

Critical Illness in the 21st Century

Critical Illness was the great success story of the 1990s, far outselling income protection policies. The offer of a lump sum benefit on diagnosis of a critical illness such as cancer or heart attack appeals strongly to consumers and advisors alike. But over the last year the market has undergone significant changes. While sales have continued to boom, the cost of cover has soared, with increases of up to 50 per cent not uncommon across the board. A number of providers have withdrawn from the guaranteed market, including a key player who attracted widespread publicity when it pulled out of the guaranteed critical illness market altogether, including all pipeline business. So, is critical illness a product of the past - or will it continue to be sold into the twenty-first century?

To answer this question, we must first consider the reasons behind the recent premium increases.

While mortality rates have generally been improving, morbidity trends have deteriorated. In essence, we are living longer - but not necessarily healthier - lives. Critical illness rates have been deteriorating at around 1 per cent per annum for males, and around 1.5 per cent for females. Improved diagnostic techniques mean diseases are now picked up earlier, enabling prompter treatment with better prospects of survival. This is obviously good news for the population at large, but raises serious issues for providers of critical illness cover.

The impact of the introduction of PSA screening for prostate cancer in the US illustrates this point. Graph 1 shows the fivefold increase in prostate cancer incidence rates recorded for males under age 65 when a national screening programme was introduced in the early 1990s. While a similar screening

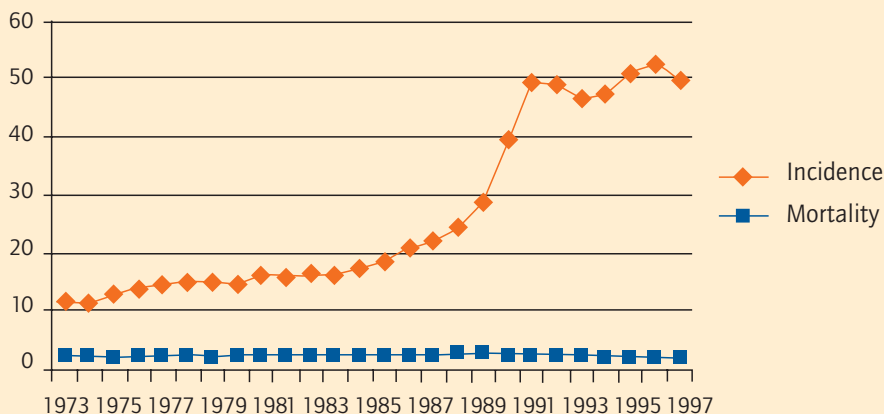
programme has yet to be introduced in the UK, the revised standard ABI definition for cancer has been amended to exclude low-grade prostate tumours. The revised heart attack definition, on the other hand, has been expanded to include troponin levels - reflecting a diagnostic technique now in common use.

It seems safe to assume that there will be many more advances in diagnostic techniques in the years ahead that will impact on critical illness claims experience. Tumour markers, in particular, have become more widely used in recent years as a clinical tool for diagnosing cancer. Studies are ongoing on a number of nuclear matrix proteins (NMPs) which could enable detection of cancer at a much earlier stage than previously possible. NMPs have already been identified for bladder, prostate, breast and cervical cancers. Future cancer claims could arise significantly earlier than is allowed for by current critical illness pricing. Some previously undetected cancers could also be picked up, increasing the overall number of claims.

The introduction of new diagnostic techniques will trigger sudden shocks in claims incidence rates - making it very difficult to predict future trends in incidence rates. Concerns over this issue have created

Continues over page.

Graph 1 Intensive prostate cancer
US age standardised rates per 100,000 at ages under 65



The truly enlightened reassurer

Critical Illness in the 21st Century continued

uncertainty over guaranteed rates, and hence big increases in the cost of guarantees over the last few months. Graph 2 illustrates the increasing differential between reviewable and guaranteed rates over the last six months. A year ago, there was only around 5 per cent price difference between guaranteed and reviewable rates. Today, one can expect to pay 25 per cent extra for the assurance of guaranteed rates over a 25-year term.

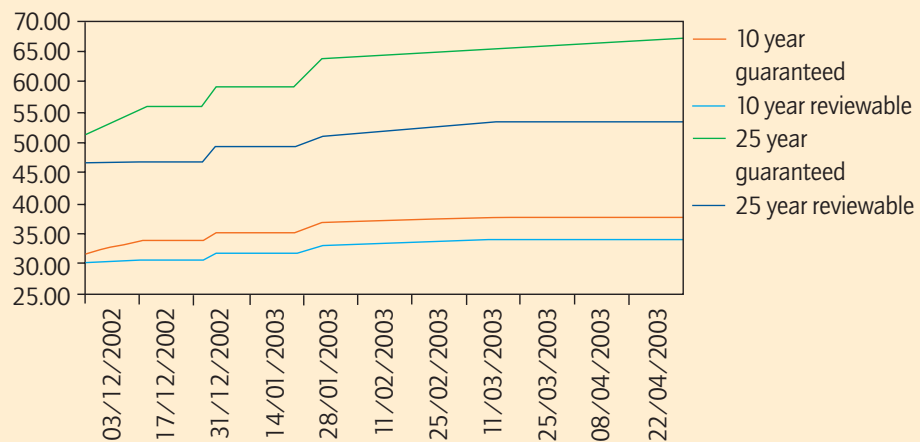
Reduced market capacity and the increasing cost of guarantees have boosted sales of reviewable critical illness products. These provide guaranteed insurability throughout term on conditions defined at outset - but with variable premium rates. Rates are typically reviewable every five years, but criteria for review vary enormously. Some products simply state that the premium may be reviewed, others that rates will be reviewed only if claims experience is worse than expected. This may refer to the current claims experience of the office, the industry as a whole, or to anticipated future experience. Consequently, it is very hard to make meaningful comparisons between these products. The cheapest product does not necessarily imply best value for money. A low premium may simply mean that rates are more likely to be increased at the policy review date. This creates a minefield for IFAs trying to offer best advice - perhaps explaining the reluctance of the IFA market to move away from guaranteed products.

Dictionary definitions:

Critical so seriously injured or ill as to be in danger of dying

Serious giving rise to fear or anxiety: a serious illness

Graph 2 Average CI premiums



Reviewable products resolve some of the problems associated with guaranteeing critical illness rates. However, have we moved away from the real aim of critical illness products: to provide benefits in case of life-threatening and lifestyle-altering events.

One potential alternative is renewable products which provide guaranteed renewability without further underwriting, but on terms and conditions current at the time of renewal. The product can therefore remain relevant throughout term, covering benefits for diseases that are life-threatening and lifestyle-altering at each point of renewal. Affordability can be maintained by excluding diseases whose impact on lifestyle has been significantly diminished by medical advances. While this represents a significant change from today's guaranteed critical illness products, the concept in itself is not unfamiliar. Critical illness is already sold in this way in Australia, while in the UK private medical insurance products are similarly renewable on an annual basis.

Another approach to providing relevant critical illness benefits is tiered benefits. Here the level of benefit payable depends on the severity of the condition at the point of claim. Interestingly, this approach is now

common in South Africa where the concept of critical illness was first developed. A product was launched into the UK market last year that takes account of impact on lifestyle and life expectancy, with the option of paying different levels of benefits on conditions variously classified as life threatening, disabling and traumatic. But the market has been slow to accept this approach - perhaps because of its perceived complexity, a wish to comply with the standard ABI definitions and the obligation to offer 'best advice'.

Much uncertainty continues to surround the future of critical illness products as we currently know them. The continuing availability of guaranteed rates will depend primarily on the availability of reinsurance capacity, already considerably limited. However, the need for a product paying benefits on diagnosis of critical conditions will certainly remain with us for the foreseeable future. The challenge for the life industry is to find ways of meeting this need in the face of all the uncertainties created by medical advances and a rapidly evolving market.

Caroline Feaver,
Marketing Actuary

Insurer-Reinsurer relations

"To provide financial solutions to our clients by building long-term profitable business relationships and developing lasting reinsurance methods"



The life insurance and reinsurance market is undergoing a period of rapid and far-reaching change. Insurer-reinsurer relationships have traditionally been typified by long-term partnerships in which mutual trust has played a key role. But with our industry subject to ever-increasing pressure from regulators, analysts, the media and the public at large, has the era of close collaborative relationships come to an end?

Few of us need reminding of the many challenges this industry currently faces. Growing consumer pressure, adverse economic conditions and an increasingly arduous regulatory burden are all changing the way we work. Regulation is perhaps the key driver of change. The FSA is imposing strict obligations and responsibilities on senior management.

This is particularly true in the area of risk management, where management is required to identify, measure, monitor and control the full range of risks to which businesses are subject. This is not merely an academic exercise. With the proposed changes to capital adequacy requirements, the effective management of these risks will directly impact on the level of capitalisation an office requires.

Coinciding with this growing regulatory requirement for capital adequacy, there has been a dramatic fall in equity values over the last few years, with lower returns expected in future. As a result, balance sheets across the industry as a whole are probably weaker than ever before.

Against this backdrop it is perhaps not surprising that traditional

reinsurance relationships are coming under review. There are important questions to be asked here. How can operational risk be quantified realistically in an environment where treaty wordings are at best vague, and in many cases treaties remain unsigned? Will it be possible in this new more tightly regulated climate to continue operating in the spirit of a treaty - or will we be forced to operate to the letter?



We also need to recognise a significant shift in the balance of risk between insurer and reinsurer. Traditionally reinsurance has been written on a surplus basis, with a high retention on the part of the ceding office. In recent years this situation has changed dramatically.

It is now more usual for reinsurance to be written on a quota share basis - with the majority of the risk reinsured. We should acknowledge going forward that insurers and reinsurers are subject to the same financial and regulatory pressures. It is essential that both parties should continue to be profitable, and this requires a greater understanding and control of the risks involved.

From a reinsurer's point of view there are probably three key questions to be asked in assessing the degree of risk involved in a reinsurance arrangement. Firstly, is it priced appropriately up front? Secondly, does it operate in accordance with the agreed terms? And thirdly, does the emerging experience conform to expectations?

In setting the initial price it is important for the reinsurer to understand fully the policy terms and conditions, sales methodology, intended underwriting and claims philosophies, and any existing or relevant experience. So we are always keen to work closely with clients to understand their requirements and develop new ideas.

Given that we are authorising clients to accept risks on our behalf, underwriting philosophy is always a key area. When establishing the terms of the treaty, it is important for us to understand the underlying processes and controls, the experience and the resources that the client will be bringing to bear. To help us achieve this we conduct an initial underwriting audit and discuss the results with the client.

Such audits are repeated periodically to the benefit of both parties and to ensure that the underlying principles and philosophy remain aligned. We also review all early claims to gain a greater insight into the underwriting and claims process. This also allows us to pick up on any common contentious issues which crop up in early claims.

We will then review the performance of each arrangement on an ongoing basis and arrange regular review meetings with clients. Receiving timely and accurate information from which the underlying experience can be monitored is essential to this process. The availability of

suitable data has sometimes emerged as an issue in the past, and we seek to avert this by bringing the respective administration areas into the discussions early on – usually before the treaty is signed.

At Hannover Life Re (UK) we are convinced that long-term relationships are essential for reinsurance business and that they provide lasting and tangible benefits for both parties. This view is encapsulated in our mission statement:

“To provide financial solutions to our clients by building long-term profitable business relationships and developing lasting reinsurance methods”

However, we all need to recognise that the world has moved on and the clock cannot be turned back. Many practices that have been deemed appropriate and acceptable in the past will not remain so in future. We must work together to redefine the insurer-reinsurer relationship to ensure that it remains fit for everyone’s purpose. Above all, we must remember that we are all in this together and continue sharing ideas and information to support our mutual profitability through this and other future phases in the market’s evolution.

Stuart Hill
General Manager-Marketing

Risk, Reassurance and Regulation

In June more than 75 delegates from the life and health assurance market attended our Risk, Reassurance and Regulation product development seminar in London.

The aim of the seminar was to provide an update on issues facing the industry and assess trends affecting future product development.

The programme included a talk from our guest speaker Veronica France who is an independent Business and Marketing Consultant and Non-executive Director of an IFA firm. Veronica provided an overview of regulation as it affects distribution for protection business and the potential effects on the distribution of protection business from the perspectives of IFAs, other intermediaries, providers and consumers.

In addition our own expert speakers covered a number of key drivers and issues for the insurance industry going forward – two of these talks are featured in this issue.

The feedback from the audience was that this year’s seminar was a very thought provoking and informative day.

If you are interested in finding out about future seminars please see our website www.hannoverlifere.co.uk or contact uk.marketing@hannover-re.com.



We hope you enjoy In Focus and we welcome your feedback, please forward any comments to Kirsteen Grant. If you wish to be added to our mailing list contact Kirsteen on 01344 846833 or email uk.marketing@hannover-re.com.

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