The way forward to improving employee benefit engagement

Mind the Gap: Aligning HR policies with employee benefit

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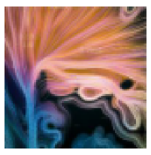
Authors and contributers



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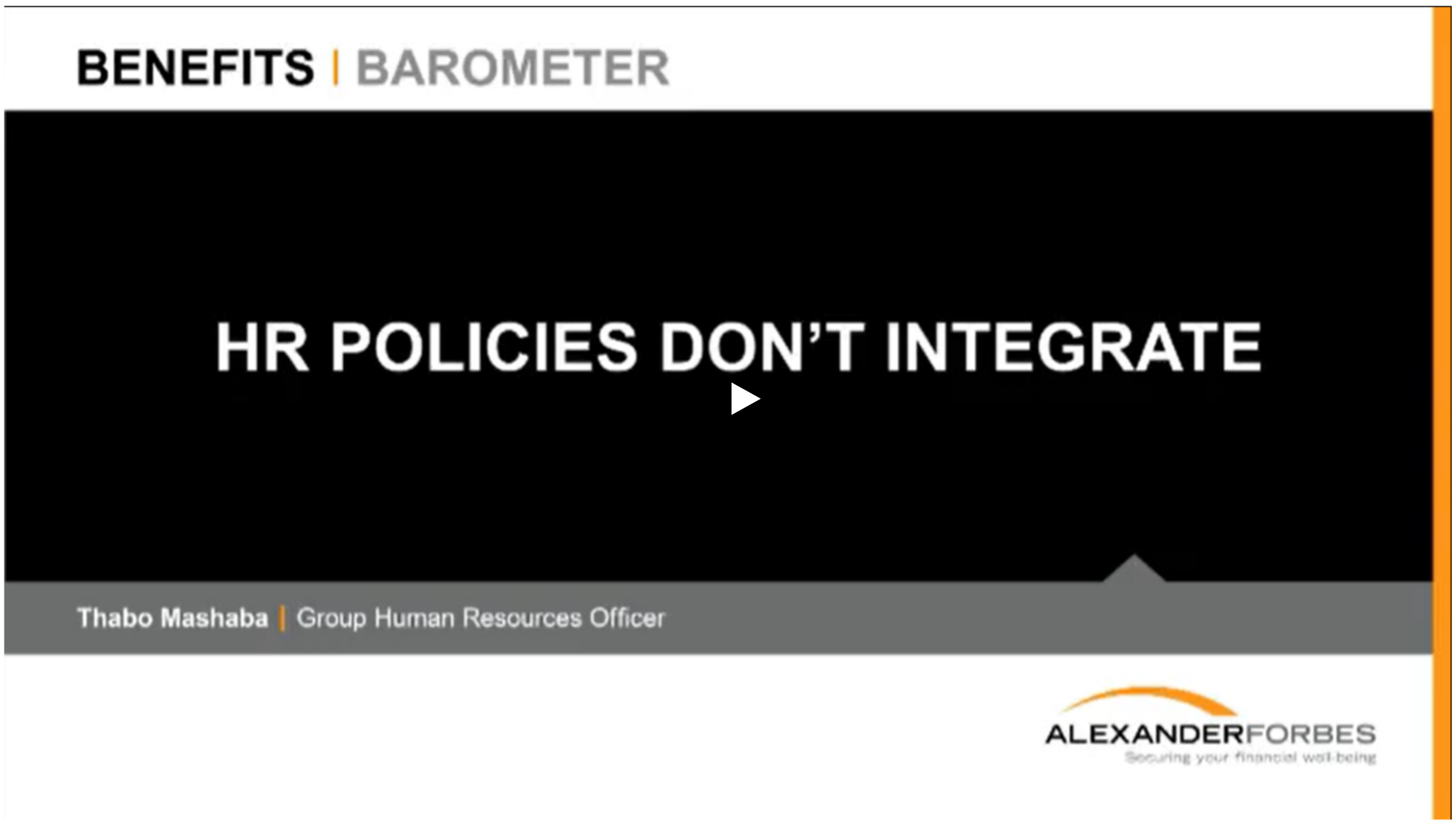
In Benefits Barometer 2013:'The employee benefits system and its inter-dependencies', we stressed the importance of an integrated approach to employee benefits design. In this edition, we identify discontinuities between employer policies, legislation and insurance policies. These are the kinds of gaps that can leave individuals without essential benefits when they most need them. An excellent case in point is the loss of life cover when employees go on a protected strike. When gaps do arise, what we need to keep in mind is that it costs money to close gaps. But it may cost an individual more not to close the gaps.



> **Gaps in cover can leave individuals without essential benefits when they need them most.**

Where to start

Often these gaps are the result of legacy issues not being reconsidered in light of new developments elsewhere in the company or in the fund. Addressing these problems demands a centralised accountability that can bring together diverse departments and legislation.

This challenge rests with various structures within an employer, including its human resources, payroll and finance departments. It's the employer's responsibility to review all employment policies and establish a clear understanding of the total rewards on offer to employees and whether or not needs are being met.

The **first step** is to review existing legislation. This sets out the high-level framework that all employers operate within. This is followed by an analysis, which consists of gathering information on:

The company's current health, incapacity and disability policies. Normally, these policies follow legislative requirements set out in the:

- Basic Conditions of Employment Act
- Employment Equity Act
- Code of Good Practice of Disability in the Workplace
- Compensation for Occupational Injuries and Diseases Act
- Schedule 8 of the Labour Relations Act.

The types of insurance policies currently in place, either through the employer or the retirement fund. Examples include:

- Permanent health insurance (PHI)
- Capital disability benefits
- Temporary disability benefits
- Extended sick leave benefits.

Other factors to be considered like:

- Definitions of disability
- Waiting periods
- Exclusion clauses
- Terms of cover.

Once the above analysis has been completed, the company must review union agreements to ensure that employer and insurer policies dovetail with existing agreements.

Step two is to determine whether there are any gaps or overlaps in the benefits that have been put in place.

> **Overlaps in benefit coverage can be as costly as leaving gaps.**

To facilitate an assessment of the employee benefits programme, we can use a matrix. Such a matrix would outline the various benefits a company can offer as part of its employee benefits package. The matrix would take note of the varying needs in an individual's (life like death, disability, retirement, retrenchment and so on). By identifying the full range of needs in an individual's life, we can then look at the benefits we can offer an employee to help meet these needs.

Overlaps in benefit coverage can be as costly as leaving gaps. As a result of corporate activity like mergers, many companies have inherited legacy benefits, which result in potential inefficiencies and overlapping with existing schemes. A matrix helps you to identify where you may be offering too many solutions to address the same need, like death cover. There are many variations of death cover that can be packaged and offered as part of a total rewards system. By using a matrix we can identify those variations that are necessary and those that are not.

Not only do the employers have to consider the insurer and union policies, they also have to avoid funding benefits the government provides to, or facilitates on behalf of all working South African citizens. For instance, all workers have some form of recourse to benefits through the Compensation for Occupational Injury and Diseases Act (COIDA)[1] if they are injured or killed in the workplace or while on duty. These benefits may prove adequate for workers, but the point is that employers should provide benefits that top up what the government provides rather than duplicating them.

Finally **step three** is to close the gaps. Cost will invariably be an issue, but employers must give serious consideration to the consequences.

As a result of corporate activity, many companies have inherited legacy benefits, which result in potential inefficiencies and overlapping with existing schemes. Overlaps in benefit coverage can be as costly as leaving gaps.

> **The relationship between disability benefit policies, incapacity policies and sick leave policies is prone to gaps, given the complexity of handling these issues.**

Incapacity and disability

The relationship between disability benefit policies, incapacity policies and sick leave policies is prone to gaps, given the complexity of handling these issues. The level of medical cover available to employees can also complicate these issues, as employees with greater access to medical services should be in a better position to prevent temporary illnesses and injuries from turning into permanent problems.

Incapacity and disability are distinctly different concepts. In the discussion that follows we'll clarify the differences in definitions as well as the different gaps which can arise around each concept. Still, they are interlinked and when an employee applies for a disability benefit, companies need to do an incapacity investigation at the same time that they define the employee's disability.

Incapacity

Incapacity is an employee's failure or inability to work according to the requirements of the job. It encompasses both poor work performance and the inability to perform due to ill-health or injury.

The key point in this definition is that incapacity is defined according to job requirements. This means employees who may be unable to perform a specific job will be declared incapacitated even though they are capable of performing other jobs with that employer. For instance, a mineworker who experiences a slight deterioration in eyesight will be declared incapacitated in terms of his job requirements because he is unable to work underground. But he could still work above ground in some other role.

Legislation does not define when an employee may be considered incapacitated, but rather forces employers to investigate incapacity and take reasonable steps to accommodate the employee, either in a different job or with further training, or by rehabilitating them.

One challenge in managing incapacity in the workplace is that work-related rehabilitation programmes or centres are rare in South Africa. Most employers find it easier and cheaper to replace an incapacitated employee rather than rehabilitate them. However, the number of holistic centres offering physiotherapy, occupational therapy, biokinetics and psychological services does seem to be increasing. Some insurance companies will pay for rehabilitation up to a stated maximum cost because, in the case of mild incapacity, it can reduce the length of the benefit payment period and hence the overall cost.

Disability

The definition of disability varies depending on the duration of the disability. In the short term, usually 24 months, it is the inability of an individual to perform their own or a similar occupation at their existing employer for which they are reasonably suited in terms of education, training and qualifications. The long-term definition of disability relates to whether the individual is able to find any work in the open labour market. That is, if an individual can find any other employment, their benefit payments will stop. Employees are often unaware of this when considering their employment contracts.

COIDA provides definitions of permanent, temporary total and temporary partial disablement. The act is also a useful guide for determining the extent of disablement, and the compensation the court may award in each case. This can help to inform the structure of the disability cover an employer may offer.

Prevalent forms of disability cover

- Income benefits provide a monthly benefit to replace income from employment while the individual is disabled.
- Lump-sum benefits provide a single payout if a member is deemed disabled. This benefit is cheaper to insure, but there can be a major shortfall for members as the lump sum is unlikely to be enough to sustain them until retirement.

Income disability policies are employer-owned policies and governed by the Long-term Insurance Act. The employer carries the cost of these policies and has the most control over their design. The retirement fund owns capital disability policies. Note that an employer may also own a lump-sum disability benefit policy.

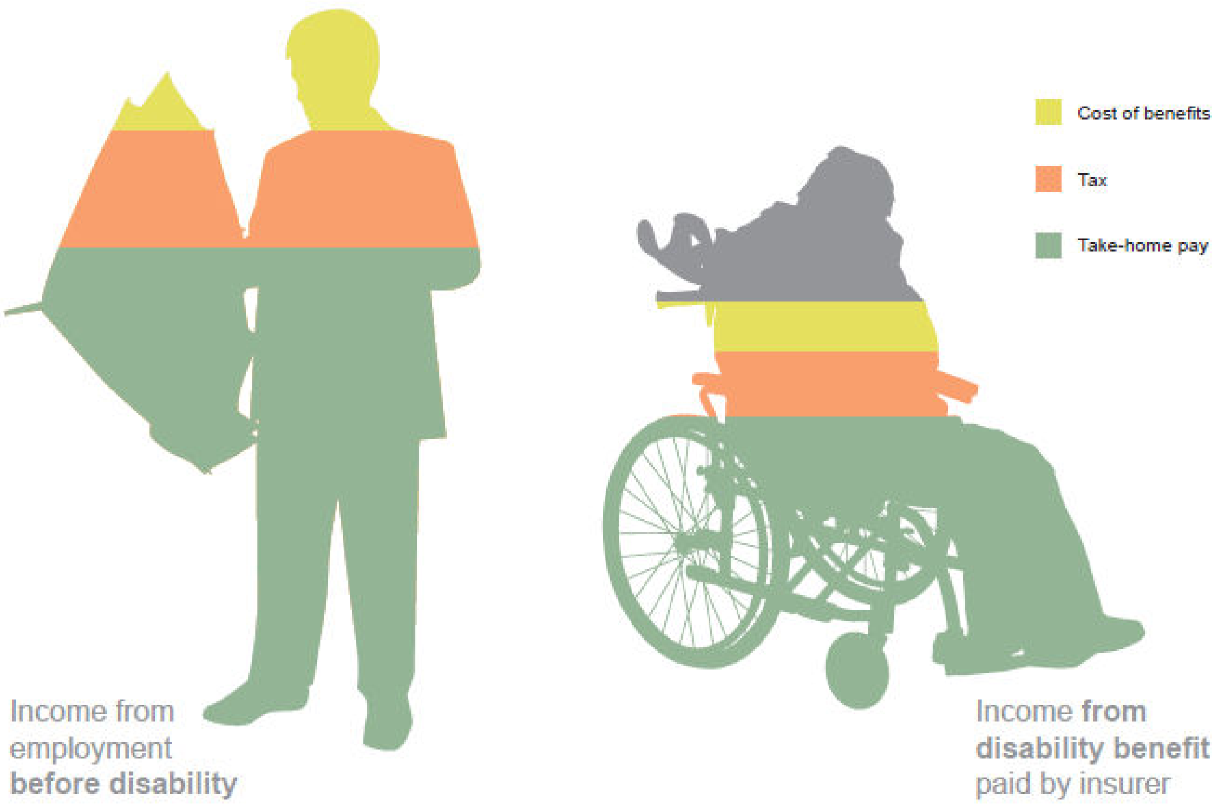
Potential gaps

1. The gap between sick leave and waiting periods
Most disability policies include a waiting period that is typically either three or six months. The longer the waiting period, the lower the cost of insurance. If a company provides 30 days of sick leave in a three-year cycle, as stipulated in the Basic Conditions of Employment Act, but the waiting period on the disability policy is six months, this leaves a period of four months or more in which the employee receives no income. In some instances, the employee may be able to claim from the state Unemployment Insurance Fund (UIF).

2. Take-home pay levels
Income disability benefits are usually 75% of the member's risk salary. The employer defines the risk salary and this is the salary on which risk benefits are based. In most instances, the risk salary may be the same as the pensionable salary. When the risk salary is a proportion of the individual's total cost to company (TCTC), employees end up taking home a fraction (less than 75%) of their pay after becoming disabled.

Consider a 30-year-old male, who has a TCTC of R200 000. His risk salary is set equal to 50% of his TCTC, so R100 000. If he becomes disabled, his benefit of 75% of risk salary equates to R75 000 per year. The member still pays tax on this income, but will receive tax credits for medical aid benefits and be subject to the secondary rebate[2]. He will also still pay risk-benefit premiums and retirement fund contributions as you can see in the diagram on the next page.

Comparison of take-home pay levels



> **The long-term definition of disability relates to whether the individual is able to find any work in the open labour market.**

Let's consider some practical examples that illustrate how costly gaps in cover can be for both employees and employers.

Case study 1

Waiting periods

An employer in the finance industry with just over 100 employees chose a six-month waiting period for their permanent health insurance (PHI) policy. Since this client had a small number of employees, they estimated that the probability of disability was low and not worth the cost to reduce the waiting period. But they did not have any policy in place that would provide cover during the waiting period if an employee did become disabled.

Shortly after policy inception, two employees became disabled in quick succession. Because of the presumed rarity of disability and lack of cover, they paid the first disabled employee their full salary during the waiting period. Having set a precedent, but still with no cover, they then faced a second disability. What made this particularly challenging was that most employees earned high salaries and it was expensive to pay out their full salaries for six months. They realised that they needed to have a clear policy in place.

Case study 2

Gap between pensionable pay and total package

An employer in the telecommunications industry with over 1 000 employees had a standard PHI benefit that covered 75% of monthly pensionable pay. But their pensionable pay was only 60% of TCTC. Employees were unaware of this gap, and when the first disability occurred, there were huge complaints because a monthly disability payment of 45% of their salary was not what they expected.

Subsequently, the company increased the monthly benefit to 90% of pensionable pay. It now uses communication to make employees aware of the gap between pensionable pay and their cost to company.

Case study 3

Inappropriate benefit structure

An employer in the mining industry offered a lump-sum disability benefit. Occupational risk is higher on mines. This, together with the high claims experience of the industry, results in high premiums for disability policies. Opting for the lump sum, rather than an income benefit, seemed more cost-effective, but the company had a particularly young worker profile.

A member became disabled at the age of 30 and received a lump-sum benefit of R200 000. The member was not able to return to work and had to survive until retirement on only a small lump sum.

Summary of these three case studies
These three case studies highlight the kinds of issues which can arise when benefits are not designed with the needs of the specific employee population in mind. PHI benefits can be very costly. Perhaps a way to decrease the cost of such cover is to limit the definition of disability to a specific set of events, although this is less likely to occur.

When policies leave individuals exposed, it is important to communicate this to members and offer them options to address those gaps in their own capacity, where possible.

Other potential gaps to consider

- In Benefits Barometer 2013, we raised the issue of gaps in coverage which can occur during strikes and mass exits.
- Another potential gap can arise when female employees are on maternity leave. Companies need a policy in place which guides what happens to retirement, risk and medical aid contributions during these months – both for paid and unpaid maternity leave. Childbirth can be dangerous, so risk and medical aid benefits need to be in place. Once the baby is born, the employee will need additional medical cover to provide protection for the child.

  If a company doesn't cover the cost of risk benefits directly, they need to allow for the employee to continue whatever contributions they might otherwise miss, in their own capacity. A company should ensure that when an employee applies for maternity leave, she is informed about what will happen to her benefits and what choices may be available to her.

- At present, temporary workers are typically not offered any employee benefits. But changes to the Labour Relations Act suggest that any fixed-term contractor, with a contract for more than three months, will be entitled to the same benefits as permanent employees. This could have implications for the company's risk profile and alter the costs of their benefits. So, in this process, it is important that reducing gaps for temporary employees doesn't end up creating gaps for permanent employees.

What follows is a table that sets out the gaps we have identified. Employers can use this as a tool when designing policies. It will help them to identify potential gaps in coverage so they can decide either to close the gap with additional insurance or to put a policy in place. When such a policy means the individual is still exposed, it is important to communicate this to members and offer them options to address those gaps in their own capacity, where possible.

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Disability insurance and incapacity

Gap identified	Applicable legislation	Key considerations	Who sets the policies?
Disability insurance and incapacity: ▪Benefits are payable at a percentage of the employees' total remuneration, leaving them with reduced income at a time when their cost of living is likely to increase. ▪Sick leave policies are not aligned with the waiting periods on insurance policies, leaving employees without protection for up to three months. ▪In some industries, the definition of incapacity is so specific that employees will be dismissed even when they are able to perform another job with the employer. This problem can be overcome by setting up a rehabilitation programme or changing the definition of incapacities.	▪*Labour Relations Act* (Act number 66 of 1995) ▪*Basic Conditions of Employment Act* (Act number 75 of 1997) ▪*Employment Equity Act* (Act number 55 of 1998) ▪*Compensation for Occupational Injuries and Diseases Act* (Act number 130 of 1993) ▪*Occupational Health and Safety Act* (Act number 85 of 1993)	▪Review the applicable legislation ▪Key questions for case management: -What is the degree of disability/incapacity and how was it caused? -Are employees capable of performing some or most of their duties? -Can the working conditions or job type be adapted to suit the employee? -During the waiting period, will the employee be paid at 100%, 50% or less of their salary? -Can the employer terminate employment at this time?	▪The insurer will set out the definition of disability, the term of payment of the benefit, the conditions under which the benefit is payable, in what form the benefit is payable, the exclusions and the price of cover. ▪Either the employer or insurer will define incapacity. ▪The employer will determine the amount of benefit, the waiting period and the employees who are eligible for cover. ▪The employer sets the policy with respect to rehabilitation of disabled or incapacitated employees, taking into account the cost and relevant legislation.

Possible effects of closing the gap

The main implication of closing the identified gaps is the cost to the employer of doing so. Disability income benefits (PHI benefits) are unapproved benefits for tax purposes. As a result, the employer, and not the fund, will own the policy. Decreasing the waiting period on the policy so that there is no gap between the use of all available sick leave and the start of payment of disability benefits will increase costs in general.

Rehabilitation programmes will also result in greater costs for the employer. The cost of rehabilitation of incapacitated employees can, in some cases, be greater than the search costs of a replacement for the individual.

Medical aid and medical insurance benefits will place employees in a better position to prevent temporary illnesses and injuries from becoming permanent. Where medical cover is unaffordable, the employer may consider subsidising this benefit.

Staff education and leave policies

Gap identified	Applicable legislation	Key considerations	Who sets the policies?
▪Often employers will not include study leave as part of an employee's benefits package. As a result, the employee will have to use their annual leave.	▪No applicable legislation on study leave entitlements ▪*Skills Development Act* (Act number 97 of 1998)	▪A survey of the employees can be carried out to determine the importance of such a benefit for members.	▪This policy will be set entirely by the employer, taking into account the needs of the workforce. ▪The Skills Development Act provides an institutional framework for devising and implementing workplace strategies to develop and improve the skills of the South African workforce.

Possible effects of closing the gap

In Benefits Barometer 2013, we identified training and skills development as a key priority for young workers. In a company that employs a large number of young workers or workers pursuing a particular profession requiring ongoing training, the result of not accommodating the needs of these workers may negatively affect both the attraction and retention of employees.

The employer should consider allowing a reasonable number of study leave days such that the productivity of the business is not affected. Employers could also consider the use of a flexible benefits package, where the employee gives up part of their salary or some other benefit in exchange for study leave.

Maternity leave policies

Gap identified	Applicable legislation	Key considerations	Who sets the policies?
▪Employees who are on unpaid maternity leave might not be covered for risk benefits while they are away and/ or the contributions towards retirement funding might cease while they are on leave.	▪*Basic Conditions of Employment Act* (Act number 75 of 1997) ▪*Unemployment Insurance Act* (Act number 63 of 2001)	▪Review the applicable legislation. ▪What proportion of the workforce is female? ▪What is the cost of providing risk benefits? ▪Can the cost of the risk benefits be insured for this period and at what cost? ▪Should cover be provided for certain categories of workers or all workers? ▪Can the cost be recouped when the employee returns to work?	▪Legislation sets out the leave entitlement of the employee. ▪The employer will determine whether the employee will be entitled to paid or unpaid leave and whether the risk benefit premiums and retirement fund contributions will continue while they are away.

Possible effects of closing the gap

The continuation of risk benefits ensures that the employee is not left vulnerable while they are away from work.

If an employee is on unpaid maternity leave, the employer may have to pick up the costs of risk benefit premiums and retirement fund contributions, although this structure varies by company and according to fund rules. This money can be claimed from the employee when they return to work. Alternatively, the employer can ask the staff member if they would like to continue the benefits at their own cost.

Provision of benefits for temporary/contract/seasonal workers

Gap identiied	Applicable legislation	Key considerations	Who sets the policies?
▪Temporary workers are often not entitled to the same benefits as permanent employees. As a result, these workers are left unprotected and without any savings at their retirement date.	▪*Employment Equity Act* (Act number 55 of 1998) ▪*Labour Relations Act* (Act number 66 of 1995) ▪*Basic Conditions of Employment Act* (Act number 75 of 1997)	▪Review the applicable legislation. ▪Prepare for anticipated changes in legislation regarding the treatment of contract workers employed for more than three months.	▪The employer has power over which employees are eligible for fund membership. Usually this excludes workers employed on a contract basis who are only expected to be employed for the duration of a special project. ▪There is a proposal to amend the *Labour Relations Act* so that temporary workers who are employed by a particular client, and not a labour broker, for a period longer than three months, will be entitled to be treated on the whole not less favourably than the permanent employees of the client. This may mean that risk, healthcare and retirement benefits must be extended to these workers.

Possible effects of closing the gap

Again the main implication here is the cost involved in offering benefits to temporary workers. There may also be administrative complexity where individuals are employed on a fixed-term contract and choose to take accumulated benefits when changing jobs.

Policy makers must consider how to treat accumulated fund credits of temporary workers when compulsory preservation is instituted.

Fund consolidation and corporate activity

Gap identiied	Applicable legislation	Key considerations	Who sets the policies?
▪In a merger or takeover, some members of the retirement fund may be prejudiced with regard to their retirement benefits, resulting in inequitable benefit structures. ▪Administrative complexity, and the cost of benefit provision, increases when there are multiple categories of fund members.	▪*Pension Funds Act* (Act number 24 of 1956) ▪*Labour Relations Act* (Act number 66 of 1995) ▪*Employment Equity Act* (Act number 55 of 1998) ▪*Income Tax Act* (Act number 58 of 1962)	▪Review the applicable legislation. ▪How many members are being transferred? ▪Is the transfer occurring from a pension to provident fund? Should the benefits be preserved? ▪What is the cost of aligning IT platforms and benefit structures?	▪Where a company has been involved in an amalgamation, transfer or other corporate activity, multiple employers would have been involved in setting the benefits policies for the workforce. Unless the predator company has a clear policy on the benefits that all employees are entitled to, workers will retain their original benefits structure. ▪Legislation will ensure that employees are treated equitably.

Possible effects of closing the gap

Moving all employees into a common benefits offering may increase or decrease the costs of insurance and administration. If all employees are brought onto a common policy, there may be cost savings that arise from economies of scale. But if the risk profile of new employees is worse than the original population, the premium could increase.

Particular care needs to be taken when transfers are made from a pension to a provident fund. All benefits transferred will be taxed according to the Income Tax Act. From 1 March 2015, this rule will change so that benefits will not be taxed on transfer.

Strike action

Gap identiied	Applicable legislation	Key considerations	Who sets the policies?
▪Workers embarking on strike action may not have risk benefit cover during this period. This depends on whether the strike is protected or unprotected.	▪*Labour Relations Act* (Act number 66 of 1995)	▪Review the applicable legislation. ▪What happens to the contributions to the retirement fund during the strike? Will the employer continue to pay them? ▪What exclusions exist? ▪Can the insurance cover be extended to workers who are on strike?	▪The employer and trustees of the retirement fund will have discretion over whether the contributions to the retirement fund will continue when the member is on a protected strike. ▪Strike action may be listed as an exclusion in insurance policies.

Possible effects of closing the gap

We raised this issue in Benefits Barometer 2013 and said that where workers are dismissed due to striking, they will automatically lose their group risk cover. Even if they are reinstated there may still be certain gaps in insured benefit cover, where pre-existing conditions or waiting periods may apply to any new cover provided by their new employer arrangement. Medical underwriting can sometimes result in a gap in cover for up to three months.

Extendable risk cover could be considered in sectors prone to strikes to reduce the impact of this gap.

Conclusion

Gaps and overlaps can arise between employer, insurer and union policies. Gaps can leave members without much needed protection at a time when they are most vulnerable, while overlaps in coverage may result in the inefficient allocation of scarce financial resources. Often these gaps are the result of legacy issues which have not been reconsidered in light of new developments elsewhere in the company or fund or within legislation.

Identifying potential gaps in coverage and closing them can be a costly exercise. As such, employers will need to decide whether they will take action to close gaps and will accept these costs themselves. Whatever decision is made, it is important to communicate this to employees and offer them options to address those gaps in their own capacity, where possible.

References

1 Holzmann & Jørgensen (2001)
2 The secondary rebate is the tax rebate that is paid to income earners between the ages of 65 and 75 and individuals classified as disabled.

HUMAN RESOURCE POLICIES | EMPLOYEE BENEFITS | DISABILITY COVER | INCAPACITY COVER