

# Combating escalating group risk costs

**T**HIS is the first of a four part series of articles in which Old Mutual looks at the increasing cost of group risk benefits and the possible actions that retirement funds can take in order to mitigate escalating risk costs. In this first article, Richard Treagus, Group Assurance Executive at Old Mutual Corporate, looks at the biggest driver of escalating costs, HIV/Aids, and gives an overview of possible solutions.



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## The problem

There is no doubt that when it comes to group risk benefits, the main concern of retirement fund trustees is how to deal with increasing costs. The underlying culprit is of course AIDS: the big impact has been on group life assurance with disability benefits less impacted. (This is due to disability claimants often dying before becoming eligible, or receiving income disability benefits for a relatively short period.)

Differences in scheme mortality rates are extreme. White-collar schemes based in the Western Cape, for example, might only be experiencing a mortality rate of three deaths per 1000 lives p.a. compared to a rate of 25 for a low income scheme in the mining sector. Mortality experience depends on geographic location, gender split, age profile, type of industry and occupation. But the simple fact is that AIDS will negatively affect every scheme to some degree, and it is therefore important for trustees to obtain some insight into the impact on their scheme. To this end, an estimate of current HIV prevalence will be most useful as this is the starting point in predicting future mortality experience. More and more companies are encouraging voluntary and anonymous HIV tests as part of 'Know Your Status' campaigns, but stigma around the disease means that it is still difficult to get full participation and reliable estimates of overall prevalence.

Indeed, the success of AIDS management initiatives in an organisation is the key factor affecting future mortality experiences. Sadly, South Africa has been very unsuccessful in limiting the spread of

the disease through education about lifestyle change. This means that the main challenge has now shifted to the provision of effective anti-retroviral treatment programmes.

Figure 1 illustrates the difference that a successful intervention strategy could make to the costs of group risk benefits.

The bars in the graph show the change in mortality experience (calibrated on the left hand axis and using 2004 as a base). As can be seen, without interventions mortality experience could still increase by more than 40% by the year 2015, but by only 10% with a successful programme. The lines show the annual increases, with the lower line demonstrating that a successful intervention strategy can bring down the level of increases to zero within a few years. (Even decreases, as the heavier past effect of AIDS deaths is worked out.) Different schemes will be at different points on the curve: those with advanced AIDS exposure may already be experiencing mortality at its highest level, whereas others could still experience many years of deterioration, intervention strategies aside.

## Eight options to manage cost

The problem facing trustees might be compared to an often-encountered domestic issue of what to do when monthly income falls short of household needs.

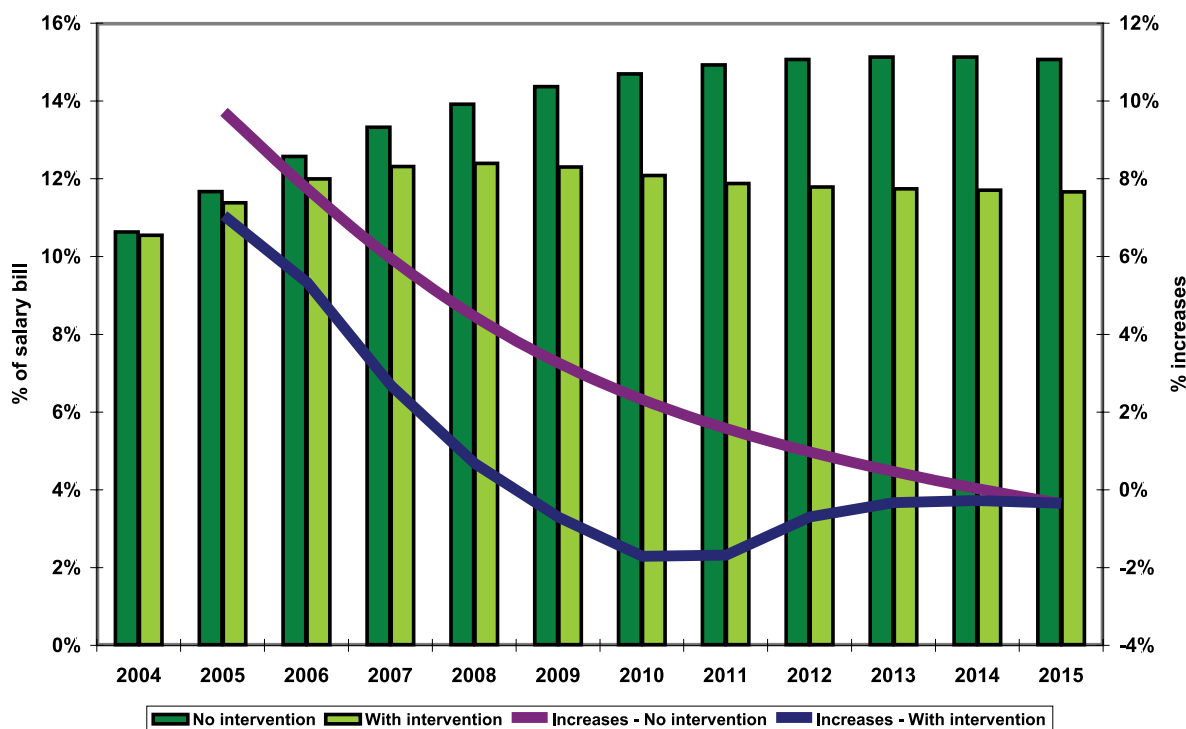
As Charles Dickens' Mr Micawber advised

David Copperfield: "Annual income twenty pounds, annual expenditure nineteen ninety six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery!"

### 1. Ask for a raise

Most employers would want to see their employees adequately provided for and it is therefore not unreasonable to ask employers to fund increasing costs. But employers want to limit their financial obligations by capping their contributions and transferring retirement funding risk to employees. So for most funds, this is usually not an option.

Figure 1: The impact of HIV/Aids on risk costs



Adjusted version of the ASSA 2002 Lite AIDS and demographic model of the Actuarial Society of South Africa

## 2. Shop around

Trustees may well find that by opening their risk benefits to tender, another insurer is found who will accept the risk for a lower premium. At best, however, this response is a short-term reprieve that will not deal with an underlying trend of increasing cost.

## 3. Raid the piggy bank

Some funds have set aside reserves to cover increasing costs of risk benefits, but in most cases, surplus legislation will prevent reserves being used to subsidise future increases. The exception is where the fund rules have allocated a certain contribution towards risk benefits and actual costs have been less than this allowing a dedicated risk reserve to be built up.

## 4. Re-evaluate priorities

The need to deal with significantly increasing risk benefit costs forces trustees to consider the question of the fundamental purpose of retirement funds. Where tough trade-offs need to be made, most trustees would weigh the balance towards preserving adequate retirement provision at the expense of maintaining life and disability cover. Hence it is critical for trustees to formulate a policy on the relative priorities of retirement and risk benefits, including the approaches to be followed in dealing with increasing risk benefits.

## 5. Tighten the belts

For funds with defined life and disability cover benefits, the most common action is to reduce the level of cover to make it more affordable. This requires clear communication to members and,



preferably, an option to replace lost cover on an optional basis.

## 6. Share it out fairly and carefully

Some funds have opted for a Defined Contribution Risk benefit solution, where benefits are purchased according to their affordability within age bands. The rationale for this structure is that each member obtains the level of cover that his or her individual contribution affords.

## 7. Target the heavy users

There are two ways of protecting the fund's mortality experience against high-risk members:

- Offer a minimum core benefit with medical testing required for members to be eligible for further cover, or
- Apply vesting scales, whereby benefits only become available after a period of membership.

Both options have equity implications.

## 8. Fend for yourself

In a non-paternalistic age, the trend is for companies to reward employees on a cost-to-company basis, with the onus on the employee to make retirement and life cover provision according to his/her individual needs. As yet, there has been very little evidence of this trend.

**Future articles will examine the last three options in more detail, giving consideration to the legal, practical and communication issues involved in each approach.**