



24 March 2022

TO: ALL LIFE INSURERS AND FRIENDLY SOCIETIES

INDIVIDUAL DISABILITY INCOME INSURANCE: SUSPENSION OF POLICY CONTRACT TERM MEASURE

During recent years, life insurers and friendly societies (life companies) have suffered significant losses from individual disability income insurance (IDII). This has translated into substantial premium increases, which is a very poor outcome for policyholders in these products. Left unaddressed, there was a material risk that IDII cover would no longer be available or affordable for the protection of the community. Given these developments, it was necessary for APRA to introduce a package of measures to address the sustainability of IDII. All but one of APRA's measures, namely the IDII policy contract term measure, have been implemented.¹

In May 2021, APRA announced that it was deferring the implementation of the policy contract term measure to 1 October 2022. This was to allow additional time for the development of solutions that met APRA's expectations, were legally compliant and mitigated unintended adverse consequences for consumers. This letter deals with further developments related to the policy contract term measure.

Industry proposals

Since its previous industry letter on this topic, APRA has continued to engage with the life insurance industry and other industry stakeholders. During this period, APRA received submissions from the industry on potential solutions for implementing the IDII policy contract term measure. The submissions demonstrated the potential value of the policy contract term measure, namely to curtail the need for future premium increases necessitated by unsustainable product features. They also indicated challenges associated with the proposals, the most significant being:

- potentially material premium increases in the short term, driven in particular by significant uncertainty around policyholder behaviour when renewing cover and commission expenses; and
- the risk of some policyholders inadvertently not renewing their cover, in the absence of effective engagement with the life company providing their cover.

APRA acknowledges the challenges associated with the operationalisation of the IDII policy contract term measure. Notwithstanding these challenges, the measure provided industry with a valuable opportunity to make changes that would improve both IDII sustainability and effective customer engagement. It is therefore disappointing that the industry appears not to have engaged with this opportunity as fully and openly as expected, or with a view to sufficiently shift away from problematic legacy practices where needed.

¹ The IDII policy contract term measure is intended to be a mechanism for life companies to update their IDII products to take account of unsustainable contract terms and changes in the operating environment.

Suspension of policy contract term measure

APRA, in consultation with ASIC, has given careful consideration to the potential solutions that have been submitted and the most appropriate course of action, taking into account the potential impact of APRA's other sustainability measures and industry developments, most notably Treasury's ongoing reviews on legacy product rationalisation and quality of advice.

In light of the above considerations and the challenges that industry has not been able to address, APRA has decided to suspend the IDII policy contract term measure for at least two years, at which time it will reassess its position. However, APRA remains of the view that there is inherent value in life companies having mechanisms other than price to address the risk of unsustainable product terms.

APRA's expectations

While the IDII policy contract term measure is suspended, APRA expects life companies to demonstrably strengthen customer engagement, which has been shown by the recent industry submissions to be an area of weakness. This includes collecting information on changes to policyholder's circumstances, including occupational and financial circumstances and dangerous pastimes, to enhance the ability of life companies to understand and manage the risks of their portfolios. Over time, such information could also be leveraged to improve customer experience and inform ongoing review of the appropriateness of products for their target market.

During the period of suspension, APRA also expects life companies to:

- maintain a strong focus on IDII sustainability, including the uplift of capabilities and practices in accordance with APRA's previously communicated expectations;
- consider conduct-related matters arising from various law reforms alongside APRA's sustainability measures, as previously communicated by ASIC. These reforms include the design and distribution obligations, unfair contract terms, claims handling and duty of reasonable care;
- take steps to support policyholders in unsustainable IDII products transitioning to newer, more sustainable products, where appropriate;
- actively contribute to the Treasury reviews mentioned above, with a specific focus on both the sustainability of products and distribution and appropriate outcomes for policyholders;
- seek to identify possible alternative ways to effectively address the risk of price being the only lever to deal with contract terms that are not sustainable; and
- strengthen their engagement with other industry stakeholders, particularly financial advisor bodies, in support of developing more robust solutions.

Industry actions in the above areas should contribute to mitigating the risk that the IDII policy contract term measure was intended to address and/or lessen the impact of some of the existing barriers to implementing the measure. Progress in these areas will stand the life insurance industry in good stead, regardless of the outcome of APRA's future reassessment of the IDII policy contract term measure.

New IDII products

An important milestone was reached when life companies released new IDII products in response to APRA's other IDII sustainability measures that took effect on 1 October 2021. While it is not unreasonable for life companies to review and potentially revise their products in response to competitive offerings and feedback from the distribution channels, APRA expects all life companies, including reinsurers, to be disciplined in their actions and apply rigorous governance to any contemplated changes. This extends to appropriate involvement of life companies' three lines of defence, and their Boards.

Life companies are reminded that IDII sustainability is about more than complying with APRA's IDII product measures and requires product design to be considered holistically, with controls commensurate with the riskiness of the features offered. Likewise, premiums should be set with the objective of providing policyholders with a reasonable degree of stability over the lifetime of their products. Where upfront premium discounts are applied, the appropriateness and level of these discounts should be carefully considered from a sustainability perspective. The temporary nature of such discounts should also be made clear to policyholders.

During the period of suspension of the IDII policy contract term measure, APRA will continue to monitor and engage with industry on their progress towards IDII sustainability, including the ongoing review of life companies' progress with meeting APRA's expectations. In particular, APRA will continue to closely monitor market developments. Where life companies' behaviour undermines the achievement of IDII sustainability, APRA will not hesitate to take strong action, including, but not limited to, increasing the IDII capital charge.

Long term IDII sustainability can only be achieved if all industry participants play their part. APRA expects life companies to continue making constructive contributions towards the achievement of an Australian life insurance industry with sustainable IDII products.

Yours sincerely

Helen Rowell
Deputy Chair