Income Protection’s Time to Shine?

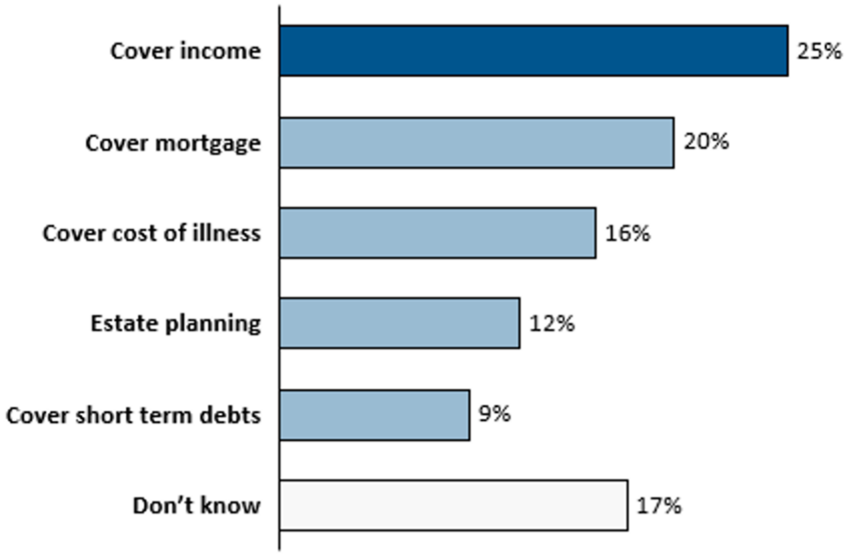
September 15, 2020

COVID-19 has highlighted the risk of involuntary unemployment and is driving consumer interest to retail Income Protection (IP); but does retail IP actually meet their needs?

Consumer Perception of Life Insurance

NMG’s latest research into UK consumer attitudes towards life insurance shows that consumers believe covering income is the main reason for holding life insurance, above paying off debts mortgage or to cover the flow on costs from any potential critical illness.

Chart 1: Main reason for holding life insurance – consumer stated



Source: NMG UK Consumer Life Risk Study 2020

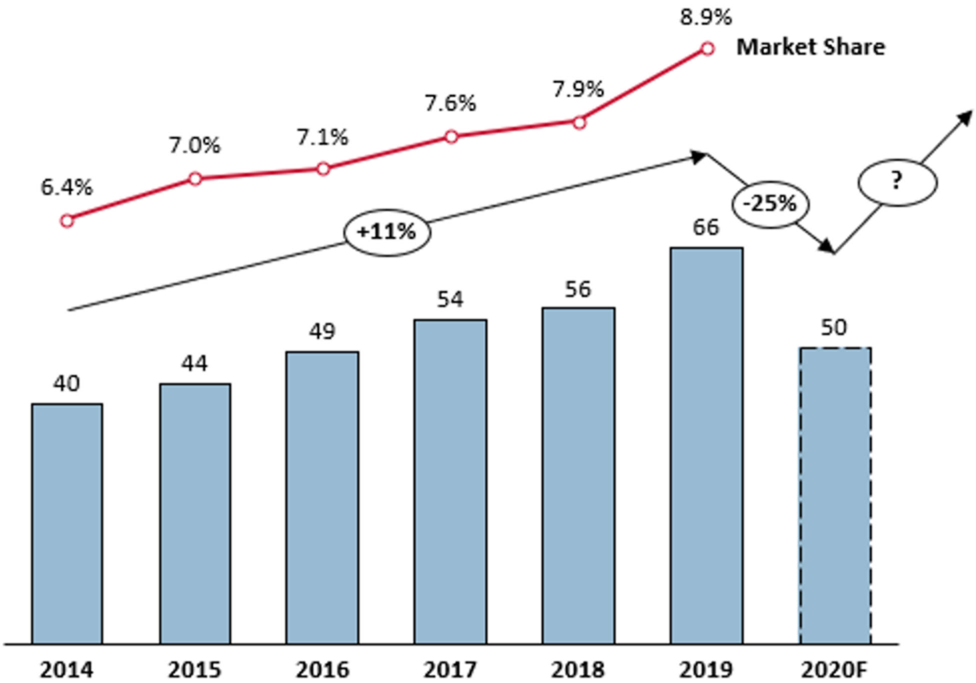
Intuitively, Income Protection is the best positioned life insurance product to deliver this coverage.

High Historical Growth but Penetration Remains Low

Advisers acknowledge the value of IP. Particularly for younger aged (<40 year old) consumers with dependents, mortgages and limited savings, who are more likely and most vulnerable to suffer a morbidity (mental illness in particular) rather than mortality event.

Combined with the aforementioned consumer perceptions on life insurance, IP has been one the fastest growing individual life protection products over the 5 years to 2019. IP has grown at 11% CAGR and increased its share of the individual life protection market from 6% to 9%. However, IP holds ~40% market share of individual new business volumes in Australia, suggesting significant further potential for IP in the UK market.

Chart 2: Individual Income Protection new business volumes & market share (2015–20F)



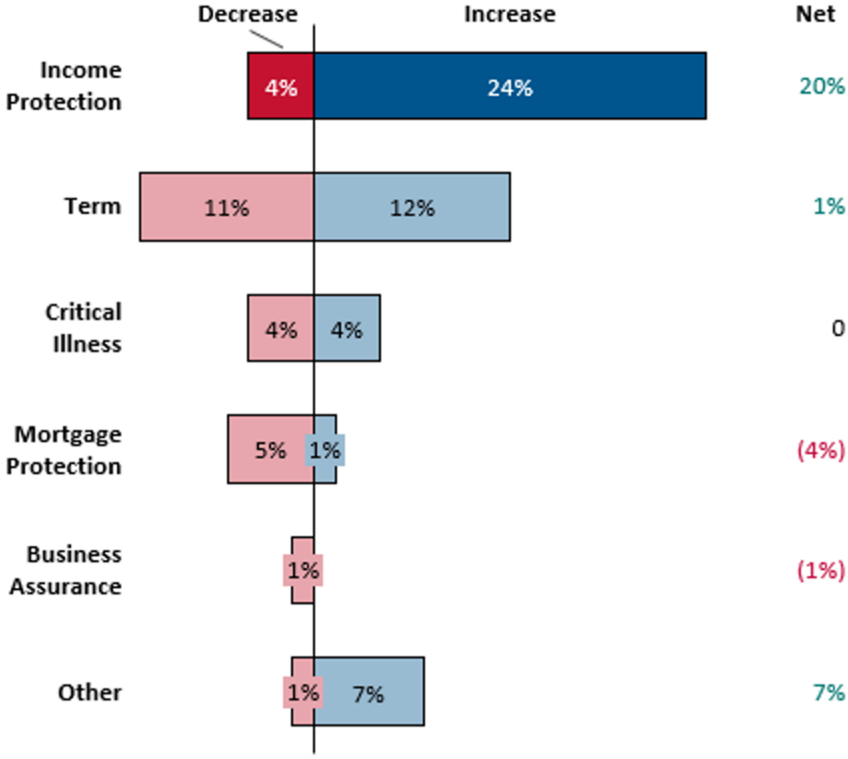
Source: NMG UK Stock & Flow Model (as at September 2020)

NMG forecasts IP sales to be down ~25% in 2020, though this is due to insurers/re-insurers restricting new business given underwriting challenges and to limit risk, rather than a lack of demand. NMG expect these restrictions to be lifted within the next 12 months (if not earlier), and volumes to return to pre-COVID levels soon afterwards. Will growth then revert to the historical trend of ~10% per annum, or has COVID-19 provided a catalyst for accelerated adoption?

COVID a Catalyst for Accelerated IP Adoption?

While COVID negatively impacted short-term supply, it has also drawn consumers attention to the risk of losing their jobs and income. Consequently, advisers saw a material spike in interest for income protection post-lockdown as shown below.

Chart 3: Reported interest in specific life insurance products by Advisers post lockdown (April 2020)



Source: NMG UK Adviser Market Volatility Pulse: COVID-19 Impact on UK Life Insurance (April 2020)

NMG expect this spike in awareness and appreciation to endure as the economic impact of COVID-19 becomes clearer and the furlough scheme is wound up. 300k redundancies were planned across June and July 2020, an almost sevenfold increase to the same period in 2019.

However, while COVID is a potential catalyst, there are a number of issues that insurers need to address before broader market adoption can arise.

A. Cover

- As mentioned above, a key driver of the increased demand is the risk of involuntary redundancy, however 'income protection' only covers loss of income due to health reasons (illness or accident), despite consumers instinctively believing it would cover both
- 'Unemployment insurance' does cover redundancies, but is a separate product and often overlaps with 'income protection' as it is typically sold as Accident, Sickness & Unemployment (ASU) insurance and is sometimes confusingly referred to as 'short-term income protection' (which can also refer to income protection with shorter benefit periods)

B. Benefit Limits

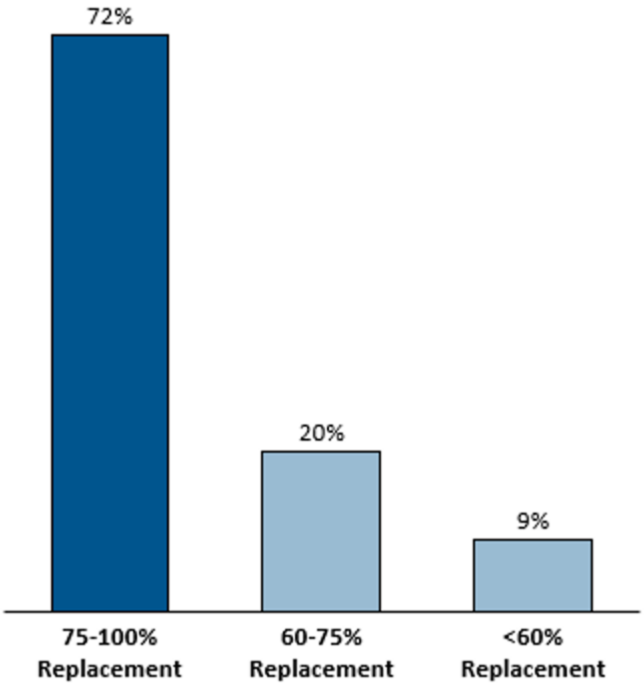
- Income protection policies in the UK typically only provide a maximum coverage of 65% of income
- However NMG research on community expectations shows that on average, consumers expect an income replacement ratio of 85%. This is of particular pertinence for more vulnerable young

and less affluent consumers

C. Complexity

- Despite adviser acknowledgement of the value of IP, placement has been challenged due to its relative complexity in comparison to dominant and longer-standing term and CI products
- Advisers must not only understand and advise on benefit level and illness coverage, but also deferral period and length of benefit payments
- This is further compounded by IP’s interaction with CI, where there is a large amount of overlap between the two and it can be argued that the main difference is the form in which the benefit is paid (recurring payments vs lump sum) and link to actual income lost (directly vs loosely)

Chart 4: Community Expectation of Income Replacement Ratio from Income Protection



Source: NMG Community Expectations Study 2019

Addressing These Issues Will Not be Simple

There are a number of challenges with bridging these gaps, including but not limited to:

- Unemployment cover typically sitting within separate GI business line (given it falls under General Insurance regulations) and the associated operational implications (separate P&L, reporting, systems, platforms, etc.)
- Increased risk from higher available benefit coverage, you need only look to individual IP

profitability issues in Australia (AU$3.4bn in losses over past 5 years) to see the potential risk from offering over-generous features and benefits

NMG is working with clients to navigate these issues and more, to help increase the number of consumers protected from loss of income.

By Ralph O'Brien