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LTC Dashboard — Key Accessory to High-Octane Performance

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BACKGROUND

Since their introduction into the insurance marketplace, long-term care (LTC) insurance products have proven to be challenging to manage to achieve desired profit margins. This is greatly attributable to the lack of credible experience in pricing the products initially and the flexible nature of LTC benefits, which can cover custodial care in a wide variety of settings and often at different levels of costs. In addition, medical advancements and improvements in technology continue to reshape how care is delivered and change claim continuance patterns.

LTC EXPERIENCE MONITORING

In view of the actual experience of LTC carriers and emerging trends which impact claim incidence and continuance, companies are encouraged to monitor their LTC experience on a routine basis to detect problems as quickly as possible so that requisite corrective actions can be modest, but effective.

Instances where such experience monitoring is in evidence can be found in several recent press releases regarding LTC financial results, wherein companies have mentioned the need for active (ALR) and disabled (DLR) life reserve strengthening, deferred acquisition cost write-offs, and/or premium rate increases on inforce policies. In some cases, carriers have discontinued new sales altogether. Among the main reasons given for these actions were that actual experience developed differently than assumed in pricing or in the original reserving assumptions. A common reason for a premium rate increase is that policy persistency has been higher than anticipated, which is expected to lead to higher claim costs in the future. For disabled life reserves, increases are often due to longer claim continuance.

Going forward, how should LTC companies monitor their experience? What metrics should they review and how frequently? As we have seen, companies failing to monitor their LTC experience actively find reversing poor performance difficult and often decide to leave the market to others.

LTC DASHBOARD

This article will take a look at the analyses a company can perform to monitor their LTC business to help detect and try to correct experience variances before having to increase inadequate reserves substantially, to request large premium rate increases, and/or to stop selling new business altogether. The goal is to create an array of information or a “dashboard” generated from the analyses that can be used to better manage the LTC risks the company has assumed.

Dashboard metrics typically focus on the assumptions used to price the products:

- **Morbidity:** Some of the biggest unknowns in pricing LTC products, and where substantial financial risks lie, are the morbidity assumptions — namely, claim incidence, claim continuance, and utilization (for expense reimbursement coverage). Companies need to monitor each of them separately. This is often performed by calculating actual to expected ratios. Depending on the need, the expected basis can be from pricing, valuation, or best estimates. While many different sets of ratios can and should be developed, the dashboard should contain those ratios that represent where the information is credible and the company’s exposure is the greatest. (Note: Too often, companies rely on actual to expected studies of *total* claim costs to monitor morbidity. This is not going to show problems in the DLR and will be slow to show problems in the ALR. Because of this, taking a deeper look at the individual morbidity assumptions separately is warranted. Also, results learned from taking apart the morbidity assumptions for the DLR analysis should be incorporated into the ALR assumptions.)

Another performance measurement tool to use for morbidity is a disabled life reserve (DLR) source of earnings analysis. This analysis projects the DLR from one period to the next and compares how the DLR was expected to perform, usually based on valuation assumptions, versus actual



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experience. A dashboard can then be set up for this to answer questions such as:

- Were claim terminations higher or lower than expected?
 - Did the terminations vary for the entire block or just a particular segment — for example lifetime benefit period versus limited benefit period?
 - How did paid claims compare to what was expected for the period? Were they higher because of increased utilization, lower claim terminations, increased incidence, or a combination of these reasons?
 - Did the claim results vary by product feature — for example, claims with an inflation adjustment versus no inflation adjustment?
 - Did the results vary by issue age band or policy form? If this is the case, companies will have to dig deeper to see if there is a problem with incidence or if it is a result of higher than expected policy persistency.
- **Claim Transitions:** Another morbidity-related item to consider is claim transitions. Depending on how your valuation system is configured, when a claim changes site of care, for example from home care to nursing home, it can cause a disconnect in your DLR calculation because of the typical increase (or decrease) in benefits. The preferred remedy would be to incorporate claim transitions in your valuation; however, if that is not currently feasible, you can track them and make adjustments, if appropriate. For the dashboard, the number of claims transitioning during the period can be monitored for reasonableness and compared to expected, if that information is available.
 - **DLR Hindsight Analyses:** To demonstrate the continued adequacy of assumptions used to calculate disabled life reserves, companies should calculate the margins or deficits for DLR balances from prior valuation dates. The dashboard should track the five most recent year ends at a minimum. Consideration should be given to those dates when reserves have been strengthened to document that the reserves are more adequate as a result.
 - **Investment Income:** Given the current low new money rates, some LTC carriers are contending with investment yields that are lower than assumed in pricing. Additionally, depending on the make-up of their investment portfolios, asset and liability cash flow mismatching is more of a problem because of the lower yields (e.g., asset durations are shortening as callable bonds are being called). To monitor the impacts of shifts in the interest rate environment, companies should include invested asset performance on the LTC dashboard. Items to consider for the dashboard are: asset quality, features (e.g., callable), current average yields versus valuation interest rates, unrealized gains/losses, etc. Lastly, a gross premium valuation analysis can be used to determine the breakeven interest, which can be a useful gauge to know how much margin there is in the investment income assumption.
 - **Total Persistency:** Given that LTC is a lapse-supported product, having the appropriate lapse and mortality assumptions is important to an adequately priced product. When LTC was first priced, total persistency was often assumed to be much lower than experience has shown and has resulted in higher than expected claim costs, both in terms of actual and projected claims. The LTC dashboard should track actual to expected total persistency ratios by policy form and other variables that are determined to be significant (e.g., policy duration). Some carriers also have the ability to track mortality accurately, which will give more insight into this assumption. After a premium rate increase, monitoring shock lapses is important. If a company has several years of LTC experience, the actual to expected persistency ratios should show improvement, assuming that more recent business was priced with reduced lapse rates.
 - **Premium Rate Increases:** If premium rate increases are being requested and implemented, it is important to have a grid to track the “success rate.” This is the ratio of the rate increase requested to the final rate increase approved by state and, when combined with the amount of premium in the state, gives the ability to calculate the overall rate increase. Adding dates to the tracking allows monitoring of the lag between request and

approval of rate increases which can be considered when determining future actions.

- **Commissions and Expenses:** Actual to expected commissions and expenses should be monitored as well. It is important to note if commissions are paid on rate-increased premiums. The recoverability of the most recent calendar year of sales should be monitored.
- **Sales Trends:** Sales trends by policy form and various combinations of region or state, age, underwriting class, benefit period, elimination period, benefit amount, spousal coverage, etc. should be monitored. Comparisons to the sales projections should be included. If based on the pricing, there are known problematic cells, for example sales concentrated in one state, these should be monitored separately. Carriers should also note the number of exceptions to the underwriting manual in the new policies. For example, are a high number of exceptions being granted or do new sales follow the underwriting guidelines?

Once most of the procedures for actual to expected reports are in place, they can be performed quarterly. However, tools such as deep-dive experience studies on morbidity are generally only updated annually. To be most useful, this should be done before cash flow testing, loss recognition testing for GAAP, and the company expected plan is performed. For any assumptions that are highlighted as being problematic in the short-term, they should be monitored more frequently. Companies find it helpful to put together a calendar for experience studies. This helps the work stay on target and gives the appearance of being a well thought-out process and not some ad hoc actuarial work.

SUMMARY

In summary, as a company's LTC products mature and credible experience develops, their true performance can be assessed. An LTC dashboard which includes metrics and information like those described in this article, can be a valuable component in monitoring the experience and determining appropriate management actions to achieve desired objectives.

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