SOCIETY OF ACTUARIES

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Pricing Benefit Costs For COBRA

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necessary because there may be a significant difference among groups. For smaller groups with pooled rates an overall model may be necessary.

We have considered two special group situations and a pool that includes groups that generally do not provide post-retirement medical benefits.

The factors that must be considered in each case are:

1. extra morbidity by type of risk,
2. turnover rate of employees and reason for turnover,
3. length of coverage period under continuation,
4. availability of post-retirement medical coverage,
5. sophistication of employees about efficient application of election.

Some of these factors are not immediately discernible, so assumptions will have to be made and experience tested to validate the assumptions.

For group ABC we assume an industrial manufacturer which does not have post-retirement medical coverage and is currently reducing its staff, especially in the middle management positions. For the next year they contemplate the current work force will drop from 1,000 people to 600 with about 250 of the terminating employees being laid off and 150 voluntarily terminating to accept other jobs.

Because of the mass restructuring one might expect a depressed state of mind, higher morbidity, a longer period before obtaining other employment, and possibly counseling to explain their insurance options.

The proportion of employees and their families taking the 18 months extension would be greater than normal. For this group a study might indicate a morbidity level of 75% in excess of the morbidity level for active employees with similar demographic characteristics. The enrollment exposure during the next year might involve 10,000 employee months of which 1,000, or 10%, are COBRA continuance months. On this basis the average monthly benefit cost may be 7.5% higher than for a group of active employees with the same age/sex distribution.

For group XYZ we assume a growing company in a business sector that is actively recruiting employees. Almost all terminating employees are accepting employment in competitive positions with other companies. The company's COBRA continuees are expected to be ineligible children, a small number of widows or divorced spouses, and short service older employees who leave before eligibility for post-retirement medical benefits. The company has a generous continuation of coverage for families of deceased employees and post-retirement medical coverage for employees over age 55 with 10 years of service. Because of the circumstances of the group which already includes early retirees not eligible for medicare and some survivors, the extra morbidity is assumed to be 25% of the morbidity level for the non-COBRA insureds with similar demographic characteristics. The enrollment exposure during the next year of COBRA continuees is assumed to be 2% of total exposure so that the monthly benefit cost is .5% higher than without such continuees.

Finally, for a pool of groups with a standard premium rate basis the assumption of extra morbidity is 50% and the enrollment exposure is assumed to be 4%, making the extra cost of allowing such continuees 2% of the standard rate basis.

In summary, the premiums for insured groups and the funding of self-insured groups will have to anticipate the extra benefit costs associated with COBRA and this cost cannot be charged directly to the continuees. The cost is likely to vary dramatically by group and wherever it is possible the special circumstances of each group should be considered. Within a relatively short time, such as two years, the aggregate extra morbidity and the relative exposures will be known. Each company should maintain the statistics to validate its assumptions and to determine future factors, because it will be vital when situations such as described for company ABC develop. □

DEVELOPMENT OF NEW VALUATION LAW FOR LIFE INSURERS

By Walter S. Rugland

At the Florida winter meeting of the NAIC's Life and Health Actuarial Task Force (LHATF), agreement was reached on an approach to be taken to reconstitute the Standard Valuation Law (SVL) applicable to life insurers.

John Montgomery, chairperson of LHATF, expects the results of the work to be approved in 1989 or 1990.

At the June NAIC meeting LHATF had been given authority to initiate a study of reconstitution of the SVL and the coordination of the project was assigned to the Standing Technical Advisory Committee (STAC), chaired by Charles Greeley.

STAC presented a proposed approach to reconstruction of SVL at LHATF's October meeting. The approach suggested the ultimate goal is an actuary's opinion as to the adequacy of the company's assets to support current and anticipated business plans. This opinion would be separate from considerations for earnings reports, currently legal solvency and tax payable calculations. STAC said the ultimate goal is not attainable within the forseeable future.

As an interim goal STAC suggested pursuit of a reconstituted SVL which focuses on the actuary's opinion as to adequacy of assets supporting the reported reserves on in force business, together with development of a minimum reserve approach which reflects the risk position of the company. This latter feature has been labeled "dynamic solvency testing".

The interim proposal is an all-encompassing revision of the Standard Valuation Law which emphasizes an actuary's opinion. Conceptually, the opinion would include all of the current reported actuarial liabilities of the company. The actuary's opinion would be based on cash flow analysis if appropriate for the company product structure and risk profile.

As a result of the work done in support of the opinion, and the opinion itself, actual reserves could be materially different from company to company, and for those companies managing risk in a manner which justifies it, materially

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Development of New Valuation Law for Life Insurers

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less than the minimum required today. Of course, for companies that don't manage risk, the minimum could be materially greater.

It is the belief of STAC that the industry needs to be able to better utilize its capital, and that those companies which wish to structure their business in such a manner to reduce risk should have the opportunity to reduce reserves and make capital available. Likewise, those that wish to take risk should carry reserves which reflect it.

LHATF concurred in the proposed intermim approach at its Florida Meeting.

In discussions at the ACLI Actuarial Committee, as well as the Joint Committee on the Valuation Actuary in the United States, there was a consensus that work in this area should be brought forward under the auspices of the NAIC with support offered as necessary from both the profession and the industry. STAC has been asked to convene task forces to work on the project. LHATF will make appointments.

The conceptual proposal is to be available in the spring of 1988, with detail model drafts available for discussion soon after. Subsequent discussion will then determine the extent of the time necessary before adoption by the NAIC. □

SOCIETY SEMINARS

Seminar topics for the next few months include:

Managing Surplus in a Return-on-Equity Environment (March 22-24 and March 25-27 in Snowbird, Utah).

Health Reserves (April 15 in Chicago and April 23 in Philadelphia).

Chief Actuaries Open Forum (June 16-17 in Chicago).

Others being planned are Flexible Benefits, Practical Ways of Managing the C-3 Risk, and Life Insurance Accounting Using the Policy Premium Method. □

DEATHS

William J. Berry	FSA 1945
David J. Cowie	ASA 1934
Martin G. Gabrelow	ASA 1981
Reinhard A. Hohaus	FSA 1924
James E. Hoskins	FSA 1920
Robert J. Rubsam	ASA 1985
Willard A. Thompson	FSA 1929

1987 Spring Meetings

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Colorado Springs, April 27,28,29

The meeting in Colorado Springs offers Insurance and Pension topics as well as actuary-focused management topics. We are introducing a new session format at the meeting: the seminar format. As is evident in the name, these sessions will combine the excellent instruction offered in Society seminars with the "deli" style menu of a spring meeting. A sampling of planned topics includes future forecasting, setting assumptions, federal income tax, managing for excellence, investment-oriented products and innovation and management in product development.

New York, May 28-29

Investments and New York are a natural combination for the last spring meeting. The general session will feature Fred Carr, President of Executive Life Insurance Company. The title of his presentation is "Risk Is Your Enemy." We expect a lively discussion from the floor at the conclusion of his speech!

Some of the other sessions planned for New York are status of the valuation actuary, profit centers, financial performance measures for mutual companies and GAAP issues. □

Spring Exam Seminars

During the week of April 25-May 3, the University of Waterloo will offer study seminars for Parts 4, 5, 6 and 10.

For further information contact Frank G. Reynolds at his *Yearbook* address.

LETTERS

January Workday Problem

Sir:

The answer seems obvious. Give in to her position! Her three points are quite telling, while the contract wording is inappropriately harsh.

I could understand the insurer's position better if (a) the amount of pension benefit were more material, (b) there was some question about the claimant's disability, or (c) the offset provision had been highlighted.

Is this a "for real" problem? If so, it is no wonder that the public has an unfavorable impression of insurance companies.

D.E. Morrison

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Sir:

There is right on both sides, so a compromise is in order.

The claimant's logic makes sense, yet the insurer had every right to expect that the income replacement ratio was no more than x%. Additional pension income destroys the incentive for return to active work.

Barry T. Allen

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Sir:

There are three issues to be resolved: (a) Who has benefited and who has been harmed? (b) What is the likely outcome of pursuing the offset? (c) What was the obligation of the insurer to the claimant when the original claim was filed?

Consideration of each of these favors no further collection action.

Fred L. Broers

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Editor's Note: Mr. Morrison's suspicion that this may be a hypothetical problem is *unfounded.* In "real life", the insurer "stuck by its guns" to the

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