Evolving Strategies to Improve Inforce Post-Level Term Profitability

A popular topic at industry meetings is how companies can best manage the post-level term (PLT) for level premium term life. Many of us started this discussion in our own companies a few years ago as the first wave of 10-year level term life policies were about to enter the PLT.

In this article I provide background on the traditional approach to PLT and touch upon two alternatives that companies have implemented. I also examine the latest idea to improve short-term PLT profitability, building off of experience learned from earlier attempts.

Background
The traditional approach to PLT pricing involved collapsing risk classes into aggregates (male/female smoker/nonsmoker). The company “shocks” the premium rates with rate increases of up to 20 times (Figure 1). The expected result is the “shock lapse,” where virtually all policy owners lapse, either because they can obtain the same coverage at a better rate with a new policy or because the rate increases are too high for all but the most impaired risks to persist.

Fast forward to the 2010s: Life insurers struggle to generate new business as the effects of the financial crisis continue. Moreover, pricing and product actuaries estimate that a lower shock lapse may create additional profit in the first few years following the PLT. The Society of Actuaries publishes a report¹ that concludes that the size of the shock rate directly correlates to resulting mortality from the block.

We begin to change our mind about our PLT approach.

New Approaches to Managing Post-Level Term
Many companies are attempting to increase early PLT duration persistency. In an earlier Messenger article (“The EOLP Balancing Act,” December 2010), I examined a graded pricing approach to the shock. PLT rates increase at much smaller increments until a future anniversary (e.g., duration 15). Rates then jump at the end of this graded period (Figure 2).

Other companies have modified the rate increase based on the insured’s select risk class (Figure 3). Rates increase

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and move to a YRT schedule for all policy owners, but
the jump's size depends on the insured's select risk.
Preferred risks experience the lowest increases, with
rates converging gradually to an ultimate rate.

Each approach has advantages and disadvantages.
The traditional shock-rate approach punishes the best
risks, causing a higher and faster lapse rate. The graded
approach appears successful in retaining better risks,
which helps the block's mortality and profitability.
However, many of these structures still aggregate
risk classes, again penalizing the best risks. The select
underwriting approach seems the most equitable and
induces more of the worst risks to lapse (due to the
much higher increase). However, individuals' risk profiles
can change over time. All choices still contain significant
selection risk.

The Latest Concept – Simplified
A few companies are trying to manage selection risk
by offering a single guaranteed YRT rate schedule
similar to the shock rate, which serves as a maximum
rate increase. At a policy owner's PLT anniversary, the
insured may choose to answer a simplified underwriting
questionnaire. The carrier uses these answers to
determine the insured's PLT risk class. Those who decline
to reply jump to the guaranteed rate (Figure 4).

The simplified underwriting approach has a number
of advantages over the other options. First, it is less
arbitrary. Even with a simplified questionnaire, the
carrier can learn much about the insured's current
mortality profile. This is new territory for life insurers,
as companies usually underwrite only at the point of
original sale. However, the underwriting optionality and
the resulting rate schedule may appeal to customers
and regulators alike. And as with the risk-class option,
the PLT underwriting approach seems fairer to the
consumer. A better-than-average risk should not be
charged an aggregate rate if we can identify them
successfully.

Challenges Remain
Offering the insured the option to undergo simplified
Using a postcard with “YES/NO” questions and an authorization to examine pharmaceutical and driving histories may be the simplest solution. Recruiting agents to assist is unlikely, but call centers may be useful. Carriers with an automated simplified issue engine may be able to implement this option quickly. Current clients of SCOR’s Velogica® solution, for example, may find the algorithm’s use especially helpful in this regard.

Conclusion
Ten to 15 years ago, PLT term pricing was a distant and seemingly inconsequential issue. Today, as carriers seek profitability, the shock-rate approach appears more harmful than originally envisioned. Companies are searching for new PLT retention ideas.

SCOR maintains one of the largest mortality and lapse databases in the industry. As you consider your PLT strategy, we are happy to consult with you to help determine which approach may be most suitable for your company.  