

Actuarial Association of Europe

Change in policyholder behavior

Living in a market consistent world

Presentation by Marcel Schep

Brussels, Thursday 21 April 2016 (12.00 – 12.40)

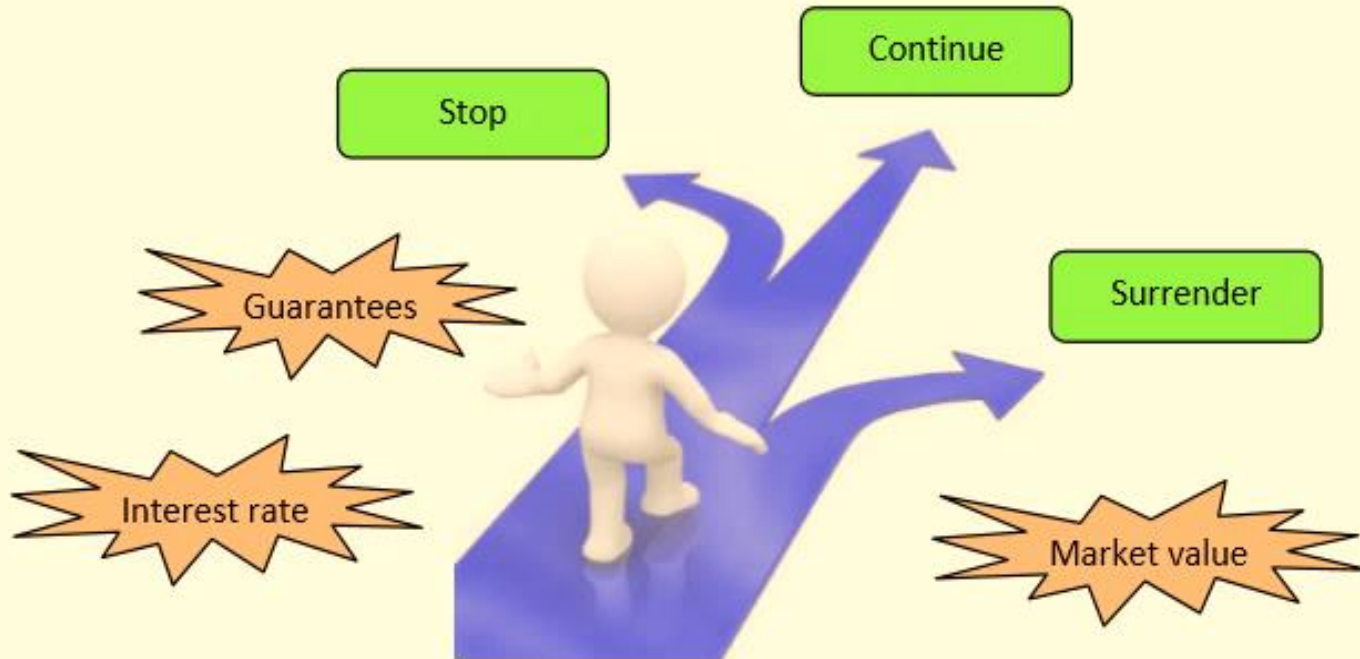
Change in policyholder behavior

- Introduction
- Living in a market consistent world
- Market consistent data
- Financial literacy and financial education
- Policyholders: awareness, understanding and acting
- Example for an endowment policy
- Market observations
- Drivers, implications and conclusions
- Questions

Introduction

- Marcel Schep
- Current position: financial risk management at ASR in the Netherlands
- Previous positions:
 - KPMG (risk & actuarial practice)
 - AON Hewitt (pensions & employee benefits)
 - MeesPierson bank
- Thesis study risk management for financial institutions
- Presentation on own behalf

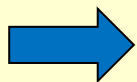
Living in a market consistent world (1)



Living in a market consistent world (2)

- Market consistent policyholders?
 - If an insurer operates in line with the market, will a policyholder do that as well?
 - How much informed is a policyholder about the conditions of an insurance contract?
 - What kind of information is available in the market to make an assessment?
 - What kind of information is needed to make such assessments?
 - What level of financial education does a policyholder have and need to do that?

- Research questions thesis:
 1. What potential effect(s) could the development of market consistent valuation have on the dynamics of individual life insurance policyholder behavior?
 2. Which drivers and conditions for a corresponding change of that behavior could be identified?



How may the development towards a market consistent driven business impact individual policyholder behavior and how would that look like?

Living in a market consistent world (3)

In order to enable policyholders to act in line with market consistent values and data, two important conditions will need to be met:

- 1. The availability of market consistent values and data**
- 2. A sufficient level of financial literacy**

Market consistent values and data (1)

- First condition for living in a market consistent world is the availability of market consistent values and data
- Insurers are implementing organizational business models based on market consistent valuation principles
- The development towards market consistent valuation is reflected in recent and upcoming changes, mainly as part of the implementation of Solvency II and, especially, IFRS4 phase 2
- Amongst other items, new regulation is expected to lead to:
 - A significant increase in disclosure requirements
 - Disclosures on a more detailed level
 - Therefore, additional public available information
 - Pricing and valuation of financial products in line with market parameters

Market consistent values and data (2)

- The development with respect to market consistency is expected to:
 - Result in more transparency
 - More and qualitative better information about the market value of insurance portfolios and financial products
 - More focus on market consistent pricing
 - Changes to new (and existing) product portfolios
- The availability of market consistent values and data about insurance policies is an essential condition for policyholders to benefit from potential opportunities

Financial literacy and financial education (1)

- Second condition for living in a market consistent world is that policyholders have sufficient knowledge of financial concepts
- For example: compounded interest, nominal vs. real values, inflation
- Various definitions for financial literacy:
 - It boosts the ability in handling day to day financial matters and will reduce the negative consequences of poor financial decisions that might otherwise take years to overcome
 - It is the set of skills and knowledge that allows one to understand the financial principles one needs to know to make informed financial decisions as well as the skills and knowledge one needs to understand financial products

Financial literacy and financial education (2)

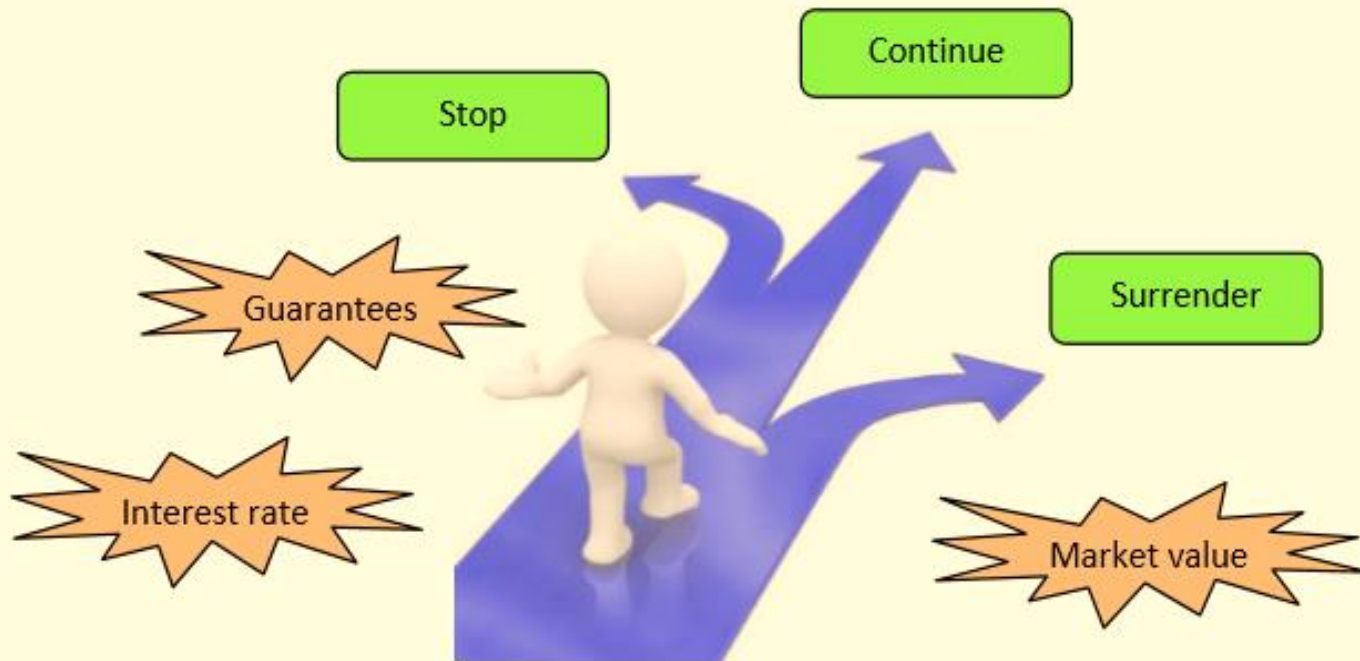
- Policyholders need to be sufficiently financially literate to understand the market consistent elements of their policies
- Research suggests that the level of financial literacy is low
- Positive effects of financial education not proven. Three streams can be distinguished:
 - Believers
 - Optimistic
 - Non believers
- Nevertheless, an increasing focus on financial education (e.g. recent global money week and money wise platform) can be observed
- Also, advisors, financial planners, nudging policies or sharing experiences may help to improve financial literacy

Policyholders: awareness, understanding and acting



- Three levels of financial literacy
- Large % of policyholders will not reach 'acting' or 'understanding' level
- However, a relative small group of 'acting' policyholders may already cause significant changes from which all policyholders can benefit
- Also, advisors, regulators, consumer organizations, comparison tools, new technology, competition (incl. new market participants) may cause changes

Living in a market consistent world – Example (1)



Living in a market consistent world – Example (2)

- Policyholder with an endowment policy
- Fixed interest rate with profit sharing based on an external index
- Some available contractual options:
 - Stop paying premiums
 - Continue paying premiums
 - Surrender the policy and get a surrender value based on a fixed formula
 - 2% interest rate guarantee upon expiration
- Some market parameters: interest rates and mortality rates

Living in a market consistent world – Example (3)

- Policyholder exercises the surrender option. This example has gained quite some attention by researchers
- Note that each option that is currently not priced in line with market parameters could qualify for an equivalent example
- Currently, the surrender value is based on a fixed formula that determines the value (cash pay-out) to the policyholder:
 - If market value < surrender value: surrender beneficial to the policyholder
 - If market value > surrender value: surrender beneficial to the insurer
- If the policyholder acts in line with market consistent principles, at least an assessment of the market value will be made before acting
- Possibilities to do this are limited as available information is limited
- In an ideal situation, periodically (e.g. each payment period) a decision may be taken on the available options based on actual information which is based on actual market parameters

Market observations (1)

- Various developments with respect to policyholder (or consumer) behavior can be observed indicating at least awareness:
 - Saving rates
 - Mortgage interest rates (incl. negative rates)
 - Waiting period mortgage loans
 - High interest payments credit cards, current account
 - Buying an annuity (e.g. upon retirement)
 - Interest rate guarantees (incl. buy outs by insurers)
 - Transaction costs individual brokerage
 - Life cycle investments
 - Negative experiences: poor results (e.g. unit linked investment policies or pension funds), mis-selling, poor advice
 - Success of new participants
 - Unclear contractual options (e.g. surrender values)

Market observations (2)

- Other developments can be observed that may lead to awareness, understanding and acting:
 - Financial technology innovations (e.g. collecting and comparing data)
 - Competition (e.g. by banks)
 - Innovation programs by insurers
 - Education programs
 - Role of advisors (changing role due to ban on commission payments)
 - General change in thinking about financial institutions (crisis, bail outs)
 - Numerous class action suits
- Nevertheless, various developments of irrational risk taking can be observed indicating no awareness or understanding

Drivers

- Availability of market consistent data
 - Implementation of SII and IFRS4 phase 2
 - Force of legislative bodies and pressure from regulators
 - Pace at which insurers can absorb the requirements
- Awareness and understanding
 - Significant increase in financial education to make people more financially literate
 - Main focus on financial products in general and awareness of potential risks
 - Changing role of advisors who need to demonstrate their added value to consumers
- Information from insurers due to the change to market consistency itself
- Lessons learned by policyholders (e.g. due to mis-selling)
- Positive effects from 'activated' policyholders
- Competition, including new market participants and new technologies
- Insurer's client focus, more transparency and providing clear explanations

Implications

- For insurers:
 - Policyholders will gradually become aware and understand market consistency
 - Acknowledge and address the potential impact on policyholder behavior by (e.g.) being as transparent and clear as possible in pricing, costs and product descriptions
 - Develop products that better reflect market developments in market parameters like temporary premium stops, decreases, increases, interest rate discounts, partially surrenders, temporary guarantees, updates of mortality tables etc.
- For policyholders:
 - Request for better explanations about the pricing and costs over the course of the contract and compare these
 - Be aware of the market value of a policy
 - Opportunity to request more information from insurers and advisors
 - This includes existing contracts (e.g. is it beneficial to continue?, what are the beneficial contractual options?)
- For other organizations (regulators, government, advisors, consumer org.)
 - Dedicate more time to education about life insurance policies and market consistency as these are currently not specifically covered in education programs

Conclusions

- Two main conditions:
 - Availability of market consistent data and values
 - Sufficient level of financial literacy
- Availability of market consistent data and values gradually increases
- Details and impact new regulation (especially IFRS4 P2) not clear yet
- Level of financial literacy appears to be limited and insufficient
- Policyholders need a sufficient level of understanding in order to act
- Even a small group of policyholder (understanding or activated) may already cause significant changes

Questions

