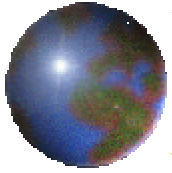


Short Term Disability

Opportunities and Challenges

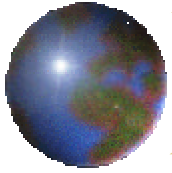
Smith Group
SOA Spring Meeting
June 25, 2002





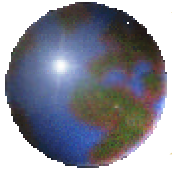
Agenda

- ✦ Why Buy STD?
- ✦ Growth and Profitability
- ✦ STD vs. LTD
- ✦ Profitability Challenges
 - ▣ Experience Rating and Credibility
 - ▣ Data Quality
 - ▣ Manual Rates
 - ▣ Other Challenges

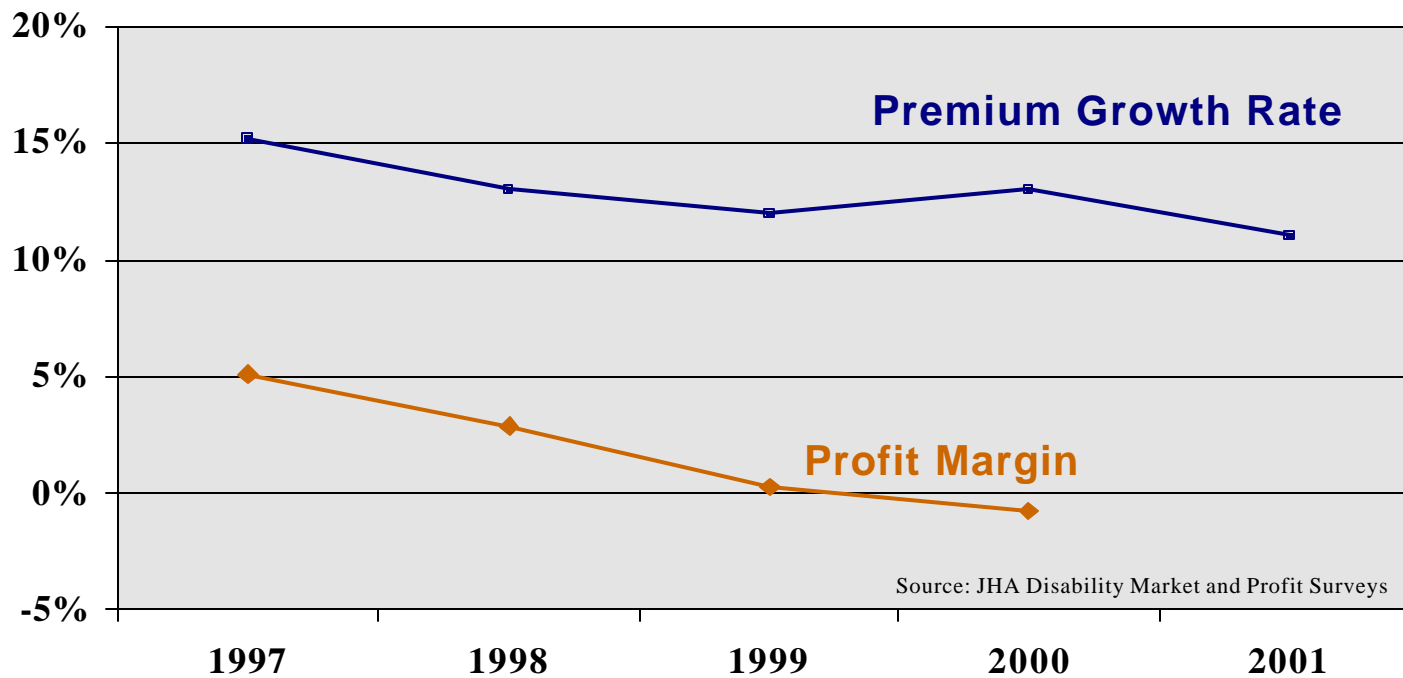


Why Buy STD?

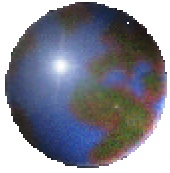
- ✚ Outsource Administration
- ✚ Leverage Disability Management Expertise
- ✚ Coordinate with Other Absence Management
 - ▣ WC, FMLA, LTD
- ✚ Risk Transfer
 - ▣ Small Case
 - ▣ Large Case also?



Growth and Profitability

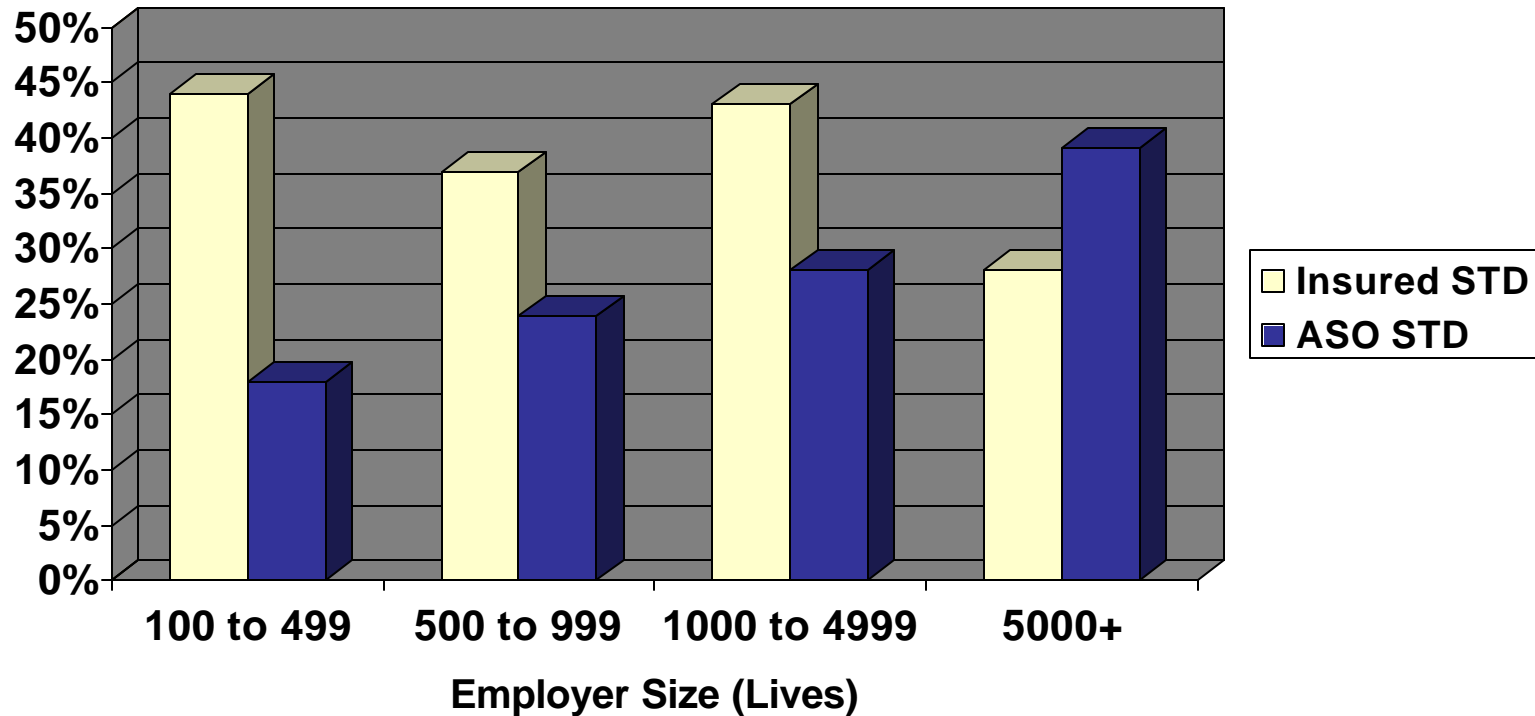


- Consistent double digit premium growth
- Steady decline in profits



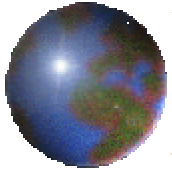
Market Snapshot

Percentage of Employers with STD



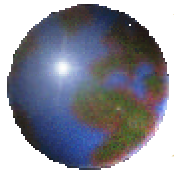
Source: Limra, "Marketing Group Health Insurance and Health Care Benefits, Trends, Insights Phase II, 2001"





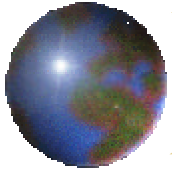
STD vs. LTD

	LTD	STD
Typical Profit Targets	Single to double digit	Mid single digit
RBC Levels (NAIC)	18%-30% of Premium	3%-5% of Premium
Premium / Life	~ \$180	~ \$150
Incidence	~ 4.5 per 1000	~ 65 per 1000
Partial Credibility	Starts ~ 500 Lives	Starts ~ 100 Lives
Full Credibility	7000 – 10000 Lives	~ 250 Lives



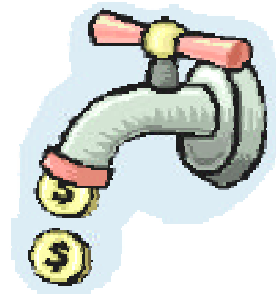
STD vs. LTD (cont'd)

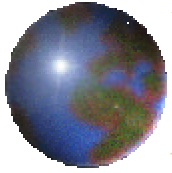
	LTD	STD
Insured Market Size	\$6 billion +	\$2 billion +
Typical Packaging	STD	LTD, WC, FMLA
Experience Review	3 years typical	2 years typical
Experience Detail	Premium, Claim List, Paid Claims	Premium, Paid Claims
Manual Rate Structure	~20 Factors	~15 - 20 Factors
Common Funding Options	Typically Fully Insured	Both Insured and Self-Insured Common



Profitability Challenges

- ✦ Lower profit target implies less room for leakage
- ✦ A few bad cases can drain most profit
- ✦ A few % in different areas can add up





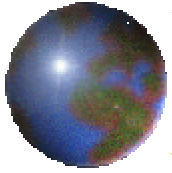
Profitability Challenges

Experience Rating and Credibility

Illustrative Credibility Factors - 7/7/13 Plan

Case Size (Lives)	Years of Experience		
	1	2	3
100	20% - 44%	40% - 63%	60% - 75%
150	30% - 44%	60% - 75%	78% - 100%
250	50% - 63%	84% - 100%	95% - 100%
350	70% - 88%	95% - 100%	100%
500	84% - 100%	100%	100%

- Full credibility as low as 250 lives with 2 years experience
- Should more than 2 years be reviewed on a 250 life case?
- Would 2 years fully account for risk?



Profitability Challenges

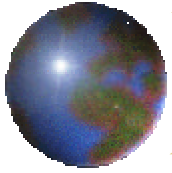
Experience Rating and Credibility

“All of us in the industry made a fundamental underwriting mistake by focusing on experience, rather than exposure, ...”

Warren Buffet

Chairman, Berkshire Hathaway

2001 Letter to Shareholders

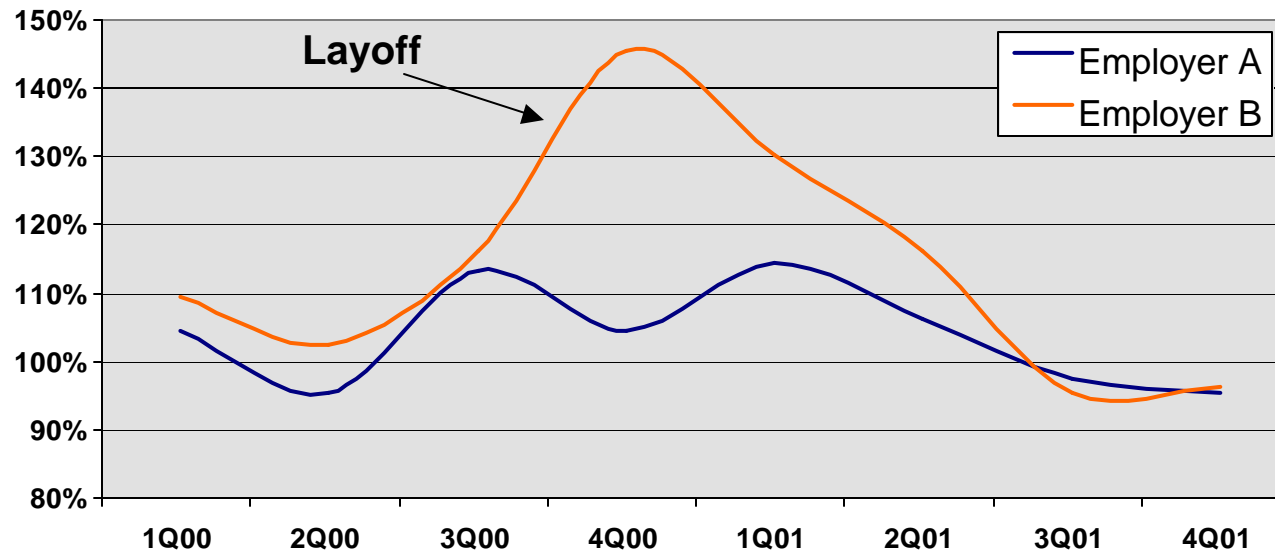


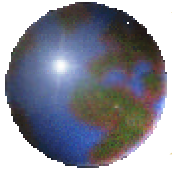
Profitability Challenges

Experience Rating and Credibility

- Assuming similar demographics, how should these two 100% credible cases be treated?

A/E Loss Ratio by Quarter



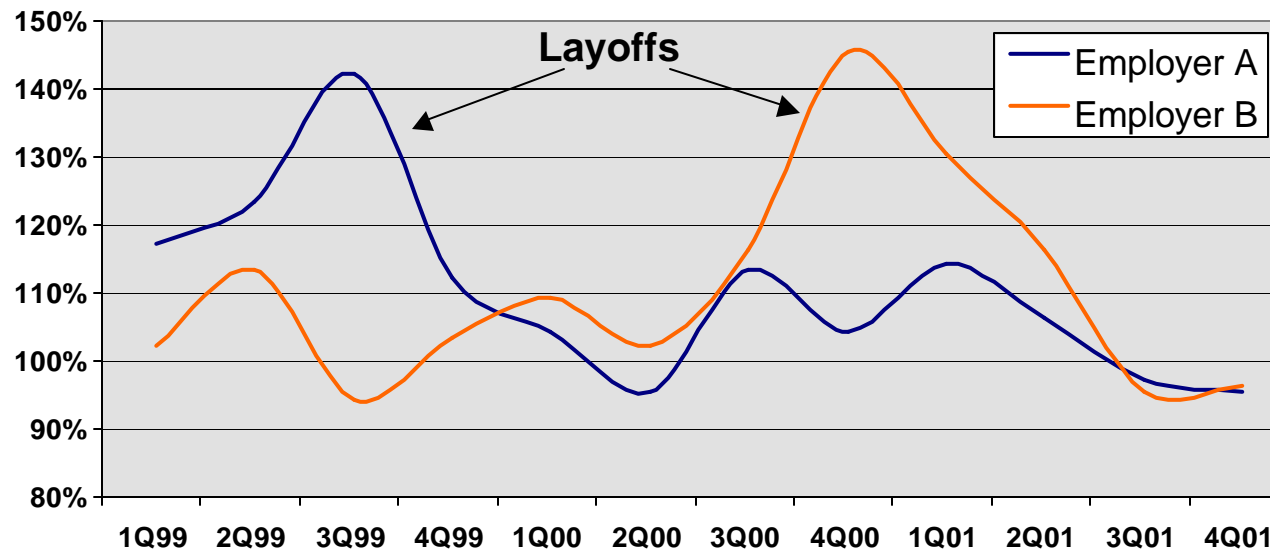


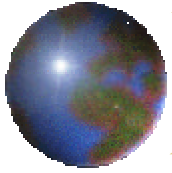
Profitability Challenges

Experience Rating and Credibility

- Now, how should these two cases be treated?
- Would we review the third year?

A/E Loss Ratio by Quarter

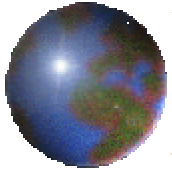




Profitability Challenges

Experience Rating and Credibility

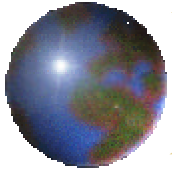
- ✚ Both cases had similar risk levels
- ✚ The two year experience period failed to capture exposure to “one-time events”
- ✚ No guarantee that 3 years always captures this
- ✚ Need to understand exposure as well as actual experience



Profitability Challenges

Data Quality – First Time Buyers

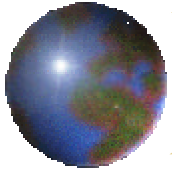
- ❖ Employers may be poorly equipped to track disability costs
 - ❑ Reason to buy may be inability to manage/track program
- ❖ Costs may shift with fully-insured program
- ❖ Need to ensure quoted rate is realistic
 - ❑ Compare to independent benchmarks
 - ❑ Understand employer motivation
 - ❑ Understand experience drivers



Profitability Challenges

Data Quality – Takeover Cases

- ❖ Broker may provide sparse claim detail
 - ❑ Aggregate paid claims and premium only
 - ❑ Sometimes no experience provided
 - ❑ Short turn-around requirements may force rating without experience
- ❖ Short review period if case moves often
 - ❑ Reliance on reserve factors
 - ❑ More likely to miss claim spike risk



Profitability Challenges

Manual Rates

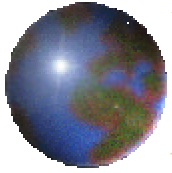
What we know ...

- ⊕ Age
- ⊕ Gender
- ⊕ Industry
- ⊕ Area
- ⊕ Occupation
- ⊕ Salary
- ⊕ Plan Design
- ⊕ etc



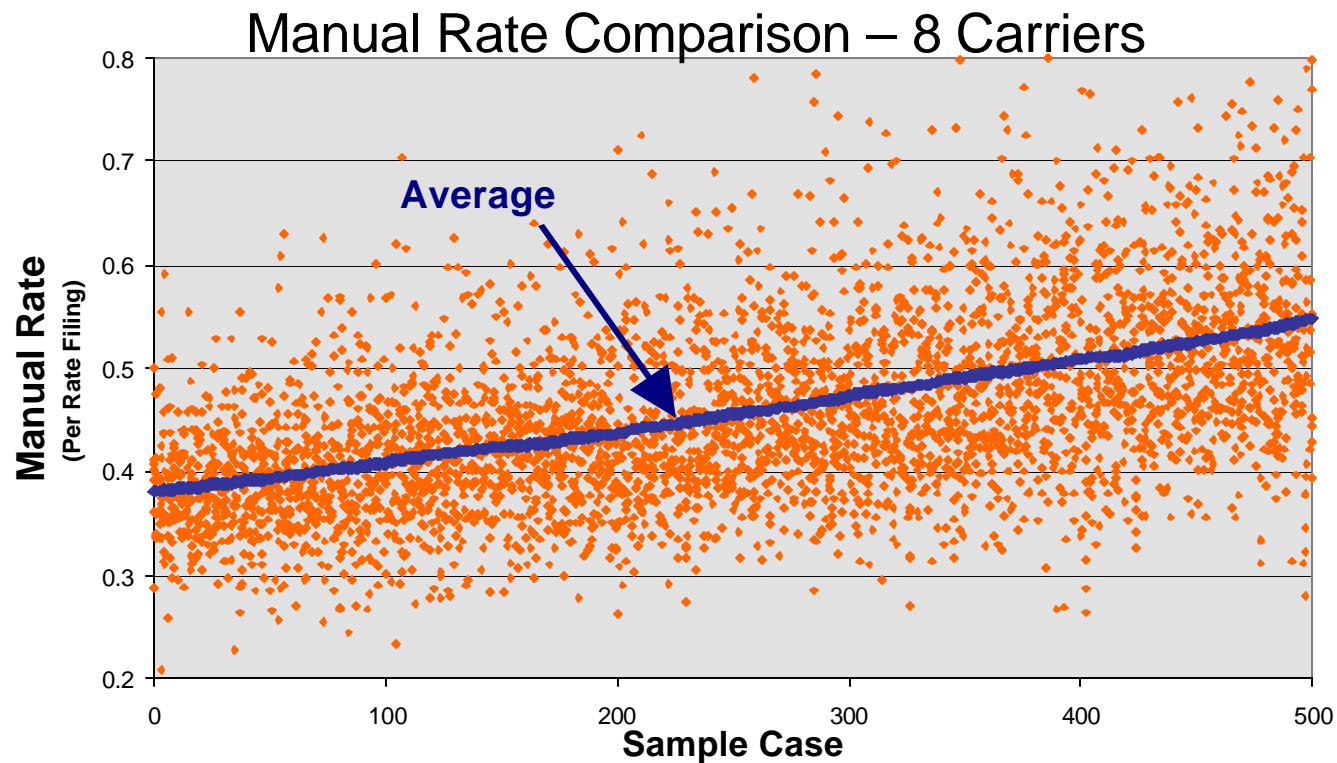
What we want to know ...

- ⊕ General Health
- ⊕ Motivation
- ⊕ Sense of Entitlement
- ⊕ Stress Levels
- ⊕ Layoff Risk
- ⊕ Hazard Exposure
- ⊕ Workplace Culture
- ⊕ etc

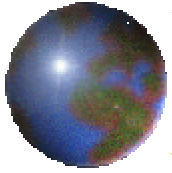


Profitability Challenges

Manual Rates



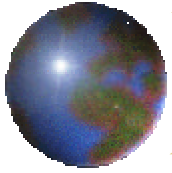
- Rate structures and factors vary significantly !
- Who's "right" ? Is anyone "right" ?



Profitability Challenges

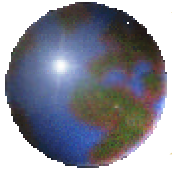
Manual Rates

- ❖ Depending on case specifics, “right” may vary:
 - ❖ If employee stress levels are high, more expensive rates could be “right”
 - ❖ If employees are highly motivated, lower rates could be “right”
 - ❖ Augment manual rates with strong risk evaluation
 - Did the rating factors make sense?
 - Is anything not included in the manual?



Other Profitability Challenges

- ❖ Employee aging
 - ❑ Working population getting older
 - ❑ Other things equal, costs should increase annually
- ❖ Commodity perception
 - ❑ Difficult to take corrective actions
- ❖ Discounts justified by cost savings / value
 - ❑ Favorable risk characteristics not in rate structure
 - ❑ Sell a profitable “package” of products
 - ❑ Difficult with thin margin product
- ❖ Add your own thoughts ...



Conclusions

- ✦ STD product opportunities exist
- ✦ Challenges exist to maintain thin profit margins
- ✦ Traditional rating tools are not perfect
- ✦ Important to understand risk drivers both included and not included in rating tools