Social protection: From precarious to outmoded

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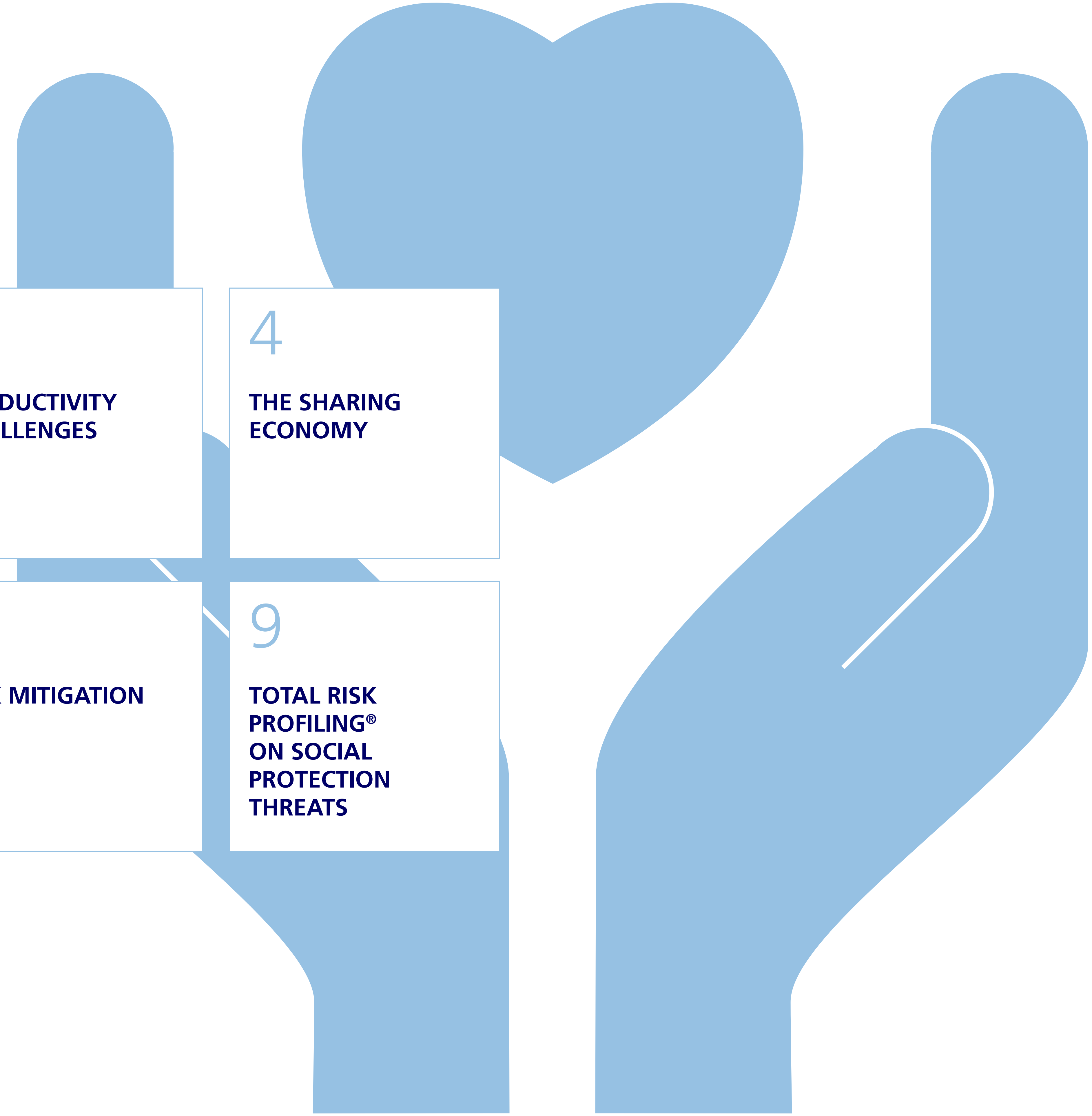
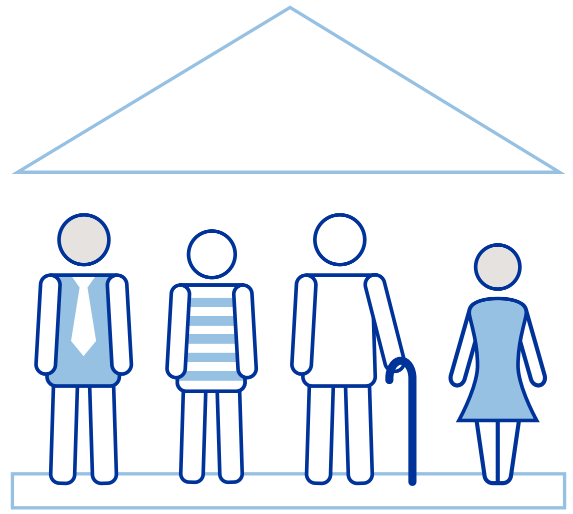




When Western social security and healthcare programs were first established in the late 19th century, life expectancy was far lower than it is today. That meant that state pension plans had to support retirees for only a few years on average and healthcare costs were substantially lower.

Today, rising life expectancy, the increasing cost of healthcare and widening income inequality are making it increasingly difficult for governments to provide this kind of social protection.

Data from the World Bank shows that national health care costs globally have risen from 8.5% of GDP in 1995 to 9.9% of GDP in 2014. Among OECD members, health spending was estimated to have accounted for 9.0% of GDP on average in 2016, but this disguises huge variations. In 2016, the United States spent 17.2% of GDP on health, almost five percentage points above Switzerland, the next highest country; a group of ten high income OECD countries, including Germany, France, Japan and Canada, follow with around 11% of GDP going on health services.[1] Separately, OECD data shows that aggregate social welfare spending among member states has risen from 18.8% to 21.0% from 1995 to 2016.[2]

At the same time, pension replacement rates in high-income countries, or the ratio of average pension income to average working income, have decreased for both men and women of all pay grades in the past ten years.[3] And in the future, pension transfers as a percentage of retirement needs are forecast to decline by more than 3 percentage points between 2010 and 2030.[4]

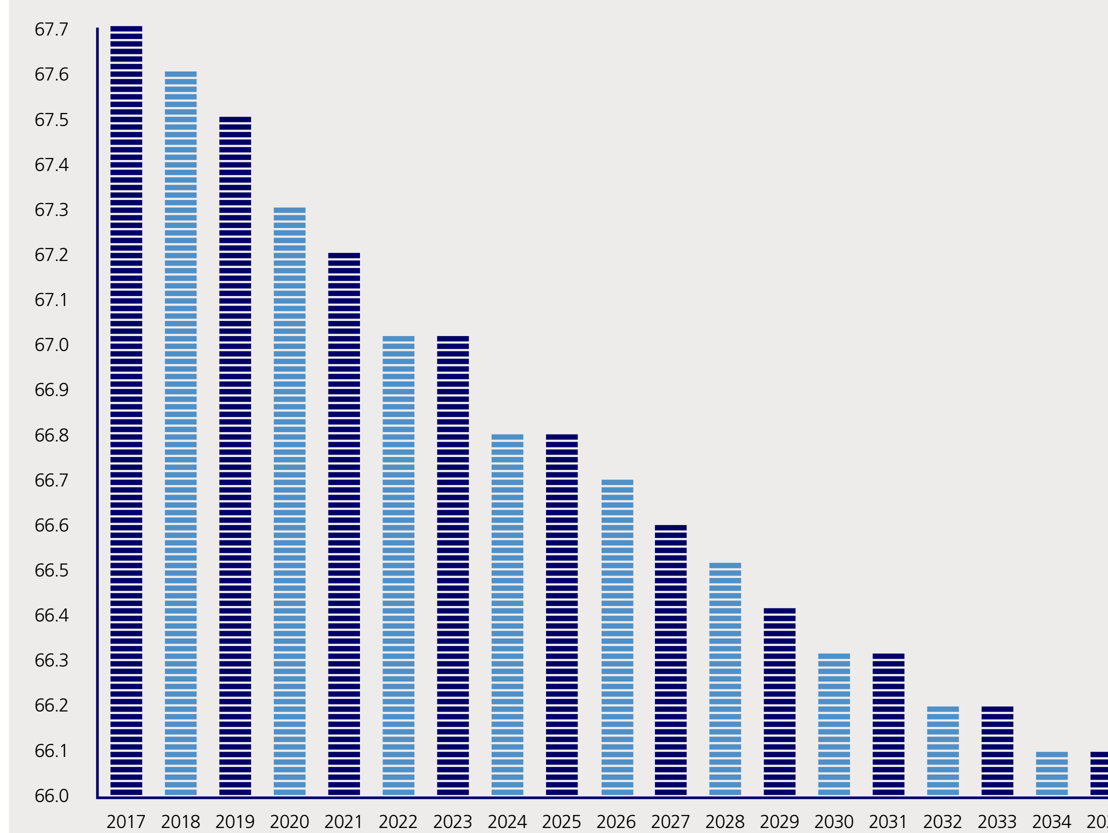
[1] http://www.oecd-ilibrary.org/docserver/download/8117301e.pdf?expires=1510943484&id=id&accname=guest&checksum=F15EBA70729C6056EE9B1EF8EE48FA1E., p. 133.
[2] https://data.oecd.org/socialexp/social-spending.htm
[3] 'Reducing the Risks from Rapid Demographic Change,' Atlantic Council (in association with Zurich), p.13, https://www.zurich.com/_/media/dbe/corporate/knowledge/docs/atlantic-council-demographic-report.pdf
[4] ibid, p.13

Raising retirement age may not be enough

Rather than enforce drastic reforms, such as switching to defined contribution schemes in which pension payments are directly linked to individual contributions, most countries have chosen simpler reforms such as increasing the pensionable age or increasing tax or contribution rates.[5] While these reforms extend the viability of pension funds in the short term, it is questionable whether they will ensure longer term sustainability.

Raising pensionable age creates its own problems. Currently, one in four people could be unable to work due to sickness, disability, or even premature death during their working life.[6] A common response[7] among chronically ill or disabled older workers – a sizable group, constituting half of the older segment of the workforce in the EU, for example – has been to claim for disability benefits to bridge the gap between reduced working capacity and retirement. Increasing retirement age is only going to increase the demand for disability benefits.

Government pension transfers as a percentage of retirement needs
High-income countries



Source: International Futures 7.18, Frederick S. Pardee Centre at the University of Denver

[5] Pensions at a Glance 2015: OECD and G20 Indicators (Paris: OECD Publishing, 2015), pp. 18-33
[6] 'Reducing the Risks from Rapid Demographic Change,' Atlantic Council (in association with Zurich), p.5, https://www.zurich.com/_/media/dbe/corporate/knowledge/docs/atlantic-council-demographic-report.pdf
[7] 'Reducing the Risks from Rapid Demographic Change,' Atlantic Council (in association with Zurich), p.5, https://www.zurich.com/_/media/dbe/corporate/docs/whitepapers/risk-nexus-income-protection-gaps-november-2015.pdf

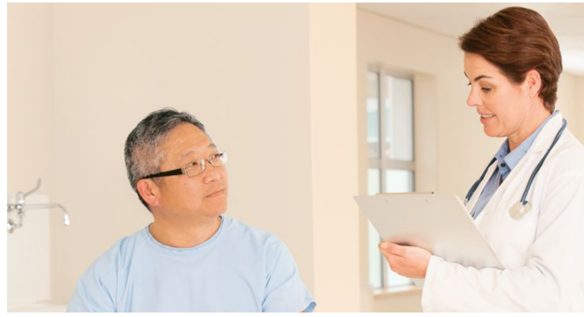
Productivity challenges

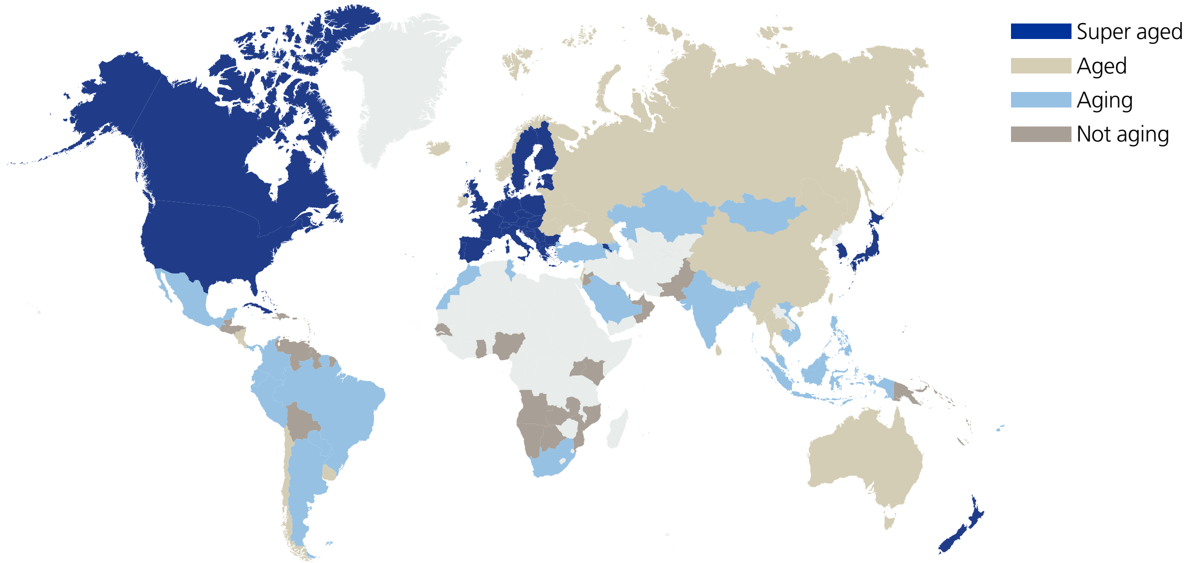
A further challenge of population aging is that countries must turn to increased productivity and increased labor participation – such as women – to assure the same levels of economic growth.

A 2015 study by the McKinsey Global Institute, Can Global Growth be Saved, suggests that while global GDP increased at a compound annual rate of 3.8% per annum between 1950 and 2014, this could slow to 2.1% per annum over the next 50 years due to slower population growth, longer life expectancy and falling productivity.[8]

The key to offsetting this decline in productivity lies in removing disincentives to innovation, cooperation and labor-force participation.

For example, many pension scheme penalize gaps in employment history which hurt women who take time off to help raise children. Striking a balance will be increasingly important. Encouraging time off for parental care is important for the long term future of society, but too much time off decreases pension income in the retirement years.





Source: Moody's Investor Service, UN data[9]

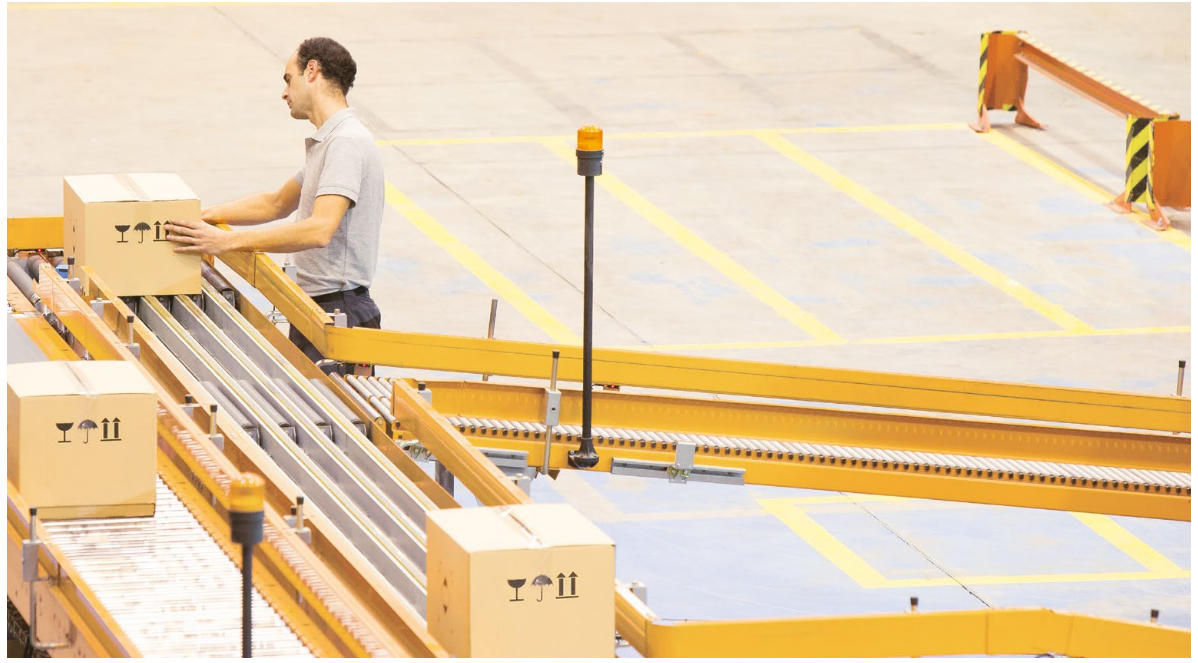
[8] http://www.mckinsey.com/global-themes/employment-and-growth/can-long-term-global-growth-be-saved
[9] http://money.cnn.com/interactive/news/aging-countries/?iid=EL

The Sharing economy

Around a quarter of the working-age population, around 162 million people, in the US and EU-15 engages in independent work. This is a larger number than reflected in government data.[10] Sixty to 80 percent of those people choose to work independently, but the other 20-40 do so by necessity, usually because their jobs were eliminated.[11] A McKinsey survey indicates that 40-to-50 percent of the working age population in the US and EU-15 would choose to be independent if they had the opportunity.

Many studies show that the sharing economy will become the norm for most workers. A joint Oxford/Zurich report[12] and other studies suggest that roughly half of all traditional jobs could disappear through automation[13] in the next couple decades. Since robots don't pay taxes, this will make it increasingly difficult for governments to fund pensions, healthcare and other forms of social protection. Most economists think that new types of jobs will emerge, but nobody is confident that good paying jobs will be created at the same pace as others are eliminated.

The Zurich/Oxford report shows that workers in general are not sufficiently aware of their pension and protection needs but, in the sharing economy, this can be especially pronounced. Independent workers don't typically pay into government protection schemes or public/private workplace protection schemes. Minimum wage, benefits, family leave, workers' compensation for on-the-job injuries, income protection for disability or serious illness and retirement schemes are currently not set up to deal with independent work.



[10] http://www.mckinsey.com/global-themes/employment-and-growth/Independent-work-Choice-necessity-and-the-gig-economy
[11] ibid
[12] https://www.zurich.com/en/knowledge/articles/2016/10/understanding-ipgaps-report
[13] https://medium.com/@gbolles/unbundling-work-learning-to-thrive-in-disruptive-times-427b172b1470#.t85c25um3

The sharing economy continued

This drawback is particularly pronounced in the US where healthcare and retirement plans have traditionally been provided by employers. A more portable system of benefits would benefit 'gig' workers and draw more people to independent work.

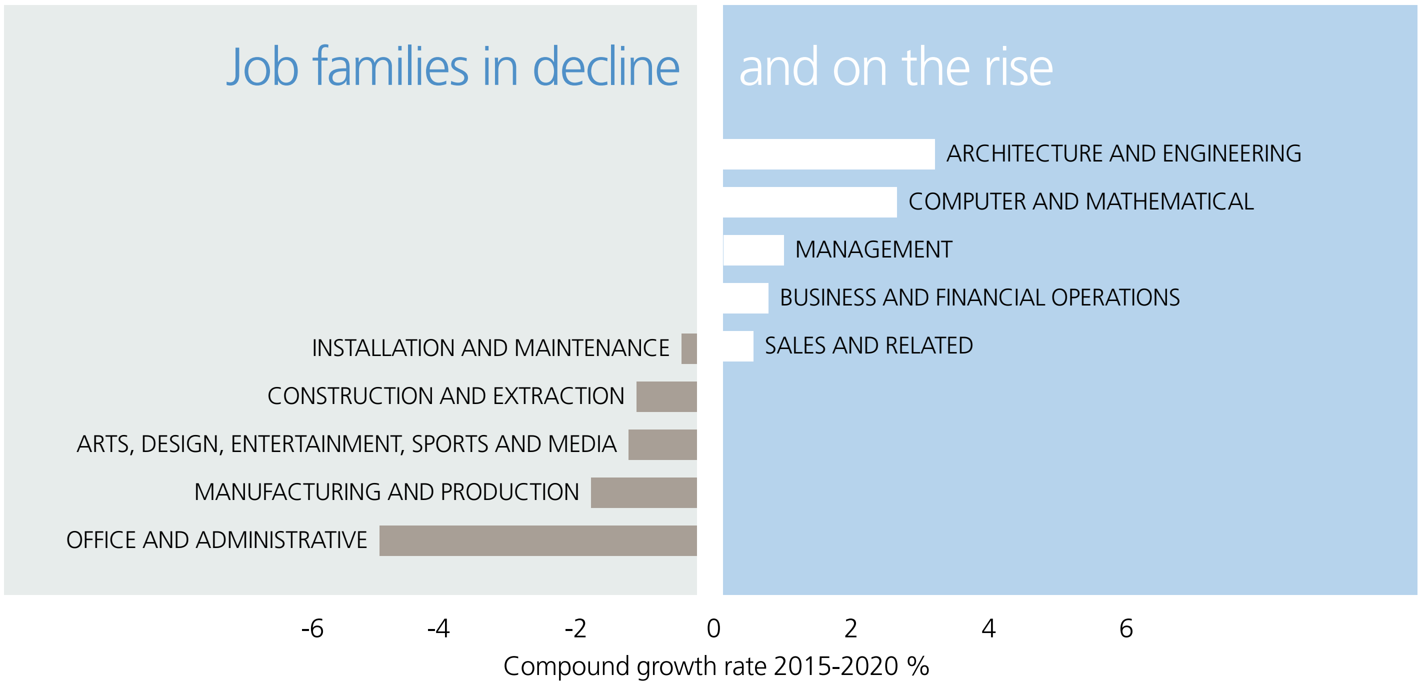
There are strong economic reasons to make independent work more attractive. Independent work could encourage more workers to stay in the workforce after retirement age, thereby lessening the drop in labor participation.

Independent work is, in fact, increasingly popular with 65-to-74 year olds because of the flexible schedule it allows. For businesses, encouraging skilled employees to stay on after retirement on a part time or contract basis cushions the loss of skills that comes with large numbers of retirees leaving their workforce all at once.

Many independent workers, however, earn less, particularly when mandatory benefits are included in total compensation. This is all right if their income supplements other sources of earnings, such as pensions. For younger workers, lower income spells a smaller pension at retirement and could make it harder for governments to fund pay-as-you-go schemes.

The changing needs of businesses and individuals argues for a 'flexi-security' approach that provides employers with a more 'flexible' workforce while offering 'whole-of-life' security to individuals.[14] Pension schemes may have to become more flexible, for example allowing individuals access to capital to meet other life needs such as education costs.

[14] https://www.zurich.com/_/media/dbe/corporate/knowledge/docs/global-risks-report-2017.pdf



Source: Future of Jobs Report, World Economic Forum

Implications for risk management

The Zurich Risk Room (ZRR) is a global risk analysis tool, designed to help illustrate the impact of multivariate risks on individual countries and regions. The tool has the ability to look at risks in single dimensions as well as show the complex interactions between many different types of risk.

Find out more here »

At a country level, the ZRR identified six indicators that increased or decreased social vulnerability. On the other side, five factors increased or decreased states' capacity to provide continued levels of social protection.

The Zurich Risk Room features a range of risk categories that fall within the scope of social vulnerability and austerity risk, as shown below:

Social vulnerability
- Employment of working-age population
- Demographic shifts
- Human rights
- Income inequality
- Overall health risk
- Social mobility

Austerity risk
- State failure
- Fiscal austerity risk
- Government effectiveness
- Sovereign debt risk
- Wastefulness of government spending

Using the Zurich Risk Room to map a variety of countries across these risk categories shows which present higher and lower levels of social vulnerability and austerity risk. Here are some examples of higher- and lower-risk countries:

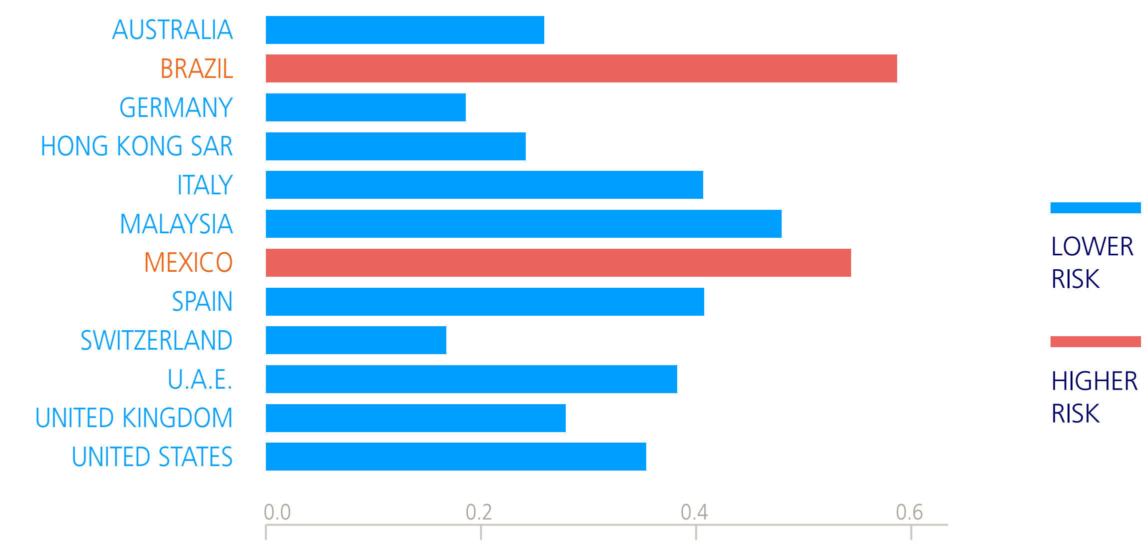
Lower-risk countries
- Australia
- Germany
- Hong Kong SAR
- Malaysia
- Switzerland
- U.A.E.
- United Kingdom
- United States

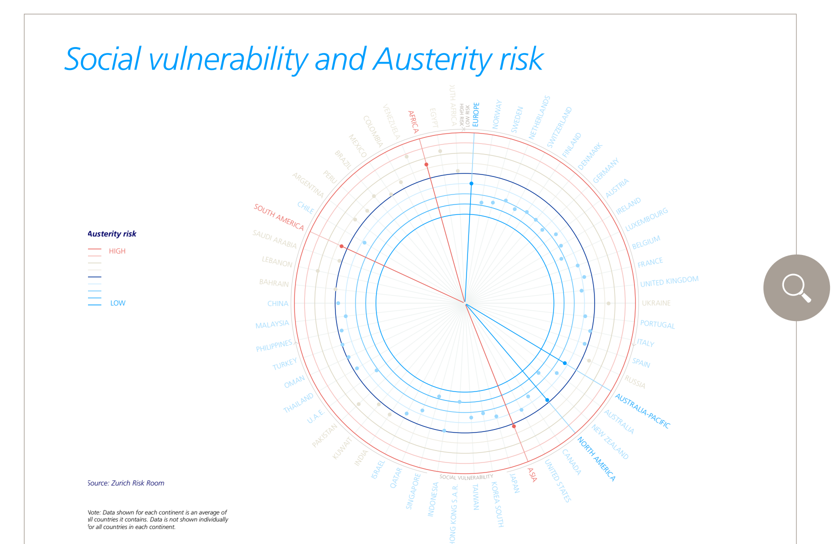
Higher-risk countries
- Brazil
- Italy
- Mexico
- Spain

Social protection

Social vulnerability and austerity risk

Risk measurement: Each risk indicator/position on the graph and aggregated risk measure in the tool is normalised between 0 and 1, where 1 represents high risk and 0 absolute no risk.





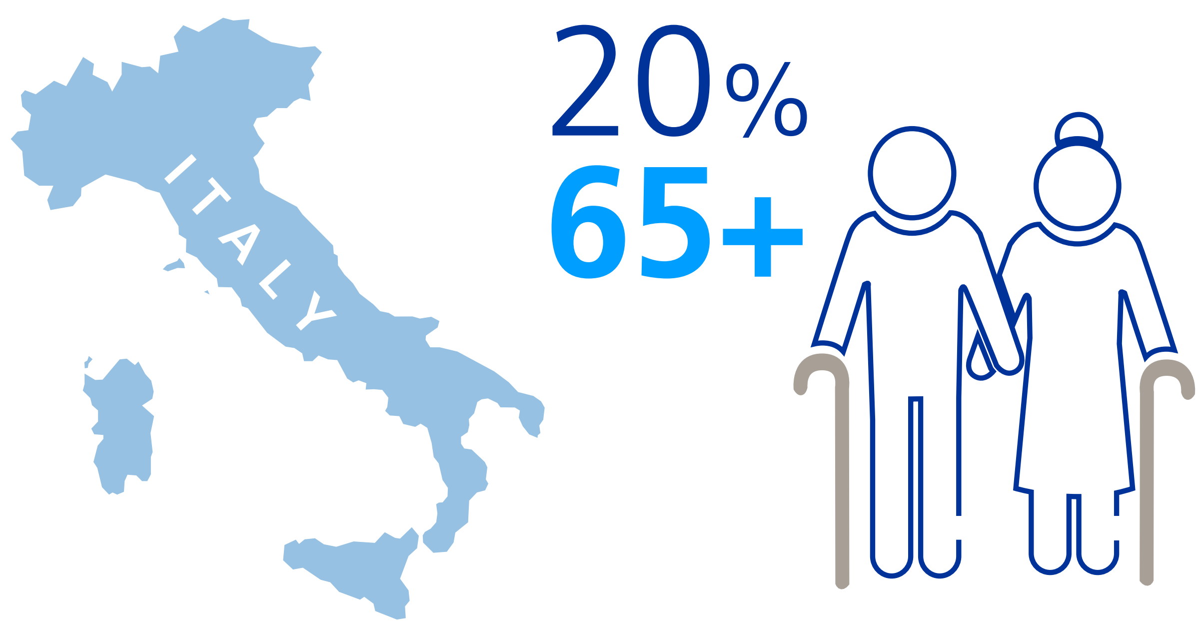
Implications for risk management continued

Mapping social vulnerability against austerity risks shows which countries are best positioned to provide social protection. Not surprisingly, the Gulf countries are currently among the least risky. The UAE has benefitted from oil revenues and its social programs only have to cover the 1 million UAE nationals, approximately 11% of the total population. UAE benefits are very generous, going not only to workers and their spouses and children, but brothers, sisters, parents and even grandchildren in some cases. Unmarried daughters, sisters and granddaughters can also be beneficiaries with the annuity continuing for the rest of their lives.[15]

The income replacement ratio is 80% for the United Arab Emirates (UAE) as compared to the OECD average of 63%.[16] UAE workers can retire at age 45 with a full pension after 25 years of work. Normal retirement is 60 years for men and 55 for women. Given lowering energy revenues and rapid increases in life expectancy, it remains to be seen whether this generosity will remain sustainable.[17]

The big problem for practically all OECD countries is sustaining current levels of social benefits in the face of rapid aging. In the absence of major reforms, US Social Security funds will be depleted in 2034 (The US is considered low risk at the moment but if some effort is not made soon to reform entitlements, US risk would increase significantly.[18] The 2008 financial crisis and slower growth in advanced countries have exacerbated the struggle. High levels of debt in some OECD countries limit the maneuvering room for government to expand social programs. In the long term, the shift since the 1980s in relative poverty from the elderly to younger members – oftentimes without steady employment – will make it more difficult to fund pensions at current levels.

Asian countries have historically taken a different approach, putting the emphasis on self-reliance. Benefits levels in Hong Kong and Malaysia are low. Malaysia spends about 1% of its GDP on pensions[19] whereas high income countries expend 8% on average.[20] The Malaysian government has called for families to help more with aged relatives. A similar philosophy exists in Hong Kong where authorities believe low taxes and high savings levels allows for less generous social welfare programs. But Asian authorities are facing growing social pressures to expand social benefits, which fits a historical pattern. Typically, as countries develop, they start increasing outlays on pensions, healthcare and education.



With over a fifth of its population 65 or older, Italy has one of the oldest population of any high-income nation. Less than 10% of spending goes to the bottom fifth of earners, one of the smallest shares among the OECD[21] states. Low growth and high debt add to the difficulty of sustaining current benefit levels.

Mexico trails other OECD members with total social spending at just 7.5% of GDP versus 21% on average for OECD countries. With a large informal sector, its coverage is much more limited. Compared to other OECD countries, Mexico has some of the lowest safety-net benefits and the highest elderly poverty rates.[22]

Brazil has used its social programs to cut back on inequality and lower the poverty rate. The federal government extended, for example, the pension coverage of the private sector insurance fund to informal workers in agriculture, mining and fishing even when those workers are unable to contribute.[23] Among Latin American countries, Brazil has the highest proportion of people older than 65 in receipt of a pension.[24] With lower growth in recent years and large government deficits, the future affordability of Brazil's social protection system is unclear.

Highest proportion of **people older than 65** in receipt of a pension

[15] http://www.actuaries.org/oslo2015/papers/IACA-LoveSoper.pdf
[16] http://www.oecd-ilibrary.org/docserver/download/8115201e.pdf
[17] ibid
[18] https://www.ssa.gov/OACT/TRSUM/
[19] http://css.escwa.org.lb/sdd/1035/SP_Malaysia_ver4.pdf
[20] https://www.zurich.com/_/media/dbe/corporate/knowledge/docs/atlantic-council-demographic-report.pdf
[21] http://finance.yahoo.com/news/countries-most-generous-welfare-programs-110004319.html
[22] http://www.oecd-ilibrary.org/docserver/download/8115201e.pdf
[23] http://www.worldpoliticsreview.com/articles/13240/a-new-contract-brazils-dual-social-protection-system
[24] ibid

Risk mitigation

Time is of the essence in reforming social protection program in line with advances in life expectancy and changing work patterns. Lowering expectations now about future support, such as pensions or healthcare, could encourage potential recipients to plan to close the gap themselves.

Any changes in social protection are politically painful so political leaders need to be persuaded that putting off the inevitable won't solve the problem. Most OECD countries have made some progress in cutting back the future cost, but **Estonia**, **Greece**, **Hungary**, **Iceland**, **Mexico**, **Slovenia**, **Turkey** and the **US** did not make any reforms **between 2013 and 2015**, according to the OECD.[25]

Reforming social protection schemes need to involve educating publics about how social protection programs are funded. Firms can play a critical role in encouraging employees to save early in their careers for retirement. Some US employers, for example, are automatically enrolling their workers in 401(K) supplemental retirement plans and deducting contributions from employees' pay. Employees can always reverse that decision, but tend not to.

Businesses will be at the forefront of rapidly changes in the nature of work. As a result, they can help develop new types of benefits, particularly for independent workers who often lack the knowledge of financial tools that would help them save for retirement. Given many firms' increasingly dependence on independent workers, it's in the interest of companies to help.

Re-training people whose job have been eliminated will be critical. Many experts believe our whole notion of education – focusing on the first twenty or so years of life – is out-of-date and lifelong learning will increasingly become the norm. Governments may have the primary role in restructuring education to fit with changing nature of work, but firms can improve their capacities by retraining their employees to keep pace with technological change.

There's no better way to protect our democracies than through more solidly grounded social protection programs.

[25] https://www.zurich.com/en/knowledge

A whole-of-life approach to social protection needs in the fouth industrial revolution era

Source: Mercer 2016

Total Risk Profiling® on Social Protection Threats

Approaches from business continuity management, especially scenario planning, can help with the identification and mitigation of risks. A method to achieve this is Total Risk Profiling® (TRP®). It is a structured approach to identifying, assessing and monitoring risks and improvement actions. Embedding Zurich's TRP® methodology can further help ensure a company's risk management culture is consistent and effective.

TRP® on social protection threats – Vulnerability identification

Potential key questions to identify the vulnerabilities related to the social protection scenario, to develop risk scenarios, quantify financial severity and assess probability can be as follows.

Risk #1 **Consumer financial mistakes** are commonplace, widespread and often profoundly harmful to long-term financial well-being. In countries and sectors where income protection insurance is not universally mandated, the challenge of closing the IPG is essentially twofold:

- increasing enrollment in benefits programs and
- sustaining regular, sufficient contributions over time

Thus as an employer:

- Have you designed effective financial education programs with employees to offer ongoing financial advice that combines instruction with practice and engagement?
- Do you choose nudges in forms that are appropriate to local country context of the workforce?
- Have you designed methods to better inform employees about what benefits are available to them and how income protection insurance fits into the package (whether from the state, employer or otherwise)?
- Do you support experimentation with scenario-building apps and other digital methods?

Risk #2 Due to the fact that **retirement ages rise**, older workers need to be accommodated with appropriate measures. Additionally, issues around employees' physical and mental well-being are widely recognized as one of the most pressing challenges facing the modern workplace. An estimated one-fifth of the working population in Organization for Economic Co-Operation and Development (OECD) member countries has had to contend with a moderate to severe mental disorder.

What programs exist within companies to manage?

- As official pensionable age is postponed, have you considered to create flexible retirement options for older workers with impaired lives that involve part-time work and an alternative income?
- In order to prevent presenteeism, do you offer contributory employee assistance plans for employee support when confronting family, legal or financial crisis outside work – or as a source of benefit corresponding to predefined health-related need?
- As an ageing workforce will carry chronic illnesses and is less likely to draw them to management's attention, do you have ways to monitor older workers carefully?
- Are you aware of increasing responsibilities for accommodating workers with physical and/ or mental problems, because careful management creates mutual benefits?
- Do you determine the types of physical and mental health problems that contribute to presenteeism, and estimate their costs?
- Do you offer annual health checks and fitness facilities in corporate wellness programs, including assessment of anxiety and stress?
- Do you encourage Human Resources and Health & Safety to coordinate health and wellbeing activities?
- Do you focus your efforts on proven methods for managing chronic diseases and on exploring new approaches to stress and lifestyle management?
- Do you conduct independent (ideally long-term and independent) assessments of existing well-being programs to identify what is effective – and what is not?
- Do you proceed with devices and apps to monitor health, given that this also has the perverse effect of raising the very stress levels companies are presumably seeking to minimize?
- Is your management supporting a proactive duty of care approach to HR and benefits practices?

Risk #3 **Contemporary transformations in the nature of employment** are challenging income protection in all its dimensions. In its most recent review of global labor market prospects, the OECD called for modernizing social security to adapt worker protection to fragmented employment and high job mobility.

- Did you consider auto-enrollment of employees into an IPG protection plan?
- Have you developed a default fund with flat-rate contributions for other employees, with the opportunity to 'opt out' if so desired?
- Have you created and maintained a core set of benefits for all employees, promoting equity and preventing social dumping, based on salary scales in each country?
- Are there profit sharing plans in place to reflect productivity growth, thereby fostering rehabilitation and inclusion?
- Did you consider recalibrating office organization to integrate action between human resources/ occupational health/risk management to engage with government initiatives?
- Do you offer portable cover for internationally seconded workers?
- Have you introduced variable coverage required in different countries by internationally seconded workers?
- Did you consider collaboration with a global insurer to guarantee income protection/rehabilitation across different countries?
- Do you facilitate savings transfers across different sectors of employment as required?

Our newest report, **Embracing the income protection gaps challenge: options and solutions**, based on extensive research, outlines practical recommendations to address critical issues and gives insights into how governments, employers, insurers, intermediaries and individuals can work together to close income protection gaps.

In parallel to the recommended actions for employers, governments and insurers to tackle this growing challenge, **individuals** have a personal responsibility in this effort to protect their household income should they become unable to work due to things like sickness or disability. Individuals should be more aware of this social protection threats (through self-education and increased financial literacy), clarify cost perceptions and to try to understand the implications of such a shortfall in income to their household. By taking a proactive approach to healthier lifestyles individuals can also build resilience to illness and disability.

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