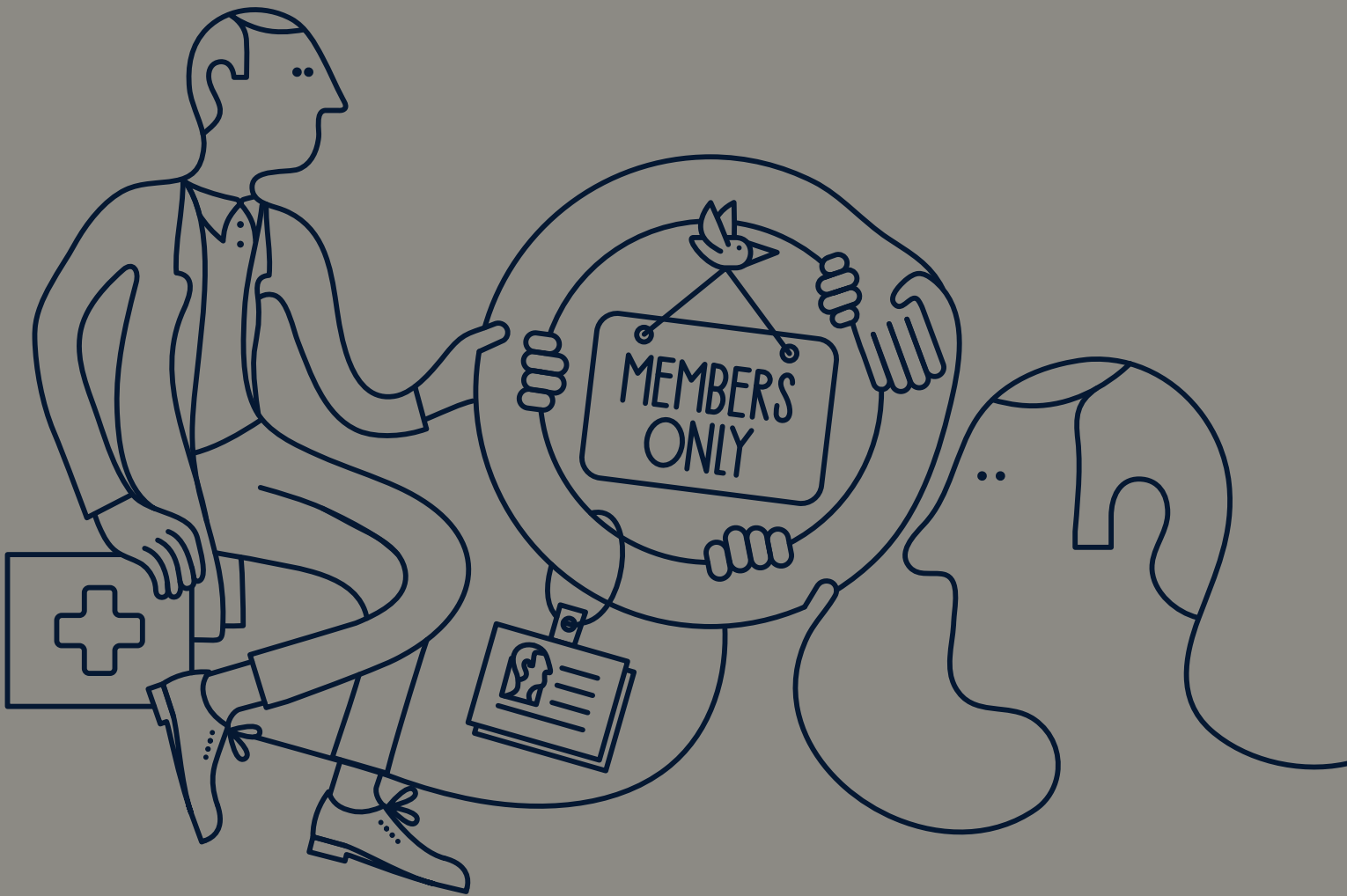


# FRONT LOADED DISCOUNTS AND THE LONGER TERM IMPACT



# CONTENTS

PPS Mutual foreword	3
Infographic	8
Rice Warner report	11

The Foreword

# IN CRISIS COMES **OPPORTUNITY**





**In the current environment of global pandemic, there is a sharp focus on economic recovery and future sustainability, new modes of doing business and the ultimate needs of consumers. This presents the Australian life insurance industry with a timely opportunity for fresh thinking.**

This research paper was commissioned by PPS Mutual in the days before COVID-19. Its findings – somewhat ironically and perhaps fortuitously, show us that change in certain underlying business practices by life insurers should happen.

In fact, there has never been a more important time to reassess past dynamics of the sector, and work towards building a strong and sustainable insurance industry for all Australians.

---

**IS NOW THE TIME  
TO CORRECT SOME  
PAST DUBIOUS  
PRACTICES WHICH  
HAVE LED TO HIGH  
LAPSE RATES  
AND UNSUSTAINABLE  
PRICING?**



## The context

Last year in Australia \$12bn was paid in life insurance claims to 101,821 Australians. This would have gone largely unnoticed by the Australian public. Having a pandemic thrust upon us, however, has forced many Australians to take a closer look at their income protection cover and life insurance.

The Coronavirus crisis has also forced insurers and reinsurers to respond to a range of unprecedented issues. It has been very pleasing therefore to witness the way in which the Australian retail life insurance industry has risen to the challenge. Insurers smoothly transitioned their operations after enacting business continuity plans, reassured customers who held individual policies that there were no exclusions for pandemics, continued to offer frontline healthcare workers cover without a COVID-19 exclusion and put in place measures to assist customers experiencing financial hardship.

The actions of insurers during the COVID-19 crisis contrasts sharply with a questionable track record before the pandemic hit Australia's shores. Insurers have been chasing market share through lax underwriting, takeover terms and special deals for certain advisers. This has led to poor books of business and anti-selection. More recently the introduction of front loaded discounts for new business premiums have also featured as part of the 'old normal' environment.

As a result, life insurers last year (2019) lost \$1.3bn, lapse rates for traditional life insurers remain stubbornly high at about 17% and policyholders have had to endure significant and repeated increases in premiums (in some cases by more than 35% year on year).

Most of the issues the industry is grappling with are a function of the macro socio-economic environment. However the worst elements of insurance product design and manufacturing must also share the blame. An historic and aggressive chase for market share by various insurers has created highly undesirable outcomes for consumers. These poor consequences - like longer term rising premiums - should not be confused with poor advice.

We must not allow the inevitable criticism for poor risk management and product design to be sheeted to advisers. It would simply be wrong if advisers were once again in the cross hairs. All too often it is the professional intermediary that bears the brunt of poor consumer outcomes when the product design, risk terms and commercial motivations of the insurers are at fault.

It was in this context (i.e. pre-COVID-19) that we decided to commission market research from Rice Warner on Front Loaded Discounts in the retail insurance market. The research confirms what we have always known - that front loaded discounts are emblematic of all that should be fixed by the retail life insurance industry today.

## The findings

The Rice Warner study demonstrates that while policies with front loaded discounts can increase affordability in first year premiums, they are less affordable over the medium to long term. For example, front loaded discount policies with stepped premiums have on average lower premiums in the first policy year, but higher premiums from the third policy year onwards.

Similarly, level premiums are more affordable than stepped premiums over the long term. Level premiums can also be used strategically with stepped premiums to offer a 'base level' of cover that will be needed long term. The findings of this study show that while non-true level policies are on average cheaper in the first policy year, true level policies consistently and significantly rank as more affordable on aggregate premiums over 20 years.

The Rice Warner study also shows how over 5-20 years, policies with front loaded discounts have significantly higher premium increases relative to the first policy year. By way of example, customers of one insurer offering a 25% up-front discount could face increases of 50% plus in premiums in the second year once you also take into account age-based increases and indexation.

The effect that these sharp premium increases have psychologically on a client, and the increased likelihood the client will lapse as a result, should not be underestimated. Indeed, ASIC notes in REPORT 413 that the steep increases in stepped premiums are one of the key factors in policy lapses (along with other features of policy design).

The study also highlights the significant saving over the medium and long-term in opting for true-level premiums rather than non-true level premiums. For a typical case, the range of premiums over time for true level and non-true level policies overlaps almost entirely for the first five policy years, but by the eleventh policy year the most affordable non-true level premium is higher than the least affordable true level premium and by the twentieth policy year non-true level premiums are approximately 44% higher on average, despite being 6% lower on average in the first policy year. With interest rates experiencing significant declines and at historic lows, however, there is once again more pressure on level and particularly true level premiums across the industry. A major insurer has even recently stopped offering a level premium option.

### Front loaded discounts are also likely to increase lapses because:

#### Reason 1

They encourage customers to switch to a policy with a lower first year premium in the first instance

#### Reason 2

They mostly have higher premiums on average from the third policy year onwards.

#### Reason 3

Not only will the premiums from the initial front loaded policies be higher from the third year onwards but they will also differ even more markedly to new business quotes where the first-year discount still applies.



## The mutual way

As a mutual company, PPS Mutual exists for the benefit of our professional Members who hold PPS Mutual Professional Choice policies. We don't have any shareholders. As a result, we are focused on the long-term sustainable best interests of our Members. This is the reason why we do not offer front loaded discounts.

PPS Mutual also do not offer front loaded discounts because as a mutual we seek to treat all our Members equitably. It is the existing 'in-force' customers at insurers who are paying for the new business discounts. A membership-based organisation like PPS Mutual, on the other hand, wants to bring its Members with it together. To give new Members a discount without any underlying rationale makes no sense in this context. If anything, we will reward our loyal Members before our prospective Members. Advisers and customers should also remember that the new business customer of today is the legacy customer of tomorrow.

Lapse rates also have a large impact on sustainability of premiums. This is the case whether the company is owned by shareholders or a mutual which is owned by its policyholders. Mutual companies typically use the profits emanating from lower lapses to either reduce premiums or pay profits to Members. Our philosophy at PPS Mutual is to price our products sustainably. This means first and foremost ensuring that claims can be paid to Members with the profits from the mutual being assigned to Members individual Profit-Share Accounts.

PPS Mutual's lapse rates are one-quarter that of the industry (i.e. 4.5% vs 17%). It is a similar situation in South Africa where PPS have been providing life insurance to professionals for over 75 years. These low lapse rates reflect that our customers are not just policyholders but also Members. If a Member feels their cover meets their needs and is competitively priced, but instead of the profits going to external shareholders, they are coming back to them as a Member - why would they go anywhere else?

The long-term nature of policy coverage makes life insurance a medium to long term purchase. Therefore, we recommend the findings of this paper to licensees (particularly those working in compliance) and advisers, to help provide advice that is in their clients' long-term best interests. The infographic could be a useful tool to help illustrate to clients the need to balance quality cover and sustainability with short-term affordability - rather than just looking for the cheapest premium.

Along with factors such as the insurer's philosophy, product definitions and features, and claims payment track record - price is one factor in determining what is the most suitable product for a client. It is easy to take the path of least resistance, however, and recommend one product over another based on the first year's premiums.

There are many lessons to take from this research. As the well known saying goes: it is important to do what is right and not what is easy. Developing a 'new normal' is a hard task and will need leadership from all stakeholders. The 'new normal' would benefit all stakeholders, as well as all Australians through the community and economic benefits to government.



### Michael Pillemer

Chief Executive, PPS Mutual

Previously Michael was founder and CEO of Centric Wealth which he built into one of Australia's largest privately owned non-aligned wealth advice businesses with assets under advice of \$5 billion.

---

**WE ARE FOCUSED  
ON THE LONG-TERM  
SUSTAINABLE BEST  
INTERESTS OF OUR  
MEMBERS. THIS IS THE  
REASON WHY WE DO  
NOT OFFER FRONT  
LOADED DISCOUNTS.**

# Are first-year premium discounts really the best policy?



Life insurers are offering tempting discounts on first-year premiums of up to 25%

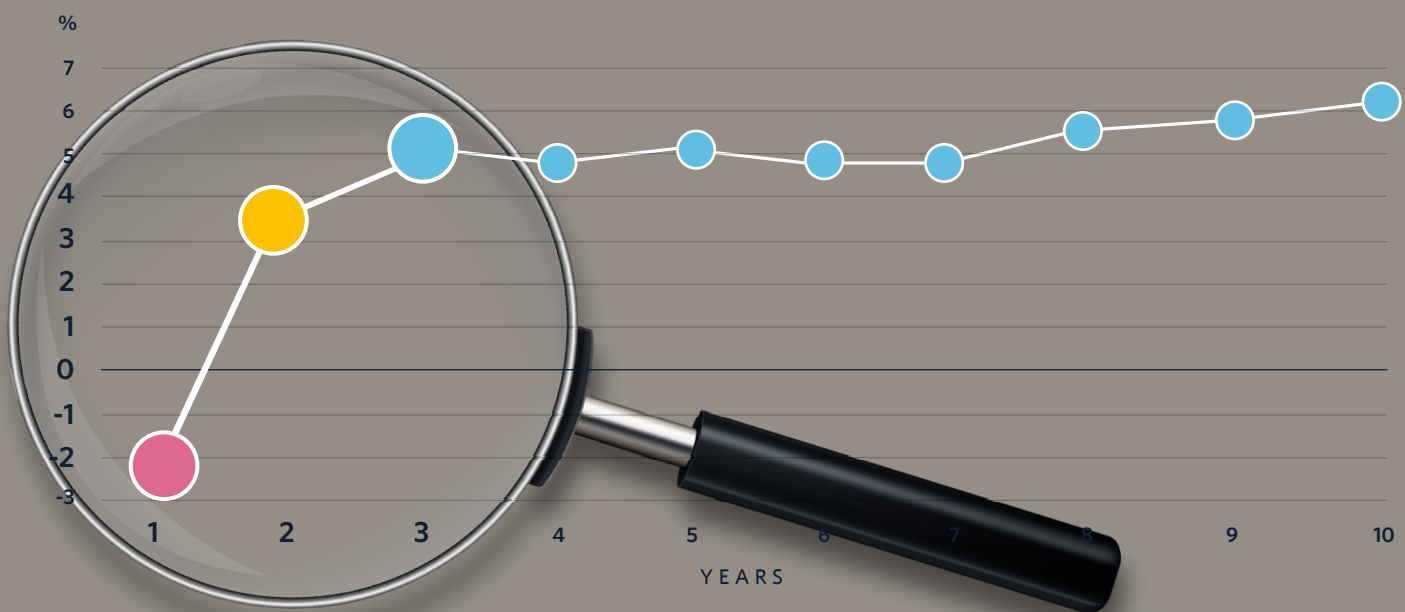
**HOWEVER**



As life insurance is a long-term contract, do these deals really represent good value?

## IT PAYS TO TAKE A CLOSER LOOK

Average percentage difference between discounted and non discounted premiums



### IN YEAR ONE

These front loaded discount products are on average...

↓  
**2.5%**  
LOWER

BUT

### IN YEAR TWO

These front loaded discount products are on average...

↑  
**3.5%**  
MORE EXPENSIVE

AND

### IN SUBSEQUENT YEARS

These front loaded discount products are on average...

↑  
**5%**  
MORE EXPENSIVE

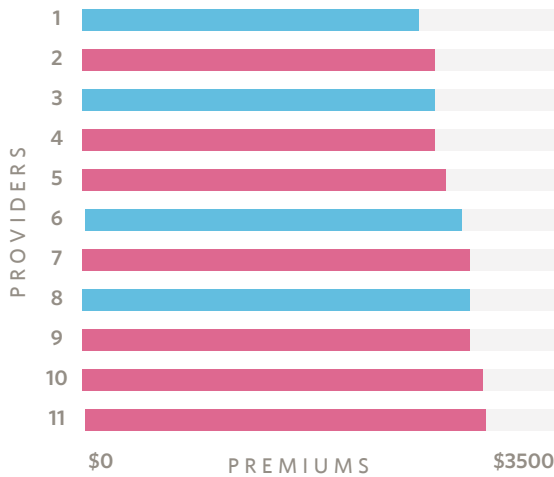


# ULTIMATELY IT ALL COMES DOWN TO...

## SHORT-TERM DISCOUNT

Based on first-year premiums

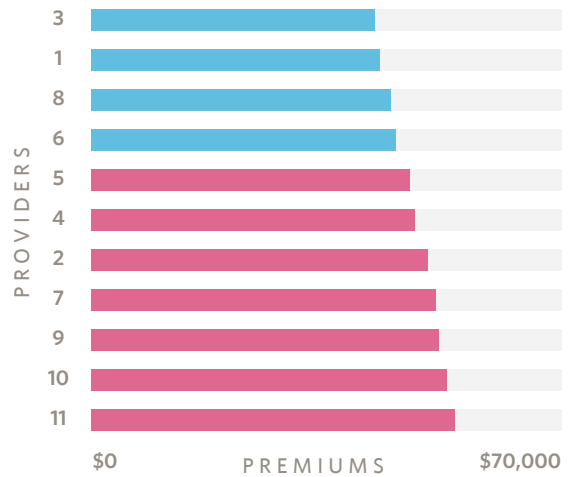
**3** out of the **5** most affordable policies are front loaded discount products



## LONG-TERM VALUE

Based on ten-year aggregated premiums

All **4** of the most affordable policies are non front loaded discount products



Non Front loaded Front loaded

SO WHAT DOES THIS MEAN FOR CUSTOMERS WITH FRONT LOADED DISCOUNT POLICIES?

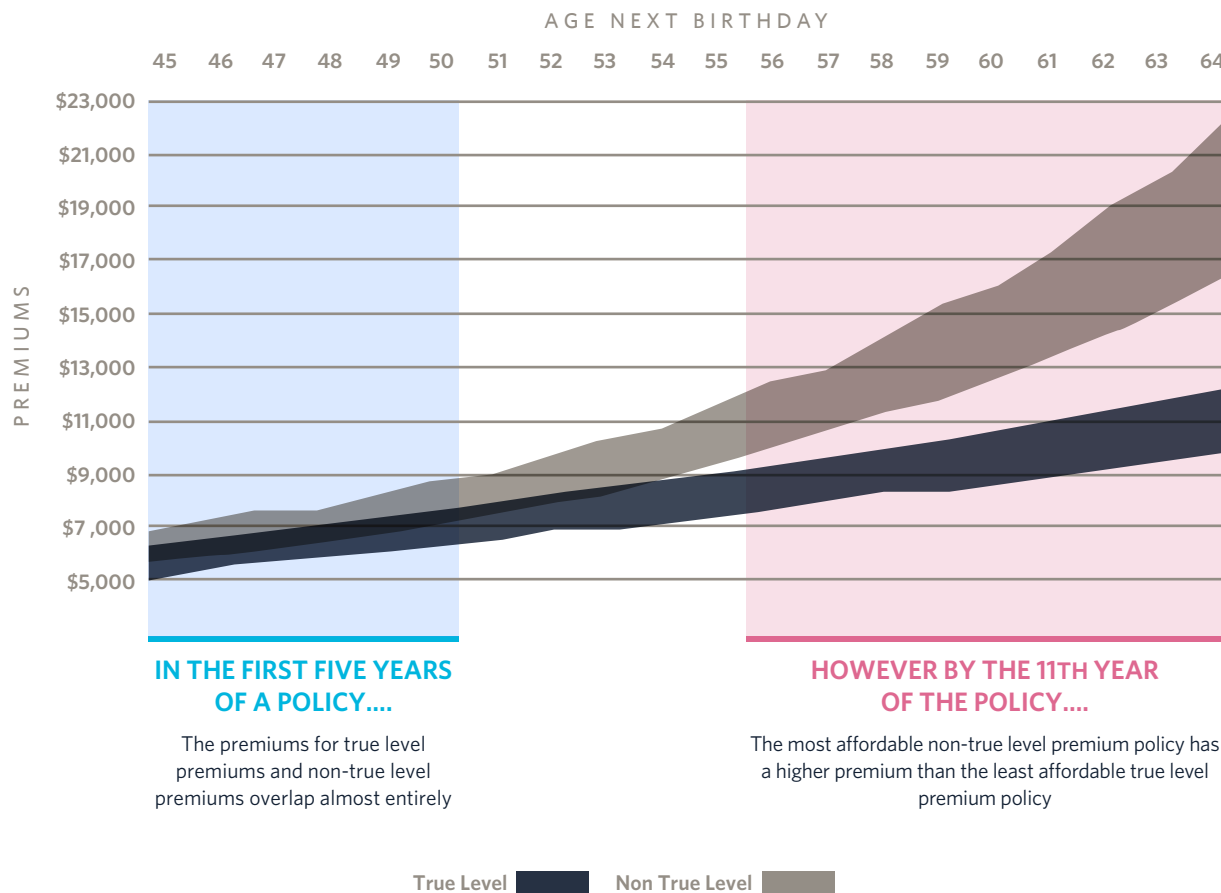
**STEEP PREMIUM INCREASES  
OVER 5-20 YEARS**



In the case of one insurer offering a 25% up-front discount, if you take into account age based increases and indexation, policyholders could face a second year premium increase of:

**50%+**

# TRUE LEVEL PREMIUM VS NON-TRUE LEVEL PREMIUM. LONG TERM PREMIUM COMPARISON.



## BASED ON INDEPENDENT RESEARCH FROM RICE WARNER

Rice Warner's scoring system allocates equal weighting to both the first-year premium and an aggregated premium total over the initial ten years of a policy, recognising that life insurance is a medium to long term purchase for most consumers.





# FRONT LOADED DISCOUNTS AND THE LONGER TERM IMPACT

## 1. Introduction

Increasingly the retail insurance market is adopting initial short term discounts for new business quotes. These are discounts on the first-year premium of up to 25%, reducing to zero over the next two to five years. This generally leads to customers experiencing steeper premium increases in the first several policy years. Typically, advisers focus on first year premiums and feature scores when recommending new policies, with most rating houses scoring based on first year premiums. These initial premium discounts may skew rankings as front loaded discounts will result in material reductions in first year premiums that are importantly not reflected in aggregated future premiums over the longer term.

Rice Warner’s scoring system allocates equal weighting to both the first-year premium and an aggregated premium total over the initial ten years of a policy. This recognises that life insurance is a medium to long term purchase for most consumers.

PPS Mutual has requested that Rice Warner explore this concept by considering the relativities of current pricing for on-sale Retail Insurance over varying scenarios and durations. This paper sets out our findings.

Table 1 lists the insurance products used in our investigation. Insurers are anonymised in the results of this report.

**Table 1. Insurers**

Product
AIA Priority Protection
BT Protection Plan
ClearView Life Solutions
CommInsure Protection
Integrity Here for You
MLC Insurance
NEOS Protection
OnePath OneCare
PPS Mutual Professionals Choice
TAL Accelerated Protection
Zurich Wealth Protection

## 1.1 Conclusions

Front loaded discounts can increase affordability in first year premiums but this does not always continue to benefit the consumer in mid-to-long term premiums in many of our scenarios. The steeper premium increases across the first two to five policy years often leads to policies with front loaded discounts ranking better in year one rather than over a longer term. There was high variation in individual product premiums by gender, age, and sum insured across all policy types.

Our study showed that across most scenarios, the rankings of premium affordability based upon aggregate premiums differed from those based upon first year premium alone.

Policies with front loaded discounts showed higher percent premium increases relative to the first policy year than non-front loaded discount policies for the first five years. Moreover, stepped premium scenarios including lump sum covers showed front loaded discount policies had on average lower premiums in the first policy year, but higher premiums from the third policy year onwards. These findings indicate that first year premium is an inconsistent indicator of mid-to-long term affordability for many customers.

## 2. Scenarios and approach

We have projected premiums across the retail insurance market for a range of scenarios to determine how the premiums of products with front loaded discounts compare to the premiums of products with no front loaded discounts. We have compared premiums in the first year and aggregate premiums over a 10 and 20 year period as well as examining for specific trends.

Our scenarios were determined based on the following parameters:

- Gender- Male and Female
- Age - 30 and 45 Age Next Birthday
- Smoking status - Non-smoker
- Occupation - Qualified Accountant (White Collar)
- Indexation rate - 3%.
- Tax environment - Non-superannuation
- Premium type - Stepped and Level
- Policy type:
  - Death
  - Death with Linked Total and Permanent Disability (TPD) and Trauma
  - Income Protection (IP) - indemnity policies, to-age-65 benefit period and waiting period of 30 days.
  - Death with Linked TPD and Trauma, and IP (referred to as a 'Package' policy within this report)
- Sum insured – as per Table 2. These have been set at both a 'medium' and 'high' level.

Health discounts were excluded, and where relevant the highest featured policy was used for each product when constructing a peer group (i.e. the policy with the highest feature score in our product database).

Aggregated premiums were calculated with each year adjusted to present value, i.e. the value of today's dollars, using an interest rate of 2.5%.

**Table 2. Sum insured/monthly benefit levels**

Cover	Sum insured/monthly benefit (\$)	
	Medium	High
Death	500,000	1,000,000
TPD	500,000	1,000,000
Trauma	200,000	500,000
IP	5,000	15,000

## 3. Our findings

### 3.1 Stepped premiums

Front loaded discounts can increase affordability in first year premiums but this does not always continue to benefit the consumer in mid-to-long term premiums in many of our scenarios. The steeper premium increases across the first two to five policy years often leads to policies with front loaded discounts ranking better in year one rather than over a longer term. There was high variation in individual product premiums by gender, age, and sum insured across all policy types.

Our study showed that across most scenarios, the rankings of premium affordability based upon ten year aggregate premiums differed from those based upon first year premium alone.

Moreover, scenarios including lump sum covers showed front loaded discount policies had on average lower premiums in the first policy year, but higher premiums from the third policy year onwards. These findings indicate that first year premium is an inconsistent indicator of mid-to-long term affordability for many customers.

Policies with front loaded discounts consistently showed higher percent premium increases each year relative to the first policy year across the first five years. Higher increases year on year may lead to an increase in lapse rates. This is potentially exacerbated as not only do policies with front loaded discounts have higher premiums on average than policies without front loaded discounts by the third policy year in our analysis, this difference may be greater between front loaded discount policies and new business quotes, where the first year discount will still apply.

Lower premiums on new business quotes may encourage advisers of policyholders who have received a premium increase and can undergo underwriting to apply for a new policy at a lower premium. This may also occur for policyholders on non-front loaded discount policies as front loaded discount policies have lower premiums on lump sum covers for new business quotes on average in our analysis.

A scenario has been selected to examine in detail for each policy type across ten policy years:

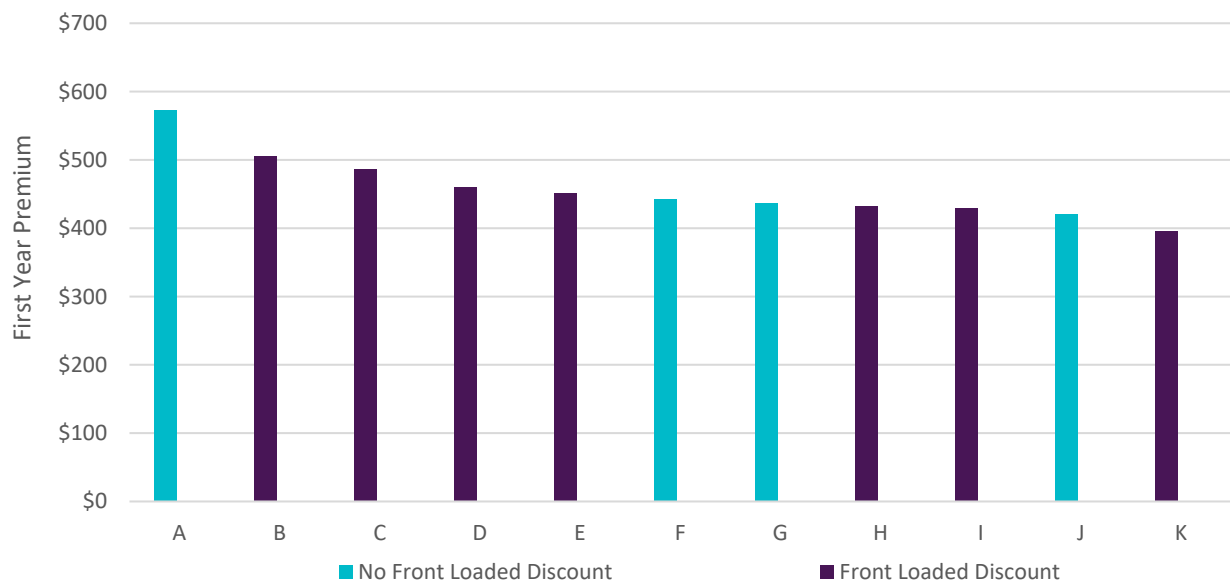
- Male
- Age next birthday 45
- Non-smoker
- Qualified accountant
- Premium type – stepped
- Medium sum insured.

### 3.1.1 Death

Graph 1 shows the first year premium for each policy, and Graph 2 shows the ten year aggregated premium adjusted to present value for each policy for the selected scenario. Policies without front loaded discounts rank one or two positions more competitively by aggregate premium compared to first year premium. Higher percentage front loaded discounts correlated with greater decrease in affordability by rank from first year to aggregate premium. This trend was consistent across death scenarios with stepped premiums.

It is worth noting that two front loaded discount policies denoted B and C improved rank by one position from first year premium to aggregate premium. This is only because of a more significant decrease in ranking by a policy with a higher percentage front loaded discount with a faster roll off offered by policy D.

**Graph 1. First year stepped premiums – male, medium sum insured, Death**



**Graph 2. 10 year aggregate stepped premiums – male, medium sum insured, Death**

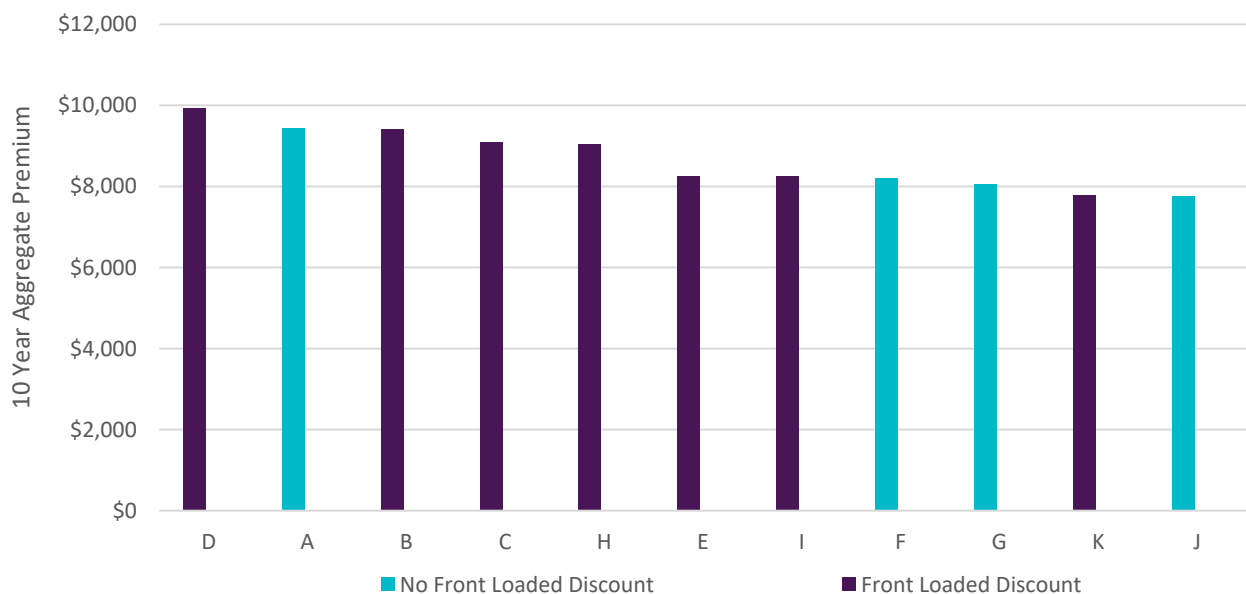


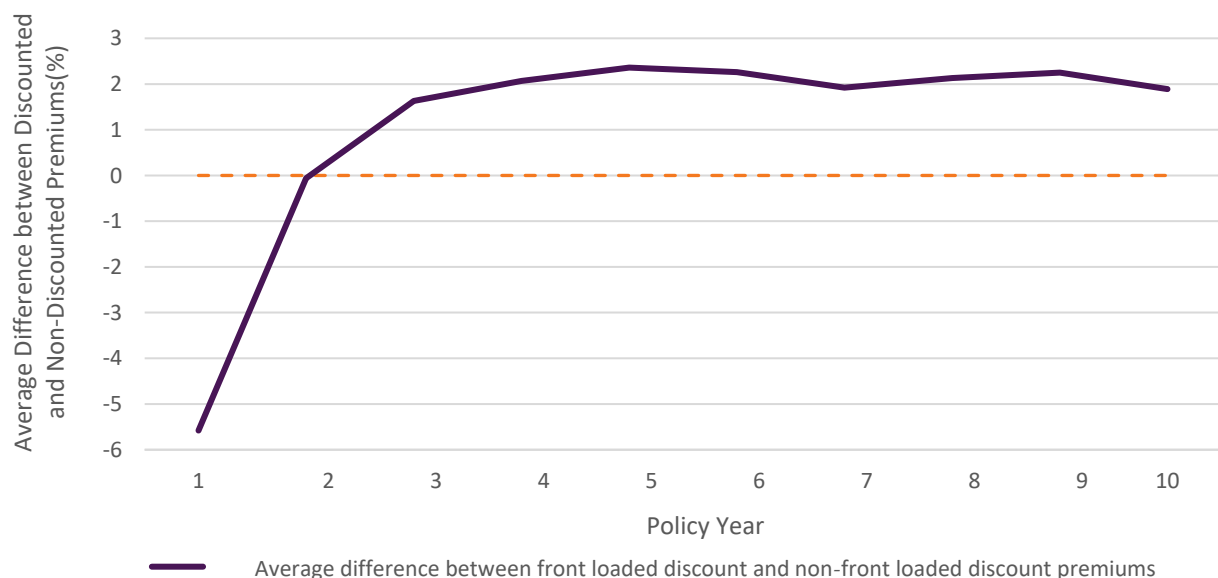
Table 3 shows the percentage increase in premiums each year relative to the first policy year. Front loaded discount policies show greater premium increases across the first five policies years than all policies without front loaded discounts. As expected, higher premium increases correlate with reduction in ranking from first year premiums to 10 year aggregate premiums. The percent increases vary heavily amongst the front loaded discount policies, while are more consistent across non-front loaded discount policies.

**Table 3. Percent increase from first year premiums – male, medium sum insured, Death**

Product	Front loaded discount	Policy year				
		2	3	4	5	10
		(%)				
D	Y	43	61	86	114	342
H	Y	22	41	65	96	359
K	Y	18	38	58	89	320
I	Y	18	41	62	87	298
C	Y	15	34	57	84	286
B	Y	14	32	54	80	289
E	Y	14	33	57	79	270
G	N	14	31	52	76	290
F	N	14	31	52	76	294
J	N	14	30	51	75	292
A	N	11	25	41	61	226

Graph 3 shows average percentage differences between the front loaded discount premiums and non-front loaded discount premiums for each stepped death scenario, with the percentage difference averaged across the death stepped scenarios in each policy year. Graph 3 indicates that front loaded discount products' premiums are on average 5.5% lower on average in the first policy year, however, by the third policy year the premiums become more expensive than policies with no front loaded discounts by approximately 2% each year.

**Graph 3. Average difference between front loaded discount and non front loaded discount stepped premiums – Death**

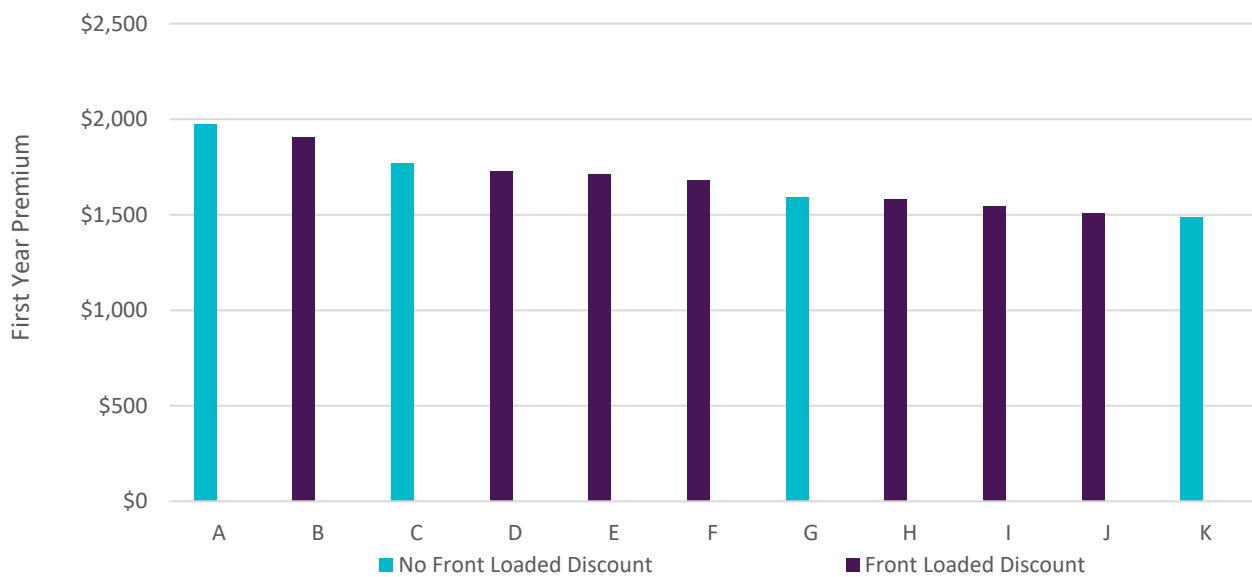


### 3.1.2 Death with linked TPD and Trauma

Death with linked TPD and Trauma showed similar trends. Graph 4 shows the first year premium for each policy, and Graph 5 shows the ten year aggregated premium adjusted to present value for each policy for the selected scenario. Non-front loaded discount policies rank between two and four ranks more affordable in aggregate premiums than first year premiums, excluding one policy which ranked as more affordable by both first year and aggregate premium than all front loaded discount policies. This trend is consistent across stepped premium scenarios for Death with linked TPD and Trauma.

As with Death, higher percentage discounts with faster roll off show greater differences in ranking between first year and aggregate premium. Policies D and E receive the same ranking in both first year and aggregate premium affordability despite their front loaded discounts. This is due to being more affordable than policy H over ten aggregate years despite the policy H being more affordable in the first year.

**Graph 4. First year stepped premiums – male, medium sum insured, Death with linked TPD and Trauma**



**Graph 5. 10 year aggregate stepped premiums – male, medium sum insured, Death with linked TPD and Trauma**

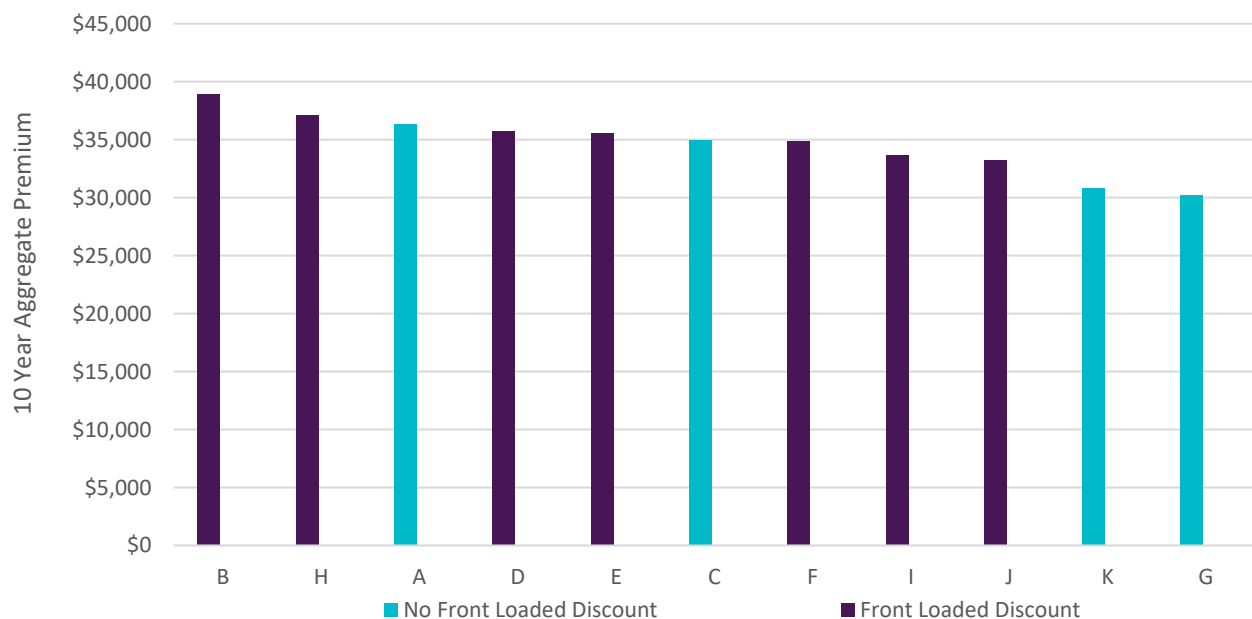




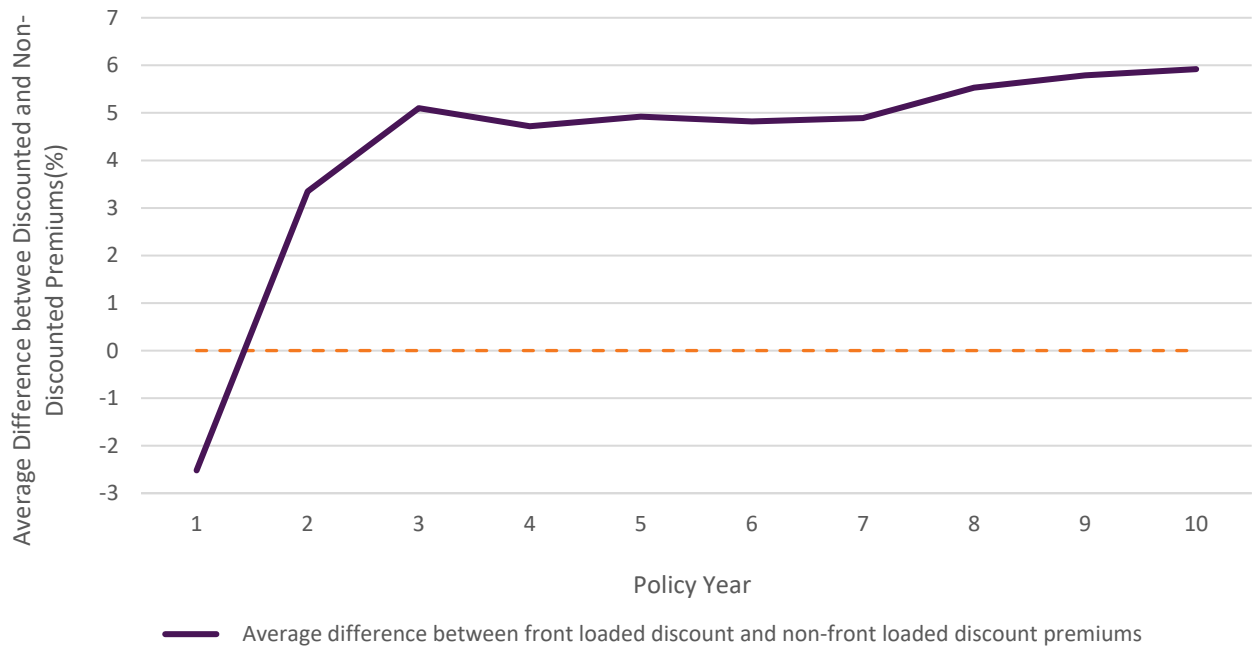
Table 4 shows the percentage increase in premiums each year relative to the first policy year. Front loaded discount policies show greater premium increases across the first five policy years than all policies without front loaded discounts excluding one.

**Table 4. Percent increase from first year premiums – male, medium sum insured, Death with linked TPD and Trauma**

Product	Front loaded discount	Policy year				
		2	3	4	5	10
		(%)				
H	Y	51	74	101	131	387
I	Y	22	49	75	108	379
F	Y	19	42	70	103	341
J	Y	22	44	66	98	405
D	Y	20	47	70	97	338
B	Y	18	39	65	95	340
K	N	18	39	64	95	352
E	Y	19	42	67	94	363
C	N	17	37	62	91	320
G	N	14	33	55	80	305
A	N	15	33	54	77	284

Graph 6 shows average percent differences between the front loaded discount premiums and non-front loaded discount premiums, with the percentage difference averaged across the death with linked TPD and trauma stepped scenarios in each policy year. Graph 6 indicates that front loaded discount products' premiums are on average 2.5% lower on average in the first policy year, however, by the second policy year the premiums become more expensive on average than policies with no front loaded discounts by approximately 3.5% in year 2 and 5% for subsequent years.

**Graph 6. Average difference between front loaded discount and non-front loaded discount stepped premiums – Death with linked TPD and Trauma**

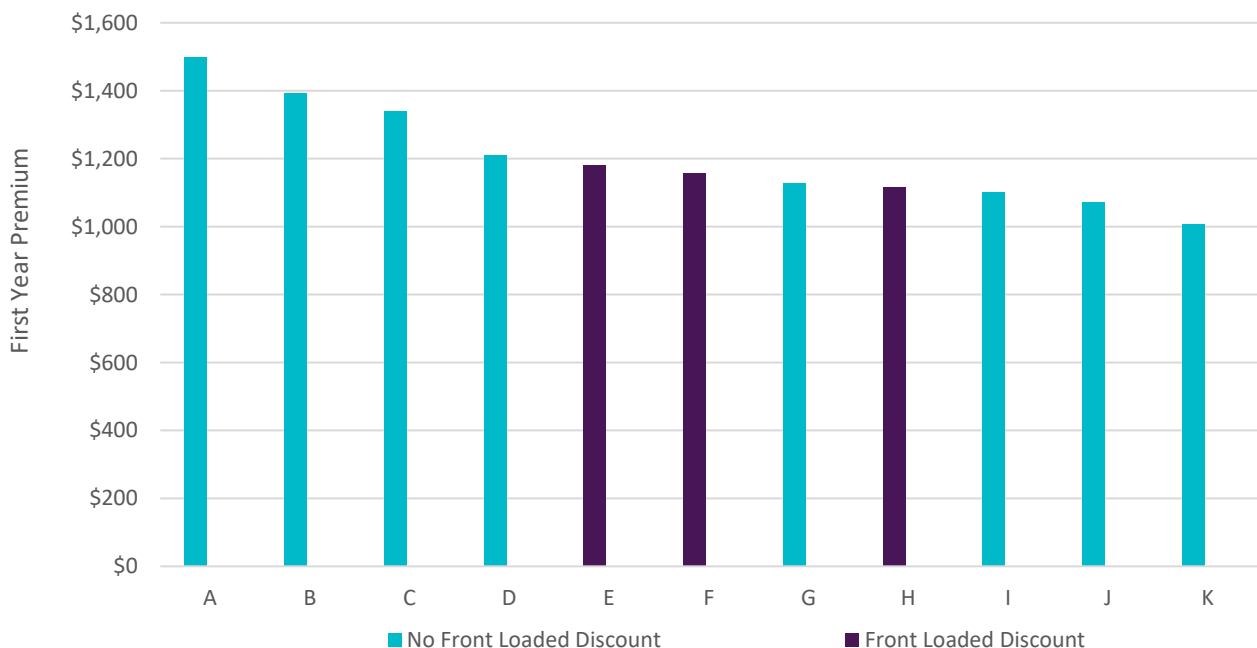


### 3.1.3 IP

IP standalone scenarios did not show higher premiums on average over time for products with front loaded discounts. Fewer insurers offer front loaded discounts on IP, and those that do typically offer lower discounts than those available on lump sum covers.

Graph 7 shows the first year premium for each policy, and Graph 8 shows the ten year aggregate premium adjusted to present value for each IP policy for the selected scenario. Policies with front loaded discounts each ranked either one or two positions lower by affordability for ten year aggregate premium than first year premium.

**Graph 7. First year stepped premiums – male, medium sum insured, IP**



**Graph 8. 10 year aggregate stepped premiums – male, medium sum insured, IP**

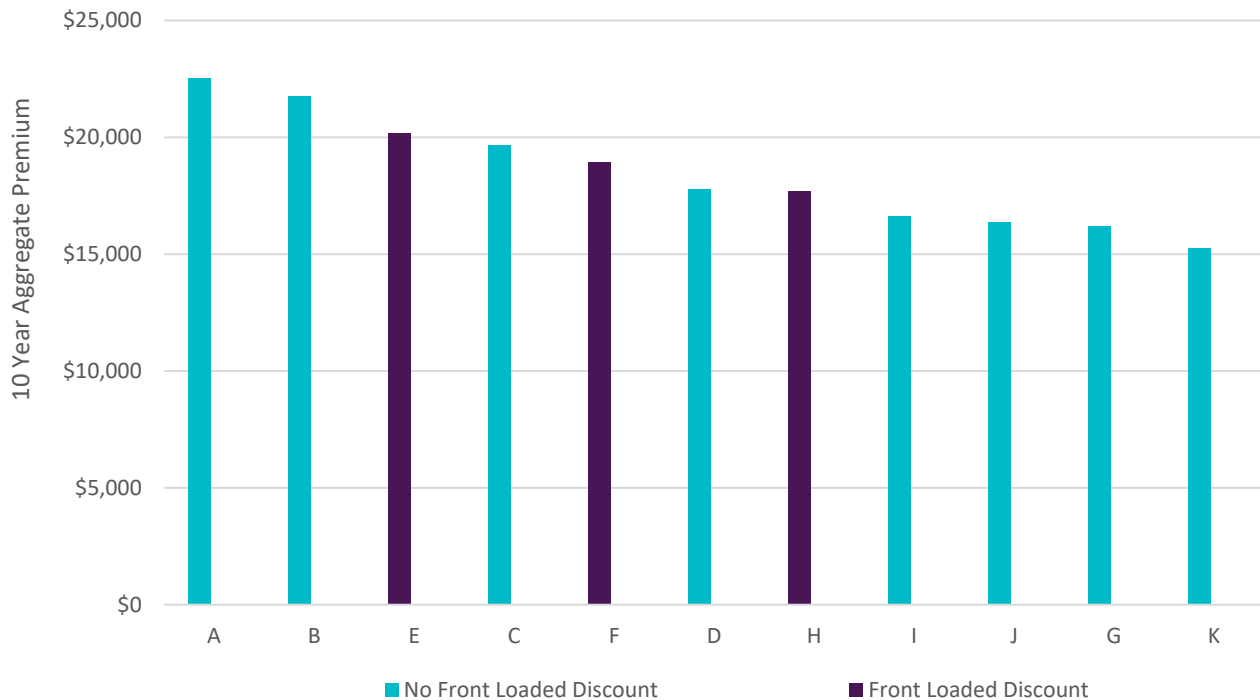


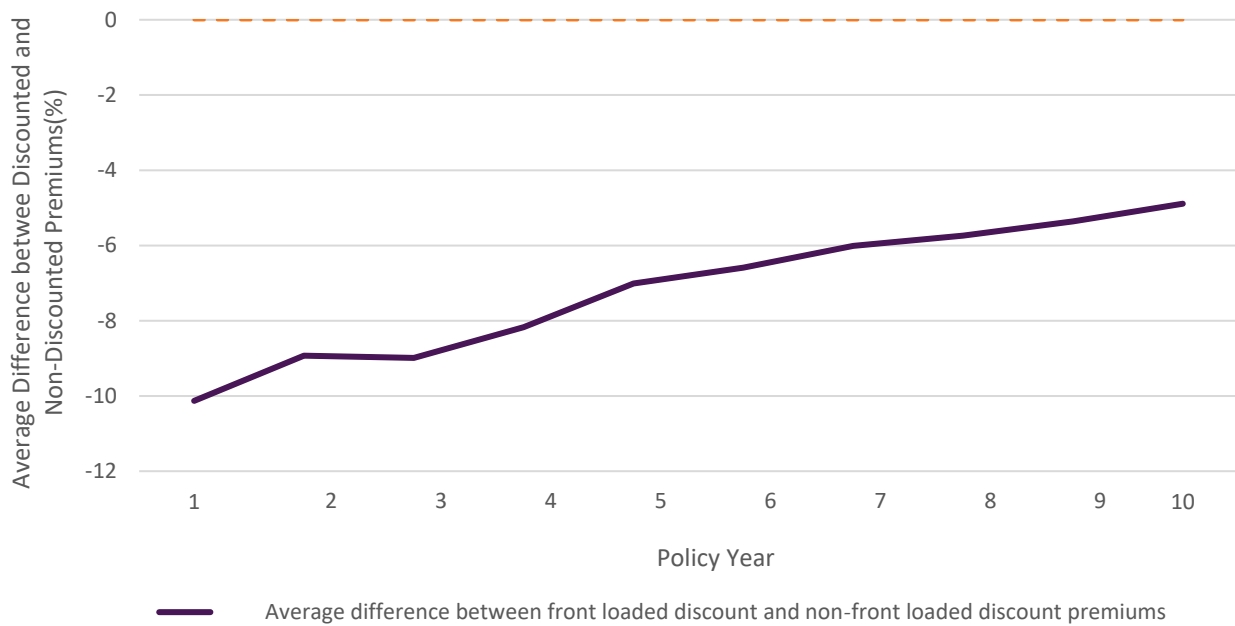
Table 5 shows the percentage increase in premiums each year relative to the first policy year. While three of the four highest percent premium increases across the first five years are front loaded discount policies, the variance is significantly lower for IP policies than in the lump sum scenarios.

**Table 5. Percent increase from first year premiums – male, medium sum insured, IP**

Product	Front loaded discount	Policy year				
		2	3	4	5	10
		(%)				
E	Y	19	34	51	69	227
F	Y	13	28	45	67	199
B	N	15	34	47	63	171
H	Y	14	29	44	63	180
J	N	11	24	38	54	182
K	N	11	23	38	53	175
I	N	12	23	36	52	173
A	N	11	22	34	49	178
D	N	12	22	32	48	162
C	N	10	21	33	47	164
G	N	9	20	32	46	153

Graph 9 shows average percent differences between the average front loaded discount premium and non-front loaded discount premium, with the percentage difference averaged across the IP stepped scenarios in each policy year. Discount structure had relatively low impact on these average differences compared to variance in IP premium rates. IP policies with front loaded discounts were on average cheaper across all policy years, although as expected this difference reduced over time.

**Graph 9. Average difference between front loaded discount and non-front loaded discount stepped premiums – IP**



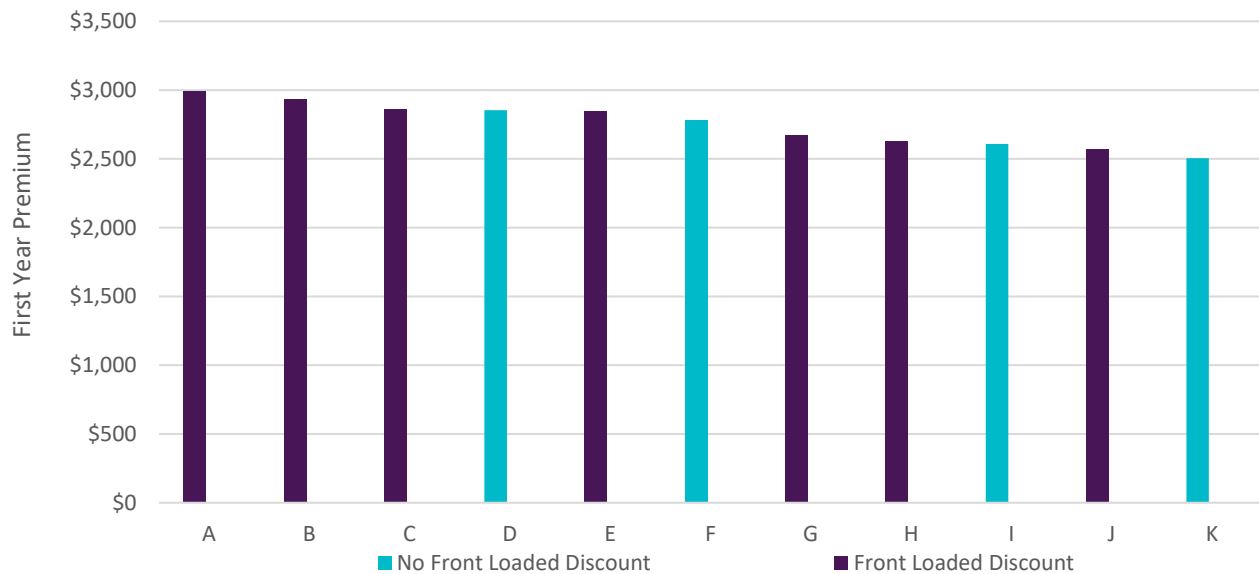
Despite this lower average, the most affordable policy by first year premium was not a front loaded discount policy in any of our stepped IP scenarios.

### 3.1.4 Package policies

Package policies, consisting of Death with linked TPD and Trauma, as well as IP, followed the trend of lump sum covers regarding front loaded discounts. For our analysis we have assumed that a policy is considered to offer a front loaded discount if any of the covers within the policy offer one, even if that discount does not apply to every cover.

Graph 10 shows the first year premium for each policy while Graph 11 shows the ten year aggregate premium adjusted to present value for each policy for the selected scenario. Front loaded discount policies account for three out of five of the most affordable policies by first year premiums, while the four most affordable policies on a ten year aggregate premium were products with no front loaded discount.

**Graph 10. First year stepped premiums – male, medium sum insured, package policy**



**Graph 11. 10 year aggregate stepped premiums – male, medium sum insured, package policy**

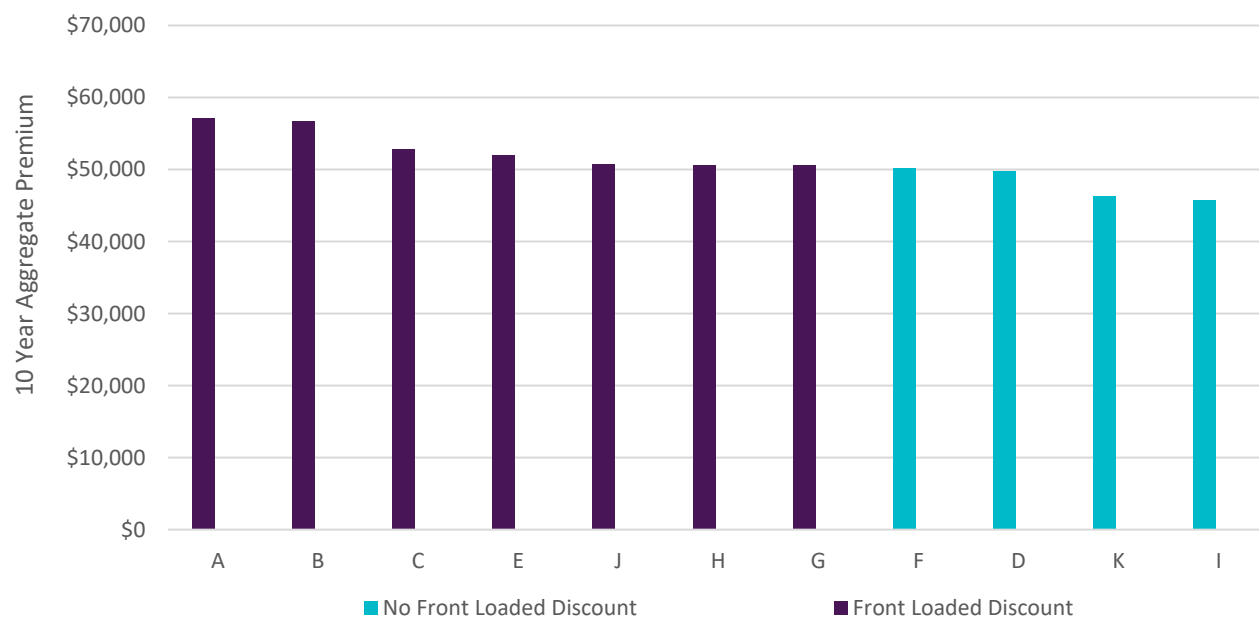
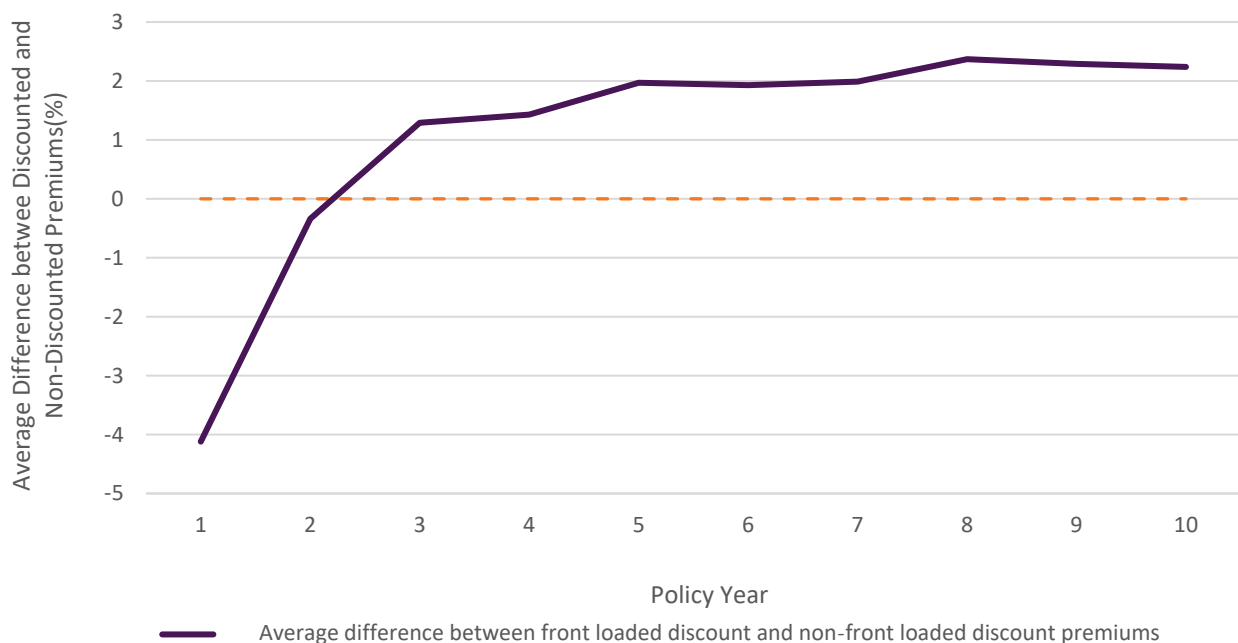


Table 6 shows the percentage increase in premiums each year relative to the first policy year. Front loaded discount policies show greater premium increases across the first five policy years than all policies without front loaded discounts, however the variance in the percent premium increases is lower than in lump sum scenarios.

**Table 6. Percent increase from first year premiums – male, medium sum insured, package policy**

Product	Front loaded discount	Policy year				
		2	3	4	5	10
		(%)				
B	Y	31	49	68	91	284
G	Y	19	42	63	87	281
A	Y	16	36	59	87	294
H	Y	18	38	60	85	304
J	Y	21	39	59	84	323
E	Y	15	33	54	79	267
C	Y	17	37	56	79	272
K	N	15	32	53	78	283
F	N	15	32	53	77	267
I	N	13	29	48	69	255
D	N	14	30	48	69	250

Graph 12 shows the average percentage differences between the premiums of products with front loaded discounts and the premiums of products with no front loaded discount, with the percentage difference averaged across package stepped scenarios in each policy year. Graph 12 indicates that premiums of products with front loaded discount charges are on average 4% lower than the average premium of products with no front loaded discounts in the first year of the policy. By the third policy year the premium of products with front loaded discounts becomes approximately 1% on average more expensive, rising to 2% more expensive subsequently compared to the premiums of products with no front loaded discounts.

**Graph 12. Average difference between front loaded discount and non-front loaded discount stepped premiums – package policies**

## 3.2 Level premiums

Across the analysed scenarios, no obvious trends relating to products with front loaded discounts were observed. Front loaded discounts are less common on level premiums. Only two products provide this discount structure on level premiums for lump sum covers and only one for IP.

While no obvious trend was observed for front loaded discounts, it is clear that the insurer's level premium structure impacted the results of the projected premiums. The market uses two methods of calculating increases to sum insured on level premiums, with approximately half using each method:

- True Level Premium – This method applies the level rate at policy entry age to any increased sum insured.
- Non-true Level Premium – This method applies the level rate at the policyholder's age at the time of increase to any increased sum insured.

The 3% indexation rate used for the scenarios in this report is an increase to the sum insured by 3% each year. While there would be no difference between these two methods if no indexation was applied, most retail insurance policies have some level of indexation applied. Greater levels of indexation would increase the discrepancy.

This calculation difference is the focus of our analysis on level premiums, as front loaded discounts had comparatively low impact compared to the underlying premium rates. Ranking by affordability rarely changed over the first five years of the policy, and ranking changes past this point were correlated with the calculation method of sum insured increases, not any front loaded discounts. There was high variation in individual product ranking by affordability by gender, age, and sum insured across all policy types, but the trend of true level policies being more affordable over the long term at this indexation rate is consistent.

This increase over time may be incorporated into the level rates, as non-true level policies are on average cheaper in the first policy year.

Policies with true level premiums showed significantly lower percent premium increases relative to the first policy year each year past the tenth policy year. This trend was more pronounced in scenarios where the policyholder had a higher age next birthday. This higher percent premium increase may lead to increased lapse rates. However, an incentive to apply for new business quotes does not exist for policyholders on level premiums who have held cover for this period due to the prepaid nature of the level premium structure. New business premiums will typically be higher than the premium for the held policy.

Policies with front loaded discounts showed slightly higher percent premium increases relative to the first premium year for the first five policy years. This did not lead to significant changes in ranking by premium affordability across the analysed scenarios.

A scenario has been selected to examine this in detail for each policy type:

- Male
- Age next birthday 45
- Non-smoker
- Qualified accountant
- Premium type – level
- Medium sum insured.

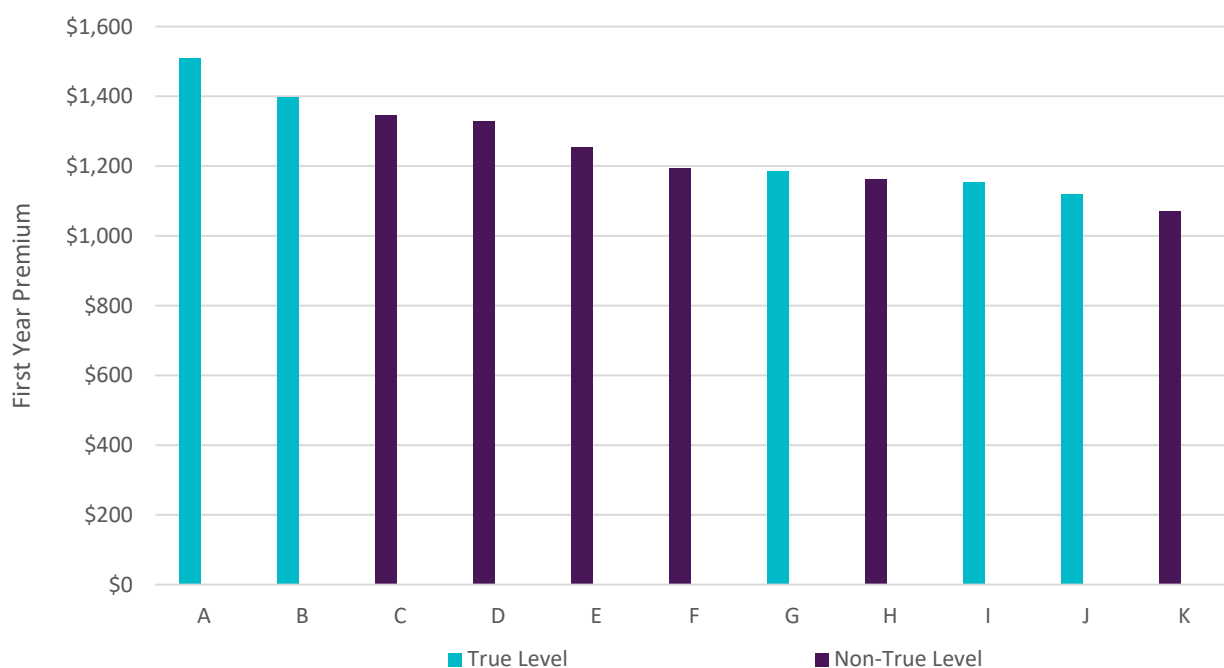
These scenarios will be examined across twenty years due to the long term proposition of level premium structures. If the policy is not intended to be held till the level expiry age, stepped premiums generally offer lower premiums.

### 3.2.1 Death

True level policies consistently rank as more affordable by aggregate premium than first year premium, for Death scenarios, while the inverse is true for non-true level policies. This is due to significant increases in premiums for non-true level policies over time.

Graph 13 shows the first year premium for each policy, and Graph 14 shows the twenty year aggregated premium adjusted to present value for each policy for the selected scenario. Despite ranking well on affordability by first year premiums, all non-true level policies excluding one are less affordable using a twenty year aggregate than all true level policies. This exception moved from rank one by first year premium to rank four by twenty year aggregate premium.

**Graph 13. First year level premiums – male, medium sum insured, Death**





**Graph 14. 20 year aggregate level premiums – male, medium sum insured, Death**

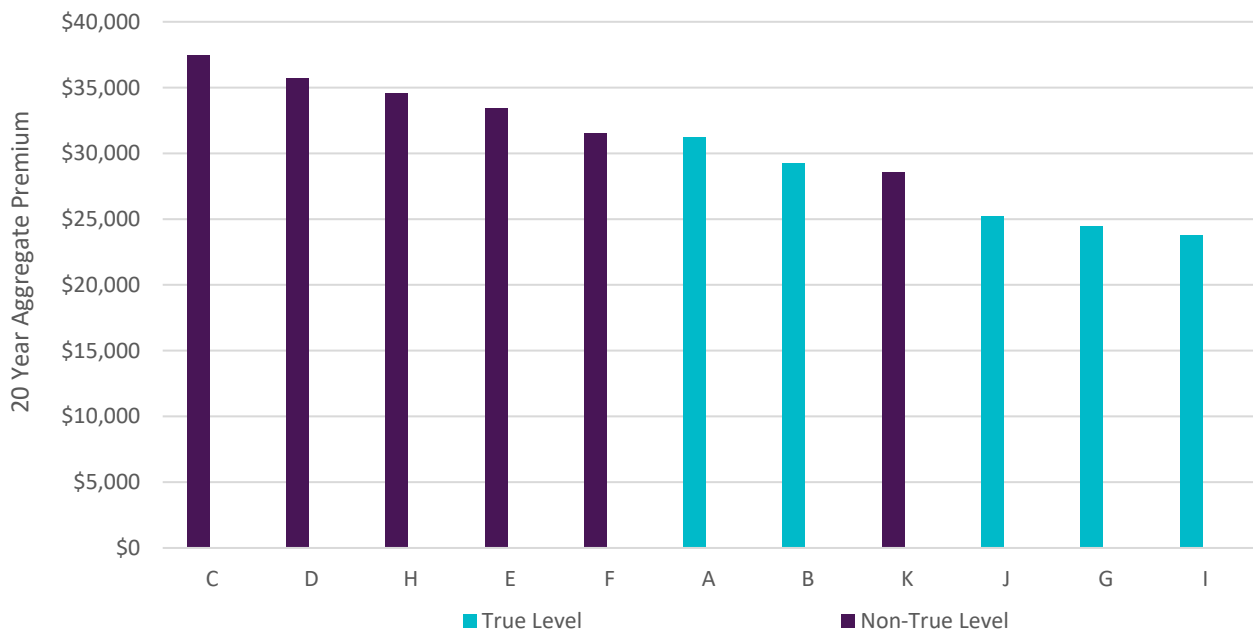


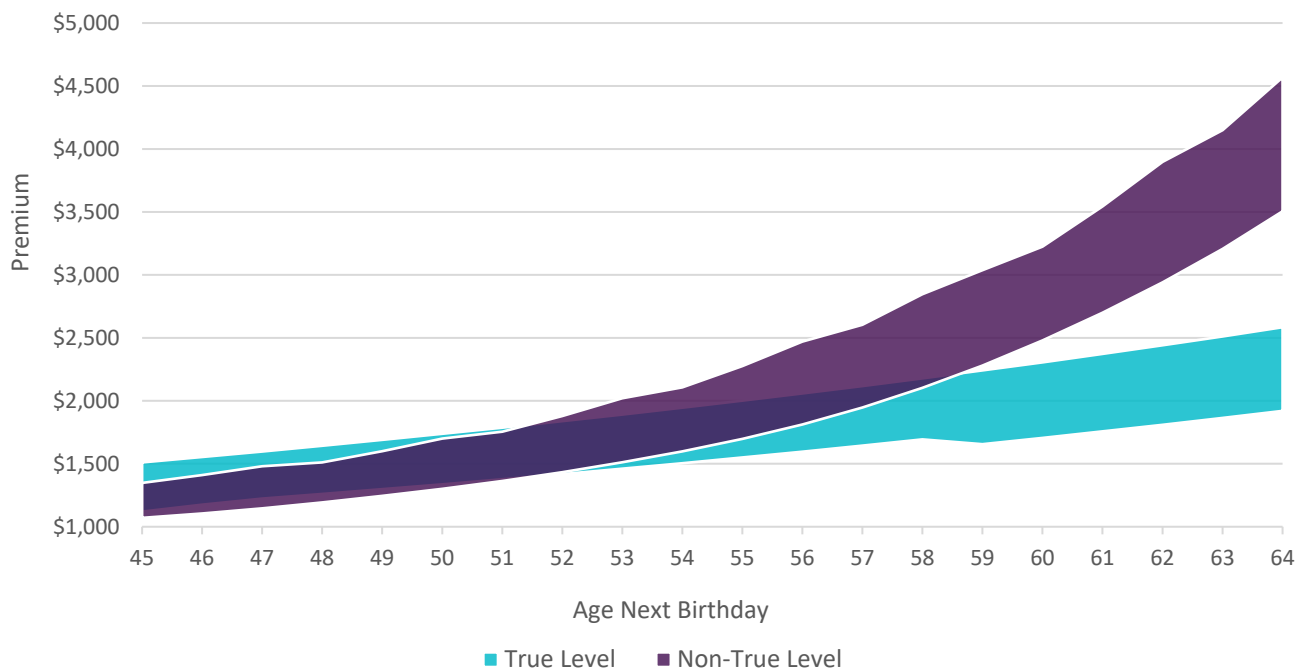
Table 7 shows the percentage increase in premiums each year relative to the first policy year. While front loaded discounts show a slightly higher percentage increase over the first five years, premium increases are relatively consistent with indexation for this period, as is expected for level premiums. However the percent relative increase in the 20<sup>th</sup> year is sharply divided by whether the policy is true level, with non-true level policies showing a relative increase of greater than 200% in the 20<sup>th</sup> policy year, compared to less than 100% for true level policies.

**Table 7. Percent increase from first year premiums – male, medium sum insured, Death**

Product	Front loaded discount	True level	Policy year					
			2	3	4	5	10	20
			(%)					
H	Y	N	9	18	23	29	70	258
C	N	N	5	10	12	19	56	239
D	N	N	3	7	11	16	52	228
K	N	N	3	7	11	16	49	227
E	N	N	3	7	11	16	51	223
F	N	N	3	7	11	16	52	208
J	Y	Y	5	10	15	21	42	88
B	N	Y	3	6	9	13	30	75
A	N	Y	3	6	9	12	29	71
I	N	Y	3	6	9	13	30	66
G	N	Y	3	6	9	13	30	65

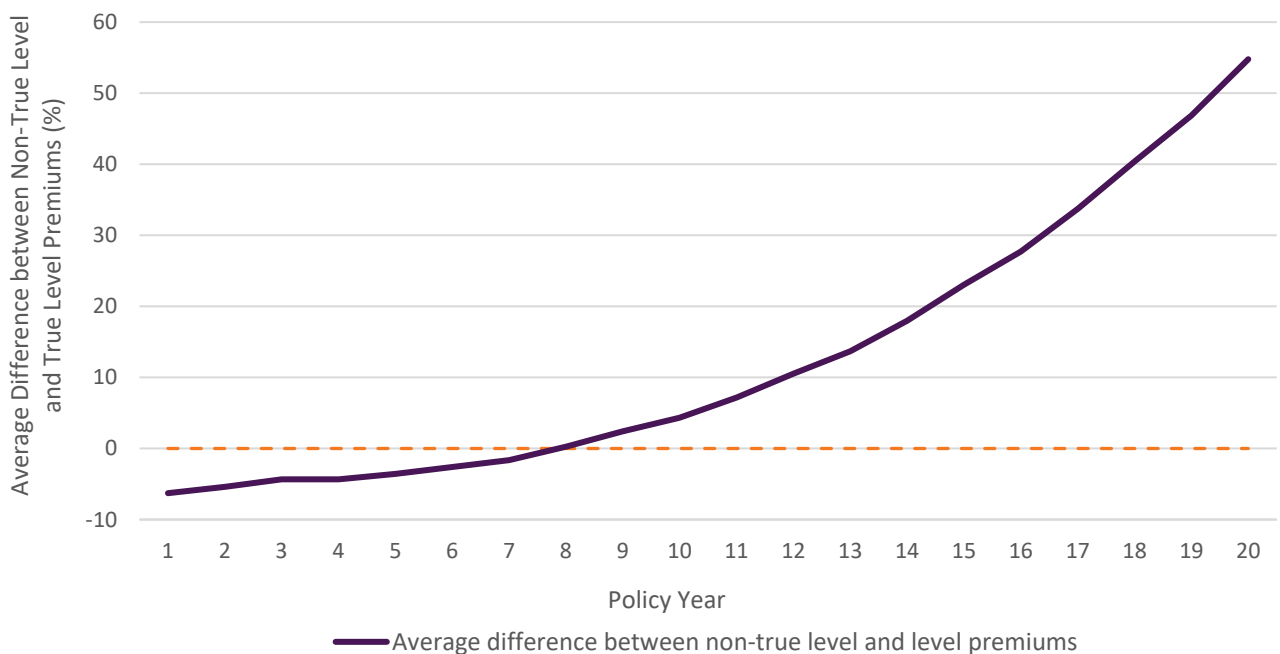
These relative percentage increases are reflected in premiums over time. Graph 15 shows the range of premiums over time for true level and non-true level policies for the selected scenario. By the fifteenth policy year the most affordable non-true level premium is higher than the least affordable true level premium.

**Graph 15. Level premium range – male, medium sum insured, Death**



This trend was consistent across level premium scenarios for death cover. Graph 16 shows average percent differences between non-true level premiums and true level premiums for each level death scenario. Non-true level premiums are approximately 55% higher on average by the twentieth policy year, despite being approximately 6% lower on average in the first policy year.

**Graph 16. Average difference between non-true level and true level premiums – Death**

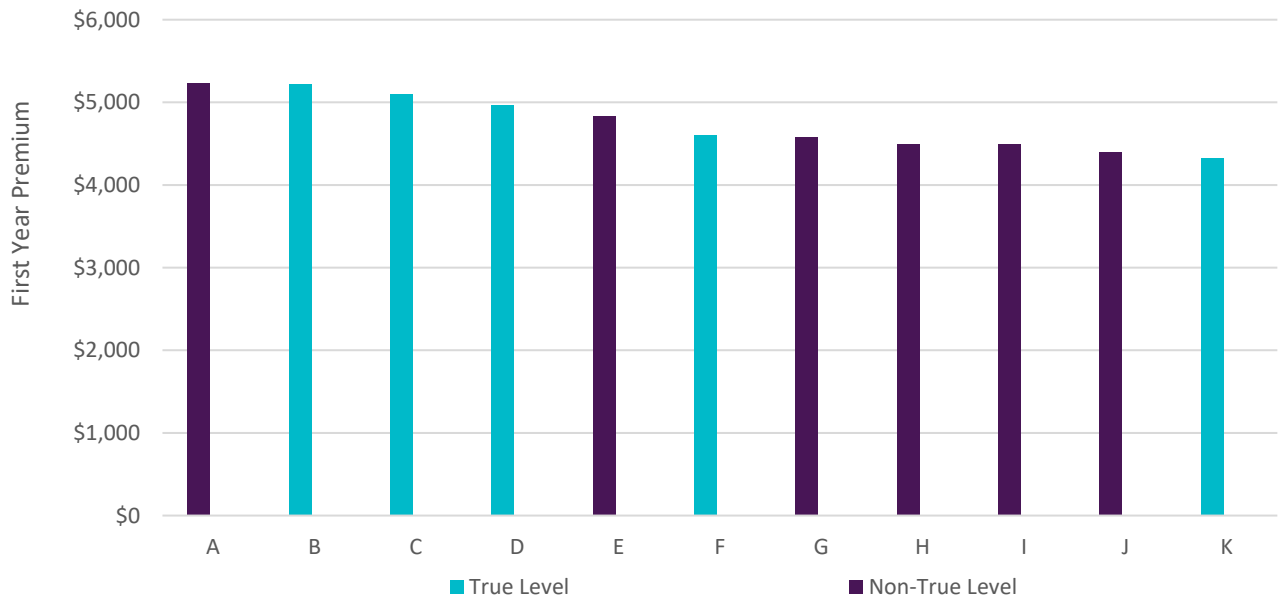


This difference past ten policy years was greater for scenarios with a policyholder taking out cover at 45 age next birthday than a policyholder taking out cover 30 age next birthday, primarily due to the greater level rate increases year on year as the policyholder approaches 65 years old. For policyholders above 60 years of age, true level policies show a year on year increase of approximately 3%, while non true level policies show year on year increases of between 8% and 10%.

### 3.2.2 Death with linked TPD and Trauma

Death with linked TPD and Trauma showed similar trends. Graph 17 shows the first year premium for each policy, and Graph 18 shows the twenty year aggregate premium adjusted to present value for each policy for the selected scenario. Four out of five of the most affordable policies by first year premium were non-true level, however all true level policies are more affordable than all non-true level policies by twenty year aggregate premium.

**Graph 17. First year level premiums – male, medium sum insured, Death with linked TPD and Trauma**



**Graph 18. 20 year aggregate level premiums – male, medium sum insured, Death with linked TPD and Trauma**

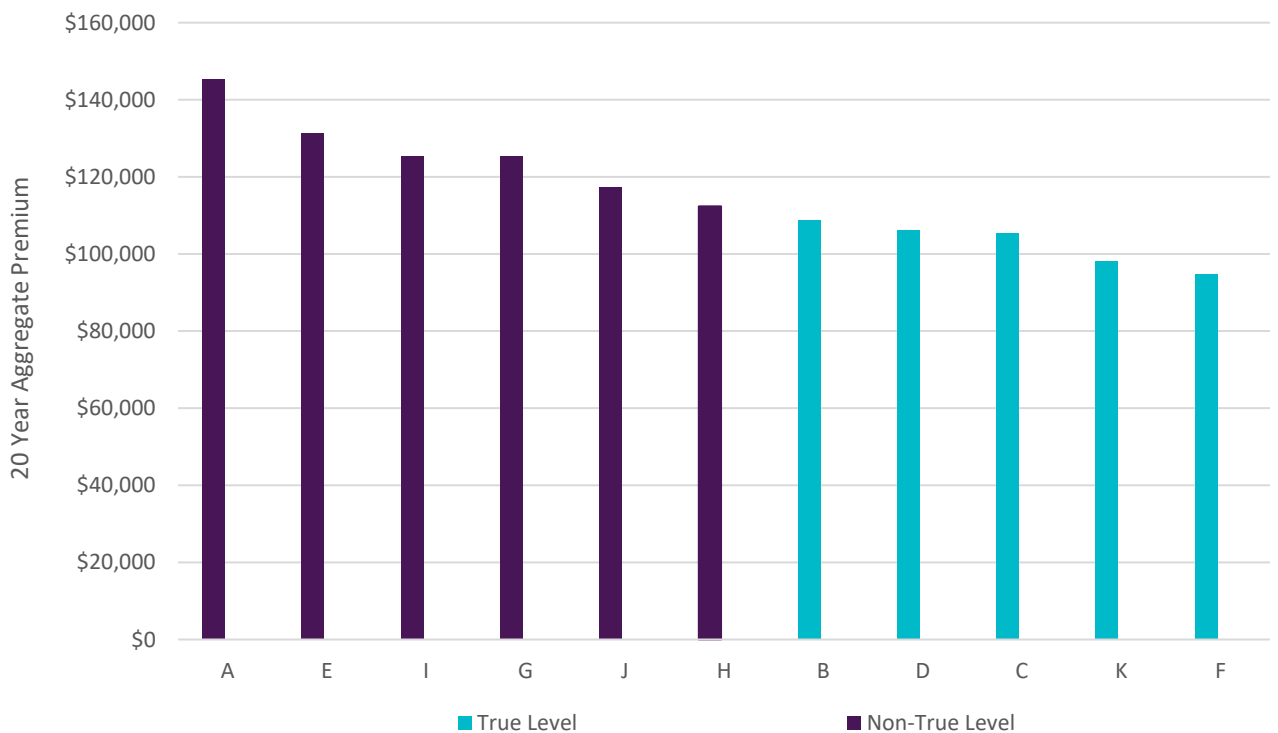


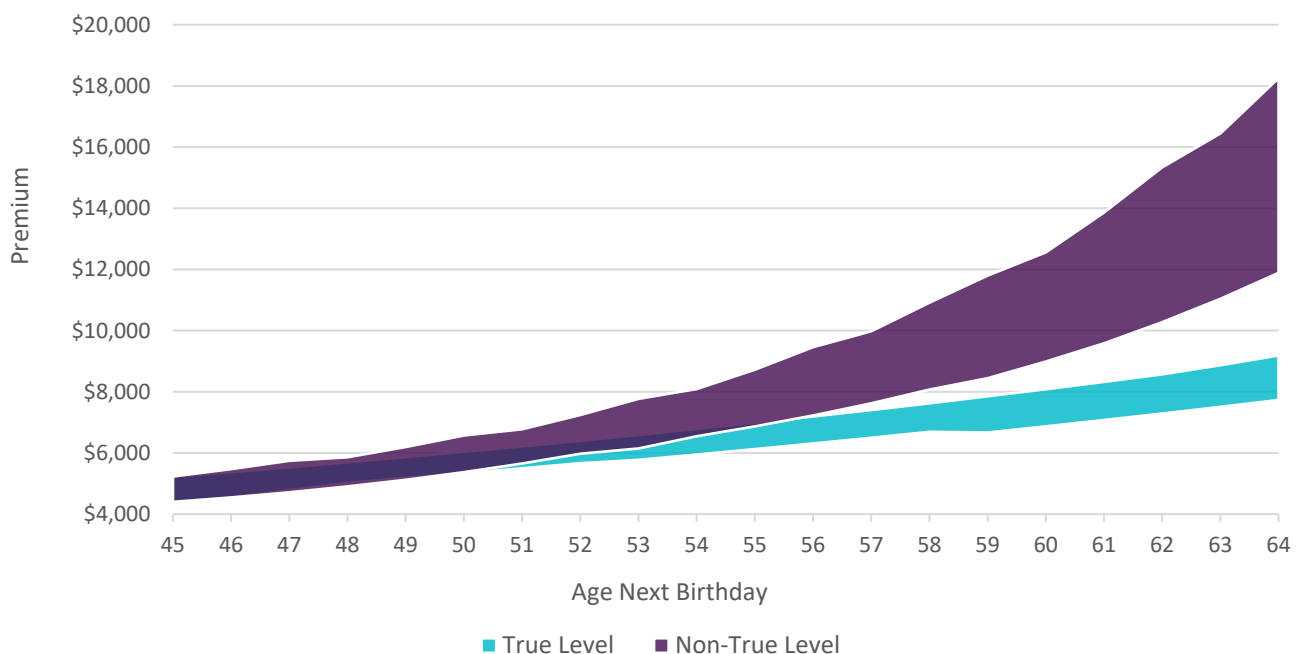
Table 8 shows the percentage increase in premiums each year relative to the first policy year. Non-true level policies show greater percent premium increases in the first five policy years than for Death only, although a similar trend is observed for the relative percent increase in the 20<sup>th</sup> policy year. Non-true level policies show a relative increase of greater than 150% in the 20<sup>th</sup> policy year, compared to less than 100% for true level policies.

**Table 8. Percent increase from first year premiums – male, medium sum insured, Death with linked TPD and Trauma**

Product	Front loaded discount	True level	Policy year					
			2	3	4	5	10	20
			(%)					
I	N	N	3	7	12	17	53	263
A	N	N	5	10	12	18	55	249
G	N	N	3	7	11	16	53	245
E	N	N	3	7	11	16	48	244
J	N	N	3	7	12	16	49	227
H	Y	N	8	16	20	23	46	164
K	Y	Y	5	11	16	22	44	90
D	N	Y	3	6	10	13	32	85
B	N	Y	3	6	9	12	30	74
C	N	Y	3	6	9	13	30	69
F	N	Y	3	6	9	13	29	68

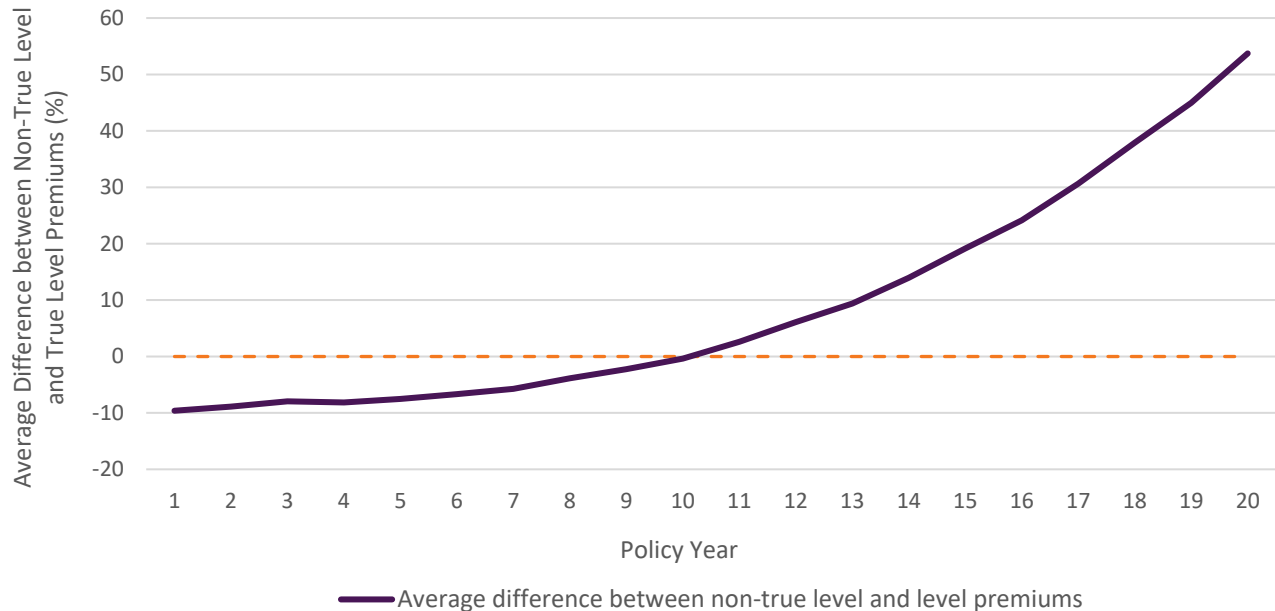
As with Death, the relative percentage increases are reflected in premiums over time. Graph 19 shows the range of premiums over time for true level and non-true level policies. By the twelfth policy year the most affordable non-true level premium is higher than the least affordable true level premium.

**Graph 19. Level premium range – male, medium sum insured, Death with linked TPD and Trauma**



This trend was consistent across level premium scenarios. Graph 20 shows average percent differences between non-true level premiums and true level premiums across level death with linked TPD and trauma scenarios. Non-true level premiums are approximately 54% higher on average by the twentieth policy year, despite being approximately 10% lower in the first policy year.

**Graph 20. Average difference between non-true level and true level premiums – Death with linked TPD and Trauma**



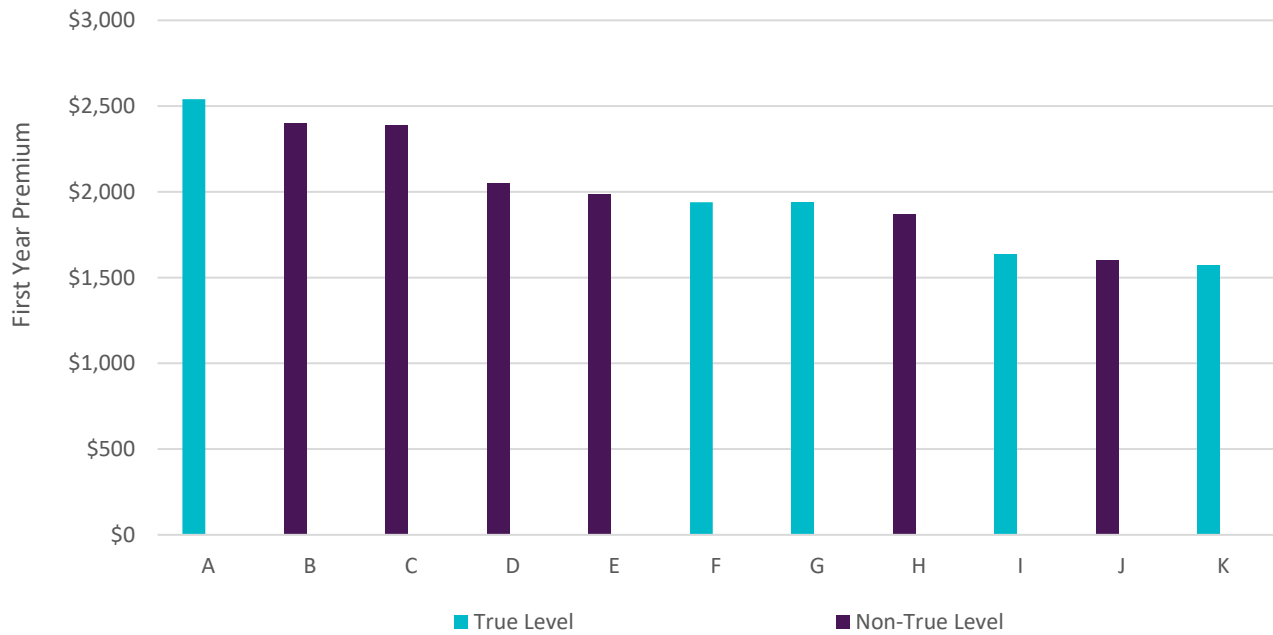
This difference past ten policy years was greater for scenarios with a policyholder taking out cover at 45 age next birthday than 30 age next birthday. For policyholders above 60 years of age, true level policies show a year on year increase of approximately 3%, while non true level policies show year on year increases of between 8% and 11%.

### 3.2.3 IP

IP showed comparatively lower increases for non-true level premiums over time. This is primarily due to IP level rates, which do not show as high year on year increases as the policyholder approaches 65 years old compared to lump sums, as the potential time on claim is reduced.

Graph 21 shows the first year premium for each policy, and Graph 22 shows the twenty year aggregated premium adjusted to present value. True level policies improved ranking by affordability by between one and two positions by aggregate premium from first year premium.

**Graph 21. First year level premiums – male, medium sum insured, IP**



**Graph 22. 20 year aggregate level premiums – male, medium sum insured, IP**

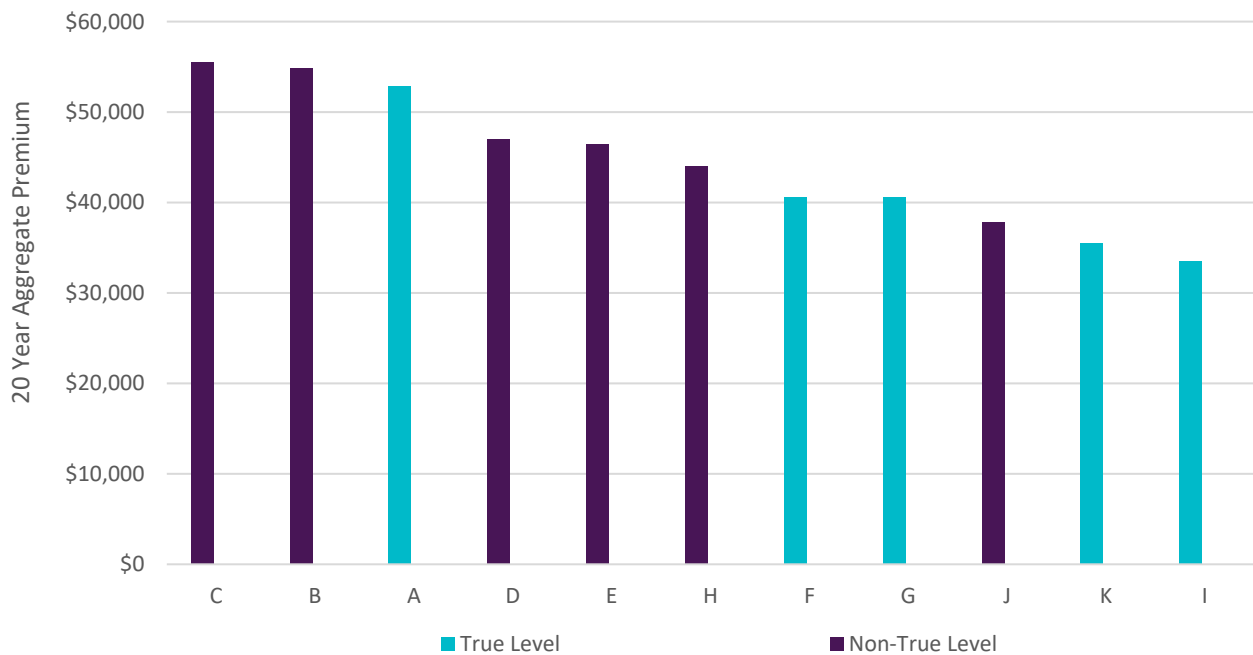
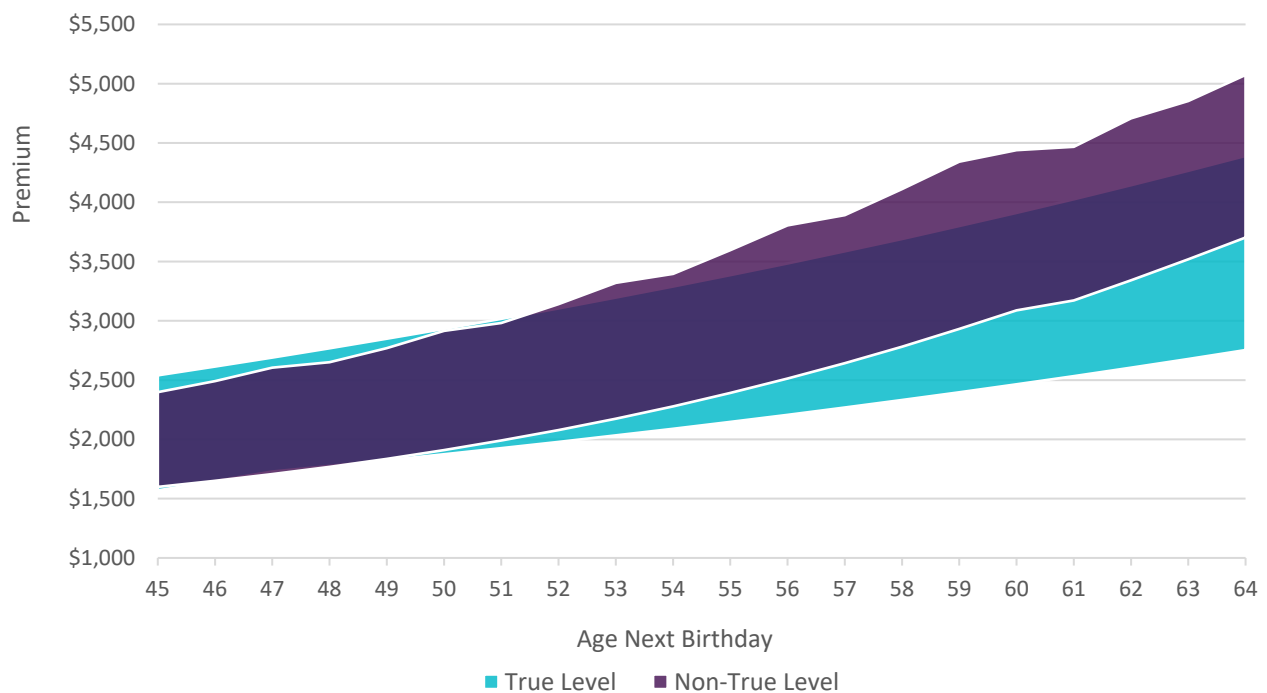


Table 9 shows the percentage increase in premiums each year relative to the first policy year. While the relative percent increases are higher for non-true level premiums, as with stepped premiums the difference is lower than in lump sum scenarios.

**Table 9. Percent increase from first year premiums – male, medium sum insured, IP**

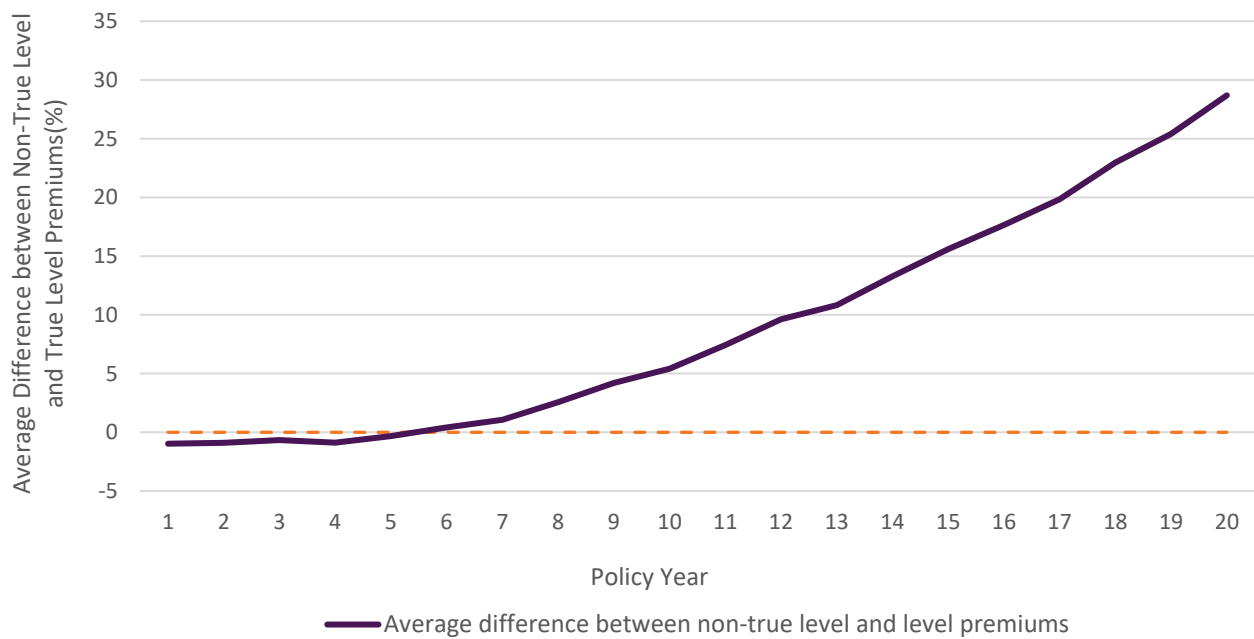
Product	Front loaded discount	True level	Policy year					
			2	3	4	5	10	20
			(%)					
J	N	N	3	7	11	15	42	132
H	N	N	3	7	11	15	42	128
E	N	N	3	7	10	15	42	125
D	N	N	3	7	11	15	42	115
C	N	N	4	9	10	16	42	112
B	N	N	3	7	11	15	42	110
K	Y	Y	5	10	16	21	43	90
F	N	Y	3	6	9	13	30	75
G	N	Y	3	6	9	13	30	75
A	N	Y	3	6	9	12	29	73
I	N	Y	3	6	8	11	28	68

Graph 23 shows the range of premiums over time for true level and non-true level policies. The scenario shows overlap in these ranges over the length of the policy.

**Graph 23. Level premium range – male, medium sum insured, IP**

Graph 24 shows average percent differences between non-true level premiums and true level premiums for each level IP scenario. The relative difference in average premiums is lower over time than for lump sum covers. Non-true level premiums are approximately 28% higher on average by the twentieth policy year and are approximately 1% lower in the first policy year.

**Graph 24. Average difference between non-true level and true level premiums – IP**

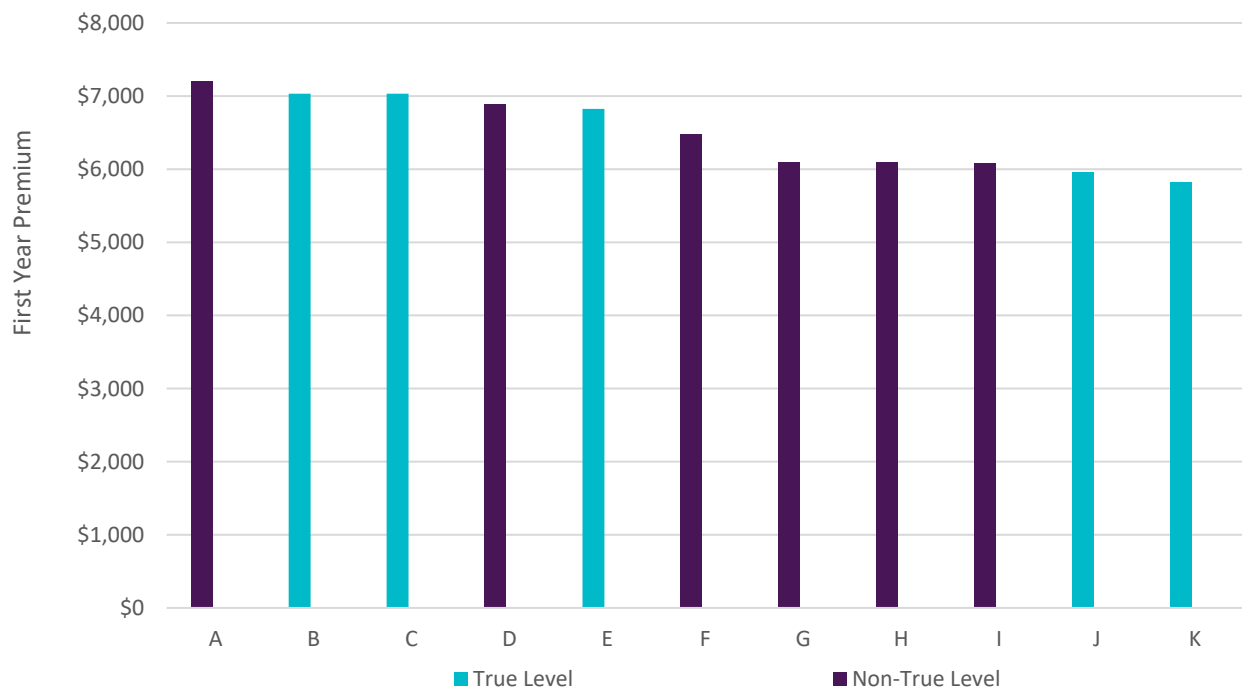


For policyholders above 60 years of age, true level policies show a year on year increase of approximately 3%, while non true level policies show year on year increases of between 3% and 5%.

### 3.2.4 Package policies

Package policies showed similar trends to lump sum cover scenarios. Graph 25 shows the first year premium for each policy, and Graph 26 shows the twenty year aggregated premium adjusted to present value for each policy. All true level policies are more affordable by twenty year aggregate than all non-true level policies, despite three out of five of the most affordable policies being non-true level for first year premiums.

**Graph 25. First year level premiums – male, medium sum insured, package policy**





**Graph 26. 20 year aggregate level premiums – male, medium sum insured, package policy**

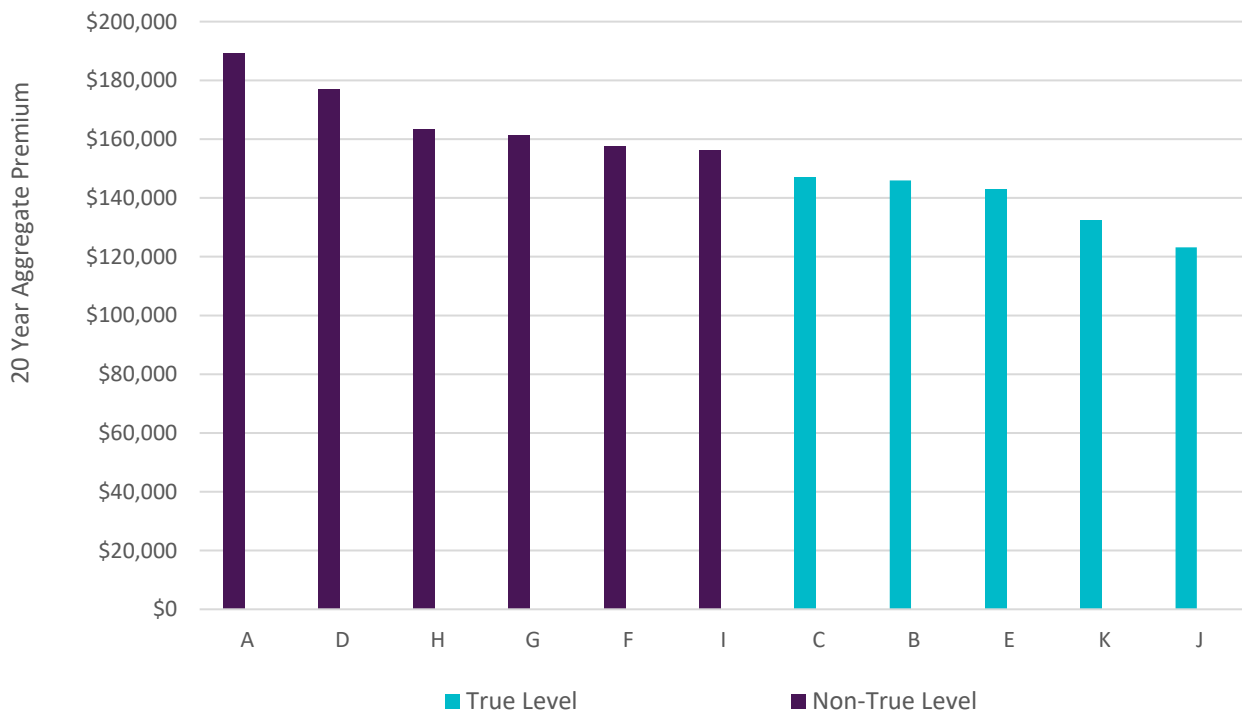


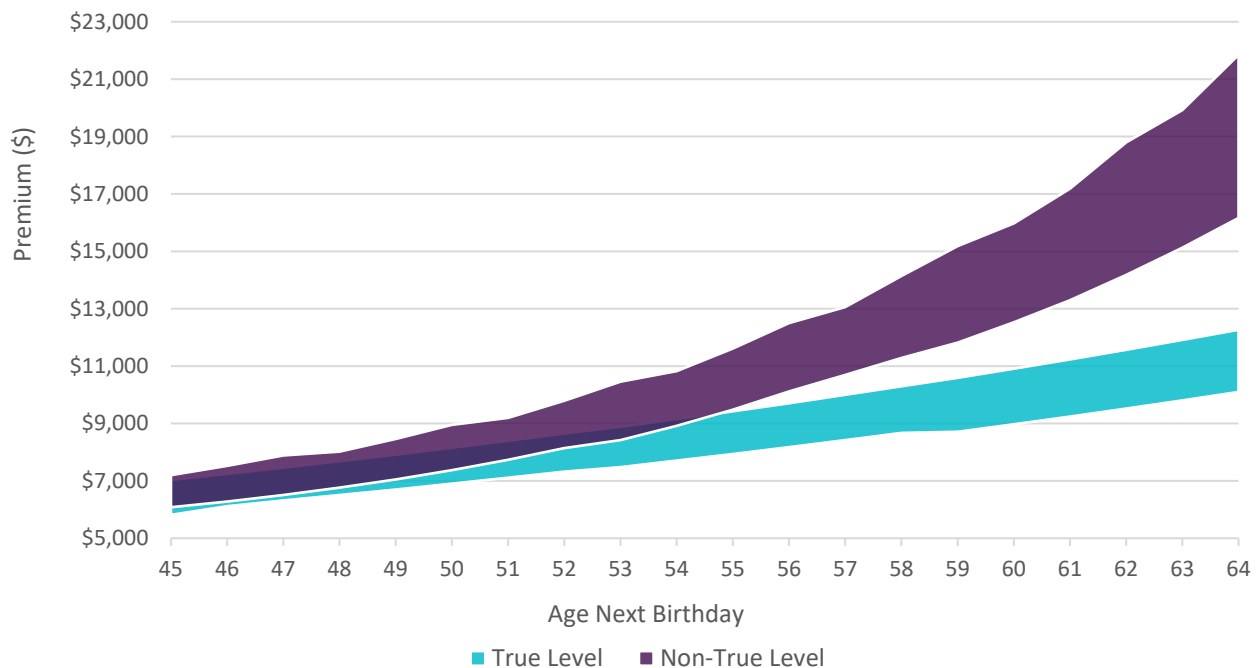
Table 10 shows the percentage increase in premiums each year relative to the first policy year. Package policies follow the trend in lump sum policies for relative percent increases. Non-true level policies show a relative increase of greater than 150% in the 20<sup>th</sup> policy year, compared to less than 100% for true level policies.

**Table 10. Percent increase from first year premiums – male, medium sum insured, package policy**

Product	Front loaded discount	True level	Policy year					
			2	3	4	5	10	20
			(%)					
H	N	N	3	7	11	16	51	228
G	N	N	3	7	11	16	51	217
A	N	N	4	10	11	18	50	204
D	N	N	3	7	11	16	46	199
I	N	N	3	7	11	16	47	196
F	Y	N	6	13	17	21	45	150
K	Y	Y	5	11	16	22	44	91
E	N	Y	3	6	9	13	30	75
C	N	Y	3	6	9	12	30	74
B	N	Y	3	6	9	13	30	70
J	N	Y	3	6	9	12	29	68

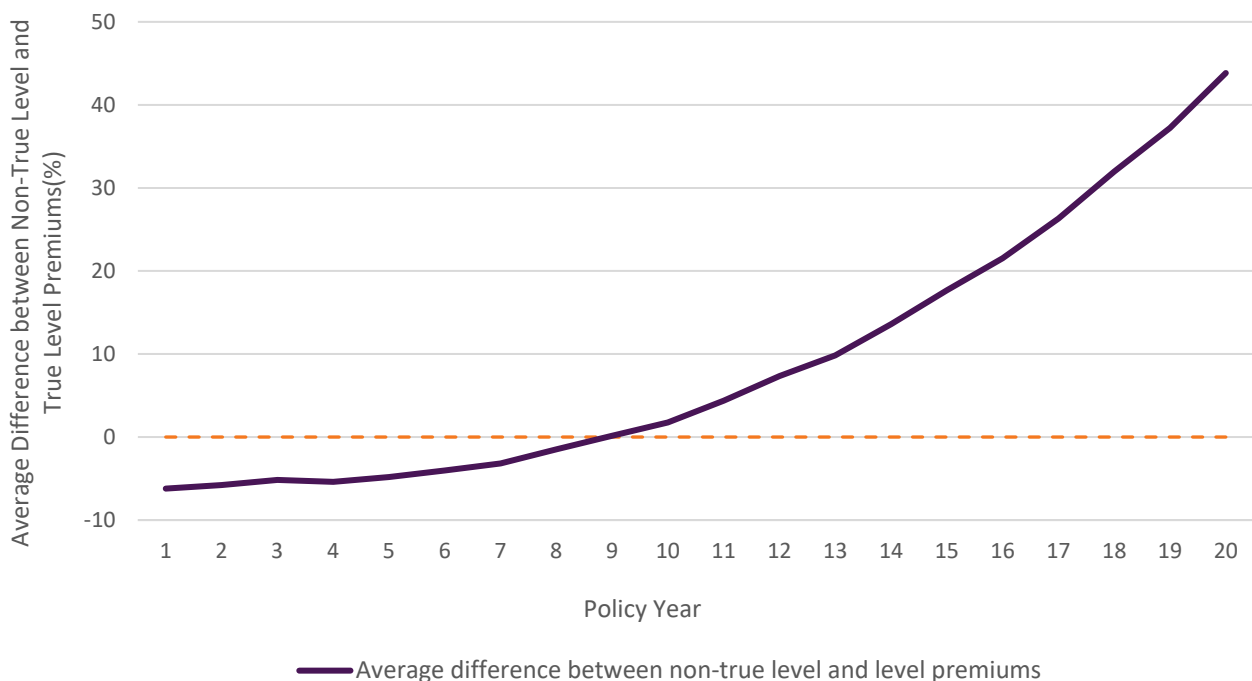
The cause for the difference in aggregate premium ranking is shown in Graph 27, which shows the range of premiums over time for true level and non-true level policies. While the range for calculation type overlaps almost entirely for the first five policy years, by the eleventh policy year the most affordable non-true level premium is higher than the least affordable true level premium.

**Graph 27. Level premium range – male, medium sum insured, package policy**



This trend for calculation method was consistent across level premium scenarios for package policies. Graph 28 shows average percent differences between non-true level premiums and true level premiums for each level package scenario. Non-true level premiums are approximately 44% higher on average by the twentieth policy year, despite being 6% lower on average in the first policy year.

**Graph 28. Average difference between non-true level and true level premiums – package policies**



This difference past ten policy years was greater for scenarios with a policyholder taking out cover at 45 age next birthday than a policyholder taking out cover 30 age next birthday. For policyholders above 60 years of age, true level policies show a year on year increase of approximately 3%, while non true level policies show year on year increases of between 7% and 10%.

## 4. Legacy pricing

We have also been asked to consider legacy portfolios. Pricing differences between in force policies and on sale policies are further affected by any underlying rate differences. Rice Warner conducted research in 2016, using aggregated insurer data covering 86% of the in-force premium across the Australian Retail Insurance market. We have noted some key highlights from this research below.

Table 11 shows the percentage split per benefit cover type between legacy and on-sale portfolios using Annual Premium (AP), showing the majority of premium paid at that time was from legacy policies. For Trauma, TPD and IP the AP was slightly weighted to legacy business whereas for Death two-thirds of the AP was legacy business.

**Table 11. Legacy and on-sale portfolio splits (weighted by AP)**

Cover	Legacy	On-sale
	(%)	
Death	63	37
Trauma	52	48
TPD	52	48
IP	51	49

For stepped premiums on an aggregate market basis the research showed that:

- Legacy Death rates were significantly higher priced than on-sale rates.
- Trauma showed a different position with legacy pricing being approximately 5% lower than on sale rates. We noted at the time that not all definition improvements had been fully passed back.
- TPD female legacy rates were approximately 5% above on sale rates, whereas male legacy rates are generally just below on sale rates.
- Legacy IP rates were more expensive than on sale rates by approximately 5% and having consistent on-going increases.

Any increase between legacy rates compared to on-sale rates exacerbates the difference between in-force policies and on sale policies caused by front loaded discounts. This may incentivise policyholders who can successfully undergo underwriting on stepped premiums to take out new policies.

## **PPS Mutual Mission**

- 1 To provide exceptional insurance benefits to Members (an exclusive group of professionals who own the business), their families and associates.
- 2 To create security, peace of mind and wealth for our professional Members during their working lives and in retirement.

## **Contact us**

Should you wish to discuss becoming an Accredited Adviser please call Brian Pillemer, Director Distribution on 0409 042 705 or you can contact the Adviser Services Contact Centre as detailed below.

**T** 1300 401 607

**E** [adviserservices@ppsmutual.com.au](mailto:adviserservices@ppsmutual.com.au)

**July 2020**

This document is issued by PPS Mutual Insurance Pty Ltd ABN 21 162 670 108 AFSL 478775 which is a wholly-owned subsidiary of PPS Mutual Limited ACN 162 634 684. The PPS Mutual Limited Professionals Choice life insurance product is issued by the Insurer, NobleOak Life Limited ABN 85 087 648 708 AFSL 247302. Please refer to the Product Disclosure Statement, available from a PPS Mutual Accredited Adviser, for more information on the Professionals Choice product before deciding to acquire the product.