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Insurance companies are changing the rules

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You might have read in the news of the Australian Prudential Regulation Authority (APRA) changes coming to income protection insurance contracts. APRA has announced a significant shakeup to income protection policies, and none of it benefits the customer.

The first big change took effect on 31 March 2020, after which time agreed value income protection policies are no longer sold. By 1 October 2021, many more changes to income protection insurance are planned to take effect.

What is income protection insurance?

An income protection insurance policy typically pays a monthly benefit of up to 75% of a policyholder's regular income when they are unable to work for longer than their waiting period, due to an illness or accident. This benefit can help them maintain their lifestyle and support their family while they focus on recovery.

Changes to income protection insurance

From 1 October 2021, insurers will have rules in place to ensure that benefits do not exceed 90% of a policyholder's earnings for the first six months of the claim, and do not exceed 70% of earnings after that. They will also cease to offer guaranteed renewable policies and have stricter disability definitions for longer benefit periods.

On 31 March 2020, new applications for agreed value income protection insurance were discontinued, which is particularly worrisome for self-employed people who have fluctuating incomes.

How the income protection rules will change

The key changes to the income protection rules are:

- ceasing the sale of agreed value and endorsed agreed value income protection policies
- less flexible terms for indemnity income protection
- no more guaranteed renewable contracts
- a six-month maximum benefit cap
- stricter disability definitions
- companies to provide up-to-date industry data to APRA.

How will it affect clients?

New income protection clients

New income protection clients purchasing an income protection policy after 31 March 2020 will have their monthly benefit based on their income at claim time. New clients will not be eligible for agreed value policies that provide more certainty at claim time, as benefits were determined during the application stage when the applicant's financial data was provided.

Existing agreed value income protection clients

Existing agreed value income protection clients' policy terms and conditions will generally remain as is, however, premiums may change in future.

When will the changes come into effect?

Agreed value income protection insurance is no longer available after 31 March 2020. With many life insurers moving early on the previous due date, it is expected that many of the providers will start implementing the other changes earlier. However, *the next planned date for changes is set for no later than 1 October 2021.*

APRA has requested that life insurance companies provide data regarding the changes implemented so that it can monitor the expected results.

Why are income protection rules changing?

APRA wants insurers to improve the profitability and sustainability of income protection products, due to the heavy, ongoing losses experienced in the past five years, amounting to $3.4 billion. The changes are a means of managing the financial risk associated with the product.

Should a life insurance company fail to demonstrate sufficient and sustainable progress, APRA will impose a capital charge, with the amount proportioned to each company's' gross exposure to income protection policies.

The income protection changes explained

Following is a more in-depth explanation of the changes to income protection insurance.

The end of agreed valued policies

Agreed value and endorsed agreed income protection insurance, that locked-in a person's monthly insurance benefit at the time of application, are no longer available for new applications after 31 March 2020.

However, the alternative is an indemnity income protection policy, which calculates benefits on annual earnings at claim time and can thus be affected by any subsequent reductions in income.

Benefits will be based on the past 12 months' annual earnings

From no later than 1 October 2021, a policyholder's monthly benefit payment will be calculated on what they earned during the 12 consecutive months before they became sick or injured. This change could have a significant negative effect, especially on the self-employed who do not have the security of a set salary.

Currently, select insurers give people the option of proving their income over the previous two to three years and then use the best 12 consecutive months of that period. There is an exception being made for some policyholders with a variable income. They will have the income at risk assessed based on the average annual earnings of a period that is appropriate for their specific occupation. However, we are yet to see how this will be interpreted by insurers and implemented in their policy terms and conditions.

Income protection contracts may not exceed five years

Another income protection change which will come into effect no later than 1 October 2022 (a year later than the other measures), is that yearly guaranteed renewable contracts will be replaced with contracts that cannot be guaranteed renewable for greater than five years.

While it is proposed that the policyholder can elect to renew their contract for further periods (not exceeding five years) without having to undergo a medical review, the renewal will be subject to an analysis of changes in occupation and financial circumstances.

Limits on income protection payments for the first six months

From 1 October 2021, insurers must ensure the benefit does not exceed 90% of a policyholder's earnings at claim time for the first six months. Life insurance companies will consider a policyholder's benefit payment and any alternative sources of income they may be receiving.

After six months, the maximum income protection benefit will be limited to 70% of a person's earnings at the time of claim, up to a maximum of $30,000 per month.

Reducing the risk of longer benefit periods

To encourage clients to recover and return to work sooner, insurers should have controls in place by 1 October 2021, to reduce the risk of long-term benefit periods. This means stricter disability definitions and setting internal benchmarks for new income protection products with long benefit periods.

Life insurance companies to provide quality data

From 1 October 2021, APRA expects life insurance companies to deliver up-to-date data promptly, so results of customer experience can be released every 18 months. FS

The quote

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