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Document A

Provisional Findings and Recommended Actions for Individual Disability Income Insurance

IDII

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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.

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 product design.

Actuaries Institute

About the Actuaries Institute

The Actuaries Institute is the sole professional body for Actuaries in Australia. The Institute provides expert commentary 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 expertise enables the profession to provide important insights 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.

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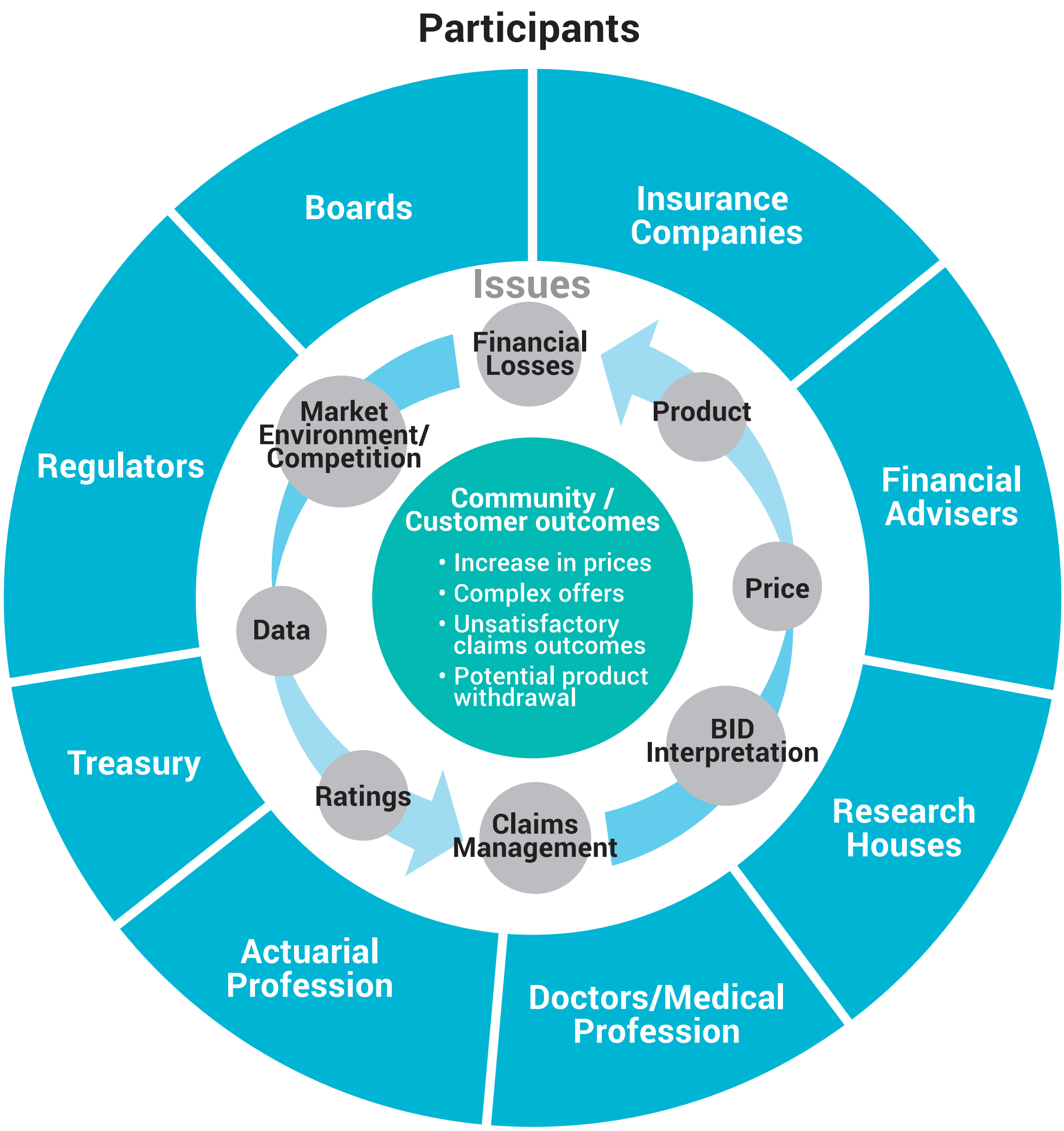
Individual Disability Income Insurance Ecosystem in Australia



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1 Summary

The Disability Insurance Taskforce (the **Taskforce**) set up by the Actuaries Institute has conducted a comprehensive review of issues with Individual Disability Income Insurance (IDII) in Australia.

As the diagram on the previous page indicates, there are numerous participants in what the Taskforce has called the IDII ecosystem[1]. As with any ecosystem, the members all contribute to its overall good health and proper functioning. It is readily apparent from the Taskforce work that the IDII ecosystem is unwell and substantial change is needed to restore its health.

The IDII product provides critical cover for many members of the community who may suffer loss of income because of disability. The IDII product has become more and more complex over time, making it difficult for customers to understand and be satisfied with claims outcomes.

At the same time, affordability and accessibility for those needing cover is declining. Increasingly, those with cover are finding the cost prohibitive, and the more-healthy policyholders are then likely to not maintain cover.

Meanwhile, insurers have been losing very large sums on IDII business, as claims have climbed in frequency and amount, and price increases have not been enough to compensate. Some insurers and reinsurers have effectively withdrawn from the market.

The market is at risk of failure.

This report contains provisional recommendations for participants in the IDII ecosystem.

Accompanying this report is a draft Sustainability Guide (incorporating the Reference Product for risk and uncertainty assessment), setting out good practices in the management of IDII business and intended as a tool for the Australian life insurance industry.

Consultation

There will be a consultation period until 31 October 2020 to give interested parties an opportunity to raise any concerns and potentially influence the final recommendations.

Comments can be provided via email to ditf@actuaries.asn.au

1 A business ecosystem '… includes suppliers, distributors, consumers, government, processes, products, and competitors. When an ecosystem thrives, it means that the participants have developed patterns of behavior that streamline the flow of ideas, talent, and capital throughout the system. https://www.investopedia.com/terms/b/business-ecosystem.asp'

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Recommendations

The Recommendations in this report are highlighted in blue in the Table of Contents.
Details of each can be accessed by clicking on the link for each one in the Table of Contents.

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2 Overview

The Retail Individual Disability Income Insurance Issue

Australia has a very competitive retail individual disability income insurance (**IDII**) market and customers have been offered a smorgasbord of product features[2], typically resulting in complex products. These product terms are guaranteed for decades into the future (when they may no longer be appropriate). In general, the premiums charged to customers do not reflect, and in practice cannot reflect, the cost of these guarantees. Instead, insurers rely on the right to vary premium rates if required.

Indeed, in recent years customers have suffered multiple increases in IDII premium rates. These increases have been steep, unanticipated and frequent which has undermined the value of this product for customers.

At the same time, in some respects customers have benefited temporarily from under-priced products at the expense of industry losses.

Price increases over the last 10 years have been driven by both increasing claims frequency and longer duration of claim payments. FSC experience studies show that claims costs also increased by 65% over about 10 years to December 2018[3].

This likely involves a number of factors including:

- Customers benefiting from competitive forces which have driven more comprehensive and more liberal policy conditions (and in some cases more liberal underwriting) and claiming accordingly;
- Customers' health and consequent claims responding adversely to economic conditions, for example with higher unemployment;
- Customers increasing their propensity to claim as society has changed – for example, technological developments affecting jobs, and changes to individualism, personal resilience and community standards (e.g. attitudes to mental health, expectations of what is fair, etc);
- Customers' increasing levels of mistrust and dissatisfaction, leading to healthier customers replacing policies (chasing price containment), or reducing or discontinuing cover (because of the perceived reduced value for money or lack of affordability).

Insurers have not necessarily understood these factors well. They have underestimated the impact of changes to product features and underwriting standards, particularly their cumulative effect over a period of years. And they have not properly understood or managed the uncertainty in claims flowing from the changes to attitudes and norms in society. This has been compounded by the inability under the Life Insurance Act of insurers to modify product terms and conditions after policies are issued.

Reducing interest rates have also added upward pressure on claims costs. 10-year Government bond yields have fallen from 5.1% in July 2010 to 0.9% in June 2020 and, consequently, insurers may have needed to increase premium rates in the order of 20% to maintain profits.

Notwithstanding the significant premium rates increases, they have not covered the increased cost of claims for insurers and so the life insurance industry has experienced very large losses on its IDII products. This is neither in the interests of customers nor the community at large.

2 For the purpose of this document, *features include* the amount and type of benefits (e.g. X% of income on total disablement) and the contingencies on which they are paid (e.g. the definitions used for disablement).

3 FSC 2014-18 Disability Income study

APRA has become so concerned with the prudential risks that this situation poses that it has intervened in the market. See APRA views here: https://www.apra.gov.au/news-and-publications/apra-intervenes-to-improve-sustainability-of-individual-disability-income.

Actuaries Institute's Target Outcomes

The Actuaries Institute is seeking a series of changes in the industry so IDII will **sustainably** provide:

- Products that perform as expected by customers, with features that, compared with the present situation:
  - better meet their needs without frills, and reflect their insurable interests – both on policy inception and subsequently, and at individual and community levels; and
  - provide more certain outcomes and are more readily understood.
- Prices for customers that are more stable and predictable over time, better understood and more consistent with underlying risk, compared with the present situation;
- Product features and underwriting that a) promote alignment between customer and insurer through appropriate consideration of each customer's insurable interests[4], and b) support loss minimisation[5] at time of claim;
- Financial outcomes for insurers that ensure a sustained ability to pay claims and that are sufficient to ensure insurers will continue to compete and provide valuable IDII products to the market; and
- Community confidence as to the enduring value and fairness of disability insurance.

Note: In this document, the words *sustainable* and *sustainability* should be read in this context.

The aim of the Actuaries Institute is to objectively and analytically assess the many factors at play in the retail IDII market with the aim of effecting significant change – either by directly making changes where it can or by driving change through reason, influence and transparency.

Actuaries Institute's Process

The Institute established the Taskforce to identify where critical reform is needed. Members of the Taskforce have many years of experience in the industry, in a variety of positions in life insurers, superannuation funds, reinsurers and regulators. Their experience covers positions in senior management, on insurance company Boards, as regulators, and in technical roles (such as appointed actuaries, chief risk officers and product managers).

The Taskforce has drawn on the skills and experience of nearly 50 actuaries to support its work. This resulted in a series of observations, assertions and questions. These were captured in a Discussion Guide which, as the name suggests, was used as the basis of discussions with many different participants in the IDII ecosystem. The observations and assertions were tested in these discussions and the views of interviewees taken on board for further consideration.

The Taskforce engaged with representatives of all parties who play a role in the performance and effectiveness of IDII. The primary means of engagement took the form of interviews based on the Discussion Guide. The Discussion Guide was provided in full to all interviewees.

4 'A person or entity has an insurable interest in an item, event or action when the damage or loss of the object would cause a financial loss or other hardships.' In this case, the insured asset is future income. See https://www.investopedia.com/terms/i/insurable-interest.asp for more detail

5 An important principle of insurance is that the insured must act to minimise the loss once the insured event occurs

Those interviewed included representatives from:

- Senior people at ASIC, AFCA, and (together) the Financial Rights Legal Centre and the Consumer Action Law Centre
- Non-executive directors
- CEOs
- CROs
- Appointed Actuaries
- GI industry specialists
- The life insurance task force set up by FPA and AFA, involving senior executives and adviser representatives
- Product rating houses
- The FSC Life Board Committee
- Claims and underwriting professionals
- A member of a law firm with deep experience in consumer life insurance claims
- A benchmarking consultant to the life insurance industry
- Treasury

In addition, there was a workshop with APRA. APRA also has participated as an observer on the Taskforce, as has the Financial Services Council.

Throughout this paper, these participants in the IDII ecosystem, are referred to as **Participants**.

The Taskforce also reviewed the professional guidance for actuaries advising on disability income insurance business.

Nature of Feedback received from Participant Interviewees

The feedback from the different Participants and from interviewees representing those Participants varied in its focus. Not surprisingly, some tended to pay attention to the sections of the Discussion Guide which were of most direct relevance for them, but comments from others (the non-executive directors were one such group, for example) ranged widely over the subjects addressed in the Discussion Guide, and beyond.

There seems to be widespread acceptance that the IDII market is 'broken' and substantial changes are needed.

In general, the interviewees strongly welcomed the work of the Taskforce and its target outcomes (as set out above), and there is high hope that the Taskforce work will be a catalyst for the changes needed.

There was widespread, but not complete agreement with the points made in the Discussion Guide. While the Taskforce did not necessarily agree with all of the counterarguments made, there were many points raised in the interviews which have influenced the position of the Taskforce.

There were numerous interesting and insightful comments made in the interviews, but it would have been unworkable to capture all of them in this document. Rather, selected comments have been drawn out to give a feel for the overall response.

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Insights from General Insurance

A number of people have expressed a belief that the life insurance industry could learn from developments in general insurance over the years. The Taskforce sought insights from general insurance and its coverage of disabilities through workers compensation and compulsory third-party insurance, both of which provide cover involving financial compensation for disablement.

The Taskforce had discussions with a number of actuaries with deep experience in these areas. One interesting insight is that the rules governing these types of policy have undergone significant change every five to ten years, with the changes often aimed at more sustainable outcomes and more affordable premiums. This is in stark contrast with IDII where changes generally have been to add benefits, which gives some context for APRA's proposal to expect IDII insurers to preserve the right to update terms every 5 years.

However, the experience with workers compensation has not been without controversy, with accusations that claimants have not been treated fairly, and that the financial outcomes of the schemes may be problematic. The life industry may be well-advised to monitor and understand this situation closely to learn from both positive and negative outcomes.

International Comparisons

To get a broader perspective, the Institute commissioned KPMG to compile a research report Disability Income, *An International Comparison*[6], to help inform the debate about changes needed to bring about a sustainable long-term solution that supports consumers. That report found the Australian retail market offers more comprehensive IDII cover to a broader range of occupations and target markets and with fewer risk management controls than the US, UK and South Africa. Australian IDII products have more features, higher benefits relative to income, longer benefit periods and shorter waiting times than products on offer in the US and UK. Another issue raised in the report is the greater rate of rehabilitation support typically provided in other markets, whereas it is substantially limited in Australia by legislation, and the strong return to work focus in other markets.

Final Steps

Through this document and associated presentations and other documents (see below), the Taskforce is communicating its position on many aspects of the IDII ecosystem that need change. This document is part of the final consultation process and the Taskforce is now seeking comments on its findings and recommendations.

Once it does finalise recommendations, the Taskforce intends to work with the various Participants to seek to have the recommendations implemented.

Scope

Existing IDII Policies (in-force business)

The work of the Taskforce has focused on future products and associated practices. While many of the findings and recommendations will be relevant for older IDII products with policies currently owned by customers, some will not. For example, the nature of the guarantees inherent in life insurance products (some driven by legislation) are such that changes in some areas are not possible.

The Taskforce expects that its recommendations will be adopted where possible and relevant for in-force policies.

6 See this report commissioned by the Actuaries Institute from KPMG: https://www.actuaries.asn.au/Library/MediaAndPublicPolicy/2020/DIPaper03022020.pdf

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Other Products

Many of the issues with IDII are also relevant for lump sum Total and Permanent Disability and Trauma benefits. However, IDII is more complex and has caused more problems than lump sum benefits, and so the initial focus of the Taskforce is on IDII. Many of the findings and recommendations from the work covered by this report will be applicable to lump sum products. In the meantime, a separate working group of the Actuaries Institute has prepared a discussion paper on sustainability of lump sum products.

A Comment on Insurance and Society

As a general principle, insurance helps the community to function by contributing to the management of risks. It is in the interests of the community that effective, well-functioning insurance is readily available for those who have a need for it.

One important risk is the possible loss of income while unable to work because of physical or mental incapacity. Many members of the community have a need for IDII to cover this risk, e.g. the self-employed, small business owners, professionals and many employees. It is in their interests that insurance is available that meets their need for cover, provides clarity and understandability of benefits and is at an affordable price with relatively stable premium rates.

Given this role in society for IDII, customer and community interests should be centre-stage in its development and provision. Any limitations on the industry, imposed by regulators or otherwise, should have similar considerations.

Context

At the time of this paper, the whole of the life insurance industry in Australia is subject to a number of substantial stresses and is undergoing a series of substantial changes beyond the IDII business issues. These include:

- Material change in ownership of life insurers and subsequent industry consolidation;
- Substantial reduction in distribution capacity, due to:
  - regulatory and community expectations with respect to direct products;
  - ongoing decline of business through financial advisers (due partly to regulation, bank channel exit, and changes to the adviser business model);
  - because of legislative change, reduction in members covered automatically via group life insurance in superannuation funds.
- The evolution of society and the Australian economy; the displacement of many jobs by technological and other developments; population ageing; health and medical evolution and dynamics; and the nature of risks consumers want and need to insure.

Much of this is resulting in an industry that at best is struggling to grow and to remain profitable.

In addition to all of this, COVID-19 is disrupting society around the world in many ways. Its full impact on life insurance in Australia is yet to be understood, but it could be profound. The economic damage and changes to society wrought by the virus are likely to have implications for death and disablement experience and policy discontinuances. It is unclear how great this will all be or how long its impact will be felt. All of this most likely will only add to the issues considered in this report but is certainly not the cause of the problems. The Taskforce has therefore chosen to not consider COVID-19 specifically in its work. However, readers may conclude that the changes proposed here have not come soon enough to protect customers and the industry from further pain.

Taskforce Output

The Taskforce has produced written output as follows:

- This document on **Provisional Findings and Recommended Actions**;
- A draft **Sustainability Guide**, which sets out good practice for sound prudential insurance management, including a Sustainability Heat Map; and
- An outline of a **Reference Product** (for purposes of prudential management of risks and uncertainty inherent in IDII).

The Taskforce has given two presentations via webinar. The first was a closed session for the actuarial profession on 28 May 2020, which was an update on the Taskforce work. The second was more recent – 4 August 2020 – at the Actuaries Institute Virtual Summit, which was open to a wider audience. This latter presentation covered much of the written content outlined above, though necessarily in abbreviated form. In September 2020, the documents above were issued for consultation with all of the Participants in the IDII ecosystem. Depending on the response, this may be supported by a further webinar.

The Taskforce will issue final versions of the documents once it has completed the consultation about the documents.

The interviewees generally supported the outcomes set out in Actuaries Institute's Target Outcomes section.

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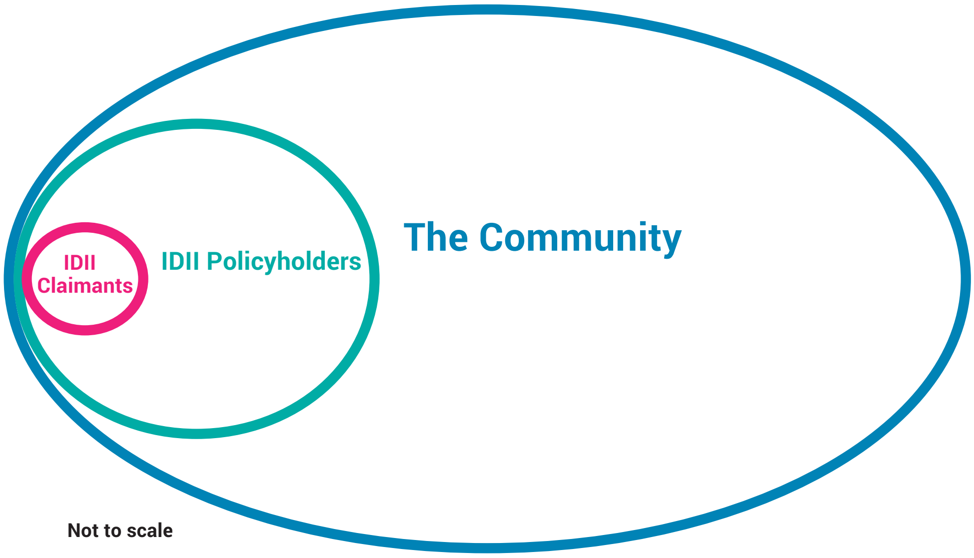
3 Customer and Community Interests

The Taskforce was concerned that the concept of pooling of risk as an inherent feature of insurance was not well understood by all Participants in the IDII ecosystem; in particular, the link between claims experience and ultimate premium rates charged.

The following diagram shows the concept of pooling, with an explanation as to the operation of pooling set out below:



Most fundamentally, premiums charged to all policyholders are used to pay benefits to claimants. Thus, an appropriate balance is needed between the benefits paid to claimants and the costs to all policyholders. The community also has an interest in benefits paid to claimants. If insurance is too expensive, then fewer people will take out insurance and the cost to the community of sickness will be borne in other ways.

This means that if IDII benefits are liberal in the sense that they go beyond indemnifying the person for financial losses, are of an unnecessarily high amount, cover minor complaints or do not require the life insured to minimise the loss then there are negative consequences for policyholders and the community. For example:

- For the many customers who don't make a claim: their premium rates will be higher than necessary, and potentially those premium rates may be subject to unexpected increases as the full consequences of liberal policy features are felt by insurers over time;
- For consumers en masse (the community): if fewer people who need the cover take out or continue insurance because of its costs, the community will bear the brunt of the financial consequences of this (e.g. through small businesses closing down, increased social security costs, other community support costs, and likely consequent higher taxes);
- For consumers en masse (the community): if fewer people return to active employment as a result of being incentivised to stay on claim by liberal benefits, a drag on productivity will emerge as well as a drain on care and other support offerings; and

- For those consumers who claim on the liberal benefits there can be longer term adverse consequences for them from delayed return to wellness and work. For example, decline in mental health, loss of confidence and self-worth.

The fact that a policyholder may pay premiums (potentially for many years) and not ever make a claim should not be seen as an indication of poor value. There is inherent value in the protection provided by insurance – and so, for example, people readily pay for house insurance every year and hope they never make a claim.

Quite a few interviewees embraced the ideas here and felt that there would be real benefit in wider understanding of the concepts amongst all Participants in the ecosystem, particularly in providing more insight into fairness. In general, the Taskforce gained comfort that these concepts were reasonably understood and accepted by most interviewees. However, there were some who did not fully accept the arguments, or who did not give them much weight.

Recommendations

3.1 Improve Participant understanding of insurance pooling concept

Insurers, the **FSC** and the **Actuaries Institute** should proactively take opportunities to discuss and explain the insurance pooling concept with regulators, politicians, consumer advocates, media and customers.

In addition, the **FSC** and the **Actuaries Institute** should produce a public statement about fairness in life insurance as a reference.

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4 Consumer Protection and Advocacy

The law, supported by industry codes of practice and the practices of individual insurance companies, offers policyholders considerable support and protection against poor treatment by insurers. Notwithstanding that position, a small proportion of individual customers can and do suffer from poor or unfair treatment. This is particularly important with respect to claims under IDII policies, where there can be a qualitative aspect to claims assessment.

Some interviewees (e.g. CROs) commented that the market has continued to design products with inadequate attention to the interests of the end customer. The Taskforce gained particular insight into a consumer perspective from three parties with extensive experience supporting consumers in disputes with insurers and have exposure to poor customer experiences with claims processes[7]. The Taskforce also looked to better understand the attitudes of the parties themselves.

The three parties were:

- The Australian Financial Complaints Authority (AFCA).
- Two consumer advocacy bodies – Financial Rights Legal Centre (FRLC) and Consumer Action Law Centre (CALC) – interviewed jointly.
- A lawyer specialising in the field of advocacy for insurance claimants.

These discussions were very constructive. All parties showed a strong understanding of the issues with IDII but were also able to give insights into examples of poor treatment of customers. They expressed a view that insurers needed to improve their claims handling and the way claims outcomes are communicated to claimants.

Contrary to views expressed by some interviewees, the Taskforce found that these groups had an appreciation for the concept of pooling of risk in insurance (see 3 Customer and Community Interests above). One interviewee commented that it is hard to expect claimants to think in the interest of the pool when insurers are profit-oriented.

Some views expressed in the various discussions included:

- There may be merit in standardising some policy terms and conditions (note: the Taskforce believes that this could stifle innovation and previous attempts at standard definitions have acted as minimum definitions and, as such, failed to achieve the objective);
- There may be benefits in reducing product complexity;
- Medical advances may benefit the industry as much as it disadvantages;
- Inadequate sales processes and commission structures also drive premium increases;
- It may be more appropriate to use treating specialists to assess disability than other professionals;
- Insurers need to be clear on their promises to consumers. If the product provides cover against heart attack, the definition should be updated over time to ensure that the promises are met.

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7 Insurers often monitor customer experiences using average figures. The Royal Commission and other recent experiences have strikingly demonstrated the importance of the variations in customer treatment and the value of working on improving the poorest outcomes.

Further details of the different parties and key issues through the discussions are set out below.

AFCA

AFCA has several roles in the IDII market, including dealing with complaints not resolved by the individual insurer, interpreting policy wording and applying considerations of fairness. In this context the Taskforce reviewed the consumer perspective of the perception and understandability of IDII products.

The Taskforce had formed a view that the terms and conditions of life insurance policies can be lengthy and drafted to be as precise as possible in a technical and legal sense. However, some of the conditions for payment of benefits cannot be precisely or scientifically described, particularly considering changes in expectations of society and advancements in medical diagnoses and treatments. In addition, the assessment of many claims inevitably involves qualitative considerations.

Therefore, the Taskforce believes there is a risk that consumers may not have a detailed understanding of what they are covered for and the insurer's expectation of them to minimise the financial cost of their claim.

The Taskforce further explored the perception of some Participants that AFCA favours individual claimants whenever there is doubt about how to interpret an insurer's precisely defined terms and/or the qualitative aspects of assessing claims. AFCA made clear that their approach is designed to achieve fairness for both parties and restore trust in the industry.

Consumer Advocacy Bodies (AFRC, CALC) – CABs

The CABs deal with complaints about claims and unexpected premium increases. Discussion covered their experiences with these customers (who tend to be on lower income), the strength of their preference to get back to work and other related matters. The impact of and allowance by insurers for the Disability Support Pension and how well IDII worked with the gig economy were also covered. It was apparent that notwithstanding the vast bulk of claimants are paid benefits expeditiously, there are some who have a poor experience.

The CABs had particular insights into the value of mental health coverage, based on the cases they see (including physical disability cases that develop an associated mental health condition).

The CABs noted the benefits of community-based, non-profit legal services, as long as there are cases where it is difficult to make a claim.

Lawyers acting for Claimants

Lawyers play a role in supporting IDII customers through providing legal advice to help the customer understand rights with respect to terms and conditions. In addition, lawyers acting as advocates for claimants in many cases play a valuable role in helping customers understand their rights and in making a claim. In other cases, lawyers inject themselves in the claims process through advertising and other promotion of their services.

The Taskforce formed a view that in some instances, there may be no net benefit for the customer in engagement with a lawyer, as the claim would have been readily paid by the insurer anyway. In these latter cases, the customer may be worse off financially because of the (sometimes large) payments to the lawyer.

Feedback from interviewees indicates that private lawyers may get involved in claims unnecessarily early[8] (i.e. before normal processes have been followed) to the financial detriment of the customer. The discussion with the private advocacy lawyer with experience in this field was interesting. Amongst various points made, they noted that IDII claims were often a 'by-catch' of lawyers pursuing personal injury business, and that fewer than 5% of IDII claims engage a lawyer from day one (noting that this percentage is higher for lump sum benefits).

8 FSC statistics show that this is of less concern for IDII than for lump sum business

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They felt that it was not workable to insist that a claim must be made and denied before a lawyer can get involved. However, involvement of lawyers can be problematic in various ways, and they strongly advocated for a code of some sort covering lawyers' involvement in life insurance claims.

Recommendations

4.1 Improve insurer insights into customer claim experiences

Life Insurers should engage with CABs, AFCA and selected customer advocacy lawyers systematically to gain ongoing insights into the extremes of customer experience. In addition, **Life Insurers** should update products to improve alignment between insurer and customers' expectations.

The **FSC** should publish case studies of customer experiences for the industry.

4.2 Establish a code of conduct for legal involvement in customer claims

The **FSC** should work with the appropriate legal professional body to develop a code of conduct setting out appropriate customer-focused conduct with respect to claims activity. In addition, the **FSC** should publish an outline of appropriate roles of various groups in the claims process (insurer, adviser, trustee, medical support, lawyers, complaints bodies, etc)

4.3 Defer standardisation of definitions

Life Insurers should use the Reference Product (as set out in Section 5) as an aid in balancing innovation and clarity with respect to definitions.

The **Actuaries Institut**e should review market practice regarding definitions two years after the introduction of the Sustainability Guide.

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5 Features of the Product/ Market

Product Terms and Conditions

It can be tempting to regard the problems besetting the IDII market as largely a function of the product terms and conditions: fix the product and the problems will be addressed.

The Taskforce strongly believes that the problems are more deep-seated and diverse than this suggests. However, it does consider that certain current features of product design cause major problems, and they must be addressed. Supporting this, the Taskforce has spent considerable time on product design and associated risk management and governance.

The interviewees made numerous references to product design. One point of contention was whether mental health should be excluded or limited to 2-year benefit periods. The Taskforce concluded that mental health must be covered because (i) it is an important consumer need and (ii) its exclusion would likely fail to meet community expectations. Ultimately, however, this is a decision for each insurer. For example, an insurer might produce a product with mental health conditions as an add-on option at additional cost.

The result of the Taskforce's product work is the concept of a Reference Product (**RP**).

The RP is intended to be a tool to help with the prudential management of IDII business through better assessment and management of the risks and uncertainty inherent in IDII. It is not intended for marketing purposes. The RP aims to deliver on the principles of insurable interest and loss minimisation. It is not intended to achieve the 'ultimate' in sustainability; rather deliver more consistent outcomes for both the customer and insurer in a range of potential future social, regulatory and economic scenarios. The Taskforce found that interviewees generally provided in-principle support for a RP.

Now that the RP concept has been fleshed out, the Taskforce is seeking more detailed responses from the Participants and other interested parties.

Some broader matters with respect to product were addressed in the Taskforce deliberations, and these are considered below.

Competition has driven complexity

From a market and competition perspective, the Taskforce formed a view that Life Insurers have traditionally been distribution-led businesses with market approaches aimed at optimising the advice/ sales process – in particular the large majority of IDII is placed through financial advisers who are remunerated via commissions on IDII sales.

In this context, insurers have competed by adding features to maximise ratings and resultant support by advisers. Consequently, products are now overly complex[9] and not necessarily designed to meet the needs of end customers. Insurers also compete on price, often by offering price discounts which may differ by adviser or customer. Therefore, the Taskforce asserts that there are few available products that meet what might be considered 'core' disability income insurance needs.

The Best Interest Duties[10] (BID) may also create an adviser perception that there are compliance risks in not recommending as comprehensive a product as is available in the market.

9 ASIC Report 413 made similar observations – see para 251(b) for example.
10 See ASIC Regulatory Guide 175 Licensing: Financial product advisers—Conduct and disclosure: RG 175.242 and following sections

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Furthermore, IDII products are typically purchased as part of a bundle of life insurance products recommended by an adviser. There are potential overlapping benefits across some of these products and more so when considering other sources of financial protection such as health insurance, workers compensation insurance, some general insurance products and group life insurance. As a result, the product and potentially the sales processes appear to no longer give enough weight to limiting benefits to the insurable interests of the customer.

The Taskforce believes that it is very difficult for customers (and advisers to a lesser extent) to understand their policies, and misunderstandings can develop. The risks and uncertainty inherent in disability coverage need to be much better understood, communicated and managed.

There was little disagreement by interviewees with these points. Indeed, there were strong supporting views, with some frustration that the industry has allowed this situation to develop. At the same time, there was a lot of support expressed for advisers in this context.

CEOs interviewed noted that the product has lost the principle of indemnity and has become too feature-heavy, and that too much capital had been invested in a market with a relatively small base. In contrast, views were expressed that the insurers had failed to invest adequately in systems, data collection etc., and this was a contributor to the problems, particularly with regard to assessing uncertainty.

Product manager interviewees noted past cross-subsidies between lump sum and IDII products and that this could not be relied on in future. They also felt pricing had not been forward-looking enough e.g. not sufficiently allowing for trends. This has led to the growing importance of back-book management, and that consistency between back-book and new business could be challenging and could compromise competitiveness.

Claims and underwriting interviewees queried whether, in light of the way competition has driven behaviour, the standard underwriting terms remain appropriate.

See Section 8 Financial Advice for further commentary on this matter.

Effect of Guaranteed Contract Terms

One particular feature of the life insurance market – long part of normal practice and supported by the requirements of the Life Insurance Act – is the long-term nature of the insurance contract and the nature of its terms.

Product terms and conditions – in particular, benefits and associated definitions – are guaranteed for the term of the policy. This is often decades after the issue of the policy, when the terms and conditions may no longer be appropriate. This guarantee is a requirement of the Life Insurance Act. Policyholders can optimise their position through their right to cancel their policy at any time. If their circumstances change or they are able to find better terms (benefits or price) with another insurer then they may terminate the contract. On the other hand, insurers are able to change premium rates for existing policyholders (for all policyholders with the product, not selectively for individuals) to take account of changing claims experience (for example).

The view of the Taskforce is that premiums charged to customers do not reflect the theoretical cost of the guaranteed product terms. Instead, insurers may rely on the right to increase premium rates in future to manage the effect of the guarantees through time - charging an extra premium in place of the right to vary premium rates is likely neither realistic nor practical.

Furthermore, during the lifetime of policies, significant changes occur to the economy, medical technology and society generally. This can materially impact the cost of the product over time – however the Taskforce's view is that the overall cost of these issues is not necessarily covered in premium rates.

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It was recognised by most interviewees who commented that this cocktail of factors may have been workable in the past when markets and products, and community expectations and social norms were quite different. However, it now creates great uncertainty for both customers and insurers:

- For customers the premium rates may increase quite significantly beyond what they may have expected at policy onset, and benefit terms and conditions may prove in time to not respond in the way they would hope, given then prevailing medical and societal conditions.
- For insurers the claims experience can become increasingly difficult to accurately predict, which in term can result (and has regularly resulted in practice) in large financial losses. At the same time, they may be unable to keep their product up to date in a way that the policyholder might expect.

There were views that the current practice of providing long term guarantees of policy conditions in a rapidly changing world was in effect providing a one-way option to customers and no longer workable. Indeed, APRA has recognised the high levels of uncertainty associated with long-term guarantees as a prudential risk for insurers (see its letter[11] of 2 December 2019). Its proposal to have 5-year contracts with guaranteed renewability on updated terms has resonated with many interviewees. There was quite a lot of support for this APRA proposal, including by CEOs. There were also some reservations about how customers would be protected at the 5-year rollover, and this would need careful consideration by insurers.

Some interviewees considered the Life Insurance Act should be changed to allow more flexibility than it currently does with respect to possible changes to policy conditions during the policy term. It is worth noting that the Act was compiled at a time when the products, distribution, regulation, alternative savings vehicles and other factors were very different to today. Arguably it needs to be brought up to date.

There were views that guaranteed benefits had not been priced appropriately in that there was little provision made in pricing for future adverse experience, and so that risk fell to the wider body of policyholders through increases in premium rates. Some believed that pricing approaches for these products tends to take an 'optimistic' view of uncertainty and, all too often, rely on product repricing rights to compensate.

A balance is needed between the upfront price competitiveness of the product and the risk that customers bear an unexpected higher cost in future. This balance is one for the insurer to determine as a matter of *pricing philosophy* and to convey appropriately to customers. For example, an insurer might have a policy that all of the costs of any claims at levels over those anticipated in the premium rates should fall back to customers. Another might make some provision for certain random variations to be carried by the insurer. In any event, the pricing philosophy should be clear, and every effort should be made to help customers understand potential variability in premiums. The Taskforce considered that pricing philosophies of insurers are unclear e.g. how uncertainty is dealt with, effect of discounts, expected pricing stability etc.

Application of the loss minimisation principle

An important principle of insurance is that the insured must act to minimise the loss once the insured event occurs. This is more explicitly recognised with general insurance and generally has not been specifically applied in life insurance policy contracts in Australia. There is an argument that the principle should be specifically included in an IDII policy so that the claimant has a clear obligation to take reasonable steps to minimise the period over which benefits are paid to them – and for example, avoid striving to return to work with appropriate treatment and rather continue to claim benefits.

11 APRA letter to life insurers: https://www.apra.gov.au/sustainability-measures-for-individual-disability-income-insurance

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The Taskforce formed a view that the principle of loss minimisation is not operating effectively in the industry. The Taskforce believes that individual customer circumstances resulted in financial loss varying significantly across customers and objective loss assessment is difficult. The Taskforce asserts that this uncertainty has been exacerbated by liberal product terms and high benefit amounts. Complexity of products has resulted in limited customer understanding of claimable events and what is expected of them by insurers to minimise the insured loss while on claim. IDII policies often provide excessively high benefits relative to normal income. This is fundamentally poor insurance practice that ultimately drives up claims costs for insurers and premium rates for customers.

In addition, claims can sometimes be notified to the insurer many months or even years after the disability commences. This can make the fair assessment of a claim challenging and largely removes the opportunity for the insurer to assist the customer minimise the insured loss. It should be in the interests of both customers and insurers that claims are notified early, considered expeditiously and strategies put in place to speed recovery of the customer to minimise the insured loss.

The interviewees generally agreed with the Taskforce's views. There was support for the loss minimisation principle to be clearly articulated and applied. However, there were differences in opinion about the community's expectations and whether the drive by insurers for growth has contributed to this situation.

There were a number of views (e.g. amongst the directors who were interviewed) that this idea should be addressed specifically in policy documents and PDSs. On the other hand, Rating House interviewees, for example, had reservations about introducing specific obligations.

On balance, the Taskforce considers that insurers should structure cover to provide a financial incentive for loss minimisation and include a clause in policy documents which makes clear that there is an onus on claimants to do what they reasonably can to get themselves back to work. This is in the interests of *all* customers as it will help push down costs of claims in a fair and reasonable way.

Discounting Practices

Some insurers offer discounts for the first policy year, which has the effect of making the price appear cheaper. It also encourages a focus on the short term for what is a long-term commitment. This adds to pressure for customers to discontinue their policy as the cost rises quite heavily, with adverse impacts on insurers and, ultimately, customers.

Level Premiums

The majority of IDII business is stepped premium - that is, premium rates increase each year as a function of increasing age. A less popular alternative is level premium, where the premium rates do not increase each year as a function of age but remain flat. However, the fact that level premium rates are not guaranteed is neither well understood nor the 'unexpected' premium rate increases well received by the market. The industry needs to address this.

This issue is raised here as it illustrates how inadequate communication (both at point of sale and ongoing) can cause issues with fairness – perceived and real.

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Recommendations

Note: Where Life Insurers are indicated as the responsible party, the Board should closely oversee the implementation, to ensure that management is not diverted by other incentives.

5.1 Introduce simpler and cheaper product alternatives

Life Insurers, without necessarily changing the use of financial advisers or making other changes to distribution, should:

- thoroughly investigate consumer preferences for features/price trade-offs and introduce simpler/cheaper product alternatives; and
- produce products suited to different market segments – with one outcome being clearer differentiation on benefits and on cost. Note: ASIC's DDO should support such a shift in focus.

5.2 Develop simpler explanations around what is and not covered

Life Insurers should develop succinct and accessible ways to simply explain what is and is not covered – not just at inception, but continually during the policy period. This would complement the policy document and/or PDS.

5.3 Improve communication, understanding and management of risks and uncertainty

Life Insurers, **Actuaries**, **Product Managers**, **CROs**, **CEOs** and **Boards** should adopt the Sustainability Guide in addressing risks and uncertainty.

5.4 Impose strong controls on level of benefits and income replacement ratios

Life Insurers should impose strong controls on level of benefits and income replacement ratios, using the Sustainability Guide and Reference Product. In addition, **Life Insurers** should ensure any ancillary benefits compensate for financial loss and do not provide a windfall for the claimant.

5.5 Improve Guaranteed Contract Term management

Life Insurers should avoid overly long-term guarantees and use the Sustainability Guide as a reference.

Life Insurers and the **FSC** should devise protection for policyholders to ensure fair treatment at rollover (e.g. incorporate broad intent in original policy for use at a 5-year rollover point)

5.6 Embed Loss Minimisation Principle in policy contracts

Life Insurers should embed in policy contracts an obligation for claimants to undergo all necessary treatment and support to return to work, as reasonably required by the insurer.

Subject to legal impediments, **Life Insurers** should embed in policy contracts incentives to notify the insurer of a claim within a reasonable period of incapacity commencing.

continued >

12 Design and Distribution Obligations: https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-325-product-design-and-distribution-obligations/

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5.7 Improve data quality

The **Actuaries Institute** should issue specifications for data which are necessary to support sustainability and which insurers should gather.

The **FSC** should include data requirements (as per specifications from Actuaries Institute above) in FSC standards.

5.8 Improve communication of Pricing Philosophy

Life Insurers should ensure their pricing philosophy is clearly articulated internally and signed off by the **Board**.

5.9 Improve understanding of Level Premium business

Life Insurers should conduct research as to current understanding and expectations of advisers and customers of Level Premium business, and include clear explanation and examples in Product Disclosure Statements, Annual Communications etc.

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6 Life insurance company governance and management of IDII

Many of the problems besetting the IDII market have been apparent to the industry for a number of years, although adverse outcomes for customers and insurers have become more significant in recent years. At first blush it is difficult to accept that governance and management of the IDII business line has been a success. This is not to suggest that Boards and management have been anything but diligent – rather, that better practices must be developed and implemented for this business line.

The view of the Taskforce is that the behaviour of the industry has been to prioritise distribution and top line growth. Insurers have inadvertently under-estimated the impact of uncertainty inherent in contemporary IDII long-term products with guaranteed terms. There also appears to be an implicit assumption on future economic growth and rising inflation and interest rates to mitigate any claims deterioration – this has not occurred and low wage growth and interest rates and pressure from changing societal expectations has continued.

As set out in Section 5, the Taskforce also believes there has been an over-reliance on the ability of the insurer to increase premium rates to offset any unfavourable experience. The apparent willingness of reinsurers from time to time to provide very attractive pricing has exacerbated this. Insurers have not pro-actively invested in building an understanding of these complex products (through better systems, data, analysis etc.).

There was no significant disagreement with these points in interviews with Participants. Some interviewees had strong views to the effect that uncertainty with IDII outcomes had not been well-conveyed to Boards and/or Boards had not necessarily understood the significance of the issue.

The Taskforce sought views as to whether risk management and governance practices of insurance companies have been adequate to manage the current issues. There were differing perspectives on this, with views ranging from strong belief that this must have been the case through to the feeling that it would have been difficult to do better in the circumstances.

The Taskforce believes that it can take a long time for issues to emerge after decisions about products and business acquisitions are made. In this context, remuneration may drive behaviour and focus of management towards shorter term outcomes and on sales.

Board Directors Perspective

The Taskforce believes that Boards may not be receiving adequate information and analysis from management with respect to IDII products and what drives sustainable performance. Given also the extent of change and disruption in the Life Insurance industry, it is difficult to ensure all issues are getting due attention and regard at Board level. These factors would make it difficult for Boards to understand the extent of long-term guarantees being provided to customers and the risks inherent in these guarantees. In addition, it may be difficult for Boards to form a view on the uncertainty in the costing of various product features and more broadly ensure appropriate risk appetite statements particularly for insurance risk.

Given these issues, it was the view of the Taskforce that it would be extremely difficult for a Board to assess the sustainability of the product, and in particular determine the trade-off between the adequacy of today's premium rates and risk that premium rates will need to be increased in the future.

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The issues would also impact the effectiveness of advice provided to Boards (e.g. from Appointed Actuaries, CROs).

The directors interviewed offered a range of views, with some broadly agreeing and others less so.

There was concern about the boundary between Board and management responsibilities, and whether Boards may be pushed further into management territory in seeking solutions to the present problems. That is not the view of the Taskforce, but rather more of a query whether Boards were getting enough of the right information and whether oversight practices were adequate given the industry experience.

There was recognition that the sheer complexity of life insurance posed a challenge for directors. The Taskforce believes that life insurer Boards need adequate experience and deep understanding of life insurance to hold management to account for sustainable outcomes.

The CEOs perspective

CEOs have ultimate responsibility for the financial performance of the IDII portfolio and the customer experience. CEOs are also responsible for ensuring that Boards receive the necessary information and advice to appropriately govern and set direction for management. CEOs play a critical role in the culture of the organisation, and in overseeing the 'airtime' that different matters receive including distribution / top line growth, product sustainability, attitude towards uncertainty and investment to improve understanding and reduce uncertainty. CEOs are accountable for articulating the target state of their organisation.

The Taskforce formed a view that CEOs would benefit from support to calibrate and monitor these settings in their organisations – this includes the idea of an industry best practice guide to assist in developing and maintaining the organisation's target state across the above matters.

Generally, most CEOs interviewed agreed with the key themes regarding the challenges facing the IDII market. Other key points from the discussions included:

- There was consensus that Boards do not have the information nor should they be expected to have the knowledge necessary to make decisions needed to fix the current issues.
- There was a high degree of ownership evident amongst the CEOs for industry taking action immediately and support for Actuaries Institute initiatives.
- Most agreed that the actions APRA has taken will help guide the IDII product in the right direction.

Some CEOs felt that Boards would benefit from a broader view of all matters relating to a particular product, such as scenario analysis, rather than just price, product design and ROC. They also considered that Boards are generally presented with consolidated profit figures and this did not help in understanding of IDII.

The CRO Perspective

There were views amongst CRO interviewees that discussion at the Board needs improvement. There were feelings that:

- Boards are too focused on financial risks and not enough on non-financial risks. There is more development needed on the latter by the industry and more focus on strategic issues, and less on numbers);

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- There is too much focus on growth, instead of sustainability, noting that growth may enhance risks at the margin;
- Closer engagement with management and staff outside senior ranks is needed.

CRO interviewees also felt that the industry has an immature product governance and approval process – product changes tend to be driven by one or two individuals (product managers) with inadequate consideration of the views of others. They felt better product management is needed, with more analysis of whether products remain suitable once sold, and product performance information is inadequate. Accountability for poor performance also seems to be unclear.

Product manager interviewees felt that both directors and senior management should have stronger understanding of the IDII product and its risks (though this position is improving).

CRO interviewees generally supported APRA's recent intervention in the IDII market, recognising they were using a blunt instrument in doing so. They felt this was only the start of what was needed to get to a sustainable state, and that product design alone was not the answer (as the industry will find ways around standardised elements).

Product Management

Product Managers are responsible for the overall design and specification of the IDII product – features and their competitiveness, distribution, underwriting, product administration and claims management. However, Product Managers are often at least indirectly rewarded for front end performance of the product in terms of sales. If products are designed in this context, the result could be that products are not necessarily most appropriate for customers.

The view of the Taskforce is that this could cause less focus to be placed on long term sustainability of the product than might otherwise be the case. In particular, customer-centric design is usually an aim, but can be compromised due to competition and distribution channel needs. Competitive terms and price can therefore be prioritised over long term sustainability of premium rates for consumers.

The Taskforce interviewed a number of product managers with considerable experience with IDII. They disagreed with the suggestion that they focus on sales – rather they focus on competition and distribution needs, in line with the job description.

They also argued that the issues with IDII are not just with product design (which incidentally is also the position of the Taskforce). Some product managers were critical of the actuarial advice they received.

There is general agreement amongst management that data needs to be improved significantly, and the industry needs to do more research and analysis. This is consistent with the Taskforce view that product managers would benefit from guidance from the broader organisation on how to trade off the often-competing factors that currently result in decisions that do not support sustainable practices in the long term.

Adviser interviewees were quite critical of industry management and governance, referring to industry experience in recent years as support for their views.

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Recommendations

6.1 Review Board composition

Boards should review their capabilities and bolster life insurance experience to target at least two or three directors with deep operational life insurance experience (recognising that this should not come at the expense of appropriate Board diversity); or ensure regular Board access to independent expert advice.

6.2 Review Board information

Boards, **Actuaries**, **CROs** and **CEOs** should adopt the Sustainability Guide, including Heat Map and assessment against Reference Product, and incorporate in formal reporting to the Board.

6.3 Shift focus to customers

Boards, **Actuaries**, **CROs** and **CEOs** should shift Life Insurer focus (via reporting, performance, remuneration etc) to obligations to customers – product, services and practices – over the long term.

6.4 CEO and Management Accountability

Boards should hold management to account for long term performance, hold formal post-implementation reviews for at least 5 years after significant product changes and ensure remuneration reflects uncertainties (with reference to the Sustainability Guide).

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7 Regulation and the Law

Australia has a comprehensive legal framework governing life insurance. This includes in particular the Life Insurance Act, the Insurance Contracts Act, the APRA Act, the Corporations Act, and the Unfair Contracts Act.

This legislation is supported by regulators – in particular APRA and ASIC - who impose regulation under the law.

The impact of the Unfair Contracts Act on life insurance (which was recently included within the scope of the Act) is not yet fully understood. Other significant upcoming changes include ASIC's product intervention power and Design and Distribution Obligations (DDO)[13].

Implementation of changes as a result of this review of IDII will need to be carefully considered in this context.

CRO interviewees felt that there was some tension between ASIC and APRA interests, with APRA tightening controls with a greater emphasis on the longer term and ASIC intent on the interests of the consumer and the short term.

APRA

APRA is responsible for oversight and supervision of the prudential soundness of the life insurance industry, which includes the IDII product. APRA is not a product regulator.

APRA has intervened in the market (letter to industry 2 December 2019) to protect the industry's prudential soundness with respect to the IDII product. APRA has proposed a series of actions it plans to take e.g. adding capital loadings while poor product practices are maintained. Furthermore, APRA's prudential framework requires adequate risk and capital management, which are critical pillars in the effective management of the IDII product.

The Taskforce has formed a view that risks for the insurer arising from IDII are unique and in some cases existing prudential standards may not be adequate to ensure risks are managed consistently across all stakeholders e.g. mandating the use of certain minimum IDII assumptions for capital purposes.

APRA has been an observer at Taskforce meetings and has had an opportunity to both comment on the discussions and challenge the Taskforce thinking. In place of interviews, APRA conducted a workshop involving a few members of the Taskforce.

In discussions with interviewees, APRA's intervention has mostly been welcomed. This is in recognition that the industry has been unable to deal with the problems with IDII. It was generally regarded by interviewees that APRA has used blunt instruments to achieve its aims. Some interviewees had views on how well some aspects of the intervention may work, and its capital impact.

ASIC

ASIC has several roles in regulating the IDII market, including consumer protection responsibilities, exercise of product intervention power, product design and distribution obligations (DDO) and adviser regulation, including Best Interest Duty (BID).

13 Consultation Paper 325: Product Design and Distribution Obligations https://download.asic.gov.au/media/5423121/cp325-published-19-december-2019.pdf

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The view of the Taskforce is that customer risks arising from IDII are unique and in some cases existing supervisory frameworks may not provide detailed guidance and direction to ensure risks are managed consistently across all stakeholders e.g. BID guidance for IDII does not have examples (for instance, to help in balancing features and price) and does not give regard for the impact on consumers of poor sustainability of IDII products.

Recognising the pooling issues discussed in section 3, if certain IDII products pay higher claims than originally envisaged, non-claiming customers will be subject to price rises to cover these unanticipated costs. In this context, the Taskforce view is that consumer protection outcomes should be considered across all customers, regardless of whether or not a customer claims i.e. sustainable IDII products will provide better value for all customers. The issue of unexpected premium rate increases could be exacerbated for consumers whose health may deteriorate and they are unable to transfer to a new (cheaper) product because they are no longer able to meet medical underwriting requirements for a new product.

Some other interviewees considered that ASIC has not really focused on the impact of the IDII product on the community but has rather concentrated on individual outcomes, especially around individual claims outcomes.

The Taskforce had a number of useful and constructive conversations with ASIC. Particular attention was paid to fairness to consumers and adviser BID.

An important overarching point that ASIC noted involved the merits of disclosure. ASIC pointed to research undertaken[14] which indicated some limitations in value of disclosure to consumers. This was raised in the context of possible publication of some sort of product rating, sustainability measure or a product classification measure (e.g. gold/silver/bronze). However, this understanding of disclosure has influenced the Taskforce in its thinking.

There was discussion about whether the upcoming DDO would help with the IDII situation because of the disciplines it would impose on insurers, and possibly lead to simpler products.

There also was discussion about the Best Interest Duty in RG 175, and in particular the issue of balancing price and features in advice. The Taskforce argued that the lack of examples for insurance in this context was a concern, as such examples may well lead to quite different outcomes of the advice process, with more emphasis on simplicity and low cost by insurers and advisers.

Treasury

There are a number of legislative issues which impact on outcomes for life insurers and their customers:

1. Payment of rehabilitation costs by a life insurer for an IDII claimant could potentially help the customer return to work more quickly. However, the law restricts the ability of life insurers to do this. This was explored in detail by a submission by the FSC to the Productivity Commission in 2018[15]. Appropriate changes to legislation would benefit both customers and insurers.

2. The Life Insurance Act was compiled in 1995 and has had limited amendments since then.

   The life insurance market was very different 25 years ago in almost every respect. In particular, the nature of the products produced and sold is very different indeed. Furthermore, technology, society and its attitudes and expectations have evolved enormously.

14 ASIC research on disclosure: https://download.asic.gov.au/media/5303322/rep632-published-14-october-2019.pdf
15 See FSC letter to Productivity Commission 22 May 2018

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Distribution of products has also changed dramatically. In 1995, tied agents were the primary means of distribution, whereas today independent financial advisers sell the great majority of IDII products. Group life insurance now covers more Australians than retail insurance and volumes of business through this avenue are now large.

The current Life Insurance Act, therefore, is not well aligned to the current products and circumstances of the industry, let alone the outlook of the industry and the future products it may need to issue and manage.

Section 48 of the Life Insurance Act deals with the requirement to give priority interests to policyholders. Its implications for the complexities and uncertainties inherent in IDII should be carefully considered, particularly in the context of the long-term sustainability of the IDII product being in policyholders' interest.

3. Most life insurers have a large legacy book of business. The Life Insurance Act does not allow a life insurer to make unilateral changes to in-force policies, other than to improve conditions for policyholders. This in turn means that it is difficult for an insurer to modernise products and potentially move policyholders with old products on to a newer generation product.

Treasury officials who were interviewed were aware of the pressures on the life insurance industry. The discussion was a helpful opportunity for the Taskforce to brief Treasury on its perspective (including potential changes to legislation etc), and for the Taskforce to understand Treasury's interest. There was agreement for ongoing dialogue.

Recommendations

7.1 Produce examples of application of Best Interest Duty (BID)

To help insurers, rating houses and advisers, ASIC should produce examples of application of BID, including the trade-off of features and price, for IDII (and other life insurance) and include in RG 175.

Pending **ASIC** provision of examples in RG 175, the **Actuaries Institute**, **FSC** and **FPA/APA** should produce examples of application of BID for IDII (and other life insurance).

7.2 Consider this report in deployment of DDO

ASIC should consider this report and its recommendations, how DDO may be deployed to address existing issues and advise industry accordingly.

7.3 Maintain APRA intervention

APRA should maintain the current intervention until such time as industry demonstrates a sustained improvement in practices and outcomes.

7.4 APRA should set expectations regarding the Sustainability Guide and monitoring

APRA should set expectations that insurers should either implement the Sustainability Guide (including use of the Reference Product) or put in place equally effective alternatives. APRA should also report back to each insurer their relative position vs peers.

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7.5. Review of the Life Insurance Act 1995 fitness for purpose

Treasury and **APRA** should review the Life Insurance Act fitness for purpose.

7.6. Improve understanding of s48 of the Life Insurance Act 1995

The **Actuaries Institute** should conduct training and discussion sessions on implications of s48 for IDII product design and pricing.

7.7. Review legislative impact of rehabilitation costs

Treasury should review relevant legislation after considering proposals in the relevant **FSC** submission and other consultation with industry.

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8 Financial Advice

As noted above, financial advice is critical for most IDII customers at the initial purchase, ongoing and at claim time. Dealer Group and Advisor bodies have an obligation to properly support the best interest duty (BID) regime. This includes appropriate consideration of price vs features – including the benefits of simplicity.

In a life insurance distribution context, advisers utilise Rating Houses for selection of products including supporting BID obligations. The view of the Taskforce was that the possible cost over the long-term of product features and guarantees is currently not able to be evaluated by advisers. This therefore may be to the detriment of customers through significant premium rate increases over several years.

The Taskforce also believes that product ratings currently give little weight to the trade-off between features and price, which may encourage the sale of the most feature-rich products with the highest ratings, with little regard to long term premium cost to the consumer. This can be exacerbated by the cost of long-term product feature guarantees not being priced into products upfront.

Various interviewees expressed views about financial advisers. Amongst interviewees from within the industry there was generally good support for advisers and the role they play in advising customers and distributing IDII. However, there were also strong views about the propensity to recommend the most feature-rich (and complex) products and commission driven behaviour.

Best Interest Duty

The BID is addressed in detail in ASIC RG 175. This covers all types of products, including superannuation, investment and insurance. ASIC has included in RG 175 examples of the application of the BID in various circumstances. As mentioned in Section 7 on Regulation and the Law there are no useful examples for life insurance. The Taskforce considers this omission to be an important factor in the way BID is implemented in practice.

The Taskforce believes that the interpretation of BID for life insurance has evolved over time and advisers tend to recommend the most feature rich policies and rely on Rating Houses to identify those products (see below).

Various interviewees mentioned this as a concern. Amongst other things, this practice tends to drive insurers to add features (and therefore complexity) to their products – in effect an 'arms race'. These additions are not necessarily driven by customer needs – indeed many customers most likely have only a superficial understanding of the full product when they buy it.

Importantly, there is provision in BID in RG 175 (see 246(e)) for product features to be balanced against price. There does not seem much evidence that this has had a significant impact on how BID is applied in practice. ASIC Report 413 also recognised this issue[16]. To be fair to advisers, insurance companies have repeatedly set prices for the products in market which in hindsight have proven to be too low, and not provided many lower-priced, simpler alternatives to the fully-featured product – again perhaps a function of the 'arms race'. Note that insurers have effectively supported this with their approach to adding features to score rating points.

Adviser interviewees felt strongly that advisers do address the trade-off between benefits and price appropriately. Furthermore, Adviser interviewees felt strongly that the lack of examples in RG 175 was not an issue of concern. The Taskforce notes this position but feels that there is no-downside and potential real benefit to be gained by including such examples.

16 See paras 182 and 251 in Report 413 https://download.asic.gov.au/media/2012616/rep413-published-9-october-2014.pdf

The Taskforce considers it to be very important that ASIC provide practical guidance by way of examples on the application of BID for IDII (and other life insurance). In particular, the Taskforce feels that it is critical that insurance examples are provided of BID in action. The Taskforce feels that in the absence of examples from ASIC, the Actuaries Institute should work with industry to provide examples.

Product Ratings

Ratings houses play a critical role in helping advisers review and select IDII products to recommend to their clients, particularly to support advisers meeting their BID obligations.

The view of the Taskforce is that rating houses provide product ratings based primarily on features of products. Given the complexity of IDII products however, there is a risk that rating frameworks do not consider long term risks and uncertainties for all stakeholders. Product ratings also appear to give little weight to price and/or the trade-off of features and price, nor the sustainability of premium rates. In turn, this may inadvertently encourage the sale of the most feature-rich products with the highest ratings with little regard to premium cost, ultimately risking providing inconsistent customer outcomes, either for claimants or the overall policyholder pool.

Given the focus on rating features, there appears then to be less focus on the value of the features placed on them by customers and their willingness to pay for them. The current process encourages numerous small features to gain points e.g. ancillary benefits only account for about 7% of claims but have a large impact on points. The current approach does not effectively help advisers assess the trade-off between features and price. To be fair to rating houses, there is limited published information on the value to customers of the benefits insurers continue to add in the ‘arms race’.

Rating House interviewees generally agreed with these views, but argued that:

- Product and pricing are separate dimensions, and the advisors are provided with information on both dimensions;
- Product ratings don’t drive recommendations – the advisor chooses the feature-rich product offered by their preferred providers;
- The rating houses do not drive complexity, the insurers drive it in order to compete.

There was one observation that rating houses rate on facts – they do not take a view on how to interpret BID.

Rating house interviewees felt that rating sustainability would be a difficult task and noted that they must take insurer’s pricing at face value. However, they expressed willingness to incorporate new measures and to work with industry to improve sustainability.

On the other hand, CEOs felt there was a need for sustainability to be addressed in ratings, with a policy lifetime view.

Product Manager interviewees thought that BID leads to advisers promoting and selling the most feature-rich products. They thought Rating Houses assess both features and price, but the difficulty comes when advisers have to weigh up the trade-off between price and features. They also thought ASIC needed to more clearly define BID for insurance.

Claims and underwriting interviewees felt that the ratings process has reduced their ability to manage product risk in favour of the sales process.

Adviser interviewees argued that:

- Rating houses are relied upon, but are not the only source for advisers.
- Pre-assessments of a client’s medical, occupational or pastimes history cannot be taken into account by rating houses.

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- Claims experience is not covered by rating houses but is a major factor in recommendations.
- Rating houses cover neither price stability nor guarantees, nor would it be straight forward for ratings houses to provide this service.
- Rating houses are considered an important factor but are certainly far from being the only consideration for Financial Advisers.

They also noted that the FASEA Code of Ethics is also relevant in this respect.

It is worth noting that rating houses are not regulated, however they have a profound influence on the regulated areas of products and advice.

Recommendations

8.1. Produce examples to support adviser interpretation of BID

See Recommendation 7.1

8.2. Make amendments to the product ratings process

Rating houses should amend the product ratings process such that:

1. The contribution of a feature to the rating is proportional to its value to the customer (in terms of claims payments).
2. In support of (1), rating houses require that insurers provide evidence of the value of all new features to the product. If evidence is not forthcoming, then provide no/low value in the ratings.
3. Rating houses discuss with the insurer their approach to the Sustainability Guide, form a view on their commitment to it and take this into consideration in the value score of features.
4. Rating houses encourage advisers to place a greater weight on long term product cost on the assumption that the consumer may be unable to switch product.

The **FSC** should publish claims data so that advisers can understand the relative value to customers of different benefits and definitions.

8.3. Issue guidance to Insurers regarding rating use

In the absence of any regulation of rating houses, **ASIC** should issue guidance to insurers and advisers on appropriate use of ratings in communication and promotion of products, and in advice to customers, to ensure a fair and effective system.

Commission

Financial advisers who sell IDII are mostly remunerated through commission on the sale.

Commission payments to advisers has been a contentious issue for some years. It was given consideration at the Royal Commission and in the Life Insurance Framework remuneration rules which came into effect at the start of 2018.

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The Taskforce has consciously not addressed the role of commission payments in the current project, given the heavy attention it has received previously and is likely to be given in the near term, post the Royal Commission. Notwithstanding this, a number of interviewees mentioned commission as a driver of problems, as the commission system encouraged more complex, expensive products.

Any review of commissions should consider the matters addressed in this report.

9 Underwriting and Claims Management

As noted above, the IDII product is very complex, and has become more so over time. Changing social attitudes to disability has changed the nature of claims – away from physical injury and to ailments requiring more judgment to assess, such as mental ill-health. Thus, both underwriting and claims assessment have become more challenging for insurers to complete in a fair, consistent and transparent manner for customers.

The ability of a claimant to return to work is a critical feature of the operation of the IDII product. Medical professionals provide critical opinions in assessing disability and ability to return to work. However, the Taskforce has some concerns about how insurers choose to use GPs to assess a person's inability to work in the context of the terms of a typical IDII policy.

The skills required to assess occupational disability are highly specialised and the medical professionals traditionally engaged by insurers in certifying IDII claims may not have all of these skills. GP assessments can be brief, even for occupational disability cases that are complex in nature requiring deeper more detailed assessment.

The Taskforce is also of the view that there may be a lack of experience/training in occupational disability that could result in only high-level assessments relating to work capacity and return to work, yet currently this assessment is a key input to claim assessment. In addition, the Taskforce worries that customers who suffer from certain health conditions which are difficult to assess, such as mental illness or chronic pain, may not be receiving adequate assessment and treatment.

It is observed that information sought from the medical community is inconsistent across the health insurance industry, and inconsistent within the life industry. This makes it difficult for medical professionals, complicating the process. Different approaches breed distrust.

It is also recognised that claims team members are expected to have a wide range of skills (spanning medical, legal, financial, occupational, rehabilitation, dispute resolution and customer empathy skills) to assess disability claims. Further, the external environment is regularly changing for claims management. However, there are no formal training requirements, no industry wide professional standards and no qualifications for claims management. Claims assessors do not always have enough access to specialist skills such as medical specialists, occupational therapists, legal support etc. and may not always utilise these subject matter experts appropriately.

Further to this, the inappropriate use of experts can delay and complicate the claims process and lead to poor customer outcomes. IDII benefits are often only one disability benefit relevant to an individual who suffers injury or illness. There is sometimes duplication in the claims processes in the different support systems creating inefficiencies and poor customer experience.

The Taskforce has also observed that life insurers do not always collect structured underwriting or claims data that would support sound risk management (such as ability to link underwriting and claims data, assess impacts of particular underwriting or claims decisions, salary etc.). In addition, current financial underwriting approaches can lead to over-insurance, contravening indemnity principles. They can also lead to situations where policyholders could be paying premiums for cover they cannot claim on.

It is also common practice that occupational underwriting practices typically focus on job title at policy inception only, don't align well to IDII benefit terms and can complicate claims management. They also don't reflect changes in employment that can occur after policy issue.

APRA has observed that, while claims case-loads impact claims termination outcomes, there is

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significant variation in claims case-loads across the industry and insurers often fail to meet their own targets.

The Taskforce interviewed experienced underwriters and claims management professionals, representatives from ALUCA[17], doctors working in the industry with relevant experience as well as representatives of the Royal Australasian College of Physicians, and considered the questions above as part of the process.

These are some of the views expressed:

- Those working in the industry thought that the product was too liberal and not aligned to insurability principles. The product is 'broken'.
- Those outside the industry were a bit more circumspect and started with a (strong) customer view of 'this is what you promised, so you have to deliver on it', though it was acknowledged that some payments did not really make sense. Those outside the industry gave less weight to the argument that disproportionately large benefits discourage people returning to work.
- There was wide acceptance that the relationship between the life industry and the medical community is not in sound condition and that there is not a lot of trust. Interviewees consistently regarded this as the life industry's fault. Nearly everyone had a case they raised to say "this happened to a patient, and I can't believe the industry asks these questions". The view was that the life industry starts from a sense that people are trying to rort the system. Those outside the industry were stronger in this opinion. These people also held strong views that people generally want to go back to work.
- There was universal agreement that terminology in use is poor. E.g. there were views that words like 'permanent' should not be used.
- From those in the industry, there was a view that financial underwriting is poor and needs much more focus / tightening.
- There was agreement that claims teams have a challenging job that requires multiple skills. There was general agreement that more skills were required within claims teams, with greater use of medical experts such as doctors, occupational therapists and psychiatrists suggested.
- With respect to GPs and their interaction with the life industry, views included:
  - GPs must be patient advocates. Their duty must be to 'first do no harm'. Often the line of least resistance for them is to agree with the patient. Anything the life industry does that looks to work against those principles will be met with suspicion or dislike.
  - GPs also get asked to use different forms for each life company, and for workers compensation etc.
- GPs are asked to do things by the life industry that they are not skilled to do, nor have the time to do. They are not occupational therapists. They do not understand the details of what determines incapacity for many occupations. The views put forward on this varied, and included:
  - Industry should use a standard form for seeking information. This consistency should make it easier for GPs and they will likely view it as fairer.
  - Industry should stop asking questions as to whether the person meets a definition and not delegate decision-making to the GPs. Instead, GPs should be asked more

17 Australasian Life Underwriting and Claims Association https://www.aluca.com/

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straightforward/direct medical questions and the life insurer should use that to assess the claim itself.

  - A view was that the medical process is: diagnose / treat / get better / return to work. Therefore, potential questions for GPs should focus more on this process e.g. ‘What is the diagnosis? What tests have you done? What is the treatment plan? Is patient doing the treatment plan? How are they responding to treatment?’
  - There should be alternative answers to yes/no. E.g. ‘I don’t know’ or ‘Unsure’ to allow for complexities regarding cases.
  - There was some support for attempting to educate GPs about life insurance, but a broader view was that this was too large a challenge.

- There was strong agreement that rehabilitation support can make a difference, particularly early rehabilitation of the right kind. There was strong belief in the health benefits of work. There was an argument that payments should be more frequent than monthly so that there is more frequent interaction, which would help in getting people back to work and setting expectations, mindset etc. about returning to work.
- There was general agreement that GPs support the health benefits of working to a degree, though they may not want to go against patient views and so take the line of least resistance.

Recommendations

9.1 Life Insurers should engage more effectively with GPs in claims management

Life Insurers should:

- Request factual medical information from the GPs only e.g. treatment plan, current stage of treatment, how patient is responding;
- Use assessments from occupational physicians, occupational therapists and other specialist practitioners in assessing a claimant’s function and capacity to work;
- Through claims assessors, retain ownership of the decision regarding payment of claim.

9.2 Make more effective use of experts in claims management

Life Insurers should:

- Develop clear guidelines for the use of subject matter experts by the claims function and incorporate these into claims competency frameworks;
- Collect sufficient data to monitor use of experts and impact they have on claims outcomes and claimant’s experience;
- Ensure claims assessors retain ownership of the decision regarding payment of claim.

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9.3 Improve the way claims information is sought from the medical community

The **FSC** should adopt a standard form across the industry to collect medical information and developed in conjunction with the medical community.

9.4 Develop Industry financial and occupational underwriting benchmarks

ALUCA should develop an industry underwriting benchmark (as a risk management tool for life insurers) to cover financial and occupational underwriting topics such as:

- Potential for overlap in different types of living benefit covers (e.g. IDII, critical illness and TPD);
- Underwriter focus on job duties (rather than job title);
- Revalidation of policyholder financial and occupational details at least every five years.

Life Insurers should adopt the Sustainability Guide and assess their current practices against the industry underwriting benchmark.

9.5 Improve underwriting and claims data

Life Insurers should:

- Develop a strategy for underwriting and claims data, including identifying gaps in current practices and develop action plans accordingly;
- Implement a dashboard of claims and underwriting data for monitoring by the Board.

9.6 Focus on return to work and lift rehabilitation

Life Insurers should:

- Focus on supporting customers to return to work, and intervention should be as soon as possible after the sickness or injury occurs;
- Make more use of rehabilitation support, invest in understanding the most beneficial rehabilitation methods and incentivise early reporting of claims.

9.7 Develop the claims management profession

Life Insurers should:

- Work with ALUCA and ANZIIF to develop a minimum industry wide qualification standard for claims assessors, including ongoing continual professional development requirements;
- Develop competency frameworks for the different roles within their claims management functions;
- Perform regular assessments against their competency framework as part of ongoing quality assurance processes and address gaps as identified.

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9.8 Simplify the claims ecosystem

Life Insurers should engage with other stakeholders in disability support systems (e.g. Workers Compensation, certain vehicle Insurance schemes such as Compulsory Third Party, National Disability Insurance Scheme, Disability Support Pension, superannuation etc.) to identify opportunities for improvement and simplification, particularly when a claimant transitions between different disability support systems. Possible areas to explore would include standardised claims forms and sharing of common information (subject to privacy and nsent considerations).

9.9 Improve claims resourcing

Life Insurers should:

- Review or develop claims case-load targets and specify required actions and reporting when case-loads are beyond target levels;
- Develop ways for the industry to grow the population of claims assessors (such as by partnering with ALUCA and ANZIIF).

The **FSC** (consulting with ALUCA) should develop case load benchmarking for the industry.

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10 Risk Management

The Taskforce view is that the introduction of the CRO role in insurers has clearly improved focus on operational risk and management of those and all other risks. However, there appears to be a gap with regards to sustainable IDII design, sale and management practices which highlights the need to significantly improve risk management for IDII.

In addition, the Taskforce believes that Appointed Actuaries and CROs need to work together to develop long term sustainable practices related to products and improve existing frameworks to ensure that senior management and Boards have visibility of and monitor core elements of these practices to ensure that an appropriate balance is achieved between distribution / top line growth, product sustainability, attitude towards uncertainty and investment to improve understanding and reduce uncertainty.

The Taskforce view is that CROs need to work to improve the Risk Appetite Statement (RAS) so that IDII risks are properly addressed and management actively use the RAS in making trade-off decisions, drawing a clear line on when to say 'no', escalating sustainability issues to the Board and enabling the Board to monitor accumulation of unsustainable practices. Related to this, the interaction of risks across all functional areas should be a key area of focus for CROs. A clear target state for the organisation may also assist CROs in assessing sustainability.

CRO interviewees were generally very supportive of the work of the Taskforce. CRO interviewees however expressed particular concern about the lack of clarity between their responsibilities and those of Appointed Actuaries. Points made included:

- Need for clearer accountability between CROs and AAs, with some suggestion that the mandate for CROs is unclear with respect to financial and non-financial risks.
- Appointed Actuary documentation can be dense and key risks can be difficult to assess.
- APRA's CPS 320 has a strong focus on financial risks but less so on non-financial risks.
- There is a need for actuarial skills in the risk team.
- There is a need for professional best practice sharing amongst CROs.

CRO interviewees felt that while the RAS is not necessarily inadequate, the application and monitoring of performance against the RAS can be improved. They also felt more scenario testing is needed.

There are aspects of risk management for life insurers which are quite different to other institutions. There is currently no facility for CROs to share and help develop good practice for life insurance.

Recommendations

10.1 Ensure adequate support for breadth of CRO role

Boards should ensure CRO job descriptions and practices should clearly cover all risks. In addition, **CROs**, **Appointed Actuaries and other executives** in a life insurer should develop protocols for working together to ensure a comprehensive and holistic approach to IDII business risks.

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10.2 Ensure CROs deal with long term risk and uncertainty in IDII

CROs should apply second line oversight of implementation of the Sustainability Guide (including heat map and sustainability index) and to use it to help assess risks and uncertainties.

Life insurers should review the responsibilities of their Appointed Actuaries and CROs to ensure that the combined expertise of the disciplines is effectively deployed and appropriately supported by other executives.

10.3 Collaborate to share good practice for life insurer risk management

The **FSC** should establish a forum for CROs for regular sharing of best practice across the life insurance industry.

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11 Actuaries' Professional Obligations

Actuaries play several roles in IDII portfolios, covering input to product terms and conditions, pricing, reserving and capital levels supporting the portfolios. They also play a critical role in assessing and managing financial risk of IDII, and in the communication of that risk to CROs, management and Board. This includes long term implications of the product features and pricing.

The Taskforce believes that because of the complexity of IDII, the regular changes to features, the lack of adequate data, changes in society's expectations, and improvements in medical diagnoses and treatment, it can be challenging for actuaries to carry out the above duties. In particular, actuaries may not have adequately communicated the considerable uncertainty inherent in long-term IDII contracts and market practices. This is not to suggest that actuaries have been other than diligent and professional in their approach to their job - rather, that better practices should be developed and implemented for this business line.

Furthermore, the Taskforce is of the view that there may be inconsistent practices in the profession in respect of data and interpretation thereof, experience investigations, assumption setting, etc, particularly where customer and financial outcomes are uncertain or untested.

A number of Appointed Actuaries were interviewed. The Taskforce and its working groups were made up primarily of actuaries, a number of whom have been or are Appointed Actuaries. There were few comments from non-actuary interviewees about actuaries, with the exception of adviser and rating house interviewees, who raised the role of the actuarial profession in the IDII issues.

Appointed Actuary interviewees generally agreed with the key themes identified impacting the IDII challenges, supporting the need for changes.

The Taskforce considers that there are a number of areas which require consideration:

- The use of the actuarial control cycle[18] in pricing work and operations of the business may be inadequate.
- There is a need for a realistic assessment and consideration of uncertainty, without undue optimism, supported by clear communication to management and Board.
- The voice of the Appointed Actuary can sometimes not be heard, particularly on matters which do not support the growth of the business or other management objectives. As a general observation, over time the influence of Appointed Actuaries has declined, the breath of the Appointed Actuary input has narrowed, with a more technical focus, and Appointed Actuaries have by and large become more junior in organisations. There may be cultural aspects to this within the profession and within life insurers.
- The Appointed Actuary is relied on for setting appropriate assumptions and tends to be held accountable when they prove to be different to experience, whereas the business should have ownership with oversight by the Board.
- Appointed Actuaries should ensure they draw on support from other actuaries in the company in a structured way for guidance, challenge and debate. In providing or preparing advice that is used by the Appointed Actuary, such other actuaries should be aware of the AA responsibilities and prepare their advice accordingly in order to provide

18 Actuarial control cycle is a methodology used by actuaries: https://en.wikipedia.org/wiki/Actuarial_control_cycle

appropriate support for the Appointed Actuary role. Where other actuarial support is not available within the company, the Appointed Actuary should seek a mentor through the Actuaries Institute.

- Impact of changes in underwriting and claims management policies/practices on pricing adequacy and risk/uncertainty can be very significant, which can often be made without Appointed Actuary involvement.
- There is often inadequate data collection to support actuarial analysis and research into complex areas of uncertainty in the products.

The Taskforce considers that actuaries can play important roles in helping the industry transform, but they must also adapt, explore new data sources and develop new methodologies.

Analysis and understanding of risk and uncertainty inherent in IDII, and communication to Board and Senior Management needs improvement. Furthermore, the risk/uncertainty tail is significant but not adequately addressed in pricing and other considerations.

Recommendations

11.1 Actuarial advisors to be explicit about uncertainty

Appointed Actuaries, **Pricing/Product Actuaries** and **Chief Actuaries** should ensure that their advice is clear about the level of uncertainty inherent in the product and what actions are required to reduce uncertainty over time. This includes:

- Ensuring that CPS320 advice explicitly discusses key uncertainties and articulates what the organisation would need to do to manage those uncertainties;
- Applying the actuarial control cycle to the management of uncertainty over time;
- Ensuring the Financial Condition Report (FCR) comments on managing uncertainty and on Sustainability Assessments (see Sustainability Guide);
- Adopting good practice for 'pricing for uncertainty' as detailed in the Sustainability Guide;
- Articulating the consequences for consumers of accepting uncertainty into the product design and pricing (see the Sustainability Guide);
- Carefully considering and quantifying where possible tail risk/uncertainty and use of plausible but extreme scenarios in advice to management and Boards, as well as considering implications for pricing, reserving, capital stress margins etc.

The **Actuaries Institute** should develop and implement training and guidance in the above.

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11.2 Increase Appointed Actuary oversight of claims and underwriting standards

Appointed Actuaries should use their authority as Appointed Actuary to ensure that the company provides them with information on all changes in claims and underwriting practices as they occur.

Appointed Actuaries and **Pricing/product actuaries** should formally consider implications of any such changes for pricing, reserving, capital stress margins etc.

CEOs should mandate communication of changes in claims and underwriting practices to appropriate product/pricing governance bodies and also the Appointed Actuaries.

11.3 Improve pricing for uncertainty

The **Actuaries Institute** should adopt and promote the Discussion Note: *Analysing Disability Income and Setting Assumptions*. The **Actuaries Institute** should also consider upgrading the status of this Discussion Note.

The actuarial control cycle should be embedded as set out in the Sustainability Guide.

11.4 Clarify respective roles of CRO and Appointed Actuary

The **Actuaries Institute** should develop guidance for Appointed Actuaries to work with CROs, including potential overlap of responsibilities.

11.5 Improve training and development of Appointed Actuaries

The **Actuaries Institute** should provide Appointed Actuaries with ongoing guidance/training sessions on communication and influencing skills, how to work with senior management and Boards, etc., with support of senior actuaries in the profession.

The **Actuaries Institute** should facilitate mentoring of Appointed Actuaries by senior actuaries.

Appointed Actuaries should use their authority as Appointed Actuary to ensure that the company provides them with information on the broader market environment and broader business deliberations for consideration in significant decisions and recommendations.

Insurers should have in place appropriate communication to share this information with Appointed Actuaries so that they can provide their advice within the wider business context.

11.6 Improve organisational and cultural environment

CEOs and **Boards** should establish processes to ensure Appointed Actuary views, reasoning and insights are properly aired, heard and thoroughly considered in significant decisions.

The Board, Chair of the Board, or **Chair of the Risk Committee** should have regular meetings with the Appointed Actuary without management present.

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12 Conclusions and Next Steps

IDII plays a critical role for society in providing financial protection against loss of income because of disability. It is particularly important for those such as the self-employed and professionals who may have no other support available.

There are many Participants in the IDII ecosystem, all of whom contribute in some way to its health and wellbeing. The IDII ecosystem today is not healthy: the market is failing consumers (as explained in this report) and insurers are hurting badly, as they lose ever-increasing amounts while offering more and more complex products. Some have effectively withdrawn from the market.

Numerous changes are needed by various Participants to restore the ecosystem to good health, so it can better support the community and customers who need IDII cover. The Taskforce has provided a series of provisional recommendations for various Participants, and designed some tools to help the life insurance industry adopt better practices.

The Taskforce is seeking feedback on the provisional recommendations in this document and on the accompanying draft Sustainability Guide and the Reference Product for risk and uncertainty assessment.

The Taskforce will consider feedback until 31 October and subsequently will produce final recommendations. It will then engage with the various Participants to help facilitate change.

Appendix

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