

Managing Income Replacement Insurance: Canadian Perspectives

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Overview

- Canadian background
- Issues
- Conclusion

Combination of Public and Private Programs

- 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

- 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

- 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)

■ 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

- 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

- 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

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

■ 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

- 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)

- 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

■ 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

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

■ 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)

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

Issues

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

Growth

- 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

■ 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

- 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)

- 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)

■ 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

- 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

- 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

- 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 opportunitiesBUT ...
 -to succeed, you must understand the issues and be able to manage them accordingly