BROKER WORLD

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The Mythical Value Of Non-Can DI

At first glance, it appears obvious—a disability policy that cannot be cancelled and also includes a provision where premiums will never increase is clearly a much better deal for the consumer than a policy that, while guaranteed renewable, has no limits on premium increases.

But hold the phone…let's look at the facts. Consumers could be paying too much for the peace of mind that a non-cancellable policy at a locked-in cost can bring. Yet there are quite a few consumers who have chosen the non-can path—about half of the $500 million individual disability income sales that will be made this year in this country will be non-cancellable, meaning the policyholder's premiums are guaranteed for the life of the contract and the coverage cannot be cancelled.

The Price of Peace of Mind

And the cost? The premium difference between non-can DI and guaranteed renewable DI (under which the coverage cannot be cancelled, but premiums are not guaranteed) is typically 20 to 30 percent—non-can DI being 20 to 30 percent more costly because of the premium guarantees.

Consider what this means to two identical clients who buy otherwise identical non-can and guaranteed renewable versions of the same DI plan. The non-can policy has an annual premium of $1,800, compared with a $1,500 premium for the guaranteed renewable plan (the cost is representative of a typical 20 percent premium load for the non-can policy).

Assuming that no rate increases are implemented on the guaranteed renewable coverage, over the 15-year life of the contract the non-can buyer will pay a total extra premium of $4,500 ($300 a year for 15 years).

The non-can buyer pays this extra amount for peace of mind as the guaranteed renewable buyer is never certain what the premiums will be the next time the premium notice comes in the mail. The risk to the guaranteed renewable buyer is really this: The insurance carrier increases the premiums to adjust for unexpected poor experience, and the guaranteed renewable buyer is now too old or has suffered a medical condition since the policy was issued that would make a newly underwritten version of the same policy through another carrier too expensive or, worse, unobtainable.

Do the Math

But does this risk hold up to scrutiny? Let's do the math.

Just adding the total premiums paid over 15 years, we can see that for the non-can to be a better deal would require the insurance carrier who sold the customer the guaranteed renewable DI to implement more than

a 30 percent rate increase after the first 5 years of coverage or, alternatively, more than a 60 percent rate increase after the first 10 years of the contract. But this ignores the interest (investment return) on the $300 the guaranteed renewable buyer saves each year. At a conservative 4 percent after-tax rate of return, the future value of the $300 premium differential over 15 years is more than $6,000.

With interest, then, this means that the guaranteed renewable rate increase needed to make the non-can policy the better deal would be 33 percent after five years or 74 percent after 10 years!

But is that realistic? Anyone who has been in the DI business the last couple of decades knows that, first, guaranteed renewable DI rate increases are few and far between and, second, when they do occur, they tend to be modest in magnitude.

DI rate stability isn't surprising when considering the coverage has been around for more than 100 years and carriers designing and pricing products have a trove of industry experience spanning multiple economic cycles, target markets and benefit features to draw from when pricing and designing products.

The Importance of Data

Contrast this abundance of experience data with the dearth of data that long term care pricing actuaries had to work with 20 years ago when they were pricing this new coverage type. The result for long term care was unfortunate: Large rate increases were implemented because of dramatically underestimated persistency and morbidity assumptions.

Actuaries weren't intentionally under pricing the long term care product to sell it, they just didn't have the data needed to arrive at a fair consideration for the risk they were taking on.

Is non-can peace of mind still worth the extra premium, you ask? Consider this irony: Most of the profit pressure carriers have experienced over the past 30 years is tied to non-can DI, not guaranteed renewable. This counter-intuitive fact results from competition for the affluent markets (which non-can appeals to) being intense enough that it goes through underwriting (profit) cycles, like most competitive markets.

A profit cycle approaches its lowest point when insurance carriers are pressured by their distribution partners to liberalize premiums and underwriting to make their coverage more competitive. A bubble, of sorts, emerges and eventually bursts, as it did in the mid-1980s. What inflated the 1980s bubble was irresponsible risk management and inadequate pricing relating primarily to non-can DI sold to physicians—not guaranteed renewable policies.

Let Your Clients Choose

My advice to agents is that they load both non-can and guaranteed renewable DI solutions into their quiver. Peace of mind is priceless, but for many clients going with a guaranteed renewable solution underwritten by a carrier who has been in the market for decades is going to allow them to save considerably on their premiums. *Your clients deserve the choice.*

Look back at the non-can DI policies you sold your clients 10 years ago and ask, wouldn't guaranteed renewable DI have been the better deal?