Disruption in the life, pension and investment markets
November 2015

Disrupt (verb): shatter, separate forcibly; interrupt flow or continuity of; hence disruption ...
Welcome

We have been publishing these journals twice a year since 2008, focusing on how we might predict the future and help our clients to be better prepared for the opportunities and challenges these futures will present. And in the main, we have been successful in this endeavour.

For several years, the RDR was a focal point for all our clients in the long-term savings and investment markets. Looking back, it is interesting to see that our publications actually suggested that the RDR would create real disruption in these markets. To some extent, our hypothesis was correct. But in retrospect, it seems clear that the RDR didn’t really disrupt activities; it just took them to a further stage of professionalism.

In these publications, we have also attempted to estimate how new business volumes might be affected by regulatory and other market developments. Of course, this is not a precise science; but again, in retrospect, we were fairly prescient.

The one product where guesswork was not part of our new business projection equations was annuities. Our projection was, in reality, a ‘no brainer’. One could actually see the wall of defined contribution cash approaching. Just assume drawdown at 20%, and annuity new business volumes are clear for the foreseeable future. But it was a future that no one foresaw – a future that actually disrupted the most solid market in the UK.

In this publication, we suggest some other potential disruptions, such as PAYL in the protection space; even more radical changes to the UK pensions market; and platform users who may disrupt their own platform providers. We also anticipate the impact of technology on wealth management models.

Finally, and unsurprisingly, we look at the risks and opportunities that big data disruption can bring to your enterprises. Thinking about this, it seems to me that managing these risks and exploiting these opportunities demands something that is not often a core competency of our clients – agility. But we have clients in other markets that have this in their DNA and would be pleased to share some insights.

I hope you enjoy this publication. As always, any feedback would be much appreciated.

Rodney Bonnard
UK Partner and Head of UK Insurance

“Predicting the future is not a precise science, but we have been fairly prescient.”
Contents

- Regulation: the great disruptor
  Can UK firms remain strong in the face of change?

- The winners are leaving from platform ... ?
  Do technological advances cause market disruption or simply enable it?

- Can PAYL disrupt the individual protection market?
  Pay-as-you-live (PAYL) could potentially disrupt an industry that has thus far remained fairly safe.

- How is digital affecting the financial advice market?
  Everyone has a digital strategy, but what do they mean for the financial services industry?

- How can insurers future-proof their businesses?
  We look at how new technologies and developments are set to disrupt the business landscape.

- Strengthening the incentive to save: the consultation on pensions tax relief
  How might the UK Green Paper encourage people to save enough for retirement?

- Contacts
In the Rugby World Cup 2011, Ireland unveiled a devastatingly effective new tactic: the choke tackle. Defence coach Les Kiss upended orthodox tackle technique; instead of bringing an opponent to the ground when he was carrying the ball, two tacklers would keep him on his feet, turning a tackle into a maul, and holding his arms in place to prevent the ball from coming out.

Use it or lose it
Kiss was taking advantage of a regulation change from the mid-90s known as 'use it or lose it', which awarded the ball to the defenders if it didn't emerge cleanly from a maul. A maul is usually an attacking weapon, but Kiss's insight was that, if the defenders created

Regulation: the great disruptor
With the financial services industry locked in a continuous cycle of regulation disruption, we discuss how UK firms can remain strong in the face of change.

By Jason Whyte
and controlled the maul, they could force a turnover. It was so effective that, within two years, nearly all teams were using it and some commentators were calling for it to be outlawed. It’s a lesson that is all too familiar to UK Life, Pensions & Investment (LP&I) players: regulation disrupts, and sometimes an unexpected response can catch existing players unawares.

The great disruptor
In that respect, rugby and UK financial services have more in common than you might expect. Both seem to be locked in a continuous cycle of disruption as their respective governing bodies change regulations and interpretations in search of better outcomes and improved safety for customers and players – only to tinker again as unexpected consequences emerge.

The key difference is one of degree. If rugby union had been through the level of regulation change that LP&I has faced over the last decade, it might have merged back into rugby league by now. Between the regulator, the Government and the European Union, we have seen multiple waves of regulation in almost every area:

- **Distribution**: depolarisation and multieties, the RDR, the Vertically Integrated Firms thematic and now the Financial Advice Market Review (FAMR), MiFID, and MiFID II
- **Conduct**: the introduction of Treating Customers Fairly and principle-based regulation, the transition to Conduct Risk, the thematic reviews on fairness for legacy customers, and the Retirement Income Market Study and Annuity Sales Review
- **Product and charges**: the RDR review of charging transparency and rebates, auto-enrolment, gender neutrality, charge caps and the Value For Money review on pensions, the Freedom and Choice changes to pensions, and the Pensions Green Paper
- **Prudential and reporting**: Solvency II, IFRS Phase IV, FATCA, and CRS

The sheer volume of change in the last decade has been overwhelming, especially against the backdrop of the global financial crisis and accelerating digital innovation. Industry reaction suggests that the sector is still digesting the most recent wave of change and it will take some time for mature responses to emerge.

**Lessons from history**
**Customer access wins**
The winning businesses in every wave of regulatory disruption have been those that managed to maintain access to customers under new regimes. Historically, the prevailing trend in
the past 30 years has been securing access through third-party distributors, but more recent trends see some distributors competing directly with the providers who used to serve them. Reading the evolving distribution landscape and understanding how to secure a route to market is key to success.

**Know when to let go**
Conversely, one of the most common mistakes is to try to shore up an old business model or distribution channel when regulation has moved against it. In recent years, many providers with an historical strength in one channel have taken too long to realise that channel is no longer sustainable, and have had to withdraw rapidly without having lined up an alternative. It has also happened with products: in the run-up to RDR, several investment providers underestimated the impact it would have on fund prices, subsequently facing sudden drops in income with cost bases that were designed for the old world.

**Owning advice can be challenging**
Advice businesses have very different characteristics from product or fund manufacturing businesses. Advisory firms tend to be smaller, more entrepreneurial, less risk averse and able to operate with a much lower level of corporate overhead. Providers, with more at stake should they mis-sell or otherwise commit a regulatory breach, tend to be significantly more risk averse and bound by controls and processes. Attempts to marry the two have generally been unsuccessful – the provider’s risk culture tends to stifle entrepreneurial spirit while often being less than fully effective at actually

“We have identified a number of emerging themes for success in the new market.”
Historically, the only winners have often been the original principals, who crystallise the value of their business. Nevertheless, in the current environment, providers are recognising the need to get closer to the customer and looking seriously at how to include advice in their models.

The challenge is to build models that are fit for the new world, as well as being economically self-sufficient and viable.

It’s easy to miss future winners
Each wave of regulatory change has seen the fall of some previously successful businesses alongside the rise of start-ups and other unexpected successes. Furthermore, ideas travel quickly, and the market copies successful models. Often, other market participants have been slow to spot and react to winning models early.

Bold transitions lead to success
The temptation in uncertain times is to place a number of small bets and nurture the ones that are successful. But that approach risks losing focus, dividing management bandwidth and failing to commit the right resources at the right time. The success rate has often been higher for players who made a bold commitment and bet the firm on a clear vision of a radical future. Failure to execute successfully is still a risk, but uniting a business behind a common, ambitious goal seems to be more effective than letting a thousand flowers bloom and hoping to pick the best.

An investor mindset maintains agility
One common feature of businesses that have successfully ridden the waves of regulatory change is the ability to step back from day-to-day activity to make dispassionate decisions about where to focus and where to cut. Sometimes, this is achieved by a tight-knit management team that is close to the business; at other times, by a strong corporate core that views its function as effective allocation of capital rather than day-to-day management. Common to both approaches is a mindset that views the business as an investor might, and is not afraid to divest non-core activities (even if they were once core) or redirect capital flows to areas with the most growth potential.

‘Front-foot ball’
Rugby coaches and pundits like to talk about ‘front-foot ball’ — securing possession while the opposing defence is still regrouping, giving the attackers opportunities to make gains. Against a backdrop of dramatic change in the UK LP&I regulatory environment, market participants need to decide what sort of team they are and how they will secure their own ‘front-foot ball’. It is not clear what winning models might emerge from the current uncertainty, but it is

“Market participants need to decide what sort of team they are and how they will secure their own ‘front-foot ball.’”
likely that when one does, it will quickly achieve a dominant position.

At the same time, the level of uncertainty makes it difficult to predict the future landscape. The Government is taking a more active role in shaping the financial services market than it has done for a generation, and the directions in which it is pushing are not always aligned to the previous direction of regulatory travel. The Freedom and Choice regime for pensions created a need for mid-market advice that had effectively been priced out of existence by the RDR. Will the ongoing FAMR and Pensions Green Paper introduce further radical change, or will they be blunted by the constraints of the systems already in place?

It is challenging to plan a response when there is this much uncertainty. Many providers found that it was all they could do to manage some level of compliance with Freedom and Choice. They are still working out their long-term propositions, which might be overtaken by whatever emerges from the Green Paper. The temptation may be to take a defensive stance and minimise investment that might be wasted if the winds change.

But the stakes are high enough that a more positive approach might be needed. EY has been in discussion with a number of clients about how they can take sensible steps to enable them to make progress and keep their options open. We have identified a number of emerging themes for success in the new market, which represent a significant transition for most players. EY has the experience to support clients through these changes and is investing in new capabilities to accelerate delivery and bring forward success:

**Be customer-centric:** one thing is already clear – a genuine commitment, throughout the organisation, to achieve the best outcome for customers is essential for success. It’s no longer enough to provide lip service. Companies must understand their customers and their needs, and demonstrate genuine commitment to help fulfil them.

**Modernise, digitise and analyse:** the recent regulatory shifts are opening up the market to platform-based businesses and pure play investment managers who typically have structurally lower cost bases. Those who want to compete with them need to understand the likely price ranges that the market will bear and what they have to do to deliver them. Increasingly, this means looking at legacy customers – now both more valuable but more vulnerable to poaching – through the same lens as new ones. Customers increasingly expect to interact digitally with all types of business, switching seamlessly between channels – something that can only be delivered sustainably if a company can analyse and respond to customer behaviour. ‘Being digital’ is not a question of adding a new channel – it requires a fundamentally different and more responsive business model.
Articulate a vision: EY’s interaction with the market and the regulator suggests divided views on how far the FAMR and Green Paper will actually go in resolving the market’s problems. But, at the same time, they represent the opening of a wider – and more industry-friendly – dialogue than we have had for some time. By articulating a bold, practical, customer-centric vision of what is needed now, companies earn the right to be part of a debate about how the market should develop that is likely to go through several cycles over a number of years. Failure to engage at the outset, or focusing too much on defending a status quo that is only working well for wealthy customers, runs the risk of having a weaker voice in the future.

Scenario planning and modular builds: the risk of investing now is that the direction shifts, thus wasting the investment. But the risk of not investing is playing a protracted game of catch-up while competitors pull ahead in the market. One option to resolve this paradox is to think in terms of scenarios: how might the market move under various regulatory outcomes? By thinking this way, it may be possible to identify capabilities that will be needed under most or all scenarios and prioritise developing those, while identifying the triggers for mobilising components that are needed for specific situations.

Agility: by adopting agile development approaches that include regular breakpoints to review the scenarios and plan the next phase, providers can build the capacity to adjust their direction in response to changing conditions. This will help to ensure that they are able to act before the competition has time to organise its defence.

To help companies respond to these challenges, EY has supplemented its traditional strengths in industry insight, strategy and regulation with new capabilities. Our digital practice, recently extended with the acquisition of customer experience specialist EY-Seren, can help companies build a digital team while simultaneously building multichannel customer journeys for their customers. We have also helped UK financial services clients to shift from traditional waterfall models of delivery to agile methodologies, improving flexibility and speed to value. And we are investing in solutions that address the regulatory challenges faced by companies today, such as our global investment in automated advice solutions and the innovative Retirement Bank Account concept, which offers UK customers easy mobile banking-style access to pensions assets.

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The winners are leaving from platform ... ?

With the financial services industry locked in a continuous cycle of regulation disruption, we discuss how UK firms can remain strong in the face of change.

By Robert Wood

There is a lot of talk about companies being disrupted – Kodak by phones, Tesco by logistics, Nokia by music, and so on. I use these examples because we ordinarily associate disruption with advances in technology, but often, technology merely enables disruption rather than causing it.

In our industry, the current major
disruptors are regulatory change and government intervention, although demographic change is arguably the major underlying disruptor.

Modern technology enables this disruption, making it happen more swiftly, with its ability to reach vast numbers of customers more rapidly than traditional channels.

Investment platforms have disrupted the wealth market over the past 20 years and are held up as a great example of technological disruption – transforming the range and flexibility of wrappers and funds available to customers and providing intermediaries with a far more reliable and professional service offering. Legacy policy administration systems now look genuinely outdated and expensive to support and maintain, with a number of major providers seeking to migrate to modern platform technology.

Platforms have hence become ubiquitous in the intermediary market and are increasingly penetrating the direct market, to the extent that they have stopped ‘disrupting’ and are now very much a hygiene factor.

**An alternative perspective**

While platform technology has changed the landscape, the disruption was arguably precipitated by intermediaries looking to control more and more of the value chain, with platform technology very much an enabler rather than a cause. This backward integration of the value chain (see Figure 1, above) is now starting to have a dramatic impact on the market and is threatening traditional incumbents who have little or no direct access to customers.
With a saturated platform market, a diverse range of suppliers and limited differentiation, there is pressure on pricing. Platform technology suppliers are also starting to secure long-term revenue by partnering directly with intermediaries on a wholesale basis. This enables those intermediaries to participate in more of the value chain as they increasingly look to provide an end-to-end service to their customers. They can achieve this at a fraction of the cost that many of the major providers have invested, and continue to invest, in building their propositions. And, clearly, they represent very real competition for those with similar offerings.

We understand it is possible to establish a virtual platform service for as little as £250,000 with minimal ongoing overhead. This provides a relatively strong business case for any firm with £200m+ under management – and a good proposition for a number of smaller firms to invest in as a shared service.

**Will the disruptors be disrupted?**

Clearly, the large incumbent platforms that currently dominate the market will be watching this closely; indeed, it is somewhat ironic that it is their investment over the years that has led to this disruption being possible.

There is a potential threat of market ‘lock out’ for these incumbents, with a significant slice of the market at risk. We predict that this will drive even greater consolidation within the intermediary market, as players strive to protect their positions through the acquisition of customers that come with the intermediary’s business. And the work we have been doing in this space has enabled us to gain some insights that we would be pleased to share with you.

For some intermediaries, this will bring riches; others may well be marginalised unless they can in some way connect up to generate sufficient scale. Technology, therefore, could well be the enabler yet again.
The way in which the UK insurance industry assesses risk has been slowly evolving from pretty basic pricing models to something a little more sophisticated over the past 20 years. For example, enhanced and impaired annuity rates designed to reflect the life expectancy of specific consumer segments are now commonplace, and term insurance products promising better rates for people with healthy lifestyles have also gained share. But this is certainly evolution, not revolution.

The distribution of the products has not changed that much either. Clearly, more web-based, non-advised transactions are taking place – but even here, we see price comparison sites and strong retail brands partnering with traditional distributors in order to access the market. And while new, highly efficient

Pay-as-you-live (PAYL) could potentially disrupt an industry that has thus far remained relatively safe.

By Malcolm Kerr

“Will we see actual disruption in the UK individual protection market? The answer is probably ‘yes.’”
underwriting technology has the potential to reduce costs and improve the adviser and client experience, it is not disrupting existing provider models. So, is there any possibility that we will see actual disruption in the UK individual protection market? And could this lead to a larger market? The answer to both questions is probably ‘yes’.

Technology will be the driver and the enabler. And a good example of how this can develop can be found in pay-as-you-drive (PAYD) motor insurance. This is gaining considerable traction in the US, Canada, Latin America, France and Norway. This solution – often referred to as telematics – helps insurers identify risk exposures and puts pricing control in the hands of customers, who can decide how much and how well they want to drive. The technology is simple and can take the form of some hardware provided by the insurer or an app on the driver’s smartphone.

The key to PAYD is that drivers can receive immediate feedback through apps, emails and provider portals to keep track of their premiums. There is already evidence to show that seeing the close correlation leads to changes in driver behaviour. In the future, this could also improve underwriting and rating methodologies.

But why stop there? How about PAYL? There are already products that reflect lifestyle, but wearable technology can facilitate an entirely different customer experience. Wearable technology or smartphones with similar functionality are already able to track exercise, footsteps, heart rate, BMI, sleep patterns, calories, training or diet logs, and other indicators to provide immediate feedback to consumers and potentially to their insurers. In the not-too-distant future, these devices will also be able to monitor blood sugar for diabetics and track food purchases at supermarkets. They will even alert those with a high probability of deep vein thrombosis when it’s time to get out of the chair and take a walk.

Evidence suggests that the data available from wearable technology provides significant motivation to improve fitness, and usage is growing rapidly. In California, the number of people wearing these devices already exceeds the number of people with gym memberships. And in the UK, we are starting to hear people comparing their resting heart rates in the office and even competing for the lowest rate at a dinner party.

According to the most recent forecast data from the International Data

“We believe this concept will be a major area of innovation in the UK life and health markets”
Corporation, vendors will sell a total of 45.7 million wearable technology units in 2015, up a strong 133.4% from the 19.6 million units sold in 2014. By 2019, total sales volumes are forecasted to reach 126.1 million units, resulting in a five-year compound annual growth rate of 45.1%.

All of this has the potential to benefit consumers, reduce the strain on the NHS and provide insurers with the data to investigate modified pricing models and risk factors, while providing value-added information and other services to customers. It also has the potential to increase the size of the market as consumers, particularly younger consumers, start to connect with institutions that can provide products, services and channels that resonate positively with them. These might include websites that are more focused on healthy lifestyles, instead of selling products and giving weekly feedback on how well the policyholder is doing in terms of fitness goals and related premium rates.

PAYL is being actively explored by a number of our global clients – particularly those that already deploy PAYD products. We believe this concept will be a major area of innovation in the UK life and health markets. Furthermore, we think it has the potential to disrupt an industry that has so far remained fairly safe from the disruption that has been seen in areas such as lending, motor insurance and payments.

We would be delighted to share the experience and insights we have gained in the US or send you some of our recent publications that cover this topic, as well as other examples of innovative thinking in life and health protection. You can explore some of our insight into this topic by visiting ey.com/insurance.

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Global investment in financial technology firms has exploded over the past couple of years, hitting around US$12b in 2014, as seen in Figure 1. More than 4,000 firms are playing in the wealth space, doing everything from automated financial advice and peer-to-peer lending to developing new payment methods.

In the asset management space, more and more companies are either building online engines or buying them — as in the case of BlackRock’s purchase of FutureAdvisor.

What is causing the focus on building a technology capability?
Firstly, consumers are increasingly demanding it. The general public, particularly the savvy investing public, are comfortable being connected and...
doing things themselves. They trust the digital touchpoints and are able to perform most tasks online.

Secondly, the technology has made it easier to do. While other firms such as Amazon have led the way in the online transaction space, the financial industry is starting to catch up by applying that well-known technology to its business models, including investment advice. In addition, the increased transparency of the investment world has led to a reduction in fees across the value chain. Also, index funds and exchange traded funds (ETFs) have gained traction as investments that lend themselves to automated online advice, due to their open and transparent purpose and low fees.

Lastly, companies are seeing the value in creating an all-encompassing customer journey, which includes an online presence. Even the most nascent firms have some sort of presence online. The automated advice evolution

There is no ‘one size fits all’ strategy and, even in more mature markets such as Australia and the US, no single solution has emerged as the clear way to offer advice. The right strategy depends on a variety of factors, including but not limited to: the target client, current face-to-face adviser capability, other firm capabilities, and the strategy for providing an online solution.

Adviser support or advice

This is probably the easiest way to introduce technology into providing advice, and nearly all market providers offer some form of online education or description of services or investments.

The process is still led by the adviser, but advice is delivered more swiftly and consistently. As firms move along the spectrum, technology helps the adviser in not only becoming more efficient, but also in reducing risk by providing consistent advice for all its clients. The adviser can use technology to produce outcome models – improving the advice and giving the client more visual aids to understand the impact of their decisions.

Adviser assisted

In the middle of the auto-advice spectrum, human advisers provide support to what is primarily an automated advice model. In general, the more complicated the case, the more likely the client is to be kicked out of the automated process and referred to an adviser. In this case, advisers are often accessed via email or telephone rather than face to face, often for an additional fee.

This type of solution has appeared in the market to increase access to investment advice, while still providing comfort that a human is available and giving assistance as needed.

Automated advice

Many believe that fully automated advice is the holy grail, as it is expected to offer low-cost advice to nearly the entire market. Regulators are interested in these types of solutions, but clear guidance has not emerged on how to treat fully automated models. As a result, this model has yet to gain momentum in the UK or elsewhere, though pure investment advice has a few offerings.
We see advice being provided along a spectrum, from advisers with intimate client relationships to fully automated investment advice. The level of automation also depends in part on the type of advice given to the client. Asset management is being pushed to automated advice much faster than more comprehensive financial planning, which might include insurance, taxes and property. To date, while there are no UK providers offering fully comprehensive advice that can completely replace a full-service financial adviser, many life companies and asset management firms have at least a limited online guidance or education engine.

**What is next for automated advice?**
Given that technology has the potential to democratise the provision of financial advice and, subject to more regulatory clarity, may even begin to close the advice gap, we suggest here how such a proposition may be developed and what kind of framework might facilitate the process.

The framework in Figure 2 touches on aspects that could be important when considering the digital transformation required to deploy the advice model(s) successfully. As we
noted earlier, companies are considering the entire customer journey, and it is important to fit the automated advice platform into the desired digital strategy. The auto-advice offering is expected to be seamless with the rest of the company offering. Above all, the entire customer journey needs to be carefully considered.

It is also interesting to note how many other areas an automated advice offering will touch outside the IT or digital realm; this is why we believe that this framework may be valuable. Everything from data and analytics to sales and marketing engines will be affected by an auto-advice proposition. We believe that a holistic approach to any advice offering is key, from understanding your current suite of products and services to the definition of your end goal.

Is auto-advice a threat to existing UK business models? Undoubtedly, yes, though how much of a threat remains to be seen, as technological propositions are continually emerging.

But in common with the topics discussed in other articles in this publication, it seems likely that ignoring these developments will put businesses at risk. We would be pleased to share the experience and insight we have in the Australian and North American markets, where auto-advice has already gained traction.

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How can insurers future-proof their businesses?

Disruptive technologies are changing the way that we do business, as well as how we interact with each other and the world around us. We consider macro trends and draw on international developments to suggest how these technologies might change the business landscape.

By Ruth Middleton
Today, we are seeing technological evolution in areas including wearables, the Internet of Things,1 telecommunication products, 3D printing and health care sensors, which offer opportunities to change markets. These technologies are not disruptive, but what will cause disruption is how they are used, priced, applied and designed – and how they could create new industries or disrupt existing markets’ value chains. These technologies have the potential to force market incumbents into re-engineering their business model, either offensively or defensively, in order to survive; some will go on to disrupt traditional risk management frameworks and insurance supply chains.

Companies that can adapt to the change will continue to prosper. But those that lack the necessary skills or fall behind will find increasingly fewer opportunities in the market, and could fall by the wayside as the more agile companies dominate.

**What does this mean for insurers?**

The dynamics of consumer behaviour are changing, reflecting the growing number of connected devices – Intel estimates that there will be 50 billion by 2020 – and increasing use of social media. The Internet of Things is connecting everyone continuously, and people are becoming immersed in the web; we are moving towards the Internet of Us. We will become part of the web through our use of wearable technology and the information it generates about our behaviour and preferences; furthermore, we see technology moving towards implantable devices, which will see the movement from the Internet of Things to the Internet of Us.

More time is spent online and multi-tasking with connected devices. For example, we use multiple devices such as smartphones, tablets and laptops while watching smart TV, or browse on smartphones while shopping. This is transforming the way in which consumers interact with brands, and insurers are starting to understand the opportunities and challenges that this new model presents.

In this high-tech world, the combination of information about people’s preferences, location, spending habits and financial affairs will be hugely valuable to insurers. Conversely, the loss of, or inability to obtain, such data could result in significant financial costs, a competitive disadvantage and a consequent impact on franchise value.

Tech-savvy consumers are looking for enhanced and interactive experiences that provide innovative, tailored solutions to address their need for ‘anywhere, anytime’ solutions. Companies need to reinvent and update

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1. The Internet of Things is the collection of devices and sensors – reaching all aspects of society – that have the ability to communicate over the internet.
their customers’ experience, and those that do not adapt risk becoming irrelevant to the consumer. Adaptation will come through a more customer-centric view, pursuing an analytics-driven strategy and exploiting the benefits of connectivity through an operating model designed for a business embracing technology, as shown in Figure 1.

**How will insurers need to adapt?**

Our technology-enabled future will see companies gaining competitive advantage by embracing big data and advanced analytics. This will be reflected in changes to the insurance model, where the changes might include the following:

- **Deconstructing the traditional insurance model into service components:** insurers need to know where they are making money and work out how they are going to defend those sweet spots. Functional components will become applications used by customers or third parties, creating their own insurance or value-added services such as claims, distribution, underwriting and marketing. By 2018, it is anticipated that one-third of the top 20 firms in most industries will be disrupted by industry-specific data platforms.

- **Automation:** the majority of business processes will become automated, which also implies a major change in the roles and tasks of the workforce.
More than 40% of occupations in advanced economies are at high risk of being automated in the next 20 years.

- **Real-time, tailored solutions:** developing and adapting in real-time and in an active manner will match customer demand for personalised, innovative, transparent and easily understandable solutions. Insurers need to decide whether they will focus on hard-to-replicate, bespoke solutions versus ‘one size fits all’ generic solutions with limited scope for tailoring to the customer’s needs. Consumer spending via mobile is estimated to increase threefold by 2018, with almost half of all e-commerce sales in the form of m-commerce.

- **Network orchestrator:** greater autonomy, flexibility and mobility of employee work style will be matched by new means of engaging with talent. Insurers are networking orchestrators, connecting skills and resources – for example, crowdsourcing and freelance platforms – rather than owning them. By 2020, more than 50% of the workforce will be from Generation Y and Z, which have grown up connected, collaborative and mobile.

- **Right-skilling teams:** insurers will need to recruit specialist talent, and develop existing staff, in order to right-skill their teams to support this way of working.

Wearables, sensors and other technologies are not useful on their own and need to be part of an intelligent ecosystem that combines big data with advanced analytics. The challenge is to connect all these elements together to create a dynamic solution.

**How companies are developing solutions to reflect technology advances**

Companies are developing solutions to address technological developments through partnerships, collaborations and acquisitions, or through setting up research and technology labs focusing on digital innovation. Recent examples of internal technology developments include:

- An insurer tailoring its home insurance based on calculations of how exposed homes are to burglary by pinpointing where a property stands in the street
- A reinsurer using Google Trends to identify disease trends in humans or livestock, so they can adjust reserves and implement measures to control the spread of disease for loss prevention
- A major reinsurer using big data in social media to identify a health risk

**“Companies are developing solutions to address technological developments through partnerships, collaborations and acquisitions.”**
issue – breast implant problems – ahead of the class action lawsuit being raised (this enabled the reinsurer to make reserve adjustments ahead of time).

Recent examples of partnerships emerging between insurance companies and technology companies include:

- **Allianz and Panasonic:** this partnership allowed Allianz to take advantage of Panasonic’s Internet of Things home devices. Panasonic-connected home devices can detect changes in heat or moisture; windows or doors opening; access through the front door; and the presence of people in the home. The connected home devices alert the insurer in case of damage to the policyholder’s property.

- **AXA:** this insurer has joined a group comprising technology companies, universities, local authorities and Williams F1 to investigate the performance of autonomous cars. Such alliances would offer insurer information to assist in being an early responder to the autonomous car market as it evolves.

- **Apple and Humana:** these US companies have partnered to let consumers share Apple HealthKit data with the Humana Vitality app. In exchange for their data relating to healthy behaviour, customers receive financial incentives, such as discounts on their monthly health care premiums.

- **American Family Insurance and Microsoft:** this partnership led to the launch of a business accelerator for start-ups focused on home automation. The accelerator will help the next generation of start-ups to create advances leading to safer and smarter homes.

- **Covéa and Paris Région Lab – Incubateurs:** this French partnership led to the launch of a start-up incubator that was dedicated to the connected home.

- **State Farm:** partnerships have been announced with home security companies ADT and Lowe's Home Improvement to install smart home-monitoring systems for policyholders.

**Implications for the UK Life and Pensions market**

A digital presence through the internet, mobile technology and social media is becoming a prerequisite to doing business, and enabling insurers to reach both distributors and customers directly. Improved mobile services will also allow firms to offer customers facilities to do things such as check their investment portfolios in real time. Digital offerings allow firms to provide self-service capabilities that might have the potential to open up more of the voluntary market. It is likely that these consumers will first research information about products online and look for sentiment towards providers through social media. Given this model, some of these customers will be looking for products that are easy to understand and compare. The wide availability of online education and self-service capabilities
will have implications for life insurance
distribution and advice models through,
for example, advisers.

We will see streamlined and predictive
underwriting developments coming
through advanced analytics, based
on big data sourced from credit
information, social media information,
health records, prescription databases
and other available data sources. Big
data analysis and predictive analytics
can also be used in areas such as fraud
detection. Repetitive processes will be
automated, with robots replacing parts
of the workforce, especially those with
repetitive tasks. Learning algorithms
can be used for customer interactions
to help provide a tailored, consistent
experience.

As these technologies become
increasingly used in the company, they
increase privacy and cybersecurity risks.

Finally, medical developments – with
sensors, nanotechnology and genetics
advances – will have an impact on
longevity and concurrent effects on the
life and pensions markets.

Companies need to design their
products and services for customers
of the future, rather than taking their
existing offering into the future. In other
words: disrupt, or be disrupted.

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Strengthening the incentive to save: the consultation on pensions tax relief

By Richard Travis and Jason Whyte

The UK Government’s Pensions Green Paper sets out its aims to encourage people to save enough for retirement and its proposed means of making such a system sustainable. To that end, it sets out four principles:

- Simplicity and transparency
- Encouraging personal responsibility
- Building on auto-enrolment
- Keeping the burden on the state sustainable

In addition, we believe that two more are needed: stability and intergenerational fairness. Individuals must be confident that they will receive what they were promised when they started saving, and the burdens and opportunities should fall evenly on different generations. Stability is particularly important because of the level of change in the pensions system.
in the recent past. Without it, simplicity alone may not be enough to incentivise saving. Simplicity is also challenging to achieve, barring legislation to move all existing assets into the new system fairly. Any new system will have to coexist for decades with the current one, inevitably adding complexity.

The current system – challenges and observations
- Most tax relief goes to higher and additional rate taxpayers, many of whom will pay a lower rate in retirement, creating a tax gap between relief and eventual receipts.
- Conversely, relief offers little incentive to lower earners – this is known as an incentive gap.
- Savers appear to value tax-free cash and employer contributions.
- People struggle to understand how big a pot they will need to fund their desired retirement.
- Auto-enrolment has two major limitations:
  - People may not feel empowered to vary contributions and investments from the defaults.
  - An 8% contribution level will not give many people the retirement they expect, though they may assume it will.

A Tax-Exempt-Exempt model for pensions
The UK Chancellor has raised the question of whether an ISA-style Tax-Exempt-Exempt (TEE) pension system, with a Government top-up, would incentivise further saving.
This approach is attractive in terms of consumer understanding and short-term tax revenue, but it creates longer-term issues to resolve.
Today’s system represents a social contract; individuals save for retirement, reducing the burden on the state and, in return, receive up-front tax relief and a tax-free lump sum on retirement. In our view, the stability of this system has been critical to maintaining the confidence of savers and their advisers in using pensions.
However, future generations may well live longer in retirement and have a greater need for public services, such as the NHS. Under a TEE system, this group will pay no direct tax in retirement to fund their consumption.
This could create a strong temptation for a future Government to plug the funding gap by reimposing tax on pension income: a Taxed-Exempt-Taxed (TET) system. Even the possibility is a strong disincentive; without the guarantee of ‘no double taxation’, confidence in the system is very likely to diminish.

Minding the gaps
An alternative to TEE that would reduce both the incentive gap and the tax gap would be flat rate tax relief, perhaps pitched to permit messaging such as ‘£1 for every £2 you save’. Care would need to be taken to ensure fairness across DB and DC savers, and salary sacrifice
might need to be adjusted under the new regime.

**A National Pensions Strategy**

One customer-centric way for the UK Government to meet its principles could be the definition of a National Pensions Strategy comprising:

- A defined target minimum earnings level in retirement, the ‘Living Pension’ — perhaps linked to the ‘Living Wage’ — and the required level of pension saving to achieve it
- Clear principles for sustainability, including the level of net incentives that the Government can afford
- A definition of the levers available to encourage savings while balancing sustainability
- Key assumptions governing the strategy and how the levers would be used to address the gap if any of them are proven wrong
- How the strategy will be governed and updated

Although each individual’s retirement needs are different, it would help savers to plan ahead if there could be a common savings and income target: a ‘Living Pension’ or a proportion of the ‘Living Wage’.

The goal of a ‘Living Pension’ will only be reached if individuals understand and believe in the pensions system. If confidence is eroded, savers may fail to buy into the principle of pensions and make alternative retirement provisions with a different and perhaps unsuitable risk profile, such as property investment. Insufficient retirement income is likely to lead to a greater reliance on the state.

The task of maintaining public confidence, managing investments to fund future retirement and tracking against the National Pensions Strategy could be met by an independent body, such as the Office of Budget Responsibility or perhaps a new Office of Pensions Responsibility (OPR). The OPR could measure and assess key data, monitor progress against the strategy and authorise changes where required. This could run alongside a broader industry governance body, ensuring that customers get the services they need.

**A fresh approach to delivery**

To put the needs of the saver at the centre of the industry’s delivery strategy, there should be several key customer experience principles, such as: a transparent fee structure; only offering services that are relevant to the customer; and no unnecessary complexity in product design.

**An incentive framework**

The consultation seeks to understand how the incentive to save can be strengthened. An effective incentive policy must engage everyone, from savers, employers and providers to policymakers and regulators. Employers as trusted decision-makers can engage
more effectively with employees and help
them agree on more informed decisions.
Incentives in a broader sense
encompass the reward and remuneration
strategies adopted by providers, and any
new system needs to balance fees against
the cost of current obligations and the
cost of future evolution.
Given the principle of sustainability,
there is an argument to support changes
to public sector pensions too, although a
simple switch to TEE would seem to risk
either reducing net pay, if the employee
bears the tax on benefits received, or a
reduction in the final benefits if the fund
bears the tax charge.

**Conclusion**
The Chancellor’s intent to address these
big questions around pension saving, and
his willingness to consider bold changes,
has created an opportunity to improve
outcomes for generations of UK citizens.
EY believes that any successful change
will need to consider, and hopefully
simplify, the system as a whole and
promote savers’ confidence by ensuring
long-term stability and fairness.

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EYG no. CQ0300

ED 1118

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