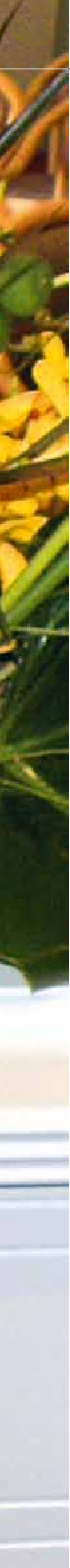
In this article we discuss the role of the actuary in the product design process and whether, as actuaries, we are providing well considered and broad ranging advice given the potential risks associated with these products.

Funeral Insurance

– paying the ultimate premium



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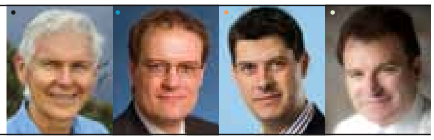

There has been rapid growth in the funeral plan product market in recent years and it has become necessary to ask: Are actuaries covering the full range of risks in their product advice to companies under LPS320 and professional standards?

The direct (non-advised non-group) life insurance market has grown quickly in recent years. A significant contributor to that growth is in the 'funeral plan' market. 'Funeral plans' in this context are life insurance policies for a modest sum insured, often purchased by an older demographic. Customers are often people who may not be financially savvy and may not have purchased life insurance previously.

The primary customer value proposition is that the policy will provide for all funeral and related expenses, so a surviving spouse, children or other estate beneficiaries are not left out of pocket from these costs. Another major drawcard is that there is no underwriting, removing a cumbersome and often poorly understood step in the sales process and leading to greater sales throughput. The lack of underwriting makes this product a 'catch-all' for applicants who are not able to qualify for a more standard term life product. This produces anti-selection risk, which is typically managed via a limited initial stand -down period of one or two years (where the policy pays out on accidental death only), plus a loading to the otherwise appropriate claims assumptions in pricing.

Mortality is typically well above the population level.

Both stepped and level premium versions are available in the market, with some life insurers providing a choice of premium type for the same product. The marketing orientation is towards stepped premiums. A common marketing strategy is to highlight the price. Advertising usually quotes the price of a stepped premium for a single life insured in the youngest rating age band (and sometimes female). One advertisement compares this weekly price to the price of a cup of coffee.

Some concerns have been expressed about funeral insurance, in relation to both value for money and whether those purchasing the cover sufficiently understand all key aspects of what they are buying. The NSW Fair Trading Minister, Anthony Roberts has advised consumers to research options carefully to ensure they get value for money, taking into account the facts (where applicable) that:

- premiums rise each year with age; and
- if premiums are not continually maintained up to date then no funeral benefit will be paid and policyholders would lose the benefit of past premiums paid.

The Australian Funeral Directors Association has expressed similar concerns, indirectly questioning whether yearly renewable stepped premium insurance contracts with no surrender value are right for this market. Sensitivity around these issues is potentially heightened by the perceived and actual vulnerability of older age consumers, both at point of sale and ongoing. The rate of increase in age related stepped premiums is likely to be higher than the rate of increase in incomes for most older consumers, resulting in decreased relative affordability over time. Actuaries might look at the level of lapse rates for indications as to whether the product is really valued or not.

The point has been made that promotional material places little emphasis on the life insurance company issuing the product. This may limit the reputational risk of the actual insurer, but from an industry perspective, may bring the industry into some disrepute.

What does this mean for actuaries who play an important role in the design of these products and must also advise the company under LPS320 and professional standards? Based on typical disclosed premiums and a loading to population mortality, the loss ratios of this business are generally lower than other major types of life insurance. On the other hand:

- mortality is typically well above the population
- the actual mortality experience is yet to mature, including longer term effects of any initial anti-selection and selective withdrawal;
- small sums insured can result in high unit costs and there are high costs of marketing to sell via this distribution channel;
- there is nothing wrong with an open and profitable market in itself, assuming there is genuine demand for the product and an appropriately informed consumer;
- without reward for the broader market coverage and sales innovation that these products provide to the life insurance market, new ways to offset the underinsurance problem are more likely to go unrealised.

Actuaries should note the requirements of Section 6.3 of PS200, namely:

"The Member must satisfy himself or herself that the documentation and promotional material related to the product and prepared by the Entity is consistent with the terms and conditions of the policy."

Therefore an important reminder for actuaries is to consider any risks around mis-selling. To mitigate any risks, the market best-practice is to have carefully scripted and recorded sales discussion and clear and concise product materials. This should be supported by a strong compliance function to ensure adherence to best practice. For any sales process, its effectiveness in communicating key aspects of the product in the context of the overall marketing and pricing strategy must be considered.

Clauses in legal documents and legal sign-offs have not always been effective in preventing companies from having to systemically compensate consumers. In the UK particularly, the life industry has paid billions in compensation for a variety of 'mis-selling scandals'; consumer credit cover being currently in the news. A key hurdle to consider is whether policyholders have been made appropriately aware of the costs and benefits of the insurance. If not, the company may be vulnerable to a class action or a Fair Trading investigation. Given the level of attention by regulatory authorities and consumer bodies, actuaries must be particularly diligent in reviewing the total product operation rather than just concentrating on technical aspects. A