August 2025

Actuaries Institute.

Life Insurance Sustainability Guide

A framework for managing life insurance products for the long-term alignment of all system participants

About the Actuaries Institute and the Profession

As the peak professional body for actuaries in Australia, the Actuaries Institute represents the profession to government, business and the community. Our members work in a wide range of fields including insurance, superannuation and retirement incomes, enterprise risk management, data analytics and AI, climate change and sustainability, and government services.

Actuaries use data for good by harnessing the evidence to navigate into the future and make a positive impact. They think deeply about the issue at hand, whether it's advising on commercial strategy, influencing policy, or designing new products. Actuaries are adept at balancing interests of stakeholders, clients and communities. They're called upon to give insight on complex problems and they'll look at the full picture. Actuaries analyse the data and model scenarios to form robust and outcome-centred advice.

www.actuaries.asn.au

Acknowledgement of Country

The Actuaries Institute acknowledges the traditional custodians of the lands and waters where we live and work, travel and trade. We pay our respect to the members of those communities, Elders past and present, and recognise and celebrate their continuing custodianship and culture.

About this Sustainability Guide

This Sustainability Guide has been prepared by the Life Insurance Practice Committee of the Actuaries Institute (the LIPC). The original version was first published in 2022 by the Disability Insurance Taskforce of the Actuaries Institute and focused on the development of a sustainability framework for Individual Disability Income Insurance (IDII) business. This update to the Sustainability Guide broadens consideration to include Total and Permanent Disability (TPD) and Trauma Insurance and with a view to facilitating ongoing implementation of the sustainability framework to disability insurance in all its forms. While the focus in this document is on retail (individual) policies, it is expected that similar principles can be applied to group insurance.

It is intended that this Guide be reviewed from time to time to reflect learnings from its application.

Users of this Guide are encouraged to consider other documents in relation to the sustainability of disability insurance, including:

- Disability Insurance in Australia: Findings and Recommended Actions (September 2024);
- Fairness in the Life Insurance System (September 2021);
- Technical Paper: Analysing Disability Income Experience and Setting Best Estimate Assumptions (September 2021);
- The Role of the Risk Function in Life Insurance Product Sustainability (May 2023);
- Disability Income Data Collection Guide (February 2024);
- Work Capability Assessments in Individual Disability Income Insurance: Introduction and Considerations for Actuaries (April 2024);
- Fairness in Insurance (October 2024); and
- Information Note: IDII Limited Contract Term – Framework for Considering Options (May 2025).

Disclaimer: The material contained in this Sustainability Guide (the Guide) is in the nature of general comment only and is not advice on any particular matter. No one should act on the basis of anything contained in this Guide without taking into account their own circumstances. The publisher and the authors do not accept responsibility for the consequences of any action taken or omitted to be taken by any person on the basis of anything contained in or omitted from this Guide.

No warranty is provided by the Actuaries Institute, the LIPC or its working groups or the members of any of them, that the Guide is complete or appropriately addresses all matters relevant for the sustainable issue of disability insurance business by an insurer.

ISBN: 9781763754225

Suggested citation: Life Insurance Practice Committee of the Actuaries Institute. (2025). *Life Insurance Sustainability Guide: A framework for managing life insurance products for the long-term alignment of all system participants.* Actuaries Institute.

Contents

Life Insurance Ecosystem[1] in Australia

Participants

1 The diagram has been reproduced from Disability Insurance in Australia: Findings and Recommended Actions (September 2024). To acknowledge that other forms of disability insurance extend beyond life insurance and not directly covered by this Life Insurance Sustainability Guide, its title has been updated accordingly.

1

Executive Summary

1.1 The Importance of Sustainability

This Life Insurance Sustainability Guide (Guide) has been developed by the Actuaries Institute to **support actuaries in their various professional roles**, other insurance professionals, boards, management, regulators, and other interested parties. In line with the Australian Prudential Regulation Authority's (APRA) expectations and sustainability measures in Individual Disability Income Insurance (IDII), it aims to create and enhance practices to promote sustainability across the life insurance sector. It has been developed with a particular focus on disability insurance across:

- IDII;
- retail Total & Permanent Disability Insurance (TPD); and
- retail Trauma Insurance.

This Guide is intended to help actuaries and any other readers to consider critical aspects of product design, operational practices, pricing uncertainty, risk management and risk appetite. It provides clarity about important practices that may lead to poor sustainability. Actuaries and other readers may use this Guide to continually improve their frameworks, policies and day-to-day practices to mitigate risks and improve long term disability insurance sustainability for customers and insurers.

A reference to "insurer" in this Guide is to an individual life insurer, not to life insurers collectively or to the insurance industry more generally, unless implied by the context.

Insurers face a number of conflicting commercial realities that over decades have resulted in poor outcomes for both retail disability insurance customers and insurers. Disability insurance products are complex and historically insurers have poorly understood the uncertainty[2] inherent in these products that has contributed to unexpected increases in claims cost. Consequently, the products have proven to be underpriced and have led to substantial industry losses. While customers have historically benefited through relatively cheaper premiums, they have also seen detriment arising from:

i. overly generous benefits and poor risk management resulting in all customers paying higher premiums than necessary to the benefit of a minority of some claimants who receive benefits in excess of their insurable interest[3] and/or who avoid minimising the insured loss[4];

ii. ongoing underestimation by insurers of the potential variability of experience and the resulting unexpected premium rate increases for customers; and

iii. in response to increasing premiums, customers with relatively low risk of claims cancelling their insurance, with the consequence of further price increases for the remaining customers.

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

- Products that perform as expected by customers, with features that, compared with the past:
  - 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.
- Product features and underwriting that:
  - promote alignment between customer and insurer through appropriate consideration of each customer's insurable interests; and
  - support loss minimisation 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 disability insurance products to the market.
- Community confidence as to the enduring value and fairness of disability insurance.

While these problems have been spotlighted in IDII through APRA's intervention, the life insurance sector is experiencing deterioration in retail TPD experience. Notably, similar and more significant deterioration was observed in the group market in 2013. Differences in distribution arrangements, awareness of cover, target market and other factors could account for the differences observed to date, however the risks associated with retail and group TPD cover are fundamentally similar.

Trauma Insurance provides cover where the payment of a benefit depends upon the occurrence of a defined medical condition. Thus, the definition of these medical conditions needs to be robust enough to meet customer expectations while providing for sustainable outcomes over time. There are risks that changing community expectations and medical developments may have significant impacts on the incidence and timing of expected claims cost for this long-term benefit design.

2 For the purpose of this Guide "uncertainty" is intended to include a range of factors outlined in A.4 Pricing for Uncertainty.
3 Insurable interest "exists when an insured person derives a financial or other kind of benefit from the continuous existence, without repairment or damage, of the insured object (or in the case of a person, their continued survival)", according to the Macmillan Dictionary. In this case, the insured object is future income.
4 An important principle of insurance is that the insured must act to minimise the loss once the insured event occurs – commonly known as "loss minimisation".

1.2 A Systematic Approach to Sustainability

In line with APRA's expectations, this Guide expects that each insurer has a documented approach to sustainability. To support best practice implementation, this Guide proposes a framework where each insurer develops their own:

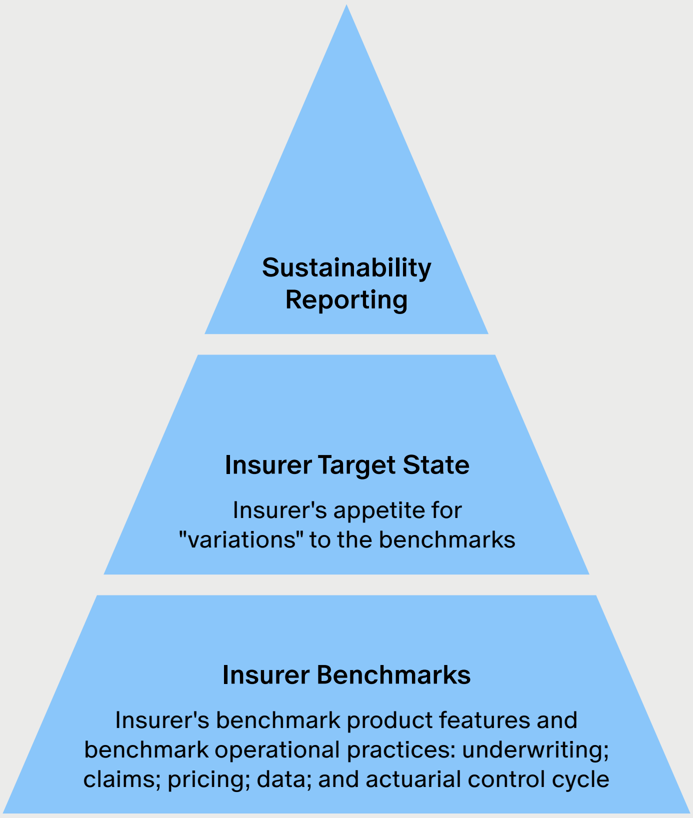
i. governance framework to improve oversight of decision making (including the adoption of a Target State);

ii. benchmarks for product features and operational practices to assist management and the Board to understand and discuss aspects of their business that may increase uncertainty and reduce sustainability; and

iii. framework to measure and monitor over time an insurer's sustainability. The measurement and monitoring framework would include an assessment of the insurer's Current State against its Target State by reference to the developed benchmark product features and operational practices (for example, including a model for an internal and self-assessed sustainability score).

1.3 Framework Proposed by This Guide

Framework Elements



Proposed steps for an insurer:

Initial implementation / comprehensive review

1. Determine the insurer's benchmark product features and benchmark operational practices.
2. Assess the insurer's rating level ("possible total points") for each benchmark element.
3. Determine product features and operational practices to adopt in the insurer's Target State and their relationship to the benchmarks.
4. Obtain Board approval of the insurer's Target State (being the variations to the insurer's benchmark product features and operational practices).
5. Identify and evaluate variations between the Current State and the Target State and their potential impact on claims cost arising from uncertainty.

Ongoing implementation / regular review

6. Execute an action plan to address gaps between the Current and Target State.
7. Periodically review the Target State for ongoing appropriateness for the insurer.
8. An annual sustainability assessment could be conducted to analyse, explain and agree actions to improve sustainability.

1.4 Wider Applicability

This Guide addresses the most critical practices thought to promote the sustainability of disability insurance for the industry. It complements, and is not intended as a substitute for, an insurer's team of insurance practitioners applying best practice in the context of their own circumstances and risk appetite. As such, it outlines principles insurers could consider in setting benchmark products and operational practices to support sustainable outcomes. It is envisaged that insurers will adopt their own practices and set a Target State within this framework.

This Guide has been prepared in the context of sustainability for on-sale (new business) retail (advised) products. The approach taken in this Guide is intended to be usable for other distribution channels, product lines and insurers' in-force portfolios.

Users of this Guide could consider its wider application to benefit types that are not included explicitly in this guide. Examples include Life Cover, Business Expenses cover, Child Cover, options available on covers, variants to covers.

The approaches set out in this Guide could also be adopted for group insurance. This could enable the framework in this Guide to be applied to an insurer's whole portfolio.

A reinsurer could adapt the frameworks suggested in this Guide to monitor its portfolio of disability insurance products and its assessment of the capabilities of cedants.

2

Governance and Target State

Insurer governance structures and reporting should enable development, maintenance and continual improvement of sustainable product features and operational practices over the long term.

The following elements for the insurer's governance structures and reporting could be considered:

i. oversight by the Board of development of the insurer's benchmark product features and benchmark operational practices;

ii. approval by the Board of a clear Target State linked to risk appetite and delegations to management;

iii. review by the Board of product performance, product changes and operational performance by senior management to drive sustainability improvements; and

iv. Board approval and monitoring of sustainability, including the insurer's sustainability scores.

2.1 Benchmarks and Target State

Insurability Principles

To assist the insurer in setting its benchmarks and Target State, this Guide suggests that the insurer determines a set of individual Insurability Principles relevant for that insurer. Such principles ideally would be durable in the context of medical advances and community expectations. An example of a set of such principles is as follows:

Insurability Principles Example

- The event giving rise to a claim is objectively identifiable, definable and measurable. The event should also occur by chance – that is, it should be beyond the control of the beneficiaries.
- The customer's net financial loss on the occurrence of the event is measurable and definable.
- The insured benefit payment does not exceed the net financial loss suffered, after allowing for other sources of financial compensation and/or support.
- Benefits do not provide disincentives to return to work, either initially or over time. A customer is not financially better off while on claim. This helps provide an incentive for customers to return to work where reasonable and for the cover to support those in need.

Benchmark Features and Practices

This Guide suggests that the insurer consider establishing the following:

- a benchmark set of product features; and
- benchmark operational practices (including underwriting, pricing and claims, use and quality of data, and use of the control cycle) that, when taken as a whole, provide a robust foundation for assessing and managing sustainability.

These **insurer benchmarks** can provide an anchor for the insurer in assessing their risks to sustainability and **would likely be conservative positions based on good practice.** They would not be expected to change significantly over time, to ensure a durable measure of sustainability for the insurer's Target State and for the insurer's actual products and practices. Nevertheless, it would still be appropriate to review the benchmarks periodically, for example, every three to five years, so that any changes in good practice, market behaviour, product design and so on are considered.

The parameters for the benchmarks would be defined by the insurer – for example, the insurer's benchmark product features could aim to:

- meet the fundamental needs of a customer who wants financial protection against significant financial loss as a result of disability, and hence the product would be more marketable; and
- be consistent with the insurer's chosen insurance principles, and hence the product would be more sustainable.

For each benchmark, the insurer could identify a range of possible positions the insurer could adopt in practice, together with a spectrum of the associated riskiness/sustainability of various positions.

Appendix A provides example considerations for how to set the benchmark.

Target State

The insurer could then set its Target State by defining acceptable "variations" from the benchmarks.

The insurer's **Target State** would set the insurer's desired position for each of the benchmark product features and operational practices, **according to the insurer's risk appetite, strategy, market conditions, the state of the insurer's portfolio, their desired profitability and sales volumes, etc.**

The insurer's Target State may therefore change over time, as strategy and conditions evolve or the insurer revises its risk appetite, for example.

The insurer should document the rationale for why the Target State is different to the benchmark features or practices. Rationales could include the considerations set out above, plus others such as the size and complexity of the insurer, access to capital, level of reinsurer support, etc.

The Target State could be expressed as a target score for each element. These scores could be added up for each category and expressed as a percentage. They could also be added up across categories by applying appropriate weights to arrive at a total Target State score for the portfolio. Appendix B – Sample Underwriting Assessment provides an example.

2.2 Product Governance and Sustainability Monitoring

This Guide proposes an insurer update its governance framework(s) to cover product sustainability which, for example, could involve the insurer:

i. receiving and considering Actuarial Advice under APRA's CPS 320 specific advice to the insurer as well as specific advice from senior representatives from the product, underwriting and claims teams on sustainability and in respect of all significant product and operational practice changes;

ii. making decisions about changes to products and processes when the above advice raises concerns in relation to long-term sustainability;

iii. ensuring that the Appointed Actuary and Chief Risk Officer are provided with the appropriate information, have the opportunity to challenge assessments prior to approval and escalate to the Board where necessary;

iv. monitoring and understanding sustainability issues detailed in an annual sustainability assessment (as outlined in A.6 Annual Sustainability Assessment / Actuarial Control Cycle);

v. periodically reviewing variations to the benchmark, mitigants, resourcing to support mitigants and the Target State itself;

vi. reporting to the Board on management's sustainability analysis and effectiveness of the sustainability framework;

vii. considering the ongoing appropriateness of historical product designs and transition of customers to on sale products; and

viii. aligning the considerations required under the Design and Distributions Obligations (DDO) regime with the sustainability considerations of the insurer. This could include incorporating Target State monitoring outcomes into the broader monitoring of appropriate distribution outcomes required by the DDO regime. It could also include incorporating target market considerations into an insurer's Target State.

3

Measurement of Variations to the Benchmarks and Target State

The actual marketed product and operational practices may well differ from the Target State (and the benchmark product features and operational practices) because of, for example, the market conditions, time to develop new products, constraints on practices because of systems, etc.

An insurer should assess its Current State against the elements in each category of the benchmark. For each identified variation from the Target State, the insurer should consider if the variation is to be eliminated or if the premium exposure percentage to the variation should be limited.

An action plan could be developed to address the variations that are to be eliminated. This action plan should be tracked by the insurer to monitor the gap to the Target State and how this is closed in line with agreed timelines. The Current State should be reassessed periodically as part of this monitoring.

3.1 Identification of Variations

Variations may be a difference to benchmark product features and operational practices or may be an “add-on” that may alter the claims cost of the product. Whether variations might be split or aggregated may be subjective.

Consider whether:

- a single variation would typically be associated with something that would be defined or described separately in the Product Disclosure Statement to other product features;
- some variations may interact with each other and might be treated as separate variations; e.g., the earnings definition and the maximum replacement ratio; and
- some variations or a group of variations may be a partial mitigant to the likelihood or consequence of adverse claims experience. The mitigant might be recorded separately (and its link to the risks explained); e.g., reducing the replacement ratio in calculation of sums insured exceeding $X maximum.

3.2 Impact Rating of Variations

Consider whether each variation has a low, medium or high impact on claims cost, assuming that uncertainty is realised. The aim would be to assess the approximate relative (rather than absolute) importance of each variation to the benchmark and Target State. Consideration may also be given to:

- whether the approach to assessing the impact of adverse variations and favourable variations / mitigants is the same;
- the benchmark or Target State may have mitigants that in the insurer’s business are absent or ineffective and those mitigants are treated as variations that reduce sustainability; and
- the metrics to monitor the ongoing effectiveness of all medium and high impact mitigants.

Consider whether each variation is evaluated assuming that an uncertainty scenario emerges[5] over a medium term such as five years (and stabilises thereafter) from inception of new policies and its impact. This may be determined by considering the following:

- reviewing the examples in Appendix A of possible impact ratings;
- ignoring the likelihood of the change;
- representing a reasonable magnitude of claims cost from the uncertainty being realised relative to the benchmark. This would include consideration of one-off effects and changes in trends in respect of claims incidence and termination rates (including a dislocation between short and long duration rates);
- using professional judgement (rather than actuarial calculation) on the magnitude of impact; and
- not requiring historic statistical information to support the assessment.

This possible approach is intended to be relatively easy to implement and to facilitate discussion within the insurer on the most important sustainability issues.

5 See A.4 Pricing for Uncertainty for examples of uncertainty scenarios.

3.3 Variations Register

Appendix B – Sample Underwriting Assessment provides an example of how a category may be assessed. Further details on the variations of the Current State to the Target State and to the benchmark may be captured in a variations register. The table below provides an example of what may appear in the variations register.[6]

The insurer could also consider what actions it could take over time to move the Current State to the Target State and reduce the variations.

Variation	Description	Type	Category	Rating (L/M/H)	Premium exposed to variation	Target State rating
Name of the variation	Brief description of the variation and what sustainability risk it could introduce / mitigate	• Risk • Mitigant	• Product • Underwriting • Claims • Pricing • Data & research • Control cycle	• Low • Medium • High	Approximate proportion of the portfolio exposed to this variation	• At target • To eliminate • Target level (L/M/H) • Premium exposure %

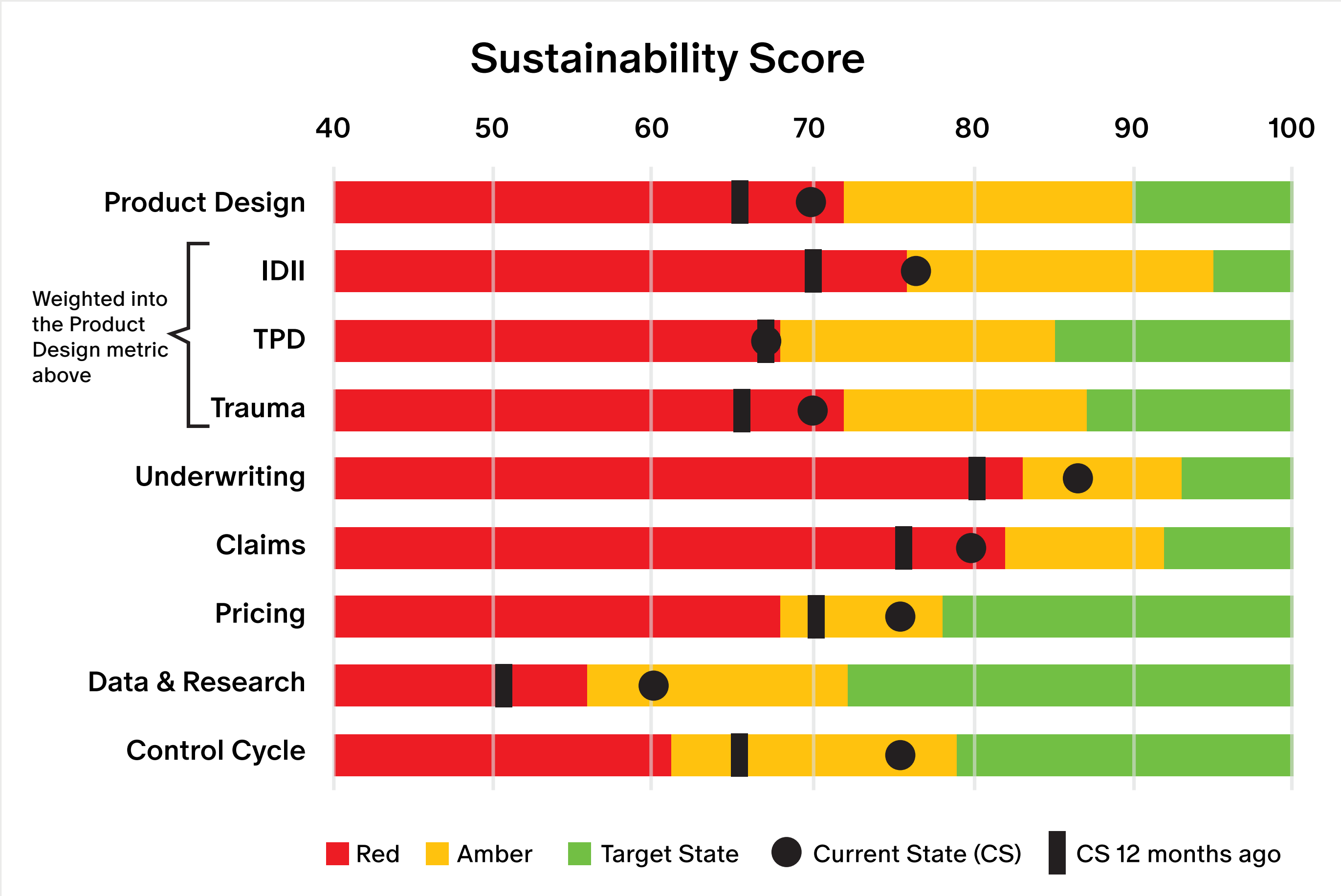
3.4 Sustainability Scores

An insurer could determine and report on its sustainability scores and also align its risk appetite to the sustainability assessment of each category. Example steps to achieve this are as follows:

- The Target State (or better) are taken as green.
- The insurer determines an amber region below the Target State, e.g., within 10 points; within 10%, etc. This could be used to identify an assessment that is close to or moving towards the Target State.
- Below the amber region, the score would be in the red – and so identify segments that require more attention and timely action.
- The Product Design segment is comprised of several different covers (the example below shows IDII, TPD and Trauma). It is noted that an insurer could have additional categories, in particular where materially different risk profiles exist within these cover types, such as TPD definitions. An insurer could consider both the rating of each cover type, but also how these are appropriately rolled up into an overall Product Design assessment. A potential approach could be to use the mix of new business sales, however an insurer should consider the purpose of the metric in determining the best way to determine an overall rating for Product Design.
- The other metrics (i.e., Underwriting, Claims, Pricing, Data & Research and Control Cycle) are based on a combined view across IDII, TPD and Trauma in this example, but could be split in the same way as shown for Product Design.
- An overall sustainability score could then be calculated as the weighted average of the category sustainability scores – for example, using weights such as 25% for Product Design and 15% for each of the other metrics (i.e., Underwriting, Claims, Pricing, Data & Research and Control Cycle).

6 Variations rated "at target" in their Target State rating would be excluded from the summary of number of variations and included in the sustainability scores.

The following chart illustrates a visual method for reporting this information by segment that could be used. A total weighted sustainability score could also be included. An insurer may incorporate the total score into its risk appetite metrics and Board reporting, as well as selected more granular measures.



3.5 Monitoring by the Board / Sustainability Heatmap

An insurer should consider the extent of reporting to the Board that is appropriate for its business. The following are the components that could be considered:

- details of the benchmark determination for product features and operational practices;
- determination of the Target State and rationale for where this differs to the benchmark;
- evaluation of variances between the insurer's Current State and the Target State, including an Action Plan to address these variances;
- updates on the Action Plan and the Current State – progress towards the Target State; and
- periodic reviews of the Target State and occasional consideration of the ongoing appropriateness of the benchmark features and practices.

The chart in the previous section provides an example of a high-level report to the Board. Incorporating these metrics into the formal risk appetite reporting provides a way to align these metrics into the broader risk framework. Monitoring of these metrics over time would provide the Board with insight into progress within the insurer in moving to more sustainable practices.

An insurer could consider the extent to which the type of details set out in Appendices A and B are shared with the Board.

The metrics could be forward looking for on-sale products. Multiple dashboards could be presented separately for each major product series. The ongoing effectiveness of mitigants could be monitored and incorporated in the low/medium/high rating within the impact scores. At least annually, the Board could review a summary of management's sustainability analysis.

Although not the focus of this Guide, the insurer may also develop a separate dashboard to monitor sustainability of the in-force portfolio. For example, a single weighted average dashboard could be developed for historic product series (weighted by premiums, for example).

4

Appendices

Appendix A: Example Impact Rating for Variations

This Section details the principles and main elements of what could comprise an insurer's benchmark product features and benchmark operational practices. These are considered by category across:

- A.1 Product Design – split into IDII, TPD and Trauma;
- A.2 Underwriting Practices;
- A.3 Claims Practices;
- A.4 Pricing for Uncertainty;
- A.5 Data, Experience Investigations and Research; and
- A.6 Annual Sustainability Assessment / Actuarial Control Cycle.

These categories and elements are not intended to cover every possible aspect of an insurer's product and organisation. The focus is on the outcomes that are expected to lead to a relatively sustainable industry. The insurer should form their own view on the approach to setting the benchmark and how the insurer will score both the Target and Current States against these benchmarks. An insurer may include all or some of the below, in addition to other matters that they consider relevant. In developing an insurer's own approach to sustainability, it is envisaged that the rationale for any variations to their benchmarks are discussed, documented and agreed by the Board.

Example impact ratings for various elements are presented in the tables. Indicative ratings are provided for the elements – differentiated as High and Medium. Insurers should consider the "points" they assign to each of these. For example, High could have 10 points and Medium 5 points. In some cases, such as the TPD Definition, it may be appropriate to assign more than 10 points given the relative importance of that element within TPD Sustainability. Appendix B – Sample Underwriting Assessment provides an example of how this could be implemented for the underwriting category.

As a rough guide, the points applied by an insurer should reflect the potential magnitude of claims that may arise from uncertainty being realised (i) relative to the insurer's product and operational practices benchmarks; (ii) relative to other factors being assessed by the insurer; and (iii) using professional judgement.

The assessment is not intended to be "all or nothing" and the extent of departure from the benchmark product features and operational practices is an important consideration. For example, an X% departure from benchmark income replacement ratio may be considered to have a High rating and a Y% variation to have a Low rating.

A.1 Product Design

Product design is considered a key driver of the sustainability of a life insurer's portfolio. Aspects of product design are considered separately below for Individual Disability Income Insurance, Total and Permanent Disability, and Trauma.

Product complexity and ease of understanding for customers are also important considerations for sustainability.

A.1.1 – Individual Disability Income Insurance

There are multiple aspects of IDII product design that could have a significant impact on sustainability. They include, and are not limited to:

- income replacement ratio including definition of pre-disability earnings;
- total disablement definition;
- partial disablement definition;
- eligibility for and level of partial disablement benefits;
- coverage of superannuation contributions;
- length of benefit periods and age at which benefits cease;
- premium rate guarantees;
- customer obligations to comply with reasonable requests;
- long contract durations with fixed terms;
- exclusions;
- tax treatment;
- benefit indexation;
- waiting periods;
- allowance for offsets;
- ancillary benefits; and
- treatment of unemployment.

These aspects should not be considered in isolation, the interaction between them should also be considered. Certain combinations of benefits, or of benefits and operational practices (as set out below), may compound the risk to sustainability. Other combinations may mitigate the risk to sustainability. It is important therefore that the insurer assesses its particular combinations against the insurer's risk appetite.

The following sections expand on some of these points that are central to sustainability. They are suggested principles (and elaborations) that an insurer may consider when developing and deciding on the insurer's benchmark product features and operational practices.

A.1.1.1 Income Definition and Replacement Ratio Incentivise Return to Work / Wellness

Consider whether the combination of income definition and replacement ratio (including offsets and ancillary benefits) seeks to ensure that the product covers an insurable interest of the customer and incentivises return to work / wellness. A particular consideration in this respect is indemnity versus agreed value benefits.

It is noted that APRA's expectation is that the benefit be of an indemnity nature.[7]

A.1.1.2 Eligibility for Benefits Is Clear and Supports the Customer When They Are Unable to Work

Consider whether the total disability definition is clear and seeks to provide support for the customer where there is a significant incapacity to work.

Consider also whether partial disability benefits seek to promote return to work and not encourage remaining on claim.

Consider whether definition of waiting periods including the requirements during the waiting period may be also a factor.

The use of capability assessments and contract terms should be considered, including the suggestions made in the Discussion Note: Work Capability Assessments in Individual Disability Income Insurance (April 2024).

A.1.1.3 The Occupation Definitions, Replacement Ratios and Benefit Periods Encourage the Customer to Minimise the Insured Loss

Consider whether claimants are aligned with the insurer on the insurance principle of loss minimisation. For example, the replacement ratio could be higher in the early stages of the disability when lifestyle changes cannot be readily made by the claimant. Another possibility is that occupation definition moves from own occupation to an Education, Training and Experience (ETE) definition at a longer-term point in time.

Consider the effectiveness of controls in place to manage the risks associated with long benefit periods, as required by APRA.[8] Consider how the totality of the product design impacts long duration claims – through initial disablement definitions, any changes in these by claim duration, alterations in replacement ratios, effectiveness of rehabilitation and return to work programs, together with claims management practices for long duration claims. Consider the lower level of data available for these durations, the impact of earlier intervention upon the experience of remaining claim cohorts, the psychological impacts of long-term disability, and increased difficulties with return to work for those not in employment for extended periods.

In summary, consider assessing the full range of features and controls that impact long benefit periods to ensure that, as a group, they remain within the insurer's risk appetite.

A.1.1.4 Product Terms and Conditions Keep Up With Environmental Changes

Consider whether the insurer might retain rights to alter substantive terms and conditions at least every five or 10 years (as examples) to ensure that changes in environmental and other factors can be reflected in product design. Factors may include social inflation (e.g., societal expectations, attitude to mental health, lawyer involvement), regulatory change, medical advances, change in the structure of the economy (e.g., casualisation of the workforce) and shifting economic conditions (e.g., high to low inflation environment).

It is noted that including such rights for the insurer may be challenging under the current legislative framework but it is a material risk management feature worthy of careful consideration.

If implemented, then consider whether the right to change product terms might be used instead to experiment with unsustainable terms that are likely to be subsequently withdrawn.

A.1.1.5 Products Communicated to Promote Alignment Between Insurer and Customers

Consider whether under the marketed product customer expectations of the product are aligned with those of the insurer, so as to better support the long-term expectations and needs of the community.

In this respect, the insurer may consider the extent to which its operational practices:

- Describe the product using language that is understandable by customers. Examples of poor use of language are: (i) calling the product "income protection" (IP) when the insurer expects return to work to be a key focus; (ii) complex disability definitions that make it difficult for customers to understand when and what they can claim; and (iii) use of the term "level premium" may be inferred by customers to mean that the dollar premiums will always remain unchanged.
- Clearly and regularly communicate the uncertainty and claims experience variations of the product so that customers are less surprised by premium rate increases. In support of this, the insurer might provide key elements of its pricing philosophy to rating houses for inclusion in their product ratings (see A 4.2).
- Support publication by the industry of claims statistics on components of benefits such as key types of disability definitions, claims causes and ancillary benefits.

7 APRA letter of 30 September 2020.
8 Ibid.

The table below is an example based on the principles above for the key aspects of IDII:

Segment	Description	Example rating
Replacement ratios	Is the replacement ratio within the benchmark product feature. Consider the size of gap and length of the period of departure. A replacement ratio exceeding the benchmark by more than X% for a period greater than Y months could be a High variation.	High
Superannuation benefit	The superannuation benefit must be paid to a superannuation fund.	High
Benefit periods	Benefit period beyond benchmark age with suitable mitigation such as: • tapering of benefits beyond benchmark age; • benefit income offsets for retirement incomes; and • financial re-underwriting the benefit period every X years to ensure that there is an ongoing insurable interest for the longer benefit period and it continues to encourage loss minimisation.	High
Total disability definition	The total disability definition does not: • have multiple tiers for the total disability definition; or • use one duty definition rather than material duties or "inability to perform work".	High
Guaranteed premium rates	Contract terms do not prevent the insurer from altering the premium rate schedule to reflect any unexpected changes.	High
Required to comply with reasonable requests	Product terms include a stipulation that the customer is expected to comply with reasonable requests of their health professionals and/or the insurer under their recovery management plan.	Medium
Long contract durations with fixed terms	IDII contracts are long-term contracts with claim payments that can extend over very long timeframes. Appropriate ways to manage contract terms over these periods as well as the risk profile – occupation/duties can be considered.	High
Standard exclusions	The product terms have the benchmark product exclusions	Medium
Clear and consistent communication to customers	A mechanism exists to ensure continuous improvement of the Product Disclosure Statement and other materials so that any gaps between customer understanding and insurer intent of the product reduces over time.	Medium

The following groupings of product features may be considered to see whether there is a compounding effect that could require a single / collective impact rating for each group.

Variation	Description	Example rating
Definition step down after a certain period	Switch to Education, Training and Experience definition (ETE) after a certain number of years on claim increases the financial incentive to strive to return to work, where this might be medically reasonable. There are requirements under the Life Insurance Code of Practice for managing these definition changes.	Group 1 Medium
Partial benefits incentivise return to work	Partial benefits cease at benchmark % capacity or hours per week (incentivising return to work).	
Partial disability benefits	Controls exist on the extent to which the benefit amount exceeds the benchmark.	
Allowance for offsets	Benefits are offset by sick leave, other insurance benefits, workers compensation and social security benefits (to the extent permitted by law).	Group 2 Medium
Tax is deducted from benefits	Tax is either deducted from benefits or the Australian Tax Office notified of benefit payments.	
Indexation	There are limits on the extent to which sum insured indexation prior to claim result in higher replacement ratios (in the context of indemnity contracts).	
Waiting periods are aligned	The waiting period terms have features that promote alignment between the insurer and customer on return to wellness/work: • periods appropriate in length; • limited income benefits payable during the waiting period; • more than X consecutive days of full-time work during the waiting period resets the waiting period; or • periods of work during the waiting period extend the waiting period.	Group 3 Medium
Insurance when not working	The total disability definition is ETE after X months of unemployment or leave from work.	
Cover suspension for ceasing work	There are limits to how long insurance cover continues after X months of unemployment or leave from work.	
Ancillary benefits	Ancillary benefits are limited to clear and significant additional costs in accordance with benchmark.	

A.1.2 Total and Permanent Disability (TPD)

The aspects of TPD product design that can have a significant impact on sustainability include, and are not limited to:

- total disability definition;
- waiting period definition;
- amount insured including indexation;
- partial TPD;
- buy back options;
- age cover ceases or changes definition;
- premium rate guarantees;
- customer obligations to comply with reasonable requests;
- long contract durations with fixed terms; and
- exclusions.

These aspects should not just be considered in isolation. The interaction between them should also be considered.

A.1.2.1 Eligibility for Benefits Is Clear and Supports the Customer When they Are Permanently Unable to Work Due to a Disability

Consider whether the total disability definition is clear and seeks to provide support for the customer where there is a permanent significant incapacity to work. This should be considered in the context of the different TPD definitions:

- **Any occupation** – consider whether with reasonable rehabilitation and retraining the customer could return to work.
- **Own occupation** – consider the ability of customers in occupations eligible for this definition to return to work in a different, though often lower income, occupation.
- **Non-occupational** – these can include:
  - **Homemaker** – consider whether the actual duties for this definition could be objectively defined.
  - **ADL/ADW** (Activities of Daily Living / Activities of Daily Work)– consider whether the definition could reasonably result in a claim being paid.
  - **Other** – these could include definitions of functional activities, cognitive loss, etc. These aim to give a more objective definition to TPD; however they can be complex, often requiring combinations of impacts. These definitions are also harder to make exhaustive across drivers of permanent disability.

In each case, and for alternate definitions of TPD, consider whether an insurable need is being met, and whether this need is met by a lump sum or an alternative design.

Consider the extent to which the event giving rise to a TPD claim is objectively identifiable, definable and measurable, and whether the TPD definition and the nature of the benefit payable should differentiate across events.

Consider whether "occupation" is objectively defined and how changes in occupation over time may impact the insured risk. Consider if the definition or management of the product over time could reflect changes in occupation and/or duties.

Consider whether the TPD definitions set out reasonable expectations for customers in terms of how permanency is assessed, the waiting period and timeframes for the assessment of benefits. Shorter waiting periods may lead to more deferrals or declines as permanency could be difficult to establish within short timeframes, creating a poor customer experience.

Consider whether the age cover is available to aligns to the age a life insured would be expected, and have appropriate motivation, to work. For example, white collar occupations could be more likely to work until higher ages than blue collar occupations due to the additional strain on the body from more manual occupations.

A.1.2.2 Amount Insured Is Clearly Defined and Aligned to the Potential Financial Loss

Consider whether the amount a customer could be insured for under the different TPD definitions reflects the actual financial loss incurred. The amount insured should not provide a financial incentive to claim.

As an example, if a claimant is eligible for a claim under an "own occupation" definition, this may not preclude the ability to work in a different, though likely lower paid, occupation. Therefore, consider whether the amount to be insured should reflect this likelihood to return to work outside of the claimant's own occupation.

On the other hand, the payment of a claim under "any occupation" should mean the claimant will find it more difficult to return to work in any reasonable capacity and therefore the amount insured could be higher to reflect this.

Consider whether the amount insured over the life of a policy is generally consistent with customer needs and will not inappropriately exceed the potential financial loss at any time.

Potential financial loss should consider all potential compensation available if permanently unable to work due to disability.

Clarity of the date of disability is important in determining the amount payable – cover may have increased with indexation during the assessment period.

A.1.2.3 The Definition Encourages the Customer to Minimise the Insured Loss

Consider whether the disability definition should include a requirement for reasonable vocational rehabilitation and retraining. Some conditions may improve with treatment and/or rehabilitation, and it should be expected that this be undertaken. Payment should only be considered after maximum reasonable medical improvement has been achieved. Similarly, it should be considered whether a reasonable amount of retraining could return the claimant to work.

A.1.2.4 Products Communicated to Promote Alignment Between Insurer and Customers

Consider whether under the marketed product customer expectations of the product are aligned with those of the insurer, so as to better support the long-term expectations and needs of the community.

The table below is an example based on the principles above for the key aspects of TPD:

Variation	Description	Example rating
TPD definition	The total disability definition includes: • requirement for reasonable treatment, rehab and retraining; and • maximum reasonable medical improvement to be reached.	High
Waiting period	The waiting period terms have features that promote alignment between the insurer and customer: • provides sufficient time to assess permanency; and • allows payment in a timely manner.	Medium
Customer obligations to comply with reasonable requests	Definition requires that reasonable treatment, rehab and retraining be undertaken.	Medium
Amount insured	The amount insured reflects the potential financial loss as a result of total and permanent disability – may vary depending on the total disability definition and over the life of a policy. Does the potential financial loss consider other covers – in particular IP benefit amounts.	High
Partial payment	A lower amount on objectively defined conditions could be considered, as long as it aligns with insurable interests.	Medium
Buy back options	Life cover only could be bought back after a reasonable period. Options to waive premiums following claim should be avoided.	Medium
Age cover ceases or definition changes	Age at which cover ceases or definition changes reflects the likely working period – may need to differ between different occupation classes.	Medium
Premium rate guarantees	Contract terms do not prevent the insurer from altering the premium rate schedule to reflect any unexpected changes.	High
Long contract durations with fixed terms	Though less of an issue than IDII where benefits are potentially paid for long periods, the contract should be flexible to react to changes in environmental factors and also to change in the occupation / duties that are insured.	High
Exclusions	Exclusions such as self-inflicted harm or pre-existing conditions should meet community and regulatory expectations and be clearly defined and explained in communications with policyholders.	Medium

A.1.3 Product Design – Trauma (Critical Illness)

The aspects of Trauma product design that could have a significant impact on sustainability include, and are not limited to:

- trauma definitions – full and partial;
- waiting / qualifying period;
- amount insured;
- buy backs and reinstatements;
- age cover ceases;
- premium rate guarantees;
- customer obligations to comply with reasonable requests; and
- long contract durations with fixed terms and exclusions.

A.1.3.1 Eligibility for Benefits Is Clearly Defined

Consider whether the trauma definition is clear and that the criteria for full versus partial benefit are objectively defined and aligned with insurable need.

In relation to the trauma definition, insurers should also consider the corresponding medical definition in the Life Insurance Code of Practice.

More sustainable designs would be those that have a mechanism to appropriately alter definitions in response to medical developments. Such definitions may focus more on the impact and severity of a trauma event.

A.1.3.2 Amount Insured Is Aligned with the Insurable Needs

Consider whether the sum insured amount reflects the potential financial impact from the risk, and that the benefit payment corresponds to the actual severity of the illness and the specific needs of the insured claimants. The insured amount should not create an undue financial incentive to file a claim or misrepresent risk at time of application. This consideration should also include external environmental factors, such as medical advancements, which could lead to early diagnosis and enhanced treatment, potentially allowing conditions that were previously untreatable to be managed.

Variation	Description	Example rating
Trauma definitions	Terms and conditions are kept contemporary and consistent with the Life Insurance Code of Practice, medical developments and community expectations. The current Life Insurance Code of Practice requires a review of definitions to be conducted every three years. Consider the impact of passing changes in definitions back to existing customers. The criteria for full versus partial benefit are objectively defined and align with insurable need.	High
Waiting / qualifying period	Certain conditions may be prone to self-diagnosis resulting in anti-selection when a trauma policy is taken out.	Medium
Amounts insured	The sum insured is commensurate with the risk, with suitable mitigation such as applying severity criteria where appropriate.	High
Buy backs and reinstatements	Apply with appropriate degrees of risk management mechanism on buy back of death cover and reinstatement of claimed trauma cover. Some mitigations could include: • enforce capability period before buy back of life cover; • requiring opt-out to buy back; • apply a waiting period and limit conditions covered for a trauma reinstatement; and • options to waive premiums following claim should be avoided.	Medium
Maximum age	Set an appropriate maximum age at which trauma coverage ceases, to manage affordability as well as the risk of anti-selective lapses at older ages.	Medium
Premium rate guarantees	Contract terms preventing the insurer from altering the premium rate schedule to reflect any unexpected changes.	High
Exclusions	Exclusions such as self-inflicted harm or pre-existing conditions should meet community and regulatory expectations and be clearly defined and explained in communications with policyholders.	Medium

A.2 Underwriting Practices

Under good practice, sound product design needs supporting underwriting and claims practices to promote sustainable outcomes, including return to work where appropriate. Under good practice, underwriting and claims practices would combine with product design to:

- limit claims to the insurable interest of the customer; and
- operate to encourage the customer to return to health and minimise loss of their income.

A.2.1 Financial Underwriting Ensures that Benefits Do Not Exceed Insurable Interests and Promotes Loss Minimisation

Consider whether under the proposed benchmark operational practices the combined value of the customer's unaffected business income, passive income, lump sum living benefits and disability income benefits incentivise or disincentivise return to work. Benefit periods that are too long may encourage the use of an insurance claim as an early retirement strategy, for example.

Note: Good practice suggests that the various types of income are clearly defined so that benefit amounts are properly understood and achieve the intended outcomes.

Two possible examples are:

Passive income is income that is not income earned from working or from the conduct of a business. Passive income includes income such as interest, dividend or rent, other investment income or capital gains, ongoing contractual royalties or annuities, or other similar recurrent income.

Unaffected business income is the insured's share of the net income (revenue less expenses) which they receive or are entitled to receive from current or former business activities, including related business entities, that can be maintained irrespective of disability (e.g., net business income earned above the cost of a locum to replace the insured's product or service delivery role in their business).

A.2.2 Insured Events Updated to Keep Up With the Customer's Changing Circumstances

Consider whether the customer should be asked annually to confirm their financial information details to ensure that cover continues to be consistent with their insurable interest and they are charged the correct premium. This could also help ensure customer and insurer expectations are consistent. For example, this information might include the customer's occupation, pastimes and income level.

Variation	Description	Example rating
Underwriting resources	The underwriting team has adequate capacity or breadth of experience and/or specialist skills to effectively underwrite in accordance with benchmark underwriting practices.	High
Non-medical underwriting	Non-medical underwriting allows for the combination of living benefits (lump sum TPD and Trauma and Income Insurance) in evaluating the sum insured.	High
Non-medical underwriting	Financial, occupation and pastimes information is confirmed regularly. If not, partial mitigants could include a meaningful opt-in underwriting process and checks at time of claim.	Medium
Unaffected business income	Financial underwriting and/or product definitions exclude unaffected business income. Consider the extent that unaffected business income may influence the replacement ratio when determining the rating.	Medium
Passive income	Financial underwriting and/or product definitions exclude passive income. Consider the extent that passive income may influence the replacement ratio when determining the rating.	Medium
Treatment of atypical income	Financial underwriting and/or product definitions exclude "atypical income" or limit it to say 20% of regular income or with a reliable history of that atypical income.	Medium
Income history	Requiring that sums insured are based on income amounts with longer history and/or considering employment history (and changes in employment, income, etc.).	Medium
Occupation definitions	Consider impact of narrow occupation definitions that may enable claimants to opt to "early retire" rather than change to a similar occupation.	Medium
Continuous improvement process	Underwriting manuals have a formal regular review process to consider: (i) emerging industry trends that may reduce sustainability; and (ii) current environmental factors.	Medium
Genetic testing	Given the currently proposed ban on using genetic testing results in life insurance underwriting, insurers should consider the potential impacts of any significant cross-subsidisation of risks among customers. This is important as advancements in the predictive power of genetic testing and their implications for life insurance continue to evolve.	Medium

A.3 Claims Practices

Under good practice, the insurer would ensure that its claims practices cover matters identified in the regulatory and industry standards – SPG 250, LPG 240 and the Life Insurance Code of Practice (LICOP) – and any other relevant regulation or guidance. Documentation would seek to highlight how these claims practices support the product's design, intended customer experience and approach to pricing.

A.3.1 Claims Team Has the Capacity and Skills to Assess the Claims Definitions

Consider whether the claims team has sufficient skills and experience with adequate capacity to assess claimants against the disability definitions. For TPD in particular, this includes the difficulty in assessing permanence, given the potential subjectivity of some claim causes.

Consider whether claims assessors retain ownership of the decision regarding payment of a claim.

Consider also whether they should and may (i) request only factual medical information from General Practitioners (GPs); and (ii) use assessments from occupational physicians, occupational therapists, psychiatrists and other specialist practitioners in assessing function and capacity to work.

A.3.2 Claims Team Actively Plans, Communicates, Encourages and Implements Return to Work / Wellness with Claimants

Consider regular communication between assessor and claimant while the claim is being assessed to ensure that expectations are set.

For IDII, consider whether during the first period of claims payments (say 18 months) the claimant receives regular communication on return to wellness / work expectations following acceptance of the claim.

Consider whether communication includes the agreed recovery management plan (where appropriate) and future changes in benefits under the product terms and conditions.

Variation	Description	Example rating
Claims practices	Stable claims practices and/or claims staff responsibilities, i.e., lack of frequent changes.	High
Sufficient claims resources	There is a sufficient level of claims resources to reliably service customers and meet benchmark practice.	High
Sufficiently skilled staff	Claims staff have adequate skills to assess the claims and with appropriate input from GPs or other factors in their assessments.	High
Insurer "in-house" claims decisions	The claims process does not rely on third parties to determine the eligibility of the life insured to claim.	High
Return to work or recovery plan (for IDII)	Claims managers set and communicate return to work expectations in accordance with benchmark product features and operational practices.	Medium
Setting and managing customer expectations	Claims managers manage the customer's expectations about: (i) any participation required to achieve a return to wellness / work (where applicable); (ii) following the reasonable requests of health professionals; and (iii) how any future benefit amount or definition changes may impact on that plan.	Medium
Comprehensive claims practices	Claims practices adequately incorporate biopsychosocial factors when triaging and managing claims.	Medium
Investment in claims quality outcomes	Claims practices result in good adherence to claims eligibility conditions. For example, IDII benefit payments exceed the normal replacement ratio in accordance with the product's design.	Medium
Effective claims practices	Claims practices related to SPG250, LPG240 and LICOP are: (i) documented; (ii) considered by the Board; and (iii) assessed as effective.	Medium
Multiple covers	Claims management considers the total covers held by a policyholder and how eligibility for a claim may change over time, e.g., an IP claim that leads to a TPD claim. Consideration includes how these multiple covers interact at claims time and drive behaviour and how this data is captured for analysing experience. Under the Life Insurance Code of Practice all relevant benefits under the policy being claimed on must be considered.	Medium

A.4 Pricing for Uncertainty

Uncertainty is particularly high in disability insurance products because of product optionality.[9] Other factors creating uncertainty for IDII, TPD and Trauma include:

- in a rapidly changing environment, historic data may be inadequate to estimate the future claims cost;
- limited understanding of customer behaviour and social factors impacting claims cost;
- the potential for social inflation, environmental changes and rare events (e.g., pandemics) to increase costs (including social, medical, economic and regulatory factors); and
- delays in reporting claims and terminations mean experience in respect of any period take time to be fully assessed.

Consider whether the insurer proactively seeks to understand and reduce uncertainty through product terms and underwriting and claims practices.

Consider whether the uncertainty associated with IDII, TPD and Trauma is acknowledged and understood by management and at the board level.

Consider whether there is a tendency to misestimate the cost of uncertainty by default (i.e., being optimistic would underestimate or being pessimistic would overestimate the cost).

Consider whether pricing assumptions / margins allow for the cost of that misestimation.[10]

A.4.1 Pricing Approach Puts a Cost on Uncertainty

Good practice suggests insurers would set a period for which the pricing approach would consider uncertainty – for example, over at least the first five years from inception of policies.

The insurer could make clear its intention in this respect – for example, that it is more likely than not that allowing for uncertainty over this period: (i) the premium rate schedule would remain unchanged; and (ii) the insurer would meet its minimum profit metrics[11] (this does not imply that premium rates should be guaranteed).

Consider whether such a requirement might be implemented and how compliance would be monitored.

Consider whether uncertainty would be allowed for explicitly in best estimate assumptions or separately in risk margins.

Consider whether in setting best estimate assumptions the starting point might be the industry table and a credibility approach used to overlay the insurer's own historic experience (and/or alternate rating factors).

In recognition that assumptions are typically built up from historic experience, a number of additional factors might be considered in respect of the allowance for uncertainty in best estimate assumptions or risk margins. Product optionality is one factor where the option cost and/or interaction with future environmental factors may increase cost above what has historically been observed. If there is reasonable empirical data or research to explain why suspected uncertainty would not have a cost, then the cost of that uncertainty might be reduced. Equally, evidence may indicate that a cost for uncertainty should be considered in best estimate assumptions. A.5 Data, Experience Investigations and Research gives examples of benchmark operational practices that could reduce uncertainty over time.

Other uncertainty factors that might be considered include:

i. continuation of adverse historic trends in experience (unless credibly explained as one-off by factors such as changes in the insurer's operations, social inflation / community attitudes, regulatory expectations or industry and legal practices);

ii. mis-estimation of the mean by assuming that the insurer's own favourable and credible experience compared with the industry would persist into the future. For example, the total claims cost arising from combinations of best estimate assumptions that are more favourable than the lesser of (i) the insurer's credibility weighted experience; and (ii) the industry experience may not be sustainable;

iii. to the extent not reflected in the underlying experience, the average cost of cyclical effects such as the impact of the economic cycle, in particular unemployment and underemployment;

iv. potential optimism in duration-based termination assumptions because, for example, (i) the insurer assumes that credible insurer experience at short durations implies credible experience at longer durations; or (ii) the shape of the industry table has been altered without evidence that there is not an unaccounted for opposite effect at another duration; and

v. any expectations that customers would reasonably have.

It is recognised that it may take insurers some time to better understand uncertainty and reduce the cost of uncertainty in pricing.

9 Product optionality means the extent to which definitions permit flexibility in behaviour and includes: multi-tier total disability definitions; partial disability benefit; and other features that may result in the customer valuing benefits differently under various future lifestyle, economic and environmental conditions.

10 See Technical Paper: Analysing Disability Income Experience and Setting Best Estimate Assumptions (September 2021).

11 It is up to the insurer to determine the methodology and metric(s) that it wishes to use to assess profitability and profit margins (i.e., this Guide neither defines a technical approach nor whether uncertainty should be included).

A.4.2 The Pricing Philosophy Addresses Key Questions of Equity

Consider how well the pricing philosophy articulates how the insurer proposes to address factors that impact on the product's cost over time. These factors could include how the insurer:

i. addresses cross subsidies between the early policy years and later periods so that pricing allows for factors including the recovery of acquisition costs and known policy duration effects on claims costs (e.g., both selection from underwriting and anti-selection effects from lapsation);

ii. deals with profitability issues that may arise from uncertainty crystallising and impacting on the disabled lives reserve;

iii. allows for uncertainty in its pricing including the operational practices detailed in A 4.1 and how pricing of uncertainty differs between short and long duration benefits;

iv. exercises its repricing rights if uncertainty crystallises and, in particular, how it proposes to balance: (i) allowance for uncertainty in upfront pricing; (ii) frictional costs that customers may face if prices increase; and (iii) how it will manage its profit metrics; and

v. ensures that pricing for each individual product line[12] is not loss making at least on a marginal cost basis.

Variation	Description	Example rating
Pricing philosophy	Any of the following apply: • the insurer has a documented approach to pricing for uncertainty; • the insurer's approach requires optimism to be removed for at least X years (including the "more likely than not" benchmark conditions in Section A.6.1); or • the insurer's approach states that adverse historic trends must be assumed to continue into the future (for at least X years) unless there is empirical rationale to the contrary.	High
Use of the latest industry tables for assumptions	Any of the following apply: • the insurer is using an industry table or industry investigation with a release date less than X months at the time assumptions are set; • assumptions set using a recent industry table unless supported by a strong empirical reason not to do so; or • assumptions are updated at least annually.	High
Granularity of assumptions	The granularity across the drivers of experience is at a sufficient level and empirically justified against the industry table and is not biased towards optimism (or pessimism). As an example, the duration shape of terminations.	High
Repricing rights	The approach to valuing repricing rights explicitly considers the insurer's pricing philosophy and other market constraints, and takes into account practical limitations of executing a reprice (including timing and magnitude).	High
Minimum profit targets	Profit sufficiently meets the insurer's target minimum requirements having fully allowed for uncertainty as part of the best estimate cost of the product.	High
Credibility theory to assumption setting	There is a documented approach to credibility in assumption setting (or non-adherence to the process).	Medium
Cyclical effects	Cyclical effects are fully allowed for in best estimate assumptions.	Medium
Communication of uncertainty	Clear communication to the insurer's decision makers that uncertainty is a best estimate cost or risk margin (not profit margin) of the product and that to reduce uncertainty actions are required in product design, underwriting and/or claims.	Medium
Impact of mix of covers	Consider whether the combination of covers may impact future experience, for example TPD held with IP.	Medium

12 Product lines include the separation of income protection and lump sum benefits.

A.5 Data, Experience Investigations and Research

To reduce uncertainty and understand risk, it is good practice for an insurer to collect data, analyse that data and participate in industry research. This is particularly important for IDII, given its inherent complexity.

A.5.1 Data Is Collected to Cost All Benefits, Options and Key Drivers of Claims Cost

Consider whether adequate data is collected so that a granular understanding of the product's cost is available. This may include consideration of the following:

- demographic information that is relevant to pricing;
- all the choices made by the customer when purchasing a policy, including features that do not attract a separate premium. This includes changes made by the customer after purchase or exercising options (such as buy backs);
- the version of the product, underwriting practices and claims practices relevant to the experience on individual policies and claims associated with that version tracked over time;
- additional covers that may impact on the claim, for example the interaction between IDII and TPD; and
- factors relevant to customer behaviour at and during claim recorded over time, including the replacement ratio and any secondary claim cause.

Consider whether the data is analysed to provide empirical evidence for product features and processes that positively or negatively affect sustainability.

Consider whether data is collected in accordance with any appropriate benchmark data specification published from time to time (e.g., by APRA or industry bodies).

A.5.2 Data Shared to Facilitate Industry Research

It is good practice for good quality research to be published as this will promote sustainability of disability insurance. Insurers with inadequate data and/or insights may make poor decisions that in a competitive market can impact all participants.

Subject to appropriate data privacy measures that protect customer and insurer anonymity, an insurer could consider contribution of data for publication and research by credible third parties – in particular, data to support research into topics considered a high priority.

Variation	Description	Example rating
Data collection	Claims and policy data meeting standards set by industry bodies or APRA are collected.	High
Experience investigations	Detailed experience investigations against the appropriate industry table are conducted at least annually.	High
Data sharing	Claims data is shared with the industry experience studies program within the published timeframes.	High
Data at time of claim	Data related to income, self-employed vs. employed status and secondary claim cause features is captured at time of claim.	High
Data on claims processes	Data is collected on the main claims practices applied to each claim and thus it is possible to measure effectiveness and improve processes in future.	Medium
Data governance	There is a documented data governance process that is regularly applied to ensure continuous improvement of data quality over time.	Medium
Data quality	There is: (i) a robust and repeatable process for ensuring quality data is produced on a timely basis; and (ii) data does not routinely require material manual fixes.	Medium

A.6 Annual Sustainability Assessment / Actuarial Control Cycle

Consider whether there is a process to regularly bring together the pricing, reserving, experience and analytics, claims, underwriting and product teams to analyse, explain and agree actions to support sustainability. Reinsurers and direct insurers could also work together on supporting sustainability.

Consider whether the sustainability assessment addresses the following items at a minimum:

i. analysis of granular experience study results compared with the latest industry study results and pricing assumptions;

ii. any trends and variations in experience and how these may link to uncertainty identified in previous CPS 320 advice;

iii. experience variations in the insurer's profit and loss including detailed movement analysis of the disabled lives reserve compared with assumptions;

iv. analysis of experience against items in the variations register (see Section 3.3), considering any root cause issues in the insurer's Target State;

v. the outcome of claims case file reviews targeted at assessing the sustainability of product design, underwriting and claims practices;

vi. a review of actual claims practices for effectiveness at achieving the outcomes for product design, customer experience and pricing as described in A.3 Claims Practices;

vii. actions to improve disability insurance product sustainability; and

viii. any external factors such the legal or regulatory landscape.

Variation	Description	Example rating
Formal cross functional team forum	A cross functional team meets at least annually to formally consider emerging experience and agree actions to improve sustainability.	High
Sustainability reporting to senior management	Findings of the cross functional team's analysis of the product's performance are recorded and the key findings are syndicated to senior management (and escalated to the Board where appropriate).	High
Actuarial control cycle	There is a complete actuarial control cycle linking experience investigations, assumption setting and financial results.	High
Governance practices and feedback	Insurance frameworks and policies (product, pricing, claims, underwriting, data) are in place, updated regularly and subject to regular feedback loops based on experience.	High
Board reporting on sustainability	The Board receives regular updates on sustainability in accordance with benchmark practice.	Medium
Claims case file reviews	There is a regular and "right sized" claims case file review process to identify product and process improvements designed to improve sustainability.	Medium

Appendix B – Sample Underwriting Assessment

The following table provides an example of how the assessment can be documented for the underwriting category. The contents of this table are illustrative only and an insurer should form their own position. The table illustrates how an insurer can assign points to each segment. A Target State can then be determined, with a rationale set for where this differs from the benchmark. The Current State can also be determined by the insurer with documented variations to the Target State. These can then give rise to an action plan. The table also shows how the totals can be converted into percentages to have consistent reporting across all the categories. While the table focuses on documentation of differences, good practice would be to also document the reasons why an insurer considers the Current State to be at target and for Target State to be at benchmark.

Segment	Example rating	Maximum points	Target State	Rationale for Target State	Current State	Variations in Current State
Underwriting resources	High	10	8	1. Rationale 2. Rationale	7	1. Variation
Non-medical underwriting	High	10	10	n/a	8	1. Variation 2. Variation
Non-medical underwriting updates	Medium	5	5	n/a	5	n/a
Unaffected business income	Medium	5	4	1. Rationale 2. Rationale	4	n/a
Passive income	Medium	5	4	1. Rationale 2. Rationale	4	n/a
Treatment of atypical income	Medium	5	5	n/a	4	1.
Established income history	Medium	5	5	n/a	5	n/a
Occupation definitions	Medium	5	5	n/a	5	n/a
Continuous improvement process	Medium	5	5	n/a	5	n/a
Total		**55 – 100%**	**51 (out of 55) – 93%**		**47 (out of 55) – 85%**	

Actuaries
Institute.

Actuaries Institute
ABN 69 000 423 656

Level 34, Australia Square
264 George Street, Sydney NSW 2000

T +61 (0) 2 9239 6100
E actuaries@actuaries.asn.au
W actuaries.asn.au