Profitability Issues in Disability Insurance

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GUAA Disability Committee Meeting
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Disability RMS Profit Survey

LTD Post Tax Profit

Target Profit
30% of Companies reported meeting their internal profit target

Reported Target margins ranged from 3.4% to 22%

90% of Companies reported recent price increases

50% expect future price increases
Trends in Closing Ratios

- 1997: Actual 8%, Expected 10%
- 1998: Actual 7%, Expected 9%
- 1999: Actual 8%, Expected 9%
- 2000: Actual 9%, Expected 10%
- 2001: Actual 10%, Expected 11%
Disability RMS Profit Survey

% Companies Happy with LTD Close Ratios

0% 20% 40% 60% 80%

Top Ten Reasons for Lower than Target Profits
#10 – Contract Improvements are over valued

What’s it Worth?

- Maximum Capacity Language: 3 to 5%
- Prudent Person Language: 1 to 2%
- 60% Gainful definition: 3 to 5%
- Limits on subjective disabilities: 5 to 10%
- Mandatory Rehab: 3 to 5%
- STD Benefits Management: 3 to 5%

Total Value: Are these really worth 15 to 30%???
# Typical Segment Analysis

<table>
<thead>
<tr>
<th></th>
<th>Pct Premium</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Contrib</td>
<td>60%</td>
<td>11.7%</td>
</tr>
<tr>
<td>Contrib</td>
<td>40%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>5.0%</td>
</tr>
</tbody>
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**2001 Growth**

- 7% Growth in Traditional LTD inforce premium
- 22% Growth in Voluntary LTD inforce premium
# 8: Over reliance on Benefits Management as a profit lever

“Sell it low and let Claims clean up the mess”

Hidden Costs

- Increasing ERISA Appeals and litigated claims
- Inadequate reserves after low-lying fruit has been picked

Questions

- How much is good claims management worth (vs. adequate)?
- Are Doctors supportive of sound disability management?
- Do Employers want disabled employees back?
High Turnover… lack of seasoned performers
Transition to multi-line underwriters – lack of LTD focus
LTD Risk Evaluation is complicated
Lack of sound and consistent UW training
UW moving out the field
Less than 1% Growth in Inforce Employers

2001 New Case Sales  
39,787

2001 Change in Inforce Cases  
836

Premium Lapse Rate  
12%

Broker Survey: Average 5 quotes per case

Why are close rates less than 10%?
Investment Income is down.
   5 Yr Corporate AAA bond yield: 3.61%

Economy is anemic… consumer confidence is down

Aging of the work-force

Shrinking of the workforce

Workplace stress at an all-time high

Disability entitlement

Increased litigation

Increased medical costs means more competition for benefit dollars
What is your Quote to Manual? How enforced?

Number One question is still “Where is the competition?”

The “Business Decision”

UW guidelines say “NO”
Benefits say “we would never…”
UW says looks like a bad call

$$$$ say “Sell it”

Can you avoid the stupid decisions???
# 3: Pricing Volatility

Average Manual Rate: $0.60

“Best Ball” Manual Rate: $0.41
Inforce Premium per Life: $195
New Case Premium per Life: $177

Who’s Hot and Who’s Not?
# 1: Profit Targets are Too High

<table>
<thead>
<tr>
<th>Year</th>
<th>AAA 5Yr Corporate Bond Yield</th>
<th>LTD Profit Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>9.5%</td>
<td>12% to 18%</td>
</tr>
<tr>
<td>2002</td>
<td>3.6%</td>
<td>12% to 18%</td>
</tr>
</tbody>
</table>

Blame the Stock Analysts!
Reserving Issues: Hard to peg true costs
Expenses are too high
Brokers too quick to shop the product
Lack of information… poor occupation data
No Innovative Product Design in 30 years
Lack of documented risk evaluation
Focus on experience and not on exposure

What else ????