AMERICAN ACADEMY of ACTUARIES

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MEMORANDUM

TO: Steve Ostlund, MAAA, FSA
Health Actuarial Task Force (HATF)
National Association of Insurance Commissioners

FROM: Bob Beal, MAAA, FSA, Co-chairperson
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Individual Disability Tables Work Group (IDTWG)
American Academy of Actuaries

DATE: Nov. 13, 2015

RE: Employer-Sponsored Claim Incidence Modifiers by Underwriting Type

Background

The purpose of this memo from the American Academy of Actuaries'[1] Individual Disability Tables Work Group (IDTWG) is to address alternatives considered for claim incidence modifiers for employer-sponsored business. This information in this document is intended to be used as Appendix 4 in the final report, including the final decision and rationale.

Originally the IDTWG proposed modifying claim incidence rates for the individual-bill and employer-sponsored markets. Policies issued in the individual-bill market would have a modifier of 105.3 percent while the policies issued in the employer-sponsored business would have a market modifier of 79.9 percent.

There are three main types of underwriting used in the employer-sponsored market:

1. <u>Individual Medical</u>

   Individual medical underwriting in the employer-sponsored market involves the company reviewing the medical history of applicants similar to the underwriting in the individual-bill

[1] The American Academy of Actuaries is a 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

market and deciding whether to decline or accept as standard or substandard with a premium rating and/or condition exclusion.

2. Mandatory Guaranteed Standard Issue (GSI)

   Mandatory GSI underwriting is utilized in employer-sponsored cases in which typically 100 percent of the eligible employees receive disability coverage for amounts under a limit specified by the company. Employees who are receiving coverage higher than the specified limit undergo individual medical underwriting. In general, most if not all of the premium for the disability coverage is paid by the employer.

3. Voluntary GSI

   Voluntary GSI underwriting is utilized in employer-sponsored cases in which the choice to purchase the disability coverage is made by each employee who pays the premium. Policies with disability coverage under a specified limit will be issued standard without individual medical underwriting. Employees who are receiving coverage higher than the specified limit undergo individual medical underwriting. Because of the risk of anti-selection, the specified limits under voluntary GSI cases typically are lower than those for mandatory GSI, and companies often require or target a minimum participation of eligible employees.

that the IDTWG received comments related to concerns the original employer-sponsored market modifier (79.9 percent) did not take into account differences in claim experience by underwriting type. In particular, this concern was focused on expected higher claim experience from employer-sponsored cases issued via voluntary GSI underwriting. In response to this concern, the IDTWG recognized that there are most likely differences by underwriting type, but the industry database from which the 2013 IDI valuation table was derived could not separate experience by these three underwriting types.
The experience supporting the single market modifier contained the aggregate of all three types of underwriting.

During a teleconference to discuss this concern, the HATF approved a modification to the market incidence modifier, under which employer-sponsored business issued with individual medical underwriting or mandatory GSI underwriting would be assigned the 79.9 percent market incidence modifier while voluntary GSI business would be assigned the same modifier as derived for individual-billed business only (i.e., 105.3 percent).

The IDTWG reached out to the seven IDI carriers, who are currently the most active in the employer-sponsored business, to discuss the modification to the market incidence modifiers, as approved by the HATF. Their general reaction was that splitting the employer-sponsored market incidence modifier by underwriting type made sense based on each company's experience, but they preferred that the modifiers be based on actual claim experience.

The IDTWG then asked these seven companies if they were willing and able to submit their own relatively recent employer-sponsored claim incidence experience to the IDTWG for a supplemental claim incidence study that could produce a more meaningful split of the single employer-sponsored market incidence modifier by underwriting type. The seven companies agreed to participate. This memo includes a discussion of the supplemental claim incidence study, which resulted in another set of modifications to address the HATF's goals

Based on the above, the IDWTG had three alternative sets of modifiers to choose from:

1. Original report
2. October HATF call
3. November 2015 IDTWG Supplemental study

The Supplemental Incidence Study

The following table shows the seven IDI carriers who contributed to this supplemental study. These companies are currently the most active in the employer-sponsored IDI market.

Contributors to Employer Sponsored Market Claim Incidence Study
Ameritas Life Insurance Corporation
Guardian Life Insurance Company
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
Principal Financial Group
Standard Life Insurance Company
Unum Life Insurance Company

Key characteristics of the study:

- Contributors provided exposures, actual claims, and expected claims from their own claim incidence studies, summarized by the three underwriting types. The expected basis was the 1985 CIDA table. Exposure and claims were measured in terms of monthly indemnity.

- The three underwriting types are individual medical, voluntary GSI, and mandatory GSI. Individual medical includes all employer-sponsored business that was not voluntary or mandatory GSI.

- Study periods for the various company studies were generally 2007 to 2012 with a few companies varying.

- For the most part, policies were in their first 10 policy years.

- As was done in the development of the 2013 IDI Valuation table, exposure from Unum Life Insurance Company in this study was limited to 40 percent of the total exposure.

- The IDTWG did not audit the incidence study results submitted by the seven companies.

The following table summarizes the distribution of exposure, actual claims, and expected claims by underwriting type for all contributors in the aggregate.

Combined Exposure, Actual Claims, Expected Claims and A/E Ratios Expected = 1985 CIDA				
Underwriting Type	Exposure	Actual Claims	Expected Claims	A/E
Individual Medical	3,826,873,771	9,085,856	17,778,430	51.1%
Voluntary GSI	2,775,452,751	5,471,272	8,982,961	60.9%
Mandatory GSI	2,344,143,893	2,799,883	7,742,336	36.2%
Total	8,946,470,415	17,357,011	34,503,726	50.3%

Although the values in the above table are presented in terms of monthly indemnity, we estimate that the exposure is comprised of approximately 2.7 million life years and 7,000 claims.

The next table shows the A/E ratios by company, labeled A, B, …,G to protect the anonymity of the companies' results.

Actual/Expected Incidence Ratios - Employer Sponsored Market By Underwriting Type and Company Expected Incidence = 1985 CIDA				
Actual/Expected	A	B	C	D
Individual Medical	65.2%	41.9%	59.6%	NA
Voluntary GSI	73.2%	41.5%	65.0%	60.2%
Mandatory GSI	40.4%	28.5%	42.5%	29.5%
Total	63.6%	35.8%	57.8%	45.9%
Actual/Expected	E	F	G	Combined
Individual Medical	37.8%	50.1%	39.7%	51.1%
Voluntary GSI	57.1%	57.8%	85.6%	60.9%
Mandatory GSI	49.4%	30.7%	41.5%	36.2%
Total	39.0%	47.2%	49.6%	50.3%

Suggested Market Incidence Modifiers for Employer-Sponsored Business by Underwriting Type

The above A/E ratios are based on the 1985 CIDA table as the expected basis. To convert to the 2013 IDI Valuation Table as the expected basis, we divided the A/E ratio for each of the underwriting types, to the total ratio assuming the 1985 CIDA as the expected basis, and multiplied the result times the 79.9 percent.

A/E Incidence Ratios By Expected Basis		
Underwriting Type	1985 CIDA	2013 IDI Valuation
Individual Medical	51.1%	81.2%
Voluntary GSI	60.9%	96.7%
Mandatory GSI	36.2%	57.4%
Total	50.3%	79.9%

The seven contributing companies have reviewed the IDTWG study methodology and results and confirmed their satisfaction with both.

Comparison of Alternatives

The table below shows a comparison of the alternative modifiers. Splitting the employer-sponsored incidence modifier by underwriting type will increase the reserve margins in the 2013 IDI valuation table, but this increase is much smaller using the incidence modifiers based on the November study.

Impact of Different Market Incidence Modifiers					
			Market Incidence Modifiers		
Market	% ES Claims	% Total Claims	Original Report	October Call	November Study
Employer-Sponsored					
Individual Medical	43.9%		79.9%	79.9%	81.8%
Voluntary GSI	33.4%		79.9%	105.3%	96.7%
Mandatory GSI	22.7%		79.9%	79.9%	57.5%
ES Total	100.0%	23.0%	79.9%	88.4%	81.3%
Individual-Bill		77.0%	105.3%	105.3%	105.3%
Total			99.5%	101.4%	99.8%
Additional margin in ES			0.0%	10.6%	1.7%
Additional margin in Total			0.0%	2.0%	0.3%

Notes: The original report column reflects no differentiation of modifiers within the employer-sponsored business; the October call column reflects what HATF approved on the October call, and the November study column reflects what is being recommended based on a subsequent study of employer-sponsored claim incidence.