Long-Term Care

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Actuarial Certification: A Reason for Pondering

by Bartley L. Munson

Background

Bartley Munson, FSA, MAAA, chaired the Long-Term Care Insurance (LTCI) Task Force of the Actuarial Standards Board (ASB) during the creation and eventual adoption, in 1991, of Actuarial Standards of Practice (ASOP) No. 18 by the ASB. It was substantially revised and re-adopted in January 1999. The statements made here are strictly his and do not necessarily represent the ASB.

Two Relevant Documents

There is reason for actuaries pricing long-term care insurance (LTCI) to pause and carefully consider the actuarial certification required by the recently adopted National Association of Insurance Commissioners (NAIC) LTCI Model Regulation. At the very least, the actuary should give it very careful attention before so certifying.

The actuarial profession's Actuarial Standard of Practice No. 18 (ASOP No. 18): Long Term Care Insurance addresses the actuary's pricing behavior for LTCI. It needs to be considered in its own right and also in light of the NAIC's new Model.

Both documents might seem reasonable. Their goals are laudable. However, the subject is troubling.

Many advocates, both professional and regulatory, have an increasing desire for "reliance on the actuary." How this reliance develops surely is of keen interest for LTCI.

Any gap, inconsistency or inadequacy between the two documents cited herein should be resolved. Any weaknesses in either or both of the documents should be corrected.

Consider what seems to have caused that concern and what the practicing LTCI actuary may ponder as possible solutions.

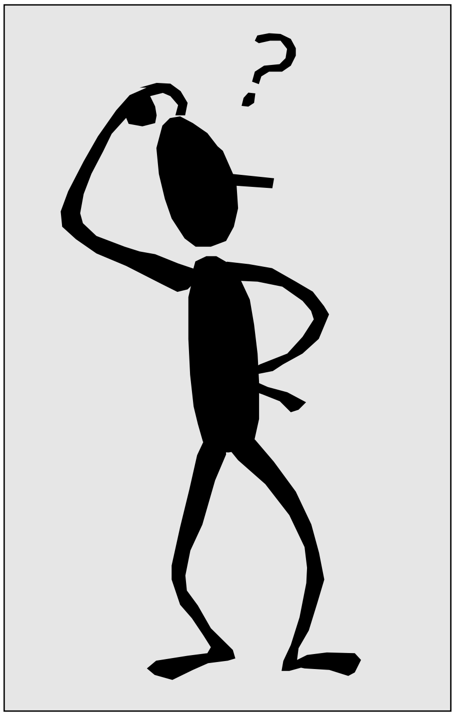
ASOP No.18

This ASOP was adopted by the ASB in January 1999. Nothing gave the LTCI Task Force more challenges in finding acceptable wording then to articulate that the actuary should adequately price the product. There was no question that requirement was paramount. How to state it and be comfortable and clear, yet legally accepted, wasn't so easy.

Being guaranteed renewable, premiums on in-force policies can be increased (with regulatory approval). However, the desire, properly, was to prohibit what became known as "planned hidden future premium increases."

This prohibition was addressed in the initial ASOP No.18 adopted in 1991. Relevant words then adopted:

> *"Experience developing in ways significantly different from that assumed in pricing may legitimately require future changes in premium scales; but in setting premiums initially, the actuary should not rely on that possibility to use assumptions which are unduly optimistic. Neither should the assumptions be pessimistic, yielding excessive premiums. Nor in any event should the actuary establish pricing assumptions with planned hidden future premium increases in mind. If premiums are described as level, guaranteed renewable, and applicable for the lifetime of the insured — as is typically the case — the actuary should use assumptions consistent with that description."*



The text on premium rate recommendations was vigorously reviewed as part of the overall update of the entire document. The revised ASOP No. 18, adopted in 1999 and current today, has these relevant words:

> *3.3 Premium Rate Recommendations. In developing such recommendations, the actuary should not use assumptions that are unreasonably optimistic. If a premium rate schedule is described by the actuary as applicable for the lifetime of the insured, the actuary should use assumptions that are consistent with that description and that have a reasonable probability of being achieved. In particular, the actuary should not rely on anticipated future premium rate increases to justify the selection of unreasonably optimistic*

assumptions when recommending premium rates. On the other hand, the actuary should not use assumptions that are unreasonably pessimistic. It may be appropriate, however, to include provision for adverse deviation in assumptions.

The wording is clear. It requires the actuary to responsibly price LTCI.

Enter the NAIC Model

The development of the many significant revisions to the NAIC LTCI Model Regulation, adopted in August last year, are well documented. The regulators desired to replace the NAIC Model that required a 60% loss ratio with revised and new provisions that, instead, placed many requirements on the insurance company and on the actuary. The goal was to produce premium rates in the industry that would be more stable and reliable.

Those changes included: removal of loss ratio requirements for new business; introducing higher loss ratios for increased premiums on inforce policies; adding considerable monitoring and reporting of experience; increased consumer disclosure; and written certification by the actuary.

The reasons for making these, and other, changes won't be chronicled here. Nor will this article speculate as to how successful those new provisions will be. (There is room for debate!)

Rather, we focus on Section 10 of the new Model Regulation, which says, in part:

"B. An insurer shall provide... to the commissioner..."(2) An actuarial certification consisting of at least the following: "(a) A statement that the initial premium rate schedule is sufficient to cover anticipated costs under moderately adverse experience and that the premium rate schedule is reasonably expected to be sustainable over the life of the form with no future premium increases anticipated."

There are many other elements required in the actuarial certification noted here. There is no question but that there is a whole new world of requirements for the LTCI actuary! But we focus here on only this one paragraph.

Challenging Words, Indeed

There are no clear or useful definitions of what is meant by "...moderately adverse experience....," as required by the certification. There are none in ASOPs for other product lines and certainly not for LTCI. To the best of my knowledge, there is no definition nor explanation to which the actuary might point.

Yet that phrase clearly is meant to help produce premium rates that the actuary can certify will be sustainable "...over the life of the form with no future premium increases anticipated...."

I suggest that may not be certifiable, without producing unacceptably high (uncompetitive) premium rates in today's marketplace.

As evidence of the elusive nature of those three words ("...moderately adverse experience..."), one might seek other actuarial practice standards. The closest we come is instructive.

ASOP No. 22: Statements of Opinion Based on Asset Adequacy by Actuaries for Life and Health Insurers is the new title for an ASOP exposed September 2000, with comment deadline of March 31, 2001. The profession's documents it would replace have no relevant definitions and have been in place since July 1990 (ASOP No. 14) and October 1993 (Actuarial Compliance Guideline No. 4). The current exposure draft of the proposed adoption of ASOP No. 22 introduces a phrase very similar to the NAIC's quoted above and, for the first time, proffers a definition. From the ASOP No. 22 current draft:

"2.14 Moderately Adverse Conditions. These are conditions that include one or more unfavorable, but not extreme, events that have a reasonable probability of occurring during the testing period."

Perhaps this definition will survive when this ASOP No. 22 eventually is adopted. Perhaps that will be what the actuary should consider when adopting, or testing, LTCI pricing that "...is sufficient to cover anticipated costs under moderately adverse experience...."

Nowhere else is there known guidance for what the actuary is to use on this direct matter. Nor am I sure this is a phrase that should or can be fully defined; perhaps it defies specific, operable definition.

> ***"I suggest that may not be certifiable, without producing unacceptably high (uncompetitive) premium rates in today's marketplace."***

Where Does This Leave The Actuary?

The actuary may well be left in a dilemma. If he prices LTCI that meets the NAIC-required actuarial

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certification, and so certifies, he likely produces premium rates that are not at all competitive with otherwise reasonably similar policies in the marketplace.

If he produces reasonably competitive premium rates, he likely can't certify there is room in those rates for "moderately adverse experience." Or he can't do so honestly. Or he must be prepared to defend his premium rates, the testing he has done, and argue about the meaning of those words in this context.

In any event, the actuary must well document what he did and be prepared to defend his actions, including the certification.

NAIC Status

Of course, the Model Regulation (any model reg) becomes effective only after a state adopts it. It should be noted that all parties — industry, regulators, consumer groups — vowed their intent to help see adoption, wherever possible, of the new LTCI Model Regulation adopted by the NAIC. It is reported that progress is being made in that regard.

Further, one should not dodge the Model Reg's applicability by avoiding states where that applies. Even where it doesn't apply yet, informally regulators may "require" or attempt to require that it be adopted. And lack of uniformity across states is expensive, troublesome, and meant to be avoided.

Thus, the actuary must ponder the Model. De facto, it is operable.

The NAIC is making slow progress in drafting, exposing, and eventually adopting the "Guidance Manual for Rating Aspects of the Long-Term Care Insurance Model Regulation" (Guidance Manual). A companion to the LTCI Model Regulation, it is to explain and expand upon the model. Among other things, it is to attempt to answer questions that arose during the model reg's development.

As this is written (February 28, 2001), the most recent exposure draft of the Guidance Manual was released November 11, 2000. It has several pieces labeled "To be developed." More will be coming, including the following two meetings:

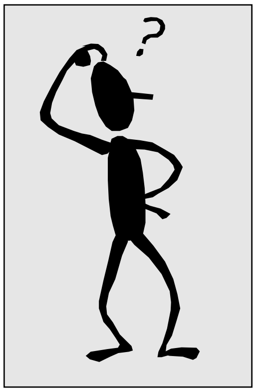
- A session at the March 24 – 28 NAIC Spring meeting in Nashville will address the then-current draft.

- A two-day NAIC seminar on "Long-Term Care Rate Adequacy Actuarial Issues" is scheduled for April 4 – 5 in Atlanta.

What Should Be Done?

If the actuary finds himself on the horns of a dilemma, what might be done? Suggestions are easier to make than resolve.

Change the Model Regulation? It's not clear how that should be worded. Furthermore, it would be sure to be a long, protracted process. The current one isn't completed yet, if one includes the guidance manual; and adoption of the model regulation by states has barely started.



Reopen ASOP No. 18? Again, it's not clear to what end. What would it say differently from what it contains?

Expect that the actuary adopt premium rates that are too high to permit a company to compete? In time, that could be a self-correcting solution, but not without serious implications.

Define "moderately adverse experience" in a clear and acceptable way? Not likely, given the long history of no useful definition — nor any that is likely. It's not clear to pursuit of an acceptable definition is possible, or useful.

The actuary might cover his work by defining for himself what he meant by those words in his certification and by documenting that in his work. Is that doable? Comforting to the actuary?

Price LTCI with non-supportable, reasonably aggressive assumptions that very well may not support level premiums for life? The actuary who does so should monitor the financial results of the LTCI enterprise and be willing to accept very low financial rates of return. The actuary should also prepare his defense for the premium rates he's adopting.

What do you believe should be done? Indeed, anything?

Suggested answers to the above questions, or your own questions and thoughts, are needed. All you send me will be shared in the next newsletter, with only any necessary edits, including any requests for anonymity.