Focus on Asia Pacific Risks

The Transformation of Australian and New Zealand Life Insurance

The life insurance industry in Australia is facing unprecedented challenges from forces within and from the effects of an increasingly globalized economy. As life industry profitability has declined in Australia in recent years, the underlying manufacturing business model is rapidly changing, according to Matthew Rose, Managing Director, Guy Carpenter.

"The challenges have been instigated by several factors, all intertwined," Rose explains. "Developments in Australia highlight the lessons learned globally about the imperatives for efficient management of capital bases to create opportunities for enhanced growth.

One factor was the increase in regulatory requirements in Australia following the global financial crisis, particularly around capital and solvency – leading to a lag on returns on capital for most insurers relative to those of other financial services industries.

Another factor revolves around economic expectations of return on capital." He adds, "Other types of financial institutions, banks among them, generally deliver stable earnings, and banks have typically been the major owners/shareholders of life insurers in Australia. The lower returns and higher volatility of the life insurance sector are leading shareholders to reallocate capital to more profitable businesses and sectors that bring a higher degree of return and certainty to their balance sheets. As a result, shareholders have been selling their ownership in life insurers or utilizing reinsurance to transfer risk."

The third reason for the changing environment in Australia involves relative cost of capital considerations, which are leading to increased investment in the sector by global entities. He continues: "Foreign companies, with their generally lower cost of capital, are seeking the long-term growth opportunities that the Australian market offers. In a recent speech, the Chairman of the Australian Prudential Regulatory Authority indicated that it "is not impossible to foresee an almost fully foreign-owned [sector] within the next five years or so."[1]

1. https://www.investordaily.com.au/regulation/42083-apra-warns-about-insurance-divestments

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The foreign companies have stronger tolerance for what they perceive as short-term pressures and are willing to adopt lower return targets and accept greater volatility of results than local insurers. The foreign companies also bring more experience and capabilities in managing a global portfolio with differing capital reserve requirements across many countries.

"These forces of disruption create awareness of the opportunities for life insurers to manage their capital more efficiently and achieve more profitable growth," he says. "With the Australian companies owned by entities with lower return targets, the participants create a 'win-win' situation with the purchase of the Australian portfolio."

The insights around these benefits and opportunities are expanding to other jurisdictions. Insurers are now gaining an understanding of the significance of efficient and dynamic restructuring of their capital to more profitable businesses and its impact in reducing volatility and creating earnings growth.

"Globally, reinsurance utilization is moving away from serving solely as a risk protection and capability solution to a strategic capital management tool. With this evolution comes a reinsurer focus on larger capital transactions," he explains.

The goal of achieving efficient capital structures is enabled by Guy Carpenter's deep market insights, which help clients restructure reinsurance relationships and negotiate treaties. "For example, Guy Carpenter has supported the development of reinsurance contract language for clients that enables transition out of treaties that have become less reflective of the company's current capital needs to those that bring the best opportunities to free up capital for deployment to achieve growth," Rose says.

"Many long term life reinsurance treaties have been in a 'set and forget' mode, with repricing done mechanically. The flexibility to terminate contracts and initiate proactive periodic price discussions provides for a more mutually beneficial, effective and dynamic ongoing partnership between insurer and reinsurer. The regular discussions also ensure that covers are properly structured to reflect current risk and capital needs – the relationship never becomes 'stale,'" he says.

Reinsurers will continue to support life insurers with innovative new risk protection products, but the solutions they bring to capital management and profitable growth are becoming ever more significant.

Rose concludes, "Insurers with lower capital targets and more shareholder tolerance of earnings volatility may pursue profitable growth opportunities in overseas markets through reinsurance placements or mergers and acquisitions. Guy Carpenter's tailored solutions in Broking, Analytics and Global Strategic Advisory help clients find opportunities that best match their capital and risk profiles."

About Guy Carpenter

Guy Carpenter & Company, LLC is a leading global risk and reinsurance specialist with more than 2,300 professionals in over 60 offices around the world. Guy Carpenter delivers a powerful combination of broking expertise, trusted strategic advisory services and industry-leading analytics to help clients adapt to emerging opportunities and achieve profitable growth. Guy Carpenter is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE: MMC), the leading global professional services firm in the areas of risk, strategy, and people. With nearly 65,000 colleagues and annual revenue over $14 billion, through its market-leading companies including Marsh, Mercer and Oliver Wyman, Marsh & McLennan helps clients navigate an increasingly dynamic and complex environment. For more information, visit www.guycarp.com. Follow Guy Carpenter on Twitter @ GuyCarpenter.