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Actuarial Certification

by Bartley L. Munson

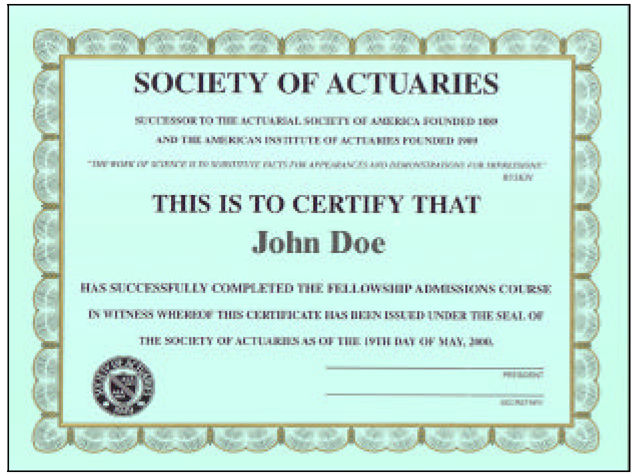
In response to concerns expressed since the latter half of last year, and brought to a head by the article "Actuarial Certification: A Reason for Pondering" in the prior issue (April 2001, No.4) of this newsletter, the American Academy of Actuaries (AAA) has formed a Work Group to address the matter of actuarial certification and rate stability for long-term care insurance (LTCI) pricing.

The Work Group is to consider, as documents relevant to this review: the new NAIC LTCI Model Regulation; Actuarial Standards Board's Actuarial Standard of Practice (ASOP) #18; the LTCI Guidance Manual under current development by the NAIC; the possibility of a new Practice Note on LTCI for the actuarial profession; and any other sources that will be helpful.

The Work Group is under the auspices of the AAA Task Force on Long Term Care. It is chaired by Eric Stallard, Chair of the AAA LTC Task Force, and consists of nine other actuaries.

It held its first meeting, by conference call, May 21 and its second on June 27. It plans bi-weekly conference calls thereafter, with face-to-face discussion(s) as needed, until this important task is completed.

The Work Group gave oral reports on its formation to three different sessions of the NAIC at its meeting in New Orleans June 8-12. The NAIC stated it was mindful of some need for clarification, help, and guidance when they adopted the Model Regulation changes and some of it wording and requirements. They also stated they are happy the AAA has determined to do so. The NAIC is glad to provide any helpful guidance they can on that effort. At the NAIC's request, the Work Group promised to give quarterly updates of its work to the NAIC. It intends to have a report of substantial progress by the September NAIC meeting.



It is difficult to know the pattern of work for this task, let alone the time and form of its conclusions. We do know that it is a challenging task—to advise our profession in light of the new LTCI Model Regulation. We also know that the end date is unclear; but it's realized that time is of the essence, for the LTCI Model Reg is being adopted, in one form or another, in many states as our work is progressing.

If members of our profession have thoughts, questions, or suggestions to contribute, please share them with the AAA Work Group, through the Academy office. We will be glad to take them into consideration.

We will provide a status report in each of the succeeding issues of this Newsletter.

As an aside, there were three letters received as a result of the article calling for this assignment, in the prior Newsletter. (Though few in number, so far, it is regrettably true that there are almost never any responses to invitations for such in our Newsletters.) These three, quoted below, with permission and in their entirety, come from varying sources and are of varying length. They give some flavor to our work and to what we hope will be additional input.

Letters to the editor, in the order received:

Tony Grippa, FCAS, MAAA wrote: "I was glad to see your article about LTCI rate stability. It is a good article."

Excerpts of a letter from David J. (Joeff) Williams, FSA, MAAA: I am a consulting actuary and have been involved with several of our clients in the development and valuation of LTCI products. I agree with many of the points you raised in your article in the April 2001 Newsletter.

I recently attended the NAIC seminar on "Long-Term Care Rate Adequacy Actuarial Issues" in Atlanta. Several key comments came out of that meeting that I would like to share that may be of interest. The attendees at the meeting were predominately from state insurance departments.

1. Some of the attendees expressed concerns about the ability of the states to review initial filings for reasonableness. One participant asked the panel if industry morbidity data is available on which to make a reasonable estimate of future claim costs under "moderately adverse experience". The panel admitted that sound actuarial data for Long-Term Care morbidity experience is not readily available. This raised the issue of how then is an actuary to sign the certification required in the model language.

   How can we be expected to sign a certification of premium adequacy over the life of the contract if a) industry morbidity experience is limited at best (probably out-of-date given the rapid changes in benefit triggers and definitions), c) the LTCI product is in its infancy within the insurance product cycle and c) there are continuing developments in the care and treatment of the applicants for this type of coverage.

2. The suitability of the LTCI product to the current market is an issue. The target market for LTCI has been 65 to 80 year olds. The 1984-93 Intercompany Experience Study shows over 63% of issues were over age 65. This issue of market suitability was raised at the NAIC meeting.

   Should not this product be marketed to the 40-55 year old market with an emphasis on retirement planning? This allows the company time to establish appropriate reserves and the insured is left with a reasonable premium. Has the industry been missing the real market for this product?

   I liken this issue of suitability to an employer establishing a defined benefit plan on a group of 63 year olds. Most employers would not be prepared to establish the liability necessary to pay the future benefits.

   Recent studies have shown that the average LTCI issue age is coming down, so maybe the target market is changing.

3. The future competitive market environment for LTCI must be considered. Loida Abraham in her editorial in the April 2001 newsletter mentioned that the market penetration rate is low. Does this mean there is adequate competition in this marketplace? Will the consumer have options from which to choose when buying a LTCI product in the future? Will smaller and medium size companies be able to afford to enter the LTCI product environment? These are additional questions I have regarding the future of LTCI.

Steve Sperka, FSA, MAAA, wrote:

I want to thank you for raising awareness and debate on an issue that I feel is very important to our industry and profession.

I agree that the LTCI actuary should pause and carefully consider the requirements of the actuarial certification. To certify to rates under the new model regulation, the actuary must build in margins for moderately adverse experience that are not required under ASOP (Actuarial Standard of Practice) #18. The LTCI actuary may have to reconsider the assumptions used in setting premium rates.

For example, what is a reasonable margin for utilization rates, considering the possible changes in future utilization that may result due to societal changes, medical advances and changes in the provider network?

Is it appropriate to project future improvements in morbidity experience when determining premium rates?

Is it appropriate to anticipate investment earnings that are representative of the recent economic conditions as opposed to long-term historical averages?

Appropriate answers to these questions may be different when looked at in the context of the requirements of the model regulation as compared to ASOP #18.

I welcome further discussion and guidance about the definition of moderately adverse experience. However, I share your concern that finding a clear and acceptable definition of moderately adverse experience may not be possible.

Ultimately, it may be up to the actuaries of each company to define moderately adverse experience for themselves, while documenting their logic.

Lastly, while the new model may create a dilemma for some LTCI actuaries, I feel the model is an important first step toward bringing greater stability and consumer protection to the industry. Rate increases and the bad press associated with them may damage the credibility of the entire industry. Even if the model manages to curb only the most abusive bait and switch tactics (if, in fact, that's really what they were), it will have accomplished a worthwhile objective.

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