

# Managing Income Replacement Insurance: Canadian Perspectives

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## Overview

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- Canadian background
- Issues
- Conclusion

## Combination of Public and Private Programs

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- Public programs
  - Unemployment Insurance
  - Canada Pension Plan
  - Workers' Compensation
  - Automobile Insurance
  
- Private programs
  - Individual disability
  - Group short-term disability
  - Group long-term disability

## Unemployment Insurance

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- Government program primarily for unemployment but some maternity/paternity benefits and sickness benefits also included
- Sickness benefits
  - people whose illness, injury or quarantine prevents them from working
  - no benefits in first 2 weeks
  - thereafter, up to 15 weeks of benefit
  - basic benefit rate is 55% of average insured earnings
  - maximum payment of \$413 per week

## Canada Pension Plan

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- Government program primarily for retirement benefits but also includes some disability features
- premiums
  - 9.9% of salary up to \$38,500
  - combination of employer and employee paid
  - no separate premium for disability benefit
- Definition of disability
  - prior to age 65
  - disabling condition can be physical or mental
  - disability must be severe and prolonged

## Canada Pension Plan (cont'd)

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- Benefits
  - to age 65
  - indexed, taxable
  - average benefit \$684 perm onth
  - maximum benefit \$935 perm onth
- Statistics (1999-2000 fiscal year)
  - \$2.6 billion in benefit payments to 287,000 contributors with disabilities
  - more than 60,000 new applications for disability benefits

## Workers' Compensation

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- Provincial plans
  - paid by employer
  - features vary by province
- Definition of Disability
  - Work-related injury or illness
- Benefits
  - from first working day after disability
  - Payable to age 65
  - 85% of salary up to \$65,000 per annum
- Statistics (Ontario)
  - premiums: \$1.8 billion
  - benefits paid: \$2.6 billion

## Automobile Insurance

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- Mandated coverage for automobile insurance in several provinces
- Injury or mental illness due to an automobile accident
- Disability requires certification by qualified medical person
- Benefits
  - start 7 days after accident,
  - continues to age 65
  - reduced lifetime benefit thereafter
- Amount of benefit (Ontario):
  - 80% of after-tax income to a maximum of \$400 per week



## Private Insurance : Individual

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### Individual Disability Insurance Market Profile

Company	Premium	Claims	Loss Ratio
Provident Life and Accident	225.2	194.1	86.2
Combined Ins. of America	151.8	55.3	36.4
Great-West Life	109.5	50.9	46.5
PennCorp Life Insurance	40.8	13.1	32.1
Canada Life	34.5	20.8	60.2
Maritime Life	29.2	15.9	54.5
Total Industry	871.6	476.2	54.6%

Source: Canadian Insurance 2001 Annual Statistical Review

## Individual Disability

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- Markets
  - Professionals
    - Health Care workers, Self-employed individuals, Association, Small groups
    - White-collar, Blue-collar
- Products
  - Income Replacement
  - Overhead Expense
  - Key Person
  - Buy/Sell

## Individual Disability

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- Product features
  - definition of disability
    - two years regular occupation and any occupation thereafter
    - own occupation available to professionals
  - elimination periods
    - 30 days or longer
    - first day accident is optional for blue-collar occupations
  - benefit periods
    - 2 years, 5 years, or to age 65
    - lifetime benefit available to professionals
  - Other benefit options
    - residual disability, partial disability, cost of living

## Individual Disability (cont'd)

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- Exclusions
  - normal pregnancy
  - for non-guaranteed coverages,
    - mental and nervous disorders,
    - soft tissue injuries,
    - back injuries,
    - pre-existing conditions
- Choice of guarantees
  - non-cancelable
  - guaranteed renewable (non-guaranteed premiums)
- Premiums
  - level premiums to age 65
  - limited use of graded premiums (step-rated policies)

## Group Accident and Sickness

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### ■ Market characteristics

- 61,000 short-term disability contracts covering 2.1 million workers
- 92,500 long-term disability contracts covering 6.6 million workers
- Dominated by multi-line companies
- Premium distribution
  - 40% short or long term disability
  - 33% medical
  - 20% dental
  - 7% other

## Group Accident and Sickness

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### Group Accident and sickness market profile

Company	Premium	Claims	Loss Ratio
Great-West Life/London Life	\$1,500.0 m	\$1,267.6 m	84.5%
Manufacturers Life	880.4	766.8	87.1
Sun Life	844.7	892.8	105.7
Clarica Life	603.8	574.2	95.1
Maritime Life	574.0	554.5	96.6
Canada Life	560.9	500.3	89.2
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All companies	\$7,669.2	\$7,314.3	95.4%

Source: Canadian Insurance 2001 Annual Statistical Review

## Group Short-Term and Long-Term Disability

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### ■ Markets

- Employee-employer, Multi-employer, Government, Municipal, Education, Associations
- Large groups (500+ lives) are typically experience rated or administrative services only

### ■ Product Features

- definition of disability, two years regular occupation and any occupation thereafter
- 4 to 6 months short term disability, long term disability to age 65
- Extensive rehabilitation and managed care provisions
- Optional cost of living adjustments

## Group Short- and Long-Term Disability (cont'd)

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- Premiums and Guarantees
  - yearly renewable premium rates
  - two or three year premium rate guarantees on groups are rare, especially for new groups



## Issues

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- Growth
- Competition
- Claim and underwriting effectiveness
- Technology and expense management
- Financial management

## Growth

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- Constraints due to stronger focus on Return on Equity
  - disability is a mature market
  - demutualization highlights need for profitability
  - increases in premium rates, especially for group LTD
- Individual disability
  - viewed as a specialty product that requires a large investment in marketing, underwriting and claims expertise
  - increasing focus on new distribution channels such as direct marketing
  - new products are emerging which expand market and reduce risks (non-guaranteed individual disability insurance)
- Group LTD
  - Companies are looking at improving customer service and claims control

## Increased competition

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### ■ Consolidation

- market is dominated by four major insurers
- companies are reluctant to share disability experience
- producers are concerned about lack of choice for products

### ■ Competition from other products

#### ■ Critical Illness

- recently introduced in Canada
- often viewed as a replacement for disability products by producers

#### ■ Creditor disability

- a number of companies are selling creditor disability products
- covers loan payments in the event of disability

## Claim and Underwriting Effectiveness

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- Underwriting
  - individual Underwriting seen as too complex and takes too long
    - new emphasis on simplifying the underwriting for producers
  - concern that lack of financial information results in over insurance and claim adjudication problems
    - new emphasis on developing incentives for producers and applicants to provide necessary information
  - dilemma for group underwriters who need to implement rate increases while retaining profitable business

## Claim and Underwriting Effectiveness (cont'd)

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- Claims management
  - concerns with increasing numbers of mental/nervous, soft-tissue and back injuries
    - has led to exclusions in new individual policies
  - rich benefits, such as own occupation definitions, cost of living adjustments, and lifetime benefits reduce the motivation to return to work
    - Companies are restricting availability, especially for individual policies
  - lack of industry claims studies means that companies must have credible internal data and capacity to analyze such data to monitor trends

## Claim and Underwriting Effectiveness (cont'd)

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### ■ Reinsurance

- poor claim experience has led to a reduction in the number of reinsurers for individual DI
- smaller companies make extensive use of the underwriting and claim facilities of reinsurers

## Technology and expenses

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- Increasing use of technology to improve customer service:
  - the internet and LANs for enrollments, submitting claims and paying benefits (group)
  - product information and illustrations, automating applications and maintaining in-force records (individual)
  - web-based support for direct and affinity marketing programs
- Expense management
  - Individual pricing: only 40% of premium available for distribution costs, underwriting, maintenance, claims adjudication and commissions.
    - Emphasis on reducing distribution costs and increasing operational effectiveness
  - Group insurers: focussing efforts on reducing administrative and claims adjudication costs

# Financial Management

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## ■ Capital Intensive

- Capital requirements are approximately 12% of premiums plus 8% of claim reserves

## ■ Asset Liability Matching

- Lower interest rate environment in Canada and US will lead to premium rate increases
- Companies need to have strong ALM process to reduce exposure to downside interest rate risk on claim reserves

## ■ Profitability

- Deterioration of claim experience has not been as great a problem for Canadian insurers as US insurers
  - lower exposure to high income professions
  - less litigious legal environment



## Conclusion

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- Tillinghast CEO survey (Group Non-Medical Insurance)
  - Primarily US companies active in group insurance
  - Confirms many of same issues and concerns
- The challenge of managing disability insurance
  - consists of very different, unique risks... ..
  - requiring specialized, unique skills... ..
  - Which lead to excellent market niche and profit opportunities... ..BUT...
  - ... ..to succeed, you must understand the issues and be able to manage them accordingly