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DISABILITY INCOME—MARKETING APPROACHES

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1. True group

2. Multiple employer trusts

3. Individual sales

The following topics will be discussed for the above markets:

a. Market identification
b. Product selection, including benefits and contractual obligations
c. Prospecting
d. Underwriting
e. The sale
f. Administration
g. Experience results

MR. ERNIE FRANKOVICH: Disability Income is an interesting but strange topic that has been the subject of numerous panels in the past. It is strange because, during a two or three year period, many companies will lose money, many will be profitable, and many will not know. Some companies will be successful marketing a particular product. Others will be unsuccessful with the same product. Today we will hear from four companies who have marketed disability insurance successfully in the past. Since disability experience varies widely by geographic area, by company, and even by agent, their experiences and comments must be adjusted to meet the needs and characteristics of your company.

MR. WAYNE V. ROBERTS: I am going to talk primarily about group insurance. I thought I would also say a few words about multiple employer trusts, which I will refer to as MET's. Although we do not write many MET's, we do have some knowledge so I will refer to it whenever I think it is appropriate.

Market Identification

For group insurance, we will write a group of ten or more lives. MET's need only one or two lives. We at Standard Insurance seem to specialize in public employee groups. It was not really planned that way but we write many groups in that area. We write all the way from white collar and professional groups to blue collar groups, although there are some blue collar groups we will not write or will write with very limited coverage. We will not cover groups of loggers, for instance, because of the seasonal nature of their work. Associations are an area that we occassionally write. They have good and bad points. There is not much competition in that area so you can basically come up with any rates, underwriting rules, or policy provisions you want for them. On the other side of the coin, however, they are very expensive to administer and take a lot of time and effort. Frequently enrollment is very low. Mail solicitation does not seem to work very well for associations so you need a paid solicitor to go out and get the business, and they are hard to find. So we have had good luck with some associations and there are other associations we should have never written. We write some administrative services only or ASO type business for large groups who want to self insure. This seems to have been really popular a few years ago. Since a lot of companies appeared interested, we developed an ASO product for disability benefits. We have not sold very much since then, but we have it available. The biggest problem I think for self insurance for disability is the legal liability that is involved. We tried to put in our contract a provision which would pass the liability on to the group. Whether that is going to work or not I do not know. We have not had any lawsuits connected with those groups yet. But there is potentially a large legal liability and I do not think the groups are aware of that.

Product Selection

For MET's you have to have a very limited number of products that are available. However, for group insurance there is a wide variety of benefits available, particularly for the larger groups. We will write elimination periods down to 30 days and up to as long as they want. We will provide benefits up to two-thirds of income, although some companies write a 60-70 plan which is the lesser of 60% of income or 70% integrated with other benefits. We will write benefits as high as $6,000 a month. I know a couple of companies are writing up to $10,000 a month on professional groups. For blue collar groups, as I mentioned before, benefits may be more restricted. We will quite often write only a two year maximum benefit for a group that is highly concentrated in blue collar workers, mainly because we are concerned what the experience will be. It varies a lot from one blue collar group to another, and once the experience develops, we may extend the benefits at that point in time.

Some special policy provisions can help. One area that seems to be popular recently is a rehabilitation benefit or, as one of our brokers likes to sell it, a partial disability benefit. He goes to professional groups and tells them that the chance of becoming totally and fully disabled is very small and that they are more likely to be partially disabled. So this partial disability or rehabilitation benefit is very important because he sells the policy on that basis. We have quite a bit of variation in the deductible benefits. Almost all contracts deduct what a person gets from Social Security but then it can vary on other things; such as whether you are going to deduct benefits from pension plans, wholesale plans, or credit disability policies. These variables depend on the company and sometimes on the group. For large groups you might allow some variations.

Generally we have a two year limit on mental and nervous benefits. For a price we will take that out of the contract. Some contracts have survivor benefits, dismemberment benefits and cost of living benefits, a lot of companies are asking about cost of living benefits with inflation getting up into the double digit area. They ask about it and, when they are told the cost, generally back away from it. They are very expensive so we have not written that type of benefit yet. The definition of disability may vary. A two year "his own occ" definition is standard but sometimes it is longer or shorter. Rate guarantees, pooling, experience rating are all things that we are involved in. Experience rating is kind of interesting. We actually have more trouble with large groups that have good experience than with those having bad experience, which would seem to be unusual. Groups of bad experience are normally willing to work with you, reduce the benefits, increase the rate and make the group a profitable one. We generally do not lose those groups to other competitiors. The ones we have lost quite often have been to self-insurance. Groups that have good experience on the other hand want everything back; all the surplus plus interest on all the reserves and it is hard to convince them that there is any risk involved. The fact that we lost a million dollars on another group or the fact that you can have a 5 million dollar punitive damage lawsuit against you on a claim is not their concern.

Prospecting

Eighty to ninety percent of our insurance is written through brokers and the remainder is mainly through our own agents, although occasionally we have a few groups come in directly from public employer groups like the State of Washington, Montana, or Alaska. We seem to get more and better business through brokers that we cultivate than those that approach us. We go out and convince a broker that disability insurance is a good product and Standard is a good company. We do not seem to write much through brokers that just contact us for an occasional quote.

Underwriting

We generally require evidence of insurability and pre-existing conditions limitations for the smaller groups and MET's. MET's usually have age-graded rates with two or three occupational classes. You pick out the rates and plan from a brochure. When you get into group insurance, the rates depend on age, sex and occupation. Some groups depend on a number of other things such as length of service, sick leave accumulations, amount of employee contributions, enrollment percentages, experience of other group, rate guarantee periods, integration provisions, level of benefits, size of groups and other benefit provisions. These different factors are what makes one company different from another.

The Sale

Large groups can get very competitive, depending on the experience. If the experience is very good, a lot of companies will quote. If it is bad experience, quite often no one will quote. Medium size groups are fairly competitive, small groups less so. Generally the agent can make a sale just based upon one or two companies. There are not much face to face sales in the group insurance area. Normally we go through our brokers, so quite often we never get involved with the group directly. LTD is very complicated and it gets more so all the time, particulary with the government getting involved in areas such as ERISA, mandatory maternity coverage, ADEA and the Privacy Act here in California. Currently, plain language contracts are being required by a number of states. Lawsuits have always been a problem. Potential large punitive and consequential lawsuits loom out there all the time. This makes it more difficult to prepare brochures and enrollment letters because you must list all the deductibles, limitations and exclusions. But if you do not list those, then you cannot use them. At least that is what our legal counsel has told us.

Administration

All of our long term disability plans are self-administered. In other words, we do not provide any home office list billing. I think we pay some extra claims because of policyowner errors by doing it that way, but I believe these are more than offset by reduced expenses. In the past, there have been some problems of convincing groups, particularly smaller groups, that they should self-administer and keep track of people enrolled. But now with the advent of computers, I think maybe it is easier for them just to take the totals off of a computer run, fill in our premium forms and send it in. So it does not seem to be that much of a problem currently. MET's normally use list billing, at least the ones with which we are involved. Administrators send out the bills, collect all the premiums and then give us a monthly check for the premiums.

Experience

The year 1980 was good and the first three months of this year have been favorable. Actually it has been very steady over the last three or four years. This is a little surprising since we expected that last year the claims would be higher due to the recession and unemployment, but it turned out not to be the case, at least for our company.

MR. WILLIAM L. HEZZELWOOD: Actuaries by nature tend to be product oriented and their natural tendency is to think about the product itself and not be too involved with the marketing side of the product. That is unfortunate because the two really are very closely related to each other with individual disability income. The way in which and the effectiveness with which you market this particular product have a direct bearing on the type of experience that you will have. If in 1981, for example, your company is going to sell 1,000 individual disability income policies and you do so with 100 agents selling 10 policies each, your experience (I'll stake my reputation on it) will be dramatically better than it would be if you did it with 1,000 agents selling 1 policy each or with 10,000 agents selling a tenth of a policy each, something like that. Market penetration is the name of the game. If you think about it a little while, you will see that that makes sense. When you have people who are aggressively marketing the product, you have a product that is sold and not a product that is bought. That is the essential difference between aggressive marketing with successful disability experience and passive marketing with dismal disability experience.

Let me give you a brief overview of Pacific Mutual's disability income portfolio. We offer guaranteed renewable disability income policies exclusively. We do not offer non-cancellable guaranteed premium products. Inasmuch as we want to compete in the professional and upper-income market, we find it very challenging because that market is dominated by the major non-cancellable disability income companies.

For a period of three or four years prior to 1980, we experienced declining sales. Our new annualized commission on disability income business declined steadily over that period. We decided in 1979 that we needed to take aggressive steps to turn this situation around. We feel that we were successful in accomplishing this, for in 1980 we had a significant turnabout in our new business production. Our total new annualized premium for disability income business was up by 72% from 1979 to 1980. The corresponding percentage increase for business overhead expense insurance was 54%. Naturally, this growth is magnified by production in 1979 being much lower than normal. However, 1980 was nevertheless the most successful year in our recent history in terms of health insurance sales.

There were six actions taken which probably had the biggest effect on our sales. Toward the end of 1979 and for the first part of 1980, we hired an outside consultant to conduct seminars in many of our agencies for the sole purpose of training our agents to sell disability income policies. His presentations were very dynamic and very effective and the result was that many of our agents began writing disability business for the first time In addition, agents who had written disablity business in the past began writing much more of it than before. In particular, the consultant was successful in helping our agents to perfect their skills in selling Section 105 wage continuation plans.

The second change that we made in the middle of 1980 was to introduce a preferred-risk discount into our individual disability income portfolio. The preferred risk discount was made available to non-smokers who are otherwise standard risks. The amount of discount was very small for we did not have any sound statistics upon which to base premium calculations for non-smokers on disability insurance. All the evidence that we had available, however, indicated that some type of discount should be justifiable on disability business and so we felt that it would be advantageous to us to introduce such a discount for marketing reasons.

The third thing that we did to help our disability sales was to reprint our rate book. We had received several complaints from agents who felt that the rate book display was difficult to use and difficult to understand. The new format that we developed and introduced does a better job of teaching our agents about our products and makes it easier for them to calculate premiums.

The fourth thing that we did was to persuade one of our more highly regarded agency managers to give his personal endorsement to our products. We have known for a long time that agents will tend to sell those disability products which they believe to be the most competitive. The endorsement that we obtained from one of our key managers enabled us to convince many agents that our product was indeed worth selling.

A fifth action which we took to improve disability sales was to give increased coverage in our field publications to our disability income products. We published, in early 1980, a special edition of our field sales magazine which was devoted exclusively to disability income insurance and approaches that can be used to market it. This generated considerable interest on the part of our field force.

The sixth thing that we did, which was introduced in late 1980, and so it really did not have too much impact on our sales success for 1980, was the introduction of a computerized disability income proposal service. This was made available to our agents at no charge. The computerized proposals are designed to contain much of the information that is contained in our normal outline of coverage. The proposals were developed with considerable input from our Agency Department and have relieved our agents of a great deal of work in figuring out how much insurance an individual can purchase and in figuring the premium for the requested package of benefits.

We have a few ideas that we have been considering for the future. One idea that we have considered in the past and which we will study further is the provision of incentives in the agent's contract to produce disability income business in larger quantities. This might take the form of a higher rate of commission payable on disability premiums in excess of a specified level. In addition, we plan to introduce sales aids for our agents which are more appealing than the ones that we've used in the past and should help our agents in their point of sale presentations. We are considering developing some form of special programs for limited evidence underwriting for certain groups, such as employee groups or association groups. At this point, very little work has been done in this area at our company but we see it as an area of significant growth potential inasmuch as we have many existing clients as a result of our aggressive position in the group insurance market.

MR. MICHAEL L. KELLEN In this discussion, I plan to focus on my company's experience with a particular product, cash value loss of time. It is my feeling that this experience will have useful marketing implications.

Before entering the discussion of the experience of this particular product, I would like to make a comment regarding the other items on the agenda. From the standpoint of market identification, product selection, underwriting and the sale. There is very little difference between the marketing of a cash value disability product and the traditional non-cash value disability product. Of course, the product itself contains inherent differences causing some unique claim administration and reserve handling.

We at Mutual of Omaha have been offering both the cash value and non-cash value disability income products simultaneously to the same market for about seven years. As such, we are able to compare the relative merits of the two products from an experience standpoint and we are therefore able to base marketing decisions on such comparisons.

We have been quite successful in marketing individual disability income products to all markets. In addition, we have been more successful than most companies in providing these products to the blue-collar market. With respect to our current mainline products, about 70% of our sales (premium volume) come from, what I would call, the blue-collar market.

With respect to both the blue and white-collar markets, the question which has always been in the back of my mind is, "Does the cash value product actually give you better morbidity?" As I mentioned earlier, we have been selling the cash value and non-cash value products side-by-side. There is no mistaking that the cash value product yields better morbidity than the non-cash value product. Unfortunately, this simple answer alone does not provide enough insight. It could be that the better risks buy the cash value product while the remaining risks buy the non-cash value product so that in combination you end up with the same average morbidity level that you would have expected if you offered only the non-cash value product.

We recently completed an extensive study of our individual disability income morbidity during the late 70's. In this study the overall non-cash value claim costs were running significantly higher than the cash value claim costs in the aggregate - about 60% higher. In combination the morbidity level of the two products was running about 5% higher than the morbidity levels developed from our previous study which covered the experience of the late 60's. Since the late 60's, as I am sure you are all aware, individual disability claim costs have risen significantly. Looking at the 1977 TSA Reports, using our own distribution of exposures, it appeared that our claim costs should have risen about 30%; whereas they rose only 5%. That is one element that would lend some credence to the possibility that the cash value product does in fact give you better combined morbidity and not just necessarily a better risk.

Attached are some exhibits showing loss ratio figures by duration which are representative of the underlying claim cost figures. Exhibit I shows our aggregate loss ratios by duration, for all of our occupation classes combined. The top line is the non-cash value product, the lower line is the cash value product. The first question which comes to mind has nothing to do with cash value and non-cash value. Why are these loss ratios so high in the first duration? While this is a most interesting phenomenon in itself, what we are interested in for the purpose of this presentation is the relative level of cash value vs. non-cash value. There is a tendency for the drop from the first duration to the second duration to be more dramatic for the non-cash value than for the cash value. That is, the cash value itself seems to have helped flatten that curve somewhat.

We should look at a specific occupation class since the occupational mix could cause some distortion here. Exhibit II shows the durational loss ratio experience under occupation class 4A (this is four of six).

This classification represents the majority of our blue-collar market and it is our largest occupational class. Once again, the non-cash value loss ratios are much higher than cash value. You might have a question now as to whether I am comparing apples to apples. In the cash value loss ratio I have removed the cash value load. That is, we are just looking at the basic loss of time loss ratios. Hence, from this standpoint it is a legitimate comparison. It is not a perfectly legitimate comparison from the standpoint that the cash value products are sold to a slightly younger person. Our issue age limits stop at age 49 on cash vaue, while non-cash value products are sold through age 69.

However, since our aggregate loss ratio statistics show the highest loss ratios at the youngest age, if we made the proper adjustments the two lines on the graph you are looking at would become even farther apart. Hence, I did not need to go through the adjustment process to make my point.

Exhibit III shows the durational loss ratio experience under occupation class 2A, which is our largest white-collar class. While the numbers are similar, they are a little more erractic because the exposures are smaller. Nonetheless the relationships are quite similar to those shown in Exhibit II for occupation class 4A. However, the cash value loss ratio curve, the lower line, tends to be a little flatter than the corresponding 4A curve. This phenomenon described above where the cash value loss ratio curve is flatter for white-collar risks than for blue-collar risks is further substantiated by the experience of our 1A classification. The number of exposures in this classification is small and no graph has been prepared but the information available supports the previous statement.

It is interesting to note that, when we view accident and sickness separately, the claim costs are high in the first year for both types of risks. The only area in which we actually experienced the traditional looking claim costs by duration (low in the early years and increasing in the latter years) was in the area of over age 50 - sickness only. With this exception our claim costs start out high in the first duration, decrease for about six durations, and then begin rising again by about 2-1/2% to 3% per year. It is also interesting to note that with the underlying claim cost curve implied by the loss ratio figures shown in Exhibit I through III, the traditional active life reserve takes on a whole new look. Hence, while our statutory statements may

indicate very high loss ratios when reserves are included, the true "experience" loss ratio is much lower.
If your company has not made a recent study of durational claim costs, it may be possible that you are experiencing this same phenomenon without knowing it.

Getting back to the subject at hand, "Does the offering of a cash value product improve overall morbidity?" For the moment I would like to rephrase this question, "If your company sold only cash value and every other carrier offering disability income sold only cash value, would the true level of morbidity improve?" With respect to this latter question, I have some facts available which would lend credence to a yes or no answer, although I really do not have enough facts available to make a definite yes or no answer.

Exhibit IV shows adjusted ratios of cash value to non-cash value morbidity for our largest blue-collar occupation class (4A). By "adjusted" I mean that such ratios are adjusted for age, sex, elimination period, and benefit. To aid in the review of this exhibit, observe the .67 under Male, 4A, Total Frequency. This figure indicates that the cash value frequency is 67% of the non-cash value frequency. Looking at this number broken down between accident and sickness you can see that there is very little variance. Looking at the next line (1 Year Average Claim under Male 4A), you will note that the cash value average claim is not significantly better than the non-cash value average claim. The 1 Year Continuance (fourth line) also indicates that the cash value product is not significantly better than the non-cash value. Looking at Female 4A, the Total Frequency of the cash value product is significantly better than the non-cash value product, similar to the Male 4A, while the Average Claim and 1 Year Continuance are actually worse.

What these figures on Exhibit IV say to me, and this is more impression than fact, is that the very short claims are eliminated or reduced by the very nature of the cash value product. That is, while many prospective cash value claimants never make it to the end of the elimination period the ones which do are not better and, often times even worse, than the non-cash value claimants.

If the assumption is made that the good risks buy cash value coverage and the poorer risks buy non-cash value coverage we would, of course, expect lower cash value frequencies. It would seem reasonable that we would also expect lower average claims and continuance. We are all aware that, because of the nature of disability income insurance, many times the desire to work is as, or more, important than actual health conditions alone. If the cash value risks are significantly better risks it would seem that they would have to be better "work ethic" risks as well as better health risks. The comparison of cash value to non-cash value average claims and continuance would not seem to support this latter statement. It appears as though the cash value product by its very nature does have an impact on the level of morbidity.

The attached Exhibit V shows the same data for our occupation class 2A (white-collar) as Exhibit IV contains for class 4A (blue-collar). You will note that these figures are even more supportive of the argument presented in the last paragraph.

As somewhat of a final note here, it is my own opinion that you can market the cash value product in both the white collar and blue collar market successfully and your overall morbidity will improve, you also have an additional advantage in that you will accumulate a large fund which will provide additional investment income opportunities.

The key element in the calculation of the cash vaue premium is persistency. We have looked at our persistency assumptions on our cash value products and our ten year average life runs about 20% better on cash value than on our non-cash value products. We originally assumed that the improvement would be even more than this so we are in pretty good shape from the standpoint of reserving with respect to this particular element. Of course, since our claims have been so much better than we expected and we have a cash value benefit which is offset by claims, our original offset assumptions were overstated.

In the marketing field we do plan to do some additional experimentation with the cash value product in the future. I personally believe it will be extremely successful from the standpoint of experience results and sales.

MR. WILLIAM J. SCHNAER: Pennsylvania Life Insurance Company began marketing disability income insurance in 1955, the year it was purchased by a successful general agent who specialized in marketing disability income. His entire sales force, which operated out of a number of sales offices, became a captive agency force for Penn Life. This sales force began in 1939 and operated in the same way before and after the purchase and therefore in describing the marketing of disability insurance by this sales force, I will be discussing a process which began before World War II and continued into the middle '70s.

Market Identification

The market that this sales force sold to was self-employed businessmen living in small towns and outer suburbs of metropolitan areas, as well as farmers, ranchers and other rural residents. The identification of this market evolved over time, and was not the result of a single strategic decision, but rather an evolutionary process. Because the salesmen received no advances, or "draws," it was necessary for them to collect an annual premium, if not with the application, at least on policy delivery, so that they could have enough commission income to live on. Self-employed businessmen and farmers usually have enough ready cash to pay an annual premium, whereas the working man often does not. As this was being realized, it also became apparent that the further away one got from the central city, the easier it was to sit down and talk to the small businessman. He was not as busy as his urban counterpart, he was usually friendlier, and of course, being the boss, he could take the time to sit and talk. In addition, the competition inside large cities was and remains very fierce. Every small business owner in the city has a number of insurance agents calling on him (and often has a close friend or relative who sells insurance), while in the rural areas the competition is not only less in number, they are often not as aggressive.

Product Selection

The product that this sales force sold also evolved over time, with the benefits designed primarily by the agency, and the price chosen by the carrier. In 1955, the same product line was adopted by Pennsylvania Life. The major product was an optionally renewable, first day to lifetime, accident and sickness policy. The sickness benefit was paid for four months for all total disabilities, and continued beyond the four months only if the claimant was house-confined. Built in to the policy were additional benefits for hospital confinement up to ninety days, ninety days of partial disability benefits, as well as lump-sum accidental death and dismemberment benefits. Originally, up to $300 a month of benefits could be issued to any one person, and this was later increased to $500 per month. This product was replaced in the very late '60s by a similar policy which was Nonrenewable For Stated Reasons Only, which, in turn, was superseded by a Guaranteed Renewable product in the middle of the 1970s.

In addition to these products, there was a Noncancellable policy which was sold to select occupational groups up to $500 a month. The sale of this policy was discontinued in the early 1970s. There were also policies designed specifically for substandard applicants, an assortment of riders providing various kinds of hospital benefits, and various coverages for family members.

Prospecting

The prospecting process was handled by the sales office. First, a geographical area would be selected, and then the prospects would be identified. In the case of the small businessman, this was primarily accomplished by using the local phone book. Identifying the owner of almost every small business in town was apparently possible by this method. For farmers, their names were identified through the local plat book. These books are published by private concerns and show the ownership, as well as the boundaries, of every piece of land in the county.

After the names had been identified, a pre-approach letter was sent. This letter was not very specific, and it mentioned that someone would be coming by to talk about their financial security. The agents themselves were given cards, each of which had a name, an address, a phone number, and a type of business. The prospects would be grouped geographically to minimize travel. The agent then either dropped by the place of business or farm, or, if they felt that it was appropriate, telephoned first for an appointment.

The Sale

Once the agent was granted an interview, the sales presentation was reasonably typical for disability income insurance. The agent laid stress on personal income protection as well as the protection of business expenses, and pointed out, in most cases, that while the businessman was protecting his employees by purchasing Workers' Compensation, he had no similar protection for himself. There obviously was and is a real need, and out of every three presentations the agents on the average made one sale. This ratio of one out of three has remained consistent for Pennsylvania Life over the years.

The agent was encouraged to collect the full annual premium with the application, and, if he could not, to collect any remaining portion of that annual premium on policy delivery. The initial collection process will be discussed in more detail shortly.

Underwriting

The sales office did an initial screening of the application, which consisted mostly of finding unanswered questions and sending the agent back to get them answered. The agent was charged by the home office for submitting an obvious rejection, for example, an application which either indicated on its face some fact which made the applicant ineligible, or where it developed that there were things about the applicant, such as extreme overweight, that were obvious to the agent and were misrepresented.

The underwriting in the home office was typical disability income underwriting, concentrating on income, occupation, and health. The policy itself had a two year pre-existing condition clause as well as a six month wait for a few specified conditions such as "heart trouble". All in all, there were few complaints about the underwriting, either by the field towards the home office, or vice versa.

Administration

The major aspect of administration that affected the marketing process was of course, the billing and collection and the payment of commissions. The first premium was always annual, and the agent's first year commission was dependent on collection of the entire first year annual premium, if not with the application, then at the time of policy delivery. If less than the full annual premium was collected by the agent, then the sales office did whatever billing was necessary to bring the rest of the premium in, but the agent received no commission on those subsequent first year payments. The first year premiums collected were deposited in a special company account. The first year commissions to agents were paid from another account which the company kept for the office. Renewal billing was handled by the home office. An interesting feature, and one which Pennsylvania Life continues to this day, was that on any billing date, the insured has the option of paying a quarterly, semi-annual, or annual premium, irrespective of what the last payment was.

The home office also prepared agent's statements and paid renewal commissions monthly. The agent received commissions of 37% first year and 10% renewal, with vesting of renewal commissions of 1/2 the normal commission for a length of time dependent upon the length of service. The sales managers' compensation is more complex. A brief (and not completely accurate) description of the process is this. The sales office was credited with commissions, which on this product were 60% first year and 22-1/2% renewal. The office was likewise charged with expenses, including the commissions to agents just decribed and other items, such as rent, telephone, etc. This calculation is performed monthly. The resulting so-called profit (or loss) is then divided among all the parties who have a share of the office profits. The company, itself, always retains a share. There may be one or several managers who participate in the remainder. Over the long run, for a successful office, the profits going to the manager (or managers) have been averaging 4% of total premiums.

Experience Results

Until 1975, the experience on this entire product line was satisfactory, year-in and year-out. In 1975, as a result of the recession of the mid 70s, the loss ratio jumped twelve points from the year before. At that time, it became obvious that Pennsylvania Life's market, which up until then had not been affected by the economic ups and downs of the country, was vulnerable to the kind of inflationary recession, with the accompanying credit crunch and high interest rates, that the Unted States was beginning to experience. Therefore, beginning in 1976, the sale of disability income insurance was de-emphasized, and only small amounts have been written from that day until now. The sales force began selling a line of field-issued accident only disability income and hospital insurance policies. So far, this line has shown a great deal of stability in the face of economic troubles.

MR. FRANKOVICH: Thank you Bill. During my work with disability income and various insurance companies, I found that each company is different. Sometimes subtlely; sometimes in a major way. We have just heard from four different companies marketing disability insurance in as many different areas. A number of new disability products and riders have been introduced recently. They are to meet a perceived need in the market or from the sales force. However, does the product or administrative approach or both solve the problem of the company?

MR. DONALD M. PETERSON: Benefit Trust has about $7 million inforce in individual disability income premium, mostly in the blue collar area. We have about twice that much in group, plus a little bit of minimum premium/ASO business. We have seen the same downturn in results during the mid 70's, but in the last couple of years disability income experience has been looking a little rosier from both the group and the individual sides. It was not mentioned, but our feeling is that inflation in this instance was a good guy from two standpoints. One, we are dealing with a product with a relatively low cash loss ratio so we are building up assets, and these newer assets are earning 12%, not the 3% at which we are setting up reserves. We have reflected this in our group experience rating with the larger groups. I think increased interest earnings have also lessened the need for some rate increases in the individual area and should be reflected, to some extent at least, in current guaranteed renewable premium rate scales. Two, inflation has had a unique impact on the recovery rate. I do not know whether your companies have noticed it, but in 1979 and 1980, an inordinate number of supposedly disabled persons seem to have recovered. This could mean that, while it was swell living on $400 a month in 1975, maybe some claimants want to go back to work now and improve upon that income. Inflation certainly has had a profound impact recently.

Mike was mentioning the high first year loss ratio that Mutual of Omaha was running into. Most of our $7 million of individual premium is in a blue collar area. We were writing railroad workers back in the 1920's and that has been a prime market ever since. We often developed 80 or 90% first year loss ratios. It is difficult to beat the selection against you, but hopefully it levels off to something you can live with.

Something came to mind as Mike described the choice between the cash value and the non-cash value policy. I would be concerned that the healthier risks were opting for the cash value policy. It would seem that you would get poorer morbidity under the non-cash value policy, which would drive up your rates, and sooner or later you are going to be charging more for your product than I am. I should then be getting the more select among those who purchase the standard product. I do not know whether you are watching out for this, but I would be concerned.

I would like to direct a question to Wayne in the group area. Our sales people are giving us a hard time of late on maximum amount. You mentioned the figure of $6,000, right now just about twice our maximum. We are talking about going to $5,000. Does your company grade the $6,000 by size of group, such that you write only $2,000 or so with a 10 life group? To get to $6,000, do you need a 50,000 life group? When you do get to the president or other high income person, do you put in some sort of limitation on the individual - such as 50% of salary in excess of $4,000, even under a 60% or 70% plan? That is to avoid a person being better off disabled, at least on an after-tax basis, when he might be able to influence whether he is deemed to be disabled or not.

Finally, I would like to raise a question for all of the panelists, since we are in California right now. I have heard no reference to the difference in experience between California and the rest of the world. Most especially, we see it in the blue collar individual area. Do your companies charge different rates or have different underwriting rules in California? We charge higher rates, have more restrictive underwriting rules; and even so, have an even higher loss ratio in California with special California products.

MR. ROBERTS: First question is "do we grade it by size of group"? The answer is "yes". To get up to $6,000, it has to be a large group but it depends a little bit on how many highly paid people you have in the group. If you had an attorney firm with a 100 partners (I am sure they are making lots of money), you might go all the way up to $6,000. I think Union Mutual takes the average salary of the top five people and uses that in their formula for instance. And then, if they want too high a level of benefits, sometimes we will require some insurability to go up to that level. So we have the size of the group, and then maybe evidence of insurability involved even on a group basis.

As far as grading the benefits down, we recently tried to make a distinction between whether it is a contributory or non-contributory group. If it is contributory or a partnership (because a partnership basically is a contributory group), then we do indeed have the benefits grade down. We are talking about 60% of the first $5,000 and 40% of the amounts over that. My understanding is that Mutual Benefit and Union Mutual use basically the same type of formula. So we do grade down and we do look at after tax dollars to try to keep it in line on that basis.

As far as California versus non-California, we only write on the West Coast. Two thirds of our business is in California. For a while we actually charged a little bit higher in California, but determined that it was not really justified by our experience. So now we have the same rates throughout our area of operation.

MR. SCHNAER: The disability income business we wrote in California had had very bad experience. Sales of disability income were terminated some years ago, but a sales operation for the limited accident product line has begun again. In addition, we have found that the major urban areas are not only difficult to sell but they are miserable in terms of experience. It does not matter whether it is in California or Chicago or New York, the experience is not good.

I would like to comment on the effect of inflation on our experience. Our experience with the blue collar markets is that in the current recession, our insureds have no jobs. We have subcontractors who have no work at all. And so, when they are really sick, their choice is collecting $500 a month from us or making a supreme effort to get better and have nothing. And that is what I think is contributing to our experience and why we felt we needed to get away from disability income into something else.

MR. KELLEN: Regarding the California question, we have a very large block of our loss of time business here in California and we took some steps to toughen our underwriting rules considerably, to raise our rates considerably, to eliminate first day coverage regardless of whether it is accident or sickness, and to go to longer elimination periods if we could. Since that time, our experience has worsened. We expected morbidity somewhere in the neighborhood of 40% higher and it appears to be about 70%.

MR. HEZZELWOOD: The only time that we have ever looked at California separately, which constitutes about 40% of our business, was just prior to development of our last rate book in 1978. Our experience at that time indicated that overall our loss ratios in California were about 30-35% higher than elsewhere. Consequently, we adopted a dual rate structure at that time such that the rates we charge in California are higher than out of California by percentages which vary from about 5% to about 20% or so, depending on occupation class. We have not looked at California experience separately for the block of business written on that dual basis since then because it is fairly young. I would not expect that the experience written before 1978 would be any better in California than it was at that time but at this point we don't know if it is any worse either.

MR. T. ALLEN PARK: I have a question for Michael Kellen. You sell the cash value plan along with the non-cash value. Which set of premiums is higher?

MR. KELLEN: We cannot sell a cash value product for a lower premium than a non-cash value product for practical reasons.

Mr. PARK: I know, but if your losses are so much higher for your non-cash value...

MR. KELLEN: If I rated them the way the experience has developed, there are many ages, elimination periods and benefits where the cash value premium would be lower than the non-cash premium, but you have to remember that, if that were the only thing we wrote, we are going to get some of the risks that are buying our non-cash value product. The image that I tried to portray during the 15 minute session is that I believe there is a little bit of both. Number one, I think you get better risks under the cash value product. And number two, the product itself also improves the morbidity. So there is a little bit of both involved. We certainly cannot charge less for the cash value than the non-cash value and we are not entirely sure that we can eliminate the non-cash value and charge lower rates on the cash value. It is not something that we jump into on a nationwide basis.

MR. PARK: Do you have any closed blocks where your rate increases have actually forced your premiums higher for non-cash value?

MR. KELLEN: No, we have no meaningful closed blocks of cash value business.

MR. PARK: I just wanted to comment: We do sell cash value versus non-cash value and they are essentially equal plans except for the cash value involved. We too are showing much better experience on the cash value plan.

MR. PHIL DANDEE *: Question for Wayne on the MET business. Are you actually selling it in California? What kind of underwriting standards are you using? What are the very limited policy benefits that you are providing? I am assuming that they are very limited.

MR. ROBERTS: Well, we do it through administrators. We have independent insurance agents writing through an administrator. It is down to about three lives and I do not believe there is any evidence of insurability involved. For example, we have a design professional's trust involving architects and consulting engineers through another administrator. Here again it gets down to very small numbers and I do not believe there is any evidence or pre-existing conditions. The benefits are very limited. For instance, we have just one plan, 90 day elimination, 60% of income, age 65; not many choices. Some are age rated, some are not.

MR. DANDEE: You have not pursued a general retail market? Multiple employers, gas stations....

MR. ROBERTS: Well, right now we are working on taking over a national trust, or part of a national trust, written by an administrator out in California . This one does not have insurance agents and covers many occupations, and service stations and maybe one that is excluded. For the blue collar risks, we are talking about a two year benefit. For the white collar salaried risks, it would be to age 65 but there would be those differentials.

MR. PAUL E.HANSEN: For Mr. Kellen, in view of your dramatic differences in your statistics for the cash value and the non-cash value, are there going to be any changes in your marketing and underwriting of those products? I got the feeling that there is not, from what you are talking about.

MR. KELLEN: It is a distinct possibility that the marketing technique of the two products combined may be shuffled in such a way that for some occupations, eliminations, benefits and sexes, there may be only a cash value product.

MR. HANSEN: For Mr. Roberts, you mentioned that the rehabilitation benefit on your group was very popular and then you also mentioned partial disability. What kind of product is it really? What kind of benefit is it? There are so many different kinds.

MR. ROBERTS: If a person goes back to work and he is disabled according to our contract; that is, if he is unable to do all or most of the duties of his regular occupation for the first two years, we will deduct 50% of his earnings from his job. He can call that a partial disability benefit or rehab benefit. The way our contract is written, we have to approve it

*Mr. Dandee, not a member of the Society, is a self-employed consultant.

as a practical matter and if we get him back to work we will approve anything that we can reasonably assume is going to be rehabilitative.

MR. HANSEN: So you are giving him a variable amount?

MR. ROBERTS: It will be 2/3 of his income and we will deduct half of what he gets when he goes back to work. So he is going to make more by going back to work than by being totally disabled.

MR. HANSEN: Are your getting any pressure to have variable rating? For example, going from 80% to 20%? You said earlier that you use a straight 50%.

MR. ROBERTS: We used to deduct 80% on the old standard contracts. Now the competition has liberalized and only deducts 50%. If a person goes back to work and we only deduct 5%, he makes more money than he did before he was disabled.

MR. HANSEN: But he has to go back to his old job?

MR. ROBERTS: He can not take another job. Normally he goes back to a job that pays less. If he went back to his old job, we would probably say that he was not disabled and cut him off completely. If he went back to another job, even if he earned the same salary, it is likely that we would only deduct 50%.

MR. HANSEN: For Mr. Hezzelwood: You mentioned grading compensation for the agents (I think your fifth point). Can you give an example of that? Is it on an individual contract or the total volume of business that the agent is selling?

MR. HEZZELWOOD: Well, there are many ways of doing it, I suppose. One that I have looked at in the past and have not completely discarded is, instead of paying, let us say a 55% first year commission, on all disability income business that an agent sells, you might pay first year commission of 30% on the first x dollars of premiums or pay 30% until first year commissions on disability business gets up to a specified amount. For production above that level in a calendar year, you would pay a higher rate, maybe 65-70%. So then you are telling your agents: "If you want to sell disability business, sell it aggressively, sell a lot of it, we would love to have your business. But if you are just going to write the occasional person who has a pain in his chest and wants to buy a disability policy, we do not want that business. We want you to sell it, we don't want people to buy it from you."

MS. DAWN E. HELWIG: I have a question for Bill Schnaer. Combined Insurance Company has customarily sold to similar groups of people. Concentrating in rural areas and only recently in urban areas. We have also noticed that the experience in urban areas is miserable, to put it nicely. We tried to determine if it was a sales problem. For example, in one of the cities, it seems our agents have insured the entire police and fire departments. But we have not had that happen in other cities and have had worse experience there. What do you see as the cause for the worse experience in the urban areas? Is it a sales problem or does it have to do with a worse spread of risk, poor work ethic, or whatever?

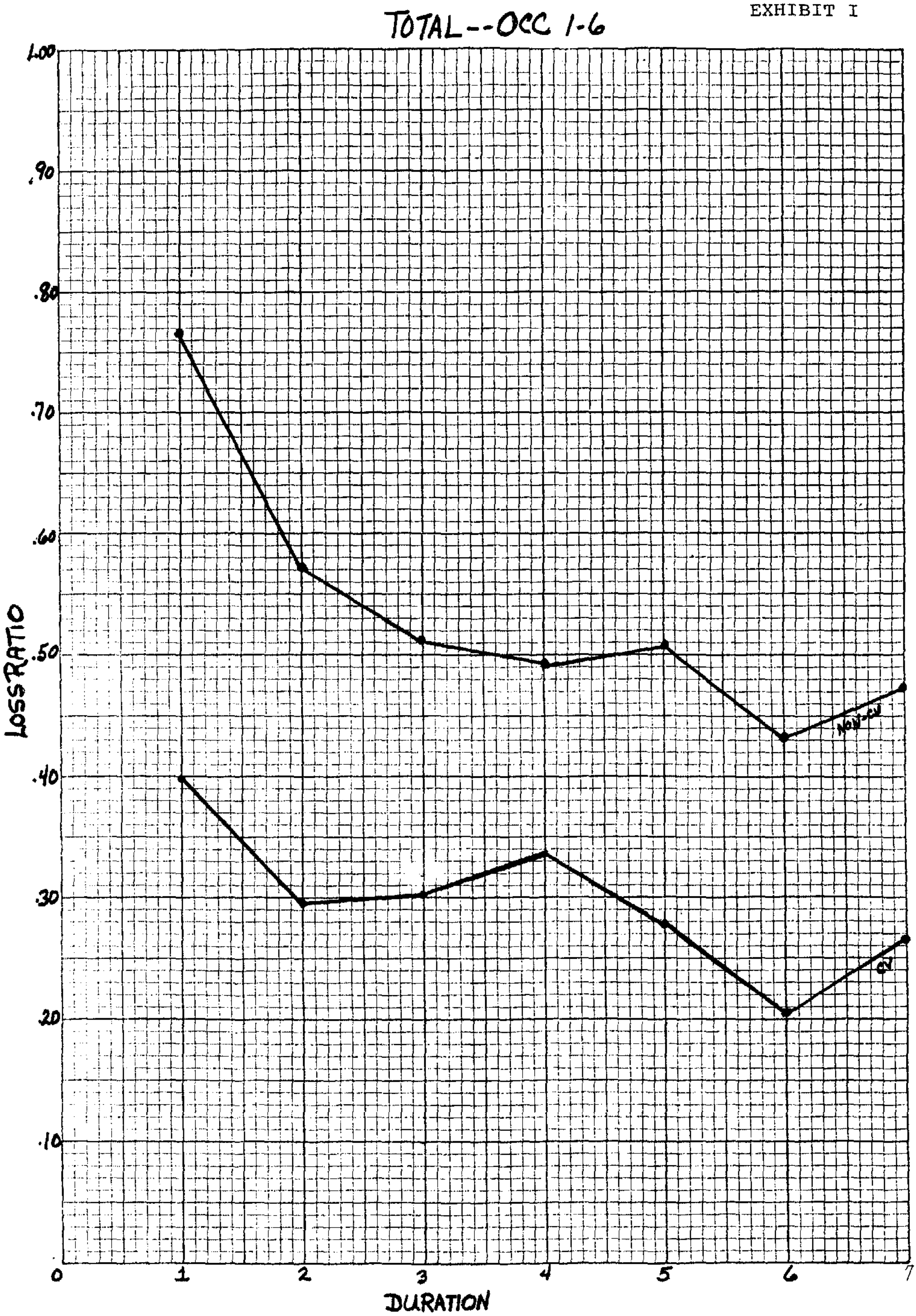
Also, is there something that can or should be tried as far as product design or underwriting standards in urban areas?

MR. SCHNAER: I'm not sure that I can answer the question with any great authority. I tend to wax somewhat philosophical about the subject. A thought that I have had about health insurance, especially disability, is that it is a product that depends a lot upon the underlying honor and work ethic of the insured. In some ways it is very similar to auto insurance. Auto insurance is also greatly subject to personality and it is not coincidence that some of the largest and lowest priced auto insurance companies have the word "farm" in their names. Farmers Insurance in Los Angeles, State Farm, etc. Going back centuries to the beginning of the Industrial Revolution, cities have had a grinding effect on lower income people. Going back to Charles Dickens and before, there has always been a constant cant about the virtue of the farmer versus the evil, crime and violence in the city. I do not know if this can be solved with product design or underwriting standards. We have noticed the same thing in our life insurance, which is not nearly so subject to the same influences, inasmuch as one has to pay the supreme penalty to submit a claim for life insurance. Even so, we have noticed that the mortality ratios among blue collar markets are much higher in the urban areas, especially in the early years, than in the rural areas. The major product our sales force sells is very similar to what Combined Insurance sells, field issued, accident only hospital and disability insurance product and we have the same experience in the urban areas. We have not come up with any solution, except not to sell in the city. I am not sure there is a product that can be sold profitably to blue collar urban market, except possibly large employer-employee group insurance.

MR. FRANKOVICH: I have a question for Wayne. During your presentation, you mentioned brokers or agents that have been actively recruited to market disability versus those that come to you on a periodic basis. How does Standard identify the brokers that should sell their disability programs?

MR. ROBERTS: We sell our insurance through salaried group representatives so they call on a brokerage, which they think will provide business. They go out into the suburbs and try to get smaller brokerage houses and agents interested in disability insurance. The large brokerage houses generally come to us. But sometimes these smaller outlying brokers sell more and better business than those big ones.

EXHIBIT I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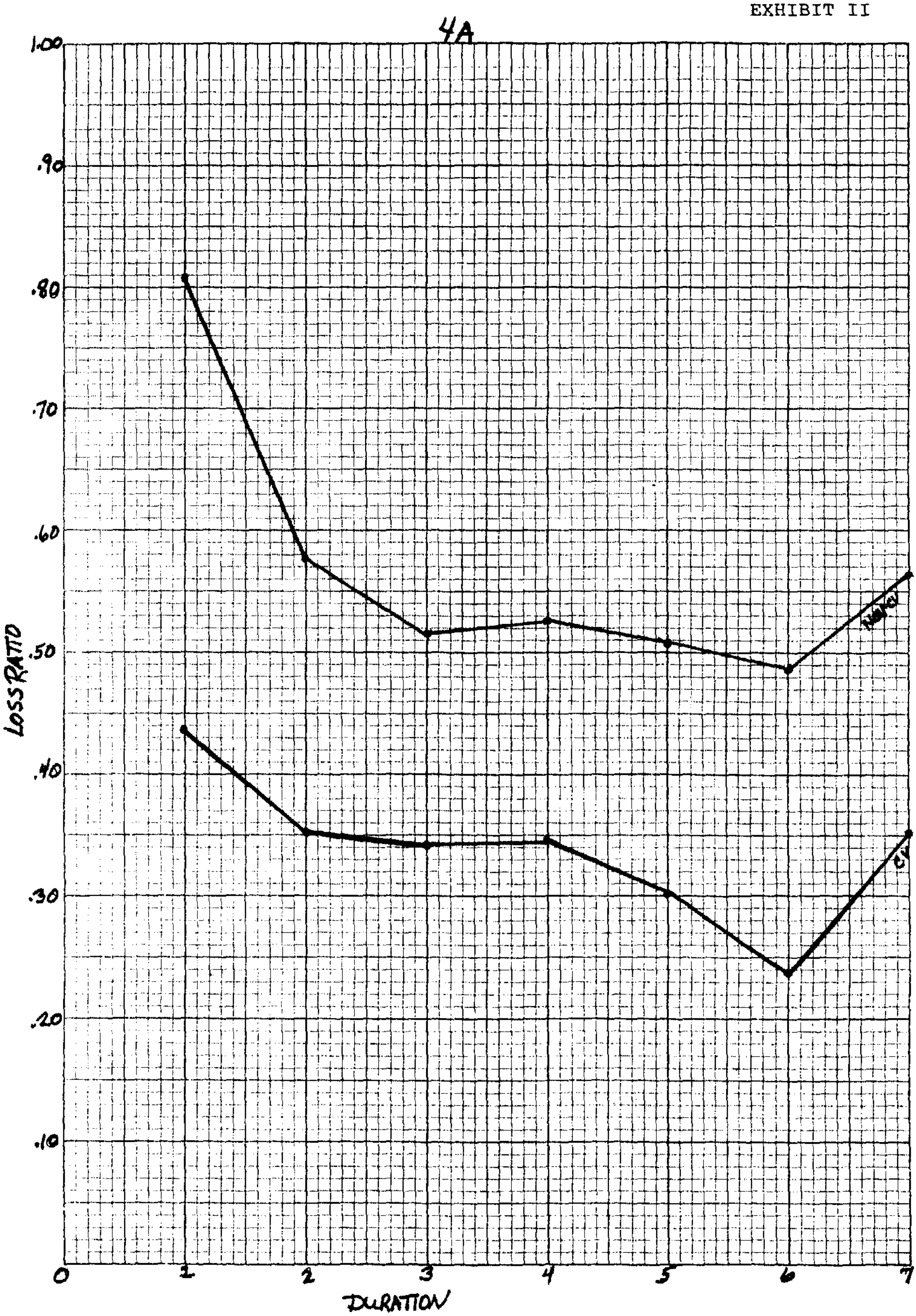
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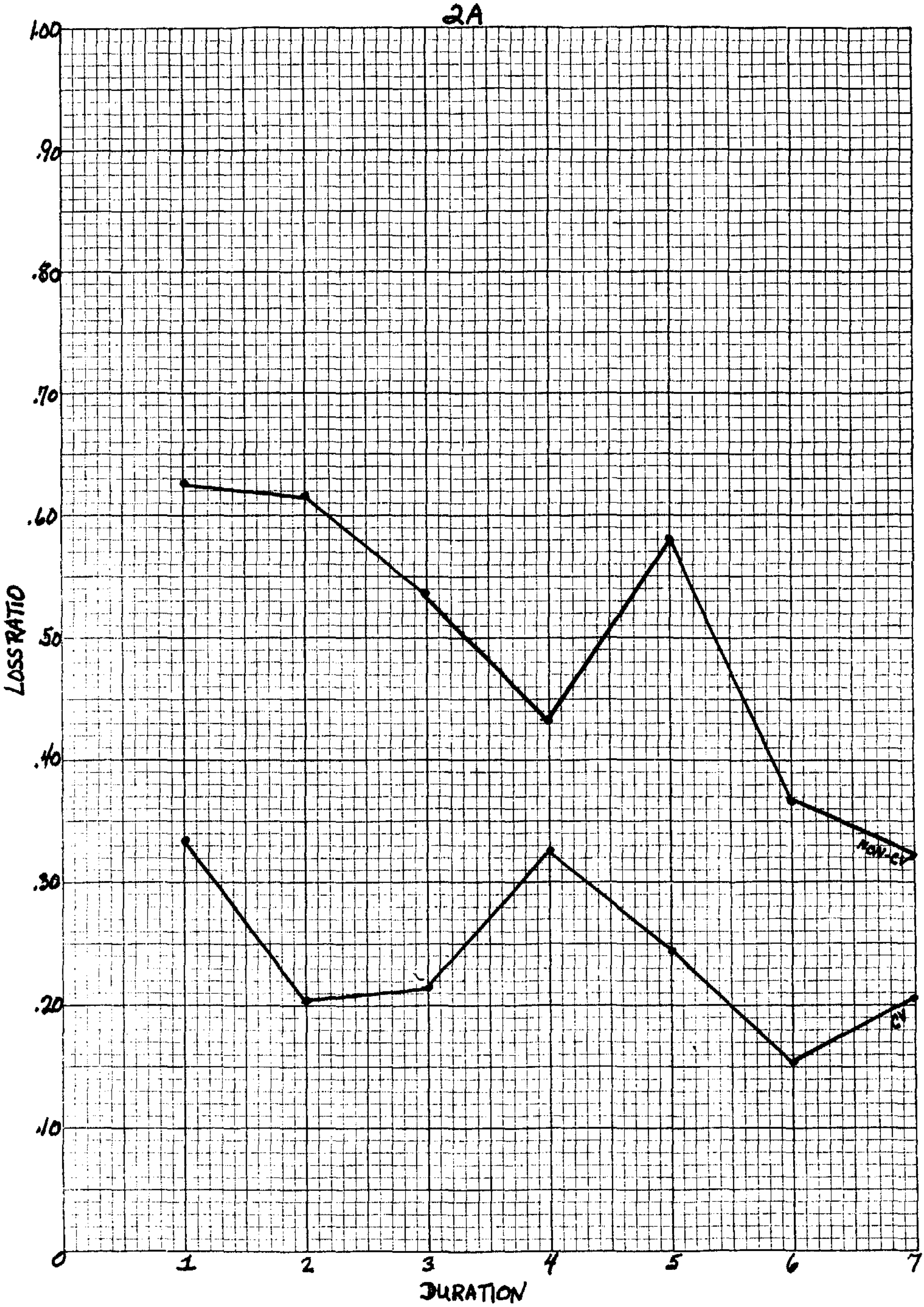
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EXHIBIT IV

150D/160D

Ratio of Cash Value A/E to Non-Cash Value A/E

Male 4A

Exposures: Cash Value 63506.0
Non-Cash Value 94085.3

	Accident	Sickness	Total
Frequency	.64	.69	.67
1 Year Average Claim	.82	1.12	.95
1 Year Claim Cost	.53	.78	.63
1 Year Continuance	.69	1.15	.96
1 Year Continuance Cost	.44	.80	.64

Female 4A

Exposures: Cash Value 6193.5
Non-Cash Value 21405.0

	Accident	Sickness	Total
Frequency	.52	.68	.62
1 Year Average Claim	1.10	1.14	1.12
1 Year Claim Cost	.57	.77	.69
1 Year Continuance	1.02	1.35	1.20
1 Year Continuance Cost	.53	.93	.74

EXHIBIT V

150D/160D

Ratio of Cash Value A/E to Non-Cash Value A/E

Male 2A

Exposures: Cash Value 18402.2
Non-Cash Value 26536.3

	Accident	Sickness	Total
Frequency	.43	.52	.45
1 Year Average Claim	.90	1.47	1.21
1 Year Claim Cost	.38	.76	.54
1 Year Continuance	1.16	4.60	2.87
1 Year Continuance Cost	.49	2.42	1.29

Female 2A

Exposures: Cash Value 17298.8
Non-Cash Value 39737.8

	Accident	Sickness	Total
Frequency	.47	.56	.53
1 Year Average Claim	.71	1.10	.96
1 Year Claim Cost	.32	.61	.50
1 Year Continuance	.50	1.25	.93
1 Year Continuance Cost	.22	.68	.49