HYMANS ROBERTSON

BRIEFING NOTE

PUBLIC SECTOR

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Ill Health Liability Insurance An introduction

This Briefing Note alerts LGPS employers to the implications of the new ill health provisions and discusses a bespoke ill health insurance product designed as a risk management tool for employers and Funds to use to protect themselves against the potentially catastrophic impact of poor ill health retirement experience.

Risk management has never been more important. Volatile funding levels, which have been created by misfiring stock markets, mean that all employers should be worried about anything that may lead to a call on their cash. These heightened concerns and the presence of many new employers in Funds mean that it feels appropriate to update you on how the ill health insurance product has developed.

BACKGROUND TO ILL HEALTH BENEFIT

In 2009, new rules changed the level of "enhancement" provided to individuals when they are forced to retire due to ill health. The new rules, in line with Government's intention, targeted the benefit towards those who were most in need – the result was that the highest tier of benefit gives a member retiring on ill health a pension based on their full prospective service.

The tiers are summarised below:

Tier 1	An unreduced pension based on accrued and 100% of prospective service
Tier 2	An unreduced pension based on accrued and 25% of prospective service

The ill health retirement pension is a valuable benefit to members, but the costs of this benefit are ultimately met by the employer.

The table below gives an idea of the approximate costs of Tier 1 ill health retirement.

Age	Salary	Service	Cost
33	£58,000	10 years	£741,000
44	£30,000	5 years	£249,000
51	£64,000	14 years	£321,000

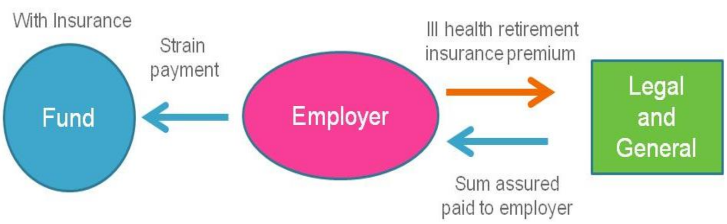
FUNDING ILL HEALTH BENEFITS

The costs of any ill health retirements from the Fund are assessed at the triennial valuations and are funded through normal employer contributions. However, the cost of individual ill health retirements is significant and incidence of ill health retirement is inherently uncertain. For any employer a relatively high incidence of ill health retirement amongst their own membership will have an adverse effect on their funding position and for a small employer even a single Tier 1 ill health retirement can be ruinous.

THE BIRTH OF ILL HEALTH INSURANCE

Many of our clients expressed concern about the potentially catastrophic affect an ill health event could have on an employer's funding level. In response to this concern, Hymans Robertson and Legal & General worked in partnership to develop a ground breaking insurance policy that protects both the Fund and employers.

HOW DOES ILL HEALTH LIABILITY INSURANCE WORK?



ILL HEALTH LIABILITY INSURANCE

In simple terms, the insurance cancels out the financial impact of the cost of the ill health retirement. Employers pay an ill health insurance premium to the insurer in lieu of the ill health element of their contributions to the Fund. In the event of an ill health retirement an insurance claim for the strain cost arising will allow the employer to make a special contribution to the Fund to avoid a worsening position at the next valuation and an unexpected increase in their contribution rate.

Without the insurance, employers are running the risk of good/bad ill health retirement experience. In the event of bad experience you will be required to fund the costs of the ill health retirements. In the event of good experience, your next set of actuarial valuation results will be marginally improved. Of course, as with any insurance, employers will be giving away the upside (of good experience) in order to get protection on the downside (the bad experience).

Many groups of employers may consider ill health insurance to be advantageous in managing risk.

- For small employers ill-health retirements are rare but very costly relative to the size of their pension contributions
- For closed employers with ageing membership ill health retirements may be more likely and may derail their funding plan
- For contractors the costs associated with negative ill health retirement experience may result in the contract becoming unprofitable. Where contractors have passed this risk back to the Awarding Authority, the Awarding Authority may consider insurance an appropriate mechanism to avoid this risk

WHAT ARE THE BENEFITS FOR EMPLOYERS?

PROTECTION FROM MANY CLAIMS	Removes the risk of the costs of more ill health retirements than anticipated.
PROTECTION FROM RETIREMENT OF “THE WRONG PERSON”	Removes the risk of the costs of a single “wrong” person being granted ill health retirement (e.g. young person, well paid manager, etc.)
COST NEUTRALITY	For most Funds, the impact on the employer is neutral as the reduction in the employer contribution rate matches the insurance premium.
STABILISATION OF CONTRIBUTION RATES	Poor ill health experience will be dealt with immediately. This means that it will not have an impact on the valuation results, which will help to keep contribution rates stable.

Next steps:

Good risk management has never been more important. We believe that the offering of ill health insurance to employers is an essential element of good risk management.

Employers who would like further information should contact Marcia MacFarlane at Hymans Robertson on 020 7082 6327.

Hymans Robertson LLP

One London Wall London EC2Y 5EA **T** 020 7082 6000 **F** 020 7082 6082
20 Waterloo Street Glasgow G2 6DB **T** 0141 566 7777 **F** 0141 566 7788
45 Church Street Birmingham B3 2RT **T** 0121 210 4333 **F** 0121 210 4343
Exchange Place One 1 Semple Street Edinburgh EH3 8BL **T** 0131 656 5000 **F** 0131 656 5050

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