AVIVA – WRITTEN EVIDENCE (EUC0121)

The economics of Universal Credit

Aviva is the UK's largest insurer and a leading provider of life insurance, critical illness and income protection. We have extensive experience in supporting customers to return to work following an ill health related absence from work – a service which is provided as part of our individual and group (employer based) protection policies. Income protection policies have the twin aims of providing financial support for those who are unable to work and practical support to help those individuals return to the workplace as soon as possible. Our response to the committee focuses on the interaction between Universal Credit and individual income protection ("IIP") policies and the impact this has on claimants.

By bringing together out-of-work benefits and tax credits, the purpose of Universal Credit was to provide both in- and out-of-work support to claimants. It was introduced with the aim of simplifying and streamlining the benefits system, improving work incentives, and tackling poverty among low income families. Put more simply, the DWP said "*Universal Credit will make work pay and increase financial incentives for people to work more*".

It is in the interest of the Government, employers, , individuals impacted by sickness absence and society as a whole to encourage claimants to return to work after a period of sickness as quickly as possible. Doing so reduces welfare and NHS costs, increases tax and NIC receipts and improves social capital and financial resilience of the UK population.

However, the current Universal Credit rules on individual income protection are counter to this behaviour which Government wishes to promote. Universal Credit rules penalise individuals who protect themselves against sickness absence by taking out Individual Income Protection ("IIP"). IIP benefits are treated as 'unearned income' for Universal Credit rules. This results in a £1 reduction in entitlement to Universal Credit for every £1 of IIP benefit received.

The rules send the wrong policy signal – *that there is no reward for improving your own financial resilience*. There is no equivalent dis-incentive (to the Universal Credit rules) included in other areas of Government policy. Where an individual makes private pension contributions their state pension is not reduced in proportion to those from private savings. In contrast, private pension savings are incentivised (via pension tax relief) as it is accepted by Government that it is desirable for individuals to reduce the potential burdens on the welfare state that would otherwise result.

The public policy need to promote protection by individuals against the potential costs of sickness absence is an analogous situation to the need to privately save a sufficient amount for retirement. In effect, this is about encouraging behaviours that boost financial resilience throughout the life course, not just in old age. Any private provision for protection should be actively encouraged as it will directly reduce the costs on the state in terms of welfare spending, health costs, and increased tax and NIC receipts.

A recent NPI report[1] sets out the scale of the issue;

- 54% of all IIP policyholders are estimated to have an entitlement to Universal Credit. There were approximately 1 million IIP policies in force in 2017.

Universal Credit regulations prescribe that as a form of unearned income, an IIP benefit reduces Universal Credit entitlement £ for £. When account is taken of the IIP in payment, NPI estimated that:

- 39% of all policyholders would have their entitlement to Universal Credit ("without IIP") removed by IIP;
- 15% of all policyholders would continue to be entitled to a Universal Credit award alongside their IIP.

This result creates problems for consumers and Government. IIP policyholders could not have anticipated this problem when purchasing their IIP. For Government – this clear disincentive will, perversely, increase Universal Credit costs and reduce financial resilience as consumers retreat from taking IIP out.

DWP has provided a welcome disregard to these rules (in their Universal Credit guidance) for any part of IIP payments used to cover mortgage repayments. Something with a similar effect to the treatment of mortgage repayments but designed for tenants would offer equality across housing tenures and ensure that typically younger and less affluent sections of society are not unfairly penalised for having taken positive steps to improve their own financial resilience.

This is especially important when you consider that the factor which has driven in-work poverty most over the last 25 years (in increasing from 13% to 18%) is the increased housing costs for lower income households compared to higher income households. The IFS have estimated that this has pushed up in-work poverty by 2.4 % since 1994. This is "*the result of much higher growth in private and social rental costs, compared to owner occupied housing costs, which have fallen, and the falling proportion of low-income households that own their own home*".[2]

The combination of these factors also brings into focus the need to more closely align the Universal Credit rules with certain wider Government objectives; the desire to promote financial resilience of households (driven by the Money and Pensions Service) and to improve the fairness and the effectiveness of the rental market.

Now, is the right time to shine a light on these issues to ensure there is public clarity about welfare provision and to provide a consistency of approach that will allow individuals and families to take the actions needed to develop the financial resilience necessary both for the knowns of retirement and old age and the unknown 'bumps in the road' on the way. The Government should therefore conduct a review into the current treatment of IIP in Universal Credit with a view to establishing whether an alternative approach could improve financial resilience and reduce the cost of welfare.

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[1] The impact of individual income protection on universal credit and the implication for policyholders

[2] Why has in-work poverty risen in Britain?