



SOCIETY OF ACTUARIES

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I Was an Audit Drop-In

by Steve Schoonveld

In the mid-80s, my college professor of Education, Dr. Cliff Schimmels, wrote a book titled, "I Was a High School Drop In." The book noted his experiences as a 47-year-old college professor who literally "dropped-in" a suburban Chicago high school. He went undercover and enrolled as a student by attending classes, completing the homework assignments, participating in gym activities, going to football games and pep rallies, and receiving grades. The intent of his experiment was to discover what really goes on as a high school freshman.

Similarly, "I Was an Audit Drop In."

There are few within the LTCI Section who possess as unique a perspective as those who work within audit firms and state insurance departments. In the last six months, these individuals have been especially busy dropping in on their clients to perform their often lengthy and laborious reviews. That such reviews are most intense during the late fall and winter months perhaps make the countless hours spent, more palatable. I often joke that some of the 90 percent of the world's population may be living north of the equator just to avoid fiscal years ending in the middle of summer.

The intensity of an audit differs based on the purpose and the established materiality levels. Given recent financial performance such materiality levels are broadening the scope of audits and increasing the intensity of the review. As of the end of 2007, more than 100 companies have blocks of long-term care business on their books and somewhere, somehow, and at some level, someone is auditing each block. Long-term care pricing actuaries need to consider the underwriting and claim adjudication processes when establishing rates. Similarly, the actuaries who audit these blocks have to take into account these practices as they render their opinions on the underlying financial health of the block. To have the unique perspective that comes from annually reviewing many LTC blocks and working with many of our fellow section members is invaluable.

Now that I am no longer an audit drop-in, I thought I would share some general findings that come from such a perspective. Specific findings remain with the audit and of course are not discussed.

1. ALL BLOCKS ARE UNIQUE. THAT IS WHAT MAKES THEM THE SAME.

Long-term care has the advantage or disadvantage—depending on your leaning—of the year-to-year volatility and ambiguity of a health product with the necessity for a long duration view of a life product.

Start with the differences in product features, available riders, covered benefits and care settings. Add in the underwriting requirements, approaches and rigor. Include the distribution methods and market focus. Bring in the claims adjudication and administration approaches. Finish with the actual product experience and policyholder behavior, and there are many, many aspects which make one block completely different from another. When you top this off with valuation approaches that run across the conservative to aggressive continuum, it should not amaze anyone why there are such diverse carrier experiences with this product line.

2. THE SIZE OF A BLOCK MATTERS, BUT NOT NECESSARILY.

There are successful and unsuccessful carriers with as little as a thousand or as many as a million policyholders. Whether insurance is purchased through a regional health plan, a frater-



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nal benefit society, a large multi-line carrier, or under an employer-sponsored plan, there are plenty of policyholder and claimant success stories across the block size spectrum. Certainly there are volume requirements to support the essential infrastructure and a strong commitment to providing a well supported product is necessary. Once met, the talents of our fellow section members have enabled many carriers, large and small, to provide meaningful products to the market and provide real value to policyholders. As the industry continues to grow, so will these successes.

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3. ADEQUACY IS IN THE EYE OF THE BEHOLDER.

As my former professor likely experienced, one high school teacher can look upon a class and see a group of enthusiastic students while another sees rowdy chaos. Similar differences of views are present when looking at the reserves and assets supporting a block of long-term care policies. Such differences of opinion are fine if adequate support is demonstrated and the applicable accounting rules are followed. While we are in the midst of significant accounting methodology change in both statutory and GAAP approaches, such support will be of a greater necessity.

4. KNOWLEDGE BREEDS SUCCESS.

Any actuarial auditor of recent years would be remiss if he did not mention Sarbanes-Oxley. The implementation and support necessary for a sufficient internal control environment were onerous for some and even more onerous for others. However, the knowledge that comes from such a control environment along with a strong experience reporting and financial modeling framework has enabled carriers to succeed. The LTCI Section regularly supports research that brings knowledge to the industry. Two such research reports were released during the first quarter of this year.

At the ILTCI conference in Reno, the LTCI Section Council announced the initiatives that are underway to enhance the offerings that section membership brings. These initiatives help foster a community that educates one another, participates in industry research, and enables the industry to grow in the presence of the unique approaches, experiences and challenges.

I encourage each of you to find your role within the section and to participate in section-sponsored research, webinars and committees. The sharing of our unique perspectives, knowledge and expertise, plays no small part in the overall health of the industry and the products which make a difference in the lives of consumers. ■