

**TRANSACTIONS OF SOCIETY OF ACTUARIES
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LONG-TERM DISABILITY BENEFITS

Underwriting

- A. What are the underwriting considerations which enter into a determination of the amount of disability income benefit from all sources combined in terms of take-home pay that can be safely offered?
- B. What deductions from the basic long-term disability benefit are being made for disability benefits from Social Security, total and permanent disability benefits under group life insurance, early retirement benefits and disability benefits from other sources?
- C. What formulas in terms of gross earnings have been developed for group long-term disability benefits in the light of such considerations?
- D. In the premium rate for a long-term disability plan, what methods are used to evaluate benefits, such as those referred to in B above, which are contractually deductible?

New York Regional Meeting

MR. PAUL H. JACKSON: After disablement, an individual may receive less income than he would have received had he not been disabled. The loss to be insured by long-term disability (LTD) would be related to what he would have received at that time, not what he was earning prior to disability.

Some forms of income cease at disability (earned income); other forms of income may continue without change (investment income). Some forms of income may commence upon termination of employment for disability (disability insurance benefits, early retirement pensions and disability pensions).

Early retirement benefits can be viewed in two ways:

1. Early retirement benefits commence when the individual terminates employment, and therefore he does not suffer a total drop in income; thus you count the early retirement benefits after disability as an offset to the amount of benefits that are being provided.
2. The individual is drawing down a capital asset by taking a lower income amount after normal retirement age in exchange for an earlier benefit. The early retirement benefit is not payable on account of disability but on account of termination. It is available to anyone who terminates with a certain age or service requirement, whether or not he is in ill health. Thus you would not offset the benefit.

Under some pension plans early retirement benefits are not reduced, and with supplemental allowances and Social Security makeups may

even be larger. Here the rationale in point (2) becomes a little more difficult.

Many life companies ignore the early retirement benefits under pension plans in defining the loss involved in LTD; those that do offset usually count any pension that the individual may receive.

Disability retirement benefits are tougher to analyze than early retirement benefits. Where an individual meets the age and service requirements for a disability pension, but not for early retirement benefits, the entire disability pension can be considered as income received as a result of disability and can be offset in determining the appropriate amount of benefit for the individual. However, when that individual has reached the age and service requirements for early retirement, some would hold that only the excess of the disability retirement benefit over the early retirement benefit should be counted as a true disability benefit and offset. In many pension plans, the disability pension is expressed as a supplement to the regular early retirement benefit, and only that supplement then would be counted as other income.

Once we have settled on the level of income before disability and after disability (and maximum loss), a number of other factors should be considered:

1. The differing effect of federal income tax or state income tax on earned income and on disability benefits.
2. Some expenses involved in working cease when disability commences: payroll deductions of various sorts, transportation expense, the expense of working clothes, office contributions, etc.
3. Other expenses commence at disability, chiefly medical expenses. To the extent that they are adequately covered under the employer's group health plan, these can be ignored.

Some years back the maximum amount of LTD seemed to be \$500. It went up to a \$1,000 in a hurry. Today people are writing \$2,000 or \$3,000 monthly. At the lower income levels, most of the income is spent on the necessities of life. At the higher income levels an ever smaller percentage of total income is spent on the necessities. Should you attempt to insure a continuation of the complete standard of living? Probably not. For example, the continuation of an investment program wouldn't seem to be insurable.

An element of coinsurance is highly desirable. The individual should have a financial incentive to get back to work.

Insurance company losses under LTD in the 1930's involved hundreds of millions of dollars. The threat of a depression should introduce an ele-

ment of caution and a reduction in the maximum amount that an insurance company might otherwise consider insurable.

The problems of deflation and inflation also have an effect on the theoretically proper amount of disability benefit. With inflation, the longer a person is disabled, the more and more inadequate his benefits become. With deflation, benefits initially proper get to be too great. This might be an argument for some sort of cost-of-living adjustment on the LTD benefit.

Social Security H.R. 6675 contained four fundamental changes in disability insurance benefits:

1. The definition of disability is liberalized (permanence dropped).
2. The amount of benefits have been increased approximately 7 per cent.
3. The waiting period has been reduced by 1 month.
4. Dependents' benefits instead of stopping at age 18 will run through 22 if the dependent child is in school. But the wife's benefit is payable only if there is a child under 18, so that this has the effect of extending only the child's benefit not the wife's.

In summary, I would say that long-term disability coverage is highly desirable. I can see it spreading widely, but I think that unless underwriting practices settle down to a sounder basis, some of the companies now writing it are in for some real trouble.

MR. RICHARD G. SCHREITMUELLER: LTD involves special problems not encountered in the neat, precise fields of life insurance and annuities. These problems stem from the words "total disability." We shall probably never see the day when total disability can be defined objectively or proved in a clear-cut fashion.

It is very important to limit a man's disability income to something less than take-home pay. This provides some financial incentive to get back to work and off the claim rolls as soon as he is able to do so. A plan providing excessive amounts of income can destroy the individual's incentive to support himself, can deprive his employer of his skills and experience and can prove very costly for the insurer.

The majority of plans being underwritten by the Aetna today are contributory, with the employee paying the full cost in many cases. This means that all or most of the income will be received free of federal income tax. We limit income to 80 per cent of the first \$4,800 of annual earnings and 60 per cent of the excess over \$4,800. These limits apply to income from all types of government-sponsored and employer-sponsored plans, including Social Security, workmen's compensation, income benefits under Group Life plans, disability pensions, etc., but not individual

policies of life or health insurance. Where an employee's total disability income exceeds these limits, the insured benefit is reduced accordingly.

In arriving at LTD premium rates, it is our practice to reduce premiums by taking into account benefits available from Social Security, disability pensions, etc. The Social Security offset factors are graded according to age, sex, and earnings.

Until recently the public was unable to purchase LTD on favorable terms. Let us hope that the Group-writing companies, in their effort to fill this void, do not lose sight of the principles which govern this form of insurance.

MR. ROBERT E. SHALEN: At the Equitable of New York we have recently been asked to underwrite very liberal LTD plans, which I believe give real cause for concern.

The recent Can Company settlement provided 70 per cent of gross earnings without any integration with the dependent's Social Security benefit. This amounts to 90 to 110 per cent of take-home pay for some employees with dependents. There are indications that the steel industry may bargain for the same kind of benefit.

An example of a very liberal plan which we have been asked to quote on followed the Can Company formula with the following liberalizations:

1. No cutback in benefits to existing disabled employees in case of poor experience. This cutback is a feature of the Can Company plan.
2. Benefits would be paid to age 65 for all employees. The Can Company plan provides a modest two-year benefit for employees with less than 10 years of service and a maximum 5-year benefit to employees with longer service.
3. Full pension benefits would be purchased while the employee is disabled. The Can Company employee accrues no pension while he is disabled, a powerful incentive to those age 50 and over to return to work.

The benefit formulas being offered today are without question more liberal than those offered 35-40 years ago, which resulted in such substantial underwriting losses in the 1930's.

MR. GEROLD W. FREY: Benefits received during disability should be at a level that will leave a reasonable incentive to return to work. However, there is no absolute standard by which such a reasonable incentive can be measured. It varies from one individual to another. Thus practical consideration must determine the amount of benefits which are written for individuals in a group.

New York Life writes benefits generally at the level of 50-60 per cent

of gross salary; together with this there is an overriding limit which is usually not in excess of 70 per cent of gross salary.

Sound underwriting requires taking into consideration income benefits during disability from all sources that we have to integrate, either through direct offset or through the overriding provision.

Our established policy does not provide for integration with individual policies of loss of time because we feel we could probably not enforce such an integration.

We do not allow in our premium rates for any credits for integration of workmen's compensation. We do not allow any premium credit for integration with total and permanent disability income benefits from Group Life. We feel we cannot force an employee to apply for income benefits under total and permanent disability in Group Life when, at the same time, he is losing Group Life benefits as income benefits are paid.

MR. ROBERT J. MYERS: I should like to give a few more details about the pending Social Security legislation:

1. The waiting period for disability benefits under the present law is, on the average, really $7\frac{1}{2}$ months because the month of disablement does not count and since the first benefit is not paid unless the beneficiary survives to the end of the seventh succeeding month. The new law would reduce this period by one month, so that the waiting period would average $6\frac{1}{2}$ months.
2. Under present law, a person who recovers from disability does not have to serve an additional waiting period, but with the change in the definition of disability, it is necessary to avoid some illogical cases. If a person recovers from a disability before 18 months, he must then serve a full waiting period for his next disability. On the other hand, a person who has been disabled for 18 months or more and who then recovers will not have to serve a waiting period if he again becomes disabled within 5 years and if it appears that his disability will last for at least 12 months or will result in his death.
3. Under the bill, if recovery occurs before 18 months of disability, the individual will get, in effect, a two-month payment, whereas those disabled for 18 months or more will get the three-month payment, as under the present law.
4. Under present law, once a person has claimed reduced old-age benefits, at age 62 or later, he cannot subsequently qualify for disability benefits. Under the bill, a person can qualify for disability benefits after receiving reduced old-age benefits, but there would then be a reduction corresponding to the period that the old-age benefits were received.
5. Duplication of disability benefits between workmen's compensation and OASDI, the House Ways and Means Committee believed that there was not sufficient information to make a decision, and it recommended that the Social Security Administration make a study of this subject and present recommendations before December 31, 1966.

6. The allocation of the contribution receipts to the Disability Insurance Trust Fund will be increased to .75 per cent of payroll, from the present .5 per cent (combined employer-employee rate), so as to recognize the increased costs involved in the benefit changes and so as to remedy the lack of actuarial balance in the DI portion of the present system.

Denver Regional Meeting

MR. RICHARD G. SCHREITMUELLER repeated the discussion which he had presented at the New York meeting.

Experience

- A. What has been the recent experience under long-term disability benefits and what claim statistics are available; e.g., frequency of claim and termination rates? What is the trend by policy year, giving due regard to the waiting period?
- B. What has been the experience on groups in areas with local economic depressions; where employers have had financial setbacks with resulting decreases in work force; or in defense industries where there have been severe cutbacks in employment?
- C. What factors should be taken into account in establishing reserves for these benefits? Are claim fluctuation reserves or stabilization reserves necessary and desirable?

New York Regional Meeting

MR. FRANK J. BUSH: The chairman of the Society's Committee on Experience under Group Health Insurance has asked me to report to the membership on the committee's proposed plans for studying experience under Group long-term disability insurance. We are contemplating a depth study in three parts:

1. An active lives study from which annual claim frequencies would be derived.
2. A disabled lives study, from which disabled life annuities would be constructed.
3. A claim cost study, in which the related effect of frequency and duration would be observed within the same experience unit.

It is expected that the initial study would cover calendar years 1962, 1963, and 1964. Most of the heavy spadework has been done, but there are still several details to be resolved.

In many respects this study, involving as it will a multiplicity of cost variables, will be as complex as any undertaken by the committee.

MR. C. GILBERT NOREN: Experience studies of LTD at the Prudential have brought out three significant facts:

1. Rates of disability are about what we expected.
2. Terminations of disability are somewhat less than expected but not critical.
3. Social Security approvals are far below expected. The results show that claims incurred prior to July, 1963, have a 75 per cent social security approval rate; claims incurred prior to October, 1963, have a 63 per cent rate; claims prior to January, 1964, have a 46 per cent rate; and claims incurred prior to April, 1964, have a 46 per cent rate. The Social Security amendments, which will remove the "permanent" aspect of the definition of disability, will make claim rejections by insurance companies more difficult, but it will help con-

siderably in the relationship of Social Security approvals to insurance company approvals.

MR. ROBERT E. SHALEN: I can cite an example of the effect that serious cutbacks can have on LTD experience. Recently we had a large defense industry group in which the number employed dropped from 35,000 to 23,000 in a period of six months. Subsequently, the LTD loss ratio was 86 per cent, probably double what we would have expected.

Denver Regional Meeting

MR. ROBERT A. HALL: As of January 1, 1964, the Aetna had approximately 400 Group LTD policies in force under which in total about 350 claims have been incurred. The financial experience in connection with these claims is now being drawn off.

A meaningful analysis of LTD experience requires a clear understanding of the methods and factors considered in developing reserves. These reserves are by far the largest segment of the total of all LTD benefit liabilities. These reserves represent the present value of future benefit payments to individuals who are known to be totally disabled and who have definitely established claims. The reserve funds held to cover this liability with appropriate interest credits on these funds are calculated to be exactly sufficient to cover all claim payments to all employees who are disabled at the time the reserves are established.

Methods of calculating these reserves are:

1. Examine each individual claim and make an assessment of the extent of the disability to determine the most likely future duration. An interest discount may be applied. This approach may be subject to criticism because of the inherently large degree of individual choice that is exercised in establishing the reserves. This subjective element may result in little uniformity both in the application of the rules for determining reserves and in the results that are obtained.
2. Use a reserve table based on one of the standard morbidity tables to determine reserve values. This reserve represents the present value of an annuity payable to a disabled life. This value does not take into account the cause of disability or the most probable prognosis of the claim but is based on age at disability, period of time disabled, and the remaining scheduled benefit period of eligibility for benefits. Generally, the same tabular reserve is used for both male and female.

Rehabilitation

- A. What contract provisions are included to encourage rehabilitation?
- B. In the absence of specific provisions, what practices are followed to encourage claimants to gradually return to full-time employment?

New York Regional Meeting

MR. C. GILBERT NOREN: The end result of rehabilitation is not necessarily putting a man back in the same job he was in prior to disability. Nor is it supporting his income at a predisability level, or some high percentage of that, after he has been rehabilitated at a lesser salary.

To be successful, rehabilitation must be completed within a year or two of initial attempts at rehabilitation. Specifications that call for an unlimited rehabilitation period (to age 65) are not asking for rehabilitation; they are asking for replacement or guaranteed income.

Other so-called rehabilitation provisions integrate the LTD benefit with only a portion (example 50 per cent) of the insured's rehabilitation earnings. This means that a person can get the equivalent of his full LTD benefit plus half of his outside earnings. If you've gone along with the salary supplement for any period of time and there is no material change in the person's condition, you may find that even though the person is receiving almost as much as before he became disabled, for much less effort on his part, you are estopped from terminating payment.

You can't spoon-feed a disabled person into rehabilitation. If he doesn't want to get back to work, no amount of financial inducement can make him.

I believe the best rehabilitation provision for an LTD contract is one of short maximum duration (one or two years) with full integration with rehabilitation earnings.

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MR. RICHARD B. SIEBEN: Both Continental Assurance and Continental Casualty are experimenting with rehabilitation clauses. I feel that the opportunities available to LTD carriers in this area are great, particularly since I get the impression from meetings such as this that the only creative thinking in the LTD field is in the area of justifying lower and lower rate levels. LTD underwriting is concerned primarily with concepts based on levels of income and how much can be written safely over long periods of time.

I have had the opportunity to thoroughly review about 75 active claim folders for the last three years. I would like to make the following observations:

1. LTD has changed employment practices, for employers are not able or willing to hire people today that they might well have hired in the past. This has broad social implications in an era when the hiring of the handicapped, the hiring of men over 40, etc., receive much attention and publicity.
2. We can talk a great deal about the clauses that define disability. However, on a large account, doesn't the basic criterion eventually become the employer's willingness to rehire rather than the ability of the employee to perform useful work? This makes the insurer a party to relegating people to the vegetable garden.
3. When we consider that the reserve on a disabled life may be \$50,000, or even \$100,000, wouldn't it be worthwhile for us to pay some part of this amount to a third party for the purposes of attempting physical and job rehabilitation?
4. The individual's attitude toward disability is extremely important, often more important than the percentage of income replaced. Experience with persons unwilling to accept early retirement ought to convince us that there are people who would fight to recover from disability even if they were paid 100 per cent of their regular income; such persons would do everything possible to become active and productive again. There are others for whom even a modest disability income would create a severe temptation to malingering.
5. A particular underwriting problem can result from the woman who has returned to work after a long period of being out of the employment market. Her return to employment might well be for the very causes that might create a potential LTD claimant of long duration.

Rehabilitation is one of several areas for potential creative thinking. Success with rehabilitation can save a lot of lives as well as money.

MR. NORTON W. CHELLGREN: The willingness of an employer to place a disabled person back on his rolls is closely related to his ability to do so. In good times it is much easier to rehire; in times of depression it can be very difficult.

MR. EDWARD H. WELLS: As an aftermath of past heavy claim experience of Mutual of New York under life insurance total and permanent disability benefits, certain rehabilitation procedures were developed which are now being extended to group disability income claims, where the attending physician or a rehabilitation center, public or private, recommends this approach, and the assured and his wife consent. Our purpose is not to avoid proper liabilities. We will consider one of three approaches, presented by a claim representative:

1. Advancement of sufficient income benefits to provide necessary funds for a training period.
2. Payment of 50 per cent of income during a specified period.

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3. Authorization for engaging in work efforts (for a limited period) without affecting the assured's right to continuance of monthly income payments.

The procedures are sometimes successful and sometimes not. In general, we believe the program has substantial and continuing value in improved relationships with our assureds, with attending physicians, and, in some cases, with other life and health insurance companies active in this area.

As previous speakers have pointed out, we sometimes run into unwillingness of an employer to rehire a rehabilitated assured. This element of resistance is absent under professional association coverages, which we believe is an argument in their favor.