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Unfair Discrimination and Individual Health Policies

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Zeno, ancient Greek genius, is credited with creating calculus. According to history, he began by realizing that to travel from point A to point B, one must first cover half the distance. He then realized that one must travel half of that (1/4), and half of that (1/8), and so on to infinity.

Legend says that Zeno carried his logic a bit too far. Awakening one morning, he realized that to reach the door from his bed, he must first traverse half the distance, but first must get halfway there, and so on to infinity. He reasoned that motion is therefore impossible, and died in bed.

We actuaries must also guard against extrapolations that extend to infinity without considering the consequences. If we aren't careful, others might sense nonsense instead of wisdom, and stop listening to us. (My wife does that to me on occasion.)

Many Medicare Supplement (Med Supp) and long-term care (LTC) policies offer a discount for married couples, partners or multiple-resident households. Claims seem lower for couples living together. This lower claims rate could be due to living together (i.e., caring for one another), or could also be affected by gender mix.

In both, most rates are unisex. Some carriers report more single sales are to females, which might make claims rates higher (at least on LTC). Most couples include one of each gender, so gender might be a contributing factor to lower rates for couples.

In 1980, the American Academy of Actuaries issued "Statement 1980-19: Risk Classification Statement of Principles." This became the basis for Actuarial Standard of Practice 12 (ASOP 12—which did not supersede Statement 1980-19). ASOP 12 is the professional standard on risk classification for all practicing actuaries.

State laws all define unfair discrimination and rebates. ASOP 12 reinforces those laws by guiding actuaries to charge equal rates for insureds in the same class. Market conduct examiners and consumer services reps are often the only state watchdogs for these laws, because it is difficult to catch in policy filings or financial exams.

Therefore, actuaries are generally considered the guardians of risk classification. Because actuarial standards are self-administered, appropriate administration of actuarial principles is largely dependent upon the rating actuary's integrity in adhering to professional actuarial principles. The Code of Professional Conduct requires, "An Actuary shall not provide Actuarial Services for any Principal if the Actuary has reason to believe that such services may be used to violate or evade the Law."*

Suppose ABC Co. offers to sell Joe a Med Supp policy at a discount, but will only give Joe the discount if his wife Jane also buys an ABC Med Supp policy. If Joe's wife is only 60, or already has a policy from another company, she doesn't need it, so she doesn't buy. This doesn't change Joe's risk; Joe is cheated out of the discount.

To increase the likelihood that Joe and Jane will be able to care for each other, some carriers require that both pass underwriting before Joe gets the discount, which seems acceptable if the carrier doesn't require both to buy individual contracts. Other carriers only offer the discount if both buy individual policies from the same company, which seems unfair. Some cancel the discount on the remaining policy if one policy is terminated, which seems to be inappropriately re-underwriting the risk.

In addition, suppose the company barely meets the 65 percent loss ratio requirement (including those who get the discount). They don't meet 65 percent for the nondiscounted class. Married people whose spouses don't buy a policy are charged excessive rates.

Suppose Jane initially buys a policy, so Joe gets the discount. If Jane later decides to drop it, Joe might lose the discount. Despite the entire contract provision, Joe's contract has been improperly changed by changes in Jane's individual contract.

In addition, the discount could be a rebate, an illegal inducement for Joe to buy a policy. It might even be characterized as an improper agent's commission to (unlicensed) Jane, as she would be enlisted in the effort to sell the coverage to Joe. She would be paid via the discount on her policy.

If married people should get a discount, then Joe should. It shouldn't matter whether his wife buys from the same company. We need to protect Joe's rights.

Discounts to individual insureds are not appropriate on individual forms unless the (legal) discount is based upon the reduced risk of that individual. It should not be based upon application for, issuance or continuance of a policy on a second person. If credible actuarial data indicates a reduced risk, discounts seem acceptable on joint policies, or on individual policies where the living arrangement, e.g., marriage, reduces the risk.

The Long-Term Care Model Regulation requires an actuarial certification: "A statement that the premium rate schedule is not less than the premium rate schedule for existing similar policy forms also available from the insurer except for reasonable differences attributable to benefits."** This implies that only reasonable differences in benefits are acceptable as justification for a difference in premium rates for equal risks.

Some insurers discount rates for individual long-term care or Medicare supplement policies for individuals who are employed by the same employer, or are part of an association, or can be list-billed. The discounts are commonly described as due to commission, expense and/or processing savings. Differences in expenses and/or commissions cannot be used to justify differences in individual insurance rates. That would be unfairly discriminatory and illegal.

If the same individual applied for the same contract directly, e.g., through an agent, the rate for the same benefits would be higher. Changing the purchase source does not change the hazard. The discount is a rebate resulting in unlawful unfair discrimination.

Charging different rates for the same coverage is unfair discrimination. Unfair discrimination under the Unfair Trade Practices Act is based upon actuarial risk classes. An individual with the same risk factors must be charged the same for the same benefits.

"Unfair discrimination" [NAIC Model Unfair Trade Practices Act, Section 4.G.]

> (2) Making or permitting any unfair discrimination between individuals of the same class and of essentially the same hazard in the amount of premium, policy fees or rates charged for any accident or health insurance policy or in the benefits payable thereunder, or in any of the terms or conditions of such policy, or in any other manner.

State insurance departments don't often check for potential unfair discrimination when they review rates. Some don't want to reject a filing on that basis, and market conduct exams often ignore such issues. People who get discounts almost never complain, and those who miss out on discounts usually don't know they're available.

Insurance regulators have largely relied upon actuaries to determine appropriate actuarial risk classes. Attorneys are often uncomfortable venturing into this actuarial arena, or arbitrating actuarial arguments. Actuarial professionalism and adherence to Actuarial Standards of Practice should suffice to appropriately administer the law.

Besides unfair discrimination, basing the discount on application, issuance or continuation of another individual contract conflicts with the entire con-

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tract provision. It also creates separate rate classes. Minimum loss ratios must be met, which could be impossible for both rate classes while keeping the original discount percentage.

Company commission or expense savings are no defense to unfair discrimination. Class of risk depends upon the insured's tendency to incur losses, not the risk that the carrier will have higher costs. Company expenses have no effect on the insured's risk of loss, so they can't switch people to different risk classes.

If you drive 75 in a 65 zone, even if a police officer has you on radar but doesn't stop you, it's still breaking the law. Drivers can't presume that not getting a ticket means it's legal. Actuaries are required to abide by the law, whether or not a regulator catches it.

People who lose due to unfair discrimination pay extra premiums even though they're buying the same insurance. If the carrier charges them more, buyers are often unaware that they're being cheated, and usually feel powerless to stop it. Actuaries must take responsibility for assuring that premium-paying policyholders are fairly treated.

If actuaries don't rely upon facts instead of appearances, and demonstrations instead of impressions, others might stop relying upon us. Actions taken on race-based pricing, credit scoring, and community rating have at times resulted from actuarial arguments not being sufficiently supported by fact (even when they could have been). If attorneys are handed the job of determining and defining unfair discrimination, all actuaries will lose. ■

This article represents my personal observations, and not the position of my employer.

* Code of Professional Conduct, Professional Integrity, PRECEPT 1.ANNOTATION 1-2., Effective 1/1/01

** NAIC Long-Term Care Insurance Model Regulation, Section 10.B.(2)(e)(i)

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Some highlights…

- The SOA CPD Requirement became effective on Jan. 1, 2009.
- Member input has helped to create a Frequently Asked Questions (FAQs).
- Now is the time to start earning and tracking your credits.
- Most SOA members will easily meet the Requirement with Alternative Compliance provisions.
- Members must report compliance with the SOA CPD Requirement as of **Dec. 31, 2010**.