PROTECTION

Will it all end in tiers for critical cover?

Nicola York assesses the protection industry's appetite for severity-based payouts on critical-illness products and asks whether this new model, introduced in the UK by Virgin and Prudential, will become as popular as in South Africa

The architect of critical-illness cover, Dr Marius Barnard, says his biggest regret is that he did not introduce severity-based payment when he created the product.

He is now trying to rectify the situation in the UK market and hopes it will become standard practice to introduce severity-based payment, as has happened in South Africa.

Barnard is the brains behind the Virgin cancer cover product – the Big V – which provides three tiers of cover with payouts of 10, 25 or 100 per cent of the sum assured, depending on the stage of cancer.

With the recent introduction of Prudential's flexible protection plan which also offers payments on a severity basis, the question arises as to whether the rest of the protection market will now move in this direction.

Not everyone is convinced that this is what the critical-illness market needs. RGA head of sales and marketing Jason Hurley says severity-based payment is a good idea in theory but presents difficulties in practice.

Hurley says: "The problem is it gets so complicated so quickly. From a reinsurer's point of view, there are the challenges of pricing, underwriting and managing claims. But from a consumer's point of view, there are even more challenges. This type of structure would be fine in a world where the consumer trusts the insurer."

Consumer trust is something which Hurley says is prevalent in the South African market and, as a result, the severity-based model introduced by Discovery – the firm behind the Pru's flexible protection plan – has been adopted by the majority of insurers in that market. However, he does not think it will necessarily work in the UK.

"We have regulation of salesforces, the ombudsman, treating customers fairly and a lack of consumer trust. Those things do not happen in South Africa. They have a low level of regulation, direct salesforces and, as a result, I struggle to see it working in the UK," says Hurley.

He says insurers have a number of choices when deciding how to compete with rival providers. They can choose to compete on price, convenience, service or the quality of risk management. With Norwich Union and Legal & General accounting for over 30 per cent of the market between them, he says this is partly why Pru has chosen to offer something totally different.

RGA is the reinsurer for the Big V and says the problem both companies faced when designing the product was ensuring that the consumer understands what they are buying. They originally considered including severity options on heart attack and stroke but the medical terminology became too complicated so they decided to keep it simple.

Hurley agrees there is potential for a product to bridge the gap between the Virgin and Pru offerings. His concerns over the Pru plan are that premiums are twice as high and brokers get twice as much commission for selling it, so he fears the product could take off for the wrong reasons.

Hurley says: "There has certainly been much more innovation in the past two years than in the past 10 years. I can see there being more innovation than that but anything providers will bring in will probably be a lot less extreme than Prudential's offering.

"If you asked me in

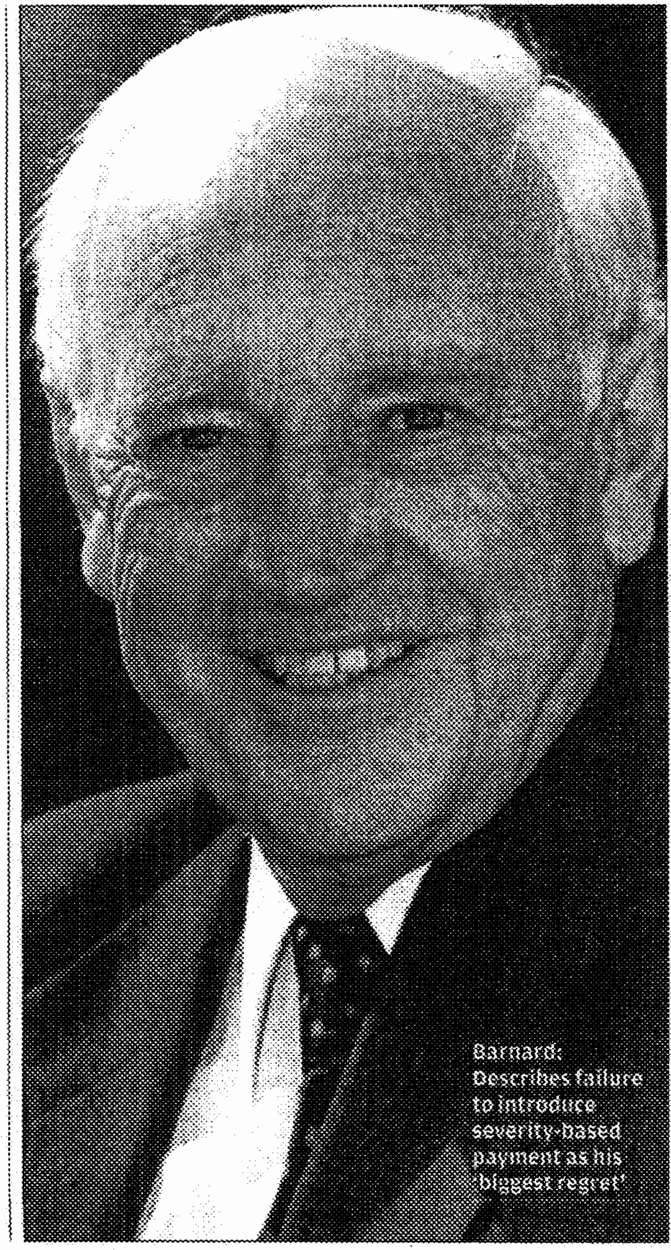
a questionnaire whether severity-based payments will become standard procedure for providers, I would tick the maybe/possibly box."

Direct Life & Pensions sales and marketing director Richard Verdin says the idea of severity-based cover has been around for years but few providers have introduced it successfully.

He says: "The lottery effect of payouts is causing a lot of concern with the insurers but the issue is does the consumer understand severity-based payments at point of sale? It is going to lead to a lot of disputes because even doctors do not agree on the definitions."

Verdin believes a tiered system of payments will lead to an additional level of complexity and confusion and an increasing number of disputes over payouts, and he is not convinced that the UK market is equipped to deal with these issues successfully. He says mortgage brokers do not understand current products fully so to introduce more complicated CI policies is not necessarily a viable option.

Verdin adds that anti-competitive concerns mean it is difficult for providers to work together with reinsurers to develop new



Barnard: Describes failure to introduce severity-based payment as his 'biggest regret'

products or change existing ones and he believes such concerns will have to be put aside so that the industry can come up with solutions to the lack of sales.

Verdin says: "We need a considerable amount of dialogue with the FSA, Financial Ombudsman Service and consumer bodies, too. There is a lot of work that needs to be done but none of it will happen unless all interested parties and stakeholders are involved and ask for it to happen."

Protection providers have been careful not to be unduly negative about the Pru's new model but what do they think about the severity-based calculations within the product?

Scottish Equitable Protect head of marketing Rod McKie says the complexity of severity-based products concerns him. He says: "There is no chance that the average man on the street would understand the differences in severity. There is also a trust factor in the relationship between the provider, the adviser and the consumer. It could only lead to further consumer misunderstanding rather than improving it. We will not increase consumer trust in us by launching a next-generation CI product."

But McKie does not rule out ScotEq introducing severity-based cover in the future and says it will be looking at the opportunities which are thrown up by the market on a periodic basis.

"There is limited scope to sell on volume with severity. We have to be sensitive to the differences between us and South Africa. In the UK, severity-based products will be a slow burner rather than a radical shift," he says.

CBK principal Peter Chadborn is frustrated by commentators who say the idea of severity-based payment is too complex for advisers and consumers to understand. He says: "It is down to the competency of the adviser. If I can explain a self-invested personal pension or equity-release plan to a consumer, I can understand and explain this type of CI product to them as well. I take it as an insult when people say it is too complex."

Chadborn thinks severity-based payouts will give confidence to consumers. He says: "I am a fan because of the all-or-something approach as opposed to the all-or-nothing approach which most policies have. Severity-based cover would be something positive we could talk to clients about. I think other providers will follow this model."

He admits there are barriers such as difficulties in pricing and more expensive premiums and says companies will need to train adviser firms individually to overcome this.

Skandia protection marketing manager Alison Turner-Holmes says it is all about managing client expectations at point of sale. She says: "It depends which end of the spectrum you want to sit. You would not introduce it if you were price-driven. Skandia will not introduce complexity to the product but we will wait and see what the ABI's statement of best practice says."

Royal Liver IFA market manager Andy Milburn says his company was looking at introducing severity-based payment but it would have led to holes in the claims' experience and became too complicated to price.

Milburn adds that severity means different things to consumers and those in financial services. He says: "Consumers see it as how ill they are, which is quite different from insurers, who would view it as to how the client's earning capability will be affected.

"I think the only viable way to measure it would be to base it on earnings' capability rather than medical definitions, which would become too complicated and cause too many disagreements."