

# The Income Protection Task Force

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## The Income Protection Task Force

### White Paper

December 2006

COMPILED AND EDITED BY LE BEAU VISAGE AND CWC RESEARCH

With contributions from leading industry experts

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## **Introduction** by Teresa Fritz of Which?

Getting the right protection insurance has never been more vital – or more difficult. Recent research shows that one Briton in three has little or no money put away for emergencies and just 27 per cent of working Britons believe they have enough savings to cover periods of illness. But despite the obvious need, consumers aren't buying the right protection products. So why is this?

It's simple really - because financial advisers, mortgage lenders, banks and insurance companies are either selling us the wrong products – or none at all.

Protection products are not something most consumers go shopping for, but if they did, what awaits them? Dozens of products with similar sounding names, all doing different things. Confusing terms and conditions. Complex and lengthy underwriting procedures and exclusion clauses, which on some policies make you wonder in what circumstances they would ever pay out. No wonder people either end up with a completely inadequate, but costly, pick and mix of products, or no cover at all because it's just too difficult and they have a life to lead.

So the first lesson the industry has to learn if it wants to sell more protection products is to simplify. Give us products that do what they say they will, have transparent charges and jargon-free terms and conditions so we can understand what we are paying for and compare products against each other. That would be a great start to getting the nation better protected. But simpler products are not the only answer.

At Which? we believe the consequences of being sold the wrong protection product are just as serious as being sold the wrong investment product. Even when the right product is sold, it's vital the right cover and terms are in place. Therefore, advice and advisers are crucial.

It's because of the huge knowledge gap between the protection industry and its customers that we had high hopes when we heard these products were to be regulated. But the celebrations didn't last long. Despite our (and others) best efforts, the Regulator saw fit to impose the same regime to protection policies as it did to house and car insurance, effectively telling us that protecting ourselves or our dependants against financial disaster is no more important or complicated than protecting the family hatchback.

The new rules allow these products to be sold on an 'information-only' basis which means firms and advisers choosing this route can sell you any old thing without having to prove the product they are selling is actually what you need. This service is often offered in the interests of 'consumer choice' so consumers who don't want or need advice don't have to have it. But this is nonsense. Real consumer choice only exists in a market where products are transparent, easily comparable and accessible to all, and the protection market is currently a million miles away from this ideal. An information-only service is offered because it is cheaper – for the firm offering the service, that is, not for its customers.

Of course consumers need choice, and ultimately some better products to choose from. But they also need help and advice to choose the right protection product, the right level of cover and the right provider. And they need providers and advisers who are willing to stand behind that advice and take responsibility for it.

Which? has been a big advocate of income protection for many years and believes it should be the first choice of protection for many people. For too long we have been one of

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its only champions and one of the few voices against the flood of sales for critical illness and payment protection insurance. However, the tide is turning. The OFT and the FSA are investigating the payment protection market. Sales of critical illness policies are falling. Insurers, re-insurers and advisers are looking for reasons why the protection market has failed and how it can be put right.

Which? welcomes the launch of the Income Protection Task Force White Paper. Many within the financial services industry are beginning to voice an opinion that income protection should take its place back at the head of the protection insurance table and be the primary protection product it sells to its customers. We agree, but there is a lot of work to be done before that can happen.

Hopefully, the industry will pick up the challenges thrown down by the White Paper so this really can be a new beginning for the protection market and the start of a better deal for its customers.

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## Executive Summary

### 1 Regulation

The supporters of income protection saw the introduction of ICOB as a positive step. The 'statement of demands and needs' should set out why a particular contract is suitable for a client. Arguably it should point out where it does not meet the customers' demands and needs. Similarly TCF should have had a positive impact on the sales of Income Protection (IP). Unfortunately, many distributors and insurers are ignoring both. We have recently seen the FSA take action against distributors for breaches of TCF. More action needs to be taken.

If both ICOB and TCF are policed robustly, individual and group IP sales will increase exponentially.

### 2 Incapacity Benefit

There are some 2.4 million Incapacity Benefit claimants. Of these, 73% have been claimants for 2 years and 48% have been claimants for 4 years. Around 40% of these claimants suffer from mental/stress illnesses and 20% suffer from musculo-skeletal disease.

These figures demonstrate clearly that IP is the only suitable product to cover long-term disability. Moreover, levels of morbidity are such that advisers should ensure that all breadwinners are adequately insured except for the tiny minority who have adequate resources.

### 3 Underwriting and Claims Issues

Underwriting of IP necessitates lengthy, detailed application forms, long delays before acceptance, resulting in cases not proceeding and high cost to the insurer.

Tele-interviewing can make a great difference in each of these areas. Where insurers do not have the resource for tele-interviewing, it is possible to outsource effectively.

Problems with occupational loadings are another bugbear. Insurers should issue more comprehensive guides. These could be incorporated into online systems. Tele-interviewing will help minimise occupational loading problems when employed to collect initial data.

Rehabilitation should be part of the IP product proposition. Claimants must see the insurer as their ally and not be worried about payments stopping before they are genuinely able to return to work. We believe the industry should work together with the State in terms of payment triggers, incentives to return to work and tools that review work capability.

The proportion of claims paid under IP is better than any other protection product other than life insurance. This message must be shouted loud and long as the consumer and the media believe the opposite.

There is much consumer dissatisfaction when payments are cut at claim time due to so-

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called over-insurance. This is particularly galling when a self-employed person's income has fallen due to illness and when they have postponed stopping work for as long as possible to keep their business going. We should also research consumer experience at claim to identify strengths and weaknesses.

#### **4 Medical and Social Trends Affecting Morbidity**

The increase of stress related illness and musculo-skeletal disease has impacted greatly on the number of IP and State Benefit claimants. The new State scheme that will commence in 2008 will be tougher and is an opportunity for the industry to work with Government.

There is a view that "The State will provide" that has always been inaccurate for all but the lowest earners. The State cannot afford not to cut the cost of the Welfare State. These messages must be conveyed to the public.

#### **5 Current Issues in the Income Protection Market**

Despite the increased incidence of long-term disability and illness and the terrible financial consequences, IP sales are falling. There is a need for education to increase awareness. Consumers are commonly unaware of the length of time employers will continue to pay them. It should be a requirement for employers to issue a statement annually to employees advising them of terms of employment such as this.

Research indicates that IP does not sell because people do not believe there is a need. At the same time around 50% of advisers and a large proportion of the public believe that they are more likely to suffer financially because of a critical illness and, in any event, they prefer a lump sum.

We believe that the concept of a protection product hierarchy should be formalised. Virtually all insurers and reinsurers interviewed rate IP as the most important product in the protection hierarchy. The protection hierarchy should become an essential ingredient of industry training.

We also believe that all individuals should be aware of their personal protection gap – the difference between State Incapacity Benefit plus what they will receive from their employer and current net income. A shared agreement with DWP on what constitutes working disability and more objective and generally-accepted methods of establishing this, and a much greater confidence about when insurers will pay IP benefit, will be helpful in building sales of IP.

IP is a complex product, but is made more so by unnecessary differentiation between products in areas where there is no competitive advantage. This results in greater confusion amongst consumers. The ABI Protection Committee should lead an initiative to agree standardisation in such areas whilst complying with anti-competition legislation.

Remuneration is an issue that is rarely addressed. Research shows that whilst commission for IP is similar to CIC, the time taken to complete a contract is significantly greater. Indeed, an IFA recently publicly announced that he could not afford to recommend IP as his clients would not pay for the cost of application.

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## **6 The Impact of the Mortgage Market on Income Protection**

The majority of disability cover is sold with mortgages. Banks and building societies typically recommend ASU/MPPI style products. They are easy to sell and pay commissions of up to 80%.

Unfortunately, many are very expensive and have extremely low claims ratios. Moreover a very high proportion of claims are declined. They are often badly sold, for example to the self-employed.

In view of the huge financial benefit to distributors, this will not change unless the regulator takes rigorous action. Should this occur, IP providers should look at MPPI to see what can be learned. The process must be made extremely easy. The use of tele-interviewing to acquire medical and occupational data and outsourcing to specialists are ways in which mortgage advisers could be encouraged to recommend IP.

## **7 Incremental Change or Radical Re-engineering?**

Sales are falling from an already low level. Radical re-engineering of both process and product must be considered. PPI demonstrates that consumers will buy disability products. Success of CIC tells the same story.

A hybrid product should be considered where a lump sum would meet given capital needs and an income would meet essential expenses. We should also consider shorter-term contracts and shorter waiting periods.

An agreed value contract where financial underwriting is carried out only in claim would be well received.

## **8 The Way Forward: Nine-point Plan**

This paper concludes with a nine-point plan that will, if followed, dramatically increase sales of this most essential of protection products by issuing policies that the public understand and trust; by ensuring that advisers and consumers are aware of the need to protect their income; by building a strategic alliance with the media to convey this important message to this and future generations of readers and by working with Government to address shared problems and with the regulator to ensure robust enforcement of existing rules and principles.

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## 1 Income Protection – A product history

Income protection (IP), in its current form, has been written in the UK for about 75 years. It has been priced on a rather arbitrary basis for much of that time.

The origins of sick pay go back to the friendly societies of the early nineteenth century that were founded to help members make provision against hard times. The desire for a balance between saving, security in sickness and provision against death, led to the formation of deposit and Holloway societies. The earliest deposit society was founded in 1831, but the idea did not catch on until later. In 1868 a society was formed at Albury in Surrey which in 1872 became the National Deposit Friendly Society, by far the largest of its type\*.

Holloway societies were based on principles invented by George Holloway who, in 1874, founded the Working Men's Conservative Friendly Society in Stroud. It combined saving and sick pay but on different lines from the National Deposit Friendly Society. Amongst these differences was the fact that it was not possible to run out of sick pay.

These immediate benefit policies still remain today and are sold by a number of specialist friendly societies.

Until about 30 years ago, a large part of income protection policy pricing was based on sickness experience from the Manchester Unity of Oddfellows, much of which had been collected in the late nineteenth and early twentieth centuries. It seems inconceivable that insurers could base their pricing approach on a subset of industrial workers in the North of England in previous centuries under entirely different economic and social conditions.

The original name of the product and one that persisted up until recent times was permanent health insurance (PHI). This was not a marketeer's dream. It was a name that failed to describe the benefits provided or the effect they could achieve. PHI became a specialised product, which was usually sold upmarket and began to emerge as the State Welfare system emerged after Beveridge. A number of insurers developed specialist expertise and were able to deal with the modest volumes that were written.

Individual PHI struggled to make large inroads into the market place partly because it was seen as a specialised rather than a mass-market product and partly because it suffered competition from group PHI. As companies developed more sophisticated employee benefit plans they saw a double benefit from GPI. Firstly, it was a very attractive benefit to a potential new employee and, secondly it was helpful in replacing the income paid out on an employee who was a long-term absentee. Just over a million lives were covered by individual IP plans in the 1980s and the figures for group IP were slightly higher. It is thought that group IP accounts for about 60% of current IP coverage in the UK.

It is perhaps surprising that group income protection levels have held up in view of the demise of the final salary pension scheme and a drift in employment from large companies to smaller businesses. However, employers have been anxious not to be seen to be removing all employee benefits when abandoning final salary schemes. In addition, many see the additional benefits of absentee management and avoidance of disability discrimination.

One sector of the market that appears to have shrunk over the last decade is the small group or executive market whereby partners or directors made provision for themselves and possibly key employees. Where policies are effected by the employer, it is possible to include NIC and employer pension contributions.

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Two events have happened in the relatively recent history of PHI to provide a potential boost to the product. Firstly, in 1984 the removal of LAPR by Chancellor Lawson put PHI on an equal footing with other protection products and several new players notably Allied Dunbar and Abbey Life were tempted into the market with a unit-linked approach to pricing which effectively passed the pricing risk back to the policyholder. This led to a modest increase in sales but no shattering of the “Glass Ceiling”. Then in the early 90s as almost a throwaway line in Chancellor Clarke’s Budget it was announced that PHI benefit in payment (which had enjoyed a tax holiday of one full fiscal year plus the unexpired balance of the current fiscal year) was now to be tax-free without limitations. If ever there was an opportunity for the product to take off, it was now! Existing insurers and their reinsurers watched carefully for deterioration in experience and an uplift in sales but neither came.

The reason was the appearance of a new health protection plan in the late 1980s – “Dread Disease”. This soon overcame one of the worst titles to afflict an insurance product and was re-named Critical Illness and its sales success has been well documented. Its attractiveness as an augmentation to mortgage cover saw sales shoot way beyond a million policies a year, despite farsighted warnings from some reinsurers that the pace of medical development would make it extremely risky to guarantee premiums for long periods.

PHI, now re-christened Income Protection but faring not a lot better, remained a product with a lot of critical acclaim but little public enthusiasm. This brings us to the present day and a situation that we believe may lead to a re-adjustment in protection priorities. IP has enjoyed a number of false dawns and is a fragmented product at present. The work of the Income Protection Task Force is ongoing but we believe the product has a place and relevance today that is indisputable. We believe that this White Paper will underline just how important IP, group and individual, could become as part of the social welfare fabric of the United Kingdom.

*\*The Evolution of Friendly Societies in Britain, David G Green, 1993*

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## 2 The Regulatory Dilemma

The FSA would undoubtedly claim that the proper application of their principles would mean that insurance products fit for purpose were sold in appropriate and ethical ways to people who knew and value what they had bought and who could be sure that they would be treated fairly. It is a fine aspiration but there must be scepticism about whether it works along those lines in practice.

Once, back in the era of self-regulatory authorities, the ABI set out a code for the selling of what we now know as pure protection policies, which of course include IP. Regulation of the distribution and promotion of investment products was taken over by the FSA under their Conduct of Business rules (COB) and less than 2 years ago Insurance Conduct of Business (ICOB) rules were introduced to extend that approach to 'General Insurance'.

ICOB was presented as lighter touch regulation and in the absence of coherent and credible evidence of consumer detriment, pure protection products were included alongside other 'general' insurance products. There was some soul searching about this outcome. For some people, these protection products were 'unusual' and they described them as high risk and complex. Could the public be trusted to buy, armed only with the information deemed relevant for simple stuff like household or motor (or marine)? Some people struggled with this view. Household and motor are sold in greater volumes but from the consumer's stance protection is unlikely to be higher risk and certainly no more complex.

In those days, IP providers issued Key Features Documents that had been validated against the purchasing requirements voiced by a consumer panel through independent research sponsored by an ABI Working Party and presented to OFT.

The headings addressed their key information needs and permitted product comparison feature by feature. There were 1 or 2 exclusions and the IP proposition was a single simple promise, **we pay you if you can't do your normal work for a long time.**

A household policy covers one's most valuable asset and it is exposed to many perils. The policy has nine major sections of cover - several are optional. There are nine general exclusions with more at the specific risk level and there are twelve general exclusions. Changing insurer becomes a burdensome task, not aided by Key Facts guides to any great degree.

The IP Task Force would contend that ICOB was not really that much less onerous than COB (allowing for the EU intermediation directive). Either route meant that the consumer knew:

- The nature of the advice they were getting and the status of the adviser
- What the product was going to do – 'Demands and Needs', 'Suitability Statement', 'Reason Why' letter etc
- The terms and conditions - 'Key Facts', 'Key Features' and plain English policies in their various forms and formats represent a considerable advance over what we had 5 or 10 years ago and offer accessible information to the interested buyer

There are still reservations about the degree of confidence with which buyers approach Income Protection. Is the single practical advantage of the ICOB route that pure protection products can be sold by the people who sell other things that the public actually want? For

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example, they want the house, need to borrow money and the insurance is swept in at the same time as part of the finance package.

If the insurance is sold as part of a financial review alongside pension design and with proper analysis of circumstances etc, the regime makes sense. If the proposition is clear and the purchase is made without advice, but based on sound application of the promotion and product description rules, the consumer can also be entirely satisfied with their policy. Our fear is that, for so many of the purchasers of pure protection, it is not a conscious and fully informed decision.

After less than 2 years, the ICOB regime is being reviewed and the status of pure protection is under the microscope again. Those who see IP as high risk, find their justification in the FSA thematic work on IP's close cousin Critical illness, published in May this year.

On a positive note, it seems that FSA were pleased to see widespread evidence of a thorough analysis of the need for protection and controls to manage the risks of mis-selling. They also thought that need for protection was well presented based on sound appreciation of the risk rather than scare tactics. However,

- The intricacies of the CI definitions could be understated and some sales staff were inadequately trained as they did not seem to understand the CI product they were promoting
- 'Key Features Documents' were not clear and the limitations of the cover were not obvious
- The justification for the sale was criticised
- Some firms were more concerned to sort out the regulatory aspects of their mortgage selling than to attend to the requirements of ICOB - but that did not mean they had been mis-selling
- Intermediaries were unclear about the medical evidence they were expected to collect and doubtless the advice given to clients reflected this
- Providers had not trained intermediaries to recognise that in the population some 10% - 20% would not be ordinary rates that meant that they and the clients were surprised when the final terms differed from the quotes.

The result of this is that in some 20 - 25% of CIC claims are rejected

- On investigation, some claimants bought CI but it is clear that the need they thought they had addressed is better met by IP
- About half of the rejected claims arise because claimants have failed to describe their circumstances properly.

Changing the ICOB rules may not address these issues. The key need is distribution training but also there seems to be work to do on the structure and description of CI products and, in some cases, processes might warrant examination too. The risk is that reclassification of pure protection, as a high-risk product will limit distribution since it seems probable that COB rules would apply.

We are told that about 40% of IP sales today are mortgage linked. How many mortgage distributors are COB authorised and will this mean that in practice their clients would be offered only payment protection style short-term cover for their loans? Given the close similarities between the customer's experience of the COB and ICOB regimes we wonder whether customers would actually appreciate any difference.

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The difference they may see is that many consumers who might otherwise have had long term cover for a risk that affects a significant proportion of us will not have that cover at all. Some might feel that this in itself is consumer detriment!

Regulation of Income Protection under ICOB has not been the panacea proponents of the product hoped it would be. Regulation has continually illustrated how prone it is to the law of unintended consequences and IP looks to be another case in point. The reason seems to be that so many protection negotiations are 'add-on' sales wrapped into other transactions, not a carefully crafted analysis of applicant need. Whilst we fail to develop a 'Protection Hierarchy' this situation will continue. If it does, it is serving the British public poorly, because they are not emerging from a key transaction in their lives with the right protection priorities identified and covered.

This situation is hard for regulators to address, but address it they must. Principles-based regulation is an admirable concept, but it must ensure that the key principle of fitting the right cover to the client's need is uppermost. We would contend that this is not happening at present and will not while a protection hierarchy is not acknowledged.

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### 3 Incapacity Benefit

It is now 11 years since State Incapacity Benefit replaced Invalidity Benefit. Despite Incapacity Benefit being considerably more restrictive, we have not seen any real growth in individual or group income protection sales. It is probable that lack of public awareness is the main reason for this, because naturally the Government isn't inclined to promote a change to the State benefit system heavily when it is not in the interests of the voting public.

Regrettably, this doesn't help people to understand the need for private provision. Lack of awareness of need is a barrier to sales.

The key changes introduced with Incapacity Benefit were:

- Higher rate benefit not obtained until 52 weeks of incapacity (was 28 weeks)
- Own occupation disability assessment replaced by significantly harsher Personal Capability Assessment after 28 weeks
- Removal of Earnings Related Component
- Dependants allowance only payable for the under 60's if caring for children
- Incapacity Benefit became taxable

There is very limited financial support available for those attempting to return to work. In general, you are permitted to work:

- For earnings of up to and including £20.00 a week for an unlimited period, or
- For less than 16 hours a week, on average, with earnings up to and including £86.00 a week for a 52 week period
- For less than 16 hours a week, on average, and earn up to and including £86.00 a week for as long as your illness or disability is considered sufficiently severe that you are treated as meeting the threshold of incapacity without undergoing a medical assessment

It is extremely unlikely that any one with a mortgage will receive 'Income Support Housing Costs' from the State.

- Income Support is an income-related benefit for people aged from 16 years up to age 60 that are on a low income. The amount of Income Support due may be affected by other income to the household.
- Savings over £6,000 usually affect how much Income Support you can get.
- Savings over £16,000 usually mean you cannot get Income Support.

To be eligible for housing costs you must receive either:

Income Support, income-based Jobseeker's Allowance or Pension Credit.

But normally, you will not receive any help towards your mortgage for the first 39 weeks of your benefit claim. You will be lucky not to have lost your house to the lender by this time.

If you are eligible, payments towards your housing costs will not cover all your mortgage liabilities, for example no payments can be made towards capital payments, insurance premiums or arrears on your mortgage (missed mortgage, interest and capital payments).

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## Who is eligible?

The following information is from the Directgov web site. This is only an extract. Please go to this web site for full details - [www.direct.gov.uk/DisabledPeople/FinancialSupport](http://www.direct.gov.uk/DisabledPeople/FinancialSupport)

You may be able to claim Incapacity Benefit if any of the following apply to you:

- Your Statutory Sick Pay has ended, or you can't get it
- You are self employed or unemployed
- You have been getting Statutory Maternity Pay (SMP) and have not gone back to work for your employer because you are incapable of work
- You were under State Pension age when you became sick

You must also have been:

- Paying National Insurance Contributions
- Unable to work due to sickness or disability for at least four days in a row (including weekends and public holidays)
- Getting special medical treatment and unable to work for two or more days out of seven consecutive days

Or, you must:

- Be aged between 16 and 20 (or under 25 if you were in education or training at least three months immediately before turning 20), and
- Have been too ill to work because of sickness or disability for at least 28 weeks, and
- Have been too ill to work before you turned 20 (or 25 if you were in education or training at least three months immediately before turning 20)

## Current weekly amounts

<b>Weekly rate</b>	<b>Amount</b>	<b>Amount if you're over State Pension age</b>
Short-term (lower rate)	£59.20	£75.35
Short-term (higher rate)	£70.05	£78.50
Long-term basic rate	£78.50	You're not eligible for long-term basic rate IB

You may be able to get extra benefit, an 'age addition' with your long-term Incapacity Benefit, if you were under 45 when you became too ill or disabled to work. You may be able to get extra benefit for your spouse or civil partner or the person who looks after your children.

## Incapacity Benefit claimants – The causes and duration

The two dominant causes of incapacity benefit continue to be mental and behavioural disorder (39%) and musculo-skeletal (20%). The more cynical may note that these are the hardest disabilities to verify, although this is less the case with musculo-skeletal disease today.

## The insurance industry and the State

The Government and the insurance industry have identical challenges in getting claimants back to work. However, it is not merely the financial benefit that should be considered. Work is, for many, the best treatment for illness. Thus, all stakeholders have an interest in rehabilitation.

The commonest causes of incapacity benefit claims do not generate critical illness payments. It is probably safe to say that less than 40% of incapacity claims would generate a critical illness cover policy payment.

Incapacity benefit claims tend to be long term. Of those included in the February 2005 figures 73% had been claiming for 2 years and 48% for 4 years. This demonstrates the weakness of the ASU or MPPI proposition, where claims are usually restricted to a payment period of 12 months.

IB2.8 Incapacity Benefit claimants at 28 February 2005, by Diagnosis Group <sup>1</sup>		
All Cases	2387000	
Not known	3500	0.15%
Certain Infectious and Parasitic Diseases (A00 - B99)	18700	0.78%
Neoplasms (C00 - D48)	34700	1.45%
Diseases of the Blood and Blood forming organs and certain diseases involving the immune mechanism (D50 - D89)	4100	0.17%
Endocrine, Nutritional and Metabolic Diseases (E00 - E90)	35000	1.47%
Mental and Behavioural Disorders (F00 - F99)	925700	38.78%
Diseases of the Nervous System (G00 - G99)	129100	5.41%
Diseases of the Eye and Adnexa (H00 - H59)	14500	0.61%
Diseases of the Ear and Mastoid Process (H60 - H95)	10000	0.42%
Diseases of the Circulatory System (I00 - I99)	151600	6.35%
Diseases of the Respiratory System (J00 - J99)	58800	2.46%
Diseases of the Digestive System (K00 - K93)	38400	1.61%
Diseases of the Skin and Subcutaneous System (L00 - L99)	14900	0.62%
Diseases of the Musculoskeletal system and Connective Tissue (M00 - M99)	481800	20.18%
Diseases of the Genitourinary System (N00 - N99)	17200	0.72%
Pregnancy, Childbirth and the Puerperium (O00 - O99)	4300	0.18%
Certain Conditions Originating in the Perinatal Period (P00 - P96)	0	0.00%
Congenital Malformations, Deformations and Chromosomal Abnormalities (Q00 - Q99)	6300	0.26%
Symptoms, Signs and Abnormal Clinical and Laboratory findings, not elsewhere classified (R00 - R99)	265200	11.11%
Injury, Poisoning and certain other consequences of external causes (S00 - U23)	143100	5.99%
Factors influencing Health Status and Contact with Health Services (Z00 - Z99)	30000	1.26%
<i>Notes</i>		
<i>* Figures are subject to a high degree of sampling error and should only be used as a guide</i>		

**Table 1 Incapacity Benefit and Severe Disablement Allowance  
Quarterly Summary Statistics: February 2005**

It is often believed both within the industry and elsewhere that critical illness is a substitute for income protection.

This is not the case. New figures from Norwich Union show that they paid more than £80m in CI claims during 2005, with 68% of all claims being caused by cancer. For females the percentage was even higher at 77.5%.

However, Neoplasms (most cancers) account for only 1.45% of the 2.4 million claiming incapacity benefit (DWP Incapacity benefit statistics). Great care should be taken when comparing these statistics. However, the difference is so great that it is clear that critical illness insurance often covers a totally different contingency.

Lastly, it should be added that, regrettably, many people who are eligible Incapacity Benefit claimants subsequently discover that they are not entitled to regular monetary payments as a beneficiary, instead they only qualify for National Insurance Credits.

	<b>Up to 1 month</b>	<b>1 month up to 3 months</b>	<b>3 months up to 6 months</b>	<b>6 months up to 1 year</b>	<b>1 year up to 2 years</b>	<b>2 years up to 3 years</b>	<b>3 years up to 4 years</b>	<b>4 years up to 5 years</b>
<b>All</b>	<b>2,387.0</b>	<b>32.1</b>	<b>81.5</b>	<b>116.9</b>	<b>167.9</b>	<b>258.8</b>	<b>219.3</b>	<b>190.2</b>

**Table 2 Incapacity Benefit claimants at 28 February 2005, by duration of benefit**

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## 4 Underwriting and Claims Issues

Whenever Income Protection is discussed in terms of its lack of success the subject of underwriting is aired as a major reason for its lack of sales penetration. There are two main aspects to this situation. Firstly, the very fact of obtaining underwriting evidence often deters people from taking out coverage they need. The British are notorious for hiding their heads in the sand regarding medical conditions and not wanting to undergo medical examination; hence the success of Over 50s plans which require no underwriting but are much more expensive than normal covers.

The second problem is the more serious one of delay, but this is also compounded by the fact that a lot of cases are subsequently rated after an initial quotation is received. The key document in the IP underwriting process is the General Practitioner's Report (GPR); this is often extremely expensive, costing well over £60 per case, and can take weeks before it is completed. Even then, many GPRs are unhelpful and confusing.

In looking at morbidity the underwriter is looking for a lot more clues than are usually relevant in a life case. Incidence of major and minor sickness is relevant and attitude to taking time away from work in past situations of illness or indisposition can be a good guide to a person's willingness to return to work after sickness or to take time off work in the first place.

While some GPRs have been of enormous help in ascertaining vital information on IP cases there has been a move away from the GPR towards tele-interviewing. A trained nurse or tele-interviewer can acquire data at the point of sale or subsequently and it is this latter course that we would advocate as a way to deal with IP cases more quickly, more efficiently and with greater and more helpful disclosure. This process can be outsourced if companies do not possess trained tele-interviewing resources themselves and we believe this process, as it becomes widespread, will produce better information, more quickly and at a much lower cost than a GPR. While subsequent investigations e.g. a medical examination may be required for a number of cases we contend that around 60% of cases might be able to be underwritten using tele-interviewing without other evidence.

The other problem is occupation. We believe all companies should have clear and expansive occupational guides so that advisers can ascertain what clients are likely to pay in view of their occupation at outset, rather than finding out several days or weeks later that a premium is likely to be changed significantly. This necessitates a question on the application form that stresses the need for the fullest details possible. Again tele-interviewers can be used to sort out any occupational descriptions that are confusing or misleading.

The Task Force believes that a big increase in sales of individual income protection would reduce the proportion of underwriting problems encountered because in some cases the IP proposition is anti-selective as certain people buy the product with intent to claim. A much bigger volume of cases would reduce this problem proportionally because the intent to anti-select will not be as marked with a high-volume selling product.

### Declined claims

There is a current perception that sales have been adversely affected by consumer concern about fairness in claim adjudication. One in five critical illness claims is declined (Source: FSA) and the mortgage payment protection industry (which is often confused with IP) has just been severely criticised by the OFT for having very poor ratios of claims paid

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versus premiums collected.

Is this criticism fair in relation to IP? If Pioneer Friendly's published statistics\* are typical, and we believe they are not far away, then IP has one of the best payment ratios of any product except life insurance. Whilst there is always room for improvement in claims practices and 'best practice' is never static, the main challenge currently is to get this positive message across to distinguish IP from less reliable forms of insurance.

### **Claims implications of the sales message**

The relationship between sales and claims is a two-way street. If someone is sold a policy on the basis that it will pay them until retirement, then they will be extremely surprised when their entitlement to ongoing claim benefits is reviewed on a regular basis. The customer thinks they have bought one thing and the claims assessor is operating the product as written. Both are theoretically right as IP could pay until retirement if all the conditions are satisfied, but it won't necessarily do so.

This becomes a negative when it comes as a shock to someone who is already in distress, but it is actually a reflection of the enormous flexibility inherent in IP products, which should be a positive feature.

IP might pay you for a week, a year or twenty years, depending on your need. If you go back to work but then suffer a relapse, it can pay you again. If you go back to work and suffer a completely different illness preventing you from carrying on working, it can pay you again. There is no limit to the number of claims you can make during your working life, provided you satisfy the conditions in the policy you bought.

The benefits are not just financial; there has been a massive investment in the provision of skilled resources to assist people to go back to productive life while their claim is being paid, and this has been done largely without an increase in premiums. Surely many potential customers would find this to be something worth buying?

Companies have to operate all of their customer-facing services, including claims management, in the context of company branding and awareness of the sales messages used. A company who sells a promise of lifestyle protection but then delivers only the elements of essential need will end up in conflict with people who should be advocates for further sales.

There is a fine line to tread and it is imperative that sales and claims management do not operate in isolation from each other and that a deep understanding of the roles of both parties is embedded into the process.

### **Reduction of benefits at point of claim**

A number of industry commentators have called for the recognition of 'other sources of income' that are applied as offsets to indemnity contracts at the time of claim. In the long term, this would make life easier for claims teams who may currently be dealing with claims on a number of different versions of products, all with different lists of other sources of income that they must take into account in calculating the entitlement to benefit.

There has also been a call for a refund of a portion of premium where people are found to be over-insured, resulting in their benefits being reduced at the time of claim. As well as

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benefiting customers, this would be helpful to claims teams who are on the front line of questioning from angry claimants who do not understand a) why they were allowed to buy more cover than they were likely to receive and b) why they are not being refunded the portion of premium that is not being used. What answer can a claims assessor give at the moment? An agreed-value product might represent a major step forward in putting an end to this uncertainty in that the claimant will know what he will be paid and the company is aware of its liability. While frank over-insurance is clearly undesirable it is the contention of the Task Force that if underwriting is done carefully at outset it is not likely to be anti-selective to agree on a value that provides a fair and sensible income in the event of genuine disability.

### **Integration of rehabilitation tools into the product**

Those acquainted with IP will know that the percentage of claims paid initially, although positive, doesn't tell the whole story. IP is designed to pay until the claimant is capable of returning to work, regardless of whether an actual return to work has taken place. It is perfectly reasonable for anyone to take an extended period away from work after a long illness for as long as they wish; the question is at what point does this become a choice and who provides the funding from that point onwards? This naturally has an element of subjectivity to it and may be a source of conflict.

Most claims teams now recognise that it is impossible to pinpoint a precise moment when someone becomes capable of returning to work, just as (except in the case of catastrophic injury) it was impossible for the claimant to pinpoint the precise moment that they became incapable of working. Most people struggle on with an illness for a period before finally giving up, and it takes a good deal of mental and physical effort to jump back into a workplace after an extended period away. This is why rehabilitation, in its widest sense, has become such an important part of IP claims management, working in co-operation with claimants rather than in conflict. Some tools are integrated into the product, such as the facility to support graded return to work, but much of the assessment and implementation of rehabilitation initiatives is done creatively outside of the policy terms and using what used to be called a 'claims investigation' budget. Integrating rehabilitation tools more fully into the product would benefit both claimants and claims teams in a number of ways:

- Customers who have bought a product with integrated rehabilitation benefits will be expecting these services as part of the normal claims practice and will not be suspicious of the company's motives, as they sometimes are currently, when the service is introduced for the first time once a claim is in payment
- Customers are likely to access these services earlier; this is known to be associated with a greater chance of success. Funding for these services will be clear and could be set up in such a way that it is ring-fenced from decisions about the overall claims team budget

With one eye on the Welfare Reform Bill, which seeks to improve rehabilitation provision in relation to State incapacity benefits, the integration of rehabilitation options into the product needs to be done in such a way that it does not bind companies into particular types of rehabilitation or providers. Again there seems much to gain from bringing the State system and insured IP product much closer together in terms of payment triggers, incentives to return to work and tools which review work capability.

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## **Product user representation**

The Insurance industry is poor in some areas at finding out customer views on its processes. Can you imagine any other industry trying to boost sales or develop new products without talking to product users? This includes qualitative data about how the product works at the time of need as well as quantitative data on satisfaction levels with the delivery of product benefits.

There is a great deal of published consumer research about the buying habits of potential customers but very little among those who have not only bought the product but also had the need to use it.

This can be more imaginative than simply asking if claimants are satisfied with what they have received. For example, we could ask how the experience of claiming under an IP policy compared with any previous experience of making a claim under other forms of insurance. If we really are offering a top class product with top class claims services, we need to refine them continually and also bring into play help other than money in equipping them to deal with the future life they have in store. We need to think proposition rather than product.

*Pioneer Friendly Society, 2005 claims statistics – 96.57% of all claims received resulted in a claim payment. Musculoskeletal and back injuries account for nearly 40% of claims. Other claims ranged from depression to lacerations and burns.*

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## 5 Medical and Social Trends Affecting Morbidity

Advances in medicine do not threaten to compromise the success of Income Protection as they do in Critical Illness; but as society progresses, the nature of disability is changing. Stress-related disorders are increasingly common and musculo-skeletal disorders are also a profound source of concern as a cause of long-term absence. These are overwhelmingly the biggest cause of current disability in the UK population and even industry awareness of this is not high. If it had been, it could be supposed that the relative sales of Critical Illness and Income Protection would have been quite different.

Knowledge of rehabilitation and absence-management are much greater than they were, but very often the over pressed medical profession does revert to the easier option of signing people off work often for protracted periods rather than grapple with getting people back to work.

This will undoubtedly change in 2008, when the new system for providing Incapacity Benefit comes into operation. It seems logical to the Task Force that we develop a much greater alignment between the state system for defining incapacity and the way it is defined by insurers.

The existence of the Welfare State is possibly one of the biggest obstacles to the development of Income Protection as there is a widespread perception that "The State will provide". This discourages many people from making provision for the possibility that they may be unable to work through sickness or accident. There is also a feeling among many people that surfaces during research, that it is the State's responsibility to do this.

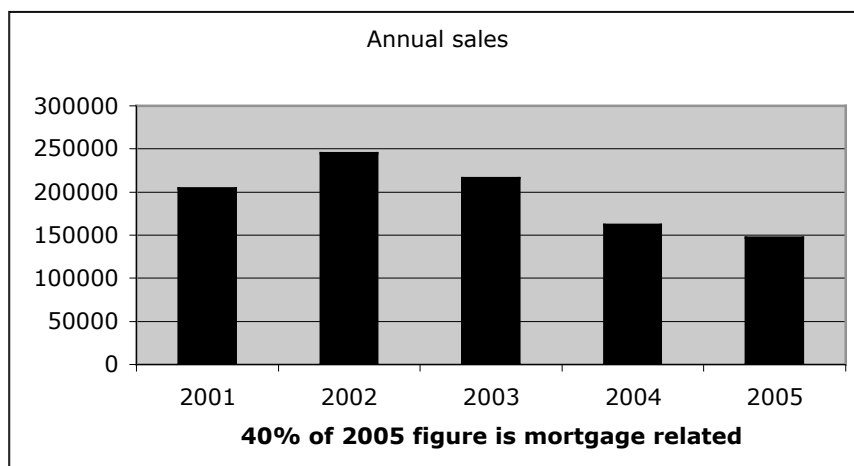
It was very clear in recent industry research that as the role of the State recedes in providing social welfare, there is an expectation that employers will take over a significant part of this task. But British employers are much less paternalistic than they were and the spectre of Age Discrimination hangs heavily over the Group Income Protection market.

It is ironic that one of the very real options that we believe needs to be considered, particularly as a way of accessing the blue-collar market, is the Holloway product. This is mentioned in the section on the history of the product. One potential obstacle to this is that the cash benefit contained in the product currently ensures that it is regulated as an investment product. There is also a feeling in British society that the equity in peoples' houses can be accessed in the event of a real change in personal circumstances caused by longstanding disability.

There is a major need to underline not only the risk and incidence of disability but also the real problems that will ensue for affected families given the level of State provision. But is there an appetite in the industry to provide this information in a sustained and hard-hitting way?

## 6 Current Issues in the Income Protection Market

There are a number of issues that need to be appreciated concerning the lacklustre sales performance of Income Protection in recent years and its poor sales penetration.



**Chart 1 Income Protection Sales 2001-2005**

Chart 1 illustrates the level of individual income protection sales in recent years. Given a UK working population of around 30 million people, it is disappointing that new sales have averaged considerably less than 1% of the available market. Group Income Protection has in force sales of roughly 3 million and this suggests that only around 15-20% of the UK working population have any form of Income Protection cover.

One of the reasons for this is the lack of awareness in the British population of the likelihood of being severely disabled. In the brief renaissance that IP had (when known by its former name Permanent Health Insurance) in the mid 1980s, some of the large direct sales forces used to base their presentations around the very well concealed fact that a person is at least 3 times more likely to suffer long-term disability than to die before the age of 65. There has been a reticence to use this figure in recent years within the industry, as if it were somehow in bad taste to remind the British public of some basic facts of life.

Discussions among intermediaries in the Income Protection Task Force suggest that there is not only widespread ignorance of the risk of long-term disability but there is also a very unclear idea amongst most people of how long their employer will pay them their full salary in the event of sickness. This naivety and lack of appreciation of the financial consequences that could befall a family if the breadwinner is unable to work is compounded by the lack of knowledge about the level of State Benefit (see section 3, page 15).

The devastation that could be caused to a family's finances if the main (or only) income earner was unable to work for 6 months or more is abundantly clear. The gap is profoundly disturbing and led Swiss Re to calculate the Income Protection Gap. This is the shortage in the amount of cover effected in the UK compared to what Swiss Re calculate to be a sensible figure based on national average earnings. When they last calculated this figure at the end of 2005 it was £170 billion of annual benefit.

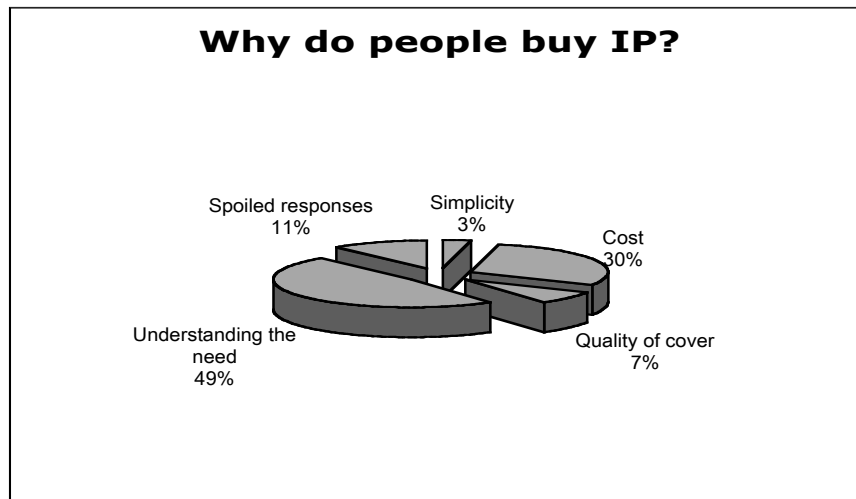
In the original research for the 2004 study “Reinventing Income Protection” we asked leading figures in the industry what the main obstacles to increasing the amount of income protection cover was. As Table 3 shows, awareness of need on behalf of both the consumer and the distributor loomed large.

4.5%	Intermediaries receive inadequate remuneration for selling IP
7.5%	IFAs don't perceive the need for IP
7.5%	The underwriting process is too lengthy
14%	Clients don't perceive the need for IP
17%	IFAs believe that the product is too complex
19%	Clients don't appreciate the risk of long-term disability
23%	CI is perceived as more attractive

Source: Reinventing Income Protection

**Table 3 Why have sales of IP have been disappointing in recent years – Provider views**

Whilst the lack of awareness of the product amongst UK consumers is understandable there is clear consumer detriment if more is not done to alert them to the importance of effecting Income Protection cover.



Source: Scottish Provident

**Chart 2 Reasons why people do buy income protection**

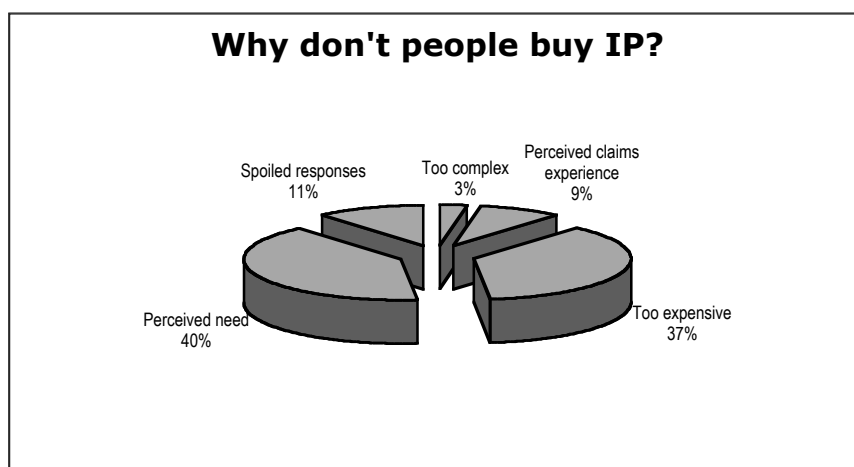
Recent intermediary surveys have also pointed to a lack of overall adviser awareness of the product. Surveys over many years have always shown similar results. There is a small, devoted core of intermediaries who position Income Protection at the head of the protection hierarchy.

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In surveys of PFS members and readers of Financial Adviser, conducted by the Task Force this year, the most important findings were as follows:

- Simplify the process
- IFA knowledge is poor on State Benefits
- Cover different benefit levels e.g. 3 months full pay, 3 months half pay, in one contract
- Provide better sales aids including 'What if?' Scenarios
- Simplify definitions
- Companies should pay out without financial underwriting at claim providing the policyholder is in work
- Underwriting needs to be quicker
- IP is a crucial area to the client's long-term prosperity
- Make advisers more aware of their responsibilities as advisers rather than product sellers
- Clients believe that State benefit will fill the gap

A more recent intermediary survey undertaken by Scottish Provident among Sesame members produced the results illustrated in charts 2 and 3.



Source: Scottish Provident

**Chart 3 Reasons why people don't buy income protection**

It is frustrating to see the overall lack of awareness of the product among many intermediaries. One of the problems is product knowledge. Many intermediaries find Critical Illness easier to sell but any 'Statement of Demands and Needs' from a client who requires disability cover should acknowledge that the two largest causes of long-term disability, depressive illnesses and muscular-skeletal disorders are not covered by the product.

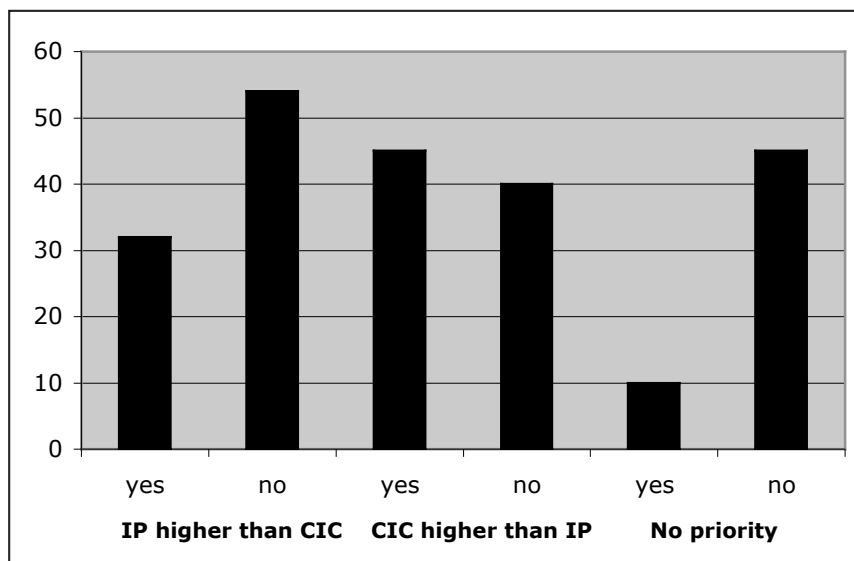
The relative iniquity of Payment Protection Insurance is subject to the glare of the Office of Fair Trading's detailed investigation but the plain fact is that it currently outsells Income Protection by a factor of 10:1 even though it is almost always an inferior purchase in comparison. The sales appeal of Payment Protection is a subject that we return to later in this report in an attempt to look at increasing the attractiveness of Income Protection to potential buyers.

It is a staggering fact that in a country where 2.4 million people are currently claiming Incapacity Benefit, and this figure is likely to be heavily reduced, following revisions to the system in 2008, so few people are enjoying the much greater security and support that Income Protection provides.

This lack of awareness of need, and of the ability of Income Protection to meet it, is the biggest single problem that the product faces in its quest to become a product that is sold much more widely in the UK. It is not right that people should have such ignorance of the comparative likelihood of long-term disability nor can it be right that so many remain in ignorance of their likely financial position when they fall ill. The gap between state and insured benefits is so high that it should be one of the most regularly communicated and understood facts when considering rudimentary financial planning and protection. This is an area where greater public awareness of the value of income protection would hugely facilitate the development of many new businesses. Moreover, it would hopefully reduce the number of genuinely long-term disabled people and improve economic productiveness and reduce costs in the welfare sector. Not only is there a consumer need, but the insurance industry must do much more to equip its advisors with good products and the impetus and opportunity to sell them.

### The Protection Hierarchy

One factor which would undoubtedly have huge impact on the willingness and ability of intermediaries to sell IP would be the establishment of a “protection hierarchy”.



Source: Reinventing Income Protection

**Chart 4 How distributors prioritise IP versus CIC**

This simple concept prioritises the main forms of protection cover and puts IP at the top. The very much clearer mandate this gives intermediaries to prioritise IP as the fundamental building-block in any protection portfolio. All protection products were not created equal and this chart indicates that. Income Protection is normally the need that requires satisfying first. Everything else must allow it to take precedence. The “protection hierarchy” should become a standard feature of industry training.

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## **Improving process**

Recent Lifesearch figures suggest that IP proposals take 42 days to process on average. This represents over twice as long a period as the average processing time according to latest estimates, giving rise to concern over the quotation and underwriting process.

The underwriting process represents the biggest problem. Underwriting limits are cautious and underwriters are reluctant to relax them in the case of IP.

IP is an inherently anti-selective product at the present time. Sales volumes suggest that many of those who take it out may expect to claim and this compounds the conservatism with which underwriters approach the challenge of obtaining the right level and quantity of underwriting information. This point can be easily illustrated by taking hypothetical new sales of 5 million new cases. Whilst there would undoubtedly be some cases of non-disclosure or lack of medical details this would not be either so financially or mathematically significant in a year of high sales.

Underwriters, whilst still needing to be vigilant towards anti-selection and inadequate disclosure, would be better served by a much higher volume of straightforward cases. Straightforward cases could be dealt with by higher medical limits, less detailed occupational categories and a more streamlined process involving tele-interviewing and paramedical investigation. The pivotal aspect of this rethink is the need to obtain greater sales through a much stronger sales message built on much greater public understanding.

At the present time the reliance on underwriting at claims stage does not endear the insurance industry to the public, inflames consumer bodies and can lead to many claims being admitted for much lower amounts than have been proposed for, with no consequential refund of the appropriate premiums.

## **Reform of the Incapacity Benefit System**

At the present time, the Incapacity Benefit System is acknowledged as one that is widely abused and which consequently produces low benefits and exists in a social welfare vacuum.

Whilst "State Benefits" are used to calculate entitlement to IP benefit the criteria for eligibility for the two different benefits are nowhere near harmonious. The long-overdue overhaul of the Incapacity Benefit System is due to take effect in 2008 and will place particular emphasis on a Personal Capability Assessment for each potential claimant and work-focussed interviews to enable claimants to return to suitable employment. It seems highly appropriate for the insurance industry to try to ensure that it brings its assessment of disability into line with the new more rigorous State criteria, to both avoid consumer confusion and to build a seamless interface between State benefit and insured plan.

There are several possible areas of real positive interaction between the Department of Work and Pensions and the insurance industry. It would seem axiomatic that one benefit might be a shared agreement about what constitutes working disability. An additional benefit could be more objective and generally-accepted methods of establishing this and a much greater confidence about when insurers will pay IP benefit. Experimentation with other standards of establishing disability like the failure to carry out "Activities of Daily Working" have often proved too obviously draconian and have prevented claims being paid where there was in all conscience a very genuine case for benefit to be paid.

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A better working partnership between the DWP and the main disability insurers has yet to be commonly touted. Yet, in the spirit of addressing consumer uncertainty and introducing greater fairness, it is something that we believe has much to commend it.

### **Trust among consumers**

The insurance industry is well aware that in many areas where it operates, there is a lack of trust among consumers that it will behave ethically and meet its obligations.

In an IP context the primary and overriding concern of any buyer is that the insurer admits the claim when it is submitted many years later. Possibly as a result of consumer-orientated television programmes and newspaper comment, there is a perception that large numbers of IP claims are turned down or adjusted in a way that has a negative impact on the claimant.

It must be realised that this is emphatically not the case and the recent publication of claims statistics, a trend started by Pioneer Friendly Society, illustrates this point.

It has to be appreciated that insurers are protecting the interest of all valid claimants by refusing fraudulent claims but these represent only a handful of cases. The construction of IP policies tries to ensure that no person is better off by receiving insurance benefits than by working. Nonetheless, if fraud is the motive, claimants will not easily be discouraged by an adjustment in their take-home pay.

A wide-ranging realisation needs to take place over this issue. Consumers and the media that inform them need to appreciate that declined claims are very much the exception to the rule, and that honest claims are paid according to the policy conditions. The industry needs to realise the uncertainty and distrust that surrounds it and move on to the front foot by encouraging a spirit of openness and transparency by opening its claims records to be public. This might not only involve showing tables of claims paid but also details of cases where claims were turned down – and why?

Insurers and trade associations have understandable concerns about faulty interpretation of statistics by non-experts. The incentive should be to make this information as clear and penetrable as possible for the layperson and to meet the consumer at least halfway in his quest for information, whilst still showing that in some areas there are safeguards to ensure that only valid claims are paid.

Whilst some providers are wary of comparative tables showing claims paid ratios, information must be published on an agreed, coherent basis so that consumers understand what they are looking for. IP must avoid the trap that Critical Illness fell into on non-payment in a particular area (in this case PTD claims). Whilst not all claims are paid the industry has a record to be proud of and could usefully demonstrate the value to the economy provided by the important buttressing of Income Protection.

### **Complexity and Standardisation**

Almost every piece of research by insurers into Income Protection reveals that its value is poorly understood because of the complexity of the product. Just as Critical Illness had a problem that it solved by standardising definitions, so IP needs to look at where competitive advantage really exists and where small differences in

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wording or provisions confuse the customer and cause complications at claim time. This exacerbates the issue of trust.

Competition law places restrictions on the ability and extent to which insurers can collaborate. So the ABI Protection Committee would seem best-placed, after consultation with all stakeholder customers, distributors, insurers, reinsurers and the regulatory bodies including the Ombudsman, to judge where competitive advantage is not at stake, where there is the opportunity to provide clarity and enlightenment without sacrificing price or future competitiveness. This is an important priority and no time should be lost in specifying the terms of reference for this group.

### **Remuneration**

There is a tendency for some distributors to become reticent when the subject of commission is raised. This should not be the case in IP. While the IPTF contends that commission levels for Income Protection are broadly OK, we also acknowledge that in the present circumstances, the time taken to sell and complete an IP proposal is almost twice as long as to sell, for instance, CI. We believe appropriate standardisation will make this situation easier and would also contend that increased sales and greater volumes of IP applications will reduce the effective time taken to complete a single proposal.

In research that we have done or analysed from Reinventing Income Protection through to the PFS research, the FT business research and the recent work done among Sesame members, commission is never cited as a major reason for the lack of success. This may be a case of the reason that dare not speak its name but there is little objective evidence that inadequate remuneration is a real turn-off for intermediaries. This may be because other reasons are bigger obstacles!

Income Protection in the UK is faced by a number of difficulties and has been assailed by doubters for years. Yet, it remains an extraordinarily important plank of protection business in the UK and has contributed enormously to many lives that have been rescued by the benefits it provides. The Income Protection Task Force believes it not only has a vital future role to play but this should and could be enhanced. The remainder of this paper illustrates how this might come to pass.

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## 7 The Impact of the Mortgage Market on Income Protection

More disability cover is sold when mortgages are taken on than at any other time. Often, only the mortgage payments are covered. Whilst this is understandable in view of the commitment, one wonders how other essential payments will be met.

The majority of banks, building societies and mortgage brokers sell ASU/MPPI cover when a mortgage is taken out. It is recognised within the industry, by the regulator, DTI and press, that many such products are both expensive and flawed.

According to Simon Burgess, Managing Director of British Insurance Ltd, one of the big high street banks typically charges £30 per £100 of loan insured. This, he says, compares with between £4 and £6 if bought separately on the Internet.

A further issue is that anyone looking for IP on the Internet will find MPPI and ASU providers misrepresenting themselves and little true income protection.

The challenge for true IP providers is to persuade the mortgage adviser to recommend the best product at the point of sale. In the majority of cases, this will be IP. There will be cases where medical condition or occupation will result in different advice.

### Barriers to sales

Let us consider why the mortgage adviser does not recommend IP.

First and foremost, it is the mortgage itself that is the income driver. Thus, if the adviser is busy, there is always the temptation to move quickly on to another customer rather than attempt to sell disability covers.

The typical bank or mortgage adviser will recommend ASU or nothing, as it fits process and gives maximum profitability.

ASU is easy to bundle. It is a standard premium. It takes very little time at the point of sale or later.

Clients appreciate the need for life assurance. Many cannot afford to cover both critical illness and IP. Many advisers find critical illness easier to sell than IP; many see it as an alternative product covering a similar need. This is not the case.

IP can be very time consuming to sell. For example many occupations are not listed. Typically, the adviser opts for the closest. If the insurer rates at a higher level, it may be appropriate to try another insurer. There is no consistency between providers on simple issues such as weeks versus months, the offset for State benefits or a maximum benefit formula. Thus it is very hard to get comparative quotations.

One adviser told us that some mortgage brokers are failed IFAs and are not confident enough to sell IP. There is a need for training.

### Regulation

Since October 2004 all mortgage lenders have had to be authorised by the FSA, with specific permission to lend on mortgages (MCOB). The FSA regulates mortgage

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advertising and requires all mortgage lending activity to include specific disclosure of the main features of the loan.

Customers are now able to take their complaints to the Financial Ombudsmen Service (FOS), and have further protection from the Financial Services Compensation Scheme.

If the adviser is not regulated by the Conduct of Business regime (COB), they must be regulated by the Insurance Code of Conduct Business rules (ICOB) for protection sales.

A failing of ICOB is that the onus of regulation placed on advisers is not as great for protection as it is on mortgages by MCOB. Under MCOB, it is imperative to offer the best mortgage deal, whereas under ICOB the adviser only has to offer best of range. If there is no income protection, there is no reason to recommend it.

Many experts in the industry believed that ICOB would increase income protection sales as the adviser is expected to recommend the most suitable cover. This has not proved to be the case.

The Treating Customers Fairly initiative from the FSA appeared likely to have a positive effect. This has yet to be seen.

Indeed, ICOB has proved somewhat toothless. It is felt that TCF may have more impact eventually; we have seen some significant fines and may well see more.

### **Payment Protection Insurance**

In view of the fact that FSA has made it clear that it is looking at PPI and MPPI, it is surprising that sales continue as they do. Lenders do not appear to take full account of ICOB or TCF.

However, when we look at the earnings from these products, it is not so surprising.

The PPI market is estimated to be worth nearly £6 billion per year with very low acquisition costs.

A report from investment bank Credit Suisse First Boston, 'PPI – time for a change', shows how important PPI is to the banking industry. They state that PPI accounted for nearly a quarter of profits at online bank Egg in 2004, while it accounted for 14% at Lloyds TSB and Alliance & Leicester.

Barclays and Northern Rock both earned 11% of group profits during the year, while it was responsible for 8% and 7% of profits at HBOS and the Royal Bank of Scotland respectively.

According to CSFB, the claims ratio is 20%. In their super-complaint to the OFT, the Citizens Advice Bureau said that their research found that 85% of consumers that had claimed on their PPI policy had been turned down.

It is a very unsatisfactory situation. It is hardly surprising that one of the UK's leading mortgage experts suggested that the banks will continue to make hay whilst the sun shines so huge are the profits however great the threat of a fine.

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## **Submission/Underwriting**

Will online submission help?

Mortgage advisers may be reluctant to submit online with the customer until confident of process. Some may never have adequate confidence unless they are pressured or see clear benefit.

Some may apply online if they feel they will get an immediate acceptance. They do not need immediate mortgage offers usually or immediate life/disability cover offers, but it does mean they do not have to spend further time on the case.

Advisers appear to be happy with tele-interviewing to gain medical data. It saves time and appears to be much less intrusive as far as applicants are concerned. Moreover, trained tele-interviewers may ask follow up questions due to their expertise which the adviser would not, resulting in an earlier acceptance.

In view of the greater complexity of income protection application and submission over ASU/MPPI, tele-interviewing could well form part of the solution, as the adviser will not be asking the difficult questions.

Leading mortgage broker, Charcol, is employing Direct Life and Pensions to write their protection business. Direct use a tele-interviewing process. It is in its early days, but appears to be going well. It will be interesting to monitor this innovation over time.

## **Product**

The hybrid product has appeal. It might be possible to use capital to pay credit card debts or set aside a couple of years of mortgage payments, whilst income meets weekly bills. The danger is that whilst options are attractive, they are complex. The hybrid may be a product for the specialist rather than the mortgage adviser.

It is felt that a number of changes could be made to improve sales to some degree. However, to persuade the bank or mortgage adviser to sell IP rather than ASU, in the opinion of a leading expert, it will require tough legislation that bites hard when the best option for the client is not recommended.

It is possible to be slightly more optimistic if providers can simplify the product and process and align it with the mortgage application process using the benefits of new interviewing methodologies.

## **Conclusion**

It is safe to say that there will be little change until the current profits on sales of PPI, where commission is typically up to 80%, are curtailed, hopefully by action from the regulator.

However, the income protection process still needs to change.

A solution may well be for specialists to take over the sale or for full tele-interviewing to be the norm.

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If the adviser only has to deal with one question on payment protection, along the lines of:

*If you are sick and unable to work:*

*Do you wish to be insured to cover essential expenses?      Yes / no*

*Mortgage payment only?      Yes / no*

*Nothing?      Yes / no*

If the sale were then handed over to an insurer or an IP specialist, the adviser might just be encouraged to recommend good income protection cover.

This could be a real step forward in meeting real client need.

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## 8 Incremental Change or Radical Re-engineering?

The picture painted by sales figures is not a happy one for IP. Despite huge loyalty to the product from devotees within the industry the simple fact is that at present, market penetration of new individual sales is substantially less than 1% of the available market.

This situation, at a time when the social welfare system is being reformed, is profoundly disappointing. Even recently at the ABI workshop on Income Protection, some respected commentators were suggesting that sales were not as discouraging as has often been claimed because of the impact of group income protection and because of encouraging sales performance from one or two of the market leaders.

This White Paper rejects any such complacency. In force figures suggest that only about 1 in 15 people who need individual income protection have bought it. While we may rationalise the background reasons for this, and several are important, it has proved to be a product that has lacked appeal for the majority of intermediaries in the UK market.

The dichotomy between the views of industry “insiders” and the intermediary population was illustrated by “Reinventing Income Protection” in 2004. There are passionate devotees of Income Protection within the industry, indeed several are involved in the production of this paper, but adherence to the traditional concept of the individual IP product will not advance its saleability to the UK public. Knee-jerk reactions to poor sales figures are inadvisable but the downward trend in overall sales is an alarming trend that must be reversed.

While the development of new product ideas will not solve the problem of poor sales on its own, it seems clear that far from heaping criticism on protection products that have achieved greater sales success the industry needs to learn lessons from the penetration that they have achieved.

Payment protection products have been widely reviled and are the subject of detailed scrutiny by the Office of Fair Trading. Aside from the huge commissions they generate for lenders, which is the main reason they are successfully sold as secondary to a major and usually attractive (to the buyer) transaction, they are also straightforward in terms of pricing and policy production. The need for income protection to replace PPI as a longer term and sounder alternative as loan protection will be compromised if the industry does not find some answers to the problems of pricing, underwriting and policy issue. Some compromises will be necessary on short-term covers.

Similarly, the success of critical illness stemmed from the lump sums that appealed to the public. Is it possible that a hybrid product could effectively combine the need for both capital and income in one much more appealing package?

History also gives us indications of how some of the “too difficult” groups were accommodated profitably. Holloway policies, which emerged in the 19<sup>th</sup> Century before social welfare was seen as primarily a state responsibility, have been enormously effective in serving the “blue collar” market. It would seem we could learn much from their success and experience in what has traditionally been a minefield for IP writers.

Perhaps the other message that is regularly emerging to support a move towards re-engineering of the product is the widespread interest in building a wider proposition than just providing income, vital and welcome as it is, at the time of disability.

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Sick or disabled people need a wide range of help from counselling, family support to rehabilitation and retraining. The industry needs to find a way to incorporate this in its IP proposition to ensure that it meets its clients' needs and can genuinely claim to be a major plank of support at a traumatic time.

We do not need to change Income Protection out of recognition. What it does in essence is socially valuable and sometimes deeply inspiring. We need to ensure that it can provide for many more people than it is currently doing and that it can break down the sales barriers that have constrained sales throughout the last twenty years.

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## **9 A Nine-point Plan for Reviving Income Protection**

### **1 Application and underwriting re-engineering**

The current process is long, expensive and not particularly effective. Cases are often 'not proceeded with' because the acceptance letter demands a higher premium than that quoted.

Income Protection can benefit from new underwriting techniques more than any other product. Use of tele-interviewing with reflexive questioning eases the problems faced by advisers at application stage, enables a higher quality of underwriting and, hopefully, will have a positive impact on claims payment – notwithstanding that current levels are superior to other disability products.

### **2 The product**

It is not the role of the Task Force to design products. However, it is clear that there are areas of product design that should be addressed.

There is too little account taken of the disparate nature of the market. We have stated elsewhere that the mortgage market requires a different process. The use of the Holloway model in blue-collar markets could teach us lessons. We should consider shorter benefit paying periods and waiting periods to reflect the nature of modern employment.

Insurers should consider 'hybrid' products that can meet a variety of needs with a lump sum and income. Alignment with Long Term Care, Critical Illness and Payment Protection Insurance could produce a more flexible product that has greater relevance for a longer period in peoples' lives.

An agreed value contract where financial underwriting is carried out at application only stage should be considered.

### **3 Regulation**

Robust enforcement of ICOB and the Treating Customers Fairly principle would ensure that Income Protection sales multiplied exponentially overnight.

Sales staff and advisers are expected to recommend a suitable product and they are expected to treat customers fairly under current regulation.

When it is considered that 73% of claimants of Incapacity Benefit have been claiming for 2 years and 48% for 4 years (based on latest DWP figures). The weakness of the ASU or MPPI proposition, where claims are usually restricted to a payment period of 12 months, is clear.

Commissions on these products are as high as 85%. Credit Suisse First Boston estimate that the claims ratio is 20%. The Citizens Advice Bureau research indicates that 85% of claims for MPPI were declined.

Customers are not being treated fairly. We implore the regulators to act swiftly. Financial security depends on it.

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Regulation should require ASU/MPPI distributors to make potential customers aware that long-term income protection also exists. If their business sells IP via another distribution route they should also offer a referral.

All providers of ASU and IP should be required to identify their product as either 'short-term insurance' or 'long-term insurance'. The ABI should produce some consumer friendly industry definitions of the two product types.

#### **4 Move to essential expenses**

A peculiar phenomenon of income protection is the fact that the default level of cover is invariably too high i.e. maximum benefit. This causes problems for underwriters who are concerned about incentive to return to work and for consumers, as cost is maximised.

Alternatively, mortgage advisers commonly recommend cover for mortgage payments only. Whilst some cover is better than none, at time of claim, the beneficiary will merely see an inadequate monthly income that will be spent on priorities, probably food and household bills before mortgage payments as the impact of non-payment is faster.

The sensible solution is to have a default of essential expenses. This has a number of advantages:

- The customer is party to agreeing the figure
- The insurer has less concerns
- The cost should be lower
- The sales proposition is irresistible – i.e. the client said this cover was essential

#### **5 Mortgage adviser outsourced process**

Mortgage advisers employed by banks, building societies and some mortgage brokers sell MPPI/ASU products because they are easy to sell and pay extremely well. It is to be hoped that sales of these products will fall dramatically as a result of DTI and FSA intervention.

There is an opportunity to replace these sales with sales of Income Protection. This is only likely to be achieved if the question on the application is a simple alternative of 'a', 'b' or 'c'.

It is suggested that the employment, financial and medical underwriting is carried out by tele-interview. A specialist distributor or provider could carry this out.

At the upper end of the market, it should be possible to outsource to financial planners specialising in Income Protection.

#### **6 Consumer awareness**

The consumer needs to be aware of their personal protection gap – the difference between what they would get from the State and their employer and their essential outgoings.

Most people are totally unaware of the potential disastrous consequences of not having any private provision. A "compulsory" annual statement of 'Sickness and Other Employee

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Benefits' would help to highlight the protection gap. Such a statement should be produced to an agreed format and include details on state provision.

The media can play a very positive role in making the public aware of their own protection gap. We believe that media support is a key criterion in the success of this project. The industry should work together and work with the media to achieve the requisite level of consumer awareness.

The industry has been surprisingly reluctant to use real case studies of people whose lives have been affected by disability yet had, at least, financial security because of income protection.

People suffering long-term disabilities tend to disappear from sight and mind. We should consider the employment of celebrities who have suffered long-term disability to increase awareness. The actor Michael J Fox made a big impression in the recent election campaigns in the US, campaigning on behalf of people such as himself with Parkinson's disease.

## **7 Adviser awareness and training**

In many cases, adviser views have been formed by product marketeers and ease of sale rather than fact and client need. This has created customer disadvantage in that in a high proportion of cases, they are sold inappropriate covers.

It is essential that distributors are aware of the incidence and impact of illness and disability and the consequences of financial hardship such as social drift. To this end, professional and trade associations should be brought into the process to become part of the solution.

Thus, we need to agree a way forward with PFS, IFP and AIFA to create and deliver a plan to ensure distributor competence and consumer benefit.

The industry and the regulator should consider whether all who are responsible for advising customers, whether front line sales personnel or those in call centres, should be required to pass an appropriate examination to demonstrate competence to give advice on disability issues.

## **8 Collaboration with Government**

The State and the industry have similar objectives – to ensure that those who are genuinely unable to work as a result of sickness are financially secure and are, at the same time, helped to return to work as soon as possible.

To this end, it is desirable to align new Incapacity Benefit system with definition of sickness under Income Protection plans.

There is a common interest in rehabilitation, counselling and re-training, suggesting co-operation between State, NHS and the industry. It would be helpful if the industry took a holistic approach on these issues.

The industry should lobby MPs across the country to get the message across that the problems of disability in the workforce and of fraudulent claims are mutual to industry and

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State. We should consider lobbying for tax relief on IP premiums. Even if success is not achieved, we will have done much to spread the message.

**9 Standardisation of non-competitively sensitive aspects**

Currently, differentiation is sought by providers in areas where there is none to be gained. The use of terms such as weeks rather than months or vice versa confuse, as do different State Benefit offsets, maximum benefit formulae etc.

We believe that the ABI Protection Committee should examine the case for sensible standardisation of product conditions where it would help consumers and advisers make comparisons and where competition would not be impaired.