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Subcommittee on Government Operations of the

Committee on Oversight & Government Reform

United States House of Representatives

Hearing on

"Federal Long-Term Care Insurance Program: Examining Premium Increases"

Statement of

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on behalf of

the American Academy of Actuaries

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The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Chairman Meadows, Ranking Member Connolly, and distinguished members of the subcommittee, thank you for the opportunity to testify on the issue of "Federal Long-Term Care Insurance Program: Examining Premium Increases." My name is Laurel Kastrup. I am an actuary specializing in long-term care insurance and financing. I am representing the American Academy of Actuaries, where for the past several years I have been the chairperson of its Health Financial Reporting and Solvency Committee.

The Academy is the nonpartisan professional association representing the actuarial profession in the United States. Our mission is to serve the public and the U.S. actuarial profession by providing independent and objective actuarial information, analysis, and education to help in the formation of sound public policy.

I would like to begin by emphasizing the importance of actuarial input from the beginning of any process involving the consideration, design, and evaluation of a potential long-term care (LTC) policy approach. Actuaries are uniquely qualified according to their professional standards. Qualified long-term care actuaries play a crucial role in the design of LTC financing systems—from private long-term care insurance (LTCI) to public programs that provide LTC benefits. Actuaries have specialized expertise in managing the risk of adverse selection in insurance coverage, the ability to recognize and incorporate uncertainty into cost projections and premiums, and experience in evaluating the long-term solvency and sustainability of public and private insurance programs. Actuarial expertise can provide a basis for exploration of new and innovative program designs.

To enhance the understanding of LTCI premium rate increases, the Academy's LTC Reform Subcommittee recently developed an issue brief that examines important underlying factors affecting such increases. Without LTCI, many more people would exhaust their savings on care costs and then [potentially] rely on public programs such as Medicaid for their additional care needs LTCI requires a long projection period with assumptions extending over 50 years into the future. Another key factor has been and continues to be high levels of uncertainty and changes in circumstances that affect the levels of premium rates needed to ultimately be sufficient.

In determining whether LTCI policies require a premium rate increase, two authorized methods are applied—one for policies subject to minimum loss ratio (MLR) certifications and one for rate stability certifications.

Despite the relatively straightforward mathematical calculations to determine premium increases, determining projection assumptions (such as, having sufficiently credible actual historical experience to justify the future projected assumptions) can be difficult. With LTCI it can be a long time from the purchase of a policy until the first time a claim is submitted. As such, there is often little claims experience to justify premium rate increases on a relatively young group of policy forms based on the experience of those forms alone. Section 3.2.1 of Actuarial Standard of Practice No. 18, Long-Term Care Insurance, requires actuaries to use alternative data sources—such as experience from the insurance company's older, similar policy forms, or public

data—for identifying reasonable assumptions.[1] Waiting until there is adequate claim information on each policy form could result in much larger, less affordable rate increases.

In the remainder of this testimony, I discuss premium rate increase within LTCI in four sections:

1. Factors affecting LTCI premium increases;
2. Differences between current and past LTCI policy forms;
3. Determining the need for premium rate increases; and
4. Alternatives to a premium rate increase.

1. Factors affecting LTCI premium increases

Private LTCI is complex—a policyholder is essentially paying today for a varied range of care he or she may or may not need years, if not decades, into the future. As such, LTCI requires a long projection period, with some policyholders receiving benefits beyond age 100. Therefore, even for the average issue age of 57, policy projections require assumptions for more than 50 years into the future. The future period is even longer for younger policyholders. Further, calculating premiums relies on a number of assumptions for variables such as:

- mortality;
- voluntary lapses;
- interest rates;
- morbidity, including
    - incidence of disabilities requiring LTC services;
    - recoveries and mortality while on claim;
    - benefit expiry;
    - service inflation costs of covered services relative to inflation protection assumptions; and
    - the amount of services required while disabled (for policies that reimburse actual expenses).

In addition, there has been and continues to be a high level of uncertainty and change in circumstances that affect the level of sufficient premium rates, such as:

- changing pattern of service/care providers (e.g., growth of assisted living facilities and continuing care retirement communities, access to home care services that are covered by LTCI);
- changing medical practice (e.g., criteria for diagnosis of Alzheimer's disease and other cognitive impairments);
- effects of mortality improvement in the population, leading to more older age benefits and longer stays;
- changes in family composition reducing availability of caregivers, leading to fewer supports for care at home;

[1] Actuarial Standard of Practice No. 18, *Long-Term Care Insurance;* Actuarial Standards Board; January 1999.

- lower investment income, a crucial consideration for a financial instrument that must accumulate large reserves over many decades to prefund the high cost of services that occur at advanced ages; and
- limited available data under existing LTCI coverage beyond 20 policy years for advanced ages, where morbidity tends to be substantially different from general population data due to the characteristics of those who purchase insurance.

If not for the ability to adjust premiums to better reflect actual experience, carriers would likely not have offered this type of insurance product.
Often, examining adverse experience from older policy form blocks provides valuable insights that may be applicable to newer blocks. After reviewing the adverse experience, insurers may need to change projection assumptions used for the newer policy forms. The revised projections could identify a need for a premium rate increase. It is important to note that even though adverse experience may not have developed yet for a newer block, the revised expected future benefits could be higher for that newer block than previously expected. Acknowledging the need to fund the higher expected future benefits for the newer block comes in the form of a premium rate increase. Actuaries will then communicate the amount of premium rate increases along with their assumed implementation timing to the relevant state insurance department. The implementation timing for the rate increases is crucial. Deferring implementation of a needed rate increase is detrimental to its objective of maintaining and restoring sustainability because waiting to implement the rate increase will not start the accumulation of the needed increased premium to fund the higher expected benefits, resulting in the need for a further increase. The effect on consumers is that deferrals generally lead to the need for a higher rate increase than originally calculated.

When original LTCI policy forms were issued in the 1980s and ’90s, morbidity assumptions were often based upon general population statistics, and lapse and mortality assumptions upon experience of non-LTC insurance products. Not only did the insured population behave differently than the general population, but improvements in medical diagnostic practices and services, and a large increase in the use of assisted living facilities, helped increase (1) the number of individuals surviving to ages where the levels of disability are higher, leading to higher claim rates per insured; and (2) the survival time following the onset of disability.

Insurers are gradually learning through their claims experience what the actual levels of benefits are and will be; nonetheless, they still do not yet have a complete basis for assessing the ultimate levels of claims to be paid at advanced ages and later policy durations, nor how these levels might change over time. Insurers will continue to use existing information to estimate these ultimate claim levels and may need to raise premium rates further as more insured life experience develops or if there are unfavorable changes in benefit usage in the future.

2. Differences between current and past LTCI policy forms

LTCI policies issued today are designed to address many of the risks experienced in the policies issued in the past. Changes to product design such as having a lower maximum issue age,

offering a defined benefit pool instead of lifetime benefits, and improved underwriting, lessen the risk inherent in the product.

There are also significant differences in the pricing characteristics for LTCI policies issued in the past, especially more than a decade ago, compared to policies being issued today and what is expected going forward. The possibility of a future rate increase, at any point in time, is a function of the confidence level in the underlying assumptions and risks associated with these assumptions. With more conservative assumptions, more data to support those assumptions, key assumptions approaching their absolute limits (e.g., ultimate lapse rates approaching zero), and higher explicit margins, it is likely that the probability of rate increases on the current generation of LTCI policies will be lower than the probability of rate increases on previous generations. Future changes in the underlying morbidity, mortality, policyholder behavior, provider behavior, or regulations could alter this likelihood, yet statistical analyses on the experience are helpful when applying historical results to future projections.

A recent presentation[2] of the likelihood of future rate increases on policies issued in 2014 versus policies issued in 2007 and 2000, based on a survey of insurers writing business in 2000, 2007, and 2014, found the following:

- Barring the potential changes mentioned above (underlying morbidity, mortality, policyholder behavior, provider behavior, or regulations), and using the same projection model for each time period, the risk of a future rate increase issued in 2014 (using 2014 assumptions) is only one-quarter that of the risk on business issued in 2000 (using 2000 assumptions), and only one-third that of the risk on business issued in 2007 (using 2007 assumptions).

- The primary reasons for this improved expectation of future premium stability are the substantially greater insured experience behind each successive set of assumptions, the significantly lower future downside risk of most assumptions, and an increase in the margins for adverse experience.
    - Amount of data increased 16-fold from 2000 to 2014.
    - Claims data for ultimate experience (e.g., durations 10 and beyond) at attained ages over 80 increased 70-fold from 2000 to 2014.
    - Ultimate voluntary lapse rate assumptions decreased from 2.8 percent in 2000 to 0.7 percent in 2014. This leaves very little room for future adverse deviations from lower voluntary lapse rates.
    - Best estimate ultimate claim costs in the year 2000 were estimated at 70 percent of the recently released 2000-2011 SOA LTC Experience Study.[3] The corresponding best estimate ultimate claim costs used for 2014 pricing were 108 percent of that SOA LTC Experience Study.

[2] "LTCi New Business Pricing - How Safe Is It?"; Stephen Douglas Forman, James M. Glickman, and Roger Loomis; Society of Actuaries Annual Meeting; October 11-14, 2015.
[3] *Long Term Care Intercompany Experience Study – Aggregate Database 2000-2011 Report*; Society of Actuaries; January 2015.

- Ultimate mortality being used in 2014 pricing is 72 percent of the mortality assumption used in 2000.
- Investment portfolio rates were assumed to be 6.4 percent for every future year of a policy issued in 2000, while they are now assumed to be 4.6 percent for every future year of a policy issued in 2014.

As a consequence of the above, the average policy premiums (for the same benefits) increased to 215 percent of the year 2000 premiums by 2014.

3. Determining the need for premium rate increases

In determining whether LTCI policies require a premium rate increase, two authorized methods are applied—one for policies subject to minimum loss ratio certifications and one for a rate stability certifications.

Historically, LTCI pricing was subject to a 60 percent minimum loss ratio (MLR) by most states, meaning that the ratio of the present value of lifetime claims to premiums could not fall below 60 percent. Beginning in the early 2000s, many states enacted rate stability laws, which stated that LTCI should be priced without using the MLR approach. Instead actuaries need to certify that the premium rates have enough margin to withstand moderately adverse experience (MAE).

Under the MLR approach, if an insurer demonstrates that revised historical and future projected experience produces a lifetime loss ratio greater than 60 percent (or the originally priced-for loss ratio), a premium rate increase could be filed that would allow the projected experience on the policies to return to that lifetime loss ratio.

Under the rate stabilization approach, a premium rate increase could be requested if actual past experience combined with projected future experience exceeds the original or previously defined MAE margin. If revised projections using updated experience exceed the MAE margin, then a premium rate increase could be filed such that the lifetime loss ratio on the original premiums is assumed to be the greater of 58 percent and the original assumed loss ratio; and the lifetime loss ratio on the increased premiums is at least 85 percent (with claims projected into the future including MAE). For this premium rate increase filing, the amount of premium rate increase would need to be large enough for the insurer's designated actuary to certify that the premiums are sufficient with no further premium rate increases in the future unless the actual experience exceeds a revised MAE margin.

Under either approach, the need for a premium rate increase should be driven by projected lifetime loss ratios also, rather than actual past experience alone. Despite the relatively straightforward mathematical calculations to determine premium increases, determining projection assumptions (i.e., whether actual historical experience is sufficiently credible to justify changes in future projected assumptions) can be difficult.

Some assumptions have a higher degree of credibility earlier in the life of a policy than others. For example, policy lapses are more likely to occur in the earlier years of the policy, and claim

submissions are more likely to occur in later policy years. As such, actual lapse experience develops a higher degree of credibility in the earlier years of the business while actual claim experience has a lower degree of credibility in the earlier years of the business.

4. Alternatives to a premium rate increase

Insurers have routinely allowed insureds to reduce coverage by changing typical benefit options in order to help offset some or all of a rate increase. In recent years, in an effort to enable policyholders faced with a rate increase to retain significant coverage, some companies have started making available an option for policyholders to avoid the rate increase and keep their same premium by reducing the size of the future benefit increases for plans with automatic built-in inflation increases.

For example, policyholders would be able to keep their accrued benefit at their current inflation rate and only the future increases are lower than they would otherwise be. This is most effective as a conservation tool if it is done on an actuarially equivalent basis, meaning that the new prospective inflation accrual is set so that the present value of the expected reduction in benefits over time will be equal to the present value of the premium increase that is forgone. This is in contrast with most benefit reductions, which are in essence "partial surrenders" where there may be a reduction in the insurer's liability.

When insureds reduce their benefits to help offset a rate increase, an insurer would expect some adverse selection—meaning that the healthier insureds are the ones reducing their benefits and thus the experience on the block will likely worsen over time. With the approach described above, there may be less adverse selection involved because the benefit reductions are gradual and may not become significant for many years.

In the past, relatively few insureds have chosen to lapse their policies when premiums were increased and alternatives to the increase were offered. According to a 2010 report from reinsurance company, Gen Re, based on an industry survey, lapses at the time of a rate increase were only higher than normal by 2.5 percent of the total policies exposed to an increase.[4] The low 2.5 percent extra lapse rate suggests that the increases were generally affordable for the vast majority of policyholders, which is likely due to LTC insurance purchasers relatively being in the higher income and asset demographics than non-purchasers.

Conclusion

In closing, I want to mention how much I understand that these premium rate increases can affect families. My own personal experience with LTC was that my grandfather had a policy. It had a small daily benefit and he had given up the inflation option to avoid rate increases. When he

[4] The context for the premium rate increases at the time of the survey included: a low-interest-rate environment, generally lower-than-anticipated lapses and mortality, an average rate increase of about 25 percent in the survey, and premium price points that were generally at or below what policyholders could purchase at their attained ages.

moved into an assisted living facility, his LTC policy along with his income from Social Security was enough to make the cost affordable for him.

Predicting future policyholder and service provider behavior can be difficult. A means for taking corrective action to accommodate the changing future is important. The more conservative assumptions in today's pricing of private LTCI and improved speed at taking corrective action should improve future projections, resulting in fewer and smaller rate increases.

I again thank you for the opportunity to be here today with you and share the recent analysis by the American Academy of Actuaries' of long-term care insurance. I would be happy to answer any questions.

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Laurel Kastrup, MAAA, FSA, is an actuary who provides advisory and audit services to the insurance and reinsurance industries, specializing in long-term care, supplemental health, as well as other accident and health products. She is the managing director and leader of the health actuarial practice of KPMG. She currently serves as chairperson of the American Academy of Actuaries' Health Financial Reporting and Solvency Committee. The committee monitors financial reporting activities related to all areas of the health actuarial practice, including LTC. She has more than 20 years of experience in the health actuarial practice, and her areas of expertise include financial reporting, liability valuation and modeling, actuarial opinions, financial projections, and experience analysis. She is a member of the Academy's Board of Directors and its Health Practice Council and Audit Committee. Laurel graduated Phi Beta Kappa from the University of Nebraska where she received a Bachelor of Arts degree in actuarial science and mathematics and a Bachelor of Fine Arts in music.