



Institute
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of Actuaries

Beveridge 2.0: Economically and Socially Useful Risk-Sharing

Nigel Wilson, Group Chief Executive
Legal & General Group Plc

28 November 2014

Overview

- 1) Digitalisation, regulatory reform and customer behaviour are combining to change the insurance industry radically:
 - Key products are disappearing: with-profits, insurance wraps, individual annuities. Profit Pools will Shrink unless we innovate.
 - Other products are under price pressure: auto-enrolled pensions, fund management, platforms
 - Costs will reduce further: fewer commission and sales incentives, reduced claims costs, improved use of technology in motor and home insurance
- 2) The continued stubborn £100bn Government deficit will mean we need substantial changes to “risk sharing” between individuals, employers and government, building on the success of auto-enrolled pensions.

**Beveridge 2.0 will emerge.
As an industry we need to decide what role we want to play**

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Social Purpose



Lord Adair Turner

“I said much of banking was socially useless. I should have been more accurate, it was socially and economically useless”

UK Insurance: £1.8 Trillion Investments... 90% of Households... £10bn in Tax

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Slow Money, Growth and Risk-sharing Not “Monetary Methadone”.

More of This...



- University of Hertfordshire
- £145m, 50-year investment
- Inflation linked leases

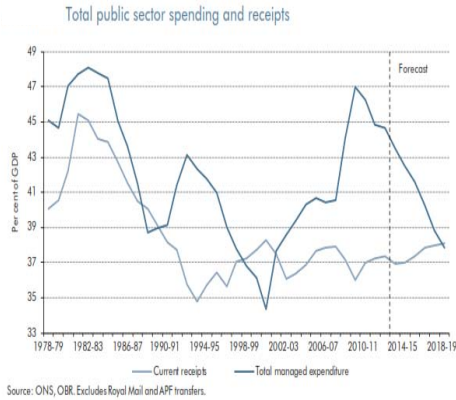
... and Less of That.



- Money printing
- Asset inflation
- Unstable Maturity Transformation

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Unrealistic Public Spending Forecasts...



- Higher expenditure of £700bn plus

- Lower tax receipts of £600bn

Result



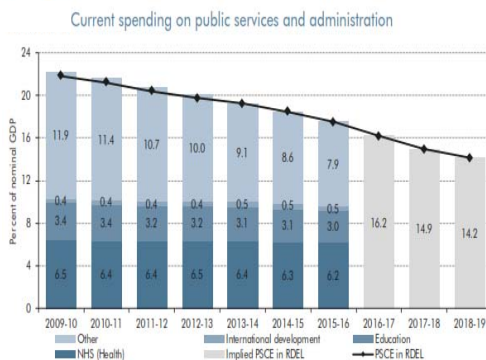
- A Stubborn £100bn Deficit

- Monetary Methadone means interest cost of deficit is low

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...But Big Protected Spending Commitments



- NHS, Education and Int'l Development are ring-fenced

- "Bidding war": NHS and tax cuts

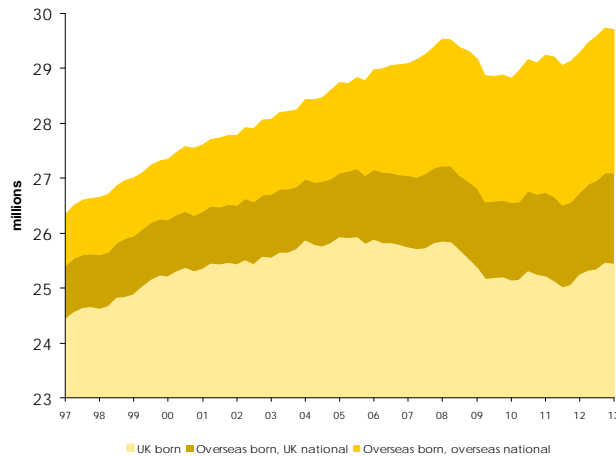
- Is "free at the point of use" a long term solution?

Further sustained Welfare Cuts in Prospect?

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UK Employment at New Highs

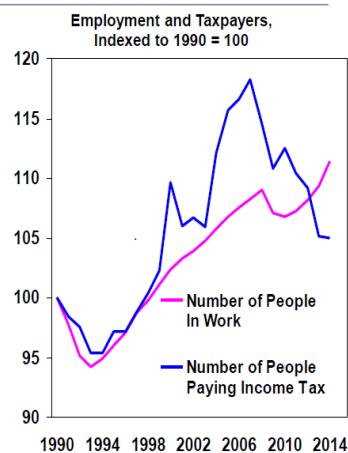
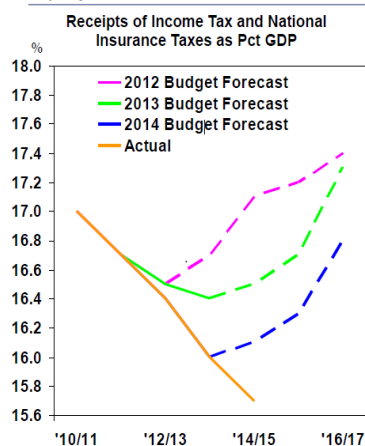


- 30.5 million now employed- level of employment “surprised” on the upside
- But part time, low paid and self employed jobs don’t yield enough tax



Plentiful Jobs, Scarce Tax Receipts

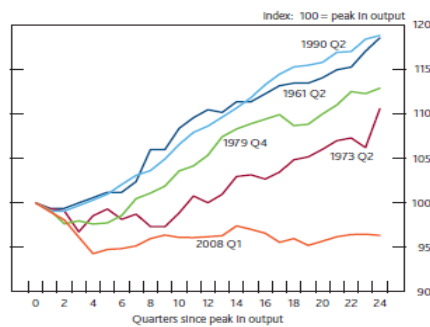
Employment and Income Tax



27 Sources: ONS, OBR, HMRC and Citi Research

The Productivity Puzzle

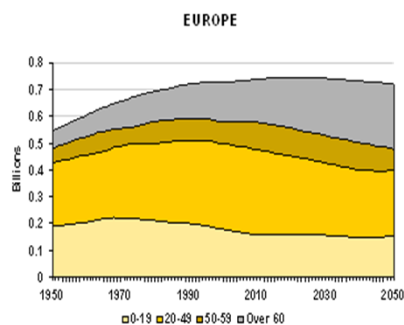
Chart 2 Productivity after UK recessions



- No post-recession productivity gain
- Low-paid jobs replaced capex
- Investment outsourced to China



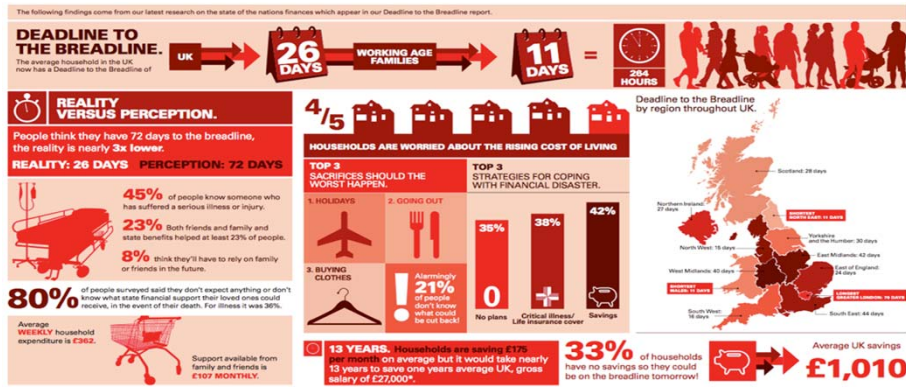
... The World is Getting Greyer



- Population ageing will massively increase public spending
- Health and Care costs will both rise
- Pension costs will rise despite higher state pension age

Actuaries Must Interpret "Big Data"

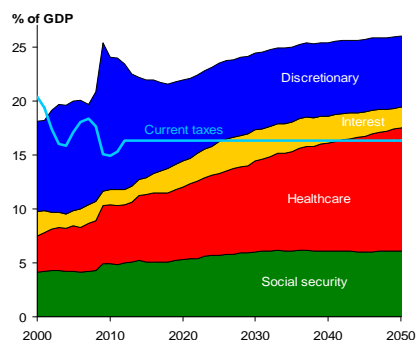
...Individual Overestimate their Savings, and Under-estimate their longevity



Actuaries Must Understand Behavioural Economics

...Welfare expectations are too high

US government spending v revenue



Source: Congressional Budget Office, Citi research

UK public sector expenditure on services

	2007-08 (£bn)	2011-12 (£bn)	% change
Pensions	99	127	28
Welfare	90	115	28
Health	102	121	19
Education	79	92	16
Total	370	455	23
Total Expenditure	583	695	19

Source: HM Treasury - Public Expenditure, Statistical Analyses 2012

Beveridge 1.0



5 “Giants”

- Want
- Disease
- Ignorance
- Idleness
- Squalor

National Insurance: Contributory Benefits, Basic Level of Welfare
Individuals make their own top-up arrangements.

Part of a Post-War Settlement: with NHS “free at the point of delivery”.

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Beveridge 2.0 – New Risk-sharing Model

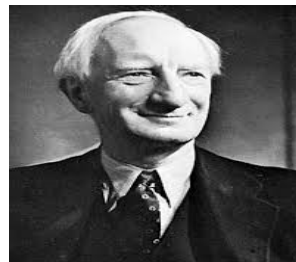
“If Europe today accounts for just over 7 per cent of the world's population, produces around 25 per cent of global GDP and has to finance 50 per cent of global social spending, then it's obvious that it will have to work very hard to maintain its prosperity and way of life”.

Angela Merkel



“Seventy years on, we should celebrate Beveridge's vision... not by asking how we freeze today's welfare state in aspic, but, instead, how we become the radical reformers again. How do we go back to Beveridge's hugely popular first principles and apply them anew to the challenges of 21st century Britain?”

Liam Byrne

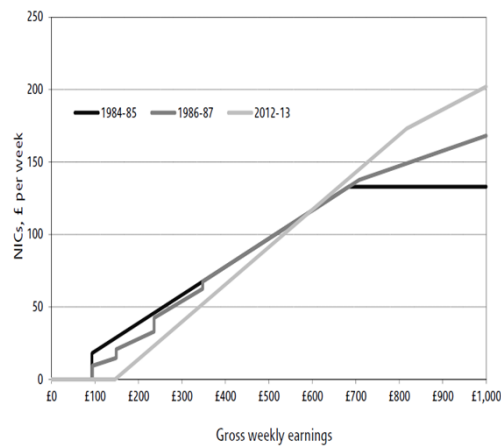


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NI – Just Another tax

Figure 4. The changing structure of National Insurance contributions



National Insurance contributions act like a tax on earnings. Contributions paid and benefits received bear little relation to each other for any individual. Some contributions are allocated to the NHS; the remainder are paid into the National Insurance Fund.

The Fund is notionally used to finance contributory benefits, when the Fund is not sufficient, it is topped up from general taxation. When the Fund builds up a surplus, it is largely invested in gilts: the government is simply lending itself money.

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NI: A Tax on Jobs

“How can the [NI] fund be used as a label and a soft way to raise tax when the money is not spent on NI benefits and pensions. Is that really what Beveridge had in mind?”

Steve Webb MP

[NI is] “...a kind of easy credit option for the government... We have come an awful long way since the start of the contributory principle.”

Steve Webb MP

NI is a tax on jobs (3x higher than Corporation Tax)

NI Bears down particularly on lower earners

Debating Headline Tax without including NI is Partially Dishonest

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3 Key Drivers of Sudden Poverty for Working Families.



Job loss

- 1.8m completely new Jobseekers Allowance claims in 2 years
- 14,000 corporate managers began Jobseekers Allowance claims in April 2014



Lack of savings

- Working age families could last for only 11 days without their salaried income
- 33% of households have no savings
- Average household savings of £1,010

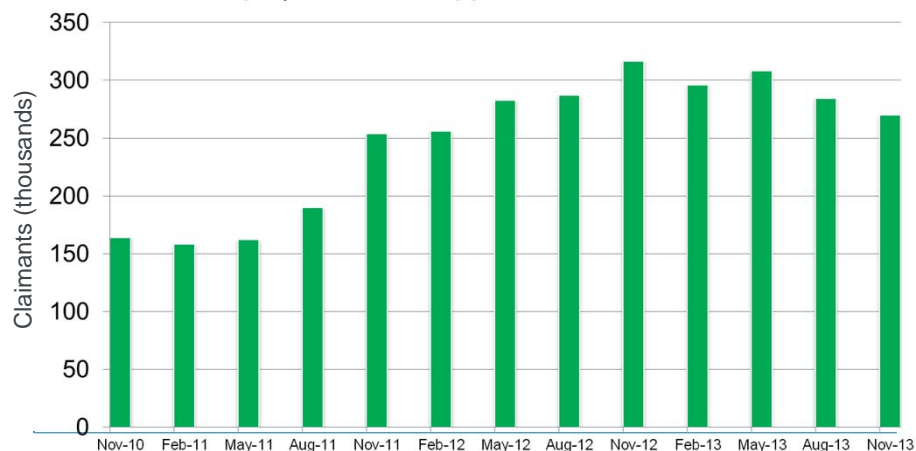


Sickness absence

- 269,000 new Employment and Support Allowance claims in a quarter

High On-Flows to Sickness Benefits.

Employment and support allowance on flow



Sickness Cost for SMEs: £5.3bn Annually*

4.9m private sector business

- 99.9% of businesses are SME
- 59.3% of workforce employed in SMEs

14.4m employees employed in SMEs

- 24.7% SMEs have employees
- average of 12 employees per SME

131m working days lost per year through sickness

- 4.4 days per person
- Each year c300k employees go from work to benefits¹
- £4,400 per SME with employees¹

Source: ONS 23 October 2013 - Business Population Estimates for the UK and Regions 2013

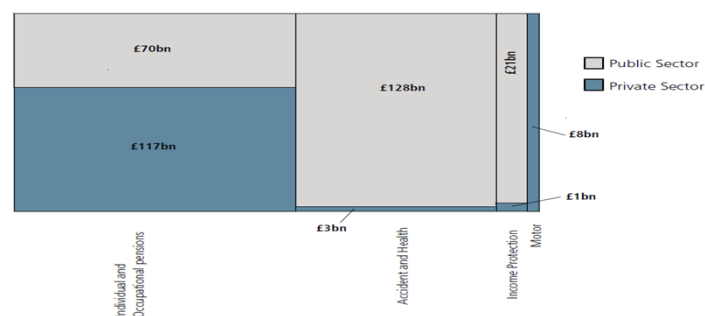
¹Health at Work - an independent review of sickness absence - Dame Carol Black and David Frost CBE Nov 2011

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Historical Shares of Addressable Risk

Figure 3 – Addressable 'risk management' market

Net premiums/benefits paid (2007)



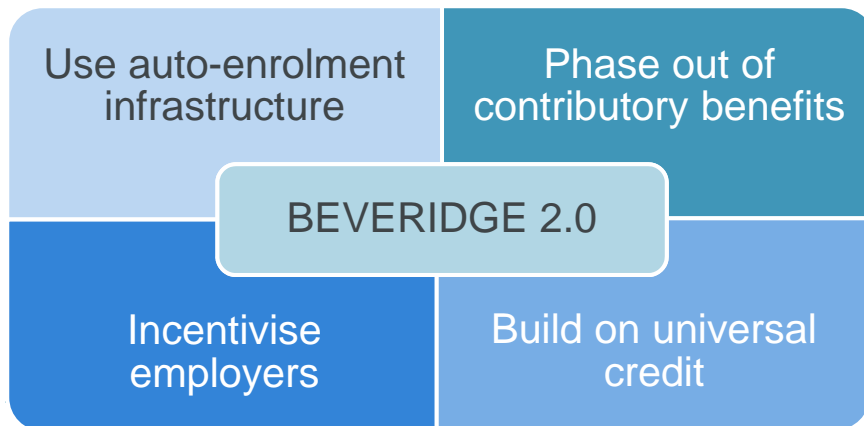
Actuaries are Risk Experts – Governments are Not

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THE DELIVERY PLATFORM.

The plumbing for Beveridge 2.0 is already in place, delivering the policies requires joining up of existing infrastructure rather than big new systems.



Workplace Pensions: A Template and a Mechanism

Huge Success: 92% Opted-in under soft compulsion

Low Starting premiums: but will rise

Employer Distribution Channel: IT “Plumbing” is in place

Low cost: capped, 40-50bps vs. “old-style” 100-125bps

Pension Tax Relief remains regressive: flat rate at 25% would be fairer and save Government £8bn

Strong public support for genuine contributory principle, especially among the young.
£26k Benefit Cap had >70% approval rating

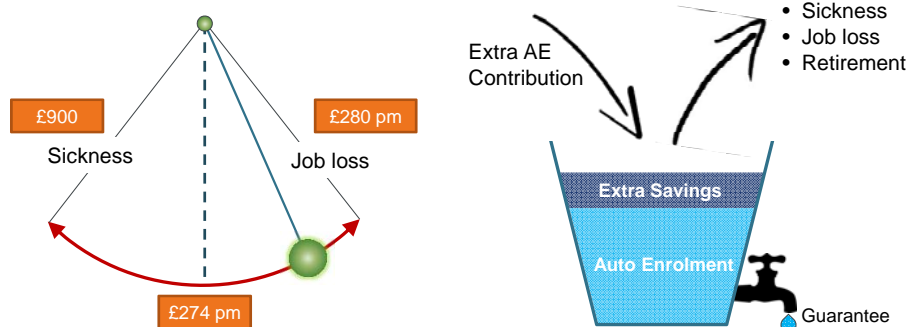
Replace complex Contributory Benefits.

BENEFIT SPENDING	Income Based	Contributory
JSA	£3.6bn	£0.48bn
ESA	£8.31bn	£4.35bn

- Not genuinely Contributory
- Complex to administer
- Hard to understand
- Difficult to align with Universal Credit

Over-Complex Benefits - Historical Accidents and Piecemeal Reforms


Beveridge 2.0 0.5% of Income Model



Protection or Savings-led

Example – Sickness

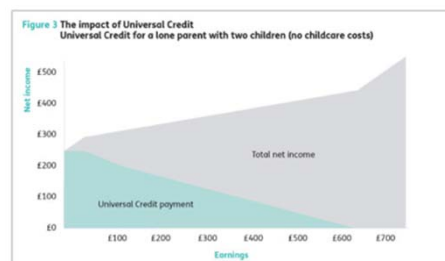
PURPOSE			HOW IT WORKS FOR THE CUSTOMER	
To reduce sudden poverty in the event of sickness absence of a wage earner			BENEFIT	
Which drivers does this tackle?			£900 per month	<ul style="list-style-type: none"> 40% of earnings 12 months of cover
Job Loss	Savings	Sickness		
		✓		
How does this policy work? <ul style="list-style-type: none"> For a 0.5% contribution, collected through the auto-enrolment system The scheme then pays benefits if the employee is too ill to work. Rehabilitation to help employees get back to work - reduces burden on NHS and HWS HMRC receives Tax and NI on benefit received by individual 			Incremental to existing benefits <ul style="list-style-type: none"> + £380pm SSP - £140pm Tax & NI = £1,140 total payment Replacing existing benefits <ul style="list-style-type: none"> *Potential SSP/ESA Saving £1.4bn *Tax & NI increase £900m *£2.3bn additional value 	



Build on Universal Credit.

Under Universal Credit, income replacement could be classed as part of family income and could deliver more government savings than under the current system.

Anyone entitled to a Universal Credit payment of less than the income replacement amount would cease to be a cost to the state.



Beveridge 2.0 benefits can deliver greater security for working families

Use Savings to Cut NI Contributions

- NI raises £107bn annually
- Threshold is lower than Income Tax: under £8,000
- Flat rate PTR at 25% would save £8bn annually
- Beveridge 2.0 could save > £5bn annually
- Re-deploy part of this to deliver NI reduction
- Focus on SME's and low-paid: a fairer solution

Alternatives are Politically Tougher... NHS no longer free at point of use?

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Rising to the Challenge

- Commercial Actuaries: Analysis and Action
- Understand Digital, Big Data, Behavioural Economics
- Our Industry has the Skills to Tackle Big Issues
- Social and Economic Usefulness Includes Unique IP

"The significant problems that we have created cannot be solved at the level of thinking we were at when we created them."

– Albert Einstein

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter. See also:

[Nigel's Blog at www.legalandgeneralgroup.com](http://www.legalandgeneralgroup.com)