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Africa Insurance Outlook 2022

New generation risk premium reviews.
Have you considered all the factors?

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Premium reviews are a product development mechanism used by insurers to reduce the initial cost of insurance. While they are effective at enabling greater access to the insurance market, premium reviews introduce their fair share of complexities and uncertainties.

Insurers need to perform financially significant premium reviews in a complex and competitive market with an attentive regulator. This requires them to have planned well and be deliberate about premium reviews. A well thought out premium review framework that has been embedded into the business is an ideal tool to capture the necessary planning and thought.

In this article we provide context to the premium review issues, introduce some of the thinking and complexities associated with premium reviews, as well as explore how a premium review framework can assist insurers to achieve an optimal outcome.

Where did this all start?

For many years leading into the 2000s, universal life insurance products were the most common products to meet the combined life insurance and savings needs in the South African middle to upper income segment of the market. However, since these were phased out at the turn of the century, the insurance offering in this market segment has been pure risk policies without underlying investment component to the product.

To ensure that these policies are affordable when insurers are faced with long-term uncertainty, insurers have only guaranteed the premium rate for a limited period of time. Effectively, this product design feature allows the insurer to share some risk with the policyholder which results in a lower initial premium.

Contract wording is often open-ended regarding the treatment of premium reviews. This leaves the insurer with significant discretion in the implementation of premium reviews, resulting in uncertain policyholder outcomes. The Financial Services Conduct Authority (FSCA) has recently proposed changes to the Policyholder Protection Rules (PPRs) which includes amendments

to the requirements for the carrying out of premium reviews for insurance contracts to ensure that policyholder rights are appropriately protected.

As the economic conditions in South Africa have developed, the need for life insurers to review premiums has become more pressing. In the recent past, the industry has seen several insurers carrying out premium reviews.

Philosophical framework

Life insurers find themselves needing to review premiums in a complex and competitive environment. Premium reviews raise many questions around which components of the premium can be reviewed and the extent to which they can be reviewed. A well-documented and clearly defined set of Principles and Practices for Premium Reviews (PPPR) will help to ensure that fair and efficient premium reviews are carried out in the future.

A valuable by-product of the PPPR is that it enables the insurer to capture the underlying philosophy of the product design, which could be lost when managing staff change, and where new staff members have different philosophical views. A useful consequence of having a clearly articulated philosophy is that policyholder expectations can be managed appropriately since there is a documented view of how the insurer intended to adjust the originally priced premiums.

While not necessarily explicitly determined in the pricing basis, or held in an administration system, the aggregate expected insurance premium can be broken down into the following components:

- a portion of the premium to cover risk benefits (current period and future periods);
- a portion to cover administration and sales expense;
- a portion to provide for a Cost of Risk Capital; and
- residual after-risk profit margin.

Where the incidence of costs and premiums are not aligned (e.g. in a level premium contract that covers a level sum assured whose expected risk benefit cost is expected to increase as the policyholder ages), there will be an element of pre-funding that needs to be considered in the premium review.

The first three components of the premium can be reviewed for changes in the expected experience of the insurer. The reasons for which they can be changed may be constrained by the policy wording; however, policy wording is often open-ended. This leaves the insurer with discretion in determining which risks and financial impacts are passed on to policyholders. A view that can be considered is that only risks that are either not foreseeable or not within the control of the insurer should be passed on to policyholders. This would, for example, prohibit the insurer from passing on losses that arise due to factors in the control of the insurer. Expense management would be one such factor.

The fourth premium component, residual profit, is not typically constrained by policy wording; however, the PPRs prevent insurers from using premium reviews to increase profit margins. Profit margins are not defined in the PPRs leaving the complexity of defining this to the discretion of the insurer. The PPRs also prevent insurers from using premium reviews to recoup past losses. This is considered reasonable since the insurer would have taken, and charged for, all the risk during this period and benefitted from any profit arising.

To ensure a fair outcome for policyholders, an insurer needs to consider principles and implement practices that balance the regulatory requirements, competitive pressures, customer experience outcomes and the preservation of future profit for the insurer.

The considerations for principles would include:

- the granularity of the premium review: this requires the balancing of fair outcomes with practical complexity;
- symmetry of premium reviews: policyholders may expect that being exposed to downside risk entitles them to the benefits of a positive expected experience.

Regulation and professional guidance

The FSCA has recently proposed changes to the PPRs. The changes proposed to the PPRs that affect premium reviews introduce a requirement for insurers to maintain a PPPR document and a requirement to notify the regulator where premium reviews are expected to be in excess of 20%. The FSCA has also recently communicated concern around the premium increases effected on funeral policies. These are both indications that the regulator's intention is to ensure that premium reviews are fair and that reviews carried out will be monitored.

In October 2021, the Actuarial Society of South Africa (ASSA) issued a version of an Advisory Practice Note (APN) on reviews of life insurance policies to its members for comment. This draft APN emphasises the need for actuaries to act responsibly and apply their minds to the discretion available to them. The APN encourages upfront consideration of the principles that will be applied at review stage and there is a strong focus on communication and policyholder expectation management.

Potential blind spots

Premium reviews give rise to many issues that are not immediately obvious. Determining and maintaining a record of an asset share for pure risk policies is one such issue.

Where policies have a premium pattern that pre-funds the cost of insurance later in the policy's life, the review should consider the value of the pre-funding that has accrued to the policyholder at the review date. This quantum of pre-funding is often referred to as the asset share of the policy. The basis used to determine the asset share would imply what is guaranteed to the policyholder during the guarantee period. Asset shares are typically retrospectively calculated and consider actual experience. Basing an asset share for premium review purposes on actual experience would mean that the policyholder shares in the experience during the guarantee period and this may not be the intention of the insurer. It is also not typical for insurers to have tracked asset shares for pure risk policies and if this has not been done, pragmatic estimations would be needed.

Where to from here?

Clearly articulating the premium review intention in a contract, managing policyholder expectations through the policy lifetime, setting up systems to administer policies that will be reviewed and actually carrying out a premium review creates a complex and comprehensive actuarial control cycle. The issues faced during a premium review require actuaries and other professionals involved to exercise judgement and execute tasks professionally and ethically. Tasks of this magnitude stand the best chance of being executed successfully if there is adequate planning and forethought. A PPPR provides a valuable tool to enable the insurer to do this efficiently. Apart from the value added by practices and principles that will be embedded in the business, the process of developing the PPPR provides the insurer with a unique opportunity to assess the products that it is selling, their implications and the needs that they are meeting.

While it is important to have a PPPR to assist with planning and forethought, it is important to ensure that it is complete. This begs the question: Have you considered all the factors?

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