

Severity-Based Critical Illness: A product for now



In the Asia Pacific market, the Severity-Based Critical Illness insurance product is fast emerging as a strong offering, benefiting both consumers who want flexible protection and insurers wanting to mitigate claims risk. **Mr Jerome Matrundola of RGA International Corp** explains the various configurations and benefits of this popular product for both policyholders and insurers.

Critical illness (CI) insurance is, arguably, the life insurance product that has seen the most innovation in the last decade. When first introduced in South Africa in 1983, CI (then called dread disease insurance) covered just four events: heart attack, cancer, stroke, and coronary bypass surgery.

Over the years, CI has evolved into a complex, wide-ranging product with broad utility. Today, insurers designing CI can differentiate their products by selecting from over 100 defined impairments, and incorporating multi-pay frameworks and reinstatement options that enable payouts for CI claims while the policy, much like car insurance, still remains in force. In addition, both standalone and comprehensive policies can be customised for women and children, via inclusion of coverage for female-specific cancers and pregnancy complications and definitions that spotlight critical illnesses more commonly affecting children. Simplified underwriting and guaranteed acceptance underwriting have also been introduced to CI.

The product has also been broadened to meet a wide range of needs, from mortgage protection and simple cancer coverage, and can serve as a proxy for health coverage. Finally, it is now available through a broad range of distribution channels, and is growing fast throughout Asia.

Configurations

Today, the CI configuration known as Severity-Based Critical Illness (SBCI) is truly coming into its own. This product, also known by the names Scaled CI, Early-Stage CI, and Staged CI, first emerged in the early 2000s. It provides coverage that aims to match claims payouts with the severity of claimed conditions.

Within SBCI are three basic impairment design configurations, which we call “Within Impairment,” “By Impairment,” and “Plus Exclusions.” The “Within Impairment” design takes a single impairment, such as cancer or stroke, and defines and stratifies a range of severity levels for claims within that impairment. Cancer severity levels, for example, are based on the stage and/or type of the cancer, depending on the product: the more serious the cancer, the higher the payout. Severity levels for other conditions are assessed using a combination of the actual severity of the claimed condition and the procedures being used to treat it. Covered impairments can have up to six levels of severity.

In the “By Impairment” configuration, the insurer examines each impairment covered by the product and then bases its assessment of the severity of the claimed impairment on whether that impairment will affect the

claimant’s life expectancy and/or lifestyle. If, for example, an insured were to claim for heart attack, an impairment that affects both life expectancy and lifestyle, the claim would most likely receive a higher severity assessment and a correspondingly higher payout. If, however, the claimed impairment only minimally affected either life expectancy or lifestyle – or neither – it would receive a lower severity assessment, and the claimant would receive a lower payout. An example might be pacemaker insertion.

Extensions and partial payouts

The third configuration, “Plus Exclusions,” permits small payouts for critical illnesses at low severity levels. These conditions are commonly excluded by the strict language of the impairment’s policy definition, and this configuration also frequently incorporates the severity-scaling elements of the first two.

Policies permitting payouts for minor forms of covered conditions that are excluded by strict CI definitions will pay out a small percentage of the sum assured upon a diagnosis of an early stage version of a covered impairment. For example, most CI definitions of cancer exclude certain of its more minor forms, such as early melanoma or early prostate cancer, but this third configuration might provide partial sum assured payouts for these forms. A similar example would be giving a partial payout for carcinoma in-situ or for angioplasty, as these are also usually excluded by CI definitions.



When claims fall into this grey area, both policyholders and insurers might deem it better to receive a payout of even 5% or 10% of the total sum assured rather than have the claim denied. Insurers will have the additional benefit of higher claim-paying statistics, which can improve trust with distributors, protect their image and brand, and by extension, the life insurance industry's reputation as a partner for consumer healthcare financial needs.

Benefits

Over the past few years, SBCI has been gaining traction throughout Asia. Currently, insurers in Australia, Singapore, Hong Kong, Malaysia, Taiwan, China, Indonesia and Japan sell the product. It is selling well in all of these countries, and it is highly likely that insurers in more Asian countries will look to develop and issue product for their own markets.

SBCI's flexibility benefits both sellers and buyers. For insurers, it discourages anti-selection and combats CI's earlier "windfall benefit" aspect, wherein a less severe version of a critical illness event could result in a payout of 100% of the sum assured amount. In versions that take into account medical advancements that occur after the policy's purchase when assessing a claim's severity – particularly important in markets where upgraded benefits are passed to existing policyholders – the insurance company's bottom line is better protected.

It also encourages policyholders to file claims at early, milder stages of their CI conditions, which is in itself a win-win situation. Policyholders benefit because the conditions are caught at early, non-severe stages, thereby extending life spans. Insurers win because policyholders, by making claims at earlier stages and do not wind up with more severe illnesses and so incur much lower expenses. It is also a huge advantage to pay lower amounts for milder forms of covered illnesses.

Finally, with all of the various levels of severity-linked payouts and the improving capabilities around claims management, payouts based on procedures, and the product configuration permitting payouts for mild versions of conditions normally excluded by the impairment definition, the product can be seen as proxy for health coverage with implicit income protection.



A bright future

SBCI is finding some success in the independent financial adviser market. According to a May 2010 article in the UK publication Health Insurance, at least one insurer offering SBCI was receiving business from over 5,000 intermediaries. Selling through intermediaries reduces the pressure on life insurers to pay for claims filed for impairments with definitions that are not completely understood by the policyholder.

A new market for SBCI is also emerging in the direct-to-consumer channel. Companies are developing and selling versions of the "Plus Exclusions" configuration, which is finding traction due to its payout flexibility.

Of course, SBCI has challenges: it is a complex product to develop, design and price. Channel options for distribution, though growing, are still limited, and multiple severity levels add yet another layer of complexity. In addition, some consumers have questioned whether the possible cost savings are worth the extra complexity, and "Plus Exclusions" coverage could have more than one significant impact upon pricing.

All in all, however, demographic trends throughout Asia have been pointing to an increasing need for the kind of financial protection severity-based critical illness insurance can provide for consumers. For insurers, the key is determining how to meet the broad critical illness protection needs of each of its market in ways that are cost-effective yet comprehensive. SBCI insurance is emerging as an effective means to do so. ■

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