Making insurance more affordable

Practical strategies to ease cost pressures for clients

There are a number of ways you can reduce the hip-pocket impact of personal insurance for clients facing cost-of-living pressures.

Rapidly rising mortgage rates and other cost-of-living increases have impacted household budgets right across Australia. Insurance premiums have also increased significantly in recent years—particularly for income protection (IP) policies in place prior to the APRA interventions* that occurred from 2020.

Many clients are on the lookout for expenses they can cut down or cut out, and personal insurances such as Life, Total and Permanent Disability (TPD), Trauma and Income Protection (IP) are likely to be among them.

Cancelling cover can be very risky

Cancelling insurance, or letting cover lapse, can expose a client and their family to significant financial risks in the event of death or disability.

Studies in Australia conducted by the government-funded body HealthDirect show that financial stress can increase the chance of physical and mental health issues, most of which can be covered by insurance.

Also, if a client wants to resume cover:

- underwiring may be required, where they may find that they either do not qualify for certain cover(s) or benefit(s) or there are significant loadings due to a demise in health since the policy was previously underwritten, and,
- certain waiting periods may need to be met again (for example, a claim may not be paid if the insured commits suicide within 13 months of starting a new policy).

Clients should, where possible, be encouraged to retain the cover necessary to help protect their current and future livelihood.

Look out for premium waiver benefits

Where a client is facing significant financial stress and is simply unable to fund the premiums at this point, you should find out if they are eligible for a premium waiver benefit or option. IP policies typically have an in-built premium waiver, and it is usually optional with Life, TPD and Trauma.

Premium waiver benefits permit eligible clients to waive their premiums for a specified period while the cover remains in place. This benefit may apply when, for example, a client experiences involuntary unemployment.

Managing insurance costs

Where there is no alternative but to look for cost savings, there are some things you can do to reduce premiums, or stop future increases, that generally fall into two main categories:

- changing an existing policy
- replacing an existing policy, including funding the insurance in super, where the sum insured may need to be grossed up to allow for any tax implications.

These opportunities are explained in more detail throughout this article.

Other key considerations

Before making any changes that improve affordability it is vital that you:

- urge the client to undergo a medical examination with their usual doctor to identify any undiagnosed serious medical conditions, and
- explain what clients may be forgoing if they die or become disabled—it is essential they understand the trade-off, including the impact on future financial well-being.

Changing an existing policy

If a decision is made to address the affordability of policies, the following options can be considered.

Review sum insured

A key way to reduce insurance premiums is to decrease the sum insured. While this results in a reduced level of protection, there may be some valid reasons why clients may want to reduce the sum(s) insured. For example, if the policy had not been reviewed for a while, a reduction in sum(s) insured could be justified on the basis that the client has:

- paid down debt
- accumulated (or inherited) additional assets that could be used to replace income, and/or
- reduced expenses/income needed because, for instance, children have grown up and are now financially independent.

Best practice is to review clients' needs regularly and adjust the sum insured accordingly.

Review product features

Premium savings could be made by removing product features that are no longer important or required. Examples are double TPD benefits, life cover buy-back after TPD, day-one IP accident and additional cost optional 'plus' or comprehensive benefits. For more information on these 'extra' benefits, refer to the relevant PDS.

Change habits or activities

Premium savings may be made by making changes to habits or activities that would reduce insurance risk. For example, non-smokers usually pay a lot less than smokers for the same cover but may need to have abstained for a certain period (for instance, 12 months) before they qualify for the lower premiums. Also, insurance is usually cheaper for people who do not participate in 'dangerous' activities such as skydiving.

Review premium payment options

The choice of paying stepped or level premiums can impact the cost of insurance in the short and longer term. While opting for stepped premiums could save money now, it could end up increasing the total cost over the life of the policy.

Stepped premiums

Stepped premiums are calculated each year in line with the insured client's age. They are usually lower than level premiums towards the commencement of the policy but higher for the same level of cover as clients get older.

Level premiums

Level premiums are premiums generally averaged out over a number of years. They may still increase over time due to CPI or poor claims experience. They are usually higher than stepped premiums toward the commencement of the policy—but tend to be lower for the same level of cover as clients get older.

Opt-out of CPI increases

The sum insured is generally indexed annually by the consumer price index (CPI) or other cost-of-living adjustment. While opting out can help manage future premium increases, it will reduce the 'real' (inflation-adjusted) value of benefit payment(s). A timeframe to opt-out may apply (for instance, within 30 days of the policy anniversary). If a choice is made to permanently opt out of indexation, medical information may be required to reinstate indexation in the future.

Pay premiums annually

In some cases, a discount may be available if premiums are paid annually in advance, rather than monthly. However, in times when the household budget is challenged, it may be difficult to switch to an annual premium in advance.

Consolidate or link insurances

If clients hold insurance in multiple policies, it may be worthwhile consolidating into one policy. This could result in significant fee savings. It can also be more cost-effective to link lump sum covers. For example, TPD and/or Trauma cover can be linked to Life cover. Where cover is linked and a TPD or Trauma claim is made, the TPD or Trauma cover will either reduce or end, and the Life cover will reduce accordingly.

Alter waiting or benefit payment period for IP policies

Most IP policies offer a choice of waiting periods, for example, 30 to 90 days, and payment periods, for example, one year to age 65. Choosing a longer waiting period and

The quote

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a shorter benefit payment period could reduce the premiums, in some cases significantly. A longer waiting period means the client will have to fund their own cost of living for a longer period until the waiting period has been served.

Change 'own' to' any' occupation for TPD policies

Changing from 'own occupation' to an 'any occupation' definition may reduce the cost of premiums, however, this will change the assessment criteria at the time of claim:

- from being unable to perform the client's own occupation—which is more expensive but easier to satisfy and make a successful claim,
- to being unable to perform any occupation for which the client may be suited due to education, training or experience—which is cheaper, but harder to satisfy and claim.

Premium waiver, suspension and freezing options

Insurance companies offer a range of options for clients who are experiencing cash flow issues. These include:

Premium waiver benefits or options

These permit eligible clients to waive their premiums for a specified period, while the cover remains in place.

Premium freeze options

These allow clients to fix their premiums at the current amount. The client's sum insured is then reduced at each policy anniversary to the amount that can be purchased based on the premium paid.

Premium suspension or 'premium holiday' benefit

Effectively a pause of cover, these allow eligible clients to suspend their policy and premiums for a specified period. However, it is important that clients understand they are not covered while policies are suspended.

Replacing an existing policy

If a decision is made to replace an existing policy, the following options can be considered:

Fund premiums in super with tax-effective contributions (Life and TPD)

Life and TPD insurances taken out in super may be funded with tax-effective contributions.

For example, clients who can make salary sacrifice or personal tax-deductible super contributions, may be able to purchase insurance through a super fund effectively with pre-tax dollars. These tax concessions can make the cover more affordable, when compared to insuring outside super. However, the sum insured may need to be grossed up to allow for tax.

Fund insurance in super without contributing (Life, TPD and IP)

Where clients are cashflow constrained, they may want to arrange to have insurance premiums deducted from their existing superannuation account balance without making additional contributions to cover the cost. This could make insurance affordable where they do not have sufficient cash flow to fund additional super contributions.

You need to consider the impact this will have on the client's future retirement benefit. While this could impact their lifestyle when they retire, it is important to consider the lifestyle impact in the interim if the worst were to happen.

Without insurance, clients could find themselves in severe financial difficulty. Having no insurance can have a far greater impact on retirement benefits and the client's retirement lifestyle than using super benefits to fund the insurance premiums.

Change to new post-APRA intervention policy (IP)

If the client has a pre-APRA intervention IP policy, premium savings may be made by switching to a post-APRA intervention policy—although certain features are no longer available, and the insurance benefits paid may be reduced.

Issues to consider before changing a policy

Any advice to amend, cancel or replace cover should always be accompanied by clear discussion and any required advice documentation, setting out possible consequences of this action in the strongest terms. This is especially so where the need for cover remains, but the client's circumstances clearly convey that the cover is no longer affordable.

Additionally, advisers should urge clients contemplating cancellation or cover reduction to undergo a medical examination with their usual doctor (before the cancellation/reduction) to eliminate the possibility of an undiagnosed serious medical condition that may be lurking. FS

***APRA interventions**

The Australian Prudential Regulation Authority (APRA) implemented several interventions in the Income Protection (IP) insurance market from 2020, in response to significant losses within the industry. These interventions aimed to address issues related to the sustainability and profitability of IP insurance products.
Key measures included discontinuing the sale of Agreed Value IP policies and imposing stricter definitions on Indemnity policies to target concerns about income variability and potential overstatement of income at the time of claim.
Additionally, adjustments to policy terms and conditions were enacted to ensure policies adhered to stricter APRA guidelines, including changes to the calculation of monthly benefits.

Source: APRA