Disability Income

Have we learned anything?

Hoa Bui & Andre Dreyer

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Agenda

1. The current deterioration
2. Compare with the 90’s
3. What happen overseas?
4. Where to next?
Current situation

Australian disability income experience deteriorates

Disability Income - Australian industry
Net of tax, net of reinsurance profit quarterly

Source: APRA Quarterly Statistics

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The deterioration is not isolated to one company …

CBA
December 2011
Profit release
…Claims experience was mixed with favourable experience in consumer credit insurance and continuing adverse experience in disability products…

Suncorp results (Asteron)
June 2011
The economic and market environment continues to place pressure on lapses and disability claims (page 57 30 June 2011 annual report).

• $20m unfavourable disability claims experience (page 55 30 June 2011 annual report)

AMP
December 2011
Investor report
In line with industry trends, recent income protection claims have been higher than long term best estimate assumptions for both AMP Life and NMLA…. As a result, the AXA Australian income protection book was put into loss recognition with capital losses of A$74m recognised on merger.

Hannover
July 2011 Update
The claims experience in Australian disability annuity business was similarly unusual: the period during which annuity recipients remained in the disability phase was longer by market standards. This prompted a strengthening of the IBNR reserves and the provision for claims already being paid out. Altogether, additional expenditure in the low-double-digit million euros was incurred.

MunichRe
September 2011
Life
Reserve strengthening for Australian disability business of €148m

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1993-1998 Deterioration

Source: IAA 2002 Report
Understanding the drivers

Is it the economy? Incidence or termination?

Comparison of Disability Income Experience and Economic Indicators

Source: RGA 2011 Retail Disability Income Experience Investigation  © Hoa Bui and Andre Dreyer
Current situation

Is it only legacy business?

Comparison of Disability Income Experience and Economic Indicators

- **Incidence A:E**
  - Pre 2002
  - Post 2001

- **Terminations A:E**
  - Pre 2002
  - Post 2001

- **Unemployment**
  - Pre 2002
  - Post 2001

Source: RGA 2011 Retail Disability Income Experience Investigation

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Contrasting the 1990’s and 2010’s

1. Market structure
2. Product design
3. Pricing
4. Underwriting limits
5. Claims management
## Comparing the 90’s and now

### Market Structure

<table>
<thead>
<tr>
<th>Then</th>
<th>Now</th>
</tr>
</thead>
<tbody>
<tr>
<td>It’s a crowded space: 23 direct offices / 5 reinsurers</td>
<td>• 10 insurers</td>
</tr>
<tr>
<td></td>
<td>• Mostly distributed through IFA</td>
</tr>
<tr>
<td></td>
<td>• Increased importance of rating house</td>
</tr>
<tr>
<td>Distribution remuneration: upfront commission up to 100% first year</td>
<td>• Distribution remuneration: upfront</td>
</tr>
<tr>
<td>annual premium</td>
<td>commission up to 120% of first year AP</td>
</tr>
<tr>
<td>Most DI business written outside of super</td>
<td>• DI written both inside and outside of Super</td>
</tr>
<tr>
<td></td>
<td>• Increased GSC in industry super</td>
</tr>
</tbody>
</table>

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Comparing the 90’s and now

**Product design: many generous features remain available, some newly introduced**

**Definition of disability**
- Total disability: any to own to important duties to one duty to 10 hours definition
- Changed nature of “Partial disability”
- Unemployment “cover”

**Mental illness: exclusion or limitation of benefit period: introduced but did not really take off**

Agreed value continue to be available for purchase
- NB and IF was 100% agreed value
- Indemnity now 30% of new business

**Lifetime benefit period**
- Withdrawn by all companies from new business
- Remain a feature of legacy business

**Indexation in excess of CPI no longer available**

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Comparing the 90’s and now

**Pricing**

- Premium rates were increased significantly
- When incidence improved in the early 2000, and durations were kept under control, benefits were improved rather than reducing prices.
- Premium rating becomes slightly more granular
  - Occupation rating 9 occupations rather than 4
  - Medical, legal, pilot
- Until recently, the demise of data and experience analysis

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Comparing the 90’s and now

Underwriting limits increased faster than wages
Issue limits have increased significantly

<table>
<thead>
<tr>
<th>Typical Limits</th>
<th>1998</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Statement</td>
<td>4,000 pm</td>
<td>12,500 pm</td>
</tr>
<tr>
<td>Plus Blood</td>
<td>4,000 - 6,000</td>
<td>12,500 - 30,000</td>
</tr>
<tr>
<td>Plus PMAR</td>
<td>6,000 - 30,000</td>
<td>30,000 - 60,000</td>
</tr>
<tr>
<td>Financial Underwriting</td>
<td>10,000</td>
<td>AIDS no longer a key issue 16,000 - 20,000</td>
</tr>
<tr>
<td>Maximum issue limits</td>
<td>30,000 pm</td>
<td>60,000 pm</td>
</tr>
<tr>
<td>Average Adults OTE</td>
<td>3,144 pm</td>
<td>5,700 pm</td>
</tr>
</tbody>
</table>
Comparing the 90’s and now

Claims Management

1990
- Claims: a back room function
- Little management attention
- Manage every claims
- Manual process
- Inadequate claims system
- Poor linkages to PAS and general ledger
- Key drivers are largely unchecked (case load 140)

2002
- Claims became a key focus
- Case load dropped to 80
- Increased use of experts
- Recognise the importance of mental claims
- Manage every claims
- Manual process
- Inadequate claims systems
- Poor linkages to PAS and GL

Now
- Recognised the strategic importance of claims as a customer touch point
- Case load monitored (55-60)
- Pay and close introduced
- Rehab, use of specialists, triage
- Risk profiling ?
- Manual process
- Inadequate claims systems
- Poor linkages to PAS and GL
- Poor management information
- Shortage of claims managers (partly due to demand from industry fund)

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Overseas experience

• Are disability income claims influenced by economic conditions?
• Has overseas experience deteriorated?
• What lessons can we learn?
Overseas Experience – Long-term studies

UK:
- IAA’s latest industry study relate to 2006. Update due later this year
- No widespread deterioration

US:
- Latest 2008 SOA study relates to years 1997 to 2006 for group long term disability
- 2009 AETNA study – found strong correlation between benefit cost ratio and unemployment

South Africa:
Key findings of interest to Australian audience

- There is some correlation between economic indicators and recovery rates, but it does not explain everything – subtext: claims and underwriting are important too.
- There is significant difference in claims duration due to cause of claims
- Waiting period has an impact on recovery rates for up to 3 years.
RGA Reinsurance Industry Survey
– Group business


Incidence Rates

- Majority of participants felt economy had minimal impact on incidence or that incidence rates had declined
- “Some industries with increasing incidence rates are offset by tendency of employees in other sectors to hang on to their employment or RTW more quickly in order to avoid losing job”
- “We have experienced more instances in which claims submitted were not eligible because their hours were reduced below plan”

Recovery Rates

- 78% felt recession had not affected recovery rates, however…
- 56% felt recession has dampened employers’ willingness to support RTW
- “There is less willingness to hold jobs open or make accommodation to allow some to return to work”

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Recent US & UK Long-Term Disability Results to Q4 2011 / Q1 2012 (Group)
Unum Experience (Global)

- Solid performance during recession

- Occasional deterioration in LTD incidence rates offset by higher recoveries

- 2Q11 incidence uptick from 1st quarter, but lower than second half of 2010
• Experience showed a 6 quarter lag to unemployment rate increase

• Unum adjusted mortality assumption within its claim resolution rate assumption

• Increased its claims reserves for the individual disability closed block of business by $184m
MetLife Experience

• Benefit Ratio includes Disability & Dental; dental contributed to increase in benefit ratio

• 2009: LTD incidence increased, recoveries significantly below expectations

• 2010: LTD incidence remain elevated, seeing improvements in recoveries

• 2011: LTD incidence rates have dropped; loss ratios improving
Standard Insurance Company

- Solid results during recession, including record low benefit ratio at 3Q08
- Deterioration since 4Q10
# Overseas experience

## – International Product Comparison

Green means the most liberal T&C compared to other countries

<table>
<thead>
<tr>
<th>Definition</th>
<th>UK</th>
<th>South Africa</th>
<th>Canada</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own Occupation</td>
<td>Unable to perform the</td>
<td>Unable to perform the</td>
<td>Own Occupation</td>
<td>Own Occupation or Any occupation</td>
</tr>
<tr>
<td></td>
<td>material and substantial</td>
<td>material and substantial</td>
<td>• Cannot perform substantial duties of occupation</td>
<td>• One duty or</td>
</tr>
<tr>
<td></td>
<td>duties of his own</td>
<td>duties of his own</td>
<td>Regular Occupation</td>
<td>• One important duty or</td>
</tr>
<tr>
<td></td>
<td>occupation</td>
<td>occupation</td>
<td>• Cannot perform substantial duties of occupation, not</td>
<td>• 10 Hours</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>employed</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Any Occupation</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Cannot perform any occupation, given ETE</td>
<td></td>
</tr>
</tbody>
</table>

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# Overseas experience
## International Product Comparison

<table>
<thead>
<tr>
<th></th>
<th>UK</th>
<th>South Africa</th>
<th>Canada</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agreed Value / Indemnity</td>
<td>Indemnity</td>
<td>Indemnity</td>
<td>Agreed Value</td>
<td>Agreed Value &amp; Indemnity</td>
</tr>
<tr>
<td>Specified Injury</td>
<td>No</td>
<td>To 65</td>
<td>No</td>
<td>Up to 5 years</td>
</tr>
<tr>
<td>No Claim Bonus</td>
<td>No</td>
<td>Integrator</td>
<td>None</td>
<td>Up to +15%</td>
</tr>
<tr>
<td>Issue Limits</td>
<td>$16K-$20k pm</td>
<td>~ $20k pm</td>
<td>$25k-$35k pm</td>
<td>Up to $60k pm</td>
</tr>
<tr>
<td>Max entry age</td>
<td>55</td>
<td>Age 60</td>
<td>Age 55</td>
<td>Age 65</td>
</tr>
<tr>
<td>Policy Expiry</td>
<td>Age 70</td>
<td>Age 70</td>
<td>Age 65</td>
<td>Age 70</td>
</tr>
<tr>
<td>Indexation Max</td>
<td>10%</td>
<td>Up to 15%</td>
<td>25% over lifetime</td>
<td>Max (CPI, 5%)</td>
</tr>
<tr>
<td>Benefit escalate</td>
<td>RPI (10% max)</td>
<td>Up to CPI+3%</td>
<td>Typically Min (CPI, 5%)</td>
<td>Max (CPI, 5%)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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<thead>
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<th>UK</th>
<th>South Africa</th>
<th>Canada</th>
<th>Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partial Claim</td>
<td>Only after full claim</td>
<td>Yes</td>
<td>Yes, based on time or income loss</td>
<td>10 hrs Partial before total allowed</td>
</tr>
<tr>
<td>Waiting Period</td>
<td>From 7 days</td>
<td>From 7 days</td>
<td>Most common 30 and 90 days</td>
<td>30 days followed by 90 days.</td>
</tr>
<tr>
<td>Replacement</td>
<td>60% for first $7K then 50%</td>
<td>100% 1st 2 yrs, 75% after</td>
<td>77% at $25k 70% at $50k 60% at $100k 30% at $1 million</td>
<td>75% to $30k Then tapers</td>
</tr>
<tr>
<td>High risk occupation</td>
<td>ADL's</td>
<td>No</td>
<td>Excluded</td>
<td>2 year benefit</td>
</tr>
<tr>
<td>Offsets</td>
<td>Yes</td>
<td>Varied</td>
<td>Not typical for top product</td>
<td>Yes</td>
</tr>
<tr>
<td>Severity boost</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>+1/3rd on ADL</td>
</tr>
<tr>
<td>Back/Psych</td>
<td>Full cover</td>
<td>Limitations</td>
<td>Full cover</td>
<td>Full cover</td>
</tr>
</tbody>
</table>

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Key Take Out

1. Income Protection claims experience has deteriorated in Australia at an industry level
   - Both retail and group
   - RGA’s study suggests both incidence and termination deteriorated and not limited to closed book

2. Compared to the 1990’s
   - Competitive
   - Pricing got slightly more granular, some segment priced
   - Product: withdrawn life time benefit, introduce indemnity, generous features remain
   - Underwriting limits and issue limits more lenient
   - Claims management more strategic, but fundamental issues remain
Key Take Out

3. Overseas experience
   – DI claims experience is partially explained by economic conditions
   – Yet, some evidence of deterioration post GFC in UK, US, but not South Africa
   – On balance product features in Australia appear more lenient

4. Why did the deterioration occur here and not overseas?
   – A convergence of factors: product, underwriting, claims management, lack of early warning signals, lack of analysis or poor use of it
What can companies do about this?
Think more than just price increase

1. **Claims management**
   - Manage claims strategically, invest in claims and data, need continuous focus

2. **Make your product more sustainable**

3. **Price sustainably / more granular premium rating / more precision in reserving**

4. **Group Salary Continuance**

5. **Use your data and analysis strategically – Value your data, it’s your competitive advantage**
What can actuaries do?

1. Look at your experience more quickly and more regularly
2. Get better at analysing experience
3. Set realistic assumptions
4. Act on your findings
5. Claims management
   – Turn analysis into insight for managing your business
   – Decides what matter and measure everything that matters.
   – Have targets and KPIs. Be action oriented.
6. Benchmark your assumptions and basis
7. Pricing increase is only part of the solution
8. Don’t underestimate the value of basic research
9. Consider the public interest

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