Both Sides Now

By Tom Penn-David

Individual disability (IDI) and group disability insurance resemble siblings in a mirror: both products insure against the same underlying risk but differences of structure, relationships and governing regulations create major variations. Many insurance professionals spend an entire career working on one side or the other. However, some people jump from one side to the other or have concurrent responsibility for both individual and group disability. With appreciation to Joni Mitchell, we have interviewed individuals who have looked at disability "...from both sides now" to see what lessons can be learned.

Whether one travels from group to individual or vice versa, the differences seem to be more noticeable than the similarities. Virtually everyone we talked to could identify only one or two similarities and could easily list many differences. The actual loss that is covered and the language used to describe that loss (any-occ versus own-occ, for example) can be very similar and most of the contract features from one have an analog in the other. However, even relatively minor-seeming differences--such as how offsets are typically handled and how the actual benefit amount is determined--can have major impacts on financial management of the business.

The differences start with two very distinct distribution models. Group sales usually feature brokers and representatives who handle a range of group products while the IDI sale is likely to involve a more dedicated specialist agent or broker. Compensation differences reflect how much of the producer's time is invested for each individual who is covered and also the very different persistency expectations for the two products. In addition, the producer's involvement with underwriting and business acquisition is likely to be very different. By its nature, the group underwriting process tends to be more fluid and to have more room for negotiation over rates and terms.

At the level of underwriting and rate setting, the disparities seem to be at their widest. For IDI, the actuary and underwriter collaborate at the beginning of the product development process. The actuary will build and test rigorous financial models projecting results far into the future and fixed sets of rates with limited discount options will be filed with the states. Because rates are more likely than not locked in for the entire life of a policy, a great deal of anxiety goes into the rate development process. However, once rates are developed, the actuary and underwriter largely go their separate ways. The underwriter looks at very detailed information about each individual risk and issues, declines or modifies an offer. Every so often, the actuary and underwriter will review experience to see if the ocean liner of rating needs to be turned.

By contrast, the group actuary and underwriter (and marketer) live closely together throughout the rating and new business process for each case. While the actuary's development of the rating structure is based on a great deal of data and analysis, it only provides a starting point. The rating manual may be applied formulaically for the smallest of groups but from medium-sized groups up to national accounts, the combination of experience and manual rating and assessment of the group's intangibles represents more of an arcane art than a rigid science, with the sorcerer and apprentice stirring the pot with seasoning from the group rep. As group prospects flow into the underwriting cycle, whether as new business or renewals, the underwriter and actuary are joined at the hips. In particular, one of the arcane mysteries of the group new business process that once startled this author is the mystery of "acquisition pricing", or the intentional underpricing of new business. How are group insurers able to deliberately quote well below the expected claim cost of a new group and still (as most group insurers do) consistently generate profits on their overall book of business?

At the point when an active insured becomes a claimant, it would appear that the differences between group and individual disability once again narrow. An individual has, through sickness or accident, lost some or all of the ability to earn a living. Although process differences of ERISA versus non-ERISA handling may appear to be significant, claim professionals noted that claims on either side are actually handled with very similar attention to fairness and timing.

Any disability claims professional wears a number of hats--medical and contract expert, investigator and communicator. However, when confronted with an IDI claim, other roles are added--those of financial analyst and detective. For a group claim, it is often straightforward to establish covered income under the contract definition and, assuming the claimant meets the contractual definition of disability, the benefit amount is somewhat straightforward (subject to offset calculations). An IDI claim, on the other hand, is most likely to occur for a self-employed person whose income, at the least, may be a matter of interpretation. Furthermore, the self-employed person may have considerable flexibility in determining what work they have been, and are currently, performing. Coordination with forensic accountants and field investigators is a common role for IDI claim professionals but infrequent for group claim professionals.

When moving into financial reporting, there are again more differences than similarities. On the face of it, the calculation of disabled life reserves should look very similar for a benefit payable to 65 whether under a group or an individual policy. However, experience with the much more involved determination of expected future offsets for group and very different approaches to other contingencies between the two lines does require somewhat different philosophies about how a balance sheet is properly reported. The addition of active life reserves to IDI financials and the capital impact of long-term rate guarantees engender a rather different temperament on the part of the financial actuary, accountant and P/L manager for IDI business. The IDI financial manager tends toward a more cautious approach to financial reporting knowing that long guarantees add extra risk to the balance sheet.

For both sides, the availability of experience data varies from company to company. The availability of industry experience data could be suggested by the fact that both sides use statutory tables that date from the mid-80's; however, both group and IDI have seen great labors in the last few years to provide up-to-date and extensive intercompany experience.

The overall differences between the two sides can be summarized in a number of different images: IDI is from Jupiter and group is from Mercury; IDI is a tortoise and group is a hare; ID is marriage, group is speed dating. Most of the professionals we interviewed who have worked on both sides found each rewarding in different ways and did not express a preference for one side or the other. IDI lends itself to a more careful, detailed, deliberate approach. Make one product mistake and you may live with financial consequences for a long time. By contrast, the group product manager has to be more nimble and responsive to fast-breaking changes. Group claims are more likely to be handled by a straight-through process while IDI may involve more of a deep dive.

When asked about the relative value of both products to insurers and to consumers, our interviewees suggested that group is beneficial to a broader base of companies and individuals while IDI provides a stronger value proposition to customers with needs for guarantees and more extensive features. There is some sense that IDI is more profitable for insurers because there are fewer competitors--with the obvious caveats about what happens when results go bad. Whether one is better or worse than the other for an insurer is largely a matter of corporate philosophy.

When we asked what one side could learn from the other, whether discussing sales or pricing or underwriting or claims, there was a consensus that group could benefit from some of the more focused, detailed approaches to developing sales or gathering risk details while IDI could learn (subject to regulatory constraints) to be a little more nimble and responsive. One long-time observer of both sides of the industry noted the increasing trend in recent years for convergence as voluntary group products and multi-life IDI products both try to address new trends in employer budgets and employee needs.

A consistent theme throughout the interviews was the satisfaction that professionals felt on either side of the divide. Whether dealing with the intricacies of IDI rate development and medical underwriting or the imponderables of group underwriting and quoting, there seems to be a consistent sense that helping to serve income protection needs is both a public benefit and an interesting, challenging and rewarding profession.

The author thanks the following switch-hitters who were kind enough to submit to our interviews: Chad Cunningham, Maggie Donovan, Kevin Farley, Harriett Frizie, Tom Heckel, Barry Lundquist, and Dan Skwire. While I have benefited from their comments and insights, any errors of interpretation are mine.

Tom Penn-David is an independent consultant who works with marketing and reinsurance issues for specialty life and health insurance products. He can be reached at tikpenn@gmail.com.