The shape of future welfare reform - Any room for partners?

Article for Reform

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It is a truth universally acknowledged that we have a large and costly welfare state in the UK. Less understood but equally true is that we have the third largest insurance sector in the world and the largest in Europe. Yet our insurance sector plays only a very small role in helping citizens manage the risks of becoming dependent on welfare as a result of losing their health or their job. This is a missed opportunity for taxpayers, workers and insurers alike and it should be part of a cross-party consensus to reform the welfare state in a way that costs less and delivers more.

Some type of reform of the welfare state is a given in the next decade; the question is ‘how?’ not ‘when?’. Our welfare system faces the triple challenges of cost, confidence and competency in a world that its founders in the 20th century could never have envisaged.

Cost will be a major crisis point because the largest element of the welfare budget is the state pension and we have an ageing population. Using OBR predictions in its 2014 Fiscal Sustainability report, the cost of state pensions to the public purse, based on current GDP, is projected to rise to £140 billion by 2050 (5.8% today to 7.4% of GDP in 2050).

Confidence in the system itself is low with a marked generational difference between younger age cohorts and older ones, not least because of the unresolved issue of whether our system is genuinely built around any meaningful contributory principles and practices.

Competency matters hugely too; how much value is the taxpayer getting for its contribution; leaving aside huge systems challenges like the implementation of Universal Credit, does the system really do anything for tax-paying working people other than provide enough money in times of distress to save them from destitution?

There are few easy fixes to any of these challenges but a greater role for income protection insurance – particularly employer-sponsored group income protection insurance - has to be part of future solutions. Why?

- Because at the moment 89% - 9 out of 10 workers – have no income protection insurance to cover the gap between State benefits and what they are used to earning; the so-called ‘Replacement Rate’.
- Because for most people this gap is very significant: 60% of working households would see their income fall by more than a third, and 40% or working households by more than half, even with State benefits if the main earner became unable to work because of serious ill health, injury or sudden disability.
- Because for most workers, group income protection is more economical and straightforward to get hold of than buying individual income protection.
- Because employees are not individually risk assessed (with the exception sometimes of higher paid staff) or excluded under group cover.
Because an increasing number of workplace ill health is due to either muscular-skeletal conditions or mental health problems. Both of these respond effectively to early rehabilitation, which is a core benefit of group income protection insurance.

Critics will no doubt cry that insurance sector involvement risks ‘privatisation’ but this is false; partnering with the state to deliver more of what the state can never afford to do is fundamentally different from putting core state provision in private hands. Nonetheless certain conditions need to be met if insurers are to contribute more:

- Cross-party consensus is needed to maximise the potential for reform to be a success; auto-enrolment has demonstrated this effectively.
- Employers need to be an increasing part of the dialogue about how to build on the auto-enrolment reforms after the 2017 review.
- Insurers need to continue to build trust and confidence much more among our customers. Customers believe their chances of a IP policy paying out are about 40%, yet Group income protection typically has a pay out rate of over 80%.

Insurers partner the state to help deliver affordable flood insurance, fund infrastructure and deliver retirement incomes. For a sustainable future for our citizens, we need to add welfare reform to that list.

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