Combatting the high costs of disability insurance

Lately we seem to be inundated with media reports of state capture and corruption, and although civil society seems to be very vocal, the focus of their dissatisfaction seems to be aimed predominantly at state owned entities.

However, during difficult economic conditions, even companies that purport to have good governance and ethics may inadvertently (or even purposefully) cross that line of integrity, or border on doing business in a way that can be considered unethical.

It is no secret that the Group Insurance Industry is facing enormous challenges, with almost all of the major insurers reporting financial losses or massive declines in profitability as a result of higher claims experience in their group insurance businesses.

Insurers have reported that these losses are mostly a result of increases in Permanent Health Insurance (PHI) claims[1], largely driven by the current economic conditions and the March 2015 tax changes which made disability insurance benefits tax free for claimants.

Knowing that there is a direct correlation between the level of replacement salary paid during disability and the duration of a disability claim, insurers were concerned that the tax change would increase both the number as well as the average duration of claims. So to counter the effects of this, some insurers offered scaled benefits, where the insured benefits would be scaled down for higher income earners to simulate their after tax salaries prior to disability. However, despite the reduced cost of this insurance, the take up was low.

Now after two and a half years, there is evidence that these tax changes have not only resulted in delays in returning claimants to work, but that there has also been a marked increase in the number of disability claims admitted, particularly amongst higher income earners. Unfortunately, to make matters worse, in addition to the tax changes, the poor financial state of the economy has also been a major contributor to these increases in PHI claims.

Poor economic conditions driving claims experience is not surprising, since accommodating a disabled employee often results in increased costs to the employer, so despite the legal requirements of the Labour Relations Act, which places a duty on the employer to accommodate a disabled employee, an increasing number of employers are not able or willing to accommodate employees who are either partially disabled or who are capable of returning to work in a reduced capacity type role.

Insurers rely on full disclosure from employers in order to determine the underwriting risk of the pool of employees being insured and the price of the insurance to be provided. Perhaps as a result of the tough economic conditions, insurers have recently seen a number of cases where employers do not fully disclose employees already being accommodated, employees on light duty, employees working reduced hours, or employees already diagnosed with a disability.

When some employers are faced with financial pressures, they submit these as disability claims to the insurer as a means to either retrench or early retire employees who form part of these accommodated work groups.

The employer benefits financially in the short term, since the light duty and accommodated employees who qualify for PHI are paid by the insurer and are no longer on the payroll of the employer- thereby reducing their staffing costs. Where these are bona fide claims resulting from a recent diagnosis of disability, insurers are happy to provide these benefits, as this is the ultimate purpose of insurance.

[1] PHI is where the insurer typically pays monthly disability benefits to qualifying employees

Not unlike taxes, through the nature of group risk business, when the insurer reprices annually using past claims experience as a prediction of future claims experience, all active employees in the insurers risk pool are impacted by the price increases, which in effect cross subsidizes the “unethical” employers bottom line, and the high income earners who as PHI beneficiaries earn more through their untaxed disability income than they did before becoming disabled.

It is therefore a misconception that it is only the insurer that carries the cost of unethical behaviour by employers or members, because it is every single active insured employee in the risk pool, from executives through to blue collar workers who ultimately carry this cost.

This most certainly contributes to the increasing costs of disability insurance, resulting in reduced savings contributions into retirement funding, thereby negatively impacting the industry’s objective of driving good financial outcomes for members reaching retirement.

The industry therefore needs to help solve this challenge of increasing costs of disability insurance, and a possible start could be to get insurance service providers to work together to keep the costs of insurance as low as possible (such as medical aid, gap cover, and group insurance).

However managing the costs of insurance in the employee benefits environment will also be positively impacted by having employers demonstrate integrity and practice the values of being ethical, and caring to their employees. If this is not done, disability insurance will be unaffordable for the majority, which will place even further pressure on the fiscus, possibly resulting in even further tax increases. So perhaps civil society should direct some of their current dissatisfaction with corruption towards employers who are not living the values which so many of them preach about.

Michele Jennings
Chief Executive Officer
Sanlam Group Risk