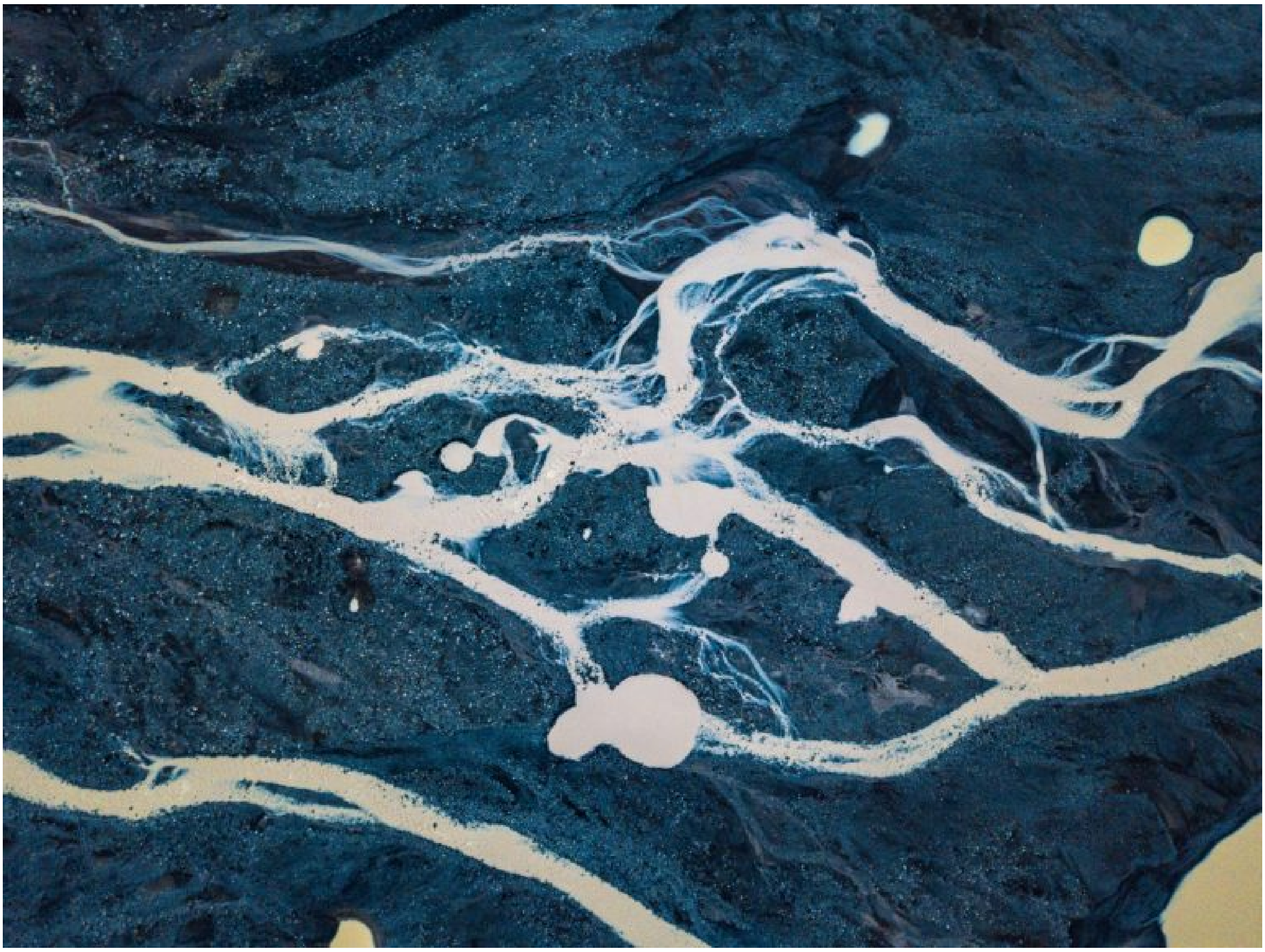
# The Silver Squeeze – decumulation dilemmas for would-be retirees

October 19, 2020



This research collaboration between NMG and Legal and General Investment Management looks at the issues faced by retirees making retirement income decisions without financial advice.

**By Chris Bailey**

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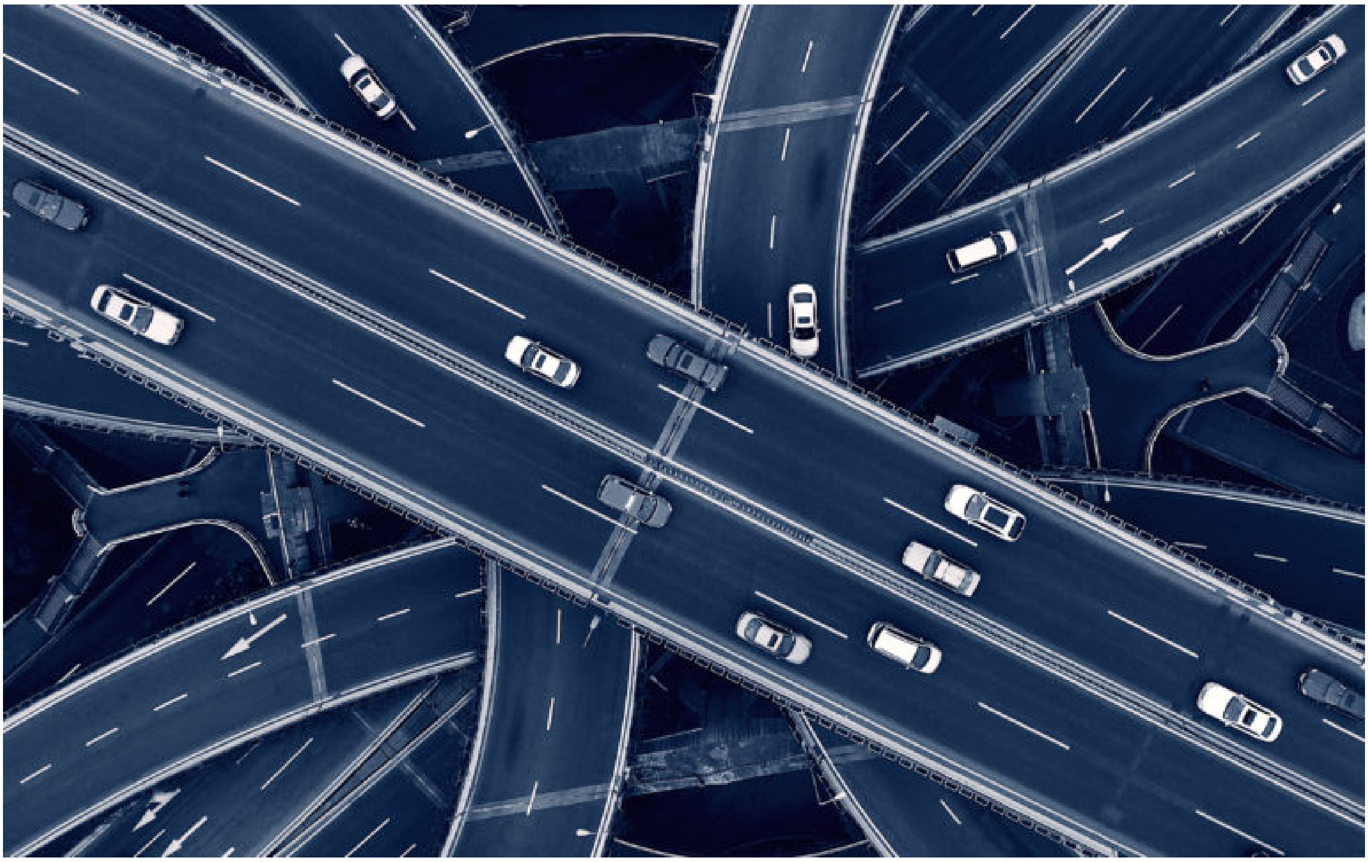
# Insurance in Super: A new opportunity for

# funds to differentiate?

October 19, 2020



Over the last few years, group insurance has become somewhat commoditised within super – funds have typically been reducing benefits to achieve lower premiums and reduce the impact on member balances. So it wasn't all that surprising when ASIC's *Consumer engagement in insurance in super (REP 673)* released recently found many members don't know, understand or value their insurance in super.

In addition, last month's Federal budget saw changes to superannuation that should result in reduced member turnover and the proposed introduction of a somewhat-questionable performance test. While the focus of these proposals has been primarily on fund growth, they also create two flow-on impacts to insurance within super:

- First-to-employment super funds will reverse their recent loss of members (due to PYS and PMIF), and with higher retained members will see a growing diverse membership base across risk occupations (and continue to provide generic, and cost-effective insurance coverage)
- Non-first-to-employment super funds will see an ageing membership base as a result of fewer new members, creating pressure on their current insurance proposition (particularly pricing)

As funds respond to these proposals and focus on member acquisition and the proposition to members, the natural focus will be on price and investment performance. However, some funds may also consider this an opportunity to differentiate based on their insurance proposition.

We think this is likely to create bifurcation within the group insurance industry:

- For many funds, group insurance will continue being seen as diluting member outcomes (instead of recognising the value it can bring for individual members if and when something goes wrong in a cost-effective manner). The resulting ongoing squeeze on group insurance will continue to impact on profitability, and see further reductions in features and value-add for default arrangements.
- A handful of funds will seek to improve their insurance proposition by tailoring benefits and premiums specific for the membership and their members' risk characteristics (eg additional cover for high risk occupations, tailored claim length and premiums). For this to work and attract new members, it requires not only specific marketing and member acquisition tactics, but also more specialist internal resources to understand what will work best for their target membership base, and how to use that to drive member behaviour.

Unfortunately, this isn't likely to make a significant impact on ASIC's next member research into group insurance in super – the increasingly few who it matters for are unlikely to overcome the majority of members where they cannot see the value of their group insurance.

Instead, these changes probably shift the focus towards personal insurance within super in future.

**By Chris Bailey**

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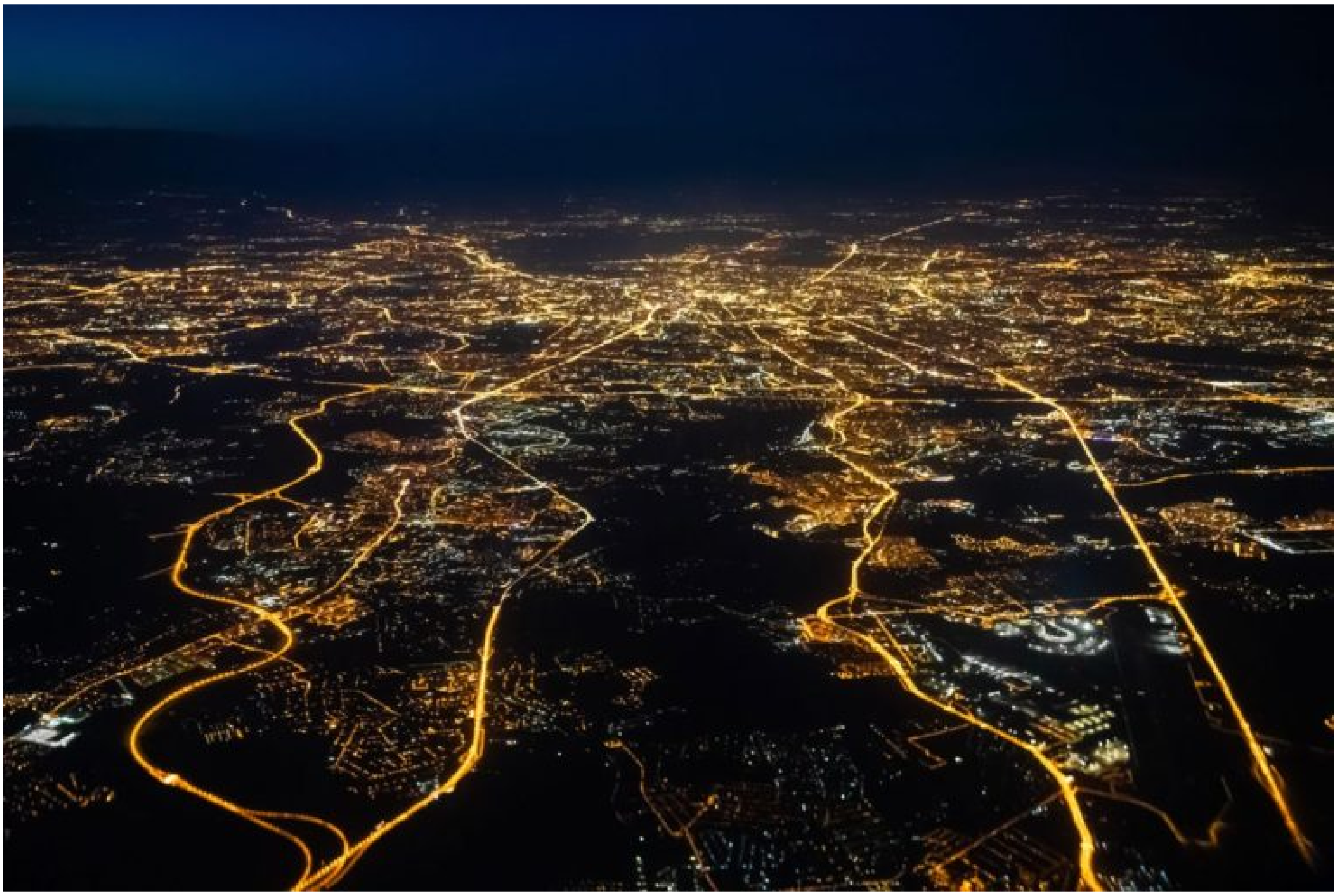
# Letting a crisis go to waste? Why adviser distribution models need to change – and now.

October 19, 2020



“Never let a crisis go to waste.” President Obama’s Chief of Staff, Rahm Emanuel, repopularised Churchill’s quote during the GFC. Some asset management firms are doing just that by ignoring the opportunity to reshape distribution models in the wake of COVID. It’s a mistake that could cost them money, time and chance to lock in growth.

In asset management, distribution teams are often shielded from organization-wide cost-out programs. Leadership teams are generally reluctant to reduce the breadth or depth of the very team that engages with the outside world and risk missing out on future opportunities or – worse – losing existing clients.

That isn’t to say sales teams aren’t constantly battered with questions as to how productive they are, how much value they really produce and whether their selling strategy is still right for the modern age.

Coming into COVID our hypothesis was that distribution models could change – for the better. Face-to-face contact has long been the model but remote working meant it was no longer possible. And whilst we’ve seen several firms try remote sales/service models in the past, we haven’t seen major success stories. In our view the old ways – established work patterns, existing skillsets – were too entrenched.

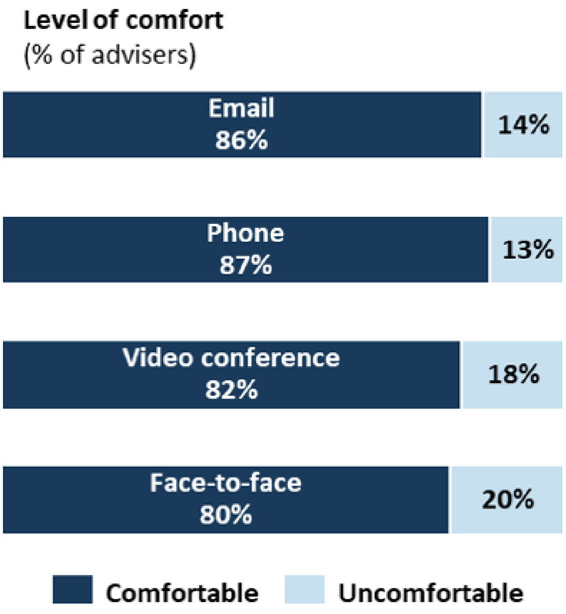
**Has COVID-19 changed distribution?**

It needed a crisis to break these patterns. So, we were interested to find out how advisers reacted now that COVID – not asset managers or platform providers – was forcing the change on them. Our Adviser Pulse research threw up some interesting answers which – combined with research conducted as part of our Global Asset Management research – showed:

- Behavioural change has happened – and it’s worked. BDMs stepped up contact via digital (email

and videoconferencing) during the crisis. Contact was up by more than a third. And advisers welcomed the extra interaction – the vast majority said the level of contact was ‘perfect’.
- Crucially, digital interactions didn’t just maintain existing relationships. During the crisis 60% of advisers have found new distribution relationships have been effectively developed as a result of BDMs reaching out via remote channels.

When we look specifically at mode of communication, we find that advisers are now as comfortable in a videoconference as they are face to face (see chart below). Most advisers were happy with content and the ease of video conferencing – getting the duration of the conference right was a big driver of satisfaction. So changing the way the industry interacts with advisers isn’t just about what works for asset managers – it’s about being responsive to advisers’ needs.




## Harvesting the efficiency dividend

In our view these results proves that the move to more and better digital-based distribution will work if you get the model right and manage the change well. That means there is an efficiency dividend to be harvested if asset managers act now to develop a new sales/service model that relies heavily (but not exclusively) on remote interactions.

In our view this efficiency dividend is significant – potentially worth up to 20% of the distribution function cost profile.

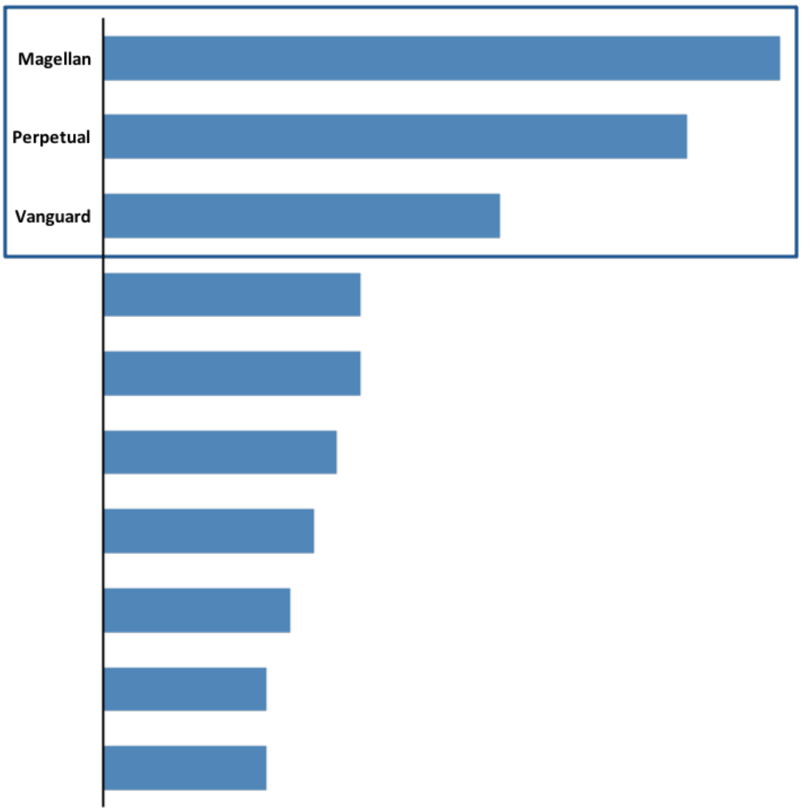
Over and above optimising digital interactions and the digital/face to face mix, asset managers now need to decide how to deploy the efficiency dividend they’ve been gifted.

Do they:

- cut costs and send that efficiency dividend to the bottom line
- invest that dividend in increased reach – hitting a broader range of advisers (including ones now more profitable given reduced distribution costs)
- improve value – invest the dividend in providing more value toa advisers through the interactions they have, perhaps by allocating more time for meeting preparation, or better using the time of internal specialists who can ‘drop in’ to an adviser video call. Access to

portfolio managers could be rapidly increased – potentially driving a wholesale re-think of the sales/service model as it is shared between the relationship manager, product/investment specialists, client service and portfolio managers.

> ***Who shares, wins***
> *When asked who delivered the strongest support during the COVID-19 crisis, Magellan and Perpetual were clearly at the top of adviser rankings with Vanguard in third place. What drove those rankings? Frequent, high-quality market, product and portfolio manager comms.*




### Initiative versus inertia

The right answer will be different for each firm. The NMG view is that intelligent, bespoke analysis can underpin the right decision. But that decision needs to be made **fast** – lest the dividend evaporates as distribution teams drift back to old ways.

Anecdotally, we've heard of sales teams in (effectively COVID-free) Western Australia booking plane tickets for their next face-to-face client visit. There are always exceptions, but for most businesses, that approach is the very definition of 'wasting a crisis'.

**By Chris Bailey**

# DC Advisor Practices Rebound in the Wake of COVID-19

October 19, 2020

Defined contribution (DC) advisors appear to be in a better spot than when we first spoke to them in late March. During the closing weeks of first quarter 2020, 38 percent said COVID-19 was having a worse impact on their practice than expected, and another 51 percent said the impact was about what they expected. There was a tremendous amount of uncertainty. The CARES Act was still pending, the economy was shutting down to varying extents, and it was unclear where the markets might go. Fast forward to the end of August, and advisor sentiment has flipped. Forty-three percent of advisors reported they were faring better than expected and just 9 percent said the situation was worse than they expected.

We attribute much of this improvement to advisors having a better perspective on the health of their practices. In March, more than half were moderately to extremely concerned about the impact COVID-19 would have on revenue, and nearly 40 percent expressed concern about sales opportunities disappearing. As of late August, just 13 percent were concerned about revenue being down in 2020. It should not come as a big surprise that as concerns about revenue and sales decreased, so did concerns about laying off staff and being able to cover payroll.

Unfortunately, business development activities still are not picking up for many advisors — 46 percent reported reduced proposal activity and another 39 percent said their prospecting had decreased (Figure 1). In addition, advisors are concerned about their health of their clients' businesses. Nearly 1 in 5 expect to lose clients due to bankruptcy or plan terminations. Given the level of market volatility seen this year, about one third of advisors are concerned plan sponsors will hold them accountable for the performance of fund line-ups (Figure 2).

**Figure 1: Impact of Market Volatility and COVID-19 on DC Advisor Practice**

**Figure 2: Top Areas of Concern for DC Advisors**

Activity within advisor practices slowly started returning to more manageable levels in August. Back in March and into May, the great majority of advisors were tending to the needs of clients. Many reported increased levels of outgoing and inbound client interactions, general conversations about plan design, investments, business with their clients, and more employee education. While things have not returned to normal, the percentage of advisors reporting increased activity in those areas due to COVID-19 dropped an average of 22 points (Figure 3).

**Figure 3: Increase in Frequency/Volume of DC Practice Activities as a Result of COVID-19**

Advisors are adapting, however. Seven out of 10 in August said COVID-19 had forced their practices to reconsider how they engage with plan sponsors and participants. A similar percentage say the changes they have made will largely remain in place once COVID-19 passes. Video conferencing appears to be one of these adaptations. In March, just under 50 percent of advisors had video conferencing capabilities in place. By August, this had grown about 20 points to 70 percent with another 25 percent considering adding it (Figure 4). Other digital methods of engagement, like webinars and marketing campaigns, have not gained traction despite relatively strong interest.

**Figure 4: DC Advisor Methods of Client Communication**

According to advisors, recordkeepers have done a good job of helping advisors and plan sponsors during the crisis. Recordkeepers have been responsive to advisors and plan sponsors, quick to implement the CARES Act provisions, and communicating proactively. While advisors appreciate the solid level of service, they still want additional help from recordkeepers. Help with lead generation and assistance with setting up video conferencing capabilities are near the top of the list.

The area where advisors would like the most help, however, is with participant education. It is not a big surprise, given advisors said social distancing impacting their ability to help participants is their number one concern. Half are looking for participant-focused content that they can present in a webinar. Of those seeking content, general investing and retirement savings top the list (Table 1). Meanwhile, 43 percent are looking to recordkeepers to facilitate digital education meetings.

**Table 1 — Advisors Looking to Recordkeepers for Participant Education Content**

The area where advisors would like the most help, however, is with participant education. This is not a big surprise, given that advisors say social distancing impacting their ability to help participants is their number one concern. Half are looking for participant-focused content they can present in a webinar . Of those seeking content, general investing and retirement savings top the list (Table 1). Meanwhile, 43 percent are looking to recordkeepers to facilitate digital education meetings.

Despite the slowed business development, most DC advisors are now in a better spot now than they were back in March. While engaging with clients, especially participants, in a socially distanced environment is challenging for some, many are taking steps to embrace new approaches to engaging sponsors and participants, but could use some content and support from recordkeepers.

**By Chris Bailey**

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# Doubling down on successful partnerships

October 19, 2020

*The insurance industry in South Africa is doing its part in responding to a 1-in-100-year global event. While the path out of the Covid crisis is long and uncertain, the successful functioning of key partnerships within the industry is making a real difference.*

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## Resilient and resolute

While pandemics typically occur every decade or so (think H1N1 in 2009, that infected 25% of the global population), it is not since the 'Spanish Flu' of 1918 that one has had such a dramatic impact as Covid-19.

The P&C insurance industry (locally more usually referred to as 'short-term' or 'non-life' insurance) is doing its job of ensuring the South African economy demonstrates much-needed resilience, despite the industry itself facing many challenges, both global and local.

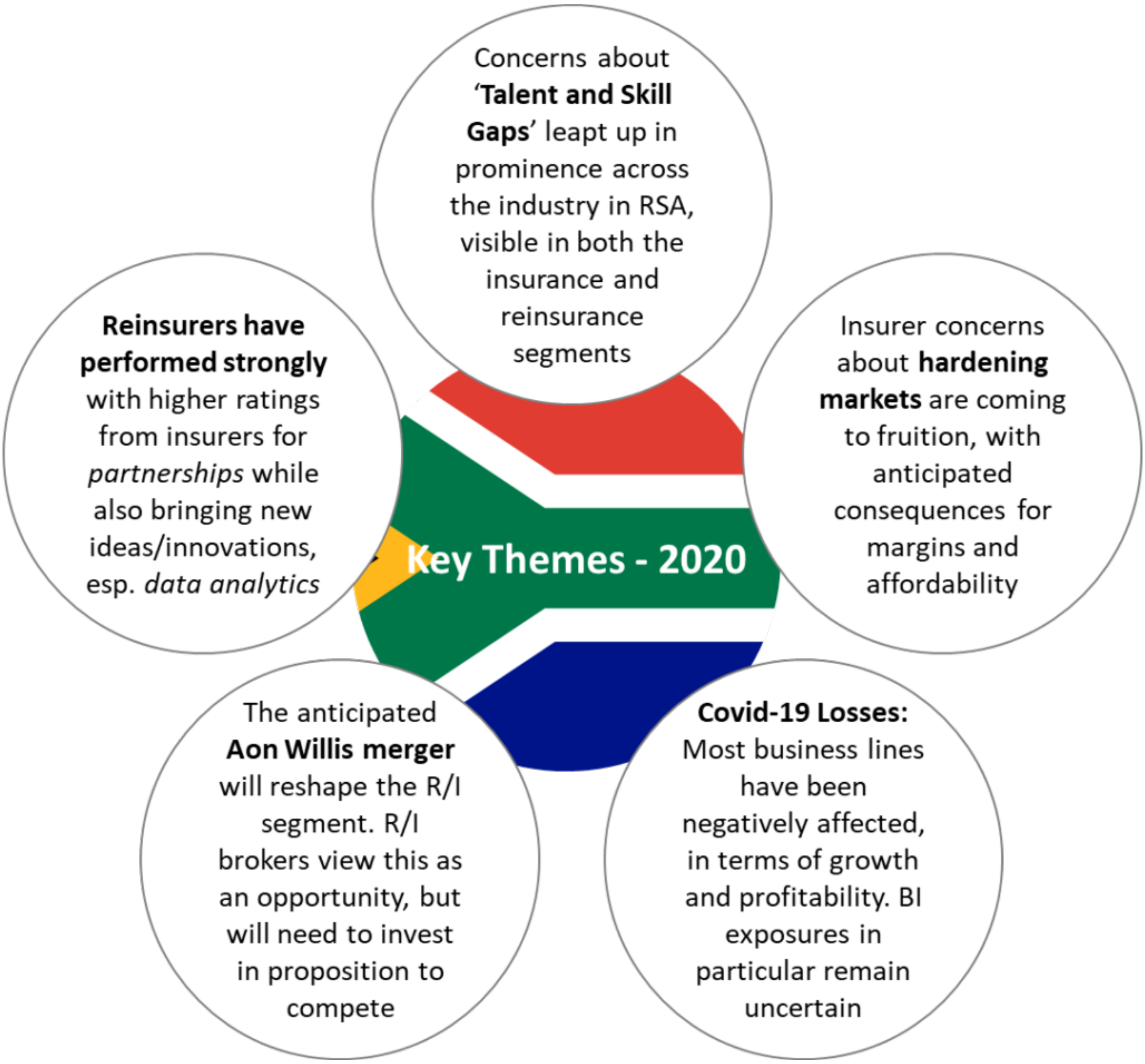
Most industry practitioners have never experienced such high levels of uncertainty, and many consider the impact of Covid-19 to be even more dramatic than that of September 11, 2001.

This 'coming together' as an industry is particularly crucial in South Africa, where the insurance sector is especially important given the absence of a meaningful public sector 'safety net'.

While the comments here are made specifically about the P&C insurance industry, evidence from NMG Studies drawn from similar (and additional) vantage points in the South African life insurance industry strongly support the same view.

**Exhibit 1: Insurance industry thematics – South Africa – P&C – 2020**

***Synthesis of insurer and broker perspectives describing the leading challenges for their industry***




*Source: NMG Consulting – Global P&C Re Study – 2020*

## Reinsurers (and reinsurance brokers) – friends in need

The results of NMG's P&C reinsurance Study 2020 clearly illustrate that both reinsurers and reinsurance brokers have lifted performance levels above those seen in recent years.

With hardening reinsurance prices and more cautious risk appetites, not to mention the enormous impact of Covid-19 on South Africa and its people, one could have reasonably expected the opposite. And yet both reinsurers and reinsurance brokers received significantly higher ratings from insurers in 2020.

A decomposition of these ratings indicates that reinsurers have done well by maintaining a focus on partnerships in these difficult circumstances, while being proactive in their support for claims settlement and fairness. Ratings for client-facing people and teams rose despite the challenges of virtual-only engagement, running counter to the global trend seen in P&C reinsurance markets in 2020.

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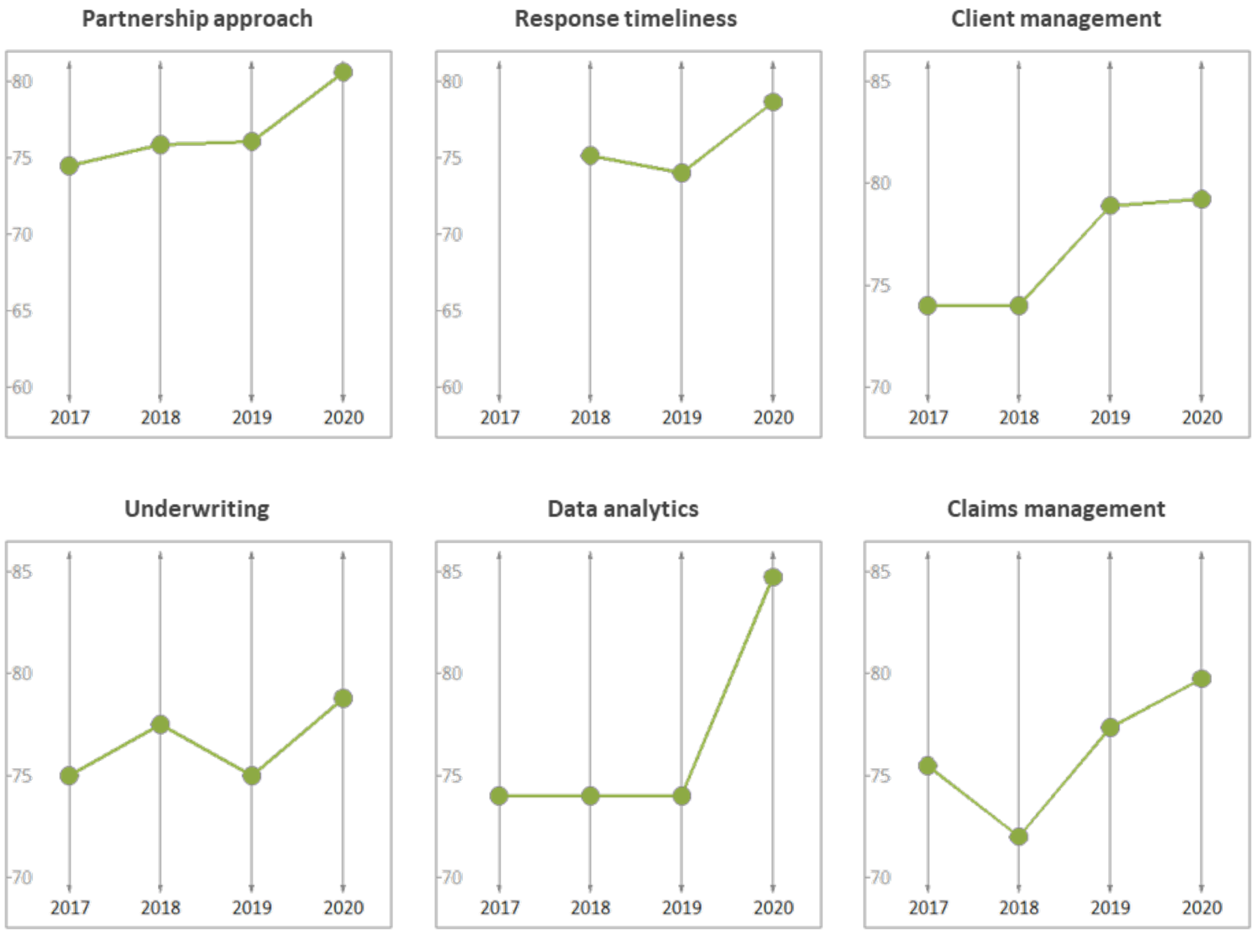
**Exhibit 2: Rising to the occasion in 2020**

***Average ratings awarded by insurers for the top 15 reinsurers (in aggregate)***




*Source: NMG Consulting – Global P&C Re Study – 2020*

## Rates to rise still further

If insurers, reinsurers and brokers in South Africa can be found to agree about one thing, it is that reinsurance prices will rise further, particularly for property lines. Insurers also seem to accept that these prices are driven by inadequate rate levels (although, surprisingly, brokers seem less convinced).

**Exhibit 3: Reinsurance Pricing Outlook – 2020 – South Africa**

***Comparison of the insurer (LHS) and broker (RHS) views on the outlook for pricing against the adequacy of current rates***


*Source: NMG Consulting – Global P&C Re Study – 2020*

Expected rate rises for Property CAT risks is a global theme, linked to a sharp uplift in concerns about climate change across the industry in 2020. Exposed to the financial consequences of climate events, the insurance industry can be viewed almost as a betting market for the consequences of climate change, and hence these opinions are a valuable reference point.

### Not quite out of the woods yet

Pressures on reinsurer engagements will rise further at forthcoming renewals. Only time will tell whether reinsurers and brokers will be able to maintain these levels (and profile) of engagement support. Challenging indeed, but by no means impossible.

Looking ahead, the key pressure points are likely to include:

- continued price increases (over the next 18 months), potentially squeezing insurance margins
- emerging disagreements on coverage definitions (which may only arise down the track once courts have ruled on contract interpretations)
- potential downturn in demand should affordability suffer in the general economic fallout from the pandemic

Fortunately, there should be enough positive news to offset these tensions:

- hardening rates should translate into improving reinsurance margins (and in some cases also

insurance margins, eg commercial lines)
- confidence should continue to improve as uncertainty retreats
- growth may be boosted by heightened risk awareness and increased recognition of the value of insurance

Given the upcoming challenges – and the success achieved so far – it would seem to make good sense for the insurance industry to double down on its partnerships for the foreseeable future.

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**By Chris Bailey**

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# APRA performance test: consolidation by stealth

October 19, 2020

It has been difficult to miss APRA's frustration at the lack of consolidation amongst super funds. The proposed annual performance testing (along with penalties for underperformance) in Budget 2020 may finally provide APRA with the tool to force the Trustee boards of underperforming funds to make the inevitable choice.

**The test**

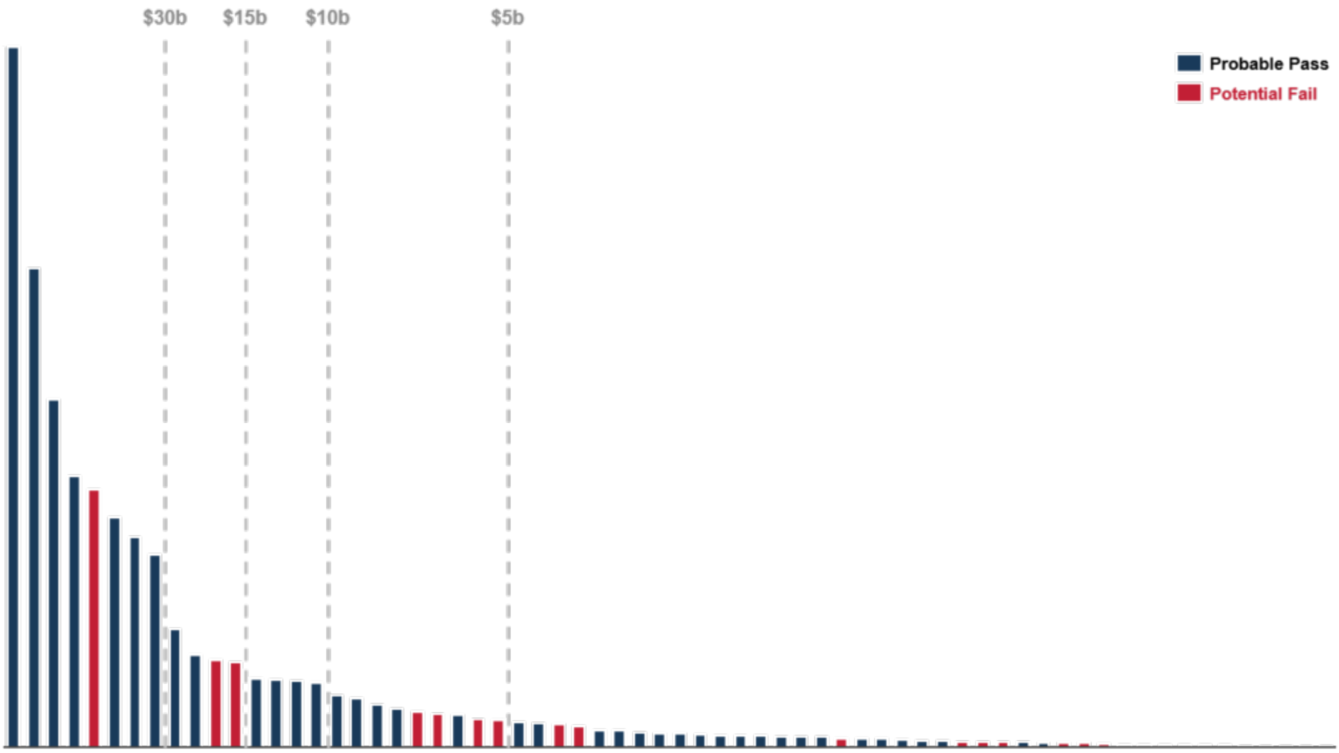
Regulators are ostensibly concerned that members can fall victim to the 'unlucky lottery' and be 'stuck' in underperforming funds. The annual performance test reform is designed to remedy this situation by subjecting MySuper funds to a regular test of long-term performance (net of fees) against an APRA-constructed benchmark tailored to each fund's asset allocation. Funds that exhibit long-term underperformance of >50bps pa will fail the test.

The reform requires funds that fail for the first time to notify members of their underperformance, and refer them to a new YourSuper comparison tool where they'll be provided with fee and performance information on alternative MySuper funds. Failing two consecutive tests will prevent the MySuper fund from taking in new members (until performance improves).

**Immediate implications**

The reality that will be dawning on many Trustees is that there may be no realistic way for them to bring their long-term underperformance up to scratch. The hole for many is just too deep. And if the reforms pass as drafted, those funds will be unable to take on new members for at least a year (and we suspect in some cases, for several years) from July 2022. Looking at current performance data from APRA's heatmap, over a third of MySuper funds (representing 16% of total assets) are vulnerable to this exact fate.

**MySuper FUM (including proposed mergers, excluding tailored MySuper) – June 2020, $b**




Failing two successive tests will prove terminal for many funds. Even after the ban on new members is lifted, access to employer arrangements and awards will have been irreparably revoked. The situation for these funds will be further exacerbated by the outflows from members prompted by the notifications of underperformance and a blacklisting in the league tables. These consequences, compounded over several years, will result in a significant loss in market share, brand strength, and revenues, while costs remain fixed.

**Action required now to avoid slow, inevitable failure**

This leaves underperforming funds with two options; commence the search for an appropriate suitor (no simple task for many funds given acquirer-funds' limited appetite to incur the transaction costs for small funds); or accept their fate and hope they're able to weather the storm (many won't).

This reform also presents a set of unique opportunities for the outperformers:

- Outperforming funds will have access to new union awards, employer arrangements and members dislodged from underperforming funds
- Medium sized funds or new entrants that can build a robust SFT / integration capability will be able to mop up smaller (<$10b) underperforming funds – quickly gaining scale and fulfilling APRA's consolidation goal
- Funds that restructure their investments conservatively to protect themselves against failing future tests can pass savings on to members, significantly improving price competitiveness (as discussed in our last [Trialogue](Trialogue))

This initiative is squarely focused on punishing underperforming funds and there is no doubt a lot of lobbying to be done before it is legislated. In its current form, it's terminal for many funds, and a clear opportunity for those in a strong position and on the front foot.

**By [Chris Bailey](Chris Bailey)**

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# [Leading engagement models set to deliver competitive advantage in advised life insurance](Leading engagement models set to deliver competitive advantage in advised life insurance)

October 19, 2020

*The pandemic has significantly and broadly impacted the US life insurance industry. Traditional* *advisor networking has been disrupted, insurers have had to demonstrate greater responsiveness and flexibility in underwriting and embrace a more digital approach. Reinsurers have had to be proactive and flexible while maintaining standards for risk acceptance and claims support. In short, the advisors, insurers and reinsurers that have performed well in the crisis, now have an opportunity to capitalise.*

## Virtual client sourcing

While advisors have been successful in supporting their current clients on a virtual basis, our recent Pulse study of 200 independent US life advisors shed light on advisor thinking about the primary challenge now faced: nearly 50% of advisors are 'concerned' or 'extremely concerned' about the difficulty in sourcing new clients.

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**Exhibit 1: Leading Advisor Concerns in the times of Covid-19**

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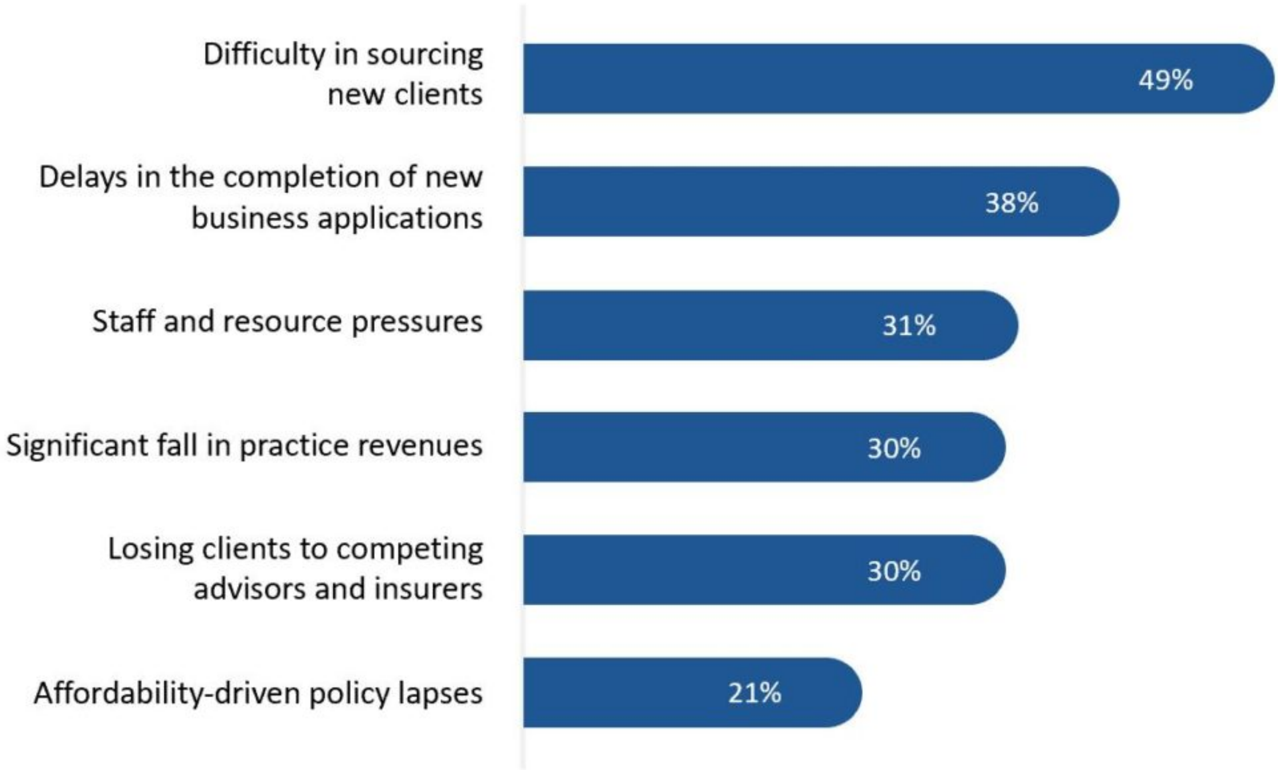


*Source: NMG's Advisor Protection Pulse, US – August 2020*

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The underlying concerns of advisors centre around the constraints arising from social distancing obligations and the new norms that could take hold before the pandemic is fully contained. Advisors, like their clients, are skewed towards the older working ages, meaning both are likely to take a more conservative approach to distancing. This is a major headache for a distribution system heavily dependent on networking. Advisors report that traditional networking activities, which are essential to sourcing new clients, are down by almost 80%.

> *Advisors report that traditional networking activities are down by almost 80%*

Absent new approaches to client acquisition, new life insurance sales can reasonably be expected to decline, at least in the short-term and potentially longer. The impact of Covid-19 has brought into stark focus the need for alternative methods of lead generation and client development. It seems that there will be no special exemptions for the life insurance advice industry when it comes to Covid-19.

## Increasingly risk-aware customers are calling for help, literally!

Rather than wait for a face-to-face opportunity and driven by heightened risk awareness generally, customers have become more proactive. More than 60% of advisors report an uplift in calls received and, crucially, one-third of these calls are from potential new clients (mostly triggered by ‘word of mouth’ referrals), who are evaluating their needs for life insurance and coverage.

> *One-third of inbound calls are from new clients, triggered by word-of-mouth referrals*

Highly-trusted advisors with strong client engagement models are set to be the clear winners in this environment, whereas those solely dependent on traditional prospecting capabilities seem set to lose ground. In a sense, the pandemic is winnowing out those advisors with poor engagement models and capabilities.

These trends have implications for insurers as well as advisors and their clients. Insurers will want to work with those advisors they perceive to be crisis-resilient, being those with proven ability to earn client engagement and resultant referrals and thus much less likely to turn to insurers for referral support. Insurers will need to be prepared for the risk that a greater proportion of applications will come from groups more vulnerable to the effects of Covid-19.

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## Winning in a crisis

According to advisors, optimal insurer support in the crisis boiled down to just two key themes:

(1) Timely, high-quality communication

The top-rated insurers so far have been those who have understood the value of proactive communications: in particular, regular updates on their changes to product coverage. Also, the top-ranked insurers have responded quickly (by phone/email/chat/text) to advisor queries.

Poorer performing insurers were either slow to communicate or, paradoxically, rushed their communications and created a disconnect between announcement and implementation. In a rapidly changing environment, insurers' automated call centre support at times frustrated advisors (because they lacked the intuitive sense to direct queries to the appropriate specialists).

(2) An effective operational response

This virtual engagement model enforced by the pandemic has rewarded insurers already well-advanced in using advisor/customer engagement platforms, and those which have refined a reliable and easy-to-navigate electronic application process.

Independently of the pandemic, life insurers have been investing in accelerated underwriting processes and technologies for many years. Insurers have adopted different strategies during the crisis and several have tightened standards for accelerated underwriting on the grounds of greater uncertainty and the potential for increased anti-selective behaviour from customers.

Others chose to differentiate their capabilities by relaxing underwriting guidelines to recognise the challenge in obtaining medical evidence in a world with social distancing and where the health industry is stretched dealing with Covid-19.

Insurers that lifted their thresholds for non-medical applications were also viewed positively. In addition, several insurers were recognised for being reliable on policy acceptance and on-time with their advisor payments, a lifeline for advisors during a period of income uncertainty.

> *"The more we can use digital tools to submit business as well as reform medical information requirements, the easier it will be to do business with carriers." Advisor*

## Performance profiles – Life Insurers

Advisors rated insurers' responses to the crisis positively overall, although the ratings of insurer performance are quite diverse.

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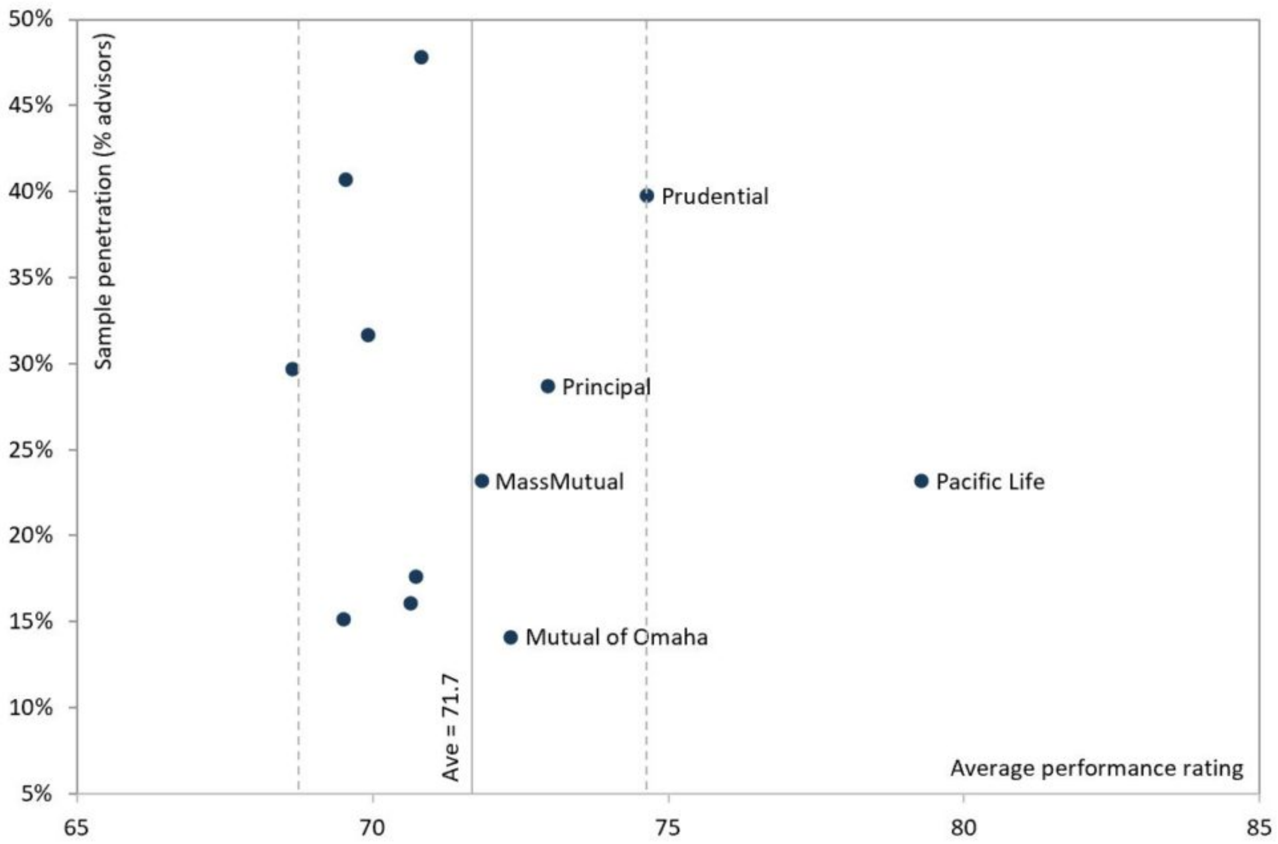
**Exhibit 2: Insurer performance during Covid-19 (Q3 2020)**




*Source: NMG's Advisor Protection Pulse, US – August 2020*

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Pacific Life is strongly differentiated from all competitors, more than enough to look beyond its smaller sample coverage and narrower product set. Of those insurers ranked 'top 3' for sample coverage, Prudential received the highest aggregate ratings from advisors.

Closer inspection of insurer-specific ratings revealed distinct insurer responses to Covid-19[1]:

- The *Advisor-centric* strategy established a competitive edge in responsiveness and issue resolution, complemented with flexible underwriting and fair claims handling. These four factors were also identified by advisors as leading influencers of future business placement, positioning this insurer strategy for growth
- The *Risk-led* engagement model combined expanding limits for accelerated underwriting and a focus on claims fairness, with strong support for advisors via an effective remote working platform
- The *Acquisition-focused* strategy targeted new business flow through proactive advisor communications and relative flexibility in underwriting
- The *Technically-driven* strategy engaged around product terms and definitions, but also showed a relative unwillingness to yield on technical factors across underwriting and premium leniency

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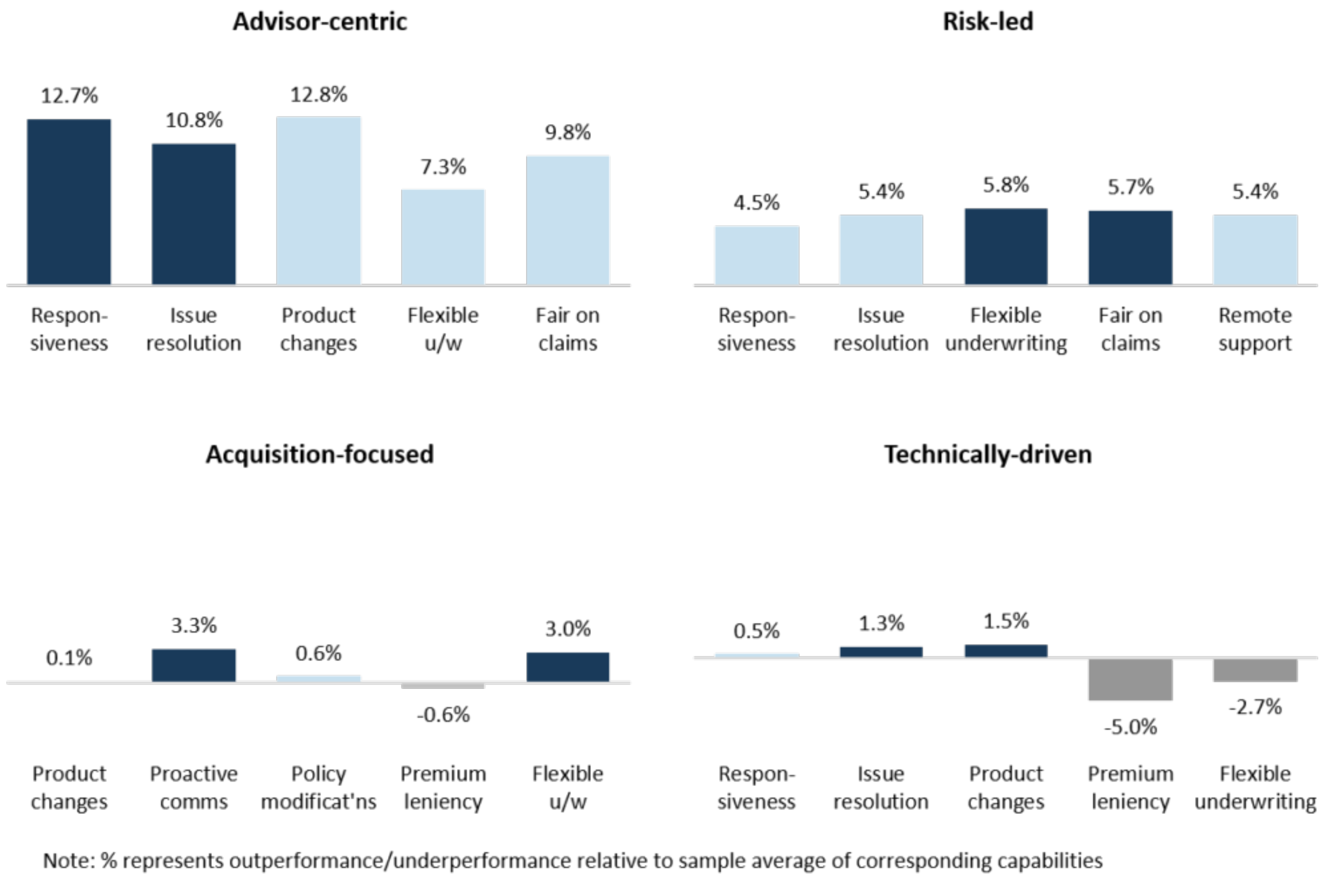
**Exhibit 3: Insurer over/under performance by capability (relative to industry mean)**




*Source: NMG's Advisor Protection Pulse, US – August 2020*

It should be noted that insurers rated as being more flexible in underwriting or better in claims does not imply technical inferiority or lower margins. Nonetheless, insurers generally seek to achieve high ratings from their supporting advisors on these factors.

[1]Note that all life insurers focus on the attributes outlined, yet are different in where emphasis is placed (measured by performance against the mean rating for each factor)

## Challenging time for life insurers

Life insurers hold a more favorable view of near-term growth[2] than do advisors, incorporating views across all distribution channels, although should take heed of current signalling from advisors.

Insurers face additional challenges, being disproportionately exposed to older lives where the impact of Covid-19 is most intensely felt. Insurer expectations are for significantly worsening claims experience in mortality and disability portfolios (with perhaps more favorable experience emerging in other classes such as longevity and LTC). Insurers also face additional margin pressures with yields at all-time lows on fixed income portfolios.

> *Insurer expectations are for significantly worsening claims experience on mortality and disability portfolios*

A lasting effect of the pandemic will be to accelerate the pace of 'digitalisation' of life insurers, although the need to double down on these efforts currently is a significant additional stress point.

[2] Insurer expectations for new premiums indicate an average decline of 10% to June 2021 (Life Insurer Covid-19 Pulse)

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## Reinsurers play their part

Reinsurers are similarly exposed to reductions in new reinsurance premiums and worsening claims experience and carry the most-skewed exposure towards older and sub-standard lives. Reinsurers also experience additional volatility arising from larger policy risks assumed.

Nevertheless, reinsurers have underlined their partnership credentials throughout the crisis, providing highly-valued support to insurers in areas including flexible underwriting, claims fairness and proactive knowledge sharing. Insurer evaluations of reinsurer performance have risen sharply, most noticeably for responsiveness and claims support.

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## What lies ahead?

US insurers and advisors face several similar challenges in the new normal. Both need to respond to more risk-aware consumers experiencing hip-pocket pressures and facing an uncertain environment. Both need to optimise their digital and remote channels to deliver information, access and underwriting at levels they have never achieved previously. Advisors and customers will have expectations that these higher levels of servicing and support will become permanent.

> *Advisors have an expectation that the higher levels of servicing and support will become permanent*

At the same time, insurers will need to balance flexibility in underwriting and new business acceptance with adequate risk management. The search for substitute risk factors for medical information will be important. Underwriting standards are thus a key risk point and one insurers and reinsurers will focus on.

Those advisors and insurers who have shown resilience in the crisis have developed a hard-earned competitive edge. As the industry settles into a new normal, we'll learn how effectively they capitalise on this.

***NMG Consulting*** *focuses exclusively on the insurance, reinsurance, wealth management and asset management industries. Our advisory model integrates strategy consulting, insights, and analytics. Within our Insights division we run annual studies, to examine market and competitor trends, as well as pulses to assess changing dynamics. This article draws on evidence from three of our 2020 studies in the US, namely: Advisor Life Insurance Covid-19 Pulse, Life Insurer Covid-19 Pulse, and our annual Individual Mortality Reinsurance Study 2020.*

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**By Chris Bailey**

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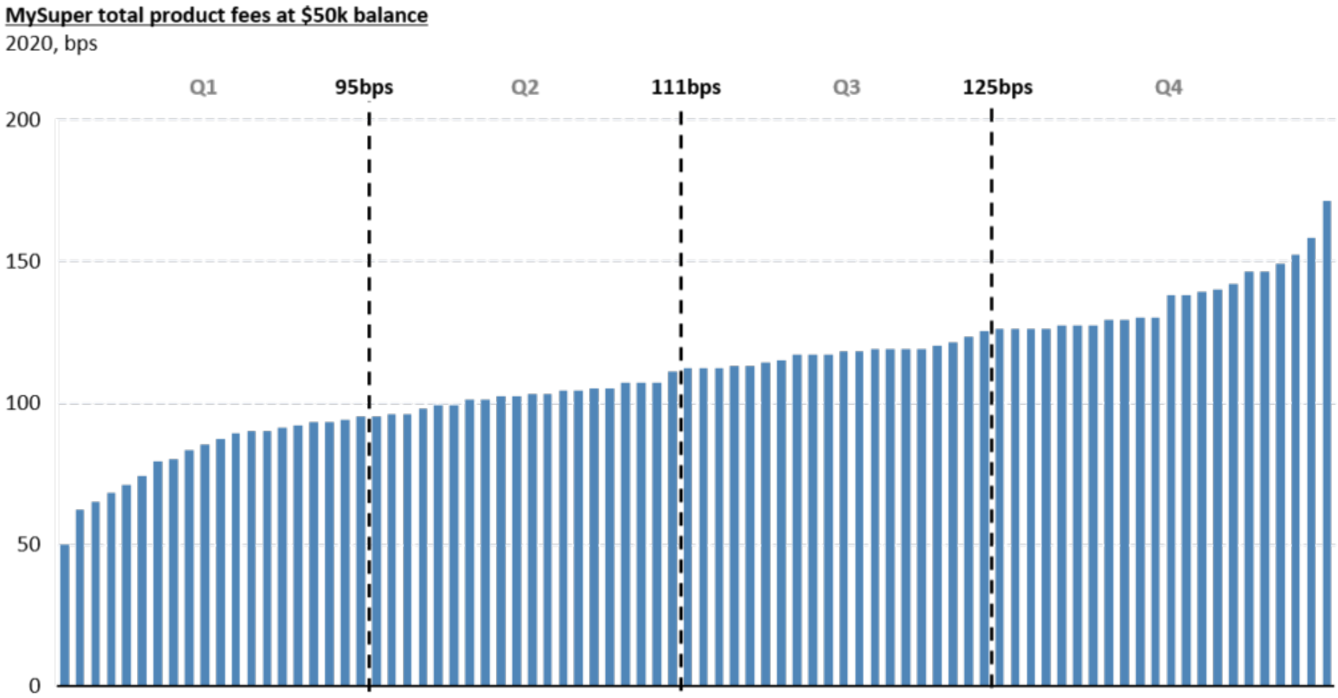
# Low cost OR high performance: super funds to decide

October 19, 2020

There is enormous disparity in fees and performance of MySuper funds (and there isn't necessarily a positive correlation between the two). To complicate matters, the recent Budget announcements –

particularly the performance testing component of **[the super reforms]** – will force trustees to make an important choice as to their ambition: low cost or high performance.

Today's first chart shows the significant disparity of fees paid by members in MySuper funds. For a $50k member, total fees range from 50bps to more than 150bps at the extremes.




We aren't alone in expecting these fees to fall across the board. And for a while this has had us thinking, how low can they go? And what's a future competitive price point?

**Biggest funds to reduce fees by 20%**

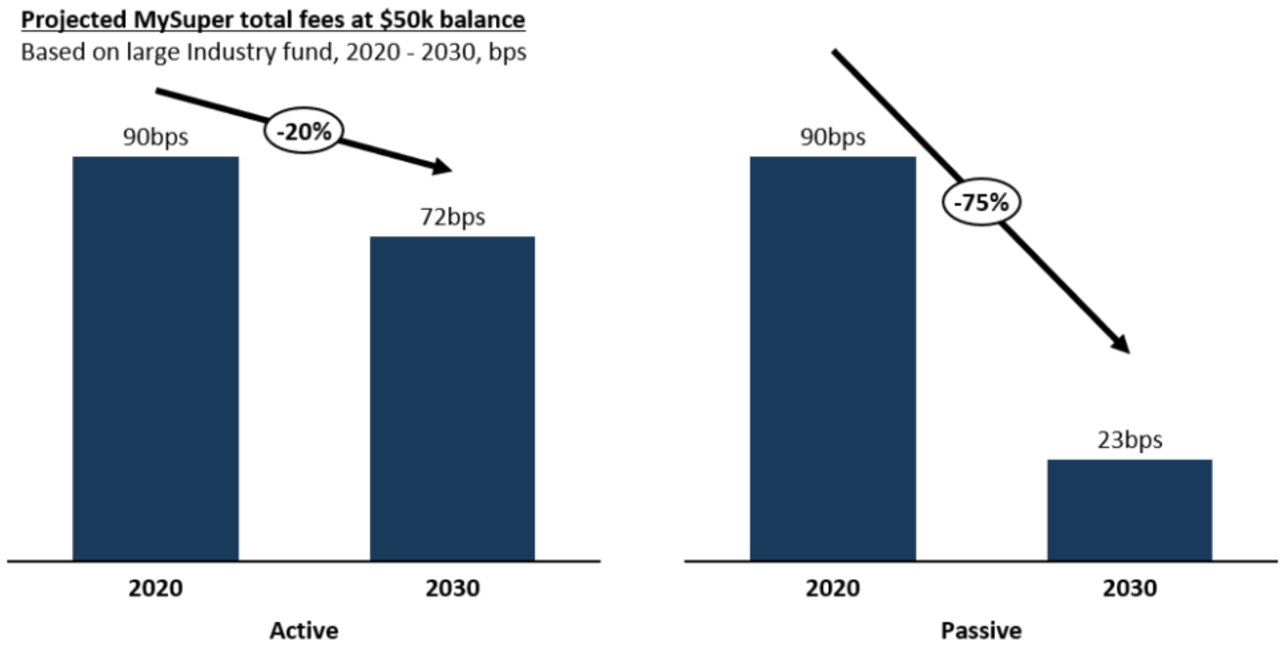
The industry's biggest funds, (the 'titans' with more than $80bn under management), are mostly growing much faster than their smaller rivals, and are likely to re-invest some or all of their scale economies into price. Our modelling indicates the biggest not-for-profit funds will have the flexibility to reduce fees by around 20% over the remainder of this decade setting a notable benchmark for their rivals and other large funds.

And it's important they do reduce fees. Price is an important lever, but one that has rarely been pulled (notable exceptions being ING, which it turns out wasn't free after all, and HostPlus). In both those examples members responded very positively, suddenly becoming engaged with their super and switching to the low-cost funds. Funds have long been frustrated by low levels of engagement amongst the member base, but it does seem as though 'low price' is an effective way to dislodge an otherwise dormant set of your competitors' members.

**Some funds will cut fees by 75%**

Is a 20% fee cut from our largest super funds enough? Perhaps, but we think others will go further. The annual performance testing announced in the most recent Federal budget is likely to cause some (but certainly not all) funds to adopt a passive, or mostly passive, approach to investing. The performance testing compares net of fee returns against an implied benchmark return series, and proposes to penalise funds that consistently fall behind over longer time periods (more on that in our next Trialogue).

Given the (mostly) active investment budget makes up around 2/3 of an average fund's total expenses, passing through cuts to that investment budget in a shift to passive will have a huge impact on fees, as our second chart shows, with possible total fee reductions for a $50k member in the order of 75% by 2030.




Which is to say, we expect to see a bifurcation of approaches emerging:

- Some funds will go low, adopting passive strategies (and mitigating the risk of falling foul of APRA's performance test at the same time). This might see fees for a $50k member as low as 30bps in 2022, and 23bps in 2030. With no real differentiation in returns, success for these funds will require scale to drive down operating margins, and non-performance related member acquisition strategies.
- Other funds, with a more rusted on active investment approach (and often large internal teams) are unlikely to give up on a 'mostly active' approach, especially if it has been working. However, as fees will continue to be a focus here, investment teams will have to deliver at least 55bps of excess returns each year to justify the fee differential – it's worth considering here that fewer than 10% of MySuper products currently achieve this on a 5 year basis[1].

Whilst many funds have hitherto positioned themselves as being both low cost and high performance, we doubt that will continue to be possible as some funds transition to being truly low cost. Trustees need to make an active choice to be either a low cost, mostly passive, fund at around 30bps – or to take a big swing and back the investment team to produce consistent alpha, probably at a total fee of 70-80bps. It's a big decision, and with APRA looking over their shoulder, an even bigger one.

Moving to such a binary choice has far reaching implications beyond just naming and shaming underperforming funds. There are big decisions for the regulator as well as trustees involved.

[1]Per the current **APRA MySuper Heatmap**

By Chris Bailey

# Superannuation: Employer channel to shrink in relevance (Australian Budget 2020)

October 19, 2020

Superannuation in Australia has had a tough year; with memories of a bruising Royal Commission still fresh, the industry has been asked to facilitate early access to super on a scale never before seen, all while helping members through a global pandemic and the associated market volatility. There is no room for sympathy, though, with Budget 2020 handing down a number of ultimately sensible but challenging reforms.

There were four main initiatives set out in the Budget, targeting what the government see as 'structural flaws' in the industry:

1. Stapling super such that it follows employees as they change employers
2. A new 'YourSuper' comparison tool for MySuper products
3. Annual performance testing of MySuper products, and penalties for underperformance
4. New best interest and reporting duties for Super Trustees

This week we look in detail at the proposal to 'staple' employees to their default superannuation account.

### Stapled Super

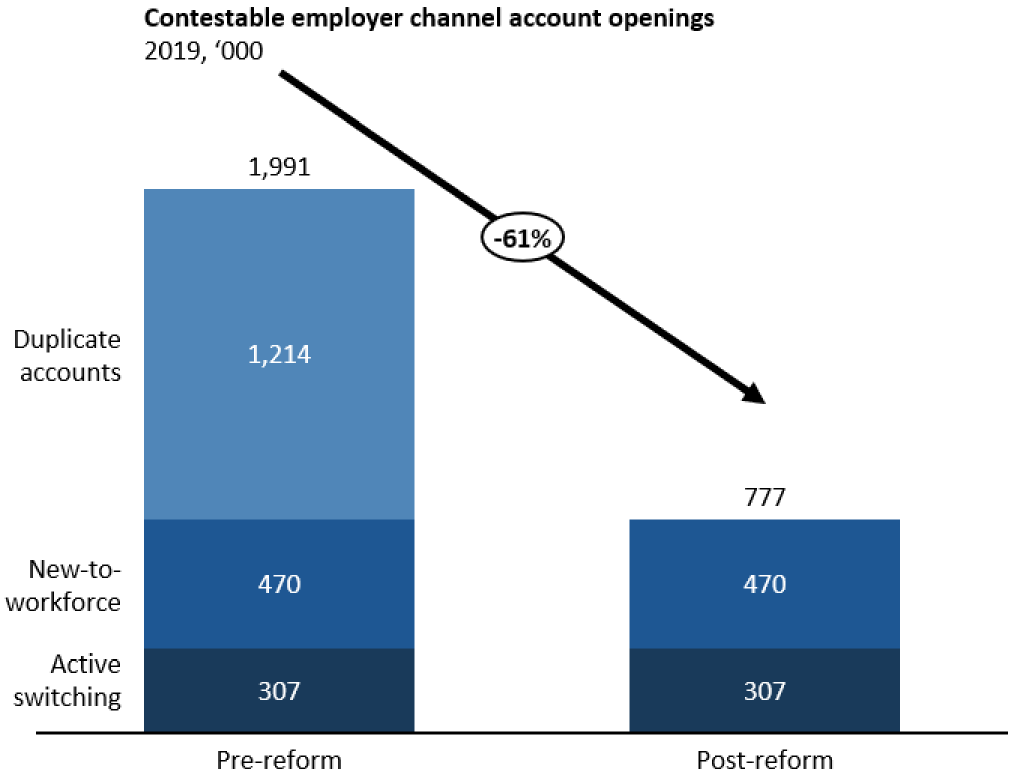
Whilst the default element of Australia's system of superannuation is often coveted internationally for its near-universal coverage, the implication of this default approach to retirement savings is that levels of engagement are low. And, arguably, that produces great outcomes for many members. However, it also creates a situation where members open additional super accounts each time they change employers, either unwittingly or perhaps out of indifference. As a result, and according to the 2020 Budget papers, 4.4 million Australians pay ~$450m every year in unnecessary superannuation fees relating to duplicate super accounts.

Stapling accounts to employees – such that they are not separated when the employee changes jobs – is designed to prevent this wastage. Under the proposed changes, when an employee joins a new employer and does not nominate a super fund, their new employer will be required to direct super contributions to their existing account.

### Reduction in employer channel opportunity

The biggest consequence of this reform is perhaps the importance of your first super account, which is clearly a boon for those funds that have strong employer relationships in the retail and hospitality sectors.

As for the impact of these reforms on new account creation, the chart below shows the contestable pool of new employer default super accounts each year potentially **falling by as much as 61%***; now entirely reliant on new-to-workforce members and active switching.




This presents an interesting distribution challenge for super funds, who will have to shift their focus from member retention to member acquisition – no simple task given the extremely low levels of engagement with superannuation among younger Australians.

Absent any change to the relationship between employment agreements and super, success will require convincing Australians young and old to be actively engaged with their super and cultivating an employer client base that hires teenagers.

The funds most adversely exposed to these reforms are those with a high portion of their members in MySuper, but who are unlikely to be their members' first fund (think any fund targeting university graduates, for example). On the face of it, the winners will be those funds like REST, CBUS and HostPlus that capture a significant proportion of the new-to-workforce opportunity amongst their target member base.

**Two other implications**
There are two other interesting consequence of this reform:

1. The incumbent default super providers appear likely to become the ongoing default super account for all their active members at July 2021. This could provide funds with high member turnover some breathing space. For these funds, a reasonable segment of their member base was prompted to switch into a new fund when they changed employers, forcing the fund to focus on acquisition to stem the tide. Removing this trigger will allow these funds to redeploy the acquisition-focussed resources. And for retail providers at least, to focus on converting those members to the retail proportion of their book over time. (Of course, the performance testing component of the reforms mean this relief may only be temporary).
2. Whilst the Budget papers indicate a saving to members of $450m per year, we highlight above the need for most funds to rapidly improve their focus on go-to-market acquisition strategies. Given the challenges of getting individuals engaged with their super, this is likely to be an expensive exercise and we wonder if funds' cumulative investment in these acquisition initiatives might eat up most of the savings.

**Future of the employer channel**
The link between employment arrangements and superannuation has been under attack for several years now, with many funds having made contingency plans for their growth should one of the Productivity Commission or Royal Commission recommendations for the allocation of default funds be adopted, for example. Even if such a change doesn't occur, stapling superannuation accounts to members decreases the size and value of the employer channel, and may be the first of several cuts to come.

*NMG analysis – we see this reform potentially preventing the creation of ~1.2m default employer super accounts based on total new MySuper accounts in 2019, after accounting for rollovers, SFT, switches in from Choice products and new-to-workforce account openings

**By Chris Bailey**

# DC Advisor Response to Market Volatility & COVID-19 – Wave 3

October 19, 2020

Thanks again for participating in our study! Please click here to download key findings from our 2019 retirement plan advisor survey.

**By Chris Bailey**