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Long-Term-Care Regulatory Developments

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Summary: With the creation of "qualified" long-term-care plans behind us, companies now have additional information regarding interpretations from the Treasury Department, regulations and directives from insurance departments, and feedback from the consumer. This session looks at what we have learned in the past two years and what state and federal regulatory changes may be on the horizon.

Mr. Darrell D. Spell: Let me introduce to you our two speakers today. Sam Morgante is a government relations manager with GE Financial Insurance in Washington DC. He will ell us about what's going on with the regulatory side. We also have with us Tom Foley, who is with the state of Kansas insurance department.

Mr. Sam Morgante: Let me talk a little bit about my background in long-term-care (LTC) insurance. In addition to the fact that I work for GE Financial Assurance and I'm a government relations person as opposed to an actuary, I chair the Health Insurance Association of America's (HIAA) LTC Committee. I serve on the ACLI LTC insurance committee, and I'm on various other boards such as the New York Partnership for Long-Term Care. Prior to going to Washington for GE, I worked in California with GE's LTC insurance business where I was responsible for the government relations, the compliance functions, and other areas like product development. I'm bringing a wide range of experience to the table.
For those of us who have done LTC and LTC alone for the better part of the 1990s, it's gratifying to see the kind of interest that we have here, as well as in the sessions that were done yesterday on LTC insurance.

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I'm going to talk about three topics. I'm going to give you an update on the Health Insurance Portability and Accountability Act (HIPAA) of 1996. I'm going to talk about some of the recent developments in Washington, and I'm also going to do a little bit of discussion on state and NAIC issues before I defer to Mr. Foley, who will do a lot of discussion on state and NAIC issues.

Let's start with HIPAA. Now, what was HIPAA? What did it do for LTC insurance? Very simply, HIPAA created a category known as tax-qualified LTC insurance. But, what HIPAA did for the insurance industry was far more important than merely creating tax-qualified LTC insurance. What HIPAA did was to send a message that people need to plan for their LTC insurance needs. The most important thing that it did for our company's business, and for the businesses of the other companies in this industry, was that prior to the passage of HIPAA, going back to 1992 and the presidential campaign, there had been some confusion as to what the federal government was going to do about LTC.

It had been raised as an issue, as it continues to be, that the Clinton people had stated that there would be an LTC program. They weren't clear on what that meant, but certainly a lot of people read that to mean that they wouldn't have to think about their LTC needs. HIPAA put an end to that discussion. By creating tax clarification in 1996, what HIPAA did was to create an atmosphere that said, "This is what the federal government is going to do about LTC, and you need to begin to plan."

Let's talk about how HIPAA did that and the two things that it did in terms of tax clarification. Some people think that HIPAA provided an incentive for sales for LTC and incentives for people to actually buy LTC. That really isn't true if you look at the impact on the marketplace and the impact to the consumers. What HIPAA did was to create some tax deductions, such as Internal Revenue Code (IRC) Sections 213(d)(1)(D) and 7702B(a)(2), that weren't quite a huge tax incentive.

When we talk about the deductions for LTC insurance, what it means is that the premiums are tax-deductible, the same way that medical care expenses are, subject to certain limits, tiered by ages and those limits. The dollar amounts increase every year because of inflation, and they're subject to 7.5% of adjusted gross income (AGI). In most cases unless, first, you're itemizing deductions, and second, your medical care expenses are 7.5% of your AGI, the HIPAA incentives aren't very significant. Most people don't end up using them.

The second thing that HIPAA did was make clear that LTC insurance was a category of insurance, and that the benefits from the policies were tax-deductible. There was a question prior to this time and prior to the passage of HIPAA as to whether this was a form of disability insurance (DI) and how the benefits from these policies would be treated. What HIPAA said was, "No, LTC isn't life; it isn't health; it's not DI. It is its own form of insurance, so those benefits are nontaxable." A third thing that HIPAA did was to create this other category commonly called nontax-qualified. If you ask what is nontax-qualified, frankly, it's everything that isn't tax-qualified.

Companies do continue to sell those. In California, for instance, we are required to offer for sale an LTC insurance policy that isn't tax-qualified.

Let's talk a little bit about the history of HIPAA and what's happened since then. HIPAA was passed in August 1996 and became effective on January 1, 1997. What happened on January 1, 1997 was that the first tax-qualified LTC insurance policies were permitted for sale. What HIPAA did in terms of amending the IRC was a question of, why would you regulate LTC insurance through the IRC? Well, the federal government doesn't really have any form of insurance law. The tool that the federal government was able to use was the IRC, so it's a question that some people ask.

Why does this fit in the tax code as opposed to fitting somewhere else? There's no place else for it to fit if the federal government wants to create an atmosphere of encouraging people to buy LTC insurance. HIPAA also created some definitions of terms that we hadn't seen before. This led to some questions with the interim guidance and regulations. What HIPAA did was to create a definition of a chronically ill individual; this is a person who is activities-of-daily-living-(ADL) deficient, who is expected to remain ADL-deficient for 90 days or more, or is somebody who is cognitively impaired and could end up being a danger to him- or herself or to others. These were definitions that we hadn't quite seen in either the NAIC model or any of the state regulations that existed. HIPAA threw some definitions out there that needed some interpretation.

By May 1997 we got some of that interpretation from the Treasury Department when they issued interim-guidance regulations. The interim-guidance regulations answered questions and created safe harbors for the transition from nonqualified grandfathered policies that were issued in 1996 prior to the tax-qualified policies. What it did was to help define terms of substantial assistance and severe cognitive impairment. It created an atmosphere where we could understand how grandfathering of group contracts would work, and also created some additional confusion in regards to material changes.

What happens if you wanted to amend a grandfathered contract? The interim guidance said that if you even changed the address on those contracts, it would end up being a nonqualified contract. They went a little bit too far in talking about material changes.

The regulations fixed that. What happened was in December 1997 regulations were proposed and adopted as finalized in December 1998. What the regulations did was to fix some of the things that had been confused in the interim guidance, clarified grandfathering, contained a lot of references to the consumer protections that were in the original law, and referenced the NAIC model through those consumer protections.

As of now, it stands that the regulations that we saw approved and put into effect in December 1998 had very little impact overall in the market. They did not prove to be disruptive. At this point we don't see any further Treasury actions coming

down the line. This was not on the Treasury's work plan for 1999, and prior to coming here I asked some people in the trade associations whether they saw any activity coming from Treasury in the year 2000. Nobody expects at this point to see this on Treasury's work plan. At least for now we see the 1998 regulations standing in place and not a lot of changes coming.

Let's talk about what's happened on a legislative format—in particular, what's going on in Washington today. As I mentioned, HIPAA did not create a huge incentive for people to buy LTC insurance. What is also going on, and this is significant, is up through now the regulatory atmosphere, the NAIC models and what the states have been doing, has been predicated on LTC insurance being a senior insurance product.

This debate is shifting in Washington now. LTC insurance is being included as a financial security issue for the baby boom generation. It's being included with the reforms in Medicare and the efforts to save Social Security. This is a change in regard to how public policy makers look at this product. The issue is, how are we going to sell these people, not how are we going to sell this product to 67-year-olds or 70-year-olds? How are we going to sell this to people who are in their 40s? That's what is going on in terms of prompting legislation at the federal level.

What's going on at the state level is also significant. The states are following on the heels of HIPAA passing state tax incentives. They either mirror the provisions in HIPAA and permit you to take a tax deduction, much like HIPAA does, or they have actually passed tax credits. Those tax credits would apply whether you itemize your deductions or not. At this point we have 20 states that have some form of LTC tax incentives. There were eight of those passed in 1999. We anticipate that there will probably be some more of these coming after the year 2000.

I want to talk a little bit about what is going on in Washington. This year we've seen some significant actions. Going back to January 1999, the president's first public statement in 1999 was about LTC. We from the industry thought it was a good idea to highlight the issue. We've also seen some legislation that was introduced earlier this year by Ohio Representatives Nancy Johnson and David Hobson. Later, as the year progressed, we saw very significant action by the House Ways and Means Committee and the Senate Finance Committee.

I'm going to start with the president's proposal and then we'll talk about what's going on with the other proposals. The president's proposal didn't specifically address LTC insurance other than as an offering of LTC insurance through the federal-employee base. What he did was to create or ask for in his budget proposal a $1,000 tax credit for LTC services. Some of us who look at this and ask, "Well, what can you buy for $1,000? That gives you about $3 a day for adult day care or $3 of home care." Through the trade associations we talked with people in the administration who said, "No, this was a starting ground." This was something they wanted to put on the table, and would work through with the Congress as the year progressed to see how that would transform.

Should that $1,000 be used as a tax deduction? Should that be used in some way to incent the purchases of LTC insurance? Congress moved with this before the president did. Also, in the president's proposal were two other points. There was a National Family Caregiver Support Program and a National LTC Information Campaign, both of which we thought were good ideas. Actually, there was money that was to be spent on the National LTC Campaign. None of this moved. As with every other issue in Washington this year, it has been tied down in partisan politics.

I'm going to talk now about the other legislation. What we saw from Congresswoman Johnson and people like Congressman Hobson was a proposal that created a real incentive to buy LTC insurance. What it did was to take the HIPAA provisions and move them to a top-of-the-line tax deduction tiered by ages not subject to AGI or the 7.5% of AGI. What it did was to take those deductions, depending on what bill you looked at, and to phase them in beginning over a five- or seven-year period. What happened, as I mentioned, was this became a baby-boomer issue.

The other significant thing that happened was that we discovered there was a $1 trillion budget surplus. Now those of us who were in Washington earlier this year looked at this and said this was going to be a tough battle getting LTC insurance moved to the top-of-the-line deduction. As soon as that $1 trillion budget surplus was discovered, we had a vehicle to move this through.

Now, as we know, there was a tax bill that was passed. The tax bill included these LTC provisions, and, along with the top-of-the-line deduction, it also removed some provisions in HIPAA that prohibited LTC premiums from being paid out of flexible spending plans or out of 125(b) plans. That was included in the tax legislation. These provisions were sent to the president in the tax bill and in September; right after being sent to the president, they were vetoed.

Round 2 is the Patient's Bill of Rights, which was passed the week before last in the House. The same LTC provisions that had been included in the tax bill were now in the Patient's Bill of Rights. That remains to be reconciled by both houses of Congress and sent to the president. We'll see what sort of presidential action there will be on that.

Clearly, LTC is a front-burner issue in the Congress, and Congress is looking for a vehicle to get passed. This is very good news for those of us who have been working on this issue. Round 3 will be once the Patient's Bill of Rights is dissected. Whether it is sent to the president or not, vetoed or doesn't become law, or whatever change is there, what we are now looking for as an industry is a vehicle to get these tax incentives into a bill that can be signed into law. The ACLI and the HIAA are working very hard on getting those things included in every piece of spending or every bill that affects the budget that is going through the House and Senate. The strategy here is that this will likely happen, but it won't likely happen in 1999.

I'm going to shift gears and talk about the federal LTC employees plan. This issue has received a lot of attention in Washington from two perspectives: 1) The federal government obviously is a huge employer, is in tune with the public policy debate, and wants to be an employer that offers LTC insurance to its employees, and 2) This is an important issue in Washington and there is a huge base of public employees who want this as a benefit. This has been enjoying bipartisan support. Nobody is opposed to the concept of a federal LTC employees program. However, what we have are Republican issues and Democratic issues. What we have are bills that have been introduced by both parties and both houses, and we have lots of details on this that need to be worked out.

There have been public hearings and discussions on this issue, issues such as: Should this program be guaranteed issue? And if it's guaranteed issue, for whom should it be guaranteed issue? Should it be for employees only who are actively-at-work? Should it be for spouses? There was actually some discussion that retirees should be guaranteed issue. There are questions such as: Should this program be a traditional employer-sponsored group LTC plan? Or should there be a way to use individual contracts? Should the military be included under this program? Should its retirees be included under the program?

One major question that needs to be resolved: Is the format here one in which this whole employer plan will be awarded to one company or will there be multiple offerings? If it's not awarded to one company, will there be permission to use some form of a consortium? Will companies be allowed to ban together to bid on the program and respond to the request for proposal as a group of companies? Much of the details here are questions that either need to be decided in legislation or in regulation to be determined by the Office of Personnel Management (OPM).

This is where the breakdown occurs. The legislation is being moved through a Republican-dominated Congress. The regulation would be run by a Democratic-dominated OPM. They can't seem to agree. We as an industry have looked at this issue and said, "We believe there ought to be a federal LTC program, we believe that program ought to be insurance, and we respect the fact that we're not the decision makers on this. Congress is the employer. The OPM is the employer. They need to decide how the program works, and we will play by the rules that they set up." We're there as an industry and as a resource. We're there to answer questions, but the ultimate decisions need to be made by that employer.

Where this stands at this point is that hearings have been held and lots of meetings with congressional staffs and the OPM have taken place, yet no action has gone forward by the end of the year in either the House or the Senate. Should we pursue a House strategy or a Senate strategy? Is there a different issue there? The issue is basically the same whether you go through the House or the Senate. If the political differences aren't decided in the course of the year 2000 Congress, what we're likely to see is the shoes on the other feet. The speculation is that we'll have a Republican president, a Republican OPM, and a Democratic Congress. The issues are going to have to be decided by the politicians here.

The last area that I want to talk about is on some of the state issues and some of the NAIC issues. As I previously mentioned, one of the main issues that we've seen with the states this year has been creating incentives for people to purchase LTC insurance via the state tax codes. The second area, and of far more significance I'm sure to the people in this room, is the issue of rates. This is an issue that has popped up on the agenda of the state regulators and state legislators, and it's an issue that the NAIC is very much involved in. I'm setting the stage for Mr. Foley's discussion.

One of the things that we saw in the course of this last year was a major piece of legislation in California, which was Senate Bill 898. This bill started out as a reaction to some consumer complaints that had been given to a California state senator. The California state senator looked at this and said, "I know how to solve this problem—by making all LTC insurance policies noncancelable." He put in a bill that moved through the state Senate and looked like it was going to pass as a noncancelable-only bill, that all LTC insurance policies would be sold only on a noncancelable basis. There was a lot of discussion and controversy. The bill was amended by the sponsor to remove the requirement on noncancelable policy and set up a mechanism for state rate approvals.

Again, I just want to touch on the role of the actuarial community. What we found in California, and those of us who were at the NAIC meeting in Atlanta a couple of weeks ago, is that the American Association of Retired Persons did a presentation on a study that it is conducting on state rate approvals. And for those who have never been involved in a state rate filing for a company filing in 50 states, it came as a surprise that about one-third of the states do not have any actuarial rate approvals on either initial filings or rate increases. California is one of those states.

For those of us who have been involved in the filing process, this was no surprise. We knew that there were states that had very significant and stringent rate reviews, and we knew that there were states that had file and use. But now we have people focused on the fact that it's inconsistent across the board. We had a discussion on how there should be certification on rates. Should this, for example, be by independent actuarial consultants? Should this be by actuaries who are retained or actually work for the state insurance department?

We know the funding issues and the staffing issues within the state insurance department, so it's unlikely that all states are going to hire actuaries. In a proposal that my own company put on the table in response to the California bill, we asked that there should be some form of actuarial certification of rates, and if the California department in our version of the legislation wasn't able to provide those certifications, then it should retain outside consultants to do so. That is an issue that, I'm sure, involves the community that's represented in this room.

Mr. Thomas C. Foley: I define rate stability as maximizing the probability that LTC policies will never have a rate increase. Because LTC is primarily purchased by people in their 60s and early 70s with several years elapsing before significant

claims develop, rate stability is critical for this product. Otherwise, we run the risk of premium being collected without coverage being provided.

As an example of what can happen, please consider a collection of policies sold in the 1980s. These were nursing home policies that were later sold to another company. The second company secured rate increases such that the average premium from 1989 to 1997 went from $900 a year to $7,000 a year.

As stated above, if we design policies and price and monitor them and do everything involved with LTC insurance and have people pay premiums for ten years or more and say, "Whoops, we missed," and then start dramatically increasing premiums, as we've seen in some blocks of business, to me that's not an appropriate way to go about doing our business. What we need to be focusing on is how we can maximize the probability that an LTC block is never going to have a rate increase. Again, that's my definition of rate stability. Never, ever have a rate increase. My experience says that once a company starts down that path of having a rate increase, it's difficult to stop having more increases. We're seeing examples of that.

What I've been doing is trying to raise the issue, both at the state level and with the NAIC, of what we can do to maximize the probability that we're going to have stability of premiums. Now, you might ask, what evidence do we have that rate stability is even possible? If you look at the dramatic changes that have taken place in what we call LTC insurance from the early 1980s to the present and just conjecture about what is going to happen in the next 10 or 15 years, how in the world can we do that? As evidence, there are companies that have been selling LTC insurance for 20 to 30 years that have never had a rate increase, show no indication of ever needing a rate increase, and by all appearances are providing appropriate return to policyholders in the form of benefits. It is possible to do this.

We also have other examples of companies that appear to take the strategy that they don't care whether they have rate increases or not. What I want to do is to discuss some ideas that are on the table at the NAIC relative to rate stability of LTC insurance.

The companies that exhibit rate stability I label as having a noncancelable mentality (NCM). At the other extreme are companies that appear to focus primarily on securing market share. We call them beat-the-market mentality (BMM) companies.
I've been asked if we are trying to keep BMM companies from selling LTC insurance. What we are trying to do is to force companies to determine where they are in this spectrum from NCM to BMM, and that consumers also know the position of each company. If somebody wants to buy from a BMM company, that's OK as long as they understand the consequences. But now there is a great push by agents and consumers to get information about which companies are in which camps.

Rate stability involves much more than the initial premium. Here is a list of items that must be considered:

- Benefit structure
- Policy design
- Initial premium
- Marketing
- Field- and home-office underwriting
- Claim adjudication
- Monitoring of experience
- Ongoing consumer education

An NCM company is going to maximize attention in each of these areas. Each of these is vital if a company is to provide appropriate benefits for insureds over the long term.

NAIC activities have focused in several areas with continued discussion:

- Contingent benefit on lapse: If an insured is subject to a triggering rate increase percentage (for example, 50% at issue age 65), then a shortened benefit nonforfeiture value equal to the total premiums paid to date must be offered. The intent is to force companies towards the NCM approach so that they will not trigger the threshold increase amounts.
- Eliminating fixed loss ratios: The initial filing will not contain a loss-ratio standard. If a rate increase is needed, then it will be judged based on returning at least 60% on the initial premium level and 85% on any increased premium. This encourages companies to make sure that the initial premiums will be adequate so that they will not need an increase.
- Purchase blocks of business: Any LTC business that is purchased will have to maintain the current premium level for at least five years. This discourages companies from using the BMM approach and then getting rid of blocks that need increases.
- Rate stabilization reserve: Companies will be encouraged and/or required to set up a special reserve fund from each premium's dollar that can be used to offset any needed rate increase.
- Eliminate attained age rating: There will be discussions about only allowing issue age premiums, which is what almost all companies do now; however, attained age is allowed in some states.
- Guaranteed renewable vs. guaranteed value: Guaranteed renewable means that contract benefits cannot be changed. With the significant changes in care that have taken place in the last 20 years and changes anticipated for the future, do we need to develop a concept that states that the same relative value of benefits will be provided in the future rather than the same absolute value? This is a very controversial issue that has a long way to go just to define it. There are those who wonder if we will be able to provide contract benefits in the future as caregiving continues to change.

Mr. Glenn A. Tobelman: Tom, this is directed to you. Granted, there are some obvious differences in the claim cost slope between LTC and Medigap or Medicare Supplement insurance. But the senior market has bought Medicare Supplement

insurance and they've lived with rate increases that have been applied on issue-age-rated products. What is there about LTC coverage that you see as being materially different from Medicare Supplement insurance?

Mr. Foley: That's an excellent question. First of all, I don't like rate increases on Medicare Supplement insurance either. There's another NAIC working group that's been working on Medicare Supplement insurance and trying to bring some kind of stability to it. The problems are different in that medical expense inflation works on Medicare Supplement policies from day one. I know of no carrier that has not had increases on Medicare Supplement. But there are many that have never had an increase on LTC.

From the Floor: Two questions for Tom and Sam to share. One, I'd like a brief comment on life-annuity-plus products and what you see in the metamorphosis of these products. Second, what is proper discrimination in terms of rates, financial underwriting as well as health? What would be acceptable in the public domain and what would be acceptable to the insurance commissioner?

Mr. Foley: The initial products that I've seen, the life-annuity-plus LTC products, include an inferior annuity product and an inferior LTC product that are put together. I'd much rather, based on early products that I've seen, have consumers buy the products individually. One product had an advertising piece that stated if you buy health LTC insurance and pay on it for ten years and stop paying, you'll have nothing. Well, whatever happened to the concept of coverage? We pay premiums to get coverage. Isn't that what insurance is all about? The implication was that if I pay on this for ten years and don't go on claim, this is really a bad deal. It's a bad deal that I didn't have to go into a nursing home.

Mr. Morgante: Let me start with the latter topic, discrimination issue, from a legislative perspective. This issue ties in with the debate that's going on with things such as privacy and genetic testing. This is an issue where what we're seeing, and it's kind of scary to us in the regulatory side, is a potential for federal legislation that isn't necessarily preemptive of the states. We could end up here with 51 different jurisdictions and 51 different sets of regulations on these types of issues. We have the federal regulation that's moving along with HR-10, the financial reform legislation. There is likely to be additional legislation on privacy issues, and we have states taking action on those as well.

In regard to the other issue of tying LTC with other products, the main question is that LTC is moving in the direction of tax-qualified policies almost exclusively. The tax legislation and the federal employees LTC program are both tied to making those programs tax-qualified policies. As long as these LTC products evolve in a tax-qualified environment, if you meet the criteria for paying benefits based on a chronically ill individual, benefits are paid for tax-qualified LTC services.

That's the direction I see these products heading. And the other part of that is that they have enormous appeal to people who are in the baby boom generation. For those of us who are in our 40s we ask, "Does the current form of LTC insurance as

a health-based product necessarily make sense?" LTC may make more sense if it's tied to a current insurance need that we have, such as disability or life.