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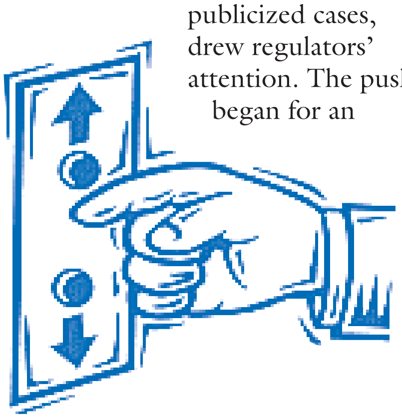
Seeking the right level

What does today's world demand in disability reserves?

by Carl Westman

As the times go, so do economic conditions. In the 1970s and '80s, with high interest rates and a strong demand for professionals such as doctors and lawyers, issuers of disability insurance wrote policies that today would be considered liberal. For several years now, independent professionals have endured intense economic competition. Among these professionals, particularly those with rich disability plans, an unexpectedly high number have exited self-employment through disability, leading to a level of claims that issuers never expected. Meanwhile, interest rates have dropped substantially, returning less to the investments that support insurers' reserves.

This situation has led to some prominent cases of insurance company losses due to reserve strengthening. Those instances, along with less well-publicized cases, drew regulators' attention. The push began for an updating of the disability portion of the NAIC's existing model regulation on accident and health reserves. Final approval of the updated model could come as early as fall 2000, with the model taking effect in January 2001.



In January 1998, the NAIC's Life and Health Actuarial Task Force (LHATF) asked the Society of Actuaries to examine disability insurance reserving standards and practices. The request grew out of the NAIC's concern over reports that statutory reserves based on current morbidity tables frequently fail tests of adequacy and reasonableness.

In response, the Society created the Task Force to Recommend Statutory Morbidity Standards for Individual and Group Disability Benefits, chaired by Tom Corcoran. This task force established subcommittees, one each for individual and group insurance. Corcoran also chairs the group insurance subcommittee, while Bob Meilander chairs the individual subcommittee.

Individual work completed

In May 1999, the individual subcommittee released its final report, which was based on a review of experience contributed by large writers of disability insurance. The subcommittee focused on claim reserves, reflecting the belief that, owing to various reserve tests, active life reserves were felt to be adequate.

The experience data showed that the existing morbidity standard for individual disability insurance, the 1985 CIDA table (85CIDA), was no longer appropriate in light of current experience. Claim termination rates for the first year of disability were approximately 25-50% lower than in 85CIDA, implying a need for higher reserves. Interestingly, for claims beyond the second year, recent experience shows higher termination rates than in 85CIDA (by approximately 33-50%). Overall, however, the SOA task force considers the 85CIDA table inadequate and inappropriate as a minimum valuation standard.

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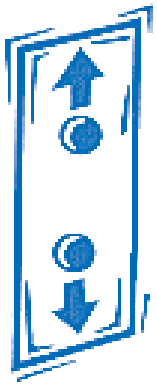
The individual subcommittee recommended that, over the long term, a completely new table be developed. However, in light of the time and effort required to complete a new table, and with pressing concerns over the current valuation standard, an interim approach was adopted. This approach recommended a set of adjustment factors to be applied to the termination rates in 85CIDA.



The committee also recommended that companies be allowed to continue using their own experience in developing termination rates for the first two years of disability.

The report has been received (though not yet approved) by the LHATF. Corcoran anticipates the NAIC will consider the recommendations for adoption once the group subcommittee finishes and submits its report, so that the recommendations will proceed through the regulatory process together.

Group work continues

The group insurance subcommittee work grew out of the 1996 SOA Group Long-Term Disability Experience Study, led by G. Nicholas Smith. This study updated LTD experience for the 1986-95 period. The subcommittee is in the process of validating the 1996 study and adding to it experience from 1997 through early 1999.

The current LTD valuation standard is the 1987 Commissioners Group Disability Table, also known as "87CGDT." This table was based on termination rates developed from Society data through 1980 and, for durations beyond 10 years, from termination rates in 85CIDA.

As with the recent individual experience, group LTD termination rate experience was found to diverge significantly from the valuation standard currently in place. However, recent termination rate experience has been higher across all durations of LTD claims. Overall, the 1996 SOA study showed termination rates significantly higher than the 87CGDT.

Corcoran's subcommittee is preparing an entirely new group disability table to be recommended to the NAIC. This table would permit lower statutory reserves. It is also expected to provide more parameters for claim reserve valuation by incorporating adjustments for type of disability (such as maternity or mental and nervous claims) and for definition of disability (when the definition changes from "own occupation" to "any occupation").

Looking ahead

The SOA task force hopes to send its recommendations to the NAIC in February 2000. This would allow the regulators to discuss them at the NAIC's spring 2000 meeting for possible incorporation into the NAIC's Health Insurance Reserves Model Regulation.

If the timetable works as planned, the model regulation would be exposed this coming spring, allowing adequate time for discussion before the NAIC's summer 2000 meeting. Comments received during the exposure period would be considered at the meeting, and if no significant revisions are needed, the model would be adopted at the committee level. The final approval would come at the fall 2000 NAIC meeting, when the NAIC Executive Committee and Plenary would vote on the model regulation. The earliest possible implementation date would be January 2001.

Carl Westman, an actuary in private practice, was an LTD actuary with Provident Companies (now UnumProvident), 1994-97, and is an assistant editor of *The Actuary*. He can be reached by e-mail at *cw@actuaryoncall.com*.

Retirement 2000 Conference

Approximately 20 papers will be presented at the Retirement 2000 Conference, Feb. 23-24, 2000, at the Washington Court Hotel, Washington, D.C.

As the year 2000 approaches, the world is undergoing significant demographic and economic shifts. Population aging is an issue in many countries, and the potential looms for policy changes, tax reforms, and changes in social security programs. The Society of Actuaries, in cooperation with other actuarial, employee benefits, government, and research organizations, sponsored a call for papers on issues affecting public policy on retirement in the next millennium.

Speakers from around the world will address subjects with both domestic and global impact. Topics relate to private retirement savings markets, demographics, employee contributions, small employers, public social security programs, 401k plans, bridge jobs, impact of legislation, annuities, women's issues, and more.

Watch the mail and the SOA Web site (*www.soa.org/conted/R2000. html*) for details and to register.

Summary of OASDI and Medicare programs

Robert J. Myers, former chief actuary of the Social Security Administration, has completed a revision of his *Summary of the OASDI and Medicare Programs.* This 62-page document describes the programs as of January 2000. Copies may be obtained by writing to him at 9610 Wire Avenue, Silver Spring, MD, 20901, after Nov. 30 and enclosing five 33-cent stamps and a self-addressed mailing label.