life and high-end medical cover.

The treatment of insurance solutions under the Common Reporting Standard (CRS) and the looming Automatic Exchange of Information (AEOI), makes it even more important to diversify and consider the fiscal benefits of the policy.

Premium financing – do hidden dangers lurk?

The fact that private banks typically offer premium financing, which allows the client to pay a fraction of the premium upfront, increases the appeal of UL for many clients. This frees up capital and enables the client to benefit from the interest rate spread - although this means policyholders are subject to interest rate and FX risks. Plus, there is the risk that if the collateral value - i.e. the policy cash value - drops, the bank may require a top-up.

"Given the propensity of clients to take out loans to pay premiums," one expert noted, "a relatively large amount of risk is strapped to these policies in a rising interest rate environment - as the loans will substantially get more expensive to service."

Another noted: "I think in the insurance space, generally, there are indeed distortions and dangers associated with premium finance for UL, namely borrowing short to invest long with the policy. The vital factor is to recommend these products to the right clients who fully understand and who can bear the risks financially."

At the same time, although market experts interviewed said UL remains suitable for HNW clients who need legacy planning, business continuity, asset liquidity and premium financing - these policies do not necessarily suit HNW clients who seek medical cover, want to be active in their investment selection, or who hold illiquid/nonbankable assets.

Resisting change – especially commission structures

Some of the resistance to change is founded on the commission structure for policies as well as the fee sharing practices that have prevailed. With roughly 95% of HNW life insurance sold in Asia being UL, this has created a market worth somewhere in the range of USD600 million to USD750 million in commissions for referral agents and brokers.

Does this mean that the industry is averse to moving away from UL by offering a far greater choice to clients, even if UL might not be the product that best suits

IF YOU ARE HONEST WITH YOURSELF, DO YOU REALLY UNDERSTAND THE DIFFERENCES IN BENEFITS AND FEATURES OF UL, VUL AND PPLI?

Source: Hubbis Asian Wealth Solutions Forum November 2017 - Singapore

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WHEN A CLIENT HAS ACTUALLY BEEN ADVISED TO TAKE OUT INSURANCE, WHICH DO THEY MOST OFTEN TAKE OUT?

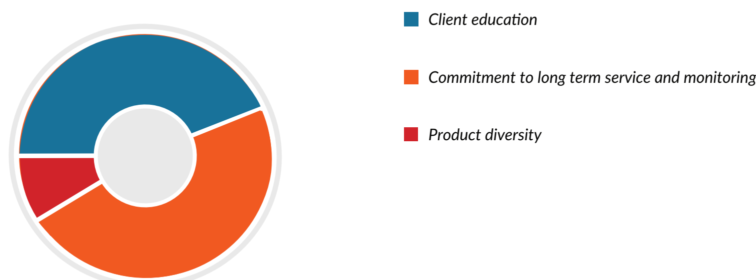
Source: Hubbis Asian Wealth Solutions Forum November 2017 - Singapore

some? Yes, say many as providers and brokers are not keen on stepping away from a product that produces commissions upfront and is immediately profitable for the providers.

A particularly thorny topic associated with this discussion on commissions has been the way fees are paid - upfront - and how they are divided between the private bank that might introduce the insurance broker, and that broker. There was a debate during the 2008-9 global financial crisis as to why investment bankers should get paid on a present value basis of the future when that future revenue stream is by definition uncertain. An income stream spread over time should be matched with commissions over time to provide a sustainable level of service to the client to whom that product is sold.

Another expert raised the issue of the length of the policies and the lower returns that many had expected due to the low-interest rate environment. "Some policies might indeed require a top up, some policies might require premium holidays because of personal liquidity problems. All in all, it should be beneficial to have a larger portion [of the commission] as recurring fee revenue, rather than all upfront."

TO CREATE A SUSTAINABLE HNW INSURANCE OPPORTUNITY, WHAT IS MOST IMPORTANT?



Source: Hubbis Asian Wealth Solutions Forum November 2017 - Singapore

Tip-toeing delicately around the status quo

The question as to what percentage a private bank should receive of the commission from an introduction of a client to a broker is highly sensitive, especially as in some instances, market rumour indicates it to be as high as 70%.

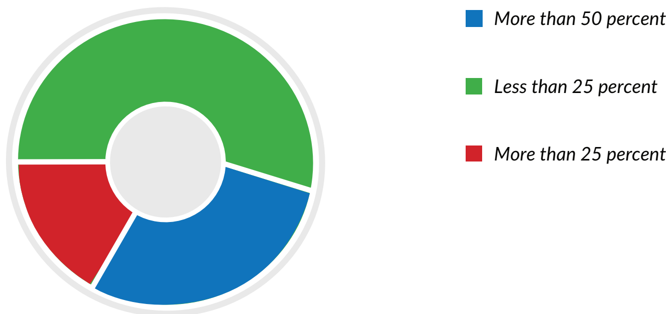
Industry experts are naturally, understandably, cagey on this issue but all conceded that this is an issue for the industry to address in the future. One commented that private banks are generally not licensed as insurance brokers and that generally, they prefer to leave insurance to the insurance brokers, implying that the split should be more favourably slated towards the broker. One expert did, however, state that, while confidential, he could confirm that the portion of such fees passed back to the bankers or introducers was lower than many might expect.

Another commented: "To be a good broker in the UL space and across the board requires an enormous skill set because you have got to do the due diligence on the insurance companies and you have got to understand that all of those policies have different policy terms and conditions. You need to translate those for the client, and then ultimately someone needs to be responsible for that advice, and that's the insurance broker."

When asked in the Hubbis poll, the largest block of respondents – 36% - indicated they felt that the private bank/banker should receive less than 25% of the commission(s). 20% said they should get nothing. Very few thought it should be more than 50%.

Changing old sales practices, improving the education of those in the industry, combined with the providers pushing a larger number

WHEN A PRIVATE BANK REFERS A CLIENT TO A BROKER THAT TAKES OUT INSURANCE, WHAT PERCENTAGE COMMISSION SHOULD THE BANK GET?



Source: Hubbis Asian Wealth Solutions Forum November 2017 - Singapore

of products - even if they are less immediately profitable – are all factors highlighted as catalysts for improvement. The industry should become less complex, partly because it is purposely complex, in other words, designed to confuse the clients.

In our recent poll we asked what the differences are in benefits and features of UL and VUL and PPLI. Some 85% said they have no idea. It's obvious that greater education and transparency are not just advantageous, they are essential.

Advisers need to up their game

One of the biggest shortfalls in the HNW insurance space in Asia identified in the Hubbis White Paper was that private bankers, with their close relationship with clients, do not know enough about different insurance products and do not attempt to mine down to identify the true needs of their clients and therefore the appropriate solutions. The 'low hanging fruit' approach prevails all too often. Helping clients navigate the ever-changing regulatory, tax and financial changes, locally and globally, is vital.

When a private bank introduces a client to an insurance brokers, only 20% or less translates to concluded business. Part of this low yield from client liaison is the paucity of relevant product offerings. "There are many, diverse types of insurance available, from medical to whole life, to PPLI, but it is not often that a client has all the solutions in place optimally," said one expert.

The HNW insurance space in Asia has generally been starved of innovation. These industry players said this should be high on the agenda for all providers, especially since tailored solutions are critical in meeting the needs of HNW customers. A move away from premium financing is one such improvement cited. Not every client should be taking on debt to put in their legacy planning strategy, believe some specialists. Further, managing that legacy planning strategy with debt raises concerns since loans would have to be paid out at some point, and interest serviced.

To the question that Hubbis posed in the survey - 'Would it be good if there was a regulated and very clear commission structure which was totally transparent in any professional service industry?' a clear majority said it would be a positive development.

However, there is also a danger of over-regulation. A European client must sign masses of documents just to buy a simple life insurance product. The theory is that so much fine print makes it even less likely that the client will actually read and understand what he or she is buying. Moreover, is the disclaimer for the client's benefit or, more likely perhaps, for the provider's security.

What do we need to do today? Surely the following areas require improvement: diversification of product; an adviser's ability to understand and cater to customer needs; adjusting products for the current and anticipated financial and regulatory environments; improved sophistication of adviser; and enhanced transparency in communication with the client.

These are clearly essential components for the industry to address to ensure the long-term sustainability of the business. ■

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