The Actuarial Profession making financial sense of the future

Approaches to Reviewing CI Premiums

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Approaches to Reviewing CI Premiums

Is it fair to Review?

- Justifying the Review
- Implementing the Review
- Comments / Questions

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Is it fair to Review?

- Market background
- FSA/FOS/ABI history
- Impact of UTCCR
- ABI Advice
- Impact on Stakeholders

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Market Background - Guaranteed makes a comeback

Choice between guaranteed and reviewable still existsStakeholders continue to demand guarantees

- Policyholder financial certainty and piece of mind
- Intermediary easier to explain at point of sale
- Insurer to compete, although keen to pass risk to reinsurer
 Increasing reinsurance capacity for guarantees following earlier withdrawl of support.

ABI Statement of Good Practice improving robustness of definitions
 Potential "unfairness" of reviewable products

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Market Background – Reviewable product still has attractions...

 Guaranteed premiums still much higher than reviewable even though CMI suggest claims experience is stable
 Consumers can make premium saving if prepared to accept risk
 Affordability leads to financial inclusion
 Increase consumer choice
 Encourages innovation
 Significant volumes of reviewable business about to or being
 reviewed

Guaranteed definitionsKey for new policies to avoid doubts over unfairness

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Market Background – changing consumer behaviour and expectations

Increased financial awareness

- Policyholders standing up for their rights
- More people trying to claim
- Culture of complaining to FOS
- Unsympathetic press coverage

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Is it fair to Review? - FSA/FOS/ABI History

•FOS expressed concerns that reviewable rate critical illness policies might not comply with the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs).

ABI, FOS and insurance industry representatives met - October 2003
 FSA became involved because it is a Qualifying Body under the UTCCRs

•FSA published "Fairness of Terms in Consumer Contracts – Statement of Good Practice" - May 2005

•ABI issued consultation paper on non-investment protection policies with reviewable premiums – May 2005

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Is it fair to Review? - Impact of UTCCR

Core Terms" not subject to fairness requirement

Are reviewable premiums a "core term"?

•ABI legal advice suggested that you could build a case that premium reviewability is a core term

FSA takes the view that premium reviewability is not a "core term"If reviewability were to be considered a core term, it must by

prominently and clearly explained. •Definition of "fairness"? – clear explanation of process with valid

reasons for review

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Is it fair to Review? - ABI Advice

Reviewability should be clearly explained at point of sale
 Choice between guaranteed and reviewable should be fully explained

Reviews can only be made for valid reasons

Assumptions should be reviewed regularlyInsurers should not reclaim past losses

Reviews should take place when specified

Option to end contracts or reduced benefit

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Is it fair to Review? – ABI Advice

Policies should state:

When the reviews will take placeHow the review process will work

 Provide a complete list of assumptions that could change and explain how they will be used to re-calculate premiums

-Set out any minimum and maximum limits (if appropriate)

•State that it applies to tranches of business and that the circumstances of individual policyholders will not be taken into

account •State that the premium review will be carried out in a "fair and reasonable" way.

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Is it fair to Review? - Feedback on ABI Consultation

•Welcomed initiative to address concerns of premium reviews •Some concern over potential for further paper to be provided to customer at point of sale

Concern of information overload for customer:
Material should be simple and understandable

Not including complex calculations detailing the review process

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Justifying the Review

- FSA/FOS/ABI considerations
- Issues to consider
- Addressing the issues
- A practical example

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Justifying the Review - FSA views

The following are unlikely to be valid reasons

Recouping losses incurred up to date of the review

Increasing profitability margins beyond those originally assumed
 Unfairly targeting a particular group

Unconsidered original pricing assumptions

Deliberate low initial price

Increasing reinsurance costs, unless based on valid reasons
One way

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Justifying the Review - ABI Advice

Base premiums using assumptions appropriate for full term
 Assumptions reviewed regularly and fully documented

Assumptions reviewed regularly and fully documented
 Assumption values for inforce should be consistent with those used

for new business

Increases for only valid reasons stated in the policy

 If valid reason relates to future incidence rates make clear it doesn't relate to individual policyholder

Increases due to events outside the control of insurers

ABI expected to publish further advice in the next few weeks



Justifying the Review - Issues to Consider

- Customer's understanding at point of sale
- -Historical experience consists of heterogeneous groups
- Interpreting insurer, reinsurer and industry experience data
- Justifying changing expectations of the future could this have been foreseen at outset?
- Alignment of interest between insurer and reinsurer
- Materiality of reasons for review
- •Time, costs and resources
- Legal opinion

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Justifying the Review - Ideal Situation

Each historic tranche has fully documented assumptions
With full documentation about how, when and what factors you will

use to review

explaining what data source will be used

•All customer literature will explain in plain English with no ambiguity how you will review

•Your reinsurance contracts and customer contracts are perfectly aligned.

IDEAL SOLUTION - UNLIKELY TO BE 100% IN PLACE!

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IDEAL SOLUTION - UNLIKELY TO BE 100% IN PLACE! BUT:

YOU CAN ENSURE IT IS GOING FORWARD!

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Justifying the Review - Realistic Situation

- You have a premium basis for each tranche
 You have reinsurance rates
 You have current experience
- •You may have some useful CMI data
- You have about 20 historic tranches
- •You have about 5 different historic wordings in your contracts
- You have current premium rates
- •You know your own historic practices around reviews
- You have a set of financials

If you apply above honestly and fairly in calculating review premiums you just about have enough to do it reasonably.

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Justifying the Review - Realistic Situation

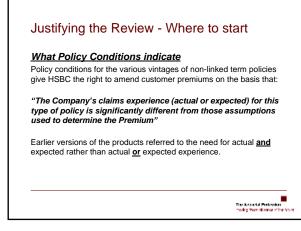
•You have a premium basis for each tranche

BUT YOU NEED TO ACCEPT THAT BY NOT HAVING THE IDEAL SITUATION YOU HAVE NOW LOST YOUR COMPANY MONEY -

YOU MUST NOT TRY TO FORCE THIS LOSS TO THE CUSTOMER

you just about have enough to do it reasonal

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Justifying the Review - Experience

>Premiums can be reviewed if experience differs adversely from that assumed at time of sale.

>Actual claims experience has been significantly heavier than assumed in premium bases.

 \succ Expectation of future CI claims across the industry has deteriorated significantly (ie the change is not a "blip")

- Reinsurance costs have increased by over 80% on key product lines
- \succ The industry have increased new business premiums by up to 85% in response to similar cost increases.

Clear change in experience that justifies a premium change. (Note premium review should happen every year but only when change is significant and permanent should that trigger a premium change.)

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Justifying the Review - Philosophy

≻Not intended to re-capture past loses.

- >Should reflect future expected experience over term of product (ie should be expected to be level when set).
- $\succ Should be set on sustainable long term basis that is capable of external review.$

>Past experience is a guide/estimation of future but not the same.

>Reinsurance rates allowed for where the credibility of own data not sufficent.

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Implementing the Review

Practical

- Consistent with promises
- Incapable of manipulation
- Balanced between customer/shareholder



Implementing the Review - HSBC experience

90% of our business written before 2004 was on reviewable terms, that amounted to over 500,000 customers and over £200m APE.

FAIRNESS is the critical in conducting the reviews.

- Review adopted a consistent and methodical approach:
 - We considered all product groups (Life, CI & IP)
 - We reviewed policies no earlier than 3 years from outset
 - We avoided a single one off review as that was considered "Unfair" and "Selective"

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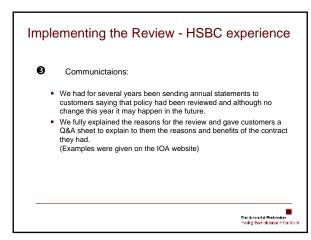
Implementing the Review - HSBC experience

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We experience rated premiums in a methodical and consistent way:

- We used a combination of changes in our own experience and where not 100% credible we used reinsurers to support.
- We changed premiums up & down!
- We made changes that reflected changes in future expected experience.
- We only made changes to the shape of rates where that is justified using the rating factors allowed for at outset, typically age, sex and smoker status.
 (Any other factors ignored, eg social economic groups)

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Implementing the Review - HSBC experience

0 Caps:

- We applied a maximum increase of £40pm to any policy
- We applied a maximum increase of 33% of premium
- We ignored trivial increases of Less than £1
- All premium increases were capped at the maximum of current new business premiums.

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Implementing the Review - HSBC experience

- 6 External Review:
 - We sought Actuarial Function holder and external actuarial peer review
 - HSBC Life board reviewed it (mainly non -execs) Considered fairness vs literature
 Considered fairness vs sales process (Took 9 months to conclude!)
 - Legal opinion, to ensure legal obligations honoured.
 - Discussed with ABI
 - Discussed with IOA working party on reviews
 - Met with FSA to explain and discuss
 - Piloted approach first with 1000 customers

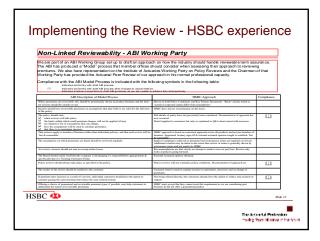
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Implementing the Review - HSBC experience

- 0 Management Discretion:
 - Kept to a minimum.
 - Caps set to benefit of customers & Shareholders
 - Any good reason to limit or delay increases was taken. Eg we decided not to take any increases for Life only.
 - Discretion was allowed only one way: In customers favour.

0 Fit with ABI working party best practice:







Implementing the Review - HSBC conclusion

Are We Meeting Our Objective of Treating Customers Fairly?

Strict adherence with Policy Conditions & Point of Sale material.

Increases limited to no more than current new business terms.
 No attempt made to recover past losses.

 $\succ \mbox{Full}$ extent of increases in experience not passed onto customers by application of caps.

ABI Model process followed.

>Objective measures used with limited scope for discretion.

>Consistent process followed across all products and all customers.

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