

**The Art & Science of Pricing Group Life Insurance**

Helping your clients wring the most value out of every benefit dollar, and reaping the rewards



*Previous issues of Get More established the current scenario: Employers are under tremendous pressure to reduce costs, yet offer competitive benefit packages. At the same time, demands are being placed on intermediaries to deliver more services at lower cost — sometimes at lower commission. What's more, the current climate of corporate mistrust and ethical scrutiny dictates benefits pricing must be completely aboveboard.*

*In this installment of the Get More series, we review the current trends that are putting the cost squeeze on all parties in the benefits delivery equation — employers, employees, providers and intermediaries. We will examine pricing fundamentals for group life insurance. Finally, we'll suggest what these trends portend for producers trying to serve the best interests of their clients while keeping their own financial picture transparent and healthy.*

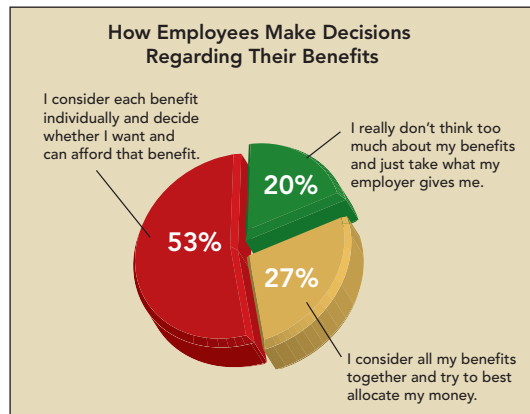
### **The price squeeze is on**

In a recent study asking benefits producers what they look for in a group life insurance provider<sup>1</sup>, respondents depicted this pricing challenge: low price might be the most important factor in winning new business, but clients aren't willing to give up any ground on the service side to achieve lower costs. If anything, producers see poor service as the primary reason employers move their business to a new carrier.

Yet, when making benefits decisions, both employers and employees tended to take a myopic view, concentrating on short-term needs rather than long-term goals. With a seemingly simple product such as group life insurance, employers are often tempted to base buying decisions solely on price. But by doing so they may be forfeiting the very features that make life easier for benefits administrators and could save the company thousands of dollars in staff costs over the long run.

Employees approach the purchase of non-discretionary or voluntary benefits in essentially the same manner they approach the purchase of other consumer products and services. According to the Life Insurance Marketing Research Association (LIMRA), the majority of employees view benefits within the context of their overall spending — in effect, pitting cable TV against life and disability benefits. The conundrum is that middle- and low-income individuals, who overwhelmingly rely on employer-paid life insurance protection, would like to have richer coverage than what their employer currently provides.

A unique price is developed for every plan – starting from scratch using demographics and claims experience for the particular group.



*Choosing Benefits: A Battle for the Employee Dollar (LIMRA, 2006)*

Straddling the widening chasm between employer/employee expectations and carriers' ability to price products tightly, intermediaries need to take stock of their own health and welfare. True, you wouldn't want your client to pay unreasonable compensation in the benefits transaction; but in a fair exchange, you need to be paid adequately for your work — so does the provider. Reaching a fair exchange is the

objective and, as discussed in previous issues of the Get More series, transparency in pricing is key to achieving it. The issue isn't about being paid; it's about every party to the transaction knowing who is getting paid and how much.

It's equally important that clients know what they've purchased. In the case of employee benefit plans covered by ERISA, choosing carriers may be a fiduciary responsibility, and in the long run, helping your clients find the best solution is as important as saving them money.

Beyond price, employers need to consider a carrier's financial strength, claims-paying ability – and service. The best of the best offer:

- **Efficiency.** Using technology to improve processes and reduce workload.
- **Long-term relationships.** Providing creative, responsive service, year after year, as demonstrated by excellent client retention and satisfaction results.
- **Prompt claims resolution.** Using toll-free service numbers, online and faxed claims submissions, and online claims forms and information to cut days off the payment process.
- **Strong communication.** Boosting participation through targeted, personalized materials that foster employee decision-making and satisfaction.

## Pricing group life insurance: the fundamentals, the future

You earn your commission, and your clients' trust, by helping them evaluate the benefits and risks of all options. We offer the following primer on the basics of group life insurance pricing to build your knowledge of the subject. In turn, you can provide valuable assistance to your clients, helping them fully understand the value of their benefits purchase.

How does it work?

Developing prices for group insurance is basically the same as pricing any product a company produces and sells.

- **Start** with the cost of the raw materials.
- **Add** various types of expenses:
  - The cost of producing the finished product;
  - The cost of managing, administering and servicing the product;
  - The cost of distributing the product; and
  - A share of company overhead.
- **Then add** a profit margin, and you have the total price.

Group insurance has one major characteristic that differentiates it from most other products: There isn't just one price developed and offered across the board. Rather, the carrier determines a new, unique price for every group insurance customer. Each time a carrier receives a proposal, it essentially starts from scratch to build a price that reflects the demographics, the claims experience and plan design of each insured group.

### Claims: the raw material of insurance

As a starting point, think of life insurance claims as the “raw materials” of the insurance product. All insurance companies start the pricing process by projecting the cost of potential claims. And, since claim results are volatile, this procedure is often more art than science. The larger the group of people, the easier it is to make a good projection, but there is always a great deal of professional judgment involved.

Plus, information about claims history isn't perfect. That's why several insurance companies, each using highly qualified actuaries and underwriters, can come up with differing estimates and differing prices.

### Expenses: covering the cost of distribution and service

After determining projected claims costs, the carrier projects its expenses. Typical expenses for an insurance carrier include the cost of:

- Developing and implementing a customized plan;
- Communicating the plan to members of the group;
- Processing enrollments, medical underwriting, premium payments and claims;
- Providing customer service to insured individuals;
- Distributing the product – the actual coverage – to the customer.

### Premium taxes: insurer as conduit

A separate expense category covers the cost of state, local and sometimes federal premium taxes. Most often, the insurance company acts simply as a conduit for these taxes which are based on premiums collected and charged to the group insurance plan.

### Profit = risk charge

In an insurance plan the profit margin could more appropriately be called a “risk charge.” It compensates the insurance company for taking the risk that claims will be greater than projected and for allocating a portion of its capital to cover potential losses. If claims are within or below projected levels, the risk charge produces a profit for the company.

To summarize, the premium charged for group life insurance is the sum of the expected claims cost, plus the expenses – including distribution costs paid to an intermediary – and a risk charge.

*This generic pricing model ignores interest on reserves, which can help to cover the cost on some products with large claims reserves, but isn't relevant on a product like term life insurance.*



### What's ahead?

From a carrier's perspective, the group life insurance market is experiencing increased pressure from decreasing margins, demand for higher guaranteed coverage limits, longer rate guarantees and aggressive credibility formulas.

Common pricing practices for group life insurance plans focus on age, gender, industry and sometimes geographic area. While these pricing practices are still valid, some underwriters believe additional information — like income, education, occupation and marital status — would help increase the accuracy of mortality estimates and, therefore, provide a more competitive rate. Some members of the Group Underwriters Association of American (GUAA) predict that a company's ability to capture and utilize this additional data will drive the future of group life pricing<sup>2</sup>.

Another element working its way into the pricing formula, post 9/11, is enterprise risk management (ERM). Proponents of ERM suggest that to adequately manage risk exposure group insurers must measure — and limit, reinsure or charge for — risk concentration by locale, down to the level of a city block or even a specific building. As this risk assessment model gains more credence, it will undoubtedly have an impact on pricing.

## To participate or not to participate?

### The choice of life insurance funding options does make a difference

The fundamental choice between funding options for a life insurance contract is whether to “participate” or not to participate.

- **Under a participating plan**, the policyholder (sponsoring company) “participates” in the financial results of the plan by receiving dividends or experience refunds when the financial experience is favorable. When experience is unfavorable, financial deficits are carried forward and recovered from future results before further dividends will be paid.
- **With a nonparticipating plan**, the policyholder does not share in the results. The insurance company retains the positive financial results and absorbs the negative results, with the expectation that the positives and negatives will balance out over time. Because no dividends or experience refunds are paid to the policyholder, the insurance company generally offers a lower premium rate than is needed under a participating basis.

Under nonparticipating plans, the policyholder pays premiums at an agreed-upon rate. That’s all there is to it. The policyholder knows that the premium it pays will be the cost of the insurance. This is the funding option most often used for optional, employee-contributory insurance plans.

### Paying premium under participating plans

There are many ways to pay premiums under participating plans, and they all share a common denominator: the policyholder doesn't know what its net insurance cost will be until the accounting period is completed and claim costs have been calculated.

<p><b>Conventional premium payment</b></p>	<ul style="list-style-type: none"> <li>• Policyholder pays premiums throughout the accounting period at a specified rate.</li> <li>• At the end of the period, insurer calculates the financial experience result.</li> <li>• If premiums have exceeded the total amount needed to cover claims, expenses and risk charges, the excess is paid to the policyholder (or it may be held in a reserve for the plan).</li> <li>• If the experience result is negative, the deficit is carried forward to be recovered from future surpluses.</li> </ul>
<p><b>Retro or "Low Remit" premium payment</b></p>	<ul style="list-style-type: none"> <li>• Policyholder pays premiums throughout the accounting period at a specified rate.</li> <li>• Premium rate may be lower than the rate used for conventional premium payment basis, because the insurer can collect additional premium.</li> <li>• At the end of the period, insurer calculates the financial experience result.</li> <li>• If premiums have exceeded the total amount needed to cover claims, expenses and risk charges, the insurer pays a dividend to the policyholder.</li> <li>• If the result is negative, policyholder pays an additional premium to cover the excess charges.</li> <li>• The additional "retro" premium amount is limited to an agreed-upon percentage or rate.</li> <li>• If a deficit still exists after payment of this premium, it is generally carried forward for future recovery. If the agreement is not to carry forward any deficit, the policyholder's premium limit will be higher.</li> </ul>
<p><b>Flexible funding or "Cost-Plus" premium payment</b></p>	<ul style="list-style-type: none"> <li>• Policyholder's monthly premium payments vary based on claim charges incurred month by month.</li> <li>• Each monthly premium includes an amount covering the insurance company's expense and risk charges, plus an amount for the actual claim costs for the month.</li> <li>• No matter what the claims experience is, the policyholder never pays more cumulative premiums than the maximum cumulative monthly premiums specified.</li> <li>• If a deficit exists at the end of the accounting period, it is carried forward for future recovery. If the agreement is not to carry forward any deficit, the policyholder's premium limit will be higher.</li> </ul>

## When all is said and done

### Price isn't everything

As consumers, we've all had the experience of getting a "great deal," only to find out that the original promise was fraught with disclaimers and limitations. Beware of the carrier who comes in with a strong quote but buries a host of restrictions in the fine print. The best price is not "best" unless it's backed by superior service and follow-through on the part of the seller.

You want to work with carriers who not only price competitively but also add value. Here are some of the efficiencies and value-added services progressive companies are looking for to sweeten their benefits mix and find a true partnership with their insurance carriers.

<b>Top-notch service:</b>	<b>Long-term relationships:</b>	<b>Technology:</b>	<b>Value-added services:</b>
<ul style="list-style-type: none"> <li>• Responsiveness</li> <li>• Superior account management</li> <li>• Ease of administration</li> <li>• Dependability and flexibility</li> </ul>	<ul style="list-style-type: none"> <li>• Trust</li> <li>• Delivery on promises</li> <li>• Synergy between organizations</li> <li>• Room to negotiate</li> </ul>	<ul style="list-style-type: none"> <li>• Online self-service for employees</li> <li>• Online reporting and claims submission for administrators</li> <li>• Secure data transfer</li> </ul>	<ul style="list-style-type: none"> <li>• Wellness coaching</li> <li>• Financial counseling</li> <li>• Targeted employee education</li> <li>• Beneficiary services</li> </ul>

## A partner for the long run

We can help you achieve the right balance between value and price for your clients.

Fair pricing is the foundation. From there, we commit to service that makes you look good and makes clients want to stay with us forever: Services such as "noiseless" implementations, where neither administrators nor employees have complaints; online services to make enrollment, evidence of insurability and claims processes faster and paper-free; exclusive personalized communication services to boost participation; and extras such as free financial counseling for beneficiaries. They're all part of the reason that 100 percent of clients are satisfied with our service and 98 percent would recommend us to another company<sup>3</sup>.



### Up Next:

Low price might be a key factor in deciding on a new benefits plan, but clients aren't willing to give up any ground on the service side to achieve lower costs. If anything, employers want more administrative and communication support from intermediaries, and benefits providers aren't shy about seeking new partners if they don't see the results they're after. In the next installment of Get More we will look at how customer satisfaction ties into service, pointing out real opportunities for you.

### For more information

To learn more, contact the group sales manager in your region or call our national sales office at 1-800-606-LIFE (5433) or visit [www.lifebenefits.com](http://www.lifebenefits.com).

### Sources:

<sup>1</sup>Group Insurance Intermediary Study, March 2005.

<sup>2</sup><http://gaaa.com/actionstories/2001fall4.html>, Trends in Group Life Insurance Pricing.

<sup>3</sup>Beneficiary financial counseling services described are provided by, and are the sole responsibility of, PricewaterhouseCoopers. These services are not affiliated with us or our policyholders.

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