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DISABILITY INCOME INSURANCE

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MR. FRANCISCO BAYO: I would like to share with you a few observations about recent developments in the Social Security Disability Insurance program. I will talk first about recent trends in the incidence and termination rates and second about some recent legislative proposals.

Social Security is one of the largest programs, if not the largest program, in existence. There are over one million applications for disability benefits every year, and over half a million new benefits are awarded every year.

As Deputy Chief Actuary I have the responsibility of reporting this experience and the change in trends. Through one medium or another, I plan to report to you at least annually. This should provide you with an indication of recent changes in the trends and hopefully will help you to plan your programs on a well informed basis.

The size of the Social Security program should result in relatively stable experience, but this has not been the case. Incidence rates increased rapidly from 1970 to 1975. Increases occurred fairly uniformly by age and by sex with only a slight tendency to faster growth at the youngest ages. A rise of over 50 percent was experienced in both the gross incidence rate and age-sex specific rates. This represents an average annual growth of more than 8 percent, which compares to increases of 2-3% recorded in the 1960's. Since 1975, however, there has been a reversal in the trend. A decline of about 9 percent occurred in 1976 and although little change occurred in 1977, the gross rate has been dropping fast so far for 1978. If the current pattern continues through December, the gross incidence rate for 1978 will be about 15 to 20 percent below the 1977 level.

No categorical reasons can be offered at this time for these wide swings in the incidence rates. Some of the factors which we believe may have been instrumental in the rise through 1975 are increasing benefit replacement ratios (ratios of awarded benefits to pre-disability earnings), changes in administrative procedures, increasing unemployment, and the Supplemental Security Income program. During that 5-year period the benefit replacement rates for steady workers with average earnings increased somewhere between 25 and 43 percent depending on age; with the largest increases going to the younger workers.

In an effort to save money in the administration the 100 percent preadjudicative review of initial determinations was dropped in favor of a 5 percent postadjudicative review. There was also more emphasis on vocational factors. During that period, the number of awards for which vocational factors were considered because of insufficient impairment severity, more than doubled.

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I feel that the decline in disability incidence since 1975 could be due in part to decreasing unemployment, the stabilization of the SSI program after the initial surge of applicants in 1975, and some administrative tightening. However, the extent of the decline cannot be fully explained by these factors, especially in light of replacement ratios that have continued to increase through 1978. Although we must recognize the declining experience observed over the last three years, it is not yet clear whether it represents a new long-term trend toward stabilization, or a return to the trend line established by the creeping increases of the 1960's. In fact we can not even rule out the possibility that it may be merely an interruption of the increasing rates experienced in the early 1970's.

The 1977 Amendments to the Social Security Act were enacted in response to a realization that the coupled benefit formula used for old-age, survivor, and disability benefits was resulting in increasing replacement ratios which would eventually become excessively high. The newly adopted formula, which is based on indexed earnings, will tend to stabilize replacement ratios after 1979. This new formula was designed to initially reduce benefits by 5 percent for workers retiring in 1979, but due to recent faster inflation it will actually reduce them by 6 percent. For disabled workers the average reduction will probably be about 4 percent greater due to the indexing. This additional reduction is not evenly distributed because of variation in the length of the computation period for different ages. The total reduction will average about 25-30 percent for workers under age 30, but with progressively less for older workers and reaching about 5-7 percent for workers over age 50. This will tend to correct the problem of substantially higher benefits for younger workers, but it will not do so completely.

The decline in incidence rates experienced since 1975 and the passage of the 1977 Amendments have caused us to revise our assumption about future changes in incidence rates. In early 1977 we projected a 33 percent rise over 10 years. As of early 1978, we projected a 25 percent rise over 20 years. If the decline in incidence experienced during 1978 continues, we will again modify our projection in the near future. We are currently considering a projected increase of 10-15 percent over the actual 1978 experience.

Of all the factors which have been proposed as possible causes of the increases in incidence rates in the early 1970's only benefit levels and program administration can be directly affected by legislation. H.R. 14048 proposed by the Chairman of the House Subcommittee on Social Security, Congressman Burke, would significantly effect both of these. The bill proposes reduction in benefits for workers with the higher replacement ratios through two provisions. First, a cap would be placed on maximum family benefits. These benefits would not exceed either 150 percent of the worker's primary insurance amount or 80 percent of the worker's average indexed monthly earnings. Second, younger workers would lose one remaining advantage they have over older workers. Currently, workers at all ages are allowed five drop out years for benefit computation purposes. The bill would only allow one drop out year for every five elapsed years with a maximum of five dropout years.

Passage of H.R. 14048 would also significantly alter the administration of the program through two provisions. First preadjudicative review of at least 80 percent of all disabled workers allowances will be required by 1981. Second, a review or redetermination will be made at least once every three years for any disability beneficiary who was not previously found to be permanently disabled.

In addition to Chairman Burke's Bill, the administration is now preparing a set of proposals which are expected to provide for major modifications in the Disability Insurance program. The set is expected to be completed before the end of the year.

As I indicated earlier, recent events in disability make planning difficult. We simply do not know how much longer recent declines in incidence will continue. If incidence rates continue to decline or begin to stabilize, current enthusiasm for cost-cutting legislative proposals will probably fade, but it is not clear whether it would give way to future liberalizations. There is always interest in expanding the program to provide some disability benefits for impaired persons who are capable of earning some wages. Some of the proposals I have seen lately tend to move the program towards an income maintenance type of approach and away from the disability risk insurance field.

MR. KENNETH J. CLARK: My role on this panel will be to comment on some of the recent, current, and possible future product ideas and product changes that will hopefully get us out of the hole that we find ourselves in. And as Mr. Rohm has said, the individual area has been the one with the biggest problems so I will focus my comments on the individual product changes that have been and are possible to make.

We have gotten rid of the differences in accident and sickness benefits and waiting periods that existed for so long. It was a good emotional sales appeal to offer lifetime accidents and 1 and 2 years of sickness but all of us have seen and read about the sicknesses that become accidents by a miraculous change a year or two after disability commences. I might mention our own case where our experience on accident-only loss-of-time business is two and three times the corresponding accident portion of an accident and sickness benefit. A change is long overdue.

The residual and loss of income or loss of earnings clauses that have been introduced are an answer to the long term his-occ clauses. No one knows what they are going to cost. There is much debate pro and con as to whether they are going to save us money or cost us money and ventures in that direction are not without risk. There are some companies still retaining the long term his-occ clauses.

Also, we are now recognizing the Worker's Compensation programs in this country. One of the major causes of our losses in the early 70's was that we had not recognized those programs in our issue limits and our policy language. This has been done by some companies by requiring nonoccupational coverage either in the form of a separate policy which covered the non-occupational risk, a separate policy for occupational coverage, or a very complicated policy which paid different amounts for occupational claims than for nonoccupational claims.

We have dropped the short elimination periods. When we do that, we have to recognize that there will be some spillover effect into the shortest waiting period which we still offer. There are going to be some real savings, not a total spillover. We are going to see poor experience on the 30 day, 60 day, or whatever we have left after dropping the shorter periods. Now, have these changes helped? I am certain they have, but have not solved all of our problems. We still have to do much in the product area to offer the maximum protection and avoid overinsurance. Now, how is that being done by companies today and how might they do it in the future?

Before I get into that, though, I might just comment on the presumptive disability clauses that were alluded to by Mr. Rohm. This is one that has been a nagging thorn in our side for years and I am happy to see now that we and others are dropping the presumptive disability clause. It certainly does not have a very high cost but why pay if there is no loss of income? And with our thin margins we cannot afford to pay even those few claims that would not otherwise be paid.

In the residual or loss of income area, there are companies experimenting with and winning fairly widespread approval of such clauses which define other income to include benefits paid under government programs. I do not believe I have seen any that just say general programs. They are usually named programs . . . Social Security, Workmen's Compensation, State Plans, No Fault Auto, or what have you. But we are seeing most states, maybe 80% or so, will approve a residual type caluse which defines other income to include benefits received under these named programs. I am somewhat surprised that many states are approving it in view of the fact that those states have the uniform policy provision law which would seem to suggest that that might not be possible. It is a very good trend.

Someone has to come out with a real workable form of renewable term coverage. Unless we can win approval of an effective coordination of benefits type clause, it has to be the only way that we can adjust to changing needs and changing government programs. This does require frequent reappraisal of financial needs, it requires reunderwriting of some sort — perhaps by computer, it does not require an underwriter to do it, but it will require a lot of extra expense and very complex policy language. One approach might be a base guaranteed renewable or non-cancellable policy which provides the front-end 6-month coverage — in effect pays in the absence of Workmen's Compensation and Social Security — and then you add to that renewable term riders of 1, 2, 3, 4 year duration which supplement the need of the specific individual in the state in which he resides for the income which he has at the time of last underwriting. The top layer then would be the full coverage benefit if he had income sufficient to qualify for full coverage benefits. This would be packaged with some form of guaranteed insurability. For example, a policy might guarantee that the company would issue up to 70%, in total, of income up to a maximum of perhaps twice the initial amount so long as the insured automatically accepted the increases for which he or she is eligible. Any time in which the insured refused to take the roll on, the guarantee would cease, and evidence of insurability would be required thereafter.

In the absence of the use of that kind of policy or the coordination of benefits type, there are companies right now that are attempting to get approval and are issuing policies which have offset riders which pay fixed amounts of benefits if you do not receive some defined benefit program, Social Security, Workmen's Compensation, or what have you. There are still some states, some key states in fact, that will not approve even that form of benefit which on the surface would seem okay. Even that, to be the best product, needs to be modified periodically as the benefit programs change. So, that is not a perfect form of integrating the needs and avoiding overinsurance.

I have seen that some companies have discontinued long-term benefits, feeling that if they get rid of the high risk policies and the big fluctuations that are possible, that that will solve their problem. It may solve individual company problems but it will not solve our industry problems. I am certain that if we do that as an industry that will just be more reason for government programs to step in and meet the needs of those people who have long-term disabilities.

We may have to underwrite using family income instead of personal income. I can see the obvious problems to underwrite and administer your issue limits in terms of the family income in view of the high family break-up rate but, in fact, that is what we should be doing. We are now looking at unearned income, investment income, etc., we should be looking at spouse's income or total family income to determine what the true insurable need is.

I am afraid we are going to have to continue to identify and cease to issue coverage to specific segments of the market which do not need the coverage, such as certain classes of government employees; state and federal employees; unskilled occupations (due to the poor persistency); certain groups of immigrant, alien, non-citizen people who have poor persistency and a higher concentration of fraudulent claims. In the old days when we had fat margins we could afford to include those people but we are going to have to identify those poor risk groups and cease to cover them.

One benefit that would be very useful for issue to the government employees is some form of decreasing benefit. These people typically have disability benefits under a pension plan rather than a formal disability program. These benefits increase in amount with seniority as well as sometimes being triggered after 5 or 10 years of seniority. We need some kind of product that will integrate with the disability programs under their pension plans. The only question is whether any one company can develop enough volume to cover the development costs of that kind of product.

We do need to have an effective rehabilitation clause or program. The property and casualty companies for years have been quite effective in getting people off disability and back to work. It may be because the nature of the blue collar occupations in which they deal, that it is much easier, but I do not think we have done a good enough job in rehabilitating claimants, getting out there early and identifying the people who might be motivated to get back to work. Social Security can also do more in that area.

One possible benefit idea that several companies have which is not seen often is an increasing annuity benefit. We have had it for 10 years as have several other companies. We have had no visible bad experience in terms of people who have malingered or stayed on because of the 4%. It has had quite good experience. In our case, it is a 4% disability annuity, where in the disability benefit after claim commences increases at a simple 4 or 5% rate. This has sales appeal in today's inflationary times.

I left to the very last the idea of just raising the premium rates. With Carter's program, I am not sure what we are going to be able to do in the area of raising rates but basic claim cost assumptions for A&S benefits are 25 to 50% higher than they were 5 years ago and Accident is much worse. I have not seen many companies raising rates in the white collar market despite some heavy losses, although rates have been increased in the blue collar market. In the white collar market, I know the experience has not been as bad, but I do not think it has been profitable in most cases.

MR. BENJAMIN F. JONES: This is the third time that I have had the honor of addressing a meeting of the Society of Actuaries. The subject concerns the ability of the private sector to make disability income coverage available to the American public on a sound basis. The fact that I have been invited back indicates that you have a continuing interest in this subject.

The Boston Meeting of the Society took place immediately following the HIAA Annual Meeting, at which time the Board of Directors, in recognition of the major role that individual, group and association disability income contracts have in providing economic security, established a special disability insurance committee to do research into areas directly affecting both the voluntary and mandated disability insurance programs. You were the first organization to learn of the establishment of this committee, but unfortunately you will not know its official accomplishments because the annual meeting of the HIAA will not be held until next Sunday, October 29, 1978, at which time the Board will be asked to accept the committee's recommendations.

The most serious issue underlying the establishment of the committee was the steady deterioration of profit margins in disability insurance which began in the early '70s. It is a world-wide phenomenon, and it is of great concern to the companies providing this type of coverage.

The financial motivation to return to work has always been one of the most powerful elements in the control of disability income claim costs. The most difficult problem companies face in managing this business is to provide benefits at a level high enough to help alleviate the financial burdens of the disabled, and yet at the same time not so high that they dissuade those who should and are able to return to work from prolonging their claims. The committee was called upon to:

1. Preserve the availability of disability insurance business to the private sector — the overriding charge of the committee.

2. Investigate the wide variations observed between benefits actually incurred and those expected.

3. Inform the industry and others of information developed, along with recommendations as to possible solutions.

4. Take appropriate steps to influence the executive and legislative branches to place the disability portion of Social Security on a sound basis.

The committee was given two years to complete its assignment. In our initial meeting, held on December 16, 1977, we divided the problem into five general areas, formed five subcommittees in each area and by September 12 of this year, prepared a report which will be presented to the HIAA Board. During that period of time, each subcommittee had at least three meetings, and several, double that number. I would like to give you a brief report about the work of each subcommittee, and then review the report.

1) Research Subcommittee - Larry K. Lance, Chairman, Vice President, Group Operations, Hartford Life Insurance Company

This subcommittee's assignment was to identify sources and levels of benefits available to the disabled. They have documented five major categories of benefits embracing 73 separate systems. Those categories are:

1. Private insurance industry.

2. Federal compensation.

3. State and local governments.

4. Employer and/or union benefits.

5. Other compensation programs.

An individual may be ineligible for any benefit or may qualify for as many as 30, depending on the nature of past or present employment, marital status, number of dependents, domicile, the type of disability suffered, earnings, age, the nature of the disability and the circumstances under which it occurred. The study also included a review of the taxation of disability benefits and, with a few notable exceptions, benefits are excluded from any federal, state or city income tax, which has the effect of increasing the net value of the dollars received.

This catalog of the network of benefits available to the American public discloses a compensation system which is massive, duplicative, expensive, and unpredictable. While any single benefit or system might appear to be properly designed, in combination with all others it results in a total system of compensation that may be fundamentally flawed.

2) Disability Insurance Record System Subcommittee - Alan N. Ferguson, FSA, Chairman, Vice President and Actuary, The Prudential Insurance Company

The initial objective of this subcommittee was to study the impact fraud, malingering and other abuses have had on the disability insurance business. The examination of the data available revealed that there were a sufficient number of examples on record to indicate that the potential for substantial loss existed. As a result of its study, the subcommittee felt that it would be of help to the individual and franchise writers if certain minimum data were made available on the activity of prospective and existing policyholders in the disability insurance market.

Such information would make it possible for each company to exercise its own independent judgment —

1. At the time the risk was being appraised, the company's judgment as to the reasonableness of total benefits in relation to earnings and the likelihood of a potential overinsurance problem, and

2. At the time claim is made, the company's judgment as to the applicability of policy provisions, if any, relating to insurance with

other insurers of the possibility of misrepresentation, particularly during the contestable period.

The system would only disclose policyholder activity in the individual and association market. It presumes that the underwriter or claim administrator would be aware of benefits available through the other systems of compensation to a prospective or existing policyholder.

If the board approves this concept, a feasibility study would be undertaken which would include the investigation of legal questions involving privacy and antitrust, the research of administrative systems and costs, and the determination of the level of participation of member companies. Substantial participation, of course, is absolutely essential if such a central record system is to be effective.

3) Federal Affairs Subcommittee - Gerald S. Parker, CLU, Chairman, Vice President, Health Insurance, The Guardian Life Insurance Company

The assignment to this subcommittee is to establish liaison with Congress, the administration and other organizations active on the federal level. The objective is to seek legislation and regulation which ultimately would reduce the excessive replacement ratios which continue to be inherent in the Social Security disability compensation system.

Social Security benefits are available without regard to those offered by private insurance programs, but private individual coverage is difficult to coordinate with Social Security benefits because of the limitations of the uniform policy provision law. There is an urgent need to place a cap in the Social Security law, so that the total benefits available to a disabled beneficiary and his eligible beneficiaries from Social Security, Workers' Compensation, and any other statutorily mandated disability benefit (such as no-fault auto) cannot exceed about 75% of net earnings at the time disability begins. The subcommittee feels that a sliding cap of about 75% of the net earnings for the lowest wage earnings group, grading down to perhaps 50% for those earning at the maximum taxable wage level would be more appropriate.

To accomplish this, the subcommittee urges an amendment to limit the maximum family benefit to 70% of the AIME (Average Indexed Monthly Earnings) or 150% of the PIA (Primary Insurance Amount), whichever is less; and to further provide that social security benefits are reduced dollar for dollar for sums payable under Worker's Compensation or other statutorily mandated benefits.

The second major recommendation was that substantial reforms be made in the claim administration system. This would include stronger supervision of state agency administration, experiments in the area of substantial gainful activity designed to motivate periods of trial work, the elimination of the second waiting period for Medicare benefits, and several other changes in the area of program accountability.

The third major recommendation has to do with the definition of disability. The present one carries with it an implication of permanence that has an effect not only on the beneficiary, but also on the state agency charged with administering the system. Claim incidence rates are higher than expected and termination rates through death and recovery are far below expectations, leading to the conclusion that healthier and healthier people are qualifying, and healthier and healthier people are remaining on the rolls. The subcommittee urges the enactment of legislation requiring in addition to the determination of disability, a determination of the expected duration of disability. This would insure periodic review to determine whether the disability still exists; and if so, the beneficial effects that might result from participation in a rehabilitation program.

4. State Affairs Subcommittee - Charles E. Soule, Chairman, Vice President, Annuities and disability Reinsurance, The Paul Revere Companies

This subcommittee was asked to monitor and initiate state legislation and regulation and to coordinate and assist the government relations effort with respect to voluntary use of offset and integration provisions. The long-term objective is to develop new uniform policy provisions that might help reduce the potential for overutilization of disability income programs.

There currently exists no meaningful way for individually-issued contracts to be coordinated with one another. Individuals have little control over federal, state, employee and/or union or other mandated compensation programs. However, it is possible to purchase more than one individual contract which could result in an excessively high replacement ratio.

The subcommittee has recommended a statement of principle having to do with the eventual development of an integrated and/or offset approach permitting the benefits and premiums of disability income contracts to be adjusted depending on the size and availability of governmental and other mandated programs. Such a document could be used in certain states where current regulations present the most serious problems and later on could be submitted to the NAIC for their consideration.

5. Information and Education Subcommittee - Richard C. Ellis, Chairman, Executive Vice President - Rehabilitation and Continuing Disability, Mutual of Omaha Insurance Company

This subcommittee was asked to develop information and educational programs to acquaint the industry, and ultimately legislators, regulators and others responsible for the development of and administration of mandated or voluntary disability income programs, with information which will help them form a basis for exercising their own independent judgment in solving the problems which are unique to this form of protection. The subcommittee has recommended a two-day seminar which would address itself to those facts which significantly affect our business. Senior officers of member companies and those who have the primary responsibility for the development and profitability of individual and group coverage would be invited to attend.

The subcommittee is also suggesting the preparation of one or more papers which would be developed to assist providers in becoming more knowledgeable and sensitive to matters involving this product line, allowing them to make independent decisions from a more informed point of view.

The disability insurance committee evaluated a number of projects which they felt would have a beneficial effect on helping to resolve some of the more serious problems facing our industry. It became apparent as our studies progressed that in view of our time constraints, the greatest impact could be achieved by concentrating our efforts in those areas outlined above.

In summary, the Disability Insurance Committee has voted unanimously to make the following recommendations to the Board of Directors of the Health Insurance Association of America:

1. They will ask the Board to approve a position paper concerning the disability insurance benefits provided under the Social Security system and that the recommendations stated therein become HIAA policy. This will include the establishment of a reasonable replacement ratio, an improved claim administration system and the developement of a new definition of disability.

2. The Board will be asked to approve a study to determine the feasibility of the development of a disability insurance record system.

3. Approval will be requested for the preparation of papers informing the industry and ultimately the public of the critical issues which affect the voluntary and mandated disability insurance programs. A two-day disability insurance seminar will be requested where the most serious issues we face will be discussed for the purpose of helping each company exercise its own independent judgment in arriving at appropriate solutions.

4. Finally, the Board will be asked to approve a general statement of principle having to do with the eventual development of integrated or offset approaches permitting disability insurance benefits to be adjusted depending on the size and availability of federal or state mandatory insurance plans.

Our objective is to preserve the availability of disability insurance coverage on a sound basis through the private sector. If these recommendations are approved, it is the opinion of the Disability Insurance Committee that we will have made a good start towards reaching that goal.

MR. CHARLES E. ROHM: There is a human tendency to forecast the future to be essentially the same as the recent past. This tendency becomes especially strong if things have been going well. If times are good we all think that is the normal, usual and expected situation. As a result, we project these good trends to continue on into the future.

A classic example of this tendency is the way our industry handled individual disability income insurance during the 1950's and 1960's. That was mainly an era of a stable economy with low unemployment and a low rate of inflation, and excellent experience and profits for disability income insurance. During that period of time we assumed that what was going on was normal and would continue on into the future. As a result we were very receptive to "innovative" changes in the conduct of the business. Then, in the 1970's we found ourselves in a tough hole.

The winds of change have blown very hard thru Individual Disability Income insurance. They have blown away all of the profits, have heaped losses in windrows throughout the industry and have obliterated a good piece of the market. A few companies think they see daylight with that slender slice of the population called the "better-buyer-market". They think they can see a reasonable level of sales and the expectation of profits by selling to higher income people such as professionals and executives.

I think that a prerequisite to attending this session should have been Concurrent Session L about futurism and demography. The winds of change are going to continue to blow hard through our business. Many potential influences can at least be identified, if not accurately measured and forecast.

The laundry list of these can be quite long. As an example there are:

(1) economic conditions - price levels and their rate of change, unemployment and the rate of employment, wage levels and disposable personal income.

(2) the interest in second careers or mid-life career changes.

(3) the future of the nuclear family - what will be the effect of increasing divorce, the two wage-earner families, the declining birthrate, and the postponing of the time for having children.

(4) future shifts in public attitudes and values.

(5) the role of government and government programs.

(6) changes in medical science and the practice of medicine, and how those changes affect those who survive to be disabled, as well as the duration of their disability.

(7) events in the courts and their effect on the law, the juries, and our claims practices.

(8) consumerist activity and pressure on legislation and regulation - such things as mandated benefits and coverages.

(9) our ability to underwrite and select risks; the whole system of risk classification and pricing based upon it.

J. M. Ryder, a British actuary, while discussing forecasting has perceptively said: "We cannot predict the future but what we do instead is make a forecast of the future; i.e., we extend observable trends on the NAIVE assumptions that the future will be something like the past. And THEN we look for the inevitable forecasting errors."

When the "inevitable forecasting errors" emerge we need to be able to do something about it. J. M. Ryder again: "Insurance companies will be able to cope with future changes so long as they retain the ability to react to such changes. The secret of adaptive control is to leave yourself something to adapt."

In committing ourselves wholeheartedly to non-cancellable disability income insurance we have closed our eyes to Mr. Ryder's perceptive and accurate comments. We have not left ourselves anything to adapt. To move successfully into the future we must retain the ability to adapt. We must have products and practices that are flexible.

The need for flexibility to successfully operate in a disability income insurance area comes through clearly if we compare group LTD with individual disability income insurance. For most companies, group LTD financial experience has been good, or at least satisfactory. For almost all of the same companies, individual disability income insurance financial experience has been poor; that is, not even satisfactory and much less than good.

Let's take a look at the characteristics of group LTD and make a comparison with individual insurance to see if we can identify some reasons for this dramatic difference in financial experience.

(1) group is written as a one year renewable contract with a one year premium guarantee.

(2) under group the benefit amount has been strictly integrated with Social Security and other government plans so that total benefits are 70% or less of gross income and also are held to a reasonable maximum dollar amount.

(3) under group there is evidence of a stronger rehabilitation incentive and leverage to have more effective rehabilitation efforts.

(4) group usually does not have presumptive disability benefits such as loss of sight, speech, limbs, etc.

(5) group has the ability to adjust the benefit amount for active lives each year to keep it both up-to-date and also reasonable in regard to current income and other benefits.

(6) group has had a more stringent definition of disability and has avoided the lengthy own-occ provision.

(7) under group most or all of the cost is paid by the employer whereas under individual the insured pays the cost and perhaps expects to get a benefit return.

Many of these items involve, in one way or another, old friends such as overinsurance, liberalized definitions of disability and changes in public attitudes and values. It is also true that most of the reasons for group's better experience involve flexibility. Group is able to adapt and adjust to changes in the insured's situation and in the pricing of the benefit. Group can adjust both internally in regard to rates, definitions, benefits amount, elimination period and benefit period as well as to external forces. Group even has available the ultimate adjustment: cancellation of the coverage.

Non-can individual disability income insurance has none of these adaptive options. Guaranteed renewable policies are scarcely better off.

Another important element in the disability income insurance picture is the cruel fact that economic hardship is needed to prevent widespread malingering. Unfortunately, for the insurer to have satisfactory financial experience the claimant must be hurting financially. Otherwise, the see-saw tips the other direction and the insurer has the pain.

There is a Henry Jackson quote made, as Jarvis Farley put it, "during the crucible of the 1930's", that elegantly makes this point: "any insurance benefit, the enjoyment of which does not interfere with the desires of the insured, will be costly to the insurance company".

Satisfactory financial experience will be obtained only if the waiting period, benefit amount and benefit period, along with all other benefits and sources of income, leave the claimant uncomfortable. Practical knowledge of human nature, surveying our industry's red ink and looking at the experience in the Netherlands all confirm and reinforce this statement.

In the jargon of the trade this boils down to: avoid overinsurance. Avoid it at issue and for as long as the coverage is in force. Avoid it regardless of subsequent events such as changes in government programs, changes in other insurance coverage or changes in the insured's job or family situation.

There is another aspect I want to mention. Benefits should be paid to replace a portion of income lost because of the genuine inability to engage in remunerative work. The insuring clause and the definition of disability should make it possible to avoid paying for "discretionary disability". Our product is socially useful if it meets a genuine need; it is not if instead it creates opportunities to malinger.

We may need to turn back to practices of the past that have been discarded in our desire to be modern and up-to-date. An example is the house-confinement provision. This provision pays long-term benefits for a confining illness but allows benefits for only a short period, say six months, if the disability is nonconfining. There are definite advantages and disadvantages to this provision. Once quite common, over the last 40 years it has become increasingly rare. Now, as discussed on the pages of the Disability Newsletter, by John Miller, such prominent people as Ed Minor and Jarvis Farley are saying a good word for it.

Mr. Farley, in a letter to John Miller published in the September, 1978 issue of the Disability Newsletter, wrote that for the general market, "The house-confinement concept may be the only really effective means of providing viable individual income coverage in volume." He pointed out that a "workable definition of disability is the key to non-house-confining policies but companies do not have a good track record in their search for a definition which (a) is fair, (b) will work, and (c) can be sold in competition."

In summary, I believe we need a new product design that is both flexible and "hardnosed". A contract like the one John Miller described at the 1977 LIMRA Health Insurance Actuarial Forum might be the basic design. Perhaps the new design might embody the "Standard of Living Account" concept suggested by Paul Brennan of Paul Revere. The new design might need to provide cash or nonforfeiture values. It might have "throwback" features such as a house-confinement provision or a definition of disability based on loss of earning power.

My experience on the life insurance side with Adjustable Life leads me to believe that such a new design is feasible. Of course, there are many problems such as convincing the regulators, selling the field force, educating the consumer, and handling the competitive problems. However, we do now have access to computer systems powerful enough to handle flexibility. Most insurance departments will respond favorably to soundly designed innovations. Field forces can and will embrace a non-traditional product that makes sense. Consumers will purchase a contract that can adapt to meet their changing needs. Finally, and most important, we need it.

MR. JOHN H. MILLER: The efforts of the HIAA under Ben Jones' dynamic leadership to solve the overinsurance problem are to be applauded and encouraged. However, any solution that requires legislation will take time — for some insurers perhaps too much time. I was glad, therefore, to hear Ken Clark's account of innovations already introduced. He also mentioned a concept similar to one which I have, on several occasions, proposed, viz. to take a leaf from the casualty business and write a disability policy covering only a one year term. This policy would contain no renewal guarantees but - instead - a guarantee of insurability for an amount which will produce a predetermined and conservative, replacement ratio.

The insurer avoids overinsurance. The insured is protected against underinsurance which can occur if a substantial rise in earnings is followed by a sickness leaving the insured uninsurable.

Reasons why this new concept won't work will come to mind almost automatically. If time permitted, I would recite the list - and then suggest how each of these objections can be overcome.

My second point is a bit of philosophy. My rather intensive preoccupation with disability insurance had - until recently - developed in me a sense of cynicism and pessimism, but a few events have led me to believe that there is another side to the disability coin. First, the Breslow-Belloc Study in California demonstrated a high correlation between a good life-style and longevity. Then last December the Paffenburger Study of 17,000 Harvard graduates indicated a 40% lower incidence of coronary attacks among those who practised aerobic exercise. At last year's meeting of the American Council on Life Insurance, Dr. John Knowles proposed the radical concept that individuals should assume the primary responsibility for their own health. The Council has now formed a committee of doctors and laymen, The National Advisory Council on Education for Health, to advise in the creation of a life and health insurance counterpart to the loss prevention activities of property-casualty companies.

Writing on the subject of The Rise and Decline of Western Thought and Culture, Dr. Francis Schaeffer has traced, over the past 100 years or so, a change in philosophy from the belief in a unity in truth and life to a progressive fragmentation. We have seen fragmentation in the growing specialization in arts, sciences, professions, other vocations, teaching and government. Now there appears to be a reversal in the form of a movement toward a holistic approach to problems, e.g. as Roy Anderson has enunciated in his talks on futurism, we see in medicine a trend toward treating the whole person, not just the disease, and more emphasis on preventive medicine. Also, there seems to be a growing recognition of the potential in rehabilitation.

Putting together all these thoughts and developments, my pessimism has given way to optimism and to the belief that the disability insurers can do much - through public education, by way of statistical demonstration, and through a more positive role in rehabilitation - to promote better life-styles and the best possible solution to the disability problem, viz. to avoid disability through preventive methods.

Conducting statistical studies, such as the Breslow-Belloc project, or the Paffenburger Study, when done as an independent operation, involves considerable expense and problems of control. Insurance companies however, have ready made lists of individuals, with much data on file. Through their billing procedures, they can keep track of a roving population. With the cooperation of even a small percentage of all insureds, very broad-based studies could be made which would not only lead to improvement in procedures of underwriting and claim administration, but serve as a basis for promotion of good health habits.

A growing number of my actuarial friends are practicing better habits with respect to smoking, exercise, and diet. If any here are interested in the promotion of a better life-style, I will be pleased to hear from you. I am not proposing that the Society undertake such an activity. Its ever-growing list of programs, from education to reorganization, already overburden its governors, officers and staff. But a grass roots gathering of interested persons - actuaries and others in the insurance business - could launch such a program. If it should prove successful, it could then be recognized, adopted, and sponsored by one or more of the existing professional or trade associations.

A program of this nature needs a name. My first thought was to paraphrase "safe driver reward", but "good liver reward" doesn't quite have the proper ring. How about "bonus for the good life-style"?

SUMMARY OF DISCUSSION

1. Need for new disability table

DONALD PETERSON: It seems to me that if we are going to be selling level premium insurance, whether it's optionally renewable, guaranteed renewable, or non-can, we have to have a basis of fact to start with and the basis of fact is the disability table. In life insurance we've got group tables, intermediate tables; individual tables. In disability income we've got the 1964 Commissioners Disability Table which was based on data which was 50 years old and stemmed from disability income riders to life insurance coverage. How in the world can we have a product out there and supposedly have facts out there where we are going to be developing premium rates, active life reserves, disabled life reserves, on a basis of this nature?

I do believe it is the responsibility of the Society of Actuaries to try and get company data accumulated so that the proper disability tables are made available. I note from the previous session that Tony Houghton and other people are attempting to update the major medical and the 1956 hospital tables. I believe there is a Society committee trying to update the 1964 Commissioners Disability Table but I think we have to start from scratch. I think there is intercompany data available if the companies will contribute. The TSA Group Reports are a great start. Ten years ago a lot of group writers were very antsy about getting into LTD. The TSA reports have proven that the Commissioners Table is inadequate or inappropriate at least as far as recovery rates are concerned. I think we need the same thing for disability income, perhaps three tables, class A, B, C, or however you want to categorize them but I would hope that we will have a 1980 disability table, hopefully group and 2 or 3 individual tables.

MR. WILLIAM J. TAYLOR: We are hoping to have the 1979 tables. The committee is being restructured to come up with a recommendation to replace the 64CDT. All of you who get John Miller's Disability Newsletter know that John is in the midst of conducting a termination rate study. The Society has picked up John's work and he is acting as a consultant to the Society committee of which I am chairman and Duane Kidwell is vice chairman. We are moving out from there to try to do this as quickly as we can or recommend a replacement for the 64CDT table. How many tables we will be recommending we do not know.

MR. CLARK: New tables will be helpful, but they really will not solve the problem of pricing. We are talking about a risk that is so subjective. We are concerned about the future incidence of disability and recovery rates, with changes in clauses and changes in the Social insurance programs. A new disability table might result in better reserves.

2. Effect of increasing the mandatory retirement age

MR. CHARLES LARIMER: My questions relate to benefits payable after age 64 due to the raising of the mandatory retirement age to age 70. What problems are there with the legality of integrating with Social Security retirement benefits as opposed to Social Security disability benefits? Can we force someone to take Social Security retirement benefits? Can we integrate with Social Security dependent retirement benefits? Can we force someone to take their private pension retirement benefits?

MR. JONES: You could require the man to work. We plan to renew contracts after age 65, but they will be on a one year renewable basis. They must be working and not retired at time of disability. It is loaded with problems.

I don't know what the cost implications are, but we've got the same problem with anyone after age 55. Most people over 55 are thinking about retirement, and if the opportunity is right and there is enough money around they will do it.

3. Tax status of disability income

MR. ROY R. ANDERSON: I didn't think I would ever make this proposition, but when I hear of the dangers we are now encountering with those who are at or beyond retirement and are expected to choose between disability income or annuity income, I believe we must reappraise the tax status of disability benefits. About a month or so ago I read in a newspaper editorial that 80 percent of the firemen and policemen in the city of Washington, D.C. who are on retirement are on disability retirement. And why? Because they found out they are tax free benefits.

The chief of police in New York, or Chicago, retired directly on disability. Well, I have always felt that that was one of the great benefits of the disability program, that your premium you paid yourself you get back in benefits. But I suggest that these kinds of things are going to emerge in our society and give people the awesome choice between collecting under disability or collecting under annuities. Our business had better reestablish a position with respect to the taxability along with all of these incomes. But while that hasn't been mentioned in this forum, it seems to me it is a major concern for the disability business.

4. Underwriting

a. Reunderwriting

MR. ALAN N. FERGUSON: Mr. Clark talked about the need to reunderwrite to get current information on income and other benefits. How would you go about this? Would this be done by mail? Would this involve agents? I think it would, and there will be expense problems because you are going to be adding compensation for it. Has anyone had experience on reunderwriting and how often it would be done?

MR. CLARK: The reunderwriting would not have to involve the agent. Certainly some agents would want to get involved, but as we design our questionnaires, we would not require an agent. We would require signature of the applicant on delivery of the modified coverage. At that point the agent may deliver the modified contract.

MR. ROHM: Mr. Ferguson, I am not aware of any company experience, but one thought I have had is that, in some ways, it is not too dissimilar to automobile insurance where every 6 or 12 months a questionnaire comes out and you check off changes and indicate the changes, and send it back with your signature on it. Without getting into the details, I have envisioned something of this type.

MR. FERGUSON: I think that is a different problem. Everyone needs automobile insurance; it is required. But you do not have to have disability insurance and one is not likely to use his disability insurance as often as auto insurance.

b. Disability information system

MR. FERGUSON: It would be a system that at the time of application you would submit a copy of your input to the Data Processing Bureau, and you would get from them the identifying information, i.e. the amount applied for, the type of plan, and what other benefits are inforce according to the application. You would also get back from the Bureau, information on what has been applied for in the past, not what is inforce rather what had been applied for. You would be alerted as to how active this person has been in the disability insurance market.

There was some skepticism on the subcommittee as how valuable this information would be. A key factor would be, how cheaply this could be done. The expense might be $.50 plus minimal administrative expenses.

c. Financial underwriting

MR. JONES: It was discussed at the Disability Committee, and as a committee it would not pass. There are people who felt that it may be the only way to control the use and abuse of disability income coverage. As the benefits approach predisability earnings, the tax becomes more prohibitive. All forms of disability coverage must be reported including credit insurance.

MR. CLARK: But the reality is that I think many big companies that write life, health, and annuities are very reluctant to go to Congress and ask for changes in tax laws.

MR. TAYLOR: How do we justify our financial underwriting on that gross earned income, while you are selling a benefit that is tax free. How can you complain about overinsurance and Social Security without taking into account individual Social Security benefits?

We changed our limit to 75% after-tax earned income. Information about gross and after tax income were asked, and are checked for reasonableness.