*Legal, Compliance & Regulatory*

# Anatomy of a Rate Increase

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Presented by
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ILTCI

Agenda

- Introductions
- Getting to yes with your regulators
- Actuarial aspects of your rate increase
- Mitigating legal risk on the back end

# Introductions

**Debbie Ellingboe**
- Partner
- Faegre Baker Daniels
- Minneapolis, MN

**Robert Eaton, FSA, MAAA**
- Consulting Actuary
- Milliman
- Tampa, FL

**Mike Rafalko**
- Attorney, Co-Chair of LTC Practice
- Drinker Biddle & Reath LLP
- Philadelphia, PA

# Getting to yes with your regulators

Debbie Ellingboe

# Anatomy of a Rate Increase

- Helping the client understand what motivates state regulators in a rate increase discussion
- Thinking outside the box in talks with state regulators
  - Creative ways to reach agreements
  - Not limited to the current paradigm
  - Addressing or conceding regulator concerns
- Reaching a mutual understanding with regulators
  - Helping your regulator understand actuarial arguments
  - Making actuarial concepts understandable to non-actuaries

# Anatomy of a Rate Increase

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Second Opinion

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## Middle-aged Americans unrealistic about their future health-care needs, U of M study finds

By Susan Perry | 01/06/15

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REUTERS/Jim Young

Sandy Wright gets some help from her Certified Nursing Assistant Jessica Haynes at her home in Peoria, Illinois.

Middle-aged Americans significantly — and unrealistically — underestimate their own future need for long-term health care, according to a University of Minnesota study published Monday in the journal Health Affairs.

The study, based on almost 12,000 responses to the 2012 National Health Interview Survey, found that only 40 percent of Americans aged 40 to 65 think it's likely that they will need long-term health-care services.

Those expectations don't match reality. Experts estimate that 70 percent of today's middle-aged adults will need some level of long-term services to help them cope with aging-related physical and mental disabilities after age 65, and almost half will spend some time in a nursing home.

"Middle-aged adults vastly underestimate

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Politics & Policy

## Sobering report details big problems with long-term care in Minnesota

By Sharon Schmickle | 12/14/10

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What do you think would happen if someone proposed a major new government medical give away? Would taxpayers swarm the state Capitol with pitchforks and clubs? After all, we've learned from Medicare that these programs grow into budget busters.

Right?

Nope. In refusing to take responsibility for their own long-term care, Minnesotans are creating a massive government program. They have made the state the insurer by default for the costly care they're likely to need when they are old.

Now comes a sobering report from the Citizens League — essentially saying, "Wake up, Minnesota. You can't sustain the cost of a program that is projected to grow from $1.1 billion this year to $5 billion in 2035 as baby boomers retire."

"We have this big costly program on the books, and unless we change it, it's going to drag us all under," said Stacy Becker, the League's Project Director. "What we need to do is to make this program work better for people and to save money while we are doing it."


If you've groused about run-away government spending at the same time you've hidden family assets so that the state will pick up the tab for your grandma's care, you definitely need to read this report, "Moving Beyond Medicaid: Long-term Care for the Elderly as a Life Quality and Fiscal Imperative."

And anyone who is not among the 10 percent or so of adults who pay for long-term care insurance should read it too.

For that matter, read it even if you do buy the insurance. You're paying twice: as a

## Some common regulator concerns:

- Was original pricing set in a professionally adequate manner?
- Is the insurer doing all it can to cut expenses and "share the pain"?
- Is the proposed rate increase "manageable" for policyholders?

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# Anatomy of a Rate Increase

| Typical regulator goals: | Typical insurer goals: |
|---|---|
| • "Win"<br>• Certainty<br>• Protect consumers<br>• Show its resolve to the industry and media<br>• Stem the tide of rate increases<br>• Keep insurers in the state | • "Win"<br>• Certainty<br>• Reduce its losses (<u>not</u> necessarily to make a profit)<br>• Protect relationship with regulator<br>• Continue to do business in the state |

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# Anatomy of a Rate Increase

## How to explain lifetime loss ratio (assume LLR of 119%)

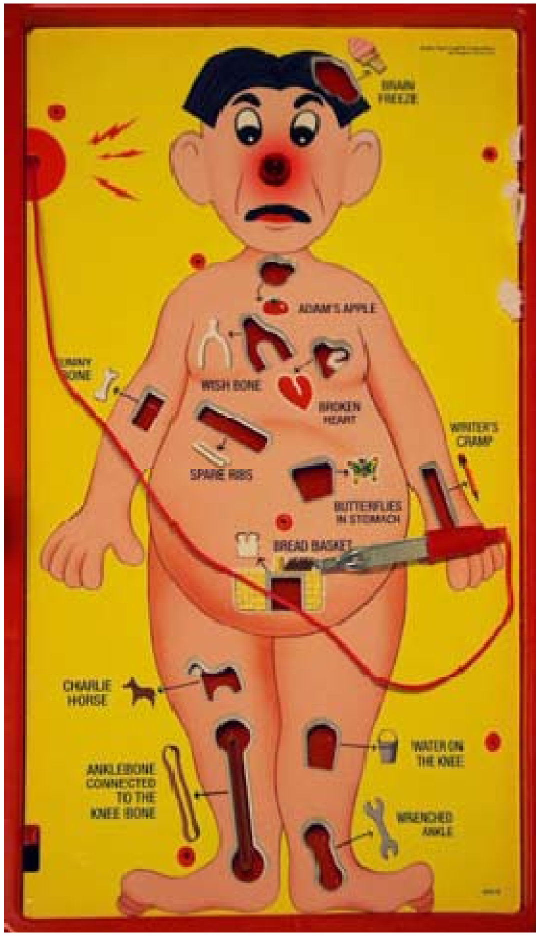

**THE INSUREDS**

**THE INSURER**

# Anatomy of a Rate Increase

## Actuarial Aspects of your Rate Increase

The Unmentionables




Robert Eaton

# Anatomy of a Rate Increase

- Actuarial Rate Increases 101
- Policyholder benefit options available in place of full rate increase
- Importance of the time value of money in increases
- Maintaining compliance through follow-up certifications
- Trends in rate increases
  - IIPRC
  - 2014 Model Reg

# Anatomy of a Rate Increase

- Actuarial Rate Increases 101
  - Justification via loss ratio approach
    - A loss ratio over 100%? Common! But makes certain assumptions.
  - Assumptions are key
    - Persistency
    - Claim incidence, continuance, and utilization
    - Interest rates
  - Recovering past losses
  - Premium scenarios:
    - Historical premiums at current levels
    - Premiums for all states at filing state level

# Anatomy of a Rate Increase

- Policyholder benefit options available in place of full rate increase
  - Non-forfeiture: no future premium payments
    - Contingent non-forfeiture: bare bones
    - Richer non-forfeiture
      - Benefit bank
      - DMB based on years of premium payment
    - Many regulators hoping to avoid
  - Benefit reduction
    - Based on existing rates and benefits
    - Example: reducing daily benefit by 33% to avoid a 50% rate increase

# Anatomy of a Rate Increase

- Policyholder benefit options available in place of full rate increase

  Landing Spots

  – New benefits (not originally filed)

  – Lower inflation options

  – New benefit periods

  – May off-set rate increase entirely

  – May be actuarially equivalent

    - Over entire block, so some better off than others
    - Anti-selection concerns

# Anatomy of a Rate Increase

- Importance of the time value of money in increases
  - Receiving approval sooner implies lower rate increases
  - Some states willing to approve sequence of rate increases
  - Rate increase strategy, state-by-state, based on perception of “speed-to-market”, chance of achieving increases

# Anatomy of a Rate Increase

- Maintaining compliance through follow-up certifications
  - Most states require annual follow-up filings for 3 years
    - Showing actual results v expected
    - Reporting new lifetime loss ratio
  - Some states require a certification of rates
    - For actuaries who cannot certify, plan must be in order to reach sustainable premiums
  - 2014 NAIC model (new product offerings) requires annual rate certification

# Anatomy of a Rate Increase

- Trends in rate increase regulation
  - IIPRC
    - LTC Participation
      - 34 full member states for LTC (including PR)
      - 5 states do not participate in modified rate schedules
      - 5 states opted out of LTC Standards
    - Standards
      - Similar to 2010 NAIC model, updated each 5 years
      - No morbidity improvement allowed in pricing (unless justified)
      - Annual filings including actuarial rate certification and filing of assumptions
      - Modified rate schedules: increasing premiums to age 65 for policies with increasing benefits, with some restrictions.
    - Rate Increases
      - One rate increase filing can receive approval in all IIPRC states!
      - Rate increases 15% and less do not need further state approval
      - Rate increases greater than 15% require specific state sign-off
      - Expedited process (IIPRC will typically have the filing for less than 90 days)

# Mitigating Risk on the Back End: How the Steps You Take During the Approval Process Can Reduce Your Risk of Legal Exposure


Mike Rafalko

Drinker Biddle & Reath LLP

# Anatomy of a Rate Increase

Only three things are guaranteed in life:

1. Death
2. Taxes
3. The consuming public will find a way, no matter the cost, to push back on premium rate increases.

# Anatomy of a Rate Increase

## The Risk to LTC Insurers is Potentially Significant:

1. Potential for class action exposure
2. Damages, including punitive damages
3. Unwinding a rate increase
4. Increased sophistication and attention of the Plaintiffs' Bar
5. Costs of litigating a case
6. Costs of settling a case
7. Negative publicity

Steps taken during the approval process can affect all of the above.

# Anatomy of a Rate Increase

**From:** Dee Miles, Beasley Allen [mailto:web@beasleyallen.com]
**Sent:**
**To:**
**Subject:** Insurance practices may yield valuable fraud claim

Beasley Allen
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helping those who need it most since 1979

We have uncovered a potential claim concerning fraudulent accounting practices by life insurance companies and long-term care insurance companies. The accounting method may result in the policyholder being charged excessive insurance premiums.

If you represent a client that has a life insurance policy or long-term care insurance policy and they have been notified of a substantial increase in premium payments, or if they have been told their policy's "cost of insurance" has increased, they may have a valuable legal claim that our firm would like to investigate.

Please contact lawyers Andrew Brashier or Rachel Boyd in our Consumer Fraud section at Andrew.Brashier@beasleyallen.com or Rachel.Boyd@beasleyallen.com, or call us at 800-898-2034.

Dee Miles

W. Daniel "Dee" Miles, III; Principal & Consumer Fraud Section Head

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# Anatomy of a Rate Increase

Unlikely we can eliminate risk associated with rate increases, so:

1. Focus is on *containment* and *mitigation*
2. How do we get there?
   – A brief history lesson
   – Document compliance with literal letter of the law
   – Communications
   – Creative benefit reduction options?

# A Brief History Lesson…

## A Brief History Lesson…

1. Rate increases litigated as long as there have been rate increases.
2. Traditional themes of liability grounded in:
   – Bait and switch
   – Targeting the elderly
   – Policies deceptively underpriced
3. Many early cases settled as companies and consumers learned/developed the legal landscape.

# A Brief History Lesson (continued)…

## 1. The Industry Strikes Back

- Realization that rate increases are here to stay
- Need for carriers to stand their ground or long term viability of product in jeopardy

## 2. The industry "wins" round one

- Key decisions erode "bait and switch" liability
  - Armor; Rakes; Alvarez

## A Brief History Lesson (continued)…

1. The initial battle was won, but the war is far from over
2. Plaintiffs' Bar poking around for the next hit
   - *Bates*
   - *Sanchez*
   - *Toulon*
3. What does this mean for us?
   - Theories of liability no longer primarily grounded in contract alone
   - External sources of liability potentially touch and concern all aspects of the rate increase process
   - Plaintiffs' Bar will throw the kitchen sink until something sticks

# Anatomy of a Rate Increase

## Document compliance with the law

1. One potential new battleground: Administrative Actions
   - *Driscoll* – Washington OIC (2015)
     - Alleged: OIC breached its own laws and regulations by allowing carrier to aggregate nationwide experience in support of rate increase
     - Response: Appropriate information re: experience provided to OIC; Driscoll, a layman, not sophisticated enough to understand it
     - Relief Sought: Retroactive relief; prospective relief; disclosure of sensitive material by carriers
     - Result: Dismissed as time-banned; affirmed on 1st appeal (plus filed rate doctrine); second appeal pending
     - Risk: Carrier not named in underlying action, but potentially stuck holding the bag. The Plaintiffs' Bar is watching.
   - *Driscoll* – Washington OIC (2016)
2. Take away: clearly documented and "self-explanatory" compliance with the law

# Communications: Early, Often, Professional

1. Communications arguably single biggest source of risk (and risk mitigation)
2. Just about every "second generation" rate increase action alleges some bungled communication
3. Two sets of communications potentially under scrutiny:
    1. Communications with the insured:
        a) Accurate?
        b) Early, often, and professional?
        c) Getting the music right?
    2. Communications with regulators:
        a) Accurate?
        b) Professional?
        c) (reasonably) accessible?

4. Takeaways:
    – Communications matter (they really, *really* matter)
    – Assume insureds will see the sausage being made

# A word about benefit downgrades:

1. Robert hit the high points; not going to rehash standard downgrade options
2. But, litigation avoidance strengthened by giving insured options that are *truly* palatable
3. How many have explored the possibility of creative downgrade options?
4. Example I: Dropping inflation protection rider
   - Three clients have approached our team about this in the last year
   - Significant opportunity for premium reduction
   - Can you do it? What are the pitfalls (assume a TQ policy)?

# A word about benefit downgrades (cont.):

1. Example II: Policy Commutation/Buybacks
   - Has anyone given this any thought?
   - Difficult for sure (but not necessarily impossible, depending on circumstances)
2. What other example(s)?
3. Takeaway: Litigation risk is often about policyholder temperament; don't immediately write off creative downgrade options as a way to manage policyholder expectations.

QUESTIONS?

# Don't forget to fill out the survey!

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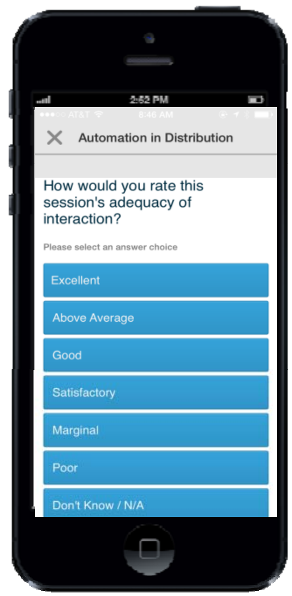


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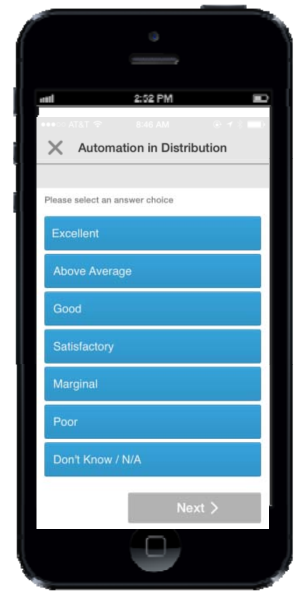


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