



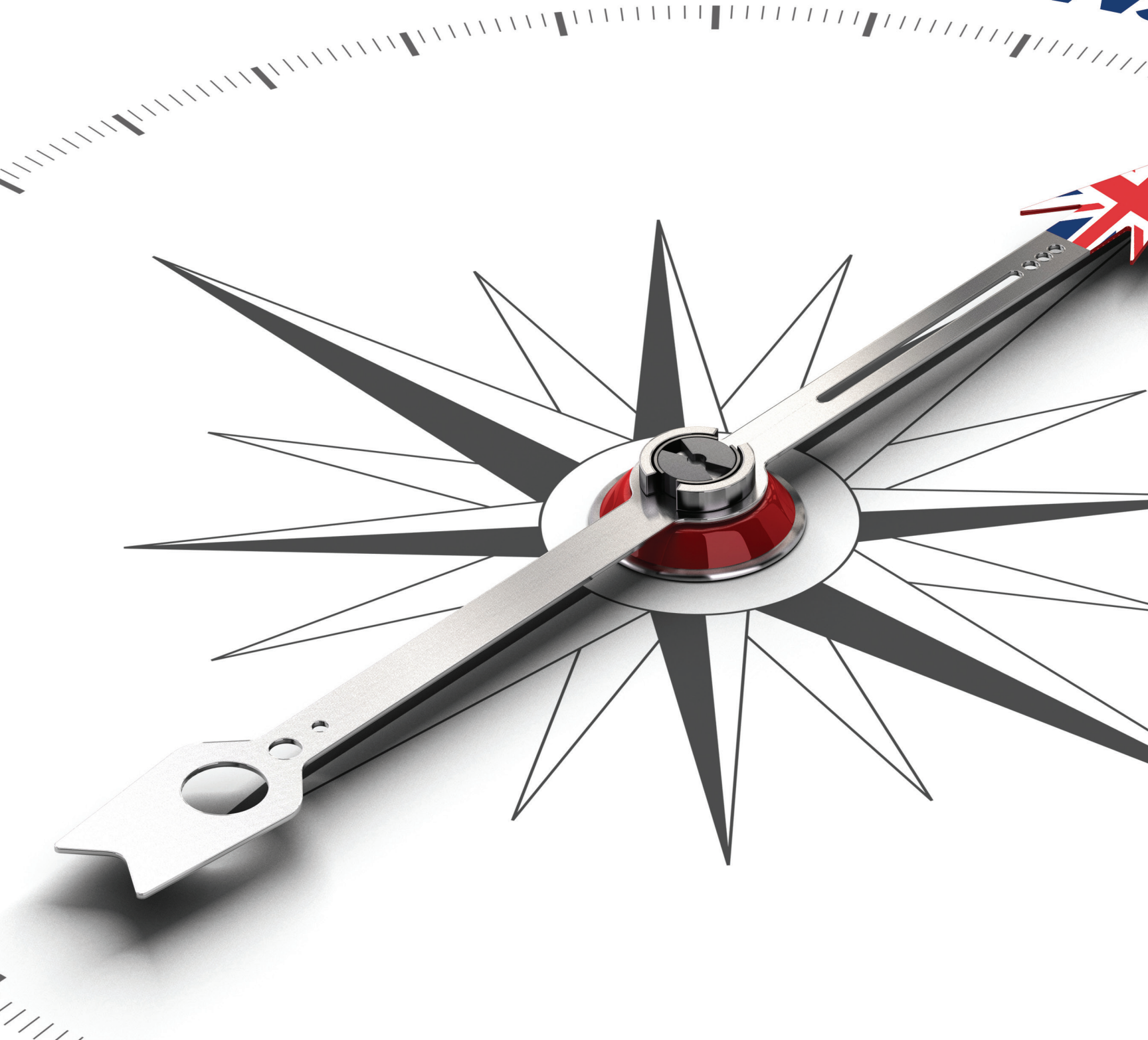
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THE U.K. IN



INSURANCE MARKET

AND HOW IT IS
CHANGING
BY TONY HORN

COMMERCIAL, CONSUMER AND REGULATORY ENVIRONMENTS ARE COMBINING TO FORM A FERTILE BREEDING GROUND FOR MUCH-NEEDED INNOVATION IN THE U.K. INSURANCE MARKET.

The U.K. life insurance market is the largest in Europe and the third largest in the world, but life insurance sales have been stagnant over the last decade, as illustrated in the chart on page 22.

This article is expected to be of interest to actuaries and students who either already operate in or would like deeper insight into life insurance/protection product markets. I hope you will be able to draw some comparisons with your home market and perhaps apply some learning points. I would be interested to receive any observations from a U.S. market perspective.

THE MAIN PRODUCTS

TERM INSURANCE

Level term insurance is a staple product in the U.K. market, providing cover for a specified duration, usually up to a maximum age of 85. Customer premiums are constant over the duration of the policy.

Decreasing term insurance is often used to cover repayment mortgages. The reducing outstanding mortgage is estimated by making an assumption of the average long-term interest rate. Life cover decreases in line with this schedule.

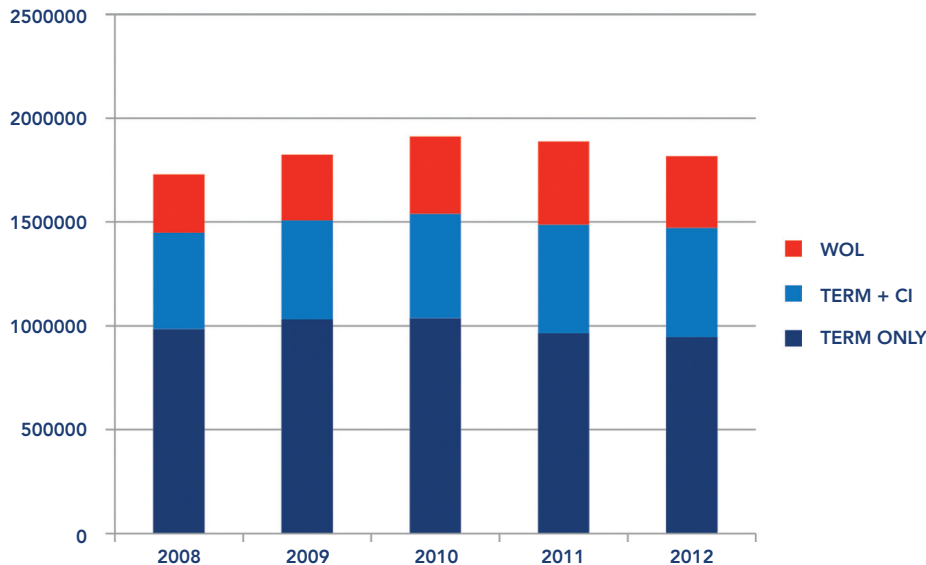
CRITICAL ILLNESS INSURANCE

Critical illness insurance emerged in the 1980s, initially paying a lump-sum benefit on diagnosis of a few specified “dread diseases.” It is usually linked to life insurance so the customer also receives the benefit on death.

For early products, customer premiums were regularly reviewed, for example, every five years. The process for calculating such reviews and the corresponding negotiations with reinsurers was complicated; the U.K. regulator would issue TCF (treating customers fairly) guidelines for how reviews should be calculated. As reinsurers became more confident at pricing the risk, guaranteed products became more popular. Initially, these were significantly more expensive than reviewable policies, but there is now little difference, perhaps reflecting the risk of pressure to reduce reviewable rates in the light of favorable experience.

New Sales (policies)

Source: Swiss Re Term & Health Watch 2013



At the risk of confusing customers, insurers have competed by adding multiple additional conditions, some medical procedures, and more recently partial payments for some less serious illnesses.

WHOLE OF LIFE INSURANCE

One purpose of underwritten whole of life cover is inheritance tax planning. This is a niche market, and terms tend to be less competitive.

Over 50s policies, otherwise known as Funeral Plans, are more popular, paying relatively small amounts on death. There is no underwriting; this is replaced by a moratorium, usually two years. Such plans are often sold via direct marketing with free gifts and have been recently criticized as offering poor value. Although they are significantly more expensive than underwritten term insurance, premium payment terms are often limited to age 80. The low interest rate environment has meant

some plans have value from an investment perspective but are not marketed as such.

INCOME PROTECTION

Income Protection is a type of product that enables customers to protect their income, should they become unable to work because of incapacity or illness. Unemployment is sometimes also covered. Most policies are now sold on an own occupation basis. Recent sales have been poor, with only 120,000 policies sold in 2012, just over half the level of 2003.

Limited payment policies are starting to appear on the market, most paying claims for five years with some one- and two-year products as well.

THE MAIN PLAYERS INSURANCE COMPANIES/PROVIDERS

Historically, the market has been dominated by large established life insurers. Product differentiation has been limited, and

providers have tried to gain advantage through scale, although this has proved difficult in a stagnant market. Smaller providers and niche operators are now increasing their influence and bringing product differentiation to the market.

REINSURERS

Reinsurers have had a significant influence for some time. Competition for business has been ferocious, with reinsurers cutting rates, which reflects mortality improvements and the prospect of such improvements continuing. Life insurers have found it profitable against their more cautious internal assumptions to cede an increasing share of the risk, often as much as 100 percent. This has ceded control of the risk market, including its pricing, to reinsurers.

Reinsurers' domination of the market price of risk has, however, become a double-edged sword. The increased cessions drew increased focus on reinsurance terms and more frequent rebroking by insurers, which the intensely competitive reinsurance market has accommodated. As reinsurers' margins have been squeezed, the market has become more commoditized and price driven, to the detriment of product innovation.

DISTRIBUTORS

Distribution has always been a key battleground. Traditional strategy has been based around the premise that "life insurance is sold, not bought." Products have tended to be designed for distributors such as independent financial advisors (IFAs) to sell, often leading to more complex features and underwriting processes.

More recently, products have been differentiated according to distribution



channel, which tends to define the pricing strategy. Distributors are starting to recognize their power to influence both the product design and its pricing/underwriting strategy to fit a specific distribution process.

DIFFERENT DISTRIBUTION MODELS

INDEPENDENT FINANCIAL ADVISERS

The IFA market advises customers on how much and what type of cover customers require and recommends an appropriate product. Price is a primary driver, particularly for term insurance, which is often regarded as a commodity, although a provider's underwriting practice can also be a differentiator. Products for the IFA market are almost always fully underwritten and regularly repriced to ensure a competitive market position.

Some IFAs are members of networks that centrally provide product research and compliance services for member IFAs.

AGGREGATORS (PRICE COMPARISON WEBSITES)

Aggregators have grown substantially in recent years and have taken a large share of the online market. They attract brands to advertise their prices for customers to compare according to their requirements. Brands usually have a choice of how to pay the aggregator, including per click or per application.

Aggregators generally host nonadvised products, although some are accompanied by guided sale information on an associated website. Customers might have access to a similar product through a different sales channel, which might be at a different price. Some brands employ an active algorithm to adjust their prices according to their position in the comparison table. This might

be facilitated by agreeing to terms through which they are able to reduce prices in return for accepting lower commission payments.

DIRECT

Although most life insurance companies have a means of selling directly to the public, this has generally been considered a minor

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distribution channel. There has been increased recent interest, with retail distribution review (RDR) perhaps operating as a catalyst, but a widely engaging direct proposition has yet to emerge. The challenge is to design propositions specifically for a direct market, whether advised or nonadvised, potentially through a powerful brand.

BANCASSURANCE

At the turn of the century, banks were widely expected to utilize their wide customer base by taking a dominant position in the distribution of life insurance products. Several joint ventures were formed between banks and life insurance companies to sell investment, pensions and protection products. Some banks shared both distribution and manufacturing profits with insurers, some bought their own insurance company, and others retained 100 percent of the distribution activity via a single tie commission arrangement.

The most successful bancassurance operations were banks that were able to integrate an in-house insurance company into their banking distribution model, but

banks were unable to dominate the market. Some banks chose to price their products at a premium to the market. Although some existing customers were prepared to pay premium prices, this limited their ability to encourage their wider customer base to buy their insurance products. As price comparison websites became more popular, the market polarized between those bank

customers who shopped around for price and those who didn't.

Some banks now compete more closely on price and include comparison websites in a multichannel distribution strategy. However, the reduced public trust in banks and the RDR are now additional barriers to overcome.

SINGLE TIE

Distributors with well-known brands, such as retailers and banks, have typically entered into an exclusive arrangement with an insurance company. A "base price" is negotiated that includes an agreed-to commission allowance, and the distributor is usually able to flex the retail price against corresponding adjustments to the commission rate.

Advised propositions are generally fully underwritten. Otherwise, the advice process might exploit any simplifications in the underwriting process, to the detriment of the insurance company. Simplified underwriting is better accommodated in a nonadvised sales process.



Pricing tends to be higher than that in the IFA market. This partly reflects both higher commissions and an adverse business mix, which tends to exhibit higher mortality.

REGULATION

The U.K. market is heavily regulated, and market change has often been driven by changes in regulation or taxation, such as those listed below.

RETAIL DISTRIBUTION REVIEW

RDR took effect on Jan. 1, 2013. In addition to increasing training requirements, this effectively banned commission payments on investment products. As many banks decided that RDR made providing advice to their mass market customers uneconomical, it had a huge effect on bancassurance business models. Although commission was still allowed on protection products, many such sales were previously made on the back of investment products. On reorganizing their sales forces, protection product sales collapsed for many banks.

GENDER DIRECTIVE

The Gender Directive came into force on Jan. 1, 2013, for all European insurance markets. Apart from a few exceptions, such as group risk products, pricing now has to be gender neutral. Life insurance premiums for males reduced modestly, and those for females increased more substantially as insurers were conscious of the increased business mix risk.

At the same time, a new tax system took effect in the United Kingdom. This significantly reduced the tax relief available on expenses for some companies, which is substantial for fully underwritten products. The effect was to balance or outweigh the reduction in male premiums due to the Gender Directive.

In the IFA market, most insurance companies repriced their products several times each year, as they compete to reflect mortality improvements. However, the regulatory changes in 2013 have combined to increase most premiums, making rebroking less

attractive. Reported protection sales for 2013 have generally been lower as a result.

MORTGAGE MARKET REVIEW (MMR)

Although already partially implemented, MMR will fully come into force on April 26, 2014. This tightens the process for customers seeking a mortgage and so lengthens the time for such sales. The consequences for protection sales, which are often built into mortgage sales processes, are unclear. It could squeeze time for protection sales out of the process, or an improved customer relationship could lead to increased sales, especially if going through a simplified underwriting process.

UNDERWRITING

Most reinsurers have developed their own underwriting models. These models usually comprise an automated set of rules to determine which customers can be offered standard rates and which should be offered a rated premium or be declined. For most providers, their core proposition is fully underwritten and usually based around their lead reinsurer's underwriting model. Products sold via the IFA market are often akin to preferred life propositions, because of the strength of the underwriting. The strategy for customers who fail the underwriting can range from a sophisticated rating process to a straight decline.

Simplified underwriting propositions exist but are not widespread. They need to be carefully tailored to a suitable distribution opportunity to avoid anti-selection risk. The reduced administration and distribution costs can more than offset the additional risk cost.

SO WHAT'S CHANGING?

AGGREGATOR MARKETS

A common feature of the aggregator market is that customers receive a quote



before submitting their health details, so they will potentially be disappointed by subsequent ratings of their premium. Some market operators have tried to address this by proposing a common question set to insurance companies who present their propositions on a particular comparison site. iPipeline, from the American market, as well as reinsurers and other innovative companies have been active in this area, threatening to wrest control of the underwriting process from the established insurers.

DISTRIBUTOR-LED BUSINESS MODELS

New business models are emerging in the wider market, enabling ambitious distributors to take control of their propositions. A distributor partners with a provider and reinsurer to agree on the product design, underwriting process and pricing, both wholesale (reinsurance terms) and retail (customer price). A small or mutual life insurance company, with a life insurance license but no strongly established product or proposition, will typically host the proposition. The model presents a new, more direct route to market for reinsurers, who will take most if not all of the life insurance risk. Propositions can be tailored to a specific distribution opportunity.

For example, an online proposition that is to be competitive on price comparison websites would have a strong underwriting process, potentially resulting in a high proportion of customers being declined. The distributor may or may not choose to develop a refined rating process to cover the maximum amount of customers possible.

This business model offers considerable scope for data and analytics to be leveraged, to both target the product more effectively and reduce costs across the value chain.

PREDICTIVE UNDERWRITING

Distributors who are prepared to utilize “big data” have opportunities to use “predictive underwriting” to select better risks, with an improved propensity to buy, while simplifying the application process.

A distributor with a deep knowledge of its customers, perhaps through a high-quality data asset, has the capability to develop a simple proposition with an easy customer journey. It might target customers who are identified as of a particular socioeconomic class (they might live in a certain area and/or exceed a minimum level of earnings) with a simplified underwriting proposition of one to five questions. By targeting a healthier than average cohort, which can still be expected to remain at or above average after a limited underwriting process, competitive premiums can still be offered. Although the mortality risk would be higher than that of IFA customers, who undertake a thorough underwriting process, there are likely to be savings across other parts of the value chain. Distribution and administration costs are likely to be lower, and by sharing the value chain, all parties have “skin in the game.”

REGULATION

Regulation has traditionally served as a barrier to new entrants and has constrained the market from within. Post-RDR, the advice sector has contracted, suggesting that the biggest opportunities might arise from Direct to Customer or redeveloping the advice system. Online audit trails could enable effective regulation of such sales processes and provide some much-needed confidence to regulators and developers of new sales processes. There is potential for applying learning points from innovation in the investment sector of the American market to the U.K. market.

Regulators are encouraging the market to develop simpler products by considering an endorsement scheme for products that meet certain criteria.

PRODUCTS

The simplicity of guaranteed acceptance products with exclusions for pre-existing conditions, often with a limited sum insured, is becoming more popular. There is greater scope to combine such products with predictive underwriting.

Investment/wrap platforms are starting to recognize the complementary benefits of adding protection, whether in a conventional or unitized form. Unitized whole of life products were popular in the 1990s. These were essentially savings plans that applied reviewable charges for mortality or critical illness benefits and could potentially be redeveloped to complement investment platforms.

SUMMARY

Commercial, consumer and regulatory environments are combining to form a fertile breeding ground for much-needed innovation to be brought to the U.K. market. I am optimistic that the market will move forward, through a combination of ambition and trust between all stakeholders. **A**

Tony Horn is an actuary/consultant at his company, Positive EV Ltd in York, U.K. He can be reached at tony@positiveev.co.uk.