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GROUP COVERAGE

A. What levels of contingency reserves are appropriate for various types of group coverages, and in what manner should these reserves be set aside? Should group contingency reserves form part of the policy reserves, or should they be carried as an explicit item in the annual statement?
B. In the event of the pooling of war risk on group life coverage, to what extent would pool assessments fall upon employers through modification of dividends and reratings? Would such assessments be within the limits of the contingency charges implicit in the operation of group life coverage?
C. Has the changed investment situation affected interest assumptions for group annuities and self-administered pension plans?
D. How are companies handling the income, disbursements and liabilities under Deposit Administration Group Annuity plans in their annual statements? Should the policy exhibits include, in the number of certificates outstanding, the employees for whom annuities have not yet been purchased? If so, what annual income should be assigned to the annuities for such employees?
E. What arrangements are being made under Group Annuity Contracts for handling payments under permanent total disability provisions of pension plans?
F. If it were desired to make individual policies available on termination of employment for the conversion of group hospital or other group accident and sickness coverages, what would be the principal problems to be faced, and how could they best be solved?

MR. E. A. GREEN expressed the opinion that the group contingency reserve is more properly a "below the line" surplus item rather than an "above the line" liability item, and that it might be considered as that portion of the group surplus arising from minimum systematic contributions, as required by management or supervisory policy, in accordance with some simple formula building toward a desired goal which in an individual company might constitute practically the entire surplus or only a portion thereof. Designed, in his opinion, to cover happenings outside the normal forces of mortality and morbidity, it is the pooled property of all policyholders for their mutual protection and benefit in case of abnormal fluctuations. It follows that contingency reserves can be considerably smaller than under a concept which would assign them for the benefit of the individual policyholders from whose contributions they arose.

Since the group contingency reserve as a surplus item does not lend itself to precise scientific development, it seems reasonable to set the company or industry contribution rate and goal on the basis of broad averages even though more refined methods may be used in the dividend or experience rating formula to secure an equitable contribution from each policyholder. Although the appropriate level of such reserves is largely a matter of opinion there are available some rough guideposts such as:

1. *Current Practice*

Many companies are building a voluntary contingency reserve for group life insurance at the rate of about 2% of premiums less dividends per year, with 50% of one year's premiums less dividends as the goal. At least one company is following a somewhat similar procedure with its group accident and health business. The 2%–50% pattern was sanctioned by the New York Insurance Department in 1934 and the Missouri Insurance Department in 1947.

2. *Legal Requirements for Nonprofit Hospital Service Corporations*

The laws of Massachusetts require that nonprofit hospital service corporations shall set aside 5% of net premium income for a "special contingent reserve fund," with an ultimate goal of 40% of a year's incurred losses; likewise, the laws of New York call for a contribution to a "special contingent surplus fund" of 4% of net premium income, with an ultimate goal of 25% of a year's net premium income.

3. *Experience 1914–1919*

Mr. Baldwin's paper, *TASA* XXXIX, showed an excess mortality rate of about 5 per thousand due to the influenza epidemic of 1918–1919. His model company demonstration showed an increase in mortality cost during the period 1914–1919 over that of the prior decade of about 12% a year for five years, or a total of 60%. Mr. Craig and Dr. Dublin published a table of increased mortality rates resulting from the influenza epidemic which indicates an increase in mortality in 1918 over 1917 of about 33% to 35% for industrial and intermediate policyholders after weighting the figures in accordance with the age distribution of the latest intercompany group mortality study.

4. *Limit of Proposed Pool Liability*

The limit of liability set forth in the proposed intercompany pooling arrangement for war catastrophe of $5 per $1,000 at risk is in the neighborhood of a year's extra claims which might average 80% of a year's premiums less dividends.

5. *Relationship between Lines of Coverage*

Three factors which might be of help in measuring the relative amount of abnormal fluctuations to be expected in the various lines of coverage are (*a*) the relationship to the premium rate of the standard deviation of the probability of occurrence of the event insured against, (*b*) the relationship to the premium rate of the maximum claim that could be incurred, and (*c*) the relative annual variations in claim rates over the four-year and three-year periods covered in the latest Intercompany Mortality and Morbidity Study. By measure (*a*), accidental death and dismemberment coverage would require about three times as great a percentage of the premium as life coverage, while weekly indemnity and hospitalization coverage would require about one-third as much as life. By measure (*b*), accidental death and dismemberment coverage would require over eight times as great a percentage of the premium as life coverage, while weekly indemnity and hospitalization coverage would require about one-third as much as life. By measure (*c*), the weekly indemnity and hospitalization coverages would require about twice as great a percentage of the premium as the life coverages. Depending upon the assumptions used as to the relative importance of these measures and the relative amount of accidental death and dismemberment insurance, the contingency reserve requirements for the group accident and health branch would range roughly from 50% to 100% of those for the group life branch.

Mr. Green concludes from these guideposts, and considering the contractual right of annual premium adjustment, that a contingency reserve goal of at least one-half a year's net cost would be reasonable for group life insurance and the group accident and health goal might well be between 50% and 100% of the life goal. Obviously these reserves would be far from adequate to take care of the holocaust accompanying all-out atomic warfare, but reserves adequate for such a type of catastrophe would be fantastic and impracticable.

These goals represent ultimate objectives to be accumulated gradually in such a way as not to discourage the continued extension of group coverage. As a result of the recent rapid growth in volume of group coverage in force, present contingency reserves are nowhere near such a minimum goal even though they have been accumulating over a period of years. It is interesting to note that the present two percent contribution rate amounts to approximately half the rate prescribed for Massachusetts and New York nonprofit Hospital Service Corporations.

MR. M. E. COMFORT submitted that the objectives of a group contingency fund are three-fold:

1. To level off fluctuations in cost from year to year. Small fluctuations in the claim rate as from the mild influenza epidemic of this year may be rather important when margins are small, and emphasize the need of funds to level off yearly costs. The availability of a contingency fund in his own company also provided an important means of establishing adequate reserves for Open and

Unreported Claims when it became apparent they were insufficient to take care of deferred maternity obligations.

2. To stabilize cost trends. Contingency reserves make it possible to avoid rate increases until it can be established that increased cost trends, such as increase in the cost of special hospital services or in connection with individual groups, are permanent.

3. To meet more disastrous contingencies which may occur, such as the influenza epidemic of 1918, the depression of the 1930's during which it was difficult to raise rates, and industrial explosions.

The London Life considers 50% of a year's premium as a fair target for all coverages with the rate of build-up depending on many factors such as surplus position, amount of new business and rate adjustment policy. They show group contingency reserves as a specific item among the special reserves of their annual statement. Mr. Comfort agreed that no individual accounting of contingency reserves by group should be required as this might encourage negotiations for return of such funds on termination of the group, which would be unsound practice.

MR. H. J. STARK, emphasizing that the level of group contingency funds is tied closely with a company's method of dividend distribution and level of initial and renewal premium rates, discussed the individual requirements of each coverage separately.

For Group Life he sees three principal needs for contingency reserves: (1) To meet the losses on the unprofitable groups. This is a common need for all coverages. (2) To meet the losses of a widespread epidemic, or a natural or man-made catastrophe. The 1918–1919 influenza epidemic, as an example, doubled the then rate of mortality. (3) To meet the cost of heavy conversions in event of termination of the master policy, or shrinkage of coverage in a severe depression—roughly estimated to require from 20% to 40% of a year's premium. Having regard for the increasingly favorable experience under Group Life and the availability of amounts otherwise payable as dividends to meet excess claims, he concludes that a suitable long-range objective is somewhat greater than one-half year's gross premiums.

For Weekly Indemnity, Mr. Stark believes the ultimate needs are probably no greater than for Group Life, but that the possibility of an adverse change in trend of claims requires more rapid accumulation of the contingency reserve. For Death and Dismemberment the contingency reserve requirement is two or three times as great as for Group Life because of greater fluctuations in experience due to smaller premiums. Hospital and Surgical coverages probably require somewhat higher contingency reserves than Group Life, again with a more rapid accumulation due to the likelihood of increasingly unfavorable experience. For the Medical Expense coverages the need seems to range from an amount moderately in excess of that for Group Life for those coverages where the premium is relatively high and the average claim per illness relatively small, to perhaps 10 times that for Group Life in the case of polio coverage.

Mr. Stark also stated that where separate coverages of a particular employer's Group plan are "packaged," so that a combined contingency reserve is built up for more than one coverage, the contribution of each coverage to that reserve may be appropriately reduced as compared with the amount required if that coverage were taken alone. He also pointed out that contribution toward contingency reserves by individual groups should be geared to accumulate somewhat more than the objective in relation to its premium, as otherwise a company would not, while its premium income is increasing, have its objective at any time with respect to its total business.

MR. H. L. FEAY cited the case of a Blue Cross plan which was not permitted by the Insurance Department to use some of its contingency reserves to meet current claims where it had failed to increase its rates in time. The contingency reserve was being held as an item of reserve along with the unearned premium reserves and the Department ruled that it had to be maintained and increased each year. Had it been treated as surplus funds it would have been available to meet the increasing claims and the hospital bills would not have gone unpaid.

MR. R. A. HOHAUS stated that the group dividend practices of the Metropolitan during World War II and their practice for catastrophes such as the Texas City disaster could probably form the pattern in event of a pooling of war risk on group life. During the war his company had retained a portion of the dividend otherwise payable which was placed in an additional contingency reserve for "Unusual Hazards arising out of the State of War." The company had complete freedom to use this reserve as a means of pooling excess losses among all policies had it deemed it necessary. Actually so few policies had excess losses greater than their contributions to the special reserve and the amounts were so small that, when the balance of the additional contingency reserve was paid as a special dividend, redistribution was based on each policy's own experience.

Following the Texas City disaster a provision was adopted in the group dividend formula for relieving the experience of a particular group of a portion of any unusual catastrophic losses. The maximum amount of such losses chargeable to a particular group is set by formula, and any excess amount is charged up against general contingency reserves. These can be replenished, if necessary, by appropriate increases in the contingency reserve charges for all groups. During World War II the Metropolitan also established a pooling arrangement for premiums and claims on policies where the employer continued group life coverage on employees serving in the Armed Forces.

In the event of an intercompany Group Life Insurance pool the Metropolitan could use methods similar to those described above to establish a special contingency reserve to meet pool assessments. Payments from the pool could be added to this contingency reserve and catastrophic losses of respective group policyholders could be charged partly to the experience under the policy and partly to the contingency reserve. Any ultimate remainder in the special contingency reserve could be apportioned to contributing policyholders in proportion to their equities.

Mr. Hohaus pointed to a parallel between this proposal and the arrangements under the New York Disability Benefits Law whereby the Workmen's Compensation Board maintains a Special Fund for meeting the costs of benefits to unemployed persons who become sick.

MR. G. N. WATSON concludes that additional amounts must be reserved for catastrophic acts of war in the "Home Area." Even those companies who have little business exposed in target areas would require such reserves against pool assessments if they joined the pool, which they might feel compelled to do in order to also have the privilege of joining the ordinary pool.

MR. D. C. BRONSON, objecting to the term "self-administered pension plan" for today's pension practice and preferring to call it a "trust-fund plan," confined his remarks on section C to that type of plan. He pointed out that inability under B.I.R. regulations to establish contingency reserves under trust-fund plans would result in a tendency for trust-fund actuaries to adhere to the more conservative interest assumptions. They may, of course, be overruled by the employer, trustees or labor-management pension board. There are also other reasons, where the employer can afford it, for using low interest assumptions, such as more adequate funding while funds are plentiful, high current tax rates, and getting in position for a possible change in reserve basis to a higher interest rate in event of difficulty in financing later on.

He also questioned whether there has been as yet any clear change in bond yields and whether the recent tendency on the part of trust companies to make greater use of common stocks in pension plan portfolios gives a clear enough picture of the investment situation. He concludes that there has been no noticeable effect as yet on interest assumptions for the trust-fund type of pension plan.

MR. W. M. RAE, while not claiming to be a disciple of the cyclic theory of interest rates, pointed out that it is a statistical method of forecasting which the actuary cannot ignore in making his interest assumptions. The cyclic theory holds that interest rates increase for a period of about 27 years, then decrease for a like period, but to a lower level than before. Having forecast a low in 1950, which materialized in 1947, the next high should come about 1975, and the next low about 2000, *a low which should be materially lower than 1947.* The 1947 low was more than 1% under the 1900 low. In view of present and almost certain future control of interest rates by the government, Mr. Rae cannot see a marked high in 1975, but possibly the maintenance of present levels as a plateau for at most the next 25 years and quite possibly for a much shorter period. On the other hand he thinks it most probable that interest rates will really skid from 1975, or even before, to an abysmal low around the year 2000. In view of this outlook he sees no justification for a liberalization in interest assumptions.

MR. R. H. MAGLATHLIN, speaking on sections D and E, discussed the practical problems that arise out of the two methods of accounting for deposit money received under D.A. (deposit administration) contracts: (1) reporting it as premium income when received, and (2) reporting it as income to a deposit account, from which transfers are made to the premium account when annuities are purchased.

Under method (1) a premium tax is payable when the moneys are received, while under method (2) the tax is not payable until annuities are purchased. The trend of premium tax rates upwards or downwards would determine which method is more advantageous taxwise. If the contract contains a provision under which the moneys may be subject to refund, method (2) may be more in accord with the facts, and no tax refund would be required in event of withdrawal, whereas under method (1) there might be a question of obtaining a large tax refund.

The liability for unallocated D.A. funds might appropriately be included with policy reserves where method (1) is used, and as a special liability item where method (2) is used. Such liability, which would usually be a percentage of the unallocated fund depending upon the loading in the premium rates, should at least equal the refund permitted under the contract if any.

As regards the policy exhibits, method (1) would seem to call for an estimate of the number of employees covered under the plan and estimated deferred annuities which could be purchased by the unallocated fund, while method (2) would seem to call for the omission of these figures. Mr. Maglathlin feels, however, that in the latter case a footnote indicating the number of employees covered under D.A. plans would be desirable.

The Travelers deducts payments for total disability from the unallocated D.A. funds on a pay-as-you-go basis up to the normal retirement date. At normal retirement date, a normal retirement annuity is purchased at the regular premium rates. This relieves the insurance company of having special premium rates for disabled life annuities and defining total disability; it fits in well with plans where a disabled pensioner's benefits are changed at the normal retirement date, and gives the insurance company the proper "spread" on retired life mortality by including all retired lives over normal retirement age.

MR. H. H. HENNINGTON stated that the Equitable reports moneys received under D.A. contracts as premium income when received. Their treatment of reserve liability and policy exhibit figures follows very closely the suggestions made by Mr. Maglathlin in regard to his method (1). He also pointed out that D.A. plans lend themselves well to the payment of disability benefits on instructions from the employer, with the employer assuming all the risk prior to retirement on disability as well as mortality experience.

MR. W. L. GRACE stated that the Massachusetts Mutual pays commissions immediately on regular D.A. plans and therefore treats funds received as premium income when received. For active lives they maintain regular policy reserves equal to 95% of the active life fund with accrued interest at the guaranteed interest rate. They also have a "Deposit Administration" rider on some of their Group Permanent policies for the purpose of accumulating the difference in reserves at age 65 between the ordinary life and retirement income basis. No commission is paid on the latter type and these funds are accordingly held in advance premium accounts until they are used to purchase annuities. They feel that the purpose of the policy exhibit is to show the number of employees covered under pension plans irrespective of funding medium and they therefore show the number of employees in the funding calculation of the previous policy anniversary. To estimate the annual income he suggests as one approach the amount that would be purchased if the policy discontinuance clause were elected. This might involve determining a valuation factor, based on an average attained age (weighted according to the method of allocation of the active life fund) and a definite retirement age, by which the amount of the active life fund would be divided.

MR. J. B. GARDINER stated that the Metropolitan has in force about 30 contracts issued in the period 1925 to 1932 under which a disability benefit was included as a supplementary coverage. Although the sale of such benefits to new groups was discontinued in 1932 the coverage under these groups has continued to grow as new employees became eligible for the benefits. These benefits, together with the underwriting rules and premium rates, were given by Mr. R. A. Hohaus in his paper on Group Annuities in *RAIA* XVIII. The original rate basis is still in effect for most of the contracts, even though the right to change rates was reserved. Experience covering a span of about 25 years shows incurred claims to be 76% of premium income.

In the last 15 years there has been very little demand for insurance to cover the total and permanent disability benefit, but more recently the pension pattern which emerged from the labor negotiations in the steel industry bids fair to increase the use of such insurance. These labor plans generally provide an annuity commencing on determination of total and permanent disability and continuing until the date of retirement at which time the regular retirement pension starts. Eligibility is usually limited to employees with 15 or more years of service at date of disability, and the disability annuity is generally fixed at $50 a month regardless of earnings or length of service in excess of 15 years. As these negotiated plans usually provide that disability status be determined by a committee representing both union and employer, it would probably be necessary to provide that the employer pay benefits directly in those cases where the insurer rejects the claim. He recommended a waiting period of not less than three months and preferably six months of disability. He also drew attention to the fact that a benefit of $50 a month is greater than the customary retirement pension of $100 a month less the primary Social Security Benefit.

The Metropolitan is again prepared to include disability benefits where it appears satisfactory.

MR. M. D. MILLER, in regard to section F, expressed the opinion that it would be reasonable to exclude weekly indemnity benefits from any policy granted in conversion upon termination of employment, (1) because most of the employees will have no continuing wages on termination of employment and (2) because the companies are under no competitive pressure, such as from Blue Cross, to give these benefits. He would limit converted benefits to hospital room and board daily benefits, hospital extra charges not to exceed 20 times the daily benefit, surgical expense benefits and in-hospital medical expense benefits. In restricting the allowance for hospital extras to 20 times the daily benefit or cutting down the scope of medical expense benefits to in-hospital coverage only, he would keep the coverage in those areas where experience has proved the benefits to be relatively sound.

Schedule type of policy forms with uniform provisions and permitting variations in fill-ins could be used. Claims for which benefits are due under the master policy should be excluded and individuals should not be permitted to elect insurance of greater amount or scope than their terminated insurance under the group policy.

He feels that in order to meet the social need as well as Blue Cross competition conversion should be offered at all ages, at retirement as well as on termination of employment, and converted policies should not be canceled on attainment of a specified age. Consideration could be given, however, to some limit, such as an aggregate amount per year, after, say, age 60, to offset to some extent the cost of benefits at the higher ages.

While it would seem in order for the insurer to reserve the right to refuse renewal on any premium due-date, such a clause should, in Mr. Miller's opinion, be included for its general effect rather than with the intention to cancel for a bad claim record. The right might be reserved to change premiums on any premium due-date—again with no intention to increase rates based on the experience of the individual policy but on this class of business as a whole.

While he feels that premium rates cannot be set so as to make these policies self-supporting, it should be possible to set them higher than the group premiums, probably at about the level charged for individual policies, and he feels that no commissions should be paid on such conversions.

Since there will undoubtedly be excess losses under converted policies, there is much to be said for charging such excess losses up against the experience of the master policy. A percentage of the first year premium for the converted policy, possibly graded according to age, and estimated to cover the excess losses on the average, might be charged against the master policy. He suggests further that the employer be permitted the option of deciding whether to make available the conversion privilege to his employees or not.

MR. C. H. TOOKEY stated that the Occidental incorporated a conversion privilege in its Group Hospital and Surgical policy about three years ago to meet Blue Cross competition.

One of the difficulties was preparation of an individual policy which resembled the group benefits sufficiently to make a satisfactory conversion. Through four basic policies, (1) hospital benefits for employees and dependents, (2) hospital benefits for employees only, (3) surgical benefits for employees and dependents and (4) surgical benefits for employees only, along with three schedules of daily hospital benefits and riders covering medical calls in hospital, pregnancy and laboratory costs, they found it possible to give benefits which are fairly close to those which were in the group policy.

They propose to study the excess claim cost on converted policies and to determine from that how strict to be on renewal of policies with high incidence of claim, and the amount to be charged against the group contracts. They may possibly charge the yearly loss against all group policies with conversion privileges rather than to the individual groups.

There has been insufficient time as yet to determine the rate of conversion and degree of adverse selection.

MR. E. H. MINOR pointed out that companies without an individual Accident and Health department would have to set up such a department if they were to offer individual policies on conversion, but even the existence of such facilities does not necessarily mean that a suitable coverage can be found. For a policy comparable to that given on conversion of group life, a "noncancelable" or "guaranteed renewable" contract would have to be given. Most policies now issued are of the one-year cancelable type.

He believes that rather than design comparable individual coverage it would be more practical for employers to give extended hospital and surgical coverage for some reasonable period, say six months, on the usual "lay-off" basis. The losses of such extended coverage would then be charged against the experience of the employer. Such extension, if applied to Weekly Indemnity coverage, should be subject to a requirement of early re-employment to justify such loss of income coverage.

Many of the conversions on male lives would undoubtedly be prompted by a desire for temporary coverage. Extended insurance for a period of six months, even if it is then followed by a conversion privilege, would cut down the number of conversions and eliminate many of the early lapses to be expected on converted policies. The lapse problem would be especially acute for resigning housewives.

High premiums required for the broader forms of family coverage and for policies on industrial risks would be far higher than the original group contributions and beyond the means of many wage-earners. This might result in considerable adverse selection, followed by a high lapse rate. In effect, therefore, an immediate conversion privilege at regular premiums might prove of little real value to the average employee.

He felt that losses on such conversions might be substantial and reluctance of employers to bear the anticipated extra cost is likely to prevent any widespread adoption of conversion clauses. He also admonished against permitting conversion of only a small part of the coverage, because the expense of carrying such small policies would be very large in proportion to the benefit, and also pointed out that elimination of commissions would accentuate the high lapse rate expected.