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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. PAUL R. FLEISCHACKER: Over the years, and particularly during the last decade, many factors have influenced the disability income marketplace. These include, among others:

- High inflation

- High unemployment

- Federal government laws and regulations in such areas as:

  - Pregnancy discrimination

  - Age discrimination

  - 501 (C)(9) Trust Regulations

  - Social Security changes

- State government regulations, such as

  - State disability benefit law changes

  - Minimum loss ratio requirements

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- o Intense competition

- o New innovative products such as social insurance riders, residual disability benefits, income replacement, and cash value riders. I should point out that some of these are not so new, just not widely adopted yet by the insurance industry.

What has been the effect of these factors on the design and marketing of disability income products? What is the prognosis for the future? Is there too much government regulation? Or too little? Will Social Security continue to erode the lower to middle income market? What markets will likely be available five years from now? Ten years? And what products will fit these markets?

These are just a few of the key questions that company management needs to address in order to operate effectively and profitably in this market.

To provide us some insight (and hopefully some answers) to these questions, the panel members have agreed to present their thoughts on marketing and on their company's experience in a number of these areas.

Our first panelist is Barry Reynolds. Barry has been employed in the insurance industry for over 16 years - most of that time with his current employer, Confederation Life. He is currently Administrative Vice President, Group Insurance. His responsibilities include group underwriting of new and renewal business, pricing, product development, issue, and general group administration. He has a B.A. degree from Queens University and is a Fellow of the Life Management Institute.

MR. T. BARRY REYNOLDS: My part of this panel is to talk about the "true" group and multiple employer trust aspect of disability income marketing in Canada. I have defined "marketing" in the broadest concept to include all phases of the distribution of the product, rather than the very narrow definition of sale.

Some of my comments represent personal views on the subject; however, most of the information relates to Confederation Life's experience as a major insurer in Canada. For your information, a measure of our size would indicate we are either the first or second largest disability income underwriter in Canada, depending on your basis of measurement.

TRUE GROUP

Confederation Life is a fairly conventional underwriter of short term disability products offering virtually a full range of products consistent with market requirements. Most of my comments deal with long term disability coverage, but apply equally well to both short term and long term coverage. Where they specifically refer to weekly indemnity coverage, I will highlight this.

1. Market Identification

   Confederation Life deals mainly (95%) through brokers or consultants. We specialize in larger groups (over 200 lives) because our feeling is that these groups illustrate more loyalty in "bad times", as well as avail themselves of professional examination of their benefit structure. As such, while they may exhibit unusual administration problems, they are easier to deal with from a marketing and underwriting point of view.

I am not advocating that all of you should only underwrite large groups. On the contrary, the public would not be well served if all insurance companies carved out the same portion of the market on which to concentrate. This was Confederation's marketing decision of the late 60's and early 70's. It certainly is not the only marketing decision, nor necessarily the right one. Another factor leading to our decision is that because our individual agency force is quite small, we do not get much demand to enter the small group market.

With respect to long term disability, we have identified some general characteristic of groups which may represent special problems. Unless there are some mitigating circumstances (e.g., past experience, written as a package with life and health coverage, etc), we do not underwrite groups having the following characteristics:

a) The additional overall loading of the premium rates due to the industry involved is 50% or more;

b) More than 10% of the employees in the total group have an industry loading of 100% or more;

c) The number of unskilled workers is more than 25%;

c) The group has an annualized premium in excess of $500,000.

Some of you may disagree with this list since there is a "technically correct" rate for any risk. I, however, am a practical underwriter. Through investigation I have found that as the number of people subject to large industry loading within the group increases, the more chance of fluctuation there is in the rate which will ultimately support the risk. Hence, we are no longer talking about small surpluses and small deficits; and, when you deal mainly with experience-rated business, you are talking about large losses.

This argument justifies the elimination of groups with the first three characteristics above. These first three characteristics are simply a result of applying information I have learned through the school of "unsuccessful underwriting". The last characteristic implies a limitation of the liability we are willing to accept. However, it is included because I have also found that the larger the size of the group involved, the more diverse the physical locations become from management, and generally the incidence of disability increases and recovery rates decrease.

2. <u>Product Selection (Including Benefits and Contractual Obligations)</u>

With respect to short term disability, we are a relatively standard underwriter as dictated by the brokerage or consulting market. We have no unusual contract provisions. Our main concern is that the level of benefit is reasonable in relation to an employee's salary and that a corridor between the after-tax-benefit and the after-tax-salary exists to encourage return to work.

Under the long term disability benefit, we are obviously much more concerned about contractual wording in view of the significant risk involved. In addition to the control of benefit level mentioned above, we also are concerned about the definition of disability for "unskilled" employees. Generally, we use a split definition of disability whereby skilled employees have an "own occupation" definition of disability for the first two years of payments while unskilled employees use an "any occupation" definition of disability. I have used the term "unskilled" rather than "hourly" or "blue collar", since we have found that many hourly and blue collar workers are definitely skilled employees.

In underwriting the benefit, we have not found it necessary to employ any specialized clauses with respect to alcoholism, drug addiction, or mental and nervous disabilities, unless specifically requested to do so. Our concept is that disabilities resulting from these causes are genuinely disabling and that no special wording is required as long as the insured is under the care of a physician and adhering to a form of treatment with which we agree.

We will enhance our normal long term disability product with such frills as scheduled cost of living increases (usually based on the Consumer Price Index), and we have even offered a survivor benefit rider which continues payment for 24 months beyond the death of the disabled employee.

3. Prospecting

As mentioned previously, my Company does not prospect for group business in the normal sense of the word. We deal mainly through brokers and consultants, and our sales force is in constant contact with the major brokers and consultants throughout Canada. As a major underwriter and administrator of disability income benefits, we would expect to be asked to provide a quotation on any significant case. Again, since we do not have a large individual agency force to appease, we only need to react to their requests as we would to a broker or consultant.

4. Underwriting

Since the group here this morning is all actuaries, you probaly all feel that you can underwrite the benefit much better than we poor laymen. I am not here to tell you of your misconceptions, so let me only indicate where Confederation Life may vary from other underwriters.

Confederation Life strongly emphasizes industry loadings and discounts to our standard table of rates. We endeavour to break the group into segments, assessing each segment its proper industry loading. Because of this, we have had questions from the consulting market regarding the variation in our rate structures for groups which seem to be similar in size and industry. However, this is usually a reflection of a different make-up within the group.

The other major factor which we take into account on large cases is the past experience under the plan. We have found this a very effective indication of what to expect in the future. The past experience is a combination of all the underwriting factors, as well as the attitude of Company management towards disabled employees. I personally believe this attitude has a large effect on the overall cost of the plan.

5. The Sale

At Confederation Life, although we are not all members of the sales area, we all consider ourselves members of the marketing team. Our concept is such that in-house personnel are quite often involved in the sale of the product at all stages. Underwriters are involved in presentations to clients; administrators are involved both through general administration and claims administration; and rehabilitation personnel are involved wherever possible.

Confederation Life tries to establish a liaison with the employer in the hope that this will establish a smoother administration system both for general administration problems and claims administration problems. A liaison will also make the employer aware of our concern about the role of the policyholder in the on-going success of the program.

6. Administration

The two facets of administration are general administration for premium billings, eligibility, etc., and claims administration.

We offer the policyholder either a self-administered or a direct billing system. Most large clients are involved in self-administration. Indeed, 90% of our premium income is self-administered business. Our administrative supervisory personnel are in touch with our major clients' administrators on a periodic basis in an attempt to iron out any small problems that might exist before they become larger.

Claims administration is much more important not only to the financial success of the program, but to the moral success of providing the needed benefit with as little trouble as possible. As with most insurers, claims are initially submitted through the policyholder and are comprised of a claimant's statement, a doctor's statement, and the policyholder's statement. These claims are reviewed by a specialized disability claims reviewer who has access to staff doctors for any opinions that might be required. The claim is automatically reviewed from a rehabilitation point of view, and possible rehabilitation candidates are referred to a rehabilitation committee comprised of the claims reviewer, a doctor whose specialty relates to the disability involved, a rehabilitation counsellor, and the Department Manager. While the number of claims that actually undergo a rehabilitation program is relatively small, the potential savings to us, and eventually the client, is considerable.

7. Experience Results

Because of the type of plan usually underwritten, we have a large amount of business which is either partially or fully experience-rated. The term fully experience-rated is self explanatory and needs no elaboration; the system of partial experience-rating used by Confederation Life employs a "years of experience rating" concept, rather than the "large amount" concept.

For an experience-rated case, we feel it is our responsibility to report fully to our clients. We submit a financial report outlining the factors which affect the overall surplus under the plan including the premium, cash claims, unreported reserve requirements, detailed and aggregate disabled life reserve requirements, pooling charges, if any, interest on reserves held, administration charges, taxes, and commissions, if any. As part of our marketing concept, we endeavour to meet with all our large clients to explain the details of the plan's operation and to discuss on-going experience trends, either good or bad.

As far as Confederation Life is concerned, the experience results of disability income are quite gratifying. Naturally, we have had bad years, but generally both short term and long term disability coverages have resulted in overall additions to our surplus structure. Long term disability provides us with constant concern because of the wide fluctuations that can be involved. We also remember the experience of the industry in general, and of our own in particular, in the late 60's and early 70's.

My final comment on experience deals with persistency. From a general health point of view, we have a lapse ratio in the area of 2% to 3% of in-force premium, and there is no reason to suspect that disability income is any different from this general average. We feel that this is an extremely satisfactory position and is a result of our overall marketing (in broad terms) effort.

MULTIPLE EMPLOYER TRUSTS

My Company is not heavily into multiple employer trusts. Our ventures into this market have generally not been successful in the disability income field.

One of the major problems that we have found has to deal with the general administration capabilities and the overall strength of the employer association. Without a strong central driving force, the success of the multiple employer association is limited. The other major problem has to deal with the setting of rate structures. Larger members of the association expect rate structures set on their own group's characteristics and experience. The experience of the larger members generally influences the rate structures which are given to other members. As smaller individual member companies obtain quotations outside the association, the good risks leave and the poor risks stay. As such, the costs tend to spiral, and the association breaks up.

However, many believe that multiple employer associations can be successfully underwritten. This being the case, the standard concerns of market identification, underwriting, and administration mentioned previously would be applicable.

MR. GERALD S. PARKER: How do you determine who is skilled and who is unskilled for purposes of your "own occupation" definition of disability, and how do you identify them?

MR. REYNOLDS: Generally, we feel that an employee who requires a training period of six months or more fits into a "skilled" category. The "unskilled" category includes fairly basic laborers such as a janitor or chauffeur. We let the employer identify which employees fit into each class and list them in the policy. We review the list to see whether we are in agreement.

MR. DANIEL L. WOLAK: In studying TSA reports, one of the biggest factors in weekly disability other than age and sex seems to be the size of the group. As the group size increases, the experience gets worse. Do you feel that size is a factor in disability income, or do you feel that industry would be a bigger factor?

MR. REYNOLDS: I don't know which is a bigger factor, but they certainly are both factors. As I indicated with regard to long term disability, once we get over half a million dollars, we have to have some other reason, such as past experience, available before we will underwrite it. And when we are dealing with short term disability, we are almost always looking at past experience.

MR. FLEISCHACKER: Confederation operates in both the U.S. and Canadian markets. In comparing the two markets, is there any significant difference in the products that are offered or in the funding vehicles that are used? For instance, is there more trust business or self-insured business in Canada? Are there differences in benefit design?

MR. REYNOLDS: Undoubtedly, there is some difference in design. I deal only with the Canadian operation, but in talking to some of my colleagues, there are some obvious different designs with regard to Social Security programs versus Canadian Pension benefits. The type of market that we have carved out for ourselves is somewhat different in the United States because of our relative size. We are probably five to six times bigger in Canada than we are in the United States and hence can accept a bigger risk. We operate essentially as two separate companies when measuring profit.

MR. FLEISCHACKER: Our next speaker is Ray Drury. Ray is the Assistant Vice President and Director of Group Sales for the Hartford Life Companies. He has been with the Hartford for over 10 years. His responsibilities include managing all four sales areas of the company, recruiting, training, and maintaining large risk accounts. He is a graduate of Williams College.

MR. FOSTER R. DRURY: The main message that I will attempt to deliver today is that in group disability in the United States, there is only one game in town - long term disability (LTD). Short term disability is price driven and, as such, will seek its own level. Group mortgage disability on the other hand, has been controlled by statutory provisions and is limited to those few companies that have the data processing capacity to handle the incredible detail required.

GROUP DISABILITY

Hartford Life has written nominal amounts of short term disability with the exception of disability benefit life (DBL) in New York State where we have a market share in excess of 8%. We have made a concerted marketing effort in LTD over the past 5 years and, at the end of 1980, ranked third among all carriers in terms of new LTD group contracts issued. As a matter of fact, 45% of all new business written by the Hartford contains LTD. We market through independent agents and brokers with full product line covering groups from 10 lives up, although our primary market is from 100 lives to 5000 lives.

Short term replacement has traditionally been aimed at the blue collar wage earner, where the employer's goal has been to meet the short term need not filled by Social Security benefits. This market has been shared over the years with salary continuation plans and with statutory plans which exist in five states and Puerto Rico. Three of the five states, Rhode Island, California, and New Jersey, are either virtual monopolies or so restrictive that insurance company writings today are virtually nonexistent. However, in New York State and Hawaii, statutory requirements have been more of a stimuli to growth than a limitation to the private sector.

Hartford, for example, has over 30,000 policyholders for DBL coverage in New York State. Part of this success can be traced to our property and casualty sister companies where we write workers' compensation. This natural tie-in has been very beneficial to our marketing effort.

Short term benefit design, be it statutory or otherwise, has been relatively stable with first day accident, eighth day sickness, being the predominate waiting period, and 26 weeks being the standard maximum benefit duration. Maximum weekly benefits are still typically less than $250, but the trend here is toward weekly maximums of up to $500.

Although underwriting concerns have been mostly related to type of industry and benefit percentages, this coverage can be subject to much abuse in certain cases. This abuse can best be controlled by the policyholder through aggressive follow-up of disabilities by a company registered nurse or similar personnel. Some policyholders have even resorted to plan designs which pay "bonuses" for early return to work. But, as you can see, part of a successful marketing strategy is to ensure that your field force understands claim control and imparts both the method and reasoning to their clients. In short term disability there really is not a lot of concern over the definition of disability or over pre-existing conditions. Nor is integration normally a problem since less than 4% of all policyholders in the United States have short term disability plans in excess of 26 weeks. This coverage lends itself to simplified renewal rating by formula, and because of its relatively stable plan design and predictability of experience, this coverage has been very profitable to the majority of carriers. But for these very same reasons, it is a line of coverage which is being increasingly self-insured by more and more employers.

LTD, on the other hand, has traditionally had as its primary market the white collar salaried employee whose employer has sought to supplement the floor of protection provided by Social Security. Here, the private sector has enjoyed a virtual monopoly with salary continuation programs and self-funded programs being almost nonexistent, except for some of the very large companies which do self-insure or partially self-insure. The most common approach is to self-insure the first 3 to 5 years of the benefit period and to insure thereafter, with the carrier handling claims from the onset of disability - in other words, a limited Administrative Service Only (ASO) upfront. Even those policyholders who go totally self-insured usually retain a coverage on an ASO basis for claim handling and rehabilitation.

One of the current problems in LTD is the "blurring" of the distinction between "technical" employees who traditionally were considered blue collar workers and who are now often more similar to professional white collar employees. The real difficulty lies in being able to discern which is which.

Benefit design typically incorporates a six month waiting period, although current trends indicate a rapid growth in plans with a 22 week waiting period (as a logical tie-in with Social Security). Until the Age Discrimination in Employment Act (ADEA) passage, the almost universal standard for benefit duration was age sixty-five. Plan design typically defined disability on a split basis (two years "his" and "any" thereafter), although there are carriers writing both extremes ("his" to 65 or "any" from inception). Offsets are another design area where great variety exists, with offsets typically being full family Social Security offset, full workers' compensation offset, and full offset for other employer sponsored disability programs. Variations on this range from primary only Social Security offset to no offset from any source. Maximum benefit amounts range from $2,000 per month up to $10,000 per month, with benefit percentages ranging from 40% to 70% of income.

Typically, "Social Security freeze" is included in plan design - particularly now that many states have mandated this benefit. Rehabilitation benefits are also quite common. The level of expertise in administering this benefit is absolutely critical to the profitability of this line of business. No carrier should ever entertain the thought of entering the LTD market without thoroughly trained claim personnel knowledgeable in rehabilitation techniques and methods.

Underwriting of LTD must be partly financial in nature, i.e., the risk in poor financial condition, or in a declining industry, is not a good risk. There is always a lot of conversation over what is a good size for LTD coverage. While there may be some dispute about how small a group can be before you worry about adverse selection, there is general agreement that the larger the group, the poorer risk it is due to: a greater tendency to use LTD as an early retirement benefit; less concern of the employee about taking advantage of the employer; and the likely lower perception of employees in the larger companies (as compared to smaller companies) of being more important, if not irreplaceable, and thus being more eager to return to work.

Therefore, proper underwriting of LTD is the real key to this coverage. However, unlike individual disability coverage, the moral/ethical problems are not of great concern due to the ability to integrate benefits from various sources under the group approach. Other than financial, underwriting normally centers around adverse selection or pre-existing conditions. Protection against this is imperative if a carrier is to be financially successful in this market. Complete awareness by all parties concerned - home office underwriters, field sales people, brokers and clients - is essential. The larger the risk, the more critical the waiver of premium condition limitation becomes. Although a no loss - no gain approach is often used for current employees in a take-over situation, complete elimination of pre-existing limitations for future employees is not recommended.

Blue collar workers present special problems, particularly when the percentage of blue collar workers exceeds 20% of the total group to be insured. The combination of occupational exposure, a lower proclivity towards a return to work, a tendency to stay on claim longer due to limited job experience, and a lower success rate in rehabilitations attempts are some of the problems associated with blue collar workers. Most carriers, therefore, either limit the percentage of blue collar workers they will cover (i.e., not more than 20%), use a restrictive definition of disability, and/or limit the duration of benefits to 5 or 10 years.

LTD is a volatile coverage heavily influenced by economic conditions, particularly in certain industries where a decline in employment could lead to employees attempting to use LTD as an early retirement benefit or as an unemployment benefit. LTD is difficult to renewal rate by use of a formula since a longer period of time is needed for experience to develop.

On the other hand, LTD can be a profit maker. LTD requires relatively large reserves which currently generate investment income far in excess of valuation interest rates. Also, the low paid claim loss ratios which occur while the plan is maturing result in substantial positive cash flow amounts. Persistency also tends to be higher in LTD than in other group coverages. LTD definitely can be a profit maker. But, I must emphasize the need for both home office and field underwriting expertise to avoid severe losses and, of course, the need of adequate "spread of risk" to avoid problems of extreme volatility.

Three pieces of federal regulation have had a profound effect on disability coverages over the past five years. These are:

1. ADEA

2. Pregnancy Amendment to Civil Rights Act

3. 1976 and 1980 tax reforms

ADEA basically prohibits unequal treatment in employer sponsored income replacement benefits, except on a cost justifiable basis. ADEA has had little effect on short term disability since benefits traditionally have not been modified based on attainment of any specific age. It is noteworthy, however, to point out that if an employer has a non-insured "sick leave" program, benefit reductions due to age are considered not cost justifiable and, therefore, illegal. But insured plans can contain cost justifiable benefit reductions based on age and be "legal".

ADEA has had a very substantial effect on LTD since benefits typically ceased at age 65 on a basis not considered cost justifiable. As a result, several alternatives have been developed ranging from full coverage to age 70 (expensive) to graded plans where benefit duration decreases for disabilities commencing after age 60 (less expensive). This latter approach seems to be the most common approach. Regardless of the approach offered by carriers, although there are no firm statistics, it is estimated that at least 35% of all policyholders in the U.S. have not elected any form of conforming coverage.

The pregnancy amendment required benefits for pregnancy to be the same as any other illness for weekly disability (WD) and LTD plans. Inequality of benefits is an illegal form of sex discrimination under this amendment. This amendment worked the reverse of ADEA in that it had a tremendous effect on WD plans in terms of cost and only a minor effect on LTD plans. To bring a WD plan which had no prior maternity benefits into compliance, 20% loads were commonplace. For WD plans with the previously prevalent 6 week benefit, increases of 10% were the rule. Estimates of compliance are again that over 30% of all policyholders have not elected conforming coverage. LTD was only slightly affected. Practically speaking, the affect is limited to plans with benefit waiting periods of three months or less. The overall effect on premiums seldom reaches 5%.

Tax legislation ramifications for disability income began in 1976. The 1976 tax reform act had the affect of making virtually all employer sponsored income replacement benefits subject to federal income tax. However, this act provided no vehicle for enforcing taxation. The employee, in effect, had to take the initiative in reporting applicable disability income.

However, in 1980, the passage of HR 5505 provided the means of enforcing taxations via:

1. Optional withholding at the employee's election

2. Requirement that third party payors report disability payments to employers

3. Requirement that employers compute taxable portions of benefits and include this amount on the W2 or Supplemental W2.

This applies to all payments made on and after May 1, 1981. The basic concern for all carriers is, and has been, their ability to correctly track, record and report disability payments. Multiple employer trusts are of particular concern due to the multiplicity of units and the prior lack of identification of individual employer unit mechanisms.

How does one market disability income on a group basis? The WD and LTD lines are seldom packaged together, but very often are written on a monoline basis. WD, because of its stability and predictability, is price driven and is more and more often self-insured.

However, LTD is another thing altogether. The marketing thrust is selling the concept of expertise in claims handling, rehabilitation, and underwriting. Emphasis on the stability of the insurance carrier is critical since so many carriers have marketed LTD aggressively for years only to withdraw - or retrench later. The Hartford is proud of its continued growth and the fact that we never have had an overall LTD rate increase. On the other hand, this market is not price driven. I will state emphatically that it is underwriting expertise, not price, that will determine not only your marketing success, but also your financial results where LTD is concerned. In order to be profitable in LTD you must devote adequate resources and market the product aggressively.

If you look at the LTD results in the United States, the results are very good for those companies which have been aggressive, and the results have been poor to disastrous for those companies who have entered the market on an accommodation or half-hearted basis. In other words, those carriers who have decided to approach LTD as a viable product line, rather than a collateral line, have developed the necessary expertise, management information systems, etc., to properly manage the business to make money. Those who have treated LTD as an accommodation and have not developed the expertise have had poor to disastrous experience.

The future for LTD is basically excellent due to:

1. A declining work force which should lead to reduced unemployment.

2. A very probable restriction of Social Security payments levels.

3. Increasing awareness by the public of the value of LTD coverage.

4. Increasing use of employee paid, but employer sponsored, plans.

However, every sky has a dark cloud somewhere, and, in this case, it is the danger of indexed benefit levels. This is a very serious concern for anyone in, or anyone considering entering, the LTD market. Inflation is today an excellent motivation for rehabilitation and a return to work. If indexed benefits become prevalent and reduce this motivation, disability experience is apt to deteriorate substantially. But overall, group disability coverages have, and will continue to have, a very bright future in the United States employee benefit market.

MR. DUANE KIDWELL: We do not have a great deal of group LTD - about 10 million dollars a year in premium. We do not experience rate any of our group LTD. Do you at the Hartford? If so, do you combine it with life and other health care for experience rating, or do you treat it as a separate contract?

MR. DRURY: Unlike Confederation Life, we only experience rate about 3% of our book of business. We find that those who are large enough to experience rate have much greater proclivity today to want some form of self-insured mechanism - such as five year waiting periods or some form of a deposit administration agreement in which we pay interest on the reserves.

MR. KIDWELL: Have you found any of your larger clients expressing an interest in going ASO on it?

MR. DRURY: Absolutely. I suspect that we get two to three requests a month for LTD ASO. Believe it or not, some of them come to us on a monoline basis - strictly for the service. It would be a very big mistake for any of us to overlook the marketplace of selling services as opposed to selling something that is insured. Who else has greater expertise in LTD, claims and rehabilitation work than us (the insurance industry)?

MR. KIDWELL: I was very interested, too, in your comment that you should not enter group LTD business without full dedication. Of course, you should not do that in the individual LTD area either. You further mentioned that you must also have an expert in rehabilitation. Rehabilitation in individual disability income is not that highly specialized yet. Do you think that the group area is far ahead of the individual area as far as performing the proper rehabilitative services? I agree with you that there should be more than just paying the claims; you should encourage and help somebody to get back to a productive life.

MR DRURY: I have to answer that two ways. Yes, I think the group industry is somewhat ahead of the individual. In addition, the Hartford has a somewhat different position in that we can benefit from the property/casualty company with which we are affiliated. They are far in advance of either individual or group in terms of rehabilitation abilities and years of experience, and we have been able to take advantage of that.

MR. PARKER: My question is in somewhat the same field. Can you make an estimate of the number of approvers or investigator types that you have related to the number of claimants or certificate holders at any time?

MR. DRURY: As far as pure rehabilitation people, I think we have 14 in the United States. I am not sure how that would translate to certificate holders. But, the one piece of information that might be more applicable here is that last year they had 14 successful hits on rehabilitation. While it does not sound like a very big number, it can translate to a large amount of incurred claims. There is also a fallout benefit in that sometimes your rehabilitation efforts permeate the rest of the employees for an employer, and, as a result, some people do not go on claim - they get better all of a sudden.

MR. FLEISCHACKER: Our final speaker is Gerald Parker. Jerry has been in the insurance business since 1938 - the last 30 years with the Guardian Life Insurance Company. His current position is Vice President, Health Insurance in charge of the individual health insurance operations of the company. In 1976, Jerry received the Harold R. Gordon Memorial Award, Health Insurance Man of the Year. In addition to his duties at Guardian, he has served on several HIAA Committees over the years, some of the recent ones being chairman of the Federal Affairs Committee of the Disability Committee and member of the ACLI Social Security Task Force. He is a graduate of Williams, a CLU, and RHU, and a Lieutenant Colonel in the active military reserves.

MR. PARKER: I did not plan to comment on what the Guardian's job is and what we do in individual health. But, perhaps a quick note. Our basic market is business and professional people, with more emphasis on the business side than the professional side. Our two main products are long term noncancellable and long term guaranteed renewable policies. They are identical except for the pricing and the renewal provision.

Individual Disability Income Sales

Talking about the problems of managing an individual disability income business to members of the Society is an interesting experience for a generalist like me, but I think that the managing of such a business may be an equally interesting challenge to the actuary. There are two reasons. The first is that the variety of coverages that must be offered in the marketplace, and the need to frequently update them, produces cells of exposure that tend to be too small for precise analysis. You must, therefore, substitute a certain amount of intuition derived from operating experience. The second reason is that the absolute key to success in this business is understanding the marketing problem and successfully dealing with it. Not everyone is comfortable in these circumstances, and I confess that I have some uneasy moments myself. This is not made any easier by the fact that the importance of marketing has really been recognized only in the last five or six years. For the 25 years before that, there was the spectacle of company after company deciding it was going to get rich in the disability business by copying the policy forms of its major competitors or worse, those they considered the "leaders", cutting the price 10%, and setting forth to do battle. And most of them made money that way for years.

All that ended sometime in the middle '70's. The constant pressure on premiums and coverages over that 25 year period combined with changes in the economic pattern and the sudden and dramatic enrichment of social insurance programs produced loss ratios in the 60% and 70% and 80% range on coverage and pricing combinations that only recently had 30% loss ratios. The anguish which ensued is well known, and there have been some departures from the business.

Market Identification

What, then, is the manager to do and how is he to deal with the present? The first step is market identification. Each of us needs to know who he is, what his company is in business to do, and who it does business with. That means we must know our field force. Is it full time career organization? Is it broker? Does it deal with people earning $15,000 a year or $100,000 a year? What else do we sell besides disability insurance? To whom do we sell it? What is our main line, and what's the subsidiary line?

The answers to all these questions are crucial to the development of a successful product. They affect claim cost assumptions, interest rate assumptions, lapse rate assumptions and so, of course, expense rates. A product that can be successfully sold and administered in a medium income blue collar market or a low to medium clerical/middle managment market will differ dramatically from one that is suitable for the professional or business owner market.

It is perfectly obvious that the persistency of the product in these markets is going to be very different. But so are a lot of other things such as average premium, mode, claim rates, job motivation, attitude towards the insurance business, contentiousness, needs and, in particular, the merchandising and field compensation situation which presents a most interesting dilemma, particularly in the markets that have inherently high lapse rates and low average premiums.

Anyone who undertakes to thread this jungle and come out of it with a loss ratio that will satisfy the regulators, a compensation scheme that will satisfy his field force, and an expense ratio low enough to produce a reasonable profit (especially considering the investment needed to set up the operation or even to keep it up) has a challenge on his hands. More and more sophisticated computer systems are needed to administer and analyze our business. They get more costly, and their lives shorten. As our margins are squeezed, an adequate return on that investment gets harder and harder to achieve.

Prospecting

Prospecting, as it has generally been done in recent years, involves all the same old methods that have been used for generations in both individual life insurance and disability income insurance. They include cold canvas, referred leads, nest markets, and salary allotment (which comes up every so often in every company - usually with a new name so that people will not remember the last time it flopped). You have heard them all many times.

There have been some new prospecting methods developed in the more sophisticated markets in recent years. In the area of business insurance marketing, one of the more interesting things being tried is the seminar selling approach. This includes variations on the old center of influence method under which you get the attorney or CPA so sold on your idea that he will get you in front of his client with a favorable recommendation. Now, efforts are being made to do it on a mass basis.

Sales

Once again, the basic personal disability income sale has not changed a bit.

The agent builds up the idea that everything the prospect owns depends on his income. Then he knocks out the income to demonstrate the need. It can be done in all kinds of sophisticated ways and all kinds of simple ways, and it still works.

It is complicated now by the very large social insurance benefits that are available in both the United States and Canada. I am more familiar with what is available in the United States than I am with the Canadian scene, but it is possible for a disabled person to obtain social insurance benefits from workers' compensation or Social Security or no fault auto insurance or what have you of around $1,000 a month, maybe a little more, maybe a little less. That cuts into the market pretty heavily when dealing with people earning less than about $25,000 a year. We have some solutions to that problem, or at least I think we have, but they do complicate it. And they are more difficult and less exact than is possible in group long term disability.

The sales process gets more interesting for tax dodges such as the salary continuation plans, business and professional overhead insurance, and key man disability income insurance. An agent operating in the markets for those products has to know a fair amount about the tax laws and their affect on the plans he is promoting. But this is where the big bucks are.

Multiple Policy Sales

Although the topic here is individual disability income insurance, it must not be thought of only as single policy sales. At least in the more sophisticated markets, there are often multiple policy sales. Guardian has one case on the books with more than a hundred participants in a salary continuation plan insured by noncancellable disability policies. A case like that is not put together easily, but it is worth it when it is nailed down. That case produced over $100,000 of annual premiums. It is routine for a business buyout case to produce $10,000 of annual premiums.

Underwriting

Underwriting disability income involves most of the same old tradeoffs such as the cost of a medical examination and inspection against the potential savings and/or losses, the training of underwriters to do a physical profile underwriting job quite different from what is required for underwriting life insurance, and the addition of sophisticated financial underwriting requirements, if your market includes business insurance.

For instance, underwriters are needed with the equivalent of a CLU business insurance, accounting, and taxation education in order to successfully underwrite the business buyout. The underwriting problem has become more difficult and more demanding by far in recent years. Up to $1,000,000 of disability benefit exposures are now accepted on a single life, and that is not to be looked at casually. People you can trust with risks of that magnitude cannot be trained overnight. When working with people whose earnings justify that kind of thing, there are also net worth problems, motivation problems, and questions that are almost impossible to answer.

Administration

The administration problems that arise in the disability income business are very much like the ones that arise in life insurance. The same things must be done:

- put it on the books
- record the exposures (so they can be retrieved some day)
- bill it
- conserve it
- pay the commissions
- lapse it
- terminate it at expiration date

There are some special problems. One of them is the need to update coverage. It is a combination of a conservation problem and an updating problem. Some way of adding coverage is needed, either by use of attained age add-ons, conversions, or what have you. The cost of living benefits and future increase options are becoming essential in these inflationary times. They are expensive to administer, unless planned very carefully, because the additions are usually in small increments. It is essential to be able to do them for less than it costs to put a policy on the books. A big policy fee cannot be charged each time. Computerization costs again!

Other problems arise from the constant changes in product. This is a highly competitive and highly innovative business. At Guardian, we try to get five years out of a product line. Sometimes we succeed, sometimes we do not. The administrative system must be able to identify the changes in coverage in the exposures and also to combine selected coverages with only modest changes to obtain some sort of reasonably homogeneous experience for claim cost analysis.

Continuation of benefits after a set age limit on the basis of continued employment is a problem that has to be administered, if you do it.

And one particularly difficult, and not to be under-estimated, problem is training your claim department over a period of years to be familiar with perhaps six to eight different sets of policy terms that may have been sold over the working lifetimes of the presently insured population.

Experience Analysis

The problem with experience analysis must be dealt with in close cooperation with the solution of the problem of administration. What is analyzed is what was just administered. The product and its experience must be able to be analyzed in spite of constant product changes.

A great many things affect the experience on this complex product. It must be analyzed by every reasonable combination of the factors that affect it. It is quite unlike life insurance where the primary factor obviously is age and other factors such as occupation, policy size, socio-economic status and even sex have much less marked influences than the major one. Here the analysis must be on the basis of market, age, sex, occupation class, and most importantly, experience by agency and by agent. Common occupations must be tracked. Both persistency and claim costs are needed for all these breakdowns. The experience on the standard business, on substandard business by impairment class, and on the more common impairments must be known. Claim rates and severity are required to get claim costs, and it is difficult to analyze severity. Most claims are going to be settled in the first year after the incurred date, and most of the rest of them will not last two years. The Society of Actuaries' studies demonstrate that the experience of even the largest carriers beyond the end of the first year of disability is thin. But one long term claim can be worth a half million dollars. Most of us are writing long term disability with very high limits as though we knew everything there was to know about it. We do not. Half of what we are doing is hope. Hopefully, the other half is conservatism.

I wish I could tell you Guardian has all of those data. We haven't. We still rely heavily, too heavily, on intuition and operating experience. But we are getting there. I hope some of you have some ideas that will help.

Finally, as Peter Drucker says, we must, for the foreseeable future, learn to manage in turbulent times - even more turbulent than they have been up to now. The two developments that will shake us the most are the need to deal with inflation in a realistic way and the need to deal with the two-earner family. Lots of luck.

MR. FLEISCHACKER: Jerry, as I recall, your company was one of the leaders in the development of the social insurance rider. Could you please tell us about the rider itself, the acceptance of it by field people and regulatory authorities, and the experience you have had since introducing it, particularly in comparison to the more traditional products.

MR. PARKER: Social Insurance Supplement or Social Insurance Substitute has been a very interesting experience. It took about three years to convince top management to do it, and it took awhile to convince some of the state insurance departments that it was legitimate. But, we do have it all over the country now.

The problem arose out of the Uniform Policy Provisions Law that prevents individual disability policies from integrating with social insurance. I came up with the notion that, if we could not reduce the face benefit, we could write a lower benefit and then increase it when there was no social insurance benefit. That's what we did. One piece of the coverage pays a set amount for a disability. Another piece pays so long as you are not getting social insurance from Workers' Compensation or from Social Security. For example, if a person is in an LTD situation and qualifies for Social Security, getting the first payment after eight months, the rider will pay for eight months and then stop. If, by some miracle, he recovers and stops getting Social Security, the rider will start paying again if he still meets our definition of disability.

This rider has done several things for us. The first thing it has done is enable us to sell more insurance. The only other alternatives were to overinsure or to underinsure and hope the policyholder qualified for social insurance in order to receive an adequate benefit. The second thing this rider has done for us is to open up a lower income market than was otherwise possible. Without the rider, we could not sell to persons earning below \$20,000, to \$25,000 because they would receive enough from Social Security (and often from Workers' Compensation, too). This rider enables us to get back into this market. I am not certain what the minimum income is that we can efficiently serve, but we try to avoid selling to persons earning less than \$17,000 annually.

We went this route because I was totally convinced that a direct offset (policy benefit is reduced by the amount of social insurance benefit) was contrary to the Uniform Policy Provisions Law. Some fellows were not as doubting as I, and there are at least three companies that are writing direct offset plans which have been approved in all but three states. There is a problem with this. Given the inflationary situation we live in and indexing of Social Security benefits, what happens when the Social Security benefit exceeds the policy benefit? Your policyholder is paying premiums and collecting nothing. Such a plan is really only useful and fair when you plan to reunderwrite the amount of insurance periodically and fairly frequently.

There is also a plan being written using a so-called indirect offset. Under this method, social insurance benefits are simply defined in the same category as earnings. Therefore, when a social insurance benefit is received, it reduces the basic benefit of the policy.

MR. KIDWELL: You mention statistics and the amount of them that you like to have and feel is necessary to properly monitor individual disability income. It would seem that the reason you need a lot of statistics is because you are not able to manage the business, nor understand it. I don't know of any other business where the reliance on statistics could be, in my estimation, so foolish as in the disability income area. The type of element that you are measuring changes so rapidly that the statistics are not fully reliable.

They do give you some trends which you can evaluate against the management decisions, such as, underwriting and claims handling changes that you made. But, there is no substitute in disability income for thinking ahead. The judgment of the underwriter and the training, attitude, judgment and methods of the claims administrator is where the real success of the disability income business arises.

If you wait until you get statistics (and if you have green management, they will), management is going to try to act on them. That is suicide. The biggest problem we have is trying to evaluate this myriad of statistics that we get. One fear we have is that the statistics will be used for purposes other than that for which they were designed. Every time we start to develop statistics in disability income, we ought to throw up a big warning sign. The success of the business is not in the use of those statistics, it is in trained, committed claims and underwriting persons.

MR. PARKER: I could not agree with that more. One of the problems with the disability income business is that what you are experiencing now is a result of what you did five to ten years ago, and what you are doing now will determine what you experience five to ten years hence.

For instance, some of the "own occ" coverage that has been written for the last five to ten years seems to have had fairly good experience so far. But, when you consider that most of the issues are at ages 30 to 45, while most of the claims are for people in their 50's, it would seem that there are going to be problems in the future.

There are things being done in the business now that scare me. Some companies are writing policies that do not require any total disability at all. The only stipulation is that there has been a loss of income as a result of sickness or injury. It sounds more like a retirement income policy being written for the price of a disability income policy. And yet, it will not be known whether they are right or wrong for at least ten years.

MR. FLEISCHACKER: Ray, would you comment on Jerry's views of the "his occ" definition to age 65. What do you think of it as a marketing tool and what has been the Hartford's experience?

MR. DRURY: We have marketed "his occ" to age 65 for about 4½ to 5 years. Jerry's comments are well founded. But, in the majority of states, if you go to court and try to enforce a split definition, you will lose. If you are going to lose, why go at all? We just had our first case where it was a little doubtful if we would have paid had a split definition been used. That is just one. Maybe there will be many more; I do not think so. It has been a tremendous marketing tool.

MR. PARKER: You are quite right on the court situation. But, a lot of this is being marketed by telling the prospect that the company will still pay if unable to perform his own occupation even though he could earn as much or more in a related occupation. If it is sold that way, eventually that is how the claims will be made. For that reason, we adopted a definition which is in effect a "his occ" definition: we will pay when unable to engage in your occupation, so long as you are not doing anything else.

MR. JOHN HOOD: My comment on the "own occ" controversy is that it is not entirely a question of what the court is going to do. My company, Union Mutual, uses "own occ" to age 65 on noncancellable individual disability income, but a two year split definition on group. We see a lot of claimants going back to work after the two year period. The key is what Mr. Parker just alluded to; what they think they have as a benefit is very important. We have never lost a court case. I do not think we have ever even had one to fight. The main thing is what they really think they are insured for.