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# Funeral Insurance

***Issue***

* Funeral insurers are not required to hold an **Australian Financial Services (AFS) License**, as these licenses require that sales staff is trained in giving general financial advice in an appropriate manner that is fair and ethical.
* **No underwriting**: The way the funeral insurance industry works is there are very few health checks and things, so the **premiums are quite high** and they continue to rise
* Funeral insurers typically targeted the same **low-income demographic** as controversial “rent-to-buy” schemes.
* **Marketing Target**: There are issues around the way those products are marketed and sold, particularly when we know a lot of consumers signing up to funeral insurance are vulnerable. They can’t come up with $6000 or $7000 at the drop of a hat for a funeral.
* **High lapse**: In 2014, 16.5 per cent of total active policies. Nearly two thirds of cancellations were initiated by consumers, with the main reason being cost. About 55 per cent of cancellations occurred during the first year of the policy, nearly two thirds of active policies had been held for less than three years, only 17.5 per cent had been held for more than five years, and just 4.7 per cent for longer than eight years.
* The high rate of cancellations points to problems not only with cost, **but the design, marketing and sales of funeral insurance**. It appears that **many consumers do not understand important features** of the product until after they have signed up
* The funeral insurance industry appears to **be enabled to exploit individuals because ASIC does not have a product-intervention power**. The steep premium increases over the life of the product appear to almost be designed to become so unaffordable that the consumer is encouraged to cancel the policy before a claim is ever made, thus making this industry very unethical and lucrative. **The least educated and most vulnerable are the ones being targeted.**

***Action***

* **Regulator** - Under the Financial Services Council’s revised Code of Practice which came into effect on July 1, insurers pledge to provide customers with a “key facts sheet” that explains “whether the premium structure is level or stepped and an illustration of the impact of this structure on your future payments”, and “whether the total amount of premiums payable under the policy has the potential to exceed the benefit amount”.**But the policy only relates to disclosure, and not the actual design of the products.**
* The Turnbull government is pushing ahead with **new laws giving ASIC “product intervention powers”**, which would allow it to temporarily ban financial products that are likely to lead to poor consumer outcomes.
  + “ASIC would be able to intervene when they see products being targeted at particular groups of people, or not taking into account the needs of consumers.”
* The corporate watchdog ASIC is urging for **funeral insurance to be re-classified as a “financial product”** under the Corporations Act. These legislative changes would mean that funeral insurers would require an Australian financial services license.
* **Alternatives**
  + Super and other ways to pay for funerals: This is payable to your dependants or estate. Any life insurance held with superannuation is also payable at this time.
  + **Funeral bonds** are an investment product that can help you save for funeral expenses. Funds can only be withdrawn after your death to pay for your funeral

Cons: 1. You only get what you've paid for

2. Investment returns on your bond may not keep up with inflation

* + **Pre-paid funerals**: You can pay in advance for your funeral, which fixes the cost in today’s dollars.
  + **Savings accounts and term deposits**: These products can help you keep money aside to pay for your funeral.
  + Money invested in burial plots, pre-paid funeral plans or funeral bonds (up to the Funeral Bond Allowable Limit) **is not subject to the asset or income test for the Age Pension**.
* **Changes to Product design**
* Changes addressing “many people cancel their policy in the first few years, losing the benefit of premiums already paid”:

1. Allow for a grace period, during which the policy is still in force and it can be reinstated by the policyholder.
2. Introduce a cooling-off period term. For example, policyholders may cancel their policies and get a refund of the premium they have paid without any fees being charged within 60 days since the commencement of the policy.
3. For those policies which lapse after a certain period, they can be converted to “paid up insurance” where the benefit will be a percentage of the sum insured and no further premiums are required

* Changes addressing “funeral insurance premiums tend to rise steeply”:

1. Develop level premium product: However, the fixed premium may be much higher than the stepped premium at the start of the policy.
2. Set a cap for the amount of stepped premiums. This reduces the premiums especially for those have been paying stepped premiums for a long time.

* Changes addressing “the possibility that the total premiums payable under a policy could exceed the benefit amount”:

1. Cap the total premium paid (without the accumulation of interest) by the policyholders at the amount of the sum insured.

Stopping premiums at advanced age

1. Increase the sum-insured automatically by the amount the premium exceeding the benefit. It means the funeral insurance has been converted to a funeral bond once the premiums exceed the benefit amount.

Provide benefits equal to premiums paid after this exceeds the benefit (noting the **maximum sum assured for a funeral product is $15,000** per the Life Act);

Change to a savings plan rather than a risk product (e.g. Friendly society benefit fund (which may have tax benefits), pre-paid funeral fund (tax exempt earnings), insurance savings product on IA or UL basis)

1. Different premium series depending on age at entry as well as current age
2. Premiums for each life calculated separately and expense allocated across policy
3. Develop non-par WOL policy with 20-year premium term (if SA less than$15,000 then no surrender value required)

# Impacts of LIF on advisers, insurers and customers – Commissions (see 2018 S1 Q3)

# Direct Insurance

***Issue***

* The biggest issue **is the remuneration structure in place that is solely based on volume of sales**. Should focus on rewarding sales force for retaining in force policies rather than purely on the selling of new business

***Action***

* Reducing its sales initiatives in direct channels such as outbound calls which do not give prospective customers the chance to fully understand their situation or the products being sold to them
* Encourage and offer prospective clients the opportunity for a face to face consultation to discuss their personal circumstances and provide product advice on that basis (a flat fee may be charged to the client which will need to be disclosed)
* Alternatively, develop a standard framework /script where outbound callers must disclose, in layman’s terms, any potential exclusions or situations where the prospective customer may be denied a claim
* Conduct internal and external audits
* The terms and conditions, exclusions should be clearly communicated to clients. For example if only accidental death policies were offered as a low cost alternative to life insurance, the exclusion of payment on death by natural causes must be communicated well.
* Increased regulatory involvement in the sales process is vital. One idea for this could be for ASIC to conduct periodic and random reviews into a company's sales processes which would include reviewing customer phone calls to ensure that ethical sales practices are being followed.

# Why bundled products (WL and endowments) became less popular in Australia from the late 1980s?

* Consumers gained greater awareness of investment opportunities, and unit trusts and share markets were becoming more accessible to the everyday investment
* Many consumers found traditional products very complex and sought greater transparency, particularly with how crediting /bonus rates are smoothed, and the concept of reversionary v terminal bonuses
* There were opportunities to obtain greater investment returns in the market than the prevailing crediting rates at the time
* The introduction of Superannuation Guarantee in 1992 contributed to the growing demand for unbundled savings products
* Australians may now choose to purchase life insurance as part of their superannuation, and see that as a way of obtaining both risk protection and investment savings instead.

# Profit Margin

Profit Margin = PV Transfers / PV of Premium

# Underwriting (Also see 2006 S2 Q2)

**Financial underwriting:** to make sure that the cover amount which you apply for is appropriate for your financial situation, do not over insure yourself, and keeps premiums down

*Techniques:*

* **Reason behind cover** - Identifying the reason for the cover requested and making sure the motivation behind this is reasonable.
* **Sum-insured reasonable** – Checking that the sum insured is reasonable for the purpose of the insurance. For example, a $20m sum insured would not be reasonable to cover a $500,000 debt.
* **Moral hazard** - Checking the asset and liability situation of the insured to ensure that there is no indication of apparent motivation for anti-selection and/or over-insurance (i.e. “moral hazard”).
* **Affordability** - Checking the earnings of the life insured to ensure that the cover is reasonable and able to be afforded. Evidence of income may be requested by the life insured providing the company with copies of recent tax returns, reducing the risk of overstatement for insurance purposes.
* **Debts** - Obtaining details of the debt to be covered if this is the reason for the insurance; consider amount, duration, etc.
* **Other life insurances already in place** - Checking for the existence of other current life insurance policies, which would reduce the need for protection to the extent that they provide ongoing cover.

*Risks:*

* moral risk (e.g. fraud, suicide, lack of insurable interest, etc.).
* **Anti-selection** in particular may be more of an issue when there is a larger benefit payable for a smaller premium outlay. “Lack of need for cover” may indicate higher risk of anti-selection.
* Larger sums insured will require higher levels of reinsurance

**Medical / Non-Financial underwriting:** the process of assessing your medical history.

*Techniques:*

* **Setting sales requirements/goals/restrictions** that the advisers are to follow when selecting clients for the product, as a means of managing “**target market**” as the first aspect of the selection process.
* Reducing the non-medical limits to **increase the medical information required**, and/or as a deterrent to anti-selecting clients.
* **Doctor’s advice** - Obtaining the advice of a qualified doctor for difficult or unusual cases.
* **Restricting the maximum sum insured** available on the product, or at least on the TPD rider.
* **Monitor -** Closely monitoring each of mortality and morbidity experience.
* **Exclusion -** Adding a suicide clause and the restriction of payment of benefits in the first year policy year.

*Risks:*

* lack of relevant underwriting experience / expertise
* anti-selection (for rider)
* new market: concerns that the company has so far not confronted (or has very limited experience), e.g. AIDS underwriting.

# Reinsurance

**The reasons for life insurers to use the services of a reinsurance company include:**

* Solvency: Protecting fund solvency by limiting amounts at risk on any one life insured;
* Fluctuation: Reducing range of fluctuation in profit due to size of amounts at risk;
* NB Strain: Reducing amounts of new business strain as well as limiting potential amounts of loss on early lapses;
* Mis-pricing: Protecting fund surplus from exposure to mis-pricing risk on new types of contract where claims expectation is more uncertain;
* Expertise: Obtaining access to ancillary services, such as advice on underwriting or claims management, intelligence on local and/or overseas markets and developments, and assistance with developing or introducing new types of contract.
* Larger SI: Allows life insurers to accept larger cases that they otherwise may not take.
* For **Direct Marketed** business, reinsurers may provide the direct office with marketing and up front financing costs for the campaigns.

**The products and services that reinsurers offer to meet those needs include:**

* **Products:**
* **Proportional reinsurance**, via facultative or treaty arrangements;
* **Non-proportional reinsurance**, for catastrophe or stop loss covers;
* **Financial reinsurance** (not a necessary part of the model answer, but can be mentioned)
* **Services:**
* **Assistance with meeting expenses** – this is generally factored into the terms of reinsurance and incorporated into the determination of any first year/selection discount and/or any commission terms offered;
* **Technical advice and assistance** with underwriting and claims support, e.g. by providing procedure manuals and/or training, conducting reviews of specific large risks at acceptance and/or claims stage; and
* **Access to expertise**, up-to-date research and developments, and support with aspects of business operations. The partnership of a reinsurance provider may assist with the wider experience and technology that a reinsurer has access to, including assistance with developing or introducing new types of contract.

# Bad claim experience

* First thing I would do is to try and understand what is the **root cause** of the trend.
* Discuss with the underwriting, claims management and pricing functions to discuss the possible causes contributing to this trend.
* Investigate data in different splits (age, sex, occupation, smoker status, employer (group), size of claim, distribution channels).
* Benchmark against other companies, industry experience and reinsurer's data to understand if the cause of bad experience is internal or industry wide.
* See if there are any changes in diagnostic methods (morbidity products), definitions in the PDS may need to be reworded.

# DI bad experience – exacerbated by Mental illness (psychiatrist)

Better management can also be done to close the claim. This can include assisting the claimant with rehabilitation programs, or agreeing to pay an accelerated lump sum if they return to work within several months.

***Difficulties for assessing mental health claims:***

* Unlike physical illness, there is no medical tests can be performed to prove a **diagnosis**. The diagnosis is made based on the customers’ descriptions of symptoms and the clinicians’ / psychiatrists’ observations on patients’ response and behaviour during the interaction. Different clinicians are likely to have different conclusions on specific cases;
* It is **hard to determine if the insured has pre-existing conditions**. The patient may not disclose the full information during underwriting or the patient is not aware of the necessity of telling insurers the previous visits to psychologists;
* Extra cares need to be taken when assessing the claims as patients suffering mental health issues are sometimes sensitive, and extra investigations and assessments may be questioned by the society and lead to life insurance’s reputational damage especially when **media** is involved;
* The insurance companies are suffering big losses on mental health claims due to the increasing claims as well as the **long-term nature of the claim**. This makes insurers pay additional attention to mental health claims in the underwriting and claim process.
* **Lack of mental illness data** as mental illnesses are not understood well. However, you cannot simply add an exclusion/loading without proving that there was an attempted to collect appropriate actuarial data, otherwise that is viewed as **discrimination**.
* There are no reliable biomedical markers to determine the existence and severity of mental health conditions, making the claims process very **subjective**
* Compared to other illnesses, there **is heavy reliance on self reporting** by the individual on the severity of their illness so there is a potential risk of fraud
* Severity and prospects of returning to work are hard to understand and measure

***Guidance on underwriting and claim process:***

* Insurance companies should **set clear definitions of mental health** issues, and clearly document the cases where a claim may be declined. Insurers need to ensure the customers are fully aware of the terms and conditions and the eligibility of claims is well understood;
* Insurance companies can improve their underwriting processes by **adding more mental health related questions such as if the person ever saw a psychologist** and if so what’s the reason, if there is any family medical history etc.
* Underwriters can actively communicate with customers with higher risks of mental illness issues (especially with stressful occupations) **in the early stage**, and arrange visits to the customers and interact with customers family or friends to better understand the situation;
* Insurance companies can **apply some loadings** to customers proved to be high risks or have some exclusions such as no claims will be paid during the first year;
* **Early intervention and contact** with claimants is paramount in all claims management, especially in mental health claims.
* Claim management can fix some of the problems when underwriting didn’t identify the additional risks, but claim criterion need to be clear and consistent among different claim assessors;
* It may be helpful to have mental health claim experience data and a team to do the analysis, so the company can understand the incidence and duration of the claim for different policy classes and different claim assessors.
* **Early communication with the claimant**, setting up effective communication channels early on in the piece with the claimant’s medical professionals, along with thorough ongoing monitoring.

***Regulators and companies’ actions to mitigate the risk of breaching the standards:***

* It is good to have a platform for everyone in the market to report potential breaching actions such as Royal Commission;
* Regulators can collect claim information on mental health issues and analyse the claim experience for different companies. Regulator can identify insurance companies with high decline rate for mental health claims and investigate;
* Insurers need to fully understand the regulations and especially claim assessors need to study the law. It needs to be clear that the reputational damage caused by inappropriate actions will cause a much severe impact;
* Insurance companies can set their key principles of assessing mental health claims and give penalties to assessors who didn’t follow the principles.
* Life companies **need to develop specialised processes for these claims, hire experienced professionals** who have a lot of mental health knowledge to devise the best claims process for policyholders. Better transparency to regulators will help detect any problems with how these claimants are treated, allowing early intervention and improvements to be made. A platform for the market to report potential breaching actions is a great idea, and I think currently, claims can be disputed via am ombudsman for claimants who are dissatisfied with their outcomes.

***Excluding mental illness:***

***Cons/risks***

* Reputation risk - this is a big step for any insurer to make and will have a domino effect on sales.
* Sales – for individual business, agents may be less reluctant to recommend a product with mental illness exclusion to their agents. This would lead to lower sales and hamper profitability. For group business, this will depend on the trustee. Group insurance is one of the product offerings super funds can offer. Including such an exclusion could reduce their rating against other super funds

***Pros***

* Claims cost –  reduce significantly. However, room for insurer’s to develop other or enhance their product offering such as enhanced rehabilitation services, home visits from health care professionals with the cost covered by the insurer, etc.
* Profitability – the cost of enhancing rehab services or providing other services may not necessarily be more effective than excluding mental illnesses.
* Underwriting – exclusions for mental illnesses may reduce the strain on underwriting or the time required for underwriters to ensure that the policyholder does not have mental illnesses. This could potentially enhance efficiency and reduce expenses.
* Reinsurance – exclusions for mental illness could possibly reduce the cost of reinsurance given that claims may reduce in incidence and length
* Capital – lower claim costs may reduce the capital required. However, the effect on capital really depends on the insurer’s approach to revamping their product in regards to the mental illness claims.

# Fee-for-Service [Also see in 2015 S1 Q3 (c)]

* ***Impact***

**1. Possible decrease in sales of life insurance**

* Life insurance is sold not bought. Commissions drive the sales of financial products allowing life insurers to maintain market share and meet sales targets.
* Commission payments consist of a large portion of adviser remuneration. The complete removal of commission payments will reduce the advisers' annual income (if they cannot replace it with enough fee-for-advice clients), resulting in some advisers exiting from the profession. A lower number of advisers distributing the product can result in lower sales volume.

**2. Lower number of individuals seeking financial advice**

* Commissions are packaged into the life insurance product. An out of pocket cost may discourage individuals from accessing financial advice.
* Fee-for-service advice may discourage ongoing advice due to the cost with individuals instead only opting for one-off pieces of advice
* The initial meeting with the adviser requires the most effort and therefore the highest cost. This may pose a high barrier to accessing financial advice for many.
* With less people seeking financial advice, this will further reduction in the sales of life insurance product, an important channel to distributing life insurance.

3. Greater incentive for insurer to create products that allow maximum flexibility to tailor to customer meets. e.g. life-stage cover, indexed cover and etc.

4**. Possibly lower lapse rate** as advisors now have not much incentive to churn customers

5. **Strong focus on customer service**, loyalty program and claims management to retain customers

# Low interest / inflation [Also see in 2017 S2 Q2 (b)]

***Impact***

* **Hurdle rate:** If the shareholders could not get the expected returns, they may look for other opportunities to gain the earnings instead of investing in life industry.
* **Lapse:**
* **New business:**

***Issue***

* **Overall underinsurance**, especially for people under age 25

# Life through Super

***Why get life insurance through your super? (Pros)***

* It's often cheaper because super funds purchase insurance policies in bulk
* You can get the cover you need for you and your family, even if money is tight
* It's easy to manage because premiums are automatically deducted
* Some funds automatically accept you for cover without requiring a health check
* You can usually choose the amount you want to be covered for

***However, you also need to be aware that (Cons):***

* **Limited cover** - The types of insurance, and level of cover, may be limited. Cover is not tailored to your circumstances and exclusions may apply. If you want more insurance, you can apply to increase your cover and a medical may be required. If you want a different type of cover, you may need to get this outside super. Check the PDS carefully.
* **Not portable** - If you change super funds; have an extended absence from your employer; your employer's super contributions stop or your account balance drops below a certain amount, your cover may cease and you could end up with no insurance. Always read the information sent to you by your super fund as they may be alerting you to changes to your cover.
* **Slower to pay** - There can be delays in receiving benefits as the insurer pays the benefit to the fund first, who then distributes it to you or your beneficiaries.
* **Who gets paid** - If you do not make a [binding beneficiary nomination](https://www.moneysmart.gov.au/glossary/b/binding-death-benefit-nomination), or your fund does not offer binding nominations, the super trustee will decide who gets your benefits when you die, although your nomination will be taken into consideration.
* **Ends at around age 65** - Life insurance coverage through super ends when you reach a certain age (usually 65 or 70). Policies outside of super may cover you for longer.
* **Reduces super balance** - The cost of insurance premiums are deducted from your super balance, reducing the money available for your retirement.
* **Multiple super accounts** - If you have more than one super account, you may be paying premiums on multiple insurance policies. This could reduce your retirement money, especially where you can only claim on one policy. Find out if you are able to claim on more than one policy, and consider which policy you might cancel. Even if you can claim on more than one policy, consider whether you need more than one policy or whether you can get enough insurance through one fund.
* **Premiums may increase when you change jobs** - Even if you stay with the same super fund when you leave your employer, you may be moved to the personal division of that fund which could increase your premiums for the same cover. Some funds default members as smokers or blue-collar workers when they move between divisions of funds, which could significantly increase premiums, and further reduce your retirement money. Check your annual statement to see how you have been classified, and contact your fund if you think the incorrect classification has been given to you.

# Guarantee product issue [Also see in 2006 S2 Q4]

# Challenger Annuity: new annuity relationship with Mitsui Sumitomo Primary Life Insurance Company

***Why are annuities popular in Japan but not so much in the Australian market (only two providers of annuities: Challenger Australia and CommInsure)?***

* **Ageing society in Asian countries**: Japan famously has an "inverse triangle" age distribution, that is, it has an ageing society with increasingly higher proportion of elderly people. This is due to Japan's decreasing birth rate since the 80s and increasing longevity with better medical and living standards.
* **Culture:** The Japanese has a culture of long-term thinking, so they are more likely to pay attention to their retirement income to cover their increasing longevity risk.
* **Awareness**: Their social culture also make them feel more obliged to be less dependent on their children in later years, hence the awareness and need of products like annuities is relatively better compared to the Australian retirees.
* **The low interest rate experienced in Japan** in recent years is probably another factor that has driven the success of the business. The implied investment return from the annuity product would appeal to the potential customers comparing with return from other investment products.
* **Centrelink**: annuities lost their exemption from the Centrelink assets test between 2004 and 2007.

***Would we expect this to change with the introduction of compulsory CIPR? If so, how?***

I would expect more annuity or similar products to become popular in the Australian market.

* **Awareness**: This is because the CIPR will be compulsory, which will bring up retirees' awareness, to say the very least, on their retirement income. This may effectively address the historical issue of Australian retirees having lack of appreciation of longevity and long-term investment risk.
* Based on the current agenda, the government only **requires the minimum features** for super funds to pre-select products. This will likely to inspire more life companies like Challenger to come up with **better product design** and features to compete to be better alternatives to the default option.
* **Legislative changes**: It is also worth noting that government decisions and the relevant legislative changes can significantly influence this space. One possibility is that the pre-select annuities may be heavily subsided by the government, making it too competitive for other insurers to jump in the market; Or the government may encourage annuity product development by giving concessions to all retirement income products that will greatly benefit life insurance innovations in this space.
* **Tax incentives**: tax exemption on earnings from deferred annuities and group self annuitisation from 1 July 2017 onwards.

***Reasons that demand for annuities in Australia falls***

* Age pension, which provides some mitigation against longevity, investment, inflation and counter-party risks
* **Superannuation** system, which predominantly focuses on the attainment of savings rather than the provision of a retirement income
* A lack of incentive for retirees to annuitize: e.g. pay off immediate debt

***Annuity Pricing Difficulties***

* Small size of the Australian market
* Lack of competition 🡺 monopolistic-type behavior
* Adverse selection 🡺 higher premium 🡺 even more adverse selection
* Limited availability of inflation-linked and long-term government bonds to match the long-term nature of annuity liabilities

***Marketing strategy for annuity***

* Get more money back than YRT products
* Increase remuneration system of advisers

# Comprehensive Income Products for Retirement (CIPR)

***Background***

The Government agreed to support the development of more efficient retirement income products and to facilitate trustees offering these products to members, in response to the Financial System Inquiry.

It is intended to increase individuals' standard of living in retirement, increase the range of retirement income products available, and empower trustees to provide members with an easier transition into retirement.

Ageing population making a Government funded pension scheme increasingly unaffordable.

**Age Pension** falls short of what is perceived as a comfortable income according to various measures.

**Goal**: Reduce fiscal burden from age pension as well as ensure Australian retirees have sufficient retirement income.

**Standard features**: why government wants some compulsory wording? To make people have the basic cover as sometimes people may buy something which is not what they thought they did. Comprehensive Income Products for Retirement

***Issue***

Low take-up rates: (TAX benefit, education and awareness will be required)

* Poor: Members are from lower social-economic backgrounds. They may prefer a lump sum at retirement to pay off debt as opposed to putting it in an income stream product (e.g. an account based pension).
* Rich: those with high balances (say $1m+) may not opt-in to a CIPR either because they may consider themselves to be 'self-sufficient' and also want to have more control over how their money is invested and managed.
* Tax: If lump sum payout is subject to taxation but retirement income products are not, perhaps CIPRs would be more popular.
* Centrelink assets test

Mispricing:

# Opt-in for super Group (Federal budget change)

**Why?** The government will force Australia’s superannuation funds to remove default life insurance for **new** superannuation fund members under 25, those with balances under $6000, and inactive members, as part of a move designed to bolster the retirement accounts of young savers and those on low income. Eroding the retirement savings of younger Australians **due to the high rates being charged for life insurance cover.**

**Ultimate Goal 🡺** help retirees avoid relying on the age pension.

***Impact***

* **Premium: The policyholders who opt in before age 25** can have a tailored premium based on the risk profile for this age group which I envisage to be between 18-25. This premium is likely to be more expensive than your standard rates to take into account of the fact that those who opt in are likely to be of poorer health.
  + When one group is **cross** **subsidising** the other group, prices need to be reset to reflect the fair price, and to achieve the same profit margin for the insurance business
  + The level of impacts depends on member demographics, fund size and premium rate structure. For example, if the fund comprises many casual members with small account and younger members, they will be more greatly impacted.
  + Further erosion of members’ benefits through increased premiums
* **Underinsured:** Young individuals in high risk industries who are not covered if they do not opt-in.
* Removes safety net for young people with dependents who are unprepared for a financial crisis that stems from mortality or morbidity related event.
* **Loss of cover**: The old 'opt-out' model ensures insurance cover is available to as many people as possible, including those who would not otherwise be able to obtain insurance due to their health history, lifestyle or employment status
* **Expenses**: increase in fixed per unit costs (due to smaller pool of lives). ==> higher price.
* It will bring up the premium rates as there will be **less cross subsidy**.
* **Underwriting**: have more exclusions or lower sum insured? Also, a full underwriting may not be reasonable to customers who have paid full premiums for the past several years, and expecting themselves to continue with the cover without any underwriting.
* **Administration cost** is likely to increase as a result, and this increase in cost is likely to be passed on to members / more staff training required
* **Reinsurers** need to adjust their assumptions as well, thus insurers need to accommodate with reinsurance changes and as a result premium is likely to be changed
* Insurers may need to **hold more capital** due to the uncertainty of the actual impact of federal budget in the long term, which results in higher cost of capital ==> higher price.

***Issue***

* **Overall underinsurance**, especially for people under age 25
* **Mispricing risk in the tight time frame**: There is a risk that insurers will not get the pricing correct due to the tight time frame which is a risk that has been brought up by CEOs of insurers that has been acknowledged but largely ignored by the government.
* **Under 25 year old’s who need cover**, particularly those with young families in a heavy manual occupation, will find it difficult or too expensive to find cover. I think that some industry funds, particularly with a large number of blue collar workers, have under 25 year olds that need and benefit from the cover and the legislation does not address this.
* **Strong anti-selection for the opt-in policies**: with the opt-in option high level of anti-selection will occur. ==> more claims, higher premium,
* **Administration**: increase the complexity of insurance administration and the risk of errors occurring.
* **Low customer engagement**: Many members will only realize their cover has been switched off in times of need. This may have adverse **reputational** impact on both the superannuation and insurance industry.
* **Operational risk** in the short timeframe: due to required administration system upgrades, training of staff, communication with members and changes to current group insurance arrangements.

***Action/Mitigation***

* **Revise best estimate assumptions** (such as business mix, expenses assumption, mortality / morbidity basis) and re-project the percentage impacts in business volume on each group scheme and portfolio
* There is an increased level of uncertainty in pricing due to the change in operating environment for insurers, **additional risk margin** mightbe required to reflect the associated risks taken. Actual experience will take years to emerge.
* Estimate the **take up rate** **assumption** (i.e. how many people will opt in).
* Sensitivity test
* Implement a communication strategy to **educate members about the importance of insurance** and the risks of being underinsured
* **Reprice:** Move away from unit rated premiums and move to age rated premiums that are more reflective or risks at each age and **reduce cross subsidisation**.
* **Underwriting** for those who opt-in. Eg, Insurers can provide a 90 day window for new members who have under $6,000 balances to opt-in through a short questionnaire. Members who want to opt-in after this window period will need to go through full underwriting.
* **Alter conditions of the premium rate guarantee**. Insurers can reserve the right to re-price during the rate guarantee if the membership and risk profile changes significantly due to the Federal Budget changes.
* **Notify** those whose account is below 6000 or not contribute for 13 months before ceasing their covers.
* **Operational**: Renegotiation of group insurance contracts, development of member communication plans and material upgrades to administration systems and/or processes.
* **Reduce AAL**
* **Reduce premium rate guarantee period:** from 3 years to 1-2 years.

***Regulator***

* Regulators can request the big group insurance business to have external consultants and ensure the prices will be reasonably set.
* Regulators can request all insurance companies with group business to do a set of experience studies and collect the analysis from the industry.

# Premium deduction error in Group scheme or unit-linked [Also see in 2006 S1 Q5 (c)]

1. Stop the transaction / suspending withdrawals
2. Identify of the policyholders affected and the magnitude of the issue
3. Channels of communication need to be established to inform policyholders that they have been overcharged
4. Work out the right premium and negotiate with the trustee to see whether any compensation is required.
5. Identify the **root cause** of the premium miscalculation.

**2006 S1 Q5 (c)**

early discussion with regulators – and reasons;

considering suspending withdrawals – with pros & cons;

reverting to date of first breach;

calculation of “correct” prices, based on asset mix differences;

“method” of determining correct prices/asset values;

recognising series of daily new prices required;

identifying categories of adversely treated clients;

unit trust requiring all clients affected to be rectified, whether advantaged or disadvantaged;

checking the tax status – ATO;

compensation – range of options;

communication to unit holders;

adjusting current unit price, asset allocation, and historical fund performance;

correcting distributions and associated tax statements or information relating to the distribution;

\*Do not worry too much the detail about unit pricing, just the principle.