Small Talk Newsletter

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NAIC Receives Morbidity Table for Credit Disability

by Robert J. Butler

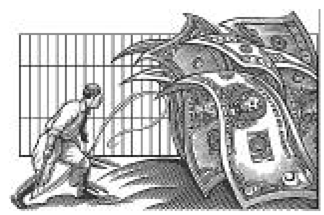
The Society of Actuaries formed a task force in September to provide a recommendation to the NAIC on the appropriate standard to use in the valuation of Credit Disability insurance. The task force made its recommendation on November 30, 2000, to the National Association of Insurance Commissioners' Accident and Health Working Group (A&HWG) of the Life and Health Actuarial Task Force. The A&HWG will now decide how to implement the recommendation through revision to the Health Insurance Reserves Model Regulation and Statements of Statutory Accounting Principles. Following this review, the group will consider adopting the changes at their next meeting in March 2001.

The Society of Actuaries' "Task Force to Recommend Morbidity Standards for Valuation of Credit Disability" built upon the work of the paper "A Credit Disability Morbidity Table" (published in the special supplement to the Summer 2000 issue of *NewsDirect*). It also relied upon techniques developed by a previous SOA task force that recommended changes to the claim reserve standard for Individual Disability Income.

Specific issues addressed by the task force included how to reconcile divergent experience of 30-day elimination period plans to that of 7-day and 14-day plans. Another issue that needed reconciliation was the interpretation of SSAP Issue paper 59 that seemed to obviate the need for a morbidity standard. Robert Butler and Steven Ostlund, representing the task force, discussed both issues in the presentation to the NAIC.

A copy of the task force report can be obtained by contacting the editor. The executive summary of the task force report is reproduced below.

Policy reserves for single premium Credit Disability Insurance are currently based upon gross unearned premiums. The Task Force has developed a recommendation to adjust the 85CIDA for use as a morbidity standard for these reserves. The Task Force built its analysis based upon the paper "A Credit Disability Morbidity Table," and the statistical methods used by the Individual Subcommittee of the SOA's Task Force to Recommend Morbidity Standards for the Valuation of Group and Individual Disability.



We recommend that the 85CIDA be used as a morbidity reserve standard with incidence rates increased 12%. The resulting policy reserves will be approximately 72% of current unearned premium reserves, but will have a margin of approximately 44% over aggregate experience reserves. To avoid discontinuity between plans using different elimination periods, we recommend that the 14-day elimination period tables be used for both 14-day and 30-day plans.

The study used data provided by 17 contributing companies on single premium policies issued in 1997 to develop an exposure base. These companies wrote in excess of 70% of all Credit Disability premium in 1997. Premium and claim experience was drawn from the NAIC's Credit Insurance Experience Exhibit for these 17 companies as well as for four non-contributing companies. Based upon each company's unique distribution of insureds by age and term of insurance, we could develop an expected claim cost for each plan of insurance written by that company using the 85CIDA. We were able to develop a single actual claim cost for each company by using its distribution of insurance by term and its distribution of premium by state. We first developed a single rate by weighting the prima facie premium rates in each state by the premium volume of that company in that state. By multiplying the single rate by the prima facie loss ratio, we obtained a claim cost.

This claim cost was compared to the expected claim cost developed from the 85CIDA to develop actual to expected ratios. A statistical analysis of these ratios showed that the chosen adjustment factor would develop reserves greater than the experience morbidity reserves 85% of the companies would establish. Beyond looking at the number of companies covered by this standard, we also determined that 94% of the premium volume for the contributing companies would be covered.

The Task Force did not study the effect of interest or mortality discounting in this report. Based upon the relatively short duration of credit insurance contracts, interest discounting would not have a significant effect. We recommend that interest discounting be allowed in a new standard. The benefit paid upon death is refund of premium, therefore, we recommend that no mortality discount be incorporated.

The Task Force did not have termination from claim experience readily available; thus, we do not make a recommendation to change claim reserve standards.

Appendix 2 in the report discusses the difference between a morbidity reserve standard, and an unearned premium reserve standard and why the former should be allowed. This appendix also analyzes amounts recoverable upon refund and the actual lapse experience of the Credit Insurance Industry. Reference is made to the requirement to evaluate reserves relative to the refund liability and to establish excess amounts if needed.

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