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Association Group Disability Coverage: Past Lessons for a Profitable Future

By Raza Zaidi and Steven Siegel

Association group coverage has played a crucial role in providing members who had few or no alternatives with an affordable means to meet their insurance needs. In the accident and health arena, the coverage that has traditionally been purchased through associations is group medical. In the days before managed care, carriers found this coverage attractive because it usually represented the largest portion of premium dollars for a member's overall insurance needs. In addition, as this was one of the few avenues of access available for many self-employed members, there was often little or no competitive pressure to reduce premium below adequate levels, with plans typically experience-rated.

With the advent of managed care and increased federal and state-level legislative momentum to provide access to health care insurance, many of these association plans suffered losses as members found alternatives for coverage. Carriers were left with the least healthy members and those who adamantly resisted even slight levels of managed care. As a result, many carriers decided the market was not viable and exited, usually by either selling their existing block or seeking reinsurance partners for any remaining business.

With the future of association group medical coverage uncertain given the current political environment, a shift in focus to other lines of health-related coverages for associations has occurred among several carriers. Carriers see new opportunities in these other types of businesses that include disability income, long-term care, critical illness, and accident coverages. Of these, disability income typically receives the most attention given that it commands the highest amount of premium dollars after group medical. Additionally, disability income coverage generates large reserve fund balances, which carriers can invest at attractive long-term rates. However, carriers that want to succeed in this market should heed the advice of the philosopher George Santayana, who wrote, "Those who cannot remember the past are condemned to repeat it."

Past Profitability Issues

Similar to their experience with group medical, carriers have not been immune to losses in the past decade on the group disability income portion of their association portfolios. Problems with profitability for disability income coverage can be traced to several factors:

- Inadequate pricing
- Contract deficiencies
- Less restrictive underwriting standards
- Lack of risk (occupation) diversification

Inadequate Pricing

One of the primary causes of profitability challenges on disability income coverage has been inadequate pricing. Pricing problems stem from a variety of factors related to misaligned rate structures and unforeseen trends. Among them:

- *Elimination Periods* — Termination rate tables used for premium rate development did not account for the ability of highly compensated professionals to self-insure their earnings loss during the early durations of their disabilities. This resulted in premium rate structures with overly steep discounts for longer elimination periods. In addition, anti-selection in the shortest elimination periods was evidenced as healthier lives opted for longer elimination periods where substantially lower rates were charged. This anti-selection was usually not anticipated and therefore, not factored into the premium rates.
- *New Business Assumptions* — Some products were priced assuming a consistent level of new business underwriting (i.e., inflow of select morbidity risk) that did not materialize. This effect was most pronounced for carriers who substantially grew their blocks of business through takeovers and acquisitions. Existing insureds in these takeover situations typically are not re-underwritten (either financially or medically) by the new carrier.
- *Specific Disabling Conditions* — Insureds were less likely to feel stigmatized and, as such, sought treatment for disabling conditions related to mental health and nervous disorders as well as substance abuse. This trend was usually not considered in the premium rate development.
- *Regional Differences* — Many carriers did not recognize geographic differences in claim costs due to regional economic conditions, unemployment rates, and other factors. This led to severe rate inadequacies in certain regions.
- *Interest Rates* — Some carriers did not accurately forecast declining interest rates that resulted in decreased investment income on reserve balances. In turn, these carriers did not act quickly enough to subsidize the investment income loss through increased rates.
- *Age Banding* — Age banded rates were not always sloped properly, resulting in anti-selection and insufficient subsidization between bands. Furthermore, the predominant use of 10-year bands as opposed to 5-year or less bands did not as effectively track the increase in morbidity risk correlated to increasing ages.
- *Gender Mix* — Most rating structures were based on unisex ratings that did not reflect the changing dynamic of the labor force. As women entered the workforce in greater numbers, unisex rate structures became severely misaligned.

- *Optional Benefits* — Several optional benefits, such as Cost of Living Adjustment (COLA) riders were mispriced. Claimants with these optional benefits were less motivated to return to work resulting in lower than anticipated termination rates.
- *Impacted Professions* — Certain professions were greatly impacted by changes in practice and overall work environment. For example, many health care professionals did not easily adapt to the additional paperwork and peer review imposed by managed care. This led to job dissatisfaction and increased incidence of disabling conditions most notably seen in mental and nervous disorders. Many carriers were slow to react to these trends.
- *Rate Guarantees* — Excessive usage of long-term rate guarantees prevented carriers from taking action when necessary. Carriers were often left waiting anxiously for guarantee periods to expire as the gap between adequate rates and guaranteed rates widened.

Contract Deficiencies

The primary purpose of disability income insurance is to insure against earnings loss precipitated by accident and sickness. Several developments occurred in the past decade where the standard disability contract was found to be ineffective at maintaining this primary purpose or preventing abuse.

- *Disabling Conditions* — In the past, societal prejudices associated with certain disabilities such as mental/nervous disorders and substance abuse caused many insureds to not seek treatment. As the stigma related to these conditions diminished, a rapid rise in incidence was experienced primarily in occupations where job satisfaction was low or suddenly reduced by outside forces. In general, disability income contracts did not clearly define such conditions and were subjected to potential fraud and abuse. Similarly, contracts were not well equipped to manage disabling conditions manifested by self-reported symptoms such as chronic fatigue syndrome and fibromyalgia.
- *Definition of Disability* — Problems were encountered with the contractual definition of disability most commonly referred to as “specialty own occ.” Contracts with this provision defined disability as the inability to perform the material and substantial duties of the insured’s specialty. For example, a surgeon might be unable to operate because of carpal tunnel syndrome, but still have significant earnings from a consulting practice or academic appointment. Regardless of these other earnings, a full disability income benefit would be payable under the specialty own occ definition. Thus, a surgeon would have no incentive to undergo physical therapy or other forms of rehabilitation as his income had actually increased from that before the disability. This unintended consequence of the specialty own occ definition led to poor experience on contracts with this provision.
- *No Integration Provision* — Along with an association group policy, insureds can purchase coverage under individual and employer group policies. Traditionally, association policies have not been integrated with either individual or employer group policies. Consequently, without strongly enforced issue and participation limits, overinsurance resulted. By adopting integration provisions such as those included in employer group disability contracts, association group carriers would have had a useful tool to prevent such instances of overinsurance.
- *Renewability* — Many association group policies had been written on either a guaranteed renewable (GR) or conditionally renewable (CR) basis. With these contractual provisions, carriers did not have the option to either unilaterally modify benefit provisions or cancel coverage for a particular association. Without the recourse of these options, carriers often found themselves with extremely difficult blocks of business to manage.

Less Restrictive Underwriting Standards

Due to aggressive growth targets and competitive pressure, many carriers relaxed their normal underwriting standards. The consequences of this trend were seen primarily in liberal plan designs and increased coverage amounts. For example:

- *Elimination Periods* — Short elimination periods — 0/7, 15/15 or 30/30 (accident/sickness) days — were issued to professionals with high incomes. These professionals had no immediate need to return to work and extremely poor experience followed at these shorter elimination periods.
- *Benefit Periods* — Lifetime benefit periods were offered without accounting for potential overinsurance due to retirement plan and social security benefits.
- *Monthly Indemnity/Optional Benefits*— Excessive monthly indemnities ($15,000 or greater) along with riders such as guaranteed purchase options (option to purchase additional coverage without producing evidence of insurability) and cost of living adjustments (COLA) led to increased malingering.

Lack of Risk (Occupation) Diversification

Among the primary buyers of association group coverage have been professionals in health care-related fields. As mentioned earlier, these professions saw rapid changes due to managed care and other influences. Carriers with particularly high concentrations of these professionals were left greatly exposed and usually suffered losses. Similarly, those who focused primarily on legal professionals were also vulnerable. In either case, a well-diversified portfolio of occupations would have minimized

continued on page 12

Association Group Disability Coverage

continued from page 11

these carriers' exposure to any profession that experienced dramatic shifts in disability risk.

Future Outlook

How can carriers succeed in the future with association group disability income coverage? By learning from past mistakes and reemphasizing underwriting fundamentals, carriers should be solidly positioned for future profitability. Carriers will benefit by focusing on a solid strategy that incorporates a carefully considered plan of pricing, contract design and underwriting philosophy. Weaknesses in any one of these three areas could leave a carrier vulnerable.

Especially encouraging for carriers in this market are continued strong economic forecasts and labor force reports. As more professionals (white-, gray- and blue-collar) pursue entrepreneurial aspirations and begin working as sole proprietors or in small groups (less than 10 lives), the need for income protection through the association group mechanism should grow rapidly.

Finally, any well-conceived strategy will contemplate the enormous potential of e-commerce. As association group coverage has typically been marketed through mass mailings, distribution through the Internet appears to be a natural fit. In the past, disability plan offerings to association members were rather inflexible due to the constraints of mass marketing primarily through a brochure. The ease of customization afforded by e-commerce technology should prove very appealing to potential buyers.

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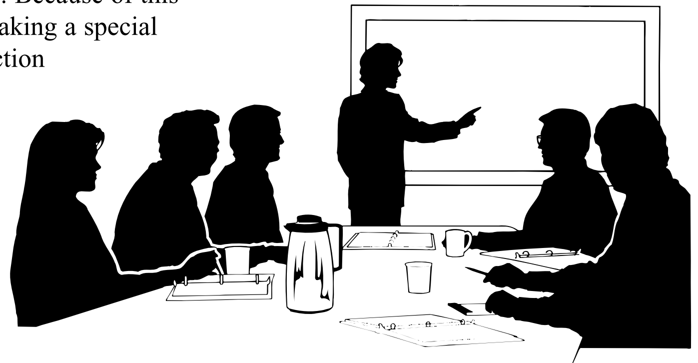
Why You Should Join the Long Term Care Insurance Section Now

By Jim Glickman

The Long Term Care Insurance Section (LTCI) was spun off from the Health Section to achieve more focus in this important specialty. Although we have grown to more than 600 members after our first year, we still need to substantially increase our membership to help carry out our ambitious plans and programs. As you will see below, an important by-product of our activities will be the promotion of the actuarial profession as experts in this field.

There is a close relationship between our Sections in that we are both involved in the financing and management of the delivery of health care. Because of this relationship, we are making a special offer to the Health Section membership who are not yet members of the LTCI Section. If you join our Section now by e-mailing *LTCjoin@soa.org*, you won't have to pay the $10 annual subscription until 2001.



The LCTI Section sponsored nine sessions for the SOA spring meeting in Las Vegas and is sponsoring six sessions for the SOA annual meeting in Chicago.

This July, *Brokers World* magazine will be publishing its 2nd Annual Long Term Care Insurance Survey. Last year's highly successful survey was co-sponsored by the National Association of Health Underwriters (NAHU) with the assistance of our newsletter editor, Bart Munson. Due to staffing changes at NAHU, they will not be participating this year, so the LTCI Section has offered to replace them as co-sponsor and technical advisor of the *Brokers World* survey.

LTCI Section is also providing authors for a series of articles for *ADVANCE*, a publication for providers of post-acute care. The first one, "Covering Our Crisis" written by Loida Abraham, appeared in the June issue and focused on LTC legislative issues.

Work is continuing towards bringing to fruition a national LTCI conference. Tentatively dubbed "The First Annual Intercompany Long Term Care Insurance Conference," this conference will be co-sponsored by the SOA and the LTCI Section. It will feature five educational tracks: 1) Actuarial, 2) Marketing, 3) Claims, 4) Underwriting, and 5) Compliance/Government Relations. In addition, the conference will feature an exhibition hall where both insurers and vendors can display their wares for an audience that will include many of the major LTCI national marketing organizations and most of the major LTCI insurers. Also, substantial time is planned for networking.

Please join our new LTCI Section by e-mailing *LTCjoin@soa.org* now. Please note that I belong to the Health Section as well.

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