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Australian Prudential Regulation Authority

# Inquiry into the Scrutiny of Financial Advice - Life Insurance

Submission to the Senate Economics Committee

April 2016

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## 1 Financial regulation and APRA

The Australian Prudential Regulation Authority (APRA) is one of four independent agencies that oversee the Australian financial system. The other three are the Australian Securities and Investments Commission (ASIC), the Reserve Bank of Australia (RBA), and the Australian Competition and Consumer Commission (ACCC). Each of these regulators has a clearly defined and distinct mandate.

- APRA is responsible for prudential supervision of individual financial institutions and for promoting financial system stability in Australia.
- ASIC is responsible for financial market integrity, business conduct and disclosure, and consumer protection in the financial system.
- The RBA is responsible for monetary policy, stability of the financial system and the safety and efficiency of the payments system.
- The ACCC is responsible for competition policy.

APRA supervises Australia's authorised deposit-taking institutions (banks, building societies and credit unions), life and general insurance and reinsurance companies, private health insurers, friendly societies and superannuation funds (excluding self-managed funds). APRA establishes and enforces prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions it supervises are met within a stable, efficient and competitive financial system.

Put simply, APRA's role is to ensure that regulated institutions remain financially and operationally viable. APRA seeks to identify potential weaknesses in supervised institutions as early as possible and satisfy itself that institutions are taking adequate steps to address them within an appropriate time-frame. However, the primary responsibility for financial safety and soundness within an institution rests with its board of directors and senior management. APRA's approach is to ensure that boards and managers understand and are meeting these responsibilities.

In addition to APRA's prudential supervision role, it collects and publishes information on the life insurance industry (and other APRA regulated industries) in the form of statistics. The statistical data is sourced from regulatory returns submitted to APRA under the Financial Sector (Collection of Data) Act 2001. A collection of our most recent publications for your information is available on the APRA website. Relevant information to his submission is included in the appendix.

## 2 The Life insurance industry

### 2.1 Industry

Although the life insurance industry continues to operate with an adequate excess of capital above minimum regulatory requirements, the profitability of the life insurance sector has been under strain in recent years (see Annex A for overview of the industry). Weak profitability has

been driven by, in particular, the mispricing of risk which resulted in losses for insurers during 2013-14:

- group risk insurers experienced higher-than-expected lump sum disablement (TPD) claims payouts which generated substantial losses in 2013, with some reinsurers being particularly affected; and
- individual disability income business was the most significant source of losses in 2014.

In addition to the issues above, the industry has had to deal with a challenging external environment, including ongoing financial market volatility, persistently low interest rates, and pressures on overall industry operating efficiency. Some insurers have managed these challenges better than others. In particular, those insurers with a strong risk management framework, an effective risk appetite statement and a robust approach to capital management have proven best able to manage and adapt to operating conditions.

## 2.2 Recent prudential activity in the life insurance sector

### 2.2.1 Supervision

APRA undertook several significant pieces of supervisory work in 2014/15 to encourage the life insurance industry to promptly and comprehensively address the underlying causes of poor risk management in group risk insurance. These underlying causes are equally applicable to the individual life sector as well.

Poor risk management over time led to claims payouts exceeded the premiums collected for group total disability and group income protection, lines of insurance during 2013 and individual total disability and life in 2014. Reinsurers provided reinsurance on generous terms to these insurers, in effect allowing poor underwriting and risk management practices. As a result, reinsurers bore most of the losses during this period.<sup>1</sup>

This outcome is not sustainable in the long term. Consumers of long-term products such as life insurance are ultimately best served if insurers are financially sustainable, thereby enabling firms to deliver on their long-term promises.

As noted in APRA's letter to the industry in May 2015, there were various reasons for losses including<sup>2</sup>:

- underwriting and pricing practices in both the life insurance and reinsurance industry left both the direct and reinsurance market exposed to adverse movement in market conditions. In particular, thin margins were exposed by pricing that did not properly align with the policy benefits. A notable example was a trend whereby default coverage

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<sup>1</sup> APRA (3 March 2015), *Speech by Ian Laughlin A challenge to the life industry: managing for long term portfolio health*, <http://www.apra.gov.au/Speeches/Pages/Life-Risk-Insurance-A-challenge-to-the-life-industry-managing-for-long-term-portfolio-health.aspx>

<sup>2</sup> APRA (18 May 2015), *Letter to life insurers: Group insurers*, <http://www.apra.gov.au/lifs/Pages/Letter-to-LI-entities-on-Group-Insurance-18-May-2015.aspx>

increased in group life schemes, but the underlying premium rates did not increase, and in many cases fell, despite the increased exposure;

- decreases in global interest rates reduced investment returns;
- competitive tension in group life market tendering saw the process often weighted toward acquisition and retention of business rather than sustainability; and
- increased plaintiff solicitor involvement drove an increase in lump sum total permanent disability (TPD) claims. The resulting increase in claims has been seen, in part, as a correction of a rate of claims which may not have accurately reflected the industry's underlying exposure. For instance, prior to targeted marketing by plaintiffs' firms, individual members may not have been aware of their available cover. An increase in the number of TPD claims related to mental illness and other complicated injuries, and changing community standards as to what conditions give rise to claims, has also resulted in more claims payments and requires greater claims management and resourcing.

Subsequently, reinsurers sought to mitigate the adverse impact of the poor experience on their financial position by significantly reducing or even ceasing to write or tender for new business. This in turn led to an increase in prices for policyholders and/or a tightening of coverage, where permitted, which has inevitably been passed on to policyholders.

Changes made by insurers include:

- no longer making 'opt-in' offers that allow members to take or increase cover with little or no evidence of health status;
- increasing the length of the 'at work' period for members to become eligible for cover (e.g. from one day to one month);
- tightening the definition of TPD (for example, from 'unlikely to work' to 'unable to work');
- introducing severity-based TPD benefits;
- introducing TPD benefits payable via instalments rather than as a lump sum;
- reducing default TPD benefits and increasing default GSC benefits;
- reducing automatic acceptance limits;
- making greater use of health questions for optional cover; and
- making greater use of exclusions for pre-existing conditions, hazardous occupations, suicides and pandemics.

During 2014/15, APRA observed that group insurers and reinsurers had made considerable efforts to address many of the issues that gave rise to high claim costs from earlier mispricing of risk. Actions taken included:

- increasing focus on early intervention and rehabilitation;
- increasing focus on mental health issues;

- increasing staff training;
- increasing resourcing in the claims department;
- better forecasting of future resourcing requirements;
- reviewing claims processes more frequently;
- making system enhancements;
- enhancing claims reporting;
- establishing service levels for turnaround times on reinsurance referrals; and
- utilising additional specialist medical officers.

APRA encourages insurers to continue to review their processes and make improvements where appropriate to incorporate lessons learned.

In 2014/15, APRA also undertook a group insurance thematic review focused on registrable superannuation entity licensees' (RSE licensees') governance and oversight of the provision of insurance to the members of their RSEs, and also the role of insurers in meeting APRA's expectations as set out in the relevant prudential standards<sup>3</sup>.

APRA has also written directly to insurers about specific issues in this area. For example, APRA wrote to insurers in May 2015 highlighting their legal responsibilities and clearly articulating its position on this issue. The letter also encouraged strong dialogue between insurers and superannuation fund trustees:<sup>4</sup>

*"APRA would be concerned if insurers chose simply to take a 'harder line' in considering claims in an effort to reduce claims costs. Insurers need to be satisfied that claims are assessed fairly and in accordance with the policy terms. This is an important requirement in order for the board to be confident that it is meeting its obligations under section 48 of the Life Insurance Act 1995.*

*Paragraph 22(a) of SPS 250 requires a trustee to consider (among other things) a prospective insurer's claims philosophy. Paragraphs 7 to 9 of LPG 270 provide guidance to insurers on important factors to consider when developing a claims philosophy and on what APRA considers is good practice in this regard. The claims philosophy should reflect the insurer's current approach to dealing with claims.*

*Recent circumstances highlight the importance of a clear claims philosophy; and the need for insurers and trustees to have a deep and shared understanding of how claims will be dealt with. If an insurer seeks to change its approach to dealing with claims, this would typically be reflected in its claims philosophy and discussed with the trustee. APRA considers that active dialogue between insurers and trustees on this issue builds*

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<sup>3</sup> APRA (2015), "Superannuation and Insurance", *Insight*, Issue One, <http://www.apra.gov.au/Insight/Pages/Insight-Issue-One-2015-HTML.aspx>

<sup>4</sup>APRA (18 May 2015), *Letter to Life Insurers on Group Insurance*<http://www.apra.gov.au/lifs/Pages/Letter-to-LI-entities-on-Group-Insurance-18-May-2015.aspx>

*trust between the parties and we encourage insurers and trustees to discuss in detail proposed changes to the claims philosophy or approach before they are implemented.*

*Claimants will also benefit from close alignment between the insurer's and trustee's approach by reducing onerous paperwork; reducing the possibility of miscommunications and disputation; and simplifying the claims process for claimants, trustees and insurers."*

In addition APRA has observed that many insurers chose to increase premiums to improve profitability. While some premium increase may be needed to ensure pricing is sustainable following a period in which premiums were insufficient to reflect risk, in APRA's view, these increases do not by themselves address the structural reasons that led to the underlying problems and have produced an unexpected increase in the cost of insurance for superannuation fund members.

As noted in the APRA's 2015 Annual Report, additional work by insurers is needed in the following areas:

- *reviewing and updating benefit definitions:* benefit definitions remain complex in many policies. A number of insurers are working with trustees to review benefit definitions, with some already having made changes. However others have yet to do so and this may occur only over a number of years into the future. APRA remains of the view that modernisation of benefit design and definitions are a critical aspect of developing sustainable group risk products and should occur as soon as practicable; and
- *completing studies of individual disability income experience:* the supervisory work found that individual insurers are undertaking analysis and studies of individual disability income experience but as yet few firm conclusions have been reached as to the underlying causes. APRA will continue to engage with insurers to ensure the industry identifies and takes action to address the causes of this deterioration.

## 2.2.2 Improving prudential standards

In support of the supervision arrangements discussed above, APRA has also strengthened the prudential framework as it applies to both insurers and superannuation trustees.

### *Prudential Standard SPS 250 Insurance in Superannuation (SPS 250)*

SPS 250, introduced in 2012, establishes requirements for superannuation funds for making insured benefits available to beneficiaries.<sup>5</sup> The trustee of a RSE licensee contracts with group insurers to provide life insurance to the fund's members (beneficiaries). Only the RSE licensee can act or take decisions with regards to insurance services as it typically is the policyholder for the purposes of group insurance.

Given this, the standard establishes that the board of an RSE licensee is ultimately responsible for having an insurance management framework that reflects the risks associated with making available insured benefits that is appropriate to the size, business mix and complexity of the RSE licensee's business operations.

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<sup>5</sup> APRA (November 2012), *Insurance in Superannuation Prudential Standard SPS 250*  
<http://www.apra.gov.au/Super/PrudentialFramework/Documents/Final-SPS-250-Insurance-in-Superannuation-November-2012.pdf>

The key requirements also include:

- ensuring that insurance arrangements adequately address the minimum requirements set out in the standard;
- overseeing an insurer's process for underwriting and claims assessment;
- implementing a policy for managing declined applications for insurance, applications resulting in reduced cover or restrictions, terminations of cover and requests for reinstatement;
- maintaining claim records to allow potential group insurers to more accurately tender for group life business; and
- formulating and giving effect to appropriate selection processes for, and due diligence of, insurers and monitoring relationships with insurers on an ongoing basis.

#### Prudential Practice Guide – Group Insurance Arrangements LPG 270

In addition to SPS 250, APRA released in October 2014 a prudential practice guide (PPG) on group insurance arrangements to assist insurers to understand the implications of SPS 250 for their operations and is equally relevant for individual insurers.<sup>6</sup> This PPG is likely to be of specific interest to the Inquiry as it outlines APRA's minimum expectations and recommended good practice for an insurer's claims philosophy.

An insurer's claims philosophy captures the insurer's current approach to claims assessment, administration and settlement. This would include its expectations of claimants (e.g. in respect of the burden of proof of disability), the nature of support given to claimants, processes to be followed by the claimant and communication with the claimant. APRA expects the insurer's claims philosophy to be clearly articulated. In particular, it is important that an RSE licensee be able to understand the insurer's practical application of the definition of disablement.

Claims philosophy encompasses those claims management processes and controls of the insurer that support the insurer paying all valid claims in a timely manner. Examples of how the claims philosophy may be supported by an insurer include, but are not limited to:

- the insurer having formal service levels for processing claims and reporting against those service levels;
- the insurer having in place a process to ensure that all relevant information has been provided to it and a process that supports the appropriate review of previous decisions when new information comes to light;
- the insurer having in place a process for providing beneficiaries with access to all material that has influenced the claims decision, when it is required to do so and having regard to any relevant privacy obligations, and the opportunity to respond and/or provide further information;

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<sup>6</sup> APRA (October 2014), *Prudential Practice Guide Group Insurance Arrangements LPG 270*, <http://www.apra.gov.au/lifs/PrudentialFramework/Documents/Prudential-Practice-Guide-LPG-270-Group-Insurance-Arrangements-October-2014.pdf>

- the reasonableness of the insurer's claims requirements (and underwriting requirements if relevant);
- the insurer's approach to managing claims which arise from a past insurance arrangement where the insurer is no longer providing the ongoing insurance for an RSE;
- the insurer's awareness of case law that might affect its decision-making processes;
- the dispute resolution procedures between the insurer and RSE licensee where there is disagreement regarding claims assessments; and
- support the articulation of its claims philosophy with quantitative and qualitative indicators.

As noted earlier, in APRA's view the claims management processes of an insurer should align to the claims philosophy and be established with a view to sustainability over the long term. APRA therefore expects that an insurer's claims philosophy would not change in the short term with a view to improving profitability by denying or reducing otherwise legitimate claims. It is also incumbent on RSE licensees to be satisfied that an insurer's claims management practices remain consistent with the stated claims philosophy.

Prudential Standard CPS 220 Risk management (CPS 220) and CPG 220 Risk Management (CPG 220)

On 1 January 2015, a new risk management standard CPS 220 was implemented.<sup>7</sup> The new standard harmonises risk management requirements across the banking and insurance industries, bringing together a range of risk management requirements into a single standard. For insurers, CPS 220 replaced and enhanced an earlier risk management prudential standard, taking account of international developments, lessons from the GFC and APRA's experiences in supervising the industry.

A key part of CPS 220 is APRA's expectation of the board's role in relation to risk culture. APRA recognises that practices and approaches in relation to risk culture are evolving, and that it can be difficult to clearly articulate the risk culture of an institution. That said, APRA does expect that the board form a view of the risk culture in the institution and the extent to which that culture supports the ability of the institution to operate consistently within its risk appetite, identify any desirable changes to the risk culture and ensure the institution takes steps to address those changes.<sup>8</sup>

Ensuring appropriate incentive structures are in place is a key aspect of risk culture. Remuneration is a significant factor in driving risk behaviour within financial institutions, including insurers, and has been an area of focus for international regulators since the GFC. Inappropriately designed remuneration structures can drive poor behaviour. Accordingly,

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<sup>7</sup> APRA (4 December 2014), *APRA releases final prudential standard and prudential practice guide on risk management*, Media release 14.29

[http://www.apra.gov.au/MediaReleases/Pages/14\\_29.aspx](http://www.apra.gov.au/MediaReleases/Pages/14_29.aspx)

<sup>8</sup> APRA (7 October 2014), *Letter to all CEOs regarding CPS 220 and CPG 220*,

<http://www.apra.gov.au/CrossIndustry/Documents/Letter-to-industry-CPS-220-CPG-220-October-2014.pdf>

remuneration needs to be properly considered in order to mitigate the risks that may arise from poorly designed remuneration arrangements.

In April 2010, APRA introduced various prudential requirements in relation to remuneration.<sup>9</sup> The requirements ensure remuneration arrangements promoted prudent risk-taking in the management of the business; and that there is effective governance of remuneration matters. They are not intended to prescribe business decisions regarding pay levels or limit innovative methods of rewarding staff, provided such measures do not compromise the requirements of the prudential standards.

### 3 Opportunities for regulatory reform

As noted above, APRA makes appropriate improvements to the prudential framework where these changes lie within APRA's powers under the *Life Insurance Act 1995*. Appropriate legislative change can also support better prudential outcomes.

One area of potential change identified by APRA relevant to this Inquiry is the introduction of a mechanism to allow the rationalisation of legacy products to occur more easily. Legacy products arise particularly in life insurance and superannuation, where the financial products often last a lifetime, but the financial, legal and social environment continually changes. In addition, the life insurance sector has undergone a significant consolidation over the past 20 years, leading to many duplicated and outdated products. The industry is still grappling with the challenge of addressing those issues.

Life insurers regularly introduce new products to better reflect consumer demand and changed market conditions; while the previous products (legacy products) are typically no longer made available for new business. However, these legacy policies must continue to be administered in accordance with the original contract terms.

Over time, legacy products become more complex and expensive to administer and may no longer meet the requirements of the beneficiaries. Industry estimates suggest that approximately 25 per cent of all funds under management are in legacy products.<sup>10</sup> The cost of these legacy products is ultimately borne by the policyholders.

As life insurance products involve a contract between the life insurer and the policyholder, terms cannot be unilaterally modified by either party to the contract. Consequently, it is very difficult to rationalise legacy products in the absence of a legislative mechanism, as each policyholder would need to consent to any changes. In the case of individual risk business, a policyholder may not be able switch to a newer product or provider readily, as their health status may have changed in the interim meaning that they either cannot obtain replacement insurance or can only do so at significantly increased cost.

There is a range of very complex legal, consumer and tax issues that arise if a life insurer seeks to move policyholders from a legacy product to a new product, restricting the ability of insurers to close legacy products. The benefits of a simpler, though still robust, mechanism to rationalise legacy financial products has been recognised for some time. The issue was, for example, a recommendation of the *Report of the Taskforce on Reducing Regulatory Burdens*

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<sup>9</sup> APRA (30 November 2009), *APRA finalises position on remuneration*

[http://www.apra.gov.au/MediaReleases/Pages/09\\_38.aspx](http://www.apra.gov.au/MediaReleases/Pages/09_38.aspx)

<sup>10</sup> The Financial System Inquiry (November 2014), *The Financial System Inquiry: Final Report, Recommendation 43*, <http://fsi.gov.au/publications/final-report/>

*on Business* in 2006.<sup>11</sup> As noted in the Financial System Inquiry Final Report, between 2007 and 2010 Government worked with industry to develop a mechanism to facilitate product rationalisation. However, such a mechanism was not finalised or implemented.

The mechanism would have facilitated rationalisation of genuine legacy products – that is, not simply those that are performing poorly – subject to a ‘no disadvantage test’ for relevant consumers. It would also have provided tax relief to ensure consumers were not disadvantaged as a result of triggering an early capital gains tax event.

Accordingly, the Financial System Inquiry Final Report recommended the development of an appropriate mechanism for rationalising legacy products.<sup>12</sup> This recommendation was accepted by the Government.<sup>13</sup>

APRA continues to strongly support the need to comprehensively address this issue.<sup>14</sup> From the perspective of the product provider, it would help mitigate the increasing operational risk that such products create, as well as improve the industry’s operational efficiency. From the consumer perspective, it has the potential to improving consumer outcomes by updating definitions, improving efficiency and administration, and lowering costs.

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<sup>11</sup> Regulation Taskforce 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, page 103

<sup>12</sup> The Financial System Inquiry (November 2014), *The Financial System Inquiry: Final Report, Recommendation 43*, <http://fsi.gov.au/publications/final-report/>

<sup>13</sup> The Australian Government (20 October 2015), *Government response to the financial system inquiry: Improving Australia’s Financial System*,

<http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/Govt-response-to-the-FSI/html>

<sup>14</sup>APRA (26 August 2014), *Financial System Inquiry: Response to the Interim Report*, [http://fsi.gov.au/files/2014/08/APRA\\_2.pdf](http://fsi.gov.au/files/2014/08/APRA_2.pdf)

## Annex A: Overview of the Life Insurance Industry

APRA supervises life companies (including friendly societies) registered under the *Life Insurance Act 1995* (Life Act). Life insurance helps protect Australians against the economic impacts of premature death, as well as long term or short term illness, injury or disability that impacts their ability to earn an income.

The most common products provided by life insurers are death cover, total permanent disability (TPD), trauma, and income protection. Annuities are also provided by some insurers.

- **Life Insurance Death Cover** pays a lump sum to the policy owner. If the policy owner and the life insured are one and the same then often beneficiaries would be a partner or child upon the death of the life insured. In some cases, a terminal illness benefit may be available and is an advancement of the death cover paid if the insured is medically certified as being terminally ill within a defined period (usually 12 or 24 months).
- **Total Permanent Disability** - known as TPD - pays a lump sum if the insured becomes totally and permanently disabled.
- **Trauma** provides payment if the insured person is diagnosed with a specified illness or injury. These policies include the major illnesses or injuries that will make a significant impact on a person's life, such as cancer or a stroke.
- **Income Protection** replaces the income lost due to a person's temporary inability to work due to injury or sickness. Sometimes also referred to as disability income insurance or salary continuance insurance.
- **Annuity**: An investment product providing a guaranteed income for either a fixed term or the lifetime of the policy holder.

Life insurance business can be divided into three groups according to the type of policyholder.

- **Individual risk insurance**: This insurance is sold to the final consumer directly or via a financial advisor. Individual consumers can choose whether to hold one or a range of life products listed above. The Life Insurance Act contains specific restrictions that significantly limit the ability of the life company to re-price the policy or change its terms and conditions. The policy holder is entitled to a guaranteed renewal of their policy.
- **Group risk insurance**: This insurance is sold to superannuation funds to provide cover to their members. Group insurers provide a default level of automatic cover, usually including TPD and death cover and sometimes income protection cover, to the trustee. The policyholder is the trustee of the fund who contracts the insurance on behalf of the membership. The terms, conditions and pricing of the policy are typically periodically re-negotiated periodically between the insurer and the trustee.
- **Reinsurance**: is insurance that is purchased by an insurance company (the cedant) from one or more other insurance companies (the "reinsurer") as a means of risk management. The cedant and the reinsurer enter into a reinsurance agreement which details the conditions upon which the reinsurer would pay a share of the claims incurred by the ceding company in exchange for a premium.

As at 20 August 2015, there were 28 authorised life insurance companies (see table 1 below). Insurers are comprised of a number of distinct groups: 8 large diversified insurers, 4 insurance risk or annuity specialists, 9 relatively small or niche market players and 7 reinsurers.

Some reinsurers both reinsure and sell life insurance directly. Many large insurers that provide individual life policies also provide group insurance to superannuation fund trustees but there are a number of insurers that largely specialise in servicing the group insurance market. Most insurers offer both life lump sum (TPD and Death) and income protection policies.

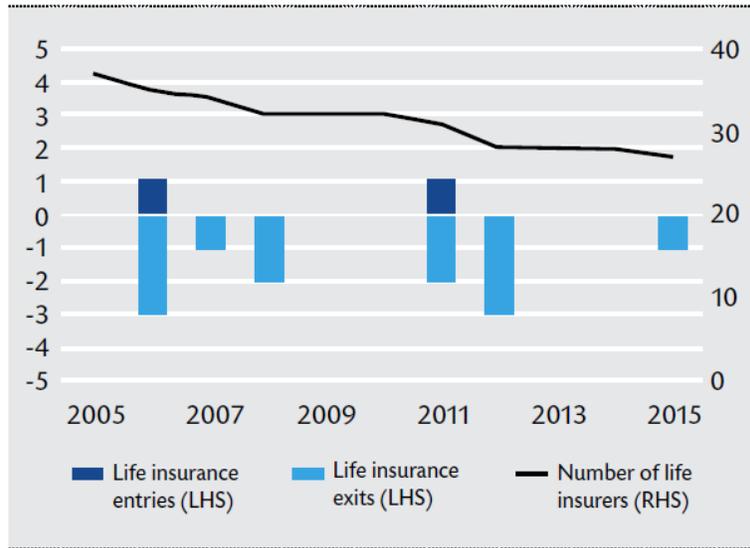
**Table 1 Life Insurers regulated by APRA**

Life insurer	Sector
AIA Australia Limited	Direct
Allianz Australia Life Insurance Limited	Direct
AMP Life Limited	Direct
Challenger Life Company Limited	Direct
ClearView Life Assurance Limited	Direct
Combined Life Insurance Company of Australia Ltd	Direct
General Reinsurance Life Australia Ltd	Reinsurer
H C F Life Insurance Company Pty Ltd	Direct
Hallmark Life Insurance Company Ltd.	Direct
Hannover Life Re of Australasia Ltd	Reinsurer
Macquarie Life Limited	Direct
MetLife Insurance Limited	Direct
MLC Limited	Direct
Munich Reinsurance Company of Australasia Limited	Reinsurer
OnePath Life Limited	Direct
Pacific Life Re (Australia) Pty Limited	Reinsurer
QBE Life (Australia) Limited	Direct
RGA Reinsurance Company of Australia Limited	Reinsurer
SCOR Global Life Australia Pty Limited	Reinsurer
St Andrew's Life Insurance Pty Ltd	Direct
St. George Life Limited	Direct
Suncorp Life & Superannuation Limited	Direct
Swiss Re Life & Health Australia Limited	Reinsurer
TAL Life Limited	Direct
The Colonial Mutual Life Assurance Society Limited	Direct
The National Mutual Life Association of Australasia Limited	Direct
Westpac Life Insurance Services Limited	Direct
Zurich Australia Limited	Direct

The number of life insurers has reduced in the past decade in a continuation of a steady trend that began around 1990, when the number of licences peaked at 61. Since that time, mutually-owned insurers - which were once the largest life insurers in the market - have largely disappeared, while the banking industry has developed a prominent role in the ownership of life insurance and wealth management businesses more generally (see Chart 1 below).<sup>1</sup>

<sup>1</sup> These insurers are currently providing life cover to policyholders. However, some providers may no longer be writing new business and instead manage only legacy products.

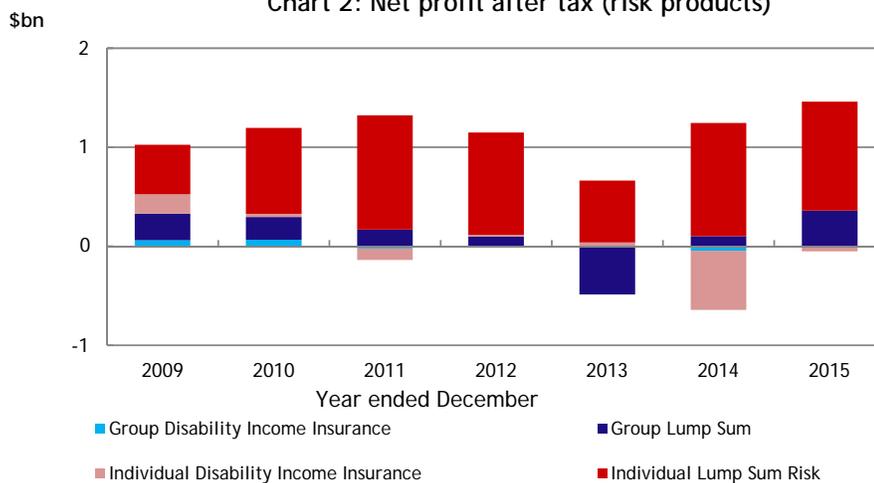
Chart 1: Number of life insurance entries and exits



Source: APRA 2015 Annual Report

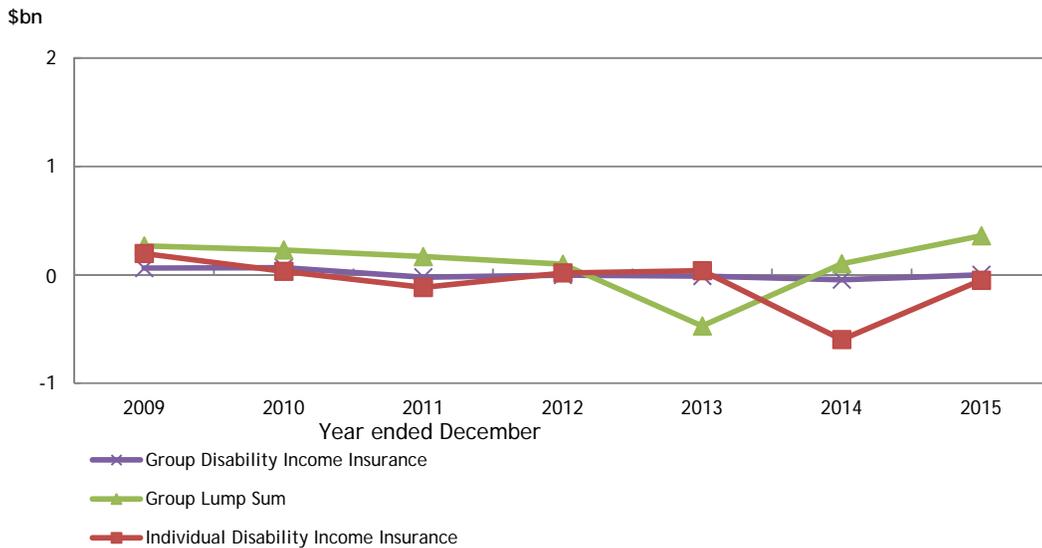
Although insurers have been profitable between 2009 and 2015 (see chart 2 below), this has been primarily driven by Individual Life Lump Sum business (includes Death Cover, Trauma, and TPD). However, it masks the low returns and deep losses experienced by group insurance and life income protection business lines (see Chart 3 below).

Chart 2: Net profit after tax (risk products)



Source: 16 February 2015 APRA, *Quarterly Life Insurance Performance Statistics December 2015*

Chart 3: Net profit after tax (excluding individual Death Cover, Trauma, and TPD insurance)



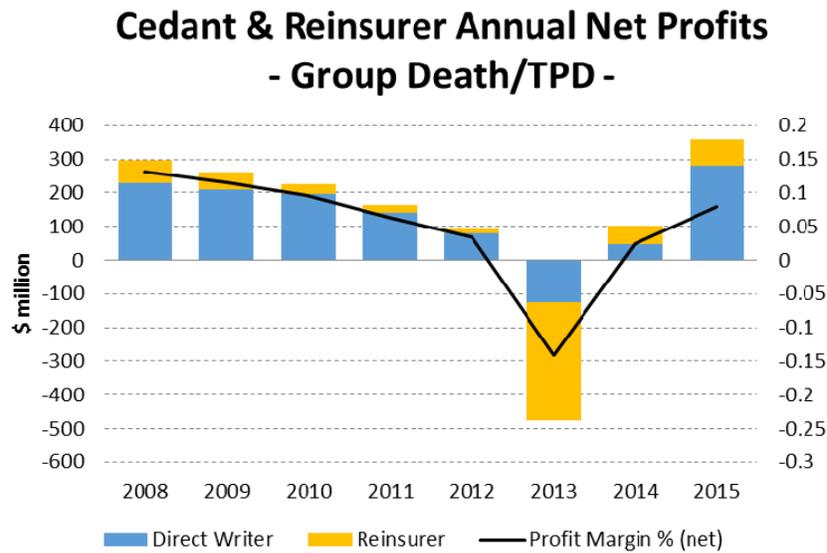
Source: 16 February 2015 APRA, *Quarterly Life Insurance Performance Statistics December 2015*

As shown in Chart 3 above, there has been considerable volatility in year-to-year results in recent times. This recent volatility has been driven by major problems in the management of risk insurance business. Increased claims for TPD business sold as group policies generated substantial losses in 2013, with some reinsurers being particularly affected (see Chart 4 & 5 below). Losses continued into 2014, although the source of the losses shifted somewhat from group to individual disability income business.

The reinsurers seem to have carried a disproportionate share of the losses<sup>2</sup>. Chart 4 below shows that reinsurers incurred more than half of the total group death and TPD losses in 2013. Followed by significant losses in 2014 for individual disability income as shown by Chart 5. This raises the question about the nature of the reinsurance arrangement in place and the role reinsurers may have played in the poor overall performance.

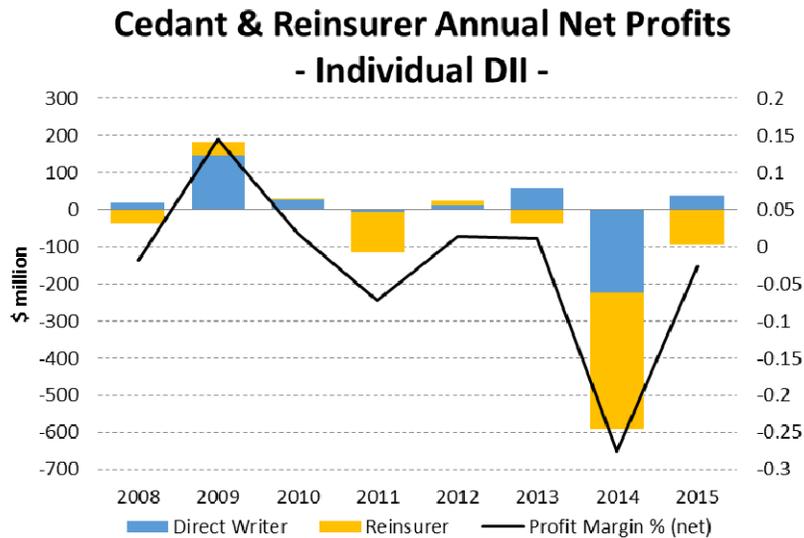
<sup>2</sup> APRA 3 March 2015, *A challenge to the life industry: managing for long term portfolio of health*, Speech by Deputy Chairman Ian Laughlin. <http://www.apra.gov.au/Speeches/Pages/Life-Risk-Insurance-A-challenge-to-the-life-industry-managing-for-long-term-portfolio-health.aspx>

Chart 4



Source: APRA Reporting Data, 31 December 2015

Chart 5



Source: APRA Reporting Data 31 December 2015

Recent premium revenue growth has been underpinned by substantial premium rate increases (see Table 2 below), particularly in group insurance business, driven by the industry's response to mispricing in the sector.

Table 2 Net premium revenue by product group (as at June 2014)

	2010 \$b	2011 \$b	2012 \$b	2013 \$b	2014 \$b
Investment-linked <sup>^</sup>	22.3	25.4	19.5	21.7	28.8
Other non-investment-linked investment <sup>^</sup> #	4.8	5.0	7.7	5.7	5.3
Traditional whole life/endowment	0.4	0.3	0.3	0.3	0.3
<b>Total investment business<sup>^</sup></b>	<b>27.5</b>	<b>30.8</b>	<b>27.4</b>	<b>27.7</b>	<b>34.3</b>
Death/disability lump sum	4.3	4.8	5.1	5.7	6.4
Disability income	1.4	1.6	1.7	2.0	2.2
<b>Individual Risk</b>	<b>5.7</b>	<b>6.4</b>	<b>6.9</b>	<b>7.7</b>	<b>8.5</b>
Death/TPD lump sum	2.3	2.5	2.9	3.0	3.6
Disability income	0.5	0.6	0.7	0.8	0.9
<b>Group risk</b>	<b>2.9</b>	<b>3.0</b>	<b>3.6</b>	<b>3.8</b>	<b>4.6</b>
<b>Total insurance risk business</b>	<b>8.5</b>	<b>9.4</b>	<b>10.5</b>	<b>11.5</b>	<b>13.1</b>
<b>Total net premium revenue</b>	<b>36.0</b>	<b>40.2</b>	<b>37.9</b>	<b>39.2</b>	<b>47.4</b>

Source: APRA Statistics

\* Rounding may cause differences in totals.

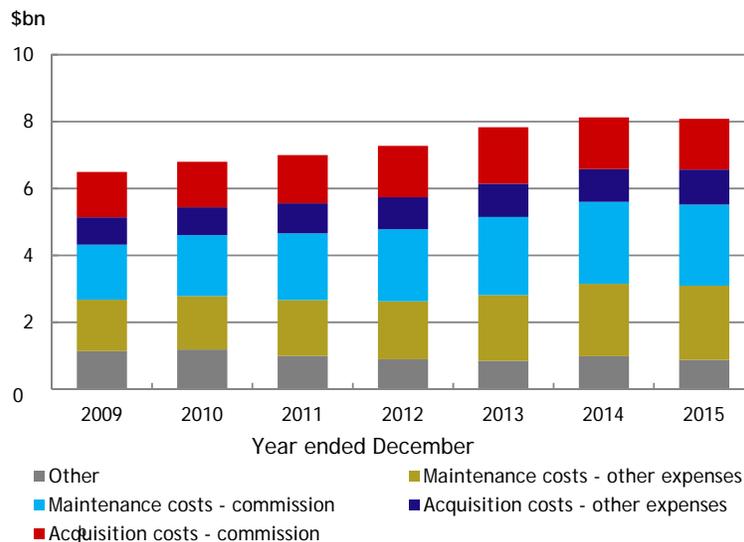
<sup>^</sup> Excludes policy conversions.

# Total and permanent disablement.

Source: APRA 2014, *Insight*, Life insurance industry overview, Issue 2

Over the past decade, there has been little improvement in overall industry operating efficiency despite its increasing use of technology to administer, underwrite and distribute business (see expense chart 6 below). This could be partially attributed to a need to maintain large books of legacy business, often on earlier generation systems, that can be expensive to administer and difficult to rationalise. The increase in the expense ratio also has reflected reduced margins caused by the increased claims paid in more recent years.

Chart 6: Operating Expenses



Source: 16 February 2015 APRA, *Quarterly Life Insurance Performance Statistics December 2015*

The life insurance industry continues to address the issues experienced in group business and, more recently, in individual disability income business. The industry's response to ongoing market volatility and a persistent low interest rate environment, together with pressures on overall industry operating efficiency, will continue to be areas of focus for APRA.

The industry continues to be well capitalised despite the impact of the recent increase in risk insurance claims on industry profits. Coverage ratios at individual insurers vary significantly across the industry, reflecting the nature of the business mix and risks of each insurer. However, at an aggregate level, the capital coverage ratio of 1.7 reflects a general strengthening of capital buffers relative to minimum regulatory requirements.