

## **Subject Coverage & Feasibility Analysis**

### **Private Unemployment Insurance**

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*(The Idea and Business Model for this Paper was proposed by the Author S. Iyer in 2002. Statistical and Research Data was provided by a Freelance contracted Third Party in 2002. Based on this, the paper was prepared as a collaborative effort in 2002 )*

**PRIVATE UNEMPLOYMENT INSURANCE**

**Table of Contents**

Table of Contents ..... 2

1) Background on the Unemployment Insurance Industry ..... 3

*Basic Understanding and History of Unemployment Insurance in US* ..... 3

*Current State of the Unemployment Insurance*..... 3

*Government Unemployment Insurance*..... 3

*Advantages* ..... 4

*Disadvantages*..... 4

2) Private Unemployment Insurance – The Solution..... 6

*The Business Model* ..... 6

*Benefits of the Model* ..... 7

*Costs Associated with the Model* ..... 7

3) An Overview of the Market Opportunity ..... 8

*Overburdened System* ..... 8

*Flexible Labor Markets*..... 8

*Attractiveness to Employers*..... 8

*Attractiveness to Employees* ..... 8

4) Competitive Landscape ..... 10

    a) *Method*..... 10

    b) *Findings*..... 10

    c) *The Prospects for Private Unemployment Insurance* ..... 11

## **1) Background on the Unemployment Insurance Industry**

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### *Basic Understanding and History of Unemployment Insurance in US*

The nation's unemployment insurance system is one of the most costly Federal programs in operation today. Critics call it counter-productive and out-of-date since:

- Its benefits (usually for 26 weeks) tend to extend the duration of unemployment by reducing an individual's incentives to search for new employment
- Firms with relatively low layoff rates, essentially subsidize firms with high layoff rates
- Benefits do not address the needs of individual workers, many of whom require education, re-training, or capital to start their own businesses

Established by the Social Security Act of 1935, its purpose is to pay benefits to workers who lose their jobs and are seeking re employment. It is funded by state and federal taxes on employers, and does ease both the individual financial impact of unemployment, and also acts as an automatic stimulus package, jumpstarting a stagnating economy.

Prior to 1935, some unions and businesses operated their own programs for supporting and retraining displaced workers. In the midst of the Great Depression, when the government stepped in, private insurance companies were effectively prevented from operating such programs, effectively ending the business of private unemployment insurance.

### *Current State of the Unemployment Insurance*

Concerns about the rising cost of Social Security have made welfare reform a central element of government policy in most developed countries, including the US. It is by now clear that policy must change, if the long-term viability of these social programs is to be supported.

As such, welfare and social security reform are likely to continue to dominate political debate for the next several years. Governments, private companies, unions and even individuals are likely to start looking for alternatives to the instable and ineffective existing government programs.

### *Government Unemployment Insurance*

When a worker loses their job, they can file for unemployment. If approved, they are entitled to receive a percentage of their last after-tax salary, subject to a maximum of about \$40,000 per year. These benefits last for 26 weeks, at the end of which it is expected that a person will have found a job. People can re-file for a 13 week extension if they have still not been able to find work.

## ***PRIVATE UNEMPLOYMENT INSURANCE***

### ***Advantages***

#### **Stabilizing the Economy:**

Besides helping unemployed individuals and families transition from one job to another, unemployment insurance (UI) acts as an automatic economic stabilizer. In a recession, UI benefits offset some of the effects of job losses on a community's spending power. Because UI benefits allow unemployed individuals and their families to continue to pay their bills, it helps maintain the incomes and spending power of the stores, landlords, banks, and service providers in the community. UI softens the blow and reduces the snowball effect of job losses.

#### **Retaining a local workforce:**

Unemployment insurance (UI) promotes stability by making it possible for employers to retain workers during the off-season or during a short downturn in business. Many seasonal industries would find it much more difficult to attract and retain employees if their workers could not rely on UI to support them through the off-season.

### ***Disadvantages***

#### **Decreasing Re-employment Incentives:**

Unemployment insurance provides the unemployed with an income cushion, which often decreases their incentives to actively search for work. Social workers will typically interview persons collecting unemployment, and request information about their latest efforts to find work. It is not hard to imagine however that such questioning is wholly ineffective since:

- i) Government Social Workers have thousands of persons to interview in any given situation and are thus unlikely to devote much thought or energy into identifying those persons that are not actively trying to find work.
- ii) Social Workers have no incentives to catch "slackers" since benefits are paid out by the state, which is not interested in turning in a profit.
- iii) Social Workers lack the expertise and training to adequately guide and help even the contentious unemployed to locate jobs.

#### **Encourages Layoffs:**

Many companies are seasonal in their business. Construction companies for instance, may do up to 90% of their work in the months starting April and ending October. As such, and for the remainder of the year, they have no need for their workers, whom they fire and then re-hire in the spring. Since unemployment insurance will pay for these people in the off-season, construction companies can be sure that their trusted and skilled workers will be available again in the spring, thus perpetuating this hire-fire-rehire process.

## ***PRIVATE UNEMPLOYMENT INSURANCE***

Moreover, since unemployment insurance is funded through taxation, industries with high layoff rates are subsidized by industries with low layoff rates, which negatively affect labor and capital productivity.

### **Existing Benefits do not Permanently Address Unemployment:**

Often, and in order to permanently combat unemployment, what is needed is structural redistribution of labor. Over the past ten years for example, the US economy has undergone a fundamental change, whereby industrial production has shifted from labor to capital intensive and excess labor has moved into services.

The problem of course, is that it is not always easy for excess labor to simply move from a steel mill, to a microprocessor production facility. Existing unemployment insurance does nothing to deal with the re-education of labor, and thus does not help people keep up with an ever-changing economy.

### **Limited Job Replacement/Search Services:**

The Government unemployment program provides very little assistance in terms of value added job seeking skills. The program primarily focuses on providing a financial assistance to overcome peoples' problems. Resume building workshops, job search approach, market opportunity avenues & channels, employer referral programs, positive attitude training and other important resources are not provided. This leaves many individuals to "seek their own opportunities" and "be their own mentors".

### **Other Challenges with Unemployment Insurance:**

During the next two decades, the number of older workers in the U.S. will nearly double. This bulge, soon to be a conspicuous aspect of the aging baby boom generation, will require a transformation in the way public and private programs are designed to support these individuals at work and in retirement. Responding with rational policies, whether they apply to workers' compensation, unemployment insurance, disability insurance, or private health insurance, is vital for preserving the nation's economic well being. The first steps toward developing these policies have now been taken.

A series of forward-looking papers was commissioned by the National Academy of Social Insurance and presented in January 2000. The papers explore implications of an aging workforce for a number of social programs in the coming decades, and point to the critical policy issues that must be faced when growing numbers of older workers begin to strain the capacity of those programs.

It is clear from the above arguments, that while existing Unemployment Insurance addresses some of the problems associated with unemployment, it is far from anything resembling a comprehensive system against unemployment. There are several key problems with existing Government programs, that more than ever before, people, unions and companies are desperate to solve.

## **2) Private Unemployment Insurance – The Solution**

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Private Unemployment Insurance may be a viable reinforcement to Government Unemployment Insurance programs if it can effectively address some of the problems and disadvantages in the Government programs.

By placing the responsibility for rehabilitation of the unemployed into the hands of private, for-profit institutions, the potential gains can be exponential. But in order to be functional private unemployment insurance must above all, be profitable for the companies that provide it and also be attractive to customers purchasing it.

### *The Business Model*

The Insurance service suggested in this document is for providing benefits and services that minimize both the stress and discomfort associated with unemployment and the time needed to find a new job. It should involve not just financial recovery, but also a network of placement firms that will commit to finding qualified people alternate employment. The insurance rate will be based on various factors, for example if the person has an inconsistent employment record, etc. it will be higher.

If the model includes a nexus of Career Counselors, Universities, re educations centers and Head Hunting agencies, all of these, working together, will quickly ensure that:

- Clients know what career they want to pursue
- Have the skills they need to pursue it
- Know where to get started

An integrated network of services would ensure that people are quickly put back into the labor force, and resume paying their insurance premiums, minimizing cost to the insurance company and maximizing its profitability.

Many of the underlying business rules for this service would be analogous to those for primary insurance offerings like Auto/ Health Insurance, etc. The core product is similar to unemployment insurance offered by the state, except it is a private issue -- by adding various highly useful career- related services to it, the private issue will offer a more competitive advantage.

## ***PRIVATE UNEMPLOYMENT INSURANCE***

### ***Benefits of the Model***

In a typical program, persons with private Unemployment insurance would receive the following benefits:

- 1) A percentage of their average salary calculated for the previous 1 year. Paid out twice a month, and for as many months as the person has been paying for insurance (i.e. a person that has paid for unemployment insurance for two months, will be entitled to two months of benefits).
- 2) Counseling and career guidance
- 3) Job search assistance
- 4) Workshops on how to improve their overall “attractiveness” for the marketplace
- 5) Specific skill oriented workshops
- 6) Access to universities and other reeducation programs
- 7) Access to national and regional employment database, Head Hunters and other service providers to help people quickly move to new jobs.

### ***Costs Associated with the Model***

In order to receive the above-mentioned benefits, individuals, their employers, their unions, the Government or any combinations of the above, must pay a certain monthly premium.

The benefits of such insurance policies can only go to persons who lose their jobs (i.e. an employer cannot be the beneficiary of the unemployment insurance).

The insurance company may take up to two weeks to investigate the circumstances under which a person covered by this insurance was fired. If continuous neglect on behalf of this person is attested to by their former employer, then that person forfeits the right to any and all insurance benefits.

To qualify for unemployment insurance, a person must establish a stable employment record. A person with a history of unstable employment, may not qualify for unemployment insurance, or may be forced to pay higher premiums.

Premiums will also depend on the type of employer. Again, to use the example of construction companies, unemployment insurance premiums will be higher for construction company employees, than they will be for civil servants.

### **3) An Overview of the Market Opportunity**

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#### *Overburdened System*

The market opportunity for private unemployment insurance companies is significant given the current burden on the federal and state unemployment programs. Many states are looking for outside assistance to overcome the challenge they are facing associated with the current downturn in the economy.

#### *Flexible Labor Markets*

The rise in flexible labor has made it more difficult for unemployed persons to meet the increasingly stringent qualifying conditions for unemployment benefits. Studies investigating the perceptions of the risk of unemployment and declining social security efficiency have shown a strong turn towards the private unemployment insurance options. Specifically, the study explored the influence of social, psychological and cultural factors on attitudes, aimed to assess the scope and applicability for private social security insurance in a comparative context.

#### *Attractiveness to Employers*

Private unemployment insurance provides an excellent option for employers that operate within industries with cyclical economic environments. The construction industry is an example of such an economic environment. Employees in this type of an industry face immense downtime, the nature of their jobs have an “on and off” type of component. This “on and off” type of job creates more time for pro-union and anti-employer type activities. By providing temporary unemployment insurance employers can keep their employees happy and also create a positive image of the management. This unemployment insurance can obviously be purchased from the private unemployment insurance companies.

#### *Attractiveness to Employees*

The current situation provides great market opportunity for new entrants in the Insurance industry, specifically private unemployment insurance companies to come and capitalize on this evolving market trend.

Table 1, provides an example of the claims filed within a period of one week within many States.



**PRIVATE UNEMPLOYMENT INSURANCE**

**TABLE 1: UNADJUSTED INITIAL CLAIMS FOR WEEK ENDED 04/06/2002**

*STATES WITH AN INCREASE OF MORE THAN 1,000*

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CO	+1,010	No comment.
CT	+1,100	No comment.
AZ	+1,125	No comment.
OR	+1,171	No comment.
IN	+1,378	Layoffs in the service industry.
MN	+1,589	Layoffs in the manufacturing, construction, and service industries.
GA	+1,685	Layoffs in the textile industry.
MA	+1,719	Layoffs in the manufacturing industry.
FL	+1,754	Layoffs in the construction, trade, service, and manufacturing industries, and agriculture.
AR	+1,776	No comment.
LA	+1,861	No comment.
PA	+2,163	Layoffs in the paper, rubber/plastics, stone/clay/glass, machinery, transportation equipment, and service industries.
AL	+2,388	Layoffs in the electrical equipment, textile, and service industries.
IL	+2,761	Layoffs in the trade, service, and manufacturing industries.
WI	+2,861	Layoffs in the construction, retail trade, service, manufacturing, transportation, communications, and public utilities industries.
PR	+3,490	No comment.
TN	+3,519	Layoffs in the textile, electronic equipment, industrial machinery, apparel, and furniture industries.
NC	+3,925	Layoffs in the textile, apparel, and furniture industries.
TX	+4,046	Layoffs in the retail trade, wholesale trade, and manufacturing industries.
NY	+6,496	No comment.
NJ	+8,273	Layoffs in the retail trade, public administration, transportation, communications, and public utilities industries

## **4) Competitive Landscape**

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### **Assessment of Successful Private Unemployment Insurance Models**

Two Private Unemployment Insurance Efficacy Studies have been performed in England and Germany. Below is an extensive presentation of the methodology and findings of each.

#### ***a) Method***

The two studies examined used similar qualitative and quantitative research methods, including:

- i. A national representative survey of over 1,000 people in employment in both Britain and Germany.
- ii. In-depth interviews with waged and unwaged households and with individuals with private unemployment insurance
- iii. Analysis of longitudinal data from the British Household Panel Study and the German Socio-economic Panel.

#### ***b) Findings***

About 7% of people in work in Britain expected to lose their job within one year after being interviewed in November 1997. This compared to approximately 16% of employed people in Germany interviewed in September of 1999. The greater sense of insecurity was likely to have been a reflection of unemployment at the time, which was rising steadily in Germany, but declining, in Britain. Over time, perceptions of the risk of unemployment proved largely accurate, but in both countries only a minority of the unemployed had anticipated that they might lose their job.

There was a strong belief that legal protection (Germany) or often-informal business practices (Britain) reduced the risk of redundancy. Households often felt they would be able, as a unit, to cope with the financial repercussions of unemployment. Single and low-income households were clearly disadvantaged in this respect.

The qualitative work highlighted considerable support for the public provision of welfare. Fraud, however, was an issue especially in Britain. In Germany, unemployment benefit was mostly seen as adequate temporarily to sustain one's living standard. This was not the case in Britain, where people were critical of the practice of means-testing unemployment benefit, especially taking account of a household's savings. Low levels of public benefit encouraged informants to consider, or take out, private insurance. Between 5 and 6 percent of people in work claimed to possess private unemployment insurance.

## ***PRIVATE UNEMPLOYMENT INSURANCE***

### ***c) The Prospects for Private Unemployment Insurance***

According to the two studies, about 23% of people in employment in Britain and 12% in Germany intend to acquire private unemployment insurance in the future.

Younger people in both countries were more likely to express an interest in this type of insurance than older people. However, there were also differences between the countries. In Germany, people who felt at risk of unemployment or who were employed on temporary contracts were particularly likely to consider taking out private unemployment insurance. In Britain, people with partners who had repeatedly been unemployed were disproportionately likely to consider this type of insurance.

In both countries, psychological factors affected insurance attitudes. Saving and investment were often preferred to insurance as a means of cushioning the financial impact of unemployment in a household. This reflected a desire among informants to obtain a return on money set aside. It also reflected financial constraints, especially in low- and medium-income households. There was little evidence of potential moral hazard (people deciding to become unemployed). However, people thought private insurance might give them more time to look for a job.

There was more evidence of adverse selection (people with a high risk of unemployment seeking to insure): people who had been repeatedly unemployed (Britain) and people who felt at risk of unemployment (Germany) were disproportionately likely to consider private insurance. Delivery of social security: Informants in both countries were concerned about financial exclusion, private insurers putting shareholders before customers, and value for money.

Most informants preferred public to private provision of welfare and some expressed a preference for a mixed public private provision that would safeguard a minimum of social security for those less well off. In Britain, private provision was supported above all on grounds of increased service or benefit levels. In Germany, private provision was supported primarily because it appeared to offer greater control over resources (entitlement) as well as better services and higher benefits.

Policy and practice: The research highlighted the limits to increasing the role of private unemployment insurance in Britain and Germany. It revealed people's concerns for high quality and high-level social security, be it delivered by the public or the private sector. Greater self-provision through private insurance looked unlikely to be achieved by appealing to people's 'rational' sense of protection. People feel adapt at managing risk situations and ignore warnings that risks, such as unemployment, and their repercussions for the household are often unpredicted and perhaps unpredictable.

Social security policy can help alleviate risk situations by taking greater account of household strategies designed to cope with risk. Long-term social security perspectives are required, which may build on people's preferences for personal insurance portfolios. There is a fundamental commonality in welfare preferences in Britain and Germany, which could provide scope for developing a common, perhaps European, model of social security.