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A Conversation on Reasonability

by Corin R. Chapman

Within the insurance industry, there are many standard risks to analyze, value and appropriately price for such as weather-related disasters, major epidemics, catastrophic earthquakes, substantial economic variations and regulatory changes. Wait, should regulatory changes really be grouped in with these critical occurrences? More than ever, implemented rules and regulations are having significant effects on the bottom line of insurance companies, particularly within the health insurance industry where new legislation seems to be created and debated almost daily. With the addition of many of these laws, a battle seems to be brewing pitting health insurance companies against regulators and vice versa. Given the understanding that actuaries from both sides have about the ultimate underlying effects of many of these regulations, it only makes sense that the burden must fall on our profession to step outside the political arena and have a conversation on reasonability. Only by working together can the relationship between those that issue insurance and those that regulate it be strengthened, therefore guaranteeing that a viable and fair market exists into the future for many of the health products marketed today, such as comprehensive medical, Medicare Supplement, and long- term care (LTC) insurance.

Each year, as medical premiums rise, sometimes by double-digit percent increases, consumers' trust towards insurance companies continues to decline. Critics cite specific examples of unscrupulous practices by a minority of insurance companies such as misleading sales practices, unfair rescissions or denial of coverage. These examples have occasionally been emphasized by the media and translated to all health insurance companies, often leading to increased pressure by the public to regulate health insurance companies. An obvious example of increased regulation is within the Affordable Care Act (ACA) in the form of a medical loss ratio requirement requiring all large group comprehensive health insurers to maintain a loss ratio of 85 percent and all small group and individual comprehensive health insurers to maintain a loss ratio of 80 percent. By limiting the allowable loss ratio, the government is attempting to essentially limit the profit a company can make, theoretically deterring any unfair practices.

Comprehensive medical insurers are not the only companies being targeted by recent regulation. Supplemental health insurance products, primarily

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excluded from ACA, have also been under increased scrutiny in recent years. In July, Representative Pete Stark from California and Senator John Kerry from Massachusetts introduced a bill to apply the ACA minimum loss ratio rules to Medicare Supplement. These rules would be in addition to the substantial guidance provided by the Medicare Supplement NAIC Model Regulation, current prior approval standards for rate increases in most states, and the fact that the Medicare Supplement market already has substantial price competition.

Additionally, through the current rate approval process, many insurance companies are being asked to set rate increases at levels that are below requested in order to maintain affordability of the product to the consumer. Reduced premium increases have the potential to put the product at a price level where it is no longer economical for insurers to remain in the Medicare Supplement market. For certain insurers, the introduction of the 80- to 85-percent minimum loss ratio would be the final deterrent from continuing to sell Medicare Supplement policies.

An additional product line where similar issues exist is within LTC insurance. LTC insurers have been a continuous focus of the media, the public, and regulators due to their product's inherent characteristics. LTC insurance premiums are paid over an extended time period, often greater than 20 years, in order to fund care that usually occurs towards the end of life. Therefore, any adverse action by the insurer, such as denial of benefits or an increase in premiums, has an increased likelihood of being experienced by an elderly individual with a fixed income. Premium increases may make the policies unaffordable for policyholders, causing them to lapse just when LTC services are becoming necessary.

In order to avoid consumers receiving unexpected rate increases, in 2000 the NAIC adopted the Long Term Care Insurance Model Regulation, which requires company actuaries to certify that rates are sufficient to pay future claims under moderately adverse experience. Additionally, the regulation requires that if companies do increase their rates, they need to meet an 85 percent minimum loss ratio on the increase from the original rate. Earlier this year, California presented and later tabled AB 999, which attempted to add an additional level of scrutiny by restricting rate increases to once every five years for pre-stabilization policies (sold prior to adoption of the NAIC LTC model regulations) and once every 10 years for post-stabilization policies.

From a consumer's point of view, increasing premiums on individuals, particularly the elderly who have already paid a substantial amount of premiums to an insurer, seems particularly onerous. Furthermore, for many regulators, the large rate increases being requested, some reaching 40 percent, seem to indicate irresponsibility on the part of the insurer. From the regulators' perspective, regulations are needed to ensure policies are priced correctly and to limit the insurers' ability to punish policyholders for their own pricing mistakes. Additionally from the regulators' perspective, it is necessary to have a given level of regulation to avoid insurers intentionally underpricing their products to build market share only to raise rates after policyholders have had the product for a substantial time period and no longer feel they can qualify for a new policy due to insurability standards. Therefore, many regulators feel limiting rate increases on LTC insurance policies is a clear and necessary step.

However, from an actuarial perspective, one cannot deny the need for rate increases for many insurers in order to maintain a sustainable product. The LTC insurance market remains relatively new and given the long tail on the claims curve, some insurers are only now starting to compile credible claims experience in which to compare previous estimates. Additionally, many of the assumptions that went into initial pricing, particularly those involving persistency, continue to evolve and differ substantially from expected. Initially, LTC insurance products were priced assuming a lapse rate similar to life insurance or Medicare Supplement products. However, lapse rates have decreased over time as the product and consumer behavior have evolved, leading to a substantial premium shortfall for many insurers. A perfect storm of lower than expected investments returns, changing mortality estimates and, in some cases, higher administrative expenses all have led to losses on insurers' blocks of business. Were these assumptions incorrect? Yes. Were they actuarially irresponsible? Probably not. When communicating needed rate increases, insurers point to the fairly immature market for LTC insurance and the fact that they need to continuously refine their assumptions to build and maintain a properly priced product.

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As with many of the health products available today, many regulators are trying to protect their constituency, but is it destroying the possibility of having a viable market? Even at an increased premium, financial advisors agree that LTC insurance remains a valuable product for those who own it. With the baby boomer generation turning 65 and nearly two-thirds of people over age 65 estimated to need some sort of long-term care either at a facility or at home, it comes as no surprise that the lapse rate of LTC insurance is lower than anticipated. Even after rate increases, most providers fail to experience significant shock lapse. Further emphasizing the need for a viable LTC insurance market, increasing the number of individuals owning private LTC insurance will help reduce the mounting pressure on the Medicaid system caused by the usage of the home- and community-based care and institutional care benefit.

Despite the growing demand for LTC services, the number of insurers selling LTC insurance is decreasing. With the rising cost of LTC and the reluctance of regulators to approve needed rate increases, many insurers have chosen to discontinue sales and sometimes sell off their blocks of business. When determining applicable regulation, there must be more consideration of the effect the elimination of competition may have on the availability of the product. Regulators must consider if the coverage long-term care insurance provides is worth allowing insurers to institute unpopular and possibly financially harmful rate increases on in-force policies.

These issues are not unique to LTC insurance or even health insurance products. In general, insurers are often thought of as entities with unlimited capital, but as additional rules are implemented to govern profitability, the viability of many of these companies may become less stable. The balance between regulators protecting their constituency and allowing insurers to maintain a stable book of business is a struggle felt across the insurance industry with actuaries taking a front-and-center role on both sides. Actuaries have a unique opportunity to encourage more constructive conversations between all parties by educating both the regulators and insurers on all the potential ramifications of possible actions that either side may take. Additionally, as actuaries, we must continue to strive to create justifiable regulations and policies that work together to create a sustainable market.

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