RECORD OF SOCIETY OF ACTUARIES
1983 VOL. 9 NO. 3

INDIVIDUAL DISABILITY INCOME CONTRACT PROVISIONS

Moderator: LORNE M. COOPER. Panelists: ROBERT M. BRODRICK, W. DUANE KIDWELL, JOHN A. YOUNG. Recorder: IAN D. BANCROFT

1. Has competition resulted in unsound contract provisions, underwriting rules and/or rates?
   a. Own occupation definitions of disability
   b. Lifetime definitions
   c. Issue limits/replacement ratios
   d. Social Security offsets/cost of living and other provisions

2. Trends in product design and underwriting
   a. Unisex rates
   b. Residual/Income replacement definitions
   c. Underwriting liberalizations

MR. LORNE M. COOPER: The topic is "Individual Disability Income Contract Provisions". The emphasis will be on the non-cancellable type of contract, although the remarks in general are applicable to other types of contracts as well.

Today's topic is very relevant. In the past two years many life companies, both large and small, have decided to enter the disability income market on an aggressive basis. Attracted by promises, perhaps made by actuaries, of low lapse rates, locked in policy reserves and low initial claim costs, many of these companies see disability income as a solution to problems that they have encountered with low or non-existant term insurance profits, and a poor outlook for ordinary life. Other companies simply seek disability income as another way to put bread on the table for their starving agents and brokers.

Do these new companies have the underwriting and claim expertise to avoid disaster? The companies which write traditional Disability Income are fighting back.

Our three panelists will attempt to answer some of these questions. They are all experts in their fields. They will provide you with some very interesting insights into some of the problems facing the Disability Income industry today. Let me briefly introduce each of them in the order they will be initially speaking.

First we have on my left Mr. Mike Brodrick, Associate Director of Lincoln National Life Insurance Company. On my right first we have Mr. W. Duane Kidwell, Vice President and Senior Actuary of the Paul Revere Insurance Company. On my far right we have Mr. John Young, who is in charge of all product development at Great-West Life Insurance Company.

The unofficial script for our open forum has been expanded slightly. First on the topic is "Has competition resulted in unsound contract provisions, rates, or underwriting rules?". After that we'll be looking at trends in product design and underwriting.

We'll be talking about things like "own occupation", definition of disability, life time benefit provisions, lessons from the past, liberalized financial underwriting rules, the very high issue limits that are very prevalent today, social insurance problems, cost of living provisions, zero qualification period residual benefits and pure income replacement benefits, rate competition, and contract definitions that are becoming very liberal now. It's essentially a buyer's market in the Disability Income industry today. We will be talking about universal life, disability products, the effects of current economic conditions, possible improving work ethics, zero inflation, things like this. We'll be talking about pricing, particularly experimental products, which a number of these products are. We will be talking a little bit about mass marketing and perhaps about guaranteed issue and other underwriting liberalizations.

I would like to begin by turning it over to Mike. Mike's company is very actively involved in the reinsurance market. It is very topical that Mike speaks to you first today because he sees an awful lot of large and small companies in various stages of development in the Disability Industry entering this market. Some of you I know are in some of these companies and some are in traditional companies that have been in this market for a long time. I think the next few years are going to prove very interesting, so without further adieu, here is Mike.

MR. ROBERT M. BRODRICK: The scenery here is beautiful. This would be a nice place to semi-retire at age 50, earning possibly 18 to 19% of my predisability earnings, with my double-indexed residual life-time "his occ" policy. The point is that your underwriters are all that stand between me and partial disability benefit abuse. We have some fine disability coverages available today but they will only last if we keep abuse of benefits to a minimum. To a great extent, this job falls in the hands of our underwriting and claim staffs.

Part of my assignment today includes describing the condition of the disability income market as it exists today. That is a big assignment, so I am going to scale it down to some important component pieces to be treated separately. I'll be commenting on renewability provisions first, definitions of disability second, competitive pricing third, including comments on unisex rating, and as a fourth general topic, I'll be making some comments on the reinsurance aspects of our highly-competitive, professional, disability marketplace.

1. Renewability provisions Guaranteed renewability would be a nice escape hatch if the "upscale" market would allow it, however, as everyone knows, this is not the case. We are in a noncancellable environment for the professional portion of our marketplace, which is where most of the innovative contract provisions are appearing, so that the topic of renewability quickly changes to one of, "do we have adequate rates to carry the noncancelable feature?". That's a very difficult question to answer. There are other difficult questions at this point. How should that typical 10% surcharge for the noncancelable feature be treated? - - - as surplus charge to be placed in a fluctuation reserve? - - - or should it be taken in the year received as a reserve for carrying the noncancelable premium risk? I was reading through Bartleson recently and he does not address the subject directly. At Lincoln, six or seven years ago, we wrote down all of our morbidity fluctuation reserves to zero in order to get excess interest earnings out of our line of business, because we were being taxed as a Phase II company. Since then, we have been flowing that 10% through as profit. Things may change again with tax law changes, and possibly our treatment of the surcharge will change. In my experience, the subject has not been covered recently.

2. Definitions of Disability I see basically two types of "his occ" definitions in the marketplace. The first is the type which is taken away to an extent by other provisions, such as those that would say, "and not working at any other gainful employment". There are some written just about in that way, but I feel that, when it gets to court, familiar "reasonableness" criteria would be applied to the "other" occupation involved and in fact would be interpreted more liberally. The other "his occ" is one that does not so readily take back the benefit offered so generously, if working in another occupation. This liberal definition exists in only a handful of companies today. It is important to note here that this liberal definition is typically used only for the professions and some highly paid business executives. Those of us who use the "his occ" definition in some form probably have various ways of justifying in doing so, other than just saying, "Well, we had to do it because our competition does it." A doctor, or an attorney, or a highly paid business executive has worked long and hard to reach his station in life and an inability to perform is a serious situation; the insured could be said to have a tremendous amount of insurable interest in it. Compare that with a skilled labourer who suffers a physical disability of some sort. He or she could be relatively quickly retrained for clerical or other work of some sort at equivalent pay. The key word there is "quickly". Any way you might try to justify using the long "his occ" definition of disability may work for you, but there is no getting around the fact that opportunities for abuse of benefits increase with the use of it. Substantial abuse has not occurred yet, professional non-can business is growing, and non-can loss ratios have been coming down slowly. That's perhaps a short sighted view in what is a long-term business.

Getting back to the current state of the market. Most companies really in the business do write a liberal definition of disability including some now extending the "his occ" for life. Also most companies add some sort of residual benefit to their policy. Not too long ago, companies required at least some period of total disability before an insured could qualify for benefits under the residual feature of the policy. However, in the past year or two these qualification periods are being written out of contracts, and what is even more important, I think, is that the residual benefits are being paid for disabilities incurred at later ages. Age 60, I think is the most liberal contract I have seen. This of course does away with protection against "early retirement" syndrome, which those earlier aged cut-offs were protecting against. Again, we have a situation in which we have a reasonable insurance benefit, but one which seems likely to invite abuse. Of course, it's hard to really tell how this particular trend in liberalization of benefits will turn out, financially, but I would bet that the courts would have a large part in determining which way it goes, and that all is a long way off.

Now comes the loss of income concept - sometimes referred to as the income replacement policy - much safer than a "his occ" policy in terms of the over-insurance problem. As I commented earlier though, I think one can make the case that the "his occ" is not really being, or leading to, an over-insurance situation. The income replacement concept seems rather loose in terms of tying the loss of income to a specific disability. I am personally much more comfortable with some wording in a contract which pins it down to "substantial duties, or material duties". I feel that there are as many openings for abuse in this kind of contract as there are in a "his occ". I feel that the final financial results of these types of policies, in the event of a significant number of attempted "abuses", will be in the hands of the court.

Getting back to the current state of the art in the professional disability marketplace, I could probably describe the Lincoln National's policy. With a recent enhancement package, we have one of those contracts about which you might ask the question, " Are we becoming too competitive in the marketplace?". We extend the "his occupation" definition for life-time with life-time benefits paid in full for claims incurred prior to age 55, scaled down 10% per year of age after 55. We have a double-indexed/zero day qualification residual, running all the way to age 60. We have a simple-interest/fixed-rate cost of living adjustment with no cap and choices of 5, 7 1/2, and 10%. Other choices? Triple indexed?

3. Competitive Pricing We see companies coming through with lower rate packages periodically, but it's a much more mild situation than, let's say, the low-cost term market price wars of the last two years. The disability contract has enough features, that it's quite a bit easier to explain price differences while looking at a 10 or 15 point product feature comparison. Generally, I don't see price as the dominant feature of our market, but it's an important part of our business. Perhaps the time will come when we have enough homegeniety to do a professional market morbidity study.

Unisex pricing - This is currently being done on an experimental basis only. If that should become a mandate, it would certainly become a major impact on our business, with potential losses, until we would be able to get some fix on the mix of business after the market stabilized.

4. Reinsurance First, liberal benefits on high amounts are a great concern to a reinsurer, because, considering client company retentions, reinsurers have a tendency to become saturated with the higher amount cases - this means a large number of professional and business executive cases. With respect to the recent expansion in the "his occ" business, across a large number of companies, we are scrambling to a certain extent to keep our portfolios balanced with other AAA/AA Business. It is difficult because many companies are now seeking reinsurance for the first time coincident with moving into the "his occ" market.

MR. COOPER: Duane Kidwell is our next panel member. He is now Vice President and Senior Actuary of the Paul Revere and he has some interesting lessons from the past as well as from his long experience with the Paul Revere that I think are very applicable in this day and age. We are coming into an era where Mike is probably more confident that I am about what it going to happen in the next few years. Duane goes back to the post-war era in Disability Income and I think you will find his remarks very interesting.

MR. DUANE KIDWELL: Actuaries in the D.I. industry are very much aware of the excessive morbidity of the 30's and the liberal expansion of the 60's, and we experienced an abrupt reawakening during the 70's recession. I submit to you that from them we have learned our lessons well. This is evidenced by the industry coming through the recession of the early 80's with very few bruises.

The industry rolled well with the punches from market erosion by social schemes and group insurance, from the changing of public attitudes towards being disabled and accepting benefits, from a devastating period of inflation, and from aggressive competition and the pressure on product and marketing from the worried agents. The industry, through and partially because of all of this is doing a much better job providing adequate and proper coverage for our customers. With all of the changes that resulted from these pressures we have become much more keenly aware of possible pitfalls and more dedicated to managing each block of business to a successful conclusion. We have serious concerns, of course, and we must relax with them, lest we swing the pendulum too far in the opposite direction, destroying the good we've done. Our comments today should be taken as comments from awareness and not as forecasts of doom.

Why did we seem to luck out in this last recession? Have we really lucked out, or have we somehow lost or disguised the facts? Or is it too early to tell?

Perhaps we can get a feel for an answer by pondering what's different between 30's, the 70's and the 80's.

1. The largest proportion of the D.I. business today is in the professional market, (nearly 60% of the premium in Paul Revere). It has moved from the equally heavy blue collar business of 20 years ago. The 1980 recession was not long enough or deep enough to seriously affect the incomes of professional people. The professions were sufficiently under-crowded that they hardly noticed the small amount of the public's cutting back and postponing of services.

2. Unemployment benefits have grown more substantial. In the 30's in particular and to some extent during the 70's, unemployment benefits were often much less attractive than were disability income benefits for the blue and white collar workers. Disability insurance therefore often unwittingly became unemployment insurance.

3. Today's policies carry longer elimination periods, making it harder to establish a period of disablement. Our contracts are designed more towards providing benefits for serious illness. They no longer match too well the temporary needs of employment.

4. Our claims handling is much more sophisticated and the expense of thoroughness is more justifiable and affordable because of the larger amounts and benefit periods. We use more direct contact through the telephone, through the field claims personnel and through the medical profession.

5. Contrary to our fears, general public awareness of the useful ways to use insurance did not, in so far as we can determine, lead to higher incidence rates. There was a noticeable slight lengthening of the claim duration on our own business but we have no evidence that early retirements have yet become vogue.

6. Management awareness and concern carried through all areas; underwriting, claims handling, field awareness, and so on to the policyholder, as companies prudently moved to strengthen claims handling procedures.

7. Unusually high investment income has helped to disguise any adverse bottom line effect.

8. Interest rates were increasing in the valuation laws. Companies may have been coincidentally changing to higher interest rates at that time.

9. Many companies use GAAP accounting which could dampen the impact, spreading adverse effects over a longer period than would the more conservative statutory accounting.

   Perhaps you can think of other differences peculiar to your own company. Think about these nine and add to the list as you design new products. Even more so, ponder them as you administer the block of policies we're selling today, where we face the potential for anti-selection at all times, not just during recessions. We must constantly remind ourselves and other management that the near term success of our operations is not so much in the sales end as it is in the management of the business already on the books.

One of our major concerns is the possibility that a claimant's experience during disability may be substantially prolonged by the attractiveness of insurance, perhaps even to the point of promoting early retirement. Underwriters try hard, through the setting of replacement ratios, to reduce this problem of de-motivation. The most illusive factor to measure and probably the most significant factor affecting our ability to achieve average morbidity is motivation. To some degree motivation is inherent but to a large degree it is self controlled and easily influenced by the particular circumstances at an opportune time. We try to influence that option by replacing only a part, though a very major part, of the spendable income lost through disability. We have traditionally set replacement ratios at about 90-95% of the net take home pay for smaller incomes, grading downward to 50% or less at the higher income brackets. We define net take home pay as the net of earned income after necessary business expenses, taxes and assessments for social schemes. Thus it is akin to spendable income. This replacement ratio has become, unwillingly, a competitive target in recent years. Because of competitive pressures we have become more liberal, and frequently tolerate ratios of 100% or more. This can occur inadvertently in underwriting where, for example, prospects of future higher earnings are good or where we might not be taking into account the full impact of social schemes or other insurance, or where we learn, too late, that incomes have been overstated. Too often, though, we merely fold in the face of competition.

During periods of high inflation incomes rose rapidly. We believed that as a result the replacement ratio would always be secure at claim time, so we could count on having a 10% or more element of co-insurance. With lower inflation, we are not now quite so confident. Furthermore, as a person's net worth grows, unearned income potential grows. Ratios established at the time of issue allow for current unearned income, but do not allow for unearned income growth. Replacement ratios, even though reduced initially, become too generous.

The Social Security Administration, through cost pressure, is tightening up on claim awards, so there is now a much lower chance of receiving an award on a claim application than there was 5 years ago. With this in mind, there is pressure to ignore Social Security benefits in underwriting limits. This would be an acceptable practice if there were a $ for $ social insurance offset provision in your policy but it leads to possible overinsurance and inadequate price for "we pay if they don't" provisions.

It is difficult to convince an applicant or some agents of the logic of including unearned income in the participation limit formula. Their attention is focused on our promise and our purpose, to replace earned income lost through disability. The agent thus becomes disappointed because he cannot accommodate the client who can clearly afford the insurance and who would seem to be highly motivated. There does seem to be a market here that we could reach IF (and that's a big if) we could more precisely define disability and recovery. Competition may well push us into that area in the next round of insuring clause development. This is a particularly sensitive area as we are continuing to refine financial underwriting techniques.

In our monitoring at Paul Revere, we review ratios of actual to expected incidence of claim, and average length of first year of claim duration, by amount of monthly income. Both the incidence and the duration on amounts of $2,000 or more are much higher than for the corresponding $500 per month policies (more than 50% higher by incidence and 25-50% higher by duration). Clearly, if you can afford it, you can sometimes choose to be disabled and to stay disabled. In contrast, a $500 per month policyholder simply can't afford to be sick. The cost of this higher morbidity on large policies has been disguised in pricing, in part, by the additional expense margins on the large amounts. Somehow, soon, we must either correct our pricing equity or find ways to control the marginal extra claim cost.

One suggestion would be to offer discounts on the larger cases that would reflect the degree of coinsurance a client would accept.

We do not have data on experience in relation to the actual replacement ratios, but we can easily rationalize the worst of impressions, begging Mr. Ruskin's forgiveness, of course, until reliable data can be developed.

Caps on maximum amounts of indemnity seem to be disappearing as applicants continue to validate larger incomes. This potentially very dangerous situation has not been promoted from sound insurance principal logic, of course, nor from facts for there are no supporting facts. It has been insidious, emerging from companies jostling for a competitive edge. Unlimited maximums are an impressive talking point - an ego builder - makes us appear to know what we're doing and that the temporary edge is worth the added risk. Unfortunately, this risk is not measurable and it is too great to endure for smaller companies who must stretch in competition to stay in business. It could be an area where regulators will need to become more involved. To quote Pogo "we have met the enemy and they is us".

We have an application in our office, now, for $17,000 per month benefits to age 65 plus $23,000 per month for the 15 month business overhead expense. It seems to be validated by our published financial underwriting rules. I don't know what we will do with it but I offer my sympathy to the underwriter. Too bad the applicant doesn't need a $9,000 per month buy and sell, or we would have that, too.

Replacement ratios are no longer even being protected by inflation because we have added cost of living and prior earnings indexing features to our policies. The recent economic period of high inflation was a very emotional period. Competition was rampant in its eagerness to "solve" the problem of deteriorating adequacy of claim payments during inflation. So, we now have automatic increases of 7 or 8% per year while on claim - nearly 2 times the 1982 inflation rate - with, in some cases, no CAP. Residual type policies often assume an automatic growth rate of prior earnings for purposes of calculating the income lost. This is called indexing of prior earnings. It leads to increasing the ratios of income lost as the claim duration lenghtens. This combination is quite an inducement to continue disablement. Growth in benefit could actually exceed normal salary increases. I, for one, am concerned that the industry is beginning to undervalue the significance of overinsurance. We are accepting it as a way of life, before first developing the appropriate policy provisions, and adequate claim techniques to handle it.

Our agenda today includes the topic of Unisex in disability income and I would like to comment briefly on developments in that area.

There has been recent Congressional activity in the United States, as you all know, on the matter of risk classification - not whether it is sound, but whether it is acceptable to the public's best interests. You will recall that the American Academy of Actuaries addressed the issue in committee a few years ago, publishing a position paper to the House Subcommittee on Consumer Protection and Finance, and including it in the 1980 Journal.

There have been at least two essentially identical bills submitted to Congress that are currently being reviewed by the Commerce Committees of both Houses. These are entitled the "Non Discrimination in Insurance Act" and "The Fair Insurance Practices Act". These bills are much broader than Unisex in Disability Income although inclusion is certainly implied. Basically, the bills attack the right to classification of risk by sex, as well as by race, color, religion or national origin.

There is no question but that actual insurance experience is clearly different between sex distinct groups. The degree to which this difference correlates solely to biological traits and the amount that is the result of other factors such as occupation class, work-stress exposure, and habits, is not clear. Sex, nevertheless, has been singled out as a major underwriting class distinction, recognized for statistical differences and accepted by the public, as have age and occupation class and health.

We can price, of course, for any defined classification, whether it is for a broad social scheme or a very narrowly selected group. The degree to which we can provide benefit to cost equity between groups with statistically distinguishable characteristics is directly controlled by the degree of public acceptance of the grouping and legal dictum, as well as our own ability to avoid anti selection. It would, therefore, seem to be immaterial to us whether the bill passed or not, because we could find other underwriting factors perhaps equally as important, and because our competition would be operating within the same boundaries.

Nevertheless, we should strongly oppose the bills proposed because they are a low blow to free enterprise. Furthermore, the retroactivity feature required by the bills is so ill conceived that I propose that it was only inserted by the proponents as a bargaining ploy.

The American Council of Life Insurance is properly opposing these bills with a resolution which still endorses sex distinction in the pricing of individual disability income and other individual contracts not used to fund employee benefit packages. The resolution would propose equal benefits for and equal contributions by employees for group purposes, but permits the employer cost to be determined by sex distribution.

There are at lease two companies that recently changed to using the same rate scale for males and females in the Professional market. Disability Income claim costs for females, in the Professional class, are as you know, higher than for males at the younger ages, crossing over at about age 45-50, remaining lower thereafter.

Unisex rates are a real problem to actuaries in their current pricing as they must stand ready with three sets of rates until they know the outcome of the bills, a situation which will probably soon be solved by giving in.

MR. COOPER: Thank you, Duane. I think I found particularly interesting Duane's comments on the very high income policies being issued that Mike referenced. The idea of offering a discount based on replacement ratio I think has broad appeal from both an actuarial and a marketing point of view and I think you are going to see more of that.

Our next panelist is John Young. He is involved in product development at Great West Life on the individual side, so he brings to his topic some very broad knowledge, specifically applying today to the Disability Income products. He has just gone through a very large change in their product portfolio in terms of pricing, product design, even remuneration. So, without further adieu, John Young.

MR. JOHN YOUNG:

I. Pricing Disability Income Products

As with the pricing of any insurance product, both competitive and actuarial considerations must be taken into account. At our company, we decide on the the position in the market where we would like to be. This entails extensive research as to the features and prices of our competitors. From this, we design the product and select price levels that we believe will position us to achieve the goals that we have set for ourselves. The goals could be increased penetration of the professional market or reinforcing our blue collar position, or any other similar objectives. To arrive at this suggested product strategy, we examine our competitors, solicit input from the field, and thoroughly analyze our alternatives via a committee procedure at the Head Office level. I can assure you that the strong competitive pressures in some markets have certainly influenced this process in the past and I can only see this continuing in the future.

Once the design and target price level is set, the actuarial work begins. The target prices are thoroughly tested by asset share techniques to see if, given our assumptions, the targets meet our minimum profit requirements. Obviously, this process depends heavily on our pricing assumptions and I will discuss some of the problems related to setting these assumptions in a moment.

In our latest product revisions, I can say that although competition has certainly affected our product design, it did not cause us to compromise our price or use any assumptions that I would consider to be overly liberal. However, I am sure that to some extent disability income prices are directly affected by competitive pressures. I wonder particularly about situations where benefits such as reduced qualification periods or removal of caps on indexed riders are extended at no extra cost. This tells me that these companies have either very precise pricing and data gathering systems or they are not really sure of the risk but, given the current competitive environment, these seemed to be attractive liberalizations. Because the true cost of many provisions will not be known for several years yet, I expect competition has initiated a certain degree of compromise with respect to disability income prices.

I would like to look at a couple of features of today's Disability Income products that create difficult pricing questions.

1. Own Occupation Coverage - This benefit provides the insured with the potential to work at another occupation and collect full benefits at the same time. Thus the insured could be better off, from a financial standpoint, by remaining disabled. All incentive for recovery is lost and thus our traditional continuance tables do not seem appropriate.

At the extreme, we could use mortality as the only termination rate and ignore recoveries completely. This, of course, is an extreme, but at least it seems to establish an upper limit on the price of this feature. Depending on the percentage of clients which you expect may work and collect at the same time, you could establish some price on this feature.

Certainly, a large degree of judgement is involved and I would caution you about relying on statistics that indicate the vast majority of professionals, in fact, return to their own occupations rather than move into another occupation. This may be true in general, but currently the "own occupation" feature is being marketed in such a fashion that I am sure most professional clients are well aware that it allows one to work and collect at the same time in some situations. Given this awareness among a block of clients, I could only assume that a higher percentage of these people are likely to take advantage of this contract provision than current statistics would otherwise indicate. This fact was brought home to me recently. We introduced our own occupation residual contract in April of this year, and it had not been out for even a week when we received a request from an applicant. The dentist wanted confirmation that if he became disabled as a practicing dentist he could indeed teach at the dental college and collect full benefits at the same time. Obviously, our clients are aware of what they are buying and with this particular benefit, this must certainly be a concern.

2. Residual Benefits - When first introduced, the residual benefit required a relatively long qualification period of 90 days or more. With this feature, it seemed safe to assume that residual benefits would only become payable following a total disability of a significant degree; consequently much of the opportunity for abuse seemed eliminated. To price this feature, we derived several degrees of progress towards total recovery and the proportionate benefits at each level. These assumptions were applied to our total disability pricing table and a modified table for the total and residual situation emerged. Due to the lack of residual statistics, this seemed like an appropriate approach at the time. Given the long qualification periods we felt our model levels of progress towards recovery had some basis. Thus, pricing the first generation of residual products certainly presented unique problems, but these become much worse as the qualification periods have been reduced due to competition. With a 0-day qualification period becoming the standard, and thus no period of total disability required to qualify for residual benefits, our model of recoveries through diminishing levels of disability seemed less credible. With reduced qualification periods your residual benefit becomes much more open to abuse, especially due to the risk of early retirement. I am not sure how best to price these features, but I hope we have been conservative enough to meet the challenges as this business approaches the ages of 55 to 60.

3. Non-Smoker Discounts - I beleive competition will force these discounts to become more common in the future. Are there statistics to justify these discounts? Even the companies that have offered them for some time do not have reliable statistics in this area. At our company, we looked mainly at the Surgeon General's Reports and became convinced

that smoking did contribute to less favourable morbidity experience. Thus, we felt that some discount was justified, but the size of discount was not as obvious. We then selected a level that we felt comfortable with in view of the statistics we had reviewed. We currently use a 10% discount on our upper classes and a 6% discount on our lower classes.

4. Pricing in the Face of Rising Issue Limits - Competition among companies, in the professional classes especially, seems to be continually pushing issue limits higher. Studies show that as the benefit level rises, experience tends to become worse. But these studies do not include any statistics relating to the levels we are offering today. What changes in morbidity experience can we expect at these levels? Are we properly relecting these changes in our pricing? These are difficult assumptions that we are being asked to make due to the effects of our competitive environment.

These are just a few of the pricing considerations which must be faced with our new experimental products and riders. No one can say if we have priced these benefits appropriately today, only the developing experience will determine this.

II. Future Trends in the Disability Income Business

I would like to briefly touch on some future trends and developments I suspect we are likely to see in the disability insurance market.

Product development hopefully will follow the true needs of the markets we are striving to serve. That is, ideally, we should examine these markets to determine where we can do a better job of providing the disability income coverage our clients need. Changes called for may be of a product nature, in our means of distribution, in our underwriting rules and practices, or in any of several other areas. As long as the goal is to try to best serve the insurance needs of our clients through the provision of sound products; I believe future developments, for the most part, will enhance the image of the industry. Now, let's look at some likely areas of development.

Firstly, with a growing participation of females in the workforce, I expect to see improvements in the female coverage available. This is a relatively untapped market today that some companies are sure to spot and key in on. Then, because of the fact more females are working, the number of dual income families is rising. I expect to see products geared to meet their particular needs as well. Our current limits of issue applied individually would likely result in some extent of over insurance given that the non-disabled spouse would continue to work. Recent high levels of inflation have insulated us to some degree from these problems, but as inflation drops, the need for a solution will be more urgent. There is a need for a joint disability plan which would provide the working couple with the correct level of coverage given their situation. This will result in less coverage than current limits applied individually would provide. However, I expect sales would improve because we would have a product specifically designed for these clients' needs. Today I expect many dual income families insure only the husband. With a joint policy we would see more working wives being adequately insured.

I also expect to see greater activity in the small business markets in the future. The potential is vast in this area and because only the disability income specialists today have reached the level of expertise to serve this market, much more needs to be done. There are excellent products and tax efficient arrangements available to this particular market today. I expect to see more effort in developing and particularly more simplified packaging and more intensive training in this area. This trend will be intensified as the professional market becomes more saturated and the agent must look to new markets to maintain his production.

I expect current trends in reduced qualification periods and the availability of non-smoker discounts to become more widespread. Also, the age above which residual benefits and/or qualificaion periods become restricted will continue to move up from today's level of between age 55 and 60. Obviously, this trend is of concern, given the many warnings about the residual feature and its potential abuse through early retirement. Another trend that is likely to continue due to competition is the rising age prior to which disability due to sickness must commence to be eligible for lifetime benefits. Until recently, most companies required the sickness to commence prior to age 45 or 50. Now we see this age limit growing to age 60 and even higher.

In an effort to provide coverage adequate for an individual throughout his working lifetime, I think we will see more contracts which automatically adjust the monthly income benefit with inflation and periodically financially re-underwrite the individual. Along with this, I expect to see more 3 or 5 year term pricing schemes being experimented with. Both your premium per unit and your level of monthly income benefit would change periodically as you were financially re-underwritten. Also, term-like pricing alone may become more widespread. This is likely, particularly as competition centering on price levels becomes more heated. To effectively compete with association group coverages or to better meet the cash flow problems of the young professional, the term approach seems a very attractive option.

Finally, I am convinced it is only a matter of time before we see the emergence of a "universal" type disability coverage. Many companies have the administrative experience and some degree of system support in place for this type of coverage due to their universal life products. It would seem a logical step forward to incorporate ones disability insurance coverage into this approach. The ideal situation would be if a client needed only one universal type contract through which he could provide himself with his life insurance, his disability insurance, and even his retirement needs. I am quite sure that this one account idea could be very attractive to the value conscience clients of the future.

Not only the products will be changed in the future, so will underwriting and marketing to adapt to the new products and client needs.

To attract more agents to sell disability income, to support the expenses of our distribution systems and the disability income line in general, I expect to see future products that will be of a packaged nature. This packaging will help alleviate concerns of the agent who today does not sell disability income due to its apparent complexities. The packaged product would be both simple to grasp and directed at a particular market segment so the agent knew where to use it. In our company at least, the mere perception of complexity has made our education and training task very difficult. If this problem could be overcome, we would be able to sell much more disability income merely because more of our agents were active in that market.

Also our external environment will continue to initiate changes in our business. I expect social programs to continue to carve out greater portions of our lower and middle income market. Recently, in Canada, one province was considering universal accident and sickness insurance for all employees in the province. We will have to continue developing products which will integrate with these programs to provide the client what he really needs - a total package of disability income coverage that is appropriate to his personal situation.

In summary, as I mentioned at the outset, I believe future developments in our business will be driven by the evolving needs of our markets, and our ability to recognize, respond, and capitalize on these needs. As long as we keep these principals as guidelines, our future products should be good, not only for the client, but for the agent, the company and the industry as a whole.

MRS. KRIS MACDONALD: I wanted to address my comments to Mr. Kidwell in reference to his talk about unisex rates.

He made some comments about areas in which distinctions between male and female morbidity were unclear. One difference between and female morbidity is the motivation factor.

When you are talking about 1,000 men generally speaking this means 1,000 employed men. When you are talking about 1,000 women and their experience, according to statistics, this means only about 500 employed women. What percentage of those are employed to their maximium and want to necessarily return to work? If you could study, for example, the morbidity experience of higher level 3A/4A professional women perhaps you could get a better picture of what true female morbidity is.

MR. KIDWELL: Only about 7 or 8% or our premium volume is in the female market so the volume is quite low, and hence the statistics would not be as reliable as if we had a larger volume. Neverthless, the experience has very clearly shown that claims cost in the 4A professional professional group are substantially higher for females up to about age 45-50 and they cross under the male claim costs and remain progressively less than male claim cost as it approaches age 65.

I don't have incidence rates yet, but we are studying the termination rates of both males and females in the disability termination study material that we are preparing for possible submission as a new valuation table. That data supports the conclusions that Paul Revere's data does. This does not necessarily mean that we couldn't live with the same rates for males and females. If it is dictated that we should live with that grouping, we will, some way. As I mentioned, there are some companies that even today have equal rates for males and females.

In our own particular case our rates on the 4A market actually are less for females at the higher ages than they are for males.

MR. COOPER: Thank you, Duane. I guess in reference also to another table, Paul Barnhart had published something recently on proof of the "82" CDT. At this meeting at some point there may be some mention made of the new valuation table which ultimately may be used as a pricing vehicle by many actuaries also.

Something that should be said on Unisex rates is in the U.S. it is primarily a political situation. It is a question of sex equality.

In terms of the differences that are apparent on current statistics on female rates, the cross-over at 50-55 may well exist because in the past replacement ratios on female policies have been very low relative to male policies. Also, on the older policies, many female policies terminated at 60 or else reduced to a 50% benefit, so those statistics are very misleading too. Nobody really knows what to expect.

Maybe the best thing that will happen will be the political enactment of Unisex rates, and we can really see what will happen in that market. Unfortunately, one possibility is that companies will target away from the female market, not towards it, and one of the main reasons for the polititians encouraging unisex rates is to try to get more females covered by individual insurance. They may in fact discourage that if it is not profitable.

MR. MARK LITOW: The New York study shows that cross over is between 50 and 55. Our M & F tables showed a cross over between 55 and 60, and I think with the changes in benefit structures and so forth the crossing over point is probably going down and may continue to do so. The thing that concerns me as much about Unisex as anything else is that if we go to Unisex the risk classification may not stop there. It may go to age. We may get no differentiation in age because that is age discrimination or distinction. That is a real concern. It may snowball and just keep going. I really do think that we are headed towards that and I tend to agree with Duane on that issue.

With respect to over insurance, I think there are a lot of factors in this recession, especially high interest rates and investment income, which helps the recent experience. This may not be true ten years from now, when we may have poor experience without the high interest rates. Do you have any comments with respect to this?

MR. COOPER: I agree with you. I think that the reluctance in the past may be forgotten by a number of companies. Everyone has assumed that this recession has bottomed out and we are on an upswing, but this may be a very short upswing or it may be not as aggressive an upswing as for instance the stock market seems to indicate. There could be some serious problems. The expense problem that many traditional companies are facing right now will not be faced by the new companies entering these markets for a few years, due to the reserving systems. They can get burned pretty badly.

As Kris commented earlier, the key to success in the disability income market is underwriting. Some of the newer companies may not have the expertise or the knowledge to stand them in good stead over the course of time. Our company is very aggressive in marketing. As I mentioned, I was a bit of devil's advocate regarding these high-limit policies with tremendously liberal definitions. We control that by very severe and tough underwriting. At least agents and brokers tell us that we're toughest underwriters in the business, but I suspect that most companies hear that from their agents and brokers. Nevertheless, it is something that those of you who are new to the market of pricing products for your own companies or clients should bear in mind.

QUESTION: It seems to me that we were talking primarily about doctors, dentists and para professional disability. There is a great market out there, I believe, for self employed people - proprietors, contractors, maybe not blue collar but certainly not high-level professionals.

We're finding in my company some problem of defining a defination of "Disability" that adequately describes the type of disability that these people have. Precisely I am talking about confining vs. non-confining disability. Many states don't allow it, and if we are using it in a state we feel it is not going to be applicable more than five or six years from now. Does anybody else have any observations on that particular market?

MR. COOPER: You're quite right. We have been focusing on the professional executive market. You're quite right also about those markets, and John touched on it briefly and Duane and Mike are into those markets very heavily too. Our company actually pulled out of those markets because of unsatisfactory performance in the past. There isn't much competition in those markets and if companies can come in who know what they're doing they can design products and definitions that can make it advantageous to enter those markets. I think that's a huge potential profit area or market area that is being ignored these days. Everyone is attracted to the professional executive market because of the high amounts, easy sales, low lapse rates, all the things that they perceive are wrong with the Life Insurance industry now. It seemed to be right with the professional and executive disability income industry but the blue collar market can be addressed and can be addressed profitably, and there isn't much competition.

QUESTION: What definition of Disability are you using for that group? Do all states permit a distinction between "House confined" and "Non-House confined"?

MR. COOPER: If I can make a comment on this, I think the minimum regulation proposed for most states virtually outlaw house confinements, so you're fighting a losing battle. I think perhaps some companies are trying to encourage the use of that definition because it may work from a pricing point of view.

MRS. MACDONALD: Traveller's underwrites all types of workers, from carpenters up. We have limited the maximum participation limit to the amount of coverage that we will cover for any rate class. Traveller's has "his occupation" for 2 years and after that we use a definition of anything that you are reasonably qualified for based on your education, experience and economic factors. Thus, we cannot make someone go out and sell pencils on the corner. I do know that our experience over the last two or three years has been better for our Class C through 2A block of business than for our 3A/4A block of business. I think that is simply because our pricing setup is better, and because we probably underwrite it a lot more carefully. We know that we can get burned if we don't underwrite it well and we can get burnt very easily. We are underwriting possibly a little less competitively because there isn't the amount of competition in the market. There are limitations on how many other options they have in the Canadian marketplace.

MR. COOPER: After the problems in the mid seventies Paul Revere was one of the first companies to pull out of the "own occupation" market. Mike described the differences between the various policies. They have recently returned to that market. Their product is more competitive than ever and it is a total reversal of positions. I would like to hear Duane's comments on why his company has changed from sort of a pure residual type of company to a "own occ" plus residual company.

MR. KIDWELL: Considering the two definitions, Paul Revere still believes that the residual definition is the right one. The residual benefit replaces lost earned income. In contrast "own occ" replaces income earned from a specific job. As such, the "own occ" definition can easily lead to overinsurance and slow recoveries whenever a person changes to another occupation while disabled.

Nevertheless, "own occupation" benefits are now available on our residual policy, by rider, for an added cost of 7-8%.

Our agents convinced us that we were losing more to competition than we could afford, and we knew that some of our contracts were being replaced.

The balance between expense growth and sales growth needed attention - expenses were winning.

Many agents have convinced themselves and their clients that the professional person is not as flexible as we believe. They like to use the appeal that "considering your substantial investment in your special training, Mr. Client, you simply must protect it fully."

After long deliberation, and a good scrap, we surrendered.

I hope the added sales and extra premium cover the added morbidity. Keep in mind that it now takes about 300 good policies of comparable size to support one bad claim.

MR. COOPER: Thank you, Duane. I think some of the things we may bring up for discussions are possible solutions to the insuring of earned income when someone is younger and then when they get a little older they have very high net worths and perhaps high unearned income. Maybe cash value or return of premium style products designed a little differently than they have been in the past possibly are solutions to that problem. I think possible solutions to the term insurance wars we referenced are combined life and health policies. Years ago you saw policies that added a disability income rider on to a life policy. Perhaps in the future you are going to see a term insurance rider added onto a health policy. I know my company is thinking in that direction, and I think you'll see that as a trend.

To give full credit due to the underwriters, the underwriters of health insurance do such a fine job that they've probably got better morbidity just based on the underwriting alone and when you've got a better occupational class, better lapse rate, longer investment time, it seems like a natural product.

I think if I can end on a positive note, I've tried to be the person in the group that warned about doom and gloom but I am also very optimistic about the successful future of this industry.