

The Actuarial Profession
making financial sense of the future

Approaches to Reviewing CI Premiums

Stephen Griffiths
Craig Colton

Approaches to Reviewing CI Premiums

- Is it fair to Review?
- Justifying the Review
- Implementing the Review
- Comments / Questions

The Actuarial Profession
making financial sense of the future

Is it fair to Review?

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

The Actuarial Profession
making financial sense of the future

Market Background - Guaranteed makes a comeback

- Choice between guaranteed and reviewable still exists
- Stakeholders 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 withdrawal of support.
- ABI Statement of Good Practice improving robustness of definitions
- Potential “unfairness” of reviewable products

The Act of Parliament
Making Good Practice of the Future

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 definitions
- Key for new policies to avoid doubts over unfairness

The Act of Parliament
Making Good Practice of the Future

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

The Act of Parliament
Making Good Practice of the Future

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

The Act of Parliament
Making Them of Force

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 be prominently and clearly explained.
- Definition of "fairness"? – clear explanation of process with valid reasons for review

The Act of Parliament
Making Them of Force

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 regularly
- Insurers should not reclaim past losses
- Reviews should take place when specified
- Option to end contracts or reduced benefit

The Act of Parliament
Making Them of Force

Is it fair to Review? – ABI Advice

Policies should state:

- When the reviews will take place
- How 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.

The Act of Parliament
Making Them of Force

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

The Act of Parliament
Making Them of Force

Is it fair to Review? - Impact on Stakeholders

Impact of ABI advice

- Policyholder
 - Clarity in product literature
 - Comfort in knowing they will be dealt with fairly
 - Continued availability of reviewable products
- Intermediary
 - Consistency between providers if adopt ABI advice
 - Requirement to explain the review process
- Insurer:
 - Updating of literature and review process
 - Toolkit for reviews

The Act of Parliament
Making Them of Force

Justifying the Review

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

The Act of Parliament
Making Them of the Year

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

The Act of Parliament
Making Them of the Year

Justifying the Review - ABI Advice

- Base premiums using assumptions appropriate for full term
- 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

The Act of Parliament
Making Them of the Year

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

The Act of Parliament
Making Them of the World

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!

The Act of Parliament
Making Them of the World

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!

BUT:
YOU CAN ENSURE IT IS GOING FORWARD!

The Act of Parliament
Making Them of the World

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.



Justifying the Review - Realistic Situation

- You have a premium basis for each tranche
- You have reinsurance rates

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

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



Justifying the Review - Where to start

What Policy Conditions indicate

Policy conditions for the various vintages of non-linked term policies give HSBC the right to amend customer premiums on the basis that:

"The Company's claims experience (actual or expected) for this type of policy is significantly different from those assumptions used to determine the Premium"

Earlier versions of the products referred to the need for actual **and** expected rather than actual **or** expected experience.



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.
- 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
- 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.)



Justifying the Review - Philosophy

- Not intended to re-capture past losses.
- Should reflect future expected experience over term of product (ie should be expected to be level when set).
- 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 sufficient.



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.

- ❶ 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"

The Annual Policyholder Meeting
Making Your Insurance Work for You

Implementing the Review - HSBC experience

❷ 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)

The Annual Policyholder Meeting
Making Your Insurance Work for You

Implementing the Review - HSBC experience

❸ Communicaitaions:

- We had for several years been sending annual statements to customers saying that policy had been reviewed and although no change this year it may happen in the future.
- We fully explained the reasons for the review and gave customers a Q&A sheet to explain to them the reasons and benefits of the contract they had.
(Examples were given on the IOA website)

The Annual Policyholder Meeting
Making Your Insurance Work for You

Implementing the Review - HSBC experience

4 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.



Implementing the Review - HSBC experience

5 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



Implementing the Review - HSBC experience

6 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.

7 Fit with ABI working party best practice:



Approaches to Reviewing CI Premiums

Stephen Griffiths
Craig Colton
