Society of Actuaries in Ireland

Persistency

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Agenda

- Trends in experience
- Actions being taken in market to address
- Impact on financial statements
- Developments in assumptions
- Other observations

Background

Persistency is one of the most critical challenges facing the Irish domestic life assurance market

Value	• Embedded values and new business value are heavily dependent on persistency experience and assumptions
Capital	• Persistency Risk will be a significant component of regulatory capital requirements under Solvency II

Economic climate and distribution models have both placed stress on persistency experience in Ireland over the last five years

Drivers impacting persistency

Economic

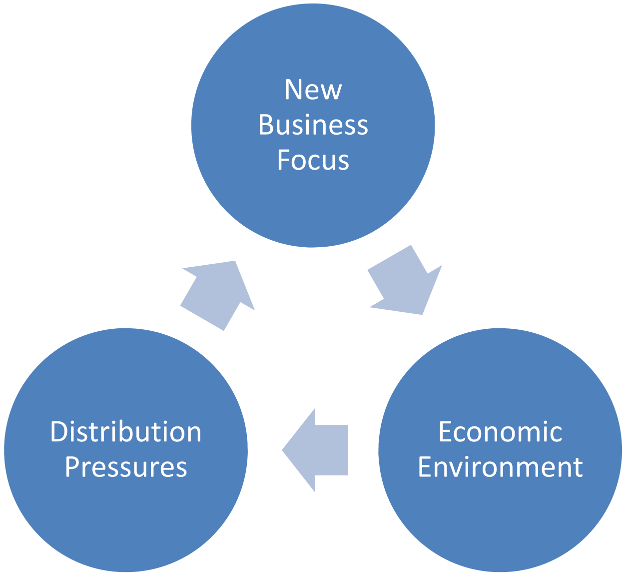
- Premium affordability
- Reduction in new business volumes impacting income from commission
- Flight to security

Business Performance Focus

- Excessive focus on new business rather than retention as indicator of success

Distribution

- Over-ride commission
- Higher up-front commission/allocation rates
- Charging structures and commission structures that do not penalise surrender and re-write



Major Trends in Experience 2008-2012

Product Category	Lapse Trend	PUP Trend
Individual Pensions RP	↑	↑ then ↓
Individual Pensions SP	↑ ↑	-
Group Pensions RP	Stable	↑ then ↓
ARFs	↑ ↑	-
Investment Bonds	↓ then ↑	-
Savings RP	↑ Then ↓	
Protection	Stable	-

2012 Persistency Survey - Methodology

Participating Companies

- Virtually the entire domestic life insurance market
- Nine leading companies representing over 99% of the market
- Participation on a confidential basis

Data Gathered

- For seven product categories
- Lapse and PUP experience and long term best estimate assumptions
- Experience data collected:-
  - For the last five years - 2008-2012
  - By policy duration
- By distribution channel
  - Where provided by company
- Rates gathered, ie not underlying data, and PwC placed reliance on the rates
- Industry and company averages based on simple averaging, i.e. not weighted by size of company/product line

<u>Product Categories</u>

Individual Pensions RP and SP

Group Pensions RP

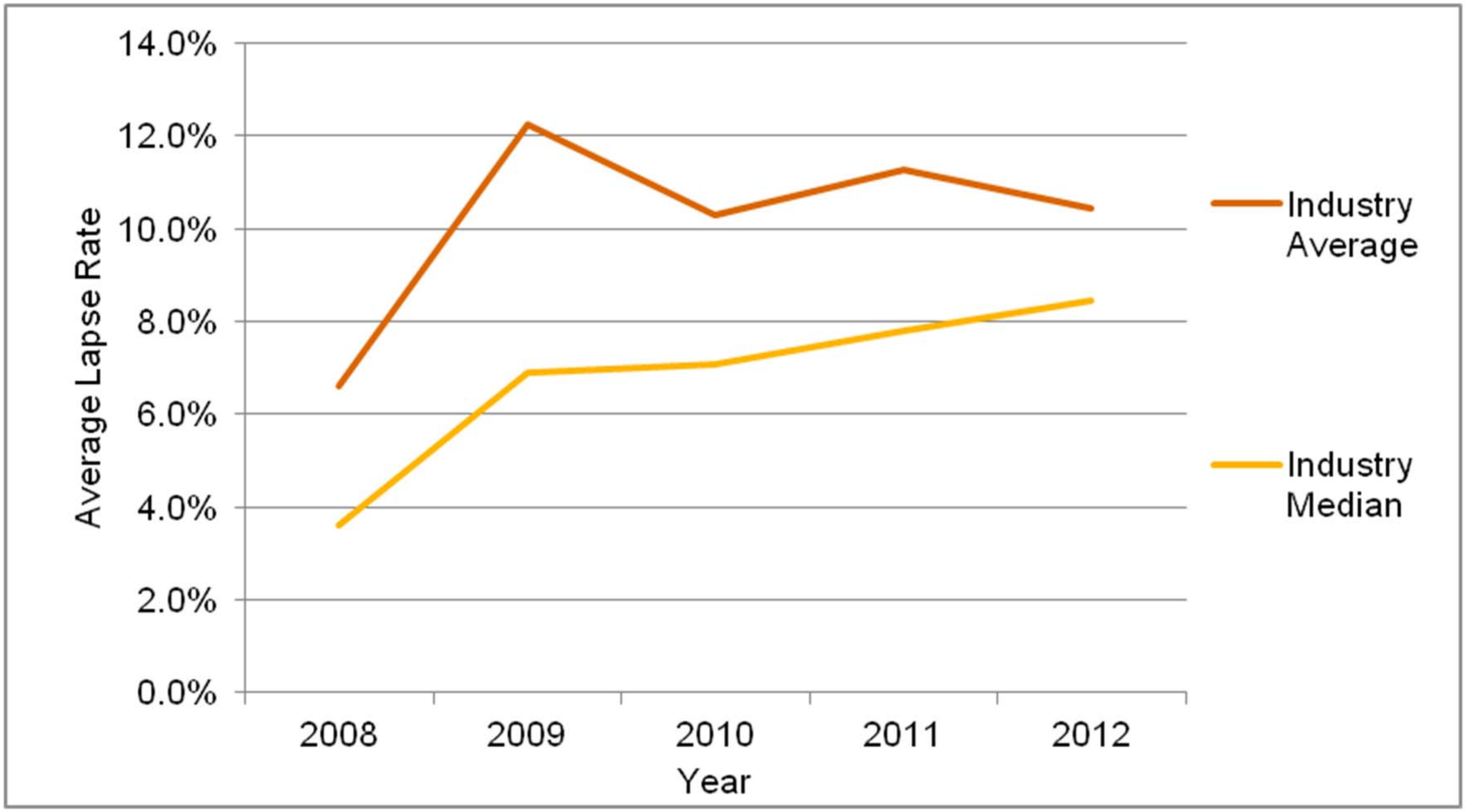
ARFs

Investment Bonds

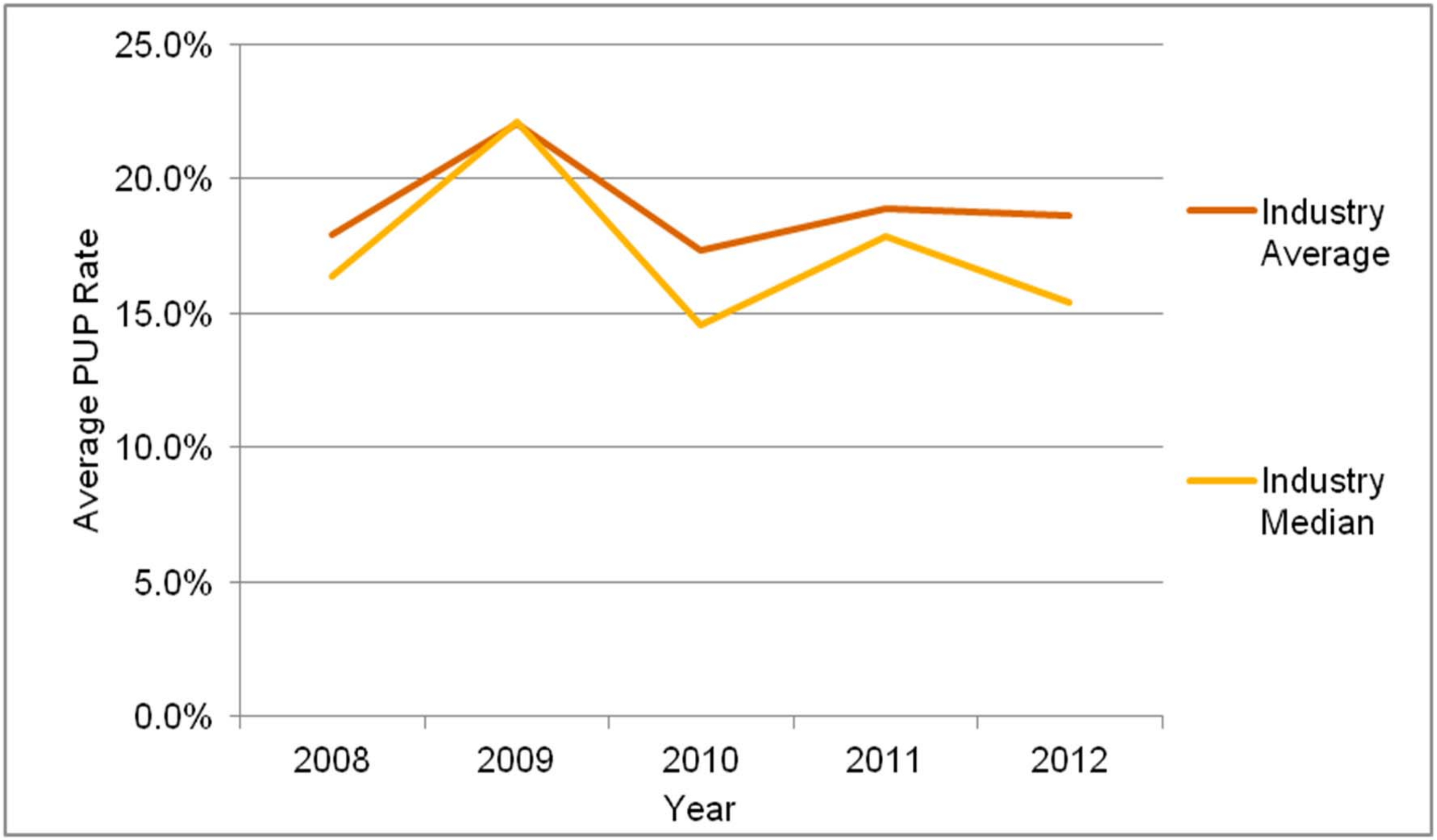
Savings RP

Protection

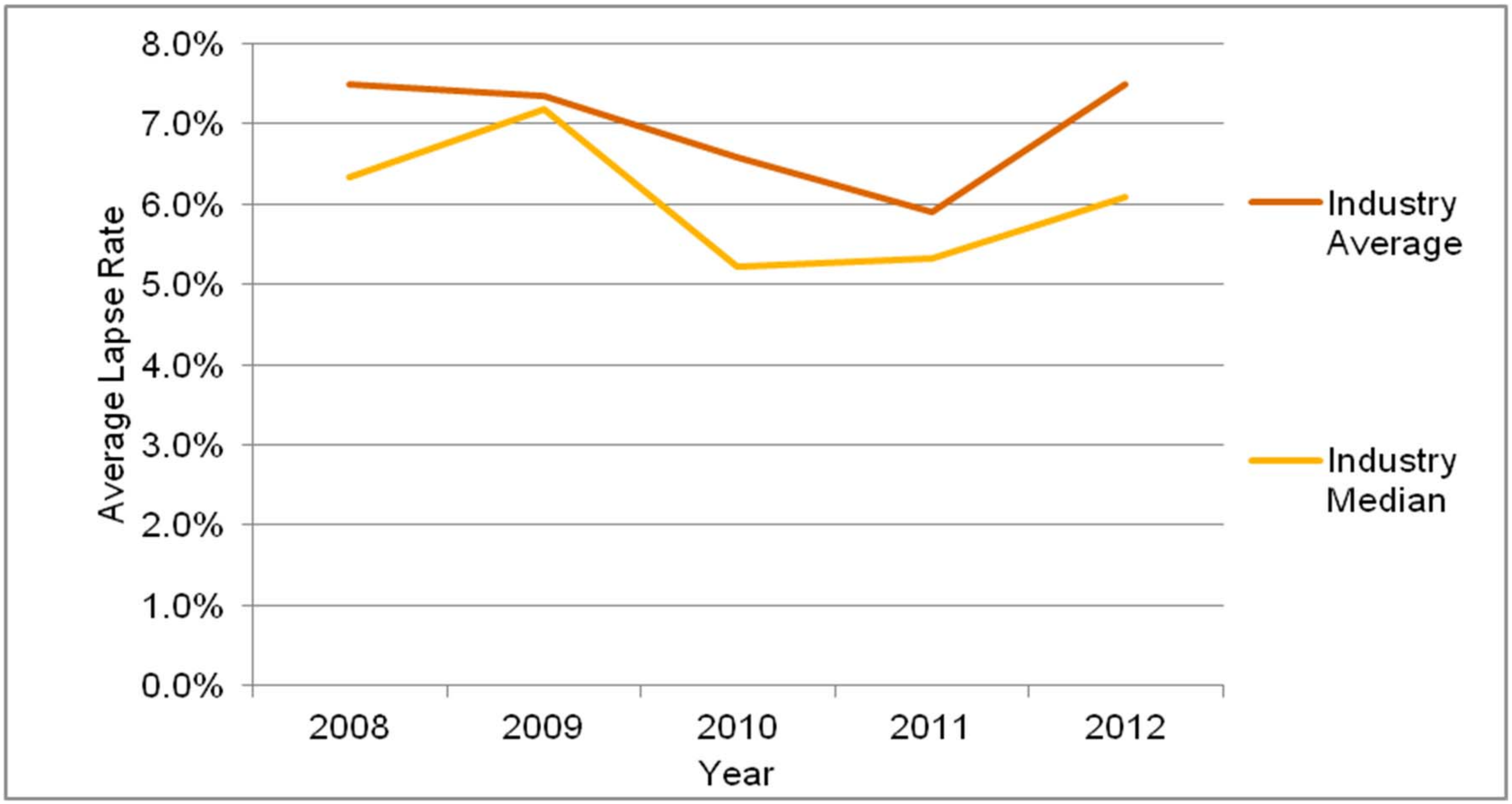
Trend in Lapse Experience 2008 – 2012
Individual RP Pensions - Linked



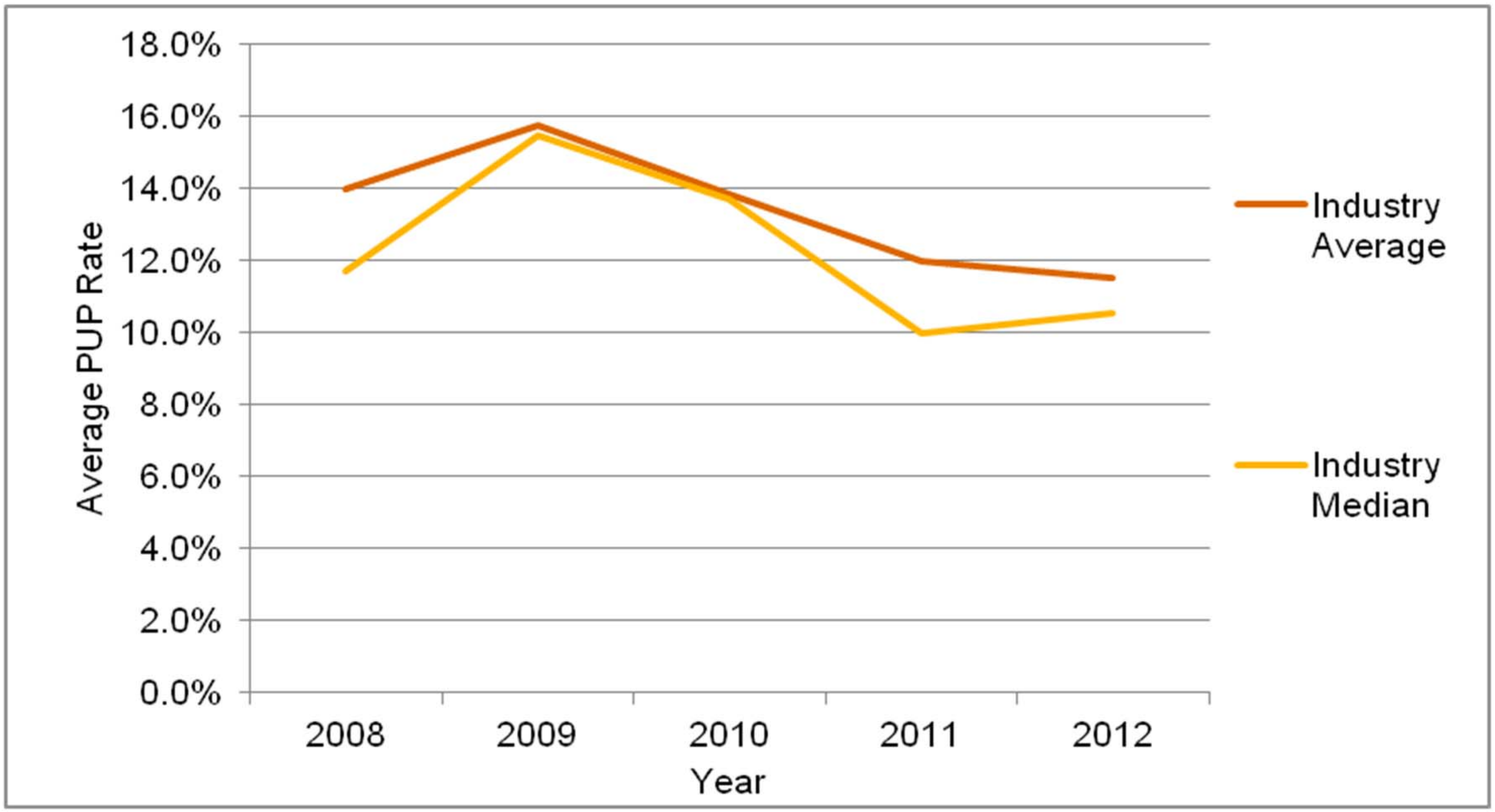
Trend in PUP Experience 2008 – 2012
Individual RP Pensions - Linked



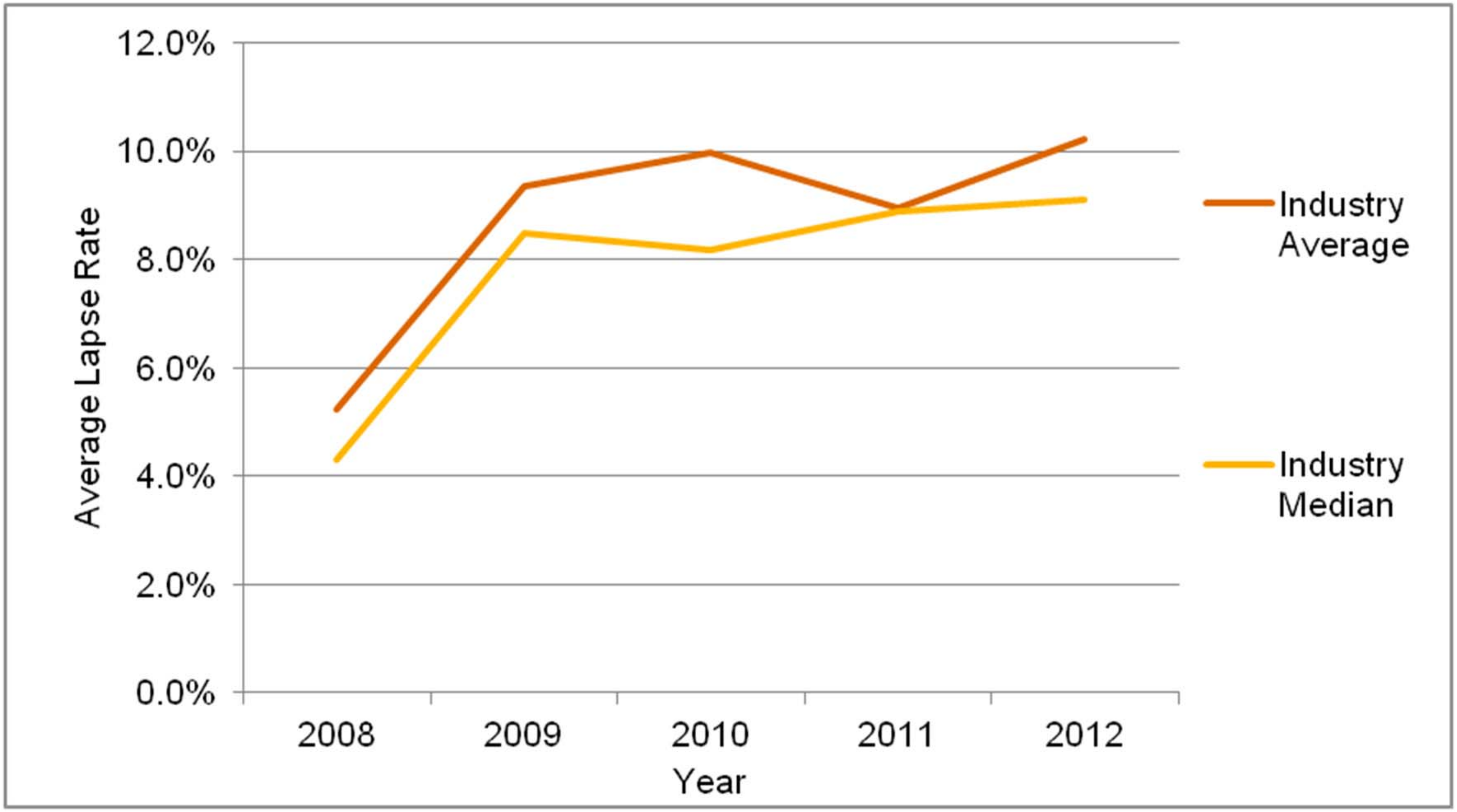
Trend in Lapse Experience 2008 – 2012
Group RP Pensions



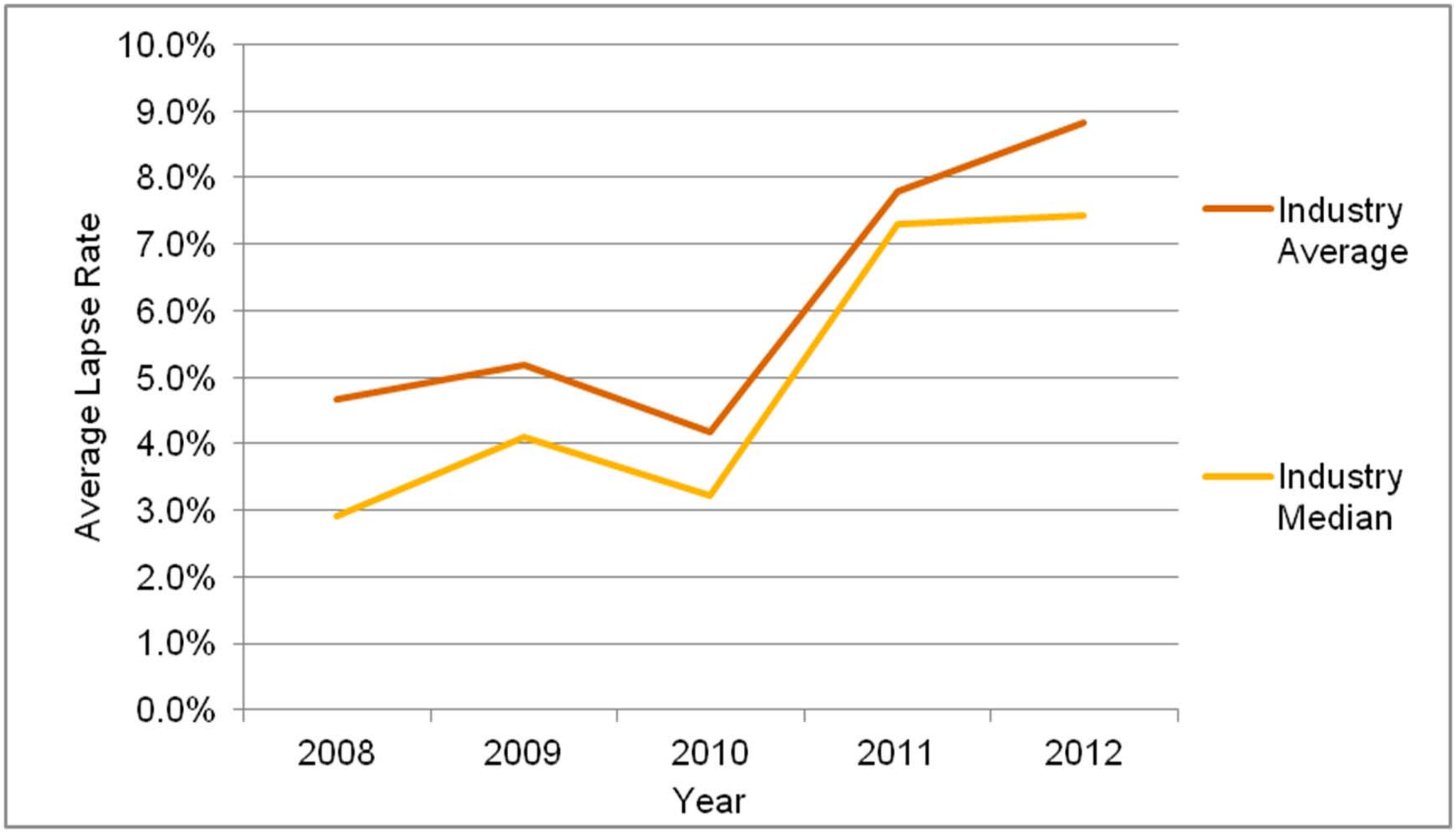
Trend in PUP Experience 2008 – 2012
Group RP Pensions



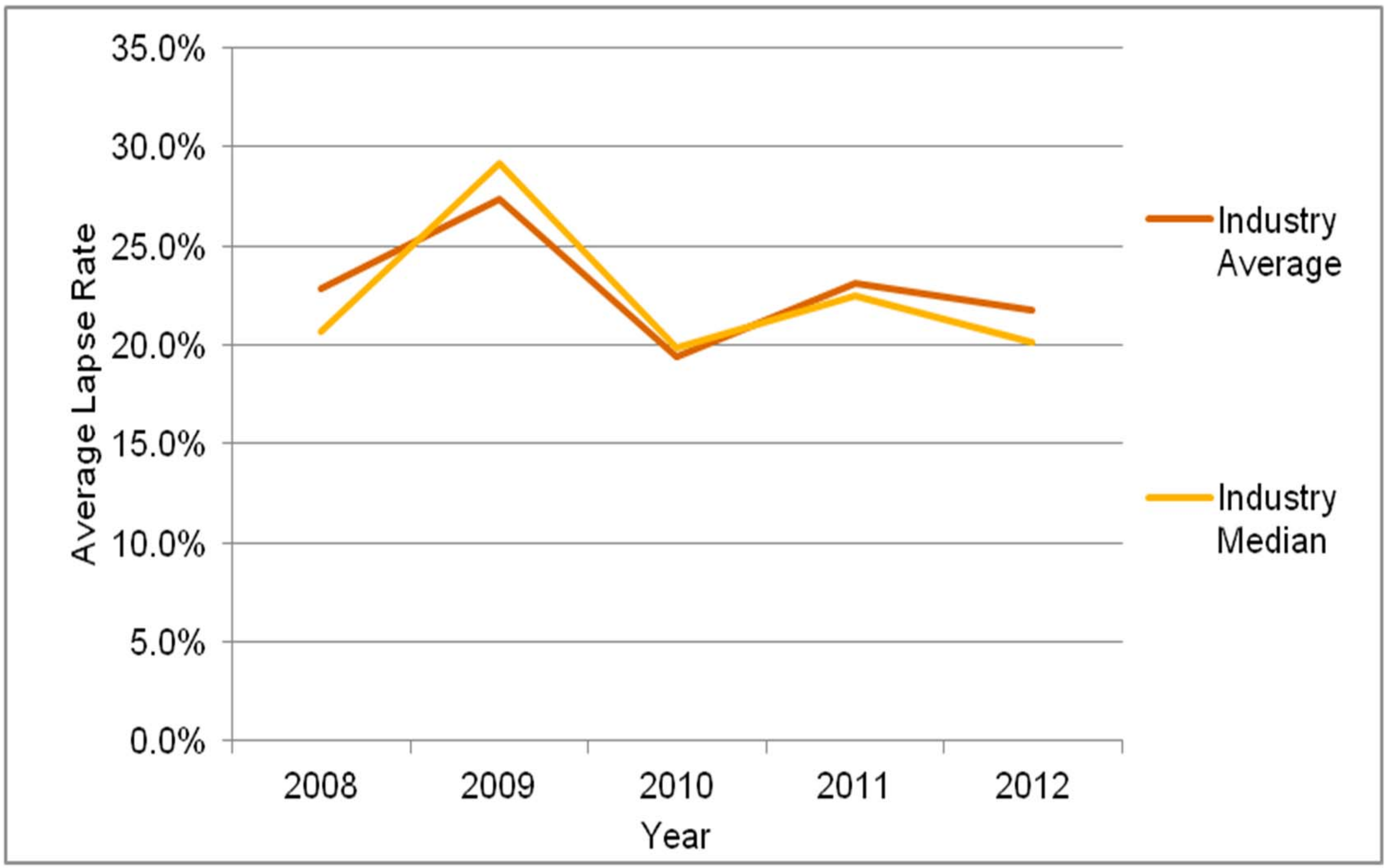
Trend in Lapse Experience 2008 – 2012
SP Pensions



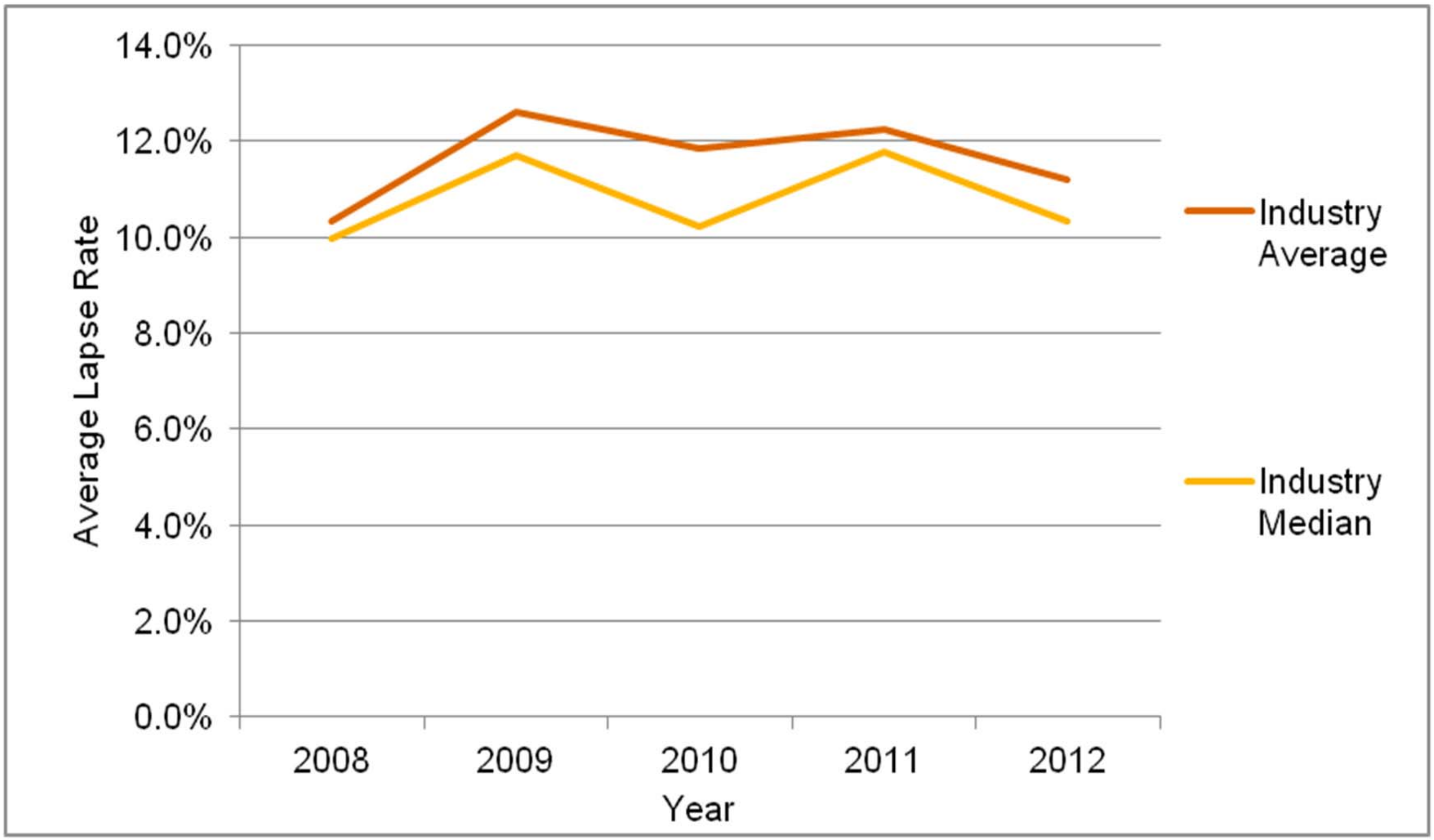
Trend in Lapse Experience 2008 – 2012 ARFs



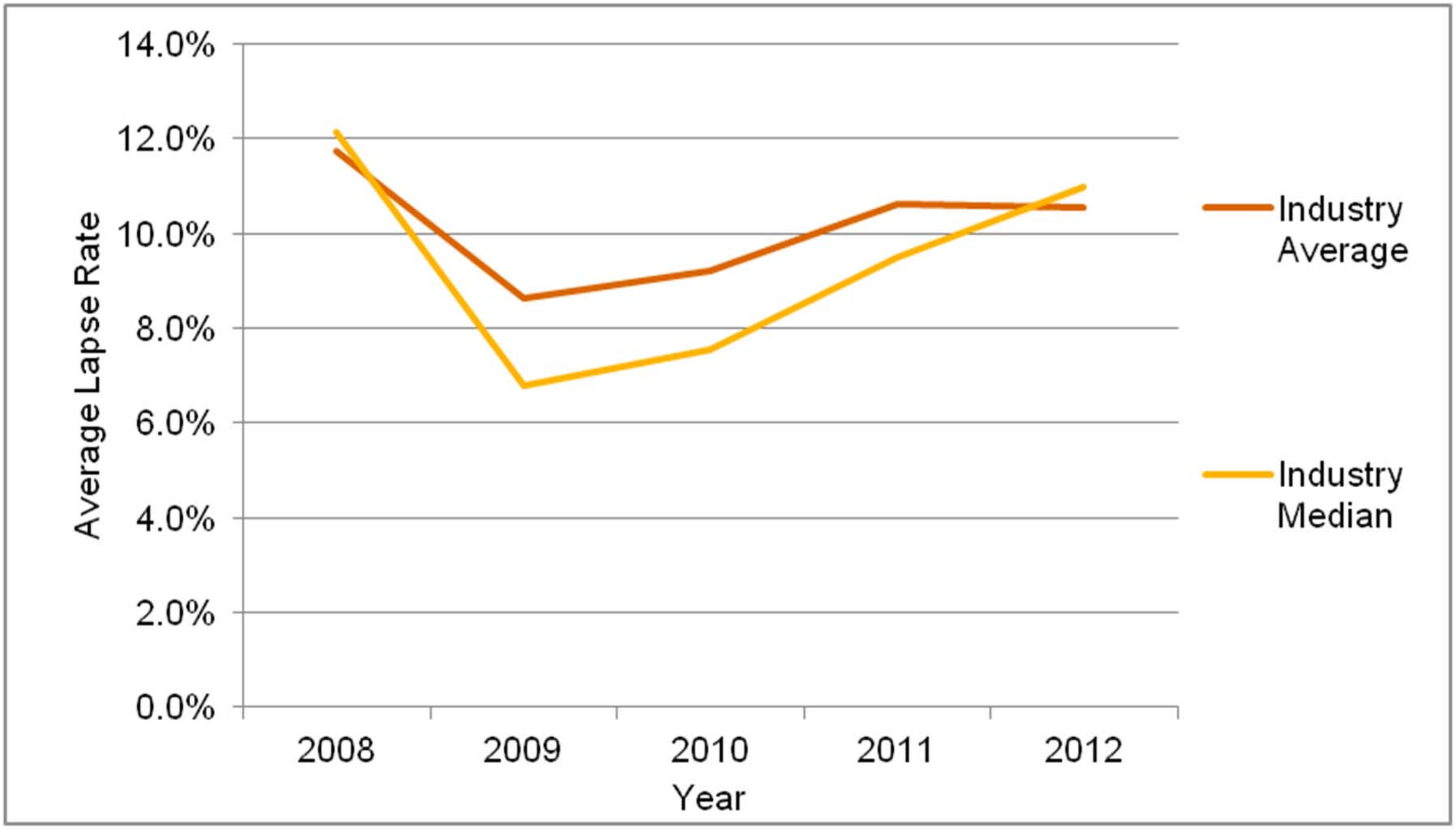
Trend in Lapse (including PUPs) 2008 – 2012
Life RP Savings



Trend in Lapse Experience 2008 – 2012
Term assurance



Trend in Lapse Experience 2008 – 2012
Life SP Bonds



Profitability Impact

Product / Persistency Element	Implied Δ in experience since 2008	Consequent Δ in value of income from product charges	Consequent Δ in level of charges required to achieve same revenue
Individual Pensions RP Lapses	+ 120%	-35%	+60%
Pensions SP Lapses	+ 110%	-20%	+25%
ARF Lapses	+ 150%	-25%	+40%

- Results are indicative only based on a simple cashflow model
- Individual Pensions product based on Standard PRSA charges, SP products based on 0% entry charge, 1% pa fund charge
- Precise results would require more detailed company by company, product by product calibration
- Profit impact would be significantly greater than income effect without corresponding change in expenses

Key retention measures across the industry

- Cultural change
- Communication
- Operational action
- Measurement
- Product features
- Reward

Revised commission arrangements

- Distributor differentiation
- Wide range of commission options with less up front bias
  - facilitating different time horizons
  - payments bridging initial and renewal gap (persistency based)
  - higher renewal commissions
  - flat commission options
  - trail commission
- Phasing out of override
- Rewarding on-line transactions

Significance of assumption

- Impact significantly different depending on the underlying basis:
  – Spectrum of effects from Regulatory to EV
  – Reported results during crisis

		2009	2010	2011
Aviva	Experience Variance	-140	-42	-23
	Assumption Change	-262	-94	-174
	Total	**-402**	**-136**	**-197**
Prudential	Experience Variance	-76	-25	31
	Assumption Change	-131	-71	-111
	Total	**-207**	**-96**	**-80**
L&G	Experience Variance	-7	-1	8
	Assumption Change	-55	-30	-15
	Tota	**-62**	**-31**	**-7**

Significance of assumption

- Regulatory:
  - Zero...though need to consider if allowing for lapses would increase reserves
  - Principally need to closely consider diseconomies of scale if significant decline in policy count
  - Impact of high lapses recognised over time
    - Reduced levels of emerging statutory surplus
    - Reduced ability to fund new business
    - Reduced dividend capacity
- Solvency II:
  - Will require a best estimate assumption
  - Need to better articulate/ document the judgments
  - Modelling the SCR lapse shocks challenging

Significance of assumption

- IFRS:
  - Depends on reserving philosophy
  - DAC recoverability impacted in extreme
- US GAAP:
  - FAS60: lapse assumption remains locked in unless Loss Recognition Event
  - Direction of prudence margin tricky e.g. Term products
  - FAS97: dynamic approach to DAC amortisation including best estimate lapse rates
- EV:
  - Most sensitive to variances/ assumption changes
  - Small changes can give rise to large changes in VIF

Trends in assumption setting

- So given very poor experience over the past 5 years, assumption setting is challenging in domestic sector
- More granular assumption setting
  – By Product
  – By Channel
  – Extended duration
  – Across active, paid ups, premium reductions
- Consideration of premium bands/ sum assured exposure
- Move from implicit margins to explicit e.g. paid ups, premium reductions set explicitly.

Trends in assumption setting

- Assume experience will improve from current observed levels
  - explicit additional provision set by product for period of up to 5 years
  - separate assumptions for each of the next 3-5 years for policy durations before reverting to long-term assumptions.
  - different approaches to setting long term

Trends in assumption setting

- Long term average of past experience starting point for setting/ assessing appropriateness of assumptions
  – Most use investigation periods of between 4-6 years
  – Most use a rolling average approach in analysing their persistency experience, between 2 and 5 years
  – Some have excluded specific years from the investigation period when calculating the long-term rolling average historic experience.

Trends in assumption setting

- Rolling nature of the experience investigations:
  - If dynamically updating - impacts come through depending on how the year rolling off compares to new year added on.
  - Balance between looking back over a long period (which captures better/ poorer economic circumstances) or a shorter period (which might be more relevant for the business inforce).

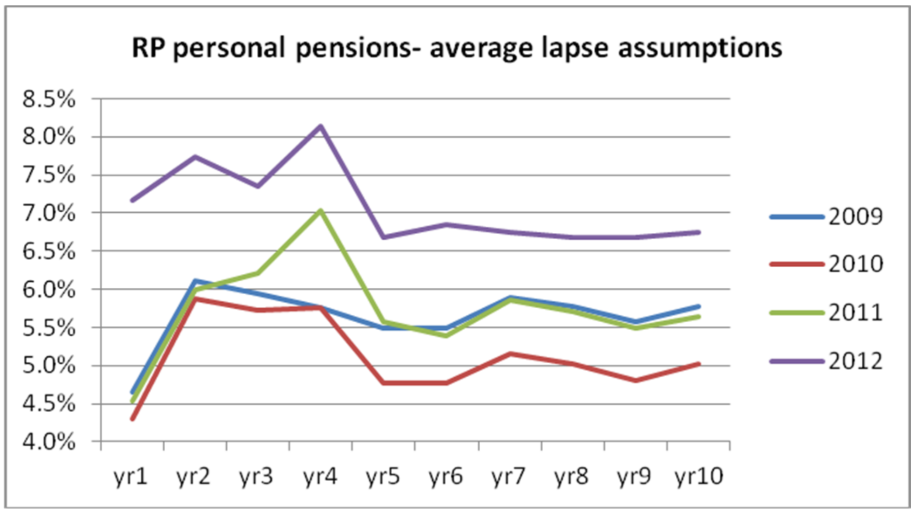
Trends in assumption setting

- Different approaches used by companies to derive recent persistency experience rates
  – For unit-linked RP most use annual premium (fund values and policy count measured).
  – For unit-linked SP mixed use of annual premium and fund values (policy count measured).
  – For paid-up policies, fund value/ premium paid/ policy count used
  – For non-linked business most use annual premium

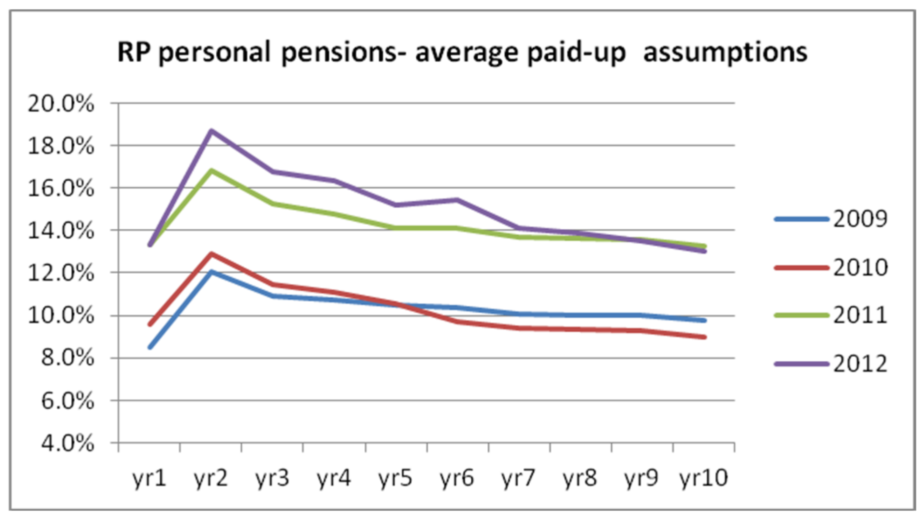
Trends in assumption setting

- Most apply some form of judgment when setting final assumptions including factors such as:
  - number of years in the investigation period;
  - which years within the investigation period to include in the rolling average calculation;
  - future expected economic conditions;
  - changes in business mix since investigation;
  - rounding of results and smoothing.
- Many analyse premium paying/ paid-up lapses separately
  - High level of PUPs on RP pensions business significant strain

Trends in assumption setting



- Trends in best estimate assumptions for selection of domestic companies 2009-2012
- Most significant shift on RP Pensions



MI

- Investigations generally annual but more frequent MI
  - Becoming more detailed
  - Monthly persistency reports
  - Some reporting persistency results to the Board quarterly
- Persistency information used more widely:
  - Support/ inform retention activities
  - Identify ‘VIF at risk’ of business
  - MI at agent level to help identify poor performing brokers…’VIF of broker’
  - Reporting to measure retention activity levels and impact of retention call campaigns.

Challenges

- At “elevated” levels - sustainability of new business is an issue
- More recently, levelling off in new business partly due to improved persistency on back-book
  - Wholesale reinsurance rates not as attractive...less churn of recently issued business
  - Surrender structures act as disincentive to intermediary in initial years
- Is there such a thing as RP paying policyholder
- Declining economies of scale

Challenges

- Regulatory focus:
  - Not on lapses as such but...impact on business model
  - Consumer perspective – product suitability, investment suitability, affordability considerations?
  - Will move to RDR type model help? – commission incentives distort alignment of interest between life co/ intermediary and policyholder

Questions