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The impact of individual income protection on universal credit and the implication for policyholders

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We would also like to thank entitledto who helped us with the case studies.

The report offers a high-level view, intended to inform policy, of how a particular type of insurance product interacts with universal credit.

The report does not constitute financial advice either about an insurance product or about universal credit; nor does it make a judgement about the value of any product.

The assessments offered here do not and cannot reflect the personal circumstances of anyone reading this report. In practice, these circumstances are crucial to any real decision about whether to take out insurance or apply for UC.

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Executive summary and conclusions

This report has been commissioned by the Association of British Insurers to inform the industry about universal credit (UC) and the Government and others involved with UC about individual income protection (IIP).

Individual income protection and universal credit

IIP is a form of private insurance bought by individuals to provide them with an income if they become unable to work due to illness or injury.

148,000 policies were sold in 2018, up more than 50% on 2014. In 2017, some one million policies were in force. At the start of 2018, there were 10,600 claims in payment.

UC is becoming the main means-tested social security benefit for working-age adults. A means-tested benefit is one in which the amount paid out depends on how much income a household has from other sources.

By the time it is fully rolled out in mid-2024, UC is expected to have a caseload of some seven million working-age households. UC is paid to households in work as well as households where no one is working.

It is in the interest of both the Government, employers, and the insurance industry to incentivise claimants to return to work after a period of sickness. Although there are important differences between IIP and UC, IIP has the twin aims of providing financial support for those who are unable to work and practical support to help individuals return to the workplace as soon as possible.

Focus of the report

The purpose of this report is:

- to explain the demographics and economic characteristics of individuals who purchase IIP;
- to explain the associated interaction between IIP and UC; and
- to set out why it matters.

Demographic and economic characteristics of IIP policyholders

We have analysed anonymised data on the age, sex and earnings for a sample of some 260,000 policyholders with four companies. Most of these policies were written from 2016 to 2018.

Compared with the working population aged 25 to 64:

- the sample of IIP policyholders is younger, with four in five being under 45-years-old;
- the proportion of IIP policyholders who are paid more than £50,000 is no higher – two-thirds of policyholders earn between £10,000 and £40,000;
- more policyholders own their home with a mortgage or are tenants; fewer own outright.

The average value of an IIP benefit is 45% of the policyholder's earnings.

The impact of IIP on UC

54% of all IIP policyholders are estimated to have an entitlement to UC if they become unable to work due to illness or injury and have no IIP to support them.

UC regulations prescribe that as a form of unearned income, an IIP benefit reduces UC entitlement £ for £. When account is taken of the IIP in payment, it is estimated that:

- 39% of all policyholders would have their entitlement to UC ("without IIP") removed by IIP;
- 15% of all policyholders would continue to be entitled to a UC award alongside their IIP.

The impact of UC on IIP

A UC award has no impact on the cash value of IIP but it does have an impact on its net value, that is, the amount by which a policyholder is better off with IIP than without. This "better-off" calculation compares a notional UC award in the absence of IIP with the cash value of the IIP benefit.

About 1 in 5 of all IIP policyholders are estimated to be no better off at the point of claim if they have IIP than if they do not. Put another way, a significant minority of policyholders could decide, at the point of claim, that their policy has little or no monetary value.

A purely financial calculation takes no account of the other differences between IIP and UC. It cannot therefore be definitive but it does place a question mark over IIP. This doubt about IIP seems easy to grasp because it is about money alone.

Other principal findings

Uncertainty about future household circumstances amplifies the problem. At the point when people are considering whether to take out an IIP policy, often years in advance, more than 1 in 5 could reasonably worry that they might be one of those whose policy turns out to have little or no monetary value should they come to claim on it.

Since the decision to take out a policy is usually made on the basis of a recommendation from a financial adviser, it is not just uncertainty in the mind of the potential policyholder that matters but also the uncertainty in the mind of the adviser.

The clarification regarding mortgage repayments helps address the problem of uncertainty: so long as their repayments qualify, a policyholder will now always be better off with IIP than without. But the clarification does not benefit tenants who are the majority of those whose IIP policies have little or no monetary value.

It is possible that some policyholders with an IIP benefit in payment may find their support from state benefits drop as they migrate from a legacy benefit (such as tax credits) to UC or lose the transitional protection attached to their UC award.

Having no entitlement to statutory sick pay, those who are self-employed are more likely to have a need for IIP as soon as they become unable to work, even if that need is only temporary. But as unearned income, IIP is treated less favourably by UC regulations than SSP which is earned income.

Why this matters

From the point of view of current policyholders, the question mark hanging over IIP is a clear problem with obscure roots. They could not have been expected to have anticipated this problem when purchasing their IIP, nor is there anything they could have done about it. The factors that influence it are either uncertain or beyond the control of the policyholder when they take out their policy.

From the point of view of the Government, IIP saves it money by reducing UC (saving around three quarters of the UC that would have been paid to policyholders if they did not have IIP). A retreat from IIP by low- and middle-income earners would push up public spending on social security.

The private and wider public interest in an insurance-based benefit like IIP is that it is better at promoting long-term resilience. Being more stable and certain than UC, IIP's net value may rise over time for someone who cannot work for a prolonged period. Additionally, unlike means-tested support, IIP does not discourage or limit savings.

Conclusion

The two-thirds of policyholders earning between £10,000 and £40,000 confirms that IIP is in no way confined to high earners. The 54% of policyholders with a potential UC entitlement if they could not work confirms the importance of the UC-IIP overlap. Yet policyholders, and especially potential policyholders, face uncertainty about what an IIP policy might turn out to be worth if they need to claim on it.

This report was produced to enable the Government and the insurance industry to understand better the current consumer demographics and economic characteristics. The question mark over IIP is clearly a problem for IIP providers but there appears to be the basis for a dialogue with Government about it.

A suitable objective would be to ensure that IIP should always have a positive net value for policyholders.

The clarification around mortgage payments appears to do this but it cannot help tenants. Something with a similar effect to the treatment of mortgage repayments but designed for tenants would offer consistency across housing tenures.

The potential of IIP to serve as an alternative to SSP for those who are self-employed may be limited by the different ways they are treated under UC, as unearned and earned income respectively.

Whether the process of migration from legacy benefits to UC over the next four years will cause problems for policyholders already receiving a benefit is uncertain. Industry and the Government should keep the matter under joint review.

1. Individual income protection and universal credit

1.1. Introduction

This report has been commissioned by the Association of British Insurers to inform the industry about universal credit and the Government and others involved with universal credit about individual income protection.

This is the New Policy Institute's second report on the subject, the first being a submission to the Government's consultation on work, health and disability in 2017.[1] We come to this subject from a background in social security rather than private insurance.

This chapter provides background information on first, universal credit (UC) and second, individual income protection (IIP).

1.2. Individual income protection (IIP)

IIP is an insurance product bought by individuals to provide them with an income if they become unable to work due to sickness or injury. 148,000 policies were sold in 2018, up more than 50% on 2014.[2] In 2017, some one million policies were in force[3].

Nearly all IIP policies are taken out following an assessment, advice and recommendation of a financial adviser. At the start of 2018, there were 10,600 claims in payment.[4]

Of the policies sold in 2018, about 60% would pay out for an unlimited term (that is, "to retirement"). Among the rest, the majority limit payment to two years. Policies also allow for payment to be deferred for a period (for example, by 26 weeks).

While there are some fundamental differences between UC (and the wider social security system) on the one hand, and IIP on the other, there are also some similarities. In particular, IIP policies do not just provide money but also provide support designed to promote recovery and rehabilitation to allow a policyholder to return to work if possible.

This help may include early intervention, access to a second medical opinion, physiotherapy or counselling for mental health issues and other medical condition treatment, plus back to work support. In the first instance, that help may be made available by a nurse or other professional whose job is to listen to, advise and make links to specialist services on behalf of the policyholder.

A distinctive feature of IIP is that it provides financial support until a policyholder is able to return to work in his or her “own occupation”. This is not all-or-nothing. Someone returning to work in their own occupation but on a part-time basis, or in another occupation but at a lower level of earnings, could receive financial support at a reduced rate from their IIP policy.

1.3. Universal credit (UC)

UC is gradually becoming the main means-tested social security benefit for working-age adults. A means-tested benefit is one in which the amount paid out depends on how much income a household has from other sources.[5] UC, which was brought into being by the Welfare Reform Act 2012, contains elements for living expenses, children and rent. It replaces six former benefits:

- income support
- income-based jobseeker’s allowance
- income-based employment and support allowance
- housing benefit, working tax credit
- child tax credit.

These six benefits are now collectively known as legacy benefits. By the time it is fully rolled out in mid-2024, UC is expected to have a caseload of some seven million working-age households.[6] UC is paid to both non-working and working households.

1.4. The process of claiming UC

For a person who falls ill and is unable to work, claiming UC is a process, not a single event. It can take anything from a few weeks to 18 months before the UC award reaches a level which would endure, so long as their capability for work remains unchanged. The process has three main phases:

- Sick pay (28 weeks). On falling ill, an employee is likely to get statutory sick pay (SSP), which may be topped up by their employer. Someone getting just SSP could be entitled to a UC award to run alongside it.
- Assessment (up to 13 weeks). When a person applies for UC on the grounds of sickness or disability, they receive a limited UC award while they undergo a work capability assessment (WCA). Assessment can take place while sick pay is being paid in preparation for it ending.
- Award (unlimited). If the claim is accepted, there are two outcomes which depend on whether the person is judged to have a “limited capability for work” (LCW) or a

"limited capability for work-related activity" (LCWRA). The latter attracts a higher UC award.

Another factor is whether the person has paid enough national insurance to qualify for contribution-based employment and support allowance (C-ESA).[7] C-ESA cannot be paid until SSP has ended.

As an insured benefit rather than a means-tested one, C-ESA has similarities with IIP. C-ESA can be paid even if household income is too high for UC. C-ESA reduces any UC award £ for £.[8] But unlike UC, C-ESA is not reduced by IIP. Following the assessment, C-ESA is limited to one year (LCW) or unlimited (LCWRA).

The analysis in this report is supported by six case studies set out in appendix 2. The case studies reflect the complexity of claiming UC and the way that UC entitlement can pass through a number of different phases through the first weeks and months of a claim based on limited capability to work.[9]

2. How much have UC and IIP really got to do with one another?

2.1. Introduction and key findings

The obvious question to start with is this: what have UC and IIP really got to do with one another? After all, isn't it the case that UC is there to help people on low incomes while IIP policies tend to be held by those who are a lot better off and therefore unlikely to have anything to do with UC? We suspect that this would be most people's response if they were asked. If it were right, there would be next to no overlap between UC and IIP.

This chapter shows that this response is far from right. It looks first at UC and UC entitlement for the whole working population. It then compares the socio-economic and demographic profiles of IIP policyholders and this working population. The main findings of the chapter are as follows:

- Compared with the working population aged 25 to 64, the sample of IIP policyholders is younger, with four in five being under 45-years-old.
- Compared with the working population, proportionately fewer IIP policyholders are low paid but no more are high paid (above £50,000).
- Compared with the working population, it is estimated that more policyholders own their home with a mortgage or are tenants; fewer own outright.
- The maximum benefit that can be paid by from an IIP policy is 60% of gross earnings. It is estimated that the average benefit paid is 45%.
- It is estimated that 49% of the working population would be entitled to UC if they were unable to work and had no IIP benefit.
- The comparable figure for policyholders is 54%. The number is higher due to policyholders' housing tenure and the greater likelihood of their having children.

2.2. UC entitlement among the working population

The reference population against whom we compare IIP policyholders is made up of those in work aged from 25 to 64.[10] To assess the extent of the overlap between UC and IIP, we start by estimating what proportion of the reference population would have an entitlement to UC if they were unable to work and had no IIP.

Entitlement to UC depends on household income and household savings. We estimate that 20% of the reference population have no entitlement to UC whatever their income because their savings exceed the upper limit of £16,000.

We estimate that a further 31% of the reference population would have no entitlement to UC because the income of their household is too high. In almost all cases, it is a partner's earnings that cause household income to be too high.

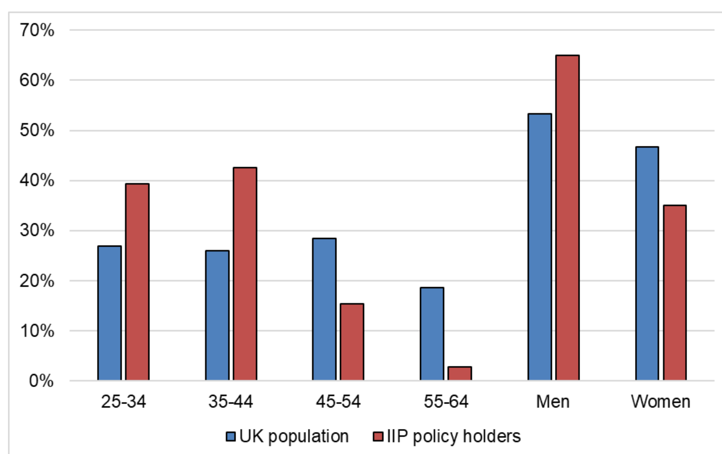
UC rolls six legacy means-tested benefits into one. This means that the total that can be paid out by UC is higher than any legacy benefit on its own. UC is particularly high for households with children who rent their home.

The other 49% of the reference population would be entitled to UC if they became unable to work due to illness or disability.[11] This underlines the potential extent of UC across the whole population.

2.3. Demographic and economic characteristics of IIP policyholders

We have analysed anonymised data on the age, sex and earnings for a sample of some 260,000 policyholders between the ages of 25 and 64 with four companies. Most of these policies were written from 2016 to 2018 although some go back to 2000. Appendix 1 contains more details on this sample.

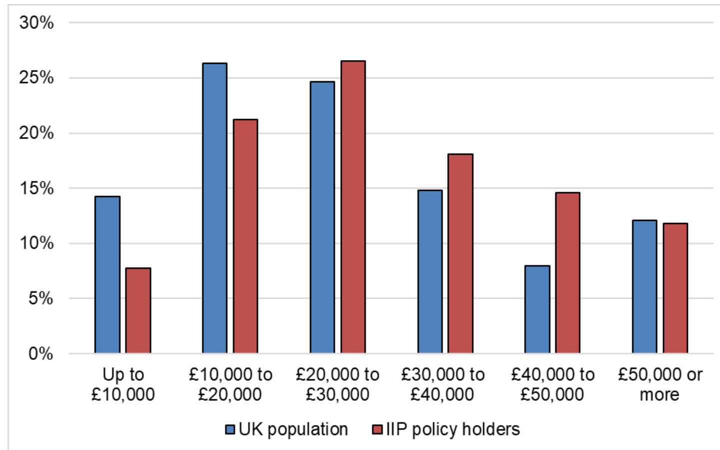
Starting with age and gender, the graph below (drawn from Appendix 1) shows that these mainly recent IIP policyholders are younger than the reference population, over 80% of them being between 25 and 45. Two thirds of them are men. The implications of the age distribution are considered further below. The implications of the gender split are beyond the remit of this report.



Policyholders are younger than the working population (82% under 45). Two thirds of them are men

On earnings, we find that policyholders are no more likely than the reference group to earn more than £50,000 a year. They are, however, quite a lot less likely to earn under £20,000. Putting this another way, policyholders' earnings are more concentrated in the £20,000 to £50,000 range than those of the reference group. Even so, around three quarters of both policyholders and the reference group earn below £40,000.

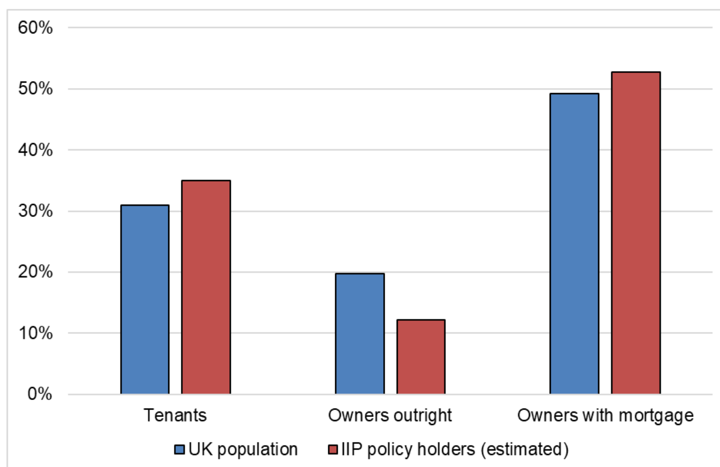
Policyholders are more likely to earn between £20,000 and £50,000 – and much less likely to earn under £10,000 – than the working population



It is also understood that a significant minority of policyholders are self-employed. Within the UK working population, those who are self-employed are more likely to have low earnings (57% of them having annual earnings under £20,000 compared with 38% of those who are employed).

We estimate that 53% of policyholders own their home with a mortgage, while 35% are tenants.[12] These proportions are both higher than for the reference group. That is because being older, the reference group has more people who own their home outright.

The proportion owning with a mortgage is also higher, and the proportion renting is lower, than it would be if we just adjust for age but not for earnings. That reflects the fact that low earners, who are especially likely to rent their home, are under-represented among policyholders. Even so, the proportion of policyholders who are tenants is still sizeable.



We estimate that just over half of policyholders own their home with a mortgage, while one third rent

2.4. The average value of IIP

The data on the sample of policyholders does not include information on the size of the IIP benefit so it has to be estimated.

IIP policies usually have a maximum benefit limit of 60% of gross earnings. Although an IIP benefit is free of income tax, 60% of gross earnings is still less than the net earnings of an employee paying tax at the basic rate. As a result, a policyholder receiving a benefit still has some financial incentive to return to work.

Combining evidence from two sources suggests that the actual average IIP benefit is well below the 60% maximum.

First, over the last three years, the average earnings of policyholders in the sample has varied between £36,000 and £38,000. As noted in Appendix 1, we cannot be certain that the sample, though large, is fully representative. For example, Friendly Societies are under-represented, accounting for 10% of the sample, but around 20% of all IIP policyholders.[13]

Second, over the same three years, the average annual benefit for new policies varied between £14,700 and £16,800.[14]

Putting these together implies an average benefit of between 39% and 46% of gross earnings. Since our original expectation was for something closer to 60%, we have decided to assume that IIP equals 45% of earnings, at the upper end of the range.

2.5. Conclusion: UC entitlement among IIP policyholders

Overall, the demographic and economic profile of IIP policyholders is similar to the reference population in many respects, even if there are some marked differences. Given both the similarity and the differences, it is not surprising that our estimate of UC entitlement among policyholders is close to that for the reference population: 54% compared with 49%.

To be precise, this means that 54% of policyholders would be entitled to UC if they were unable to work due to illness or injury and had no IIP.[15]

The main reason why the estimate of entitlement is higher for policyholders than for the reference group is that being younger, a higher proportion of policyholders have children. Children increase the maximum UC award that a household could receive. A higher maximum means a higher likelihood of UC entitlement once other income (for example, partner earnings) have been taken into account.

The other 46% of policyholders would not be entitled to any UC even without IIP. Policyholders in this position have no interaction with UC and to that extent, fit the assumption that UC and IIP belong to different worlds. But with 54% of policyholders having at least a potential UC entitlement, the assumption is clearly wrong. UC and IIP have a large overlap. The question for the more than half of IIP policyholders who are not beyond the UC system is: how do IIP and UC interact?

3. Analysis of the UC-IIP interaction

3.1. Introduction and key findings

This chapter looks at the interaction between UC and IIP. As a means-tested benefit, UC takes account of every source of income that a household applying for support has coming in. Income from other sources usually reduces the size of the UC award.

An IIP benefit in payment is one such source of income. The UC regulations set out precisely how an IIP benefit in payment will impact the size of any UC award. This chapter starts by explaining that; but what it is really interested in are the implications of that impact on the worth (or value), to the policyholder, of having IIP.

In order to look at this, it is helpful to divide IIP policyholders into three groups depending on what their UC entitlement would be at the point when they claim on their IIP policy. These groups play an important role in this report. The box below provides a short description of each and the name used to refer to each group.

The three groups

Someone who is unable to work will be in one of three situations as far as their entitlement to UC is concerned:

Group	Description	Short name
A	No entitlement to UC even if not receiving an IIP benefit	"No UC even without IIP"
B	An entitlement to UC if not receiving an IIP benefit – but no entitlement to UC when they are receiving their IIP benefit	"UC removed by IIP"
C	An entitlement to UC even when receiving their IIP benefit	"reduced UC alongside IIP"

As their circumstances change, policyholders may move between groups. We classify them at the point of claim, when a policyholder first makes a claim for IIP.

The main findings of the chapter are:

- Measured by the benefits they receive, Group A (no UC even without IIP) and Group B (UC removed by IIP) are both better off with IIP than without.

- By contrast, Group C (reduced UC alongside IIP) is no better off with IIP than without.
- Although there is more to IIP than the benefit itself, policyholders in Group C could conclude that on narrow financial grounds, their IIP is not worth anything.
- Policyholders in Group B who are only a little better off with IIP could reach the same conclusion.
- At the point of claim, 39% of policyholders are in Group B and 15% are Group C. Around 1 in 5 of all policyholders could conclude that their IIP is not worth it.
- IIP saves the Government money – around three quarters of the UC that would be paid to policyholders in Groups B and C if they did not have IIP.

3.2. The impact of IIP on UC

The £ for £ rule

Other sources of income reduce the value of a UC award but not all income is treated by UC in the same way. Earned income is subject to a taper: every extra £1 of earned income above their work allowance reduces a UC award by 63 pence. Group income protection (GIP) is treated in this way.

IIP is treated as unearned income. Unearned income is not subject to a taper or disregard. Instead, every £1 of unearned income reduces the amount of UC that would be paid by £1.[16] This is referred to in this report as the £ for £ rule. The legacy benefits which UC replaces treat IIP in widely different ways. Further details are provided in chapter 4.

The "UC award without IIP"

In order to work out the impact of IIP on UC, it is necessary first to know what the UC award would be without IIP, that is, before the £ for £ rule is applied. An estimate of what this notional UC award would be for each policyholder is the basic building block of this analysis.

As explained in chapter 2, the size of the UC award depends on four main factors, namely household earnings and other income, the number of children in the household, the rent paid and the level of savings. This "UC award without IIP" is calculated on the basis that the policyholder is unable to work due to illness or disability. This corresponds to the situation in which the policyholder would be at the point when they were about to claim on their IIP policy.

The “UC award without IIP” divides policyholders into two groups, namely those who would not get a UC award without IIP and those who would. The estimate for this split was reported in chapter 2, with 46% not getting an award and 54% getting one.

The UC award with IIP: the three groups

That is the end of the story for the 46%: if they have no entitlement to UC without IIP they certainly won’t acquire one once they are receiving IIP. The value of their IIP makes no difference to their UC award.

With the 54%, however, the £ for £ rule means that the value of their IIP is crucial to the actual value of their UC award. Depending on how the value of their IIP compares with their UC award without IIP, the 54% divide into two groups, namely:

- those who would actually get no UC award – because the value of their IIP exceeds the value of their notional “UC award without IIP”;
- those who would get a UC award, albeit reduced, alongside their IIP – because the value of their IIP falls short of the value of their notional “UC award without IIP”.

We estimate that the 54% is split 39% and 15% across these two groups. Taken together with the 46%, that gives a total of three groups, as follows:

- Group A (no UC entitlement at the point of claim even without IIP): 46%.
- Group B (UC entitlement at the point of claim removed by IIP): 39%.
- Group C (reduced UC entitlement at the point of claim alongside IIP): 15%.

Although Group C are entitled to a UC award alongside their IIP, that actual award is lower than the notional “UC award without IIP” by the exact amount of their IIP. This is the £ for £ rule in action.

Case studies 1 to 3

The first three case studies in Appendix 2 show examples of policyholders in each of the three groups.

- In case study 1, partner earnings (£42,000 a year) leave the family with an income that is too high for them to qualify for a UC award even if the policyholder had no IIP. This puts the family into Group A (“no UC even without IIP”).
- In case study 2, partner earnings (£21,000 a year) mean that the family would be entitled to a UC award (£242 a month) if the policyholder had no IIP. The IIP benefit (£1,688 a month, equal to 45% of the policyholder’s £45,000 annual earnings) is way above this. When the IIP is taken into account, the UC award drops to zero. This puts the family in Group B (“UC removed by IIP”).

- In case study 3, partner earnings (£10,000) plus the fact they are tenants gives them a much higher UC award if there were no IIP (£1,029 a month). 45% of the policyholder's earnings (£25,000 a year) gives an IIP benefit (£938 a month) below this level. Even with IIP, there is a UC award (£91 a month, equal to £1,029 less £938). This puts the family in group C ("reduced UC alongside IIP").

3.3. The impact of UC on IIP

The net value of IIP and the "better-off" calculation

IIP, which can reduce a notional UC entitlement to zero, impacts the cash value of any UC award. By contrast, whether there is a UC award or not makes no difference to the cash value of IIP. Whatever group they are in, policyholders receive IIP in full.

For those in Group A ("no UC even without IIP"), that is the end of the story. Since they would not be entitled to any UC anyway, their IIP leaves them better off by its full cash (or face) value.

For the rest, however, the net value of their IIP – the amount by which they are better off as a result of IIP – involves a comparison between the value of the IIP and the value of the UC that they would have received if they had no IIP.

Those in Group B ("UC removed by IIP") are all better off with IIP than without. That is because the value of their IIP is higher than the value of their notional "UC without IIP".

Unlike those in Group A, however, those in Group B are not better off by the full amount of their IIP. Instead, they are only better off to the extent that their IIP exceeds the notional UC they would have got without IIP. The net value of their IIP is still positive but it is less than their IIP's face value.

Those in Group C ("reduced UC alongside IIP") are no better off with IIP than without. Thanks to the £ for £ rule, the sum of their IIP and the reduced UC award they get alongside it is exactly equal to the UC award they would have got if they had no IIP. The net value of their IIP is zero.

The table summarises the similarities and differences between the three groups which have been discussed in this chapter.

Similarities and differences between the three groups

Group	A	B	C
Short name	"No UC even without IIP"	"UC removed by IIP"	"Reduced UC alongside IIP"
UC entitlement without IIP?	No	Yes	Yes
UC entitlement with IIP?	No	No	Yes
Net value of IIP compared with face value	Full	Reduced	None
Better off (in narrow monetary terms) with IIP than without?	Yes	Yes	No

Differences within Group B and variation over time

It can make quite a lot difference exactly where policyholders in Group B sit within that middle group.

For many of those at the top of Group B, whose IIP is large relative to their notional "UC without IIP", their interaction with the UC system may never be more than hypothetical. For example, monthly IIP of £1,688 in case study 2 dwarfs the notional UC payment of £242. While it is strictly correct that the net value of IIP is less than the gross value, is this really going to matter to this policyholder given how large the difference is between the two sums? A small difference is a quantitative one only, whereas a large difference – in this case, £1,446 a month – is qualitative too.

For those at the bottom of Group B, by contrast, the fact that they are only a few pounds better off with IIP than without may not seem much at all. If nothing else, the narrow financial calculation used to allocate policyholders to groups takes no account of the premiums that have been paid for the IIP.

This report has not undertaken a wider financial assessment which takes account of premiums. It is, however, able to estimate how many policyholders in Group B are better off by only small amounts. For example, about a tenth of the group (4.5% of all policyholders) are better off with IIP by £30 a week or less. This is an arbitrary number, but it gives a sense of scale. Some, at least at the bottom of group B are going to reach the same conclusion about the limited monetary worth of their IIP as those in Group C.

Another characteristic of those in Group B is that their situation over time is more unstable than those in Group A or Group C.

For example, most of the case studies assume that payment of the IIP benefit is deferred for six months. Those in Group A won't apply for UC at any point. Those in Group C will apply for UC as soon as they become unable to work – and will then likely continue to receive a UC award from that point on.

By contrast, some of those in Group B may also apply for UC as soon as they become unable to work: the calculations here say they would be entitled to it. Then, once their IIP benefit begins to be paid, UC entitlement will end. Having received payments of both IIP and UC, the policyholder will have a clear visibility of both.

A similar tangible comparison will also be evident to anyone in either Groups B or C whose IIP policy is for a fixed term only and who has been unable to return to work before it comes to an end.

Case study 4

The policyholder is case study 4 is a single adult who receives SSP for 28 weeks and is eligible for C-ESA. IIP benefit (£1,313 a month, equal to 45% of their £35,000 annual earnings) exceeds the maximum UC award. This puts them in Group B ("UC removed by IIP"). However, with no other income, they do have a varying UC entitlement before their IIP payment (deferred for one year) begins, as follows:

- Weeks 1 to 5: SSP (£408 per month).
- Weeks 6 to 13: SSP (£408) and UC (£61).
- Weeks 14 to 28 (after a work capability assessment): SSP (£408 and UC (£654).
- Weeks 29 to 52 (once SSP ends): UC (£170) and C-ESA (£486).
- Week 53 onward (once IIP benefit begins): C-ESA (£486) and IIP (£1,313).

3.4. Conclusion: the question mark hanging over IIP

If £30 a week is taken as the level below which those in Group B take the same view as those in Group C, a total of about 1 in 5 of all policyholders would be concluding that their IIP policy really was not worth anything in narrow monetary terms.

We stress that a proper evaluation of IIP goes far beyond this narrow calculation. Chapter 5 considers that further. Yet the ease with which a simple calculation can (apparently) be understood, coupled with the significant proportion of policyholders who could make that negative judgement, suggests that IIP has a problem. A narrow monetary assessment cannot be definitive – but it can place a question mark.

4. Some further issues to do with UC and IIP

4.1. Introduction and key findings

This chapter looks at three different and particular aspects of the UC-IIP interaction.

The first concerns policyholders who are self-employed. The self-employed are treated differently by UC in several ways. These are mainly to do with when they are working but there are two which apply when they are unable to work due to illness or injury.

The second concerns the issues that might arise from the process of "migration". This is when someone currently in receipt of legacy social security benefits has those benefits replaced by UC. Unlike chapter 3, where the focus was on policyholders starting a claim on their IIP policy, the focus with migration may be on policyholders whose IIP benefit has been in payment for many years.

The third concerns the clarification issued by the DWP regarding the way that UC regulations treat mortgage repayments paid from IIP.

The main findings of the chapter are:

- A policyholder with an IIP in payment could receive a UC award worth less than the legacy benefits they were receiving alongside their IIP. This fall in support could be understood as having been caused by IIP.
- Those who can gain from the mortgage clarification are the 38% of policyholders in Groups B ("UC removed by IIP") and C ("reduced UC alongside IIP") who have mortgages. Just over a third of them are actually estimated to gain from it.
- To the extent that this makes those with mortgages in Group C always better off, it helps to address the problem of IIP policies with a low or no net value.
- As most of those facing this problem are tenants not owners, there is a case for trying to devise something similar to the clarification but for tenants.
- With no entitlement to SSP, the self-employed may see IIP as a substitute for SSP. However, UC regulations treat IIP less favourably than SSP.

4.2. UC and self-employment

The self-employed are in a different position in relation to UC from those who are employed. This is partly to do with their characteristics as a group and partly because UC treats them differently.

As noted in chapter 2, the self-employed are more likely to have low earnings. In itself, this increases the likelihood of UC entitlement and the size of the UC award.

Against this, UC assumes a notional minimum income floor for someone who has been self-employed for more than a year.[17] Basing UC on a notional income like this decreases the likelihood of UC entitlement and the size of the UC award. For someone aged 25 or over, the floor is about £1,250 per month or £15,000 per year. 44% of the self-employed in the reference population have earnings below this level.

However, as far as the interaction with IIP is concerned, these considerations are most relevant when it is the partner of the policyholder who is self-employed, rather than the policyholder.

When the policyholder themselves is self-employed, two other considerations are important. First, the self-employed are less likely to meet the conditions for (contribution-based) C-ESA.[18] This increases the UC award. Second, someone who is self-employed is not entitled to SSP. This means that a UC application is more likely to be needed straightaway, if only temporarily, before the IIP payment begins.

Case study 5

The policyholder in case study 5 is self-employed and so has no SSP; nor do they meet the conditions for C-ESA. The IIP benefit (£1,313 a month, equal to 45% of the policyholder's £35,000 annual earnings) exceeds the maximum UC award they would get with no IIP. This puts them in Group B ("UC removed by IIP").

However, since the policyholder receives neither SSP nor C-ESA, they are entitled to UC as soon as they become unable to work until their IIP payment (deferred for six months) begins. Their varying UC awards are as follows:

- Weeks 1 to 5: no UC award is ever payable for the first five weeks.
- Weeks 6 to 13: UC (£808 per month).
- Weeks 14 to 26 (after a work capability assessment): UC (£1,144).
- Week 27 onward (once IIP benefit begins): IIP (£1,313).

The different treatment of IIP and SSP

Case study 5 prompts the question of what would happen if IIP were payable at once. A point to bear in mind about that is that the UC regulations treat SSP more favourably than IIP. That is because SSP is a policyholder's earned income. Like IIP, earned income reduces a notional UC award – but it does so at the lower rate of 63 pence of UC for every £, rather than the £ for £ rule which applies to IIP.

4.3. Migration from legacy benefits to UC

Natural and managed migration

It is not only at the point of claim that a policyholder may find that their state support falls as a result of having IIP. A policyholder whose IIP benefit has been in payment for several years could also experience a problem as part of the process of migration, during which their legacy social security benefits are replaced by UC. The reduction in state support would show itself as a UC award which was lower in value than the sum of the benefits that the UC replaces.

The reason why this is relevant here is that the lower value of the UC award could be explained as being due to IIP. What is driving this result is that UC's £ for £ rule treats IIP less favourably than legacy benefits. The table below provides details.[19]

Legacy means-tested benefits	**IIP (regular payment) treatment**
Income Support (IS), Income-related Job Seeker's and Employment and Support Allowances (JSA-I and ESA-I).	As unearned income, £86 per month of IIP is disregarded for lone parents or claimants who qualify due for health reasons. Otherwise, singles receive a disregard of £22 per month and couples, one of £43 per month. IIP above the disregard reduces the award £ for £.
Housing Benefit (HB).	As unearned income, £108 per month of IIP is disregarded for lone parents; otherwise, the disregards are as above. An extra disregard is applied if the claimant or their partner meet conditions on hours worked and if they qualify for a disability premium. IIP above the disregard reduces the award by 65p per £.
Child and Working Tax Credits (CTC & WTC).	IIP is counted as income and along with all other income is subject to a disregard of £535 per month for WTC and £1,342 for CTC. IIP above the disregard reduces the award by 41p per £.

This opens up the possibility that a policyholder whose IIP has been in payment for some time could find that their IIP leaves them with too much to qualify for UC, even though they had previously been receiving a legacy benefit.

There may be three ways in which state support could fall like this.

The first is that a policyholder receiving child tax credit chooses to claim UC for the first time. Nobody can get UC and legacy benefits together; a claim for UC terminates legacy benefits.

In moving from legacy to UC by choice, the policyholder undergoes what is called "natural migration". The key thing about natural migration is that there is no "transitional protection" available to prevent the value of the UC award from falling below that of the legacy benefit/s (in this case, child tax credit).

By contrast, if the recipient of legacy benefits is required by the Department for Work and Pensions (DWP) to migrate to UC – "managed migration" – then transitional protection is available. This means that if necessary, the UC award will be topped up to ensure that the recipient does not experience a reduction in benefit income.

The second way that a household could see a fall in state support is if a "change of circumstance" obliges them to apply for UC. Again, this is counted as natural migration so there is no transitional protection available.

The third is that a household already receiving UC with transitional protection experiences a change of circumstance. At that point, it will lose that protection.

All new claims for means-tested benefits now have to be for UC. The process of migration is expected to last for a further four years. Even so, it is still at an early stage and there is much uncertainty. For example, it is uncertain whether a new claim either should or must be made for UC, as well as what exactly constitutes a change of circumstance.[20] Those contemplating a UC claim and in receipt of legacy benefits are usually urged to seek advice before doing so.[21]

If the UC award is less than the value of the previous legacy benefit, it will be because of changes in the social security system, between the old regulations and the new. The concern is, however, that the reduction could be attributed to the receipt of IIP.

At present, this is an issue to watch. If problems start to emerge, they should be viewed as systemic rather than isolated and addressed as such.

4.4. The impact of the mortgage clarification

A disregard for mortgage payments

In a clarification of its policy, the DWP has stated that IIP may be disregarded in the UC calculation so long as it is used to make a regular mortgage payment.

Assuming this condition is met, we can estimate how many policyholders would gain on the assumption that an amount equal to their mortgage repayment is disregarded when calculating the value of any UC award.[22] What we mean by "gain" here is that the policyholder has more income if mortgage payments are disregarded in this way.

The policyholders who can gain from the clarification are those with mortgages in Group B ("UC removed by IIP") and Group C ("reduced UC alongside IIP"). This includes all those with mortgages in Group C, who get a higher level of UC than before.[23]

It also includes some with mortgages in Group B who would now get a UC award alongside their IIP.[24] The reason they now get something is that the award is now calculated using a value for the IIP less the amount of the mortgage payment.

Case study 6 shows how the clarification works. Prior to the clarification, IIP (£938 per month) exceeds the UC award without IIP (£456). After disregarding a sum equal to the monthly mortgage payment of £667 from the IIP, the UC award is reduced by that amount (£271) alone. This leaves a UC award alongside IIP of £185.

Those who gain from the mortgage clarification

38% of all policyholders with a potential interaction with UC (that is, all those in Groups B and C) have a mortgage. We estimate that 14% of this 38% – that is, just over a third – gain if mortgage payments are disregarded when calculating UC. Three quarters of those gainers are in Group B.

Why do so few policyholders gain from the mortgage clarification? First, although all those with a mortgage in Group C gain, they are a small proportion of this group, most of whom are tenants.

Second, those with a mortgage in Group B only gain if their mortgage payment is bigger than the difference between their IIP and their notional UC award without IIP. The official dataset used to provide the background information for this research suggests that mortgage payments are not large relative to earnings, with half of them less than 22% of earnings.[25] Since mortgage payments are therefore rather small, not many policyholders benefit from the clarification.

The significance of the mortgage clarification is about more than the number of policyholders who gain.

The most important of these is that it increases the net value of the IIP to the policyholders who qualify for it. As a result, any policyholder in this position is now better off with IIP than without. This includes all those with mortgages in Group C who previously were no better off with IIP than without. It also includes those with mortgages at the bottom of Group B.

4.5. Conclusion: consistent treatment for tenants and for the self-employed?

By ensuring that anyone who benefits from it is now better off with IIP than without, the mortgage clarification helps to address the problem of IIPs with no net value. The trouble is that only a minority of those whose IIPs have no net value are homeowners. Instead, most are tenants.

Considerations of both consistency – fairness between homeowners and tenants – and effectiveness – ensuring that there is always a net monetary value to IIP – point in the direction of trying to create something similar to the mortgage disregard but for tenants' rental payments.

As this is not a policy report, it does not consider how that might be done. But two points can be made. First, there are several ways UC could do this.[26].

Second, by giving some policyholders a UC award which they previously lacked, the clarification has made them better off in cash terms but at the cost of bringing them into the embrace of the means-tested system. Some of the disadvantages of doing that are discussed in the next chapter.

A consistency point could also arise if IIP were to be seen as an alternative to SSP for those who are self-employed. At present, as earned income, SSP enjoys the advantage of reducing UC at a lower rate than does IIP.

5. Why the question mark hanging over IIP matters

5.1. Introduction and key points

At the end of chapter 3, we argued that there is a question mark hanging over IIP. At the point when they claim against their IIP policy, 1 in 5 policyholders could decide that their policy was worth little or nothing: if they did not have IIP, they would have an equal amount of UC. Most of those affected are tenants rather than owner-occupiers.

Many more policyholders at the point of claim could decide that the net value of their policy – how much better off they are with IIP than without – is a lot less than the face value of the policy itself.

Altogether, this means that a significant minority of policyholders could decide that their policy "is not worth it".

This is obviously undesirable. The purpose of this chapter is to consider why it matters. In outline, our answer and where it leads to runs as follows:

- The question mark hanging over IIP is not the whole story – most other differences between IIP and UC favour IIP.
- Uncertainty about future household circumstances means more people may worry about this than will be affected by it – uncertainty amplifies the problem.
- The value of UC relative to IIP likely falls if someone cannot work for several years – a short term view that IIP isn't worth it may be wrong in the long term.
- Unlike UC, IIP does not discourage or limit savings – a big reason in its favour for someone who cannot work for a prolonged or indefinite period.
- The mortgage clarification improves the value of IIP – but renters predominate among those affected so most of them aren't helped by it.
- IIP reduces the UC bill and serves the goal of promoting financial resilience – the Government has an interest in IIP.
- The question mark over IIP is a problem for providers but there appears to be the basis for a dialogue with Government to see what could be done.

5.2. Why the problem with IIP matters

Most other differences between UC and IIP favour IIP

The finding that 1 in 5 policyholders could decide that their policy was worth little, or nothing, certainly poses a serious question about IIP. But on its own, the relative monetary benefit of IIP compared with UC is only one of the elements that need to be taken into account in this comparison.

What are the main non-monetary elements and how do they compare?

First, IIP policies support policyholders to help them to return to work. The non-financial support on offer differs between IIP providers but a package typically includes early intervention, rehabilitation and services to help the policyholder as they start back. Although UC also aims to get people back to work, the style and content of how it does it is quite different.

Second, IIP policies usually offer financial support until a policyholder is able to return to work in their own, prior occupation. Those who can only return to work but at a lower level or for fewer hours may continue to receive financial support from their IIP to compensate for the shortfall. By contrast, UC simply aims to get people back into any job rather the one they were doing before.

A fundamental difference between UC and IIP is the basis on which they are paid. A policyholder earns the right to IIP by paying premiums but there is no equivalent right to UC which instead depends on the financial circumstances at the time. These circumstances are, moreover, those of the household and not just the policyholder. This is a difference between any insurance-based benefit (including a national insurance benefit) and a means-tested benefit.

One consequence of this is that IIP is more certain than UC, which depends on a partner's earnings, the number of dependent children, the rent paid and the level of savings. Changes in any of these will likely change the value of the UC award.

A second is that some people will regard a benefit received by right as preferable for that reason alone. The attachment to insurance-based benefits has a long tradition. Lord Beveridge, the architect of the Welfare State, rested his argument for national insurance in the 1940s on what he saw as the British people's attachment to the principle of "benefit in return for contributions". Evidence that Beveridge cited in support of this claim included "the phenomenal growth of voluntary insurance against sickness, against death and for endowment". [27]

In our view, all these differences favour IIP over UC. Even if a policyholder is no better-off in narrow monetary terms with IIP than without, these differences mean that they are better off in non-monetary terms.

The trouble is, though, that the narrow financial calculation is prominent and memorable because it seems easy to understand. By contrast, although support for return to work in "own occupation" sounds tangible, some of the other advantages are less obvious – and their worth more subject to personal preference.

Uncertainty about future household circumstances amplifies the problem

Despite IIP's advantages, there is one way in which the inherent uncertainty about the value of a future UC award works against IIP.

The assessment of how IIP compares with UC can only be made when the policyholder claims on their policy. The UC award, which is always for the here and now, depends on the household's financial circumstances at that time. When the decision to become an IIP policyholder was made, usually long before, those household circumstances, at what was then some unknown point in the future, would have been uncertain.

This uncertainty means that even if only 1 in 5 policyholders decide at the point of claim that their IIP policy is not worth anything, a higher proportion of potential policy holders could reasonably worry that they might turn out to be one of them.

While the passage of time inevitably leads to uncertainty, it is amplified by the extreme sensitivity of UC to IIP (the £ for £ rule).

As noted in chapter 1, IIP policies are taken out on the recommendation of a financial adviser. This means that it is not just uncertainty in the mind of the potential policyholder that matters but also the uncertainty in the adviser's mind too.

Even if IIP isn't worth it in the short term, it may be worth it later

Even if the idea that IIP might not be worth it at the point of claim is correct, it may become worth it for someone who is receiving an IIP benefit for a prolonged period. There are two ways this could happen.

First, high levels of UC usually arise when the household has children. As those children grow up and either leave home or cease to be counted as dependent, the IIP policyholder's UC award will fall. As a result, even if IIP was once "not worth it" at the point of claim, when UC falls with the passage of time, that judgement could change.

Second, even when household circumstances are unchanged, the future value of a UC award is subject to political decision and economic pressures on public spending. For example, social security benefits have not been uprated in line with inflation in recent years. There is no reason to think that a similar freeze could not happen again.

By contrast, the future value of an IIP policy in payment, which is governed by a contract, is predictable. Over the longer term, this means that it is more likely that IIP will rise relative to the value of UC than fall.

Someone who is unable to work for a prolonged period may therefore be better off relying on IIP as much as possible.

Unlike UC, IIP does not discourage or limit savings

An IIP policyholder who is unable to work for a prolonged period will want to protect their savings and add to them if possible. As a means-tested benefit, UC discourages this. Its upper limit on household savings means that no household receiving UC can allow its savings to exceed £16,000 or it will lose its entitlement.

As an insurance benefit, IIP needs to take no account of savings. This means it neither discourages savings nor sets an upper limit on them. Those policyholders whose entitlement to UC is removed by IIP (the 39% in Group B) are the ones who gain from this.

Again, someone who is unable to work for a prolonged period is better off relying on IIP if, by doing so, they can avoid having to claim UC.

Disregarding mortgage repayments helps – but those who need help mostly rent their home

If IIP devoted to mortgage repayments is disregarded for the purposes of calculating the UC award, then this ensures that anyone making such payments is strictly better off with IIP than without it. In its absence, policyholders who have a UC award alongside their IIP are strictly no better off with IIP than without (though they are not worse off).

If being "better off with IIP than without" is judged to be one of the keys to defending IIP and explaining its merits, the mortgage clarification is effective. The difficulty with it is that most of the policyholders who are strictly not better off with IIP than without do not own their home with a mortgage but rent their home. If something could be created for tenants that had the same effect as the mortgage clarification, it would go a long way towards ensuring that everyone with IIP was strictly better off with IIP than without it.

5.3. The wider public interest in IIP

IIP and public expenditure

The £ for £ rule ensures that IIP saves the Government money by reducing the amount that is paid out in UC. We estimate that the reduction in public spending is equal to about three quarters of the UC award that would be paid out to IIP policyholders if they did not actually have IIP. In round terms, this saving in public expenditure is estimated to be worth about £400 per month for each of the estimated 54% of policyholders who would have a UC entitlement without IIP.

It is clearly in the interests of the public finances that people who would otherwise be able to claim UC should have IIP. Three quarters of the UC that would otherwise be paid is a high proportion. To save this much reflects the effectiveness of current regulations, dominated by the £ for £ rule.

But it is also in the interests of the public finances that there is no widespread retreat from IIP by middle and low earners. In principle, there is a trade-off to be made between the effectiveness of regulations in reducing the UC award and the disincentive to take out an IIP policy that the UC interaction may represent to some potential policyholders.

Resilient households

Government also has a longer-term objective of promoting households' financial resilience, both in its own right and to avoid households becoming dependent on UC.

Two arguments earlier in this chapter provide additional reasons for there being public and Government interest in IIP. The first is that someone who is unable to work for a prolonged period may be better off on IIP than the estimates based on UC entitlement at the point of claim may imply.

The second is that as an insurance benefit, IIP provides no disincentive for a household to save whereas UC, as a means-tested benefit, certainly does.

5.4. Conclusion: a basis for a dialogue between Government and providers

The idea that IIP might not seem worth it at the point of claim must be a cause for concern. We have explained why there is more to it than the narrow monetary comparison between IIP and UC on which this finding is based. In our view, an insurance-based benefit is strongly to be preferred to a means-tested one if the claim is likely to be prolonged. But the idea and the question mark that the problem leaves hanging over IIP are easy to grasp. The qualifications and counter arguments are less easy.

This is clearly a problem for insurance providers. What we have shown is that Government also has an interest in IIP continuing to be a product taken up by middle and low earners. It should always be remembered that like UC, IIP has twin goals: not just providing financial support for someone who is unable to work but also supporting them back into work if possible.

The root of the problem for IIP lies in how the UC regulations treat it. Although this is foreshadowed in the legacy benefits' treatment of IIP, the UC regulations are different in scale and intensity. We can infer from the extent of the shift from legacy benefits to UC that there may be scope for different approaches.

For all these reasons, there appears to be the basis for a dialogue about this problem between Government and providers. A possible objective for such a dialogue would be to ensure that IIP should always have a positive net value for policyholders. Specific questions for consideration could include:

- whether something similar to the treatment of mortgage payments could be fashioned for rental payments;
- whether the potential of IIP to serve as an alternative to SSP for those who are self-employed may be limited by the difference in treatment of unearned and earned income;
- whether the process of UC migration might cause problems for policyholders receiving legacy benefits or UC with transitional protection alongside an IIP benefit already in payment.

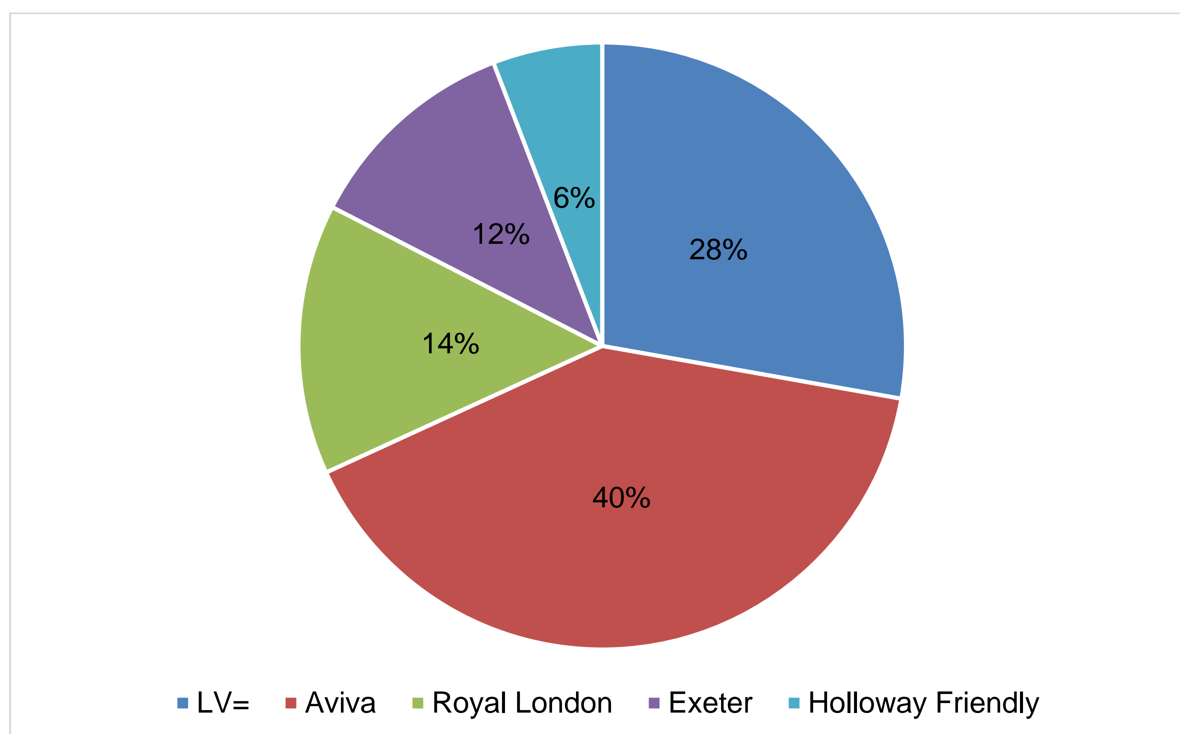
Appendix 1: policyholder data and population demographics

The sample of policyholders

For this project we received data from individual income protection providers. This data included: the date the policy was taken out; age and annual salary at time of taking out the policy; gender and the term of the policy.

Our overall sample is of 379,508 IIP policyholders, past and present - a considerable base of which to represent the industry and its customers. Their shares of the overall sample are shown below. The two largest companies in the industry, LV= and Aviva, together make up over two-thirds of our sample, with Friendly Societies making up just under a fifth.

Share of IIP records by company

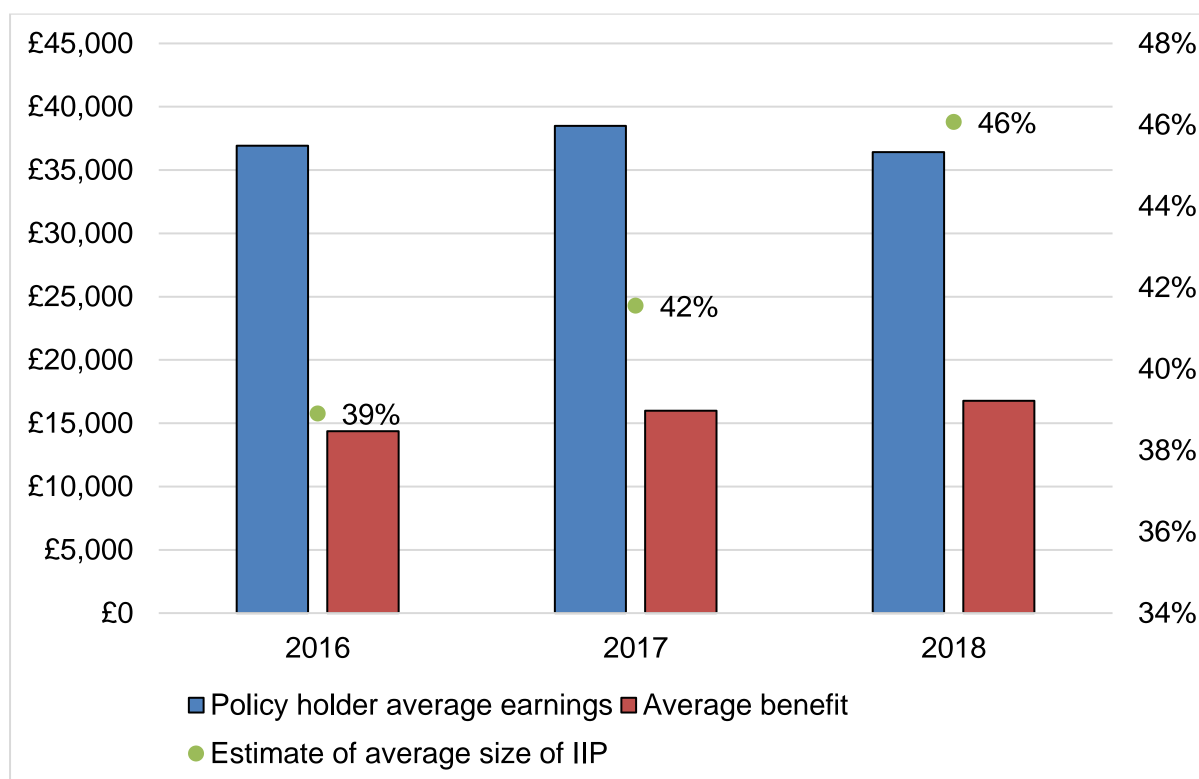


Not all companies were able to provide all the information listed above.[28] The sample was therefore restricted to those records that contained all three of age, gender and salary and were written since 2000. Further, to match the analysis of the Family Resources Survey, we restricted the age range of clients to between 25 and 64-years-old.[29] As a result, the final sample size for our analysis of the IIP industry, and the basis for most of the subsequent graphs, is 261,968.

Origins of the average IIP benefit as 45% of earnings

In general, IIP products can insure up to 60% of someone's income, however, individuals can choose to insure less of their income to reduce the premiums on their policy. As such, to measure the relationship between IIP and UC, a more representative level of IIP is important. Using a combination of the earnings of individuals from polices sold in 2016, 2017 and 2018 in our sample and the Term and Health watch 2019 from Swiss Re,[30] the data suggests the average IIP product is much lower than 60%.

Average IIP policy benefit and client annual earnings for 2016 to 2018

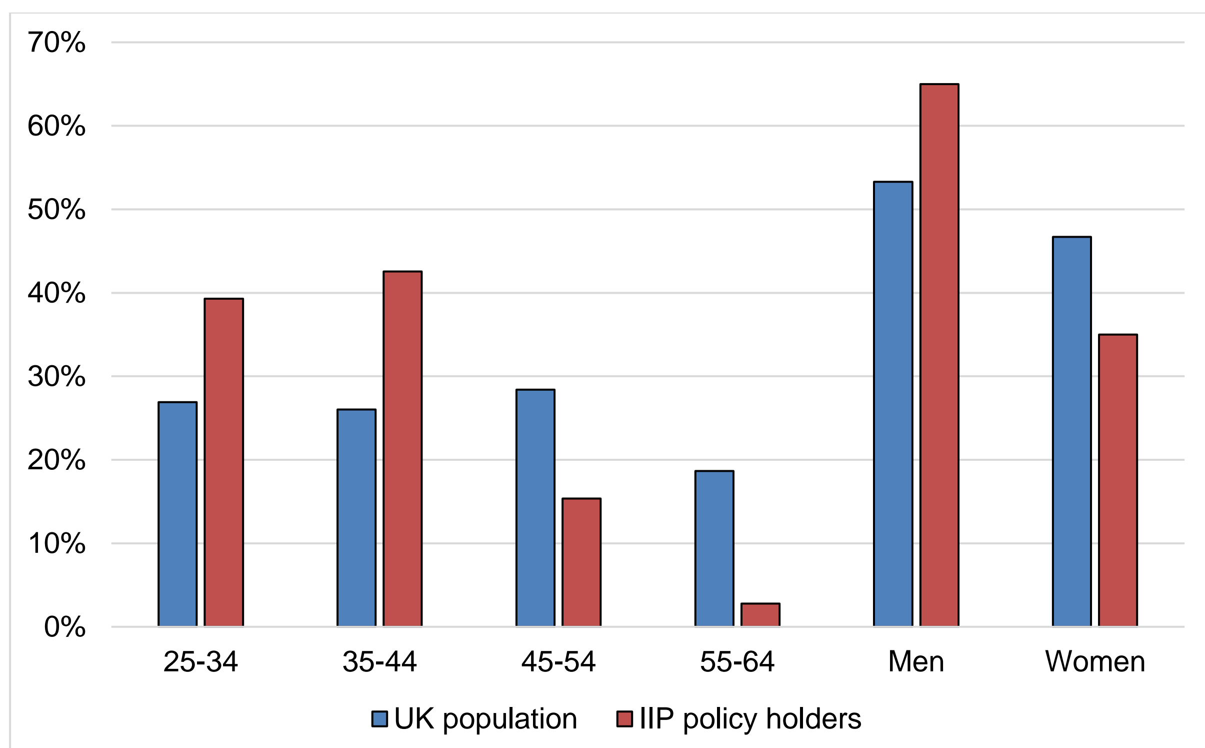


This is not a perfect estimate of the average portion of earnings that have been insured for the last three years. Friendly societies are underrepresented in this sample, accounting for only 10, whereas they account for twice that in the overall market. In addition, due to the low number of companies involved the sample, the averages are susceptible to skew as a result of trends for certain companies. The key point, however, is that lying between 39% and 46%, the average level of earnings that is insured against is far below the maximum. Since our expectation was for something higher, we have decided to assume for our analysis that IIP equals 45% of earnings, at the upper end of the range.

IIP policyholders compared to the UK population

From our final sample size of just over 260,000 records, the demographics of IIP policyholders is noticeably different from the population at large represented in the Family Resources Survey (FRS), who are between the ages of 25 and 64 years, are in work and earning a wage. As such, the following statistics are part of how this report weights the results from the FRS to be more representative of IIP policyholders.

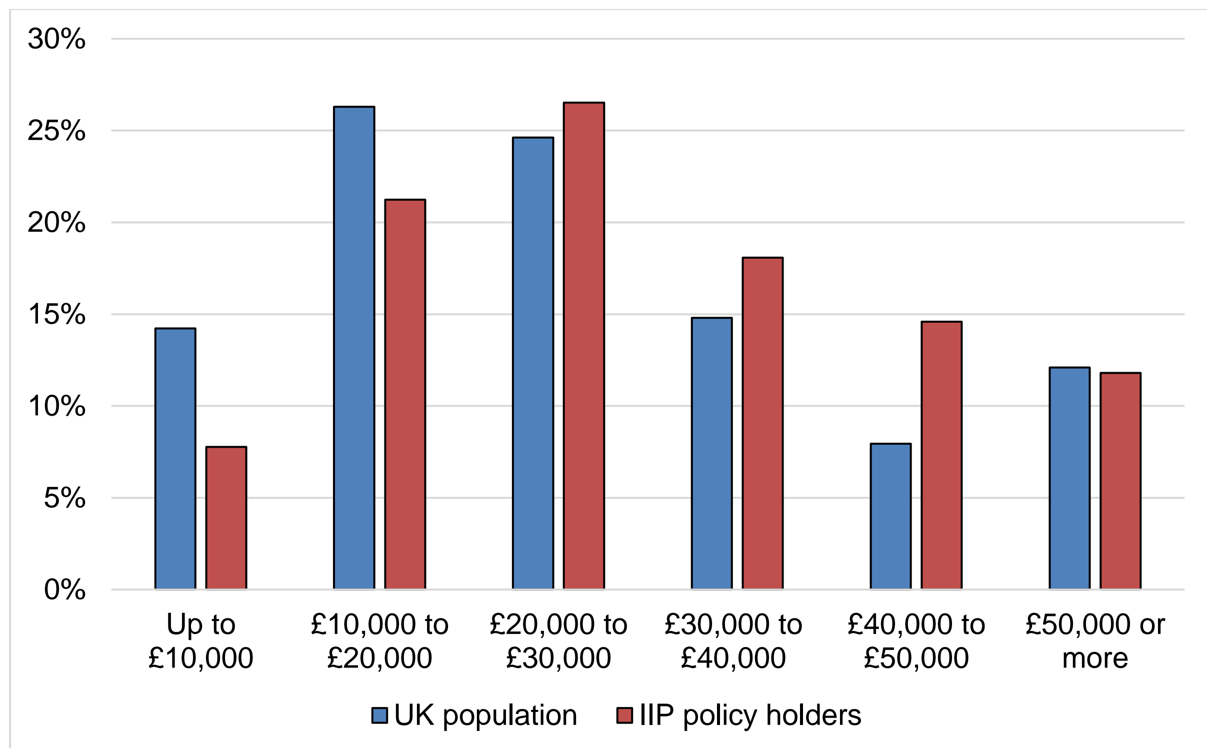
Distribution of those in work by age and gender



IIP policyholders are both younger and much more likely to be men. Four-fifths of IIP policyholders in the sample were between the ages of 25 and 44, compared to just over half in the overall population. The significantly smaller proportion aged between 55 and 64 is no surprise given demand for IIP policies will be much lower in that age group.

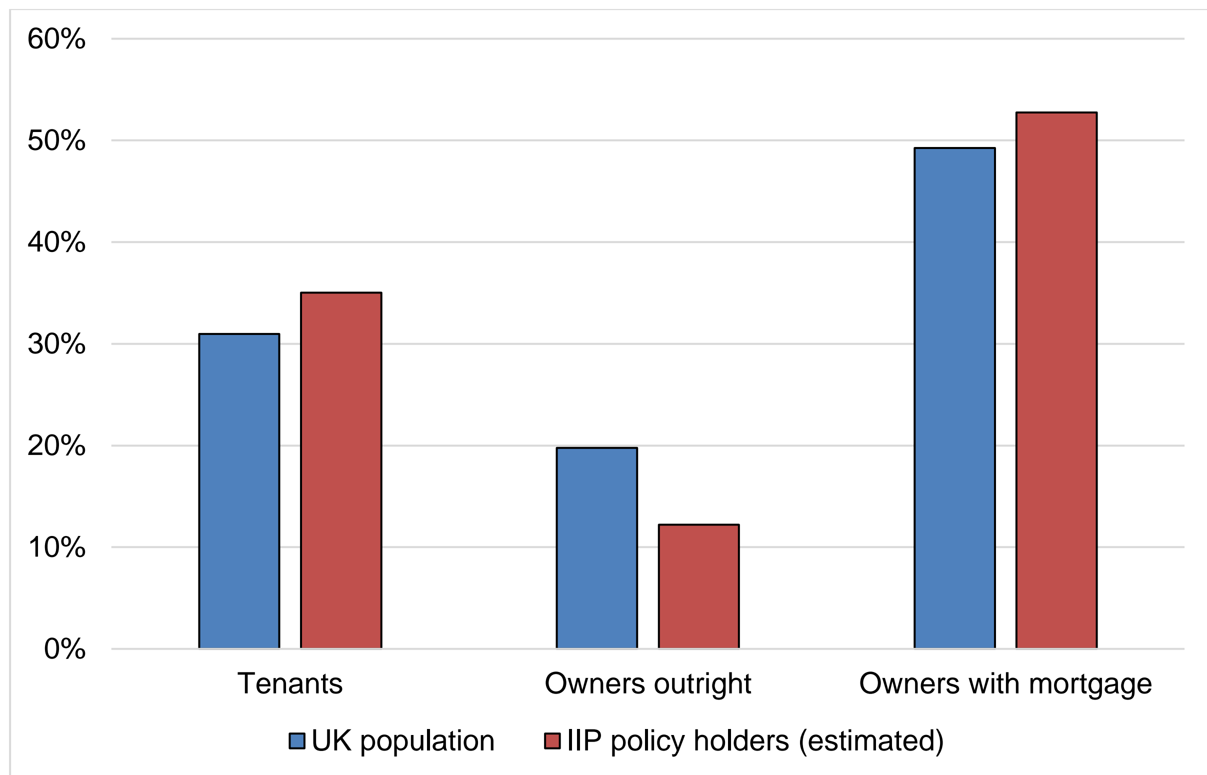
In addition, although the population of those in work between the ages of 25 and 64 in the UK is already slightly skewed towards men, the skew is even more drastic for IIP clients, with men making up nearly two-thirds.

Distribution of annual earnings of those in work aged 25-64



Compared to the population, the distribution of annual earnings for IIP policyholders is much more concentrated, with 60% earning between £20,000 and £50,000 per year. This compares with less than half in the population in this range. The high earners are represented evenly in the population and the policyholder sample, accounting for roughly an eighth in both. In comparison, the lower end of the earnings range is underrepresented in the sample of IIP policyholders with three in every ten earning less than £20,000 per year. For the UK working population aged 25 to 64 years, four in every ten earn less than that level.

Distribution of tenure of those in work aged 25-64



Unlike the previous comparisons this one does not involve any data from our sample of the IIP industry. Instead, we have weighted the splits of tenure in the FRS according to the age, gender and salary of IIP policyholders in our sample. As such, this is not an exact picture, more a modelled estimate for their demographics.

Appendix 2: case studies

These six case studies are designed to the main features of the interaction between UC and IIP.

Each case study is allocated to one of the groups (A, B or C) described in the main report. The three-way classification depends on whether there would be a UC award even without IIP (if not, group A) and if so, whether there would still be an award when IIP was being received (if not, group B). The UC (and C-ESA) awards quoted here have been assessed using the online benefit calculator provided by Entitled To with whom we have discussed the results. While we have striven to be accurate, it should be emphasised that the case studies are illustrative rather than definitive. Not all the state benefits which the policyholders can be expected to receive are shown, notably child benefit and the personal independence payment (PIP). The time taken to secure UC decisions can vary. Despite voluminous regulations, award decisions can come down to judgement by benefit assessors.

As noted in the report, the IIP-UC interaction is not a single event but a sequence which can stretch over two years. Most of these cases studies play that down, largely by design. When a single UC award is shown, it can be thought of as what would be paid in the 'long-term state', that is the point where there are no time dependant aspects of their UC claim (for example, like the work capability assessment period). Case studies 4 and 5, themselves somewhat simplified, address the sequencing rather more explicitly.

All case studies assume that the outcome of the policyholder's 'work capability assessment' places them in the higher 'limited capability for work related activity' for UC and the 'support group' in C-ESA. All case studies bar 5 assume the policyholder meets the national insurance conditions to claim C-ESA.

Only case study 3 shows a case where, in narrow financial terms, the policyholder is not better off once their IIP policy starts paying out.

Case studies 1 to 3

The case studies refer to the same family consisting of a policyholder, their partner and two children (aged 9 and 11). The policyholder is involved in a serious car accident which left him hospitalised for a month and restricted to a wheelchair for several months thereafter. On top of their physical injuries, they began to suffer from anxiety and depression. As of now, doctors agree that there is no prospect of them returning to work in the foreseeable future.

Differences between the case studies are to do with: the earnings of the policyholders and their partners and whether they rent their home or own it with a mortgage.

Case study 4

In this instance the policyholder is a single adult involved in a similar accident as the previous case studies leaving them unable to work. The policyholder is one who having previously been an employee is entitled to SSP and too has sufficient NI contributions to apply for C-ESA.

In this instance the policyholder has a deferral period of 52 weeks. This example shows again how the financial benefits a policyholder could be claiming vary significantly over the course of the deferral period. So too does it highlight the differing treatment of SSP, ESA and IIP by UC.

Case study 5

This case study is based on the same family as in case studies 1 through 3. The key difference in that this time, the policyholder was self-employed prior to their accident. As such, to reflect issues discussed in chapter 3 regarding the self-employed, the policyholder fails to satisfy the conditions to claim C-ESA. This case study therefore shows how the take home income for policyholders formerly self-employed can fluctuate significantly over the course of their deferral period.

Case study 6

This case study is also based on the same family as in case studies 1 through 3. The key feature is to show how the mortgage clarification, discussed in chapter 4, would work in practice and its impact on the household's income.

Case Study 1: no entitlement to UC even without IIP (Group A)	
Policyholder's annual earnings	£45,000
Partner's annual earnings	£42,000
Homeowner or tenant?	Owner, with a mortgage
Income Protection policy	45% gross earnings, deferred for 6 months, payable to state retirement age
Sick pay	Statutory made up to full pay for 28 weeks
Entitled to C-ESA?	Yes, payable once SSP ends
Work capability assessment	Limited capability for work-related activity (LCWRA; support group): C-ESA payable indefinitely
Monthly state benefits without IIP (after sick pay ends)	£0 (UC) + £486 (ESA)
Monthly state benefits with IIP	£0 (UC) + £486 (ESA)
Policyholder's monthly income (after sick pay ends)	£486 (ESA) + £1,688 (IIP)

Case Study 2: UC entitlement without IIP but no entitlement with (Group B)	
Policyholder’s annual earnings	£45,000
Partner’s annual earnings	£21,000
Homeowner or tenant?	Owner, with a mortgage
Income Protection policy	45% gross earnings, deferred for 6 months, payable to state retirement age
Sick pay	Statutory sick pay only (28 weeks)
Entitled to C-ESA?	Yes, payable once SSP ends
Work capability assessment	Limited capability for work-related activity (LCWRA; support group): C-ESA payable indefinitely
Monthly state benefits without IIP (after sick pay ends)	£242 (UC) + £486 (ESA)
Monthly state benefits with IIP	£0 (UC) + £486 (ESA)
Policyholder’s monthly income (after sick pay ends)	£486 (ESA) + £1,688 (IIP)

Case Study 3: UC entitlement with IIP (Group C)	
Policyholder's annual earnings	£25,000
Partner's annual earnings	£10,000
Homeowner or tenant?	Tenant (monthly rent £1,807)
Income Protection policy	45% gross earnings, deferred for 6 months, payable to state retirement age
Sick pay	Statutory sick pay only (28 weeks)
Entitled to C-ESA?	Yes, payable once SSP ends
Work capability assessment	Limited capability for work-related activity (LCWRA; support group): C-ESA payable indefinitely
Monthly state benefits without IIP (after sick pay ends)	£1,029 (UC) + £486 (ESA)
Monthly state benefits with IIP	£92 (UC) + £486 (ESA)
Policyholder's monthly income (after sick pay ends)	£486 (ESA) + £92 (UC) + £938 (IIP)

Case Study 4: No UC entitlement with IIP, single adult with a 12-month deferral period (Group B)	
Policyholder's annual earnings	£35,000
Homeowner or tenant?	Owner, with a mortgage
Income Protection policy	45% gross earnings, deferred for 12 months, payable to state retirement age
Sick pay	Statutory sick pay only (28 weeks)
Entitled to C-ESA?	Yes, payable once SSP ends
Work capability assessment	Limited capability for work-related activity (LCWRA; support group)
Monthly state benefits without IIP (after sick pay ends)	£170 (UC) + £486 (ESA)
Monthly state benefits with IIP	£0 (UC) + £486 (ESA)
Policyholder's monthly income	£408 (SSP) + £0 (UC): weeks 1 to 5 £408 (SSP) + £61 (UC): weeks 6 to 13 £408 (SSP) + £654 (UC): weeks 14 to 28 £170 (UC) + £486 (ESA): weeks 29 to 52 £0 (UC) + £486 (ESA) + £1,313 (IIP): from week 53

Case Study 5: UC entitlement without IIP, no entitlement with; no SSP; no ESA (Group B)	
Policyholder's annual earnings	£35,000
Partner's annual earnings	£10,000
Homeowner or tenant?	Owner, with a mortgage
Income Protection policy	45% gross earnings, deferred for 6 months, payable to state retirement age
Sick pay	None (self-employed)
Entitled to C-ESA?	No
Work capability assessment	Limited capability for work-related activity (LCWRA)
Monthly state benefits without IIP	£1,144 (UC)
Monthly state benefits with IIP	None
Policyholder's monthly income	£0 (UC): weeks 1 to 5 £808 (UC): weeks 6 to 13 £1,144 (UC): weeks 14 to 26 £1,313 (IIP): from week 27

Case Study 6: UC entitlement without IIP, no entitlement with (Group B)	
Policyholder's annual earnings	£25,000
Partner's annual earnings	£15,000
Homeowner or tenant?	Owner, with a mortgage (monthly repayment £667)
Income Protection policy	45% gross earnings, deferred for 6 months, payable to state retirement age
Sick pay	Statutory sick pay only (28 weeks)
Entitled to C-ESA?	Yes, payable once SSP ends
Work capability assessment	Limited capability for work-related activity (LCWRA; support group): C-ESA payable indefinitely
Monthly state benefits without IIP (after sick pay ends)	£456 (UC) + £486 (ESA)
Monthly state benefits with IIP	£0 (UC) + £486 (ESA)
Policyholder's monthly income (after sick pay ends)	£486 (ESA) + £938 (IIP)

Variant if policy qualifies for mortgage disregard	
Monthly state benefits with IIP	£185 (UC) + £486 (ESA)
Policyholder's monthly income (after sick pay)[31]	£185 (UC) + £486 (ESA) + £938 (IIP)

Appendix 3: sensitivity testing for age and tenure

Age mix of the policyholder sample

The estimates reported in chapter 3 assume that each policyholder is as likely as any other to make a claim. One reason why this may not be so is that the average age at claim is several years older than the average age of the policyholder sample. The average age at the point of claim varies between companies, within companies according to the variety of IIP, and over time. Age 45 is a reasonable midpoint for these different averages.[32]

To check how much difference this makes, we have recalculated the estimates excluding those aged under 35. The effects are as follows:

- increase the size of group A ("no UC entitlement") from 46% of policyholders to 49%;
- decrease the size of group B ("UC entitlement removed by IIP") from 39% to 37%;
- decrease the size of group C ("UC entitlement alongside IIP") from 15% to 14%.

Housing tenure

Policyholders' housing tenure has also had to be estimated.[33] All estimates assume that policyholders either rent their home, own it with a mortgage or own it outright, in the same proportions as the working population. We have then adjusted this to reflect the age, gender and earnings profile of the policyholder sample. Using this approach, chapter 2 reported that 35% of policyholders aged 25 to 64 years and 28% of those aged 35 to 64 years were estimated to be tenants.[34]

Almost all IIP policies are sold by financial advisers. Someone seeking a mortgage is more likely to be taking financial advice at that point than someone about to begin a new tenancy. This suggests that we may have underestimated the proportion of policyholders with a mortgage and overestimated the proportion renting.

To check what effect this might have, we have recalculated the size of the three groups on the assumption that the tenant proportion is reduced by a half compared with our main estimate.[35] The result is to increase group A ("no UC entitlement") to 53%, reduce group B ("UC entitlement removed by IIP") to 38% and reduce group C ("UC entitlement alongside IIP") to 9%.

Although this is a big drop for group C (down from 15%), its size is still significant. The concern about group C therefore remains valid.

References and technical notes

[1] *Private Insurance and Social Security: what happens when they collide, why it matters and what could be done*, February 2017, NPI (for the Impact Protection Taskforce, in partnership with SAMI Consulting).

[2] *Term and Health Watch 2019*, Swiss Re, p15, unpublished.

[3] *Business in Force: Protection and Long-term Care*, Association of British Insurers, October 2018.

[4] Association of British Insurers. It is possible this value is not fully aligned with the business in force data because whereas this number includes the Association of Financial Mutuals, the business in force data does not.

[5] Throughout the body of this report, we will use the term "household" rather than the technically correct term "benefit unit" (a single adult, or couple, and any dependent children living with them). Although one and the same in most cases, some households contain more than one benefit unit, for example, when a grown-up child (a benefit unit in their own right) continues to live with their parents (a separate benefit unit).

[6] *Economic and fiscal outlook*, March 2019, Office for Budget Responsibility, para 4.85.

[7] Two conditions need to be met for a valid claim to C-ESA (also known as "new style" ESA), to do with the amount of national insurance either paid and/or credited in both of the last two tax years.

[8] Although, for trivial reasons, there can be a discrepancy of a few pence or pounds.

[9] Allowing for two assessment outcomes and entitlement (or not) to C-ESA pushes the number of possible outcomes from the three phases to seven. The different levels of UC award associated with each are reduced to a single weighted average. The first and second phases are weighted 20% between them, with the SSP phases dominating. The third phase is dominated by the single most likely long-term outcome, namely, an assessment finding "LCWRA (with C-ESA)".

[10] The data source for this reference group is the 2017-18 Family Resources Survey (FRS). Included within it are all those in the FRS who are: a) aged 25 to 64 (HDAGE 2 to 5); b) employed (EMPSTATI 1 to 4) and c) have positive earnings from employment and self-employment (This is so the modelled IIP of an individual is also positive). This produces a reference group of 26.05 million people (using GROSS4 as the weight).

[11] In order to produce this estimate, we have attached a simplified model of UC entitlement to the FRS dataset to work out UC entitlement (at the benefit unit level) row by row. Our main quality check has been at the micro level of the UC model itself. Comparison with information provided by the OBR on the DWP's Policy Simulation Model (which does the same job in more detail) allows a macro check. We estimate a total potential UC caseload of eight million. Compared with the official estimate of seven million, we are on the high side but not to such an extent that the shape of the picture we paint is likely to be seriously distorted. Comparison is qualified by the fact that the OBR's information (from its Welfare Trends Report, 2018, especially para 4.24 and box 4.1) relates to the 2015-16 FRS. Compared with an official £60bn estimate, we estimate total "counterfactual" UC spend at £63bn.

[12] The tenure split is obtained in the same way as the UC entitlement calculation above.

[13] Information provided in a conversation with Swiss Re.

[14] *Term and Health Watch 2019*, Swiss Re, p16, unpublished.

[15] To estimate UC entitlement for the sample of IIP policyholders, we re-weight the reference population so it reflects the age, earnings and gender composition of the policyholder sample. With four age groups (25 to 34, 35 to 44, 45 to 54 and 55 to 64), six earnings bands (under £10,000, £10,001 to £20,000 … £40,001 to £50,000 and above £50,000) and male/female, this means dividing the reference population into 48 sub-groups and then using a weight for each sub-group according to its share of the policyholder sample.

[16] The simplicity of the £ for £ rule and its implications for this analysis is only strictly correct so long as the benefit cap does not come into play. Having examined its potential impact, we have decided to ignore the cap, for three reasons. First, it doesn't make much difference even when it does apply. Second, the number of cases in which it might apply (that is, to households who have only just stopped working) is very small. Third, it makes an already difficult story even harder to tell.

[17] There are exceptions, for example, looking after a child under three, being pregnant or having given birth in the last 15 weeks, caring for a severely disabled person or being in full-time education. The floor does not apply to those assessed as either LCW or LCWRA.

[18] Our evidence on this is incomplete, relating just to the amount actually paid in one year. This shows 14% of the self-employed with weekly earnings below the level at which national insurance would be paid.

[19] Information listed here is correct as of the point of writing. The source used is: Child Poverty Action Group (2019), Welfare Benefits and Tax Credits Handbook 2019/2020.

[20] For a flavour, see this discussion by the House of Commons Work and Pensions Committee.

[21] See, for example, EntitledTo and the Child Poverty Action Group.

[22] In order to do this, we are using information contained in the FRS dataset on the size of mortgage repayments (both interest [MORTINT] and principal [INTPRPAY]). In taking this approach, we are therefore assuming that the clarification permits a mixed approach, that is, mortgage repayments are ignored but any amount above and beyond that – in effect, for living expenses – is not ignored. A different interpretation of the clarification is that if the policy qualifies, then the whole amount is disregarded.

[23] This assumes that they were not already getting the maximum UC possible for them.

[24] By our classification, that also means they move from Group B to Group C.

[25] It is possible that the FRS data we are using on mortgage payments underreports their size. Making a reasonable adjustment for this pushes up the proportion benefitting by a few percentage points. This is not enough to change the basic picture.

[26] They include: i) a general disregard (say "ignore the first £50 of IIP"); ii) a specific disregard ("ignore that part of IIP used for mortgage repayments"); or iii) apply a taper to the portion of IIP used to repay rent.

[27] *Social and Allied Services: Report by Sir William Beveridge* (1942), para 21.

[28] Due to the way Holloway Friendly write their policies they were unable to provide salary data. Therefore, the final sample excludes them.

[29] This is the result of HDAGE being the only age range available to us in the 2017-18 FRS.

[30] *Term and Health Watch 2019*, Swiss Re, unpublished.

[31] If the IIP policy qualifies for the mortgage disregard, the monthly UC without IIP (£456) will only be reduced by £271 (equal to £938 less the now disregarded mortgage repayment of £667). As a result, there will now be a UC award of £185 (£456 less £271) payable alongside the IIP benefit and ESA.

[32] This is based on separate information provided by some of the companies about the characteristics of the IIP policyholders whose policies are now in payment.

[33] The only independent source of information we have seen on this is from Global Data's 2018 UK Insurance Consumer Survey. This gave tenants and those living at home with their family a 28% share, of which one quarter were renting in the private sector. While the age profile reported there is similar to the one here, earnings are higher, with 45% earning above £50,000. If our sample had this earnings distribution, it would certainly produce a higher share for owners and a lower one for tenants.

[34] The full tenure split between tenants, those owning with a mortgage and those owning outright goes from 35/53/12 for those aged 25 to 64 to 28/48/14 for those aged 35 to 64.

[35] Halving the tenant share takes the tenure split between tenants, those owning with a mortgage and those owning outright from 35/53/12 to 18/70/12.