

2020 ALUCA Turks Scholarship 2nd Runner-up Paper

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Towards sustainable income protection cover

In examining the performance of individual disability income insurance (IDII), APRA's Executive Board Member Geoff Summerhayes stated 'The ultimate outcome should be more financially resilient life companies and more sustainable products for policyholders. Unless insurers stop losing hundreds of millions of dollars each year, it's only a matter of time until [IDII] – and the protection it provides – is no longer available at all.'

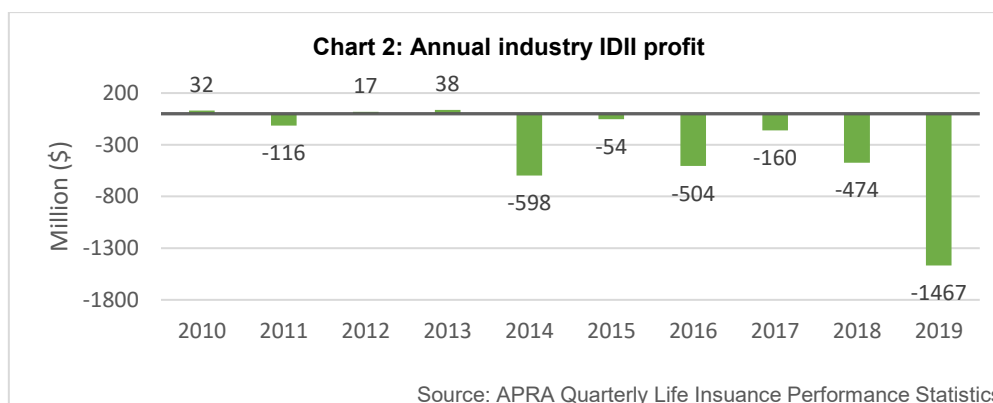
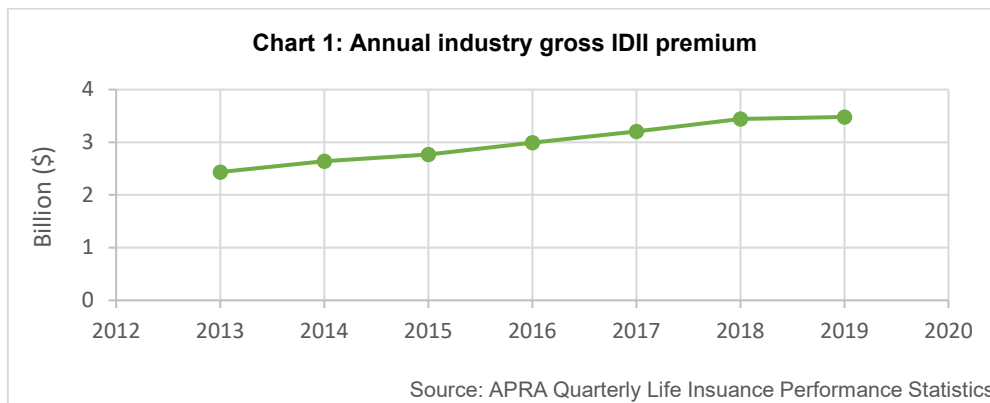
These are sobering words regarding a product which has long been a cornerstone of the Australian life insurance market.

Is there still a place in the Australian market for IDII (or income protection insurance) or is it time for a new policy design? What practical measures can be taken in relation to the policy design to support the sustainability of income protection insurance while still providing the customer with adequate protection in times of need?

Introduction

Individual disability income insurance (IDII), also known as income protection insurance, was introduced to Australia in the 1970s.¹ The underlying premise of the product is fairly compelling. It provides financial protection against the risk of lost income if a person is unable to work for a period due to illness or injury. For most people, the loss of a regular income would have a significant and detrimental impact on their lives.

The product has typically sold very well. New business sales almost doubled in the 5 years from 2010 to 2014 (compared to the previous five-year period)² and in the last decade the average annual growth rate of IDII premium was around 9%.³ Chart 1 shows the annual industry gross premium over the last 7 years. Unfortunately, while premiums have been increasing, claims costs have shown an even more steep trajectory. This has resulted in life insurers suffering ongoing material losses in connection with IDII.⁴ As illustrated in Chart 2, life companies are reported to have lost around \$3.4 billion over the past 5 years.⁵



In December 2019, the Australian Prudential Regulation Authority (APRA) wrote to life insurers to express its concern about the unsustainability of the IDII market. APRA required

¹ Service, D.A (2010) Disability Income Insurance – The Australian Experience 1980 – 2001. Australian National University.

² Threlfall A (April 2015) Income Protection – A time for review ([link](#))

³ Martin G (January 2019) Clearview White Paper - Income protection and the economic cycle ([link](#))

⁴ Threlfall A (April 2015)

⁵ APRA (December 2019) Sustainability measures for individual disability income insurance ([link](#))

insurers take immediate action to address the risks posed by IDII. Among other things, this included the cessation of agreed-value contracts and other overly generous product features.⁶ The removal of such features is sensible, and should no doubt go some way to improving the sustainability of IDII. However, IDII policy design has been largely unchanged for the past 10 years.⁷ It is therefore evident that overly generous product features are only one of several factors that have contributed to the deteriorating experience in the Australian disability market.

Mental illness is now one of the greatest health issues of our time....

Mental health problems are becoming increasingly common in Australia. In any year, one in five people will be affected by a mental health condition and almost half of all Australians aged 16–85 years will experience a mental disorder at some time in their life.⁸ The World Health Organisation notes that globally the number of people with common mental disorders (such as anxiety and depression) is increasing⁹ and these conditions are now estimated to be the leading cause of work absence in the developed world.¹⁰ In Australia, mental illness has surpassed musculoskeletal problems as the main cause of work incapacity¹¹ and it is estimated that poor mental health costs the economy up to \$180 billion a year in lost productivity and participation.¹²

After the Government, the life insurance industry is regarded as the biggest supporter of people with mental health conditions.¹³ The industry was recently recognised by the Productivity Commission as having an important role to play in resolving Australia's growing mental health crisis.¹⁴ Of the various products life insurers offer, income stream products are considered to be best placed to appropriately deal with the complexities of mental health conditions and provide sufferers with appropriate support.¹⁵ When viewed in this context, it is clear that IDII still has a valuable place in the Australian market.

However, the increasing prevalence of mental health conditions is obviously also relevant to conversations around the sustainability of IDII. In fact, many insurers are already paying large amounts of money to people claiming for mental health problems. In the period 2013 –

⁶ APRA (December 2019)

⁷ Martin G (January 2019)

⁸ Australian Bureau of Statistics 2008, National Survey of Mental Health and Wellbeing: Summary of Results, 4326.0, ABS, Canberra.

⁹ World Health Organisation (2017) Depression & Other Common Mental Disorders ([link](#))

¹⁰ Harvey, S, Joyce, S, Modini, M, Christensen, H, Bryant, R, Mykletun, A & Mitchell, P (2013) Work and depression/anxiety disorders – a systematic meta-review ([link](#))

¹¹ Actuaries Institute (October 2017)

¹² Productivity Commission (October 2019) Draft Report on Mental Health ([link](#))

¹³ Life Insurance Industry (January 2020) Response to the Productivity Commission's Draft Report on the Social & Economic Benefits of Improving Mental Health ([link](#))

¹⁴ Productivity Commission (October 2019) Draft Report on Mental Health ([link](#))

¹⁵ Actuaries Institute (October 2017)

2018, payouts for mental health conditions doubled to \$4.9 billion¹⁶ and a recent research paper by the FSC and KPMG indicated that mental health claims were the second highest cause of claim for disability income insurance.¹⁷ This is consistent with trends seen in other parts of the globe where mental health conditions are a leading cause of income protection claims.¹⁸ In order to sustainability deal with the expected onslaught of mental health claims,¹⁹ it is proposed that a more holistic approach to the traditional IDII policy design is required. This paper explores some ways in which IDII could be reimaged in this context.

Cover that is proactive, protecting income by helping a person maintain their mental health...

Rather than simply providing cover for financial loss, IDII could be designed to insure a person's income through protecting and maintaining the person's ability to work. Holistic support features that assist with the prevention or early treatment of mental health conditions would be bought to the forefront of IDII policy design, with financial benefits forming a supplementary part of cover.

Early intervention after the detection of risk factors that may lead to mental illness is important to prevent the onset of illness or curtail a deterioration in mental health.²⁰ Evidence from the workers compensation jurisdiction indicates that intervention within the first 6-12 weeks of symptoms leads to improved health (and consequentially claim) outcomes.²¹ The life insurance industry has for several years promoted rehabilitative services in the management of persons on claim. However, it is contented that these services should be extended to providing a range of early intervention or 'pre-habilitative' services. These psychosocial services would be available at the very early stages of illness and even before a mental health condition occurs. For example:

- unemployment is widely acknowledged as having a significant impact on a person's mental health.²² IDII policies could provide a range of employment assistance services to an insured person who find themselves unemployed. This benefit would be available before disability has arisen (i.e. without the person being required to demonstrate an inability to work).

¹⁶ FSC Media Release (June 2020) ([link](https://www.pc.gov.au/inquiries/completed/mental-health/draft/mental-health-draft-overview.pdf))<https://www.pc.gov.au/inquiries/completed/mental-health/draft/mental-health-draft-overview.pdf>

¹⁷ KPMG and FSC (October 2019) The impact of Psychosocial factors on Mental Health and their implications in life insurance: Research Paper

¹⁸ One UK insurer recently reported that mental health conditions accounted for more IDII claims than cancer and musculoskeletal conditions combined. See Aviva's (2019) Individual Protection Claims Report ([link](#))

¹⁹ <https://www.afr.com/companies/financial-services/life-insurers-brace-for-surge-in-mental-health-claims-20200727-p55frv>

²⁰ Productivity Commission (October 2019)

²¹ Superfriend (December 2017) Taking Action: A best practice framework for the management of psychological claims in the Australian workers compensation section ([link](#))

²² KPMG and FSC (October 2019)

- IDII could be designed to offer a range of preventative benefits that attempt to reward or support wellness behaviour, such as meditation services or cover for the cost of a day's wellness leave once a year.

Ideally the support services would be supplemented by access to funded psychological and counselling treatment.²³ These 'treatment' benefits would be provided on a voluntary basis and be intended to assist the insured take care of their condition before it has become disabling. Such benefits can be of significant value. Data from the UK indicates that, in 2017, 3,000 claimants that were provided with early intervention services (such as counselling) were able to return to work before they were eligible for any benefit payments.²⁴ As the treatment services would be available before a benefit has become payable a number of the existing concerns around life insurers funding treatment to 'get off claim'²⁵ should not apply.

While early intervention helps people recover quicker (and in turn helps the industry manage its sustainability problem), an inherent issue for life insurers is that they often do not know anything about a person making a claim or their condition until well after the condition has arisen and/or the insured person has left work.²⁶ This may be partially caused by traditional IDII product design, which does not really incentivise an insured to engage with their insurer at the earliest opportunity. Most benefits are not payable until after a person has been totally disabled and/or ongoing disability over a prescribed waiting period has been established.²⁷ This initial delay may cause a person with a mild condition to withdraw from the workforce potentially worsening their condition and entrench a mindset of long-term work incapacity.²⁸

IDII should be designed in a way that incentivises the insured person to connect with their insurer while they remain at work. In addition to customer-centric interventions designed to support the insured person manage their condition, this may also include a limited range of financial benefits that are available upon the diagnosis of a potentially disabling condition and/or which are available without the need for any preliminary period of total disability. Providing benefits that are easier to access may seem counterproductive to discussions on sustainability. However, early financial relief would enable a person to take a temporary reduction in work hours or pay for specialist treatment services. For many people this may be all that is required to mitigate against a significant and long-term deterioration in their condition.²⁹ Insurers therefore benefit by reducing their potential liability for more extensive and expensive periods of disability.

²³ It is acknowledged that life insurers are currently precluded from providing insurance that covers the cost of medical treatment. However, there have been a number of promising advancements in this area recently, see <https://www.investmentmagazine.com.au/2020/08/life-insurers-to-seek-reforms-following-mental-health-claims/>.

²⁴ Actuaries Institute (January 2019) Disability Income: An International Comparison ([link](#))

²⁵ <https://www.moneymanagement.com.au/news/liferisk/life-insurers-not-solution-mental-health-crisis>

²⁶ <https://www.investmentmagazine.com.au/2020/02/the-cost-of-secondary-mental-health/>

²⁷ A recent survey by the Actuaries Institute found that the most common waiting period is 30 days, but it can be much longer in some cases. See Actuaries Institute (January 2019) Disability Income: An International Comparison 2019 ([link](#))

²⁸ Threfall A (2015)

²⁹ Steen, J (July 2019) 'Taking a mental health day (and not feeling guilty about it)', ABC Life.

When financial support is required benefits should be grounded to the insured's core need...

The financial benefits currently available under IDII products are not conducive to sustainably dealing with mental health conditions. The level and amount of benefit(s) provided need to be rationalised. While this is true for all IDII products, it may be of even more importance in connection with mental health conditions, given that the amount paid for these claims tends to be much larger than for other claim types.

Mental health conditions can be divided into two broad categories: high-prevalence conditions (such as anxiety and depression) and low-prevalence conditions (such as schizophrenia and, bipolar disorder). High prevalence conditions are the most common form of mental health condition, representing around 79% of those Australians with a reported mental illness.³⁰ These conditions are often of shorter duration and more readily treatable.³¹ For instance, overseas research has found that 50% of people diagnosed with a depressive disorder had recovered within three months and this increased to 63% within six months and 76% within 12 months.³² While recognising that each case will be different, high-prevalence conditions may generally be thought of as time-limited disorders.³³

Given the propensity for recovery, long benefit periods do not seem appropriate. This is more so when it is considered that even those claimants with a chronic condition may experience some improvement in the future. The Actuaries Institute noted that in 2014, a provider of group insurance surveyed people who had received a TPD payment and found that 23% of those who had claimed for a mental health condition had returned to the workforce after receiving their payment and a further 12% were actively seeking work.³⁴

In fact, long term benefits may decrease a claimant's health outcomes. The theory being that these create an unconscious financial incentive for the claimant not to get better as long as the benefit lasts.³⁵ The majority of the IDII policies sold in Australia have long benefit periods, some which extend beyond retirement age.³⁶ It is proposed that benefit periods should instead be restricted to a maximum of 5 years with consideration given to even shorter terms for certain high-prevalence conditions.

³⁰ Australian Bureau of Statistics (2008)

³¹ Actuaries Institute (October 2017)

³² Spiker, J, de Graff, R, Bilj, R, Beekman, A, Ormel, J and Nolen, W 2002, Duration of depressive episodes in the general population: Results from The Netherlands Mental Health Survey and Incidence Study, British Journal of Psychiatry, Vol. 181

³³ It is however acknowledged that some studies have shown that while recovery may occur, it is possible for a person to relapse and for some disorders this can be reasonably common. Benefit design should be structured in a way which recognises the potentially episodic nature of these conditions.

³⁴ Actuaries Institute (October 2017)

³⁵ Actuaries Institute (October 2017)

³⁶ This creates additional risk in the context of mental health, where a person's condition is largely subjective and self-reported. For instance, it would not be overly difficult to imagine that an unscrupulous 60-year-old may consider reporting symptoms of anxiety or stress in order to be deemed disabled and entitled to 75% of his or her income for life.

To ensure that claimants remain appropriately motivated to try to return to work, a tapered benefit design could also be considered.³⁷ A tapered approach recognises that a higher benefit may be appropriate at the beginning of a claim, when the initial the stress of financial loss may exacerbate a person's condition. However, over time and with appropriate treatment, a large proportion of conditions should rebate. Where this does not occur additional solutions or strategies can be put in place to assist the person cope with their reduced income levels.

A collaborative approach to benefits focussed on ability, not disability...

For some people, obtaining benefits under the current policy design is quite stressful. This leads to an exacerbation in their condition. IDII could be redesigned so that benefits are not obtained by way of an 'adversarial' claims process but are instead delivered through a collaborative model which integrates benefits as part of a broader program of rehabilitation.

Incorporating rehabilitation as part the fundamental policy design further assists with recasting IDII from a strictly financial compensation arrangement which can only be obtained by successfully proving your entitlement (i.e. disability) to a more holistic product that is designed to protect and maintain the insured person's ability to earn an income. Under the rehabilitation model, an insured person would be partnered with an independent expert right from the beginning of their claim. It is envisaged that this expert would be engaged and paid for by the insurer, selected from a panel approved by a forum of industry stakeholders.³⁸ The expert's role would be multi-faceted.

- For insurers mental health conditions tend to be inherently more difficult as symptoms, severity and treatment can vary between individuals. The expert would assist the insurer to make financially disciplined decisions by providing independent evaluation of the insured person's condition. This may also assist with the evidential issues that arise from the self-reported nature of mental health conditions. To date insurers have struggled to find appropriate sources to determine the veracity of information provided by a claimant.³⁹
- There is evidence to suggest that the current method of determining entitlement via a claims process may exacerbate the mental health condition of some claimants, lengthening their time on claim.⁴⁰ A large part of the expert's function would be to

³⁷ For instance, an income replacement ratio of around 75% could be provided for the first 12 - 24 months, which is tapered to 50% for the remainder of the benefit period.

³⁸ Such stakeholders would include AFCA, FSC, beyondblue and other organisations that specialise in mental health conditions.

³⁹ For instance, some of the approaches previously used by insurers in this context, such as surveillance and daily activity diaries, have proven to be inappropriate in the context of mental health conditions.

⁴⁰ Actuaries Institute (October 2017)

provide support services to the insured person, making the process of obtaining a benefit less overwhelming. The nature of services would be tailored to the person's specific circumstances and level of need. They may include simply facilitating the completion of claim forms through to coordinating the person's participation in health coaching and wellbeing programs.

- The majority of mental health conditions are managed by a GP. However, most GP's typically have limited time to engage with their patients and lack specific training on the management of mental health conditions.⁴¹ The expert may therefore provide treating GP's with much needed assistance in the treatment and rehabilitation of the insured person.

Putting rehabilitation at the front and centre of IDII design should also lead to a change in public perception. That is, rehabilitation and attempts to support a claimant back into work are not self-serving or simply made by insurers to get out of paying a claim. That said, it may take some time for this change to occur and to encourage claimant participation benefits should be structured in a way which rewards those who agree to participate.⁴²

Conclusion

The life insurance sector plays a critical role in ensuring the financial security of millions of Australians. It is important that its products remain sustainable. The problem created by the increasing prevalence of mental health conditions are complex and not related to IDII alone. However, as time-limited income streams are considered better suited to addressing mental health disability than large lump sums, there is obvious importance in developing a product design that is sustainable.

This paper has proposed several ways in which the traditional approach to IDII may be reimagined in the context of mental health conditions, including changes which can be made before, during and at the time of claim. These changes are of course only a piece in the sustainability puzzle. However, by tailoring cover that focuses on the specific needs of those with mental health conditions, insurers may be able to provide cover that is not only more sustainable but provides the insured with better cover in the time of need.

⁴¹ Actuaries Institute (October 2017)

⁴² For instance, the standard benefit could be set at a level of around 50% of pre-disability income. This may be increased to 75% where the insured person agrees to participate in the expert partnership program.