

Moving target: a more mobile work force and a drop in employer-provided benefits could enhance the market for individual disability-income insurance. (Disability: Life/Health).

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Economic and demographic trends are fueling the sales of noncancelable individual disability-income insurance. A variety of forces are putting American workers' income at risk, leaving them with less ability than ever to tolerate disruptions in income. The U.S. work force is balancing compensation and assets increasingly linked to the volatile stock market with rising household debt. At the same time, disability insurers are enjoying two trends making their product suddenly attractive to consumers. Baby boomers are expected to remain in the work force longer, creating the necessity for longer income protection, and employers are looking to shift employee benefit costs to their workers.

As a result, after years of declining sales and negative profits, writers of noncancelable individual disability-income insurance hit the double digits in both profit margin and sales growth during 2001, according to an article in The Disability Newsletter, a Milliman USA publication.

Income and Debt

Before the technology boom and bust, income was a simple concept for most workers. They received an annual salary, possibly with a modest bonus based on corporate performance. Total compensation would change due to factors such as job performance, inflation and corporate results, but because incentive-based compensation was a small piece of the total package, overall income volatility was low.

That situation changed rapidly when stock options were introduced as a standard form of compensation for all levels of employees, rather than just senior executives. Suddenly, a large portion of employees' income was subject to the significant volatility of the stock market, and the even greater volatility of a single company's stock performance. Large fortunes were made and lost overnight as stock option grants fluctuated wildly in value.

At the same time stock options were gaining popularity in compensation plans, corporate stocks became widely held assets at all income levels. For instance, in 1980 13.2% of U.S. households had financial assets in the stock market, and in 2000 it increased to 19.5%, according to the Federal Reserve. High-volatility stocks also have replaced more conservative investments for many households, resulting in a much higher degree of financial uncertainty. The Federal Reserve also reports U.S. households placed 18.2% of their assets in bank deposits in 1980, whereas in 2000, that proportion dropped to 9.6%.

Meanwhile, consumer debt has increased significantly. The Federal Reserve says the ratio of household debt to disposable personal income has steadily grown in the past 20 years, from 12.5% in 1980 to 14.3% in 2000. At the same time as income and assets have become more volatile, consumers have taken on more debt. These two trends combine to put an extraordinary amount of pressure on incomes. Even brief disruptions in income can have a catastrophic effect when mortgage or credit card payments come due and the value of mutual funds and stock options is declining.

Demographics and Employment

The changes in assets and liabilities are coupled with a fundamental change in the demographics of the American work force. This change shows up in several areas.

First of all, due to the basic demographic pattern of the baby boom, the U.S. work force is getting older. The percentage of working-age Americans who are older than 50 will grow to 38.3% of the work force by 2010. The reason for the rapid increase in workers over age 50 is clear. For many of these older employees, retirement may be further away than ever before. The downturn in financial markets has depleted their assets, and the increase in the proportion of Americans over age 65 has put pressure on the Social Security and Medicare systems. Many Americans are increasingly unwilling to rely on these government programs for their financial security in old age. The result is that Americans are working longer than ever, and that the need for income protection is extending to older ages.

At the same time, the American work force is becoming more mobile. This is another situation where individual disability income insurance has the opportunity to address a growing need among American workers. The Department of Labor reports that the average worker has three careers and 10 different jobs in his or her lifetime. Employee turnover rates have risen, and according to Workforce.com, some 60% of the work force plans to change jobs in the next 12 months.

A greater willingness to change jobs and careers complicates employee benefits significantly. Traditional long-term disability plans offer limited options for portability, often providing stripped-down coverage at high rates, so many employees risk being left without disability coverage if they move to an employer who does not offer a group plan.

Employee Benefits

One of the most consistent economic trends over the past several decades has been the rising cost of employee benefits, driven largely by group health care. Employee benefit costs as a percentage of total compensation nearly tripled from 1970 to 2000, according to the Employee Benefit Research Institute and the Bureau of Labor Statistics.

Because of this surge in the price of benefits, employers are shifting both risk and cost to their employees. Risk-shifting already occurred in other areas of employee benefits, paving the way for disability insurance. Employees are used to paying in to defined contribution pension plans, such as 401(k)s, and Section 125 or cafeteria plans, where employees are asked to pay a portion of the cost of health care and other benefits, are growing in popularity.

Because health care is generally viewed as the most important employee benefit, many employers that want to reduce their benefit costs have focused on other areas including disability insurance. Disability insurers especially have great opportunities for selling their products to small businesses with 100 or fewer employees. The number of employees covered by group long-term disability insurance in businesses with 49 or fewer employees is only 15%, and rises to 23% in the 50 to 99 employee segment, according to the Bureau of Labor Statistics. This means among firms of fewer than 100 employees, nearly four out of every five employees are not covered by group long-term disability.

The fastest-growing market segments for disability are those where premiums are paid by employees, rather than employers. Recent market studies by John Hewitt & Associates reveal that inforce premium for group long-term disability grew by a total of 8% in 2001, but the inforce premium for voluntary group long-term disability, where premiums are paid by employees, grew by 22% in the same year. In addition, new sales for individual disability-income insurance increased by approximately 15% from 2000 to 2001, a significant improvement from a decade where average sales growth was on the order of negative 5%.

These employee benefit trends add up to a golden opportunity for individual disability insurers. Employers are reducing the amount of long-term disability coverage they are willing to pay for at the same time as employees have a greater need than ever for income protection due to financial uncertainty and debt burden.

But the additional trends of a more mobile work force and increasing cost pressure on employee benefits point to the particular potential for individual disability insurance. The first signs are already present as sales for individual and voluntary group products have begun to increase significantly. Perhaps the increases in future years will be even more dramatic as insurers take advantage of these trends to refocus their disability offerings or re-enter markets that they left during darker days.

Distribution of Household Financial Assets

High volatility stocks have replaced more conservative investments for many households, resulting in a much higher degree of financial uncertainty.

	1980	1990	2000
Bank Deposits	18.2%	16.5%	9.6%
Stocks	13.2%	12.0%	19.5%

Source: Federal Reserve

Ratio of Household Debt to Personal Disposable Income

At the same time as income and assets have become more volatile, consumers have taken on more debt. These two trends are putting an extraordinary amount of pressure on incomes.

	1980	1990	2000
Ratio	12.5%	13.4%	14.3%

Source: Federal Reserve

Age Distribution of Working Age Americans

Americans will remain in the work force for longer periods of time due to fluctuating financial markets impacting assets and the unwillingness to rely on government retirement programs as a sole source of income

	1990	2000	2010 *
Under 50	73.2%	70.3%	61.7%
50 & Over	26.8%	29.7%	38.3%

* Projected

Source: U.S. Census Bureau

Employee Benefit Costs as a Percentage Of Total Compensation

The costs of employee benefits are rising and are driven largely by group health care.

	1970	1980	1990	2000
Costs	10.7%	16.6%	19.3%	27.4%

Source: Employee Benefit Research Institute, Bureau of Labor Statistics

Percentage of Employees Covered by Group LTD

In firms with fewer than 100 employees, nearly four out of five employees are not covered by group long-term disability.

Number of Employees	% Covered by LTD
1-49	15%
50-99	23%
100-499	29%
500-999	36%
1,000-2,499	37%
2,500+	60%

Source: Bureau of Labor Statistics

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