Get more out of life #13

Pricing for the long run

How longevity is changing group life insurance pricing

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People are living longer and healthier lives. Compound that trend with baby boomers working beyond typical retirement years, and you'll find that employers are facing a new type of benefit dilemma – providing benefit coverage for an aging yet active population. What is the impact of this trend on the pricing of active benefit plans?

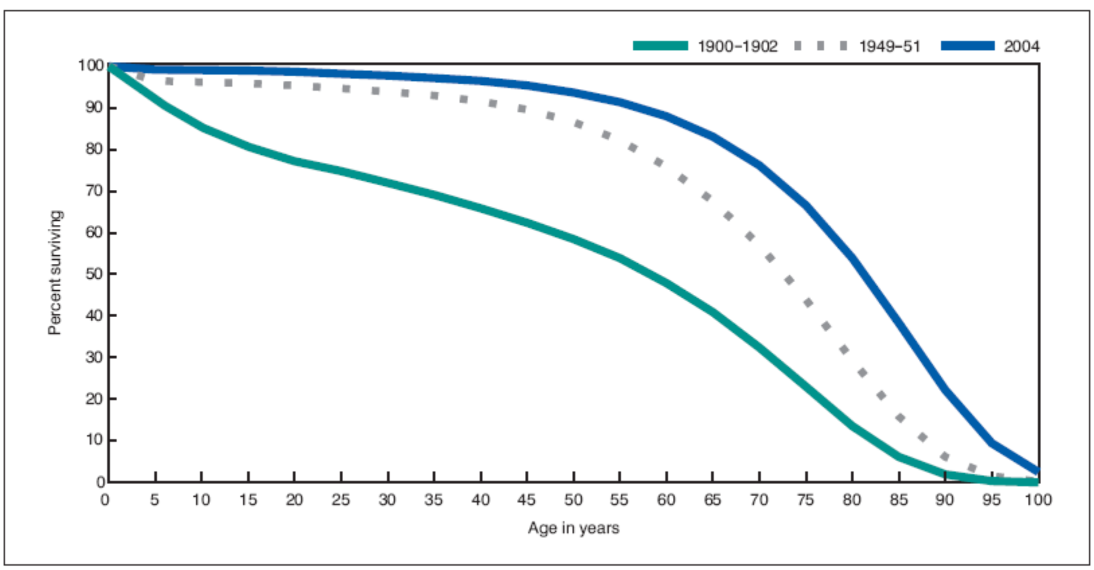
In this installment of the Get More series, we explore how longevity, coupled with the latest mortality tables published by the Society of Actuaries, has the potential to affect the pricing of group life insurance plans. We'll also revisit the fundamentals of pricing group life insurance for large employee groups to help producers learn what to expect in this marketplace.

Increasing life expectancy

Factoring longevity into the pricing equation

Over the last century, U.S. life expectancy has increased dramatically. According to the U.S. Department of State, for the first time in history, people age 65 and over will outnumber children under the age of five.[1] Figure 1 below illustrates this information by showing the percentage of the population surviving by age over three historical periods: 1900-1902, 1949-1951 and in the year 2004.

Figure 1



Source: CDC National Vital Statistics Report, Vol. 56, No. 9, United Stated Life Tables, 2004, December 28, 2007.

With the advances in medical technology and the development of new pharmaceuticals, it is believed that life expectancy globally will continue to rise and mortality will continue to improve. Specifically, the U.S. Department of State notes the following trends regarding longevity in the world population:

- Life expectancy is increasing throughout the world. Most countries show a constant increase of longevity over time. This leaves many wondering how much further life expectancy will rise.
- In 2006, it is estimated that there were more than 500 million people worldwide age 65 and older. By 2030, this number is estimated to increase to one billion — which will be one in every eight of the earth's inhabitants.
- People age 85 and over are the fastest growing segment of the population worldwide.
- The number of centenarians continues to grow. It is estimated that the number of people over age 100 has doubled since 1950.[3]

Impact on the workforce

Generally, as people age, their workforce participation falls. This was the predominant trend in the U.S. through the majority of the 20th century. However, in the 1990s, experts observed that there appeared to be a steady increase in workforce participation at older ages.[4]

As workforce participation increases, so too does older workers' need for finding life insurance options to match their longevity. Indeed, older employees are buying more life insurance than they did in previous decades. Universal life insurance products that extend coverage to higher ages are a good fit for this population.

Pricing products for extended ages, however, can be challenging. Recent studies have found that retirees experience higher mortality than active employees of the same age.[5] Between 2000 and 2005, many insurers have experienced a significant increase in their mortality exposure for insureds age 75 and older.[6]

It is also now common to find the older segment of the population, working part-time or even full-time as active employees. This is a positive trend to counter the exodus of baby boomers from the workplace, but employers will need to focus on what this older population needs to be productive and make the accommodations necessary to keep them actively employed. The phased retirement trend also will force employers to re-evaluate the benefits traditionally made available to retirees a few decades prior.

Mortality tables

Using the past to predict the future

"In the business world, unfortunately, the rear-view mirror is always clearer than the windshield."

— Warren Buffet, Chairman and CEO of Berkshire Hathaway

Mortality rate tables are key to helping insurance companies create and validate pricing assumptions. These tables focus on the ratio of total deaths to total population in a specified community or area over a specified period of time. Actuaries use these tables to predict death and survival rates for individuals of various ages.[7]

In 2006, the Society of Actuaries completed a report on group term life insurance mortality experience. This report covered the time period 1999 – 2001 (the most recent previous report was based on data gathered from 1985 – 1989). The new report, dubbed the "2006 study," focused heavily on the impact of the aging population and its correlation to the mortality tables.

The 2006 study concluded that there has been a consistent trend of mortality improvements over the time period since the previous report[8] (the amount of improvement, however, may vary by age and gender).

With the release of this study, carriers could reevaluate their pricing and begin applying this new information to their pricing models. Each carrier's application of the information would vary based on its market focus, the experience of its own book of business and its philosophy regarding the use of industry data vs. its own data.

What is the importance of this new study?

The new mortality information will have the most impact on the pricing of smaller employer plans which is largely based on manual pricing models. These smaller groups may see improvements in their group life insurance rates.

Rates for large employer plans are based almost entirely on actual company experience; underwriters assume the group's claims history is the primary indicator of future claims. For these employers, the new mortality information has minimal impact on rates.

Pricing 101: The fundamentals

In the large employer market, a unique price is developed for every plan – starting from scratch using demographics and claims experience for the particular group

We offer the following primer on the basics of group life insurance pricing and funding to assist you in helping clients fully understand the value of their benefits purchase.

How does it work?

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

1. Start with the cost of the raw materials.
2. Add various types of expenses:
   - Cost of producing the finished product;
   - Cost of managing, administering and servicing the product;
   - Cost of distributing the product; and
   - A share of company overhead.
3. 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. The carrier determines a new, unique price for every group insurance customer.

While each carrier strives for consistency in their pricing approach, there are many different factors that may influence their pricing of a plan. Each time a carrier receives a request for proposal, their underwriting team 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

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

- Any value-added services the client may be requesting
- 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.

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 margin = risk charge

In an insurance plan the profit margin could more appropriately be called a "risk charge." This charge 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.

And the result is…

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.

Figure 2

To participate or not to participate?

The role funding options play in pricing

The fundamental choice between funding options for a group life insurance contract is whether to "participate" or not to participate. Each funding option has its own unique set of features and the upfront premium rates vary among the options. The chart below provides a helpful guide to help evaluate which funding option may best suit your client.

Funding option	Payment details
Non-Participating (Fully pooled)	• Premiums remitted at the stated rate. • Carrier retains the full insurance risk of the plan. • No experience refund calculations are performed. • Underwriting gains and losses are kept by the carrier.
Participating (Dividend eligible)	• Premiums remitted by the policyholder at the stated rate. • An experience calculation is performed at the end of the period. • If financial experience is favorable, policyholder receives an experience refund (or a plan reserve may be held). • If financial experience is unfavorable, deficits are carried forward and recovered from future results before experience refunds are paid.
Cost-Plus (Flexible funding)	• Policyholder's monthly premium payments vary based on claim charges incurred month by month. • 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. • No matter what the claims experience is, the policyholder never pays more cumulative premiums than the maximum cumulative monthly premiums specified. • If a deficit exists at the end of the accounting period, it is generally carried forward for future recovery. If the carrier has agreed not to carry forward any deficit, the policyholder's premium limit will be higher.
Low Remit (Retroactive)	• Policyholder pays premiums throughout the accounting period at a specified rate. • Premium rate may be lower than the conventional premium rate because the carrier can collect additional premium. • An experience calculation is performed at the end of the period. • If premiums have exceeded the total amount needed to cover claims, expenses and risk charges, the carrier pays an experience refund to the policyholder. • If the result is negative, policyholder pays an additional premium to cover the excess charges. • The additional "retro" premium amount is limited to an agreed-upon percentage or rate. • If a deficit still exists after payment of the excess premium, it is generally carried forward for future recovery. If the carrier has agreed not to carry forward any deficit, the policyholder's premium limit will be higher.

Not all funding options may be available to all group life insurance plan sponsors.

A vantage point for producers

What's ahead?

Many carriers had assumed that mortality was improving; the new mortality data has validated that assumption. This allows carriers to be more comfortable with their pricing offers.

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 an even more competitive rate.

Some members of the Group Underwriters Association of America (GUAA) predict that a company's ability to capture and utilize this additional data will drive the future of group life pricing.

While improved information about mortality and risk helps group life insurance carriers fine tune their pricing, market forces – such as demand for higher guaranteed coverage limits, longer rate guarantees and aggressive credibility formulas – continue to put downward pressure on group life insurance margins.

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.

Looking beyond price

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

- **Advanced technology solutions**. Easy, secure access to user-tested web sites that reduce work for administrators and improve education and satisfaction for employees. Innovations include real-time reporting, automated evidence of insurability processing, online claims submission and online beneficiary management.

- **Long-term partnerships**. Creative, responsive service, combined with long-term pricing strategies, is reflected in excellent client retention and satisfaction results.

- **Equal treatment of all customers**. Providing all customers — new or existing — the same access to new product and service innovations.

- **Strong communication**. Boosting participation through targeted, personalized materials that foster employee decision-making and satisfaction. Providing employers with participation benchmarking to assess their industry position.

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

Active account management

- Ease of administration
- Responsive
- Consultative
- Dependable
- Flexible

Long-term partnerships

- Pricing structured for longevity and plan stability
- Performance guarantees
- Trust
- Delivery on promises

Self-service technology

- Online claim submission
- Online evidence of insurability
- Online beneficiary management
- Secure data transfer
- Easy access
- User-tested

Suite of products and services in one plan

- Term and cash value products
- Wellness programs
- Health coaching
- Travel assistance
- Will preparation/legal services
- Beneficiary financial counseling

A partner for the long run

About Minnesota Life

With more than $610 billion of group life insurance in force, Minnesota Life is the nation's fourth largest group life insurer. The Company has provided customized group life insurance programs to government, business, and associations for more than 90 years, and is highly rated by the major independent rating agencies that analyze the financial soundness and claims-paying ability of insurance companies. View our ratings at www.lifebenefits.com.

[1] Why Population Aging Matters: A Global Perspective, U.S. Department of State, March 2007.
[2] Report of the Society of Actuaries Group Life insurance Experience Committee, Society of Actuaries, August 2006.
[3] Why Population Aging Matters: A Global Perspective, U.S. Department of State, March 2007.
[4] Ibid.
[5] Ibid.
[6] Tillinghast Finds Mortality Gains Among Older Insureds, National Underwriter Life & Health, February 2008.
[7] Risk Insights: Mortality, Gen Re LifeHealth, November 2004.
[8] Report of the Society of Actuaries Group Life insurance Experience Committee, Society of Actuaries, August 2006.

F62382-21 8-2008
A02306-0608