



White Paper

---

# Recent Trends in the Australian Disability Income Protection Insurance Market *Are There Lessons for Other Markets?*

Over the last two years the quarterly results of reinsurers have pointed out the problems in the Australian Income Protection market.

The Australian Life insurance market accounts for 1.67%<sup>1</sup> of the world market but in recent years has been “punching above its weight” when it comes to the impact on global reinsurers. The deterioration in profitability in the Australian Income Protection market has flowed through to the results of the major reinsurers. It is a valuable exercise to understand the factors behind this deterioration and consider whether there are lessons for other markets.

Over the last two years the quarterly results of reinsurers have pointed out the problems in the Australian Income Protection market.

In November 2011 Munich Re reported it had “strengthened its reserves for Australian Income Protection business by approximately €150m; cases of Disability Claims are becoming more expensive market wide in Australia due to significant lengthening of the run off period.”<sup>2</sup> The problems in Australian Group Salary Continuance reinsurance have continued and in the third quarter of 2013 Munich Re again increased claim reserves by €130m.<sup>3</sup>

In its 2012 Annual Review Gen Re noted ‘underwriting results were negatively impacted in 2012 by greater than expected claims frequency and duration in the Individual and Group Income Protection business in Australia.’<sup>4</sup>

Reinsurance Group of America (RGA), in announcing results for the quarter ended June 2013 reported a \$184 million charge to increase claims liabilities in the Australian Group business. The adverse performance in Australia has prompted RGA to suspend all quoting activity in the Australian Group Total and Permanent Disability market indefinitely and to be extremely selective in other aspects of that Group market until it stabilizes and the products become more profitable”<sup>5</sup>

When announcing results for the third quarter of 2013 Swiss Re reported an increase of US\$121m for claims reserves in the Australian Group Disability business.<sup>6</sup>

Hanover Re’s Quarter 3 results in 2013 have been impacted by substantial losses from Individual Income Protection insurance in Australia. Hanover Re virtually stopped writing this business in 2009 but continues to suffer losses 4 years later.<sup>7</sup>

---

<sup>1</sup> World Insurance in 2012, Sigma No 3 2012.

<sup>2</sup> Munich Re Third Quarter 2011 Press Release, 6<sup>th</sup> November 2011.

<sup>3</sup> Munich Re Third Quarter 2013 Press Release, 7<sup>th</sup> November 2013.

<sup>4</sup> Gen Re 2012 Annual Review, page 8.

<sup>5</sup> Greig Woodring Reinsurance Group of America Second Quarter Press Release, 18<sup>th</sup> July 2013.

<sup>6</sup> Swiss Re Third Quarter 2013 Results, 7<sup>th</sup> November 2013.

<sup>7</sup> Hanover Re Interim Results 3/2013, 5<sup>th</sup> November 2013.

Individual Disability has had the highest compound average annual growth in Net Policy Revenue but the lowest ratio of Profit before Tax to Revenue.

In the year to June 2013 the Australian Life Risk market generated Net Policy Revenue of A\$11.5b. This was split Retail business and Group business. There are 11 major direct life companies with the Top 5 (AMP, MLC/NAB, Comminsure, TAL and ANZ OnePath) accounting for 68% of the Risk Market. There are 4 dominant Reinsurers: Swiss Re, RGA and Hanover Re all have strong positions in the risk reinsurance market.

The table below shows over the last 5 years the Individual Lump Sum segment is the only part of the Life Risk Market in Australia to have been consistently profitable.

Group Lump Sum has experienced declining profitability ending with a loss in the year to June 2013. Individual Disability has had the highest compound average annual growth in Net Policy Revenue but the lowest ratio of Profit before Tax to Revenue. Group Disability has had the second strongest growth in revenue but has been unprofitable for the last two years.

#### Australian Life Insurance Risk Market

##### Net Policy Revenue A\$m

	FY09	FY10	FY11	FY12	FY13	CAAGR %
Group Lump Sum	\$2,264	\$2,335	\$2,461	\$2,906	\$2,987	7.17%
Group Disability	\$490	\$531	\$588	\$701	\$824	13.88%
Individual Lump Sum	\$3,808	\$4,296	\$4,764	\$5,132	\$5,712	17.91%
Individual Disability	\$1,023	\$1,386	\$1,595	\$1,739	\$1,977	10.67%
<b>Total Risk</b>	<b>\$7,585</b>	<b>\$8,548</b>	<b>\$9,408</b>	<b>\$10,478</b>	<b>\$11,500</b>	<b>10.96%</b>

##### Profit Before Tax A\$m

	FY09	FY10	FY11	FY12	FY13
Group Lump Sum	\$362	\$406	\$286	\$242	\$158
Group Disability	\$122	\$31	\$73	\$28	\$32
Individual Lump Sum	\$963	\$1,367	\$1,092	\$1,878	\$892
Individual Disability	\$28	\$71	\$82	\$287	\$205
<b>Total Risk</b>	<b>\$1,475</b>	<b>\$1,875</b>	<b>\$1,533</b>	<b>\$1,805</b>	<b>\$907</b>

## Competition has resulted in an expansion of coverage and benefits.

The profit pressures in the Group Risk market have been apparent for several years. The Australian Prudential Regulation Authority (APRA), the regulator of banks and insurers, noted in its report for the year to June 2010 "price and service competition in the Group Risk market has become intense". APRA went on to express a concern that premiums in the Group Risk segment "will not prove sustainable".<sup>8</sup>

The factors giving rise to the deterioration in profitability in the Group and Individual Disability segments of the Life Risk market are a combination of cyclical and structural.

- Rising unemployment is a cyclical contributor to increased Disability Income Protection claims. In Australia the seasonally adjusted unemployment rate has risen from 4.5% in November 2007 to a high of 5.8% in August 2009 before falling to 5.1% in November 2010.<sup>9</sup> APRA has noted "the significant downsizing that has taken place in some sectors of the Australian economy has impacted on claims in two ways. Firstly the downsizing has caused increased incidence of stress, depression and related claims and secondly there are fewer jobs for claimants to return to."<sup>10</sup>
- The impact of competition on pricing - for example in July 2006 the annual cost of \$300,000 Death and TPD cover for a 40 year old member of AustralianSuper was \$760.50. By May 2010 this had fallen to \$376.81. Under revised pricing that came into effect from June 2013 the cost has risen to \$520.00, still 32% below the cost 7 years earlier.
- Competition has resulted in an expansion of coverage and benefits. Agreed value as opposed to Indemnity value cover has been offered. Disability Income benefits payable to age 65 and even older are not uncommon benefit features.
- Mental health claims are increasing and have become the most common category of claim for women. For both men and women mental health claims have the longest duration.<sup>11</sup>
- There has been an increased propensity for policyholders to lodge claims. Television advertisements from plaintiff lawyers have increased awareness of Disability Income cover provided by Superannuation funds.

---

<sup>8</sup> APRA 2010 Annual Report, 12<sup>th</sup> October 2010.

<sup>9</sup> Australian Bureau of Statistics Labour Force Australia 6202.0, November 2013.

<sup>10</sup> APRA 2013 Annual Report.

<sup>11</sup> "Disability Income Product Innovation in Australia", Jame Louw Chief Actuary Gen Re Australia International Congress of Actuaries Hong Kong, May 2012.

There is strong evidence from Workers Compensation claims showing the benefits of early and pro-active intervention in the claims management process.

- There is wide acknowledgement that a shortage of skilled claims staff is causing problems for insurers. Paul Morden and Aaron Tindale from Munich Re referred to this problem in a presentation to the Institute and Faculty of Actuaries in May 2013.<sup>12</sup> APRA made similar observations in its 2012 Annual Report.<sup>13</sup>
- In reporting to investors on issues in its Wealth Protection Business in August 2013 AMP noted an immediate action was to increase the size of claim teams and thereby reduce case loads.<sup>14</sup>
- Morden & Tindale observed companies have “a strong focus on investigation and medical assessment but less focus on pro-active claims management to assist claimants back into work”. There is strong evidence from Workers Compensation claims showing the benefits of early and pro-active intervention in the claims management process.
- An issue FINEOS observed in the Australian market until very recently is a historic underinvestment in modern Claims Management Technology systems. However the current profit pressures and need for improved customer care have led many insurers to review the suitability of their claim systems and a number have recently purchased modern Claims Management Technology solutions or are about to make a purchase in this area.
- Furthermore, in the past re-insurers and Insurance Carriers have increased premiums in IP to cover losses.<sup>15</sup> This has previously had the effect of dampening the market and reducing new business. A new approach would be to use portfolio analytics to predict and define problem areas in claims and then design products to allow tailored underwriting, exclusions, longer eligibility periods, underwriting premium factors, etc. This could provide a way to increase the profitability of portfolios with a lesser impact on overall new business acquisitions.

Investment in claims staff and claims management systems will not overcome historical problems of low pricing, lax underwriting and weak product design but they will minimize the damage. A modern Claims Management system should offer the Claims Management team best practice in areas such as customer centric care, early intervention and return to work guidelines, accurate reserving, timely payments and overall management information, reporting and process which enables the team to get the balance right for the customer care side as well as for the overall efficiency and effectiveness of the insurance carrier.

---

<sup>12</sup> “Horrors from Down Under”, Health and Card Conference, 14<sup>th</sup> May 2013.

<sup>13</sup> APRA 2012 Annual Report.

<sup>14</sup> AMP Investor Presentation, 15<sup>th</sup> August 2013, page 12.

<sup>15</sup> Australia: Life Insurance Premiums could rise by 25% this year”, AIR eDaily, 7<sup>th</sup> January 2014.

Within the next two years we believe that every Australian Income Protection insurance provider will have implemented a modern claims solution.

In an article in The Actuary in July 2012 Andy Rear from Munich Re looked at the lessons for the UK market from what had happened in the Australian Disability Income Protection market. The key message was the importance of investing in systems, processes and above all skills. Gerard Kerr, Head of Retail Products, Marketing, Reinsurance and Insurance at ANZ Wealth, said "Ongoing investment in your claims people and supporting capabilities is core to your success".<sup>16</sup>

**Finally, to address the question with respect to lessons for other Disability and Income Protection markets, we believe the Australian experience is not unique and similar issues exist and need to be addressed in all of the main Disability and Income Protection markets. In fact, the impact of the Global Financial Crisis on the Australian economy has been less severe than the impact it has had on most other advanced economies. It is well known that market declines in the economic sense usually lead to an increase in Disability and Income Protection Claims and reduced profitability within this line of business. Within the next two years we believe that every Australian Income Protection insurance provider will have implemented a modern claims solution. We also expect this trend will be emulated throughout the main Disability and Income Protection markets around the world. Perhaps the Australians are leading the way?**



Michael Kelly is CEO of FINEOS Corporation. FINEOS list four of the Top 10 Australian Life and Disability carriers as Claims Management System customers. In addition, FINEOS Claims is used by the National and State Accident Compensation Schemes in New Zealand as well as Victoria and New South Wales, Australia. FINEOS is the global market leader in Life, Accident and Disability Claims Management systems with six of the Top 20 Group Life & Health carriers in the US as FINEOS customers.

### About FINEOS

FINEOS is a market leading provider of core software solutions for Insurance and Government Accident Compensation Insurance. Our flagship product, FINEOS Claims, is the insurance industry's best-in-class solution for all Life, Disability, and Government Compensation Insurance. Established in 1993, the company delivers innovative solutions to a global market and has customers, employees and established bases in North America, Europe, Africa and the Asia Pacific markets. For more information, visit [www.FINEOS.com](http://www.FINEOS.com)

<sup>16</sup> The Actuary 30<sup>th</sup> July 2012 "Disability Income: Are we sitting on a time-bomb?", Andy Rear.



