

booz&co.

The Future of
Life and Pensions
*Lifesaving
Solutions*



Contact Information

Amsterdam

Christian Lageweg

Principal
+31-20-504-1925
christian.lageweg@booz.com

Beirut

Peter Vayanos

Partner
+961-1-336433
peter.vayanos@booz.com

Chicago

Tom Nodine

Senior Executive Advisor
+1-312-578-4565
tom.nodine@booz.com

London

Alan Gemes

Senior Partner
+44-20-7393-3290
alan.gemes@booz.com

Margaret Cameron-Waller

Principal
+44 20 7393 3559
margaret.cameron-waller@booz.com

Fabienne Konik

Principal
+44-20-7393-3777
fabienne.konik@booz.com

Sid Azad

Senior Associate
+44-20-7393-3563
sid.azad@booz.com

Milan

Davide Valenti

Principal
+390-2-72-50-91
davide.valenti@booz.com

Mumbai

Jai Sinha

Partner
+91 22 2287 2001
jai.sinha@booz.com

São Paulo

Ivan De Souza

Partner
+55-11-5501-6368
ivan.desouza@booz.com

Shanghai

Andrew Caine

Partner
+86-21-2327-9800
andrew.caine@booz.com

Sydney

Sarah Butler

Partner
+61-2-9321-1920
sarah.butler@booz.com

Tokyo

Yoshiyuki Kishimoto

Senior Executive Advisor
+81-3-6757-8609
yoshiyuki.kishimoto@booz.com

Zürich

Christian Reber

Partner
+41-43-268-2121
christian.reber@booz.com

Nicholas Donovan also contributed to this Perspective.

EXECUTIVE SUMMARY

The life insurance industry is set to become the next victim of the credit crunch—so say the doomsayers. On the face of it, they have a good case: Life insurers' exposure to global equity markets, commercial property, and corporate bonds—asset classes that have suffered heavy falls this year—has had a severe impact on balance sheets. There are other pressures too: Changes to the capital gains tax regime and increased competition from cash deposits could also affect the bottom line. Some insurers will have to raise fresh capital, while smaller and weaker players will almost certainly face the threat of takeover.

But the outlook is not as poor as it may at first appear. Booz & Company believes that many players will prove resilient. There have been some ratings downgrades this year, but there have also been a couple of upgrades. The past performance of European life insurers also gives cause for optimism: Their share prices have proved less

volatile than those of banks in the past, underperforming during growth periods but outperforming when markets are falling.

Booz & Company believes that the industry is being affected by a fundamental set of six trends (see *Exhibit 1*).

Players that manage to reposition themselves in response to these key trends are likely to benefit disproportionately from current market discontinuities. Aggression and radical action will, in some cases, be required—unusual behaviour for life and pensions businesses.

Exhibit 1
Life and Pensions Market—Six Key Trends

- 1 CHANGES IN COMPETITIVE ENVIRONMENT: SCALE OR SPECIALISATION?
- 2 SHIFT TOWARDS ASSET MANAGEMENT
- 3 MATURE MARKETS INCREASINGLY UNATTRACTIVE
- 4 CHANGING CUSTOMER NEEDS AND TREATING CUSTOMERS FAIRLY (TCF)
- 5 EMERGENCE OF NEW DISTRIBUTION MODELS AND NEW TECHNOLOGIES
- 6 TRANSFORMING OPERATING MODELS, EXECUTION, AND CULTURE

Source: Booz & Company

1. CHANGES IN THE COMPETITIVE ENVIRONMENT: SCALE OR SPECIALISATION?

With new entrants such as portals and retailers joining the market and the distressed assets of businesses damaged by the credit crunch up for sale, now is the moment for insurers to make a clear strategic choice: Do they wish to position themselves to capture the benefits of scale, or to pursue specialisation? Those players who currently occupy the middle ground will have to make acquisitions or position themselves for takeover.

The pursuit of scale is not straightforward, however: In the past, consolidation and acquisitions have delivered size, but not necessarily scale. Insurers will need to target not only traditional integration objectives, such as ensuring business continuity and migrating future business, but also more ambitious goals—including shifting in-force policies, both open and closed. They will also need to address the issue of rationalising legacy systems and eliminating sources of complexity. The Lloyds TSB–HBOS integration of life businesses will be an interesting example to watch, as its approach to capturing synergies is likely to set a new, more radical tone in the industry.

While increased specialisation has been a key industry trend over the past 10 years—55 percent of U.K. players followed a diversified approach in 1998, compared with 33 percent in 2007—it is Booz & Company's view that specialist players risk becoming increasingly marginalised in the current environment, as national and European scale players emerge.

2. FORTUNE FAVOURS THE BRAVE: MOVING INTO ASSET MANAGEMENT

A shift towards asset management may seem highly counterintuitive given the state of global equity markets; however, over the longer term, those players who take bold steps into the sector may be richly rewarded. Booz & Company forecasts the compound annual growth rate for the asset management industry between 2006 and 2017 at about 6 percent, compared with less than 4 percent for life and pensions.

A number of key trends reinforce the prediction that asset management will be the fastest-growing business line. These include the increased wealth and greater sophistication of many emerging markets, changes in demographics leading to longer periods of asset accumulation, and the shift in responsibility for healthcare and pensions from the state to the individual.

Some traditional insurers have already repositioned themselves as asset managers: Allianz, for example, took over both Pimco Advisors in 2000 and Nicholas-Applegate in 2001. AXA acquired Framlington Group in 2005 and established a joint venture with Shanghai Pudong Development Bank and Shanghai Dragon in China and one with Bharti Enterprises in India, both in 2007. Other players will need to follow suit if they wish to exploit the long-term growth in funds under management.

3. LOOKING EAST: GROWTH TO BE FOUND OUTSIDE MATURE MARKETS

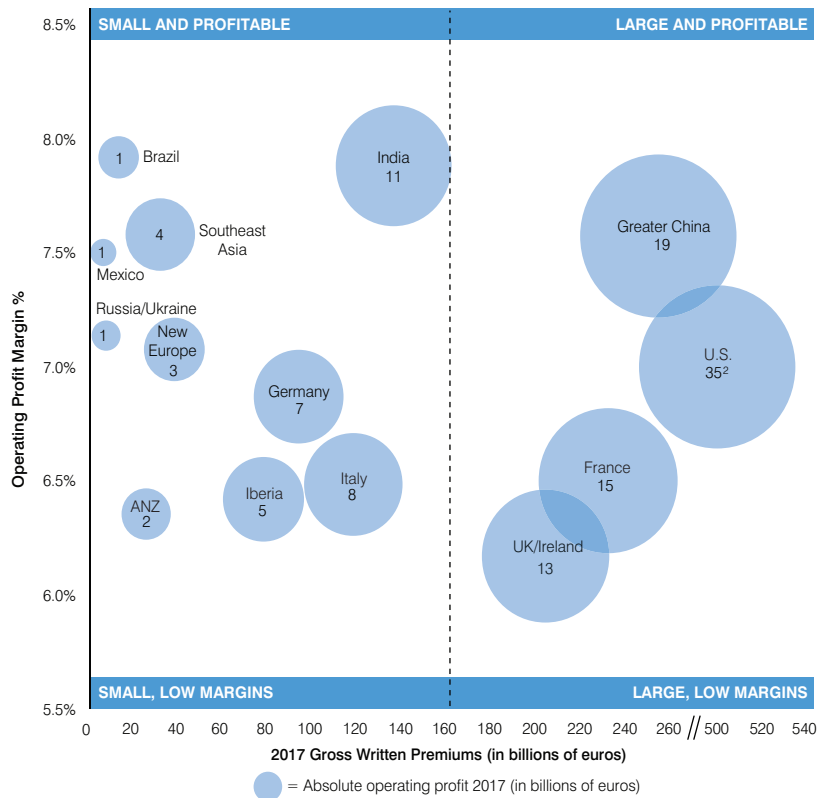
The best-performing insurers already have a strong presence in Asian markets. Prudential, for example, has a presence in 13 Asian markets, which generate more than half of its new business profits, and it is looking to grow its Asian business further, possibly through the acquisition of AIG's considerable assets in the region. ING, which has taken stakes in Indian, Chinese, and Thai banks, earned 48 percent of its new business profit from Asia in 2008, while 33 percent of AXA's new business profit was from Asia.

There is a strong case for continued investment and expansion in Asian and other developing markets (see Exhibit 2). Booz & Company predicts that by 2017, the highest margins in

the life and pensions business will be found outside mature markets: In China, India, Southeast Asia, and Brazil, profit margins are forecast to be about 8 percent. By contrast, in most Western markets, where competition is fierce and distribution networks firmly established, margins will be thinner—most likely 7 percent or less.

Growth in emerging markets will need to be explored—balancing short-term with long-term opportunities. Short term, there is clearly value in riding the wave created by the current downturn. Longer term, there will be growth opportunities in emerging markets, such as the BRIC countries. These will require in-market “know who” as well as “know-how.”

Exhibit 2
Projected Life and Pensions Profit Pools 2017¹



¹ Projected pretax operating profit.

² US profit pool not to scale.

Source: Booz & Company

4. THE THIRD WAY: CUSTOMER NEEDS COME TO THE FORE

Demographic changes, as well as a more challenging economic environment, will have a significant impact on the kinds of products that customers need. Volatile equity markets create a greater demand for structured products with built-in guarantees to cap the potential downside. Increased longevity means customers will be forced to work longer and will therefore have longer periods of asset accumulation, but drawdown periods will be longer too. In addition, as life expectancy increases, there will be a growing demand for long-term-care products and more flexible annuity and drawdown arrangements.

The retirement income market in the U.K., currently worth £12 billion (US\$20 billion) a year, is set to grow to £18 billion a year by 2012. Of this, a growing share should be made up of “third way” products that fall between the traditional poles of annuities, which provide a guaranteed income but no prospect for capital growth, and drawdown products, which offer growth but no guarantees.

Increased pressure to focus on customer needs comes from regulatory initiatives such as the Financial Services Authority’s Treating Customers Fairly (TCF) scheme, which places a greater obligation on firms to deliver appropriate products, suitable advice, and clear information to their end customers, and the Retail Distribution Review (RDR), which aims to simplify—and clarify for consumers—the way in which financial products are bought and sold.

In response to these trends, insurers must become more end-customer-centric. In order to benefit from the age-50-plus opportunity, for example, a shift from a “product-forward” to a “market-back” approach is required. The best performers will deploy sophisticated customer segmentation, tailored marketing, sales approaches, and products, as well as smarter packaging based on increased risk appetite and strategic pricing.

5. TECHNO- ADVICE: LOOKING FURTHER INTO THE FUTURE

While current debates over the way in which financial products are sold in the U.K. hinge on initiatives such as RDR, forward-thinking insurance providers should be considering the longer-term future of distribution.

There are two key trends to consider. First is the value shift towards distributors. In most of Europe, distribution is dominated by bancassurers; in the U.K., however, independent distributors such as independent financial advisors (IFAs) currently make the lion's share of sales. With commissions rising, they are capturing a larger share of value too: Between 2000 and 2005, manufacturers saw profits grow by 16 to 17 percent, while IFAs' commissions grew by 23 to 25 percent. Moreover, IFAs own client relationships, have critical access to market information, and are the players best placed to benefit from cross-selling.

While there could be a value shift back to manufacturers as RDR starts to produce results, there remains a strong case for insurers to gain a greater share of distribution by investing in direct sales forces and gaining access to bancassurance.

The second trend is the emergence of remote advice delivery, which could become mainstream sooner rather than later: HSBC is already running a trial of a remote advice delivery system using videoconferencing. Videoconferencing, which is expected to hit the mass market within five years, will be used in the affluent and mass affluent segments much sooner. This will transform the way in which advice is delivered to the customer and significantly improve the economics of customised advice delivery.

Bancassurance and technology-enabled direct channels therefore emerge as major opportunities for insurers to capitalise on.

Bancassurance and technology-enabled direct channels emerge as major opportunities for insurers to capitalise on.

6. CULTURE SHOCK: TRANSFORMING OPERATING MODELS

Life and pensions companies are slow-moving beasts, as befits an industry where mistakes may not be felt for many years. Some companies have used this situation as a cover for inactivity; not until recently have they felt significant pressure to transform their operating culture in order to maximise profitability. Booz & Company's Org DNA Profiler® identifies almost 23 percent of U.K. insurers as "overmanaged," while 40 percent have a "passive-aggressive" culture: Though the organisation seems consensual, in reality accountabilities are not enforced and governance is cumbersome, resulting in slow and second-guessed decisions.

In some areas the comparisons between benchmark strong execution companies and insurers are shocking: For example, 97 percent of benchmark companies agree that important

strategic and operational decisions are quickly translated into action, compared with just 31 percent of insurers; 55 percent of benchmark companies say information flows freely within and between departments, compared with 20 percent of insurers.

If insurers are going to deal with the key trends noted above—if they are to become more customer-centric, embrace new technologies, develop new products, and exploit new markets—they must improve their execution capabilities and operating culture. The first step is to identify barriers to execution and the root causes of execution failure; the second is to come up with an improvement strategy. The third, and most challenging, step is to shape an operating model, enhance capabilities, and embed new ways of working in order to deliver the future business strategy.

Booz & Company's Org DNA Profiler® identifies almost 23 percent of U.K. insurers as "overmanaged," while 40 percent have a "passive-aggressive" culture.

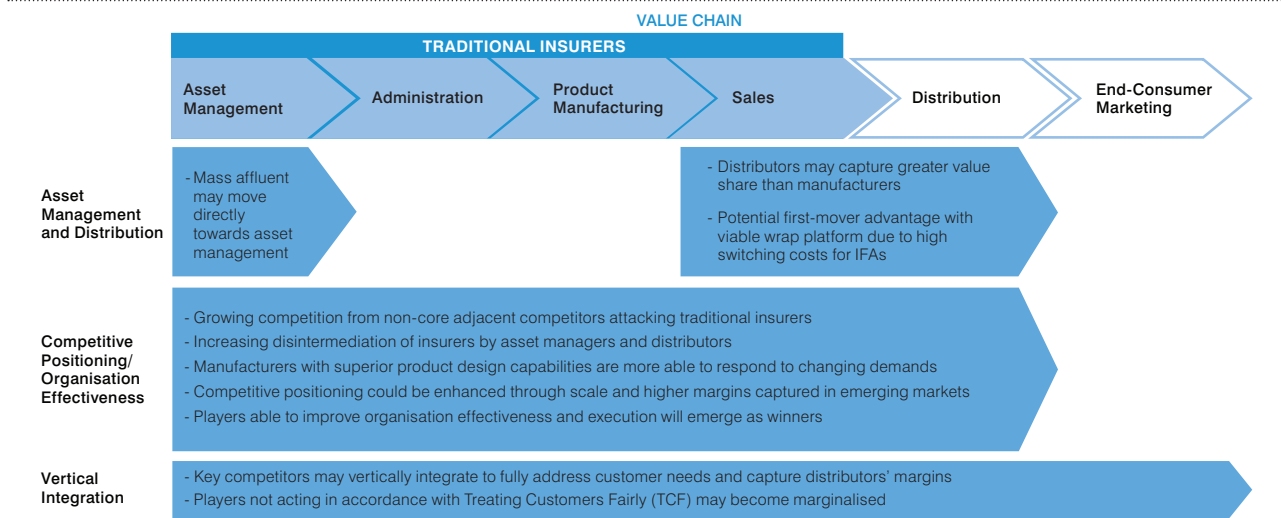
NEXT STEPS

The traditional insurer operates within a small segment of the value chain, covering administration and product manufacture: That needs to change (see Exhibit 3). Players need to expand in both

directions, going up the chain into asset management as well as down into sales, distribution, and marketing. These changes need to occur rapidly, and within the context of the most challenging economic and financial environment we have seen for decades. Exhibit 4 sets out the strategic choices that life and pensions players will need to make in response to the six trends impacting the industry.

The changes we have witnessed so far have come at a breathtaking speed. Anticipating and responding to the trends in the life and pensions industry will allow insurers to control their own destiny and build a sustainable profitable future. Those that fail to do so might be the ones having to collect their own retirement funds soon.

Exhibit 3
Impact of Key Trends on the Life and Pensions Value Chain



Source: Booz & Company

Exhibit 4
Key Trends and Strategic Choices for Insurers

KEY TRENDS	SPECTRUM OF STRATEGIC CHOICES		
	Orthodox		Aggressive
1 Changes in competitive environment	Focus only on select product lines and specialise	Grow organically and reduce costs	Acquire/consolidate attractive L&P companies and achieve economies of scale
2 Shift towards asset management	Outsource asset management	Develop limited asset management capabilities	Position as a full-fledged asset manager
3 Mature markets increasingly unattractive	Major player only serving the domestic market	Major player with some emerging market presence	Major player with sizeable presence in emerging growth markets
4 Changing customer needs and TCF	Stick to "product forward" approach and selectively invest in new products	Progressively adapt a "market back" rather than "product forward" approach	Be the first to take segmented approach and adopt to needs of new segments (e.g., ages 50+)
5 Emergence of new distribution models and new technologies	Establish strong partnerships with distribution networks and banks	Acquire major distribution networks/access to bancassurance	Aggressively build own sales force (direct and online) and invest in new technology
6 Transforming operating models, execution, and culture	Change operating model without addressing people	Take steps to improve execution capabilities while adapting operating model	Transform operating culture and model holistically to increase commerciality

Source: Booz & Company

About the Authors

Alan Gemes is a senior partner with Booz & Company in London. He is the global head of financial services for the firm and has worked with many of Europe's leading banks and insurers.

Fabienne Konik is a principal based in the London office of Booz & Company. She specialises in life and pensions and bancassurance, focusing on strategy and distribution issues. She has worked with a number of insurance companies in the UK and across Europe.

Sid Azad is a senior associate with Booz & Company in London. He focuses on long-term strategy development and transformation for banks, insurance companies, and asset managers.

The most recent list of our office addresses and telephone numbers can be found on our website, www.booz.com

Worldwide
Offices

**Australia,
New Zealand &
Southeast Asia**

Adelaide
Auckland
Bangkok
Brisbane
Canberra
Jakarta
Kuala Lumpur
Melbourne
Sydney

Europe

Amsterdam
Berlin
Copenhagen

Dublin
Düsseldorf
Frankfurt
Helsinki
London
Madrid
Milan
Moscow
Munich
Oslo
Paris
Rome
Stockholm
Stuttgart
Vienna
Warsaw
Zurich

Middle East

Abu Dhabi
Beirut
Cairo
Dubai
Riyadh

North America

Atlanta
Chicago
Cleveland
Dallas
Detroit
Florham Park
Houston
Los Angeles
McLean

Mexico City
New York City
Parsippany
San Francisco

South America

Buenos Aires
Rio de Janeiro
Santiago
São Paulo

Booz & Company is a leading global management consulting firm, helping the world's top businesses, governments, and organizations.

Our founder, Edwin Booz, defined the profession when he established the first management consulting firm in 1914.

Today, with more than 3,300 people in 59 offices around the world, we bring foresight and knowledge, deep functional expertise, and a practical approach to building capabilities and delivering real impact. We work closely with our clients to create and deliver essential advantage.

For our management magazine *strategy+business*, visit www.strategy-business.com.

Visit www.booz.com to learn more about Booz & Company.
