

EXAMINATION

September 2006

Subject SA1 — Health and Care Specialist Applications

EXAMINERS' REPORT

Introduction

The attached subject report has been written by the Principal Examiner with the aim of helping candidates. The questions and comments are based around Core Reading as the interpretation of the syllabus to which the examiners are working. They have however given credit for any alternative approach or interpretation which they consider to be reasonable.

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Chairman of the Board of Examiners

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Comments

In both questions, candidates who approached the problem, especially the more substantial elements of each question, in a methodical and detailed manner were far more likely to satisfy the examiners and receive a pass in the subject. Generally, candidates lost marks by giving insufficient detail in the answers. Usually each valid point in the answer would normally attract $\frac{1}{2}$ marks whilst the more basic elements e.g. details in a pricing basis such as age and sex, would attract $\frac{1}{4}$ marks.

Candidates should also recognise that whilst Reinsurance can play a valuable role in the UK health insurance market reinsurance is not a panacea for all evils.

1 (i) Cause for concern?

Insufficient information to tell — the MD's claims trend is not necessarily a deterioration in experience

Need more detailed investigation as to what the figures are

Strengthening reserving basis may indicate an underlying deterioration since the policies were priced

The strength of the reserving basis will increase, not reduce, the average claim per policy, if the numerator of the calculation includes both claims paid and statutory reserves.

The growth in average claim size is significant. One might have expected recent distributional changes to have worked through to claims more gradually, especially with a six-month deferred period

Is the portfolio ageing on average (or any other demographic change that could increase claims eg higher occupational class mix)?

What has happened to the company's premiums; they may be higher than the industry average.

Need to check accuracy of figures

Comparison of claims experience against expected claims costs

Effects of selection

(ii) Additional analysis

Should be regular claims investigations

Typically quarterly

New claims / existing claim portfolio separately

Incidence and claims cost separately

Actual experience v expected

Important to subdivide data to assess trends and any causes

But need to consider credibility of data.

Especially as small insurer

Analysing trends in components of healthcare costs is vital

Investigate IBNR/RBNS

Output from previous premium reviews

Supplement with external data — published data, rates from consultants or reinsurers — calibrate to own experience, where possible

Subdivision of data

Morbidity

Subdivision:

Product type

All products

Policy type

Sales channel

Age

Sex

Occupational class

Region / area

Duration from entry

Underwriting method

Level of benefit

Income Protection

Investigate inception rates

And recovery rates

Deferred period

Incapacity

Critical Illness

Cause of claim

Mortality

Mortality needs to be investigated

Pre and post claim

On some policies (e.g. Acc CI) death triggers claim payment

On others a release of reserves

Consider rest of market

Economic and demographic trends for this portfolio

Advances in medical science

(iii) Changes in mix of business from any of factors in (i)

Particularly

Sales Channel. We are now selling through intermediaries.

Different policy type. Previously sold alongside mortgages

Higher claims through greater anti-selection?

Greater market knowledge as increased sales through intermediary

Reduced positive selective effect of mortgage purchase

Higher sums assured

Intermediaries — higher net worth individuals

Sales alongside mortgages may have lower sums assured as only cover mortgage amount

Higher average age — mortgage purchasers younger/intermediary purchaser older

Strengthening of reserving basis

Increase claims figures if used to calculate outstanding claims

Particularly for IP where claims paid for long periods (so earlier period claims still relevant)

Shorter deferred periods

Higher replacement ratios

IP benefit escalation rates

Change in incapacity definition

Reduction in survival period for stand-alone CI

Later cessation ages

Weakened underwriting

Weaker claims management

Random fluctuation

Relevant as we are described as a small insurer

Falling interest rates so IP annuity factors rise

Competitors use more rating factors

(iv) **Principles**

The FSA Statement of Good Practice, the position of the FOS on existing business, ABI advice and companies' own processes should mean that consumers get:

- clearer explanations of what reviewability means and why (or not) they should choose it against guaranteed rates
- greater confidence that review increases or decreases were calculated fairly
- continued availability of reviewable rate products in the future
- ability to buy valuable protection at a lower price than would apply to similar cover if sold at guaranteed rates
- access to new forms of protection that insurers might not otherwise be prepared to offer.

Practical implications

- Where premiums are reviewable, this should be prominently shown in product literature
- and the basis for reviews should be clearly set out.
- Insurers should base reviewable premiums on assumptions that they believe are valid for the full term of the policy.
- The assumptions on which premiums are based should be reviewed regularly.
- The assumptions used for in-force business should be consistent with those used for new business with justifiable grounds for any differences.
- At reviews, premium increases can only be made if the insurer changes one or more of the relevant assumptions stated in the policy for "valid reasons"
- At reviews, insurers should not aim to recoup earlier losses from claims.
- When a premium changes as a result of claims experience (and expected future claims) it should be made clear that this does not relate to the claims experience of the individual policy holder but to the general claims experience for similar policies
- Policy reviews should always take place as specified in the policy.
- The results of the review should be notified to the customer.
- If premium rates increase as a result of a review, individual customers may be given the option to continue paying the same premium but reduce the sum assured instead.
- Where insurers offer a policy with a choice of guaranteed or reviewable premium types, an explanation of the differences should be given.
- Insurers should keep records of the assumptions used to calculate premiums and analyses undertaken to support reviews.

(v) **Implications for this company**

- Although not mandatory, it is advisable to follow statements of best practice
- Company should ensure that for policies already sold the literature was clear
- Analyses should identify valid reasons for increase in premiums
- In particular, investigations should demonstrate that the assumptions require amending. Should not be used as a mechanism to recover earlier losses from claims.
- MD appears to want to review existing rates without increasing new business rates
- Need to ensure consistency between NB and in-force
- But may be different if there are justifiable grounds
- Discussion relating to practical implications of amending processes and record keeping

(vi) **Product design — change policy or premium conditions**

Pricing — setting a price according to a valid set of assumptions

Marketing / Sales — changing policy literature, remuneration structures

Underwriting — change mix between 0/r, rated or declined, automation, more or less internal control

Claims Management — increased training, tighter control of both acceptance and payments

Experience Monitoring — comparing actual v expected

Competitors/regulation

Links

Product Design to Pricing

Pricing to Marketing/Sales

Marketing/Sales to Underwriting

Underwriting to Claims Management

Claims Management to Experience Monitoring

Experience Monitoring to Valuation

Experience Monitoring to Pricing

Valuation to product design

Competitors/regulation to Pricing

Marks were also given to candidates who followed the approach outlined in CA1 which, as well as the above, discusses specifying the problem, developing the solution, monitoring the experience and professionalism.

(vii) **General points**

Need to understand profitability by sales channel (not just claims trends)

Need to understand costs of distribution and servicing by channel

Particularly levels of commission paid

Does volume of business justify lower profit per policy?

Consider competitors approaches

Discuss reinsurance/changes with reinsurer

Insurer should consider if they have any competitive advantages

Strategic options

Concentrate on area of means of distribution with most profit potential

- Will save on expenses
- Will concentrate management effort
- In theory will maximise profit
- Will eliminate diversification
- Will cause market/policyholder ill-will
- Will reduce volumes and spread of overheads
- May not meet with shareholders' requirements
- May have to write off investment in developing business

Increase premiums for in-force

- Implications covered in part (iv)

Increase premiums for all new business

- May correct any under-charging in current rating structure
- May need additional features to soften blow
- May lose new business
- May need to keep increases within market levels
- Effect on premium revenue depends on elasticity of demand
- Needs negotiation with distributors who may have difficulty with new rates if out of line with the market

Introduce differential pricing between building societies and intermediaries for new business

- Fewer subsidies — each policy pays for itself, expenses and claims
- Office's profit is independent of source of business and is indifferent of volumes in each risk cell
- Reductions may not produce new business, while the increases will certainly deter portfolio growth

Introduce differential pricing between building societies and intermediaries for in-force business as well

- May cause significant changes in individual premiums charged to in force business
- Reductions may be offered where unnecessary to retain the business
- Elsewhere significant increases will cause lapses
- Big TCF/PRE issue
- Similarly may cause dissatisfaction with distributors who have to explain reasons to policyholders
- May need reinsurer's buy-in to new basis (if reinsurance is O/T)

Close unprofitable portfolio

- Expense saving
- Concentration of management effort
- Potential release of capital
- Managing run-off book may be expensive, with worst business persisting

- Selling run-off book may be difficult and may require enhancement of reserves
- Distributors may not be happy and may not now support remaining product
- Loss of EV and goodwill
- Shareholders requirements?

Consider alternative means of distribution

Amend commission payments so that intermediated business remains profitable

- Risk of reduced business if not market proximate commission

Identify strongly performing intermediaries and deal exclusively with them

- Limits potential market
- Likely to be impacted by random fluctuations
- Upset distribution partners

Change terms and conditions through intermediary channel

Reduce level of benefits provided by the product

- May make product less competitive
- May not meet customer needs
- Dissatisfaction from intermediary IFAs
- May reduce sales

Stricter medical underwriting through intermediated channel

- Improve questions
- Stronger internal controls
- Increase automation
- Complexity of dual processes — likely to be applied to all channels

Stricter financial underwriting

Stricter claims management

Stop selling poor performing product line through intermediaries

Review competitor strategies

2 (i) Income

Replacement income when off work

Provision of assistance when spouse disabled

Locum cover for single person protection

Specific income needs e.g. pension contributions, national insurance, mortgage repayments, policy premium, LTC

Meet cost of expensive healthcare where State does not provide

To provide immediate care/surgery where the wait is too long

To provide choice of best consultants/ hospitals

To provide a savings vehicle with payout linked to disability

To offset capital needs on extreme disability

Vehicle for early retirement

Change in lifestyle as a result of disability or illness

To minimise time off work

To help meet cost of recuperation

(ii) **Rationale**

Employer requirement is to minimise absence from work of employee
by reason of illness or injury
or illness or injury of spouse

Provision of health benefits

Encourages employee loyalty

Aids recruitment

Group PMI

Meets employer needs

provides treatment for acute conditions in UK

need full cover — acute and chronic overseas

employee who is ill can be treated quickly

same applies to employee's dependants

Group IP

Meets employer requirements in provision of sick pay for employee

Overseas staff will require full coverage

Can provide longer IP benefits for permanently ill employees

Group CI does not match requirements

Group LTC does not match requirements

Keyman IP

Can be used to cover key staff

Whose absence directly affects employer's profitability

Short term sickness and accident

Meets some but not all sick pay requirements

Group Dental

Provides cover — useful in areas where there is a shortage of NHS dentists

(iii) A suitable schedule might include:

2 categories — management and directors, other employees (note may need to separate out those overseas employees — benefits may be different)

Deferred period — management & directors 6 months,

other employees split 50% for 3 to 6 months and then full from 6 months

Benefit basis: (75% salary — State incapacity benefits) OR 50% salary.

Termination age — 60 for management and 65 for employees

May need to consider age discrimination laws here
Escalation of benefits — RPI to provide some link to salary
Proportionate/rehabilitation
Counselling services
No u/w — actively at work requirement or limited u/w cover
Free cover

(iv) **Data**

IFA — Broker
Commission basis

Employer details

Name of employer
Location where employees work and numbers
Nature of business
Eligibility
Occupations — mix — professional, supervisory, skilled, semi-skilled, unskilled manual
Sales reps — driving > 18K miles p.a.

Cover required

Basic benefits — deferred period
Escalation of benefits
Basic benefit basis e.g. 50% of salary, 75% of salary less state benefits
Salary definition
Guaranteed period
Free cover level and treatment of cases above this
Supplementary benefits
Pension contributions — employer and employee
National insurance
Commencement date
Renewal date
Aids cover
Continuation option
Are benefits in payment to be limited
Is PMI available? If yes, may give discount

Are there employee helplines available?

Has the scheme been previously insured?
If so, who by and details of cover

Claims experience

Scheme exposure — past 5 years, number of lives, salary roll (split by category if poss)
Current claims details — date of birth, sex, inception date, cause of incapacity, benefit amounts.
Ceased claims (same info + date/reason for cessation)
Rated lives and details

(v) **Morbidity**

Perform an analysis of own company experience over a suitable recent period
3–5 years may be suitable depending on volume of data — credible but homogeneous
Split analysis into major different risk groups e.g. male/female, smoker/non-smoker, location.
Adjust data for other possible influences which will affect its immediate usage e.g. past changes in underwriting standards or claims management.
Compare own data with that from other sources over the same time period, in both the home market and in the overseas territory:
Industry data e.g. from insurers' associations
Data from reinsurers
Published tables based on insurance experience
Population figures and government health statistics
Assess the level of adjustment needed to the local data (which may be more plentiful) to make it relevant to the prospective overseas market.
Ratios may be appropriate initially but margins will be needed.
Assess the adjustment needed to relate any published data, which may not be underwritten, to the particular circumstances of the company, its products and target market.
Analyse trends in experience by age, sex, by smoker status.
For IP, analyse claim inception and claim termination rates. If data permits, investigate by occupational classes and deferred period.
Investigate the availability and cost of reinsurance arrangement of various sorts e.g. risk premium, original terms.
May base premium terms on reinsurance rates, subject to the above analysis.
Need to investigate potential impact of AIDS/HIV
Further adjustment needed to align different target market with that underpinning the base data.
Need to include reserving basis among pricing assumptions, affecting cash flows.
Will probably use adjustments to a standard table, the adjustments derived from the above analysis.
Need to allow for deterioration also.

Mortality

Similar analysis to the above.
Data needs to be interpreted with care
For IP, need to split pre-claim and in-claim mortality

Investment

Assess level of potential investment return on the assets backing this portfolio, dependent on where the assets are held.
Allow for currency differences.
Include net of direct investment expenses

Expenses

Start with company's most recent inhouse expense analysis.
Allow for trends if this is an annual exercise

Allow separately for acquisition (sales, marketing and underwriting), servicing and claims costs
Claims costs will be split between initial claim validation and ongoing claim maintenance
Split policy costs into those that are premium related and those that are per-policy.
Need to understand the extent to which specific one-off costs (e.g. establishment overheads) and expected additional costs (e.g. regulation) are to be costed against individual policies.
Degree of detail will depend on size of company and volume of expense information
Inflation may need to be split between manpower costs, future equipment costs and others.
Projected inflation may possibly be measured as difference between government fixed-interest and index-linked securities.
Adopt consistency of assumptions between investment returns and expense inflation.

Commission

Commission as paid. Load directly into premium basis.
May need some adjustment if there are volume-related overrides — thus dependent on new business forecasts.

Lapses

Analyse experience for IP products.
Ensure appropriate to the distribution channel.
Adjust data if target market is different from those underlying the above researches.
Further adjustment may be needed if past period of data collection was influenced by unusual economic circumstances, or any other abnormal historic situation.

Tax

Make suitable assumptions as to the insurer's current and future tax position.
Make allowance for any tax liability in overseas territory, including premium sales tax

Profit

Include company profit criteria, commensurate with underlying risk of venture — risk discount rate, PVFP, pay back period.

Sensitivity analysis

Test the sensitivity of the final premiums to adjustments in the individual assumptions and refine inputs accordingly.

Competitors' rates

Research competitors' office premium rates to assess levels of new products – adjust assumptions then if deemed appropriate.

Assumptions and strategy

The values of the assumptions and the premiums that they produce will reflect the company's strategy in launching into the new market:
An aggressive growth strategy may require assumptions stripped of margins.
A slow portfolio build strategy may permit more caution in the assumptions.

(vi) **General Comments**

Group Income Protection will generally be priced using unit rates which are scheme specific.
The unit rate will however be calculated based upon the expected experience of the scheme based upon the insurers previous experience of similar schemes.
and allowing for the profile of the scheme e.g. age, sex, occupation profile.
Some Group Income Protection business may also be single premium costed where rates are calculated for each individual covered.
Book rates
Credibility formula
This would generally be used for cover above the free cover limit and for partnership schemes.
The experience analysis will be similar to that for individual. Specific differences are highlighted below:

Morbidity

Lack of detailed exposure data, detailed claims analysis being more difficult.
For specific schemes, would analyse their own claims experience.
Potentially use loss ratio analysis.

Investment

Note short term contract — limits potential for investment of premiums

Commission

Note many brokers may be on a fee basis, so may quote net of commission rates.

Lapses

Generally 2 yearly renewable contract.
Analyse expected renewal rate.

Competitors rates

Note there would generally be a competitive tender process but may not be aware of competitors' rates for GP.

(vii) **Self insured**

- + any favourable experience will benefit the company
- + not paying out commission to broker
- + not having to pay insurer's profit margins

- + control over all aspects of the benefits (not limited to what is available in the insurance market)
 - risk remains with the employer hence poor experience will impact directly on the company
 - smooth results
 - lacking expertise in managing group income protection claims
 - claims adjudication expertise required internally
 - lack benefit design expertise
 - lacks other services provided by insurers e.g. employee assistance services
 - less protection on claims following liquidation, takeover or sale
- (viii) Key issue — the footballers are the assets of the football club.
Key concern that unable to play and have to continue to pay their wages.
Footballers generally very highly paid.
Medical costs not large relative to players wages.
Some form of income protection cover to cover their wages on incapacity.
Cover for limited period to meet the players contracts.
Due to large risk, may consider exclusions.
Also need to consider non footballers.
Management — key person cover.
Staff (e.g. groundsmen etc.) — protection in the event of illness — Group
Income protection/PMI cover
Availability of cover — how insurable is the risk?
LTC possible need but not likely to be available
Sports clinics, international physiotherapists, surgeons etc; may not be insurable

END OF EXAMINERS' REPORT