



The Actuarial Profession

making financial sense of the future

Life conference and exhibition 2010 Charles Woodd and Mike Claffey – Workshop session C7



Practical Aspects of Premium Reviews on universal life protection policies

7-9 November 2010

Agenda

- Background
- The Review Process – An Experience
- The Ideal Review Process
- Current State of Play in the Industry
- Future “Opportunities”



Background

Mike Claffey

Background to Universal Life Products

- Regular premium unit linked policy with flexible benefits (sum assured and premiums), reviewable charges, and non-guaranteed surrender values.
- Products may be sold with “savings” targets – endowment mortgages, “school fees” savings plans
- Products may be sold with protection targets – single life, joint life first death (e.g. mortgage cover), joint life second death (e.g. Capital Acquisitions Tax or Inheritance Tax planning)
- This was a time of LAPR – policies had minimum life cover (“qualifying policy”)
- Term targets for maintaining life cover
 - “maximum protection”, typically 10 years on a prudent growth assumption
 - specified term (e.g. mortgage term, or perhaps to target age 65)
 - whole of life (was to age 100, now 109)

The environment at point of sale

- Sold from the 1980's, popular in the 1990's, still sold today.
- Industry bodies set maximum “illustrative investment returns”.
- Premium typically reviewed after 10 years, every 5 years thereafter to (e.g.) age 70, annually thereafter
- “Flexible” products allowed premium adjustments, single premium top-ups, premium holidays
- Cover could be level or indexed (e.g. inflation index, or fixed increase).
- Premium escalation choice:
 - Same as cover (so initial premium for indexed cover higher than premium for level cover). This was rarely offered
 - Higher than cover increase rate (typically to give same initial premium as level cover quote)
- Usually wide choice of unit linked funds with switching and/or premium redirection options – in theory each policyholder could have their own unique investment performance history.

The players

- Domestic UK insurers
 - Almost all companies including SJP, Zurich Life, Prudential / Scottish Amicable, Friends Provident, Axa, Legal and General, ...
- Cross border insurers selling to UK residents
 - SJPI
 - Prudential / Scottish Amicable
- Domestic Irish insurers
 - Almost all companies, including Irish Life, Zurich, AVIVA, Bank of Ireland Life, Acorn Life, ...

Regulation and guidance

- Initially mainly from the Actuarial Profession
 - UK working party in 2004
 - UK TCF Working Party in 2005-2007
 - Society of Actuaries in Ireland “Universal Life Premium Reviews Committee” 1993
- FSA – particularly for Endowment Mortgages, but also under TCF agenda
- ABI Guide to Endowment Mortgage reviews 2004 (very prescriptive on policyholder communication)
- Irish Regulator (now Central Bank) has written to life companies
- Irish Ombudsman “case studies”

Irish Ombudsman December 2008

€ 50,000 award following delayed review of Unit Linked Whole of Life. Policy-systemic problem in 1,800 other cases also identified by Ombudsman

- The policyholders, in their late 60s, were medical professionals paying premiums in excess of **€780** a month since 1999 for substantial life cover. In order to maintain their existing level of cover the Company informed them in September 2006 that the premiums were to increase to **€2,000** a month in 2007. They were understandably upset and sought a return of over €60,000 of premiums already paid since 1999. The Company acknowledged that there had been errors in its administration of the policy but would not return the premiums.
- The evidence reviewed by the Ombudsman indicated that the Company:
 - carried out the first scheduled review in 1999, one year after its due date in 1998 **did not apply the default option**, to automatically increase the premiums, when the complainant did not contact the Company regarding the options put forward by the Company in 1999.
 - neglected to carry out the **second scheduled** policy review five years later in 2004, and
 - quoted **an incorrect fund value** following a request for same by the complainants in 2007.

Irish Ombudsman July 2009

€3,000 insurance fund increase for reviews not carried out - possible 96,000 other cases

- The Complainant purchased a unit-linked, whole of life insurance policy with the Company in **1983**. Life cover under the policy was approximately €240,000, with a yearly premium payable of **€900**.
- A review was carried out on the **10th anniversary** of the policy. The Company advised the Complainant at the time that there was **no need for her to change the premium payable** in order to maintain benefits under the policy. However, in **2008** the Company wrote to the Complainant advising her that the premium payable was no longer sufficient to maintain the level of cover under the policy. The Company advised the Complainant that she could continue to pay annual premium of €900 for life cover of €85,000 or maintain life cover of €240,000 for an increased annual premium of **€4,900**.
- In assessing the complaint the Ombudsman looked at the **policy documentation** and examined whether the Company had carried out the policy review in line with the policy's terms. The Ombudsman concluded that the Company **was entitled to carry out policy reviews** and these were clearly provided for under the policy documentation. However, the Ombudsman noted that while the Company carried out a review on the 10th anniversary, it **failed to carry out reviews in 1998 and 2003**.

Irish Ombudsman December 2009

Overcharging of insurance premiums for non smokers

- The Ombudsman investigated complaints against **two** insurance Companies about increases in premiums following policy reviews. While he did not uphold these complaints in the course of his investigations he found that the Companies had incorrectly applied '*Smoking Rates*' to the life policies where the holders were in fact non smokers.
- He increased the amount because of other errors made by the Company **in the overall policy review exercise**. He requested that the Company review all similar cases to identify if any other policies were affected. The Company has since then identified a possible 200 other cases of overcharging for non smokers and its review is continuing.
- Due to the serious matters raised by these two complaints and implications for the industry in general the **Ombudsman referred the matter to the Financial Regulator** to carry out a review industry wide [of life company approaches to premium reviews].



The Review Process – An Experience

Charles Woodd

Starting in time – Hindsight is a wonderful thing ...

- Define the method
 - System development
 - Results review – theory is not enough
 - Policy discussion
 - Policyholders and advisors also need lead-in time
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- Try again ...

Starting in time – Hindsight is a wonderful thing ...

- Policy discussion
- Define the method
- Results review – theory is not enough
- System development
- Policyholders and advisors also need lead-in time

Defining the method – The devil is in the detail

- What was originally intended? T&Cs are rarely definitive
- What basis elements are reviewable? (pre and post UCT)
- Original pricing approach
- Premiums and deductions (funding v actual cost)
- Other factors:
 - New business rates comparison
 - Charges/profit on any premium increase (initial commission?)
 - Default option – increase premium or decrease cover?
 - Reassurance
- Who decides? Appointed Actuary, Actuarial Committee, Management, Board?

What has changed? – It's not what you expected

- What do you want to review?
- Can you measure it? Is it credible?
- What was it originally?
- Whose risk is it anyway? Policyholder v company
- Passive v Active approach to change
- What will happen in future?

What are the implications? – I'm not sure I like that

- Impact of:
 - Assumed future investment return
 - Fund performance to date
 - Future charges (risk benefit and expenses)
 - Deductions to date
- Impact on:
 - Client (TCF)
 - Advisor
 - Reputation
 - Valuation (reserving implications of zero lapse requirement, also EV)

Implementation – actuaries complicate everything!

- Complex systems required for reviews (not just a point of sale illustration system)
- Detailed testing – do you need a separate manual review system?
- Data quality of inforce (premium history, accurate data, missing data)
- “Deep dive” on the system, what else might you find?
- Complexity of communication – lots of policy specific information in letters, listing of options, groupings of policyholders into “whole of life”, term, etc.

The reaction – What did you expect?

- Good news – no reaction
- Less good news – still not much reaction
 - Some individual clients can be very upset, but not many
 - This may be the first time the client has contacted his broker since policy inception
 - Contacting clients provokes other queries / reactions / requests
 - Default option or “deferment” are typical reactions
 - Lapses are typically higher at review



The Review Process – The Project

Mike Claffey

The IDEAL steps for a premium review project

- Prototype review system to establish scoping of reviews
 - Range of premium increases required
 - Sensitivity to assumed investment growth rate
 - Sensitivity to other key assumptions
 - Explanation of increase – amount due at review date, amount due for time lag to actual review date
- Typically use inforce valuation extracts (but you may need additional data)
- Prototype data extract process and calculation process, and rehearse the communication process

Data file required - example

Personal Details:

Policy No, Date of Birth, Smoker, Sex, Death Basis Code

Rating Details:

Extra percentage addition, Additional years to age, Per mille addition, Term of per mille addition

Debt Details:

Debt, Opening Debt Term (months)

Benefit Details:

Life Cover , Life Sum Assured, Life Sum Assured Indexation, Wavier of Premium, WoP Cease Date, Critical Illness Cover, Critical Illness Sum Assured

CI Sum Assured Indexation, Accelerated Critical Illness Cover, Acc CI Sum Assured, Acc CI Sum Assured Indexation

Rider Benefit:

TPD

ADL

Premium Details:

Annual Premium Estab (most recent increments 1, 2 & 3)

Annual Premium Accum

Premium Frequency

Fund Details:

Estab Fund Value (Year 1 to Year 6)

Accum Fund Value

Miscellaneous Policy Details:

Product Code, Level of Cover, Policy Commencement Date, Indexation

Basis decisions – assumptions on future experience

- Investment returns (plus amc for fund choice)
- Future reviewable charges
- Risk deductions

- Term for cover duration
- Future premium indexations – amount and number (and link to past)

Example first attempt – offshore protection (sample data)

Summary Analysis		Number Requiring		Change in total premium	
		Increase	Decrease	Increase	Decrease
Total Policies	1,442				
Total Policies requiring premium adjustment		753	675		
STD cover					
Number of policies	1,164				
Policies requiring adjustment		705	459	7%	6%
MAX cover					
Number of policies	238				
Policies requiring adjustment		10	214	2%	40%
NSR cover					
Number of policies	40				
Policies requiring adjustment on std basis		38	2	128%	0%
Policies requiring adjustment on max basis		2	24	14%	37%
Life cover only					
Number of policies	1,187				
Life cover with accelerated CI					
Number of policies	255				

Scope of review changes – actual results

- Proportion of plans unchanged at review in recent years ranges from 15% to 60% with fixed term business more stable and experience correlating with stockmarket levels.
- Material variation in premium increase calculated, with “maxi-cover” plans requiring particularly large increases (as expected)
- A mixed portfolio of whole of life and maxi-cover business resulted in premium increases evenly spread between those less than 50%, between 50-100%, and greater than 100%.
- FSA returns have contained some information on the level of premium reviews since 2005.

Ready reckoner for main review impacts

- Consider impact at different ages, and different terms
- Current fund value increases in importance for whole of life cover
- Possibly different types of business e.g. mortality and morbidity
- Prepare for communication - e.g. Zurich Adaptable Life Plan adviser review guide

Automation of premium review process

- 3 months in advance of policy anniversary – send options to policyholder
- At policy anniversary – default option if no reply received
- What if you cannot contact policyholder?
- Do you involve the advisor/broker?
- Consider what your approach will be for future claims on “no reply” reviews (pay lower sum assured, or higher sum assured less increases on past premiums).

Policyholder reactions – onshore portfolio

- *Mixed portfolio including whole of life, term, CI and PHI business*
- Active
 - Increase premium
 - Surrender
- Passive
 - Decrease premium (default)
 - Defer changes

	Active	Passive
%age	c.20%	c.80%

Policyholder reactions – offshore portfolio

- *Mixed portfolio including whole of life, term, CI and PHI business*
- Active
 - Increase premium
 - Surrender
- Passive
 - Decrease premium (default)
 - Defer changes

	Active	Passive
%age	c.12%	c.88%



The Review Process – Current Status

Charles Woodd

Current state of the industry

- 2004 UK working party – anecdotal feedback afterwards suggested lots of people feeling a need to address the area
- Heavy focus on TCF by the ABI
- FSA annual returns:
 - New format provides indication of changes being made
 - Not much indication of action over the last 3 years (but hopefully everyone addressed any issues earlier)
 - Could be that everything is now as expected ...?
 - ... or that a passive approach (akin to being guaranteed) is being adopted?
- The spotlight now seems to be shining on Ireland

Future Opportunities

- Reviewable business remains an important element for some companies – presumably any teething issues are resolved and are now good for the long term
- Stockmarket outlook and impact – what are future growth rates? Do we need to worry about differential reviews based on client investment?
- Possible direction of mortality in future? Should it be good news? Ditto morbidity?

Regulation and Risk

- Impact of Solvency 2, IFRS 2 and MCEV on this business
 - “Contract boundaries”
 - Operational risk
 - TCF risk?
- A risk based assessment of the product (using hindsight)
 - Has it worked out?
 - Was it better than guaranteed?

Questions and comments

The views expressed in this presentation are those of the presenters.

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