ABI

ABI response to The Independent Review of Employment Practices in the Modern Economy

May 2017

Executive Summary

The ABI welcomes the opportunity to respond to the Independent Review of Employment Practices in the Modern Economy. The review presents a timely opportunity to explore how the growing number of people, either self-employed or working within the gig economy, can benefit from protections and long-term savings advantages enjoyed by the employed, and what additional protections can be put in place to support this group. The continuation of the review should remain a priority for any new government.

The ABI believe that this review is a good opportunity to examine and refine the definition of the three types of employment status: employee, self-employed and worker, to find the appropriate balance of rights and responsibilities for individuals and businesses in the modern economy. We advocate for a better balance between flexibility and security of income following sickness or retirement.

This submission is split into three parts focusing on our recommendations for improving pension saving for the self-employed and those within the gig economy; improving access to guidance and protection and savings products; and encouraging individuals to better protect themselves against the consequences of ill health with income protection insurance.

Our proposals are outlined below:

Supporting the self-employed and gig economy workers to save for their retirement

Further information is required to better understand gig economy workers, who they are, and what specific challenges they face in interacting with the welfare system and saving for retirement. The ABI calls for the Office of National Statistics (ONS) to undertake a review of how to improve measurements on those who are neither strictly employed nor self-employed, in order to gather a more accurate and detailed assessment of gig economy workers.

A recent report by the Work and Pensions Select Committee recommended creating an assumption of the employment status of "worker" by default, rather than "self-employed" by default. The Committee argues that this would help to ensure a higher level of rights and benefits for those individuals, consequently protecting those individuals as well as having a fiscal benefit[1]. The review should consider supporting such a measure.

Employers should not be able to opt-out of employment responsibilities by falsely labelling someone as self-employed. The consequences of doing so are an increased burden on the

[1] Work and Pensions Select Committee (2017) Self-Employment and the Gig Economy

welfare state, and a hollowing out of the tax base which supports it. The ABI believes that the Government should take action to make sure that existing rights are available to all those who are de facto employees but are currently labelled as self-employed.

The ABI recognises the stark and worsening problem of current pension provision for the self-employed and gig economy workers and understands that a one-size-fits-all approach to the problem of this diverse group may not be appropriate. However, given the significant financial vulnerability of gig economy workers, we believe it is important to act quickly to help as many of this group as possible.

The ABI believes that this review, in tandem with the Department for Work and Pension's (DWP) review of automatic enrolment, should look at how to streamline the automatic enrolment policy to increase its coverage to include multiple job holders and improve pension provision for the self-employed. The ABI advocates for an automatic enrolment type system of pension saving for the self-employed as the most effective way of helping self-employed individuals save for their retirement. Further consideration should be given to how Government, regulators and providers can work together to ensure this group of customers can find a scheme or policy that is right for them.

Improving access to guidance and protection and savings products

The creation of the new Single Financial Guidance Body is an important opportunity to improve the signposting of products, services and advice available to the self-employed and those within the gig economy, enabling individuals to better protect themselves in their working lives and equip themselves for their retirement needs. The ABI would like to see a body that takes a preventative approach rather than a pure focus on crisis management, and also uses language and information that is consistent with other Government channels.

Any new online platform developed to help these groups to access services and information should allow individuals to assess their retirement and protection needs through tools and calculators, and should signpost to, and provide information about, the range of retirement and protection provision available.

Increasing awareness and uptake of income protection products

Individual Income Protection (IIP) insurance could play an important role in improving the financial resilience of the self-employed, by providing them with a secure alternative income if they find themselves unable to work for medical reasons. However, under the current system of Universal Credit (UC), individuals could be disincentivised from purchasing IIP because the benefits provided by this are treated as 'unearned income' and therefore, for every £1 claimed under the policy, the claimant loses £1 of UC entitlement.

In order to address this disincentive, the Government should consider a combination of two measures to ensure the fairer treatment of IIP under UC.

- A full disregard for mortgage loan and home rental payment elements of IIP claims;
- IIP to be treated consistently with Group Income Protection – with any remaining IIP benefit withdrawn at a rate of 63p for every £1 received.

Rather than adding further complexity to UC, these measures represent different uses of disregards already in place in the UC system. Taken together, these two measures represent short-term action to prevent significant disincentives to purchasing IIP, a subsequent shrinking of the IIP market and therefore an increase in the government's overall welfare spend.

In the longer term, the ABI believes IIP can play a greater role in reducing welfare spending and supporting people into and within the workplace. We were pleased to see the role that income protection insurance can play recognised in the joint Department for Work and Pensions and Department for Heath Green Paper on Work, Health and Disability, and we are keen to collaborate closely with the new Government in order to explore this potential further.

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Understanding the self-employed and gig economy workers

1. There are 4.6 million self-employed individuals in the UK, of which 1.2 million are gig economy workers, who account for 15 per cent of the overall workforce[2]. The median self-employed worker earns 40 per cent less than the median employee and 1.7 million self-employed individuals are currently paid below the government level set for the National Living Wage.[3]

2. More research needs to be conducted to better understand the demographic of gig economy workers, although it has been reported that they represent 4 per cent of the UK workforce. 58 per cent of gig economy workers have additional full-time employment and will have the benefits of employment, including a workplace pension, if they fall within the automatic enrolment qualifying criteria[4]. Just 28 per cent of gig economy workers consider gig work their main job, with 20 per cent also being self-employed or having freelance work[5].

3. However, Chartered Institute of Personnel Development (CIPD) research shows that despite gig economy workers currently only having the same employment rights as the self-employed, 47 per cent do not feel like their own boss or in control of their working patterns. 57 per cent of workers think that gig economy firms are exploiting the current lack of regulation for immediate growth and 63 percent believe that Government should regulate the gig economy so that gig workers are entitled to basic employment rights and the benefits of employment, such as a workplace pension[6].

4. There is some concern that a proportion of self-employed workers within the gig economy, or elsewhere, are classed as such in order to lower costs for their employers, rather than because these individuals genuinely experience the flexibility of working that comes with being self-employed. Citizens Advice suggest that this "bogus classification" of workers as self-employed could be impacting up to half a million people[7].

5. We believe that employers should not be able to opt-out of employment responsibilities by falsely labelling someone as self-employed, and that the Government should take action to make sure that existing rights are available to all of those who are de facto employees but are currently labelled as self-employed.

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[2] CIPD (2017) To gig or not to gig? Stories from the modern economy
[3] Resolution Foundation (2014) Just a job – or a working compromise?
[4] GOV.UK, Joining a Workplace Pension
[5] CIPD (2017) To gig or not to gig? Stories from the modern economy
[6] CIPD (2017) To gig or not to gig? Stories from the modern economy
[7] Citizen's Advice (2015) Neither one thing nor the other: how reducing bogus self-employment could benefit workers, business and the Exchequer.

6. The Office for National Statistics (ONS) should develop better measures on atypical working and how to measure the gig economy more accurately and effectively, undertaking a review of how to improve measurement in this area.

Supporting the self-employed and gig economy workers in saving for their retirement

7. The ABI believe that this review is a good opportunity to examine and refine the definition of the three types of employment status: employee, self-employed and worker, to find the appropriate balance of rights and responsibilities for individuals and new businesses in the modern economy. We advocate a better balance between flexibility an security of income following sickness or retirement and believe having both should be possible.

8. Despite recent legal cases, the rights of gig economy workers to be automatically enrolled into a workplace pension and receive employer contributions are not entirely clear. We believe that this review could produce valuable evidence and recommendations so that we can better understand the longer term implications of trends in employment.

9. The 2017 Automatic Enrolment Review is looking at the existing coverage of the policy and considering the needs of those not currently benefiting from automatic enrolment, as well as considering how the growing group of self-employed people can be helped to save for their retirement. Although this and the Taylor Review will be running concurrently, it is important that they each take into account the findings of the other.

10. The ABI's response to the DWP Automatic Review list of initial questions[8] called for streamlining the automatic enrolment system so that, ideally, being employed would mean being automatically enrolled, bringing in those with lower earnings and multiple jobs into workplace pensions. This would have a positive impact on the pension provision of multiple job holders and part-time workers, such as those in the gig economy. The ABI response also advocated for an automatic enrolment type system of pension saving for the self-employed as the most effective way of helping self-employed individuals save for their retirement.

The problem of under-saving

11. Automatic enrolment has been successful to date, addressing the problem of mass participation in long-term savings and reversing a decades-long decline in the proportion of the population saving for their retirement through workplace pensions. Since the enrolment process started in 2012, over 250,000 employers have successfully

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[8] Association of British Insurers (2017) ABI response to the initial 2017 Automatic Enrolment Review questions

implemented the system and more than six million new savers are now contributing to a workplace pension[9]. The ABI remains committed to automatic enrolment as the best means of ensuring people save adequately for retirement.

12. However, the self-employed, including those working in the gig economy are not currently benefitting from this success. The ABI believes that this review, in tandem with the DWP's review of automatic enrolment, should be looking at how to extend the coverage of automatic enrolment to be more inclusive, looking at how to adopt something like an opt-out system of pension saving for the self-employed.

13. Research shows that just 30 per cent of the self-employed, including 16 per cent of gig economy workers, are currently saving into a pension. Research also shows that 35 per cent of gig economy workers are not saving for retirement at all and 66 per cent are not confident of having enough savings or pension provision to live comfortably in retirement[10].

14. Citizens Advice and the Resolution Foundation have both identified a number of possible reasons for this lack of pension provision for the self-employed, including:

    - That contributing to a pension may be unviable for many self-employed individuals – the median self-employed person earns 40 per cent less than the median employed person;
    - A lack of awareness or understanding of the benefits of pensions, including tax relief - currently 69 per cent of the self-employed do not understand the tax breaks provided by a pension;
    - A lack of awareness of how to set up a pension;
    - A lack of accessible information about pensions, including the availability of affordable advice.[11] [12]

15. There are also a number of practical barriers specific to the self-employed and those in atypical work. For example, the impetus is on the individual to proactively set up and contribute to their pension rather than this being set up and managed by an employer. It is also the case that without the employer contribution, self-employed individuals do not have the same incentives to save into a pension as employees do.

16. This problem of lack of pension provision is compounded by evidence that the self-employed are not substantially investing in cash savings as an alternative to a pension -

[9] Aviva (2016) Aviva's Auto Enrolment Pre-Review
[10] CIPD (2017) To gig or not to gig? Stories from the modern economy
[11] Resolution Foundation (2014) Just a job – or a working compromise?
[12] Citizen's Advice (2016) Shy of retiring: addressing under-saving among self-employed people

cash savings for the employed and self-employed are broadly similar[13]. Whilst any policy mechanism that encourages people to save is welcome, this could suggest that availability of pensions and other savings products is not the problem, and new savings products may not necessarily be the answer to the problem of under-saving of the self-employed.

17. The ABI recognises the stark and worsening problem of current pension provision for the self-employed and understands that a one-size-fits-all approach to the problem of this diverse group may not be appropriate. However, we believe it is important to act quickly to help as many of this group as possible.

Increasing the coverage of Automatic Enrolment

18. Currently, 23 per cent of employed people do not currently meet the automatic enrolment qualifying criteria. The main reason for not being eligible is low earnings: of those in employment who are not eligible for automatic enrolment, 57 per cent are not eligible because they fail to meet the earnings threshold. This is 13 per cent of the UK employed population that earn below the threshold and must either be in part-time work, have multiple jobs or be receiving less than the minimum wage[14].

19. The ABI believes there is considerable scope for making the automatic enrolment regime simpler and more inclusive. In our response to the DWP's initial Automatic Enrolment Review questions we advocated that, ideally, being employed should correspond with being automatically enrolled[15]. This would bring those with lower earnings and multiple jobs into workplace pensions, which would have a positive impact on the pension provision of gig economy workers, 78 per cent of which have multiple jobs[16].

20. It's important to note that there could be more than half a million individuals who are currently falsely labelled as self-employed who could be benefitting from automatic enrollment[17]. We believe that the Government need to take action to prevent such practices and to enable these individuals to be automatically enrolled into a workplace pension.

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[13] Citizen's Advice (2016) Shy of retiring: addressing under-saving among self-employed people
[14] Pensions Policy Institute, Briefing Note 75: Who is ineligible for automatic enrolment?
[15] Association of British Insurers (2017) ABI response to the initial 2017 Automatic Enrolment Review questions
[16] CIPD (2017) To gig or not to gig? Stories from the modern economy
[17] Citizen's Advice (2015) Neither one thing nor the other: how reducing bogus self-employment could benefit workers, business and the Exchequer.

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An automatic enrolment equivalent for the self-employed

21. The ABI advocate for an automatic enrolment type system of pension saving for the self-employed as the most effective way of helping self-employed individuals save for their retirement. This behavioural 'nudge' could best be delivered via the tax self-assessment system. However, it is important to recognise that if such a system were to be established that timing could be a potential problem, as the self-assessed often save enough money to pay tax, but may not feel they have additional funds to contribute towards a pension. The forthcoming move away from an annual self-assessment process could help to alleviate this problem.

22. There are further issues which need to be addressed in designing a self-assessment system for the self-employed, stemming from the absence of the employer role in making automatic enrolment a success.

23. Whilst the tax self-assessment system could provide the necessary behavioural nudge, the self-employed are still missing out on the following benefits provided by the involvement of an employer:
    - implicit reassurance as to the merits of the pension provision;
    - an employer contribution to supplement the employee contribution; and
    - choosing a pension provider for the employee.

24. Whilst it should be possible for Government, providers and other stakeholders to provide necessary reassurance as to the 'safety' of pension saving, the other two elements are more difficult.

25. To try and replicate the employer contribution, Citizens Advice has suggested a model where the Government provides an additional 'top up' of 1 per cent of gross income[18]. Royal London on the other hand had suggested an additional class IV National Insurance Contribution (NIC) charge of 3 per cent which is available to recycle into a pension on an incentivised opt-in basis[19]. Inevitably, neither model can sidestep the obvious issue – that replicating the employer contribution requires extra money from somewhere.

26. On balance the ABI supports the Royal London approach as it provides an amount equivalent to the employer contribution. However, as the recent events of the 2017 Budget show, any wider political impact of changes to class IV NICs would need to be carefully considered. The upcoming General Election on 8th June 2017 will give a new

[18] Citizen's Advice (2016) Shy of retiring: addressing under-saving among self-employed people
[19] Royal London (2016) Britain's "Forgotten Army": The collapse in pension membership amoung the self-employed – and what to do about it.

Government the opportunity to look again at if and how NIC contributions from the self-employed could be utilised for long-term saving or pension provision.

27. With such a model the second issue would be the supply side – finding a provider. This could be solved in a number of ways, including having a central register of pension providers for the self-employed to choose from. These providers would need to have agreed quality standards. However, care needs to be taken to ensure that introducing choice at this stage in the process does not create a barrier, as currently the success of automatic enrolment comes from utilising inertia. Consequently, further exploration as to how a provider is found in such a system would be needed with no compulsion or presumption for the self-employed to use NEST.

28. Any roll-out of an automatic enrolment option for the self-employed should be heavily signposted through self-assessment communication and awareness campaigns, with accessible guidance and advice services available to help overcome current knowledge barriers. The move to digital tax returns and increased frequency of returns will also help in this process.

Improving access to guidance and services

29. It should not be forgotten that pension and protection products are already available for the self-employed. Although take up for both broadly remains low - only 30 per cent of the self-employed are currently saving into a pension and just 9 per cent have purchased an income protection product.

30. This low uptake of long-term saving and protection products is due, in part, to a lack of awareness, understanding and engagement. Although these problems do not just apply to the self-employed, industry solutions in the pipeline will be more easily delivered to those who are already saving, and people who have an employer.

The role of the new Single Financial Guidance Body

31. The ABI believe that there are ways in which the Government can help the industry raise awareness of and improve access to protection insurance – including IIP – and retirement products specifically suited to the self-employed and those within the gig economy. For example, the new Single Financial Guidance Body (SFGB) presents an important opportunity to improve the provision of information about a range of financial issues, including pensions and protection.

32. The ABI's responded to the Government consultation on the SFGB[20], and will be engaging fully to ensure that the new body provides comprehensive information and support. We will also be advocating that the body takes a comprehensive approach to supporting financial wellbeing by prioritising financial resilience and prevention, rather than only seeking to intervene at crisis points.

33. We are particularly concerned that the FCA and HM Treasury seemed to suggest only a minor role for protection for the new body. We have made strong representations that protection ought to be a key element of any holistic financial information, and we encourage a joined-up approach across Government to build awareness of protection needs and the solutions available.

34. In addition to the SFGB, the Improving Lives: The Work, Health and Disability Green Paper suggested the creation of a one stop shop for employers that will provide information about protection[21]. Furthermore, as a consequence of one of the recommendations of the Financial Advice Market Review (FAMR), the Financial Advice Working Group has developed a prototype website for employers which has information on protection and other products[22].

35. The ABI welcomes all of these steps. However, there would be merit in a greater degree of coordination across similar initiatives such as these, to ensure a more joined up approach to improving levels of financial capability and resilience across the working population.

The role of online platforms

36. We are encouraged to see that the review is considering, among other things, the role government-accredited online platforms could play in helping the self-employed and those within the gig economy access services and support. We believe that such a platform should allow individuals to assess their retirement and protection needs through calculators and aggregators such as pensions dashboards, as well as signposting to and providing information about the range of types of provision available.

37. The ABI is currently leading the Pensions Dashboard prototype project on behalf of HM Treasury with input from 17 pension providers, which includes firms from the full spectrum of the pensions industry. The prototype is a collaborative effort to build a digital

[20] Association of British Insurers (2017) Public financial guidance review: consultation on the creation of a single body
[21] Department for Health and Department for Work and Pensions (2016) Improving Lives: The Work, Health and Disability Green Paper
[22] Financial Advice Working Group (2017) Financial Well-being in the Workplace: A Way Forward

data-sharing system that will empower people to pull together their pensions data from different providers, schemes and the state to get a full picture of their retirement.

38. The ABI believes that dashboards could enhance engagement with those who are self-employed and working within the gig economy, by integrating an individuals' aggregated pension data with payroll software platforms used by thousands of self-employed workers in the UK.

39. The project successfully launched a dashboard prototype in April 2017, and is on track to meet the Government's commitment to make the service available to consumers by 2019. To ensure that savers can have a complete picture of their current and future retirement pot, we believe the next step is for the next Government to introduce legislation that will make it mandatory for all pensions providers to share data with the dashboards.

Increasing awareness and uptake of income protection products

40. The UK workforce is, as a whole, highly vulnerable to the impact of long-term sickness absence.[23] The insurance industry is committed to improving the financial resilience of individuals and households in the UK, and we believe that greater take up of protection can play a strong role here. Taken together, protection products paid out more than £4.75 billion in total, across 167,000 claims, in 2016.

41. As well as having a financial impact, being out of work for long periods of time can have a detrimental effect on an individual's health. Conversely work is associated with positive health outcomes and wider wellbeing.[24]

42. The self-employed are particularly vulnerable to the impact of being unable to work due to health reasons as, unlike those that who are employed, they do not have access to Statutory Sick Pay or other kinds of Occupational Sick Pay. They are also currently excluded from the Government's Fit for Work service.

43. In order to identify solutions to improve the work outcomes of those with disabilities and long-term health conditions, the Government published Improving Lives: The Work, Health and Disability Green Paper in October 2016. The ABI issued a response to the Green Paper and is keen to work with the new Government to identify how those with disabilities and long-term health conditions can be better supported.

[23] Swiss Re (2015) European Insurance Report 2015
[24] Waddell and Burton (2006) Is work good for your health and well-being?

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44. As part of this agenda, the new Government should consider how more of the self-employed could be helped and encouraged to cover themselves with Individual Income Protection (IIP).

45. Some providers have raised with us that there is scope for innovation in how insurers offer products to the self-employed and those working in the gig economy. In particular, providers and distributors may wish to begin looking beyond the binary between 'Individual' and 'Group' offerings. However, in order to drive this innovation, it is vital that demand for protection is improved by a greater awareness and understanding of protection needs as well as the solutions available.

Individual Income Protection (IIP)

46. Individual Income Protection (IIP) could play a strong role in improving the safety net for both employees and the self-employed. IIP is a product purchased by an individual to insure their income against the risk of being unable to work due to illness or injury. If a policyholder is unable to work, IIP will pay a proportion (usually between 50-85 per cent) of their income until they are able to return to work, or for period of time specified in the policy (usually 2, 3, 5 years, or until retirement). In 2016 about half of the new policies sold on the market paid until retirement[25].

47. IIP also offers vocational rehabilitation services in order to help someone to return to work more quickly. These services have a proven track record of helping to return individuals to work.

48. IIP is virtually always purchased through an Independent Financial Adviser (IFA). This is because expert advice is needed to determine if a product is suitable for an individual's specific circumstances. This is partially due to the way in which IIP interacts with means tested benefits, as explained later in this response.

49. The most common causes of a claim on IIP are mental ill heath, musculoskeletal conditions, and cancer.

Understanding IIP policy holders

50. Currently, around 3 per cent (1.1 million people) of the working population is covered by an IIP policy[26], with a further 7 per cent (2.2 million) covered by Group Income Protection (GIP)[27].

[25] Swiss Re (2016) Term and Health Watch
[26] Association of British Insurers (2016) ABI data shows promising growth in income protection market
[27] Swiss Re (2016) Group Watch

51. A significant percentage of self-employed individuals have already purchased IIP. A survey by the Federation of Small Businesses found that around 9 per cent of self-employed individuals currently have an IIP policy in place, a figure that is corroborated by Swiss Re. This contrasts with around 3 per cent of the employed population.[28] However, those in the employed population may well have access to insured group income protection, and others will also have access to similar benefits on a self-insured basis. Swiss Re estimates, that around 2 million people are covered by self-insured schemes. These are generally the preserve of very large firms and public sector bodies.

52. There is a common misconception that income protection is an 'executive benefit' purchased mainly by high earners, whereas the evidence suggests that in fact IIP is bought by people on a whole range of incomes. Analysis of IIP data from one provider shows that a third of their policies are held by people earning less than the national average pay, with 60 per cent being held by basic rate tax-payers.

53. Furthermore, all of those covered by IIP have access to early intervention and back to work services provided by insurers, regardless of salary.

54. IIP policies are medically underwritten, however insurers accept those with pre-existing conditions where possible. Figures from LV show that 90% of those who apply for an IIP policy are accepted. Furthermore, given that IIP is a long term contract spanning the whole working life, someone who develops a health condition or disability after they have purchased an IIP policy will still be covered and would not see their premiums rise. This is especially important given that, as the Disability Confident campaign rightly highlights, 83 per cent of those with disabilities develop them during their working life. [29]

55. This evidence demonstrates that IIP can, and indeed does, serve those on average and modest incomes, and in particular those who are self-employed or work in the gig economy.

56. Given that this is the case, the ABI argues that a partnership between Government and industry, that promotes IIP, should therefore be one part of a package of measures to improve the financial resilience of the self-employed and those working in the gig economy.

The interaction between IIP and Universal Credit

[28] Federation of Small Businesses (2016) Going it alone, moving on up: Supporting self-employment in the UK
[29] Department for Work and Pensions (2014) Disability Confident employer scheme and guidance.

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57. Universal Credit (UC) replaces six current welfare benefits. It will be means-tested based on a range of factors, including household earnings, family composition, housing tenure, savings and whether claimants have children.

58. Under UC, IIP benefits will be treated as 'unearned income'. Under the current system, IIP is completely disregarded when calculating an individual's entitlement to tax credits. Under UC there will be a £1 reduction in state benefit entitlement for every £1 of IIP benefit received. This leaves individuals with IIP significantly disadvantaged compared to a pre-universal credit scenario.

59. Anything that disincentivises this form of self-provision and protection will likely serve to increase levels of financial vulnerability, particularly among the self-employed. The treatment of IIP under UC does just this, and addressing the disincentive that currently exists should be a high priority for the new Government.

60. Assessing the impact of UC is complex and can only be predicted based on a series of assumptions. The process for the self-employed is particularly complex, given the real time assessment of earned and unearned income.

61. Under UC, those on higher incomes would still have an incentive to have an IIP policy. However, for those on middle incomes this change could wipe out much of the value that IIP would provide them if they were unable to work, as the majority of their IIP claim would only compensate them for the UC for which they would have otherwise qualified.

62. The Centre for Economic and Social Inclusion (CESI) analysed the impact of UC on IIP in their 2014 report to the ABI entitled 'Getting the balance right; social security and income protection'. Extracts from the report include:

    "The benefits of Income Protection will be less clear-cut for many middle-income families, because of often substantial increases in the rate at which benefits income is withdrawn. There is a risk therefore that Universal Credit reduces the incentive for middle-income households to make provision for themselves.'

    'Under UC, replacement rates will be generally lower and Marginal Deduction Ratios (aka MDRs which is the 'effective tax rate') generally higher for Individual policies compared with Group policies. Overall, our analysis suggests that more households will face higher MDRs as a result of UC, and substantially fewer will see a very strong benefit. '

    'Most worryingly, MDRs will increase most substantially for middle-earning households – who should arguably be a key priority group for encouraging self-provision.'

"Overall, our analysis suggests that more households will face higher MDRs as a result of UC, and substantially fewer will see a very strong benefit".[30]

63. Insurers will have to write to customers informing them of the shift to UC, and the potential impact this might have. Unfortunately, the natural response for many of those on low and middle incomes will likely be to cancel their policy, thus leaving them potentially reliant on state benefits. In addition, far fewer people will have an incentive to take out IIP in the first place. Furthermore, advisers may reassess their clients needs and judge them to no longer benefit from the product, and may become less likely to offer the product at all, if they judge it to be of less relevance to their clients.

64. The consequence of lower IIP coverage will be higher levels of welfare dependency, lower levels of financial resilience, and poorer employment outcomes for those with long-term health conditions and disabilities.

65. In addition, fewer people will have access to early intervention services, resulting in reduced return to work rates. Evidence from group income protection insurers found that their services are very effective at reducing the length and frequency of long term sickness absences, such as those for mental ill health. For example, Canada Life's early intervention service reduces the length of time claimants spend off work for mental health reasons by an average of 70%.

Remedying the treatment of IIP under UC

66. The ABI advocates a combination of two measures to ensure the fairer treatment of IIP under UC. Both these measures are necessary to prevent the creation of significant disincentives to the purchase of IIP.

    - A full disregard for mortgage loan and home rental payment elements of IIP claims; and
    - IIP to be treated consistently with Group Income Protection Insurance under Universal Credit – with any remaining IIP benefit withdrawn at a rate of 63p for every £1 received.

67. Taken together, these two measures represent short-term action to prevent significant disincentives to purchasing IIP, a subsequent shrinking of the market and an increase in welfare spend. The ABI would be happy to provide the review with further information on

[30] Centre for Economic and Social Inclusion (2014) Getting the balance right; social security and income protection

how these two disregards operate in practice. What is important is that, rather than adding additional complexity to UC, they merely represent different uses of disregards that already exist.

Comparison of IIP treatment under three different models

68. The below sets out a comparison of how IIP is treated under three different models: the Pre UC benefits system, Universal Credit, and the ABI's proposal.

69. The consequence of means-testing is that the real value of IIP can be reduced because it may lead to a fall in income received through the benefits system. This is usually called a 'marginal deduction rate' (MDR) or 'effective tax rate'.

70. Under the ABI proposal, MDRs are higher than under the pre UC benefits system, but lower than under the UC system, particularly for households with a mortgage or paying rent.

71. An example of this is outlined below:

- A working couple has three children. They have incomes of £25,000 and £9,000, an £80 per week mortgage (or rent) payment and Individual Income Protection product that would pay £150 per week in the event of a claim.
- Under the current UC arrangement, all their £150 IIP benefit is offset by a £1 for £1 reduction in UC. IIP has increased their household income by £0 – an MDR of 100% - and thus rendering their IIP effectively 'worthless'. Such a person would likely have decided to stop paying their IIP premium and rely on the welfare state.
- Under the ABI proposal, £80 of IIP benefit is paid to the mortgage lender and disregarded for UC, with the remaining IP benefit reducing UC by 65p for every £1 benefit received. In effect, their IIP has increased household income by £98 per week. This is lower than the full £150 insured amount but sufficient to protect their lifestyle and give them genuine value and protection.

About the ABI

72. The Association of British Insurers is the leading trade association for insurers and providers of long term savings. Our 250 members include most household names and specialist providers who contribute £12 billion in taxes and manage investments of £1.6 trillion.