2018

Class of Business Training: Long Term Insurance: Life Risk Policy

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Introduction

Class of business training Forms part of the Fit and proper competency requirement as embedded in the Board Notice 194 of 2017. All FSP's and Representatives are required by the FAIS act to complete the class of business training and Product Specific Training prior be rendering any financial services in terms of a particular product

COB contains financial products are categorized as per the Long Term Insurance Act. The COB training will also form part of the FSB CPD requirements of the REP.

Long term is categorised under Class of Business 3: Long Term subcategory 3.2. and 3.3

Class of Business 3: Long Term	
3.1	Assistant Policies
3.2	Life Risk Policy
3.3	Life Investment Policy
3.4	Fund Policy
3.5	Sinking Fund Policy
3.6	Long Term Reinsurance

Table 1: Class of Business 3: Long Term

What is a Policy?

A policy is a contractual agreement between the insurer and the life insured. The policy document is the actual contract. It contains all the significant information about the agreement and the parties involved. Both parties have to uphold their end of the contract for the agreement to remain valid. The policyholder has to make his regular contributions as stipulated in the contract, and the insurer has to pay out the benefits when called for, as stipulated in the contract.

The owner of the policy (or policy holder) may be someone other than the life insured. It is also possible to change ownership of the policy during the term, by means of a session.

What is a Long Term Policy?

The Long term insurance Act defines Long Term Policy as:

“means an assistance policy, a disability policy, fund policy, health policy, life policy or sinking fund policy, or a contract comprising a combination of any of those policies; and includes a contract whereby any such contract is varied”

This type of insurance is provided by a life insurer, such as Sanlam Life Insurance Ltd. It is regulated under the Long Term Insurance Act of 1999.

Examples of long term insurance policies: Whole life insurance, term life insurance, endowment policies, retirement annuities, savings and investment policies, life and term annuities.

A long term insurance contract stipulates an inception date plus a maturity date (or option date). The rates and premiums are calculated over the full term of the contract. There has to be a life insured on the policy (even if there is no actual life insurance on the policy, e.g. on a pure savings policy).

Long Term Insurance Policies

Pure risk and pure investment policies

Pure risk policies offer only risk benefits. The entire premium (after deduction of costs) is used to pay for the risk benefits. There is no investment element on the policy. Apart from the insured risk benefits no other payment will be made from the policy.

Pure investment policies, on the other hand, don't provide any insured cover amounts, but is geared entirely towards savings. The entire premium (after deduction of costs) is used to accumulate an investment value.

Although policies on which risk and investment elements were combined were very popular over the past few decades, the latest trend is to separate risk from investment, and rather use separate policies for each purpose. Pure risk or pure investment policies can be structured optimally to provide the best value for a client's money. Although Sanlam still has many combination policies on its books, we no longer market new policies on which risk and investment elements are combined.

COB 3.2: LIFE RISK POLICIES

What is a Life Risk Policy

Is a contract in terms of which a person, in return for a premium. undertakes to—

- provide policy benefits upon, and exclusively as a result of a life event; or
- pay an annuity for a period;
- and includes a reinsurance policy in respect of such a contract;

Whole life risk policy

In terms of the contract the insurer covers the life of the life insured for as long as he lives. There is no actual maturity date. The contract will end as soon as the life insurance is paid out.

Term risk policy

The insurance is taken out for a specified term. The policy will expire as soon as the term has run out.

Insurance Risk?

In insurance terms, risk is the probability that a claim event might take place before the end of the contractual term. Simply put: What are the chances that the life insured might die before the end of the term?

On the one hand, there is the client that represents the risk. This risk has to be quantified as well as is humanly possible. On the other hand there is the insurer that is accepting the risk. His cost for accepting the risk also has to be calculated.

It is not possible to know when or if a claim event will take place. But in order for the insurer to calculate the risk he's taking on, he has to make certain assumptions. He has to calculate what the probability of risk is that the life insured brings into the risk pool. And this probability must be based on scientific evidence. Scientific evidence such as real experience and statistics from the industry. Each life insured is underwritten individually in order to determine an appropriate risk profile as a basis for calculating his probable risk. The insurer then accepts the risk at a price which according to his calculations reflects the true risk represented.

Risks that can be covered by long term insurance policies

- Provision for loss of life: Life cover
- Provision for loss of ability to earn an income: Disability cover
- Provision for loss of ability to function normally due to injury or illness: Impairment Cover
- Provision for serious illness: Severe Illness cover
- Provision for serious injury or loss of use of limbs: Accident Cover

Income or capital needs

All of the above events can trigger both capital and income needs. At death all outstanding debt must be repaid to the bank and other creditors, and the executor will need capital to settle the estate. But just as important, the family will continue to have an income need – monthly household expenses, school fees, rates and taxes will continue as before. Previously this income need was catered for via lump sum life insurance that is used to buy an income, but nowadays insurers offer income products that are tailor made for income needs at e.g. death, disability and sickness.

Most normal people hope to live a long and healthy life, earn a decent living until they are too old to work, and then to retire peacefully…

But no one can be sure of that. Even with the best precautions you can't prevent death, illness or injury from happening. And you can't take out insurance to prevent it from happening either.

The best you can do is to take out insurance that will cover your financial needs should death, illness or injury befall you during your working life. The long term insurance industry has evolved to make provision for exactly this – the need to make provision in advance for the most serious events that could prevent you from taking care of yourself or your family financially.

If we have to summarise the events that life insurance covers it will be grouped as follows:

- Life Protection – will my family be taken care of if I die?
- Loss of income protection – Will my family and myself be taken care of should I lose my ability to earn an income?
- Lifestyle protection – Will I be able to financially survive a major health event and I do not die but have to drastically adjust my lifestyle?

These are the questions we need to ask ourselves and our clients when we do financial planning for a client. There are several different benefits available to make provision for these three pillars of insurance cover.

Life cover

A benefit that will be paid out in the event of the death of a life insured, usually in the form of a lump sum. But there are also benefits available that will pay a monthly income to the family if the client chooses this.

Disability cover

A benefit that will be paid out in the event of the life insured becoming totally and continuously unable to fulfil his occupational demands due to injury or illness.

In the case of lump sum disability cover, the disability has to be permanent – the insurer has to

be certain that the life insured will never again be able to do his work as stipulated in the contract, before the lump sum is paid out.

In the case of disability income benefits, the disability does not necessarily have to be

permanent. The insurer will pay out the income benefits for as long as the life insured is unable to fulfil his occupational demands as stipulated in the contract.

It follows from this that the probability of qualifying for disability income benefits are better than for lump sum benefits.

In order to improve his chances of qualifying for disability benefits, the life insured can choose to be covered for the specific occupation he is practising at the time of the disability event (regular occupation). On the other hand, he can choose to pay a lower premium and be insured for regular and reasonable alternative occupation instead. Once again it is much harder to qualify for the regular and reasonable alternative occupation benefit, than for the regular occupation benefit, because the insurer may refuse to admit a disability claim for the latter benefit if the life insured is still able to fulfil the occupational demands of any alternative job that his training and experience could reasonably qualify him for.

Remember: disability is the alteration of one's capability to meet personal, social or occupational demands due to an impairment, and is assessed by non-medical means (LOA definition of disability)

No-one that still has to work for an income can afford to be without disability cover, as your ability to earn an income is your biggest asset in life (provided you are not too old to qualify).

Impairment cover

A lump sum benefit that falls somewhere in between disability, dread disease and accident cover. It does not cover your ability to fulfil any occupational demands; it covers your ability to function normally after injury or illness. When assessing your claim the insurer will measure your ability to function normally against the criteria as stipulated in your contract, and not against your ability to do your job. Your contract will stipulate a list of qualifying conditions, as well as the degree of severity of such conditions. It also denotes clearly what percentage of the cover amount will be paid out in event of a qualifying claim.

One strict condition for payment of an impairment claim is that the impairment has to be permanent. For this reason, the insurer has to be satisfied that the claimant has already undergone all the treatment he could reasonably be expected to, and that he has already recovered as far as

can reasonably be expected in medical terms. In other words, the insurer has to be certain that any further (reasonable) medical intervention would not lead to recovery.

Functional impairment

Functional impairment is concerned with the proper functioning of the body as an integrated system. It would typically cover the central nervous system, the respiratory system, and the gastro-intestinal system.

Physical impairment

Physical Impairment is geared more towards the separate components, or limbs, of the body. It would typically cover the permanent loss of feet, hands, arms, ears, eyes, speech and hearing. Remember: Impairment is assessed by strict medial conditions and NOT your ability to earn an income.

Dread Disease cover

Dread Disease cover is not always easy to distinguish from impairment cover. The most prominent difference is that a dread disease benefit will be paid once it has been diagnosed, even if the condition is not necessarily permanent. The insurer will assess a claim without looking at the claimant's ability to do his job, and without waiting to see whether the condition will get worse or better. If the disease qualifies in terms of the conditions of the contract, the insurer will pay out as soon as it has been diagnosed.

For instance, if the insured has suffered a heart attack that meets the qualifying criteria, the insurer will pay out, regardless of whether the client will be able to go back to work, or of whether he will recover sufficiently to lead a normal life again. A list of qualifying conditions is stipulated in the contract, along with specified percentages of the cover amount for each condition. Claim events

will typically include cancer, heart attacks, heart valve surgery, strokes – the diseases most dreaded for their severe traumatic impact on the lives of the victims.

The fact that the claim condition does not have to be permanent, and does not have to be optimally treated before a claim can be assessed, means that it will be easier to qualify for dread disease benefits than for impairment benefits. It also means that dread disease benefits will be more expensive than impairment or disability benefits.

"It was never meant to play the role of a medical aid or provide cover for occupational disability. Dread disease cover was conceptualised by Prof Marius Barnard with the intention of ensuring people who are diagnosed with severe illnesses that will have a major impact on their financial situation, are able to claim for financial assistance." (Dr Eric Starke – Sanlam Medical Doctor)

Accident cover

Accident cover is a lump sum benefit that pays out if the life insured dies or loses the use of specified limbs or organs as a result of accident or injury. No medical underwriting is required to take out this benefit. Clients that can no longer qualify for death or disability benefits because of ill health will still be able to take out accident benefits.

Accident benefits are paid out as soon as the condition is confirmed. Unlike impairment benefits, the assessor doesn't have to wait until the claimant has recovered as far as possible after having undergone optimal treatment.

The benefit will only be paid out if the claim arises from an injury or accident. For instance, a claim for blindness will not be admitted if it can be traced back to hereditary or disease factors.

Typical accident benefits would include: Accidental death, total loss of hearing or vision, amputations, loss of use of arm or leg, multiple rib fractures.

The contract would specify a percentage of the cover amount for each listed benefit. For instance, loss of vision in one eye could qualify for 60% of the cover amount, while loss of vision in both eyes could qualify for a 100% claim.

ASPECTS OF RISK INSURANCE

- Premiums and pricing
- Guarantees
- Premium patterns
- Underwriting
- Sessions
- Exclusions and loadings
- Beneficiaries and nominees
- Stand-alone and accelerator benefits

Premiums and pricing

Don't confuse "*rates*" with "*premiums*". The **rate** is the price paid per unit of cover, while a **premium** is the payment, made on a regular basis (usually monthly). The premium includes the different rates for all the risk benefits, multiplied by the units of cover for each, plus other costs, such as policy fees.

Insurance is a contract between the life insured on the one hand and the life insurer on the other hand. The contract stipulates the rates payable in return for the cover (risk rates). The rates are calculated over the full term of the contract. In order to calculate the appropriate rate, the insurer has to take various factors into account, including the age of the insured, and the term of the proposed contract.

But he also has to include factors based on projections for the future. He has to take a view about what he perceives his future risk to be, based on current experience and expectations for the future.

It follows that, should his future claim experience differ dramatically from his current experience and current expectations for the future, the rates that he had calculated originally would no longer be able to sustain his risk over the full term of the policy. (For example, an outbreak of a world-wide untreatable killer disease, that had not been factored into the risk rates).

In such an event the insurer could go under, taking all his policyholders down with him. In order to protect himself and all the other stakeholders, the standard contract would make provision for an amendment of rates should the claims experience take a dramatic new direction.

This sounds ominous, especially to a client that is taking out insurance exactly to protect himself against unforeseen future events.

Guarantees

The insurer therefore gives a guarantee – this could differ from insurer to insurer, and from product to product – that the basis of his rates would remain the same for a specified term: The **guarantee term**. The guarantee term would apply to the first few years of a whole life policy. The longer the guarantee, the higher the rates (because of the bigger risk that the insurer is taking onto himself).

What happens at the **end of the guarantee term**? Once again this could differ from insurer to insurer and from product to product. The norm is to guarantee that once the guarantee term has expired, the basis of the rates would only be changed if the insurer's claim experience and future expectations differ significantly from the assumptions used when the original rate was calculated. (Note that the basis of the rates *won't* be affected by the life insured's higher age or new health status.)

Even here, after expiry of the original guarantee period, there is room for more guarantees. The insurer could conceivably offer a **rate cap** - a guaranteed maximum percentage with which the insurer could potentially increase the rates after expiry of the original guarantee term. But with every guarantee that is added, the rates will also have to be increased to reflect the additional risk for the insurer.

If the rates have to be increased at the end of a guarantee period, there will be a choice: Either increase the premium to maintain the same cover amount, or reduce the cover amount in order to retain the same premium.

Premium patterns

Once the risk has been priced appropriately, it still has to be distributed over the term of the policy. This distribution could take on the form of several possible premium patterns. For instance, the premium as well as the cover amount could remain constant over the duration of the period (**level payment pattern**). Or the premium could start out lower but escalate annually at a chosen rate over the period while the cover amount remains constant (**compulsory growth payment pattern**).

It is also possible to arrange for an automatic increase in the *cover* amount every year, in which case the *premium* will also have to be increased annually (usually at a higher rate than the actual cover increase rate).

Why are there so many choices? Because every individual has different needs and circumstances. The client's age and financial status at inception will probably be the determining factors when choosing an appropriate payment pattern. For example, a young client may need a substantial amount of life cover, but may not be able to afford a high premium while he's still struggling to get on his feet. He will be grateful to have the life cover right away at a lower initial premium, knowing that he'll be in a better position to afford the higher premiums later.

Underwriting

Underwriting refers to the process of evaluation that a prospective client has to undergo when applying for risk benefits – medical as well as occupational underwriting. The better the underwriting processes, the better the insurer's chances to rate the client's risk appropriately. And if an insurer's pricing is appropriate, his rates will be sustainable. And sustainable rates are the key to long-term success in this industry.

Medical underwriting

Medical underwriting involves a look at the client's medical history. His age, gender, weight, length, and smoking habits will all play a role. He will be asked for details about existing and previous medical episodes, medication, procedures, therapies, family medical history and so on, in order to form an accurate picture of his health outlook over the term.

Occupational underwriting

Occupational underwriting involves a look at the client's qualifications, level of income, type of occupation, time spent on administrative duties and so on, in order to form a picture of the client's socio-economic status, which plays an essential role in determining his risk. For instance, a person doing an administrative job in an air-conditioned office has a less risky occupation than a truck driver.

Part-time activities Underwriting

The life insured will even be asked for details about his **part-time activities**, should they include dangerous activities such as deep sea diving or hang gliding.

Exclusions and loadings

If the client's medical history does not warrant standard rates, the insurer may decide to impose a **medical exclusion** on identified risks, or he may add a loading to the premium, or he may refuse the cover for a specific benefit altogether.

Based on his occupational underwriting, the insurer may decide to exclude certain benefits, or to impose a **loading,** or to refuse the cover for a specific benefit altogether, if the associated risks with a specific occupation is deemed too hazardous.

The insurer may also impose a **contractual exclusion or loadings** on certain benefits, or refuse certain benefits altogether, because of the client's dangerous part-time activities. The loadings or exclusions will be stipulated in the contract.

Then there are also the **general exclusions** – blanket exclusions that apply to all the Sanlam risk benefits. For instance, death due to suicide is not covered. And injuries and disability if they

can be traced directly or indirectly from participation in riot or terrorism, deliberate self-inflicted injuries, drug and alcohol abuse, dangerous underwater diving, speed contests, sky-diving, professional boxing and so on, are also excluded.

Medical exclusion

If the client's medical history does not warrant standard rates, the insurer may decide to impose a medical exclusion on identified risks, or he may add a loading to the premium, or he may refuse the cover for a specific benefit altogether.

Cessions

A policy is an extremely handy tool to provide the security necessary to secure a loan. A bank, for instance, wants to be sure that a client's bond will be settled in the event of his death or disability before the end of the bond term. The client can cede a policy with life and/or disability cover to the amount of his bond to the bank, in which case the bank relies on the cover amount as security for the debt. A session like this is called a **collateral security session**. The bank is only entitled to the risk benefit in event of the life insured's death or disability, to the value of the outstanding amount of the bond. If the total risk benefit exceeds the outstanding bond debt, the excess becomes payable to the deceased's beneficiaries or estate. (At present it is Sanlam's policy not to cancel the beneficiary when a collateral cession is registered, but a nomination will be cancelled). The collateral cession may be cancelled and the policy contract returned to the owner. An outright session on the other hand means that the original owner cedes full ownership of the policy to the cessionary. The new owner is entitled to the full proceeds of the policy.

Cessions and	
Cessionary	New owner
Cedent	Original owner
Collateral security cession	Partial transfer of ownership onto the cessionary. The cessionary's claim to the policy is limited to the amount of the outstanding debt.
Outright cession	The full ownership goes over onto the cessionary. The original owner loses all rights on the policy.

Beneficiaries and nominees

Parties on a policy	
Policyholder / Planholder / Proposer	He is the owner of policy. In most cases it would be the life insured himself, but it could also be another person taking out the policy on the life of the life insured.
Life insured	The person on whose life the risk benefits are taken out. There can be more than one life insured on one policy.
Beneficiary	Will receive the death benefits after the death of the life insured. There can be multiple beneficiaries on one policy.
Nominee for ownership	Will become the new owner of the policy in the event of the policyholder's death. There can only be one nominee on a policy.

Benefits

Stand-Alone and Accelerator

An accelerator benefit is only available if there is life cover on the policy as well, because the accelerator benefit is actually linked to the life cover. When the accelerator benefit is paid out, the death benefit is reduced accordingly – in other words, an accelerated payment of the death benefit.

A stand-alone benefit can be taken out even if there is no life cover on the policy – in other words it can be taken out on its own. When a stand-alone benefit is paid out, it will not affect the life cover on the policy.