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Some Thoughts on Rate Stabilization

by Joan P. Ogden

I have been ruminating on the recent move by many in the regulatory community to "rate stabilization" concepts and approaches for LTC insurance. I find myself confused by the motives driving this move. I also struggle with the position into which we, in the actuarial world, become forced.

Before I go further, I need to make clear that I have been involved with LTC insurance since the mid-1980s, primarily with one client, which has never implemented a rate increase. I have worked in the health insurance actuarial world since 1976, and thus have seen myriad changes to the way the world "works" with respect to the need for, use of and delivery of health care services. So, while I would not claim my background makes me an expert, it does make me old enough that I have a reasonable amount of history (not to mention more than a few gray hairs) upon which to draw.

Not having had any regulator specifically detail for me his or her objectives with respect to the implementation of "rate stabilization", I can only speculate what the regulators hope to accomplish and what has driven them to this approach. I am also guessing that the heart of the regulators' concern is the "senior" population — age 65+.

Historic Response to Inadequate Profit

Certainly, a primary driver has been the responses of a number of carriers of LTC insurance to less than optimum financial results with resultant rate increases. Regulators have regularly shown a decided dislike for premium rate increases applied to the senior population. That phenomenon has certainly not been limited to LTC coverage, but has been evident for years when fully documented, justified requests for Medicare supplement rate increases have been filed, only to receive a response that some lesser percentage of the justified increase would be permitted.

My speculation is that regulators see the senior population as not only living on a fixed income (despite annual cost-of-living increases in Social Security), but moreover, living in a marginal fashion due to inadequate income. Certainly, some portion of the senior population is impoverished, but one would hope that those are not the segment buying LTC coverage. While the facts belie the categorization of the senior population as not knowing where their next meals are coming from, that is not the thrust of this musing, and I will leave that to the reader to verify.

Dependency of Senior Population?

A second driver — again my speculation — is that regulators see the senior population as "vulnerable." I base this speculation on recent insurance-department proposed legislation in one of the states in which I am active, which sought to define "vulnerable adults" as those adults with limited mental capacity and age 65 and over. The idea of the senior as limited in mental capacity is nothing new. The move to standardized Medicare supplement plans (10 sizes fit all) was often supported by the contention that seniors were unable to understand what they were buying. The closer I get to senior status (those gray hairs again) and being married to a senior, the more annoyed I am that there are those who would marginalize a significant segment of the population by treating them — or worse, declaring them in law — as incompetent to conduct their own affairs. However, I am guessing that regulators believe that as vulnerable individuals, seniors would not expect premium increases, nor be able to cope with them when received, despite annual experience with increases in Medicare supplement premiums.

Inadequate Information

So, we are now approaching an environment where not only must the purchaser of the LTC product be warned of the premium increases the insurer has implemented in the past, but that same purchaser must pay a rate which incorporates a margin for "moderately adverse experience", whatever that is. Thus, since there are no caveats to the warning about past increases, (unlike stock prospectuses which warn that past experience is no guarantee of future results), the purchaser is led to expect that a carrier which has increased premiums in the past will be expected to do so in the future and may unfortunately conclude that a carrier who has had no increases in the past will also have none in the future.

Paying Too Much

Today's purchaser will likely pay "too much" for their LTC policy because every actuary will be forced to "pad" the expected experience to provide for that "moderately adverse experience." The restrictions applying to a future rate increase are such that it is easier for every company to just "jack up the price" so that they think they will never need one, and certainly no actuary wants to have to go back to the regulators and indicate that the expected "moderately adverse experience" wasn't adverse enough.

Frankly, I believe it is supreme arrogance to even pretend to claim we have a view of the future which extends 20 or 30 years, moderately adverse or not. I remember being asked about the future of national health insurance back in the late '70s and my response was that I thought it was very likely, because I could not see employers willing to tolerate premium increases of three percent and four percent year after year for employee health coverage. Look how wrong I was.

Now, I believe most actuaries did their best to price LTC coverage for a level premium over the lifetime of the policy (guessing about a lot, including what they thought the lifetime of the policy was), but did not price to issue that policy on a "non-can" basis. They knew that the future was not perfectly predictable. The pricing allowed for a rate increase in the future should one become necessary due to adverse circumstances. Some, for whatever reasons, found that the "future" need for a rate increase was uncomfortably too soon. Under the terms of "rate stabilization", I believe actuaries are forced to find themselves pricing with pretty close to a "non-can" mentality.

Let me draw a parallel with buying a refrigerator. I can buy one with or without a maintenance contract. Just speaking as a normal human being (instead of an actuary), if you tell me that I can pay an even $1200 for the refrigerator with protection against adverse circumstances (a refrigerator breakdown) for service for the life of the refrigerator or pay $790 for the same refrigerator with no protection against adverse circumstances and take my chances on paying for service should I need it, I know what my answer is. I'll pay the $790, thank you very much, since past experience tells me that refrigerators need service infrequently and I may save some money to permit me to pay for that service call should the refrigerator need it in the future.

Even if I don't save the money, I can choose to gamble that my income sources will permit me to pay for that service call when I need to. If I have no choice and am forced to pay for the inclusion of the service now, I will likely choose a less costly brand, or maybe even stomp my feet and refuse to buy it and live with the old one.

Further, the deal for the inclusive refrigerator may be to my detriment because there may not be adverse circumstances — the refrigerator may never need service, I may decide to move to where I cannot use that refrigerator or, even worse, I may not live long enough to reach the stage where the refrigerator needs service. So to put this analogy on ice (sorry, couldn't resist), I would have really overpaid, to no avail!

Now, speaking as an actuary (clearly not a normal human being), given the choice of a lower price now and an additional charge in the future vs. a higher (and likely too high) price for the duration to protect against future adverse circumstances, I will take the former, thank you very much. I can calculate present values and I have a reasonable assumption that I will be better off with the former. Ibelieve that regulators do the buyer of LTC coverage a disservice to establish an environment where that buyer has to "overpay" now to avoid the possibility of an increase in the future.

Blaming Someone Else?

A third driver of the regulatory approach might be the very human desire to "blame someone else." After all, regulators (some of whom were/are actuaries) reviewed those early LTC filings, and approved those initial assumptions and rates, which were later to prove inadequate in many cases. In the regulators' defense, it was a new product. They didn't have the resources to know that a particular set of assumptions was out of whack. Neither did many of the actuaries generating those sets of assumptions, although we all "know" of some carrier or another who deliberately underpriced.

Rate stabilization would put the onus on the carrier to be "perfect" — that is, generate a premium rate which should not need an increase and take the heat off the regulator's back. Should conditions change over the next 20 to 30 years from everything we can guess about the future now (never happened before, right?) resulting in the need for a rate increase, the regulator can deliver the carrier a satisfying "whack upside the head," and in the meantime, be a hero to all of those seniors out there who have never had a premium increase.

Consequences

The nasty little secret is that with policies priced for "moderately adverse experience," a number of carriers are going to have windfall profits paid for by those same seniors the regulators have sworn to protect. I invite you to guess with me as to the response by regulators to LTC premiums which, in 15 or 20 years from now, turn out to have generated significant profits for their carriers (e.g., return of premium for Medicare supplement coverage where loss ratios are too low).

Another thing to consider is, if premium rates set for "moderately adverse experience" reduce the number of policies issued, then there will be a social and political outcome. The government, at its various levels, will find more individuals relying on tax dollars to support their LTC, and more families will find themselves sandwiched between kids in college and parents in LTC. Will we all then be better off because of rate stabilization?

Have there been abuses by some carriers in the LTC market? Sure. Were some carriers unwise, or did they get into business they did not understand, or did they make mistakes? Sure. Do we solve the problem of abusive, unwise or erroneous practices with rate stabilization? In my view, no more than my third grade teacher solved the behavior problems of Bobbie by having the whole class stay one-half hour longer, although she touted peer pressure of the rest of the class on Bobbie as having the potential to make the little guy stay in his seat. We were eight years old back then. What did we know about Attention Defecit Hyperactivity Disorder (ADHD) and why was it presumed we could solve Bobbie's problem by warming our seats an extra 30 minutes? We just ended up hating Bobbie and the teacher. ♿

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