




Protection Product Development: Is it all about risk?

August 2009

The economic landscape is changing, leading to a need for immediate action

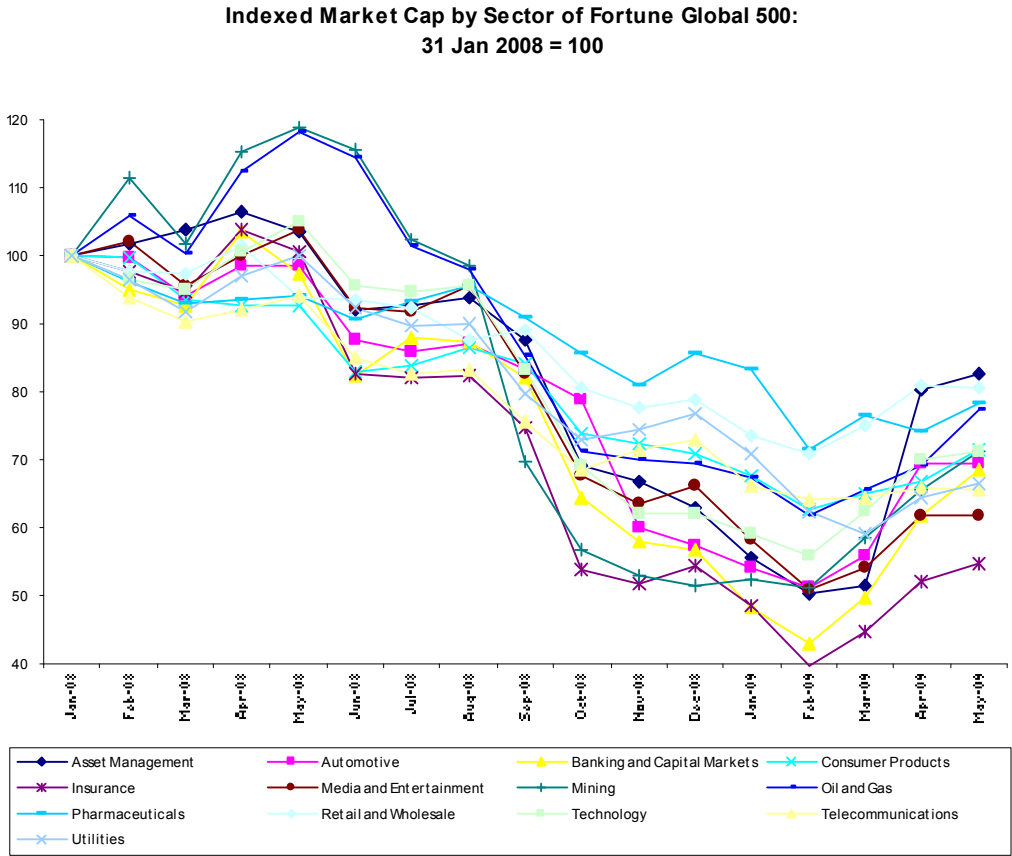
- ▶ The global economy has seen many years of sustained economic growth
- ▶ Sustained fiscal relaxation in the world's financial markets led to extraordinarily high levels of liquidity, cheap debt and increased use of leverage
- ▶ Now we are seeing significant challenges in raising debt financing combined with a downturn in the global economy
 - ▶ Increasing difficulty in raising "new" financing, together with stricter controls and higher costs for refinancing
 - ▶ Knock-on effects of the credit crunch leading to a reduction in confidence impacting the day-to-day business (reducing sales, increased price pressure)
 - ▶ Volatility in exchange rates and raw material prices, leading to difficulties in planning with any degree of certainty
 - ▶ Companies at risk of breaching covenants or failing to repay debt or arrange new financing, resulting in insolvency / liquidation risk
- ▶ Winners and losers will be defined in the next 12-24 months



- ▶ Unemployment rates
 - ▶ **Projected global 2009 rate between 6.1% and 7.1%**
 - ▶ International Labour Organization forecast Asia is likely to have 7.2 million more jobless people in 2009 than last year, making the total number of unemployed workers balloon to 97 million in 2009. That would raise the region's jobless rate to 5.0% from 4.8% last year. In the most pessimistic scenario, the number of unemployed could swell to 113 million, or 22.3 million more than last year.
- ▶ Increasing corporate bankruptcies in a slowing global and regional economy
- ▶ Risk and regulation
- ▶ Government intervention
 - ▶ Many countries announced stimulus plans to prompt economic growth, such as China, Singapore and Korea;
 - ▶ Interest rate cut to increase liquidity in China, Hong Kong and Vietnam

- ▶ Global economy
 - ▶ **GDP growth rate estimated to fall to 0.9% in 2009 –the lowest since WWII**
 - ▶ **Emerging mkts v developed mkts (-2.5% to +7.0%)**
- ▶ Capital markets (1 Jan 2008-28 Feb 2009)
 - ▶ FTSE 100 (-40%)
 - ▶ Dow Jones (-44%)
 - ▶ DAX 30 (-52%)
 - ▶ Nikkei 225 (-48%)
 - ▶ Shanghai 180 (-61%)
- ▶ Commodity prices
 - ▶ **Oil price down over \$100 pb**
- ▶ Interest rates
 - ▶ Lowest in history –China 2.25%, HK 0.5%, Singapore 0.64%
- ▶ Consumer confidence has fallen significantly and shows no respite

Fortune Global 500 sectors affected in varying degrees



Source: Capital IQ (market cap indexed to 100 as of 31 January 2008)

NOTE: non-USD-denominated market caps converted to USD at fixed 30 Apr 2009 exchange rates to eliminate currency fluctuation effects

NOTE: No Biotech company appears on the 2008 Fortune Global 500

| % fall in value: 31Jan08 to 31May09 | Sector |
|---|---|
| 0 < 10 | Hospitality and Leisure |
| 10 < 20 | Asset Management Prof Firms and Services Retail and Wholesale Construction |
| 20 < 30 | Pharmaceuticals Oil and Gas Real Estate Consumer Products Mining Technology |
| 30 < 40 | Automotive Sum of all sectors Govt, Public Sector & NFP Banking and Capital Markets Utilities Telecommunications Aerospace and Defense Media and Entertainment Other Transportation Chemicals |
| 40 < 50 | Airlines Insurance Diversified Industrial Products |
| 50 < 60 | Provider Care |

Source: Capital IQ (market cap indexed to 100 as of 31 January 2008)

Impact on consumer behaviour

- ▶ People inevitably reflect on their financial circumstances when events like those of the recent past occur
- ▶ Predictably, consumers are saving more
- ▶ Consumers want to have adequate coverage in the event of unforeseen events occurring e.g. death, illness, loss of income due to unemployment and/or illness
- ▶ Consumers are shifting their focus to protecting their family, their livelihoods and their capital/investments
- ▶ Consumers are now more risk averse.
 - ▶ They increasingly want guarantees on their capital (yet they want upside on their investments)
 - ▶ They want to trust the person /company they are buying the product from
 - ▶ They want to understand the products they are buying

Implications for insurance companies

- ▶ Capital is scarce and the companies must use it wisely to maximise returns for shareholders
- ▶ Capital restrictions imposed by regional offices
 - ▶ This is a new paradigm for many in Asia, where market share was king before
 - ▶ Now it is profitable sales of less capital intensive products, and bottom line
- ▶ Companies ideally want to write less capital intensive products i.e. those with little or no guarantees
- ▶ Companies may need to “re-invent” themselves
 - ▶ Focused heavily in investment linked / variable products
 - ▶ Align distribution channels and products to changing demands of consumers

Implications for insurance companies (contd.)

- ▶ Distribution:
 - ▶ Agents have had a relatively easy time selling investment products in a rising market....things just got a lot tougher
 - ▶ Newer agents have not sold “real” insurance products – retraining being done
- ▶ Underwriting:
 - ▶ Underwriting departments have been allowed to wither with little focus on protection in the recent past
 - ▶ Experienced underwriters in the market are at a premium...along with the actuaries and marketeers who are experienced in protection products
- ▶ Counter party risk is now more of an issue than ever before – companies need to determine the right reinsurer to partner with
- ▶ Companies need to consider standardising and revising sales process to minimise regulatory risk of inappropriate products being sold to customers

Why should CEOs be focusing on Product Development?

Product drives the business

Product is central to:

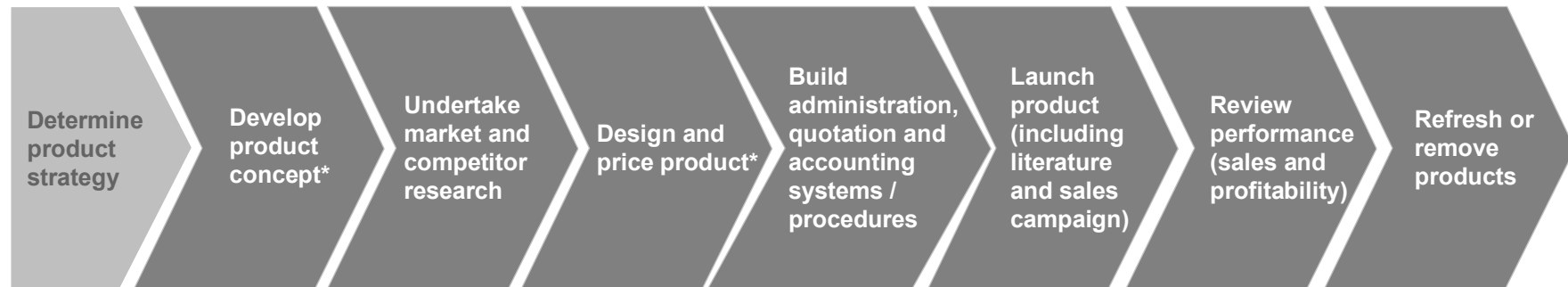
- ▶ Delivering the Strategy
- ▶ Managing Risk, and
- ▶ Delivering acceptable return on Capital



CEOs need to increase their oversight given the constraints on capital and focus on earnings

Product development – an effective process

Example of a “Product Development Process”



* Approval to proceed is required at this stage

- ▶ Ensure there is a well defined product development process which is followed
- ▶ Ensure the process is complete in its scope (i.e. End-to-End)
- ▶ Place accountability/responsibility for product development with a single executive
- ▶ Be satisfied that the following matters are addressed in the product development process:
 - ▶ Consistency with Corporate Strategy
 - ▶ Appropriate level of Governance
 - ▶ Allocation of Capital is appropriate for benefit expected
 - ▶ Profit and Return on Capital meet Corporate Objectives
 - ▶ Operational areas can support the product within the amounts priced into the contract
 - ▶ Sales processes are defined and managed to minimise regulatory risk of inappropriate products being sold to customers

Checklist for a successful product launch and a sustainable business going forward

▶ **Strategy**

1. Ensure that the product strategy is consistent with the overall company strategy
2. Ensure the product is consistent with the product strategy
3. Ensure that the distribution remuneration strategy consistent with the product strategy
4. Ensure that the product strategy is understood by the distribution partners and teams

▶ **Governance**

1. Ensure that there is a formal product approval process and that its nature and scope are clearly documented and understood by the relevant parties
2. Ensure there is one clear owner of the product development process. Who approves the launch of new products is it the Chief Actuary, Chief Product Officer, Chief Risk Officer, Chief Financial Officer?
3. Ensure there is a mechanism to determine suitability of product for retail consumption
4. Ensure there is an appropriate mechanism in place to assess the variety of risks in introducing a new product e.g. market risk, reputational risk, financial risk, modeling risk, investment risk etc.

Checklist for a successful product launch and a sustainable business going forward (contd.)

▶ **Capital**

1. Determine the capital budget for introducing new products
2. Determine the formal process for setting the amount of capital to spend on new products
3. Determine if there are capital parameters/thresholds that new products must not breach
4. Monitor, on a regular basis, the amount of capital spent on the entire product development process e.g. actuarial and IT resources, capital reserving

▶ **Profit**

1. Determine what are the formal profitability requirements (hurdles) for new products
2. Allow for the cost of capital in the profitability calculations
3. Monitor product profitability at individual product level post launch – rather than on a cohort or block/product group basis
4. Determine the remediation process to be followed if a product is “unprofitable” post launch.

Checklist for a successful product launch and a sustainable business going forward (contd.)

1. Determine if there is a process to ensure that new products being launched meet the requirements of the company's operating model (i.e. can they be serviced on existing administration and accounting systems)

2. Determine if there is adequate information available to measure the effectiveness of the development process:-
 - (a) how long does it take to launch a product
 - (b) how much did the changes to the accounting system cost
 - (c) how many variations of the quotation engine are needed to produce

3. Determine if there is a process to manage any additional product servicing features that are to be implemented post launch as protection products may be more feature rich than their investment linked counterparts

4. Determine if there are appropriate governance and monitoring mechanisms to change the company underwriting practice based upon unfolding claims experience

Passing thoughts...

- ▶ Has the world really changed – or have we gone through a cycle and we are now “back to basics”?
- ▶ Are we able to re-tool our business quickly to re-align our products and operational capabilities to new customer demands?
- ▶ Will our salesforce/distribution partners be able to adjust to selling a different set of products?
- ▶ Will we be able to meet new regulatory requirements around suitability of products for customers?
- ▶ Do we have the right people on my team to operate in this new environment?
- ▶ Will we make our next quarterly earnings target?

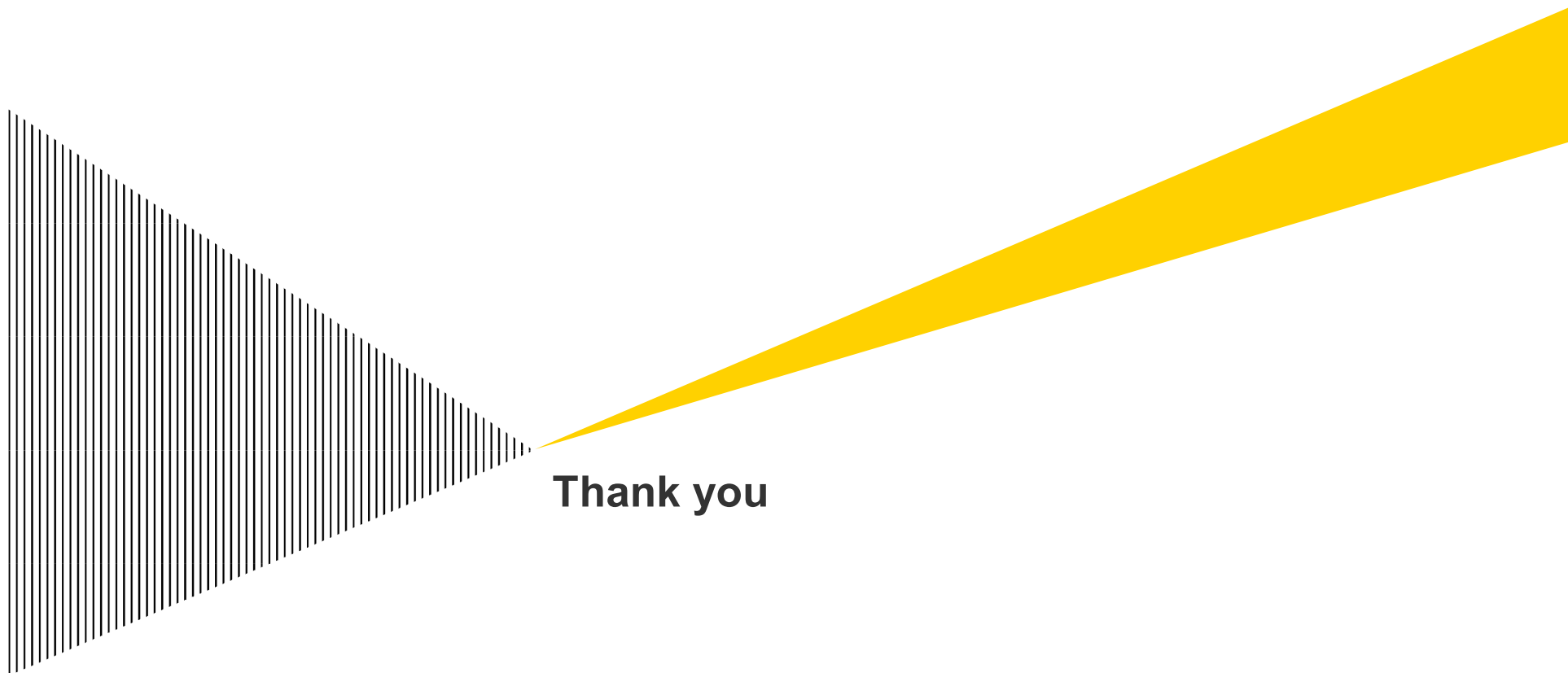
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Thank you

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