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CONSULTATION

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**Summary of
Reference Product
Individual Disability
Income Insurance**

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Disability Insurance Taskforce of the Actuaries Institute



**Actuaries
Institute**



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About the authors

Members of the Actuaries Institute Disability Insurance Taskforce are listed in the Appendix of Document A – *Provisional Findings and Recommended Actions for Individual Disability Income Insurance*.

Disclaimer

This paper is circulated by the Disability Insurance Taskforce for the purpose of providing information on the work to date and to facilitate further consultation. The Disability Insurance Taskforce is comprised of a range of participants and stakeholders in the Individual Disability Income Insurance ecosystem. The work of the Disability Insurance Taskforce has been to establish guidelines for a sustainable ecosystem including the development of a Reference Product for Individual Disability Income Insurance. The work has been undertaken to promote better, more sustainable outcomes for both consumers and the industry. The Taskforce participants have shared knowledge on the basis that the outcome was the public benefit of advancing the debate of more sustainable.



About the Actuaries Institute

The Actuaries Institute is the sole professional body for Actuaries in Australia. The Institute provides expert comment on public policy issues where there is uncertainty of future financial outcomes.

Actuaries have a reputation for a high level of technical financial expertise and integrity. They apply their risk management expertise to allocate capital efficiently, identify and mitigate emerging risks and to help maintain system integrity across multiple segments of the financial and other sectors. This unrivalled expertise enables the profession to comment on a wide range of issues including life insurance, health insurance, general insurance, climate change, retirement income policy, enterprise risk and prudential regulation, finance and investment and health financing.

Summary of Reference Product Individual Disability Income Insurance

The Reference Disability Income Insurance Product (Reference Product) has been designed to:

- meet the fundamental needs of a customer who wants financial protection against loss of income as a result of disability, pending return to work;
- be reasonably easy to understand, notwithstanding the inherent complexity of the issue of disability;
- have premium rates that are reasonably affordable and stable over the course of the policy; and
- follow sound insurance principles.

It is expected that the Reference Product, were it to be offered as a retail product, would be seen by consumers as a reasonable product at a reasonable price.

However, the purpose of the Reference Product is not to dictate the design of a retail product. Rather, its purpose is to provide a reference point to aid senior management, the Board and regulators in assessing risk and uncertainty for both customers and insurance companies. In other words, it is intended to assist an insurer in the assessment of risks and uncertainty and in the prudential management of their individual disability income insurance product line.

Any significant difference in an insurer's product from the Reference Product is expected to be subject to rigorous assessment to meet minimum requirements for CROs, Appointed Actuaries, Product Managers, and CEOs.

The Reference Product will not address all issues that the Taskforce believes are needed to achieve suitable ongoing community outcomes, and is only one element of a range of proposals from the Taskforce.

Sound Insurance Principles

The Taskforce believes the following principles are necessary for insurance companies to follow to achieve appropriate ongoing community outcomes:

1. The event giving rise to a claim must be objectively definable and measurable. The event should also occur by chance - that is, it should be beyond the control of the beneficiaries.
2. The customer's financial loss on the occurrence of the event must be measurable and definable.
3. The benefit payment should not exceed the financial loss suffered, after allowing for other sources of financial support.
4. Maximum benefits provided should be set at a level to provide a financial incentive for claimants to return to work. Benefits should not provide disincentives to return to work, either initially or over time. A customer should not be financially better off while on claim. This helps provide an incentive for customers to return to work and for the cover to focus on those in need.

Key Background Points

Firstly, the Taskforce has adopted a consumer lens in this work.

Secondly, it is acknowledged that there is a wide range of views on what should be included in a Reference Product, and that the end result does not contain everyone's exact preferences. The Reference Product is a balancing act between a product that consumers would understand, value and purchase, that advisors can recommend, and a product that would allow an insurer a reasonable chance to ensure the principle of indemnity is observed throughout the contract.

Next, it is desirable for the Reference Product to be robust enough to avoid it being overly easy to claim, yet liberal enough that it would be attractive to the consumers and therefore quite a marketable product. For example, the maximum benefit is lower than is commonly available in the market today; however, it is comparable with that offered in overseas markets.

Last but not least, the product should be considered as a whole and the merits of restrictions/limitations assessed in the context of the overall product construct.

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Reference Disability Income Insurance Product

Overarching Philosophies

- The Reference Product is an indemnity contract, designed using sound insurance principles, both at inception and over the duration of the policy.
- The purpose of the Reference Product is to support the customer to Return to Work (RTW) to help shift the focus from how disabled the customer is.
- In addition to 'income support', actual expenses incurred can be reimbursed where consistent with the RTW purpose. Other than this, there are minimal ancillary benefits.
- Terms and conditions should be updated over time to remain contemporary and respond to evolving society needs, for the benefit of customers.
- The Reference Product is intended to support longer term product affordability.

Key Product Elements

Total Disability Definition¹

First 2 Years: Unable to perform the customer's 'Own Occupation'

Beyond 2 Years: Unable to perform work in any occupation for which the customer is reasonably suited by education, training or experience (i.e. an 'ETE' occupation definition).

All Periods: The customer is required to comply with the insurer's and health professionals' reasonable requests to participate in rehabilitation and/or retraining. Reasonable job modification is expected if it will allow return to work.

Excluded: The above definition is different from the current common '3-tiered' definition and does not include hours-based and income-based definitions. The definitional focus on inability to perform work means benefits are not paid simply because appropriate work is not available in a particular location. Retraining is specifically designed to facilitate appropriate return to work.

Whole Person Permanent Impairment (WPPI)² test: a Whole Person Permanent Impairment Test may be used as a tool by the insurer to help assess long term disability after the disability conditions have stabilized (that is no further improvements are expected, usually after about two years).

Basic Sum Insured – Income Replacement Ratio (IRR)

Long Term: The long-term maximum IRR is calculated as follows (in 2020 dollars):

- 60% up to \$240,000 p.a.;
- 40% of the next \$240,000 p.a., and
- 20% of the next \$480,000 p.a. (nil thereafter).

Super: Super Guarantee contributions can be insured in addition to the long-term IRR but claim payments are paid directly into a complying superannuation fund (not paid in cash to the policyholder).

¹ See Note 1 for more detail

² See Note 2 for more detail

6 Month Top Up: An additional 25% percent of the long-term IRR scale (e.g. $60\% \times 1.25 = 75\%$ up to \$240,000 p.a. income) can be payable for a maximum period of 6 months. This supplement is to be payable only if the customer is meeting RTW objectives, reports claims within 12 months of the date the disability was incurred and collaborates with the insurer in seeking ways to return to work.

Partial Disability³

Definition: The customer has reduced work capacity due to injury or sickness.

Eligible: When the customer earns a 20% reduction in their “insurable income” due to reduced capacity to work.

Benefit Ceases: When the customer has 80% or more capacity to work OR if the customer is capable of working 32 hours of work per week.

Waiting Period: Must be served in full.

\$ Payment: Total Disability Benefit (pre offsets) – 75% x current earned income while partially disabled – 100% x offsets

Income Definition⁴

Basic Insurable Income: income from personal exertion from the customer’s main occupation.

Passive Income: Is not insured.

Self Employed Adjustments: Income is after business expenses have been incurred and before tax.

Benefit relates only to the true personal exertion component of the customer’s income (and not any ‘profit’ element). For example, for a customer who can replace himself with a contractor while he is ill, and retain the business profit flow, the contractor’s cost is reflected in the insurable income amount.

Income Period: Income over the previous 12 months.

In the first twelve months of a policy (after issue), insurable interest is limited to the actual average monthly income of the customer from the date of policy issue.

In exceptional circumstances, a different period for averaging may be considered, but it must be ‘unbiased’ (e.g. it will not be higher of averages over two different periods).

Reflects a maximum of 40 hours of work per week (consistent with claim payments).

Atypical Income: Infrequent or atypical amounts are excluded. For example, variable annual bonuses should only be counted where there is a genuine history of their payment but not exceeding a reasonable, modest limit (e.g. 20% of regular income).

Benefit Offsets and Income Tax⁵

Tax: The insurer deducts the expected tax from the benefit before payment to the customer⁶.

Where benefit payments are not expected to be subject to income tax, the basic sum insured (and related IRR) is reduced to ensure a relationship consistent with the intentions of the basic cover.

Offsets: Any benefit payable will be comprehensively reduced for the effect of other ‘disability income support’ payments received by the customer, such as sick leave; workers compensation; other similar income replacement insurance payments; disability support pension or other social security payments.

³ See Note 1 for more details

⁴ See Note 3 for more details

⁵ See Note 4 for more details

⁶ A change in legislation may be required to enable some rehabilitation and medical costs.

Indexation

Benefit Indexation: No automatic indexing of cover. Increase of cover is an option, provided evidence for the insurability for the increased cover is provided by the customer.

Claims Indexation: No automatic indexing of claim payments. An option for indexation of claims payments may be purchased, with the indexation limited to CPI until age 55 and CPI less 2% after age 55.

Parental Leave and Sabbatical Adjustments

Definition: Eligibility for the 'own occupation' provisions of the total disability and partial disability definitions only apply for the first 3 months of claims payments (i.e. any ETE applies from 3 months);

Cover Suspension: Benefits are suspended from 12 months until the customer returns to regular employment.

Benefit Periods and Waiting Periods

Max Ben Period: To age 60 [Seven years before 67, the current full age pension entitlement]

Waiting Periods: Between 30 and 180 days.

Waiting periods of greater than 180 days are considered to be inconsistent with a Return to Work purpose.

Updating Contract Terms at Regular Intervals

Financial Underwriting: The customer is required to update income, occupation and pastime every 5 years, but not health evidence. This updated information may be used to adjust premium rates.

Product Terms: the policy terms and condition can be updated every 5 years, subject to the customer being treated fairly at the 5 year roll-over.

Recovery Management Plan, Rehabilitation, Retraining⁷

A recovery management plan is central to the Reference product, being a Return to Work product, and may include rehabilitation and retraining programme.

The customer is expected to actively participate in the recovery management plan including rehabilitation and training, in order to receive benefits.

Ancillary Benefits

The Reference Product has limited ancillary benefits in order to maintain simplicity and insurable interest. Where ancillary benefits are offered, they relate to an expense incurred or a need. For example:

Premium waiver: Yes.

Reimbursement of Costs: Unexpected costs incurred as a result of the cause of disability (e.g. medical and rehabilitation costs) will be met.⁸

Other: None.

Coverage for all Causes of Claims

Access to benefits is not restricted for any cause of claim.

The decision to pay a claim rests with the insurer, but using the medical assessments made by a

⁷ See note 5 for more details

⁸ Under existing law, payment of medical costs is not currently allowed to be paid by a life insurer.

suitably qualified medical practitioner - for example an occupational specialist can determine work capacity, as opposed to a general practitioner. Medical conditions will be diagnosed by an appropriate accredited specialist (e.g. certain mental health claims to be diagnosed by a Psychiatrist or other appropriate accredited specialist).

Explanatory Notes

1 Total and Partial Disability Definitions

Total Disability Definition

Solely because of *sickness* or *injury*:

- You are not working and you do not have work capacity in your *suitable work*; and
- You are under the regular care and following the advice of a *medical practitioner* in relation to that *sickness* or *injury*; and
- You are meeting your *recovery obligations*.

Partial disability Definition

Solely because of *sickness* or *injury* you are working:

- less than 32 hours per week in *suitable work*; and
- to your full *work capacity*; and
- your current monthly income is less than 80% of your *pre-disability earnings*; and
- you are under the regular care and following the advice of a *medical practitioner* in relation to that *sickness* or *injury*; and
- you are meeting your *recovery obligations*.

If you are working but not to your full *work capacity*, then your partial disability benefit will be calculated allowing for your *work capacity* and not your actual hours worked.

Solely because of sickness or injury you are not working:

- but you have *work capacity* in *suitable work* for less than 32 hours per week; and
- you are under the regular care and following the advice of a *medical practitioner* in relation to that *sickness* or *injury*; and
- you are meeting your *recovery obligations*.

Suitable Work

Suitable work means:

- Your regular occupation in the first 2 years from the date of disability;
- After the first 2 years from the date of disability, any occupation for which you are reasonably suited by way of education, training or experience. In performing this assessment, we will have regard to:
 - the nature of your incapacity;
 - your age, education, skills and work experience;

- any plan or document prepared as part of your recovery management plan;
- any occupational rehabilitation services that are being, or have been, provided to/for you; and
- any other matters we may consider relevant.

In performing this assessment, we will not take into consideration:

- whether the work or the employment is available;
- the nature of your pre-injury employment; or
- your place of residence if you have moved from your pre-disability place of residence to the current residence.

Work Capacity

A work capacity decision is a decision by us about your capacity to work in your *suitable work*, and may involve us performing a work capacity assessment. A work capacity assessment may affect your entitlement to total or partial disability benefits.

In assessing your ability or inability to perform *suitable work*, our assessment will have regard to:

- Your pre-disability income;
- The typical weekly hours you work in your *regular occupation*, which we will assess based on your working status over the twelve months immediately prior to the date of your disability;
- However, in no case will we consider or assess you relative to a working status involving more than 40 hours per week (i.e. we will not assess inability to work beyond standard full-time working hours);
- to what level you can engage in their *suitable work* to create earnings without substantial risk of exacerbating your *sickness* or *injury*.

A *work capacity assessment* will be conducted no more than once every 12 months.

2 Tools for Assessing Disability

Whole Person Permanent Impairment Test

A Whole Person Permanent Impairment Test (WPPI) is a tool that may be used by the insurer to help assess long term disability after the disability conditions have stabilised (that is no further improvements are expected).

A Whole Person Permanent Impairment test involves a clinical assessment of the claimant as they present on the day of assessment taking account the claimant's relevant medical history and all available relevant medical information to determine:

- whether the condition has reached Maximum Medical Improvement (MMI);
- whether the claimant's compensable injury/condition has resulted in an impairment;
- whether the resultant impairment is permanent;
- the degree of permanent impairment that results from the injury;
- the proportion of permanent impairment due to any previous injury, pre-existing condition or abnormality, if any, in accordance with diagnostic and other objective criteria (guidelines). For example, these guidelines may include:

- The American Medical Association (AMA) Guides® to the Evaluation of Permanent Impairment, Fifth Edition: Hardbound (AMA5) or updates or replacement thereof.
- The Comcare Guide to the Assessment of the Degree of Permanent Impairment Edition 2⁹ or updates or replacement thereof.

The degree of permanent impairment that results from the injury/condition is determined using the tables, graphs and methodology given in the guidelines.

Some example guidelines are outlined below.

Non-Mental Health WPPI Assessment Examples

Scenario	AMA 5th Edition – Chapter – Table & WPPI %
35, male, plumber, hurt back while lifting large heavy box 3 years ago, with ongoing occasional pain, normal examination, normal investigations, diagnosed with non specific chronic back pain.	Chapter 15, table 15-3 No significant clinical findings, no neurologic impairment, no change in anatomical structure/function, no fracturest. WPPI assessed 0%
54, female, executive, fell from ladder 2 years ago and sustained lumbar spine fracture (compression) without neurological findings, fracture healed after 6 months, ongoing pain and difficulty with some activities of daily living (able to do most). Mildly tender on examination, reduced range of motion, normal neuro exam. Diagnosis lumbar spine compression fracture with ongoing pain.	Chapter 15, table 15-3 Due to nature of injury WPPI assessed 20%
44, male, factory worker, sustained blow to neck from machinery 4 years ago, unable to use dominant left hand for ADL without pain in neck, left upper back, left upper limb (radiating pain due to nerve injury). No other discomfort. Refuses surgery. Diagnosis cervical (neck) disc herniation with nerve injury (radiculopathy).	Chapter 15, table 15-5 Given injury and ongoing nerve injury with interference in function WPPI assessed 18%.
58, male, doctor, first myocardial infarction (heart attack) 2 years ago due to coronary artery disease, treated with stenting. Ongoing shortness of breath on exercise with reduced exercise capacity (symptoms after walking 1km, able to tolerate jogging on stress test), treated with ongoing with medications. Examination is normal at rest. Diagnosis exertional angina secondary to coronary artery disease.	Chapter 3, table 3-6a Due to ongoing symptoms and reduced functional capacity WPI assessed 30%.

The Reference Product includes the WPPI as a tool to be used to assist with the assessment of total disability under the ETE definition.

9 <https://www.comcare.gov.au/about/forms-publications/documents/publications/claims/assessment-of-degree-of-permanent-impairment.pdf>

Mental Health

Various medical individuals and organisations have noted concerns with mental disorders chapter (Chapter 14) of AMA5.

It is noted that:

- Various improvements to the mental health chapter have been made in AMA6, however AMA6 is not commonly adopted in Australia.
- The issues with chapter 14 in AMA5 are resolved in various jurisdictions in Australia by adding another assessment tool (for NSW Workers Compensation it is the PRIS: <https://www.actuaries.asn.au/Library/Miscellaneous/2020/11PsychiatricAndPsychologicalDisorders.pdf>.)

3 Definition of Insurable Income

Income

If you are an employee, **monthly income** means the gross monthly income earned from your personal exertion by way of total remuneration package and includes salary, regular overtime, commissions, bonus payments, salary sacrifice amounts and fringe benefits.

If you are self-employed or a working director, **monthly income** is the gross monthly income generated by the business or professional practice as a result of your personal exertion less your share of the business expenses necessarily incurred in generating that income.

In either case, monthly income excludes:

- Any superannuation guarantee contribution amounts paid by you or on your behalf;
- Any element of passive income reflected in your earnings.

Passive income

Passive income is income which you receive that is not derived from your personal exertion or activities. **Passive income** includes income such as:

- Interest, dividend or rent, or other investment income or capital gains;
- Ongoing contractual royalties or other similar recurrent commission income from past efforts or activities;
- Business income, or your share of such income, that can be maintained irrespective of your disability (e.g. net business income earned above the cost of a locum to replace your product or service delivery role in your business).

Insurable Monthly Income

Your **insurable monthly income** is based on your *monthly income* adjusted as follows:

Where your *monthly income* is derived based on you working more than 40 hours a week, we will pro-rata reduce your *monthly income* to a 40 hour week to derive your insurable monthly income (i.e. you cannot insure your income beyond what you can reasonably earn within a 40 hour week).

We will also adjust your *monthly income* for single large amounts or amounts that are not reliably recurrent in nature (i.e. you cannot insure short-term, above-normal income as if it is normal income to be expected over the longer-term future).

This means that:

- Large, unusual amounts of bonuses, over-time, one-off transaction fees or income, will be excluded;
- Reasonable periodic bonuses or profit shares derived as a result of your personal exertion (excludes profit share that comprises passive income) will be spread over the period to which they relate (e.g. an annual bonus will be counted as 1/12th for insurable monthly income).

Pre-disability Earnings

Pre-disability earnings are your average *insurable monthly income*, for the consecutive 12-month period immediately preceding the date of your disability.

During the first 12 months from your policy commencement, your **pre-disability earnings** will be calculated based on the average of your *insurable monthly income* for the period between the date of commencement of your policy and the date you became disabled.

If you become disabled while on parental leave, sabbatical or long service leave, then **pre-disability earnings** will be based on your average insurable monthly income during the 12 months before the period of leave commenced.

Pre-disability passive income has a corresponding meaning – that is, your average monthly *passive income* during the 12 months prior to your disability, or since policy commencement, as relevant.

Current Monthly Income

Your **current monthly income** is the greater of

- Your actual *monthly income* while you are claiming a *partial disability* benefit. Your current monthly income is your *monthly income* in the month related to the calculation of a *monthly benefit amount*; and
- The amount we have assessed you are capable of earning monthly based on our *work capacity* decision.

4 Benefit Amount

Monthly Benefit Amount

While you are *totally disabled*, your monthly benefit amount is the lesser of:

- Your *insured monthly benefit amount*; and
- Your *eligible monthly benefit amount*.

Your eligible monthly benefit amount is calculated as:

Total Monthly Income = *Pre-disability earnings* + *Pre-disability passive income*

Max insurable total = 60% of the first \$20,000 p.m. of *Total Monthly Income*; plus
40% of next \$20,000 p.m. of *Total Monthly Income*; plus
20% of next \$40,000 p.m. of *Total Monthly Income* (and nil thereafter).

Eligible monthly benefit amount = Max insurable total – *Pre-disability passive income*.

Monthly Partial Benefit Amount

While you are *partially disabled*, your **monthly partial benefit amount** is calculated as your *monthly benefit amount* (as if you were *totally disabled*) less 75% of your *current monthly earnings*.

Offsets Amount

We will reduce any *monthly benefit amount* or *monthly partial benefit amount* we pay you by the amount of any other disability income support payment you are entitled to receive, such as:

- Sick leave;
- Workers compensation;
- Any other similar income replacement insurance payments;
- Any social security benefits.

Where you receive a lump sum disability insurance payment, such as a total and permanent disability insurance benefit, that you insured subsequent to the date we issued you this disability income policy, we may also reduce your monthly benefit amount or *monthly partial benefit amount* by the monthly income equivalent that would be generated by that lump sum amount.

5 Recovery Management Plan and Customer Obligations

When a benefit is being paid to a customer, the insurer will establish a recovery management plan in consultation with the customer, the medical practitioner and the customer's employer (if applicable).

A recovery management plan is a plan for co-ordinating and managing those aspects of injury/illness management that concern the customer's treatment, rehabilitation, retraining and return to work steps, for the purpose of achieving a timely, safe and durable return to work outcome for him/her. A recovery management plan can provide for the rehabilitation and retraining to be given or provided to the customer.

Reasonable job modification may be involved when designing retraining.

The customer is expected to:

- Participate and co-operate in the establishment of a reasonable recovery management plan established for him/her; and
- Comply with the reasonable obligations imposed on him/her under his / her recovery management plan.



Institute of Actuaries of Australia
ABN 69 000 423 656
Level 2, 50 Carrington Street,
Sydney NSW Australia 2000
t +61 (0) 2 9239 6100
actuaries@actuaries.asn.au
www.actuaries.asn.au