Swiss Re

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# Life Cover Payouts – under the microscope

# Summary


In this Report, we provide updates on the issues raised in our previous reports, *Life cover payouts: changing direction* (February 2021) and *Trust registration and unintended consequences* (November 2019), now viewed through the lens of the Consumer Duty:

- potential pitfalls from the trust registration rules now in force, and
- the existing problems with life policy setup and trust flaws

... along with options to meet the Consumer Duty requirements.

In 2019, we researched and provided evidence of the unintended consequences for individual life policy setup that registration of trusts under the anti-money laundering legislation would have brought.

Fortunately, and partly in response to this work, near-complete exemption for pure protection was confirmed in January 2022, as we will go on to explain.

We will also show how the other issues with life policy setup, as identified in 2019, have grown still further since our updated Report in 2021, "Life cover payouts – changing direction".

Unless otherwise stated, the data used are from respondents surveyed for Swiss Re's Term & Health Watch reports.

## Risk factor movements

The key risk areas previously identified, relating to an increasing proportion of life policies being sold to cohabitees for their partner without ensuring the partner can claim, have increased further:

- **% single life policies** – moved up again in 2021 to 78.5% overall (level and decreasing term) from 76.6% in 2020, and remains at nearly 90% of all level term life cover, including with critical illness (CI).
- **% non-advised level term life** – up again, this time to 50.3%
- **% policies in trust** – the trust gap remained unchanged in 2021 at approximately 84% of single own life policies
- **% unmarried** – in 2021, 27.6% of all couples living together and under 65 were cohabitees (18.5% in 2001 and 22.9% in 2011)
- **probate delays** – in H1 2022, the time from application to grant of probate or equivalent in England and Wales has increased by roughly two months, compared to 2018.

This combination of factors has placed an even greater number of potential claimants at risk of delays or, for the cohabiting sub-set of these, no access to the death benefits. The market-wide exposure to this was over a million new cases a year over the last 3 years. In 2021, this included an increase of an additional estimated 56,000 single life policies not in trust, bringing the possible total to approximately 1,086,000.

## But there are solutions

Greater adoption of contractual beneficiary nomination would substantially resolve this.

Until then;

- simple interim quick fixes can be applied, and
- unnecessary trip points can be assessed and removed from trusts and policy wordings.

## Why 2023 should be a turning point

The Consumer Duty means that insurers and intermediaries alike must move much further to ensure and be able to demonstrate that they have taken all reasonable steps to protect customers and their beneficiaries from the risks of life cover proceeds not being available to the intended person.

We are grateful to all those who have contributed the data included in this Report.

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# Why just focus on term assurances?

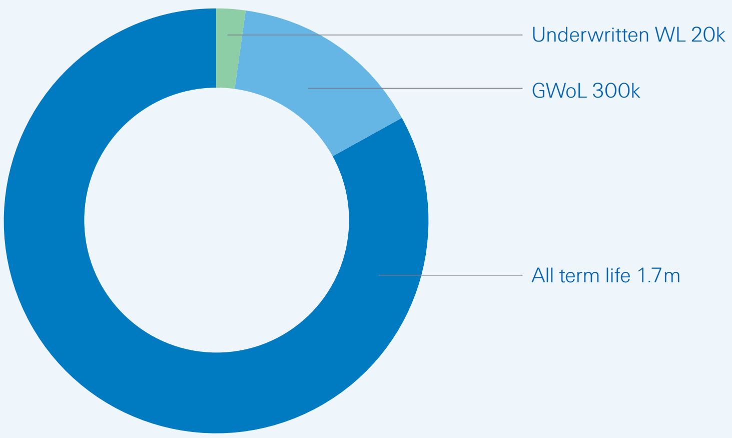
As previously, our Report focuses on the four main types of term assurance, level and decreasing term, with and without critical illness (CI), for two main reasons.

Firstly, this is where the main volume of new life cover sales lies. In 2021 almost 1.7 million new term policies were written. Family income benefit policies face the same issues but account for only 1.8% of all term policies. In the majority of cases, these are written as part of a package including lump sum death benefits, so it's simpler not to include them in the analysis.

Secondly, the policy setup issues in the marketplace are not as pressing for new whole life policies. The bulk of these are guaranteed acceptance policies, most usually intended for funeral cover with sums assured on average around £4,400 and which can often be paid directly to funeral directors if desired.

Finally, underwritten whole life remains a small minority and has a different context. These policies are more often taken out following advice and specifically for the purpose of inheritance tax planning, including where correct policy setup is much more likely.

2021 Life Policy Sales




Term & Health Watch 2022

# The good news – trust registration resolutions

At the time of our last Report in February 2021, there was concern that the exemptions for trusts of life policies weren't quite as complete as needed.

This turned out to be the case in two respects regarding trusts of term assurance policies:

Firstly, HM Revenue & Customs (HMRC) confirmed that payment of the proceeds for CI or terminal illness (TI) would trigger a requirement to register the trust at claim.

Secondly, our investigations of the impact on life policy trusts of not allowing temporary disability within the exemption showed a much wider problem than had at first been anticipated.

This would have meant immediate registration would be required in a number of scenarios. This included some types of CI cover and a possible range of 12,000 – 42,000 in-force trusts across up to eight insurers where a life policy trust might have an income protection element included among the retained benefits.

Fortunately, HMRC representatives responded positively to representations on the issue: HMRC has amended the regulations to exempt trusts of life cover policies which happen to include a benefit or an associated policy paying on temporary disablement.

For payment of proceeds due to meeting the CI or TI definition, it has confirmed that the trust need not be registered as long as the proceeds are not paid via the trustees but, on their instructions, instead go directly to the life assured (or beneficiary).

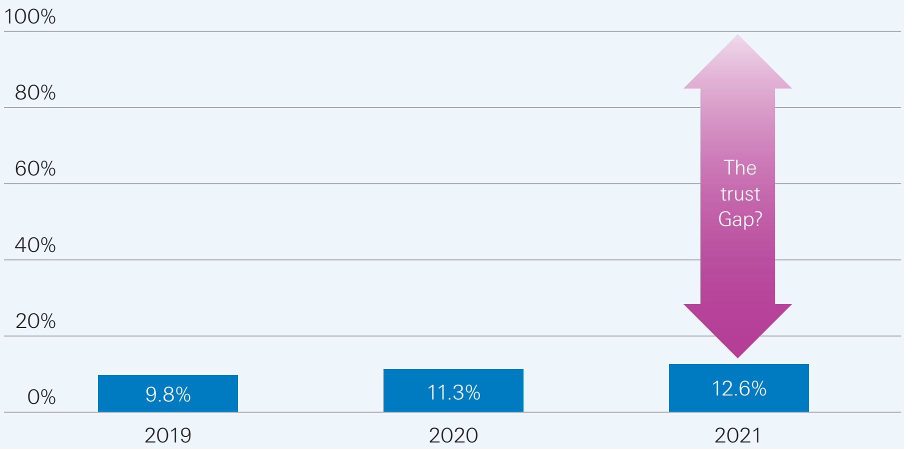
# Trust uptake increased again in 2021, but remains low

The good news is that since more detailed market data gathering began for new business, the proportion of new policies placed in trust has been going up.

Since the remaining registration impediments to encouraging trust uptake have been cleared and with wider industry awareness and efforts, the rate increased further in 2021 to an estimated 12.6 % of all term policies, up from 11.3%.

An optimistic view of the high-level picture is that great strides have been made, with a doubling of the overall proportion of policies in trust. However, this is from a very low base over several years. It has taken about six years from when, anecdotally, a rate was first estimated in 2013. That starting rate was a lowly 6%.

Term life policies in trust




However, in absolute terms of single life policies not in trust, the picture is more concerning. Growth in sales has meant more non-trust cases were set up in 2021 than in previous years, adding about 55,000 more policies than in 2020.

# The actual trust gap

The above indicator of percentage of policies effected under trust doesn't quite show the reality.

- Data are collected as a percentage of all level and decreasing term policies, as some respondents aren't currently able to differentiate between joint and single life cases.
- Also, some Term & Health Watch respondents, representing a minority of term business, have been unable to supply figures at all. Between them, they have a similar business mix to the rest of the market. Market totals are therefore estimated from the proportions shown by the vast majority.

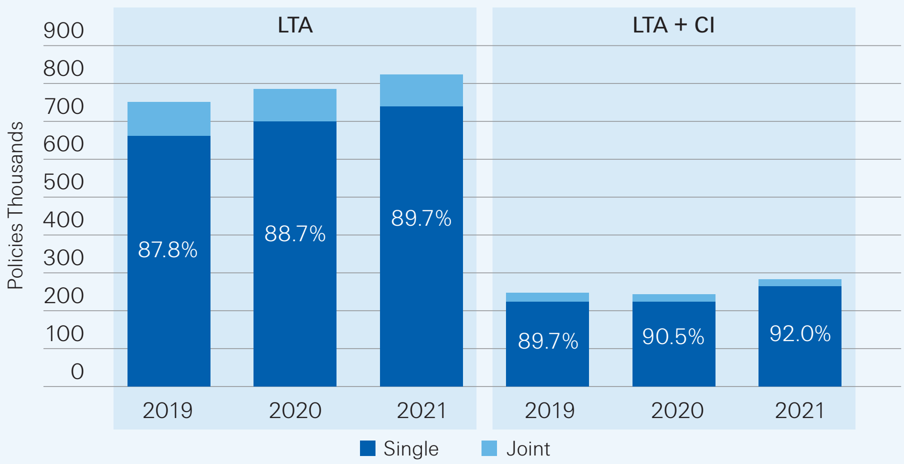
Single own life policies present the big problem of who to pay. So, we estimate the proportion of single life term below by applying market averages of overall trust rates to average single versus joint life proportions.

## Single life level term continues to increase

Whilst it is increasingly recognised there are many good reasons to write single rather than joint life term insurance, this does increase the size and importance of the problem of direction of death benefits not being addressed in the terms of the policy.

As can be seen below, whilst the proportion of policies written as single life has steadily increased, the volumes involved are the biggest driver of additional total single life policies as the market grows.

Single vs joint life level term



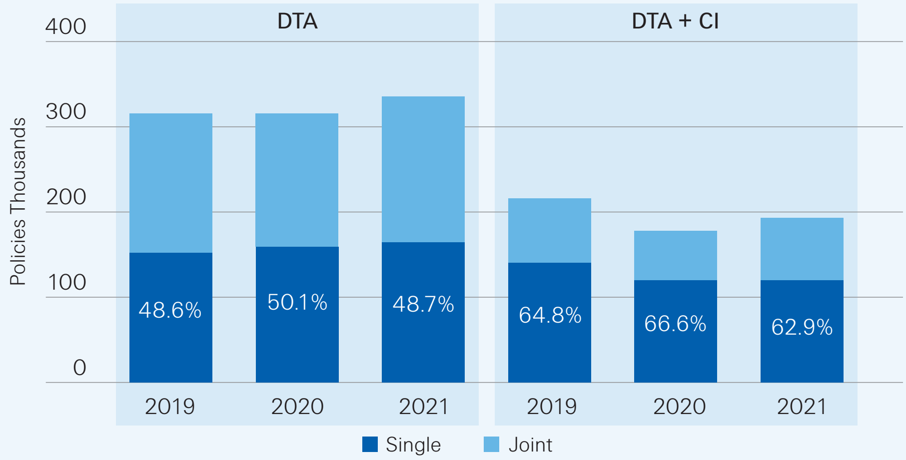
## Joint life increases amongst mortgage sales

By contrast, although decreasing term single policies did also increase compared with 2020, the overall proportion of these noticeably reduced in 2021.

Whilst this reduced the number of policies which would otherwise have needed a trust, it seems unlikely, although possible, this is the reason behind the decline. Increased budgeting pressures may have had more customers seeking the absolute cheapest option.

The main factor seems more likely to be a reflection of increased nervousness within compliance teams at some mortgage broking networks over the perceived Financial Ombudsman Service attitude to dual cover policies in relation to a mortgage loan.

Single life decreases for mortage sales




## Single life policies – the 84% beneficiary gap

To narrow down the extent to which the lack of trusts is potentially a problem for avoiding the probate process and unintended direction of death benefit proceeds, we have made estimates based on a few assumptions.

A key assumption is that nearly all policies in trust are single own life cases.

**On this basis, 12.6% of all new term policies written in trust in 2021 implies a maximum of 16.0% of single own life policies were placed in trust in the same period**. The actual rate would be a little lower, as a few of the trust cases will be of joint policies where a trust is wanted to deal with the possibility of the lives assured dying within short time of each other.

**The above implies a minimum of 84% of single life term policies were not written in trust**.

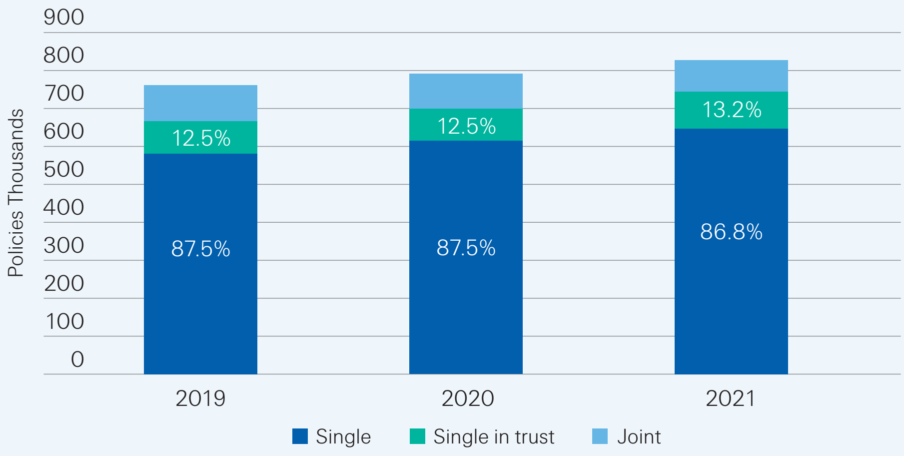
It is probable that the percentage of new sales where ownership can be seen to be secured has risen when new policies set up on a life of another basis and policies written with nominated beneficiaries are considered.

Further, there is a minority of jointly-owned single life cases, where this is offered by a small number of insurers. Uptake of this solution is not well quantified but is likely to be in the range of 16,000–20,000 policies. Removal of these from possible totals of single life policies not in trust would still mean the latter totalled just over a million a year for the last three years.

Making the assumption that jointly owned single life and beneficiary nomination policies balance out numbers of joint policies accounting for trust cases, allows us to use total trust numbers as if all were single life as a proxy for those not in trust being at risk of unwanted consequences.

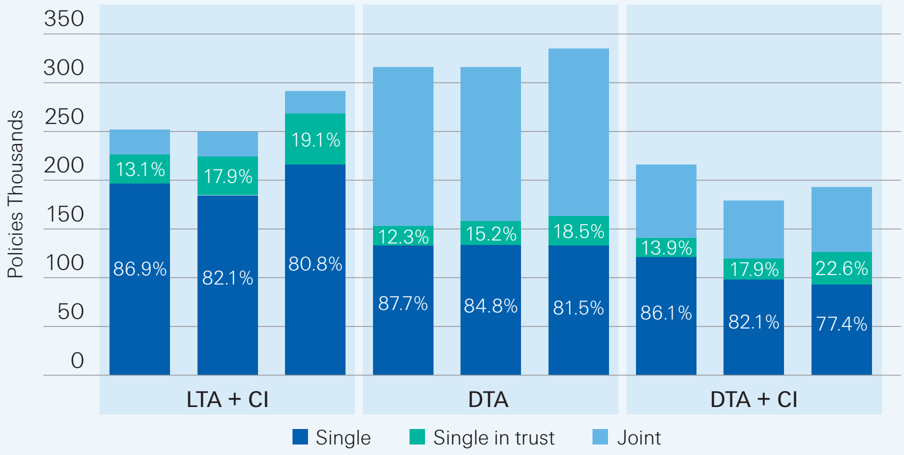
Level term life cover only is clearly where the bulk of the problem lies. As the product with the lowest maximum possible proportion of single life policies placed in trust and by far the highest volumes of single life policies sold, it is the greatest contributor year-on-year of yet more policies set up without securing beneficiary rights to the proceeds.

Level term life setup




More encouragingly, for other products a noticeable increase is apparent in proportions of single life cases placed in trust in 2020 and again in 2021.

Other term setup 2019–2021



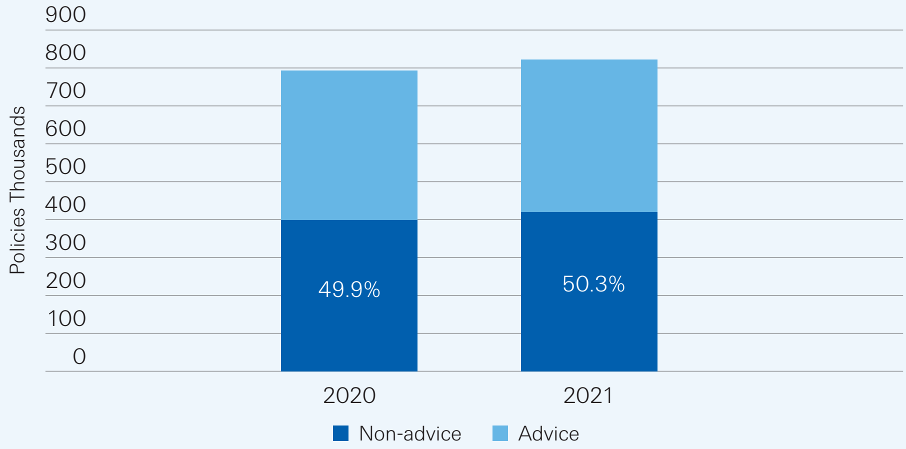
# Trust gap roots

Although the breakdown by distribution channel was not requested in this section, we look at the extent to which advice may affect trust take up and variations in experience amongst insurers.

## Non-advice sales increase – Non-advised LTA exceeds 50%

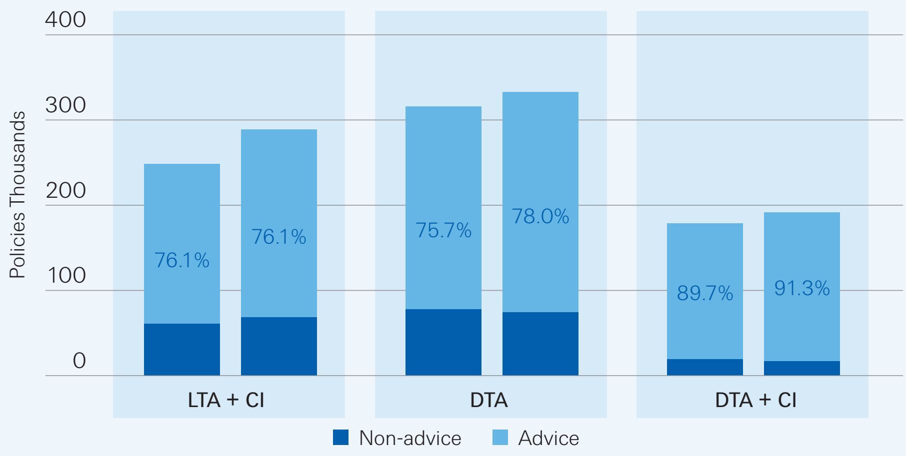
The effect of non-advised sales continues to be seen in level life cover only policies. The proportion of these sold on a non-advised basis reached 50.3% in 2021.

### Non-advice level term life only




By contrast, while total non-advised level term volumes with CI benefits rose in line with the rest of the market, fewer decreasing term policies, with or without a CI benefit, were sold without advice.

### Advised rates 2020 vs 2021



## Trust gap amongst advisers

It could be assumed that policies taken without advice will generally not be in trust. However, this is not entirely true: some intermediaries using a non-advice model actually make their free trust service a feature of their offering.

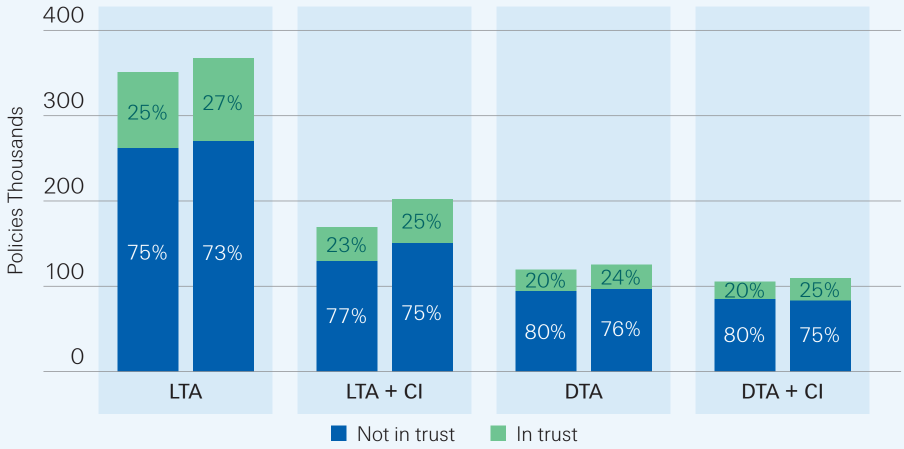
Nonetheless, it can be expected that trust rates will be much higher amongst advised cases and that the risk of single life policies with no direction of death proceeds will be reduced accordingly.

Below, we have made some assumptions to test the maximum reduction in risk that might be seen in the advised part of the market if:

- proportions of joint vs single policies apply equally across advised and non-advised sales
- all trusts were of advised, not non-advised policies
- all trusts were of single life, not joint life policies

On this basis, the policy setup risk for single life policies can be estimated to be reduced by 25%, where advice has been given.

Maximum advised single policies in trust 2020 vs 2021




Conversely, this can be interpreted to mean that at least 75% of single life policies sold with advice are still not being put in trust.

## Trust gap across insurers

Not surprisingly, given the above, percentage trust uptake experienced by different insurers varies substantially according to business mix.

As reflected in the market wide trends, efforts at some insurers have been rewarded with year-on-year improvements, but this has also served to widen the gap between those with highest trust uptake and those with lowest. There is also no comparative uniformity of rates experienced across product lines.

In 2021, two insurers with predominantly advised business reported trust uptake rates as high as 33–34% for level products (not split out for joint versus single). Elsewhere, however, higher trust rates for decreasing products were reported.

Clearly, a heavier weight of responsibility can be seen for foreseeable consumer outcomes at those insurers experiencing the lowest rates and where they know advice is not being given.

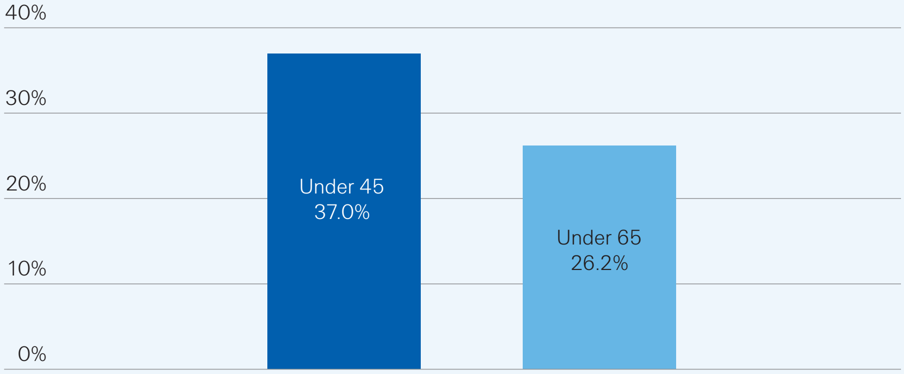
# Cohabitee risk pool – one in three couples

In 2019, iptiQ, Swiss Re's digital B2B2C insurance company, carried out some detailed research into life insurance buyers in the UK in its *Life Insurance Market Study*. Its numbers indicated that one in three out of people living in a couple who bought life insurance were cohabiting rather than married.

This is unsurprising when compared to the rising rates of cohabitation amongst the general population reported by the Office for National Statistics:

The proportion of couples who were cohabitees in 2020 accounted for one in three of all couples under 45 and over one in four (26.2%) of all under 65.

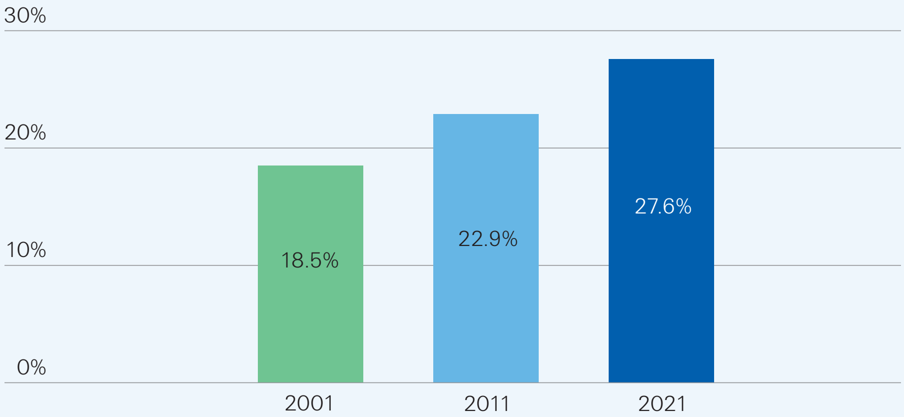
% of all couples living together who are unmarried cohabitees




Source: ONS Q12020 data

The 2021 census confirms continuation of the upward trend, finding cohabitees represented 27.6% of those under 66 living in a couple. (Age-based data comparing under 45 and under 65 were not available.)

% of all couples up to age 65 living together who are unmarried cohabitees




Source: ONS census data for England and Wales

From this, we can deduce that, out of the total term policies bought with life cover, exceeding 1.5 million a year in recent years, around **400,000 buyers were cohabitants**.[1]

However, since it is now no longer standard practice to ask marital status as part of the application process, we don't know which customers these are or how many bought single life cover without the death benefits being directed.

1 This allows for one in five life insurance purchasers being single, in line with iptiQ's research.

# Delays for all – longer probate waits

Recent quadrupling of the time taken for issuing grants of probate or administration threatens to undo the previous advances made by the market in reducing average times from notification of death to payout. Whereas the time from application to grant issue was typically within two weeks prior to 2019[2], the average times over recent quarters have deteriorated to eight or nine weeks.[3]

For those awaiting an expected payout, at the point when their need for the proceeds can be urgent and immediate, this increases the importance of the policy being set up to avoid probate.

[2] "Applications are usually processed within 10 days and sometimes one week." 2.5.2019 https://www.lawgazette.co.uk/law/it-glitches-causing-major-grant-of-probate-delays/5070133.article
[3] Source: https://www.gov.uk/government/statistics/family-court-statistics-quarterly-april-to-june-2022

# Consumer Duty relevance to life cover payouts

The FCA's Consumer Principle states that firms must act to deliver good outcomes for retail clients.

- The Consumer Principle and its cross-cutting rules form part of the Consumer Duty, which firms have until July 2023 to implement.
- The rules are underpinned by four key elements to help deliver good outcomes for retail customers – products and services, price and value, consumer understanding and consumer support.
- These elements are not necessarily all new to the insurance industry, with existing enhanced product governance rules looking at fair value, and the Insurance Distribution Directive.

However, one part which goes beyond the existing rules is on consumer understanding:

- It requires firms to test the consumer understanding of product features and reduce information asymmetries. This is positive as insurers can all benefit from better-informed customers.
- It's a reasonable assumption that consumers would have someone in mind when they apply for a life insurance policy. But they are often unaware that making sure this happens efficiently is dependent on how the product is set up (i.e. for it to pay out to the intended beneficiaries).
- There is an onus on the industry – insurer or distributor – to explain this to them and to ensure that it happens. Then, a customer can be empowered to make their own decision, with the right information and, where relevant, financial advice or guidance.

The Consumer Duty signals a significant cultural shift, with a movement to put yourself in a customer's shoes.

We should now be asking ourselves what we would expect from a policy for ourselves or a family member – would you intend to take out a life insurance policy and make it harder (or even just slower) for your loved ones to access the money after your death?

The likely answer is no. So, we should look at how we can support customers to understand their options and help them make good financial decisions.

# Trusts failing the mass market

Trusts (or life of another) will always have a place for the minority of wealthy applicants wanting term cover to pay inheritance tax liabilities for gifts made while they are alive. This is not least because TI benefits need to be directed outside the estate along with the death benefit.

Others with complicated personal lives (e.g. with multiple beneficiaries from different families or with beneficiaries who need protecting) may also find a trust useful for a number of reasons, so we can be sure that trusts will always be needed.

However, for the vast majority it's clear from the continued low take-up that they are not up to the job when it comes to the usually simple requirement of stating who should get the death benefit.

Additionally, the fact that they can be unnecessarily complicated and burdensome for all concerned means that, even supposing communication and process improvement could significantly raise volumes, the increased resulting overheads borne by both insurers and intermediaries would also be material.

# Solutions

## More joint life? – maybe not

Future proofing generally means two single own life policies will protect couples better than joint cover whatever happens to their financial responsibilities, their relationship and/or their health. So, it would be a retrograde step to return to selling more joint cover simply to fix the direction of proceeds gap.

Alternatively, where available, single life policies could be written as life of another, or with the partner simply added as a second policyholder. However, this doesn't allow for easy removal without co-operation if the couple separates. Nor does joint ownership shelter the deceased's estate from partial inclusion of the sum assured value in the calculation of potential inheritance tax if that might be relevant.

## Focus on who it's for – trusts communication and processes

Where trusts are the only option, a lot more can be done to ensure take-up.

In communications, intermediaries and insurers should consider prioritising payment to the right person as the main reason for putting single own life policies in trust.

- Recommendations, trust materials, key facts and joint vs single cover descriptions of "how it works" should all be making clear this is essential for the money to go where you intend.
- Secondly, speed of payment by avoiding probate is a bonus for all, demonstrating that we can deliver quickly at what is often referred to as the "moment of truth".
- But avoiding inheritance tax is the hygiene factor which has least relevance to the vast majority, having applied to well under 5% of deaths for the last reported eleven years. Although the recent Government announcement freezing the inheritance tax threshold for a further two years until 2028 will mean that more people may leave a tax liability on their death, it should never be the leading message for the mass market.
- Whilst this applies primarily to pre-sales/new business, there is also scope to address the messaging in benefit statements and customer portals.

Processes need to be geared to ensuring the ownership part doesn't slip, especially for unmarried partners.

## Universal easy payout trust

Advisers have been asking Insuring Change for an alternative trust solution, as an interim part-easing of the trust problems while they await wider availability of beneficiary nomination.

A potential solution would be a universal trust designed to eliminate or mitigate some of the trip points of existing trusts. Amongst several other things, it would mean one form could be used for the majority of cases across the market and it would fix the problem in all existing trusts of omitting cohabitees from the classes of beneficiary, as well as reducing the chances of additional trustee appointments needed at claim.

However, there are several potential impediments to implementing such a solution and it could never deliver the same convenience and benefits as contractual beneficiary nomination.

## Contractual beneficiary nomination

Where contractual beneficiary nomination is available, it can provide the same simplicity as adding a joint policyholder, but without the drawbacks. It also removes the customer servicing overhead of dealing with checking of trusts at new business, which would increase substantially if trusts were to remain the majority solution.

# Conclusion

The Consumer Duty should be the catalyst to ensuring that benefits access considerations and any changes as circumstances alter are at the forefront of consumer offerings, irrespective of how they choose to engage with the sector.

As a minimum, insurers and intermediaries should look to improve communications with consumers to enable them to make effective decisions, especially when it comes to setting up their life insurance.

However, to achieve consistent consumer outcomes of prompt access to death benefits fully for all intended claimants, the processes applied across the whole market will need to be very different from those of today.

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