RECORD, Volume 26, No. 1*

Las Vegas Spring Meeting
May 22-23, 2000

Session 109IF
Long-Term Care Rate Stability Issues

Track: Long-Term Care

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Recorder: BARTLEY L. MUNSON

Summary: This session reviews long-term-care rate filing and approval developments. Proposed changes to the NAIC models are being designed to promote initial rate adequacy and decrease the role of rate increases in maintaining profitability. Updated drafts of proposed changes are reviewed. Also, discussion on open issues is covered, such as:

- *Pooling or rate-stabilization reserves*
- *The depth of adverse scenario testing in the actuarial memorandum*
- *Phasing-in rate increases without violating the level premium concept*
- *Rate increase limits on acquired blocks of business*
- *Effects of added disclosure on marketing and issue costs*

Mr. Bartley L. Munson: Let me say just one quick word about the panel. I suspect most of you know them all. I think we have a perfect panel for this discussion. Van Ellet is the health policy team leader of the American Association of Retired Persons (AARP). Van has been very active in this, representing, if you will, the consumer perspective. He has been very active in this subject going back ten years or more.

Tom Foley is going to speak next. He's director of the A&H Division of the Kansas Insurance Department. More important and germane to this, he's the leader on the regulatory side of the Rate Stability Group and has been with the Life and Heath Actuarial Task Force (LHATF) for several years. Tom is Mr. NAIC on rate stability.

Bill Weller is chief actuary of the Health Insurance Association of America (HIAA) and has been representing the industry in the reactions and discussions that have been going on. Bill, too, has worked on this for a long time.

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This draft that's been proposed and moving along is new, and is fundamentally very different from the regulation that exists now for stabilization of rates for long-term-care insurance (LTCI) . And that's what we want to address.

The intent is to go forward with the regulation that can be adopted by the NAIC and be supported by the industry and the consumer groups, and to take action in the states.

Mr. Van Ellet: This is a really critical issue for AARP and for consumers. And as you know, consumers have had problems with LTCI over the years. It's too difficult to trigger the benefits, too complex a product, and too costly for many people. And there are too many other conflicts in terms of where they need to spend the resources.

But I think consumers, as the baby boomers take care of their parents, are finding out the product has improved dramatically in recent years. I think that we at AARP recognize that. I think they're really beginning to understand the need for coverage and the fact that there's no real end in sight. The federal government is more than likely not going to have any kind of comprehensive solution in place anytime soon with Medicare and Social Security and other big-ticket items being debated. Long-term, the time for LTCI will come, but it's not going to come for quite a while. I think they're realizing that this much-improved product really is something that they need to be thinking about.

Although a lot of the research says that consumers realize it's a problem, everybody thinks "not now," so they're not really doing that much to take care of themselves. As you may realize this, the cost issue is a paramount concern. And in fact, the cost study that was done in terms of buyer/nonbuyer in 1995 (there's a new study coming out sometime soon) found that 57% did not purchase because of cost. There were a bunch of other reasons as well, but that was the number one issue. And then you look at the fact that 62% of the purchasers had incomes of less than $35,000 a year; 41% had liquid assets of less than $50,000 a year. Now what's that going to mean in 10 or 20 years when a lot of claims come on-line? That doesn't leave a lot of margin for error for cost increases and premiums of an already expensive product.

Consumers are still very confused about this product. They don’t understand how it works. And one thing they don't really understand that's really troubling, and a very core issue here, is the problem of the likelihood that they will experience some sort of rate increase in the future. This product's sold as a level-premium policy. It says we have the right to raise premiums. They don't understand that. Level premium means level premium.

They labor under the assumption that state regulators are really paying close attention to the rates and to the marketplace in general. I think that they would be surprised if they really knew some of what was going on at the state level in terms of rate approvals and the types of resources that the state devotes to actually reviewing these products and monitoring the marketplace.

Three or four things have happened in just the last couple years that show that the problem is out there. There's a loaded time bomb, which is not something that the industry would want. This kind of bad publicity about having skyrocketing premium increases is really not something that would be good for consumers, the industry, or for the life of this product in the future.

Just a year or two ago there was a situation in North Dakota where some LTCI business was bought out and premiums of a policy started going up. Premiums increased from $1,000 to $7,000 a year. There was a class-action lawsuit and an out- of-court settlement on that case. But I think it woke a lot of people up as to what the potential is for some of the rate increases out there.

In California last year somebody who had been in the insurance business had concerns about the product. About 20 months after they purchased it, they got an 18% premium increase. They were outraged and refused to pay, saying, "This was sold to me as a level premium product." It went right to a state senator, and as a result there were a couple of bills put in the hopper. One was a non-cancelable LTCI bill, and another a disclosure premium history bill that was enacted into law last year in California.

There are some other lawsuits in the works right now about this subject. And last but not least, there was a report put out last year by The Larson Group in Seattle, Washington, that actually looked at the filings from all the state insurance departments and did a profile of what the rate increase histories had been of the various insurers over the last seven or eight years. It did show that there were some firms that were more likely than others to request rate increases. Certainly, some of those increases were difficult to deal with from a consumer's perspective.

We are really concerned about the multiple increases over a period of time, that finally, when somebody gets to be 80 or 85 on a fixed income and can't afford it, policies are all of a sudden going to have to lapse. This is a problem that I don't think a lot of consumers are aware of. We are hoping that some of what's been going on now, through the NAIC, is going to address this problem. We have some concerns about it that I will talk about in a little while.

Mr. Thomas C. Foley: I come to you a prejudiced person. I hate rate increases for LTCI. I want to talk to you about what we're doing at the NAIC in terms of the model regulation. But even more importantly I want to talk to you about what now is becoming a trite expression, and that is a "paradigm shift."

I became an actuary in 1970 and got involved in health insurance in 1974. One of the first things I learned from my mentor in health insurance is the way you do health insurance: You issue business, you close the block, you isolate the blocks with adverse experience, and you get rate increases on those. You never talk about the blocks where the experience is good. That's the way we do health insurance. And historically, that's the way we've done health insurance in this country for the last 50 years.

What I want to present to you are some reasons why that attitude does not work for LTCI. LTCI, as you know, is classified as health insurance. There are regulators who believe that health insurance, as has been practiced in this country, is appropriate for LTCI. There's another regulator who has an editorial in the current issue of *Contingencies Magazine* who's basically saying the same thing. I have tremendous respect for her.

You need to understand that not all regulators have the prejudice that I have. I became involved in LTCI first as a regulator in 1991 in Florida when that block of business that Van just referred to wanted a 75% rate increase on some ages. That block, as has been well-documented, saw the average premium go from $900 in 1989 to $7,000 in 1997. Clearly, that's the worst of the worst. We have other examples where we've had significant rate increases.

It's almost impossible for somebody who buys one of these at age 64 and then gets popped with rate increases starting at age 72 to do anything other than drop that policy or continue to pay those higher premiums. They can't go down the street, in all likelihood, and qualify with another company because their health has deteriorated, and/or their age is significantly greater so the premium is going to be higher. What we do is lock people in. I want to give you two or three examples.

You know about the one that was just referred to where the premiums went up so greatly. Glenn Pomeroy, who's currently the Commissioner of Insurance in North Dakota, and I visited with probably 2 or 3-dozen friends and relatives of people who had that coverage and were facing $7,000 premiums. The conversation was the same time and time again. That is, Aunt Nellie or Uncle Bob is now 82, 89, or 92 and do I pay $7,000 to continue this coverage? There is no answer to that question. If we get into a situation where we have significant rate increases, there's no way out for the consumer.

You heard the keynote speaker Terry Savage talk about the fact that the expectation of LTCI consumers is that there will not be a rate increase. I was talking with my mother a couple years ago, who's now 82, in an assisted-living facility and doing very well, thank you very much, and she said, "You know, we bought a policy several years ago." I said, "Oh, is that right? Well, what company is it with?" And she told me. I said, "Well, you're still paying the premium." "No." "Why not?" "Oh, they raised the premiums. And you know if they raised the premium once, they'll just keep doing that." I think that's the attitude that many consumers have in this country.

The other thing that we have to deal with is the way this product is marketed. There's not an agent in this country who's going to tell people when he or she is trying to convince somebody to buy LTCI that the premium's going to go up. There's not one.

We tried to adopt contingent benefit on lapse in North Dakota a couple of years ago. The agent groups came to us en masse and said, "We cannot do that." The rationale was if we do that and we include that in the outline of coverage, then

we're going to have to talk to consumers about the fact the premium's going to go up, and they refuse to do that. The reality is with LTCI the consumer's expectation is going to be that the premiums do not go up. That's their expectation.

What I'm strongly suggesting, and have been for years, is that we, as the LTCI industry, need to make the paradigm shift to what I call a non-cancelable mentality. I'm not suggesting that we offer non-cancelable LTCI. Clearly that is not appropriate. We need to sit down and have a good hard long talk with any actuary who wants to do that. But that doesn't preclude us from having a non-cancelable mentality. That doesn't preclude us from making sure that if we're going to err, we err on the side of conservatism when we develop the initial premium. That doesn't keep us from making sure that the benefits are tight. That doesn't keep us from having strong underwriting and appropriate claims adjudication. That's the kind of mentality that I'm talking about. What we're doing at the NAIC is we're changing how initial and renewal premium rates are going to be determined for LTCI to encourage companies to make this paradigm shift. That's what it's all about.

Since most people in the room raised their hand when they indicated that they'd been following this, I'm sure you're aware of the inner workings and hidden mechanisms. But basically what we're doing is eliminating the concept of fixed-loss ratio. Fixed-loss ratio puts a cap on the initial premium. If the actuary, in his or her certification, is abiding by our standards of practice, then he or she is not going to want to certify that a given premium meets a 60% loss ratio, if indeed it doesn't. If you're performing actuarial science appropriately, a fixed-loss ratio puts a cap on the initial premium. If we're going to make sure that we err on the side of adequacy with regard to premium rates, then we need to eliminate the cap.

This redo of the regulation does that. It eliminates fixed-loss ratio in the initial filing. An actuarial memorandum is required; assumptions are required. But basically there's not a loss ratio required in the initial filing. You get a policy form approved, you get the rates approved, and you start selling it. And if you never need a rate increase, we never talk to you. If you return 30 cents on the dollar, I don't care. In fact, that would be my preference, rather than having rate increases.

I presented this talk to AARP volunteers a few weeks ago; Van had me come to Chicago. And at this point in the presentation there was a young man in the back of the room who said, "Wait a minute. Doesn't that mean the premiums are going to go through the roof?" I said, "Well, if we had three companies selling LTCI in this country and that's all, then I think we might run the risk of that being the case." But at this point in time, at least, we have a tremendously competitive marketplace.

To me the problem is not that premiums are too large, but I continue to see premiums going down. I continue to see benefits getting richer. I continue to see whistles and bells. I continue to see more aggressive marketing material. All of this is going to lead to higher claims and higher probability of rate increases in the future, so we should eliminate the initial loss-ratio requirement.

Then if you do need a rate increase, you're put through a buzz saw. If you do need a rate increase, then you have to show that lifetime claims versus lifetime premium at the initial level return 58 cents on that initial premium and return 85 cents on any increased premium.

Basically what we're saying is we're going to try to provide as much encouragement as we can for you to get the initial premium adequate and not have to have rate increases. The expense load and renewal for any increased premium is going to be 15%. That's the essence of the change in the model.

We have some other concepts. We've included a concept of exceptional increases. If it turns out that because of state laws or extraordinary activity in the claims area that's pervasive throughout the industry, there's a different expense margin. Instead of 85%, it's 70% for increased premiums that come from these outside influences.

Let me talk for just a few minutes about where the model is and what to expect. I really would like to echo what Bart said. I would be delighted to hear your comments about this paradigm shift. Either here, or send me a letter, an e-mail, or call me. This is something that all four of us up here have been working on since the early 1990s.

We had a whole series of meetings in Tampa, Florida in the early 1990s, trying to come to grips with this concept. The NAIC meets in Orlando in a couple of weeks. I anticipate right now that several groups will adopt this model regulation. And, specifically, I anticipate that it will get to what's called the B Committee, which is the health insurance committee of the NAIC, and that it will reside there for the next three months and be adopted by the NAIC, i.e., the commissioners at the September meeting. Then it will be available.

I can tell you that in Kansas we're going to start adoption of this just as soon as we can. We understand that California is continuing their development of legislation. I think there're going to be other states that are going to look at adopting this.

I would ask you, what's going to be the effective date of this new regulation? Now basically what the industry's proposing is that there be 12 months from the effective date of the regulation. I proposed that there be one month from the effective date of the regulation. Clearly one month is not long enough. At this point, we are loosely sitting on six months following the adoption of the regulation. I don't know how that's going to play out. That has not been resolved.

But I would invite you to consider the following: If you're a responsible company, if you're interested in providing stability of premiums over time for your consumers, then why not adopt this voluntarily? Why not go to the states where you do business, and if you have any trouble call me? I'll go to them for you and say, "I'm going to start using this. I want to use this reg."

Mr. William C. Weller: I guess I should make the normal disclosure that the views I'm going to give you are primarily my own, and are not necessarily those of my employer or the members of HIAA.

I think of this in terms of a fairly extended process that probably started back in 1991 when the NAIC asked Bart to form an actuarial group to look at nonforfeiture values. The issue that the NAIC has been wrestling with is the impact of rate increases, as all the other panelists have mentioned. With no nonforfeiture value and that pre-funding, there is no continuing value upon lapse. The potential costs of a mandatory nonforfeiture value are clearly significant. Those were demonstrated in the two reports that Bart's group prepared.

But one of the things that I think came out of those two groups was a lot of information, including the concept of the shortened benefit period, which was adopted by the NAIC as the mandatory nonforfeiture that was supposed to be in all contracts. The NAIC also adopted a rate stability measure that absolutely limited the amount of rate increases you could have by age over time.

Those two aspects, because of the cost of the first, the nonforfeiture, and the heightened risk to the product, were strongly opposed by industry. That opposition was unsuccessful at the NAIC, and they did adopt those as part of the models. But we were successful in our opposition in the states on a general basis.

However, while we were opposing them, we did recognize that there were a number of risks. And I think that we generally felt that they came in three different areas. The first was Washington, DC to the extent to which federal law might use those items that were in the model. When the Health Insurance Portability and Accountability Act was passed, it referred to the 1993 law, which was the last one that did not have those two provisions in it. Getting the federal law to do that required a good bit of effort on the part of the industry. And it was recognized that that was a concern if there were further changes.

The second risk that we had was that a state or some states would actually adopt this and then other states would see that that might happen. One state that actually was putting through a regulation on this was New Mexico. They adopted a regulation that basically said, "You have your choice of either doing a mandatory nonforfeiture benefit, or you have to meet the rate stability rules." The industry asked them to defer the effective date of that while we work with developing an alternative.

And the third the industry recognized was that if there were more rate increases and they received more visibility, it would be much more difficult to argue to the states that the language that was in the NAIC model was not needed, as opposed to the right answer.

We had a wonderful opportunity with Glenn Pomeroy and Tom Foley. Glenn, as chair of the Senior Issues Committee, and Tom, in the LHATF, really wanted to deal with the problem of initial rate filings. They wanted to focus on that, as opposed to

punitive regulation at the end, without recognizing that part of the risk was at the front. They were willing to seek alternatives to the existing model. The industry was happy to work with them.

The first step was the contingent benefit on lapse. We won't go through that, but clearly that provides protection for the person who has a substantial increase so they don't lose all of their funding. It was recognized that while it might encourage companies to avoid having high rate increases, what we really needed to do was to focus on the initial rate.

Certainly the expectations are that the initial rate is going to be adequate, and that it would include margins to avoid the need for rate increases. What we've tried to do within this model, as I perceive it, is to make an economic value change to the company so that the value of having an adequate initial premium is substantially greater than having a slightly more competitive premium and then trying to get your profits through rate increases. The dual-loss ratio, I think, goes a long way to do that. One option is if you never raise the rates, you never have to deal with the administrators or the regulators. The other option is if you want to be a little bit more competitive, you're more likely to file for rate increases if you need them; then you run into the buzz saw that Tom talked about.

There is a significantly higher reliance upon the actuary. We're going to be talking about that afterwards, because you as the actuaries are going to be doing this.

What is the buzz saw going to be like? When you file the rate increase you're going to be subject now to a loss-ratio test. You weren't at the initial filing, but you would be at the time of a rate increase. You're also going to be subject then to monitoring the assumptions that went into that rate increase over a period of time, which can be fairly extensive unless your actual experience is very close to what you projected. The minimum is three years that you would have to talk to regulators. Presumably this could be regulators in 50 states. More likely it's probably going to be regulators in 10 to 15 states.

If you can't justify your emerging experience close to actual, then the commissioner has the right to require you to reduce your premiums or make other modifications so that the policyholders are assured of getting the 58-85% loss ratio. That's considerable administrative difficulty on your part.

If the rate increase is a little bit higher, then there is the potential that the commissioner would look at your operational plans, administration of claims, and underwriting and get you to make some changes in your processing so that you would not have to have rate increases in the future or to reduce the size of the rate increase that you're filing for.

We go to the next level. This one requires a few more things to happen, but clearly the example in North Dakota that we've been talking about is an example of the kind of thing where there is a rate spiral. There are excessive adverse lapses, which lead to additional rate increases. There is a protection for the policyholder in that

the company has to offer another product of a similar type, and you can move those people into a more stable product, presumably a larger pool, although this is not pooling of experience. You are moving a smaller block of people presumably into another product. The model has limitations on the rate increases that you can make to that new product.

We also have the final aspect of the buzz saw when they turn your electricity off. Essentially this is a death penalty in that you would not be able to market for a period of five years. There the buzz saw gets pretty significant.

It gets even worse if you are trying to catch up with rate increases, where increases come on a fairly regular basis. For some types of products, the company may try to get a rate increase on a regular basis, but the regulator doesn't give you all of the rate increase. You say, "Fine, I'll take what I can." One tries to come back later and get a larger rate increase, and you start getting into larger and larger increases. That's not going to work in LTCI. We have to get the rate increase we want the first time, if we have to. But far better is to get the right rate initially.

In closing, I'd like to mention a little bit about the process here, because I think it was a good process. I think the use of a subteam that included regulators, consumer representatives, and industry people worked very well in addressing issues. We got them on the table; we were able to talk about them. It was possible for industry people to draft language that tried to address them. I would also note in closing that it's my belief that we would not be as far along as we are without both Tom Foley and the California senator who was mentioned earlier. We do, as industry, tend to work faster when we're under pressure.

Mr. Ellet: I'd like to just give a few of our impressions of what's been done so far. We really appreciate the process as well, and a lot of the cooperation and discussion that's gone on. I think it's been useful for all of us involved. We're glad it's gotten to this point, and we're going to work hard to get this adopted and implemented. But we have concerns.

One, is this really a buzz saw? We know kind of reluctantly that the current system doesn't work. The potential for having big problems down the road is there. Something needs to be done. But LTCI in general is still kind of an experiment built upon the utilization data and what's going to happen 15 to 20 years from now. I think there could be a lot of surprises that could impact premiums. We're really in the middle of one experiment, and we're going to layer another one on top of it.

Will these incentives do what they're intended to do? Certainly we've had to rely on the people sitting here at this table to say, "Yes, this has a good likelihood of working." That's a concern. Will it?

Second, the complexity of the model. Initial reaction to regulators I've talked to and some other actuaries say this is a tough change. It's a change in mentality and it's a very complex set of regulations. This is going to take time for people to understand, adopt, and implement, if it's going to be done properly. There's some

concern about how this is all going to be done, given the complexity of what we're dealing with.

Third is the fact that states, as has been alluded to, have not always been right out there in front to implement NAIC regulations, for many reasons, whether it's philosophical differences or whether it's because of the requirements in terms of dollars and manpower. Consumers think they're out there really watching these rates. This is a concern to us, given the current capacity of state insurance departments to adopt and do.

We did a survey last year to look at state departmental capacity to administer and provide the oversight on this product. When you talk about having information for consumers or even providing good oversight of the marketplace, 38 states do not maintain information on the policies sold. In fact, the information on just the most rudimentary oversight statistics about the marketplace was the toughest thing that we could find in trying to get at what states are currently doing on this issue.

Fifteen states currently require the use of an actuary. Thirteen do not require an actuary, but an actuary actually reviews the rates. Four do not require an actuary but will use one if needed. And 16 states do not require an actuary, and no actuary reviews rates. That's pretty scary, at least to me as a consumer.

Again, I think a lot of it has to do with resource requirements, qualifications, and availability of qualified staff around the country to do this. Very few states collect information. They may require, when you file for rate increases, some information about the rate increase histories and premiums of that form, but certainly not about other similar products in other states. They're really getting just a very limited view on what's going on with the particular policy.

Seventeen states don't currently retain policy and rate-filing information for more than four years. Only 12 states collect and maintain data by policy form. Even to try and track the same policies over a number of years in the histories is very difficult right now. Only 18 states are fully computerized and can extract information. I still would have some doubts about how completely they can do that. There are a lot of states that are not necessarily fully computerized and are going to have a heck of a time doing some of what's to be required to be done.

Interestingly enough, at the end of the survey we asked the people in the State Insurance Department about the need for guidelines when related to the actuarial assumptions contained in rate filings. Thirty-five states said there really could be a need for guidelines, given the complexity of the product. And we also asked, "Do you believe there is a need for standards for approving LTCI rates and increases?" Thirty-four states responded "yes." I think states are already feeling this is not an easy one.

We're letting go of the 60% loss ratio, even though we know it didn't work. In fact, based on what Tom says and the experts say, it was really counterproductive. We still have trouble letting go of that. We also have concerns that a very

comprehensive rate filing isn't being required at the front end. We know that the industry doesn't want to do that. But, again, there's a queasiness; it'd be nice to have that in the file cabinet and have somebody take a look at it just to see if everything makes sense. The real lack of any meaningful front-end review is a concern. But if the rest of the incentives work, so be it.

We still have concerns about the whole business about contingent nonforfeiture. How many consumers get hurt in having to meet that contingent nonforfeiture? And in these regulations, to enter the penalty phase 50% of people holding that policy have to be eligible for contingent nonforfeiture before some of the penalties get imposed. We're concerned that that's a high bar. We really won't know until we get down the road about how many people get to that stage. We really don't want consumers to have to get to that extra 30–50% increase in their premiums. If the bar is set that high, there are a lot of people that could have a lot of premium increases before the real penalty kicker comes in.

And last but not least is where we're going in negotiating this thing. With the various concerns and complexities, you have the avowed experts in the industry sitting around the table and really struggling to understand what the terminology means. People who are going to try to implement this need help. They would say, "Well, we won't put this in the regulation. We will put it in a guide, an interpretive guide, for those of you sitting in the room right now and regulators who are going to implement this." We took things off the table. We didn't address issues. We didn't put drafting notes in the regulation, saying that it was going to be in this interpretive guide. We have a big concern about this regulation going forward and getting out the door without an adequate interpretive guide. We think it's going to be necessary.

Those are basically our concerns. We think some wonderful work has been done. We think a lot of progress has been made. We're very hopeful that this is all going to work. We're going to be glad to work with Tom and the industry anyway we can to help get this adopted and put in place.

Mr. Munson: I'll just take a quick couple minutes to talk about the actuarial implications of this.

At the annual meeting of the SOA this October in Chicago, there will be a session on the professionalism of the actuary in filings of LTCI. That's really, in a sense, a follow-up to this, and we'll be talking about what the regulation does say and what it means for us. I would just refer you to a couple Standards of Practice (SOPs). One is the filing one in general for health insurance. The other comes from our LTCI standard, *ASOP No. 18*. Some of you in the audience were on the task force, and we worked hard on that standard. I think it's gotten more attention lately, and for that I'm very happy. It's going to get a lot more attention if this regulation passes.

I was asked to write a memo to the NAIC about this subject. I think there are some things in this regulation that actuaries need to read very carefully and take to heart. If you do, it's going to change your LTCI actuarial life. How, I don't know,

and you don't either yet. But there are actuarial certifications required in the new regulation. The actuary must certify that this initial filing will take care of the needed premiums and there are not intended rate increases. On the rate increase filing the actuary has to certify more, indicating that the increase will take care of everything. And the actuary must certify to the assumptions and the things that the actuary has done for that filing. That's new. I think, as Tom alluded to earlier, we need to take to heart and take seriously, of course, our obligations as a profession and follow our SOPs.

There are slippery words in the model regulation. I suggest that some lawyers ought to look at it and maybe give us some opinion about that. But words like "moderately adverse experience" need to be understood, as do "reasonably expected," and "moderately adverse conditions." Read those carefully and see what you're certifying to for LTCI. And it's not, in my opinion, an easy thing to certify to.

I'll just say one other comment. In doing the SOP, there was nothing we spent as much time on as a couple paragraphs that finally got in there about no hidden rate increases. Our actual Standards of Practice Task Force of the Actuarial Standards Board (ASB) worked long and hard to get words the AAA lawyer would approve, and would do what we thought needed to be done in the standard. It was very hard to articulate what we meant to ourselves as a profession to say we aren't going to have hidden rate increases in there. We couldn't use those exact words, but that's what we meant.

My memo had also identified the fact that the Actual Board for Counseling and Discipline (ABCD) has never had a question brought to their attention about LTCI. As we did the SOP, we confirmed that there's never been a question raised about LTCI to the ABCD. Regulators can raise questions, for private consultation; there's no condemnation or presumption of any guilt or wrongness. But they're there for advice. I think some of that practice, or lack thereof, is going to change. We're not trying to make it change, but I'm happy that there is an ASB and an ABCD as we consider this new regulation.

Join us in the fall if you're going to go to the annual meeting and let's talk more about this subject.

Mr. Foley: I'm delighted that I went after Van went the second time, because the compliance manual that he's talking about is something that I proposed six or eight months ago, and that I have the responsibility of developing. I want to publicly tell Van, right here in front of God and all you wonderful people, that by September it will be completed. That's number one.

Number two, I want to let you know about something and suggest that you think about this. The ACLI came to the commissioners in February in their annual retreat and basically blackmailed the NAIC and said that what we're going to do, since it takes so long to get life and annuity filings approved in a 50-state basis, is go to the federal government and try to get a federal charter, unless the NAIC comes

through and develops a much quicker way that companies can get products approved. I don't know how many of you are aware of that process, but the NAIC now has several high-level committees working on financial modernization, and one of those is called "Speed To Market."

There was a lengthy meeting in Kansas City last week. There will be more meetings in Orlando in a couple of weeks. And this "Speed To Market" business for life and annuity filings is going to go very quickly. I think what's going to come out of it is there's going to be some kind of central body (whether it's NAIC-sponsored or independent or private or nonprofit or whatever, I don't know) that a company will be able to send filings to, and then there'll be a certain number of states—maybe 50, maybe 30—that will automatically accept approval of that.

At this point in time, it's the sense that health insurance is very much a local activity; therefore, there's not this movement toward "Speed To Market." I would posit, and I've not heard this from anybody, that LTCI may be somewhere between health insurance, being a local activity, and life insurance and annuities. Maybe we need "Speed To Market" for LTCI. That may work very well in conjunction with this redo. That may take care of a lot of the concerns that Van has expressed, and a lot of different kinds of concerns that I'm sure Bill would express on your part.

Mr. Martin McBirney: I have a couple questions and an observation that I would like to throw out and have any of you comment on. The first one is to Tom Foley, in particular. How will the voluntary compliance play out at the state level for a company to voluntarily file on the relieved initial loss ratio with a stepped-up requirement? And how would the states enable such a filing, given that they have regulations on the books that do require 60% initial loss ratio? It seems like it puts them in a bind.

Second, I'd like any of you to comment on the implications to the state guarantee fund of the progressive buzz-saw mechanism, since it's directed at maverick carriers in our industry. Clearly it will put pressure on that mechanism, and I wonder if you could comment on that.

And last, as someone who works for a marketer, it's pretty obvious how companies will respond with regard to the first step up in loss-ratio level on initial rate increase, and that is that you just decommission rate increases. The clear way you relieve the expense-associated pressure from going from a 58–60% loss ratio or whatever standard up into 80–85% loss ratio is you just don't pay the agent on the rate increase. I don't really have an opinion on that one way or the other, but I do think that what's going to happen is, again, the maverick carriers in this marketplace will play their cards smartly with regard to the distribution, since that's whom they compete for. They're not competing for customers. They compete for distributors, since distribution governs this market today. And they're going to redo the high-low bit.

Agents are going to figure out that they're not going to get commissions on the 25% rate increase that they were going to get on renewal income, so they're going

to put pressure on commission sales to have them elevated in the first year and depressed in the subsequent years. I think you're also going to see pressure on lapse rates as everyone tries to figure out how they're going to make the same amount of money under the new rules as the old rules. I just wonder if I could maybe solicit some comments on that.

Mr. Foley: First of all, your last question. Hopefully what this will do is get the agent community in sync with the company to try to get the initial premium adequate and not deficient. Because if we're going to pay full first-year commission on the initial premium, then I would hope that the agents would want a larger premium rather than a smaller premium. That's part of the motivation.

You ask about voluntary adoption of this. What I hope is that companies will want to do this. They will go to the regulators in their domicile states or their states and get them to adopt it. I agree with you. Given the current state of the regulations, it's going to be close to impossible that you can get it approved in a given state. Although I can tell you in Kansas if somebody comes to me tomorrow, I'd certainly try to find some way to do it.

I'm hopeful that what this will do in the long run is require less guarantee fund activity because we're going to have more adequate premiums initially, and as we go, so it should remove pressure.

Mr. Weller: I think that on the solvency issue there are a couple of things. One, I think it's unlikely that a single rate increase is likely to, by itself, create a solvency problem. It will be able to go through if we have good initial rates and something does happen so that there is an absolute need for an increase. The company is monitored, and we are assured that the policyholder is getting the initial 58% and renewal 85% loss ratios.

With regard to the commissions, I think that that is something that each company and its marketing people need to deal with. It was specifically not addressed within this model change. The model limits are going to be available to the company on rate increases. And in some situations the marketing arms will be strong enough that some commission will be paid on rate increases. In other situations, there won't be any. But it's certainly going to change the way in which a company looks at how aggressive to be in assumptions in order to generate a premium that is competitive. And that's the aim of this.

Hopefully we don’t have the agent for us saying the important thing is to have a really competitive initial premium, and if it turns out that you need to increase rates, then go ahead and increase rates. We have to have the agents on our side and agreeing that they don't want it. And if the reason is that they have a whole lot of problems dealing with rate increases and no commissions, then it seems to me that they're going to want to make sure they get a commission on an initial rate that never changes.

Let me talk a little bit, if I can, about the effective date issue and why the industry suggested that 12 months are needed. I would still suggest that 12 months are needed, as opposed to 6 months. There are a number of things that we can expect to happen. When this is adopted in a state, we would expect that the contingent benefit on lapse would be adopted at the same time. Very few states have adopted contingent benefit on lapse to date.

Some companies may decide that given this new rule they want to change their policy form and include more margins so that there is less likelihood of a rate increase in the future. They felt that they were unable to do that, given the 60% loss ratio that they're currently operating under. Some may want to include language in the policy with regard to contingent benefit on lapse. Although that's not required, some companies may wish to do that. There is a filing issue.

There are also marketing changes that need to be made to the materials. We haven't really spent a lot of time on that here, but there are new disclosure requirements that will be coming along with this. Those are going to require changes to marketing materials. You're going to have the approval time of that. While we would love to suggest that once you get it approved in one state, through "Speed To Market" or the desire of the regulators for consistency it's approved, but we all know the reality is that what you file in one state, another state will say I want you to change some of it. You're going to have a filing time getting things approved in states.

Once you have that done, you're going to have to train the agents or your marketing force in how to use those new marketing materials and make the appropriate disclosures, because they are complicated with regard to your rate increase history. I don't see the time frame necessarily being something that can be shortened to six months, and certainly not one month. But that's my own opinion, and we'll continue to talk about it.

I think that contingent benefit on lapse could have been done on a voluntary basis, and I think a few companies have done that. I would applaud them. I think that voluntarily tends to come about when you're making a change to your policy form in several states and you want to make it consistent across all states. The important thing is if the NAIC wants to have this done, get as many states quickly and then the companies will operate that way in the other states, as long as they can legally.

Mr. Michael S. Abroe: I have about three or four scenarios that I'd like to present to the panel to get a sense of the impact of the proposed model regulation. They're some of the obvious ones that a lot of us looking at risks are thinking about.

Examples would be NAIC changes, risk-based capital requirements, changes in valuation requirements, codification, issues that change the financial liabilities so a company doesn't have to put up and have an impact on cash flows. Purchased or acquired blocks of business. How would that be treated under the model law?

How would the major changes in tax code, back taxes, and federal income tax changes be reflected?

The last one is probably the most important one. As all of us are aware, there are significant changes in lapse rates for a lot of LTCI products that are in the market today. Many of those products have not been priced with the lower lapse rates that a lot of companies are currently experiencing. How does the model handle that? Would that be through exceptional rate increases? Would that be a risk the company would be required to bear on an ongoing basis? Or do you see some means through which companies would be able to file for rate increases under some of those circumstances?

Mr. Foley: Yes, I think the short answer is those fall under exceptional rate increases. In fact, that's the reason why we put that concept in the model.

Mr. Weller: I think that you're not precluded. If you look at the entire model in the disclosures, one of the things required is reporting the history of your rate increases. Whether you had an exceptional increase that occurred because of a unique situation, there are going to be some companies that say, "We're going to eat this cash-flow timing difference." You're going to be competing with companies that say they've not had a rate increase at this point in time. I suspect that your agent force is going to say to your company, "Didn't you put some margins in there so you don't have to apply for a rate increase?" The rate increase is there if it's needed. The aim of the model is to make companies not want to do them.

Mr. Foley: Let me add that I've made presentations about this concept to agent groups throughout Kansas and actually throughout the country. What the agents tell me is they don't want to be associated with companies that are going to have rate increases in renewal years. That just fouls up their pension plan that they're trying to set up for themselves in terms of renewals and requires them to do all kinds of additional work.

The strong input that they give me (and, again, I'm not naïve enough to think that they might not be telling you a different story) is that they want to make sure that premiums are adequate. As Bill indicated, we considered, and in fact it was a proposal from the industry, to put in the model that commissions could not be paid on increases. We didn't put that in the model to give companies more flexibility, but it's my sense, the way it's designed, that few companies will do that.

Mr. Bruce A. Stahl: I'm wondering if you considered allowing for rate increases on new business only, which would go along with the non-cancelable concept. There are a number of states that will not allow that at this point.

Mr. Foley: My experience on that is mixed. We could talk for half a day about that very concept. Assume we have a block that's getting somewhat sick and the company wants a halfway measure, which is they're going to increase premiums for new business only. I'm willing to do that, as long as there's no in-force in the state. We do that occasionally. I might have even approved one or two situations.

We did not consider doing that in this particular model. In fact, I don't know that that ever came to our attention.

Mr. Weller: Yes. When you file a set of rates, No. 4 in the actuarial certification, the premium rates are to be not less than the rates for existing similar policy forms. The idea is that you can file a new higher new business rate and it follows exactly the same rules. The certification is all you have to file. There's no loss-ratio justification. There's no review of the existing policies, as long as you're not increasing the rates on the in-force. That's how I read it.