Climate change in the Group Risk Industry

Just like the debates around climate change, are we ignoring the early warning signs relating to the sustainability of group disability insurance? Have we become too complacent to notice the steady deterioration in disability experience and the ultimate impact on the affordability and availability of these products in the future?

by
Michele Jennings
Chief Executive Officer
Sanlam Group Risk

In the recent Benchmark Survey, Employee Benefits Consultants identified increases in group risk rates as a dominant advice trend. The consultants interviewed indicated that over half had experienced large rate increases over the past three years and 1 out of 5 have seen an increase in the number of claims being repudiated. Could these be the early warning signs of a "climate change" in the group risk industry?

We believe this is indeed the case and that too little is currently being done to ensure group risk is a sustainable proposition for insurers and, more importantly, members of group schemes.

What are the main drivers of rate increases?

We believe a combination of factors has led to the current status quo. The group market is particularly competitive, with insurance products being treated as commoditised items that are moved between insurers based on the cheapest price and highest medical proof-free limits.

From 1 March 2015 disability premiums are no longer tax deductible and disability income payments are tax-free, with the unintended consequence of this change being that new and existing disability claimants with an income above the tax threshold get significantly increased income in their pockets (after tax). This results in increased claims incidence as well as reduced return-to-work rates for higher earners, which impacts negatively on disability experience.

Insurers anticipated these consequences at the time, but employers and consultants were hesitant to implement scaled benefit structures to mitigate these anticipated risks. To emphasise the point, despite the deteriorating disability experience since 2015, more than 70% of respondents indicated that their existing replacement ratio is between 75% and 79% of annual salary, which is the historical level before the tax changes. Only 15% of respondents in the 2019 Sanlam Benchmark Survey indicated that they would consider implementing reduced benefits to counter the effect of these tax changes.

South Africa's well-documented economic woes have also impacted on insurers' disability experience. Many employers have come under pressure to retrench staff and this has led to increased disability claims as employers try to "outsource" the liability to insurers. While these are mostly valid claims, these individuals would probably still be able to work despite their disability. Furthermore, they will have very little incentive to rehabilitate in future, as their disability income is stable, and their jobs no longer exist.

Other indirect effects of the economic downturn include unhappy work environments and excessive work demands due to downscaling. These lead to increased stress levels and higher incidence of illness, resulting in death or disability. Various global actuarial studies have found that increased disability claims incidence is positively correlated with higher unemployment, lower corporate profitability and also lower consumer confidence.

How do we avert a catastrophe?

In other words, how do we contain the cost and ensure the sustainability of disability insurance in South Africa?

There are some lessons to be learnt from countries like the USA and Australia. In both countries, insurers eventually withdrew certain disability products from their markets due to prolonged negative experience. To avoid a similar fate, the role players in the South African group risk market will have to come up with creative solutions to the problem.

Various solutions to remedy the current situation, without resorting to these extreme measures, were tabled to the stand-alone and umbrella fund respondents in the 2019 Sanlam Benchmark Survey. The following benefit changes were suggested:

- Scaling down the disability income according to the size of the member's salary. The idea is to bring the after-tax income replacement ratios of high-income earners more in line with those of low-income earners, as was the case before the tax changes were implemented, by putting members in approximately the same position as before the tax changes. This will not only help to contain the deteriorating claim experience but also prevent the deteriorating disability experience caused by the high-income earners being subsidised by the low-income earners.
- Scaling down the disability income depending on the age of the claimant. Younger claimants will get a higher benefit relative to older claimants, which might influence older members to opt for early retirement rather than disability benefits, which ultimately would reduce the cross-subsidies existing between younger members who have a lower risk of disability versus older members with a higher risk of disability.
- Determining the replacement ratio according to the % of functional impairment the claimant is experiencing. A claimant suffering from paraplegia or total blindness would get a higher benefit than someone who cannot work due to a lower-back problem. This is one way of addressing the problem of whether a person qualifies for the full benefit or no benefit, by allowing the insurer to differentiate between the different levels of impairment.
- Disability income benefits that are linked to the % of the job description the claimant cannot perform. A claimant who cannot perform 100% of his/her regular duties get a higher benefit than an employee who cannot perform 40% of his/her regular duties. This allows the insurer to differentiate between different levels of job performance, and will enable employers to accommodate their disabled employees at appropriately reduced salaries.
- Using a reduced benefit scale for claimants who do not meet fitness for work criteria due to a diagnosis or medication, but who have no real impairment. This type of benefit would apply for certain occupations like underground mining, where employees are required to meet certain minimum fitness criteria to be allowed to work at the mine. The reasoning is that these employees may be able to perform other types of work not related to mining.
- Scaling down the disability income depending on the severity of an employee's pre-existing impairment/disability before joining the group scheme. This will help manage the risk of selection by newly appointed employees with known illnesses or disabilities compared with other members of the group scheme. This is especially relevant given the practice of employing individuals with existing disabilities who are insured via the group scheme without exclusions or limitations.
- Increasing the replacement ratio gradually over a period of five years from the time the employee joined the group scheme. This will mitigate the risk of anti-selection by newly appointed employees with known medical conditions compared with existing members of the group scheme.
- Taking certain lifestyle factors and compliance with medical treatment into account in determining the replacement ratio of the claimant, e.g. an employee with a poor lifestyle (obese, smoker, inactive) or who does not comply with medication gets a lower benefit than an employee who is fully compliant. The idea is to promote a healthy lifestyle among employees and identify employees with certain risk factors early on to help manage the risk of disability and improve their quality of life.
- Determining the replacement ratio according to the prognosis for the medical condition. Employees who are unfit for work due to a terminal illness or have a poor prognosis get a higher replacement ratio than others with a condition that has a good prognosis or is not life-threatening. This allows the insurer to differentiate between employees depending on the prognosis for the medical condition, with the reduced payment being part of the return-to-work incentive.

- Using a reduced benefit scale for diseases and injuries that are not related to the workplace. Employees who suffer from diseases and injuries that are related to the workplace get a higher level of compensation. This would be appropriate for employers who want to provide disability cover mainly for work-related diseases or injuries or where employees participate in high-risk activities outside of work.

Unfortunately, the responses to these suggested remedies in the 2019 Sanlam Benchmark Survey were largely negative, with 80% of the respondents indicating that they were not in favour of these proposals. This begs the question whether the various role players in the market, specifically employers and consultants, fully understand the seriousness of the current situation. It also shows that insurers have an important role to play in educating them on the consequences of the current market trends.

As an industry, we have the responsibility to enable the financial resilience of our members by providing meaningful cover at sustainable rates. The lesson to ourselves is to find ways to work together to sustain the financial inclusion provided by group disability products, which provide meaningful access to a vital insurance mechanism to millions of people who would otherwise be uninsured.