Interesting and Current Issues in Group and Individual Life

Breakout Session 1B

Actuaries' Club of Hartford & Springfield

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Agenda

- New group long-term disability (LTD) valuation regulation and table
  - National Association of Insurance Commissioners (NAIC) model regulation and table
  - Implications
  - Implementation issues
- New individual disability income (IDI) valuation regulation and table
  - Summary of features
  - Status
- Next steps for LTD
  - Experience study update
  - Incidence study
  - Credibility research project
- Discussion potential impact of Affordable Care Act (ACA) on markets and products
  - Impact on voluntary group life and disability markets

2012 Group LTD Valuation Table and Actuarial Guideline

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Background

- 2008 Experience Study: 21 Carriers, > 1M Claims, 680K Terminations
  Experience Period: 1997 - 2006
  Result = Experience Table: GLTD 2008
- 2011: NAIC charges Academy with developing new valuation standard
  Joint Academy and NAIC work group formed
  Results = Valuation Table: GLTD 2012
- April 1, 2014: NAIC approves changes to the model regulations governing minimum standards for GLTD reserves, which references GLTD 2012 and actuarial guidelines

Background (continued)

- The NAIC has adopted the amended model regulation, *The Health Insurance Reserves Model Regulation*
  - Final decision on adoption of the model regulation resides with each state commissioner
  - Valuation actuaries would need to refer to the appropriate states' regulations for implementing statutory valuation changes

Model Regulation Summary

- Amendment to model regulation states
  - “For group long-term disability income claims incurred on or after October 1, 2014, and before the date specified in Paragraph (2), the minimum standards with respect to morbidity may be based on the 2012 GLTD termination table, or subsequent table…”
  - “Subject to the conditions in this section, the 2012 GLTD or subsequent table with considerations outlined in Paragraph (1) shall be used in determining minimum standards with respect to morbidity for group long-term disability claims incurred on or after October 1, 2016…”

Model Regulation Summary (continued)

- What about older claims?
  - There is separate language for claims disabled pre- and post-2005. Intent is to be consistent with prior regulations. Key points:
    - No requirement that the reserve basis be changed for older claims
    - The new standard can apply to older claims optionally
    - No explicit timing restriction for when such change can take place
  - Amendment to model regulation: “Once an insurer elects to calculate reserves for all open claims on a more recent standard, then all future valuations must be on that basis”
  - Amendment introduces the expression “long-term disability.” The new standard strictly applies to long-term disability claims
    - Previous standards did not distinguish short- and long-term claims
    - New standard does not alter short-term disability reserve basis

Description of New Valuation Table (GLTD 2012)

- Separate expectations for Recovery and Death Rates vary by Age, Gender, Duration, Diagnosis, Elimination Period, Gross Monthly Benefit
- Recovery Rates also vary by the Definition of Disability, with a recovery "bump" at the change in definition, and as well as differences in recovery rates after the transition.
- Recovery and Death Rates are each determined starting from base tables that vary by age, gender, duration, and diagnosis. Additional factor adjustment tables are subsequently applied to each.
- Use of five-year age groupings, with interpolation, is recommended
- Diagnoses are grouped into thirteen buckets
- Separate logic is used for maternity claims with duration less than 36 months

Summary of New Valuation Law

- Use of table is described in an Actuarial Guideline that is referenced in the new model regulation
- The Guideline contains language that governs explicit adjustments to the new table based on each carrier's own experience
- Additional key components of the Actuarial Guideline
  - Specifies how credibility and own experience margins are determined
  - Can be updated without requiring individual state law changes

Application of New Valuation Law

- Minimum reserves use GLTD 2012 Table multiplied by an experience adjustment factor determined from each carrier's own termination experience, modified by a credibility factor and an application of margin
- Factors are determined for each of five duration groups

  Group 1: 1-3 months
  Group 2: 4-24 months
  Group 3: 25-60 months
  Group 4: 61-120 months
  Group 5: 121+ months
- Carriers have option to segment results into "any major subgroups that may produce significantly different results"
- Carriers should "combined affiliated statutory entities and assumed reinsurance, where claim management is under a common structure"

Own Experience Adjustment Calculation

- Actual-to-expected (A-to-E) termination calculation
  - Use five-year experience period with “suitable lag”
  - Segment results into the five duration groups
  - Terminations exclude settlements, claims that reach the end of the benefit period, or claims that reach the end of a contractual limit, such as a Mental and Nervous limit. Claims termination due to a change in definition do count as terminations
  - “Recognize where appropriate any flexibility built into the 2012 GLTD Valuation Table”
  - A-to-E terminations are weighted by count, unless another measure is deemed more appropriate

Own Experience Adjustment Calculation (continued)

- Credibility

  Adjustment factor: T = (Z * F * (1 – M) + (1 – Z))

  Z = Credibility

  F = A-to-E ratio

  M = Margin

  Credibility is based on the number of expected claims (N) by duration group

  Credibility = $\sqrt{N/K}$: capped at 100%

  Credibility Factor K

  Group 2: 3,000

  Group 3: 2,500

  Group 4: 2,100

  Group 5: 1,700

Own Experience Adjustment Calculation (continued)

- Margin

  M = 3% + 1.65 * $\sqrt{A/C}$: bounded by 5% and 15%

  C = Actual number of terminations

Margin Factor A

Group 2: 4.0	Group 4: 2.5
Group 3: 3.0	Group 5: 2.0

Own Experience Adjustment Calculation (continued)

- Special considerations

  Termination Floor: “Company shall not use termination rates that produce total reserves for claims disabled for more than two years that are less than the reserve produced by computing *T* as *T* = 1.30”

Group 1, 2 (1-2 Yrs):	No termination floor applied
Group 3 (3-5 Yrs):	May apply for exemption from floor (consistent with language in prior regulation for own experience) exemption
Group 4, 5 (6+ Yrs):	Termination floor applies in all cases

Own Experience Adjustment Calculation (continued)

- Small carrier exemption: use 100% of GLTD2012 if carrier has fewer than 50 open claims within two years of duration and fewer than 200 open claims with more than two years of duration
  - Timing of calculation: Update should occur “at least once every five years. In addition, the valuation basis must be updated whenever the company’s annual own experience study produces ... a value T that changes by more than 10% from the one used in the current valuation basis for any of the five duration groups”
- Reserve basis is not locked in
  - All claims reserved under the new standards will share the same basis
  - Updates will trigger reserve changes (5A adjustments)

Regulation generally

- Reserve adequacy
  - Compliance with the actuarial guideline should not be considered an assurance of reserve adequacy, which needs to be separately evaluated: Items not considered include handling of estimated and actual offsets, handling of settlements, and handing of mental and nervous (M&N) and other contractual limits
  - Nothing in this guideline should be assumed to prohibit the actuary from building a case and requesting permission from the state insurance commissioner for other appropriate variations."

2012 GLTD Table Implementation Issues

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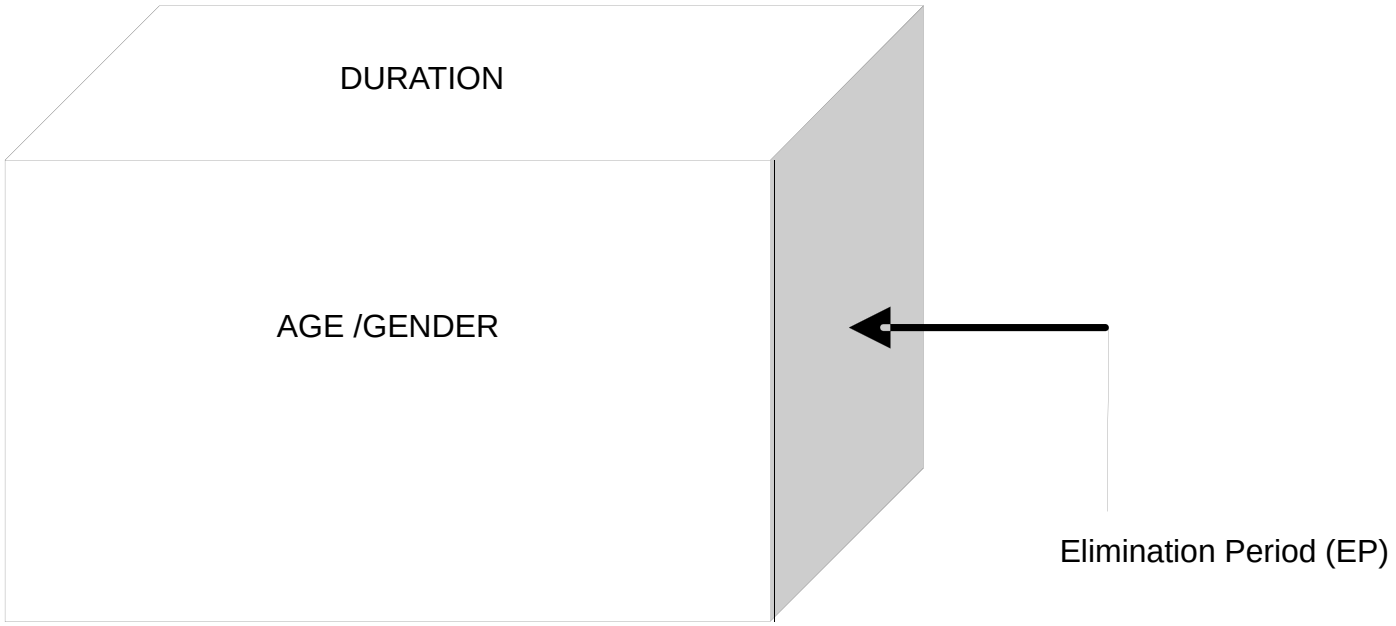
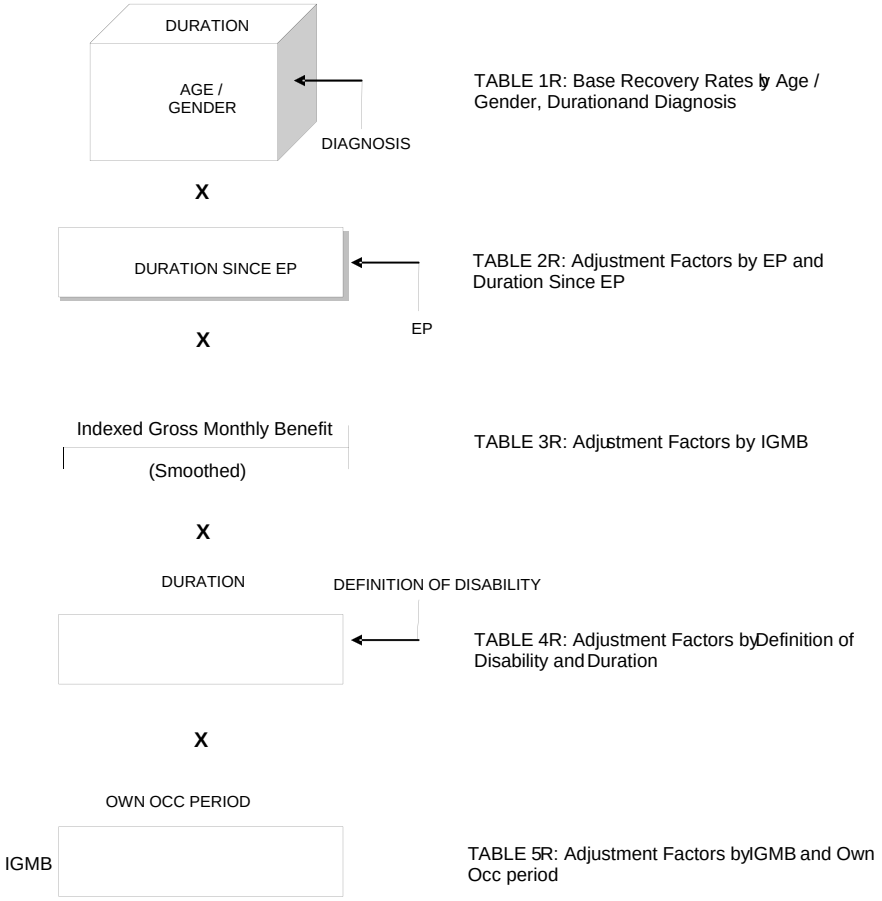
2012 GLTD Table Implementation

- 1987 CGDT LTD Table Structure – Combined Terminations



2012 GLTD Table Implementation (continued)

- 2012 LTD Valuation Table - Recoveries



2012 GLTD Table Implementation (continued)

- 2012 Valuation Table - Deaths

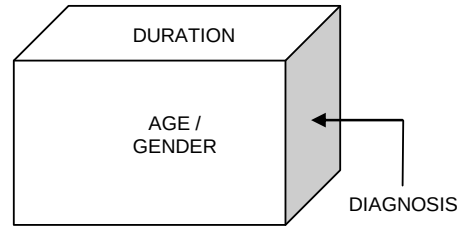


TABLE 1D: Base Death Rates by Age / Gender, Duration and Diagnosis

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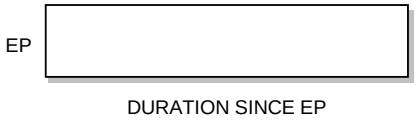

TABLE 2D: Adjustment Factors by EP and Duration Since EP

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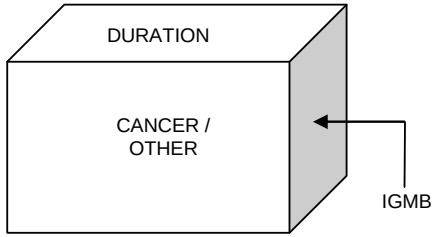


TABLE 3D: Adjustment factors by IGMB, Duration and Cancer / Other

Potential Implementation - Statutory

- Instructions are fairly prescriptive
- Will your existing reserving systems accommodate the new table structure easily?
  - Older production reserving systems may contain look-up coding that assumes a CGDT-type structure
  - Coding may need modifications to utilize new parameter fields
- How should you adjust your reserving tables to reflect your own experience?
  - The statutory formulas are straightforward
  - However, GAAP or best-estimate reserves present a range of choices

Potential Implementation - GAAP

- Traditional durational A-to-E analysis may not add much value
- A predictive modelling approach might be an optimal way to determine adjustment factors, including:
- Which parameters to vary own experience factors by
  - Traditional: e.g., duration
  - New table parameters: e.g., diagnosis
  - Outside parameters:
    - Industry
    - Receipt of Social Security
    - Salary replacement ratio
- Vary deaths and recoveries separately
- Add decrements; e.g., settlements
- Adjust for valuation view vs. full view

Potential Implementation – GAAP (continued)

- Evaluation of parameters for impact
  - Adjust only for variables that show a statistically credible difference from the industry and that logically make sense
  - Does not automatically revert to the industry table at extreme values (where data is limited)
  - Avoid over-fitting the adjustments
  - Consistency of impact by calendar year is a good test of predictiveness
  - This is different than a simple credibility weighting your experience vs. Valuation Table value

LTD Studies – Next Steps

- Update of 2008 LTD Termination Study
- Potential LTD Incidence Study
- LTD Credibility Research Project

Update of 2008 LTD Termination Study

- Background
  - 2008 Study covered terminations for 1997 – 2006
  - Update will cover 2004 – 2010
- Objectives
  - Measure recent trend, especially recession impact
  - Measure the effect of additional parameters
- Potential timeline
  - Committee currently formed
  - Request for data in 2014
  - Study results in 2015
- Leverage structure created in 2008 Study for process efficiency
- Chair Roger Martin

Update of LTD Study – Additional Parameters

- Six new parameters
  - Integration with short-term disability (STD)
  - Industry (SIC) code
  - Taxability of benefits
  - Monthly salary
  - State of residence
  - Case size
- Also building map of new ICD-10 diagnosis to 2008 study categories

Potential LTD Incidence Study

- Objectives
  - No official precedents
  - Would provide much better understanding of incidence risks
  - Would encompass a significant recessionary period
  - Exposure data is difficult to get
- Potential timeline
  - Will follow termination study update
  - Potentially a pilot program in late 2014
  - Primary intent of pilot would be to identify and resolve data issues before issuing a broad request

LTD Credibility Research Project

- Background
  - LTD uses credibility across a range of applications
    - Pricing: Experience rating individual cases and evaluating experience for manual rates
    - Valuation: Selecting own experience assumptions
    - Regulatory: Selecting appropriate valuation margins
  - Most insurers' application of credibility has been simplistic and fairly crude
    - It is not at all clear how traditional credibility theory should be used in LTD applications
- Objectives of research project
  - Understand current state-of-the-art for credibility applications for LTD (or potentially similar products)
  - Document current best practices (if such exist)
  - Identify analyses that could develop useful LTD credibility tools
    - Must be practical

LTD Credibility Research Project (continued)

- Initial phase – Literature search
  - Identify current industry methods and challenges they present
  - Research and compile bibliography of sources that discuss credibility for LTD [plus life, medical and property and casualty (P&C), if relevant]
- Result – Paper on Society of Actuaries' (SOA) website
  - Summary of credibility applications
  - Several challenges identified, including:
    - Non-independence of claims
    - Heterogeneous claims
- Committee conclusions
  - Most current applications are based on classical mathematical credibility theories that assume variables are independent and homogeneous
    - With modifications since variables do not meet criteria - based on judgment
    - However, it was not evident to the committee how judgment ought to be applied

LTD Credibility Research Project (continued)

- Next steps
  - Committee is designing an analysis approach based on predictive modeling, that will start by identifying some useful relativities, for example the relative predictiveness of:
    - Incidence vs. terminations vs. benefit amount
    - Diagnosis
    - Industry
- Will likely propose a limited industry study

Proposed 2013 IDI Valuation Standards

- Status and next steps
- Changes from current standards
  - Valuation table
  - Valuation standard

Status and Next Steps

- Proposed valuation standard exposed for comment until June 30, 2014
- Dates for optional and required implementation of standards currently not specified
  - Proposal is to allow application retrospectively for claim reserves, similar to group LTD
  - Prior to required use date, prior rules are not changed
- If no major issues arise out of comment period, NAIC could approve by end of year

Changes from Current Standard - Valuation Table (1985 CIDA, CIDC)

- Valuation Table structure changes
  - Claim incidence
    - EP's 180, 360, 720 added to 0, 7, 30, 60, 90
    - Medical occupation (occ) class added to 1 – 4
    - Attained ages 20 to 70 vs. 20 to 65
  - Claim terminations – select period
    - New select periods: months 1 – 60, years 6 – 10 vs. weeks 1 – 13, months 4 – 24 and years 3 – 10
    - EP's same as for incidence
    - Medical occ class added
    - Attained ages same as incidence
    - Accident terminations use adj. factors times base rates vs. independent table
  - Claim terminations – ultimate
    - Medical / non-medical split is new
    - Attained ages 32 to 119 vs. 32 to 99

Changes from Current Standards – Valuation Table (continued)

- New claim incidence adjustment factors
  - Contract type – new factors that vary for accident and sickness (AS), key person (KP), buyout (BO) and overhead expense (OE)
  - Smoker / non-smoker – factors that vary by occ class, gender and EP
  - State of issue – new factors for CA, FL, NY and all other states
  - Benefit period for AS policies only – new factors vary by occ class, EP, and benefit period (lifetime/age 65-70/short)
  - Market modifiers for AS – new factors vary by employer sponsored (ES) vs. traditional individual billed (IB)

New Claim Termination Modifiers – Select Period Only

- Contract type – new factors vary by OE vs. all other
- Benefit period and cost-of-living-adjustment (COLA) – new 3-D factors vary by claim duration, benefit period (life/65 – 70/short) and COLA (with/without)
- State of issue – new factors vary by FL vs. other states
- Diagnosis (applies to claim reserves only) – new 2-D factors vary by diagnosis groupings (five gradations from very high terminations to very low – vary by claim durations)

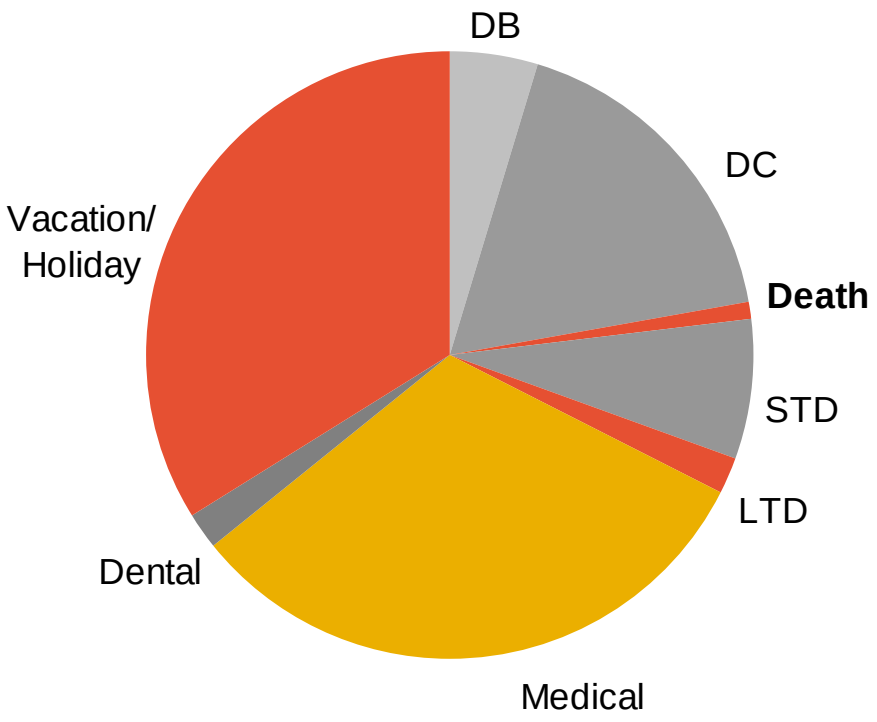
Changes in Valuation Standard - Process

- Valuation Table margins
  - Incidence – 50% margin covered 10 to 12 participating companies
  - Terminations – 5% margin in year 1 and 15% margin in years 2+ (approx. 10 of 12 companies)
  - Mortality improvement – not observed over short study period (2000 – 2007), so postponed for future study)
- Own company experience adjustment
  - Incidence – determination of appropriate company experience was deemed too complex (e.g., adding margins to incidence and terminations can reduce ALRs, not increase them)
  - Terminations – basically followed the group LTD model
    - Explicit own experience margins and credibility (by duration band)
    - Similar requirements to measure own experience, floors etc.
    - Similar transition rules
    - Actuarial Guideline approach

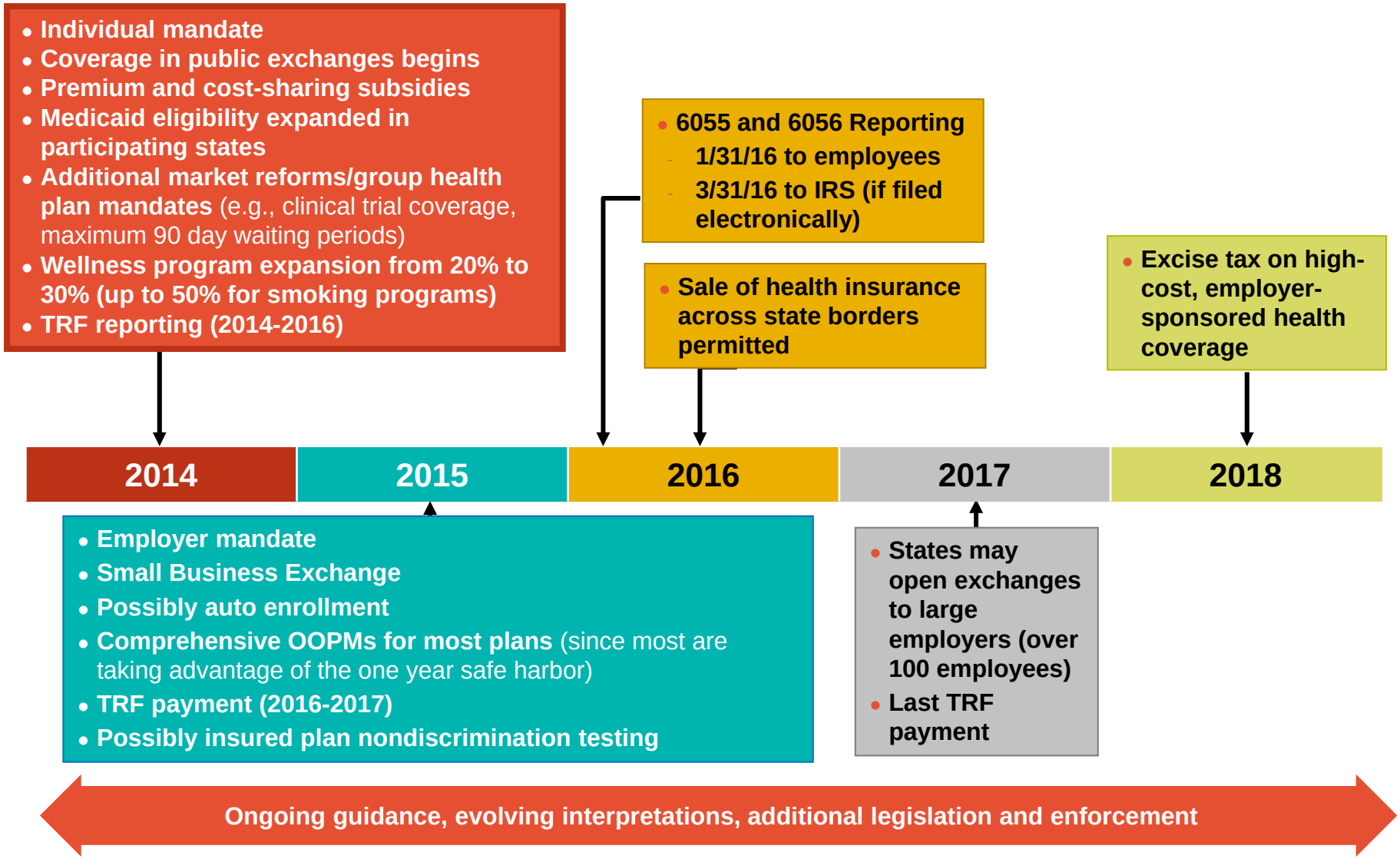
Employer Priorities
(Towers Watson BDS Annual Participant Report – U.S. – 2013)

Average Values of Employer-provided Benefits

(Proportions)



PPACA Implementation: 2014 and Beyond



Employer Concerns

- The challenges stemming from the federal health care reform law (PPACA) and the evolving nature of its provisions are daunting and complex
- Employers need to recognize that the law has broader strategic implications than the “play or pay” mandate. Organizations need to evaluate the far-ranging effects to avoid costly or unintended consequences, and meet their business objectives
- While most organizations are affected by the law's 2014 employer mandates, employers will face more complicated workforce challenges if they possess these attributes:
  - Diverse range of seasonal/temporary and part-time workers
  - Large population of low-wage workers
  - Contract employees are material to how your organization delivers or manages its services
  - Low-margin or nonprofit businesses
  - Labor cost represents a significant portion of overall costs in industries such as retail, customer service, health care, hospitality, and low-margin or low-skill manufacturing

Excise Tax

Beginning in 2018 an excise tax of 40% will be assessed on total benefit costs of employer-sponsored coverage that are in excess of specified thresholds

- Estimated thresholds are $10,200 for single and $27,500 for coverage other than single in 2018
  - Actual thresholds will be based on medical inflation between 2010 and 2018 using a measure that looks to the Federal Employees Health Benefits Program (FEHBP)
  - Indexed by a cost-of-living adjustment annually (CPI-U, plus an additional 1% in 2019), or about 2.4% (~3.4% in 2019)
  - Health *care cost trends likely to exceed CPI-U*
  - Increased for retirees aged 55 or older who are not eligible for Medicare and for employees in high-risk professions
- The cost of applicable employer-sponsored coverage shall be determined under the rules similar to the rules of section 4980B(f)(4)

Top Strategies to Control Costs and Avoid the Excise Tax (Towers Watson's Health Care Changes Ahead Survey)

Provider Strategies

- 47% offering a benefit differential for use of a high-performance network
- 40% using value-based benefit designs to promote effective medical interventions that improve health outcomes
- 36% evaluating new financial terms and performance standards for health plan vendors
- 33% using reference-based pricing in the health plan that established a set price for a medical treatment
- Change plan designs 40% in 2014 and 31% in 2015 / 2016

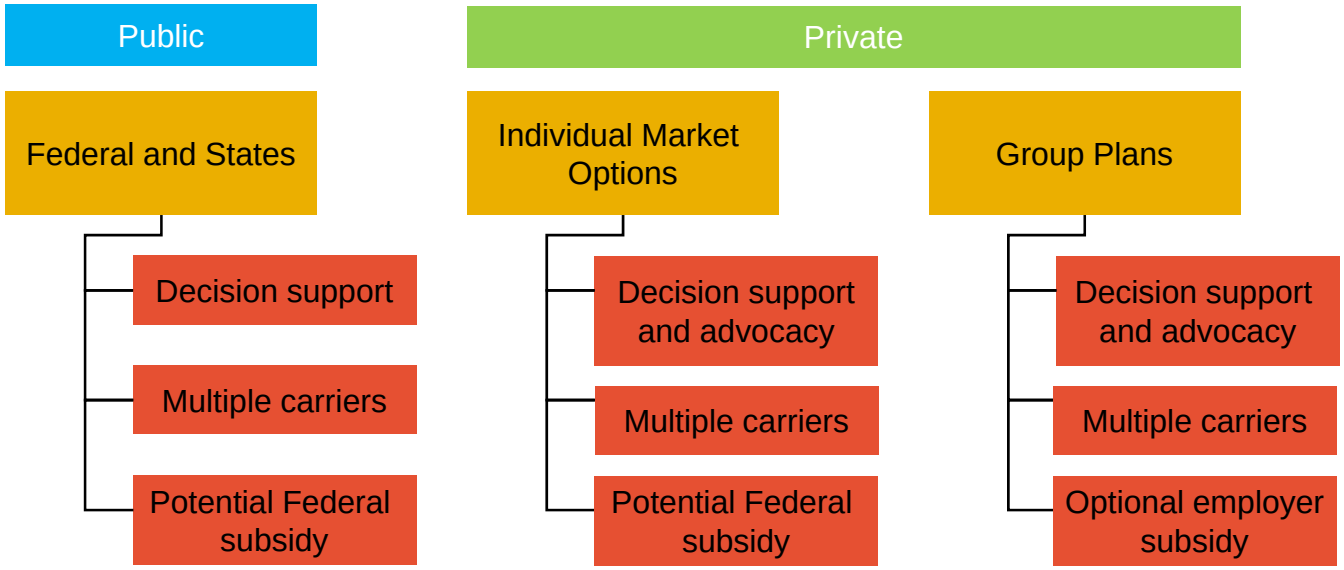
Employee Strategies

- 49% offer outcome-based incentives to encourage healthy behaviors
- 34% of employers expect to increase premium contributions for dependent coverage
- 28% implement a full-replacement, account-based health plan to employees become more informed consumers
- 25% provide pricing and health-quality transparency tools to help employees make wise health care decisions

Employer Options

- Continue to sponsor and manage optimal health plans?
- Dependents
  - Rethink dependent subsidies in light of reform? Introduce spousal exclusion or surcharge?
- Low wage or part-time workers
  - Redirect to public exchanges to optimize subsidies?
  - Use a private exchange to facilitate navigation?
  - Redirect lowest wage workers to Medicaid?
- Examine high value private exchange for active employees?
- Exit for active employees?
  - Pay penalty and direct employees to public exchanges?
  - Use a private exchange to facilitate navigation?
- Exit for retirees?
  - Exit Medicare-eligible retirees to private exchange?
  - Exit early retirees to public exchanges? Use a private exchange to facilitate navigation?

ACA-Driven Medical Exchanges



- Private exchanges generally also offer traditional group life and disability plans
  - Employer has to pick one carrier, like today
  - Most private exchanges are requiring supplemental lines to be renewed through exchange
    - Source of additional revenue

Discussion of Voluntary Life and Disability

- Hard to have meaningful discussion since voluntary markets cover a huge range of:
  - Product types
  - Distribution (and compensation)
  - Markets
  - Product designs (term/permanent, group/individual)
- Context is critical
  - This discussion will address a broad view of the drivers that make voluntary markets attractive to insurers
    - Then will narrow focus to discuss implications for voluntary life and disability

Discussion of Voluntary Life and Disability (continued)

- Voluntary market is seen as potentially huge opportunity, as it represents the logical solution to several major industry trends
  - ACA is changing the employee benefits landscape
    - Dominated by high deductible plans, leaving large gaps
    - Major opportunity for supplemental medical coverages
    - Future excise tax will likely exacerbate the situation
- Industry trend of shifting benefit costs from employers to employees
  - Many in industry view move to a full cafeteria-plan approach as inevitable
- Traditional distribution solutions (i.e., one-on-one sales) too expensive for middle- and low income markets
  - Technology presents new opportunities to bridge the sales information gap to customers

Discussion of Voluntary Life and Disability (continued)

- There has also been a big push for voluntary products from the distribution side
- Group brokers are pushing insurers because they need to find additional sources of income
  - Appears medical commissions are shrinking due to ACA
  - Voluntary products generally carry higher commission rates than traditional group
  - Brokers have become more comfortable with voluntary sale and enrolment processes
- Appears voluntary growth may be more driven by broker push than employee demand
- Traditional group writers have said they are expanding their voluntary efforts in recent years
  - What that means appears to vary widely by company
  - From adding front-end financial educational tools to existing voluntary group life and disability products
  - To developing a broad range of product offerings (critical illness (CI), hospital indemnity (HI), Accident, Whole Life etc.)

Voluntary Programs Categorized – Voluntary Life

- Most common form appears to be traditional optional group life
  - Definition reclass rather than new market
  - GVUL is niche market
- Face-to-face WL or UL products (with heaped commissions) have been significant voluntary products in the past
  - Tended to be sold by worksite specialists
  - Is this a limited niche market or potential growth market?
  - LTC rider appears to be a popular product, because it is hard to get standalone LTC at an affordable price – how is it selling?
- What else is going on? Are other voluntary life plan designs growing quickly?

Voluntary Disability Programs Categorized

- Traditional group-term STD (on a voluntary basis) is not new
  - Is it changing?
- Other stand-alone voluntary disability products appears to concentrate on certain markets where traditional group LTD is not popular
  - Industries
    - Hospital and teachers
    - Union plans
    - Low income / part-time; e.g., restaurants, retail (market penetration is not clear)
  - Usually limited benefit periods (6 mo, 1, 2 and 5 yrs.) and elimination periods (30, 60 and 90 days)
- Core/buy-up LTD is fairly rare and not new
- Worksite IDI is really a specialty market (primarily existing IDI writers selling to professionals)

Voluntary Medical Programs Categorized

- MediGap policies (exempt from ACA Excise Tax)
  - Critical illness (CI)
  - Hospital indemnity (HI)
    - No outpatient coverage allowed
  - Accident only coverages
  - Are medical carriers developing customized ACA gap products to address their specific gaps?
    - Will they have a distribution advantage over separately sold generic gap products?

Other Voluntary Coverages Categorized

- Dental
- Vision
- Prepaid legal
- Home
- Auto
- Pet
- Others

New Trends in Distribution

- Automated financial advice tools presale to employees are becoming more important as employees face a greater number of more complicated choices
  - Benefit portals are an obvious option, either standalone or through private exchanges
    - Technology companies
    - National brokerages and consultants
    - Regular brokers and third-party administrators (TPAs)
    - Insurance companies
    - Employer-built
  - Insurance company advice may be viewed as inherently biased
    - Also what do you advise on?

Implications of Portals on Distribution

- Implications of third-party interfaces are potentially significant
  - Portal manager may want to make employee choices more directly comparable – reduce ability of insurers to differentiate themselves
  - Some portals may limit who can participate, in order to improve their efficiency
- National and large regional brokerages appear to be buying up small brokers, who do not want to reinvent themselves and/or are ready to monetize their practices
  - Consolidation implies increasing influence of distributors and decreasing influence for insurers
- Combined with producer consolidation, this could lead to reduced insurer control – including potential “pay-to-play” scenarios

Additional questions for discussion

- Will you need to have a wide range of voluntary products available to be successful?
  - Which ones are critical?
- Is brokerage consolidation a major trend or nothing new?
- Has primary force for expansion of voluntary products been broker demand, employee/employee demand or company optimism?
- Is this presentation's categorization of products reasonably consistent with your company's view, or is it way off?
- What percentage of your "new" voluntary business is take-over vs. no prior-coverage?