Benefits Perspectives

CURRENT ISSUES IN EMPLOYEE BENEFITS DECEMBER 2018

Group Disability and Life Insurance: Considerations at Renewal Time

Jennifer Fleck, FSA, MAAA

Peer reviewed by Dan Skwire, FSA, MAAA

Employee benefits managers may not spend a lot of time thinking about their companies' life and disability benefits since the overall spending on these products is significantly less than the costs for healthcare coverage. However, there can often be real savings to be had on these products, as well as improvements to employee satisfaction.

When your rate guarantee is ending, you will generally get a renewal notice from your insurance company. This will let you know if your rate will be changing and could give you some detailed justifications for the rate change. To determine the rate change, an underwriter will review the claims your group has had in the past, along with any product or company changes.

This article provides a discussion of items for employers to consider when group disability and life insurance benefits come up for renewal. Most policies have between a one-and four-year rate guarantee, and renewals happen when the rate guarantee is ending. But benefits managers need not wait until the renewal to review the program's experience; performing such reviews annually can ensure that there are no surprises.

Shopping the rate

It is not necessary to shop for a better rate every time your policies come up for renewal. If you have a good relationship with your insurance carrier, if they are providing good service to your employees, and if they are giving you a fair rate, there is no need to spend time requesting rates from other carriers. In fact, if you consistently change carriers to get the lowest rate, underwriters may stop giving you their best discounts because they expect that you will not be a customer for the long term.

Knowing if you have a good relationship with your insurance carrier and whether it is providing good service to your employees is not usually too hard to figure out. The difficulty can be in knowing if it is charging you a fair rate. Group insurance is typically priced specifically for your group of employees, and if you have a large enough group, for your own claim experience. Your advisor or an independent actuary can help you understand the pricing you are receiving and determine if it is reasonable. Just remember that some advisors are paid a percentage of the premium you pay, often along with supplemental compensation based on the volume of business they place with a given insurance carrier, so their objectives may not be aligned with yours.

Depending on the number of employees you have, the calculation of your premium may be based on your past claims experience. Larger employers will have more of their experience taken into account in the calculation of the rates because that experience is more statistically meaningful than for smaller employers. Smaller employers' rates will be calculated mostly from the insurer's rate manual, where groups with the same demographic mix and plan design will generally receive the same rate. Each insurance carrier has its own guidelines for what size of employer has "credible" experience. When a group's experience is 100% credible, the renewal will be based only on the claims experience of that group. The premium will be set so that it will cover the expected amount of claims in a year plus the insurance carrier's expense and profit requirements, or "retention."

The retention can be determined from the target loss ratio. For example, if the target loss ratio is 70% for your case, then for every dollar you pay in premium, 70 cents goes toward paying claims. The other 30 cents is the retention and will be used for expenses, commissions, premium taxes, and profit. Although understanding this breakdown for your target loss ratio is helpful, employers also should be aware that the insurance company's profits can come from sources other than just the explicit profit margin in the loss ratio calculation. Profits can also come from implicit sources such as reserves being set with additional margins and from interest earned on those reserves in excess of the assumed rate in the reserve calculation itself. An independent actuary can help you explore how much additional implicit profit your insurance carrier may be receiving from your business.

In performing this analysis, however, bear in mind why you have insurance instead of just providing these benefits to your employees directly. In the example above where the target loss ratio was 70%, the insurance company will pay all of the claims even if your employees had a year where claims were actually 120% of premium. The expenses, commissions, and premium taxes will all still need to be paid by the insurance company, and it will bear the loss for that year. This helps keep cash flows level for the employer. The year of poor experience may come into consideration when the contract comes up for renewal, but understanding this dynamic will help the employer prepare for the potential premium increase. The insurer's retention, as well as its spread of risk across all of its customers, allows it to manage the risk of volatile experience.

Disability insurance specific considerations

As part of your insurance renewal discussions, you should request the back-up data, which should include an experience exhibit containing the amount of claims and reserves by incurral year (the year that the disability first began). You can also request a claim listing, which you may share with an independent actuary to calculate the reserves. This will allow you to estimate the reasonableness of the insurance company's estimate of future benefit payments to disabled employees.

You also will want to understand if your insurance renewal considers any reserves for claims that are incurred but not yet reported (IBNR). The typical best practice is to consider only experience set back a short amount more than the elimination period. This is known as the IBNR period. If the insurance carrier includes it in its renewal evaluation, you should have your actuary review the IBNR reserves to ensure they are reasonable.

Another way to look at the reserves being used to calculate your premium is to have an actuary perform a run-out study. This study will look at the change in the insurance carrier's actual loss ratios over time to see if the reserves are reasonable. Because long-term disability (LTD) claims are paid out over several years, an overly conservative reserve can make the experience look worse than it actually is, resulting in higher premiums than needed.

The insurance carrier can sometimes provide a comparison of averages for LTD and short-term disability (STD) claim experiences. A claim audit can show if there are certain diagnoses that are more prevalent in your organization than on average in your industry. Some of these, like a high number of stress or back claims, might even reveal underlying issues in your organization relating to company culture or work environment. Digging into and addressing these issues might not only save you on insurance premiums, but also produce a happier workforce with less turnover.

Figure 1 shows the distribution of claims in their first year according to the Society of Actuaries' 2016 Group Long-Term Disability Experience Study Tables. You can see how your distribution of new claims experience annually compares to this benchmark. Your insurance carrier can provide similar breakdowns for STD, or more specific distributions for your industry.

FIGURE 1: DISTRIBUTION OF NEW LTD CLAIMS

DISABILITY CATEGORY	PERCENTAGE OF NEW CLAIMS
Back	15.1%
Cancer	15.3%
Circulatory	10.5%
Diabetes	1.0%
Digestive	2.3%
Ill-defined and miscellaneous conditions	2.2%
Injury other than back	8.2%
Maternity	1.8%
Mental and nervous	8.1%
Nervous system	6.9%
Other	12.9%
Other musculoskeletal	12.9%
Respiratory	2.7%

Another method to address high premiums for disability plans is to think about plan changes. Do you offer higher-than-average benefits? Doing so might encourage more workers to file initial claims and discourage their returning to work. Think about what you offer compared to your competitors. Is it necessary to offer an "own occupation" definition of disability until retirement age? This kind of plan can have very high claim costs compared to one that switches to "any occupation" after two years. Employers can collaborate with their insurance carrier to benchmark plan designs against other employers in the same industry.

Life insurance specific considerations

If you have a life insurance plan that allows your employees to purchase additional ("supplemental") insurance beyond the basic amount you are providing to all employees, you may want to look at the relationship between the basic and supplemental rates. Employers should understand the pricing underlying each coverage separately through a frank conversation with their insurance carrier. Looking at the experience loss ratios for each part of the life insurance plan separately will let you know if the supplemental premiums are subsidizing the basic premiums. This is a fairly common practice to help keep the premium low for the employer, while charging more than is necessary on the portion that employees pay for out of their pockets. Your company may choose to make each rate self-sufficient to make the pricing more fair to your employees. When comparing rates between insurance carriers, be aware of this practice, which may be used to make the employer costs lower.

Many employers that price their life insurance coverages in the aggregate (i.e., with a significant subsidy between employer-paid and employee-paid life insurance) may not realize they also need to test imputed income to their employees in the aggregate, as it is tested at a policy level. This typically results in the need to impute income on the combined basic and supplemental life insurance amounts greater than $50,000, because they are considered a single policy under the tax code. If employers do not realize the basic and supplemental policies are priced in the aggregate, they would only impute income on the basic life greater than $50,000 and may be incorrectly calculating taxable income for their employees. Employers should further discuss this issue with their legal counsel and tax advisors.

Other considerations

Separate from the premium cost, employers should consider the service received from the insurance company. Does the company offer online enrollment and claim forms, or must employees download and mail in paper forms? Do your employees get treated fairly and with respect when contacting the insurance company?

Integrated leave management is another service that employers may want to ask their insurance carriers about. In addition to STD and LTD coverages, employees may also need leaves to care for family members or bond with a new child. These can be covered under the Family Medical Leave Act (FMLA) or the Americans with Disabilities Act, or as paid family leave (PFL). PFL is now the law in California, New Jersey, New York, and Rhode Island. Massachusetts, Washington, and Washington, D.C. will have fully operational programs in place over the next few years. The 2017 tax law also added a new tax deduction in 2018 and 2019 for employers offering PFL to employees in states where it is not a required benefit.

An insurance company can manage all of these various leave programs for an employer. By doing so, it can help with a comprehensive leave program for employees and assist the employer in keeping up to date on the various regulations and requirements for each program component. For example, the insurer can coordinate a maternity claim that may be covered by paid time off, short-term disability insurance, bonding time covered by PFL, and job protection from FMLA.

Depending on the size of your company, you may want to consider self-insuring your disability or life insurance programs. You would still want to work with an insurance company or a third-party administrator to administer the programs, but self-insurance allows you to take on the financial risk of the insurance. STD plans usually have the most stable claim patterns and may be the best place to start, if you are considering self-insuring. Self-insurance of LTD plans is most common for employers with at least 20,000 employees.

Assessing the data and the alternatives

All of these items are important to consider when renewing your group life and disability plans. An independent actuary can help you understand the pricing you are receiving from your insurance company, bids you are receiving from other companies, or if you should consider structuring your benefits programs differently.

CONTACT

Jennifer Fleck
jennifer.fleck@milliman.com

Benefits Perspectives is published by Milliman's Employee Benefits Editorial Committee as a service to our clients. This electronic newsletter is available on milliman.com/bp. Articles or excerpts from this publication may be reproduced with permission when proper credit is attributed to the firm and the author.

Milliman

IT TAKES VISION