Actuaries Institute recommends disability insurance sector reform to ensure community and customer benefits

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- Australia's $5 billion disability income insurance sector must undergo long-term reform to protect customer and broader community interests.
- Product design, rating, advice, risk management, governance and regulation must be reviewed.
- Global comparison shows liberal benefits in Australia could threaten long-term viability.

The Actuaries Institute said Australia's $5 billion disability income insurance (DII) sector needs urgent reform, noting that failure to implement significant changes will reduce consumer access to affordable disability cover in the future.

The Actuaries Institute has established a taskforce to identify where critical reform is needed. It commissioned KPMG to compile a comparative research report *Disability Income, An International Comparison*, to help start the debate about changes needed to bring about a sustainable long-term solution that supports consumers.

"This is a valuable contribution that will help the profession identify and tackle some of the issues that are impacting the DII market," said Actuaries Institute chief executive Elayne Grace.
The report found the sector needs simpler products, a reduction of 'bells and whistles', a change to definitions, and a review of the benefits to encourage those who can, to return to better health as soon as possible.

"Modern life insurance provides valuable financial benefits for people who can't earn an income due to injury or sickness," said Ian Laughlin, convenor of the Actuaries Institute's Disability Insurance Taskforce. "Australia has a very competitive market and customers have been offered a smorgasbord of product features. However, they have also been subjected to multiple unanticipated premium increases.

"A decline in insurance company profitability despite these steep premium hikes has called into question the sustainability of disability income insurance in its current form, and suggests the potential for market failure," Mr Laughlin said. "That raises real concerns for consumers, and the broader community, about future access to affordable DII cover."

The Actuaries Institute has drawn on the skills and experience of almost 50 actuaries to support its DII taskforce. It has started liaising with regulators, and hopes to engage with the director community, insurance company management, advisers, product ratings agencies and consumer groups to drive significant, long-term industry changes. It will also review the professional requirements for actuaries in the disability income insurance business.

The KPMG report, released today, states that individual disability income insurance does not adequately support a policyholder's move back into work in Australia's modern economy. The report also acknowledges increased concerns by Australia's regulator about product sustainability.

The Australian Prudential Regulation Authority announced in December that it had written to industry participants in response to ongoing heavy losses in the market (see **here**).

Life companies had collectively lost around $3.4 billion over the past five years through the sale of DII to individuals. APRA executive board member Geoff Summerhayes said life companies had kept premiums at unsustainably low levels and policy features were too generous. In some cases, he said, there was a financial disincentive for policyholders to return to work.

The KPMG report *Disability Income, An International Comparison* states the Australian retail market offers more comprehensive DII cover to a broader range of occupations and target markets than the US, UK and South Africa. Australian DII products have more features, higher issue limits, longer benefit periods and shorter waiting times than products on offer in the US and UK.
Another issue raised in the report is rehabilitation support in other markets. Data for 2017 from the UK indicates 3,000 employees were provided with services that allowed them to return to work before they were eligible for any payments. This includes services like counselling or physiotherapy.

More than half of these employees were provided with help to deal with a mental health illness and 17 percent were provided with support to help with musculoskeletal conditions. Of 5,255 who made claims in 2016, almost 2,000 people were helped by the insurer to make a full return to work in 2016 or 2017.

By contrast, in Australia there are limits on what early rehabilitation services can be offered to policyholders, particularly when the policy is written through a member's superannuation fund. It is estimated only 20% of claimants access rehabilitation programs, which have the potential to help claimants return to work, and help the industry become more customer-centric by offering a more holistic approach.

The report found:

- competitive pressure has resulted in products that are complex, making them difficult and expensive to administer;
- these products can be problematic to manage from a claims perspective;
- guaranteed insurability has further aggravated sector problems by increasing the complexity of legacy business; and
- insurers have responded with increased premiums, perpetuating potential anti-selective lapses leading to worse claims experiences and falling profit margins.

Daniel Longden, KPMG Actuarial and Financial Risk Partner, said: "Our research found that Australian workers tend to have higher payouts than their counterparts in comparable jurisdictions. A replacement rate of 75% of earnings is quite common in Australia with up to 80% replacement ratios available," he said. "By contrast replacement rates in the US are generally 50-65% of income, and in the UK 60-65% of income.

"In some circumstances, where an Australian policyholder has an income replacement ratio of 75%, the policy may typically permit more than 102% of pre-disability take-home pay. A high replacement ratio can be a disincentive to returning to work."

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KPMG make a number of observations about the DII industry in Australia. KPMG describes product proliferation as an "arms race". Financial advisers use comparison tools that score products on the number of features and the generosity of the definitions. The more features and more liberal the definitions, the higher the score and the greater the likelihood an adviser will recommend the product.

"This has resulted in insurers competing on the basis of the number of features on their products and the generosity of the definitions backing those features," the report states. These benefits are then often passed back to existing clients through upgrades, locking insurers in to benefits that fail to reflect changes in workplaces or occupational factors, lifestyles and healthcare.
It also states more Australians are working more than one job, but DII policies typically cover income lost from only one occupation. The industry needs to better reflect the way Australians work.

The Actuaries Institute Taskforce will consider KPMG's observations about the DII industry in its ongoing work.

Mr Laughlin said: "Over time, we have seen significant increases in premiums for customers, unsustainably high levels of claim costs and large losses for most insurers. The concern is that this could eventually lead to the withdrawal of the product, to the detriment of all customers and the community.

"It is clear there is a need for all of the stakeholders in the industry, including insurers, reinsurers, rating houses, government, regulatory bodies, and professional bodies, to tackle this problem, in a way that supports customers' needs."

Mr Laughlin said the Actuaries Institute Disability Insurance Taskforce will also look at product design, pricing, and risk management, as well as environmental and behavioural factors.
"We have a clear intent to drive change," Mr Laughlin said. "The ultimate aim is to continue to provide the community with valuable, affordable DII cover in a sustainable manner and to continue to support disabled customers as they seek to resume their normal working life".

A full copy of the report is available **here**.

Mr Laughlin and Mr Longden are available for comment.

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About the Actuaries Institute
As the sole professional body for Members in Australia and overseas, the Actuaries Institute represents the interests of the profession to government, business and the community. Actuaries assess risks through long-term analyses, modelling and scenario planning across a wide range of business problems. This unrivalled expertise enables the profession to comment on a range of business-related issues including enterprise risk management and prudential regulation, retirement income policy, finance and investment, general insurance, life insurance and health financing.

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