

**The Actuarial Profession**  
making financial sense of the future

Health and Care Conference 2012  
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## IncomeChoice Learning the lessons of PPI

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### The Competition Commissions ruling:

- Means a contract of insurance which provides a pre-agreed amount paid directly to the Policyholder or the Policyholder's nominee in the event the Policyholder experiences involuntary unemployment or incapacity as a result of accident or sickness and which:
  - (a) has a maximum time limited benefit duration;
  - (b) may include or combine other forms of insurance cover or include other benefits;
  - (c) is written for a term which is less than 5 years and not predetermined by the term of any Credit; and
  - (d) can be terminated by the Insurer

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### The Competition Commissions ruling:

- Short-term IP is usually offered on a stand-alone basis—that is, not combined with credit. However, one provider of short-term IP (HSBC) initially started selling this product as a replacement for MPPI (and a life insurance product), and now offers to consumers to whom it previously offered PLPPI and CCPPI the chance to discuss their broader protection needs with one possible outcome being to take this product (if it is the most suitable product). In addition this product is available on a non-advised basis through its telephone sales channel

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### The Competition Commissions ruling:

- We considered whether short-term IP is in fact a form of PPI. Our analysis of this is shown in Appendix 2.3. We concluded that short-term IP is a form of PPI, though we recognize that it can be used for alternative purposes. We also concluded that the sale of a short-term IP policy, such as HSBC's LifeChoices product, as a result of a referral made to the sales-person during a credit sale is a sale of that short-term IP product at the point of sale. We therefore concluded that short-term IP sold in such circumstances is PPI and enjoys the same advantages, and gives rise to the same concerns, as PPI sold at the point of sale.

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### The problem for HSBC (customer):

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To design a product that meets our customers needs, namely:

- Provide income when unable to work
- Simple to understand
- Speed of acceptance
- Affordable
- Built in flexibility

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### Comments from Which?:

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“Income protection is the one form of protection most of us need but hardly anyone has it. The financial services industry must shoulder most of the responsibility for this. When you buy a mortgage or loan you will often come out with a protection policy tucked under your arm – the problem is it is usually the wrong one.. They (also) pay out for a limited period – usually 12 months, unlike income protection which pays out until you can get back to work or until the end of the policy term whichever is longer.”

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### **The problem for HSBC (advisor):**

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To design a product that meets the needs of our salesforce, namely:

- Fix the 'income' product gap left by AS
- Simple to explain to customers
- High acceptance rates
- Affordable
- To fit within current IT and product suite

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### **The problem for HSBC (company):**

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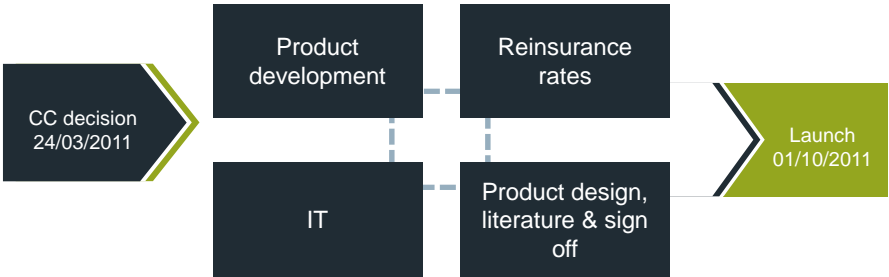
To design a product that meets our shareholders needs, namely:

- Maximise sales opportunities
- Future proof and simplify the product
- Maintain penetration rates
- Profitable within risk limits
- Administer within current IT and back office

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# Timeline for Product Development



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# The Pricing Puzzle

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## The design in more detail

Feature	HSBC Standard IP	LifeChoices Accident & Sickness	Income Cover
<b>Definition of disability</b>	Own occupation	Own job	Own occupation
<b>Deferred period</b>	Full range	1 month	Sick-pay taper (min 13 weeks)
<b>Payment term</b>	To retirement	1 year	First recommend term to retirement.  Offer a 5-year payment term if eligibility or affordability are issues.

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## But what about affordability?



	Multiple of DP 4 weeks, 1-year pay risk rate	
Age	30	40
To-retirement DP 26 weeks	2.9	3.2
5-year pay DP 26 weeks	1.0	1.0
5-year pay DP 13 weeks	1.2	1.0

Based on CMI IPM91-98 tables and 3% interest

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## And ease of acceptance?

Underwriting	HSBC Standard IP	LifeChoices Accident & Sickness	Income Cover
<b>Medical</b>	Full application form	PEC 12 months / 12 months + chronic conditions	PEC 12 months / 12 months + chronic conditions
<b>Occupational</b>	Classification into occupation classes	Average occupation  All occupations are eligible	Average occupation  All occupations are eligible except Class 4 for payment to retirement

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## Pricing data sources

Source	Use	Shortcomings & assumptions
AS Inceptions Experience HSBC data	Reflects combined effect of <b>PEC and average occupation</b> of typical HSBC customer	<ul style="list-style-type: none"> <li>• 1-month deferred period</li> <li>• Mix change within products</li> </ul>
Standard IP inceptions experience HSBC / CMI / Reinsurance data	Extrapolate AS experience to <b>longer deferred periods</b>	<ul style="list-style-type: none"> <li>• Assumes PEC effect is the same across DPs</li> <li>• Sick-pay taper is a mixed DP</li> </ul>



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## Interesting features of AS inceptions experience

- Experience is heavier than standard IP
  - *PEC is robust but still misses some important points like work absence history*
- No significant difference by duration
- Male experience is relatively heavier (occupation mix)
- Amounts experience is somewhat heavier

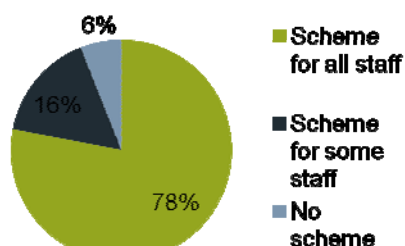
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## Pricing data for sick pay

Source	Use	Shortcomings & assumptions
CBI/Pfizer report (2010) 5% of UK workforce	Estimate average deferred period	<ul style="list-style-type: none"> <li>• Lack of detail</li> <li>• Great variation by industry &amp; sector</li> <li>• No corresponding HSBC customer data</li> <li>• % self-employed?</li> </ul>

% of employers



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Mean sick pay weeks

Length of service	Full pay	Reduced pay
12 months	11.8	9.6
5 years	21.25	17

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### Pricing data for occupation mix

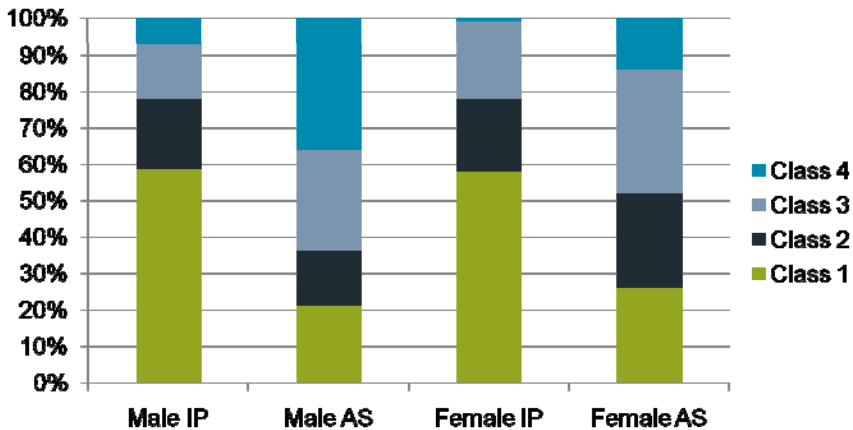
Source	Use	Shortcomings & assumptions
HSBC IP and AS business mix	Estimate average occupation of all customers	AS mix estimated from claims file and relative inception rates by occupation class
HSBC views on future sales volumes by product	Estimate average occupation by product	Guestimate of effect of new sales process & product



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### Existing HSBC occupation mix



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## Likely occupation mix

- Average occupation class on 5-year product will be more manual than on AS
  - Class 4 eligibility
  - Affordability
- Average occupation class on “to retirement” product will be more manual than on standard IP
  - Premium cross-subsidy benefits manual classes
  - Average customer previously not offered “to retirement” benefits

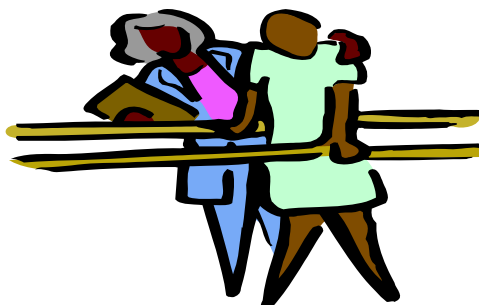


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## Pricing data for termination rates

- Standard IP termination rates
  - Rehabilitation not a focus for short payment term
  - No terminations beyond 1 year
- Data sources
  - HSBC Standard IP
  - CMI data and tables
  - Reinsurance data

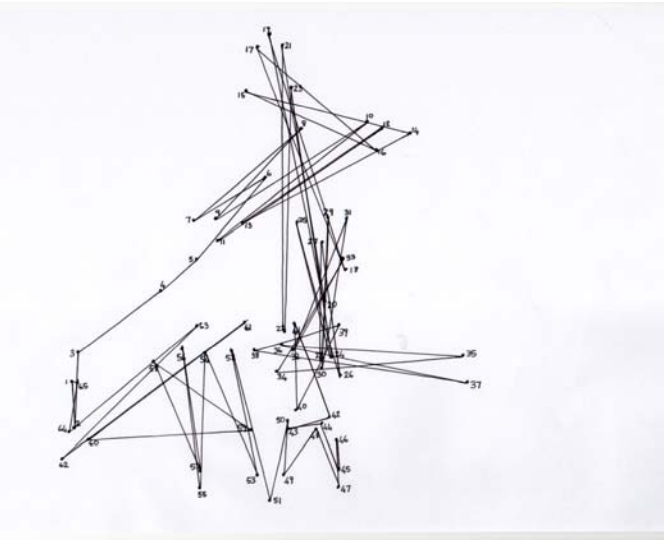


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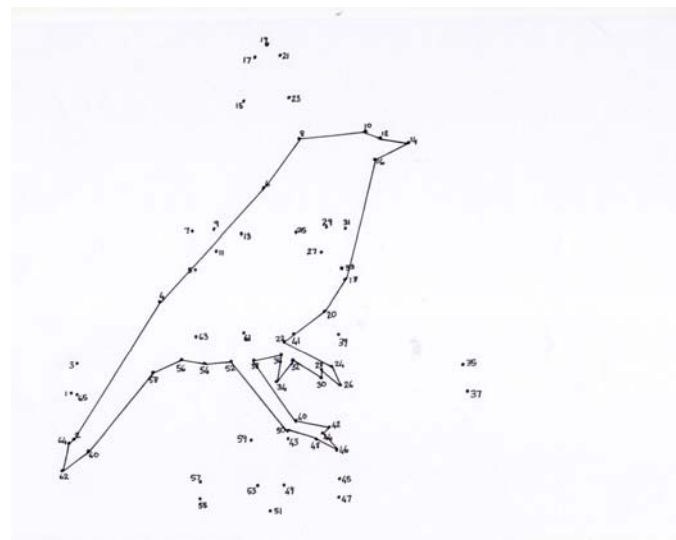
# The Pricing Solution?

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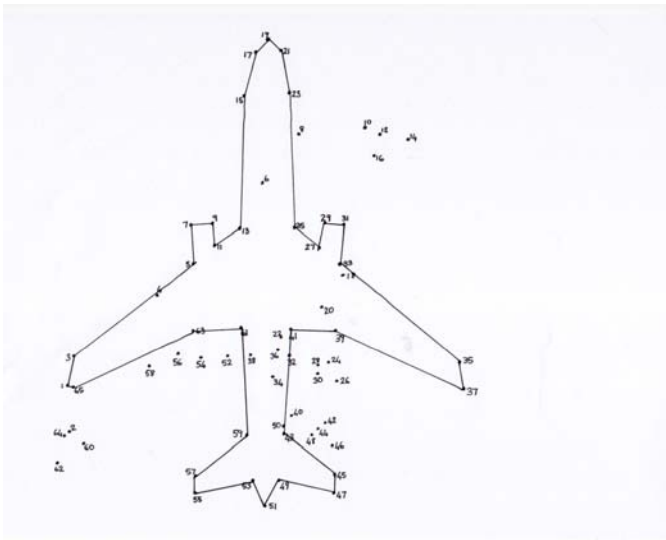


# A Pricing Solution!

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**Another Pricing Solution!**

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### The solution for HSBC:

The final solution met the objectives of all three stakeholders, namely:

- IP and AS were replaced by a 5 year and 'to retirement' option of sickness cover so no product gap
- Occupation and deferred period removed for simplicity
- PEC to allow up front acceptance
- Rates comparable to standard IP and current AS
- Products sit within current LifeChoice suite for admin/IT
- Volume maintained

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## Questions or comments?

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Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of Adele and Nick.

