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**Term Insurance Disclosure Issues
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Abstract

This paper describes some problems with the Australian disclosure requirements for term insurance and some areas where insurers do not appear to be complying with the disclosure requirements. It also contains suggestions for adjusting the disclosure requirements.

1. Introduction

Farmer (2003) summarised the features of term insurance products being sold in the Australian life insurance market at 31 August 2003. The research for that paper discovered some apparent breaches of disclosure requirements. This paper reports on those breaches and related disclosure issues.

It is stressed that this paper does not provide a thorough summary or investigation of all the disclosure requirements for term insurance in the Australian life insurance market. Rather, it is only reporting on particular problem areas which were noticed while carrying out research not primarily concentrating on disclosure requirements.

To summarise briefly, Farmer (2003) reports on 17 term life insurance products being sold in Australia at 31 August 2003. The products could be subdivided into 5 simple “no-frills” products which contained very few options or no options at all, and 12 more complex “full-featured” products. The products were issued by 14 different insurers. Of the 14 insurers, 2 offered only a no-frills product, 3 offered both a no-frills product and a full-featured product and 9 offered only a full-featured product.

The primary source of information on the products was Customer Information Brochures (CIBs) issued by the insurer.

The required content of Customer Information Brochures was specified by the Insurance and Superannuation Commission (ISC) Circular G.I.1 issued in February 1996. Responsibility for the content of CIBs subsequently passed to the Australian Securities and Investments Commission (ASIC) and Circular G.I.1 can now be obtained from the ASIC web site.

The Financial Services Reform Act 2001 implemented new requirements for disclosure. Under the new requirements life insurance companies will issue Product Disclosure Statements rather than CIBs. The Act allowed insurers time to implement the new requirements. In the investigation of products on sale at 31 August 2003, the term insurance disclosure documents collected from insurers were all CIBs. In many cases these CIBs will be the last the insurer issues before switching to the new Product Disclosure Statement structure.

Thus this paper is partially concerned with apparent deficiencies in disclosure under a Circular which will soon be irrelevant. This is still regarded as a useful exercise since similar problems could occur in future under the new disclosure structure. This paper also suggests how the requirements of Circular G.I.1 could be altered. It is recognised that in practice, due to the limited life span of that Circular it is unlikely that any changes will be made. Still, the suggestions may prove useful if similar difficulties occur under the new Product Disclosure Statement structure.

2. Format of Key Features Statement

Circular G.I.1 indicates that within the CIB, the description of each product must begin with a Key Features Statement. Section 5 of the circular specifies the format and content of the Key Features Statement.

The Key Features Statement must not exceed six A4 pages in length. It must include the information specified in Section 5 and must not include additional information to that specified. The information required is divided into sections under such headings as “The Plan”, “Premiums”, “Benefits”, “What are the Charges?”, “Taxation” and “Cooling Off Period”. The first heading in the above list is only a suggested heading and most CIBs have adopted a more meaningful heading incorporating the product name. The remaining headings are mandated and they must occur in the order specified. This restriction presumably is aimed at assisting consumers who are trying to compare competing products. Several other headings are specified for investment products but do not apply to risk products such as term insurance.

CIBs typically follow the Key Features Statement with an “Additional Information” section which includes all the relevant information not required in the Key Features Statement. The six page limit on the Key Features Statement also causes the treatment of some issues to be fairly brief, with a cross reference to the “Additional Information” which provides more detail. For example, where a term insurance product allows trauma cover as an option, the definitions of the trauma events could easily run for two or more pages. Hence the trauma definitions were usually relegated to the “Additional Information” section and the “Benefits” section of the Key Feature Statement would only contain a broad description of what the trauma cover was trying to achieve, or perhaps a bullet list of the trauma events without any attempt to define what the events meant.

One CIB contained a Key Features Statement which breached the six page length limit.

In two CIBs the mandated “What are the Charges?” section was missing. In one of these cases the required information could with some difficulty be obtained from other sections of the CIB. For example, the policy fee could be determined by working backwards from tables of premiums for various sums insured.

In one CIB the sections had been presented out of order, the “Premiums” section being placed after “Benefits” rather than before. In fact this seems to produce a more logical order, since it places “Premiums” immediately before “What are the Charges?” and for term insurance the premiums are equivalent to the charges. However, this order is likely to confuse consumers who are comparing competing CIBs and is a breach of the disclosure requirements.

One CIB includes extraneous information in the Key Features Statement, extra sections concerning exclusions and policy termination having been inserted between the “Taxation” and “Cooling Off Period” sections. The information in the extra sections might reasonably have been included in the “Benefits” section of the Key Features Statement, but their inclusion as separate sections under headings with equal prominence to the required headings appears to be a breach of the disclosure requirements.

There was also one case where the headings adopted did not make it clear where the Key Features Statement ended and the additional information began, though the table of contents did clarify the borderline.

3. Disclosure of minimum premiums

Section 5 of Circular G.I.1 states that the “Premiums” section of the Key Features Statement must give details of any maxima or minima that apply. For term insurance, maximum policy

sizes are usually stated in terms of sum insured, but minimum policy sizes are usually imposed by a minimum premium.

In three products the “Premiums” section of the Key Features Statement did not disclose a minimum premium. In one of these cases information elsewhere in the CIB indicates that there definitely is a minimum premium, so the omission of this information from the “Premiums” sections appears to be a breach of the disclosure requirements. In the other two cases the situation is unclear. It is unlikely that they do not impose a minimum policy size at all, but it is possible they impose the minimum in some other way, perhaps as a minimum sum insured. While they do not disclose a minimum sum insured in the CIB, the disclosure requirements do not require minimum sums insured to be disclosed.

4. Disclosure of policy fees, frequency loadings and occupational loadings

Section 5 of Circular G.I.1 states that the “What are the Charges?” section of the Key Features Statement must include a “description of all fees and charges.” It goes on to specify precisely how those fees and charges should be subdivided and expressed.

This section appears to have been written primarily to cope with unbundled products where fees and charges are taken from premiums paid or from the investment component of the policy. It is not always clear how to interpret this section for risk products where the premium may be thought of as being entirely composed of fees and charges. Not surprisingly, insurers display some variety in their interpretation of this section’s application to term insurance, including the already mentioned extreme where two CIBs regard the section as irrelevant and omit it.

Most CIBs disclose the size of the policy fee in the “What are the Charges?” section. There are three exceptions.

As noted above, two CIBs omitted the “What are the Charges?” section. Neither of these products disclosed the size of the policy fee, though in one case it could be determined by working backwards from tables of premiums for various sums insured. There was one more product where the “What are the Charges?” section was included but it did not state the policy fee. In the two cases where the policy fee could not be determined from the CIB, it is theoretically possible that there is no policy fee.

There was more variety in the level of disclosure of premium frequency loadings. It is not clear whether Section 5 of Circular G.I.1 intends that these should be disclosed. It can be argued that there is little value in disclosing frequency loadings since in isolation from the full premium rate table they do not help the consumer determine which product is the best value for money. Of course, similar comments could be made with respect to the policy fee, but most insurers have interpreted Section 5 as requiring that the policy fee be disclosed, even if that information is not helpful in isolation.

10 of the 17 products disclosed the size of the premium frequency loadings and six did not. There was also one product which only allowed monthly premiums; when there is only one premium frequency there are no premium frequency loadings to disclose.

Premium rates for Total and Permanent Disablement (TPD) options usually depend on the insured life’s occupational category. No CIBs disclosed occupational loadings. As for frequency loadings, occupational loadings are of little use in isolation from the premium rates to which they apply.

5. Statement on availability of premium rates

Section 5 of Circular G.I.1 states that in the “Premiums” section of the Key Features Statement:

“In respect of risk benefits a statement must be included that tables of premium rates for each type of benefit are available on request.”

Three of the 17 products included premium rates in the CIB. In one case this was in the form of a premium rate table with the policy fee clearly stated, so the premium could be determined for any desired sum insured. The other two cases were simple “no-frills” products where the customer could only choose from a small number of possible sums insured, and the premium was shown for each of the possible sums insured.

Circular G.I.1 did not seem to envisage that some CIBs would include the premium rates in the CIB and thus required all risk product CIBs to include the wording saying that premium rates were available on request. Since these three products have effectively disclosed the required premium information in the CIB, they did not include the required wording. They have clearly complied with the intention of Circular G.I.1.

Of the remaining 14 products, 13 included some form of wording indicating that tables of premium rates were available on request. This leaves one product which did not include such a statement and which appears to be in breach of the disclosure requirements.

Most of the products that included the required statement used wordings of the form “A table of premium rates is available on request” or slight variations thereon. Only in two of these cases did the statement explicitly indicate that the tables were available for each type of benefit, as required by Circular G.I.1.

6. What is the purpose of the table of standard premiums?

Circular G.I.1. does not state the purpose of the table of standard premium rates, so we can only speculate.

The obvious question is: Why does the regulator want the insurer to provide a generic table of premium rates when the insurer can easily provide a tailored quote for the customer using the insured life’s current age, sex, smoking status, desired sum insured and premium frequency, and perhaps their occupational category if that is relevant?

The most likely answer is that the quotations supplied by insurers usually only show the first year’s cost. That is, they only show the premium for the current age, while most term insurance policies are sold on a stepped premium basis where the premium changes each year to reflect the insured’s increasing age. The customer who is trying to compare policies solely on the first year’s cost is not seeing the full picture. The table of standard premium rates shows that full picture. It may for example show the customer that Product A is only cheaper for the next two years, Product B is cheaper for the next three years and Product C is cheaper thereafter.

Not surprisingly, insurers would prefer potential customers to not see the full picture. In the above example, the customer seeing the full picture is likely to buy Product A and put a reminder in their diary to switch to Product B in two years’ time and to Product C three years after that, though of course it will only be worth their while to implement the switches if they remain healthy enough to satisfy the underwriting requirements. Insurers are unlikely to profit from a policy lapsing after only two years or three years. Any increase in switching of healthy lives, and the associated non-switching of the unhealthy lives who can’t satisfy the

underwriting requirements, reduces the profitability of the product and forces insurers to increase premium rates.

This can be viewed as an example of the “Fallacy of Composition”. A customer benefits from implementing the switches provided other customers don’t switch. However, if lots of customers implement switches then premium rates increase, possibly making all customers worse off. Insurers would prefer that customers only see the current year’s cost, since they are then not alerted to the “benefits” of frequently switching insurers.

Another possible justification for only providing a quotation of the first year’s cost is that the premium scales are not guaranteed. It is claimed that it does not make sense to provide estimates of premiums 10 or 20 years ahead if the premium rates may change at any time. However, changes to premium rates are a relatively rare event and where they do occur, they tend to be due to factors affecting many insurers, such as the gradual reductions in mortality levels experienced for the last few decades. Thus, for the purpose of a 30 year old *comparing* products, the current premium rate for age 50 probably is a good proxy for the premium the customer will be paying in 20 years’ time. If mortality levels continue to decline the premium rate may drop, but the drop could affect all the products being compared in a similar way.

Let us assume that ASIC’s primary purpose for making tables of standard premium rates available is that they want consumers to be able to make the best-informed decision based on current premium rates, and further assume that ASIC will ignore the danger that giving the customers this information may increase switching and adversely affect future premium rates. We can then ask: Is the table of standard premium rates the best way to provide this information to the consumer?

I suggest not. The tables of standard premium rates can not be directly compared since this would ignore the effect of the policy fee and frequency loading. The customer would need to perform further calculations involving the desired sum insured and desired premium frequency to determine which policy has the lowest total cost in each future year. Given the difficulties many customers would have with this process, particularly if they try to build in CPI indexation for future sums insured and policy fees, it would be preferable for these calculations to be done by the insurer. A cost illustration tailored to the customer’s age, sex, smoking status, sum insured and premium frequency would be more informative than a premium rate table, *provided* the former shows the estimated premiums for every future year that can be determined from the latter.

I suggest ASIC might wish to consider waiving the requirement to provide a table of standard premium rates if the insurer provides a quotation which includes premium rate projections for every potential future year of the policy. If this route was taken, it would be necessary to detail the assumed future rate of CPI indexation, decide whether it would be necessary to show the current value of future sums insured, and specify that the quotation include a suitable warning that future premium rates are not guaranteed. These are not insurmountable issues, particularly when it is considered how much simpler the process is for term insurance compared to the investment products for which such guidelines already exist.

7. The reality of availability of tables of standard premium rates

At this point a pedant might argue that Circular G.I.1 only required that the CIB include the *statement* that premium rates are available on request. It does not actually require the insurer to honour that statement and make the premiums available when they are requested. Without making any suggestion as to how a court would view this argument, I suggest that any sensible interpretation of the Circular is that insurers are required to ensure that the table of premium rates is available on request.

This is the point on which breaches of the disclosure requirement were most frequent.

As noted above, three products disclosed the premium rates in the CIB. In respect of the other 14 products, I phoned the insurers concerned using the inquiry number listed in the CIB and requested a copy of the standard premium rates.

Invariably the customer inquiry staff would ask for data such as my date of birth and desired sum insured so that a quote could be generated. I then clarified that I was not seeking a specific quote for me but rather the table of standard premium rates for all ages, both sexes and for smokers and non-smokers, and I pointed out that the CIB indicated I could request these.

For only five of the 14 products did the customer inquiry staff member appear to understand the concept of supplying potential customers with a table of standard premium rates, though in only three of those five cases was the table received as a result of the first inquiry.

In the remaining 9 cases it seemed that the staff member had not received this request before. Thus my request usually caused confusion, and sometimes complete disbelief. Some indicated that no such tables existed, to which I would repeat the statement that the CIB indicated they were. Most were unaware of the relevant statement in the CIB and often I had to point out the location of the statement to convince them that it existed.

The result of the initial request in respect of the 14 products was that for only five of the products did the insurer succeed in supplying some sort of table of standard premium rates, though in one of these cases the tables were incomplete, not covering all the available benefit options.

This resulting data was too sparse to be useful so further attempts were made to obtain the tables of standard premium rates for the remaining products. I must admit that at this point the investigation method lost some consistency. Ideally the same maximum number of attempts would have been used for each insurer. In practice, some subjective bias occurred. For many products if a second attempt to obtain the tables of standard also failed no further attempts were made, though in some cases a third attempt was made, and in one case success was finally achieved on the fifth attempt. The maximum number of attempts made was influenced by many subjective factors such as whether calls to a particular insurer usually involved waiting in a queue for lengthy periods of time, whether the customer inquiry staff seemed knowledgeable, whether I had to contact a particular insurer again anyway to clarify other issues from the CIB, and whether previous attempts had seemed promising though unsuccessful. That is, the number of attempts made for each product could vary from one to five in a rather unscientific manner.

Eventually, this process did produce something which could be claimed to be a “table of standard premium rates” for 11 of the 14 products, though for one product the table did not include all the available options.

8. Reasons for unavailability of premium rate tables

The obvious question here is: In the attempts that failed (including the many cases where subsequent attempts did finally succeed), what reasons did the insurers give for not supplying the tables?

The common scenario was that the customer inquiry staff member indicated that s/he would need time to locate the tables or to consult more senior staff member, would take my contact details to forward the tables when they were found, and would never be heard from again.

When second (or more) attempts were made, usually the new staff member could supply no reason why the previous attempt had failed.

There was one humorous case where the customer inquiry staff member claimed that a premium quotation provided for my particular current age, sex, smoking status and sum insured constituted the “table of standard premium rates” for my particular case!

There was also one more general reason for failure which has relevance for the design of the disclosure standards. Circular G.I.1 requires that the CIB state that the table of standard premium rates be “available on request”, but does not specify who the request should be addressed to. In practice some parties denied that it was their responsibility to supply the data.

This most often occurred where an insurer only sold business through brokers. In this situation it was common to find that a request to the insurer for the table of standard premium rates met with the response that the insurer did not deal with customers, so I would have to contact a broker for this information. In most cases they could assist by providing contact details for a broker in my geographical area. However, a request to the broker for the table of standard premiums usually elicited the response that they did not have this data. They had a computer program provided by the insurer which could produce a quote based on my current age, sex, smoking status and desired sum insured, but they had no way to extract the underlying premium rates from the program. Hence the broker would refer me back to the insurer.

Another situation where this difficulty occurred was where the customer inquiry staff stated they could give product advice, such as explaining how a particular product worked, but they could not provide financial advice, such as advising which particular product I should buy. They deemed the provision of a table of standard premium rates to be financial advice! Thus to obtain a table of standard premium rates I would have to meet with one of their company’s agents, who they usually called financial planners. Occasionally a phone discussion with an agent did result in the table of standard premium rates being mailed, but in one case it seemed no progress would be made unless I booked in for a face to face consultation with an agent. There *are* limits to what a researcher is willing to do in the pursuit of data.

If ASIC believes that tables of standard premium rates serve a useful purpose, I make the following suggestions with regard to their availability.

- The ASIC requirements should clarify that it is the *insurer’s* responsibility to provide the table of standard premium rates, so that insurers cannot pass these requests to brokers who do not have access to the data.
- Clarification is needed as to whether the table must be available by phone request or whether it is acceptable for the insurer to only provide the data if the customer has a face-to-face meeting with an agent or broker. I suggest the former is more appropriate.
- To avoid any possibility of confusion or buck passing, it would help if the required statement in the CIB indicated that the premium rates were “available on request by phoning” with the phone number clearly stated.
- In cases where the table of premium rates is not supplied in the CIB, ASIC may wish to consider requiring that the table also be available on the insurer’s web site. That is, customers would be able to view the table without phoning the insurer or meeting with an agent. This is akin to the practice of restaurants displaying their price list in their window so that customers can decide whether to dine there before entering the restaurant. As yet access to the internet is far from universal, so it would still be necessary for customer to also be able to request the tables by phone.

The above suggestions still seem relevant if, as suggested earlier, ASIC decides to waive the requirement to provide a table of standard premium rates where the insurer instead supplies a personally tailored quotation of all potential future years' premiums. For example, with respect to the last point above, it would be possible for a program on the insurer's web site to produce the quotations.

9. Format of tables of standard premium rates.

As stated above, eventually some form of premium rate table was obtained for 14 of the 17 term insurance products.

For three products the premium data had been included in the CIB. In all such cases the explanation was quite clear.

For two products, both from the same insurer, the table of standard premium rates was supplied in the form of a professional brochure clearly designed for customers, and perhaps also for agent or brokers. The brochure was well-designed and very easy to understand.

One insurer supplied a series of tables printed on the insurer's letterhead. While the document clearly identified itself as a guide for financial advisers, it did seem to contain sufficient explanation to make it intelligible to customers and the use of letterhead made it look reasonably professional.

In three cases photocopies of internal documents were supplied. In one of these cases a broker had supplied photocopies of the relevant pages of a premium rates book. In the other two cases the customer inquiry staff has photocopied other internal documents, in one case with some handwritten additions explaining the more obscure abbreviations used. In two of these three cases the documents would probably be understandable by customers but in the last case insufficient explanation was supplied.

In the remaining five cases a spreadsheet of premium rates was e-mailed. In all cases the spreadsheet was clearly designed for internal use, not for distribution to customers. However, in three of these cases the spreadsheets probably contained sufficiently clear headings and information to be understandable by customers. The other two cases were unintelligible to anyone who doesn't work in the industry. One such spreadsheet contained a single table which apparently included premium rates for every risk product the insurer had ever sold and was probably unintelligible to all but a few employees of the insurer.

Thus while it can be said that tables of standard premium rates were eventually obtained for 14 of the 17 products (including the three cases where the tables were in the CIB), it is probably more relevant to say that 11 of the 17 products provided tables in a sufficiently intelligible form.

The other major conclusion that can be drawn is that it is a very rare occurrence for anyone to actually request the table of standard premium rates. This was already obvious from that fact that few inquiry staff seemed aware of the existence of the relevant clause in their CIB, and is confirmed by the fact that most insurers could only supply documents or spreadsheets which were designed for internal use rather than for customers.

10. Disclosure of premiums by age

Circular G.I.1. does not clearly explain how much detail is required to constitute a "table of standard premium rates". In particular, the circular does not indicate which ages must be included and so several insurers do not show the full age range.

For nine of the 14 products for which tables of standard premium rates were obtained or appeared in the CIB, the tables show rates for all ages at which the product could exist. (Actually, in one of these cases the table extended one year beyond the expiry date! That is, the highest age in the table could never be used.)

For two products the premiums are only shown for the allowed entry ages. In both these cases the premiums are shown in the CIB. This is consistent with the common practice of providing a premium quotation only for the customer's current age. The insurer is assuming the potential customer will only want the premium for her current age and so only shows the premium rates for the possible entry ages.

In three cases the premiums were shown to some age beyond the maximum entry age but not all the way to the expiry age. One of these products showed premiums to age 80 and two to age 85, the expiry ages in all these cases being in the vicinity of 100.

Most products have an expiry age in the vicinity of 100. (Strictly, the expiry date tends to be specified to be the policy anniversary either before or after either age 99 or 100, so there are 3 common expiry dates near age 100.) Many CIBs make a selling point of the fact that their term insurance product can be renewed to ages in the vicinity of 100. However, if they truncate the disclosed table of premium rates at some lower age, they are not disclosing that the premium rates at those high ages are extremely high and few customers could afford to renew at those ages.

To give the potential customer the full picture, I suggest that the table of standard premium rates should disclose the premium rates for all ages up to the expiry age. This gives the customer the truer picture, which is that for most products the expiry age is beyond the point of affordability and so the expiry age is not a relevant factor when comparing most products.

Based on the above data it could be argued that most insurers are already acting responsibly and disclosing premiums for the full age range. However, it needs to be recalled that in most cases the insurer had not produced a table of standard premium rates specifically for marketing purposes but instead supplied some sort of document or spreadsheet designed for internal use. Documents for internal use will of course usually include the full age range to expiry. Truncation of tables was more common in documents intended for public consumption. For example, two of the three products that included premium rates in the CIB only showed them for the possible entry ages, not to expiry age.

11. Revisiting frequency loadings and occupational loadings

It was noted previously that not all products disclosed frequency loadings in the CIB and no products disclosed occupational loadings in the CIB.

A case can be made that a "table of standard premium rates" should contain enough data for the customer to be able to calculate their premium on the assumption that the underwriting process does not impose any special loadings. That is, if the frequency loadings were not in the CIB they should be in the table of standard premiums.

The similar argument for occupational loadings is perhaps not as strong, due to the possible counterargument that the customer may not know which occupational category they are in. However, many insurers adopt the same grouping of occupations into four broad risk categories. It can be argued that a customer who has been advised of her occupational grouping and loading by one insurer should be able to see the loadings the competitors would use on the reasonable first guess assumption that they use the same four occupational categories.

There were four products where the premium frequency loadings were not disclosed in either the CIB or the table of standard premium rates obtained. (There were also two products where the loadings were not given in the CIB and attempts to obtain a table of standard premium rates was not successful.

Only two of the 14 products clearly disclose their occupational loadings in the table of standard premium rates. Generally, the loadings only apply to TPD cover, and are a very significant factor, potentially doubling or trebling the cost of that cover. However, one of the products also provides a small 5% discount on the death cover for the very top occupational group.

For a third product which supplied its premium rates as a spreadsheet the occupational loadings appear as a small poorly labelled table within the spreadsheet. It would not be clear to the general reader what the numbers mean, and even the reader familiar with these products is left to guess to which cover(s) they apply. Comparing their size to the previous two products, an educated guess is that they probably only apply to TPD cover.

A fourth product provided different premium tables for different occupational categories, with no clear link between the scales. This was the product for which the insurer did not provide separate tables for each benefit, as was requested. Since the tables combined death, TPD and trauma cover it is not possible to determine which benefits were loaded and by how much.

The other 10 products do not disclose any occupational loadings. However, three of these 10 products only provide death cover, so it is quite possible that in those cases there were no occupational loadings to disclose. The other seven do offer TPD cover as an option and given the size of the occupational loadings on TPD cover in other products it would be surprising if these seven products did not have TPD occupational loadings which they are not disclosing in the table of standard premiums.

Given the different interpretations adopted by insurers, I suggest that ASIC needs to provide clearer guidelines as to whether it expects premium frequency and occupational loadings to be disclosed in the “What are the Charges?” section of the Key Features Statement and/or in the table of standard premium rates.

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