Income protection and APRA sustainability measures

Factsheet
July 2020

The Australian Prudential Regulatory Authority (APRA) recently announced changes impacting the types of income protection cover life insurers can offer. APRA is making these changes to safeguard future sustainability of the life insurance business by addressing perceived 'flaws in product design and pricing'.

What are the APRA changes?

As at 31 March 2020, life insurers were required to cease offering income protection products with 'agreed value' terms to new customers. Agreed value policies use the insured person's income at the time of application to determine the monthly benefit amount. At time of claim (which can be several years later), this monthly benefit value is provided, irrespective of whether the insured person is still earning the same level of income at this point in time.

Why this change needed to be made

Often people with incomes that fluctuate year to year would choose this type of cover as they would not be penalised when going through a lower income period when claiming.

However, it has also led to scenarios where an insured person would receive claim benefits substantially more than their actual income. The relatively higher benefit payments to income reduced the claimant's incentive to return to work and resulted in costly payouts for the insurer, for longer periods of time.

These periods of long-term high-value benefit payments by the insurer impacted the future sustainability of the life insurance business in Australia.

Life insurers have previously been reluctant to make these changes on their own accord for fear of being uncompetitive, despite the unsustainability of the products they were offering, hence APRA stepped in.

What terms can be offered?

Following this change, only policies with an 'indemnity' structure will be available. Indemnity policies look at how much income the insured person was earning at the time of claim and base the monthly benefit on that more recent figure.

The good news is indemnity policies are typically around 15% less expensive than agreed value policies.

Further changes to follow

In addition to the removal of agreed value policies from sale, further changes are expected to be rolled out in 2021. Several measures have been outlined for the industry to consider, such as introducing a maximum monthly benefit of $30,000 per month and reducing the proportion of income that an individual can claim benefit payments for (known as replacement ratios).

It is also proposed that stricter criteria be placed on claimants remaining on claim payments for longer periods. However, at this stage APRA is only seeking feedback from the industry.

While none of these additional proposed measures are certain to be implemented, it is clear the product terms available to consumers will become more restrictive than those currently available.

How are existing customers impacted?

Existing in-force policies are guaranteed to retain their current terms – they will not be impacted by the removal of agreed value policies from sale, nor will they have the more restrictive terms proposed in any further 2021 measures which may be implemented, applied to them. This is because life insurance policies are guaranteed renewable, meaning so long as premiums continue to be paid, the policy will continue on its current terms (or better terms if updated by the insurer) until the policy end date.

It is possible though, that existing policies will incur premium rate increases as life insurers attempt to return these products to profitability.

Get advice that suits your situation

This factsheet provides an overview of APRA's current and proposed sustainability measures. Further information on these changes can be found on the APRA website.

For professional advice that addresses your specific situation, contact the expert team at Doctors Wealth Management.

You can find additional resources and information about Doctors Wealth Management at **avant.org.au/doctorswealthmanagement** or call **1800 128 268**.

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