

CASH BENEFITS UNDER VOLUNTARY DISABILITY INSURANCE

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Disability is a major cause of dependency and insecurity. It entails both the loss of earnings and the expense of medical care. On an average day, 5 to 6 (or possibly 7) million persons are incapacitated for work or other usual activities by reason of disabling physical or mental illness. The widespread extent of this disablement gives an idea of the social problem involved. The loss of wages by workers who are in the labor market is estimated at upwards of \$1 billion annually. The expense of medical care amounts to more than \$3 billion a year.

The costs and losses that make up this aggregate of more than \$4 billion are borne in a number of ways. Of the \$3 billion or more in medical expenditures, including payments for professional services, for hospitals and public-health services, medicines, and the like, families pay directly approximately 80 percent. Government defrays about 10 percent, industry about 2 percent, and philanthropy about 2 percent. The share borne by families is paid, for the very large part, on a fee-for-service basis.

Two characteristics of disabling sickness stand out sharply: that while the frequency and duration of sickness may not be predicted for the individual, both are capable of measurement for the population as a whole. Various studies of the health of the population give data from which valid estimates may be drawn. The most recent of these surveys, comprising 2.3 million persons in 81 cities, found that 172 illnesses, disabling for one week or more, occur annually per 1,000 population. It is estimated that each case including chronic disablement lasts on the average 57 days. On this basis, it is estimated that a person may expect in a year an average of 9.8 days of incapacity from illness lasting one week or longer.¹ Further, these studies have confirmed the observation that the impact of disabling sickness, both in frequency and severity, is greatest among low-

income groups least able to bear the costs and losses. Among at least one-third of the population these burdens cannot be financed out of family income or savings.² Disability is therefore a serious social as well as an individual risk.

Insurance against the risk of sickness may take several forms. It may pay cash benefits or it may grant medical services or hospital services or provide all three, as in workmen's compensation.

A relatively small number of persons, perhaps 2 million in all, receive medical service under prepayment plans. This insurance spreads expenses for a stated period over a group of persons and enables families and individuals to budget costs in advance. A somewhat larger number, nearly 3 million at the end of 1938, including both wage earners and salaried workers and sometimes their families, have a limited protection against medical costs through hospitalization insurance. These plans, established on a nonprofit basis and usually under community auspices, ordinarily do not cover doctors' bills. They entitle the insured to hospital service, if necessary, for a stated number of days, generally 21, within a year.

Except for the cash benefits payable under workmen's compensation, insurance protection against financial risks of sickness and disability has been made in the United States almost wholly by voluntary insurance. Insurance on a voluntary basis has been extensively used in the United States to finance the risk occasioned by death. The purpose of this article is to summarize available data on the nature and extent of the analogous provisions of voluntary insurance to finance burdens produced by sickness, that is, insurance that pays cash benefits.

The limitation of the present treatment to insurance that pays sickness benefits in cash excludes consideration of the medical care or hospital service insurance schemes mentioned above. Likewise, since the insurance here discussed is voluntary, consideration is not given here to disability com-

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¹ *The National Health Survey: 1935-36, An Estimate of the Amount of Disabling Illness in the Country as a Whole*. Preliminary Reports, Sickness and Medical Care Series, Bull. No. 1, p. 3.

² Interdepartmental Committee to Coordinate Health and Welfare Activities. *Report and Recommendations on National Health*. H. Doc. 120, 76th Cong., 1st sess., p. 10.

compensation for Federal, State, or municipal employees. For the same reason, workmen's compensation for industrial accidents applying to approximately 25 million employees and, in some States, to a limited extent compensation for occupational diseases also, is omitted from the discussion.

Not to be confused with insurance schemes is the protection afforded certain salaried and wage workers through the generosity of employers who continue their salaries during sickness for a more or less limited period, or provide, from company funds, certain benefits in the event of sickness, disability, or death. Such measures, which apply chiefly to office workers, much less often to wage earners, are not considered here. Nor is consideration given to other individual resources which might be used by sick or disabled individuals, such as owned homes that might be mortgaged, savings bank accounts and other investments, cash-surrender and loan values under ordinary or industrial life insurance policies, matured endowment policies, annuities and pensions, and so on. It may be assumed that in many, if not most, instances these resources are available for expenses arising from illness only at the sacrifice of other essential needs for which they are intended. In any event, they are doubtless slight or entirely wanting among some 65 percent of the families of the Nation who have annual incomes under \$1,500.³ Members of these families constitute the group which suffers most from disabling illness, both in frequency and severity of cases.

Voluntary sickness insurance may be classified as commercial or cooperative. As contrasted with the insurance issued by commercial stock and mutual companies, cooperative insurance is found among fraternal societies and in employees' and trade-union sick-benefit associations. Classification of insurance as commercial or cooperative is adopted to identify practices according to the terminology ordinarily used. It is recognized, of course, that the mutual companies, included in the first category, constitute a borderline group, in that any excess of income over disbursements is returned to policyholders.

Commercial Insurance

Commercial insurance, more highly developed than cooperative insurance, has two types of

³ National Resources Committee. *Consumer Incomes in the United States*, August 1938, p. 2.

contract, individual and group. Like other business enterprise it has devised types of policies to fit the purse of would-be purchasers, policies for persons in moderate or well-to-do circumstances and policies for industrial workers. Disability insurance has not developed as a separate branch of commercial insurance but has been attached to life and casualty insurance. It has become increasingly common to separate the two risks of sickness into temporary and permanent disability and for different insurance carriers to insure these risks, but there is no clean-cut distinction between the two risks such as is found in social insurance under foreign systems. The tendency is for casualty or multiple-line companies to insure temporary disability while life insurance companies generally insure the risk of permanent disability.⁴ Temporary disability as a result of ordinary sickness, i. e., sickness not due to accidental causes, is not underwritten alone. A policy covering temporary disability from ordinary sickness is accompanied by an accident policy, written either in connection with the sickness policy or separately. Insurance against total and permanent disability may be provided in a disability clause attached to a life insurance policy. Permanent disability due to an accident is also covered by certain accident policies.

As might be expected, competition among commercial insurers has produced a great variety of disability policies, estimated at more than 800 by one authority.⁵ From the array of limited, restricted, and general policies, typical policies have been selected for illustration. Policies usually purchased by persons of moderate or comfortable income to cover the risk of temporary disability are: (1) cancelable general accident and health policies, (2) noncancelable, aggregate indemnity, accident and health policies, and (3) accident policies. Among wage earners there are (1) industrial life, accident, and sickness policies and (2) group accident and health policies. Persons in moderate circumstances insure against permanent disability by means of (1) the total and permanent disability clause attached to life insurance policies, (2) acci-

⁴ Life insurance companies which insure temporary disability through special accident and health departments are in a sense multiple-line companies.

⁵ LaMont, Stewart M. "The Contract of Personal Accident and Health Insurance." *Proceedings of the Casualty Actuarial Society*, Vol. 18, Pt. 1 (November 1931), p. 21.

dent policies, and (3) a few noncancelable, life indemnity, accident and health policies.

Among wage earners certain specific dismemberments that are considered causes of total and permanent disability are insured by (1) industrial life insurance policies and (2) similar provisions of group accidental death and dismemberment policies. Some group life insurance policies, issued prior to 1932, pay the face of the policy in either a lump sum or installments in the event of total and permanent disability. Although these policies are no longer issued it is likely that 4.5 million persons still have this coverage. For a limited number of wage earners holding group annuities, the surrender value of the annuity may be collected in the event of total and permanent disability.

The provisions of a cancelable general accident and health policy illustrate insurance of temporary disability. The accident part of the policy provides a flat sum for accidental death and specific dismemberments, a weekly benefit for total disability up to 52 weeks, and, in case of total and permanent disability, a benefit as long as this condition lasts. Two-fifths of the weekly indemnity is granted for partial disability. The policy gives, moreover, certain medical benefits in the form of cash payments for surgeons' fees, operations, hospital, and nurses up to a definite sum and in accordance with a fixed schedule of charges. The sickness policy, after a waiting period of 7 days, pays a weekly benefit for total disability up to a maximum of 52 weeks and medical benefits similar to those of the accident policy.

Permanent and total disability insured under a disability clause attached to life insurance grants a monthly income and waives future premiums on the life insurance policy. A long waiting period of continuous total disability, generally 6 months, is required to establish the permanency of total disability. Because of the poor experience with policies that continue income during permanent disability, 60 percent of the life insurance companies, representing 85 percent of the business, have done away with the monthly income feature in new policies and grant only the premium waiver.⁶

Nor has underwriting the so-called health risk in accident and health insurance been profitable to

⁶ Miller, John H. "History and Present Status of Non-Cancellable Accident and Health Insurance." *Proceedings of the Casualty Actuarial Society*, Vol. 21, Pt. 2 (May 1935), p. 252.

the companies. This is the risk of sickness arising from ordinary causes, as distinguished from sickness or disability due to accidental means. The Nation-wide experience of 45 stock companies licensed to do business in New York State in underwriting cancelable policies shows that company losses and expenses have turned out to be higher than the sum set aside by actuarial computation.⁷ Accident and health departments in large life insurance companies which make a practice of selling these policies and underwrite them with great care have a satisfactory experience.⁸ The poor experience of noncancelable accident and health policies has paralleled that of the income provision of disability clauses in life insurance. In 1935 only four companies continued to underwrite indemnity for life in new policies. Others had gone over to aggregate policies limiting benefits to a designated period of disability or to a specified amount of indemnity.⁹

Industrial insurance, specially planned for wage earners, is primarily life insurance and provides a small death benefit—somewhat over \$200 on the average. The distinguishing feature of this insurance is the weekly collection of premiums in small amounts by agents who come to the homes of wage earners. Some 50 million wage earners and their families pay annually about \$742 million in premiums.¹⁰ Disability benefits, a relatively insignificant part of the policy, are granted for specific dismemberments, loss of both feet, of both hands, of one foot and one hand, and total loss of eyesight. They consist of premium waiver and a sum equal to the whole or, usually, one-half the value of the life policy. Since these particular severances occur rarely, the total cash benefit paid by industrial insurance for disability benefits is small, amounting in 1935 to \$2.2 million in comparison with \$199.3 million for total claims paid.¹¹

In the South and Southwest an industrial policy is sold which covers the three risks of death,

⁷ *The Spectator. Insurance Year Books, Casualty, Surety and Miscellaneous, 1932-37; Nation-wide experience of different casualty lines.*

⁸ Sommer, Armand, a discussion in *Proceedings of the Casualty Actuarial Society*, Vol. 23, Pt. 1 (November 1935), p. 116, of papers by Ward Van Buren Hart and John H. Miller.

⁹ Miller, John H., *op. cit.*, p. 249.

¹⁰ Average for 5 years, 1931-1935, based on the premiums minus dividends of 3 large industrial companies doing an average of 83.7 percent of total industrial business, according to the annual reports of the New York State Superintendent of Insurance.

¹¹ Based on reports of 8 major industrial companies doing 84.1 percent of total industrial business. New York (State) Insurance Department. *Seventy-seventh Annual Report of the Superintendent of Insurance*, Pt. II, 1936.

accident, and sickness. These policies, held largely by Negroes, contain restrictions and limitations of many kinds. The number of weeks of benefit varies from 10 weeks in 6 months to 13, 15, 16, 20, or 26 weeks in 12 months. A waiting period of 7 consecutive days with payment retroactive is usual. In general, weekly benefits for diseases whose causes run back over a period prior to the date of the policy are reduced to one-half regular benefits during the first 6 months or year. Often the policy lists specific diseases which receive half benefits the first year. In reply to a questionnaire, data from 17 companies showed an average annual sick benefit of \$4.87 to disabled policyholders. The average annual premium paid by all policyholders amounted to \$4.62.

Group accident and health insurance is underwritten for as small a number as 25 employees. The employer may or may not contribute to the plan, but he agrees to deduct wage earners' premiums from wages. Each group of employees is underwritten separately, since the premium has to be determined by factors that vary with the establishment, the amount of weekly benefit, wages, waiting period, duration of benefit, nature of the industry, sex and race of the employees. As a rule the waiting period is 7 days, and benefits are granted for 13 weeks in a year. The monthly premium rate for \$10 weekly indemnity on these terms is 60 cents a month, but this is a basic rate which applies to white men in nonhazardous occupations. Actually, monthly premiums for industrial groups run considerably higher. The amount of initial premium to cover expenses and contingencies varies from 34.6 percent to 16.2 percent. When the monthly premium is 60 cents, 30 percent or 18 cents is set aside for these administrative expenses and margins. These percentages are probably higher than those actually paid, since it is the practice of the companies to leave a wide margin in loading in order to carry without loss a comparatively small group, even if the morbidity should be higher than average. A wide margin has the double advantage of covering the first year's expenses which are higher and of obviating the necessity for increasing the premium the next year on renewal of the policy, should the morbidity have proved higher than expected. If the premium¹²

¹² Fitzhugh, Gilbert W. "Recent Morbidity Upon Lives Insured Under Group Accident and Health Policies and Premiums Based Thereon." *Transactions, Actuarial Society of America*, Vol. 38 (October 1937), p. 278.

turns out to be more than sufficient the rate can be lowered the next year or a dividend paid. By the payment of an extra premium hospitalization benefits and surgical fees may be granted the insured and, under recent plans, to his family.

Mutual accident and sickness associations on an assessment basis, which constitute a form of mutual casualty insurance, may well be included under commercial insurance. They resemble fraternal societies and sometimes operate in connection with them but appear commercial, in that they are staffed to a considerable extent by salaried physicians and agents. Instead of assessments, advance premiums subject to assessment may be paid. The associations cover for the most part persons in the same order or calling, such as Masons, commercial travelers, clergymen, railway employees, physicians. About 2 million persons carried this insurance in 1935; benefits paid in that year amounted to \$18 million.

Cooperative Insurance

Among representatives of cooperative insurance, the fraternal societies have directed their efforts to life insurance. Practically all societies insure against death, while less than one-half provide insurance against temporary disability and less than two-thirds against permanent disability. The disability insurance plans of different societies vary widely both in amount and duration of benefits. The temporary sickness benefit is commonly \$5 a week; and the benefit for permanent and total disability may be one-half the amount of the life certificate, waiver of future premiums, or the surrender value of the certificate. The number and membership of fraternal orders have been declining. At present there are over 7 million members, 1 million of whom are children. Perhaps 2 million members have some sort of sickness protection available, but the extent to which they insure is unknown. With the exception of certain organizations of persons of foreign birth, members of fraternal associations are chiefly small businessmen and skilled workmen, rather than low-paid wage earners. Probably the membership of fraternal orders includes half a million wage earners who are insured, in one way and another, against disability.

Nonprofit mutual sick-benefit associations are most commonly found among employees of an

establishment or among members of a trade-union. Employee associations are about equally divided between those entirely self-supporting and those aided by employers. Benefits are paid for temporary disability chiefly, and usually amount to \$9 or \$10 a week for an average period of 13 weeks. In case of permanent disability, a lump sum is granted equal to the maximum number of weekly benefits the plan provides. Dues are deducted from wages and in nearly two-thirds of the societies are the same for all members regardless of age. The associations have demonstrated their ability to operate successfully and, because of the unpaid services of members, at low cost, but apparently they are not growing. Somewhat more than a million persons are insured against sickness by this means.

Interest in sickness insurance on the part of trade-unions has manifested itself in various ways. Some of the national and international unions have benefit plans for temporary sickness and permanent disability; in other unions such plans are left to the locals. Another group of unions, notably the railroad brotherhoods, have established insurance departments where members may take out life and accident insurance. The number of national and international unions with sick-benefit associations has dwindled from 12 in 1926 to 6 in 1936. With annual dues of \$7.60, these associations furnish benefits for temporary disability in amounts running from \$4 to \$10 a week for a period of 8, 10, 13, or 16 weeks after a waiting period of 7 or 14 days.¹³ A maximum is prescribed as to the amount of benefit any one member may receive. A few associations pay the death benefit for permanent disability. In view of the great emphasis the unions place on life insurance, it is natural that the risk of permanent disability is more insured than that of temporary disability.

Extent to Which Cash Benefits Are Provided

There is no way of knowing with accuracy the number of persons in the United States who are insured against sickness by means of cash benefits. It is safe to say that only a small fraction are adequately protected. Some persons in better circumstances may hold accident and health policies against temporary disability and older life insurance policies with income during permanent

¹³ Two unions include sick-benefit dues in general union dues.

disability, but for the great majority the protection is fragmentary and inadequate. They may have a limited accident policy here, or an accident and sickness policy there, or a premium waiver on life insurance.

Table 1.—Estimated cash benefit payments for sickness losses in the United States in 1935 through voluntary insurance¹

Classification of insurance	Benefits (in millions)
Total.....	\$202.2
1. Commercial insurance:	
A. Purchased chiefly by persons with moderate or comfortable incomes:	
Temporary disability:	
Accident and health departments.....	24.3
Stock casualty and surety companies.....	33.5
Mutual benefit and assessment companies.....	16.0
Permanent disability:	
Ordinary life insurance.....	68.6
B. Purchased chiefly by wage earners:	
Temporary disability:	
Industrial life, accident, and sickness.....	9.3
Group accident and health.....	11.0
Permanent disability:	
Industrial life insurance:	
Dismemberment and blindness.....	2.2
Group life insurance.....	12.0
2. Cooperative insurance:	
A. Purchased chiefly by persons of modest income and by a few wage earners:	
Temporary and permanent disability:	
Fraternal societies.....	9.0
B. Purchased chiefly by wage earners:	
Temporary or permanent disability:	
Employees' mutual sick-benefit associations.....	10.0
Trade-union sick-benefit associations.....	4.3

¹ Deductions have been made from reported payments under commercial policies for amounts estimated to have been paid as accidental death and double indemnity benefits and—under ordinary and industrial life policies—for amounts of premium waiver during total and permanent disability.

² Includes some benefits for total and permanent disability. The figure of \$24.3 million is obtained after deducting from reported payments \$11 million included below under group accident and health, and \$4.1 million included in the figure given for industrial life, accident, and sickness insurance.

³ Includes a small amount of payments for total and permanent disability.

⁴ Represents reported amounts after deduction of \$12 million included below as disability payments under group life insurance.

Source: The Spectator, *Insurance Year Book, 1936-37, Casualty, Surety and Miscellaneous and Life Insurance Volume*; New York (State), Insurance Department, op. cit., Pts. II and III, 1936; industrial life, accident, and sickness insurance is estimated on the basis of payments in 1935 from 81 companies; Fraternal Monitor, *Consolidated Chart, 1936*, for fraternal societies; employees' mutual sick-benefit associations are estimated; American Federation of Labor, *Report of the Executive Council, 1936*, for trade-unions.

A better idea of the extent of insurance is to be gained from the amount of disbursements for benefits. The amount of cash benefits from all forms of voluntary sickness insurance is shown in table 1. These figures are taken from all available sources, but it is realized that complete accuracy is difficult. They show that about \$202 million was paid out in cash benefits in 1935. On the basis of these data, it seems evident that cash benefits under voluntary insurance¹⁴ represent in a year not more than 5 percent of the aggregate amount of the Nation's annual medical bill of more than \$3 billion plus the annual wage loss of

¹⁴ For a discussion of the items included and not included under this heading see pp. 27-28.

upwards of \$1 billion. The latter figure includes only the wage loss of persons who are ordinarily gainfully occupied and makes no allowance for the permanently disabled who have dropped out of the labor market.

In spite of their greater need of protection and their larger numbers, wage earners receive disability benefits amounting, in a year, to only about 40 percent of the sum paid to persons in better circumstances. Payments under the types of insurance generally held by wage earners aggregated less than \$58 million; those made under policies generally purchased by persons of moderate or comfortable income amounted to about \$144 million. It is apparent that, in proportion to their numbers, persons of the higher income levels make greater use of voluntary sickness insurance than members of the industrial population.

The number of wage earners insured to some extent against temporary and permanent disability by the various forms of cash-benefit sickness insurance may be estimated approximately as follows:

<i>Type of insurance</i>	<i>Wage earners (in millions)</i>
Temporary sickness:	
Employee mutual benefit associations.....	1. 2
Group accident and health.....	2. 2
Industrial life, accident, and sickness.....	3. 0
Permanent disability:	
Group life (policies issued prior to 1932).....	4. 5
Group accidental death and dismemberment..	. 7
Industrial life (dismemberment and blindness)..	15. 5
Either temporary or permanent disability:	
Fraternal societies.....	. 5
Trade-unions.....	1. 2

There is considerable overlapping in these numbers, since, for example, the same wage earners insured under older group life certificates with permanent disability benefits may also be covered for temporary disability by group accident and health insurance. Likewise, members of employees' and trade-union sick-benefit associations may be covered by group insurance too, and undoubtedly many of them carry industrial life insurance policies.

These figures, it should be noted, represent estimates for persons insured under types of insurance commonly carried by wage earners, and do not include estimates for persons protected against disability under ordinary life policies. As

has been mentioned, disability benefits in connection with ordinary life policies written in recent years have commonly taken the form of premium waiver only, though a considerable amount of insurance written earlier and held largely by persons in moderate or comfortable circumstances provides income payments for life in the event of total and permanent disability.

Conclusion

Voluntary cash-benefit insurance is predominantly commercial; the benefit payments of commercial insurance amount to \$179 million, or over six times those of cooperative insurance. Commercial life and casualty insurance, which blazed the trail, have shaped disability insurance. Under the spur of competition between life and casualty insurance both lines have insured a particular risk in order to help the sale of more life or accident insurance. Consequently, their sickness policies are characterized by limitations and restrictions which grant benefits in the event of certain specific disabilities and deny them in others. Where commercial insurance has attempted more protection, as in noncancelable accident and health policies or in the income provision of the total and permanent disability clause, the companies have generally suffered loss and have stopped underwriting new policies.

With the exception of trade-union sick-benefit associations and a few employees' associations, which insure all who apply, cooperative sickness insurance has tended to follow the restrictions of commercial insurance. Cooperative systems have demonstrated their ability to operate successfully at low cost. The obvious defect of this insurance is that relatively few persons insure. More wage earners insure in commercial companies, which have higher administrative costs and in some cases seek a profit, than in cooperative insurance, which costs less. Such an anomaly appears to support the claim among insurance companies that insurance is sold, not bought, and that the pressure of salesmanship is needed to induce people to insure.

Voluntary disability insurance has had an undisputed field in the United States. Among wage earners who need the protection most, the number of persons so insured is comparatively small and the amount of benefit incommensurate with the risk to which they are exposed. This type of

insurance is far more common and adequate among persons in middle and high-income classes. Moreover, the experience of commercial and cooperative disability insurance suggests that insurance of the risk of sickness is not suited to voluntary methods. The number of persons who voluntarily insure against sickness is small; contrast with it the large number of persons who hold 121 million life insurance policies.

The insurance of small numbers furnishes a narrow distribution of insured risks and results in limited benefits. The protection afforded becomes

of necessity restricted and socially inadequate. In the case of commercial insurance, adverse selection operates against the company with the result that the cost of insurance is increased and fewer persons insure. Because of small numbers and poor risks the insured pay higher insurance premiums. Wage earners, with the highest incidence of sickness and the greatest need of protection, must pay rates for sickness insurance incommensurate with their income. The basic principles of social insurance, on the other hand, merge special risks as far as practicable in a general distribution.