Statement of Kathleen Sebelius

I. Introduction

Good morning, Mr. Chairman and Members of the Committee. My name is Kathleen Sebelius. I am the elected Insurance Commissioner for the state of Kansas. Also, I am the Vice President of the National Association of Insurance Commissioners (NAIC) and the chair of the NAIC's Health Insurance and Managed Care (B) Committee. I would like to thank you for providing the NAIC[(1)] with the opportunity to testify about long-term care insurance and what the NAIC and the states are doing to regulate this relatively new product and respond to recent consumer issues.

The members of the NAIC understand that Congress is considering several pieces of legislation affecting long term care insurance. Our experiences in regulating long-term care insurance policies and protecting consumers can be helpful to you in developing such legislation. We look forward to continuing our cooperative federal-state effort in this area.

II. Background

- In General

Developed in the early 1980s, long-term care insurance is a relatively new product compared to other insurance products. Originally, long-term care insurance was a policy that just covered nursing home costs. However, over the years, it has evolved into a more sophisticated product that may cover home care services and adult day care.

Even with this progress, long-term care insurance still poses several concerns that have yet to be resolved. Due to its newness, it is challenging for insurers to set rates since many of the policies sold years ago may not have had claims filed. Second, long-term care insurance has experienced rate increases because fewer insureds have lapsed than anticipated. Regardless of when an individual buys long-term care insurance (the average age is in the sixties), if an individual is on a fixed income, the ability of the individual to handle an increase in premiums is likely to decrease over time. Finally, there is the concern regarding whether consumers, who may be told their rates cannot increase due to age or physical condition, understand that they are part of a class whose rates can increase.

The members of the NAIC believe there needs to be increased and ongoing consumer education in all aspects of long-term care insurance, including: (1) who is a suitable candidate to buy long-term care insurance; (2) what issues consumers should consider when shopping for this product including benefits, exclusions, restrictions and cost of various policies; and (3) the potential for future rate increases. The NAIC has been very active in this area, publishing a consumer handbook, "*A Shopper's Guide to Long-Term Care Insurance,*" and working to include additional consumer protections in the NAIC model laws and regulations.

- NAIC Model Act and Regulation

The NAIC has been closely monitoring the development of long-term care insurance since the product's inception. The NAIC developed its Long-Term Care Insurance Model Act and Regulation ("NAIC Model Act and Regulation") (Attachments A and B) in the 1980s with the intent of promoting the availability of coverage, protecting applicants from unfair or deceptive sales or enrollment practices, facilitating public understanding and comparison of coverages, and facilitating flexibility and innovation in the development of long-term care insurance. The NAIC has been updating the models ever since as the market and the product mature.

For the most part, the NAIC Model Act and Regulation apply to all long-term care insurance policies and life insurance policies that accelerate benefits for long-term care. The Model Act and Regulation establish:

- Policy requirements: (a) requiring a standard format outline of coverage; (b) requiring specific elements for application forms and replacement coverage; (c) preventing cancellation of coverage upon unintentional lapse in paying premiums; (d) prohibiting post-claims underwriting; (e) prohibiting preexisting conditions and probationary periods in replacement policies or certificates; and (f) establishing minimum standards for home health and community care benefits in long-term care insurance policies.

- Benefit requirements: (a) requiring the offer of inflation protection; (b) requiring an offer of nonforfeiture benefits; (c) requiring contingent benefit upon lapse if the nonforfeiture benefit offer is rejected; and (d) establishing benefit triggers for non-qualified and qualified long-term care insurance contracts.

- Disclosure requirements.

- Suitability requirements: (a) explaining and reviewing a personal worksheet with applicants; and (b) requiring that insurers deliver a shopper's guide to buying long-term care insurance to applicants.

- Insurer requirements: (a) reporting requirements; (b) licensing requirements; (c) reserve standards; (d) loss ratios standards where applicable; (e) filing and actuarial certification requirements; and (f) standards for marketing.

- Penalties.

The NAIC models have been used as guides in most states in developing legislation and regulations, and these models have been developed with the combined efforts of state regulators, industry and consumers.

III Consumer Protections Added to the NAIC Model Act and Regulation Since HIPAA

As you know, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) created tax-qualified long-term care insurance policies and specifically cited the NAIC's 1993 models for establishing policy requirements and consumer protections for these qualified plans. Since that time, the NAIC has updated its models in a variety of ways to include additional consumer protections and to recognize the changes in the market.

A. Suitability and Nonforfeiture Benefits

Two of the most significant consumer protections added since the 1993 version was adopted are the provisions on suitability and nonforfeiture benefits.

1. Suitability

The first major change was in the provisions determining the suitability of a long-term care insurance policy for an individual. Suitability is an important issue in deciding whether long-term care insurance is appropriate for any particular individual. The consumer and the insurer must determine: (1) whether the applicant will be able to afford the policy even if the premiums do not go up (income goes down or becomes fixed); (2) whether the applicant will be able to afford the policy if the premiums do increase; and (3) whether the benefits included in a policy are appropriate for the particular individual.

In the 1993 version of the NAIC Model Act and Regulation, the suitability provision was entitled "Appropriateness of Recommended Purchase" and was one sentence long. In the current version, this same section had been renamed as "Suitability", and it is a more comprehensive section that requires insurers: (1) to develop suitability standards; (2) to train their agents on the issue; and (3) to obtain more information from the applicant. The insurers are required to examine: (1) an applicant's ability to pay for the proposed coverage and any other pertinent financial information related to the purchase of the coverage; (2) the applicant's goals or needs with respect to long-term care; and (3) the values, benefits and costs of the applicant's existing insurance, if any, when compared to the values, benefits and costs of the recommended purchase or replacement any existing insurance (if any). A highlight of the current version is a personal worksheet that the applicant should complete in order to determine whether a long-term care insurance policy is appropriate for the applicant. The worksheet factors in income, expenses, savings and investments. The insurer must request that the applicant fill out the personal worksheet.

2. Nonforfeiture Benefits

A second protection added to the 1993 version was nonforfeiture benefits. These are benefits that are triggered when there is a lapse or non-payment in a long-term care policy. At such time, the policy would convert to one with a shortened benefit period providing paid-up, long-term care insurance coverage after lapse. In addition, the standard nonforfeiture credit would be equal to 100% of the sum of all premiums paid, including the premiums paid prior to any changes in benefits.

In 1993, the NAIC models included mandatory nonforfeiture benefits. The requirement that these benefits be included in the policy was not well received by the industry and Congress did not include these mandatory benefits in HIPAA. The NAIC's current version does not require inclusion of mandatory nonforfeiture benefits in the policy, but instead requires the insurer to offer nonforfeiture benefits to the consumer as an option to the policy (for an additional premium). If the consumer refuses these optional benefits, then the insurer will not include them in the policy; however, the insurer instead must provide "contingent benefit upon lapse" or a "contingent nonforfeiture" benefit (without any added premiums).

"Contingent nonforfeiture" is an alternative to nonforfeiture benefits and is triggered if the individual's rate increases by a certain accumulative percentage from the time the individual bought the policy (issue age). The current version of the NAIC's model regulation includes a chart showing issue age and the percent increase that triggers contingent benefit upon lapse. Once triggered, the consumer has three choices: (1) pay the higher premium for the same level of coverage; (2) pay the same amount of premium, but have a decrease in the level of benefits to the individual; or (3) convert the coverage to a paid-up status (no more premiums) with a shortened benefit period. This mechanism gives options to consumers when there is a substantial increase in rates. In addition, a policy or certificate offered with nonforfeiture benefits must have coverage elements, eligibility, benefit triggers and benefit length that are the same as coverage to be issued without nonforfeiture benefits.

B. Rating Practices and Consumer Disclosures

With the growth of long-term care insurance and the many changes in the market, the issue of rate stability for long-term care insurance has become a big concern for regulators, lawmakers, consumers and industry. Under a long-term care insurance policy, a company cannot raise an individual's rates, but it can raise the rates of an entire class directly increasing an individual's rates. Not only is the rate increase itself a concern, but disclosure to consumers about the potential for future rate increases is also a concern. In response to these concerns, two NAIC working groups developed a plan to address these two issues, with the input of regulators, insurance companies and consumer groups. Last month on August 17, 2000, the nation's insurance commissioners by unanimous vote adopted amendments to the model regulation that would assist in stabilizing rates and enhancing protections for and disclosures to consumers regarding rate increases.

1. Rating Practices / Rate Stabilization

To further protect consumers from rate increases, the NAIC adopted rating practices amendments. These amendments establish a new rating process that encourages insurers to establish adequate initial premiums or be penalized in the future for rate increases. A company must show why it needs a rate increase. The goal is to increase the likelihood that the premium rates offered by a company will be adequate over the life of a policy, rate increases will be less likely, only justified increases will occur, and necessary increases will be smaller and less frequent.

The amendments would: (1) eliminate the initial loss ratio requirements; (2) require companies to provide actuarial certifications regarding adequacy of all rates; (3) impose limits on expense allowances on increases; (4) require reimbursement of unnecessary rate increases to policyholders; (5) authorize review by the commissioner of companies' administration and claim practices; (6) provide policyholders with the option to escape the effect of rising rate spirals by guaranteeing the right to switch to currently sold insurance without underwriting; and (7) authorize the commissioner to ban from the market place for five years companies that persist in filing inadequate initial premiums. An executive summary of these key provisions is attached.

Under the previous NAIC model regulation, companies were required to use a 60% fixed loss ratio, which is the ratio of claims to premiums, as a basis to calculate rates for long-term care insurance policies. This fixed loss ratio method effectively established a cap on premiums that a company could charge, artificially limited initial premiums, and created an incentive for insurers to increase claims so they could receive higher expenses. This method often lead to future rate increases.

Under the new amendments, there would not be a fixed loss ratio requirement on initial rate filings, but there would be penalties imposed in the future if there are rate increases. If a rate increase is filed, 58% of the initial premiums and 85% of the increased portion of the premiums must be available to cover claims on a lifetime present value basis. If a carrier has demonstrated a persistent practice of filing inadequate initial premium rates, the commissioner could: (1) prohibit an insurer from filing and marketing comparable coverage for a period of up to five years; or (2) require that the carrier offer all other similar coverages and limit marketing of new applications to the products subject to recent premium rate schedule increases. Because of these penalties, an incentive exists for companies to price their policies adequately in the first instance.

The amendments also propose a mechanism to handle rate changes due to changes in state laws or regulations or due to increased and unexpected utilization affecting the majority of insurers of similar products. Under these "exceptional increases," there is a 70% loss ratio requirement on that rate increase of the present value of projected additional premiums.

2. Consumer Protection / Disclosure Amendments

Another concern regarding rating practices is whether consumers, who may be told their rates cannot increase due to age or physical condition, understand that they are part of a class whose rates can increase. The NAIC has adopted additional enhanced consumer protection amendments, which primarily focus on disclosures to consumers regarding potential future rate increases for all long-term care insurance policies, other than for policies where the insurer does not have the right to raise the premium (sometimes called "noncancellable" policies).

These amendments require: (1) an insurer to disclose rate increase histories for the past 10 years; (2) an insurer to supply the applicant with a list of information including a statement that the policy may be subject to rate increases in the future and an explanation of the policyholder's options in the event of a premium rate increase; (3) an applicant to sign an acknowledgement of the potential for rate increases; (4) producers who sell long-term care insurance to be adequately trained in all aspects of the product; (5) agents to provide copies of the disclosure forms and provide an explanation of contingent benefit upon lapse during the marketing of long-term care insurance coverage; and (6) the outline of coverage to state who consumers may contact if they have questions. The amendments also update the disclosure forms and personal worksheets regarding potential rate increases. An executive summary of these key provisions is attached.

3. Follow-up to the Amendments

As a follow-up to these new changes, the NAIC's Accident and Health Working Group is developing educational materials for insurance department personnel as guidance for applying this new system and in reviewing rate and form filings. An education seminar to explain these changes was held this past Saturday, September 9, at the NAIC's Fall National Meeting. Additional education programs on these changes are expected in the future. The state insurance departments will now be working to have the changes adopted into state law and/or regulation. Industry representatives have said they are willing to help the state regulators get these changes passed through the legislatures in those states that cannot accomplish it by regulation.

In addition, the Accident and Health Working Group is drafting a compliance manual, which would allow regulators with experience reviewing long-term care polices to lend guidance to other regulators. Regulators, interested parties and NAIC staff are currently involved in the drafting process. A first draft was exposed for comment this past weekend at the NAIC Fall National Meeting.

IV. Working with Congress in Implementing Changes for Tax-Qualified Plans

Because of the recent amendments made to the NAIC models[(2)], the models now provide additional state law protections for non-tax-qualified policies that are not current requirements for federally tax-qualified plans, including provisions on contingent benefit upon lapse, suitability, rate stabilization, and premium rate increase disclosures. In the past, Congress has incorporated protections for federally tax-qualified long-term care insurance policies by referencing the NAIC Models. However, we caution that some of the most recent changes are best accomplished at the state level.

The contingent nonforfeiture benefit and suitability requirements are two consumer protections that can be implemented easily at the federal level. We recommend that Congress amend the tax code to include contingent nonforfeiture as a mandatory consumer protection in tax-qualified plans. In particular, the NAIC believes that contingent nonforfeiture is a vital consumer protection. We applaud you, Mr. Chairman, for the inclusion of this protection in your stand-alone long-term care legislation, S. 2225, the Long-Term Care and Retirement Security Act of 2000. We also would support its addition to any patient protection legislation that includes long-term care insurance provisions. Currently, both the House and

Senate patient protection bills contain provisions relating to the tax treatment of long-term care insurance. If the final patient protection conference report includes tax provisions on long-term care insurance, we believe contingent nonforfeiture benefits and suitability provisions should be added to the conference report as consumer protection requirements for tax-qualified polices.

Although the suitability provisions and the nonforfeiture benefits can be implemented immediately, there are some issues that are best left to the states to enact, and rating issues is one of them.

Congress must carefully consider whether to implement the rating practices/rate stability amendments for tax-qualified plans through federal legislation. There are several issues that need to be addressed before implementation of these amendments. If the rating practices amendments are implemented immediately at the federal level, the sale of tax-qualified policies would be illegal in most states because of the 60% initial loss ratio requirement that is currently in effect. The insurance industry is quite concerned about the market disruption that could occur. We agree that this is a legitimate concern.

Another reason to leave the rating issue to the states is because currently there is no rating process found in federal law except for the Medicare Supplement Program (Medigap) and that is limited to establishing a loss ratio standard. It is unclear how the federal government would or could regulate rates for long-term care insurance. This is an area where the states need to be involved. Cooperative efforts by the federal government, the states and the NAIC are needed in order to regulate this product effectively and to enforce consumer protections. Therefore, we request that Congress defer implementing the rating practices amendments at the federal level and give the states the opportunity to implement these changes for all long-term care policies, not just tax-qualified policies. If the states fail to accomplish this task within a reasonable time, then Congress could revisit the issue.

V. Conclusion

Long-term care insurance is a relatively new product compared to other insurance products. The NAIC has been closely monitoring the development of long-term care insurance since the product's inception, and developed its Long-Term Care Insurance Model Act and Regulation to provide an array of protections to consumers of this product. The NAIC has been updating the models consistently over the years as the market and the product mature.

HIPAA created tax-qualified long-term care insurance policies and specifically cited the NAIC's 1993 models for establishing policy requirements and consumer protections for these qualified plans. Two of the most significant consumer protections added since the 1993 version was adopted are the provisions on nonforfeiture benefits and suitability. We agree with you, Mr. Chairman, and your colleague on the House side, Representative Nancy Johnson, that the contingent nonforfeiture benefit should be added as a requirement for tax-qualified plans, and we suggest that the new suitability protections be added as well.

Our more recent amendments regarding rate stability are more complicated. These amendments radically alter the regulatory landscape by eliminating initial loss ratio requirements in favor of instituting a system that creates incentives for insurers to adequately price their products so that any rate increase over the life of the product will not be necessary. Given the unique aspects of insurance rate regulation, this important new aspect of consumer protection should be left to the states. If, however, Congress decides to implement these amendments for tax-qualified plans as part of federal legislation, we would request that there be a transition period before the amendments became effective to give the states ample opportunity to change their laws before any preemption took effect.

We look forward to continuing to work with the Congress on the important issue of consumer protection for long-term care insurance. Thank you for the opportunity to testify before you today.

[1] The NAIC, founded in 1871, is the organization of the chief insurance regulators from the 50 states, the District of Columbia, and four of the U.S. territories. The NAIC's objective is to serve the public by assisting state insurance regulators in fulfilling their regulatory responsibilities. Protection of consumers is the fundamental purpose of insurance regulation.

[2] In addition to the changes described above, the NAIC amended its models to recognize and accommodate federally tax-qualified long-term care insurance policies as provided for under HIPAA. Under previous versions of the models, tax-qualified policies would not have been allowed under state law. The amendments affirmatively allow for and address these types of policies within the model act and regulation. The amendments allowing such policies under state law were adopted by the full NAIC membership at the Spring National Meeting on March 13, 2000.