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A Suggestion to do a Postmortem Analysis of the Work Done by LTC Pricing Actuaries Over the Last Quarter Century

by Ali Zaker-Shahrak

Ali Zaker-Shahrak, Ph.D. (Econ.), FSA, MAAA, CFA, is a senior life actuary at the California Department of Insurance. He can be reached at *Zaker-shahraka@insurance.ca.gov.*

In this note, after a lengthy introduction, I suggest we do a postmortem analysis of the work of the Long-Term Care (LTC) pricing actuaries.

It is well known that the pricing of any insurance product is as much an art as it is a scientific endeavor. In developing premium rates, we use well-known actuarial principles, but, in addition, we take into account many other factors, not least of which is whether our company can market the product, and, what the competition is doing. There is always a danger of following the crowd—herd mentality—and arriving at low premium rates when others do the same. Of course, there is no free lunch, not even for the actuaries. Low premium rates resulted in low profits (losses) and many subsequent red faces in the years that followed the introduction of initial prices. Pricing an actuarial product becomes especially challenging when the product is new and little is known about historical, industry wide claims experience for the product in question. Looking back, this was the case during the 1980s, when insurance companies started pricing and marketing the first generation of LTC products.

As is well known, in the beginning, some actuaries came up with premium rates for LTC products that have turned out to be woefully inadequate. Did they use very optimistic assumptions? And perhaps, part of the problem was because everybody else was employing similar assumptions? Perhaps too, *there was too much reliance on the minimum required LTC policy provision statement that the product was* ***guaranteed renewable?*** Guaranteed renewability meant that insurers could increase the premium rates if the assumptions turned out to be off-the-mark. That is what has happened. Over the last quarter century, most insurance companies selling LTC products have implemented significant rate increases (many repeatedly). There still seems to be no end in sight for how many more rate increases are to follow.

It goes without saying that individuals who had bought LTC policies do not appreciate such repeated rate increases, and in many instances have vociferously complained to state insurance regulators regarding such increases.

To combat the inadequacy of initial LTC premium rates, the National Association of Insurance Commissioners (NAIC) came up with a model law—referred to as "rate stability law"—at the beginning of this decade which has since been enacted into law in many states, including my home state of California. The new law emphasizes adequacy of initial rates. For example, California Insurance Code, Section 10236.11(a) states, "*No approval for an initial premium schedule shall be granted unless the actuary performing the review for the commissioner certifies 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*."

Also, in Section 10236.11(b) we read,

"*The insurer shall submit to the commissioner for approval a rate filing for each policy form that includes at least all of the following information: ...* ***(2) An actuarial certification consisting of … 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.***"

It was hoped that with the enactment of rate stability law, rate increases for policies sold following the enactment would happen relatively rarely and only when the experience turned out to be more than moderately adverse. Unfortunately, we are seeing rate increase filings for "post rate stability" policies more frequently than the authors of the new law would have hoped for.

It is, therefore, appropriate and timely that we look back and analyze LTC pricing over the last three decades. We should do this so that we can identify the shortcomings of former and current practices and recommend ways in which pricing of LTC products can be improved in future years. ■
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