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Is the value chain broken?

Can providers still make money and how do actuaries remain relevant?

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Gary Warman (Deloitte)

Is the traditional value chain broken (for actuaries)?

- The value chain is being squeezed
  - Over the last 30 years margins on new business have reduced from circa 360bps to around 180bps and this trend seems likely to continue
  - New products are being simplified and are less actuarial intense
- Regulations are evolving and becoming more onerous
  - Solvency II, conduct risk agenda, large complex models, options pricing etc.
- Actuaries are expensive and generally still undertake ‘traditional’ roles in life insurance
  - Average salary of £280 for a graduate 60 years ago to £28k today (8% CAGR)
  - During SII, contractor and consultant rates peaked, passing on costs to life offices
- The cost of actuaries is largely being met from margins on in-force books
  - These are being squeezed and are also running off
- Today we want your input as to whether this is sustainable

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What we are going to discuss today

- Reduction in the value chain
- Regulation, consumers and products – past, present and in the future
- Possible industry responses to these challenges
- What does this mean for actuaries in the future?

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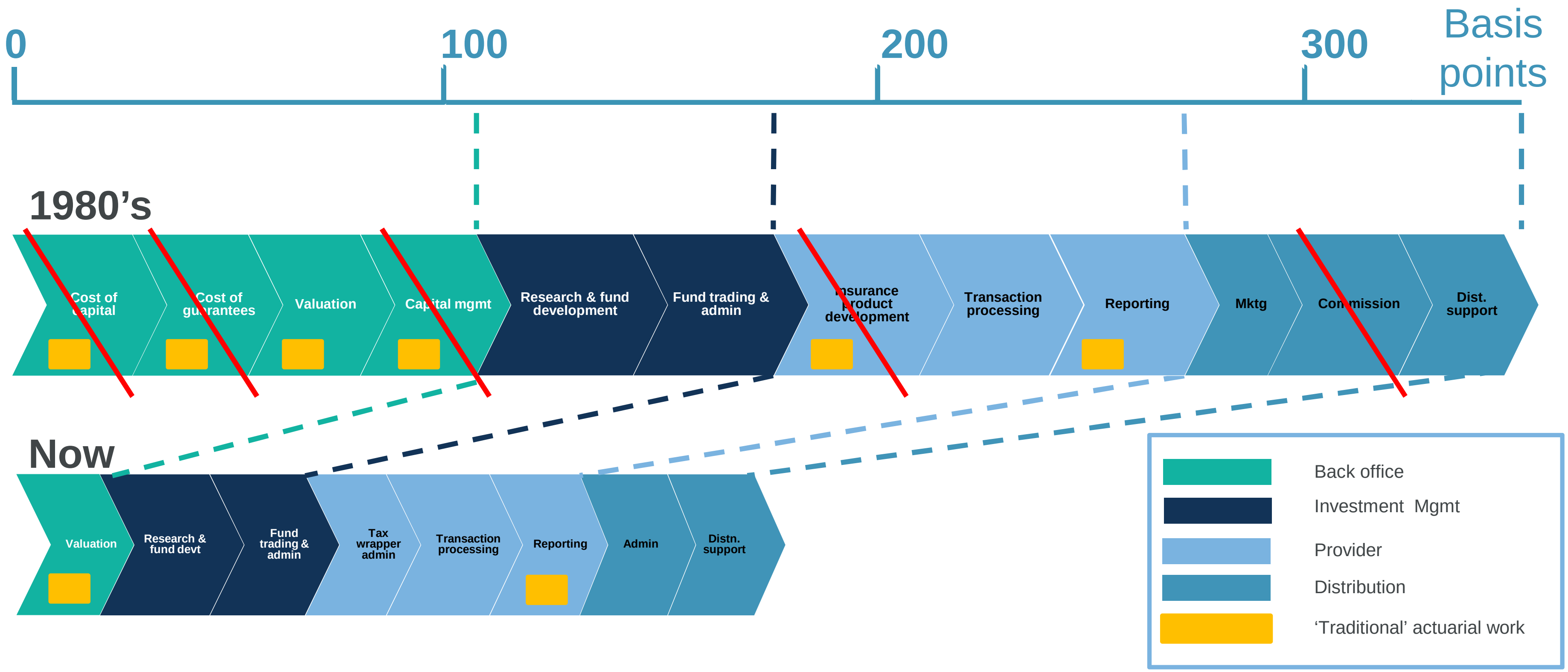
New business margins have reduced significantly over the last 30 years



The components of, and the total fees included in, the value chain have changed dramatically over the past 30 years.

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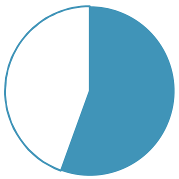
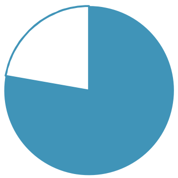
Source: Deloitte analysis

Long term trends might suggest a reducing demand for actuarial skills…

When	Issues	Need for actuaries
Then	• Under-pricing cost of capital and cost of guarantees • Poor understanding of underlying costs • Limited persistency risk • High rates of commission paid to advisers • Multiple manual processes (valuation and reporting) • Greater number of insurers	
Now	• Increased regulatory requirements – reliance on SII & ICA • Long term low inflation, low IR environment (“return squeeze”) • Greater valuation costs due to increasing complexity • Potentially complex risk mitigation strategies (e.g.. Hedging) • Restructuring of with-profit funds • Focus on cost reduction	
Future	• Lower guarantees and capital (and costs thereof) • Consolidation of insurers • Greater automation of process (modelling and control environment etc) • Following Solvency II implementation, less frequent regulatory change?	

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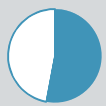
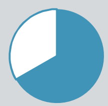
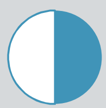
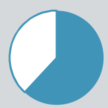
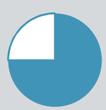
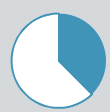
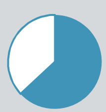
…and distribution models and product design are become less ‘actuarially intense’

	Then	Now	Future
Regulation			
Consumers			
Products			
Overall			

- We are currently in an era of high demand for actuaries, with regulatory change and rectification of historical errors requiring significant actuarial resource.
- Consumers are becoming more knowledgeable leading to products becoming increasingly commoditised.
- New products have minimal guarantees and charges for cost of capital so actuaries are moving away from these traditional areas of work.

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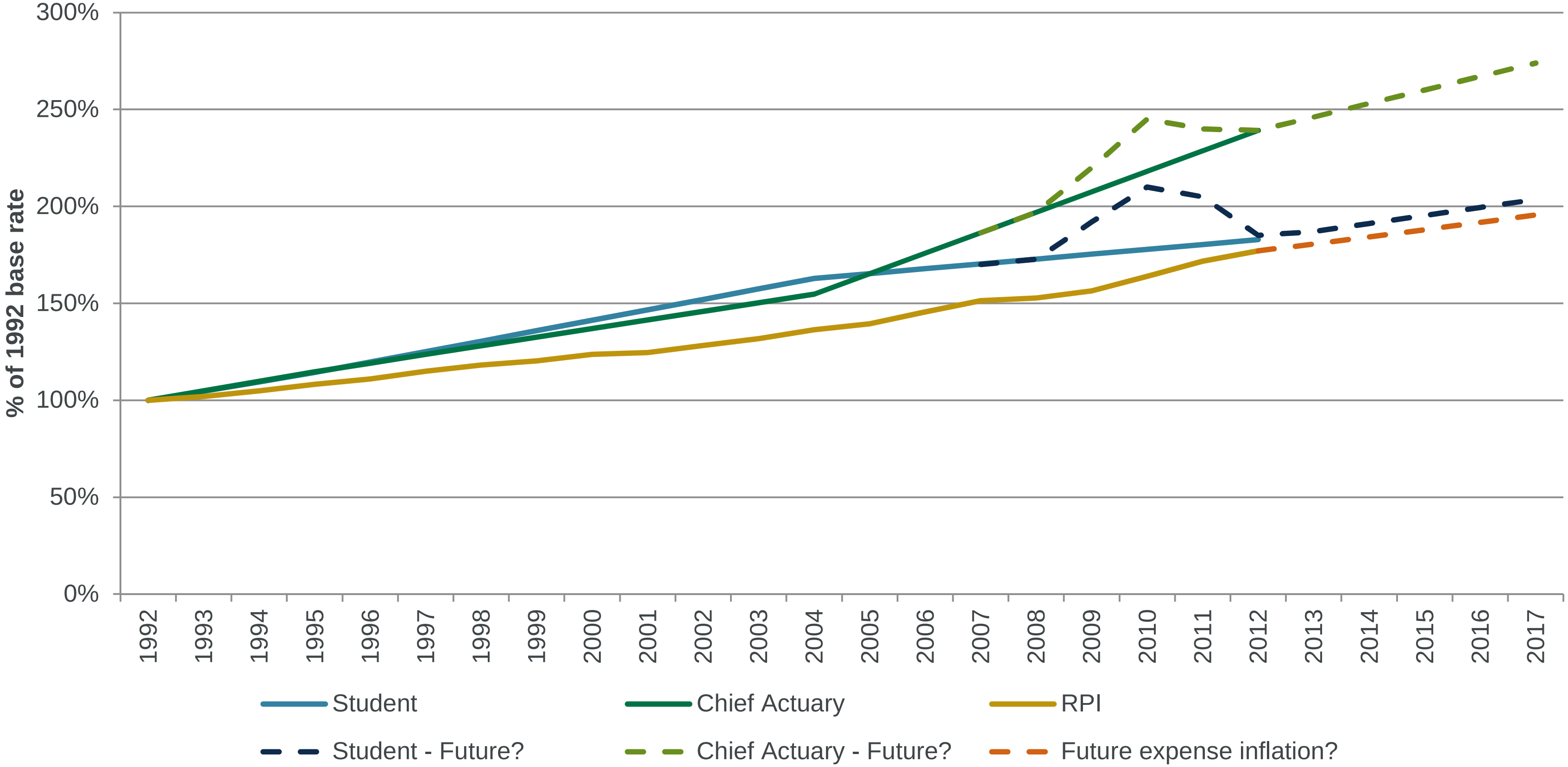
… and yet actuarial salaries are still increasing!



Actuarial salaries have increased at rates above inflation almost continuously over the past 20 years.

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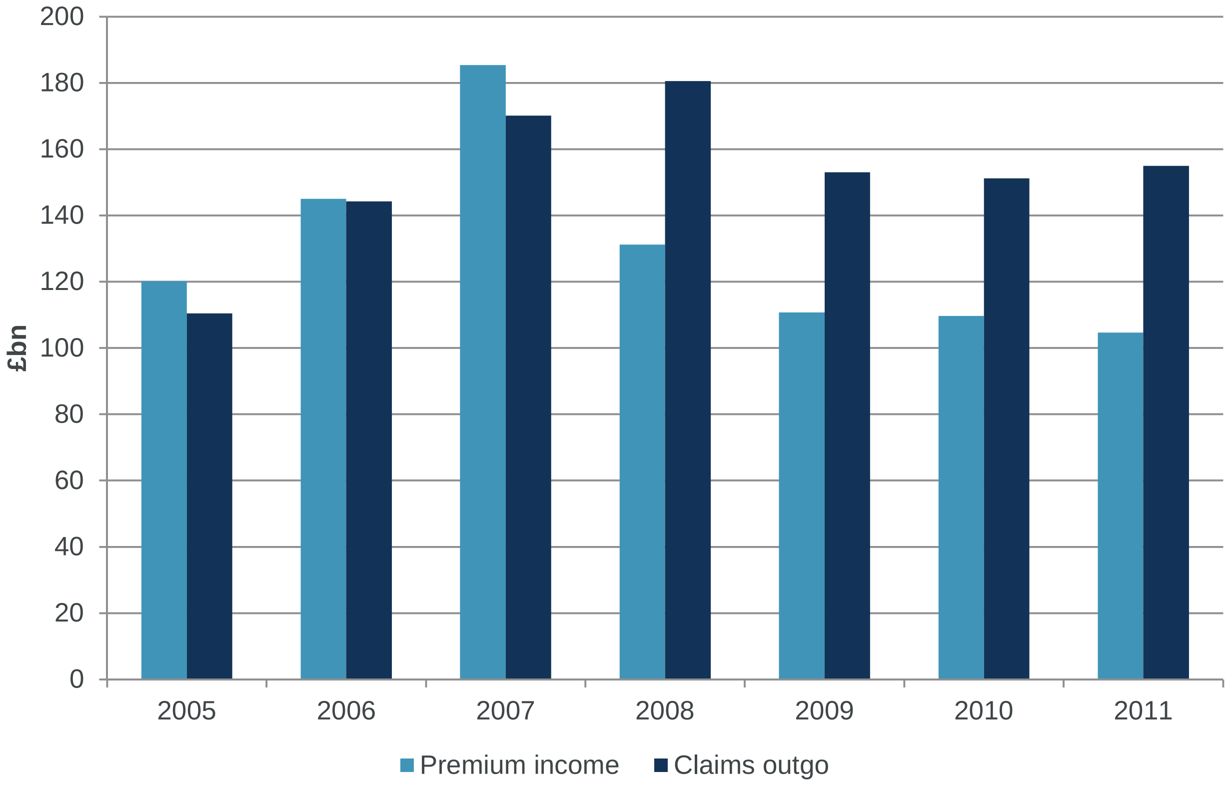
Source: Staple Inn archives & Deloitte analysis

In-force books are running off and there is no premium income growth in the UK...



‘Cannibalisation’ has meant less total margin as “new business” has replaced the in-force book

New business premiums are shrinking, and cash flows have turned negative.

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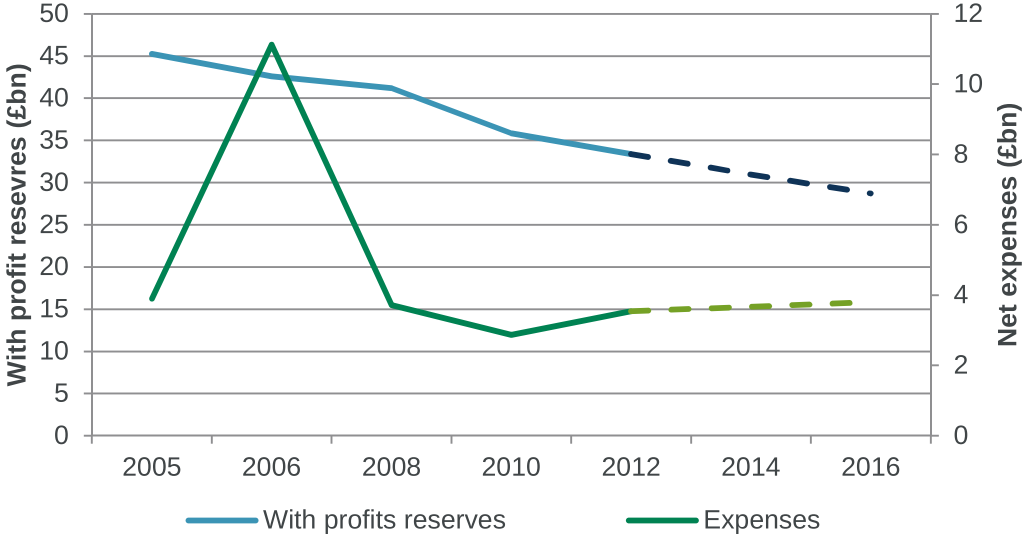
Source: ABI Data

… so life offices cannot support costs from in–force margins for much longer

- The graph below shows the with profit reserves against the change in expenses since 2005 in aggregate for five of the top 10 UK insurers, with projections based on persistency over previous years and an expenses inflation rate of 3.5%.



As well as ‘cannibalisation’, higher capital requirements on in-force books have squeezed margins further.

- As with profit reserves have reduced, expenses have also reduced. However, expenses are now on the rise and in-force books will only get smaller.

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What can the industry do to address these challenges?

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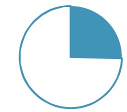
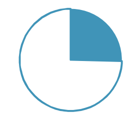
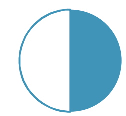
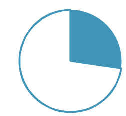
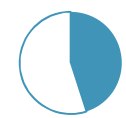
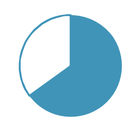
Possible industry responses

	Need for actuaries	Likelihood
Close to new business and aggressively remove associated costs (including overheads.)		H
Consolidate and take advantage of cost synergies ("economies of scale")		H
Cost reduction initiatives/process re-engineering		M
'Dumb it down' – simplify processes, move processes 'offshore', outsource admin or other functions		M*
Focus on other locations with lower regulatory burden and higher margins		L*
Innovate products based on consumer life stages and requirements thus providing incremental margin opportunities		L**

* Due to regulatory burden
** No increase in fees, even if we innovate.

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What can actuaries do to address these changes?

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Actuarial skills are still highly relevant and sought after, perhaps in wider fields

	Oil exploration	Medical research	Investment banking	Asset management	Others?
Data analysis & interpretation	✓	✓	✓	✓	✓
Statistical Modelling	✓	✓	✓	✓	✓
Risk management	✓	✓	✓	✓	✓
Risk modelling	✓	✓	✓	✓	✓
Commercial awareness			✓	✓	✓
Communication of complex information		✓	✓	✓	✓
Decision making	✓	✓	✓	✓	✓

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There are significant opportunities for actuaries…

Thoughts!!

… do we need to and are we prepared to evolve?
… are we ready to act now?

Final thoughts

- The value chain is being squeezed
- Regulations are evolving and becoming more onerous but it would be 'un-actuarial' to assume this will continue forever
- Insurers are chasing margins, leading to automation, cost cutting and potentially relocation
- Actuaries are being paid more than ever before and are beginning to diversify, using our actuarial skills in non-traditional areas
- The profession is evolving – where will we be in 20 years?

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Questions Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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