The Forgotten Hero? The Role of Employer Group Risk Schemes in Closing Protection Gaps

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Summary

• The scale of the group risk market is too big to ignore. In terms of total protection insurance held in the UK, group life schemes provide around 40% of all insured death benefits.

• For many individuals, and for low- to middle-earners in particular, group risk cover is often the only long-term insurance coverage they have.

• Nearly 8m people in the UK were covered under death benefit schemes at the end of 2010, and nearly 2m had long-term disability income schemes. Price competition is fierce as employers control costs, but there is little evidence of firms closing down schemes.

• However there are considerable misperceptions. Many employees are vaguely aware that they provide cover, and only about a third of people actually have the cover that they think they possess.

• Despite the efforts of trade associations, there is still much to be done to raise awareness of the existence of group risk benefits among employees and to promote the value better with employers.

• The group market, and indeed the whole insurance sector, could be well-positioned when the final picture emerges with the employer becoming a natural conduit for the provision of benefits and services.

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CII Introduction: one of the most important players influencing an individual’s personal finances is not the financial services industry or the government but the employers. While much of the policy debate in recent years regarding the employer’s role in addressing coverage gaps has been around pensions, the group risk market which provides millions of people critical illness, long-term disability income and death-in-service cover, and is often the sole source of protection cover for low and middle earners, is often completely overlooked. In this Thinkpiece, Ron Wheatcroft, Technical Manager for Swiss Re’s Life & Health business in the UK, and Keith Williams, Group Risk Specialist, look in detail at the UK group risk market, emerging trends and the threats and opportunities it faces. They draw data from Swiss Re’s Group Watch 2011 report, a comprehensive survey of new and in-force group risk business in the UK at the end of 2010.

For many individuals, and for low- to middle-earners in particular, group risk cover is often the only long-term insurance coverage they have. In terms of total protection insurance held in the UK, group life schemes have for many years provided around 40% of all insured death benefits. In the case of long-term disability income, group schemes now account for almost 75% of insured benefits.

Box 1: An introduction to group risk

Death-in-service benefits
Benefits can take two forms; a lump-sum, typically tax-free, and payable to nominated beneficiaries or a taxable pension payable to the employee’s spouse, civil partner and/or other financial dependants, or both. Policies can be put in place by pension scheme trustees to cover the scheme’s liabilities or by an employer to cover a contractual promise outside a pension scheme to pay a benefit on an employee’s death-in-service.

Long-term disability income
This provides a continuing income for employees if illness or injury prevents them from working for a prolonged period of time or can also replace lost income where an employee has to take a part-time or lower paid position because of illness or injury. The policy is used by an employer to cover a contractual promise of long-term sick pay to employees.

Benefits are paid after a pre-arranged waiting period – usually around six months – and can be payable until retirement or for a fixed payment period. Most policies integrate to some extent with State incapacity provision. Benefits are normally paid to the employee via the employer’s payroll system on a monthly basis. The employee pays income tax and National Insurance contributions in the normal way.

Insurers use vocational rehabilitation services and case management services to support both employers and employees.

Critical illness cover
This pays a tax free lump-sum to an employee on the diagnosis of one of a defined list of serious conditions or on undergoing one of a defined list of surgical procedures. There is usually a choice of core cover or core plus additional cover.

Unlike most personal policies, the benefit is paid once the employee has survived for a specified period, typically 14, 28 or 30 days.

Pre-existing conditions at the time of enrolment into a scheme are normally excluded.

Research conducted for Swiss Re’s Insurance Reports shows that many employees are vaguely aware that something is provided but with little idea of the detail. In the case of disability income, this has resulted in around 10m people believing that they are protected should they be long-term sick. The truth is that only around one-third of this number is covered.

At the end of 2010, nearly 8m people in the UK were covered under group death benefit schemes, nearly 2m were covered under long-term disability income schemes, and over 300,000 had critical illness cover through group schemes.

The size of the market — too big to ignore
The scale of the group risk market is too big to ignore. At the end of 2010, nearly 8 million people in the UK were covered under death benefit schemes. Nearly 2 million people were covered under long-term

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1 All data used in this report is from Group Watch 2011 published by Swiss Re in April 2011 unless sourced otherwise. The report covers group death benefits, long-term disability income and critical illness sales and summarises the views of 44 industry figures representing all the major product providers and intermediaries.
disability income schemes and over 300,000 had critical illness cover through group schemes. Group risk scheme rates are normally guaranteed for two years, and the majority of the business is intermediated through employee benefit consultancies and specialist intermediaries.

Price competition is fierce as competitive pressures on employers to control costs have fed into greater competition among intermediaries and product providers. Schemes often move between insurers and intermediaries.

While in-force premiums fell by nearly 2% in 2010, in-force sums assured across all product lines increased. Death benefit sums assured grew by 7%, long-term disability income benefits by 1.4%, and critical illness sums assured by 7.6%.

Despite pressures on their costs, there is little evidence that employers are closing down schemes. This suggests that employers who provide cover for their workforce value it as a recruitment and retention tool, although more needs to be done to communicate that value better to scheme members and to employers who do not provide cover currently.

Figure 1: Premiums for Death and Death-in-Service Benefits 2006–2010

Source: Swiss Re, Group Watch 2011

Group death benefits in more detail

Figure 1 show premiums for death benefits for 2006 to 2010, split between lump-sum payments and death-in-service annuities. Over the period from 2006 to 2010, lump-sum death benefit premiums increased by 8% while premiums for widow’s and dependants’ death-in-service pensions fell by nearly 15%. In 2009, premiums payable for lump-sum benefits fell but the market recovered subsequently in 2010.

Both death benefits and dependents’ death-in-service pensions are written under trust which allows for prompt repayment of claims outside the estate of the deceased.

Over the same five year period, lump-sum death benefits in force increased by 33% while widow’s and dependants’ death-in-service pensions increased by slightly by just 1%. While some may consider that an income payment better fits the needs of dependants, widow’s and dependants’ death-in-service pensions are a taxable benefit. For most scheme members, lump-sum death benefits are paid free of tax to the beneficiaries.

In both cases, arrangements are written under trust which allows for prompt payment of claims outside the estate of the deceased.

Group long-term disability income and critical illness cover in more detail

Group long-term disability premiums fell by about 9% in the period 2006—2010. Although comprehensive data were not available, around 10% of all schemes now provide limited payment term benefits. This is growing, being 7% in 2009, as some employers adapt their benefit promise to the needs of their business. Direct year-on-year premium comparison should be treated with caution since the benefits are a mixture of arrangements which potentially pay up to the expected retirement date of the member and others where benefits are limited, for example to a five year period. Meanwhile, in-force critical illness premiums grew by over 45% in the period from 2006 to 2010, including about 5% in 2009—2010 alone.

Group death benefits in more detail

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Flexible benefits

A feature of the group risk market is the ability for scheme members to “flex” their cover, either by purchasing additional cover or by reducing cover. It is common in death benefit and long-term disability schemes to have a core level of cover which helps to reduce any anti-selection when pricing schemes.

In 2010, flexible benefit premiums for death benefits grew by nearly 8%. Long-term disability income premiums fell by 3%. Flexible benefit arrangements are common where critical illness cover is offered with 53% of all premiums being on a flex basis. In 2010, flexible benefit critical illness premiums increased by 12%.

Market in context: addressing the profile gap

Until very recently, the group risk market had a low profile, attracting very few column inches in the media. One consequence has been that employer awareness of the benefits has often been low or non-existent, making it difficult to attract genuinely new schemes.

Raising the profile

The need to raise the profile of group risk has been recognised with the group risk trade body Group Risk Development (GRID) undertaking a programme of activity designed to achieve this. GRID’s activities, which have to date been focused on greater engagement with government and the media, were recognised in 2010 by winning the prestigious Organisation of the Year Award at the Protection Review.

There is still much to be done to raise awareness of the existence of group risk among employees and to promote the better value with employers.

While progress has been made, there is still much to be done to raise awareness of the existence of group risk benefits among employees and to promote the value better with employers. This may need to be part of a wider industry campaign around protection messages and through working closely with others such as employer bodies and the Money Advice Service.

In the market, GRID has developed a group risk examination to facilitate the upgrade of skills and knowledge. Group risk business can be an excellent way for intermediaries to enter the corporate market but the examination unit caters for an extensive range of people, including insurance company employees, HR staff, IFAs and employee benefit consultants.

A landmark exception

Group risk products are more impacted by employment legislation than many other sectors of the long-term savings and protection markets. A major legislative change that will affect the group risk market is the Government’s decision to abolish the Default Retirement Age from April 2011. While the legislation should be good news for employees, the industry argued successfully for an exception for insured group risk benefits which would allow them to stop at state pension age without being discriminatory.

Overall, this is good news for employees too. Without this important exception, employers would have been faced with providing the same benefits to everyone irrespective of age unless able to justify objectively not doing so. Group risk provision is entirely voluntary and, faced with rising bills to provide cover, the lack of an exception could have seen large numbers of employers reducing cover or withdrawing it completely. This would have had the greatest impact on long-term disability income schemes where
the absence of a benefit termination age would likely have made cover beyond an employer’s budget.

**Pensions changes**

Although the Default Retirement Age abolition has been the main concern for the group risk market, changes to the Lifetime Allowance for pensions saving which drops from £1.8m to £1.5m in April 2012 could impact group death benefits.

Lump-sum death benefits written in registered pension schemes count towards the Lifetime Allowance and we expect that some employers will stop covering death benefits through registered pension schemes and, instead, insure the cover in excepted group life policies, where benefits do not count towards the Lifetime Allowance.

Excepted group life schemes were introduced in the Finance Act 2003 and, subject to some criteria, allow for more than one death benefit payment out of the same policy without breaking the qualifying rules for life assurance so beloved by CII students.

**The future challenges**

As employers continue to offer limited payment term long-term disability, we can expect to see more flex options for members to buy an extension benefit in the longer term.

**Flexible benefits**

The past few years have seen more employers offering flexible benefit packages where the emphasis is on "total reward" and where employees can select the benefits most suited to their circumstances. There has been some market growth, and critical illness cover in particular has been popular but the challenge will be to ensure the insurance proposition in the flex package remains attractive against other more immediate and tangible benefits such as discount vouchers and gym membership.

As employers continue to offer limited payment term long-term disability income, we can expect to see more flex options for members to buy an extension to the benefit term. There are no equivalent retail products where benefits begin once somebody has been off work for, say, two years.

**Gender-based premiums**

Group risk policies are unlikely to be affected directly by the European Court decision earlier this year to ban on gender-specific pricing for contracts from December 2012, on the grounds that the banned pricing was "private, voluntary and separate from the employment relationship". Nevertheless some employers may wish to offer gender-neutral pricing for "flex" and voluntary arrangements.

As the economic recovery continues and the demand for quality staff resumes, employer group risk benefits will become increasingly important.

**Greater engagement**

As group risk benefits are so closely linked to employment issues, it is unlikely that many new schemes will come to the market until the economic climate improves. As the recovery continues and demand for quality staff grows, group risk benefits will become increasingly important.

Since much of the cover provided is related to salaries, there will be less growth during a period of low increases. The high level of scheme retention is good news but, ultimately, the market needs to grow by genuine new schemes.

The whole issue of greater engagement is a massive challenge and not unique to the group risk market. In the context of the retail market, despite falling protection premium rates over many years, too many consumers have been insufficiently engaged to purchase the cover they need.

**Auto-enrolment**

Does auto-enrolment into pensions bring the next big challenge to the group risk market? While it will be phased in over a number of years, there can be no doubt that its implications are now beginning to occupy the minds of employers and their advisers.
Rightly or wrongly, many low to middle earners are solely reliant on group risk benefits for their protection cover. Reaching the point where consumers have become more aware of their needs and act to protect themselves is a long way off.

Time will tell whether this is a threat or an opportunity for the group risk market? Potentially, the group risk market could benefit from auto-enrolment as some employers automatically provide risk benefits to all pension scheme members, but many employers will find the costs of running their business increase. It may be that employers will seek to meet these costs by cutting other parts of the remuneration package, including group risk benefits. This would be unfortunate as it could leave lower-earners without cover.

Pure protection business is not within the scope of the adviser-charging model under the Financial Services Authority’s Retail Distribution Review and commission-based protection sales can continue. However, access to protection advice is likely to reduce due to the falling number of advisers generally. Low-earners without cover may find it difficult to obtain advice on their needs.

In the absence of advice, will they seek out the protection cover they need? Rightly or wrongly, many low- to middle-earners are solely reliant on group risk benefits for their protection cover. Reaching the point where consumers have become more aware of their needs and act to protect themselves is a long way off. There is no short-term fix to creating a financially-savvy UK population.

It is easy to see auto-enrolment in negative terms yet it will bring many new consumers into contact with financial services products. This could encourage them to begin to think of their wider needs.

**Insure yourself?**

Some larger employers have chosen to self-insure insurance risks either through their business or pension scheme. The competitive rates on offer could make it attractive to consider insurance alternatives. This would also allow employers to take advantage of the exception for insured group risk benefits in the default retirement age legislation.

**Welfare changes**

With the government’s intention to reduce the cost of state provision, the need for people to protect themselves against the financial impact of misfortune has never been clearer.

Employers will be key to this change, whether through provision or facilitation of benefits. The group market, and indeed the whole insurance sector, should be well-positioned when the final picture emerges with the employer becoming a natural conduit for the provision of benefits and services. In the absence of compulsion, this would need incentives and the solutions may not be the traditional group risk models but, potentially, for the group risk market, welfare reform could provide the greatest opportunity of all.

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