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for you



Protection

Learning Outcome 1

By the end of this learning material you will be able to demonstrate an understanding of the consumer and retail market factors and trends relevant to financial protection.

1. Introduction

Protection is the foundation of insurance cover. The public's view of their need for protection changes constantly and the insurance industry needs to adapt and change its products to meet this expanding and changing market.

1.1 The Role of Insurance in Mitigating Personal Financial Risk

Some risks can be easily avoided and controlled – and for others the best solution is to insure against the risk. It is important to be able to identify the risks that can be managed and those that need insurance.

The simplest way to look at risk and the need for insurance is to think about avoidance and impact.

Avoidance

- This can be more easily controlled when thinking of events covered by "General Insurance" i.e. not leaving your front door open – an invitation to burglars and loss.
- It is more difficult to avoid events that could have a catastrophic impact on you and your family in regard to serious illness and death. These events have serious effects on you and your family – and can be insured. You can't stop the event happening – you can make the impact easier to cope with financially.

Impact

- The effect on a family's financial situation in the event of early death of one of the wage earners or child care providers can be catastrophic.
- Serious illness extending beyond any period of sick pay from an employer can be devastating for a family – outgoings may remain the same while the income may be extremely low if relying solely on state benefits.

It makes sense to insure against the events that may have a low likelihood of happening (e.g. suffering a critical/serious illness that means you cannot work for an extended period of time) but will have a major effect on the family's security and ability to enjoy the same standard of living. These events are insured with the range of "Life" products e.g. life insurance, critical illness cover, income replacement plans.

Other events may have a higher likelihood of happening but the repercussions are much less – and insurance products are generally available under the "General Insurance" range e.g. insuring your smart phone against loss or theft.

1.2 Consumer attitudes and behaviours to protection needs and planning

In the past – life events and patterns were much simpler and more predictable – generally people lived at home with their families, left home when they got married, set up home with their spouse and children and worked till they retired. Today's life patterns have changed – with trends of multiple relationships/families often with periods of returning to the family home – and for many retirement is a far off dream – the threat of job loss prior to retirement is very real.

Life Insurance

In the 50's the typical scenario would be for men to be considered the "Breadwinners" as many women did not work outside of the home. The pattern would be progressive – buy a house with a mortgage – and mortgage protection – buy a bigger house as the children came along. Pension planning was generally taken care of by generous Final Salary Scheme pensions – which meant that many people stayed with the same company for all of their working life. Simple products such as Family Income Benefit plans and Permanent Health Insurance were used to protect the family in the event of the wage-earner's death or long term disability. Most additional "insurance" plans were in the form of endowments – for many to repay the mortgage or save for future weddings or a nest egg. Insurance was made available to many people through the activities of the "Industrial Insurance Sales Force" – the door to door sales and collection service.

Advice and sales of Life Assurance

With changes to life style came changes to how Life Insurance Protection is made available to the general public. The old adage says "Life Insurance is sold not bought" and that is very true today. Many people see the need to "cover the mortgage" but are reluctant to commit funds or don't see the need to protect their families – and indeed themselves in the event of long term disability. The "It will never happen to me" mind set.

Availability of advice is a contributory factor to the lower take up of Life Insurance. The Industrial Insurance Sales Force has all but disappeared and while insurance is readily available on-line, via advertisements in newspapers and TV – and as advised by Financial Advisers – many people simply don't bother. When the Industrial Salesman made his regular calls – he would often spot an insurance need and this would often be taken up as a result of this personal service and the trust that had built up over the years.

The Industrial Sales Force was expensive to maintain – a lot of sales people collecting relatively low premiums – much cheaper and easier to use Direct Debit.

The government wants everyone to have easy access to quality generic financial advice and a lot of information and help is available on www.moneyadviceservice.org.uk

Public views on protection insurance

- Many people mistakenly believe that “The State will take care of me” – without having any knowledge of low levels of benefit that will be paid – if indeed you qualify to receive it.
- The average “Family” model has changed – more single people/single parents, people in multiple relationships rather than one partner for life – this should lead to an increase in the people who take out insurance to protect “their responsibilities” – but this does not happen.
- Past and current miss-selling scandals have affected the general public’s view of “Insurance Salesmen” and Financial Advisers. Whilst regulation has improved security for the general public – many potential customers are a bit wary as a result of publicity.
- Insurance is frequently bought on line – but generally as a non-advised sale and there is a high potential for the wrong type /wrong sum assured scenario arising.
- Many people see money spent on insurance as being a waste of money – and as budgets are strained - very often the existing insurance plans are the first things to be cancelled.

Many people over estimate the amount of cover they have and what protection this would actually give them and for how long and many people underestimate the amount of cover they actually need.

One of the problems is that people do not understand what the various protection products do – and how they will meet their protections needs. The similarity in product names adds to this confusion. Another consideration is that of consumer trust. In the past, customers bought from their visiting agents because a good degree of trust had been built up over the time.

What drives people to buy life insurance products?

The demand for life assurance is driven by a number of factors

- Affordability – the cost of the product. Experience shows that more life cover is bought when the price drops.
- The age and life stage of the individual – willingness to consider and purchase protection products.
- Movements in the housing market - a drop in the activity in the housing markets will lead to decreases in the amount of mortgage life cover and critical illness cover being bought.
- Willingness to purchase with the cost of products available being in the budget the customer is willing to commit.
- Inflation in the economy – if inflation is increasing – the amount of life cover bought often decreases. Some schools of thought attribute this to the belief that the future buying power of a current sum assured will be so low that it is not worth the bother and cost of buying now.

The amount of protection being bought tends to increase with the age of the customer, as they move into a different life style with family responsibilities.

Income and affordability are key to the amount of cover taken and this is normally highest in the age range 45-54 when people have more responsibilities for family and mortgages. Many people have to delay full retirement. They may have to meet their continuing family responsibilities when they either retire or are made redundant from one job – by moving on to another job on a full or part time basis.

The protection gap and the demand for financial protection

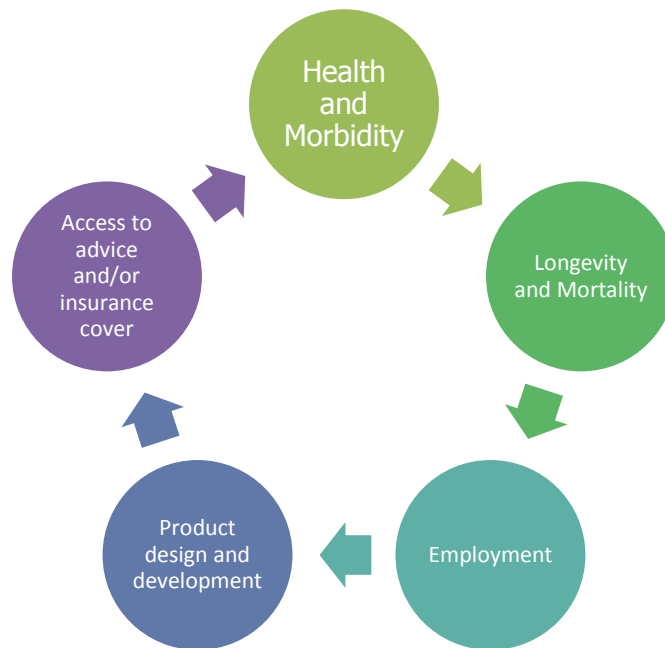
One insurance company has carried out research to establish the gap between the insurance needs identified and the extent to which this is being met by the protection industry – the protection gap.

- Their formula for calculating the protection gap is



- It is calculated on a gross basis before taking into account the impact of taxes on spendable income.
- The resulting figure represents the amount of life cover that should be in place less what is actually in place
- The UK protection gap calculated on this basis has been estimated to be as much as £2.4 Trillion
- The UK is the 3rd largest life insurance market in the world – and this is at a time when Term Assurance rates are affordable.
- The gap illustrates the difference between what customers should have and what they actually have and are willing to pay for.
- It also illustrates the gap created by customers not being aware of what they need or should have to protect their families and themselves
- Another worrying fact is that a large number of mortgage and secondary loans secured on the family home – are not protected by life or critical illness cover. This is a growing area of concern – increasing as a lot of lenders no longer insist on life cover to match the loan being in place.

1.3 Trends



Health and morbidity (Morbidity is the ratio of incidence of ill health)

Changing life styles, better health education (especially the decrease in the number of smokers), better health care and long term illness management combined with the emphasis of the importance of physical fitness have all contributed to an improving mortality. This has forced a rethink in insurance pricing.

Longevity and mortality (Mortality is the frequency or number of deaths)

Although early deaths will always happen – the rapidly improving trends in Mortality means that the biggest concern facing most people is not dying too early but living too long. This leads to concerns in not having enough money for a comfortable retirement or money to pay for long term care.

The cost of providing sufficient income for retirement has grown and most final salary schemes have now been closed to new and existing members. In many cases this has led to the need to working beyond the normal retirement age to provide for a longer life span.

This change in mortality and funding for retirement will continue to impact on the protection industry.

Employment

The link between morbidity and mortality is far from clear. There is a lot of evidence that being actively at work has had very positive health consequences and not being in work and being more inactive has had a detrimental effect on health. This links in to the Government's thinking around the provision of disability and incapacity benefits.

There is no evidence at this stage about the effect of extending the “working life” by delaying retirement has on morbidity – and indeed if this delay will bring about new causes of morbidity in the future.

The pattern of employment has changed over the past few years. People now have a pattern of working in a number of jobs and for different employers or indeed being self-employed throughout their working lives. This can mean that the financial consequences of suffering long term disability can have more impact as they may not have the protection of Employer benefits.

Many people with disabilities and long term illnesses can now expect to work – although this may mean changes to the workplace or the pattern of working.

All of this can affect the need for protection insurance – especially as the benefits that may be paid by the state are small in comparison to wages. Most people would be significantly worse off and in difficult financial circumstances in the event of long term ill health.

Although health remains the main consideration when assessing risk – the insurers are now able to segment the health issues that have the most impact e.g. smoking status etc.

Product Design and Development

Living and working longer impacts on some of the “traditional” approaches to life insurance. Most life insurance policies are written to match the redemption date of the mortgage and take into account the expected retirement date.

People are working longer and pushing back the retirement date – and may also extend the term of the mortgage. This can cause a miss-match on maturity/expiry dates and the required insurance - leaving a gap in protection which may not be easy or affordable to meet.

Longer-term underwriting may cause significant problems – as there may have to be a shift in assessing “normal” health profiles to include plans to cover and take into account the issues arising from insuring longer lives.

Smoking/non-smoking products

The health of smokers is fundamentally worse than that of non-smokers – as backed up by statistics. Non-smokers should be able to buy products with much lower premiums than smokers. This also fits in with public health policies on smoking/non-smoking and is part of the move to discourage smoking.

Another consideration is the suggestion of “preferred life policies”. This means that applicants who engage in high levels of fitness and healthy life styles may be offered lower premiums than someone following a more sedentary lifestyle – effectively rewarding the positive steps taken to achieve and maintain good health. This approach is common in the USA market but has yet to make significant impact on the UK market

Underwriting

Mortality rates have improved and some actuaries now factor in this improvement in mortality to produce very competitive rates. However it does mean that underwriting procedures are used to ensure that these competitive rates are only offered to those applicants who would pose the least risk. Attention is paid to many factors such as height and weight and pre-existing conditions to limit the low rates to those less likely to make a claim

Administration

Costs have been reduced and kept lower because of the competitive nature of the life protection market. The industry has responded by building and maintaining underwriting systems that aim to fast-track up most proposals – simplified underwriting – meaning that more time is spent on the applications that need more attention to assess the risk.

Access to advice and/or insurance cover

Being able to shop around for and apply for life cover on line has had a great effect on the pricing and simplification of the process. For the customer shopping on line – price is often the determining factor. Insurance companies try to feature high on the price comparison sites – it would be unlikely that a customer would scroll further down than the initial few companies on the list.

Getting “advice” on protection needs increases the cost of the product - but the positive side is that advice is given and received. This can be of particular importance when considering Critical Illness cover – not all companies cover the same illnesses or have the same claims payout history. One company may take a different view on an underwriting issue to another – and this may not be easy to determine from a list with costs. Advice can be vital to selecting the right product and company for a product that covers serious illness or disability cover.

The process of advice where a thorough analysis of the need and the required solution is recommended can make sure that the customer applies for the correct product for their situation with the correct sum assured, waiting times etc. This however can bring its own problems if a more complex solution is recommended than a customer may have self-selected. There can be delays with underwriting due to the complexity of the product etc. which may make the customer think he should just have gone ahead with the on-line self select and less sophisticated product.

Non-advice protection sales are easy to buy and complete – with insurance companies doing all they can to make the process as simple and straightforward as possible. The downsides are

- the customer may just “shop around” and not actually complete the process
- It can be difficult to bring the need for life insurance and protection products to the customers attention
- Customers may just “give up” rather than complete the underwriting and compliance issues
- Customers may buy the wrong type of insurance for their needs – with wrong sum assured, term, lives to be insured etc.

The UK protection industry is large – but the Protection Gap is also large – and increasing.

Protection Learning Outcome 1 (PROT1) – End of Module Test

Multiple Choice Questions

Question	Answer	
1.1 - Which of the following best describes preferred life policies?	A.	Applicants who engage in high levels of fitness and healthy lifestyles may be offered lower premiums than someone following a more sedentary lifestyle.
	B.	Applicants who are prepared to complete online simplified underwriting questionnaires are automatically given cheaper premiums than those who undergo full underwriting.
	C.	Products which are used by the public to cover protection needs that they appreciate the need to address, such as mortgages.
	D.	Applicants who are prepared to undergo genetic testing for hereditary medical conditions may be offered lower premiums, subject to the test results.
1.2 - Which of the following is NOT a factor contributing to the reduction in the price for life cover?	A.	Improvements in mortality rates.
	B.	Reduction in product providers' administration costs.
	C.	Changes in morbidity rates.
	D.	The introduction of simplified underwriting.
1.3 - Which of the following is NOT a factor in employment demographics which makes insuring against long term ill health more important now than in the past?	A.	Health remains the main consideration when assessing risk.
	B.	State benefits are now large when compared with wages.
	C.	Expectation for disabled / long term ill to work.
	D.	Increasing numbers of people undertaking periods of self-employment during their working lives.

1.4 - Which of the following is NOT a driver of demand for life cover?	A.	Inflation in the economy.
	B.	The age and life stage of the individual.
	C.	Movements in the housing market.
	D.	Currency exchange rates.

1.5 - Which of the following statements about the protection gap is FALSE?	A.	The formula for calculating the protection gap is: Resources needed minus resources available.
	B.	It is calculated on a net basis after taking into account the impact of taxes on spendable income.
	C.	The gap illustrates the difference between what customers should have and what they actually have and are willing to pay for.
	D.	The UK protection gap calculated is currently £2.4 trillion.

1.6 - What statement best describes mortality?	A.	The likelihood of someone being ill
	B.	Number of years to retirement
	C.	The probability of someone contracting a critical illness
	D.	The frequency or number of deaths

1.7 - What statement best describes morbidity?	A.	The likelihood of someone being ill
	B.	The frequency or number of deaths
	C.	The average retirement age
	D.	The average life expectancy of a person

1.8 - Which of the following could mean a higher premium for life protection?	A.	A smoker
	B.	A non-smoker
	C.	A male student in good health
	D.	A female student in good health

1.9 - What are key considerations to the amount of cover taken by an individual?	A.	Retirement age
	B.	Income and affordability
	C.	Parents attitude to wards life cover
	D.	If you are a non-smoker

1.10 - The government wants everyone to have easy access to quality generic financial advice, information and help is available on which website?	A.	FSA.co.uk
	B.	moneysupermarket.com
	C.	moneyadviceservice.org.uk
	D.	thisismoney.co.uk

- **End of Questions** -

Answers

Question	Answer	
1.1 - Which of the following best describes preferred life policies?	A	Applicants who engage in high levels of fitness and healthy lifestyles may be offered lower premiums than someone following a more sedentary lifestyle.
1.2 - Which of the following is NOT a factor contributing to the reduction in the price for life cover?	C	Changes in morbidity rates.
1.3 - Which of the following is NOT a factor in employment demographics which makes insuring against long term ill health more important now than in the past?	B	State benefits are now large when compared with wages.
1.4 - Which of the following is NOT a driver of demand for life cover?	D	Currency exchange rates.
1.5 - Which of the following statements about the protection gap is FALSE?	B	It is calculated on a net basis after taking into account the impact of taxes on spendable income.
1.6 - What statement best describes mortality?	D	The frequency or number of deaths
1.7 - What statement best describes morbidity?	A	The likelihood of someone being ill
1.8 - Which of the following could mean a higher premium for life protection?	A	A smoker
1.9 - What are key considerations to the amount of cover taken by an individual?	B	Income and affordability
1.10 - The government wants everyone to have easy access to quality generic financial advice, information and help is available on which website?	C	moneyadvice.service.org.uk