

# LTD REINSURANCE – MEETING A MARKET NEED

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Long Term Disability (LTD) Reinsurance provides the resources and flexibility necessary to allow almost any insurance company to offer attractive disability products and participate more broadly in insurance markets. UNUM was one of the founders of disability reinsurance more than twenty years ago, and has been an originator of many innovative developments as disability reinsurance has evolved into a multifaceted, highly specialized and highly competitive business.

## What is LTD Reinsurance?

Reinsurance originated with the objective of risk sharing. Theoretically, any "risk" that can be insured can be "reinsured". Since this is not limited to just life insurance risk, various types of reinsurance enterprises operate in today's market place. LTD reinsurance involves the acquisition of *disability* risk from a ceding company in return for premium.

The ceding company gains a risk sharing partner and access to the reinsurer's array of services, and reduces its in-house requirements for risk-reserves and operational support services. This enables the primary insurance company to deliver a comparable level of products and services to that offered by large, experienced, full-service LTD providers. Behind the scenes the reinsurer provides whatever pieces the primary insurer needs: risk relief, claims management, underwriting expertise, product development, contracts and filing expertise, as well as financial, technological, and marketing support.

Disability differs from life insurance — and disability *reinsurance* from life reinsurance — in a number of key ways. Underwriting and pricing/reserving assumptions for disability reflect the fact that morbidity rather than mortality is being indemnified. A person dies only once, but disability can be for multiple periods in a lifetime and for variable durations, short-term to permanent. Death is an all-or-none phenomenon, but disability can be a spectrum, from partial to total, and may not be static but subject to further recovery/restoration or further deterioration over time. Disability is occupationally sensitive in more ways than life insurance needs to address, both in terms of sickness and accident *risk*, and in terms of *recovery* to work. Return-to-work — irrelevant in life insurance but one of the happier forms of disability claims resolution — is a complex interplay of factors, including functional capacity, motivation, adaptation, and others. Finally, claims management from a disability perspective cannot simply be claims processing, but must generally be an ongoing and creative process of active claims management.

## Why Insurance Companies seek LTD Reinsurance

People as individuals seldom "self-insure" for disability risk. Rather, they seek indemnification from an insurer who can spread the risk. They pay a premium and receive coverages and services.

Individual *insurance* companies behave somewhat similarly when they "lay off" the risks that they have assumed from

their various individual and group policies and pass that risk, or a portion of it, along to another company. Those companies that accept such risk from a primary insurer become the "reinsurers". Depending on what types of risks have been insured and how the coverages have been set up, the insurer, by means of a "reinsurance treaty", enters into an arrangement with the reinsurer to risk-share. There are various reasons why it might make good business sense for an insurance company to consider using a reinsurance company to help them with their disability offerings:

- Financial protection against the cumulative and adverse effects of multiple or catastrophic claims
- Diversification of a product portfolio while devoting time, energy and resources to primary or "needy" lines or areas
- Providing an additional source of income and a stable product with high persistency
- Offering clients an additional line of coverage while avoiding some or most of the capitalization risk
- Providing a "door opener" to other lines of coverage, possibly attracting new agents and brokers
- Offering the opportunity to work with disability experts in the new disability line without having to invest in special resources, additional personnel and training, or transitionally until the desired comfort level is obtained.

The various reinsurance arrangements available in today's arena run the gamut from a strictly financial agreement, which would be likely if an insurance company was already knowledgeable about LTD and only needed "outside" dollars to expand or develop this line, all the way to a full service facultative agreement where the insurer utilizes *all* of the reinsurer's specialty services. Many LTD reinsurance clients choose an intermediate position, using the "risk control" or "exposure-to-loss" elements of a reinsurer's services, such as underwriting of risks and managing of claims.

## Case Study

In 1989, at age 41 Jane Doe was diagnosed with a herniated disc, spinal stenosis, degenerative disc disease and hypertension. Unable to continue as a computer operator for a major financial institution, Jane stopped working. Jane's physician prescribed medication and physical therapy and told her she would probably not return to any type of employment that involved physical tasks. Eventually, a surgical remedy was pursued.

Fortunately for Jane, her employer had previously purchased a long term disability policy to cover his employees, and Jane qualified to receive 60 per cent of her "pre-disability" earnings under the policy.

This particular claim was reinsured with a full-service reinsurer whose services included a regional consulting physician (RCP) program; therefore, Jane's situation had been reviewed by an RCP at the time she went on claim and again shortly afterwards. The RCP noted Jane's impairment and its recovery potential. When one of the reinsurer's field investigators was visiting claimants in Jane's vicinity, he stopped in to see her. Since Jane indicated that she would like to return to work as soon as her condition permitted, the field investigator told her about the rehabilitation (rehab) program, another reinsurer service.

The reinsurer's rehab coordinator got in touch with Jane to assess her skills, interests and motivation to return to work. Jane continued to express a desire to work, but felt she needed additional time on her new physical therapy and medication regimen. Jane and the rehab coordinator decided on a one-month follow-up.

When the rehab coordinator contacted Jane a month later, she was managing to better tolerate the pain in her back and leg; and now appeared to have the capacity for sedentary employment. Both her physician and the reinsurer's RCP strongly supported her attempt to return to work through the vocational rehabilitation program offered by the reinsurer under her long term disability coverage.

Jane wanted to return to her former employer, but their personnel office told her that no special or preferential accommodation could be accorded her. With vocational counseling Jane was able to overcome her initial feelings of rejection and dismay, and then move forward to determine a rehab plan and vocational goal. It was agreed that the Rehab Coordinator would contact Jane's former employer.

Jane's former department manager was initially apprehensive when the rehab coordinator spoke with him about Jane, but then invited Jane to apply as "any new employee would." The rehab coordinator quickly pointed out that Jane had 14 years of experience with the company, had many useful skills, displayed "positive work performance," and was extremely motivated to be a contributor to the company — rather than a liability. Also pointed out was that Jane's re-employment could prove a morale booster since the employer would be seen as a caring partner in the process. The rehab coordinator also mentioned that the employer's experience would be favorably impacted at the time of LTD renewal.

The manager was impressed with the rehab coordinator's confidence and advocacy for Jane, and quickly realized the benefits of re-employing a former employee with a proven "track record." The rehab coordinator agreed to coordinate information with Jane's physician and forward it to the manager, who would explore sedentary jobs within the bank.

Jane was reemployed and at the one-month follow-up informed the rehab coordinator by way of a "thank you" note that she was enthused about her job as a computer output microfilm operator.

This was the type of win-win outcome where everyone involved in the case came out a winner: Jane recovered enough to return to the workforce as a happy and productive member; the employer regained a grateful, hardworking and longtime employee while improving his LTD renewal experience; the

insurer was associated with the successful handling of the claim and able to release the insured portion of the claim reserves; and the reinsurer closed the claim file and released the reinsured portion of the claim reserves. Many insurers would have lacked the service depth to manage the claim to this outcome, but a reinsurer can supply the missing pieces that would allow most insurers to function as capably as full-service disability insurers.

### Employers and Employees Need LTD

Jane Doe's case is a perfect example of the need for long term disability insurance by employer and the employee alike. Jane needed those LTD benefit checks while she was unable to earn a living; and her employer avoided the problems of salary continuation and other costs of a disabled employee for indefinite lengths of time while paying an additional salary for a replacement. As professionals in the worlds of medicine and insurance are only too aware, Jane Doe is just one of many individuals who, at some time during their lifetime, will require medical intervention and care, and rehabilitative and other specialized support services.

Other types of insurance coverages, like life, medical and short term disability (STD), will take care of many of the "unexpected needs" an average individual has in his or her lifetime. None of the aforementioned, however, would adequately cover Jane Doe through a long course of disability, recovery and re-entry into the workforce.

In the last 25 years, the probability of becoming chronically disabled for short and long periods of time has more than doubled. It is sobering to note that while the overall American population grew only 30 per cent between 1962 and 1986, the number of adults unable to work, attend school, or maintain a household because of a chronic health condition increased 120%. Three out of every ten individuals between the ages of 35 and 65 will become disabled for 90 days or longer. One out of ten employees will be disabled for five years or longer before normal retirement. At the age of 32, a disability of three months or more is six times as likely as death. Statistics like these clearly indicate there is a pressing and ever-increasing need for the unique kind of insurance coverage offered by Long Term Disability Insurance, and with this there is a parallel need for disability *reinsurance*.

### LTD Reinsurance Services

Long term disability reinsurance is a progressive, highly specialized business. When an insurance company needs to diversify or wants to place an emphasis on non-medical lines of coverage, LTD is a logical and attractive choice. Unlike many traditionally reinsured products, LTD is different and typically *requires* more services. A quality reinsurer will usually consist of a team of LTD Reinsurance professionals who possess and offer the following:

#### Marketing

Reinsurance marketing experts should be skilled at maximizing the effectiveness of a client's sales force. They will have strong product knowledge and a keen awareness of the marketplace, and promptly provide the products, services and training necessary to meet client needs. In short, these experts should do everything possible to make it easy for a client to be competitive, profitable and project the most favorable image while selling and administering long term disability insurance.

### Underwriting

Underwriters must be experienced at line underwriting (in this case, LTD is the "line") and should consist of some of the best and most knowledgeable "risk evaluators" in the business. Through them, client companies should have the benefit of an LTD database and be able to compare their block of business with a large block of inforce LTD cases. Client-oriented underwriters should be able to provide reports (customized if desired by the client) detailing client company:

- production activity
- inforce block profiles
- case level and block loss ratios and profitability
- open claim reserves
- make-up and mix of both quoted and sold business; analyzed by Nature of Industry (Standard Industrial Codes), location, occupational mix, plan design, case size, etc.

### Claims Management

Claims should not be "processed," but rather "managed" by a full-service LTD Claim adjudication program. Depending on client needs, claim operations should be flexible, with experts who can handle all aspects of claim investigation and administration working directly with all sources (physicians, attorneys, etc.) on behalf of the client. If the client prefers, the reinsurer's role can be advising and supporting them through the claim process from "behind-the-scenes." Benefits specialists should also offer training which is tailored to meet client needs. Additional services a client could expect from a comprehensive claims service:

- Social Security assistance
- Vocational rehabilitation services
- Field investigations
- Regional consulting physician (RCP) programs

### Products and Contract/Filing and Compliance

Professional staffs in the product and contract departments should perform a variety of services. Typically, product areas are heavily involved in market research and in identifying, developing and "packaging" new products and promotional material. Contract staff should be able to draft new contracts, assist clients in obtaining filing approval from the various state insurance departments, track legislation affecting LTD, evaluate and interpret contracts and compare competitive products.

### Systems/technology

In today's fast-paced and competitive world, it is necessary to have and maintain a serious commitment to the use of technology in the management of business and in the delivery of quality services to LTD clients. Success is achieved when the business is simple to operate and easy to manage. The systems area supports virtually all reinsur-

ance functions (from sales and market information, financial reporting and effective management information to data entry at the quoting stage to communications, issue, and claims management). A progressive systems area will have developed systems which result in quality services, fast response times, and minimized expenses to assist clients in expanding and better managing their LTD business while improving their overall results.

### Finance

The finance department is a vital link to a client's overall success in the disability market and should consist of a full-time actuarial staff specializing in LTD reinsurance. Line actuaries (F.S.A.s who specialize in the LTD line) offer another differential advantage to the reinsurance client. They possess all the necessary information and tools to regularly and readily provide clients with management information, as well as supply special risk pricing and any other "special needs" information that may arise from time-to-time. From offering information and advice on setting up optimal billing and accounting procedures, to auditing policy and procedure information, to providing timely and accurate data on proposal activity, sales, closing ratios, persistency, claims and loss ratios.

### Role of the Medical Director

The Medical Director's role in an LTD reinsurer in many ways parallels the role of the medical director of a direct writer. This might include participation in product design efforts, corporate development, consultation to underwriting and benefits areas on individual cases and on medical risk management efforts relating to broader issues affecting risk selection and claims adjudication, and support of the marketing area.

### Conclusion

Employees, employers and insurers need LTD today and all indications point to an increased need for LTD in the future. With advances in medical technology and a more health-conscious world, mortality rates should continue to decrease while the number of chronically disabled individuals will likely increase. With less than 20 per cent of America's population insured for long term disability, and an ever-growing global market, it is a crucial time for insurance companies to consider expanding their product portfolios, meeting client needs, and procuring the advantages and business potential of adding a solid, non-medical coverage to their line.

Being the nation's leading provider of LTD for the past thirteen years, UNUM has been able to offer a full-service *reinsurance* operation as well. UNUM's LTD database is the largest private (non-government) database of its kind in the United States, giving client companies the benefit of the kinds of vital information that over 30,000 inforce LTD cases (over four million lives) can provide. With over two decades in the LTD *reinsurance* business, UNUM exemplifies the kind of experience, technology, and resources needed to provide attractive LTD and LTD RE products and services in a competitive and growing global marketplace.

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