The Messenger

Risk Management Newsletter

August 2014

By George Hrischenko, FSA, MAAA
Vice President, Marketing Actuary Leader

Evolving Strategies to Improve Inforce Post-Level Term Profitability

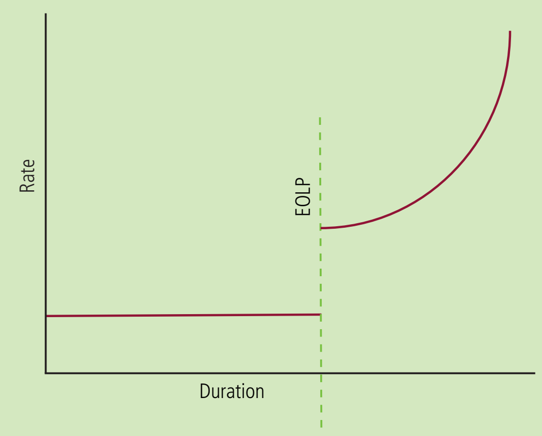
A popular topic at industry meetings is how companies can best manage the post-level term (PLT) for level premium term life. Many of us started this discussion in our own companies a few years ago as the first wave of 10-year level term life policies were about to enter the PLT.

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.

Figure 1 – The Traditional Shock Rate Approach



The traditional shock rate approach could see premium rates jump as high as 20 times the level premium (all figures illustrative).

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 report[1] 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

SCOR Global Life Americas

Charlotte
101 South Tryon Street
Suite 3200
Charlotte, NC 28280

Kansas City
11625 Rosewood Street
Suite 300
Leawood, KS 66211

Minneapolis
45 South Seventh Street
Suite 1850
Minneapolis, MN 55402

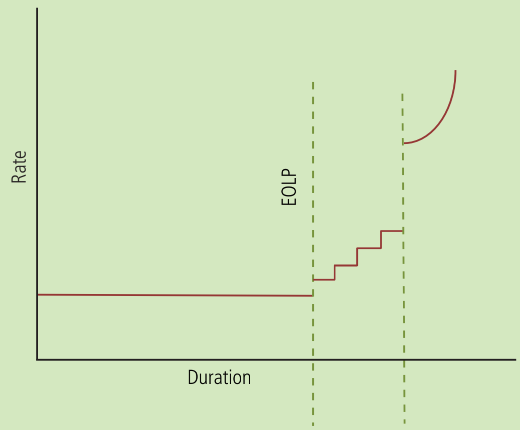
www.scor.com/SGLA

SCOR Global Life

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.

Figure 2 – PLT Graded Approach



Premium rates gradually increase PLT, jumping to a higher YRT in a later duration.

The Latest Concept – Simplified

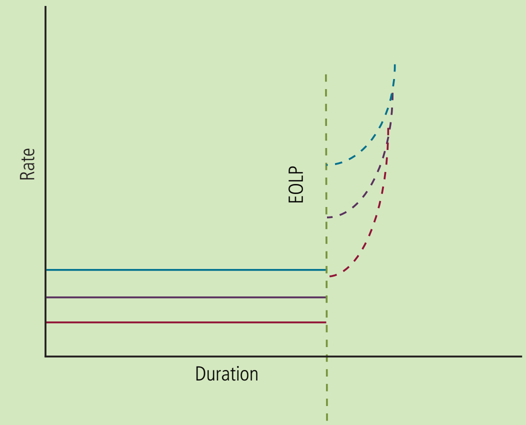
A few companies are trying to manage selection risk by offering a single guaranteed YRT rate schedule similar to the shock rate, which serves as a maximum rate increase. At a policy owner's PLT anniversary, the insured may choose to answer a simplified underwriting questionnaire. The carrier uses these 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

Figure 3 – Select Rating PLT Approach



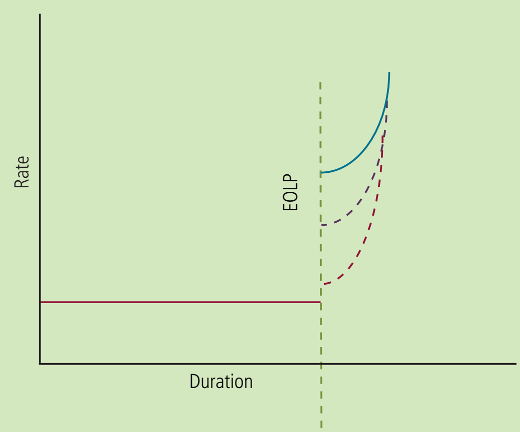
The PLT jump is based on the insured's original underwriting classification. The better the class, the lower the jump.

underwriting has some advantages, but the approach needs to address several challenges. Experience demonstrates that many preferred term policies stay inforce for a short time in the PLT because it takes policy owners a while to recognize the rate increase. Offering the simple questionnaire before the PLT anniversary may remind the policy owner of the premium jump and cause the preferred policy owner to lapse. Conversely, it may lead less healthy policy owners to take advantage of conversion provisions to lock in low rates.

Regulatory hurdles also may exist. Carriers are permitted to underwrite once. Despite the optionality in this approach, regulators may question the effect on risk transfer. If they approve the forms, regulators may restrict the approach to new business only.

Perhaps the greatest challenge lies in implementation. How will the insurer communicate this offer? What information will the insurer seek? How will the insurer ask the questions and collect the answers? What will the insurer do with incomplete questionnaires? How can the insurer encourage a high response rate and in the process increase credibility?

Figure 4 – Simplified Issue PLT Approach



The insured is given the option to undergo simplified underwriting, which may result in more favorable rates. Those who decline jump to the guaranteed rate.

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. ∞

[1] "Lapse and Mortality Experience of Post-Level Premium Period Term Plans." Society of Actuaries, 2010.