Subject SP1

CMP Upgrade 2022/23

CMP Upgrade

This CMP Upgrade lists the changes to the Syllabus, Core Reading and the ActEd material since last year that might realistically affect your chance of success in the exam. It is produced so that you can manually amend your 2022 CMP to make it suitable for study for the 2023 exams. It includes replacement pages and additional pages where appropriate.

Alternatively, you can buy a full set of up-to-date Course Notes / CMP at a significantly reduced price if you have previously bought the full-price Course Notes / CMP in this subject. Please see our 2023 *Student Brochure* for more details.

We only accept the current version of assignments for marking, *ie* those published for the sessions leading to the 2023 exams. If you wish to submit your script for marking but only have an old version, then you can order the current assignments free of charge if you have purchased the same assignments in the same subject in a previous year, and have purchased marking for the 2023 session.

This CMP Upgrade contains:

- all significant changes to the Syllabus and Core Reading
- additional changes to the ActEd Course Notes and Assignments that will make them suitable for study for the 2023 exams.

1 Changes to the Syllabus

There are no changes to the Syllabus Objectives.

2 Changes to the Core Reading

This section contains all the ***non-trivial*** changes to the Core Reading.

Chapter 1

Section 2.3

The paragraph at the top of page 15 has been replaced with:

Where policies are written to an expiry age, it is not normal to charge premiums at the very end of the policy (the duration being governed by the deferred period), when any new sickness could not result in a claim.

Chapter 2

Section 2.3

The final sentence on page 12 has been deleted:

A relatively minor illness such as epilepsy could lead to bus drivers losing their licence and thus being unable to fulfil the major part of their job and needing alternative employment.

Chapter 3

Section 3.2

The final line of the first paragraph has been expanded as follows:

The type of benefit could be selected from a range of alternatives, including a single lump sum payment, an annuity certain, a lifetime benefit subject to ongoing disability, a restricted benefit (*eg* payable for a maximum period, or to a maximum total amount) subject to ongoing disability, or possibly full <u>or partial</u> indemnity.

Chapter 6

Section 4.2

The first paragraph has been replaced with:

The individual with dependants (for example a spouse and/or children) needs the comfort of knowing that there will be an income stream to provide for their upkeep and welfare in the future. This must include a situation in which the individual is unable to work, or must take a lower-paid job, due to ill health.

Chapter 7

Section 1.1

In the second paragraph under 'Environmental, social and governance (ESG) considerations, change 'life insurance companies' to 'health and care insurance companies'.

Chapter 12

Section 3.3

The penultimate sentence on page 9 now reads:

These data sets are often readily available (in many territories) and are often free.

Chapter 21

Section 2.2

The section on unexpired risk reserve has been amended as follows:

- **Unexpired risk reserve** (URR)**: a reserve held in excess of the unearned premium reserve where it is felt that the premium basis is inadequate to meet future claims and expenses in respect of these periods of insurance not yet expired.**

  This is effectively a prospective approach: how much is needed now to cover the expected claims and expenses from the unexpired risk period?

  If the UPR is inadequate to cover the claims and expenses for unexpired risk due to insufficient premiums, then more will be needed. The URR is an estimate of the additional amount that is *actually* needed to provide for the unexpired risk, over and above a simple proportion of premium.

  The URR would typically be calculated by estimating the future loss ratio, applying it to the proportion of premium unexpired, and subtracting the UPR.

Chapter 31

The following definition has been added to the Glossary:

Cedant

The term cedant is most commonly used with respect to reinsurance, where a ceding insurer (the cedant) transfers all or part of the risk on business it has written to a reinsurer. The ceding insurer pays the reinsurer a premium in respect of the risk transferred.

The definitions for 'Proportionate benefit' and 'Rehabilitation / partial benefit' have been split into three separate definitions and amended as follows:

Partial benefit

Under IP policies, a benefit is usually only paid if policyholders are unable to work. However, there may be cases where their ability to work is clearly limited by their condition, but they've attempted to continue working as best they can. In these cases, health and care insurance companies sometimes agree to pay a partial benefit even though the policyholder was never so incapacitated to be 'unable to work' (as defined by the claims criteria).

Proportionate benefit

Under IP policies <u>that use an 'own occupation' claims definition, a proportionate benefit can be paid to claimants who return to work but in a new, lower-paid occupation. That is, if a claimant takes up employment in an occupation that is different to the one from which they were originally incapacitated, the claim benefit may continue, but it is usual for the continuing benefit to be reduced.</u> The reduction will relate to the ratio that the gross earnings from the new job bear to those from the occupation against which disability was being claimed.

It is a standard requirement that disability from the original occupation continues whilst a proportionate benefit is being paid. Unlike for a partial benefit, companies typically require a full claim to be established before a proportionate benefit can be claimed.

<u>Rehabilitation benefit</u>

<u>Under IP policies that use an 'own occupation' claims definition, a rehabilitation benefit can be paid to claimants who return to their own occupation but in a reduced capacity.</u> The amount of benefit is usually calculated in the same way as that for proportionate benefit, as described above.

Rehabilitation can also apply to the process of counselling, whereby disability counsellors assist disabled persons with advice on practical matters to do with the benefit and their disability, in order to aid a return to work.

3 Changes to the ActEd material

This section contains all the ***non-trivial*** changes to the ActEd text.

Chapter 1

Page 12

The section on 'Proportionate or rehabilitation benefits' has been replaced by a section on 'Partial, proportionate or rehabilitation benefits'. Replacement pages can be found at the end of this Upgrade.

Chapter 21

Practice Question 21.1(ii)

In the solution, the section on 'Unexpired risk reserve (URR) / additional unexpired risk reserve (AURR)' has been amended to read:

Unexpired risk reserve (URR)

The URR is the reserve held in excess of the UPR where it is felt that the premium basis is inadequate to meet future claims and expenses in respect of unexpired periods of cover. [½]

This should be small, unless there have been significant shortcomings in recent premium rates. [½]

Practice Question 21.2

This question and solution have been deleted.

4 Changes to the X Assignments

Overall

There have been minor changes throughout the assignments, including changes to mark allocations.

More significant changes are listed below.

Assignment X4

Question and Solution X4.8

The dates have all been rolled on by 3 years.

5 Other tuition services

In addition to the CMP you might find the following services helpful with your study.

5.1 Study material

We also offer the following study material in Subject SP1:

- Flashcards
- Revision Notes
- ASET (ActEd Solutions with Exam Technique) and Mini-ASET
- Mock Exam and AMP (Additional Mock Pack).

For further details on ActEd's study materials, please refer to the 2023 *Student Brochure*, which is available from the ActEd website at **ActEd.co.uk**.

5.2 Tutorials

We offer the following (face-to-face and/or online) tutorials in Subject SP1:

- a set of Regular Tutorials (lasting a total of three days)
- a Block (or Split Block) Tutorial (lasting three full days)
- an Online Classroom.

For further details on ActEd's tutorials, please refer to our latest *Tuition Bulletin*, which is available from the ActEd website at **ActEd.co.uk**.

5.3 Marking

You can have your attempts at any of our assignments or mock exams marked by ActEd. When marking your scripts, we aim to provide specific advice to improve your chances of success in the exam and to return your scripts as quickly as possible.

For further details on ActEd's marking services, please refer to the 2023 *Student Brochure*, which is available from the ActEd website at **ActEd.co.uk**.

5.4 Feedback on the study material

ActEd is always pleased to receive feedback from students about any aspect of our study programmes. Please let us know if you have any specific comments (*eg* about certain sections of the notes or particular questions) or general suggestions about how we can improve the study material. We will incorporate as many of your suggestions as we can when we update the course material each year.

If you have any comments on this course, please send them by email to **SP1@bpp.com**.

Assessing income is straightforward for those salaried employees with one job. However, many self-employed people purchase IP insurance and their cases are generally less simple. The self-employed often have incomes that fluctuate over time, and proof of income is not straightforward because accounts are usually only prepared on an annual basis for tax purposes. For efficient tax planning such individuals may receive income partly as salary and partly as dividend income, and in small businesses there may be complex arrangements for the payment of family members.

If the above methods fail to prevent over-insurance, many policies will address the issue at claim stage, with claim benefits being cut back where benefits exceed the maximum benefit formula. If there is no corresponding refund of premiums, this can result in policyholders having paid for cover to which they are not entitled. Failure to manage the expectations of policyholders can lead to conflict between insurers and those responsible for representing the interest of consumers, so that a robust initial design is better than relying on cutting back benefits at claim stage.

The process of checking the proposer's income and other circumstances to prevent over-insurance is known as financial underwriting.

Escalating benefits and premiums

IP insurance policies can be completely level, whereby the benefit to be paid on sickness remains at the same level as that specified at the outset of the policy and does not increase in or out of claim.

Nowadays, increasing benefits are much more common. Examples of escalation rates include a fixed percentage, *eg* 5%, or increasing in line with some form of published prices or earnings index. The index would usually be subject to a cap.

It is common to offer a link to an index of consumer prices, subject to a maximum increase of, say, 5% *pa*. The chosen index should be one that is familiar to, and well understood by, policyholders (*eg* one that is frequently discussed in the newspapers and on TV, such as retail price inflation (RPI) or consumer price inflation (CPI) in the UK). However, a link to an earnings index, such as the National Average Earnings Index (NAEI) in the UK, may provide a better way of maintaining living standards during incapacity.

It is not prudent to have escalation rates that exceed expected rates of earnings escalation, as these increase the replacement ratio. High escalation rates may also result in difficulty for the insurer in matching assets and liabilities. For this reason, insurers restrict the level of fixed rate escalation that they will offer on new business.

Benefits may increase at different rates in and out of claim, though this can lead to complex product design in some cases.

Some specific examples are:

- **Benefits escalate at the same rate in and out of claim: relatively straightforward, and the most common design.**
- **Some benefit escalation out of claim but none in claim: an unusual design motivated perhaps by a desire to encourage a return to work.**

  For example, benefits and premiums might increase each year by the rate of inflation subject to a maximum of 5% *pa*, but once a claim commences, the claim payment remains constant.

  A more common design is to have some escalation in claim with a higher escalation out of claim.
- **Some escalation in claim, no (or lower) escalation out of claim: slightly more common. If the design is such that, following a claim terminating, the benefit reverts to the level of the pre-claim benefit, then this might be difficult to justify.**

Designs in which benefits escalate when not claiming usually feature escalating premiums as well. A simple and popular design has the premiums increasing at the same rate as the benefits. This effectively means that the increase is based on the premium assumptions prevailing when the original contract was taken out.

Some protection against adverse trends in claims experience (and high inflation) may be obtained by an alternative design whereby the increase in premium is based on the current premium rate for additional benefit, using the age at time of increase. This will usually mean a greater rate of escalation of premiums than of benefits, unless rates have reduced. There are a number of possible variations on these two designs.

Partial, proportionate or rehabilitation benefits

Partial, proportionate and rehabilitation benefits all offer a lower level of benefit to policyholders whose health is not so incapacitated as to be 'unable to work' (as defined by the claims criteria). Specifically:

- partial benefits – these may be paid to policyholders who are still able to work, but whose ability to work is clearly limited by their condition; in this case, the policyholder will never have been fully signed off work
- proportionate benefits – these may be paid to claimants who return to work, but in a new, lower-paid occupation
- rehabilitation benefits – these may be paid to claimants who return to their own occupation, but in a reduced capacity.

The reduction in benefit will relate to the ratio that the gross earnings from the new job bear to those from the occupation against which disability was being claimed. This is defined in more detail in Chapter 31 (Glossary).

Waiver of premium benefit

Most IP policies will include the condition that premiums are waived (*ie* credited without the policyholder making payments) during periods when benefits are payable. This will usually be charged for by a small percentage addition to the premium rate.

2.3 Benefit definitions (timings)

In this sub-section, we discuss *when* benefits are payable. There are three relevant 'periods' to consider, namely the:

- waiting period
- deferred period
- linked-claims period.

We also consider the expiry age or term of the policy.

Waiting period

This is a specified period following the commencement of the policy during which benefits will not be paid. This is now uncommon in product design.

The aim of a waiting period is to control selection against the insurer, *ie* the risk that those who think they have an increased chance of falling sick in the near future will choose to buy an IP policy. This is necessary as the proposal form may not pick up that there is an increased risk of sickness, perhaps because the current symptoms have not resulted in the proposer seeking medical advice yet. A period at the start of the policy (*eg* six months) during which premiums are paid but there is no entitlement to benefits may dissuade prospective policyholders from seeking insurance if they expect to make a claim soon. If they *do* buy insurance, it removes the liability to pay benefits as a result of early claims.

However, the idea of paying premiums with no entitlement to benefit will not appeal to many prospective policyholders and so initial underwriting is generally now used to reduce the risk of anti-selection instead.

Deferred period

An insurer will not usually pay benefits during the first few weeks of sickness. This is known as the deferred period. The main reasons for most contracts having a non-zero deferred period are to:

- **integrate with benefits provided by the policyholder's employer**
- **reduce the cost of claims to the insurer (and therefore the price** (premium)**)**
- **reduce the insurer's administration costs (and therefore the price** (premium)**)**
- **meet true customer needs (*eg* most policyholders would not want to submit a claim for a couple of days off with 'flu).**

In the UK, for example, the most common deferred periods in the market are 4, 13, 26 and 52 weeks. Other less common deferred periods are 0, 1, 8 and 104 weeks. 28 weeks is often found as a deferred period under group arrangements.

Another possibility is a 'split deferred' policy. An example of this is a policy that pays out a benefit of £250 per week after 13 weeks' sickness, increasing to £500 per week after 26 weeks' sickness. The main reasons for such a design are the first two points listed above.

Recently it has become common to insert a policy condition that requires the policyholder to notify the insurer when they have been sick for a given period (*eg* one month), even though the deferred period is much longer than this.

Question

What is the insurer hoping to achieve by the use of this early notification condition?

Solution

This allows the insurer to offer help and advice through their rehabilitation services at an early stage. This early intervention may help to reduce or even eliminate a claim at the end of the deferred period. The policyholder gets a 'free' benefit in the form of an advice service, but the insurer is hoping that the cost of providing the service will be more than paid for by the claims costs that are saved. This is seen as part of the claims management process.

Early notification also means that near the end of the deferred period, the insurer can conduct a thorough claims assessment and so be ready to pay a valid claim immediately when the deferred period ends. This will remove the pressure to assess a claim quickly at the end of the deferred period, thus reducing the likelihood of a disputed claim.

Linked-claims period

One way in which many insurers seek to encourage a return to work when claiming is to waive the deferred period if sickness recurs within say 26 or 52 weeks. This is sometimes known as a 'linked-claims' condition.

Question

How does a linked-claims period encourage claimants to return to work?

Solution

If claimants return to work and relapse into sickness within a short period, they would have to serve another deferred period before policy benefits resume. As a result, they might tend to delay returning to work until they are certain of not falling sick again within a short period of time. With a linked-claims period, they can try returning to work, without the fear of having to complete another deferred period if they fall sick shortly after returning to work.

Expiry age or term

The expiry age is the age at which benefits cease and is often the same as the expected retirement age.

Typical expiry ages in the market are 50, 55, 60 and 65. Other expiry ages are sometimes offered (either intermediate or lower for those with lower normal retirement ages, *eg* professional sportspeople).

There are examples where this is not the case, such as mortgage business, which is usually written for a fixed term rather than to an exact age.

A minimum potential term of five years ensures that IP business is classified as long-term rather than short-term business.

Where policies are written to an expiry age, it is not normal to charge premiums at the very end of the policy (the duration being governed by the deferred period), when any new sickness could not result in a claim.

2.4 Claim definitions

In this section, we discuss *what* conditions result in a valid claim, *ie* the definition of incapacity. Definitions are typically occupational, however non-occupational definitions also exist.

Occupational definitions

The insured's occupation affects IP insurance product design in two ways:

(a) the price charged

(b) claim payment.

(a) ***The effect of occupation on the price charged***

IP insurance rates are usually dependent on the policyholder's occupation. In the UK and elsewhere, most occupations are divided into different classes (*eg* between three and six). The cheapest rates are then applied to the least risky class, with other classes usually being set as some flat multiple of these. The multiples can be quite high, *eg*:

Class 1	**=**	**100%**
Class 2	**=**	**175%**
Class 3	**=**	**300%**
Class 4	**=**	**400%**

These classifications, and the multiples used, can vary among insurers and between territories.

The categorisation of occupations is related to the claims experience. Claims experience is reflected in the number of sickness inceptions and also the length of the periods of sickness. Some occupations have an obvious physical danger. Some others might be thought of as being 'healthy', but in reality experience high levels of absence, *eg* due to mental illness. Claims experience can also be worse when the demands of the occupation require complete recovery before the policyholder can resume working.

Some 30 years ago, teaching was generally rated (in the UK) as a Class 1 occupation, but over the years many companies have rated teaching as a Class 2 or 3 occupation. The rating of an occupation depends upon its expected claims experience, so this change suggests that insurers have seen a rise in claims from those in the teaching profession.

The increase in claims is most likely to be a result of the increased pressures of the job. This has resulted in an increase in stress-related illnesses, such as psychiatric illnesses and heart attacks.

The class into which an occupation falls may vary by insurer. Sometimes some occupations (such as doctors or dentists) might have entirely separate rates.

This is probably due to IP insurance being a popular cover amongst professions such as doctors and dentists. People in these professions are often self-employed, and so some insurance companies will have sufficient experience on such professions to be able to calculate separate premiums for these occupations if they so wish. There may also be an argument that people in specialist occupations, such as dentists or surgeons, may present particular risks to the insurer. For example, a dentist that damages a finger may not be able to work until it is fully recovered.

(b) ***The effect of occupation on the claim payment***

There are many possible definitions of claim. The main distinction is between those that relate to being able to carry out an occupation, and those that do not. The former may be unsuitable for those not in paid employment (*eg* housepersons and the unemployed).

For those not in paid employment an alternative criterion for assessing incapacity, such as one based on inability to perform various tests (see below), will be used. However, a common approach is to use an occupational-based definition.

Most definitions are occupational – examples are as follows:

- **inability to perform own occupation**
- **inability to perform own occupation and any other suited occupation by education, status or training**
- **inability to perform own occupation for an initial period (*eg* the first two years) of claim followed by inability to perform any occupation thereafter**
- **inability to perform any occupation.**

The expected claims cost will usually be highest for the 'own occupation' definition and lowest for the 'any occupation' definition. These two definitions are straightforward compared to the 'any other suited occupation by education, status or training' definition, which has the potential for dispute at the claims stage. With effective counselling and rehabilitation, the policyholder usually welcomes the opportunity of returning to work at a reduced salary, which is then augmented by the policy benefits to the level insured prior to sickness.

Alternative incapacity criteria

The alternative to an occupational definition will need to define the claim event in terms of an inability to perform various tests, regardless of occupation. Examples of possible types of test are:

- **functional assessment tests (FATs)**
- **activities of daily living (ADLs)**
- **activities of daily working (ADWs)**
- **personal capability assessment (PCA).**

Disability claim definitions are considered further in Chapter 2.