



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

Human Resources
Products and Services
Division

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Per _____

The Honorable Eleanor Holmes Norton
Member, U.S. House of Representatives
529 14th Street N.W., Suite 900
Washington, DC 20045-1928

Dear Representative Norton:

Thank you for your recent letter on behalf of Mr. Chester M. and Mrs. Donna F. Joy. Mr. and Mrs. Joy question the premium increase under the Federal Long Term Care Insurance Program (FLTCIP) and have requested the increase be postponed until a public analysis can be conducted.

Mr. and Mrs. Joy expressed several concerns about the premium increase for certain individuals enrolled in the Automatic Compound Inflation (ACI) option. First of these concerns is their understanding that the premium would never increase, as expressed in the Benefits Booklet provided with their inquiry. They are correct in reading the brochure that their premium will not increase due to the annual benefits increases designed to protect them from inflationary increases in the daily or weekly benefit amount payable under the ACI option. This statement is included in the section titled, "How Benefit Changes Affect Your Premium." However, in the preceding paragraph in the section titled "Premiums," the next to last sentence indicates that premiums may be increased for groups of enrollees whose premium is determined to be inadequate. The premium is inadequate for certain groups enrolled the ACI option, and the premiums must be increased to ensure that funds are available to pay benefits as enrollees become eligible. The premiums are **not** being increased because of the annual increases in the benefit amount to protect against inflation.

Another concern is the question of whether there was an actuarial miscalculation or incompetence involved in the initial premium pricing. Insurers of the FLTCIP are required to adhere to the rate stabilization guidelines issued by the National Association of Insurance Commissioners. Although the guidelines were adhered to, experience over the past seven years and projections into the future are different than expected in 2001, when the original premium pricing was established. The premium increase is based on revised assumptions that more accurately reflect expected future return on Program investments over the life of the enrollees, and the number of individuals who remain enrolled in the program and are projected to be eligible for benefits. The revised assumptions have been reviewed by an independent actuary, as well as OPM actuaries. The review found the assumptions reasonable with a moderate level of risk. While OPM cannot guarantee there will be no future increases, there is no expectation that

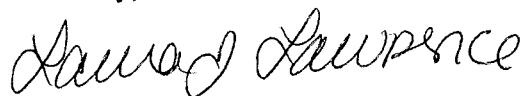
an increase will be necessary during the seven years of the new contract, or upon award of a third contract. Under both the current and new contracts, premiums may increase for any group of enrollees whose premium is determined to be inadequate.

Mr. and Mrs. Joy's third area of concern is their belief that the premium increase structure is the result of social policy and subsidization, because not all age groups and not all enrollees will be subject to the increase. They question the tiered structure of the increases, which are based on the enrollee's age when the ACI option was purchased. There are several factors that cause the premium increase to be less for individuals who were age 66 or older at the time of purchase, than for those who were age 65 or younger at time of purchase. Premiums for long term care insurance are based on the age of the enrollee at the time of application. Older enrollees pay higher premiums for the same coverage than younger enrollees pay. There are several reasons for this, but two are particularly important. First, since long term care insurance claims are correlated with age, the younger an enrollee is, the longer the insurer can expect to invest the enrollee's premiums before the enrollee will claim benefits. These expected investment returns offset some of the up-front premium that younger enrollees would otherwise have to pay. Second, the younger enrollees are, the less likely they are to remain in the program until they claim benefits. This difference in persistency is reflected in younger enrollees' lower premiums. Consequently, the changes to assumptions about investment return and persistency have a larger impact on younger enrollees' premiums. Therefore their premium increase is higher. Future Purchase Option (FPO) premiums are designed to increase every two years along with benefits. Because an FPO benefit does not require the same degree of prefunding as the ACI policies do, the announced premium increase does not apply to enrollees with FPO.

We regret that we must increase insurance premiums, but OPM and John Hancock agree that the announced premium adjustment is necessary so that the rates will be sufficient to reflect the cost of the benefits provided, as required by FLTCIP law. It is critical that the Program investments be adequate to cover projected costs of future benefits. Please know we are requiring the insurer to revise the program materials to ensure they mention the conditions under which premiums may increase in a more prominent manner.

I appreciate the opportunity to respond to your inquiry.

Sincerely,



Laura J. Lawrence, Chief
FSA, Life and Long Term Care Insurances Group
Insurances Services Program