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SPOTLIGHT

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Issue 68: Income Protection – the changing face of an old friend

As the move from defined benefit to defined contribution pension provision continues, many employers face the question of how to provide for employees in long-term ill-health. Traditional Income Protection (IP) (also known as Permanent Health Insurance or long-term disability) schemes can be expensive and fail to meet the needs of modern business.

The good news is that many insurers are changing their group income protection offerings. This gives an opportunity for employers to review their IP arrangement to ensure it continues to meet their needs. In all cases, employers would need to consider their contractual position.

Brief overview of IP
Income Protection is a benefit paid by an employer to an employee who is unable to work for a prolonged period due to accident or illness. A typical amount of benefit is between 50% and 75% of earnings (less state benefits). IP benefits are commonly insured, so the type and availability of insurance is important to the employer.

For the employer, the insurance premium is typically between 1-2% of the annual salary roll. However, this depends very much on the organisation's employee profile and the benefit design of the scheme. The benefits can be tailored to meet the employer's budget.

Some recent market changes and actions for employers
Limited-term IP benefit: Traditional IP schemes paid benefits until the employee's normal retirement age; but very few new arrangements are set up on this basis. This is because of the cost of this design and its lack of fit with the changing pattern of employment. A typical maximum payment period for a new IP scheme is two to five years.

Possible action for employers: Consider whether a short-term benefit would be a better business fit.

Additional lump sum payment: In association with a limited term IP arrangement, some employers provide a final lump sum payment, which can be used to supplement a retirement fund. Insurance is now available for lump sum benefits, after a suitable period of absence.

Possible action for employers: Consider whether a cash payment is more attractive than an ongoing income benefit.

Definition of disability: Insurers assess a claim against a specified "definition of disability"; traditionally an inability to carry out the employee's own, or a similar, occupation. Insurers now offer progressive definitions which enable employers to target longer-term benefits to the most seriously disabled while still containing the cost.

Possible action for employers: Review whether your IP benefits could be better targeted to need.

Improving absence management: Statistics show that early intervention dramatically improves the return to work of members. The total cost of absence is a huge issue for many employers, and effective absence management can make a big difference to a company's bottom line. IP insurers can offer a range of supporting services, including 24 hour medical helplines.

Possible action for employers: Review the real cost of absence to your company.

Temporary working: To encourage employees back to work; a proportion of benefit can be paid when a member goes back to work part-time.

Shared liability: The employer can cover part of the risk themselves with just the excess amount insured. For example, the employer can be responsible for the first £1,000 per month with the insurer reimbursing the employer for the excess. Some insurers will look at shared risk, or with profits type policies.

Possible action for employers: Consider if your IP arrangement is financed in the best way for you.

Welfare Reform Act 2007: The government has published a green paper on welfare reform. Although this is not aimed solely at people on long term incapacity benefits, the current State Long-Term Incapacity Benefit (LTIB) is being withdrawn (currently targeted for October 2008) and replacement benefits will come into play based on a new set of criteria. Many IP arrangements offset the amount of LTIB from the income benefit. This will be an opportunity to look again at the provision of IP-type benefits for employers. Insurers are also watching developments to determine what effect this may have on their policy terms.

Possible action for employers: Watch this space for more about the Welfare Reform Act.

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