Income protection insurance

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ABSTRACT

The main objective of this paper is to give an overview of the income protection insurance which is currently non-existent in the Indian market. Starting from the key features of the product design, focusing on the issues surrounding the income and benefit relationship, State provision, claim triggers, customer need and PRE considerations and sales and marketing issues are discussed. The paper also highlights some of the trends in sales and claim experience observed in a few developed markets and briefly touches upon the pricing, reserving and experience rating of the income protection insurance.

KEYWORDS

State provision; Income replacement ratio; Waiting period; Deferred period; Moratorium; Multiple-state modelling; Disability annuity; IBNR; Claim counselling and rehabilitation; linked-claim period

1.1 Introduction

India is emerging as a key insurance market after the Indian insurance industry was opened up for private sector participation in the year 2000. The life insurance industry is expected to grow to the extent of around US$ 100 billion in terms of annual premium written in about 10 years' time from the current level of around US$ 20 billion. This would mean the penetration, expressed in terms of GDP, is expected be in the region of 5% after a decade compared with the current level of around 2.5%.

As far as health and care insurance is concerned, India is yet to make a good start. It has been confined to short term medical expense and hospital cash plans offered by the non-life insurers and of late there has been some critical illness and accidental disability and dismemberment covers sold by the life insurers as rider benefits. But the volumes are still low. Currently the insurers are focusing on the mortality protection gap. It would only be a matter of time before insurers would need to diversify into healthcare insurance products if they want to grow their protection business once the mortality risk market is saturated. The Government too is expected to encourage individuals to fund themselves for healthcare needs so as to reduce their reliance on the State provision.

In an age where the informal family support has almost become a thing of the past, job security is disappearing, medical and education costs are continually rising, the Governments are increasingly expecting individuals to fund themselves for their own healthcare needs, and two incomes are often required to fund a mortgage for own home, it could be argued that protecting income is becoming more and more important nowadays than in the past. India is no exception to this phenomenon. In this paper, we attempt to look at the key feature of the income protection insurance, aimed at protecting individuals' income during periods of incapacity that continues to present opportunities and challenges for insurers and reinsures worldwide.

1.2 Contents

This paper has been broadly divided in to 5 sections:

In section 2, we cover the size of the income protection business in a few developed markets and the commercial and socio-economic issues to be considered in the determination of the Income protection insurance business potential in India, particularly the impact of State disability income provision.

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In section 3, we consider the typical products features of income protection insurance contracts, how they meet customer need and some suggestions on the desirable product features for the Indian market.

In section 4, we briefly look at the pricing, reserving and the importance of experience review of an income protection contract, highlighting some of the lessons learnt in other developed markets.

In section 5, we look at the sales and marketing issues encountered by different insurers and some suggestions on how the income protection business can be better positioned from a marketing viewpoint.

In section 6, we conclude with summarising the key factors that should be considered if one wants to succeed in the income protection insurance business, some of which would equally apply to other healthcare insurance business as well.

2. BUSINESS ENVIRONMENT

The first step in appraising any business opportunity is to see whether the commercial, economic, legal and regulatory environment is conducive to do that business. This environment may not remain the same and is likely to evolve over time. Once the business is up and running, it is important, therefore, to monitor the environment closely so as to ensure that our business strategy remains appropriate.

The demand for the income protection business is heavily determined by the extent to which the State takes care of the disabled lives. In India, the Employees' State insurance (ESI) scheme covers around 8 million individuals working in certain establishments with monthly wages upto Rs. 7,500. It is funded by contribution from employers (4.75%) and employees (1.75%) and these percentages vary from time to time. Employees with daily wages below Rs. 40 are exempted from the contribution but the employers should contribute their share. The scheme provides a sickness benefit of roughly 50% of the average daily wages for 91 days after the first two days of sickness. It also covers temporary disablement due to employment injury or occupational diseases, and the benefit is nearly 85% of the average daily wages payable as long as the disablement continues. We may reasonably assume that it is unlikely that the Government will widen the scope of the coverage. So any product targetting the employees covered already by the ESI needs to be designed in such a way that it complements the ESI benefit. Those who are not covered by the ESI can of course be targetted with any suitable design to meet their needs. There is obviously plenty of scope for the income protection business in India considering the minimal State provision.

The state of the economy will influence the amount of disposable income the individuals will have towards insurance spending and the willingness of employers to offer comprehensive insurance coverage to their employees. Indian economy is steadily growing, the real GDP growth is expected to be around 6-7% per year over the next 10 years. GDP per capita is expected to increase to around US$ 1,600 in a decade's time from the current level of around US$ 730.

The legal and regulatory environment in India is maturing quite well. It is sometimes argued that the courts generally take a view that the financial impact on the insured is more severe than on the insurer and so decides in favour of the insured when it comes to resolving a dispute between them. But it must also be recognised that there may be some sort of lack on the part of the insurer, may be poor record keeping or misselling or unclear contract wording etc. that could have led to such outcomes. So it is important that the insurer keeps upto date its contract wordings, selling and administration processes legally compliant.

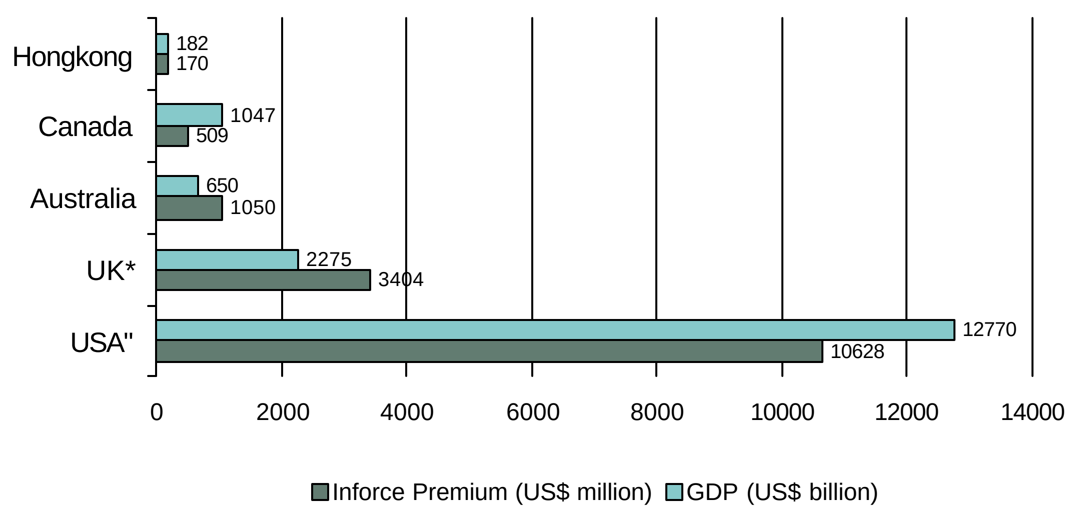
The Insurance Regulatory and Development Authority (IRDA) of India is quite keen on developing the health insurance market and there has been a number of study groups set up to look at various aspects of the business. It is also quite likely that the regulator may consider relaxing the capital requirements for setting up of the health insurance companies. So the regulatory environment in India is likely to favour the income protection business and the legal system is unlikely to be a deterrent for its development.

The income protection business requires professional sales people. There is now a shortage in this area in India but there are many young business graduates available who can be groomed to be successful salespersons. This business has more potential for misselling than a mortality product. A well-designed sales training and monitoring system is therefore crucial for this business.

The tax incentives available to individuals in buying insurance is a main driving force for insurance sales. In India, premiums paid for health insurance is deductible from the taxable income. In case of corporates, the premium is treated as business expenses. This is clearly a plus. The general attitude of the individuals not want to be seen as disabled would mean that the individuals are less likely to stay disabled just for the sake of insurance benefits as long as they are not financially better off by staying disabled.

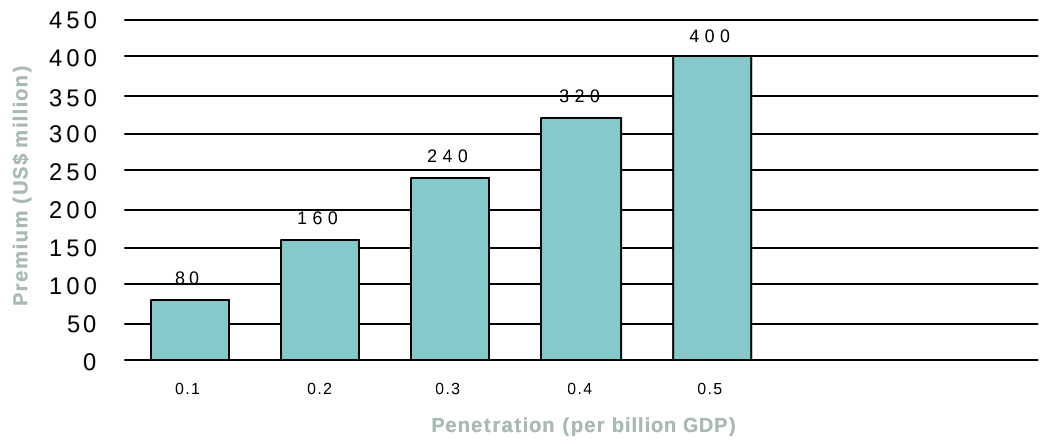
The two charts below, chart 1 & chart 2, show the level of income protection insurance premium income generated in a few developed markets in the year 2004 compared to their level of GDP and the business potential for India in terms of premium income that can be generated for different levels of penetration.

CHART 1 – INFORCE PREMIUM 2004



* includes stand-alone critical illness; “group business only; GDP (official exchange rate)

CHART 2 – PREMIUM POTENTIAL FOR INDIA FOR DIFFERENT LELVELS OF PENETRATION



3. PRODUCT DESIGN

Product design is about ‘fitness for purpose’. It needs to adequately reflect the needs of various stakeholders involved. This is the most important aspect of the income protection insurance business. There is very high risk of losing money if you do not get your design right, no matter how you set premium rates and manage claims. Let us look at the needs of two important stakeholders, the customer and the insurer. Further, we go on to briefly see the typical product features and the desirable features that may be considered for the Indian market.

3.1 Customer needs

Providing replacement income when the insured is off-work due to sickness or injury is the primary need met by individual Income protection insurance. Individual would need to meet certain financial outgo whether they are active or incapacitated (ie. whether they are earning or not). They include:

- regular household expenditure
- mortgage repayments
- insurance premiums (life, non-life and other health insurance premiums)
- pension and other social welfare contributions

Employers may want to purchase income protection insurance to their employees in order to:

- cover the statutory sick-pay requirements
- enhance the remuneration package so as to attract and retain quality staff
- show paternalism
- minimising awaytime
- meet the cost of temporary replacement (this is particularly a problem for small organisations when a key employee is off-work eg. head chef in a restaurant – this sort of cover is sometimes known as locum protection insurance)

Lending institutions may want to take income protection insurance on the borrowers in order to cover

- loan repayments in times of borrowers' inability to make the payments due to incapacity

The later two types of needs are met by group version of the income protection insurance.

3.2 Insurer needs

The primary need of the insurer is to meet the profit criteria set by its shareholders. In order to achieve this, the insurer would need to resort to various risk management tools. They include:

Income replacement ratio (ratio of post-claim income to pre-claim income-net of income tax). This needs to be set at an appropriate level, taking into account all other sources of income available to the insured in-claim (e.g. tax relief, State benefits etc.), so as to create an incentive to return to work. The ratio may change with the insured's income (eg. moving from full-time job to part-time job and vice-versa), so it is important that the ratio is altered as and when necessary in order to ensure that the insured is not better-off staying sick rather than getting back to work.

The sum at risk in the initial years could be very large in case of long-term products and so appropriate medical and financial underwriting is crucial. There has to be an appropriate balance struck between the level of initial underwriting and a moratorium approach (ie. pre-existing conditions are not determined at the proposal stage but excludes any claim arising out of pre-existing conditions within a specified period, say 2 years). Cutting back benefits at the claim stage for reasons of over-insurance or others might lead to disgruntled policyholders and bad publicity causing reduced sales and higher withdrawals.

Exclusions are required to avoid misuse and provide a cushion against adverse events over which the office has no control. The possible exclusions include: pre-existing conditions, unemployment, redundancy, reluctance to return to work (this cannot be explicitly excluded but should be prevented through keeping a financial incentive to return to work, investigating claims for any unusual periods of sickness, claim counselling and rehabilitation to help them back to work etc.), HIV, self-inflicted injuries, Alcohol or drug abuse, certain hazardous pastimes, illegal acts and War etc.

Claim counselling and rehabilitation are important to enable the claimant to get back to work as quickly as possible. Encourage the claimant to get back to work through the provision of linked-claim period whereby claims separated by less than a certain period of time are treated as if they were one continuous claim so that the individual does not have to serve another deferred period.

3.3 Typical product features

Benefit

- regular income payments during periods of incapacity
- benefits escalate at the same rate both in and out of claim
- the rate of escalation is linked to some index
- there can be a number of separate benefit periods without the cover ceasing
- Usually a deferred period at the start of incapacity, during which no benefits are paid. Deferred periods of 13, 26 and 52 weeks are common in UK.
- Guaranteed insurability options where by benefits can be increased without further underwriting upon a particular life event occurring (eg. marriage) – usually available only for standard lives.

Definition of incapacity

- Occupation based (eg. inability to follow own occupation, own or similar occupation or any occupation)
- Activity based (eg. inability to carry out certain activities of daily living or working) – suitable for those who work but not paid, eg. house persons, students and self-employed.

Policy term

- a fixed period or until certain age (usually normal retirement age)
- group policies are yearly renewable and reviewable

Premium

- payable through out the term of the policy with premiums waived during periods of claim
- level premiums dependant on the age at entry, occupation, deferred period and policy term
- escalate at the same rate as benefits

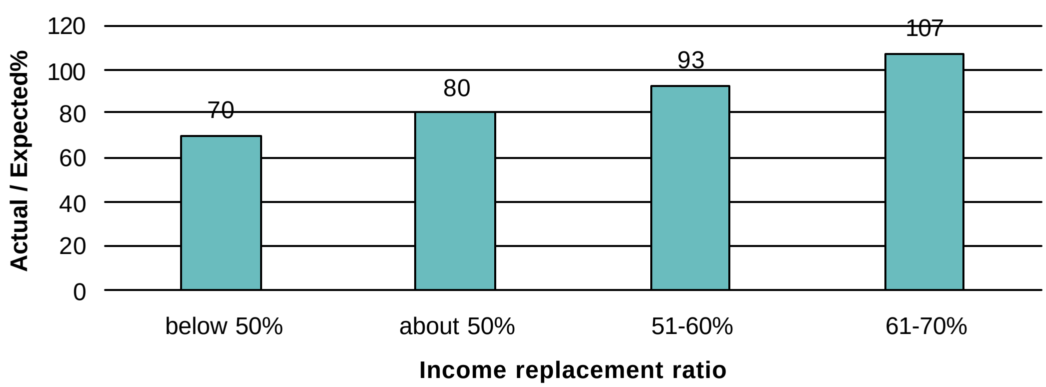
Renewability provisions

- Guaranteed renewable – insurer is required to renew as long as the premiums are paid. but premiums can be reviewed if the experience of the portfolio as a whole is different from that expected
- non-cancelable – insurer can neither refuse to renew nor review premium rates

3.4 Desirable product features

Income replacement ratio of around 50% may be appropriate initially to keep the cost of the product low and encourage people to think about buying the coverage. This can then be gradually increased to 60-70%. Anything more than 70% is not desirable. The following chart 3 shows the impact of the income replacement ratio on the experience based on a US long term disability model. Benefit level is ideally to be an 'agreed value' fixed at the outset and may escalate in line with Retail price index (RPI) subject to a maximum uplift of around 5% per year. There can be an option given to the policyholders to increase their benefit levels in line with their salary increases without further underwriting. The policy provision should require that any reduction in income (which is very rare) to be reported and the benefit level and premium reduced accordingly.

CHART 3: IMPACT OF INCOME REPLACEMENT RATIO



Premiums should be reviewable at least every 3 years given the considerable uncertainty surrounding the estimation of incidence and recovery rates. Once sufficient experience builds up the review process can be carried out every 5 years. Premiums should escalate at the same rate as the benefit. Occupation is a key rating factor apart from age, sex and deferred period. The four occupational classifications used for the group life insurance business in India can be adopted for the income protection business as well. However, it is important to recognise that the relative impact of different occupational classes on the experience will not go in the same way as life insurance. The following table shows how the impact of different occupations differ from that expected based on the Society of Actuaries Study of actual versus expected incidence rates (by amount) over the period 1990-99.

Occupation	A/E	Exposure
Physicians & Surgeons	135%	29.2%
Executives & Managers	83%	14.3%
Lawyers	89%	8.0%
Other Sales	104%	4.0%
Dentists	121%	4.0%
Accountants & Actuaries	78%	2.1%
Insurance Sales	158%	2.0%
Engineers & Architects	66%	1.9%
Other Medical Occupations	112%	1.7%
Psychologists, etc.	98%	1.3%
Nurses	134%	1.2%
Stockbrokers & Commodity Traders	160%	0.9%
Pharmacists	104%	0.6%
Chiropractors	235%	0.6%
Teachers	66%	0.6%
Veterinarians	112%	0.5%
Podiatrists	179%	0.4%
Other	82%	26.9%
Total	101.60%	100.0%

It may be suitable to have split deferred periods for long-term individual contracts. For example, no payment for the first 4 weeks, and 25% payment for the second 4 weeks, and 50% payment for the third 4 weeks and so on to 100% after 16 weeks. This may suit the individual needs given the fact that the individuals may have some savings to cope with initially with the financial implications getting adverse as duration of incapacity increases. This would also help to reduce the cost of coverage relatively low. For the yearly renewable group products the deferred period should be relatively shorter, say 2 to 4 weeks, with even shorter deferred periods for *"accident only"* coverage, say one week.

On the underwriting side, it is quite desirable to use longer waiting periods (the initial period during which premiums are payable but benefits are not payable), say 6 moths, to limit anti-selection and reduce the level of initial underwriting. Moratorium approach to pre-existing conditions may not be suitable given that the Indian insurers have traditionally been losing on most of the claim disputes in the court of law and the potential for bad-publicity.

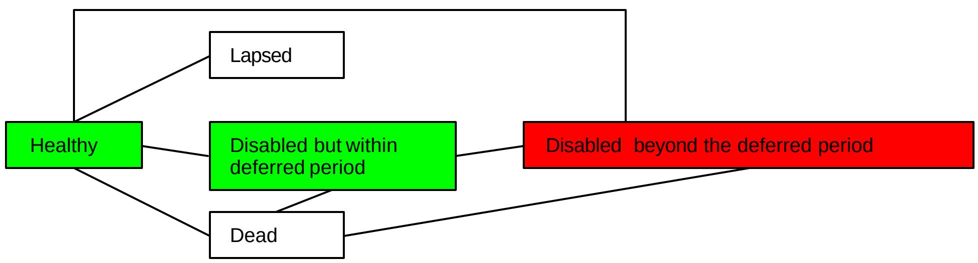
On the definitions of incapacity, it may be desirable to use strictly "any occupation" definition (i.e., the inability to follow any occupation and the incapacity remained so for a period of atleast 6 months). Ideally the incapacity should be determined by a panel of doctors with representations from the Govt. and the insurer. The wording and the procedure for admitting the incapacity should be crystal clear in the policy contract. In case of group contracts, it may be acceptable to use "own or similar occupation" definition (i.e., the inability to follow own occupation and any other suited occupation by education, training or status and the incapacity remained so for atleast 6 months). Activity based definitions should be used for those who work but not employed, e.g. the inability to perform certain activities of daily living (ADL). It is to be noted that many insurers worldwide lost money due to very loose incapacity definitions.

4. PRICING, RESERVING AND EXPERIENCE MONITORING

4.1 Pricing

The risk of incapacity is quite different from mortality from the pricing perspective. For incapacity cover, we need to estimate the incidence rate as well as the likely length of the period of incapacity to ascertain the expected claim outgo. Further, the risks that affect the incidence and recovery rates of incapacity change overtime in ways that are extremely difficult to predict with any precision. Consequently, the shareholders would expect a higher rate of return on capital to compensate for the higher uncertainty compared to mortality. There are two approaches used for pricing the income protection insurance: *Multi-state modelling and inception/disability life annuity.* The later is the one that is most commonly used.

Multiple state modelling involves estimation of transition intensities for moving from one state to another. The different possible states are shown below. The green shaded states are premium paying states. The red colour shaded state(s) are claim receiving state(s). There can be more than one claim receiving state if there are provisions for split-deferred period or partial benefits if the claimant takes up a less-paid job.



Using the transition intensities, the proportion of lives in each state in each subsequent period can be estimated. The claim outgo can be estimated by multiplying the proportion of lives in the claim receiving state(s) with the average benefit then payable. Premium can then be estimated in order to meet the claim outgo, other expenses and cost of capital. Investment returns should also be taken into account.

The problem with this approach is that the model could get very complex with a number of transition intensities required for different risk profiles. Some grouping and approximations need to be made to avoid spurious accuracy. The advantage is that the model will provide good insight into the robustness of the pricing structure and also allow sensitivity testing to be performed.

In most courtiers, enough data not available to estimate credible transition intensities. The KAZO model in Netherlands is an example of the multiple-state model. In UK, the CMIR reports on income protection experience split claim terminations into death and recovery.

The inception/disability annuity approach, as the name suggests, involves two separate double decrement tables: healthy -> disabled or dead, and disabled -> recovery or dead. It is to be noted that the claim inception is different from disability inception due to the presence of the deferred period. Claim inception rate is therefore the disability inception rate multiplied by the probability of the person remaining disabled for the deferred period. The claim inception rate multiplied by the value of a disabled life annuity would give the expected claim outgo. The value of a disability benefit of 1 pa payable continuously to a healthy life now aged x is given by

$$[(al)_{x+t} \quad (al)_x]\,(a\mu)^{i}_{x+t}\ v^{t}\ a^{i}_{\ x+t}\ dt$$

Where $[(al)_{x+t}\ \ (al)_x]$ = probability that the x is alive and well at time t
$(a\mu)^i_{x+t}$ ät = probability of becoming disabled in time interval ät
a^i_{x+t} = the value of the annuity then payable during disability
the integral is over time t=0 to t=

Reasonable statistics is available in a number of countries for this pricing approach: US - tables for Individual (CIDA 1985) and group (CGDT 1996), UK - CMIR 12, 15, 18 and 22, Australia - IAD – 1983-93) and a disability committee report 2002 published by the Institute of Actuaries of Australia compares the experience during 1995-98 with the earlier investigations.

It is quite important when setting bases for pricing the experience seen elsewhere need not necessarily be appropriate for the local market due to differences in policy conditions, target market, distribution methods, underwriting and socio-economic influences etc. The chart 4 below shows how the experience differs from country to country based on Individual disability income experience from the late 1980s for Male, Unisex, class1 with deferred period 6 or 12 months. Charts 5 and 6 respectively show the prevalence and incidence of disability in India according to *National Sample survey organisation, Govt. of India, in 2002.*

CHART 4: INCIDENCE RATES BY COUNTRY

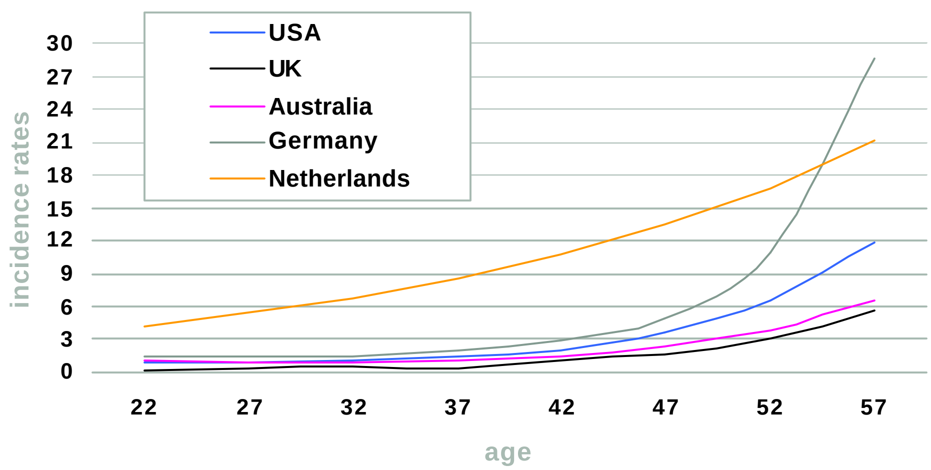


CHART 5: PREVALENCE OF DISABILITY IN INDIA

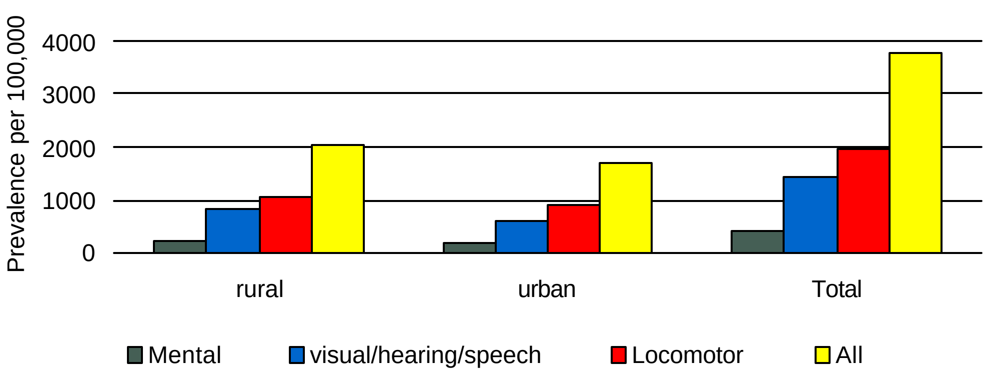
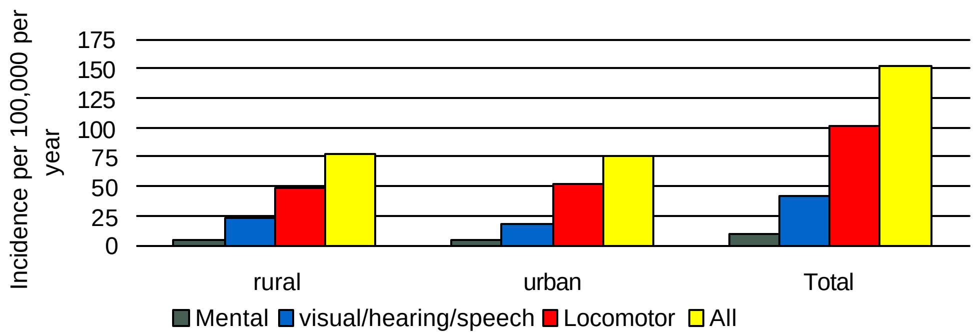


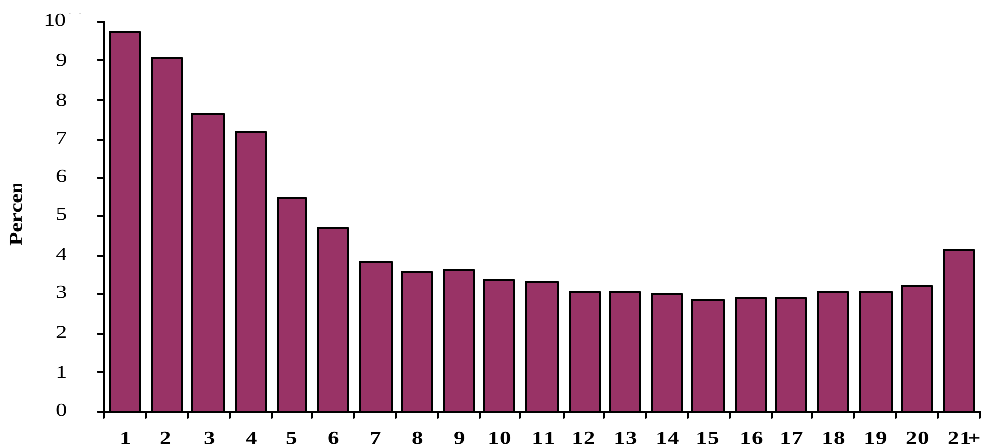
CHART 6: INCIDENCE OF DISABILITY IN INDIA



Locomotor disability is defined as a persons inability to execute distinctive activities associated with moving both himself and objects, from place to place and such inability resulting from affliction of musculoskeletal and/or nervous system – *Ministry of social justice & empowerment, Govt. of India*

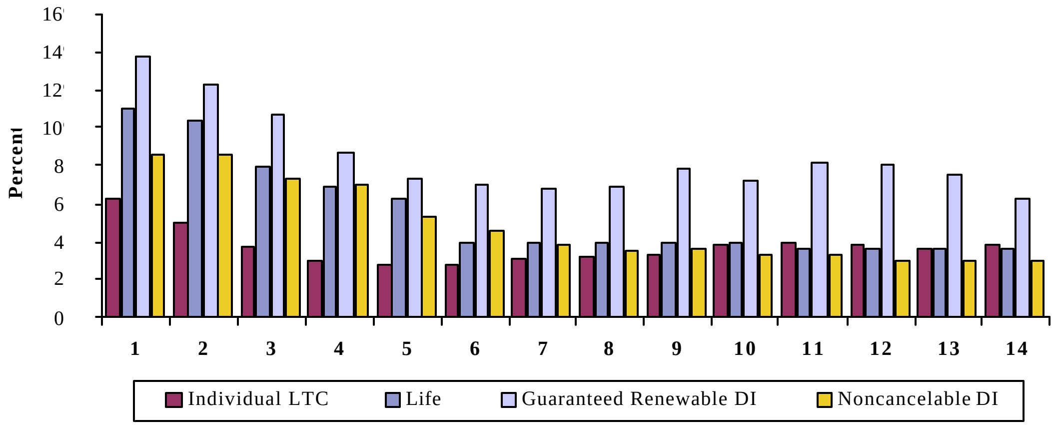
It is also important for the long-term contracts that the pricing allows for the lapses appropriately. The following chart 7 shows the lapse experience over the policy duration in the US.

CHART 7 – INDIVIDUAL DISABILITY INCOME LAPSE EXPERIENCE IN US
Report of the Individual disability experience committee, Society of Actuaries



It is quite obvious that the lapes rates will vary by distribution channels as they tend to reach out different target markets. The product design factors can also have significant influence on the lapse experience. For example, the following chart 8 shows how the lapse rates differ for two different renewability provisions and also how they compare with other products.

CHART 8 – INDIVIDUAL DISABILITY INCOME LAPSE RATES IN US
Report of the Individual disability experience committee, Society of Actuaries



The following table shows the sample monthly cost of the income protection insurance for a benefit of
£ 20,000 per annum in UK.

Entry Age	Expiry Age	DP 4 weeks	DP 13 weeks	DP 26 weeks	DP 52 weeks
25	60	43.17	25.01	18.52	18.09
35	60	61.74	33.71	24.44	23.47
45	60	87.35	49.91	36.67	33.95
55	60	109.49	66.36	51.21	43.95

DP – deferred period
Source: Kluwer IPI report 2000, An average of all premiums (except those of the most expensive company)

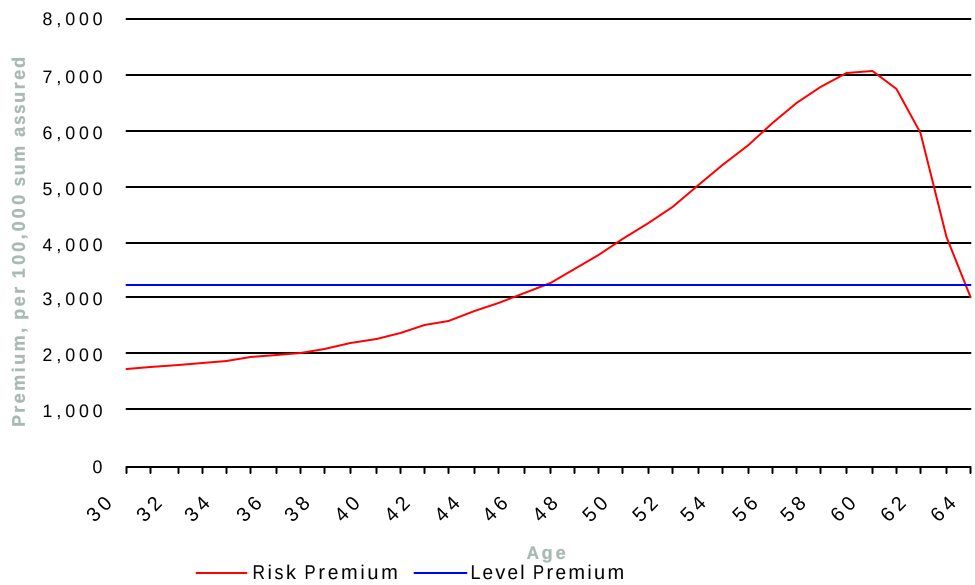
4.2 Reserving

The following reserves are required to be set up in connection with the long term Individual income protection insurance for the reasons mentioned thereof.

Active life reserves

- Discounted value of future cashflows in respect of lives who are currently healthy, including the cashflows arising out of exercising any policyholder options and guarantees offered.
- This is required if level premiums are charged for a risk which is not uniform across age. As age increases, disability incidence rates increase and value of disability insurance benefits decreases. The following chart 9 depicts this.

CHART 9 – RISK PREMIUM VS LEVEL PERMIUM



Disabled life reserves

- Claims in payment - Discounted value of claims that have been admitted, need to estimate the likely length of the claim at the beginning and monitor regularly to review the adequacy of the reserve set up.
- Claims in transit - Discounted value of claims that have been reported but not yet admitted. Here we need assess the probability of the claim being admitted and the likely length once admitted.
- Mostly statistical estimates are used for the whole portfolio of claims and only small volumes of claims are assessed on a case by case basis.

In the group context, the following reserves are set up:

- UPR – Unearned Premium Reserve - the balance of premiums received in respect of periods of insurance not yet expired – a prospective approach
- URR – Unexpired Risk Reserve – reserve in respect of the above unexpired insurance premium where it is felt that the premium basis is inadequate.
- Outstanding claims reserve – reserve in respect of claims notified to the insurer but not yet settled
- Incurred but not reported (IBNR) – reserve in respect of claims that have arisen but which have yet to be notified to the insurer
- Incurred but not enough reported (IBNER) – as above but where it is felt that not all details have yet been submitted and a provision needs to be established for the remainder.
- Equalisation and catastrophe reserves – reserves where it is felt that the current year is atypical and amounts will have to be held back for abnormal events.
- Claims in transit – reserve in respect of claims reported but not assessed, or not recorded

The reserving basis is usually prescribed by regulation and is likely to be more prudent than mortality risk reserving due to the considerable amount of uncertainty surrounding the claim rates. It is therefore important that the guarantees and options are kept minimal, capital efficient unit-linked designs are used and adequate reinsurance programmes are put in place so as to keep the capital requirement low and hence the price of the product low and affordable. The promotion of this sort of products requires prices to be low initially so that they are seen as “value for money” by the potential buyers.

4.3 Experience monitoring
Given the absence of reliable data, any attempt to pricing income protection business for the Indian market is nothing more than a guess-work using the available statistics from other markets. So it is extremely important to regularly and more frequently look at how things actually turn out compared to that expected. There are difficulties associated with the experience review of the income protection insurance. They include:

- the relationship between exposure and claims are not clear cut
- many rating factors affecting the experience differently in different combinations
- data in individual risk cells are often too small for any credible analysis
- uncertainty over Disabled life reserves (DLR) and IBNR
- under or over estimation of DLR could significantly distort experience

At a macro level, it may be important to look at the following:

- industry experience studies
- loss ratios (allowing for change in DLR)
- actual vs. expected – claims
- actual vs. expected - change in DLR
- claim numbers vs. claim amounts
- if there is enough data...incidence and termination rates

At a more micro level, the following may be of interest:

- problem causes of claim
- problem occupations or other groupings
- analyse large claims
- underwriting and claims audit
- problem distributors
- Problem benefits and etc.

The following charts 10 to 12 illustrate how the income protection experience moved over time in US (profitability), UK(incidence rates) and Australia (claims cost) respectively.

CHART 10: US EXPERIENCE
Individual non-cancellable disability income - Statutory profit/loss as a % of earned premium before policyholder dividends and Federal income tax
Source: Milliman & Robertson

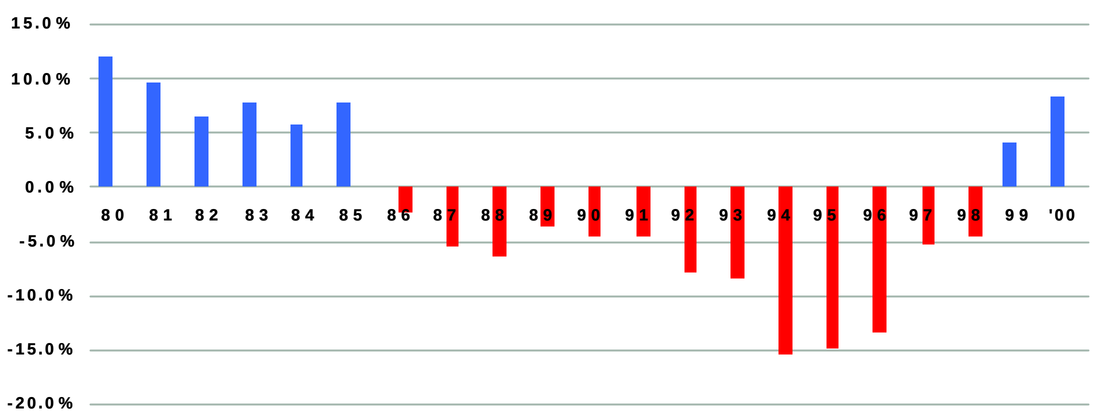


CHART 11: UK EXPERIENCE

CMIR 22 – A/E incidence rates, 'E' based on CMIR 12 model using 1975-78 experience

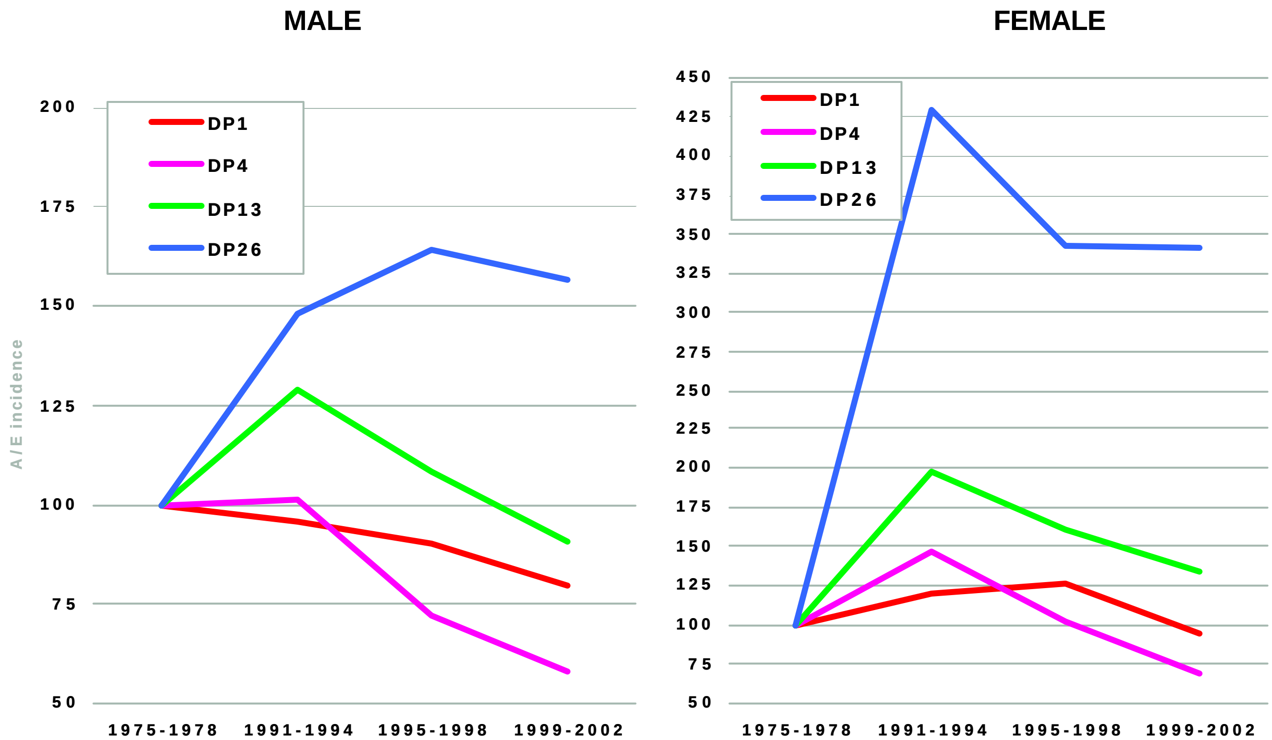
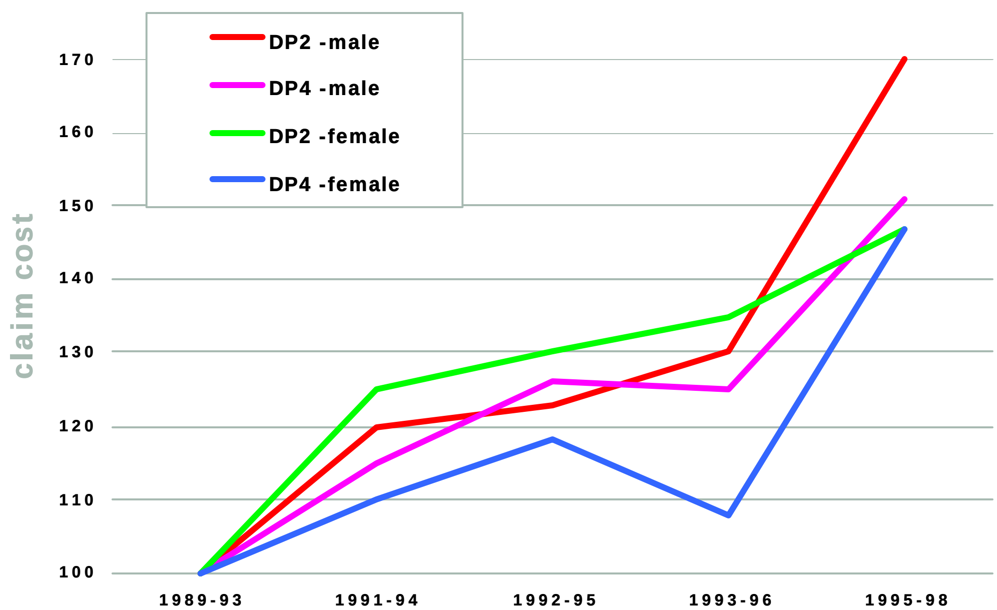


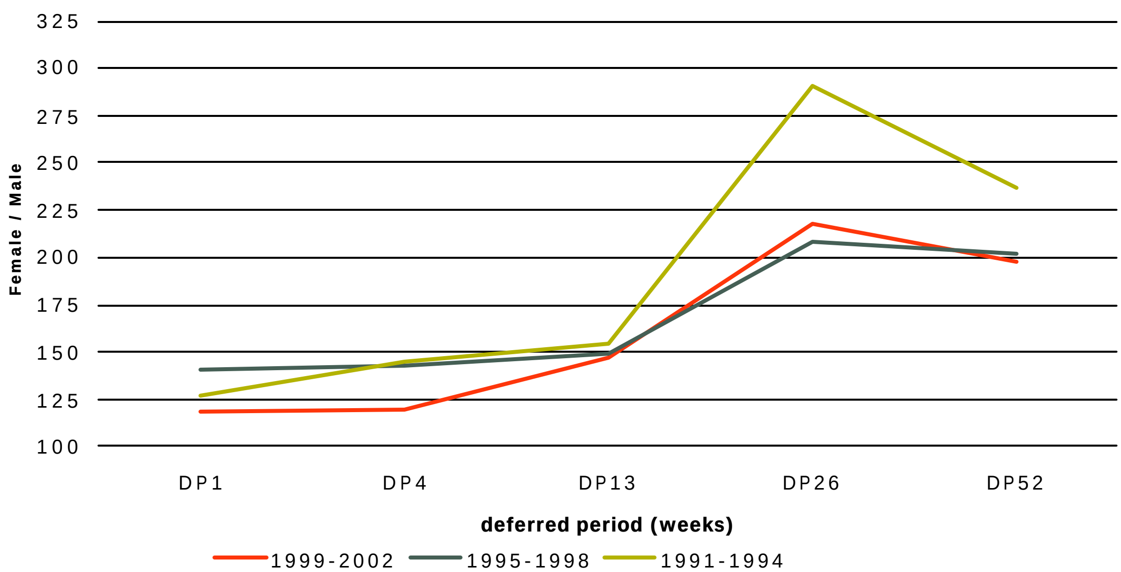
CHART 12: AUSTRALIA EXPERIENCE

Claim cost trend – report of the disability committee 2002, Institute of Actuaries of Australia



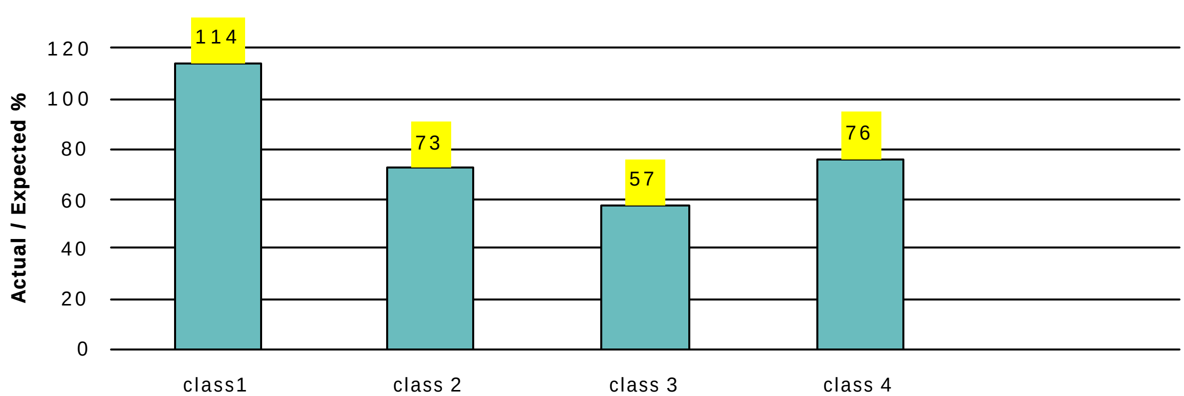
It might also be interesting to see how the impact of rating factors such as gender, deferred period and occupation on experience differed from that expected. The chart 13 below show the expected experience of females relative to males by deferred period, in UK, turned out be different from that expected.

CHART 13: FEMALE A/E INCIDENCE RATES RELATIVE TO MALE
CMIR 22 – Individual income protection insurance, Female/Male A/E,
'E' based on CMIR 12 model using 1975-78 experience



Occupation can have a key influence on the experience of the income protection insurance. The nature of work may be changing over time for the same occupation. So it is crucial to monitor the relative loading in the premium rates and incapacity definitions applied for different occupations remain appropriate. The chart 14 below illustrates how the experience of different occupational groupings differed from that expected.

CHART 14: A/E INDIVIDUAL DI INCIDENCE RATES IN US 1990-99
Report of the Individual disability income committee, Society of Actuaries



Class1	Professional, technical and managerial occupations that are generally office duties only
Class 2	Supervisory and other skilled clerical and skilled technical people
Class 3	Non hazardous work with light manual duties
Class 4	Hazardous work with heavy manual labour or using heavy equipment

Another important aspect of experience monitoring in income protection insurance is to closely monitor the causes of claims and how they impact the length of claims. It is a widely accepted fact that the incidence of claims due to mental illnesses are increasing. Pro-active claims management is key to prevent or curtail those claims. Mental and nervous disorders are particularly a major problem area for income protection insurance because:

- they are highly subjective in nature
- likely to last long and hence huge claim outgo
- incidence of such disorders is increasing

You may also have noticed from charts 5 and 6 above that India is not an exception to the problem of mental disorders. The following charts 15 & 16 show the causes of claims by number and by size of disabled life reserves respectively.

CHART 15: CAUSES OF CLAIM BY NUMBER
Mercantile & General / Swiss Re UK 1997

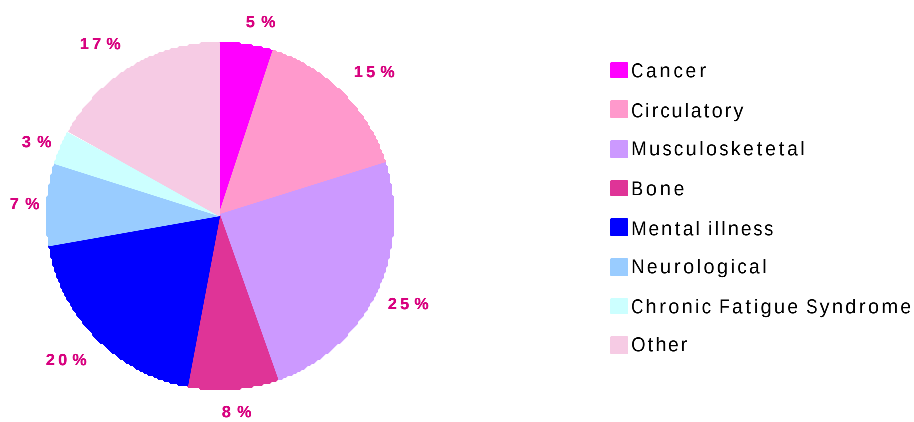
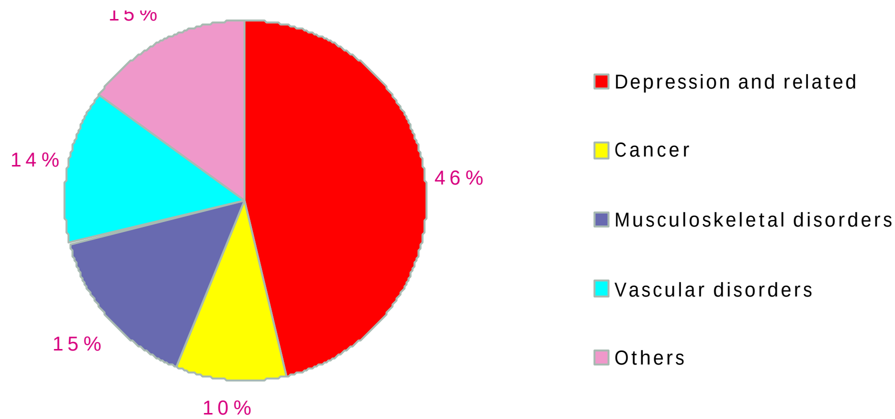


CHART 16: CAUSES OF CLAIM BY SIZE OF DISABLED LIFE RESERVES
Top 50 claims by size of disabled life reserves, SwissRe Australia, April 2005



It has also been observed in some markets that the income protection claims start with some cause of claim and then transform into another secondary cause of claim. This is something which needs to be closely monitored as the duration of a claim from a particular cause may lengthen due to the cause itself is making such a transformation. For example, the impact of a cancer claim can be short-term, but it can become longer term as a result of some damage caused to other organs in the course of treatment. The impact of increasing prevalence of obesity on disability claim incidence is another must-watch area.

5. SALES AND MARKETING

"Insurance is sold not bought". This is very much true when it comes to health insurance business. Health insurance goes way down in the list of individuals' priorities. There are various reasons quoted for the low sales volumes in some markets.

They include:

- Customers prefer lump sum to income. This is the reason the Critical illness cover is more popular than Income protection insurance in some markets.
- Most of the salespersons, excepting a few, are not able to clearly explain why an individual need income protection insurance.
- Customer have not fully recognised the need for such a coverage
- The cost of cover is perceived as expensive – 'poor value for money'
- Underwriting is seen as a barrier
- Claim definitions are seen as vague
- treated as a niche product by insurers and therefore given less priority than it may deserve

Some of these issues may be addressed through innovative product design and efficient sales process. The following chart 17 shows the trend in new business sales seen over the last 5 years in a few developed markets. There are various reasons (including the above list) are attributed to the ups and downs in sales but we are not going into the details here. But it is imperative that various socio-economic factors have had influence on the supply and demand for the product (eg. a fall or rise in the protection business in general, which is more pronounced in the case of income protection business due to its complexity, slowdown in the mortgage market etc.).

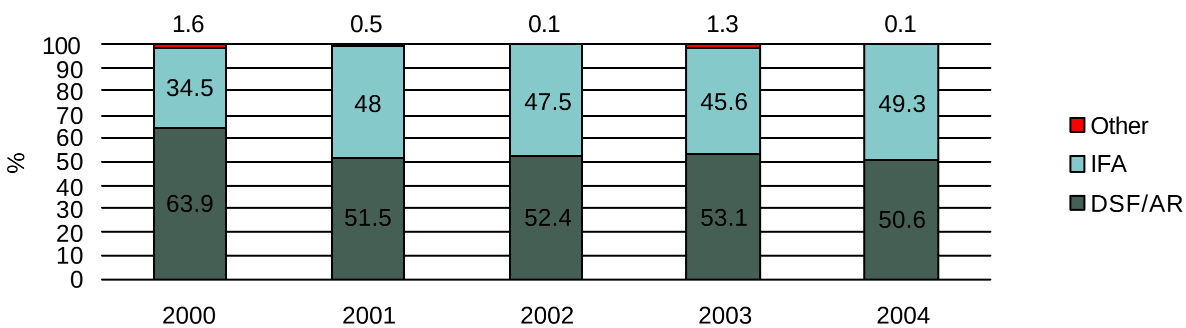
CHART 17 – NEW BUSINESS SALES

* Premium “No. of policies

Given the boom in mortgage business in India, it may be appropriate to target this market for the income protection business. Another important target market is employer-ee groups. Nowadays, the employers in India are increasingly showing interest on innovative benefit packages in order to retain the best talent. When it comes to the distribution of the product, Independent financial advisors (IFAs) play a major role in the group market and well-trained direct sales force (DSF) are crucial. It is unlikely that the direct sales (eg. mail shots, telephone selling and internet sales) would be useful at this point in time given the complexity of the product. The following chart 18 shows the number of new policies sold by distribution channels in UK.

CHART 18 – NEW BUSINESS SALES BY DISTRIBUTION CHANNEL

Association of British insurers



Mis-selling is a major area of concern as it is bad for the insurance industry as a whole. If you create wrong expectations in the minds of your customers through sales literatures or otherwise then you invite trouble. Even the developed markets have faced number problems with mis-selling. As far as the income protection insurance business is concerned, the potential for misselling can arise in a number of ways, they include:

- Policyholders might be led to think that the insurance benefits will replace their full income whereas the income and the insurance benefits may change over time at different pace. As long as the customer is made clear on this fact, then there is less potential for mis-selling.
- Under ‘agreed value’ benefit structures, the insurer’s right to restrict benefits when the insured’s income drops though the full premium has been paid for the agreed benefit may lead to problems. There has to be standard guidelines on such benefit limitations

might help address this problem in addition to making the policyholder clear on the impact of fall in his or her income on the benefits.

It is quite important that the products needs to be positioned in the market very carefully keeping in mind the needs and sentiments of the customers. The transition of the product name from "disability income" to "income protection" is a clear direction to go. Say the product attempts to "secure income" rather than "replace income". The marketing literature needs to be worded very customer-friendly rather than just a if-what list of things to follow. Example, instead of saying "you need to notify your claim within 6 weeks", better express it as " please refer to brochure 'when you are ill' which also contains which also contains some tips to prevent …". The key marketing message should send out a very positive signal to potential buyers. For example, the message "*…and even if you stay ill longer than expected, it's a reassuring idea to be able to rely on us to provide you with a disability benefit as long as you're disabled."* does not sound positive. It may better be replaced by something like "*"…and even if you stay ill longer than expected, we will try together with you to look for possibilities to get you back to work as soon as possible."*

6. SUMMARY

Income protection business requires dedicated insurers given the greater degree of complexities involved in the product development, sales and administration and claim management compared to a mortality product. The summary of the key issues to be considered in each of these areas include:

❖ Product development

- Be aware of the insurance environment (state provision, tax, regulation etc.)
- ensure appropriate balance between 'indemnity' vs. 'agreed-value' benefit structure
- ensure robust, unambiguous and easy-to-understand incapacity definitions
- ensure appropriate waiting periods consistent with the underwriting philosophy
- ensure appropriate deferred periods commensurate with real customer need and affordability
- ensure appropriate income replacement ratios
- put in place appropriate medical and financial underwriting
- use appropriate exclusions
- understand and allow for the impact of anti-selection, non-disclosure and moral hazard
- understand the presence and impact of various risk factors and their regular monitoring
- understand the cost implications of guarantees and options
- allow for economic and medical trends

❖ Sales and administration

- target sophisticated customers
- use professional salespersons
- identify and address pretty quickly any misselling possibilities
- understand the complex administration and ensure adequate IT support

❖ Claim management

- ensure pro-active claim management through early-intervention
- ensure that the claims are handled sensitively
- use claim counselling and rehabilitation
- watchful of trends in causes of claims and duration of claims

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- Mr. Gavin Maistry, Corporate Actuary, Swiss Re, Zurich

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