

PRINCIPLES OF RISK MANAGEMENT AND INSURANCE

CLASS NOTES

Chapter 23 Social Insurance

Topics

- Social Insurance Basics
- Old-Age, Survivors, and Disability Insurance (OASDI)
- Medicare
- Unemployment Insurance
- Workers Compensation

Reasons for Social Insurance

- Social insurance programs are necessary for several reasons:
 - To help solve complex social problems
 - To provide coverage for perils that are difficult to insure privately
 - To provide a base of economic security to the population

Basic Characteristics of Social Insurance

- Social insurance programs have certain characteristics that distinguish them from other government insurance programs:
 - Most programs are compulsory
 - This makes it easier to provide a floor of income to the population
 - It also reduces adverse selection
 - Programs are designed to provide a floor of income
 - Programs pay benefits based largely on social adequacy rather than individual equity
 - The benefits are heavily weighted in favor of certain groups, such as low-income persons, large families, and retirees
 - Benefits are loosely related to the workers' earnings
 - Programs, benefits, and benefit formulas are prescribed by law
 - A formal means test is not required
 - A means test involves disclosing income and assets
 - Full funding of benefits is unnecessary
 - For example, it is not necessary to fully fund Social Security because workers will always enter the program and support it
 - Programs are designed to be financially self-supporting
 - Programs should be almost completely financed from the earmarked contributions of covered employees

Old-Age, Survivors, and Disability Insurance (OASDI)

- Commonly known as Social Security, OASDI is the most important social insurance program in the US
 - Enacted in 1935, it covers more than 9 out of 10 workers
- Groups covered under the Social Security Program include:
 - Employees in private firms
 - Federal civilian employees
 - State and local government employees
 - Employees of nonprofit organizations
 - Self-employed persons who earn \$400/year or more
 - Domestic employees in private homes who earn \$1500/year or more (in 2006)
 - Miscellaneous other groups, including ministers, US military personnel, and railroad workers
- A worker becomes eligible for benefits by attaining an insured status:
 - To attain a fully insured status, a worker must have 40 credits
 - In 2006, a credit is earned for each \$970 of covered earnings
 - A maximum of 4 credits can be earned each year
 - You are currently insured if you have earned at least 6 credits in the past 13 calendar quarters
 - The number of credits required to be disability insured depends on the age when you become disabled
 - Eligibility for certain benefits depends on insured status:
 - Fully insured: retirement and survivor benefits
 - Currently insured: survivor benefits
 - Disability insured: disability benefits

OASDI: Retirement Benefits

- Social security retirement benefits are an important source of income for most retired workers
 - Full retirement age for unreduced benefits is age 65, but will gradually increase to 67
 - Workers and their spouses can retire at age 62 with actuarially reduced benefits
 - More than half of the OASDI beneficiaries apply for retirement benefits before the full retirement age
 - Monthly retirement benefits can be paid to retired workers and their dependents

OASDI: Survivor Benefits

- Survivor benefits can be paid to the dependents of a deceased worker who is either fully or currently insured
 - The benefits provide a substantial amount of financial protection to families
 - For the average family, the benefits are equal to a \$354,000 life insurance policy

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OASDI: Disability Benefits

- Disability benefits can be paid to disabled workers who meet certain eligibility requirements
 - The benefits provide protection against the loss of income during a long-term disability
 - For the average family, disability payments are equivalent to a private disability insurance policy worth over \$233,000
 - The worker must meet a five-month waiting period, and satisfy the definition of disability
 - The worker must have a physical or mental condition that prevents him or her from doing any substantial gainful activity and is expected to last at least 12 months or is expected to result in death

Long-range OASDI Actuarial Deficit

- The present program is running an annual surplus, but the OASDI trust funds will experience serious financial problems in the future
 - Projected OASDI tax income will begin to fall short of outlays in 2017
 - The program can be actuarially balanced over the next 75 years in various ways, including:
 - An immediate increase of 16% in payroll tax revenues
 - An immediate reduction in benefits of 13%
 - Using general revenues of the federal government to pay benefits
 - Or, some combination of these options
 - One proposal would create voluntary personal retirement accounts, allowing workers to divert two full percentage points from the OASDI payroll tax into voluntary personal retirement accounts

Medicare

- Medicare covers the medical expenses of most persons age 65 and older
- The program also includes prescription drug plans and health care plans of private insurers
- Beneficiaries can select among an array of plans including:
 - The original Medicare plan
 - Medicare Advantage plans
 - Other Medicare health plans
 - Medicare prescription drug plans
- Under the original Medicare plan:
 - Beneficiaries can elect any provider that accepts Medicare patients
 - Medicare pays its share of the bill, and the beneficiary pays the balance
- The original program provides benefits in two parts:

- Hospital Insurance (Part A) provides coverage for inpatient hospital stays and other services including skilled nursing facility care, home health care, hospice care, and blood transfusions
 - Hospitals are reimbursed for inpatient services under a prospective payment system
 - A flat amount is paid for each service based on its diagnosis-related group (DRG)
- Medical Insurance (Part B) is a voluntary program that covers physicians' fees and related medical services
 - Covered services include physician services, clinical laboratory services, home health care, outpatient hospital services, and blood
 - Beneficiaries must pay a monthly premium for the benefits
 - Currently beneficiaries with annual incomes under certain levels pay 25% of the cost of the program, and the federal government pays the rest
 - A means test will be applied beginning in 2007
 - The beneficiary must meet an annual Part B deductible
 - The program pays 80% of the Medicare-approved amount for most physician services, outpatient therapy, preventive services and durable medical equipment
 - Payments to physicians are made on an assigned or nonassigned basis
- Medicare beneficiaries have other choices for coverage besides the Advantage Plans
 - Under a Medicare Cost plan, members receive care from primary care doctors and hospitals that are part of the network
 - Services obtained outside the network are covered under the original Medicare plan, but members must pay the Part A and Part B coinsurance and deductibles
 - A PACE program combines medical, social, and long-term care services for the frail elderly

Unemployment Insurance

- The federal and state governments provide unemployment insurance
 - Programs pay weekly cash benefits to workers who are involuntarily unemployed
 - Cash benefits are paid during periods of short-term involuntary unemployment
 - Applicants are encouraged through local employment offices to seek employment
 - Unemployment benefits help stabilize the economy during recessionary periods
- Most private firms, state and local governments, and nonprofit organizations are covered for unemployment benefits
 - Private firms are subject to the federal unemployment tax
- To be eligible, an unemployed worker must:
 - Have qualifying wages and employment during the base year

- Be able and available for work
- Be actively seeking work
- Be free from disqualification
- Serve a one-week waiting period
- Benefits paid depend on the worker's past wages, within certain limits
 - Most states use a formula and pay a fraction of the worker's high quarter wages
 - The maximum duration of regular benefits is limited to 26 weeks in most states
 - Under the extended-benefits program, an additional 13 weeks of benefits is paid during periods of high unemployment
- Programs are financed largely by payroll taxes paid by employers on the covered wages of employees
 - For 2006, covered employers paid a federal payroll tax of 6.2% on the first \$7000 of annual wages
 - Experience rating is also used, by which firms with favorable employment records pay reduced tax rates
- State unemployment insurance programs face numerous problems:
 - Only a small proportion of the total unemployed receive benefits
 - Reasons include tighter eligibility requirements
 - Many states have low trust fund balances for paying benefits
 - A high percentage of claimants exhaust their benefits during business recessions

Workers Compensation

- Workers compensation is a social insurance program that provides medical care, cash benefits, and rehabilitation services to workers who are disabled from job-related accidents or disease
- Under the common law of industrial accidents (1837), workers injured on the job had to sue their employers and prove negligence before they could collect damages
 - Under the contributory negligence doctrine, injured workers could not collect damages if they contributed in any way to the injury
 - Under the fellow-servant doctrine, the injured worker could not collect damages if the injury resulted from the negligence of a fellow worker
 - Under the assumption-of-risk doctrine, the injured worker could not collect if he or she had advanced knowledge of the dangers of the occupation
- Objectives of state workers compensation laws include:
 - To provide broad coverage of employees for job-related accidents and disease
 - To provide substantial protection against the loss of income
 - To provide sufficient medical care and rehabilitation services to injured workers
 - To encourage firms to reduce job-related accidents
 - To reduce litigation
- Workers compensation laws provide four benefits:
 - Medical care generally is covered in full with no limitations
 - Disability-income benefits can be paid after the disabled worker satisfies a waiting period

- Death benefits can be paid to eligible survivors if the worker dies as a result of a job-related accident or disease
 - All states provide rehabilitation services to restore disabled workers to productive employment
- State workers compensation programs face numerous problems:
 - Insurers face the continued risk of terrorist attacks
 - Claim costs continue to increase due to the rising cost of medical care
 - Attorney involvement in workers compensation claims increases claims costs by 12-15 percent
 - Court decisions have eroded the exclusive remedy doctrine, which states that workers compensation benefits should be the sole and exclusive remedy for injured workers

End.