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Long-Term Care

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Insolvency Due to Long Term Care

by Gary L. Corliss

Insolvency, Bankruptcy, Failure, Financial distress, Financial impairment. None of these terms sound pleasant. Their exact definitions may have subtle differences. All of them connote an unhappy occasion.

Long term care insurance has arrived. There have been several insolvencies of smaller insurers who have focused their marketing primarily on long term care coverage. Our third party administrator has been called upon by state Guaranty Associations in some of these instances to administer the existing policies and manage current plus future claimants. The process requires that the business in force is assumed by a financially sound organization and becomes that new company's responsibility and liability.

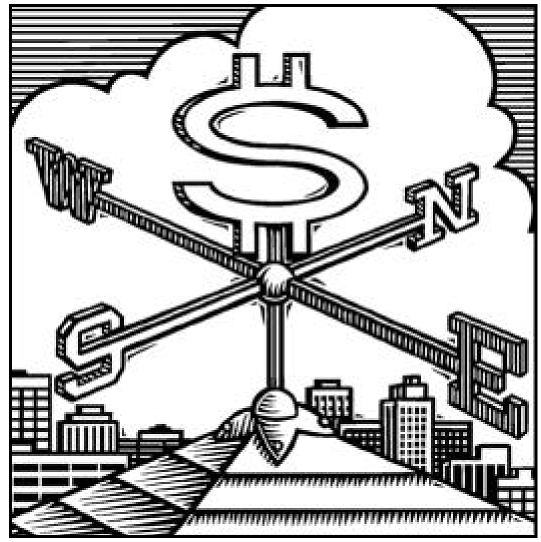
Based on our involvement in assuming business as a result of insolvencies, we have determined that there have been certain common characteristics of insolvent LTC insurers. Let me explain.

First, I would like to dismiss the common notion that insolvencies are often caused by external factors to the insurer (e.g. investment yields) or the industry (e.g. unreasonable competition). We have found no evidence in our experience that indicates that external factors caused the failure of LTC insurers. It appears quite the contrary; the failure developed primarily due to internal considerations.

When any insurance organization fails, and the reason can not be charged to external causes, it is tempting to suggest that there was inadequate pricing. In one sense that may be so. Clearly, if the premium is sufficient to handle all benefits and expenses, then insolvency should not occur. However, premiums may be deficient because something or several somethings have gone awry. Our experience indicates that failures in three functional activities are usually precedent to company failure: Underwriting, Contract Language, and Claim Processing.

1. Underwriting, performed with less sophistication than quality competitors of the time, appears to be the primary organizational deficit that eventually leads to a company's demise. If this activity is performed poorly, no premium rate has a chance to be adequate.

2. Contract Language specificity is so important. The policy language determines whether the claim department is provided



support in determining whether a claimant is properly entitled to benefit under the policy. With inadequate language, the claim department could be required to pay benefits even when an insured was not in a condition to collect according to the pricing expectations.

3. Claim Processing is of third importance, but very close to number two above. The claim area must assure that contract eligibility for benefits has been met and that benefits are paid in accord with the benefits purchased. It should be simple to process the claims by reading the contract. We have observed that it was not so for several failing insurers!

Certainly proper premium development is essential to a successful product and a successful company. Proper premium development requires that the pricing actuary fully understand all the administrative processes of the insurer for which he is pricing and the impact that those processes have for premium development. The NAIC Rate Stability Model language is properly putting pressure on actuaries developing premiums to know how insurer functions are being con-ducted and to consider the functional methodologies in pricing. Further, just as the actuary should check out “actual to expected” pricing assumptions over the life of a portfolio of LTC insureds, the actuary should verify periodically that the “actual” processing of the business is following the “expected” approach built into developing the program.

When prudent pricing is bonded with responsible functional processing, insolvencies should be minimal to non-existent.

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