

# Demystifying Income Protection

Until recently available disability income cover only replaced 75% of the pre-disability salary. One simply has to ask the question: "Could I survive with a 25% cut in salary?"

## Basis for 75% replacement ratio

Historically disability income benefits were associated with early retirement due to ill-health. 75% might be suitable as post-retirement income but should it also apply to disability insurance?

## The need for more

The person who receives a disability benefit still needs to save for retirement, pay the home loan or care for children. Then add costs related to a serious medical condition and it's not surprising that 75% disability income benefits aren't fully meeting the need.

We recently surveyed a sample of our disability claimants, asking them three general open-ended questions. One striking result was that 43% said they struggle financially. This underscores the notion that the current income replacement ratio is often not enough.

## Industry concerns about 100%

In response to claims trends, especially during tough economic times, insurers structured cover to avoid risk that was perceived as unmanageable.

From an insurance perspective, there are mainly two concerns about 100% income benefits:

- Would more employees apply for disability benefits if there is no loss in income?
- Would claimants who recover go back to work if there is no financial incentive?

In summary, would the incidence and duration of disability claims increase?

## A different perspective

Like most insurance risks, we believe that both these concerns can be addressed with the right expertise, processes and knowledge. For instance, to qualify for the disability benefit the applicant must be unable to work due to an illness or injury. Claims are admitted if there is sound medical evidence to confirm physical and/or mental limitations that impact on the claimant's ability to work. This is irrespective of the replacement ratio.

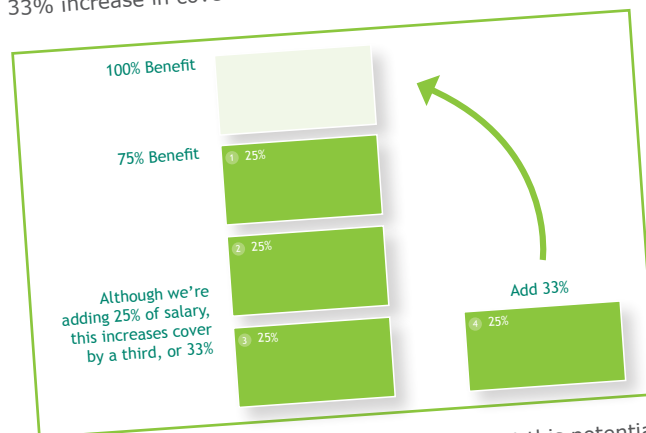
Insurers pro-actively identify claimants with the potential to return to work and involve key role players in their preparation for workplace reintegration. This benefits all stakeholders, including the claimant, as employment generally improves our quality of life.

It's important to recognise that the need for a full income replacement product has always existed, but the platform to

deliver it has not. Over the past decade, risk management and claims practices have improved significantly. The risk of poor claims experience due to a 100% rather than a 75% benefit is thus not as significant anymore.

## Impact on cost

At first glance, it may seem like having 25% more insurance. But the increase is 25% of salary – people will actually have a 33% increase in cover.



Naturally the price of a 100% benefit will reflect this potential increase in benefits and it may take time for groups to consider and negotiate the funding of this option.

## Impact on group risk strategies

Up to now group risk plans have been set with the 75% maximum in mind, largely allocating the remaining funds to Group Life cover and riders.

Now that the option exists to provide more appropriate disability cover, we expect people to start re-thinking the optimal balance between life and disability products. For many schemes, income protection is cheaper than life insurance. Therefore a small reduction in life cover can purchase a much higher level of disability insurance.

The group disability market has evolved considerably over time. Today's 100% benefit – payable for the entire duration of a claim and regardless of the medical condition – is a culmination of many small steps.

From scaled benefits that gave way to flat cover, to the more recent developments (e.g. a 100% benefit for the first two years, and a 25% top-up for certain severe and permanent conditions) – each change has supported the same demand: comprehensive disability insurance.

**Introducing the 100% benefit option is an exciting transition in the development of disability cover – moving from basics to true income protection.**



OLD MUTUAL

Corporate