The Actuarial Profession
making financial sense of the future

Life Conference 2011
Ian Owen and Mike Williams

What about the customer?

20-22 November 2011

About your presenters

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- Chairman Partnership Group
- Canopius NED (Lloyd’s GI)
- Chairman A-Plan (Insurance Broker)
- Unum NED (Group risks)

Mike Williams
- Towers Watson, Insurance Management Consultancy
- Customer, markets, strategy
- Health insurance

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What about the Customer?

Insurers are focusing strongly on the financial drivers of their businesses. With increasing sophistication of risk calculation at the individual level, fundamental concepts of insurance are being challenged

Additionally, Solvency II encourages insurers to pass risk back to the consumer creating further challenges to the principles and value of insurance

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Premise #1

- *With increasing sophistication of risk calculation at the individual level, fundamental concepts of insurance are being challenged*

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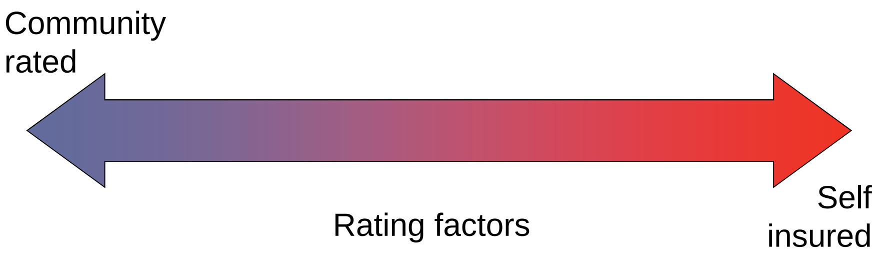
Pooling of risk

- *"…the good fortune of the many compensates for the misfortune of the few"*

Source: CIFP

Risk calculation is graduated



About community rating

- Health insurance – Australia, South Africa, Ireland
- No underwriting or selection allowed
- Same price and benefits (within policy type)
- Free movement of policyholders
- Risk equalisation

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The Irish private medical insurance market

Market features

- 2.2 million people covered by private health insurance (50% of population)
- 2010 premium income of €1.95 bn (approx. £1.7 bn)
- Four regulatory pillars:
  - Community rating
  - Open enrolment
  - Lifetime cover
  - Minimum benefits

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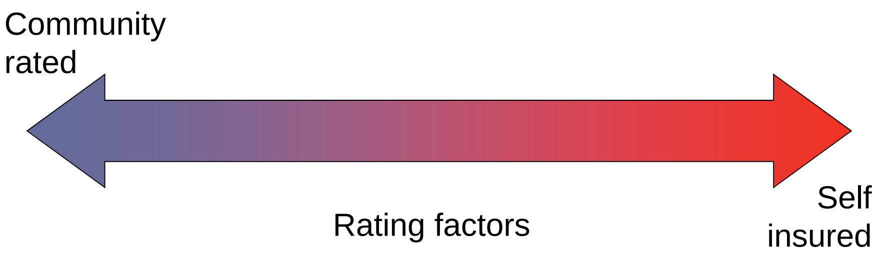
Risk calculation is graduated



Pros and cons – decreasing risk rating

Pros

- Levels playing field
- Provides 'fair' rate to all, regardless of status
- Allows wider spreading of risk pool
- 'Worse' customers are not priced out
- More aligned with principle of insurance

Cons

- 'Better' customers don't see cost benefit
- Insurers less able to select risk

Pros and cons – increasing risk rating

Pros

- Accurately reflects individual position
- Matches rate to risk
- Less cross subsidisation
- Insurers know what is being taken on
- Rewards more sophisticated insurers
- Rewards ‘better’ customers

Cons

- Ultimately challenges concept of insurance
- Can make insurance unaffordable
- Penalises less sophisticated insurers
- Penalises ‘worse’ customers

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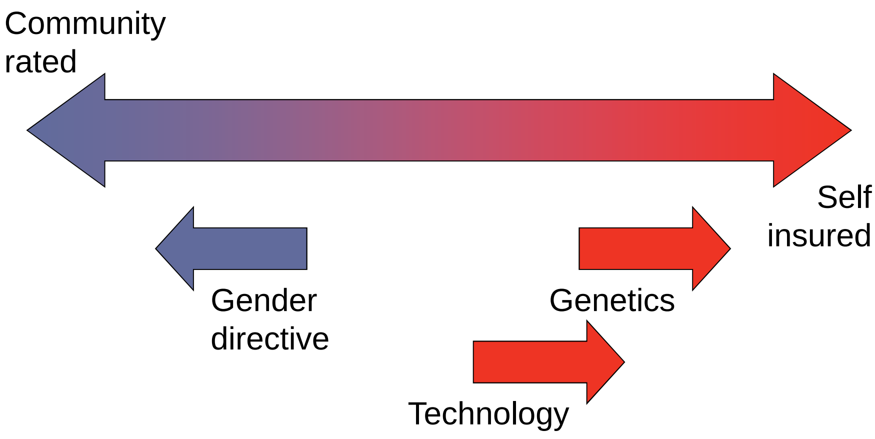
External factors pull in opposing directions



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Gender directive

- Association Belge des Consommateurs Test-Achats
- The use of sex as an actuarial factor must not result in differences in premiums and benefits for insured individuals……
- From 21 December 2012
- Age – the next battle ground?

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Genetics

- *Concordat and Moratorium on Genetics* extended to 2017
  - Predictive genetic test will not affect a consumer's ability to take out any type of insurance
  - Life insurance > £500,000 excluded in some cases
  - Next review will take place in 2014
- But how different to other medical data?
- What about when it’s in the customers interest to disclose?

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Technology

- Advances tend to increase risk understanding
  - Tests
  - U/w methodology
  - Demographics
  - Actuaries!

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Summary – premise #1

- Opposing forces and considerations
- Rating sophistication → smaller risk pools
- Regulation → larger risk pools
- What's best for customers?

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Premise #2

- *Solvency II encourages insurers to pass risk back to the consumer creating further challenges to the principles and value of insurance*

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Solvency II – the Regulator's view

- *"First and foremost, in answering the question of why are we doing Solvency II, the simplest answer is because the UK has no choice other than to implement it"*
- *"…FSA's determination and commitment to ensuring that the substantial regulatory agenda that faces us all is executed in a manner which improves the resilience of insurance firms and brings benefit to their customers"*

Word 2379

Hector Sants, April 2011

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Solvency II – the customer dimension

- *“For insurers, the current draft of the rules is poorly thought through in places, leading to them holding unnecessarily high levels of capital, ultimately penalising consumers”* [1]
- *“[There is a] risk that the cost of life insurance policies will increase so drastically that it may no longer be worth customers using this safe provision”* [2]
- *"Customers must have confidence in financial institutions, yes, but this does not equate to an over-calibrated regime based on capital levels which target zero failure, with the result that the industry is forced to change the products it provides to such a degree that they no longer meet the needs of customers at a price they can afford"* [3]

1 Peter Vipond, Director of Regulation Association of British Insurers. Reuters 4 April 2011
2 Michael Diekmann, CEO Allianz. Financial Times, 25 February 2011
3 Tim Breedon, ABI Chairman, October 2010

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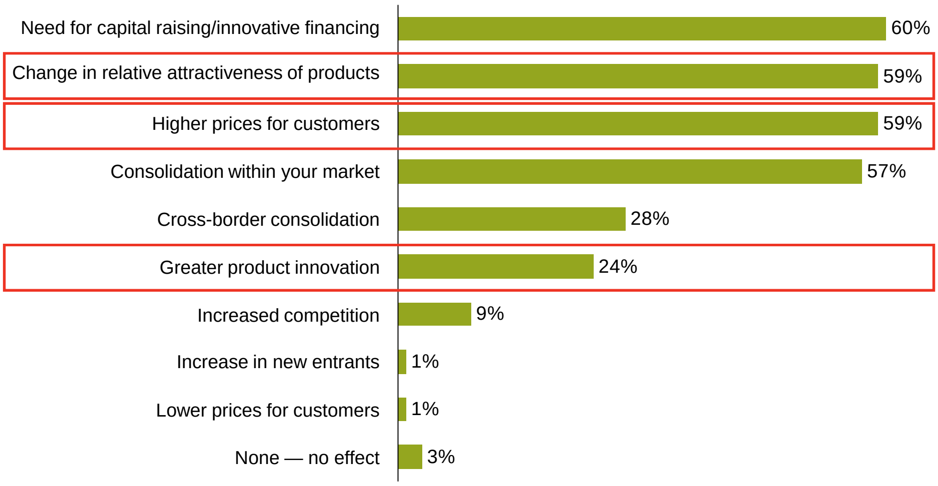
How do insurers rate customer impact?



Source: Towers Watson Sixth Biennial Global Enterprise Risk Management Survey. Sample: European insurers n = 175

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Solvency II – Life Convention 2010

Major theme running throughout last year's Life Conference:

'Solvency II will have a major capital impact – insurers will need to de-risk their businesses in order to reduce the capital required. Product innovation will pass risks back to the customer'

The ultimate de-risking of insurance risk

- Insurers don't do insurance
  - savings and investment products
  - any risk carrying more illusory than real
  - ultimate extension of recent trends
- Why has the UK Life Industry run away from insurance risk (unlike Non-Life)?

The consequences of de-risking insurance risk

- Where does this leave the customer?
- Where does this leave the shareholder?

Statement of the incredibly obvious .....

"*The role of the Insurance Sector is to take Insurance Risk*"

The alternative to de-risking products

- Charge extra for insurance risks
  - will need to educate consumers on underlying risks and therefore cost
- Diversify product portfolio to reduce insurance risk
  - mortality/longevity
  - geographic spread of catastrophe risks
- Diversify investment portfolio to reduce market risk
- Seek regulatory arbitrage over capital calculation
- Lower shareholders' expectations of ROE

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Summary – premise #2

- SII costs the industry £100ms – paid for by customers
- For 'risk' products
  - Increase cost
  - Reduce risk (cover)
  - Diversification
- Don't take risk – but what about customer need?
- What do customers want/need?
- Can shareholders' needs still be met?
- Don't forget low risk generally goes with low returns
- What actuarial skills are required to help 'square the circle'?

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What about the customer? - Summary

- Customers impacted by increased risk selection and SII
- Potential customer detriment:
  - Smaller risk pools
  - Risk/cost transfer
- What do customers want/need?
- How should insurers respond?
- No quick answer…but remember what insurance is:

  “…*the good fortune of the many compensates for the misfortune of the few*”

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