RECORD, Volume 23, No. 1*

Palm Desert Spring Meeting
May 21–23, 1997

Session 99IF
Reinsurance for a Changing Long-Term-Care (LTC) Environment

Track: Reinsurance/Health
Key words: LTC Products, Reinsurance

Moderator: JAMES M. GLICKMAN
Panelists: GARY L. CORLISS
GERALD A. ELSEA†
MICHAEL A. LILLIE‡
Recorder: JAMES M. GLICKMAN

Summary: Recent legislation (i.e., Kennedy-Kassebaum) has rejuvenated products. Reinsurance may allow companies to enter the LTC market without substantial up-front investments. Attendees will learn about the new LTC products in the marketplace, the potential of the LTC market, and the ways in which turnkey reinsurance agreements operate with LTC products.

Mr. James M. Glickman: This session will be an interactive forum. This format is designed to create a talk show atmosphere. Although our expert panelists and subject matter are not nearly as controversial as you would usually see on a talk show, with your active participation, we should learn a great deal. I will introduce each of several topics, and then our experts will provide their perspectives.

I am president of LifeCare Assurance Company. LifeCare is an insurance company specializing exclusively in the LTC market. We are both a reinsurer and administrator of LTC. As an actuary, I have been involved with LTC insurance for 16 years, working with both the field and home office sides of LTC.

---

†Mr. Elsea, not a member of the sponsoring organizations, is Assistant Vice President of Employers Reinsurance Corporation in Overland Park, KS.

‡Mr. Lillie, not a member of the sponsoring organizations, is Regional Vice President of Allianz Life Insurance Company of North America in Minneapolis, MN.

I would now like to introduce each of our three expert panelists. Jerry is from Employers Reinsurance Corporation. He is an assistant vice president with responsibility for managing the LTC division. Jerry's professional background is in the area of underwriting rather than actuarial. As an underwriter, I am sure Jerry will be able to share many of his unique perspectives.

Next, we have Mike Lillie. Mike is regional vice president of reinsurance for Allianz Life Insurance Company of North America. Like Jerry, Mike is not an actuary. He has a marketing background with a particular emphasis in the LTC reinsurance market.

Finally, we have Gary Corliss, who is executive director for Duncanson & Holt's American LTC Reinsurance Group as well as for its International LTC Reinsurance Group. Although Gary is a recognized actuarial expert in the LTC field, his experience with marketing, underwriting, and claims should provide us with some unique perspectives.

I am sure most of you are here because you think the LTC market has a great deal of potential. Our panel would like to provide you with some background on this market. Jerry will start us off with a discussion of the demographics of LTC.

Mr. Gerald A. Elsea: First, I would like to give everyone an idea of the size of the LTC market. From 1987 to 1995, there were roughly four-and-a-half million policies sold. A little over half a million of those were sold in 1995 alone. That represents about $620 million in 1995 premiums with 20% of that premium from employer-sponsored plans. These employer-sponsored plans have shown the greatest growth in recent years, a trend that I expect to continue into the future.

Also, the average issue age has continued to decrease. In 1995, it was about 68 years old. Now, as baby boomers get older and see their parents needing care, the realization is increasing that there is a need for this product. Although growth has been slow in the past few years, I think the recent legislative changes will result in the sales volume picking up tremendously in the next two to four years.

Mr. Michael A. Lillie: I would like to add a couple of comments to the demographics Jerry just described. Fortunately, Gary Corliss and I have the advantage of being members of the Health Insurance Association of America's (HIAA) LTC Committee. As members we have recently had the opportunity to review the advance copy of the soon to be published HIAA LTC study. Much of the information that we will be discussing will be from either the HIAA committee or the HIAA report.

Until now, LTC riders on life insurance contracts have not been a big part of this marketing boom. A primary reason for this is that the early products were not designed very well. Thus, the individual stand-alone LTC product represents about 95% of current sales. However, with life insurance companies looking to enter this market and an increase in the use of return-of-premium features, I think these products will come into their own.

Before I continue, I should ask how many companies represented in our audience are active right now in LTC. It looks like about half of your companies are currently active. This is good. I would now like to talk about some of the demographics. The average premium for an LTC product is approximately $1,300 a year. This is comparable to the cost that most seniors currently pay for a good Medicare supplement program.

Interestingly enough, the price of an LTC policy just five years ago was approximately $1,700. Thus, the cost is coming down, thanks in part to better administration and more knowledge about LTC. Also, LTC, as most of you know, has been around since the early 1970s. CNA and AMEX were the two primary pioneers of this product. Since then, a tremendous amount of knowledge has been gained about LTC.

Up until seven years ago, the LTC market was only nursing home insurance, and it remained essentially unchanged from its inception. There were merely a few marketing adjustments here and there. Thanks mostly to the major changes in the National Association of Insurance Commissioners (NAIC) LTC Model Act, the product has changed much more during this decade than it had in the prior two decades combined. Now, with the passage of the Kennedy-Kassebaum bill in 1996, LTC will be changing dramatically in the future.

I will take a few minutes to discuss the features typically available in a LTC policy as described in the HIAA study for policies sold in 1995. Because of recent changes, especially due to the passage of the Health Insurance Portability and Accountability Act (HIPAA), also known as Kennedy-Kassebaum, some of these benefits have changed. I will try to point these out as we review the HIAA survey.

HIAA surveyed 11 insurance companies that together in 1995 accounted for 80% of the LTC business written in the U.S. on an individual basis. All 11 of the companies surveyed provide nursing home care, home health care, and alternative care. Nine of 11 companies provide coverage for assisted living facilities. Hospice care was provided by ten of the 11 companies. Respite care was provided by all 11.

All 11 companies provided daily benefits ranging from at least $40 a day, as a minimum, to $250 a day, as a maximum, for both nursing home care and home health care. In all 11 companies, benefit eligibility is triggered by activities of daily living (ADLs) or cognitive impairment, with several of them also allowing medical necessity as an additional trigger. With the passage of HIPAA, qualified plans are precluded from using medical necessity as a benefit trigger.

All 11 companies had a lifetime maximum benefit period. Two of the 11 had a six-month preexisting condition requirement which is the maximum allowed by law. The other nine either had no preexisting condition period or at least had no preexisting condition period for anything revealed on the application.

Finally, all 11 companies provided guaranteed renewability, coverage for Alzheimer's, waiver of premium, and an offer of lifetime compounded inflation protection. These are all part of the NAIC LTC model.

Mr. Glickman: I would like to remind you that this is an interactive forum, so if any of you have either a question or a comment, please speak up. I remember someone raised the question in one of the LTC discussions about whether a viable marketplace exists for LTC, and if so, what is the opportunity? These types of questions and your thoughts about them are what will make this session interesting. Otherwise, it is too easy for this session to become just a procession of speakers making individual presentations.

From the Floor: At the beginning of this year, every carrier I visited was swamped with applications and the underwriters were way behind in their work. However, I have not been hearing about this problem much after the initial surge of new business in January and February. Was this just a one-time surge due to the effect of the Kennedy-Kassebaum bill, or will it continue?

Mr. Elsea: Well, I think that Kennedy-Kassebaum caused part of the surge. As you said, the first quarter of 1997 was busy for everyone as consumers made sure to get their applications dated prior to December 31. Determining whether this surge was temporary depends on which company you are talking about. Some of our clients are still swamped with new cases.

Mr. Glickman: Gary, would you like to mention anything about your perspective on the demographics?

Mr. Gary L. Corliss: I have just one thought to add. There has been some conversation over the last few years about whether LTC would ever become a viable marketplace.

What's interesting is that when Bill and Hillary Clinton were suggesting a national health care program for the country, it seemed ridiculous that this could possibly become part of our country's future. As you look around the world, there are some common events that suggest LTC insurance is here to stay.

I will just briefly describe some of these events that have increased interest in LTC insurance. The demographics have already been alluded to, especially the aging population. You can add to that the fact that governments have less funds available than they had historically. We have seen socialism and communism change dramatically. The ability to fund varying national ventures is very tight. Furthermore, people everywhere are tired of government taxation. We complain about taxes here in the U.S., but the same complaints are heard in Europe and elsewhere around the world.

All this leads to the conclusion that there are not going to be any massive new government programs. That gives us all a great opportunity in this expanding LTC insurance marketplace. Individuals are realizing they need to take personal responsibility for their lives with regard to social programs like pensions, health insurance, or LTC insurance. We have a bright future for LTC insurance; we must take advantage of it.

Mr. Glickman: Well, that is a perfect lead into our next topic which is the Health Insurance Portability and Accountability Act, which is known more commonly as HIPAA. Within a year or two, nobody will remember what the acronym HIPAA stands for.

In any case, around August 1996, Congress passed this legislation, which essentially tells the public that the government is not going to take any additional responsibility for the costs of LTC. Furthermore, Congress indicated, even more forcefully, that to the extent the government already provides funding for LTC, which is very significant, there will be less government involvement in the future.

This legislation evolved from original congressional legislation on LTC drafted in the early 1990s. The Treasury became heavily involved in this legislation, as it usually does whenever tax revenue is involved. They wanted to determine how much it would cost. Congress was particularly interested in finding a way to get its message across to the public without actually spending tax dollars, although it is always happy to make everyone feel as if money is being spent on their behalf.

Congress actually did a very good job of accomplishing that purpose. They managed to develop legislation with a specific set of standards for a qualified plan. This qualified plan was then given special tax status, with limited deductibility and

tax-free receipt of benefits. In some specialized niche marketplaces, a qualified LTC plan is actually tax sheltered better than virtually any other type of product. But for the mainstream uses of LTC insurance, the tax advantages are so limited that they have very minimal impact on the budget, especially relative to what may be saved in the long run by people buying private coverage.

Since I am sure that most of you are familiar with the basics of HIPAA by now, I would like to focus our discussion on updating the latest developments. As those of you who have been following HIPAA are aware, Congress passed the legislation and then left it to the Treasury to develop the specific guidelines.

A few months ago, Treasury released its Blue Book interpretations on several key issues. The HIAA has, of course, been very involved in trying to get the Treasury to develop reasonable interpretations of the multitude of detailed issues that need to be defined. Just within the last month, the Treasury issued preliminary Notice 97–31, which provides safe harbor interpretations on which all can comment. But until this notice is finalized in September, companies will have to comply with these preliminary interpretations.

I would like to ask our panel to give us an update on the details of this preliminary ruling.

Mr. Elsea: I can talk about the Treasury interpretation on what substantial assistance actually means. It was originally feared that the Treasury would define substantial assistance in too narrow a way, thus preventing some legitimate claims from being paid. Fortunately, however, the Treasury clarified substantial assistance by including not only hands-on assistance but also standby assistance.

Mr. Lillie: Let me jump in here with a question. How many are familiar with the details of Notice 97–31? Based on the show of hands, it seems that relatively few of you are familiar with the details. Notice 97–31 was issued on May 6, 1997. Coincidentally, Gary and I were at an HIAA meeting in Washington, DC that day. So, as they say, we literally got it fresh off the press.

Let me discuss Notice 97–31 and add to what Jerry and Jim have already said. The notice will be in effect until September or October 1997. There are ten items that Notice 97–31 helped clarify, and two additional items still need further clarification.

The insurance industry had several questions concerning the interpretation of Kennedy-Kassebaum. The HIAA, operating as a central voice for the insurance industry, wrote to the Treasury requesting clarification on certain issues. Notice 97–31 is the Treasury's preliminary attempt to clarify these issues.

The first area clarified was the intended definition of substantial assistance. As Jerry described, Notice 97–31 adopted the HIAA's recommendation that both hands-on and standby assistance be included under the definition of substantial assistance. Severe cognitive impairment was clarified following the HIAA's suggestion that clinical evidence and standardized tests be used to measure cognitive impairment.

The substantial supervision definition is clarified to include verbal cuing, as requested by the HIAA. The definition states, however, that the substantial supervision must be continuous. It is unclear whether this continuous supervision is intended to include a case such as when an individual is asleep. That issue still needs to be clarified.

Also, it was important to get clarification of ADL requirements. There are six ADLs that are used in the Model Act. The Treasury says that an individual needs to be unable to perform either two or three out of either five or six ADLs to qualify for benefits. Alternatively, an individual can qualify with a severe cognitive impairment. If anybody needs clarification of the ADLs, I can read the definitions to you.

Mr. Glickman: Mike, what I would like to do now is to ask the audience if their companies currently have LTC products in the marketplace. I would presume that those of you with products have had to deal with the HIPAA requirements, especially in drafting the policy definitions. Does anybody have any comments or thoughts that they would like to make about that process or what your companies have had to go through to decide what policy language to adopt?

Ms. Janis A. Alexander: We have only a small amount of LTC business that we market as a rider to a life policy. We have not yet done anything in response to HIPAA except to try and keep on top of the legislative developments. My question is, what do you do with these preliminary guidelines that are only effective until the final guidelines in September? We get new regulations from different states every day, and we are not sure whether to file something and then three months from now try to respond to a new regulation or just wait for the final guidelines due out in September.

Mr. Corliss: The best thing that did come out of Notice 97–31 is that the government will accept a good-faith attempt to comply with the law, even if the final guidelines are different. If anybody wants advice on how to proceed, my answer is, do what you can and get as much approved as possible. Make your best effort at getting something approved that you think meets the qualification rules and it appears the IRS will accept it later even if you guessed wrong. That is all you can do right now. We are going to remain in limbo until we get final regulations.

Mr. Lillie: I would like to put a little different slant on this issue. Although I agree with Gary on most of what he said, the Treasury has said that Notice 97–31, unless something dramatically changes, will probably be mostly unchanged when the final guidelines are released in September or October.

Also, as Gary said, the Treasury position is, if you meet the state requirements for qualification, then you have met the federal requirements. My advice is to try not to guess what the Treasury is doing and just stay in line with what the states come up with. Then you should not have many problems.

Mr. Glickman: There is still one other major issue in the HIPAA discussion, and that has to do with the distinction between qualified and nonqualified plans. The IRS has clearly stated that qualified plans have a safe harbor position. However, the Treasury has effectively gone on record as saying that nonqualified plans do not have any such protections. What's even worse is that the Treasury has failed, despite what I would call fairly severe pressure, to come down with a position on the taxability of nonqualified plan benefits beyond "Don't ask—won't tell." They have basically added, but only when cornered, "You did not know about the taxability of nonqualified benefits before HIPAA, and as far as we are concerned nothing has changed; you still do not know."

Is there anything any panelists would like to add about HIPAA's unresolved issues before we move on to the next topic?

Mr. Corliss: I think that the point about nonqualified programs is the most important unresolved item. I know there is a debate about the advisability of selling nonqualified plans. You can read any number of articles discussing the pros and cons of offering a nonqualified program. I think that anybody who is offering a comprehensive LTC program is making a serious mistake if they have a nonqualified program. Maybe somebody else has a difference of opinion about that.

Mr. Glickman: Any thoughts out in the audience about the nonqualified issue? Among those of you in the audience, how many have introduced both qualified and nonqualified plans?

Mr. David R. Benz: If you are offering LTC insurance in Wisconsin, you are currently required to offer both qualified and nonqualified plans. However, next month Guenther Ruch is expected to change that position on behalf of the insurance department, thus preventing the current emergency regulation from becoming final. Likewise, California currently seems opposed to approval of any qualified plans. Even the three bills currently pending in the state legislature enabling qualified plans all require nonqualified plans to continue to be offered.

Except for these two states, the Aid Association for Lutherans (AAL) is only offering qualified plans once the new forms are approved.

Mr. Lillie: If anybody in the audience has been writing group LTC, you may be interested in the clarification made under Notice 97–31. Any group master contract written prior to 1997 and grandfathered under HIPAA has now been clarified to also allow grandfathering of any new certificates issued, including those issued after 1996.

Mr. Glickman: Does anyone else in the audience care to describe their position on nonqualified plans?

Mr. Patrick O'Rourke: Right now we are selling both because there are many states that have not yet approved our qualified plan.

Mr. Glickman: Let me try this from a different perspective. In the states where you have introduced your new qualified programs, have you also introduced a nonqualified one?

Mr. O'Rourke: No.

Mr. Glickman: So essentially there is a differentiation in approach depending on whether the new qualified plan has been approved in a particular state. Because many states have not yet approved the new qualified plan, even companies planning to discontinue their nonqualified plan have to wait until the qualified plan is approved. Since everybody continues to offer their nonqualified plan until such time as a qualified plan is approved, the big decision for each company is, should the nonqualified program be discontinued when the new plan is introduced?

Mr. Benz: One of the main reasons we offer only the qualified plan is because we have a captive agency. Our captive agency sells not just LTC, but also life, disability income, annuities, and mutual funds. If we tried to give our district representatives two LTC products, qualified and nonqualified, each of which is very similar in most respects except for the benefit triggers, we would have mass confusion.

In Wisconsin, where we are required to offer both plans, we get calls asking us which plan is best to use. It is very difficult for our agents to delve into all the issues like an agent selling only LTC might be able to do. That is one of the main reasons we have decided to offer only the qualified plan. It is just simpler, and it does not create the situation where in five or ten years we could wind up with benefits being taxed on a group of nonqualified policyholders.

Mr. Allen J. Schmitz: Our strategy has just recently changed. We are going to offer both qualified and nonqualified plans in each state where we get our new products approved. Our big reason for that is, unlike Dave whose agency force is mostly captive, the biggest percent of our agency force is brokerage.

It seemed to us that many of the brokers were requesting that the nonqualified product be continued. In order to satisfy this brokerage market, we needed to offer them what they wanted. Originally, we had taken the position that we were going to offer only the qualified plan as states approved it and not offer the nonqualified. Although we have changed our position, we are still recommending to our agents that they sell the qualified plan**.**

Mr. Glickman: Al, have your legal people been involved in this decision relative to Time Insurance Company's responsibility ten years from now if nonqualified plans are taxed and your agents recommended them, perhaps suggesting that the benefits would receive favorable tax consideration?

Mr. Schmitz: Our legal people have definitely taken a close look at this situation. Right now, of course, we are requiring everyone to sign a statement saying they understand all of the risks involved. But I do not know how well that is going to protect us. It is a delicate situation. We are not sure quite how this will eventually be resolved.

Mr. Lillie: Al, do you think your brokers' main concern about the qualified plan was the benefit trigger and the fact that medical necessity can no longer be used?

Mr. Schmitz: I think it was more than just the medical necessity issue. I think the requirement that an insured was to be chronically ill for at least 90 days was their major concern. So, yes, it was definitely a benefit trigger issue, but mostly the issue was that they do not want to deal with the 90-day certification.

Mr. Corliss: In addition to the 90-day certification, there are other reasons I hear frequently as to why the agents really want to have a nonqualified program.

As the Treasury clarifies its position with Notice 97–31 and other positions they will take later this year, I think many of the methods companies currently use will explicitly be allowed to remain the same as they are now. The one area that is likely to remain different is the 90-day certification requirement.

I would like to make a personal observation about the 90-day certification issue. I have tried to discourage clients from offering very low elimination periods in their product design. We have seen the first, or early dollar concept, phased out from

disability income and medical expense policies as experience has shown they do not work. Based on intercompany studies as well as individual companies we work with, we know that if you have a low elimination period, you will not meet your pricing assumptions. I expect that the short elimination periods will disappear from the market.

Taken from a global perspective, the U.S. is the only country that is confused about this 90-day issue. For the 90-day rule to have an impact, you have to be dealing with acute care. When you look at plans in other countries, most do not even offer less than a 90-day elimination. The assumption is that an LTC policy should be for services needed over a long period of time, not for short-term acute care. I think that one way or another short elimination periods will fade away over time. The real issue will be whether a company can take a deduction for their reserves.

Mr. Glickman: I think we should move on to our next topic. We will discuss some of the risks associated with the LTC market. Those of you already in the market have been exposed to many of the thoughts and processes we will discuss. Those of you who have not, or who are now thinking about it, will probably be very interested in hearing what our panel has to say.

I would like to ask each of our panelists to talk about one of the risk areas. I think we can start with Jerry and talk about underwriting.

Mr. Elsea: First of all, underwriting LTC is a very subjective process. You must read between the lines quite often. As a result, there is only limited expertise in the industry about LTC. In fact, one of the major reasons for obtaining reinsurance is the ability to share in the knowledge and underwriting expertise of the reinsurer who specializes in the LTC market.

Let me give you an example of reading between the lines. Assume you have medical information about a 73-year-old applicant. The information shows that the doctor gave the applicant a pair of prescription glasses recently. However, the doctor has noted that this is the seventh pair of glasses the patient has required in the last nine months. Nothing is said about memory loss, Alzheimer's, or senile dementia, but if you did not pick up on that subtlety and notice that seven pair of glasses have been lost, then you may be in store for a quick claim.

There are many other subtleties to focus on. The check used to pay the premium offers some important clues. Did someone other than the insured sign the check? Often when mom or dad start to lose functional or cognitive ability, the children assume responsibility for their parents' finances. Also, muscular or cerebrovascular

problems may be present if the insured signing the check exhibited handwriting that is shaky or uneven.

To properly underwrite the typical elderly patient, you need to be aware of the physiology of aging. Older people have more fluctuating blood pressure. This leads to several other problems such as dehydration that often affect the kidneys. Also, your skin gets thinner as you grow older. That makes you more susceptible to diseases and the aging processes. You also have fewer sweat glands. These and other normal aging problems can trigger more serious complications.

The biggest problem in underwriting, obviously, is spotting memory loss, senile dementia, and Alzheimer's. Nearly as important is recognizing and evaluating cardiovascular, cerebrovascular, kidney, and liver function problems. Many of these problems can run the full spectrum from virtually no impact to uninsurable. So if you can find an underwriter who has been through this process before, you can learn from their experience rather than make your own mistakes. I have been a reinsurer in this market for over a dozen years, and I can tell you that information on this type of experience is difficult and often painful to acquire.

We are in the process now of rewriting our underwriting manual to reflect the substantially different approach necessary for underwriting home health care versus nursing facility coverage. While you may feel quite comfortable issuing someone a nursing-facility-only policy, you may not want to give that same person home-health-care benefits. Our new underwriting manual, due to be completed in the summer of 1997, will actually split the underwriting into two separate categories.

Mr. Dennis M. O'Brien: I would like to know how assisted living fits into the spectrum of underwriting you described and how that pertains to nursing home and home health care.

Mr. Elsea: I would probably put it closer to home health care, although it is in a gray area. We are just now trying to analyze how it fits in.

Mr. Glickman: One very interesting facet of LTC underwriting is the difference from life or disability underwriting. In fact, you should be aware of two major underwriting challenges. The first challenge is the applicant who knows something is wrong with their health and is trying to keep you from finding out about it. Having this policy issued may save their estate, and thus they have a vested interest in getting you to approve it. Sometimes their action is quite subtle and sometimes it is absolutely overt. Therefore, your underwriters have to be aware of clues that will lead them to the right information.

The second challenge is much more difficult and probably occurs more frequently. It stems from the fact that people, especially as they get into their 60s and 70s, start to have significant chronic health problems emerge. For someone to psychologically accept these permanent problems, especially those that will continue to worsen, they compensate by convincing themselves that this is just part of getting older. They tell themselves, "Just take the pills and ignore the rest of the problem."

Then, of course, there are the imagined problems. I can think of one underwriting situation where a lady, over a period of seven years, kept telling her doctor that she was losing her memory. Well, that is about as bright a red flag as you can get in the underwriting world. But, in fact, there was no evidence over that seven-year period that could document any problem. She just kept complaining about it. What we finally did from an underwriting standpoint was require her to see a geriatric specialist and get a workup of her cognitive status to determine whether she was oversensitive to a routine problem or really had the early stages of some type of senility.

As you can see, underwriting challenges go both ways. You do not want to automatically decline everyone who has a reference in their medical records of potential problems. Nor do you want to ignore what may be some very subtle clues about a significant or undisclosed problem.

Mr. Elsea: When underwriting life or disability, you are primarily dealing with a working population. If someone has a significant problem, it is usually confined to a single illness. However, in LTC, the person often has multiple problems and the underwriter needs to understand how the they all interact. The patient may also be on several different medications, making it much more complicated.

Mr. Lillie: From an underwriting standpoint there has been a great deal of debate in the last several years about genetic testing. I know of some labs that are very interested in getting involved in offering genetic tests.

Probably the most interesting test that has come along in the last several years concerns Apolipoprotein E. Apolipoprotein E does not affect much of the population, but it is very easy to detect and has an extremely high correlation with someone's predisposition to develop Alzheimer's during their lifetime. Physicians are reluctant to order this test since the prognosis is poor for someone testing positive. However, labs are very interested in promoting this test.

From an underwriting standpoint, it would be helpful to have the results of this test before issuing an LTC policy. Genetics may, to the extent that legislation and regulation allow, play a greater role in the underwriting process in the future.

Mr. Corliss: You can take genetic testing as well as other specialized screening tests to an extreme. For example, you can screen for nuns with a college degree. You know that they are extremely unlikely to develop senility. That has been proven in studies. But what does this type of screening process do for you? We have discussed complicated situations as well as very specific kinds of problems you can look out for.

We look at the underwriting process from a more global perspective and are searching for an applicant who desires to remain independent. Despite the availability of all of these tests, we advise our clients to concentrate the underwriting effort on identifying those people who best adapt to the problems going on in their lives. Their potential to stay off claim is directly proportional to their ability to function independently.

Mr. Glickman: Gary, can you discuss what we currently understand about claim costs for LTC and what we think will be the trend?

Mr. Corliss: We talked first about underwriting because many of us think that underwriting is really the key to being financially successful in LTC insurance.

Our next topic is naturally claims, claim processing, and the design of the product. If we refer to the SOA intercompany study that examined experience developed from 1987 until 1991, we saw the incidence of claims in the industry generally improve during that time frame. We are now trying to expand that intercompany study to at least 1993 or 1994.

In reviewing the initial data for the second study, although not all companies have yet submitted their information, there seems to be a small reversal in the downward trend of incidence rates. We do not know if underwriting has trailed behind the applicant's ability to predict problems or if companies are just getting so aggressive in writing new business that their standards are slipping. There does seem to be some initial indication that claim incidence rates are increasing.

We know that insured claims are longer in duration than the general population data. This is an indication that underwriting is still very effective. In fact, this phenomena may be the curse of good underwriting. We have learned a great deal, but we still have a long way to go.

Mr. Glickman: I would like to make a quick comment on the issue of longer duration claims. Interestingly enough, these longer duration claims might merely be a function of the difficulty in underwriting cognitive impairments and other progressive degenerative diseases that are just beginning to manifest themselves. For example, somebody who is experiencing tremors may decide to apply for coverage before they are actually diagnosed with Parkinson's.

It is even more difficult for the insurer to detect the very early stages of Alzheimer's in an applicant, even with the use of objective testing. But the applicant's relatives will surely notice the memory lapses, and if they are knowledgeable about LTC insurance, pursue the purchase of a policy.

Ten years ago, when the public was unaware of this coverage, new business was generated by an agent convincing a client to buy. Now the public is more aware and occasionally realizes that if symptoms appear, perhaps coverage should be purchased before a diagnosis is obtained, especially if an agent happens upon them at the right time.

Mr. Corliss: As the title of this session indicates, reinsurance is an important tool in the quickly changing LTC environment. Not only can the reinsurer bring knowledge about underwriting and morbidity risk to the table, but the reinsurer also can provide the risk protection necessary to safely enter the market. I would like to briefly describe the types of reinsurance available and how they relate to the LTC marketplace.

Most reinsurance in this country is offered on a quota share basis. This means that the reinsurer shares with the insurer in all the risks, whether it is morbidity risk, mortality risk, persistency risk, expense risk, investment risk, or even regulatory risk.

However, there are companies that are both large enough and experienced enough in the LTC business to not be concerned about the risks I just mentioned. They are just looking to protect their company from adverse claims experience or unanticipated claim trends. Reinsurance is available for them as well on an excess-of-loss basis where claim benefits in excess of either a dollar amount or period of time are paid by the reinsurer.

A variation of the excess of loss method is aggregate stop loss. This is a process that effectively protects the loss ratio, by paying any losses in excess of the specified loss ratio amount. I often refer to this type of reinsurance as the executive bonus protection plan, since in any given year, this type of reinsurance ensures that results do not get so out of whack in one particular line that it affects your bonus.

Mr. Elsea: I would agree with Gary that most of our reinsurance is quota share. However, we also provide excess-of-loss coverage in which the insurance company retains either the first $100,000 of a claim or the first year or two of a claim and then we quota share the excess over the retention.

Mr. Lillie: Our company, like Jerry's and Gary's, is mostly involved with quota share coinsurance. However, we also provide LTC reinsurance on a YRT basis, modified co-insurance basis, or stop-loss basis.

Mr. O'Brien: I wonder if anybody is aware of a facultative reinsurance outlet, where a complicated case or a marginal risk might be considered by a reinsurance company on an individual case basis?

Mr. Elsea: From our point of view, we reinsure only on an automatic basis. If you want to submit a case to us for a second opinion, we would be more than willing to provide our opinion as part of our normal service. However, to have an occasional facultative case submitted to us would not be worthwhile unless we were already providing other reinsurance services to you.

Mr. Glickman: Dennis, I think the answer to your question centers around a commonsense business analysis. The biggest problem a reinsurer faces with facultative quoting is the relatively small probability of being able to make an offer. The situation is quite different for life insurance where facultative quoting is usually a question of what price to charge rather than if a policy be issued.

This is because in LTC, there is much more of a cliff effect, where you go right from an acceptable risk to the edge of the cliff with little room for substandard offers. When you take that next step, you no longer have an insurable risk, no matter how many more dollars you charge for offering it. I am sure that many reinsurers would be happy to set up a facultative facility in conjunction with an automatic reinsurance program since they could expect to make enough money from the automatic program to justify providing that service.

I would like to ask if any of the companies represented in our audience are selling LTC utilizing reinsurance, and if so, what type of reinsurance.

Mr. Schmitz: Right now we have a YRT agreement for the first seven years. We have coverage only on the older issue ages—those that are older than 72.

Mr. Michael A. Hulme: We currently use a standard quota share arrangement.

Mr. Glickman: Judging from our response, there is relatively little reinsurance currently in the LTC marketplace. In my opinion, this is a unique situation affecting the LTC marketplace. Up to this point, companies that have been actively looking for reinsurance are primarily those that have been the most aggressive marketers. Not surprisingly, reinsurers have been reluctant to provide coverage to these carriers. At the other end of the spectrum, the very large companies with a fairly conservative structure have not generated enough LTC business as a percentage of their total business to require looking for reinsurance.

However, this situation is beginning to change. Many of the marketing-oriented companies that were somewhat more liberal in their underwriting philosophy have been getting more conservative over the past few years, especially as postclaims underwriting and other NAIC provisions have limited their ability to take corrective action after the fact.

Likewise, some of the larger companies are now starting to write in large enough premium volume to attract the attention of corporate management. This, in turn, has convinced many of these large companies to start looking for reinsurance solutions to an inherently risky business. So I expect reinsurance to become a much more important part of the marketplace.

Reinsurers are also offering solutions for companies that are new to the LTC market and need risk protection to satisfy upper management as well as the expertise and guidance to set their programs up properly. Gary, can you provide us with your thoughts about this use of reinsurance?

Mr. Corliss: Companies that are thinking about entering the business, or have just recently entered it, are generally considering one of four different reinsurance approaches to safely pursue LTC. The first approach is to use a co-marketing arrangement with a company that is successfully selling a product, which essentially means brokering that other company's program.

A second approach that is similar is private labeling a program. In this case you take another company's product, file it on your own paper, and typically utilize that other company to administer and reinsure the program.

The third approach is to utilize a turnkey product, developed by a reinsurer to help you enter the marketplace more quickly and safely. Finally, the fourth approach is to create your own program and use a reinsurer to provide the expertise and reinsurance to maximize your chance for marketing success and profitability.

We have noticed that the big advantage to using the first two approaches is the ability to get into the marketplace quickly; that is because the product has already been approved by the insurance departments. The real question in using this approach is: Does selling another company's program fit your corporate culture and goals? Does it fit your agents' expectations? Does it fit your marketing strategy? Finally, does it fit your administrative and profitability approaches to the marketplace?

The latter two approaches tend to be more customized to an individual organization. Therefore, they can be made much more proprietary to a particular organization. Of course, this customization tends to cost more and take longer to get to the market.

Historically, the first two approaches have been used very readily. There are a number of leading writers who have made their products available to other organizations. Over the last two years, we have seen a trend for companies to feel they know how to best market this product through their own people. Thus they are primarily looking for advice on how to get into the marketplace with their own program.

Mr. Elsea: Employers Reinsurance Corporation also offers reinsurance products in exactly the same ways already described. We offer a full range of reinsurance options from just reinsuring the company's program all the way to a complete turnkey program. We have the capability to perform all administrative functions for our clients including compliance, underwriting, claims, pricing, and management reporting. Of course, a company is welcome to do some or all of these administrative functions themselves. We try to be flexible with regard to the needs of our clients.

Mr. Lillie: As a reinsurer, we like to advise companies contemplating the LTC business from a somewhat different approach. We like to sit down with them and explain all the reasons why they should go into LTC. We then explain all the reasons why they should avoid LTC.

We do this because we realize that it takes a great deal of time and money to get into the LTC field even if you only sell one policy. Earlier I mentioned that 11 companies wrote 80% of the LTC business. That means the other 125 companies wrote only 20%. Many of these other companies should not have entered the LTC market because they apparently did not know how to market it, or their agents were not right for this market, or perhaps there was some other reason.

As a reinsurer, we like to encourage the use of a turnkey product because the market can be entered more quickly and safely. If you are successful, then you can either continue down the same path or pull out and confidently develop your own programs and systems. We try to help you get into the market and are then happy to phase out later, knowing that either way, you will still need reinsurance to safely continue.

But again, the most important factor is to first sit down with your reinsurer and examine the opportunity from all perspectives. It is quite embarrassing to later have to sit down with your company president and explain why you spent $3 million in two years creating 500 in-force policies. Believe me, this is not a rare scenario. So you must do some soul-searching first, to see if this is the market for you. Then, if you do decide to proceed, you can safely do so with the help and support of your reinsurer, hopefully learning from that reinsurer's mistakes.

Mr. Glickman: Of course it is nice to know that those reinsurers made their mistakes with their own money.

Mr. Lillie: That is exactly right, unfortunately.

Mr. Glickman: I would like to move on to our next topic. Just as we discussed new issues in the regulatory environment, we now want to explore some of the new developments in the marketplace. Companies are getting more aggressive with the benefits they choose to offer. We already discussed that claim costs are not particularly well known. We also do not know whether these costs are trending up or down.

Perhaps we could get our panelists to comment on some of the features that are distinguishing one company's product from another's. Who would like to start?

Mr. Elsea: Let me start. Underwriting has typically been performed on an accept or reject basis. Now we are seeing several rating classes used on a regular basis with most companies offering at least preferred, standard, and substandard classes. I think this subdividing of risk classes is a trend of the future.

Mr. Glickman: Gary, can you comment on this issue? Do you think it is a good idea for LTC to go the route of life insurance, trying to subdivide applicants into ever-increasing numbers of rate classes?

Mr. Corliss: I think a natural transition for any product line is to learn what features attract more business, and then it is best to move in that direction. Price is a big

issue in LTC insurance. Anyone who can pick out the better risks will be able to charge the lowest prices. It is just a normal progression for this line of business.

From the Floor: I have a question about multiple underwriting classes. Assume you have an applicant who is offered a substandard rate class because he or she had cancer three years ago. Two years later the same insured would be eligible for a standard rate if applying for new coverage. Would you allow that insured a premium reduction? If the answer is yes, how would you handle commissions?

Mr. Elsea: Although each company will have different rules, I would require the insured to buy a new policy.

Mr. Lillie: Normally, I would agree that an insured wanting a reduction needs to apply for a new policy. But, depending on the type of cancer and the insured's other health problems, the new offer can range from the best rate class all the way up to a rejection.

Mr. Corliss: There are some real complications in a situation like this. First, this is probably more of a theoretical issue than a real one, since the number of people who have actually bought substandard policies is relatively small.

One issue for consideration in reducing the premium is the effect on reserves. Do you necessarily want to deal with the effects of a product that has such a steep claim cost curve? You could take the position that there are savings from the lower risk class so that your financials are not adversely affected, but it is an issue. The premium rates increase significantly over a couple of years. Forcing the insured to reapply at an attained age may well take a great deal of pressure off the underwriter in these situations.

Mr. Glickman: I would add a few comments on this issue. There is a re-underwriting situation that occurs relatively frequently. Many companies use different rate classes for smokers and nonsmokers. Likewise, many smokers request that they be allowed to apply for a lower rate in the future if they stop smoking. The answer that I have seen the insured receive most often is, "Yes, but only if you can prove it to our satisfaction, and you are also qualified for our lower rate in all respects." In practice though, a change is rarely made because the person is unable to quit long enough to qualify.

Recently, Notice 97–31 was introduced as a further complication to this issue. Any policy issued prior to 1997 and grandfathered under HIPAA, Notice 97–31 is prohibited from changing the rate class if the policy is to retain its qualified status.

The prevailing opinion before the Notice 97–31 was that if you increased benefits, the policy would become nonqualified, but if you decreased benefits, it would not.

However, the notice made it clear that any material change to the benefit or premium structure would disqualify the policy as qualified. Many companies are now thanking the Treasury because they can refuse policyholder change requests by saying, "Sorry, our hands are tied. We are not allowed to make changes to your policy without disqualifying it."

However, this issue will resurface in a few years when many policyholders are on the new qualified or nonqualified track. Therefore, it is still an issue that needs to be resolved as there are substantial trade-offs between administrative simplicity and marketing expectations.

Mr. Corliss: I have another thought related to Notice 97–31 that Jim just commented about. There is language in Notice 97–31 that defines what is considered a material change. It states that if a change is unilaterally exercised by the insured within the provisions of the policy, then it is not considered a material change.

For the situations we have been discussing, there is obviously bilateral agreement. This would clearly be considered a material change under Notice 97–31.

Mr. Craig E. Hanford: I am still confused about one issue. One of the panelists mentioned that the average premium has been going down over the last few years, while another panelist said that the incidence rates are up. Since the length of stay has not materially improved, is this phenomena a function of longer elimination periods, or is it a function of competitive pressures?

Mr. Corliss: There are a couple of reasons why this has happened. First, I think there is more competition in the marketplace. Second, this is a very price-sensitive product, so companies are trying to design their programs with lower premiums.

Mr. Glickman: Craig, I think you probably described the real reason in your question. It is bottom-line marketing pressure. We previously discussed our inability to accurately determine what the right premium should be, even on a theoretical level. We therefore do not know whether a premium 10% higher or 10% lower is going to be more accurate. All we can do as actuaries is describe for the management of our companies what we think is the relative risk of being overpriced or underpriced.

In this marketplace where premiums can be revised, much of this risk can be mitigated through the rate increase process. From a marketing standpoint, if a 10% lower premium is needed, the actuary is hard pressed to take a stronger position with management than describing that the lower premium increases the risk of needing future rate adjustments.

When you think of that type of discussion occurring each time a company develops a new product, it is not hard to imagine premiums being ratcheted down over time across the industry.

Mr. Hanford: Is it not true that you are constrained by the regulators from offering a lower rate if your current product does not justify the rate change?

Mr. Glickman: In theory, companies might be constrained by needing to justify proposed rate reductions with actual experience. But as companies introduce new generations of products, there are enough differences in product design, underwriting style, and other factors to make it impossible to detect a premium reduction quite a bit greater than the 10% we just described.

In addition, most of the competitive pressures to lower rates come from new companies entering the market. Since they do not have a current product, it is quite easy for them to justify as competitive a premium as they like.

Mr. Lillie: Jim, I would also like to add a comment. A recent study that we did on the buying public shows that the largest portion of sales are between age 65 and 70. The age group between 55 and 65 is almost as large. So the average issue age has been dropping. The average age used to be over 70, and now it is closer to 65. We are also seeing estate planners become more active in the LTC market; this also contributes to a lower average issue age.

Mr. Glickman: I would like to bring up a new topic. Over the last four to five years, home-health-care-only policies have been gaining popularity. Home-health-care-only was originally offered by only the most aggressive companies, but it recently has been offered by some of the more prominent companies. Gary, do you have any comments about this trend?

Mr. Corliss: I do not like home-care-only products. I am not sure whether this product type will survive. There are a number of features that we feel are dangerous, and some of the experience has not been that favorable. Having said that, of course, we reinsure it, but overall I am not really excited about this product.

Mr. Glickman: I'll pick on someone from the audience. I know Time-Fortis has a home-health-care-only policy.

Mr. Schmitz: We do offer home-health-care-only policies, but we are emphasizing our integrated products. As a company, we do not like offering a stand-alone home-health-care policy. We have gathered more experience with it, especially in Florida. So our marketing strategy has been to move toward the integrated policy and away from the home-health-care-only policy.

Mr. Glickman: Would it be fair to say your attitude about home-health-care policies is similar to your attitude about nonqualified policies? You are offering them because your brokers insist on it, but you are trying to minimize its use.

Mr. Benz: At AAL, we get asked about home-health-care policies quite often. It is probably the number one question our agents ask. They want to know when we will offer a stand-alone home-health-care policy. We always tell them never.

One of our big concerns with home health care is that it will be marketed as an alternative to confinement in a nursing home. We think this is an illusion. Even worse, we do not want to say to our claimants, "Sorry, now that you have gotten worse, we can no longer pay you any benefits since you needed to go to a nursing home." We have trouble with agents selling it that way. Even though we can try to control this, we know we cannot completely control it. In any case, we believe this type of policy will be abused by agents.

Mr. Lillie: From a marketing standpoint, rather than an underwriting standpoint, I like home-health-care policies. However, from a corporate standpoint, I agree with Gary. I am not wild about home-health-care-only policies.

Here is something to think about. I recently read that the majority of LTC benefits are paid for home health care. Since every company offers some type of home health care within their LTC product, it is not surprising that the majority of benefits are paid for home health care.

So even though we are worried about stand-alone home health care, we routinely offer it in a comprehensive policy. With the typical LTC product, most of the payments are then made for home health care. So from this perspective, stand-alone home-health-care policies do not bother me that much.

Mr. Elsea: Our position is basically the same as Gary's. We do not like stand-alone home-health-care policies. I believe that when you combine the nursing home and home-health-care benefits, the home health care serves as a gatekeeper for the

nursing home coverage. Instead of going into a nursing home, home-health-care benefits are used. Thus, there are significant savings on nursing home confinements. This helps keep premiums lower. With a stand-alone home-health-care policy, there is no premium from the nursing home portion available to offset these costs. Therefore, from this perspective, we are definitely not proponents of stand-alone home-health-care policies.

Mr. Lillie: I spoke in front of a home-health-care association, and it was really quite interesting. We had a philosophical debate about these issues. When you mention home health care as the gatekeeper for nursing home costs, it is interesting, because the cost for home-health-care can be four, five, or even six times higher than the cost for a nursing home stay.

So if someone has an adequate benefit for home health care, they will have much too high a benefit for the nursing home care. Likewise, if the nursing home benefit is right, the home-health-care benefit will be inadequate. Therefore, I think the LTC designers have misread this benefit in their LTC products.

Mr. Corliss: This is a nice transition into our next topic about where the marketplace is headed. Home-health-care policies represent only 8% of the LTC sales with 90% of those sold in the state of Florida. In fact, the vast majority of these Florida sales are from Dade and Broward counties where the people have a very different idea about how home health-care-products are used. They think home health care is intended to be more like private duty nursing for seniors on a cruise.

Where is the marketplace going? I think as soon as we become adjusted to the Kennedy-Kassebaum bill, we are going to see some innovations come into the marketplace. One direction that home-health-care-only coverage might head is it might become more of a health-oriented program. The customer might want immediate coverage with no elimination period. This would be more of an acute program. I think we will see some product designs evolve in that direction. I think we will see an increasing number of new companies entering this marketplace.

We are starting to see many of the large companies look at this market, each with its own marketing strategy. Some want to manufacture the retail product themselves while others want to use some other company's back-room operation. I think we are going to see much more interest, especially from disability companies trying to figure out how to expand into this market. The annuity companies are also looking at this product.

Companies are trying to find ways to market these products at a lower cost than is possible with the current high/low style of commissions. Once we get comfortable with this new federal regulation, we are going to see a great deal of innovation. When that innovation occurs, you will want to involve your reinsurer to safely sell in that market.

Mr. Glickman: Mike, do you want to make any final comments?

Mr. Lillie: After you have talked to a reinsurer and other LTC experts, be sure that your management understands that they are not going to sell 10,000 policies overnight. It is a slow building process to become successful in the LTC market.

Mr. Glickman: Actually, I think that every company should go through an evaluation of how much money will be necessary for education and administration relative to the volume of business necessary to justify the risk of entering this business. However, if the business starts up too quickly, you may have developed a product that is too aggressive. So there is a very fine line. You have to generate enough production to cover your costs. But, if you find too much production, you need to look around and make sure that nothing has gone wrong.

One of the big opportunities in using reinsurance is to protect yourself from the contingencies that are unpredictable. But it is also important to be able to learn from the reinsurer's relationships with other companies who are experienced in the marketplace. The real opportunity that lies with a reinsurer is he or she is someone with whom you can test your ideas and someone experienced with the benefits and price. Then you can be sure you are not developing a loss leader.

Mr. Hulme: In the last few years a number of reinsurers in other product lines have become sources of information for providing in-depth competitive analysis for their clients. Do your reinsurance companies provide that kind of support during product design or pricing for your clients?

Mr. Lillie: We absolutely provide that kind of support.