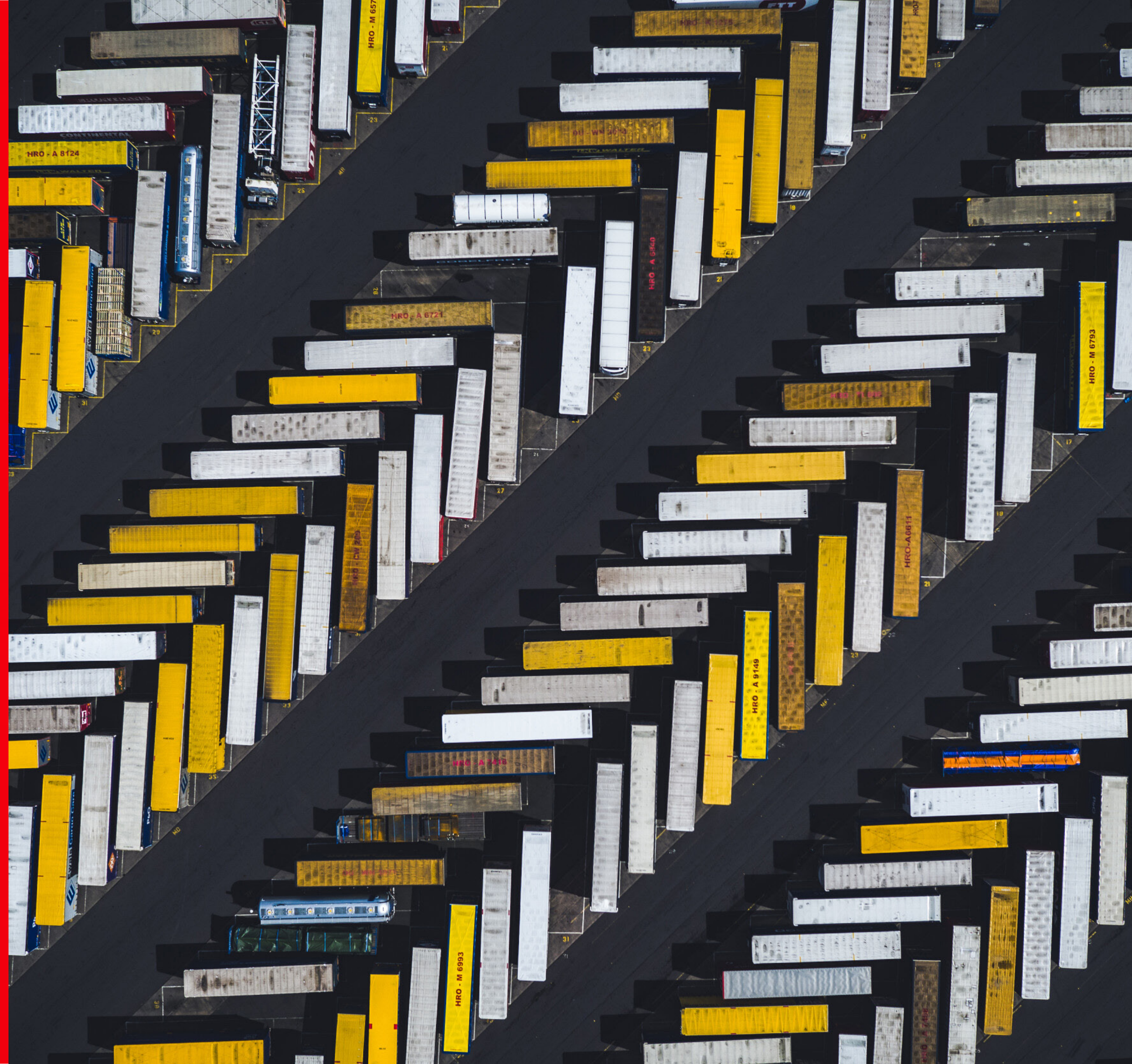


AON

The Impact of Rising Inflation on Employee Benefits 2022



Executive Summary

As price inflation in many parts of the world reaches levels not seen for 40 years, the impact is being felt across the economy – and the world of employee benefits is definitely not immune. This is uncharted economic territory for most companies with many factors combining to make it very difficult to navigate.

Firstly, as we emerge from the shadow of the global pandemic, the health and wellbeing of employees is a priority for all employers and we have seen many of our clients beginning to enhance their benefit programs to ensure all employees and their families have the support they need.

Secondly, strong global economic growth in the months coming out of the pandemic has led to talent shortages in many industries driving up salaries (which is one driver of high price inflation) with a knock-on impact for employee benefits that have a link to those salaries.

Finally, governments and central banks are trying to bring inflation under control by raising interest rates which is slowing economic growth and putting further pressure on employers to save costs. Rising interest rates will also have an impact on pension costs and premium rates.

The situation is complex and fluid. Responses from organizations have tended to be reactive, and vary significantly by industry, geography, and company. There are also numerous organization-specific factors which influence the decisions being made - such as cost-base, profit margins, risk appetite, and wider people strategy - but there are some common trends emerging both from Aon clients and the wider market.

In this paper we summarise the key impacts of inflation on the full spectrum of employee benefits and what employers can be doing to mitigate this impact.

Carl Redondo
Global Benefits Consulting Leader, Aon

Aon is in the business of better decisions.



Price inflation around the world

High inflation is affecting all regions around the world, with the exception of Asia. Rising energy prices, rising salaries and supply chain issues are the primary factors driving the high inflation and the more exposure an economy has to these factors then the higher the inflation is likely to be.

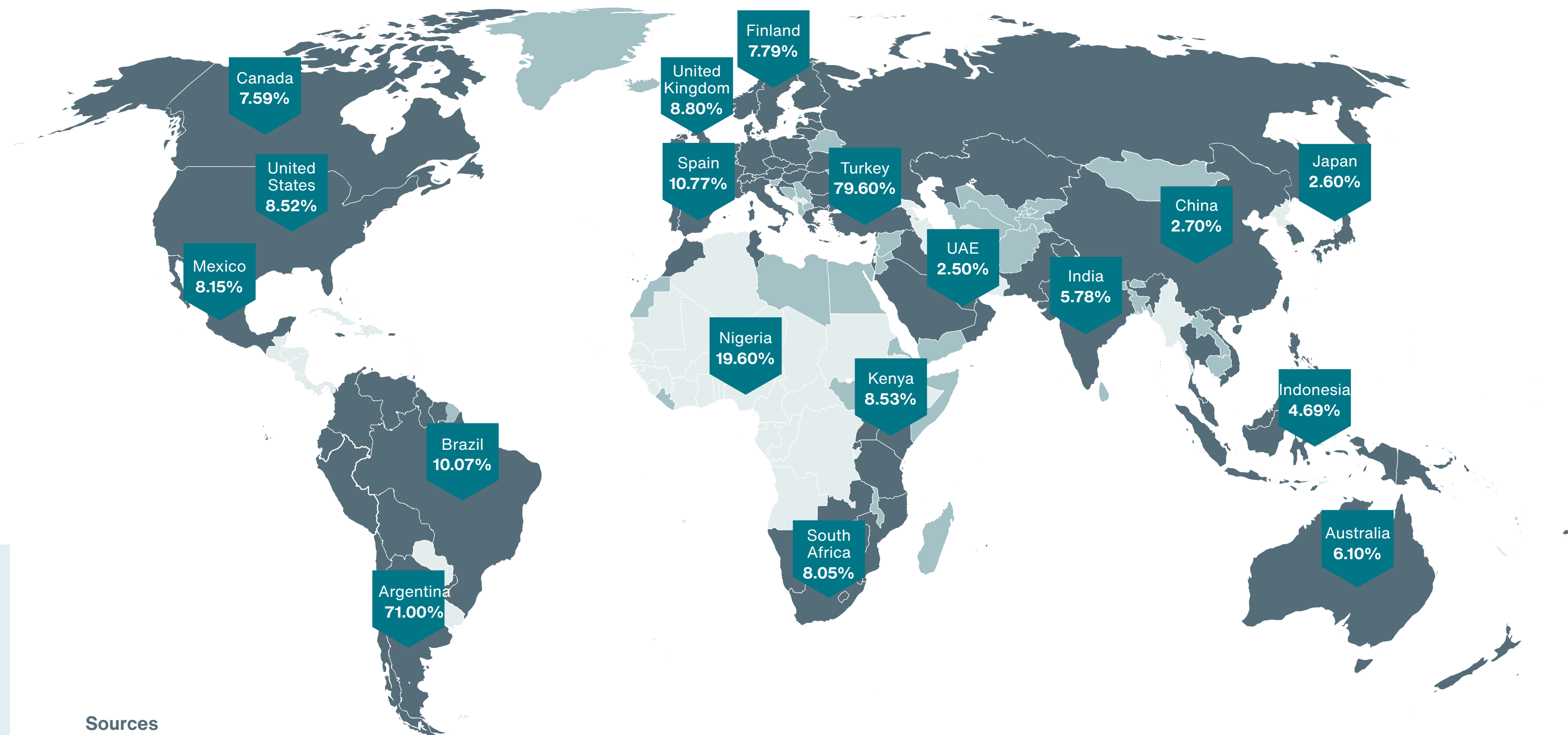
The map shows the current price inflation in various countries around the world; it should be noted that in Western Europe and North America these are levels of inflation not seen for 40 years.

Turkey and Argentina have specific issues within their economies driving inflation even higher and can be considered as outliers from the rest of the world.

Defining Inflation

For the purpose of this document, 'inflation' is defined in terms of the broader economic trends across salaries, energy prices, rents and product costs – rather than the factors which influence medical trend rates or just simply price inflation.

We are deliberately using a loose and broad definition of inflation to address the thematic issues impacting employee benefits. The impact of medical trend is dealt with as a separate topic and is covered in Aon's annual medical trend study.



Sources

Argentina: <https://data.oecd.org/price/inflation-cpi.htm> Australia: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release> Brazil: <https://data.oecd.org/price/inflation-cpi.htm> Canada: <https://data.oecd.org/price/inflation-cpi.htm> China: <https://data.oecd.org/price/inflation-cpi.htm> Finland: <https://data.oecd.org/price/inflation-cpi.htm> India: <https://data.oecd.org/price/inflation-cpi.htm> Indonesia: <https://data.oecd.org/price/inflation-cpi.htm> Japan: <https://data.oecd.org/price/inflation-cpi.htm> Kenya: <https://www.centralbank.go.ke/inflation-rates/> Mexico: <https://data.oecd.org/price/inflation-cpi.htm> Nigeria: <https://www.ft.com/content/fb8882bb-32cb-4b76-bb45-eeda3ce1f304> South Africa: <https://data.oecd.org/price/inflation-cpi.htm> Spain: <https://data.oecd.org/price/inflation-cpi.htm> Turkey: <https://data.oecd.org/price/inflation-cpi.htm> UAE: <https://tradingeconomics.com/united-arab-emirates/inflation-cpi> United Kingdom: <https://data.oecd.org/price/inflation-cpi.htm> United States: <https://data.oecd.org/price/inflation-cpi.htm>

The Inflation Impact – Talent and Pay

Inflation and salary growth are intrinsically linked. Historically, high inflation has driven corresponding wage increases; and it is expected that as companies navigate macro-economic conditions wages will increase – but potentially not as fast or high as inflation measures. However, for many employees, their real income may still be lower on a net basis.

2021 saw some significant increases in salaries due to talent scarcity along with unprecedented demand for hiring. This has been compounded by low unemployment levels and increased talent mobility. The cost of retaining and attracting good talent has inevitably increased. Invariably, this is sector-specific; not all companies are able to support salary adjustments due to higher fixed cost-base or a reduction in income as a result of decreasing consumer buying power. As rising living costs start to impact consumers, discretionary spend decreases – for example, we are seeing some global technology firms starting to take early intervention to reduce costs by cutting headcount.

“

“In the US, the combination of the Great Resignation and rising inflation is driving increases in pay of 4-8%, depending on industry, for the 12-month period ending in June of 2022, with 2023 pay increases projected in the 4% range (in the US). For most workers, pay increases are not fully offsetting inflation and we are seeing companies investigate how they can help employees manage higher living costs.

However, businesses’ ability to offer new benefits is limited by inflationary pressure and uncertainty on the business. Some of the key strategies are to communicate existing benefits that can help employees manage the impact of inflation, like financial wellbeing tools and discount platforms.”

Janet Faircloth,
Senior Vice President, Aon

UAE: The impact on total reward

Employers are looking to increase salaries and allowances as a result of rising costs, but few are taking action now. Aon’s research shows that companies are planning for increased compensation costs; 29% are amending housing and transportation allowances, 49% are budgeting for higher salaries for the 2023 pay cycle and 14% are planning mid-year pay reviews for 2022.

Source: Aon Internal Data, 2022

The Inflation Impact – Medical Benefits

In this paper we are not considering the impact of “medical trend” as this is an important topic in its own right which is dealt with in Aon’s annual medical trend study.

Insured medical benefits are a key benefit for employees and their families and we continue to see employers (particularly in segments with talent shortages) increasing these benefits and expanding coverage in many markets around the world.

Medical insurance providers, administrators (and intermediaries managing the plans) will be affected by the overall inflationary increases on their own core businesses (salaries, energy prices, etc) and so administration and other premium loadings are likely to increase. Rising interest rates have a minor effect on medical insurance premiums as insurance companies do not hold large reserves to support these plans.

From a benefit design perspective, the changing talent agenda has led to an increased focus on diversity, equity and inclusion (DE&I) initiatives like family forming benefits, mental health and chronic condition support, and expanding virtual care to a wider range of practitioners such as mental health clinicians and physiotherapists. In addition, the rise in mental health claims may lead to increases in maximum benefit levels available, a wider array of eligible practitioners, a shift towards virtual solutions and a greater uptake of mental health first aid training for employees.

Germany: Increasing prevalence of private healthcare

The public health system in Germany is considered one of the best in the world and private health insurance is less prevalent than in other locations. Talent shortages in key industries are seeing this change with more companies looking to offer private medical insurance as an attraction and retention tool.

Many German multinationals see the German health system as the benchmark for their employee populations around the world. In a post-pandemic environment, these companies are now seeking to improve medical provisions (even with the associated increase in costs) to provide a higher level of coverage.

Canada: Family forming benefits

Many carriers are introducing family-forming benefits as part of their products. This is largely due to recent legislation making surrogacy costs tax deductible. However, at the same time, a lack of resources within the system is leading to a greater incidence of high-severity claims as a result of delayed or abandoned procedures.



“Given uncertainty around inflation trends, in combination with an expectation of an uptick in claims, we’ve seen an increase in medical benefit carriers placing a greater influence on their predictive models and forecasts over client claim experience, using internal analytics to drive pricing strategies.”

Doug Ries
Global Broking Chief Strategy Officer, Aon

The Impact of Inflation – Pensions

Note: The impact of inflation on pensions is complicated, and will differ by location and pension scheme type. The below is only a high-level, global, summary.

For the majority of companies their defined benefit balance sheet position has improved as a result of rising interest rates, despite current high inflation and the recent market downturn. This is because DB benefits are long-term and the market expectation is that the current high levels of inflation will be relatively short lived (or for many countries the pension benefits are not inflation linked). These significant rises in global interest rates have led to a reduction in defined benefit service costs, offsetting the negative impact companies may be seeing in their P&L (profit and loss) from rising healthcare costs.

As a result of balance sheet improvements, some companies are in the unexpected position of being able to remove DB balance sheet risk entirely through the purchase of insurance with no additional funding. Indeed, many multinational organizations now have surplus assets trapped in their defined benefit pensions schemes which they are looking to use either to improve benefits for members struggling with cost of living increases or, in more cases, take back into the business. From a benefit design perspective, we are yet to see changes in approach. In other words, we are not seeing organizations providing increases that are higher than those required or those that have become customary through prior discretionary practice.

In most countries employees have the option to access their pension early if they need additional funds over the next 12 to 18 months. However, this could lead to a lack of savings in later life, particularly if they are drawing on DC (defined contribution) funds at a time when equity markets are low. Instead of encouraging this, some companies have agreed they will continue to pay the maximum company pension contribution even if employees need to stop paying their own contributions as a result of stretched finances.

If you would like to find out more about Aon's views on the outlook for inflation and investment markets and what this means for pension investments you can find our research papers [here](#).

For more up to date views please reach out to one of the team.

“

“In order to help employees understand their options we have seen a notable increase in financial education sessions being provided by companies this year.”

**Olly Walker,
Senior Partner, Aon**

Aon has made these broad observations based on recent and current industry conditions as of September 2022. Given the complexity and breadth of environmental factors, this analysis is subject to change.



The Inflation Impact – Risk Benefits (Life, Accident, Disability)

As salaries increase any benefits provided as a percentage or multiple of salary will increase which in turn will raise the costs of providing those benefits. In addition, many organizations have also expanded or increased coverage for these core programs as a result of the pandemic which will lead to higher benefit costs.

Rising interest rates help to reduce the cost of risk benefits as insurance companies are able to earn higher levels of return on the reserves that they hold for these programs. Offsetting this, insurance companies (and intermediaries managing the plans) will be affected by the overall inflationary rises on their own core business (salaries, energy prices, etc) and so administration and other premium loadings are likely to increase.

Some large organizations use a captive insurance vehicle as a way of financing their risk benefits around the world. The impact for these captive insurance vehicles will be similar to conventional insurance although they are likely to have greater exposure to currency fluctuations than local insurance companies as the funds will be invested in a single global location for all of the policies covered.

Turkey: High inflation driving higher salaries and benefit levels

Turkey's inflation has been running at 70-80% in recent months and many companies have increased salaries multiple times within the last twelve months to help protect the financial wellbeing of their employees. Risk benefits are typically provided as a multiple of salary in Turkey and so the sums assured have also increased significantly leading to higher costs for these insurers.

At the same time, the local currency in Turkey has fallen sharply and so any benefits denominated in USD or EUR will have led to local costs increasing significantly over the last few months.

Ireland: Insurance markets hardening

There is a growing consensus among the major insurers that group risk has been under-priced – and an expectation that there will be significant pricing headwinds. However, the proposed increases to Irish interest rates should alleviate some of the pricing pressures as insurers will expect to earn a higher investment return on their reserves – which could positively impact pricing in the short to medium term.

“

“While covid-related Life claims have been decreasing, carriers are beginning to see delayed diagnosis of cancers, musculoskeletal issues and mental health illnesses leading to increased claim activity on Life and Disability policies – a trend that is expected to increase over the next 2 years”

Doug Ries,
Global Broking Chief Strategy Officer, Aon

The Inflation Impact – Perquisites, Leave and Wellbeing

These traditionally less prominent benefits are often overlooked but in the current climate they can be incredibly valuable to employees looking to optimise their outgoings. This is covered more in the Conclusions section and we have seen a steady increase in employers providing access to discount portals or voluntary insurance products.

In some parts of the world – notably the Middle East and parts of Asia – housing and other allowances are common and there is a lot of pressure for these to increase in line with the overall inflationary trends.

In the past few years, wellbeing has become a critical component of people strategy and is now a top priority for all leading organizations. While we see financial wellbeing emphasized in the current climate, other areas of wellbeing will continue to be high on the agenda of those companies seeking to lead their markets. Employers are increasingly seeking to capitalize on low-cost benefit opportunities that can deliver an out-sized positive impact for their employees; for example, low-cost wellbeing apps that support employees with their physical and psychological wellbeing along with integrating financial wellbeing through the inclusion of pension and insurance support.

Canada: The spotlight stays on wellbeing

There has been a huge evolution in how companies perceive their wellbeing programs; they're now viewed as foundational in supporting mental and physical health, building DE&I initiatives, and demonstrating a true sense of care towards their employees. With the talent war still strong in many industries, employers are not looking to disrupt key rewards pillars like employee benefits.

“

“This year, we have seen a significant demand from multinationals looking to offer a comprehensive financial wellbeing programme globally – financial wellbeing is clearly a top priority for employers due to economic volatility and the rising cost of living.”

Olly Walker,
Senior Partner, Aon

Supporting Employees manage the inflationary impact

Employees are invariably feeling the financial impact; how can employers provide appropriate support, whilst balancing rising business costs?

A focus on reinforcing employee resilience is more important than ever, as people face tough economic conditions both in their work and personal lives. Each organization is different and our advice to clients is typically anchored around the following:

1. Undertake regular employee research

Understanding your workforce needs can help you tailor your strategy into providing better support. Employee surveys and focus groups – across different segments and different geographies – will help you build a comprehensive picture of how your existing benefits are performing and any gaps that need attention.

The research can also be used to assess the impact of a new benefit post implementation.

2. Review your financial wellbeing strategy and benefits

When compensation budgets are tight, companies can implement cost-effective approaches to help employees better manage their money. Running financial education sessions, better signposting to available existing benefits and pivoting to benefits which have an immediate impact on their personal finances – such as retail discounts, childcare support and lower-cost insurance benefits – can all provide some immediate relief.

The link between poor financial wellbeing and mental health should not be overlooked. Employees struggling with their financial health are more likely to have poor mental health; people experiencing mental health problems are three and a half times more likely to be in problem debt than people without mental health problems. Companies should ensure that all employees are aware of Employee Assistance Programmes and any available mental wellbeing support.

One way of improving financial wellbeing is the use of financial technology; apps such as Well One Money are available to employers to cement their financial wellbeing programs. By providing an aggregated overview of an individual's financial situation, it can help users understand both their everyday spend and their holistic short-term and long-term financial health. The use of machine-learning and Artificial Intelligence is embedded within the platform to help users identify saving opportunities and provide an alert if financial activity does not align with pre-populated goals.



“Employer support comes down to two key principles: have a strong benefits strategy and know your employee population.”

Jill Malila,
Senior Vice President, Aon

Supporting Employees manage the inflationary impact (cont'd)

3. Engage employees with their benefits and improve utilization

In a competitive employment market with tight salary budgets employers should consider the full experience that employees experience from their reward programs. It's important to meet employees where they are. From benefits awareness, through to access and service delivery, the experience of utilizing corporate programs should be seamless. A global technology platform (such as The Benefits Solution) can help multinationals create a consistent experience in a user-friendly way, whilst virtual delivery can provide support to employees when they need it. Businesses should also consider how inclusive their benefits are for a diverse workforce – do all your employees and families have equal access to the programs your company offers? Utilizing voluntary benefits platforms where employees have the flexibility to choose the benefits that fit their lifestyles can provide better outcomes and achieve higher engagement than a one-size-fits-all approach.



“The aftermath of the COVID-19 pandemic combined with a high inflation environment has activated a need to work with greater speed and deliberation in order to attract and retain talent”

Jill Malila,
Senior Vice President, Aon



“In our current conversations with clients, companies are wanting to take a sustainable approach to talent. There is an increased focus on upskilling and reskilling their existing talent portfolio rather than taking drastic short-term action.”

John McLaughlin,
Chief Commercial Officer EMEA, Aon

Conclusions: Navigating this inflationary storm

We are in an unprecedented inflationary environment that comes straight on the back of a global pandemic that has transformed the way organizations and economies operate. The future outlook is also unknown and volatile. What is clear is that organizations, their leaders and their employees will need to remain agile and resilient to navigate the coming months successfully.

Each organization will face a different set of challenges but our advice to clients in mitigating the impact of inflation on employee benefits is anchored around the following three areas:

1. Get the basics right

Ensure your benefit spend is optimized. There are a number of factors associated with benefit spend that an employer can control and these need to be managed tightly in the near term.

The list of actions here is long but all are important; ensure fees and expenses are in line with market rates, eliminate duplicate coverage, review benefits regularly to ensure they are at market levels, review utilization of benefits to ensure value, look at financing solutions like multinational pooling or captives to capture global scale and make sure decisions about benefits are taken with appropriate governance.

Aon acts as a global benefits partner to hundreds of multinationals and our primary task is to make sure our clients are getting these basics right.



“Our experience shows that multinationals will often be able to save 10% of their overall benefit spend by optimizing their benefit spend.”

Carl Redondo,
Global Benefits Consulting Leader, Aon

2. Define your strategic position and pursue it

The last few months have shown many companies that there is always a competitor that is willing to pay more and chasing the market is an unsustainable strategy. Our advice to clients is to set a talent, reward and benefits strategy that is aligned to your business culture and then align the tactical programs with this.

We are seeing organizations place a much greater focus in their core business on DE&I and ESG but their benefit programs are not always aligned to support this. Ethnic minorities, low paid employees, women, disabled employees report facing more serious issues across several areas in the current environment — notably, they are more likely to report not having enough emergency savings. Benefits play a critical role in ensuring that corporate strategy trickles down to make a positive impact on employees.

We are helping organizations review their benefit programs against these priorities and then drive their alignment. In many cases the changes to the benefit plans cost very little but have a huge impact on employee perception of the overall benefit program.

Conclusions: Navigating this inflationary storm (cont'd)



"It is important to acknowledge that the impact of inflation will be unequal across your workforce. Understanding your employee needs as you are rolling out mitigation and support measures is key to have the desired impact"

Dr. Avneet Kaur

**Head of Advisory and Speciality Practice,
Health Solutions, EMEA**

3. Put wellbeing at the heart of your benefit strategy

Prior to the pandemic wellbeing was typically seen as a perquisite or a top-up to the main benefit program, but we have seen a revolutionary shift as wellbeing and preventative healthcare grows increasingly prioritised. Aon is advising clients to be at the centre of why they provide employee benefits and each benefit program should have a clear link back to improving employee wellbeing.

Financial wellbeing is critical in this inflationary environment and there are a number of relatively small and cost-efficient benefits that can be provided to employees that can make a big difference. The rapid development in the use of technology in this area has led to app-based solutions that can be integrated into the main suite of benefit programs.

Aon is working with companies to review and set their wellbeing strategy and also ensure they are making the most of the tactical programs that are on offer.



"It is important to recognise that all of the wellbeing components are linked and that financial stress (for instance) quickly manifests itself as a physical health issue or a productivity issue.

In the past few years, wellbeing has been put on the agenda by all leading organizations – and whilst we may see financial wellbeing emphasised in the current climate, other areas of wellbeing will still remain a key priority."

**Olly Walker,
Senior Partner, Aon**



"Often clients shy away from investing on population health risk management in times like now, but we need to understand that this investment is the way to build long-term resilience"

**Dr. Avneet Kaur
Head of Advisory and Speciality Practice,
Health Solutions, EMEA**

Sources:

Ethnic minorities: Commission on Race and Ethnic Disparities: The Report - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/974507/20210331_-_CRED_Report_-_FINAL_-_Web_Accessible.pdf

<https://www.hsph.harvard.edu/news/press-releases/poll-high-u-s-inflation-rates-are-having-a-more-serious-impact-on-black-americans-than-white-americans/>

Low paid employees: <https://www.tuc.org.uk/blogs/tale-two-pandemics-low-paid-workers-hit-hardest-covid-class-divide>

Women: <https://www.cnbc.com/2019/11/18/women-are-still-lagging-behind-men-when-it-comes-to-saving.html>

Disabled employees: <https://www.bristol.ac.uk/news/2022/september/disabled-households-and-cost-of-living-crisis.html>

Aon has made these broad observations based on recent and current industry conditions as of September 2022. Given the complexity and breadth of environmental factors, this analysis is subject to change.



Contact Us

Carl Redondo
Global Benefits Consulting Leader
carl.redondo@aon.com

Janet Faircloth
Senior Vice President
janet.faircloth@aon.com

Doug Ries
Global Broking Chief Strategy Officer
douglas.ries@aon.com

Olly Walker
Senior Partner
oliver.walker@aon.com

John McLaughlin
Chief Commercial Officer, EMEA

Dr Avneet Kaur
Head of Advisory & Specialty Practice, EMEA
avneet.k.kaur@aon.co.uk

Jill Malila
Senior Vice President
jill.malila@aon.com

About

Aon plc (NYSE: AON) exists to shape decisions for the better—to protect and enrich the lives of people around the world. Our colleagues provide our clients in over 120 countries with advice and solutions that give them the clarity and confidence to make better decisions to protect and grow their business.

©2022 Aon plc. All rights reserved.

Aon UK Limited is authorised and regulated by the Financial Conduct Authority. Registered in England and Wales. Registered number: 00210725. Registered Office: The Aon Centre, The Leadenhall Building, 122 Leadenhall Street, London EC3V 4AN. Copyright 2022 Aon UK Limited.