Ill health liability insurance (IHLI) employer briefing note dated 05 04 2023

Taking out IHLI can help to manage risk for your organisation by creating greater cost certainty through reducing the potential for significant ill health early retirement funding strain costs which could prove unaffordable and possibly impact your future viability as an organisation.

Hymans Robertson and Legal & General have developed a bespoke product for the LGPS to eliminate this risk, and this briefing note has been prepared for you to gauge whether this insurance would benefit your organisation.

Basically, IHLI helps to protect your LGPS funding position against future tier 1 or tier 2 (i.e. not tier 3) ill health retirements. It does not protect against deferred members being granted access to their benefits on ill health grounds. The maximum benefit that will be covered in respect of an insured member is £2 million.

The insurance is particularly suitable for small employers where, for example, one highly paid or young employee retiring on ill health could have a significant impact on the employer's funding position at the next actuarial valuation, meaning that its future employer payments may rise significantly at the next triennial valuation.

For example, an employee aged 30 earning £49,000 who retires on tier 1 ill health is being granted an immediate enhancement to their accrued annual pension paid for the rest of their life of (49,000 ÷ 49 * (years between State Pension age of 68 less 30)) = £38,000 p.a. If that extra £38,000 p.a. pension is paid for 50 years (assuming the employee dies at 80), the total extra pension paid out would be £1,900,000.

Under our current approach, when an ill health retirement occurs, there is no immediate cost to be paid by the employer. The cost of that retirement is calculated as the current actuarial value of the extra payments (totalling £1,900,000 in the example above). Then, at each triennial actuarial valuation the actuarial value of all an employer's ill health retirements is compared with its ill health retirement allowance from the previous valuation and any shortfall is added to the employer's deficit contribution requirements going forward. Ill health retirement allowances are revised at each actuarial valuation and will generally differ from the premium required by the IHLI insurer. Between 01/04/2008 and 30/11/2019 Worcestershire Pension Fund (the Fund) had 532 tier 1 / 2 ill health retirements with 3 individual cases adding > £500,000 to an employer's liabilities and 122 adding > £100,000.

The current premium for IHLI is 1.80% of LGPS pensionable payroll. Policies renew annually each 1 April.

If you decide to take out IHLI, you have the option to reduce your existing employer contributions by the ill health allowance included within your future service contributions from the 2022 actuarial valuation.

As an example (each employer has its own ill health allowance assumption), the ill health allowance assumption in the 2022 actuarial valuation for Worcestershire County Council (WCC) is 0.83% of pensionable payroll. So, if WCC took out IHLI it would pay Legal & General, the product provider / insurer, 1.80% of its LGPS pensionable payroll and could reduce its existing LGPS employer contributions by 0.83% meaning that to protect its funding position against ill health retirements it has increased its costs by a net 0.97% (= 1.80% - 0.83%).

WCC would have 0.83% less pensionable pay invested in the Fund if it offsets its ill health allowance assumption against the IHLI premium. Importantly, in the event a tier 1 or 2 ill health retirement is agreed, WCC would receive a payment from the insurer. This payment would then need to be passed to the Fund to be taken into account when reassessing the employer contributions at the next actuarial valuation. This would give WCC more certainty of future ill health costs in exchange for a higher ongoing cost.

It is also possible to pay the IHLI premium costs in addition to your existing employer contributions to maintain how much you are investing in the Fund.

The IHLI product works like this:

- You set up IHLI and let us know what adjustment, if any, you wish to make to your employer contributions
- You pay your revised employer contributions to the Fund
- You pay your IHLI premiums to the IHLI product provider by monthly direct debit NB your D-D does not vary in amount during a year: differences in your monthly pensionable payroll are taken into account at renewal each 1 April / cancellation
- If the cost of a future ill health retirement is met by the IHLI product, you claim from the product provider and pay over to the Fund the claim monies received NB the Fund will advise of the claim amount when you supply the Cessation Leavers and Ill Health forms

Where an employer takes out IHLI, all employees (not just those in the LGPS) would also benefit from access to a free Employee Assistance Programme for personal / work issues.

For more information about IHLI visit: https://www.hymans.co.uk/services/ill-health-liability/

If you would like more information or you are interested in IHLI, please email cfrohlich@worcestershire.gov.uk who will be able to advise you what your ill health allowance assumption is, after which you can contact Hymans, the intermediary for the insurance, or decide that you are not interested in IHLI.

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Please Note: Hymans Robertson LLP is an ancillary insurance intermediary in relation to the services provided to insured employers under their IHLI agreements, and it is authorised and regulated by the Financial Conduct Authority (Financial Services Register number 414430). Please refer to following link for further details: www.fca.org.uk. Hymans Robertson LLP acts as an introducer to Legal & General Assurance Society Limited. It is remunerated for its support and administration services on an introductory/administration fee basis (paid by Legal & General), which is 10% of the annual premiums paid for IHLI.
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