



# Reducing Group Risk Costs Through Pre-Benefit Testing

This is the last of a four-part series of articles in which Old Mutual looks at the possible actions that retirement funds can take in order to mitigate the escalating costs of risk benefits. In this article we look at the introduction of medical testing as a requirement for benefit eligibility, and the associated considerations.

Whether due to the progression of HIV/AIDS or other factors, many retirement funds are faced with the problem of escalating risk costs, either putting pressure on contributions or in certain cases requiring a change in the risk benefit structure.

Pre-benefit testing aims to provide a solution to escalating risk costs. It is the medical testing of *new members prior to them becoming eligible for full risk benefits*.

## How does Pre-Benefit Testing reduce risk costs?

The concept of pre-benefit testing requires all new members to meet minimum health standards. All new members that join the scheme would then have a lower than average risk, as they need to prove their health in order to be granted cover. Over time, the proportion of low-risk members in the scheme increases and eventually exceeds average-risk members. This improves the risk profile of the scheme over time, which leads to reduced claims for the scheme, and a consequent decrease in risk costs.

An alternative, and generally recommended, solution is to offer a core level of cover for all members but offer higher cover for those members that meet the medical requirements. This ensures that all members receive some level of cover, while the low risk members (those that meet the medical requirements), receive more cover. In this case, pre-benefit testing will help

to save risk costs by separating the high and low risk members and providing less cover for those that are considered high risk.

## Nature of medical tests

The level and nature of required medical evidence will need to be weighed against the cost of testing and administration. As schemes in South Africa have very different risk profiles, suitable tests may vary from scheme to scheme. An important point is that the fund or employer can choose the nature of the medical testing that they will require members to undergo. Typically, this would be lighter and simpler than the tests that an insurer might impose when assessing the health of individuals with high levels of cover.

## Further issues to consider

1. Medical testing would commonly include blood tests. An HIV/AIDS test is the obvious form of testing, as it is often the largest driver of escalating risk costs. As the testing of HIV/AIDS limits the equality rights of persons living with HIV, the Trustees will (if challenged) bear the onus of justifying its system of treating HIV positive persons differently from other participants.
2. The effectiveness of a pre-benefit testing strategy can only be realised if new members actually undergo medical testing. In some cases, a large proportion of new members

may delay or not undergo pre-benefit testing, which may mean that some members receive less cover than they are eligible to receive. Trustees should therefore encourage all members to go for pre-benefit testing by making the testing process simple and educating members about the potential benefits of undergoing the tests.

3. If a large proportion of new members do not pass the medical requirements, it may mean that over time, a greater proportion of an employer's workforce may typically have lower or no cover compared to those that meet the requirements. The stricter the pre-benefit testing, the more likely this is to occur. Trustees of retirement funds are compelled to look at the best interests of all members. If pre-benefit testing is seen to place an advantage on only a small group of members (if most members do not meet the medical criteria), it may be seen as contrary to their fiduciary duties.
4. A flexible benefit structure (where members are able to choose their level of cover) usually involves medical testing and may therefore be seen as the solution described here.

The difference is that with flexible benefits the member will need to allocate extra contributions towards the chosen voluntary cover. For pre-benefit testing described here, the member becomes entitled to higher cover at no extra cost by virtue of his/her good health.

***Pre-benefit testing reduces risk costs by increasing the proportion of cover for the "low risk" group, by requiring all new members to meet medical requirements before receiving full cover.***

***Before Trustees embark on implementing pre-benefit testing, they should consider the merits of using pre-benefit testing to help contain risk costs, against the legal and operational challenges that pre-benefit testing could present. Actuarial, legal and consulting advice is therefore highly recommended.***



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# Optiplus Adds Real Value

Pensioners invested in Old Mutual's Pensions OptiPlus annuity are smiling all the way to the bank after OptiPlus recently declared bonuses well in excess of inflation across all investor categories. Pensioners invested in category 1 of OptiPlus will be especially pleased with their very handsome 12% bonus – the highest in nine years!

These bonuses across all OptiPlus categories were based on returns for the year ending 30 September 2006 and will be effective for pensioner increase dates from January 2007 through to December 2007.

These OptiPlus bonuses, which are significantly higher than the expected long-term average bonus rates on this investment, were the result of a combination of very strong performance by equities over the past year and the appropriate positioning of the underlying investments by the fund managers to take advantage of these equity returns without excessive risk exposure.

Most OptiPlus members are in category IV, which enjoyed a very pleasing bonus declaration of 10.1%. This is 5.0% above the CPIX figure of 5.1% and compares very favourably with the expected increases for this category. In fact, the long-term projection for Category 1 OptiPlus investors is an increase of roughly 1% above inflation, while Category IV increases are generally expected to be around 1% below inflation per year.

The bonuses for all ten OptiPlus categories are as follows:

Profit Category	After Retirement Interest Rate	2007 Bonus <sup>1</sup>	CPIX <sup>2</sup>	5 Year Average Bonus	5 Year Average CPIX <sup>3</sup>
I	3.5%	12.0%	5.1%	7.4%	5.9%
II	4.0%	11.4%	5.1%	6.8%	5.9%
III	4.5%	10.7%	5.1%	6.1%	5.9%
IV	5.0%	10.1%	5.1%	5.5%	5.9%
V	5.5%	9.5%	5.1%	4.9%	5.9%
VI	6.0%	8.9%	5.1%	4.3%	5.9%
VII	6.5%	8.3%	5.1%	3.8%	5.9%
VIII	7.0%	7.7%	5.1%	3.4%	5.9%
IX	7.5%	7.1%	5.1%	2.9%	5.9%
X	8.0%	6.5%	5.1%	2.4%	5.9%

<sup>1</sup> Applicable to Pensions OptiPlus annuitants only.

<sup>2</sup> Year-on-year CPIX as at 30 September 2006.

<sup>3</sup> Five-year average year-on-year CPIX as at 30 September 2006.

## OptiPlus gives steady long-term returns

The excellent bonuses declared this year come on top of a number of years of solid investment returns and great value for money by Pensions OptiPlus.

Over the past five years, category IV increases have averaged 5.5% – a mere 0.4% shy of the average CPIX rate of 5.9% for the same period. This translates into an underlying return on investment of 4.6% ahead of inflation, every year.

The category 1 OptiPlus figures tell an even better story, with an average increase of 7.4%. This means category 1 pensioners have seen their pensions increase at an average rate of 1.5% above inflation each and every year over the past five years. Over the past 15 years, this average increase goes up to a healthy 2.9% ahead of inflation each and every year for this category.

When you consider that these returns are calculated after all charges and the costs of the guarantees have been deducted, OptiPlus represents a solid return on investment. What's more, every increase, once granted, is guaranteed for life – so pensioners on OptiPlus also enjoy significant financial peace of mind.