



# Disability Income

## An International Comparison 2019

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# Abstract

In this paper, we have compared the structure and the recent experience of the disability income insurance (DII) of the UK, USA, and South Africa with that of Australia. The focus of this paper is the design of the DII products in these markets and whether there are insights that can be of value to Australian insurers.

Our research shows that while the Individual and Group DII products across the world have similar product features, there are also some key differences between the Australian product and the products offered across the other markets researched here.

In general, Australia offers comprehensive cover to a broad target market, but also has very liberal policy terms and conditions on DII products, especially for the Individual DII products, which are not evident in the other markets. There has been a tightening of product features by some insurers in the last two years in Australia. However, the overall products in Australia remain an outlier compared to the other markets due to the breadth of coverage and the level of benefits offered.

The findings from the paper reiterate the need for the whole industry (including insurers, reinsurers, government and regulatory bodies, and professional bodies) to collaborate strategically on the future of DII in Australia and how it impacts each of the stakeholders as well the broader society in meeting customers' needs.

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# 1. Purpose of this paper

Individual disability income insurance (DII) products in Australia have faced adverse claims experience through the last decade. Whilst insurers have adjusted premiums upwards for these policies in the recent years, the poor claims experience has not abated. This has put pressure on the insurers to re-think their longer term strategies around Individual DII products. There is also a general sentiment in the market that the design of the current Individual DII product does not adequately support the customers' journey back into gainful work in Australia's modern economy. In addition to commercial and social pressures, recently there has been an increased focus from the regulator requiring insurers to consider implementing changes to ensure the stability and sustainability of Individual DII products in the future.

This paper aims to explore the structure and the recent experience of the DII products (Individual and Group) in the UK, USA, and South Africa and how these markets compare to Australia. A key focus of the paper is to compare and contrast the differences in design of the DII products in these markets and whether there are insights that can be of value to Australian insurers.

## 1.1 Reliance and limitations

This paper has been researched using various publically available sources. For the comparison of product features, we have used publically available product disclosure documents for major market participants in each country. Whilst we have tried to ensure the credibility of the sources used, we have not independently audited or verified the data available to us. We have not conducted any independent research. Readers of this paper should exercise care and professional judgement when using this paper to ensure that the results are suitable for the intended purpose. We strongly recommend that readers of this paper also familiarise themselves with the underlying information used within this paper. We do not accept any liability for any inaccuracies or omissions in the data used within this paper.

This paper provides a point in time view of the DII market and is intended to encourage further discussion on the current state and the future of the DII market.

This paper was commissioned by the Actuaries Institute and prepared by Hoa Bui, Daniel Longden, Michael Dermody and Huda Ansari of KPMG Australia.

We would like to thank RGA and KPMG US, UK and South Africa for their insights into this paper.

## 1.2 Structure of this paper

We have structured this paper in the following way:

- Provided a brief summary of typical DII products and the recent claims experience of the DII products in the different markets.
- Discussed the key features of Individual DII and Group DII products and how they differ across the markets in scope.
- Included worked examples to illustrate the differences between the markets considered.

We have concluded the paper with our observations of the key differences between Australia and the other markets and how these may be expected to impact the DII claims and customer experience.

The numbers presented in this paper have been rounded to the nearest AUD 1,000 where possible. The exchange rate used for currencies throughout this paper is:

AUD 1 = USD 0.70 = GBP 0.56 = ZAR 9.78

# 2. Overview of Disability Income Insurance (DII)

In this chapter, we discuss the basic features of a DII product. We also discuss the differences between an Individual DII and a Group DII policy, followed by a summary of the changes, growth, and recent experience of DII products within each of the markets.

## 2.1 What is a DII product?

DII is a protection product which covers the insured against the risk of lost income if they are unable to work for a period of time because of illness or injury.

Most DII products provide cover for a proportion of income, subject to a maximum cover limit. They pay regular benefits until the policyholder is able to return to work, or to the end of the benefit period, whichever is shorter. The period over which the benefit is provided can be short term in nature (such as 2-5 years), or longer term (to retirement or lifetime benefits). Waiting periods apply before a claim becomes payable. Benefit indexation options are usually available on long term benefit periods to allow for inflation.

Variations of these product definitions and features are used by insurers to differentiate their products from others and to suit the needs of their customer base.

## 2.2 How is disability defined?

Different insurers may define disability differently and accordingly the benefit payout between insurers may differ based on the nature and impact of a policyholder's disability.

DII policies define disability in terms of the ability of the insured to perform an occupation. There are generally two types of occupational criteria as far as the DII definitions are concerned:

- **Own Occupation:** Own Occupation is defined as the occupation that the insured is trained for – it is generally the occupation the insured is currently employed in at the time of applying for a DII policy.
- **Any Occupation:** This is a broader category which covers any occupation that is suited to an insured's education, training or background.

Based on these definitions, a DII policy based on Own Occupation will trigger a claim payment if the insured is disabled and cannot work in the specific job they were employed in at the time of claim, whereas the Any Occupation policy will only trigger if the insured cannot work in any occupation that they are suited to by way of their education, training or experience. For example, a neurosurgeon who injures their hands and cannot operate may be paid a claim under an Own Occupation policy, but may not be paid under an Any Occupation policy as they may still be able to function as neurosurgery lecturer.

Disability may be total or partial. Insurers use different metrics to differentiate between total and partial disability. The main metrics used to define disability are:

- **Duties-Based:** Under this metric, the insured, after an accident or sickness, is following the advice of a medical practitioner and is unable to perform a certain number of duties of their own occupation.
- **Hours-Based:** This metric is used if, due to accident or sickness, the insured is working in a reduced capacity and is following the advice of a medical practitioner.
- **Income-Based:** Under this metric, the insured, after an accident or sickness, is following the advice of a medical practitioner, and suffers a reduction in income due to their accident or sickness. For example, a payout will be made if the insured suffers a reduction of more than X percent in ability to generate monthly income.

Generally, the duties based metric applies in the definition of total disability in own occupation, whereas hours and income based metrics may relate to either own or any occupation.

## 2.3 What are the types of cover available in the different markets?

### 2.3.1 Individual DII products

DII products can be sold directly to the customer or sold to the customer via financial advisers: this is insurance covering an individual under a single policy document. We refer to these as Individual DII products in this paper.

### 2.3.2 Group DII products

DII products may also be sold as group business: Group business is an insurance contract covering a number of people under a single policy. The members of the group are linked in some way (e.g. employees in the same company or members of the same superannuation fund). The employer or superannuation fund facilitates the payment of premiums and administrative matters. Although participation under group contracts is not always compulsory, these contracts typically cover all or most employees or members. Product design tends to be simpler under group policies and they typically have lesser underwriting requirements or offer automatic cover up to certain limits (no medical underwriting required). We refer to such policies as Group DII contracts in this paper.

Group DII contracts can be written through different sources. We detail in Figure 1 how we have differentiated between Individual DII and Group DII products for this paper for each of the markets.

As shown in Figure 1, in Australia, Group DII can be written through superannuation funds (Retail Master Trusts, which have characteristics of both Group and Individual DII, and Industry superannuation funds) or directly issued to employers (Corporates). Individual DII policies may be purchased directly or through retail superannuation funds. In the other markets, Corporate Group DII contracts offered by employers for their employees are the most common type of Group DII contracts. Individual DII in the other markets is generally sold to customers via financial advisers, outside of superannuation or pension schemes. A small amount of Individual DII business is written directly (i.e. without a financial adviser) in Australia.

Figure 1. Differences between Individual DII and Group DII Products

		Source of Business			
		Retail advised	Retail Master Trusts (Multi-employer)	Corporates (Single employer)	Industry Super (multi-employer)
Type of Business	Ordinary Business (Non-superannuation)	Individual DII in UK, the US and South Africa	Group DII in UK, the US and South Africa		
	Superannuation Business	Individual DII in Australia	Group DII in Australia		

## 2.4 How the DII have markets evolved around the world?

In this section we consider a brief history of the DII products (Individual and Group) and the relative size of the markets in scope.

### 2.4.1 Australia

The 1970s saw the introduction of disability income insurance in Australia (Service, 2010). In the wake of the deregulation of the financial sector in the 1980s and 1990s, the life insurance industry underwent a number of changes. Competition led to the rapid expansion of the DII market, with a focus on enhanced product features development and lowering of premiums. However, this led to a poor claims experience in the 1990s leading to tightening of some product features and increased investment into claims management functions.

Subsequently, the industry went through a period of rationalisation reducing the number of life insurers over the next decade as a number of foreign-owned companies exited the market and smaller firms merged or sold out to larger ones. The result of this consolidation of the market meant that, by the 2000, 91 percent of the industry's assets were held by the top 10 insurers (Keneley, 2004). This consolidation allowed the remaining insurers to take advantage of scale and write higher business volumes. Through this period, sales of Individual DII picked up and, measured by premium volume, have generally been considered a success since then, thanks to marketing campaigns and financial advisers recognising Individual DII as a core insurance need for their clients.

A recent paper indicates that as at 30 September 2018, the annual growth rate for Individual DII risk premiums averaged at 8.9 percent for the last decade (ClearView, 2019). However, the year-on-year growth has slowed in the last few years. Our understanding is that part of the increase in the Individual DII premiums to date is attributable to in-built indexation, stepped premiums (as the majority of business in Australia is stepped), and recent premium rate increases put through by a number of insurers. The growth in premiums from new business (i.e. new policies), therefore, may be significantly lower than the 8.9 percent p.a. growth rate observed above.

The financial advisers in Australia use product comparison tools to recommend the 'best' products for their customers. These product comparison tools score products for each insurer based on the number of features the product has on offer and the generosity of the associated definitions. The higher number of features on offer and the more generous the definitions, the higher the score, and accordingly the better chances of the product being recommended to customers. 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. Additional features and expanded definitions offered are also commonly passed back to existing clients through the automatic upgrade clause<sup>1</sup>. Furthermore, given the long-term nature of DII, insurers effectively lock-in benefits for the duration of the contract, with limited consideration of how changes in future occupational factors, lifestyles and healthcare may impact the relevance of these additional product features.

1. The provisions in the Life Insurance Act 1995 (LIA 1995) mean that benefits provided under continuous disability policies (TPD, trauma and disability income) cannot be altered except to improve them (LIA 1995 Paragraph 9A (4)). As products innovate and medical science advances, a policy-owner of a long-term contract taken out in earlier times may be disadvantaged in comparison with a customer who takes out a new product with better terms. A life insurance company therefore may wish to upgrade a cover, benefit, option, sum insured or periodic payment under a life insurance contract or policy. For a life policy which has already been issued, the life insurance contract might contain a term by which the life insurance company promises or has the obligation to grant a feature or rider upgrade.



This “products arms race” (Threlfall, 2015) and competitive pressures have resulted in products that are complex in nature, making them difficult and expensive to administer, and problematic to manage, from a claims perspective. Guaranteed insurability on contracts further aggravate the issue by increasing the complexity on legacy business. The resulting poor experience has led insurers to respond with increased premiums, which in turn have most likely perpetuated anti-selective lapses, leading to further worsening in claims experience, and further decreasing profit margins.

The Group DII market has been growing rapidly as well. Whilst adverse experience and losses have been noted on the Group DII business over certain years in the last decade, the business appears to be profitable overall. It is noted, however, that this business is less mature than the Individual DII business; its profitability may alter as the portfolio matures. The operating expenses (excluding claims cost) for a Group DII policy generally tend to be lower due to relatively simpler product features, wholesale nature of the contract and no commissions.

There are 18 insurers who offer DII products in Australia. However, the top four insurers hold over 50 percent of the market share based on in force annual premiums. The current size of the Australian DII market in terms of in force annual premiums is around AUD 5 billion (Individual: AUD 2.8 billion, Group: 2.3 billion) (APRA Statistics: Life Insurance Claims and Disputes Statistics, 2018). This is approximately 0.25 percent of the Australian GDP as at December 2018<sup>2</sup>.

All the numbers presented here are pre-implementation of the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2019 (“PSY changes”). We expect these changes to shrink the insurance market as insurance policies for inactive members are cancelled. The actual overall impact of the PYS changes for are not yet quantified.



2. <https://data.worldbank.org/indicator/ny.gdp.mktp.cd>



### 2.4.2 United States of America

Individual DII is offered primarily in two forms in the US:

- Non-cancellable policies which give policyholders the right to continue coverage as long as premiums, which are fixed, are paid on time; and,
- Guaranteed renewable policies that can be automatically renewed with the same benefits. The premium for this type of policy may be increased only if it is changed for the entire class of policyholders (American Council of Life Insurers, 2017).

The Individual DII market in the USA has faced volatile returns that can be traced through a very long history. Individual DII picked up in the USA in the early 1920s. However, losses due to mispricing of the product and economic environment surrounding the Great Depression resulted in certain players exiting the market and limited the development of the Individual DII products. With the growing need for insurance in the 1950s, growth and competition in the market picked up alongside relaxation of policy terms and conditions. This period of growth was then followed by another period of losses, accentuated by the recession of the mid-1970s.

With economic conditions improving, many insurers targeted their sales towards medical professions: doctors and nurses. During this period, competition increased with new insurers entering/re-entering the market, and the product features were relaxed. While initially the short term results were favourable, the liberalisation of Individual DII product terms on the policies written (which were largely non-cancellable policies, and hence had fixed premiums) resulted in losses over the next decade, especially for doctors and nurses as their claim rates were higher than those expected by insurers. In the early 1990s, the market consolidated but the claims experience did not improve. Product definitions were subsequently tightened, better underwriting, pricing and claims management practices were implemented, and the proportion of guaranteed renewable policies written were increased from 10 to 21 percent of all Individual DII sales, all of which collectively resulted in market stabilising by the mid-2000s (Beal R. W., 2006).

Whilst doctors and nurses still account for 30 percent of the new premiums, insurers have seen better returns, with the Individual DII products showing favourable claims experience (lower incidences and higher terminations) (Beal & Khan, 2017). However, MetLife, one of the largest provider of Individual DII, exited the market in 2016 to focus on other more profitable and strategic products.

The Group DII products in the US are generally offered as part of employee group benefit packages, typically blended with employer-provided health insurance.

There are two types of products offered:

- Short-term DII, which provides for income protection cover for a temporary illness or injury. Benefits commonly last 24 weeks, although coverage can range up to 104 weeks. Such a cover may offer protection during the waiting period before long-term DII cover can commence.
- Long-term DII provides cover for both occupational and non-occupational sickness and accidents. Benefits typically start after a waiting period of three to six months and benefits are generally paid up to age 65, or retirement age.

According to the U.S. Bureau of Labor Statistics, 40 percent and 32 percent of all private sector workers were participating in short-term and long-term disability income insurance in 2016 respectively (American Council of Life Insurers, 2017).

There are over 25 insurers offering DII products in the US. The top 14 insurers cover 90 percent of the market for Individual DII, with the top 25 covering 90 percent of Group DII market. In terms of in force annual premiums, as at December 2017, the market size was around AUD 39.7 billion, with Individual DII accounting for AUD 8.9 billion (Insurance Information Institute, 2017) and Group DII the rest (Milliman, 2018)<sup>3</sup>. This is approximately 0.14 percent of the US GDP as at December 2018<sup>4</sup>.



3. Calculated as the sum of short-term and long-term DII across in-force and new business, scaled up to market size

4. <https://data.worldbank.org/indicator/ny.gdp.mktp.cd>

### 2.4.3 United Kingdom

UK has a well-established DII market with DII being first issued in 1885 (Service, 2010).

However, in recent years, growth of DII products has been generally slow: In 2013, annual premiums shrank by 14 percent and the number of new policies sold declined by 19 percent compared to the prior year. The reduction was due to a number of changes that impacted the UK life insurance market such as the Retail Distribution Review, the move to gender-neutral pricing and the review of the mortgage market. However the market for these products has adjusted and the DII market grew by 10-11 percent over 2015 and 2016 (EY, 2018). The growth is driven largely by the Group DII market which has continued to grow, increasing by 23 percent to 2.5 million members over 2017. The large increase in group protection was offset by a decrease in individual protection products (Association of British Insurers, 2019).

Individual DII is usually sold as a rider policy along with other life insurance policies to high income individuals (Swiss Re, 2018). The policies are offered with short benefit periods (2-5 years) or with long term benefits (until retirement). Around 50 percent of the policies under Individual DII are short benefit period policies, with the majority of these being two-year benefit period plans (Swiss Re, 2018).

Only a few insurers offer income protection insurance as it requires specialist staff and needs sophisticated systems to administer, price and analyse experience. This, in addition to the competitive pressures because of difficulties in selling the product due to it being seen as complex, has put pressures on the profit margins which anecdotally tend to be between 5-10 percent of premium. The top 5 insurers cover over 75 percent of the new sales in the DII market.

Long-term Individual DII policies generally do not allow premium reviews until the policy has been in-force for at least 5 years. This is a well-established industry pricing practice. Given competitive pressures, this level of premium guarantee also drives the investment into active claims management and underwriting at the claims stage in the UK. This investment is further supported by the fact that the Group DII market in the UK is larger than the Individual DII market: it is in the employers' best interest to have their employee return to work in a short span of time, and be supported through early intervention and rehabilitation services, where possible.

In 2017, Group Risk Development (GRiD) data indicated that almost 3,000 employees were provided with interventions (such as counselling or physiotherapy) which allowed them to return to work before they were eligible for any payments. 52 percent of these employees were provided help to overcome mental illness and 17 percent were provided support to overcome musculoskeletal conditions. In addition to those, for employees who did go onto claim payment in 2016 (5,255 claims), 1,955 people were helped by the insurer to make a full return to work during that year or during 2017<sup>5</sup>. The lower number of claims (compared to say the Australian market) appears consistent with the longer waiting periods which are common on DII products in the UK (see Section 4.2.6).

The total earned premiums for long-term DII for 2018 amounted to AUD 2.6 billion (Office of National Statistics, 2018) – this is about 0.06 percent of the total GDP for UK in 2018<sup>6</sup>. AUD 1.2 billion were paid out in claims in 2018, of which AUD 0.8 billion related to Group DII payouts<sup>7</sup>.

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5. The South African regulatory authority is currently working through the data transitions associated with the creation of a two-regulator model in 2018.
  6. <https://data.worldbank.org/indicator/ny.gdp.mktp.cd>
  7. <https://www.asisa.org.za/statistics/long-term-insurance/>

### 2.4.4 South Africa

The South African DII market started to gain momentum in the 2000s. Whilst the Individual DII market is focussed on self-employed people and professionals, the Group DII market is reasonably established due to limited government benefits on offer.

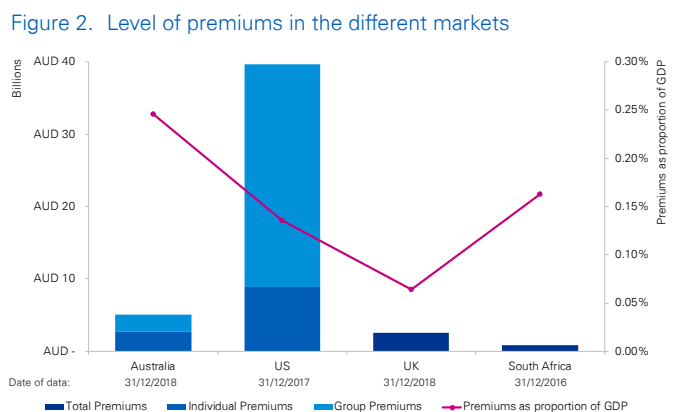
The performance of the market has not been positive in South Africa in the last few years. There have been higher than expected claims being reported on Group DII products. Claims ratios in excess of 120 percent were commonly reported on certain risk portfolios in 2016 (KPMG, 2017). Poor economic conditions with high levels of unemployment are likely to be contributing to the deterioration in claims. Recovering employees often do not have suitable roles to return to and hence stay on claim. Mental stress claims in recent years on some portfolios are at 24 percent in 2018 (Alexander Forbes, 2019). A survey indicates that 41 percent of responders feel that financial stress in a poor economy leads to psychological stress, which then results in physical problems, thus, eventually increasing a policyholder’s propensity to claim. According to this survey, mental health issues are seen as the biggest issue for the next three years in South Africa (Old Mutual Corporate, 2017).

South Africa has also been facing issues around shifting behaviours of working households. A 2017 survey showed that more than a third of individuals are working multiple jobs: while 13 percent had a second job similar to their everyday job, 24 percent had a job that was totally different from their primary daily work (GenRe, 2017). This results in issues whereby premiums are based on lower risk primary occupations (such as lawyers or accountants) but the claims experience is that of higher risk secondary occupations (such as a taxi-driver). Pricing changes have been implemented over 2016 and 2017 to address the declining profitability.

The total premiums for DII market (Group and Individual) in 2016<sup>8</sup> amounted to AUD 0.9 billion (Financial Services Board, 2016), which is about 0.16 percent of the GDP of South Africa in 2018<sup>9</sup>. In comparison, AUD 1.3 billion was paid out in claims in the year ending June 2018<sup>10</sup>.

We summarise the relative size of the markets in the Figure 2. Whilst the split between Individual and Group DII premiums was not publically available for the UK and South Africa, it has been anecdotally reported that a large proportion of the business is Group DII in these two markets. This is similar to the US where close to 80 percent of the market is Group DII. This is in contrast to Australia where about 55 percent of the market is Individual DII based on written annual premiums.

8. <https://grouprisk.org.uk/group-income-protection>  
 9. <https://www.ftadviser.com/protection/2019/06/24/why-income-protection-is-evolving/?page=2>  
 10. <https://www.abi.org.uk/news/news-articles/2019/04/protection-payouts-see-insurers-support-record-numbers-through-be-reavement-sickness-and-injury/>





## 2.5 How do the causes of claims compare around the world?

The top three causes of claims for non-accident related DII claims across all the four markets are generally mental health, musculoskeletal and cancer. In Australia, around 32 percent of the claims payment for Group DII were due to mental health, followed by 15 percent musculoskeletal, and 14 percent cancers. The splits are different for Individual DII claims: mental health claims only accounted for 13 percent of claims payments, musculoskeletal 15 percent and cancer 14 percent (FSC - KPMG Data Collection, 2018).

Similar to Australia, in the UK, for Group DII claims cost, 25 percent is due to mental health conditions, followed by 24 percent due to cancer<sup>11</sup>. For the Individual DII claims, 9 percent are due to mental health claims and 7 percent due to cancer<sup>12</sup>, whereas 30 percent<sup>13</sup> relate to musculoskeletal.

In the US, mental health claims only account for 9 percent of the claims. This is likely to be driven by a combination of policy terms and how mental health issues are processed through the healthcare system. The largest causes of claim in the US are musculoskeletal conditions (29 percent) followed by cancer (15 percent)<sup>14</sup>.

In South Africa, overall statistics have not been published. The Group DII statistics show that the proportion of the mental health claims has is currently 24 percent, followed by 16 percent for musculoskeletal, and 12 percent for cancer (Alexander Forbes, 2019).

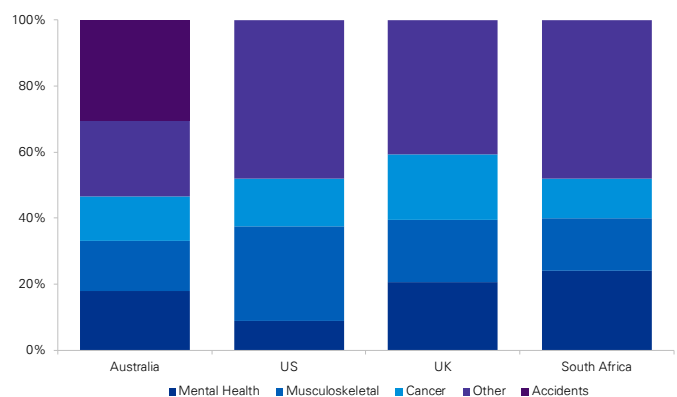
We represent the overall causes of claims by the different markets in Figure 3<sup>15</sup>.

In Australia, accidents account for 31 percent of the claims cost. For the other markets, accidents are included in the 'Other' category, as they are generally not one of the top three causes of claim:

- In the US, the accidents are often covered by accident only policies. Also Disability Awareness Council indicates 90 percent of disabilities are not accident related.
- In the UK, the top three causes as indicated by the Association of British Insurers are cancer, mental health issues and musculoskeletal injuries.
- In South Africa, the top three causes of claim vary from insurer to insurer depending on the type and variants of the DII policies written. The top causes may include cancer, musculoskeletal injuries, mental health issues, retrenchment (if separate retrenchment cover is purchased), cardiovascular issues or accidents.

11. <https://disabilitycanhappen.org/disability-statistic/>  
 12. Weighted averages by premiums of Individual and Group are used to calculate totals. For UK Group DII, the proportion of musculoskeletal is assumed to be 15 percent in line with Unum's experience. <http://www.actuarialpost.co.uk/article/group-risk-industry-has-another-record-breaking-year-13444.htm>  
 13. <https://data.worldbank.org/indicator/ny.gdp.mkt.p.cd>  
 14. <https://www.abi.org.uk/news/news-articles/2019/04/protection-pay-outs-see-insurers-support-record-numbers-through-bereavement-sickness-and-injury/>  
 15. Weighted averages by premiums of Individual and Group are used to calculate totals. For UK Group DII, the proportion of musculoskeletal is assumed to be 15 percent in line with Unum's experience.

Figure 3. Cause cost by cause of claims





# 3. Individual Disability Income - Product & Market Features

In this section, we compare the different product features of Individual DII available in the four markets. We also compare the sales channels and the target market for such products in each country.

## 3.1 Definition of disability income

In this section, we define disability and some of the key determinants of the Individual DII benefits.

### 3.1.1 Total disability

#### Australia

In general, in Australia, the insured is considered totally disabled under Individual DII if they are under regular care of a medical practitioner and:

- Are unable to perform one or more duties of their own occupation and are not working (for income or profit); or,
- Are unable to perform the duties of own occupation for more than 10 hours; and/or,
- Have suffered a reduction of 80 percent or more of earnings before disability.

A full benefit is often paid out in this case even though the insured may still be working in a reduced capacity.

The insured is considered partially disabled in Australia if they are under regular care of a medical practitioner and:

- Are unable to fully perform the duties of their own occupation; and
- Are working in a reduced capacity in either their own occupation or any other occupation; and,
- Have suffered a reduction of 20 percent or more of their earnings before disability.

A reduced benefit is paid out for partial disability – we discuss partial claims in the following paragraphs.

Since only people earning an income are eligible for Individual DII policies in Australia, there are generally no activities of daily living type definitions for disability. Some insurers may offer riders to cover housepersons which can be attached to an Individual DII policy for an individual with income. Activities of daily living definition for the claim conditions on such a rider are separately defined.

The definitions of disability can vary from insurer to insurer and across the different variants of the product offered by the same insurer (such as basic versus premium product). For example, in recent years, many insurers have made attempts to tighten the definitions above on the basic variants of the product by moving to a two-tier definition or limiting the period over which the '10-hour' clause is valid.

## US

In the US, Individual DII policies generally have total disability defined as the insured being unable, due to injury or sickness, to perform the substantial and material duties of their own occupation, are not engaged in any other job or occupation for wage or profit, and are receiving regular medical care from one or more physicians appropriate for their injury or sickness. Partial disability is defined differently by various insurers. Some definitions noted in our research were:

- Being able to return to work part-time after a period of total disability;
- Being unable to perform duties of own occupation in the normal time it would, and the loss of income is at least 20 percent due to the disability; or,
- Working in own or any occupation, but have a loss of duties, time or income, due to disability.

## UK

In the UK, the definition is generally described as being totally unable, by reason of illness or injury, to follow own occupation(s) and is not following any other occupation. Occupation may be described as any work where the insured works 10-16 hours or more during a week and are paid for their work. Partial disability is defined as being able to return to work (in own or any occupation, where occupation generally is a job worked for at least 10-16 hours each week), but on reduced earnings due to disability. For the self-employed, the insurer may need to work with the insured to understand how the working capacity has changed.

In the UK, Individual DII is also available for housepersons (homemakers and those who may not be currently working). Since traditional occupation-related definitions cannot be applied, insurers use activities of daily living to define disability. Most insurers consider the insured to be disabled if they are unable to perform three of the listed activities of daily living, which may be:

- Walking
- Climbing
- Bending
- Dexterity
- Lifting
- Getting in and out of a car
- Managing healthcare
- Financial Independence

Housepersons generally can only qualify for total disability and not for partial disability. Benefit amounts are generally limited for housepersons.

## South Africa

In South Africa, the definition of disability is duties-based with the insured being unable to perform major duties of own or reasonable occupation. In South Africa, it is possible to obtain policies which offer lifetime benefits. The disability definition, similar to the UK, is also available in terms of activities of daily living and applies to assess benefits beyond retirement age. Partial disability is defined as being partially disabled or impaired.

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**Australia has very generous definitions for total disability compared to other markets, most notably by allowing the insured to work up to 10 hours and/or earn 20 percent of their pre-disability income while receiving a full benefit.**

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### 3.1.2 Partial claim

If the insured is not totally disabled, or returns to work gradually after being away due to disability, a reduced benefit, referred to as a partial claim, may be paid. An insured may be required to be totally disabled for a period before partial disability benefits can be paid. However, some policies do not require the insured to be totally disabled before a partial disability benefit is payable. This treatment varies between insurers across the different markets.

In Australia, waiting periods may apply on the partial claims. Some insurers also require the injured to be partially or totally disabled during the waiting period for the partial benefit to apply. For certain occupation classes, insurers may also require total disability to occur before the partial disability claim can be claimed. The partial claim paid is generally calculated as the proportion of the total benefit that would be payable based on the insured's current earning capacity.

In the US, partial claims may be allowed based on proportion of income lost. Treatments vary across insurers on whether a total disability claim needs to be established before a partial claim can be made. As part of new product developments, total disability products have been designed in the last couple of years which pay no partial benefit (Milliman, 2018).

In the UK, proportionate benefits may be allowed if a partial disability definition is satisfied. The reduction in benefits generally relates to the ratio of the gross earnings from the reduced role to the gross earnings from the occupation against which disability was being claimed. For the benefit to continue, the disability from the original occupation has to continue. In addition to this, many insurers require a full claim (total disability claim) to be established before a partial benefit can be claimed.

In South Africa, partial claims are payable when the insured is unable to perform only some of their duties due to disability and as a result suffer a partial loss of income. The proportion of income lost must be at least 20 percent for a partial claim to be considered by most insurers. There does not appear to be a requirement to be totally disabled before the partial disability claim can be applied.

### 3.1.3 Changes in definition over the duration of a claim

The definition of disability may alter if the insurer is on claim over a certain period of time. For example, if an insured has been on claim for 24 months, the definition of total disability may change from own occupation to any occupation.

This change in definition is common in the US whereby after 24 months of being on claim, the disability definition moves to any occupation. This change of definition is generally not seen in Australia. However, in our research, one insurer applied a change of definition on their basic Individual DII product variant by moving to an any occupation definition after 24 months of being on claim.

In the UK, change of definition is not common for Individual DII policies for major insurers but is offered on group insurance.

In South Africa, there does not appear to be any change in definition over the duration of a claim.

### 3.1.4 Definition of income

Income is defined slightly differently in each of the four markets discussed in this paper.

Income in Australia is generally defined as:

- For self-employed customers: it is the income of the business or practice generated by the personal efforts of the life insured after the deduction of their appropriate share of business or practice expenses in generating that income.
- For employed customers: the total remuneration paid by the employer to the life insured including salary, commissions, fringe benefits, fees, regular bonuses, regular overtime, and regular superannuation contributions paid by the employer on behalf of the life insured.

It does not include investment income, rental income, and is calculated before tax. If the insured works in multiple occupations, generally only income from the primary occupation is insurable under Individual DII. Some insurers may choose not to include employer contributions into superannuation as part of income.

In the US, covered earnings for the purposes of insurance are defined as basic monthly earnings or basic wages. They are typically defined as the salary or total wages earned on an hourly basis not exceeding 40 hours of work a week. It may not include items which are not considered basic earnings, such as commissions, bonuses, tips, shift differentials, overtime pay<sup>16</sup>. For self-employed individuals, which are seen as an area of growth in the Individual DII market, it is their earnings from self-employment.

In the UK, income is defined as:

- For self-employed customers: It is the income from the business before income tax in the 12 months immediately before disability, less any allowable expenses against income tax.
- For employed customers: Earnings, salary or wage (including regular and consistent bonuses and commissions) before income tax from the employment in the 12 months immediately before disability. In addition to this, benefits in kind such as company car, living accommodation, private medical insurance are also included. If the insured is an employed director, or plays an active role in a private limited company, the dividends from this company are also included as income<sup>17</sup>.
- If someone is unemployed right before disability, the benefit may be based on the last one year of income prior to being unemployed. However, if the insured has been out of work for over a year, the benefit is generally limited to the minimum guaranteed amount (i.e. the insured is effectively treated as a houseperson).

16. <http://fsgbrokerage.com/resources/glossary-of-terms/>

In South Africa, income definitions vary across different insurers. It is generally the after-tax insurable income (basic salary, net business income, employer’s contribution to retirement funding and medical aid). For clients with fluctuating earnings, an average over a specified period is usually used to determine the income. Passive incomes such as rent and investment income (other than remuneration in the form of dividends) are excluded from the measure of income<sup>18</sup>.

We illustrate these differences in Figure 4.

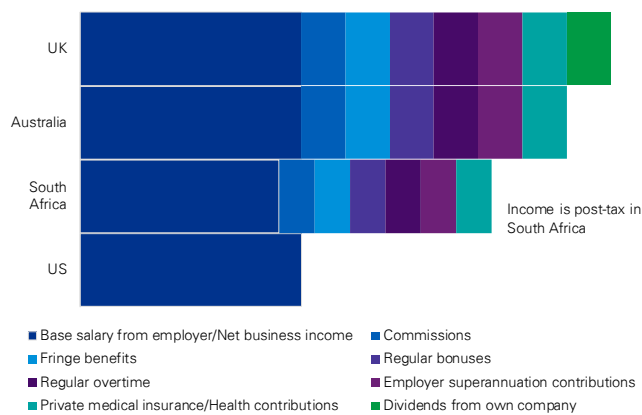
It is arguable that the dividend income from own business in the UK will be included under the earnings of a self-employed person in Australia.

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**It is worth noting that in Australia, for Individual DII benefit calculation, income generally includes employer contributions into superannuation. Benefits are paid to the insured and not contributed to superannuation funds unless specific riders are purchased. This implies that the DII benefit may provide a higher direct benefit to the insured than what the replacement ratio may indicate. We discuss this further in Section 3.4.1.**

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Figure 4. Representation of components of income



17. Further details can be found here: <https://www.lv.com/income-protection/faq/do-you-take-dividends-as-income>

18. <https://www.asisa.org.za/wp-content/uploads/2017/05/Considerations-for-Disability-Insurance-Nov-2012.pdf>



## 3.2 Key product features

### 3.2.1 Type of cover

Cover can be offered on an indemnity basis or an agreed value basis. For agreed value cover, the sum insured benefit is based on the income at the time of the application. Once the sum insured is 'agreed', the insured does not have to provide proof of income if/when they make a claim. Under an indemnity policy, the insurer has the right to validate that the benefit is not excessive relative to the pre-disability income at time of claim. For Indemnity cover, the benefit payable is generally limited to the income in the 12 months immediately prior to disability. There may be extended Indemnity covers also available whereby the sum insured is based on the highest income over a 12-month period in the last 2-3 years prior to claim. However, there may be restrictions with regards to the occupation classes which may be allowed this basis.

In Australia, a significant portion of business is still being written on an Agreed value basis, even though indemnity contracts were introduced in the 1990s.

In the US, both Agreed value and Indemnity value contracts are offered but Indemnity contracts are much more popular. In the UK, all business is written on Indemnity basis.

In South Africa, a "financial free" period exists where for shorter duration claims and / or claims of a certain cause, the insured amount will be paid without validation at claim stage i.e. on Agreed Value basis. However, contracts do allow for verification of pre-disability income to ensure an appropriate benefit is paid which are more akin to Indemnity basis contracts.

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**Australia still offers mostly Agreed Value contracts whereas other markets either offer mostly indemnity contracts (US) or only indemnity contracts (UK).**

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### 3.2.2 Replacement ratio and issue limits

A replacement ratio of 75 percent of earnings (pre-disability income if indemnity basis) is quite common in Australia, with up to 80 percent replacement ratios available as well up to certain income thresholds. For income above these thresholds, a lower replacement ratio applies. Issue limits of AUD 30,000 per month are common. Some insurers provide issue limits of up to AUD 60,000 per month. However, these may be restricted to shorter benefit periods (such as 24 months) and limited occupation classes.

Replacement ratios in the US are generally between 50-65 percent of income (pre-disability income for policies on an indemnity basis). However, for lower income customers this can be around 75 percent. Issue limits vary by occupation classes. They can range between AUD 15,000 and AUD 30,000 per month in the US (Beal & Khan, 2017).

In the UK, replacement ratios are around 60-65 percent of income. Issue limits are around AUD 35,000 per month in the UK.

South Africa allows up to a 100 percent replacement ratios on income (pre-disability income for indemnity policies) for an initial period of disability, but then generally reduces to 75 percent. The benefits are limited to around AUD 20,000 per month.

Replacement ratios should be considered in line with the tax treatment of Individual DII benefits and how pre-disability income is defined. For example, in some markets, benefits from Individual DII are not taxable, whereas in others they are taxable. We discuss these issues in Section 3.3.1.

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**The replacement ratios offered in Australia (75 percent) and South Africa (100 percent) are among the highest, with some Australian insurers also allowing one of the highest issue limits. This is exacerbated by the inclusion of superannuation contributions in the calculation of the DII benefit which can be payable to the insured themselves (instead of directly being paid into the superannuation fund). To fully understand the actual effective replacement ratios, tax treatments need to be taken into account (see Section 3.3.1).**

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### 3.2.3 Definition of pre-disability income for indemnity basis

The pre-disability income in Australia is defined as average monthly earnings for the consecutive 12-month period immediately prior to the start of the Waiting Period. However, on extended indemnity plans it can be the highest income over a 12-month period in the last 2-3 years immediately prior to the start of the Waiting Period.

In the US, the pre-disability income is the income the policyholder was earning on their last full day of active work, though some policies may use average earnings over a period of time. Pre-disability earnings do not include bonuses, commissions, overtime pay, or the employer's contributions to a retirement plan. They do include personal contributions to a retirement plan, as well as regular salary<sup>19</sup>.

Pre-disability earnings in the UK are the pre-tax earnings for PAYE assessment purposes in the 12 months before the insured became disabled. This may include the taxable value of benefits that are lost as a result of disability such as living accommodation where they live and pay tax; company car when used for private use; insurance; beneficial loans; regular bonuses and commissions; dividends received by them from a private limited company in which they and no more than three other shareholders are employed as full-time working directors; and spousal salary and dividends if they are employed by the same company as the insured<sup>20</sup>.

The pre-disability income in South Africa is generally defined as monthly earnings for the consecutive 12-24 month period immediately prior to the start of the waiting period.

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**The definition in the UK is the most generous with regards to the components of the pre-disability income.**

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19. <https://www.investopedia.com/terms/p/predisability-earnings.asp>

20. <https://adviser.royallondon.com/globalassets/docs/protection/pcp8p10012-plan-details-for-the-personal-menu-plan-income-protection.pdf>





### 3.2.4 Underwriting limits

There is generally no automatic medical underwriting beyond a full personal statement required in Australia for benefits less than AUD 10,000 per month.

However, based on the responses within the personal statement, further medical underwriting may be required. Between AUD 10,000 and AUD 20,000, it is possible to obtain cover by only having non-fasting blood test and a medical examination completed by a nurse. Above AUD 20,000 per month, personal medical attendant's report and other examinations may be required.

In terms of financial underwriting, it is possible to obtain cover if the benefit is under AUD 6,000 (AUD 8,000 for employed) per month. Above this, tax returns may be required by the insurer, depending on the occupation class of the insured.

In the US, financial underwriting is generally required for all policies. Paramedical exams (specifically for ages above 40) are required for benefits greater than AUD 3,000. Above AUD 4,500 blood testing starts becoming a requirement with some insurers requiring it from AUD 3,000 of benefit. Above AUD 7,000 of monthly benefit, an electrocardiogram (ECG/EKG) may be required. However, recently some insurers have simplified underwriting with no medical or financial underwriting for benefits up to AUD 8,800 (Beal & Khan, 2017).

In the UK, below AUD 1,500 of benefit per month, no medical underwriting is required. It increases incrementally based on benefit and age of the insured. Above around AUD 5,500 of cover, nurse health check, non-fasting blood test, microscopic urinalysis, cotinine testing, and HIV testing is required.

In South Africa, underwriting limits vary considerably from client to client. Generally, proof of income is required for covers above AUD 5,000 – AUD 10,000. The medical underwriting limits vary significantly between insurers. However, HIV testing and medical questionnaires are generally required for all levels of cover. Other requirements increase with age and cover (often above AUD 1,000 per month) and the testing conducted includes medical reports, cotinine testing, blood tests, ECG, and liver function tests.

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**Underwriting limits in Australia are more generous than the UK, the US and South Africa.**

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### 3.2.5 Maximum entry age, policy and benefit period

Australia allows age 60 as the maximum entry age with policy duration up to 70 years of age. The benefit durations can be as short as 1 year or as long as until retirement. For certain manual occupation classes, the eligibility to apply may be restricted to a lower age. Both level and stepped premium policies are offered, but most policies are stepped premiums. Lifetime benefit periods were offered in the 1990s but were withdrawn from new business in the early 2000s.

In the US, maximum entry age for Individual DII policies can be as high as 75. This is unlikely to be common since the maximum policy term is to retirement. More recently, to age 70 plans have been introduced (Beal & Khan, 2017). Short-term plans with benefit period of 7-30 days are also available. Most business is level premium but stepped premiums may apply in older ages.

The maximum entry age for the UK is 64. However, the common maximum entry age is generally 59-60 years. Benefit periods can span from 2 years to retirement. Premiums are generally level, except for certain higher risk occupations.

South Africa allows contracts to last until 70 years of age and offers lifetime benefits. Business is commonly written on both level and stepped premiums basis.

It may be valuable to understand how the average contract period varies between these four markets. However, this is not part of the scope of this paper.

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**In this regard, South Africa has the most generous terms with lifetime benefits. It is noted that the disability definition applied for lifetime benefit period is based on activities of daily living beyond retirement age.**

**Most business in Australia is written on a stepped premium basis whereas level premium is more common in the UK and the US markets, whereas both are common South Africa.**

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### 3.2.6 Benefit indexation

In Australia, whilst most insurers apply consumer price index<sup>21</sup> (CPI) like increases to benefits before and after claim and there has been a move away from offering benefit indexation higher than CPI, some insurers still offer benefit indexation of as much as maximum of CPI and 5 percent, though maximum of CPI and 3 percent is more commonly offered by insurers. Newer products terms have minimum of CPI and 3 percent as the benefit indexation. The benefit indexation is an optional benefit.

The US Individual DII policies offer riders to ensure benefits are not eroded by inflation. This rider allows benefits to be indexed to minimum of CPI and 3-6 percent.

In the UK claim indexation is limited to the minimum of CPI and 10 percent. However, some insurers may limit it to 12 percent. In general, to take benefit of the benefit indexation option, the insured must agree to premium increases of 1.5 times the percentage increase in the benefit amount.

In South Africa, they can be CPI adjusted or CPI + 3 percent in certain cases.

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**South Africa is quite generous in the application of claim indexation. However, given the low inflation environment in Australia over the recent years, the claim indexation on contracts offering maximum of CPI and 5 percent is quite generous.**

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21. The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

### 3.2.7 Waiting period

In Australia, waiting periods can range from 2 weeks to 2 years. 30 days is the most common waiting period. Options on policies are available to allow for Day 1 or Day 4 benefits in the event of accidents.

In the US, waiting periods range from 30 days to two years (typically 30, 60, 90, 180, 365, and 720 days) and the most common period of time in recent years is 90 days<sup>22</sup>.

UK allows waiting periods between 4 to 104 weeks. Waiting periods of 26-52 weeks are considered the most common. Early claim interventions may be allowed during the waiting period.

In South Africa, they can range from 7 days to a year. For professionals and self-employed individuals 7 days is common, which is backdated to Day 1. For other occupations, it most commonly varies between 14 days to 1 month. Other options are not popular in the Individual DII business.

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**South Africa has the shortest waiting period, followed by Australia (30 days) and then the US (90 days). The UK has the longest waiting periods.**

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### 3.2.8 Notification period

For Individual DII claims, the notification period (the period between the date claim incurred and the date the insured notifies the insurer) is generally “as soon as reasonable”.

In Australia, 30 days is a common time stated in policy documents for the notification of claim. However, policy documents do not specify penalties if the claims are notified late. It is not common practice to penalise late reported claims.

In the US, the notification is generally within 30 days of disability with further claims details to be provided over the next 90 days. Penalties may be applied if claims are notified beyond one year from the date of disability (Wells & Barrett, 2013).

In the UK, claims should be notified as soon as possible and often within two weeks of disability. If notified later, the insurer reserves the right to not back-pay claims to the original waiting period, but only back-pay to what is deemed to be the waiting period as per the policy document based on the notification date.

In South Africa, claims need to be notified as soon as reasonably practical. Some companies impose a time limit of 90 days to 12 months (Wells & Barrett, 2013). Penalties are generally not imposed in practice.

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**The US, UK and South Africa all have some controls over late reported claims. However, Australia has little control on the notification period in the terms and conditions of a policy.**

**UK has the least generous notification periods.**

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22. <https://www.policygenius.com/disability-insurance/disability-insurance-elimination-periods/>



### 3.2.9 Specified injury cover

In Australia, it is common to have a specified injury cover on Individual DII policies. This provides benefit payments from the date of injury if the injury event results in one of the specified injury benefit list. The commonly covered injury events are paralysis, loss of limbs, and certain fractures. However, these may vary between insurers. The payment period for these benefits can range from 1 month to 5 years.

We have not come across details of any specified injury cover for Individual DII in the US.

In the UK, certain fractures are covered by most policies as part of specified injury cover. There are limitations on the number of fractures (1-2) that may be covered in a 12 month period. In addition, there are limits on how much may be paid out under the fracture cover. There are also exclusions around activities which will result in the fracture cover not applying.

In South Africa, similar to the UK, fractures cover (and in some instances maternity cover) is included as a specified injury providing short-term benefits.

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**For specified injury cover, Australia has the most generous cover in terms of injuries covered as well as the benefits payable.**

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### 3.2.10 Occupation classes

In Australia, it is common to classify occupations by professional collar, white collar, blue collar, heavy blue collar, and special risk. Whilst the nomenclature and subclassing of these classes may vary across insurers, the classification criteria is broadly similar. Underwriting rules engines are employed in Australia which use information provided by advisers and customers to determine occupation ratings. For example, if the customer is a civil engineer who splits their time across a desk-based role and an on-site role, the adviser will assess with the customer the relative proportion of the on-site duties. This would have traditionally been done by the underwriter after a detailed assessment of the day-to-day duties of the civil engineer.

In the US, occupation classifications tend to vary from insurer to insurer. In general, the categories are rated from 1 to 6, with specific categories for medical professionals. Generally speaking, the higher the numerical value, the lower the rate of insurance (notwithstanding other factors like age, health, and income)<sup>23</sup>.

In the UK, the classification is similar to Australia and the US, but generally most insurers use fewer categories:

- **Class 1:** Very low levels of risk, such as professionals, managers, administrative staff, computer programmer; secretary. Little to no travel involved for job.
- **Class 2:** Skilled occupations requiring a moderate level of manual duties, such as engineers, florists, shop assistants. Travel may be required for the job.
- **Class 3:** Skilled manual workers and some semi-skilled workers such as care workers, plumbers, and teachers.
- **Class 4:** Semi-skilled occupations and some unskilled occupations where job is mostly manual, such as bartenders, construction workers, and mechanics.

Some insurers may split these groups into further, smaller groups. Different loadings may apply on premiums based on the occupation class. Automated rules engines may also be used in the UK for underwriting.

In South Africa, an occupational loading is generally applied based on occupation class. Occupation specific loadings may also be applied to certain occupations based on their duties. Traditionally, the categories are largely based on broad classifications considering education and qualifications such as white collar occupations, light manual occupations and heavy manual occupations. When an insured works across multiple occupations, the occupation class is based on the riskiest of all occupations.

In recent years, there has been a consideration to move away from job titles and focus more on the nature of duties to determine occupation classes. However, this is still an area of future improvement for the market.

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**Similar occupation classes are used across all the markets discussed in this paper.**

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23. <https://www.tfiins.com/blog/disability-income-101-occupation-class.aspx>



### 3.2.11 High risk occupations

In Australia, high risk occupations may be covered subject to policy terms which may restrict benefit period and restrict guaranteed renewability. Specific policy conditions may also apply to such insured individuals.

In the UK, specialist insurers can provide income protection policies for high risk occupations, such as abattoir workers and miners. A large number of risky professions are not covered by non-specialist DII policies. However, some riskier occupations may be able to get a cover with non-specialist insurers with certain restrictions, or with stepped premiums. This is determined by the insurer after underwriting is conducted.

We have not noted cover availability for high risk occupations in the US and South Africa.

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**High risk occupations are treated similarly in the UK and Australia.**

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### 3.2.12 Offsets

In Australia, pay-outs from other insurance policies, any undisclosed superannuation plans, age pension, workers compensation, and sick leave may be deducted from the benefit pay-out. Any lump sum amounts paid in relation to the disability are converted to an income for the calculation of the offset. However, a number of major insurers do not apply these offsets for white collar occupation classes. Common law payments or compensation for pain and suffering are excluded from the offset calculations. Under the '10-hour' clause, the injured may effectively work for up to 10 hours and be on a total disability payment. In effect, there is no offset for income from employment. Above the 10 hours, continuing income or income from other employment is considered to trigger the partial claims definition in Australia.

In the US, whilst generally social security disability benefits (government benefits), state short-term disability benefits, workers' compensation benefits, and third-party settlements (such as a personal injury award) are offset from the benefit pay-outs<sup>24</sup>, some Individual DII may be exempt from offsets such as workers' compensation or Social Security Disability Insurance. Generally income from 401(k) plans (tax-qualified, defined-contribution pension plans), individual retirement accounts, severance packages, stock options, and profit-sharing plans are not offset against DII benefits<sup>25</sup>.

In the UK, depending on the insurer, 60-100 percent of any continuing pay, dividends, and early pension pay-outs may be deducted from the benefit payable under Individual DII policies. All of the pay-outs from other insurance policies due to disability are deducted. However, non-means tested State benefits are not deducted. It is worth noting that the benefits payable may impact the insured's ability to claim on means-tested State benefits.

In South Africa, the benefit pay-out is reduced for any other income benefit cover. Entitlement to other benefits are typically deducted, but may not be deducted for the first 12 or 24 months. Any continued income is also deducted (Wells & Barrett, 2013).

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**Similar offset rules apply in the US, UK and South Africa. Australia has more generous rules around offsets due to the '10-hour' clause and lack of offsets on certain occupation classes.**

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24. <https://www.nolo.com/legal-encyclopedia/long-term-disability-insurance-company-take-social-security-disability-backpay.html>

25. <https://www.nolo.com/legal-encyclopedia/long-term-disability-insurance-company-take-social-security-disability-backpay.html>

### 3.2.13 Claims process

In Australia, after the notification of claim, the claim forms need to be completed and sent by the insured. Generally, a claims manager is assigned to follow-up and work with the insured around what documentation may be needed to support the claim. Authority request forms are accordingly signed based on the request for information.

In the US, the process for claims may differ by insurer and by the State. In general, the claim forms need to be submitted which must be completed by the insured's physician as well as the employer.

In the UK, proof of injury and income (documents and certificates from the tax office) are normally required at time of claim lodgement along with the claim and authority request forms (to contact employer and/or doctor). Some insurers will also pay for non-routine medical reports if they need them for further assessment of the claim. Once the claim is approved, claims counsellors are allocated to the injured to provide advice on coping with disability. They also work with the injured to try to establish a date of return to work. Additionally, over the period of claim, representatives of the insurer may conduct house visits to discuss and monitor the ongoing claims. The frequency of these visits depend on the severity of the injury. The monitoring process focuses on the rehabilitation of the injured and is performed, where appropriate, by specialist nurses (Institute and Faculty of Actuaries, 2016).

In South Africa, in order to claim, the insured needs to submit the relevant claim forms, medical certificates, employer's declarations, as well as identification documents. The insurer may then ask for any additional documents that may be required to process the claim.

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**The claims process is similar in all the four markets. However, there appears to be more pro-active claims management in the UK.**

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### 3.2.14 Recurrent claims

In Australia, if the insured returns to work on a full-time basis after a period of disability, but suffers from the same or related disability within 6-12 months of returning to work, the waiting period does not apply and the claim is considered a recurrent claim. The 6-12 month period varies from insurer to insurer and may vary by the benefit period and age of the insured. The combined periods of disability may not exceed the total benefit period.

In the US, if the insured claims again due to the same disability within a 6-12 month period (depending on the State), waiting periods do not apply.

In the UK, if the insurer makes another claim because of the same disability as the original claim within 6-12 months of the original claim, the waiting period is waived. However, some insurers may require the insured to still be employed in the same occupation for this condition to apply. Exceptions may apply on short term policies, whereby the waiting period is only waived if the limited term of benefit has not been fully utilised under the original claim.

Recurrent claims provisions in South Africa were not typically common historically. However, provisions for recurrent claims are now standard on all contracts as insurers have amended 'continuous' illness definitions to allow for an injured worker to go on claim again without facing a waiting period if the claim is related to the original injury and is within a pre-defined period of time after the original claim. For short benefit period contracts, the claimant can only qualify for the balance of the payment due – for example, if the benefit period is for 24 months, and the claimant were paid 6 months of benefits under the first claim, a maximum of 18 months of claim can then be made under the recurrent claim.

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**Recurrent claims are treated similarly in all the four markets.**

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### 3.2.15 Rehabilitation

In Australia, some insurers offer payment for pre-approved rehabilitation services as a benefit. Recent products have added the requirement for claimants to engage in mandatory rehabilitation services. However, in practice benefit payments do not cease if the insured refuses to comply. One insurer in our research also offered a bonus for attending approved rehabilitation services.

Insurers in the US often provide rehabilitation benefits on Individual DII policies.

Rehabilitation benefits are also offered by insurers in the UK. Some insurers may require the claimants to go for treatments and services which they believe will assist in their rehabilitation. A refusal from the claimant to follow these reasonable requests may result the benefit payments to be stopped.

At present, there do not seem to be policies explicitly offering rehabilitation benefits on Individual DII policies in South Africa. However, based on a disability survey conducted by a major insurer in South Africa, it appears that rehabilitation services will be a key focus for insurers going forward (Old Mutual Corporate, 2017).

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**Whilst Australia and the UK have similar approaches in the policy documents, rehabilitation benefits are more widely utilised in the UK because of their claim process, as discussed in 3.2.13.**

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### 3.2.16 Other benefits

Most insurers in Australia offer the following benefits/riders:

- **Waiver of premium:** During the period of the claim the premiums payable on the Individual DII policy (and often any associated life insurance policies) are generally waived by most policies.
  - **Death benefit:** If the insured dies during disability, a death benefit is paid to the beneficiary.
  - **Trauma benefit:** A lump sum trauma benefit is payable under some policies under pre-defined traumatic events.
  - **Guaranteed increase options:** This option allows the insured to increase the benefit payable due to increase in income without further underwriting at fixed intervals, or when certain life events occur (for example, birth of a child).
  - **Elective surgery benefit:** This benefit allows for a monthly benefit if disability results due to an elective surgery procedure (different insurers may define these as cosmetic, transplant or other elective surgery advised by a qualified doctor). A qualifying period may apply for this benefit.
  - **Retirement benefit option:** This option allows another 5-10 percent of monthly income to be added to the benefit and contributed into the insured's superannuation fund.
- Some insurers may also offer unique additional benefits on Individual DII policies. We list some of these below:
- **Involuntary unemployment cover:** Available for up to 3 months.
  - **Severity boosts on claims:** These include up to 30 percent additional benefit if the insured is totally disabled and cannot perform at least 2 activities of daily living & under care and supervision.
  - **Needlestick injury benefit:** Offered to medical staff to cover the risk of reduced earnings if the insured are accidentally infected with HIV, AIDS, or Hepatitis B/C.
  - **Accommodation benefit:** Offered for members of the family if they need paid accommodation to be near the insured during treatment.
  - **Home assistance:** Provides a fixed daily benefit to allow the insured to cover the cost of a registered nurse.
  - **Transportation benefit:** Provides for an airfare cost if the insured is totally disabled outside of Australia for at least 4 weeks. There may be restrictions on how many times during the policy term this benefit may be paid.
  - **Return to work benefit post-rehabilitation:** Provides a capped lump sum bonus if the insurer attends pre-approved rehabilitation services and returns to work.
  - **No claims bonuses:** Provides bonuses which increase based on the number of years the insurer has not claimed under their Individual DII policy – the bonuses can be up to 15 percent.

In the US, common additional benefits on policies include:

- **Guaranteed increase options:** To allow benefit to increase in line with income increases when the insured is working, regardless of change in health.
- **Death benefit:** Paid to beneficiary if the insured dies during disability.
- **Waiver of premium:** During the period of the claim, the premiums payable on the Individual DII policy are generally waived by most policies.

There may be other benefits and riders offered such as hospitalisation benefits, trauma benefits, family care benefits, and cosmetic or transplant surgery benefits. These vary across insurers and States.

In the UK, the following additional benefits and options are provided on Individual DII policies:

- **Minimum guaranteed benefit:** most policies will offer the option of a minimum guaranteed benefit per month, subject to various terms and conditions. This benefit is payable if the insured has suffered a reduction in income, prior to suffering injury or illness. This is generally limited to AUD 3,000 per month and subject to any offsets applicable on the disability benefit.
- **Waiver of premium:** During the period of the claim, the premiums payable on the Individual DII policy are generally waived by most policies. Some policies may provide a waiver for periods of unemployment. However, these are subject to strict conditions such limited periods covered over the life of the policy and waiting periods before the waiver benefit can be claimed.

- **Hospitalisation benefit:** If the insured is hospitalised for over 6-7 consecutive days, a daily hospitalisation benefit is payable. The amount and the duration of the payout may vary significantly by insurer.
- **Trauma benefit:** A lump sum trauma benefit is payable under some policies under pre-defined traumatic events.
- **Global treatment benefit:** Some policies provide treatment options in certain other countries if the insured is abroad.
- **Guaranteed increase options:** This option allows the insured to increase the benefit payable due to certain life events, such as marriage, mortgage, and parenthood.

There are also specific benefits on offer for doctors and surgeons, such as minimum guaranteed benefits and sick pay allowances during the waiting period. Teachers, midwives and nurses may be able to apply for similar benefits under certain policies. Some policies may also offer a lump sum death benefit.

Other benefits associated with Individual DII policies in South Africa include child trauma benefit to provide for a lump sum payment in the event of a trauma or death event of a child. Guaranteed increase options (subject to negative HIV tests), death and trauma benefits are also offered on some policies.

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**There are a significant number of benefits on offer in Australia which are not offered in the other markets. Of note are the no claims bonuses and severity boosts on claim which can take the replacement ratio to over 100 percent of pre-disability income.**

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### 3.2.17 Exclusions

General limitations apply in Australia which include disability due to intentional self-inflicted injuries, routine pregnancy and childbirth, undisclosed pre-existing conditions, war, terrorism, riots, and criminal activities. Some insurers may also not cover claims if injury occurs when the insured is in a country for which the Australian Department of Foreign Affairs has issued a 'Do Not Travel' warning advice. Some insurers may also apply restrictions on mental health claims by limiting benefits term to 24 months. Generally, Individual DII is not available for homemakers in Australia, except as specific riders.

In the US, standard limitations apply such as disability due to routine pregnancy or childbirth, war, riot, committing felony, or intentional self-inflicted injury. In addition to the usual exclusions, in the US, there may also be pre-existing conditions exclusions on certain Individual DII policies as well as mental health limitations and exclusions. These may include placing 'mental disorder and substance abuse limitation' riders which limit benefit periods if the primary cause of disability is solely a psychiatric or substance abuse disorder, including Post Traumatic Stress Disorder (PTSD), anxiety, depression, drug and alcohol abuse or addiction<sup>26</sup>. A limitation rider usually does not apply to a disabling condition that is caused by an organic disease (such as Multiple Sclerosis, Parkinson's, Alzheimer's, or dementia), stroke, infection, or injury<sup>27</sup>. A limitation rider is not dissimilar to an endorsed policy written in Australia with exclusions for known prior or current conditions.

In the UK, general exclusions include disability due to or caused by HIV/AIDS, routine pregnancy or childbirth, war, self-inflicted injuries, criminal acts, misuse of alcohol or drugs, failure to seek or follow medical advice, or hazardous pastimes.

Exclusions in South Africa are similar to those in the other markets and relate to deliberately taking part in war or acts of war or riots, deliberately breaking the law, exposure to radioactivity or nuclear explosion, self-inflicted injuries, and excessive consumption of alcohol, drug or any other poisonous substance and routine pregnancy or childbirth.

In addition to this, fraudulent and deliberate non-disclosures can generally void the claim in the markets discussed.

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**Similar exclusions apply in each market with the exception that Australia may not cover the insured if they are in a country for which the Australian Department of Foreign Affairs has issued a 'Do Not Travel' warning advice. The US treatment of mental health claims seems more restrictive compared to the other markets.**

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26. <https://www.whitecoatinvestor.com/disability-insurance-nervous-about-mental-nervous-benefits/>

27. <https://physiciansthrive.com/does-disability-insurance-cover-mental-health/>

### 3.3 Key market features

#### 3.3.1 Taxation of benefits

In Australia, Individual DII premiums are tax deductible. Benefits received from the policy are considered assessable income for tax purposes and are accordingly taxed in the hands of the policyholder at their marginal tax rate.

In the US, as far as the tax status of the benefits is concerned, it depends on whether the premiums were paid out of pre-tax or post-tax income. If the Individual DII policy is purchased from pre-tax income, then the disability benefits are taxable. If it is purchased from post-tax income, then the benefits are tax-free<sup>28</sup>.

In the UK, premiums under individual DII policies do not normally qualify for tax relief. Benefits paid under Individual DII policies are tax-free with effect from April 1996 if the premium is paid by the insured<sup>29</sup>. However, if the premium for an Individual policy is paid by an employer, these benefits will be considered taxable<sup>30</sup>.

In South Africa, the tax regulation around DII changed in March 2015. Since then, premiums on Individual DII are no longer tax deductible. However, any benefits paid from the policy are now tax free<sup>31</sup>.

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**Individual DII benefits are generally considered tax-free in the UK and South Africa whereas they are taxed in Australia and the US (if premiums are paid out of pre-tax income). Where benefits are taxed, a progressive tax system can lift the effective replacement ratio.**

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#### 3.3.2 Sales channel

The Individual DII products that we have considered are generally sold by advisers and/or brokers. In the US, however, some of these products may be sold through the employer (but not paid by the employer).

There may be value in understanding the different research tools used by the advisers to recommend products to their customers in each of these markets. This is an area of possible further research to be undertaken as a follow up to this paper.

28. <https://www.ameriprise.com/research-market-insights/tax-center/tax-planning/taxation-of-disability-insurance/>

29. <https://www.gov.uk/hmrc-internal-manuals/insurance-policyholder-taxation-manual/iptm6110>

30. <https://www.gov.uk/hmrc-internal-manuals/insurance-policyholder-taxation-manual/iptm6120>

31. <http://www.702.co.za/articles/1827/the-implications-of-income-protection-no-longer-being-tax-deductable>

### 3.3.3 Occupations of customers

In all the markets we have considered, the target market for Individual DII products is generally high income earning white-collared or self-employed people as the product is sold via financial advisers.

In Australia, over the period from 2011 to 2015 professional and white collar individuals made up 50 percent of the Individual DII exposure, blue and heavy blue collar around 20 percent and tradespersons around 15 percent, with the remainder being other occupation classes.

The US Individual DII market is dominated by doctors and surgeons who account for over 30 percent of the new premiums in 2016. Dentists account for 9 percent, lawyers about 6 percent, accountants about 2 percent, and the remainder are executives. As indicated by this split, the individual DII market is quite targeted towards the higher income professionals. In the recent years, insurers are starting to focus on more non-medical markets (Beal & Khan, 2017).

In the UK, there has been a trend around an increased number of short term policies being obtained. The average salary for policies written with a short benefit period in 2017 was 40 percent lower than for "to retirement" products. The types of clients who purchase these products are generally less affluent, and work in lower grade occupations (Swiss Re, 2018).

Whilst detailed information on the occupations of the buyers on Individual DII is not readily available, we note that there is a shift in the work pattern around the globe. In South Africa, a 2017 survey notes that more than a third of individuals were working multiple jobs. Of these, 13 percent had a second job similar to their everyday job and 24 percent had a job that was totally different from their daily work (GenRe, 2017). This has implications as policies may have been underwritten on one occupation class but the claims experience will be reflective of the risk profile of the second or third job as well as the primary job.



### 3.4 Worked examples

#### 3.4.1 Effective replacement ratios

To illustrate how the effective replacement ratios may vary across the different markets, we have considered an individual who has a total remuneration of AUD 100,000 a year. We assume the following:

- Of his total remuneration, 10 percent are the employer contributions made into the insured's superannuation fund if he is in Australia. If he is in one of the other markets, there are no employer contributions, which means his salary is AUD 100,000.
- All markets have a progressive tax system and the same tax rates where the first AUD 50,000 of income is taxed at 20 percent, and all income above this amount is taxed at 30 percent.
- Income for the Individual DII policy in this example is defined the same way across all the four markets and is assessed to be AUD 100,000.
- The insured will not make any concessional or non-concessional superannuation contributions from the disability benefit payout.
- The insured does not have any riders attached to their policy which make any superannuation contributions on behalf of the insured.
- If the insured is able to work in any capacity, the income earned will include employer superannuation contributions and will be taxed as usual.
- The insured is able to work 10 hours as well, earning AUD 20,000 a year.
- No allowances for tax savings through negative gearing have been made.
- We have calculated the effective replacement ratio as ratio of the total take-home pay/benefit after tax post-disability and the total take-home pay after tax pre-disability.

The results of our worked examples are shown in Figure 5.

This table shows that for Australia, a replacement ratio of 75 percent in the policy document may typically permit more than 102 percent of the pre-disability take home pay in some circumstances. In the other markets, this potential difference is not significant.

In particular, we note that:









- The replacement ratio as per policy documents is on the higher end in Australia and South Africa.
- Since benefits are taxed in Australia and the US, paying tax on a lower income implies that effective replacement ratio is higher than that specified in the policy document. In Australia, this can be even higher if the injured decides to not make any concessional superannuation contributions from their disability benefit.
- In Australia, under the three tier definition of disability, the injured may be able to earn another 20 percent of their pre-disability income and still obtain the full disability pay-out. After taxation and superannuation contribution on this pay, the effective replacement ratio for the injured in this example jumps to above 100 percent.
- If the injured is able to claim on other benefits offered by insurers in Australia which increase the benefit amount (such as severity boosters, no claims bonus, higher than CPI inflation) or belongs to an occupation class which is exempt from offsets on the benefit payable, the effective replacement ratio may be well above 100 percent for the injured.



High replacement ratios in Australia and South Africa are likely to be a disincentive to returning to work. In the UK and the US, the lower replacement ratios are likely to provide incentive for the injured to focus on recovery to return to work.

As a further area of research, it may be valuable to also conduct this analysis with the actual tax rates applicable in each of the markets. The analysis could include and assessment of what ancillary benefits typically apply to a policy in each country and how these impact the effective replacement ratio. However, this analysis was outside the scope of this paper.

Figure 5. Implication on Effective Replacement Ratio

Product Feature	Australia (taxable benefits)	US (taxable benefits*)	UK (tax-free benefits)	South Africa (tax-free benefits)
 Replacement ratio as per policy document	75%	65%	60%	100%
 Savings from paying tax on lower 'income' and no superannuation contribution	84%	67% (No superannuation impact)	60% (No impact since benefits are tax-free)	100% (No superannuation impact)
 Income from other sources (less than 20 percent of pre-disability earnings or 10 hours of work)	102%	67% (N/A – disability defined as not gainfully employed)	60% (N/A – any income is offset against benefit)	100% (N/A – any income is offset against benefit)
 Other benefits and options such as higher than CPI increases of benefit, severity bonus, no claims bonus, contribution to super option	>102%	67% (N/A – other benefits generally don't increase regular payouts)	60% (N/A – other benefits generally don't increase regular payouts)	100% (N/A – other benefits generally don't increase regular payouts)
A highly effective replacement ratio is likely to result in a disincentive to return to work				

\* The income received from disability income insurance in the US may or may not be taxable, depending on the type of benefits, whether the premiums were paid with pre-tax or post-tax income, and whether the premiums were paid by an individual or their employer. Refer to section 3.3.1 for further information. If the income received is not taxable, the equivalent "pre-tax" replacement ratios in the table above will be higher, with the amount depending on the tax rate of the individual.

### 3.4.2 Application of disability definitions

We have considered how the disability definitions may apply for the same injured person in the different markets. We have looked at four scenarios. The scenarios indicate our interpretation of the policy definitions. Different treatments may apply based on precedence and varying interpretations in the different markets.

#### Scenario 1

John is injured and is unable to work in his own profession. He is currently not working and is being attended by a doctor regularly.

The definition of total disability is met by John in every market and accordingly a full benefit will be paid out, as noted in Figure 6.

Figure 6. Application of Disability Definitions: Scenario One



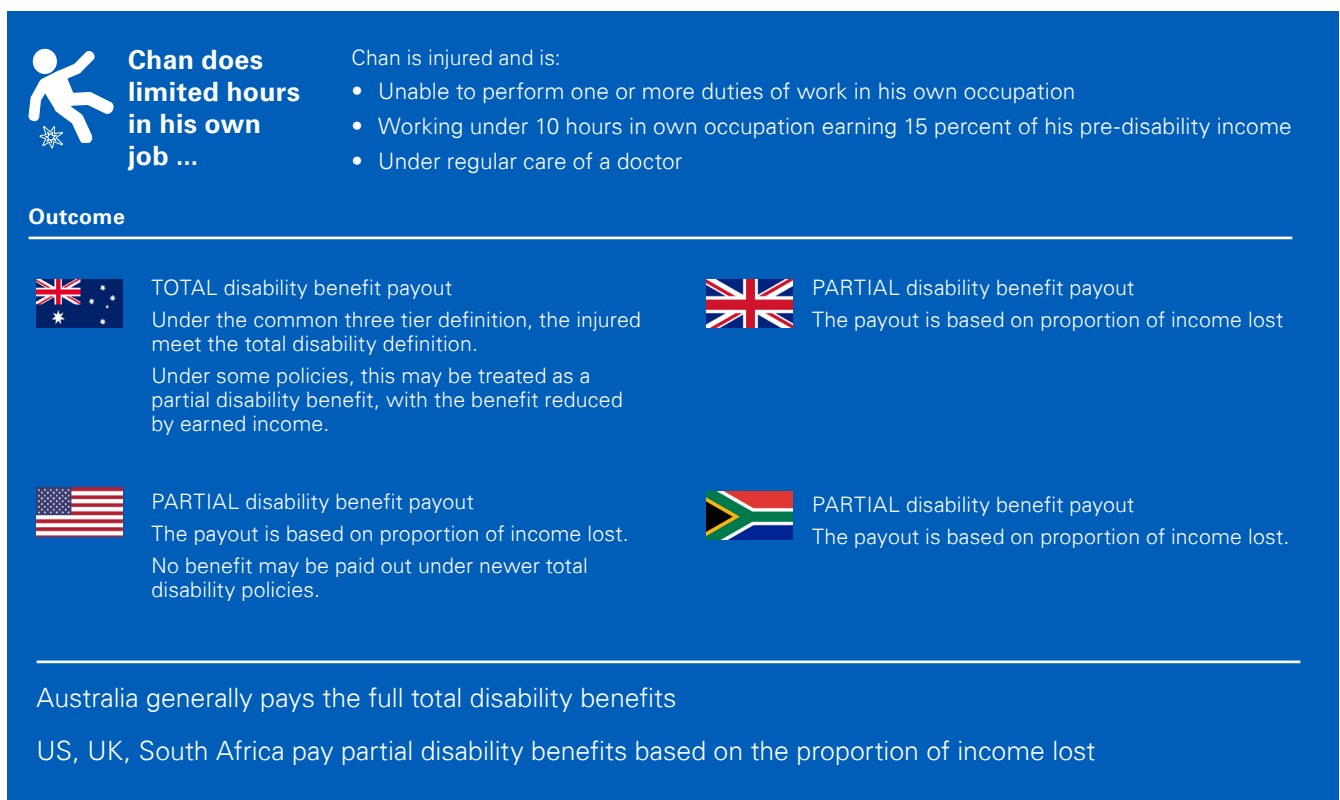
### Scenario Two

Chan is injured but is able to perform some duties of his own profession. However, he is unable to work more than 10 hours, and is only earning 15 percent of his pre-injury income. He is also being regularly attended by a doctor.

In this case, in Australia, Chan would meet the definition of total disability under the three tier definition and be paid a full benefit. Some insurers, however, may treat this as a partial claim if they are not using the hours/income based definition for total disability.

In the other markets, this generally qualifies for a partial benefit, as indicated by Figure 7.

Figure 7. Application of Disability Definitions: Scenario Two



### Scenario Three

Gabriella works in two occupations. She gets injured and can only work in a reduced capacity in her primary occupation. She is still however able to continue in her secondary occupation. She is also under regular care of a doctor.

Australia generally allows for the income from the primary occupation to be insured. Based on the underwriting at the time of writing the policy, an endorsement may be issued around how the secondary occupation will impact the benefit pay-out, and if any offsets may apply if they start working more in their secondary occupation. However, if no endorsement is issued, a partial disability benefit will be paid based on the proportion of income lost on the primary occupation.

In the other markets, the partial benefit based on proportion on income lost on their own occupation, offset by any other income, is likely to be paid out. This is shown in Figure 8.

Figure 8. Application of Disability Definitions: Scenario Three



## Scenario Four

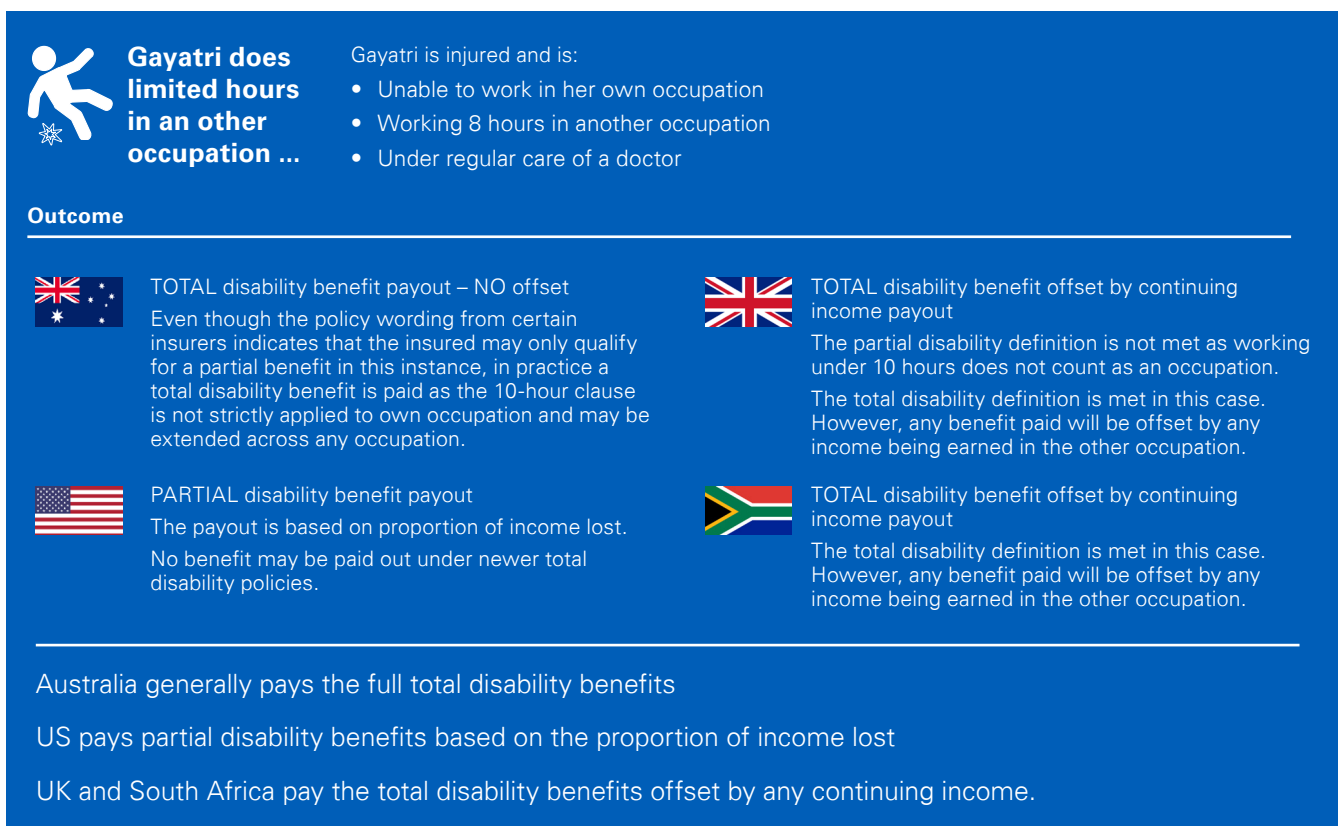
Gayatri is injured and cannot work in her own occupation due to the injury. However, she is able to do part-time work in another occupation but is only able to work for 8 hours a week. She is also regularly attended by her doctor.

In Australia, this would generally result in a full disability benefit pay-out as the hours and income based definition may not be applied strictly to own occupation by insurers.

In the UK, whilst this qualifies for a full disability benefit pay-out, the benefit is reduced by the income earned as any continuing income is offset from benefits.

In the other two markets, this will qualify for a partial claim. We see this in Figure 9.

Figure 9. Application of Disability Definitions: Scenario Three



These examples have been based on the typical policies available in each of these markets. There has been a tightening of features by some insurers in the recent years in Australia. As a further area of research, it would be valuable to conduct the above scenario analysis on these new variants of the Individual DII policies to assess how the tightened product features may compare to the products in the other markets.



# 4. Group Disability Income - Product & Market Features

In this section, we compare the different product features on Group DII available in the four markets. We also compare the sources of the Group business in each market.

Group DII contracts in the US, UK, and South Africa are mainly employer sponsored group contracts and offered as part of employee benefits packages. In Australia, over 82 percent of Group DII contracts (APRA Statistics: Life Insurance Claims and Disputes Statistics, 2018) offered by employers are written through the employees' superannuation funds (we refer to these as Superannuation Group DII) with the remaining being written directly through employers (we refer to these as Corporate Group DII contracts – these are usually held outside of superannuation funds). The superannuation fund or the employer negotiates the insurance contract with the insurers and pays Group premiums to cover their members or employees as a group. In case of the Group DII being written through the superannuation fund, the premiums are deducted from the superannuation accounts of their members to pay for the insurance.

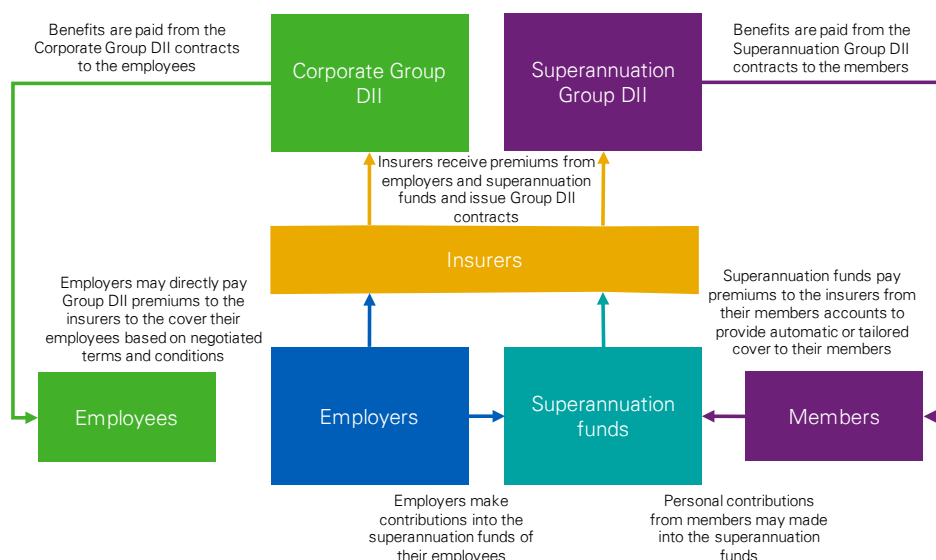
- Group DII contracts written through a superannuation fund often provides automatic cover (no health information required, but age limits and other conditions apply) up to certain limits to its members. It may also provide tailored cover (underwritten as per usual practices) to its members. Product features are standard across the automatic cover. Automatic cover (also referred to as default cover) is generally taken up by all or most of the eligible members.
- Employers can generally negotiate the types of cover based on number and type of employees under Corporate Group DII contracts.

In Australia, Group DII contracts may also be written through Master Trusts (investment vehicles that collectively manage pooled investments). For the purpose of this paper, we have grouped them under Superannuation Group DII contracts.

We summarise this arrangement in Figure 10.

Our discussion will differentiate between Superannuation Group contracts and Corporate Group contracts, where possible.

Figure 10. Group DII arrangements in Australia



## 4.1 Definition of disability income

### 4.1.2 How is disability defined?

For Group products (Superannuation and Corporate), Australia uses simpler definitions than to those used for Individual DII. The definitions commonly used relate to duties where the insured is unable to perform one or more, or any of the major duties of their occupation, with a major duty defined as one which involves 20 percent of the insured's occupational tasks.

In the US, the total disability definition is defined as the inability to perform the material duties of their own occupation. Some insurers may also require a loss of at least 20 percent of pre-disability earning within the definition.

In the UK, for Group DII contracts, the disability definitions vary depending on whether the contract is agreed on an Own occupation, Suited occupation or 'Other' basis. For Own occupation, disability for an insured is defined as being unable to perform the essential functions of their role and not performing any other jobs. The Suited occupation is defined as inability to perform duties of own or other suited roles (on a full and part-time basis) due to disability, where suited roles are any roles which are appropriate to their experience, training, or education. The Other basis may vary from contract to contract but is largely based around being unable to perform at least three activities of daily living as defined in the policy documents.

South Africa defines disability as being unable by reason of illness or injury to follow own occupation(s) and not following any other occupation.

### 4.1.3 Partial claim

Partial claims in Australia may only be payable under Group DII contracts (especially Superannuation Group DII) if the insured has been totally disabled for commonly 14 days of the waiting period and consequently fits the definition of partial disability.

Partial disability definitions in the US vary across insurers with definitions usually involving the inability to work full-time in own profession but working on a part-time basis in an occupation. Partial claims benefits are the total disability benefits adjusted by the earnings during the partial disability.

In the UK partial disability may be defined under Group DII contracts as follows: if due to disability, the insured is working in their own occupation but at a reduced capacity, or in another occupation and are suffering a loss of earnings. Similar to Individual DII, proportionate benefits may be payable on Group DII if the terms and conditions of the policy can be met to establish partial disability.

South Africa allows partial claims if the insured is able to return to work in some degree.

#### 4.1.4 Changes in definition of disability

In Australia, on Corporate Group DII contracts, there may be allowances for employers to negotiate different terms with an option to move to an any occupation definition after a given period of time. On Superannuation Group DII, generally the definition of disability does not change, especially since the automatic cover benefit period is often two years (see Section 4.2.4). Furthermore, the definition of disability under Superannuation Group contracts are aligned to the Superannuation Industry (Supervision) Regulations 1994.

Depending on the superannuation fund or the employer, for the Group DII contracts, the definition of disability is likely to change to any occupation from own occupation after a given period of time which may be 12 to 24 months in the US.

It is very common in the UK for the policy definition to change from Own occupation to 'Other' occupations after 24 months under Group DII contracts. If the insured is still disabled after 5 years, activities of daily living definitions may also apply from that point onwards.

Similar to the UK and US, in South Africa, the definition of disability generally moves to any occupation definition after a period of 24 months.

#### 4.1.5 Definition of income

In Australia, income is defined as pre-disability income which is generally the average monthly income paid by the employer in the preceding 12 months. Generally, income is pre-employer contributions to superannuation.

In the US, income is generally salary, contributions made through salary deductions towards pensions, and contributions made toward fringe benefits. Income does not include bonuses, commissions, overtime pay, allowances, employer's contributions to pensions and other compensations.

Income under Group DII contracts typically means annual salary in the UK. If there are variable components to salary, the average of the variable components over the last 12-36 months may be used. The variable components may include bonuses, overtime, commission, value of benefits in kind, and dividends.

Income is considered the cost to company or pensionable salary. Pensionable income is the income used by employers to calculate the employee's pension or provident fund contribution. This income will typically include any fixed remuneration (e.g. salary or wages) but may exclude variable amounts such as commissions, bonuses and overtime<sup>32</sup>. For employees with variable income, the average income over a 12-month period over a defined period is used for Group DII contracts.

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32. <https://www.sataxguide.co.za/4100-2/>

## 4.2 Key product features

### 4.2.1 Type of cover

Group business is generally written on Indemnity basis in the four markets considered. In Australia, under Superannuation Group DII contracts, cover is expressed as a dollar amount. For some arrangements, the option to purchase cover in terms of units may be available (see Section 4.2.2) but it is limited to the amount of cover based on the replacement ratio on the pre-disability income.

### 4.2.2 Replacement ratio and issue limits

Replacement ratios of up to 85 percent of pre-disability income (as defined in Section 3.2.3) are generally available under Superannuation Group DII contracts with 10 percent of the benefit paid directly into the superannuation fund and the remainder paid to the insured. However, the superannuation funds can negotiate different terms. Issue limits can be as high as AUD 30,000 per month. Automatic cover is often provided in blocks of cover called 'units'. The number of units allocated under automatic cover depends on the age of the member. Additional units can be obtained through tailored cover, but the total cover is generally limited to the 85 percent of pre-disability income or the issue limit as noted above.

For Corporate Group DII contracts, the employers may be able to negotiate replacement ratios.

In the US, replacement ratios of up to 60 percent on pre-disability earnings are available on Group DII contracts. Issue limits of AUD 15,000 of benefit per month generally apply but may vary from insurer to insurer.

Replacement ratios in the UK can be around 80 percent of the employee's earnings, and 50 percent for equity partners, with an issue limit of AUD 625,000 per year per employee. There may also be limitation on the maximum pension contributions.

Some insurers in South Africa allow up to a 100 percent replacement ratios of pensionable income for initial period of disability, but then generally reduce to 75 percent of the pensionable salary. The benefits are limited to around AUD 20,000 per month per employee. However, these may vary significantly across insurers.

Replacement ratios should be considered together with the tax treatment of Group DII benefits. We discuss these in Section 4.3.1.

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**Based on this, the replacement ratios in Australia are more generous than other markets with the exception of the initial period of disability which is more generous in South Africa. However, the issue limits in the UK are very high under Group policies.**

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### 4.2.3 Underwriting limits

In Australia, the underwriting limits are generally negotiated between the superannuation funds/ employers and the insurer.

In the UK, Group underwriting limits generally start at benefit levels of AUD 10,000 and AUD 20,000 per month. Generally no medical underwriting is required for monthly income which falls within the automatic acceptance limit (the limit above which underwriting is required). The automatic acceptance limit on group contracts may vary from group to group.

Information on Group DII underwriting limits could not be sourced from the US & South Africa.



#### 4.2.4 Maximum entry age, policy and benefit period

In Australia, maximum entry age may be up to 64 years of age, however maximum benefit period is generally available only to age 65 (or retirement) in Australia. Benefit periods can be from 2 years to retirement. Some 'to age 70' benefit periods may also be available. The default cover is generally 2 years for Superannuation Group contracts. Corporate Group DII contracts depend on the terms negotiated by the employer with the insurer.

The maximum entry age in the US is just before retirement with policy durations up to retirement age or leaving employment. As short-term benefit plans are also offered through employers in the US, benefit periods of 7-30 days are available with long-term benefit plans catering for benefits spanning from 2 years to retirement.

In the UK, 64 is the maximum entry age with benefit period up to retirement (70 or State Pension Age) or leaving employment. The benefit durations can be between 2 years and until retirement. Benefit payments stop if disability ends, the benefit period is completed, the maximum allowable age is reached, insured leaves the employment, or the insured dies (whichever comes sooner).

The maximum entry age for South Africa is 55, with contracts lasting until age 60 or leaving employment. Benefit periods can span from 2 years to retirement.

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**South Africa is less generous with its maximum entry age than the other markets, including Australia.**

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#### 4.2.5 Benefit indexation

Benefit indexation in Australia on Group contracts (Superannuation and Corporate) is generally limited to the minimum of CPI and 5 percent for most policies.

The US policies do not seem to include benefit indexation.

In the UK, groups have the option of increasing the benefit in line with CPI (capped to a maximum of 5 percent) or by a fixed rate of the employer's choosing, with the maximum allowed being 5 percent.

In South Africa, the benefit indexation is generally limited to CPI (Wells & Barrett, 2013).

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**In this regard, the treatment is similar across all markets except the US.**

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#### 4.2.6 Waiting period

In Australia, waiting periods generally range from 30 days to 180 days. For Superannuation Group DII contracts, the common waiting period is 90 days. Corporate Group DII contracts will have waiting periods from the range as agreed by the employer and the insurer.

In the US, waiting periods can range from 7 days to 180 days.

In the UK, waiting periods can be between 8 to 52 weeks, with 28 weeks being quite common.

In South Africa, they can range from 30 days to a year. The most common is 30 days.

Early interventions may be allowed during the waiting period. This is especially the case in the UK. However, in Australia there may be limitations on what early interventions and rehabilitation services may be provided during the waiting period if the policy is through superannuation as these are governed by Superannuation Industry (Supervision) Act (SIS Act) 1993. Furthermore, the Private Health Insurance Act 2007 prevents Australian insurers from making payments relating to health benefits.

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**UK has the longest waiting periods, compared to the other markets, including Australia.**

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#### 4.2.7 Notification period

For Group DII claims (Superannuation and Corporate), the notification period in Australia is specified to be "as soon as reasonable." No penalties for late notifications were indicated on the policy documents we considered for this paper.

In the US, it is also indicated for most insurers to be as soon as possible. There may be some penalty implications if event is reported after 12 months (Wells & Barrett, 2013).

In the UK, claim notification for Group plans vary with general notification period between 4 weeks and 10 weeks. If there are delays in the claims notification, the insurer may only pay the benefit from a later date. There may be onus on employers to send in absence notification forms if employees have been absent from work due to disability. One insurer in our research allows for early notification bonus for Group policies if at least a specified percentage of absences are notified within a specific period of time.

Notification period varies between 6-12 months in South Africa. If the claim is late and the insurer can show that they have repeatedly informed and educated the client regarding late notification, they may decline the claim. In most instances, however, the insurer will then accept liability from the time of claim submission and will not backdate payment. On larger employer schemes, it can be challenging as the process of notifying and submitting claims evidence as this often relies on the line managers and human resources personnel whose main priorities may not be dealing with an insurance claim.

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**Contrary to the other markets, there is no provision for penalties on late notification of claims in Australia. This is generous.**

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#### 4.2.8 Offsets

Sick leave, workers' compensation, motor accident compensation, social security benefits, other insurance payouts for disability, employer superannuation contributions, any income earned during disability may all be offset from the Group DII benefit payment in Australia (Superannuation and Corporate).

Offsets in the US include sick pay, workers' compensation benefits, state disability benefits, Social Security disability or retirement benefits, any other disability or retirement benefits, settlements from third parties in relation to the disability, and any other form of continuing income.

In the UK, continuing sick pay from employers, continuing income from partnerships, regular income from other insurance policies, and early retirement pensions are offset against the Group DII benefit payment.

Offsets in South Africa include continuing income and other income replacement benefits. Lump sum payments in relation to disability and any other receipts which are less than 25 percent of the income before disability may not be included in offset by some insurers.

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**Similar offset arrangements exist in the four markets. However, some South African insurers are generous to not offset income sources which return less than 25 percent of pre-disability income.**

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#### 4.2.9 Claims process and rehabilitation

The claims process in Australia is for the insured to contact the insurer (or the superannuation fund if the contract is a Superannuation Group DII contract) and notify them of the claim, where the representative can help with guiding the injured on the appropriate claims forms and related documents to submit. Some insurers may also have eClaims service which allow a claim to be lodged online and provide access to third parties (employers and doctors) to populate relevant details needed of them to complete the claim. Proof of income is generally required on all claims.

In the US, the insured needs to complete the claims forms including employer's statements and doctor's statements. Further authorisations and consents may also be required. To receive the benefit post-tax (see Section 4.3.1), a Group DII tax notice may also be required.

In the UK, employer and employee forms need to be completed, along with evidence for the disability, and any relevant consent documents. The insurer may also have representatives discuss the condition with the employee. Insurers generally have the right to request medical examinations and attendance of sessions with disability counsellors for the claim conditions to be met.

Similar to the other markets, in South Africa, the relevant claims forms need to be completed and sent to the insurer. Additional documents are accordingly requested.

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**Similar claims processes exist in the four markets.**

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#### 4.2.10 Recurrent claims

If the insured returns to work but suffers from the same condition within the next 6 months generally, and is disabled, the waiting period is waived and disability payments can re-commence as these are recognised as recurrent disability or recurrent claims in Australia. If the contract is a short benefit period contract, the previous claim payments are taken into account when determining the benefit period for the 'new' claim. The treatment is unlikely to differ between Corporate and Superannuation Group DII contracts.

UK treats recurrent claim in a similar manner to Australia. However, some insurers may also consider claims recurrent if the insured suffers from disability lasting more than 30 days albeit from a different cause but within the 12 months of the last benefit payment.

No specific details were found on recurrent claims on Group DII contracts in our research for the US or South Africa.

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**UK is slightly more generous in terms of recurrent benefits with longer period of time allowed between recurrence of disability.**

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#### 4.2.11 Other benefits

In Australia, Group DII plans typically offer:

- Rehabilitation support and benefits under which the insurer works with the injured to support rehabilitation from disability and provide vocational expertise to retrain the insured if needed. These benefits are paid directly to the insurer's preferred provider. While it may not be mandatory under some Group DII contracts, it may be so under others and refusal to take part or delay in participating in the rehabilitation efforts may reduce benefit payments. Mandatory rehabilitation is quite a recent change to respond to higher claims costs being experienced. There may be limitations on rehabilitation benefits on Superannuation Group DII contracts such as not being able to pay any rehabilitation benefits during the waiting period.
- Interim accident cover is offered which provides cover between the point of underwriting application and the decision being made by the insurer. Waiting periods apply in line with the policy documents.
- Continuation options are provided to the insured to continue their DII policy as an Individual DII policy when they leave employment.

Group DII products tend to be more standardised and generally offer limited other benefits. No unemployment cover is offered. However, cover during paid and unpaid leave, along with cover during overseas employment is offered.

Common Group DII benefits in the US include:

- Death benefit for the beneficiaries which is generally equal to three times the monthly benefit.
- Rehabilitation benefits to allow the insured to return to work. Some insurers may withhold or deny claims if the insured does not agree to follow treatment or re-training plans approved by the insurer.



Some insurers may also offer worksite modification and waiver of premiums for the employer as part of benefits.

In the UK, it is common for Group DII contracts to offer:

- Lump sum benefits if the insured is still disabled at the end of the benefit period. These generally do not apply to policies which are to retirement.
- Workspace modification benefits to cover the costs to adapt a workspace to allow the injured to return to work. These generally work with integrated rehabilitation programmes offered by the insurers.
- Continuation options are provided to the insured to continue their DII policy as an Individual DII policy when they leave employment.

Other benefits such as National Insurance and employee pension contributions are also available. Group DII also offers benefits to the employer such as short and long term supplementary benefits to cover the cost to the employer of the employee being away from work (such as covering holiday pay, company car allowance, hiring temporary workers).

In South Africa, rehabilitation benefits are commonly included within Group DII contracts. There are also options for benefit payments into the retirement fund if the insured is unable to contribute to it due to disability. Lump sum disability benefits are also paid out if the insured is permanently disabled. A waiting period may apply on this. Benefits such as maternity cover and death benefits may also be offered by some insurers. Group DII policies in South Africa may also benefit employers by providing for premium waivers and salary refund benefits during waiting periods. Certain high risk occupations may also be covered under Group DII contracts in South Africa, based on a case-by-case assessment.

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**UK offers more benefits on Group DII contracts compared to the other markets.**

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#### 4.2.12 Exclusions

In Australia, standard exclusions around self-inflicted injury, routine pregnancy, deployment to a hostile environment, war, criminal activities, and fraudulent claims apply on Group DII contracts.

Standard exclusions apply in the US (war, criminal activities, riots, self-inflicted injuries). There may be exclusions on cosmetic procedures on short benefit period Group DII contracts. There may be a number of limitations (such as limited cover for these or no cover for first 12 months) on the Group DII policies in the US relating to mental health conditions, and pre-existing conditions. For example, the injured must be confined to a mental health facility to receive benefits beyond 24 months; or benefit period is limited to 24 months for self-reported conditions, chronic fatigue syndrome, allergic or reactive illnesses, musculoskeletal and connective tissue disorders of the neck and back (such as sprain, strains, injuries to the muscles of cervical, thoracic, or lumbosacral regions).

In the UK, standard exclusions around war, criminal activities, riots, self-inflicted injuries apply along with pre-existing conditions clauses as defined in the Group DII policy documents.

Exclusion in South Africa are similar (war, self-inflicted injuries, riots, criminal activities). Additional exclusions imposed by some insurers may include pre-existing conditions, excessive alcohol consumption, participation in aviation except as a passenger, exposure to nuclear radiation or biological/chemical hazard, and mental health conditions in first 2 years.

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**The US market applies strong limitations on mental health conditions compared to the other three markets.**

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## 4.3 Key market features

### 4.3.1 Taxation of benefits

For Group policies (Superannuation and Corporate), generally premiums are tax deductible and benefits are fully taxable in all the markets discussed.

In Australia, premiums paid through superannuation on Group policies are 15 percent tax-deductible to the member. The insurers generally withhold a PAYG tax on the benefits from such policies. For Group policies through employers in Australia, the premiums are tax deductible for the employer. Benefit payments are taxable in the hand of the insured<sup>33</sup>. Typically, if the insured remains employed with their pre-disability employer at the point of disability, the insurer pays the gross amount to the employer as they are the policy owner. The employer then processes the benefit to the insured member through their normal pay roll process and withholds PAYG tax. If the insured is no longer employed by the same employer, the insurer pays the member directly but withholds the tax from the payments made to the insured.

In the US, for employer paid Group DII policies, the premiums are considered a tax deductible business expense. The benefits from the policy are taxable in the hands of the employee<sup>34</sup>.

In the UK, premiums are treated as a business expense (for all employees except controlling directors) and therefore the employer will qualify for tax relief (at the corporation tax rate). Premiums are not assessed for tax on the employee as a "benefit in kind". No tax relief is allowed if the premiums are paid by the employee. If the premiums were paid by the employer, the benefits from Group DII policies are taxed in the hands of the employee under PAYE (Pay As You Earn) and are subject to the deduction of NI (National Insurance) contributions. However, if the premiums were paid by the employee, the benefit is tax-free (Institute and Faculty of Actuaries, 2016).

As noted in Section 3.3.1, benefits are now tax-free in South Africa.

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**Benefits are generally taxable in the hands of the insured, except in South Africa and the UK (if the premiums were paid by the employee).**

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### 4.3.2 Sales channel

The Group DII products in Australia are written via employers or through superannuation funds. Of the AUD 2.3 billion of annual premiums in 2018 for the Group business, AUD 1.9 billion is written through the superannuation funds (APRA Statistics: Life Insurance Claims and Disputes Statistics, 2018).

In the US, DII is written mostly as an employer benefit. As indicated above, over 30 percent of private sector employees are covered by Group DII policies (American Council of Life Insurers, 2017). Over 40 percent of Group DII policies cover white collar employees, with around 25 percent covering grey collar employees (jobs in sectors such as health care, aged care, child care, food preparation and the catering industry)<sup>35</sup>. Blue collar and unknown make up the rest of the Group DII policies in the US (Society of Actuaries, Group Long-Term Disability Experience Committee, 2018).

In the UK and South Africa, most Group business is written through employers. However, there may be some written through other groups which link people (such as holders of same credit card may have access to a Group DII policy).

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33. <https://www.finder.com.au/income-protection/income-protection-tax>  
 34. <https://www.thehartford.com/business-playbook/in-depth/disability-income-insurance-benefits-taxation>  
 35. <https://definitions.uslegal.com/g/grey-collar-worker/>

### 4.3.3 Other market considerations

Group contracts are negotiated between the employers (and superannuation funds in Australia) and the insurers over regular periods of time. Group premiums can accordingly be adjusted on an annual basis or at the end of the rate guarantee. In Australia, since a large proportion of Group business is written through superannuation funds, it is important to note the role of the superannuation Trustees in deciding which Group insurer to insure their members with and whether the overall insurance arrangements are in the best interest of the members.

In addition to that, any Group DII contracts written through the superannuation funds must adhere to the Superannuation Industry (Supervision) Regulations 1994. For example, the disability definitions on Group DII policies written through superannuation need to align to the definitions under the Superannuation Industry (Supervision) Regulations 1994.

There are also a number of regulatory changes being proposed for the superannuation industry in Australia which may impact superannuation Group DII business in the future. At the time of writing, the government has introduced legislation to remove default cover from inactive members, unless they explicitly opt to maintain cover. This change, along with the proposed removal of default cover for members under 25 or those with small account balances, is likely to impact the Group DII market further as it reduces/removes the comprehensiveness of the cover, and allows the insured optionality to opt into cover. In addition to this, changes in whether default superannuation funds may be used in the future to pay insurance premiums will impact the Superannuation Group DII market further.



# 5. Conclusion

## 5.1 Key takeaways on Individual DII

We have summarised below the notable exceptions from each of the four markets for each product feature for the Individual DII products.

Product Feature	Notable Exceptions	Market(s) with highest benefit
Definition of disability	Australia with its three tier definitions has the most liberal definition of disability. Australia also does not offset continuing income from partial claims making its definition of partial claims more liberal than the other markets. UK allows cover for housepersons.	Australia
Change in definition of disability over duration of claim	Australia, UK and South Africa do not change the definition of claim through the duration of the claim i.e. the own occupation does not change to any occupation.	Australia, UK & South Africa
Income	The income definition which is used to calculate the benefit may be more accommodating in the UK, followed by Australia.	UK & Australia
Type of cover	Australia has a large proportion of business written on Agreed value basis. South Africa offers both agreed value and indemnity contracts, whereas the US and the UK are mostly indemnity basis contracts.	Australia
Stepped or level premium	Mostly stepped premium policies are written in Australia. South Africa both offer level and stepped premiums whereas UK and the US are largely level premiums.	Australia
Replacement ratio	While South Africa has the higher replacement ratio, the effective replacement ratio may be higher in Australia because of: a. Ancillary benefits and tax treatment of benefits; and b. Policy terms resulting in superannuation contributions being paid to the insured and not to the superannuation fund.	Australia
Underwriting	Medical underwriting limits are higher in Australia compared to the other markets.	Australia
Maximum entry age and policy term	The US allows the maximum entry age of 75 for the contracts. South Africa still offers some lifetime benefit contracts for Individual DII.	US South Africa
Benefit Indexation	South Africa has benefit indexation in excess of CPI. However, it is also possible to obtain policies in Australia which apply indexation in excess of CPI.	Australia & South Africa
Waiting period	The common waiting period in South Africa is 7 days, compared to the 30 days in Australia, 90 days in the US, and the 26 weeks in the UK.	South Africa & Australia
Notification period	South Africa, UK, and US all have restrictions in the contracts on how late a claims can be notified. Australia does not apply any penalties for late notifications.	Australia



Product Feature	Notable Exceptions	Market(s) with highest benefit
Higher risk occupations	Both UK and Australia may provide cover with limitations for certain higher risk occupations.	UK & Australia
Offset	Australia applies lower offsets than the other markets because of product features such as the '10-hour' clause and lack of offsets on certain occupation classes.	Australia
Recurrent claims	Australia, the US, UK and South Africa all waive waiting periods on recurrent claims.	Similar across all markets
Rehabilitation	Both UK and Australia may require claimants to participate in rehabilitation, but anecdotally this is not exercised as frequently in Australia.	UK
Other benefits	Australia offers a large number of ancillary benefits, some of which may which pay lump sum benefits (such as severity boosts) or increased monthly benefits, which result in increasing the effective replacement ratio on the policies	Australia
Exclusions	In the US, there may be significant exclusions on mental health claims.	Australia, UK & South Africa

The table indicates that the Australian Individual DII product appears to have broader features and more liberal definitions which offer a higher level of benefits than the Individual DII products in the other markets considered.

## 5.2 Key takeaways on Group DII

We from each of the four markets for each have summarised below the notable exceptions product feature for the Group DII contracts.

Product Feature	Notable Exceptions	Market(s) with highest benefit
Definition of disability	The definition of disability is similar across all the markets.	Similar across all markets
Change in definition of disability over duration of claim	Australia does not apply changes to the definition generally for Superannuation Group DII contracts as the benefit periods are often only 2 years. On Corporate Group DII contract, employers can negotiate different terms that involve changing definitions.	Australia
Income	The income definition which is used to calculate the benefit is the most accommodating in the UK and Australia.	UK & Australia
Type of cover	Group DII contracts are generally based on a proportion of pre-disability income (or units under Superannuation Group DII in Australia).	Similar across all markets
Replacement ratio	South Africa has the highest replacement ratio in the initial period of disability.	South Africa
Maximum entry age and policy term	The US allows people to buy a policy just before retirement. Most markets offer benefit periods 'to retirement'.	US
Benefit indexation	Indexation is limited to CPI across all markets.	Similar across all markets
Waiting period	US has very short waiting periods starting from 7 days for the short benefit period Group DII contracts, followed by South Africa (30 days), Australia (90 days) and the UK (28 weeks).	US & South Africa
Notification period	Australia does not apply penalties for late notifications.	Australia
Offset	Similar offsets apply in all markets but in South Africa, lump sum payments in relation to disability and any other receipts which are less than 25 percent of the income before disability may not be included in offset by some insurers.	South Africa
Recurrent claims	Similar practices apply in all countries. Some insurers in the UK consider claims recurrent if the insured suffers from disability lasting more than 30 days albeit from a different cause but within the 12 months of the last benefit payment.	UK
Claims process and rehabilitation	Australia, the US and South Africa have similar claims processes. In the UK insurers have the right to request medical examination and attendance at sessions with disability counsellors.	Australia, US & South Africa
Other benefits	UK has the most other benefits available on Group DII contracts.	UK
Exclusions	The US commonly applies mental health limitations on Group DII contracts.	Australia, UK & South Africa

The Group DII contracts are generally similar across all the four markets. However, nature of the Australian market with Superannuation Group DII contracts sets it apart from the other markets. This accordingly has implications on how the products are structured in the Australian Group DII market.

### 5.3 Key differences between Individual DII and Group DII

We summarise below the key differences between the product features across the Individual and Group DII in each market in the table below.

Product Feature	Australia	US	UK	South Africa
Definition of disability	Three tier definitions used for Individual DII.  Simpler duties based definition generally used under Group DII.	No significant differences.	Occupation under Individual DII are generally defined in terms of hours worked.  Own and suited occupations under Group DII are defined based on experience, training or education.	No significant differences.
Change in definition of disability over duration of claim	No significant differences.	No significant differences.	No change in definition under Individual DII.  Definition changes to any occupation or activities of daily living after 24 months or more under Group DII.	No change in definition under Individual DII.  Definition changes to any occupation after 24 months under Group DII.
Income	For Individual DII, the employer superannuation contributions are included in the income.  For Superannuation Group DII, income is generally excluding employer super contributions of 10 percent or less.	No significant differences.	No significant differences.	No significant differences.
Type of cover	Agreed value common for Individual DII.  Indemnity basis common for Corporate Group DII and for automatic cover on Superannuation Group DII.	No significant differences.	No significant differences.	Agreed value and Indemnity contracts under Individual DII.  Mainly Indemnity basis used under Group DII.
Replacement Ratio	Up to 80 percent replacement ratios available on Individual DII.  Up to 85 percent replacement ratios available on Group DII.	No significant differences.	Up to 65 percent replacement ratios available on Individual DII.  Up to 80 percent replacement ratios available on Group DII.	No significant differences.

Product Feature	Australia	US	UK	South Africa
Issue limits	No significant differences.	Up to AUD 30,000 of cover limits available under Individual DII. Generally AUD 15,000 issue limits exist on Group DII.	Up to AUD 35,000 of cover limits available under Individual DII. Up to AUD 625,000 issue limits exist on Group DII.	No significant differences.
Maximum entry age	No significant differences.	No significant differences.	No significant differences.	No significant differences.
Benefit period	Under Group DII automatic cover benefit is generally 2 years.	No significant differences.	No significant differences.	Generally no lifetime benefits under Group DII.
Benefit indexation	Individual DII has maximum of CPI and 3 percent or 5 percent available as well as minimum of CPI and 3 percent. Group DII generally offers minimum of CPI and 5 percent.	Individual DII has maximum of CPI and 3 percent to 6 percent available. Generally no indexation available on Group DII.	Individual DII has minimum of CPI and 10 percent or 12 percent available. Group DII generally offers minimum of CPI and 5 percent.	Individual DII has indexation adjustments equal to CPI or CPI + 3 percent. Group DII generally offer indexation equal to CPI.
Waiting period	30 days is the most common on Individual DII. 90 days is the most common on Group DII.	90 days is the most common on Individual DII. On Group DII, they range between 7 days to 180 days.	26-52 weeks are the most common under Individual DII. 28 weeks is the most common under Group DII.	Depending on occupation, it varies between 7 days and 30 days. Under Group DII, 30 days is the most common.
Notification period	No significant differences.	No significant differences.	2 weeks for Individual DII. 4-10 weeks for Group DII. Similar penalties apply for late notifications. The employer may have a role to play in the notification of claims for Group DII.	90 days to 12 months for Individual DII. 6-12 months on Group DII. Penalties generally not applied in practice. The employer may have a role to play in the notification of claims for Group DII.



Product Feature	Australia	US	UK	South Africa
Offset	Income from working while disabled is offset under Group DII whereas it is not offset under Individual DII. Under Individual DII, continuing income may trigger a partial disability definition.	No significant differences.	Some insurers may offset only 60 percent of continuing pay under Individual DII whereas all is offset under Group DII.	Lump sum payments in relation to disability and any other receipts which are less than 25 percent of the income before disability may not offset benefit under some Group DII, which are offset under Individual DII.
Claims process	The employer may have a role to play in the claims process for Corporate Group DII.	A Group DII tax notice may be required under a Group DII claim.	No significant differences.	No significant differences.
Recurrent claims	No significant differences.	Insufficient information to conclude.	No significant differences. Some insurers may consider claims recurrent if the insured suffers from disability lasting more than 30 days albeit from a different cause but within the 12 months of the last benefit payment under Group DII.	Insufficient information to conclude.
Other benefits	Numerous other benefits exist on Individual DII which are not available on Group DII such as elective surgery benefit, needlestick injury benefit, transportation benefit.  Rehabilitation benefits on Superannuation Group DII may be limited.	Some employer specific benefits available on Group DII such as worksite modification benefits.	Some employer specific benefits available on Group DII such as supplementary benefits to cover cost of employee being away.	No significant differences.  Maternity benefits may be offer on Group DII.
Exclusions	No significant differences.	No significant differences.	No significant differences.	No significant differences.

## 5.4 KPMG concluding thoughts

Based on our findings on the different markets discussed here, we note that Australia offers comprehensive cover to a broad target market. In general, Australia has very liberal policy terms and conditions on DII products, especially for the Individual DII products, which are not evident in the other markets. Whilst profit margins are also poor in South Africa on the DII business, they appear to be driven more by an economic downturn and possibly the recent changes in the tax treatment of benefits. There has been a tightening of product features by some insurers in the last two years in Australia, such as a two-tier definition of disability, and a change in the definition of disability over the period of the claim. However, the overall Australian products still continue to be an outlier with higher benefits and more liberal terms and conditions compared to the other markets.

More liberal definitions, higher benefits and features tend to make the product more expensive and in some cases create a situation where a policyholder is financially better off remaining on claim rather than returning to work. This is contrary to the principle of indemnity in insurance. We have already seen large losses for most insurers and unsustainably high levels of claim costs. Ultimately, the concern is that this could eventually lead to the withdrawal of the product, to the detriment of all customers.

There are some observations from the research and KPMG's wider view of the market that are worth highlighting:

- Australia has a large Individual DII market of \$2.8 billion in force individual premium as at 31 December 2018 driven mainly by advised sales. The Group DII market is of a similar size with AUD 2.3 billion in force premiums as at 31 December 2018. The relative size of the Individual DII market in the other countries is significantly smaller when compared to the Group DII market in those countries.
- The Individual DII product in Australia is comprehensive and around 50 percent of Individual DII business is sold to non-white collar occupation classes. In the other three markets, the main target market for Individual DII is largely high-income earning white-collared professionals.
- The effective replacement ratios in Australia appear to be higher than those in the other markets after allowing for the definition of income, the taxation basis for benefits, and the ancillary benefits that are unrelated to a need, such as no claim bonus, lack of offsets for certain occupation classes, and severity booster benefits. The effective replacement ratios available in Australia may, in many scenarios, result in insurance cover that exceeds actual policyholder loss. This gives rise to disincentives for some claimants to return to work.

- A feature of the Australian market is the provision of agreed value contracts on long term benefit period without any change in the definition of disability for the full benefit term. Agreed value contracts continue to be offered to Individual DII policyholders and account for the majority of the business written in Australia (over 50% of the exposure on accidents and sickness policies over the 2011-2015 period). The Agreed value product design limits the replacement ratio checks that insurers can perform at the time of claim, potentially allowing claims that exceed policyholder loss and adversely impacting the incentive for the insured to return to work. In the US and the UK, the policies are predominantly written on Indemnity basis whereas in South Africa, they are written on a hybrid design combining Indemnity and Agreed value bases.
- Most of the business written in Australia is stepped premium business whereas level premium business is more common in the US and the UK. South Africa writes both stepped and level premium business. The issue with stepped premium is that premium increases accelerate with age. As premiums become very high at older ages (i.e. over 55), healthier lives are expected to have a greater propensity to discontinue cover, leaving less healthier lives in the insurance pool. This is commonly referred to as selective lapsation, and typically requires the insurer to increase premium rates for the back book to compensate for this effect.
- There are many ancillary benefits on offer in Australia under Individual DII products which are not commonly available in the other markets. High ancillary benefits effectively increase the replacement ratios and reduce the incentive to return to work.
- Benefit periods up to retirement are generally offered in Australia, US and UK. However, in the UK, there has been a recent trend around an increased number of short benefit term policies (2-5 years). South Africa still offers lifetime benefits which were discontinued in Australia in the 1990s.
- Australian Individual DII contracts do not have a number of controls commonly found in other markets, such as:
  - penalties for late claim notifications (the UK, US, and South Africa), and
  - change of disability definition for over two years benefit periods (the US).
  - the application of income offsets in Australia appears to be less strict than the other markets. For example, some insurers do not apply offsets for certain occupation classes and income from the first 10 hours of work each week is not offset under the '10-hour' clause. In the other markets such as the UK, claims monitoring is undertaken regularly throughout the duration of the claim which may include assessment of on-going income over the duration of the claim which is then offset.

We also note level premium business presents different challenges from a customers' perspective, particularly if no surrender value is payable. Anecdotally, it has been contended that overall level premium represent higher overall cost for the customer. However, level premium leads to lower selective lapsation risk.

Similarly, there is no clear limitation for late reporting of claims under Group DII in Australia.

- The UK commonly employs product features such as long waiting periods (26 weeks to 52 weeks) whereas Australia offers comprehensive cover under DII with 30 days and 90 days waiting period for Individual DII and Group DII respectively. South Africa applies very short waiting periods (7 days for white collar professionals, the main target market).
- The US applies tough exclusions and limitations for certain pre-existing and mental health conditions which are not as common in the other markets.
- The complexity of the product makes claims management expensive and difficult. Claims managers need a high level of training and skillsets which may not be in line those that are needed for the management of other insurance products. The limitation of trained claims managers limits the effort that can be applied to early interventions. It is interesting to note that even though the UK Individual DII product is simpler than that offered in Australia, the UK market is facing challenges on both the sales side from their customers (due to the product being seen as complex), and on the operational side (as requiring a lot of administrative support).
- Australian Individual DII contracts do not have a number of controls commonly found in other markets, such as penalties for late claim notifications (the UK, US, and South Africa), and change of disability definition for over two years benefit periods (the US). Similarly, there is no clear limitation for late reporting of claims under Group DII in Australia.
- Australian insurers are limited by the Private Health Insurance Act 2007 and the Superannuation Industry Act 1993 in terms of the “needs based” benefits they can offer in addition to the basic income replacement. The rehabilitation benefits offered in Australia within these limitations do not appear to be used as frequently, or as extensively as they could be, with only an estimated 20 percent of claimants using this benefit<sup>36</sup>. When utilised appropriately, rehabilitation can help the injured return to full functionality and add overall value to the well-being of the injured. Rehabilitation programs have the potential to support the industry in being more customer-centric by helping the injured cope with their disability more holistically, and not just through replacement of income. For example, the UK operating model design makes extensive use of rehabilitation, partly driven by the employers’ and insurers’ interest in getting the claimant back to work, to ensure the injured can effectively manage their disability and can return to work within a reasonable period of time.
- Underwriting rules may contain limited details on the nature of the duties that the insured performs in their occupation. More detailed information could allow better assessment of the risks and the costs associated with providing insurance to the customers.

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36. <https://www.moneymanagement.com.au/features/editorial/rehabilitation-benefits-unsung-heroes-income-protection-insurance>



- Even though Individual DII has been unprofitable for insurers in Australia for some time, insurers continue to write this business, citing first mover disadvantage as a barrier to changing products which is amplified by the impact of rating companies on product sales. While some insurers have launched products with less features or are needs based rather than income based, anecdotally the product take-up has been low due to limited pricing differential and lack of competitiveness of such products under the current rating house scoring systems.
- Increasing Individual DII premiums to remedy the situation can trigger the downward spiral of anti-selective lapses, and the resulting portfolio returning even poorer profitability.
- It is KPMG's understanding that the operational costs of Individual DII, particularly relating to claims management, are significantly higher than those for other risk products. It is worth considering whether the systems and processes in place for managing Individual DII products are appropriate and whether they could be streamlined for efficiency.
- Whilst Group DII experience has been more positive than the Individual DII, it may be related to shorter benefit periods, simpler product features and lower replacement ratios. Given insurers have a high exposure to policies written through superannuation but generally have limited information on these customers, proactive and effective claims management practices should be considered going forward. This will be especially relevant for the management of mental health related claims which account for the largest proportion of all Group claims. A key to this may be to have detailed information about the insured and their situation.

The overseas analysis shows that the Australian product is generally more complex than the other three markets, applies more liberal definitions and provides higher levels of benefits. These factors combine to make the claims management process more difficult and point to the need to provide more extensive training for claims managers as well as considering alternative strategies to manage claims and simplification of product designs. Reliance on increasing premiums to address deterioration in claims experience is not considered sustainable for the industry and the customers. A key consideration for insurers may be using technology solutions in tandem with customer-centric claims management procedures. For example, incorporating artificial intelligence in certain parts of the claims process may drive efficiencies and free up claims managers' time, which can then allow them to work more collaboratively with the injured on their recovery plans.

It is clear there is a need for the stakeholders in the industry, including insurers, reinsurers, rating houses, government, regulatory bodies, and professional bodies to collaborate strategically on the future of DII in Australia, taking into account how it impacts each of the stakeholders as well the broader society in meeting customers' needs.

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