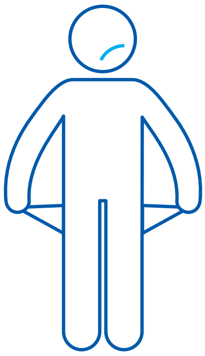
Executive summary

Embracing the income protection gaps challenge: options and solutions

Individuals have few guarantees of lifelong financial certainty



without significant personal initiative and long-term planning

The pain of a prolonged spell of ill health can go well beyond bodily ailments. Chronic sickness, injuries, and other conditions that render an individual unfit to work can impact household budgets, savings, and retirement accounts.

Living longer and working more years of one's life is a positive development. It is not without complications, however, as it can also pose a greater risk that individuals will become disabled for at least some part of their career. Governments, employers, and individuals must find ways to address these types of income protection gaps, or 'IPGs.' What's to be done? A study by Zurich Insurance Group and the Smith School of Enterprise and the Environment, University of Oxford sheds light on some solutions.

In one of the most striking social and political trends of 2016-17, we are witnessing something of a backlash against the decades-long shift of financial risks onto the individual. As longevity increases and state-sponsored social safety nets are stretched nearly to the breaking point, individuals have few guarantees of lifelong financial certainty without significant personal initiative and long-term planning. However, household financial decision-making has become a highly complex task, and one which is

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subject to a number of basic but often unavoidable cognitive biases. Further complicating matters are transformations in the nature of work. The Fourth Industrial Revolution has displaced jobs for both lower- and middle-income workers while also giving rise to the sharing economy. Self-employment has become a prevalent coping mechanism in response to both trends. But while this offers flexible work opportunities, it generally lacks sufficient legal safeguards and fails to provide basic benefits to ensure workers' continuity of income.

In this environment, it is becoming clear that the burden of guaranteeing long-term financial security is simply too great for many individuals to bear. Individual capability is therefore in many ways at the heart of the two main questions posed by this report. First, how should we think about the balance of responsibilities between governments, employers, insurers and other financial institutions, and individual workers and their families in securing household income? Second, in light of this, what types of measures aiming to close the IPGs can we propose to each of these groups?

Motivating individuals

Although we take the roles of three main stakeholder groups – employers, governments, and insurers – as the building blocks of this report, we recognize that the ecosystem of insurance provision is more complex, with other types of institutions helping to ensure the health of the whole. Agents, brokers, banks, Employee Benefits Consultants (EBCs), and others have important functions as intermediaries in the insurance market, not just linking supply and demand but importantly advising and educating customers (whether employers or individuals), and feeding market and customer requirements back to insurers.

One obvious place to start is with individual employees. Enrolling people in income protection insurance programs automatically, and then ensuring they make regular, adequate contributions, is one proven part of a workable solution.

That said, employees cannot be completely passive bystanders in their financial futures. But in order to be effective planners, they must be equipped with practical knowledge and skills. A successful employee financial education program requires two elements: formal instruction that is followed up with tangible, beneficial action. The ideal is a program of intensive instruction, complemented by one-on-one counselling that integrates goal-setting, that takes place over multiple sessions. Advice should also be tailored to different segments of the workforce so that it is more personalized.

Financial education is not restricted to classroom-based instruction; digital materials, including apps and games, in principle also offer possibilities for delivering content. The newest generation of digital tools in the overall area of personal finances is more interactive, using gamification techniques as well as opportunities for continuous microsavings. There is still much room for experimentation with these tools – and a great deal of room to assess their overall effectiveness.

Governments could play a useful role here by putting pressure on the financial industry to create and promote income protection products that are transparent and easy for consumers to understand.

Insurers, too, have a contribution: these need to get better at explaining to consumers the benefits of income protection. Insurers can also help by making financial planning relevant to households, for example, by presenting income protection within the context of overall household finances. And, they shouldn't be afraid to explore new digital approaches that support the case for income protection products.

Employers are a key part of the solution. They can include income protection as part of their employee benefits, maximizing coverage through auto-enrollment and auto-escallation. They are also natural hosts for financial education programs.

Finding workplace solutions

Promoting corporate 'wellness' constitutes an industry worth USD 6 billion annually – in the US alone. It's clear that companies believe encouraging employees to look after themselves is money well spent. Yet for all that, there is not yet clear evidence that some existing corporate wellness programs actually cut costs. This reflects the fact that promoting health can be a minefield. For example, certain types of incentives for employees to participate in wellness programs can have the unintended consequence of discriminating against less healthy workers. Monitoring employees' health too closely can exacerbate the very stress that companies hope to alleviate, ultimately backfiring. Stigmas associated with mental illness also need to be addressed.

Targeting problems at the organizational level enables a broader range of workplace issues to be identified and addressed. In practical terms, this involves much closer collaboration between human resources and health and safety departments within the company, with risk management also being involved. Once these departments collaborate, the goal is to achieve sustainability, rather than securing an immediate return to work that is swiftly followed by renewed absences.

Problems associated with long-term disability are likely to grow more common as people are living and working longer. Many national policymakers, facing budgetary restrictions as public pension obligations rise, are encouraging their citizens to postpone retirement. This might be fine for healthy office workers, who are also more likely to have private insurance cover, but it can be problematic for people who have spent decades doing heavy manual labor. A more nuanced approach is needed to ensure fairness, for example by calculating pensionable age in terms of social insurance contributions that reflect the number of years in work. Good practice for progressive retirement would also entail part-time workers continuing to build up pension savings on a pro-rata basis.

Apart from seeing to it that pension ages are reasonable, governments should consider offering companies incentives to make medical monitoring, health and fitness programs part of their work culture. Given the years many workers are likely to remain in the workforce, employers need to offer flexible retirement options, too, while working to make sure workers facing disabilities, including mental health issues, feel welcome in the workplace.

Insurers should offer pension cover against loss of income, create retirement products that increase income later in life, and work together with employers to assess employee health data.

New approaches to closing income protection gaps

The decline of state welfare creates new opportunities for governments and private insurance providers to collaborate and form partnerships to extend social protection, using fiscal incentives to attract new customers. This strategy is already well established. Some governments use negotiated agreements with private providers to offer fiscal incentives to encourage people to purchase long-term insurance products that bridge IPGs. In Germany, for example, corporate pension plans often offer not only retirement, but also disability and survivor benefits.

Private insurers, often working with employers, can also augment cover to mitigate the risk of IPGs. Here, governments promoting private income protection insurance also have a role by providing the proper regulatory framework.

Governments can also incentivize employers to safeguard the incomes of their disabled employees. Many employers have the resources to take on this responsibility. The best in this regard already offer regular employee health assessments and fitness programs, and medical facilities are available for early, individual appraisals and rehabilitation.

Independent workers and the self-employed also need ways to save and provide for themselves in the case they become disabled. The sharing economy has afforded flexibility to workers, but it does not usually extend the usual benefits and protections to them. This could be accomplished, for example, through reforms that introduce more sophisticated employment classifications. Workers on IT platforms in particular could negotiate group income protection with insurers to offer plans to registered workers at advantageous prices.

The ability to transfer private IPG insurance cover between employers is needed when workers change location, employer, or profession. This can be mediated by provisions covering whole industries and through professional associations. Portability between different jurisdictions is even more challenging, although social security totalization agreements can allow companies to coordinate pension contributions made in two different jurisdictions, facilitating workers' cross-border mobility.

> "Income protection gap – The reduction in household income as a consequence of the loss or incapacitation of an adult wage earner on whom that household relies, taking all public and private income replacement sources into account."
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About this study

This report, published in October 2017, is the third and final study in a series focusing on income protection gaps (IPGs). The first phase of this project was based on a global mapping of the scope and significance of IPGs for governments, employers and the global economy, summarized in the study 'Income protection gaps: a rising global challenge' released in 2015. The second study, 'Understanding income protection gaps: awareness, behaviour, choices' released in 2016, looked at behavioural and institutional factors influencing individuals' decision on whether or how to protect their household impact.

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