TRANSACTIONS OF SOCIETY OF ACTUARIES
1959 VOL. 11 NO. 30AB

INDIVIDUAL ACCIDENT AND SICKNESS INSURANCE (SAN FRANCISCO REGIONAL MEETING)

Premium Factors

A. What level of expenses are companies experiencing in underwriting, claims administration and general administration under various coverages:
   a) Hospital-surgical?
   b) Major medical?
   c) Loss-of-time?
   d) Over-age policies?

B. What are the advantages and disadvantages of premium scales for hospital-surgical and major medical policies which vary by geographic area? Can the problems be met better by variations in benefits?

MR. CHARLES N. WALKER, in giving some expense factors drawn from the Lincoln National's business, stressed that they were at 1957 expense levels and, because of allocation methods, probably represented a comparatively high ratio of first to renewal expense. Exclusive of commissions, premium taxes and federal income taxes, these expense factors were:

First Year	$60 per policy plus medical and inspection fees
Renewal	$3.20 per policy

These expenses were identified by Mr. Walker as including some noncommission general agency costs, a full share of allocated expenses and general overhead, and claim adjustment expenses. These expenses were about 70% of corresponding life expenses. Mr. Walker favored allocation of claim expense proportionate to the net claim cost component of the premium.

MR. EDUARD H. MINOR said that Metropolitan prefers to view the claim adjustment expenses as a percentage of claims rather than premiums. Such expenses run less than two and one-half percent of the Group claim payments, whereas (before the introduction of hospital expense coverages) they accounted for about nine percent of Individual Accident and Sickness claim payments. Metropolitan's loss ratio on Individual Accident and Sickness business is running about fifty-two percent.

MR. BEN J. HELPHAND made the point that the level of claims expense on accident and sickness policies varies considerably depending, in addition to type of business issued, upon a company's method of claims handling and concentration of business. Many companies pay claims directly from the home office by mail, with difficult claims being handled by home office claims adjustors on field trips or by employing field claim men

who operate out of their homes and cover a surrounding area. This proves to be a low cost method of claims operation since only a small percentage end up in the difficult category. A few companies make use of trained girls in branch agency offices for paying routine claims, with difficult cases being referred to the home office.

One company with a large concentration of business in several areas achieves a low level of claims expense through the use of district claims offices which operate as independent units. On the other hand another company which uses district claims offices experiences a relatively high level of claims expense because of a lack of concentration of business in some of the areas serviced by these offices.

MR. PHILIP F. FINNEGAN described the Prudential's practice of paying certain hospital claims under individual policies from the branch sales office during the contestable period. After that time, most hospital claims are paid by the branch offices, although certain claims must still be referred to the regional home office.

Mr. Finnegan went on to make these personal observations on the medical care situation in the area serviced by Prudential's southwestern home office:

1. In the southwestern part of the United States, the pattern of charging is such that a substantially larger share of the total hospital bill results from miscellaneous hospital charges than is the case in the North and the East.
2. Now that a high percentage of the general population has hospitalization insurance, it is possible for a hospital to operate without public subsidy and, in fact, even make a profit for the owner or owners.
3. In the Southwest, particularly in the newer communities, hospitals are not unpleasant places to go to, featuring rooms and meals comparable to those in a first class hotel.
4. It is a rarity for a doctor to make a house call in the Southwest. People too sick to go to the doctor's office are seen by him at the hospital.

These observations led Mr. Finnegan to the conclusion that a set of rates which may be perfectly adequate in old established areas, such as Kansas City, St. Louis or New Orleans, may not be appropriate in communities with private hospitals, new facilities, and different medical practices.

One possible solution to this problem is to establish a set of rates which vary by area. Unfortunately, in Mr. Finnegan's experience, high cost areas do not always follow state lines, so another method of area differentiation must be established. Mr. Finnegan believed that the proper solution is to issue a special set of policies only in that area where the individual Accident and Sickness claims are higher than desired. For example, he proposed selling a ten dollar plan in such an area with rates only slightly less

than those for regular twelve dollar plans. As he saw it, this solution would eliminate any questions of discrimination or overt problems of rate changing when policyholders move from one territory to another.

MR. WILLIAM D. BISHOP stated that the question of varying premium scales, level of benefits, or both, arises because of the fact that average costs and utilization of hospital, medical, and surgical services vary by geographical area. This may not be a significant problem to a company which has only a small portion of its business on the West Coast. However, Pacific Mutual has a large proportion of their agency force operating in California and has found from its statistics that average costs and utilization of these benefits are well above the levels for the rest of the country. Consequently, it has had to consider this problem in policy drafting and rate making.

Mr. Bishop found that some of the advantages of varying premium rates by area over using an average premium for the country as a whole are:

1. It affords more individual equity among policyholders since it puts a more realistic price on benefits which are offered throughout the country.
2. It allows the company to be highly competitive ratewise in low cost areas.
3. It reduces selection against the company from abnormal increases in new business in high cost areas because of rate "bargains."
4. It also permits shifts in distribution of new business by area without having any appreciable effect on loss ratios as long as premiums are adequate in each area.

On the other hand, some of the disadvantages of varying premiums by area are that:

1. More than one premium scale is more costly both in rate book preparation and in proper administration.
2. Problems in adequacy of rates are encountered if significant shifts in the distribution of outstanding business occur from low cost to high cost areas. Conversely, if shifts occur from high cost to low cost, persistency could be affected if there were a large spread in the rates.
3. Agents in high cost areas might have difficulty with competitors who use a national average rate for similar benefits.
4. Finally, if benefit levels, such as hospital room and board, are not also varied by area, these benefits are liable either to be inadequate in one area or to tend to promote malingering in another.

Mr. Bishop identified this last disadvantage as the primary reason that Pacific Mutual has favored the approach of using benefits geared to levels of average charges by area with premiums adequate for these benefits. For example, Pacific Mutual offers its individual comprehensive hospital

and medical expense policy in two plans, one designed for California and one for outside of California. The California plan provides a maximum benefit of seven thousand five hundred dollars for any one disability, subject to a deductible and certain inside limits such as twenty-five dollars per day for hospital room and board and a seven hundred fifty dollar surgical schedule roughly based on the California Relative Value Scale. The outside-of-California plan has similar policy benefits, but with a maximum payment of five thousand dollars and inside limits of fifteen dollars per day for room and board and five hundred dollar surgical schedule. The rates for these two policies not only differ because of the difference in benefits but also reflect higher payment levels and utilization in the California policy. Sales and loss ratios on both plans have been very satisfactory.

MR. ALFRED L. BUCKMAN said that the Beneficial Standard has about twelve million dollars of premium income on an individual and family hospital and surgical policy plan. About ten years ago, Beneficial Standard expanded its activities from the central, western, and northern states to the South, running into immediate difficulties. Claims for hospitalization confinement are much more frequent by number and much greater by volume in the South for confinements not involving surgery than they were elsewhere in the country. Many of the hospitals are small and operated by individual doctors or by partnerships of two or three doctors. The slightest ailment, even simple respiratory ailments, often would cause a patient to be confined to a hospital.

Mr. Buckman pointed out that since the Beneficial Standard's policies provided an indemnity benefit, many policyholders made a profit by taking a hospital room that cost less than that provided by the benefit. Realizing that antiselection through malingering was being directed at it, Beneficial Standard changed its policy in the southern states from the indemnity type to a reimbursement benefit for daily hospitalization confinement. This did not solve the problem. Mr. Buckman described a more efficacious tactic, consisting of raising the rates in a half dozen southern states to thirty percent above the rates elsewhere.

Beneficial Standard offers an unusual "double indemnity" benefit for hospitalization resulting from an accident, the daily benefit doubling in that event.