

03/2017

FINNISH CENTRE FOR PENSIONS, STUDIES

# SUMMARY

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## Effectiveness and incentive effects of experience rating in disability insurance

*A questionnaire study on employers' views*

Under the Finnish pension system, the costs of disability insurance are allocated to major employers in proportion to the disability pensions awarded to their employees. This funding system is called disability insurance experience rating. The key purpose of the mechanism is to encourage employers to take a proactive approach to disability prevention.

This study complements earlier research on experience rating and explores the views of Finnish private sector employers on the effectiveness of the system and its potential desirable and undesirable effects. The data were collected by questionnaire.

We have three broad research questions. First, to what extent are employers familiar with and understand the experience rating system; second, how effective and how just and fair is experience rating; and third, what impact does the system have on supporting employees' capacity to work and on recruitment and dismissals?

### **Allocation of costs to employers encourages businesses to support employees' capacity to work**

The questionnaire results indicate that the allocation of disability insurance costs to employers encourages businesses to support their employees' capacity to work. The bigger the employer, the greater the perceived effect of experience rating. This result applied not only to supporting employees' capacity to work, but also to how well the mechanism of experience rating is

known and how closely cases of disability retirement and their costs are monitored. By contrast it seems that the size of employer has no clear association with perceptions of the system's effectiveness or justness and fairness, or with how easy it is to understand.

### **Experience rating has some undesirable employment effects**

Especially in larger businesses it seems that experience rating has at least some undesirable employment effects, both from the point of view of individual job applicants and society at large, particularly in recruitment among certain risk groups. The larger the employer, the greater the perceived recruitment effects. In the largest employer category, 30 per cent expressed the view that experience rating has affected company recruitments to a great or rather great extent. In addition, only one in five major employers said they thought there had been no effects on recruitment. Open-ended responses also made some reference to the fact that experience rating can have negative effects on the recruitment of older employees, for instance. Furthermore, the system was considered to have some effect on dismissals, but the data collected in this questionnaire cannot provide an unequivocal answer to this question.

### **Majority of employers consider experience rating rather effective**

The majority of employers in all size categories thought the system of experience rating was at least partly effective, although many of its details were criticized in open-ended responses. Some 15–30 per cent of employers in different size categories had no reservations at all about the effectiveness of experience rating. These positive perceptions were underscored by the finding that most employers were in favour of retaining the current cost effects of the system, although in larger companies there was also quite strong support for mitigating the cost effects. Only very few respondents took the view that disability pension cases should have no effect on the size of pension contributions.

### **Problems stem from lack of employer influence and complexity of experience rating**

The majority of the employers who responded to the questionnaire considered experience rating at least partly just and fair. Open-ended responses, however, included quite a few criticisms of the system of experience rating. The respondents particularly drew attention to the fact that in many situations the employers have only limited influence over the prevention of disability pensions. Furthermore, employers reported having problems with the complexity of the system and difficulties understanding some details of the system. There were also critical comments regarding the high cost effects of single pension cases, the randomness of the cost effects and poor predictability.

The complexity of experience rating is reflected in the result that across all size categories, one-third of the employers coming under the system found it rather difficult to understand. Based on the questionnaire results smaller companies in particular need more information about the system. The larger the size of employer, the better the perceived adequacy of

information. Some proposals were put forward to help make the system easier to understand. For instance, it was suggested that pension providers should make available the calculation tools that employers need to more readily assess the cost effects of the system.

### Employers would improve details of the system, but the majority consider it appropriate and fit for purpose

In sum, the results of this research show that some employers have criticisms concerning the details of experience rating, such as the lack of employer influence and its recruitment effects, but overall it is quite widely felt that the system is appropriate and fit for purpose.

#### The Publication is available only in Finnish:

Työkyvyttömyyseläkkeiden maksuluokkamallin toimivuus ja kannustinvaikutukset – kyselytutkimus työnantajien näkemyksistä. Eläketurvakeskuksen tutkimuksia 03/2017.

#### Ordering of publication:

[www.etk.fi](http://www.etk.fi) > Publications > Studies > Effectiveness and incentive effects of experience rating in disability insurance: A questionnaire study on employers' views  
or [aineistotilaukset@etk.fi](mailto:aineistotilaukset@etk.fi)

ISBN 978-951-691-272-4 (s-b)

ISBN 978-951-691-267-0 (PDF)

ISSN 1236-3049 (printed)

ISSN 1798-7482 (online)

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