

Income protection: protecting families, taxpayers and the economy

- The chance of having a long term health problem during our working lives is increasing so people need help to stay in work and build their financial resilience.
- Increasing the number of people with income protection would save taxpayers millions by reducing long term sickness absence and boosting tax revenue.
- A tax incentive for employers and building the financial capability of UK employees could increase the number of people with income protection
- Various stakeholders including consumer groups and the ABI would be supportive of such efforts, and cross-industry initiatives are already under way.

Too close to the headline

Workers in the UK overestimate how much support they would receive from their employer and the state if they became too unwell to work.

They also underestimate how likely they are to suffer an illness or injury that stops them working. A study by Demos found only 16% of Britons accurately estimate the chance of becoming disabled.

That means if something does go wrong, few families have enough protection in place.

Not enough support to stay in work

With the right support early on, many people with serious health problems can return to work when they are ready. In a recent speech, the Secretary of State for Work and Pensions Iain Duncan Smith called on companies to pay more attention to staff who are unwell.

He called on businesses to recognise “the importance of staying in touch with their staff when they get sick and of providing early support to someone to stay in work or get back to work.” Not only is this sound business sense, it reduces the number of people falling out of work and being written off as unable to work.

However, many employers do not have the expertise or resources to properly manage sickness absence so thousands of staff miss out on the support they need to stay in work. Income protection provides exactly this type of support.

The Chartered Insurance Institute

The need for protection in numbers

- Each year, **1 million workers** suddenly find themselves unable to work due to serious illness or injury.
- Around **250,000 people** leave employment due to ill health.
- **10.8 million households** (more than 60% of working families) would see their income fall by more than a third if the main earner had to stop work due to ill health.
- Of these, **6.6 million households** (40% of working families) would see their income fall by more than half.
- People out of work for 6 months only have a **1 in 5 chance** of working again in the next 5 years.
- **2 million people** currently covered by Group Income Protection save taxpayers about **£165m annually** in foregone Universal Credit and other income support.
- If this take-up increased to **8 million**, this could save the Exchequer over **£725m annually**.

Plugging the gap: income protection insurance

Income protection plugs these gaps by helping employers manage sickness absence better, providing rehabilitation for people with health problems so they can get back to work and protecting the finances of those who cannot work.

Income protection uses vocational rehabilitation to help employees on long term sickness absence to get back to work when they are ready. It is effective across the health conditions which are the biggest causes of disability and sickness absence, such as mental health and musculoskeletal problems. The NHS England Cancer Strategy recently recommended providing more vocational rehabilitation to improve the health and employment outcomes for people fighting cancer.

While people are unable to work, income protection pays a large percentage of their salary and provides a crucial safety net that lets them focus on getting better and looking after their family.

Such protection could come either from individual income protection, or group policies taken by employers. Individual income protection policies vary in terms of level of income provided: typically between 50–75% of earnings before illness, regardless of savings, home ownership tenure, or other household income. A key benefit of group policies is that all employees can be covered without medical underwriting so nobody is excluded because of their medical history or lifestyle.

Benefits to society

When someone who cannot work because of ill health has income protection, taxpayers benefit because the person:

- continues to pay income tax and national insurance contributions
- is less likely to claim state welfare

A study commissioned by Zurich published in March 2014 found that the 2 million people who are currently covered by Group Income Protection already save taxpayers about £165m annually in foregone Universal Credit and other income support and by continuing to pay taxes on their earnings. If take-up were to increase to about 8 million, this could save the Exchequer over £725m. The true saving to taxpayers is higher as income protection prevents many people from falling out of work in the first place.

There is consensus across the medical profession that good work is good for people's health. By providing vocational rehabilitation and helping people stay in jobs that are good for their health, income protection provides further societal benefits. Rehabilitation can also prevent more serious health problems developing. For example, if someone struggling with depression falls out of work, their health may well get worse. If they have income protection though, that takes away some financial stress and helps them stay in work, which can in turn prevent their depression from worsening. Helping people back to work also improves productivity in the UK economy.

The Office of National Statistics calculates that 131 million working days were lost to sickness absence in 2013. 31 million days were lost to musculoskeletal problems and 15 million to stress, anxiety and depression, which are areas where income protection providers have a great deal of experience. The CEBR will shortly publish research indicating a significant reduction in long-term absence when using a provider's rehabilitation service.

The one protection product that every working adult in the UK should consider is the very one most of us don't have – income protection.

Which? website "What is income protection" (accessed Sep 2015)

The public continues to assume that the state in the 21st century global economy can continue to deliver a welfare system designed in the 1940s.

Mark Hoban (former Treasury Minister) speaking at a seminar on welfare reform
Sep 2014

The barriers

Despite these benefits, take-up of income protection is still much lower than it could be meaning people are under-protected and the benefits to households and taxpayers are not realised. Several barriers have been identified which could prevent people from accessing income protection:

- **Perceptions of risk:** estimating the likely occurrence of risks does not come naturally to most people, and consequently most underestimate the need for long-term sickness cover.
- **Overestimation of state and employer protection:** surveys show people overestimate how much income they would receive from the state and their employer if they were unable to work because of ill health. 40% of working families would see their income fall by more than a half if the main earner had to stop work due to ill health.
- **Lack of awareness among employers:** employers also have limited understanding of the costs and benefits of income protection, often preferring to offer life insurance or private medical care when income protection could be a more valuable benefit for the business and its employees. Employers may also be less likely to protect the incomes of women than men – Unum recently published evidence that men are 1.5 times more likely than women to have income protection despite women being more likely to be absent through ill health or injury.
- **Lack of trust in private insurance:** a general distrust in the financial sector combined with successive mis-selling scandals especially Payment Protection Insurance has made the public sceptical of private insurance and its willingness to honour claims.
- **Under-realised societal benefits:** income protection carries societal benefits of owning this good that are greater than those felt by the individual. However these societal benefits are spread across employers and other households, and the efficiency gains felt by each are themselves perceived as insufficient to provoke action.
- **Complexity:** income protection is a complex product by virtue of its very effectiveness. It has complicated eligibility requirements that exist between interlocking state benefits. This makes the product less attractive to the customer to purchase, and labour-intensive for an intermediary to sell.

Enabling more people to access income protection

The insurance sector is working with government, thinktanks, and the third sector in re-thinking how to improve people's financial resilience at a time when more and more workers have long term health problems. Proposals under consideration or actual design include:

- a temporary tax incentive for small and medium sized businesses that provide income protection for all their staff;
- creating a better link between the basic safety net to keep households away from poverty, and private insurance that protects income household income;
- incorporating the principles of the two-tiered pension system which has basic state and optional private components, a concept the public are beginning to understand; building on the success of auto-enrolment for pensions;
- better demonstrating the benefits to employers for having group arrangements in place; and

Some previous and current initiatives

Efforts to increase protection insurance take-up are not new:

- In the late 1990s, successive reductions in the home ownership safety net led to calls for coordinated initiatives to break the link between cyclical unemployment and repossession rates. Protection was seen as one solution.
- Several income protection providers and intermediaries formed in 2005 the Income Protection Task Force (IPTF) to raise awareness of the income protection issue.
- The IPTF's latest *Seven Families Initiative* was launched in May 2014 to publicly demonstrate the product's effectiveness. To date, 17 providers have together contributed £340,000 to provide a payout for one year to seven appropriately assessed households. Finally
- The ABI has identified welfare reform as a major issue where more needs to be done in its 2015-2020 strategy, and just published a major report with the Centre for Economic & Social Inclusion (CESI) on this subject.

- creating simpler products: there is more insurers could do to make the products simpler, and significant strides have been made by some providers. For example, Unum has created a simple group IP policy for auto-enrolled pension members (see <http://tinyurl.com/nsde29g>). They are also rewriting all their terms to simplify their products and by easing broker access to resources such as the Pure Benefits online portal to help SMEs (<https://vimeo.com/94967871>).

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Our Social Value of Insurance Series

Insurance has a long and distinguished history. The UK has played its part in the insurance story, from as far back as the reaction to the Great Fire of London in 1666 and the development of insurance trading in Edward Lloyd's coffee shop in 1688.

It is an essential part of everyday life, playing a crucial role in both economic development as well as having a role in supporting wider societal ends.

Though insurance products are provided in a commercial context, both for individuals and for corporate customers, they clearly serve a wider purpose. Insurance helps oil the engine of the economy, for example in underwriting trade through trade credit. It also provides peace of mind to the public through collective insurance for a host of perils including flood, fire, and health. In short, the economy and society as a whole benefits from the certainty insurance brings through (to quote our first paper in this series):

- Efficiently protecting the public through innovative risk management techniques.
- Freeing up businesses and professionals from everyday risks and encouraging innovation and competition.
- Relieving the burden from the state and providing comfort to individuals by providing safe, effective and affordable pension savings, protection and de-cumulation products that convert pension savings into retirement income.

These are just some of the areas where insurance contributes to society. As the professional body for the insurance sector dedicated to protecting the public, the Chartered Insurance Institute is looking at various aspects of the social role that insurance plays. We thought this might be helpfully brought to life with a series of short papers considering this concept in greater detail, setting out the purpose, which is often intangible, of insurance and the benefits it brings and risks it mitigates. Insurance is vital. Just imagine a world without it.

Briefing papers in the social value of insurance series. All can be downloaded from www.cii.co.uk/32307

- **Imagine a world without insurance, if you can.** Explains the value of insurance by describing a world without it.
- **The mechanics of insurance: the magic of averages in aid of the millions.** Explains how insurance works and the concept of risk pooling.
- **Motor insurance: taking the fear out of driving.** Explains how motor insurance not only provides peace of mind but also works to improve road safety.
- **Safe as houses: flood insurance and a history lesson for the future.** The work of the insurance industry to prevent floods, drawing on the example of fire insurance.
- **Climate change and insurance: not just coping but helping.** The role of the insurance industry in mitigating and preventing climate change.