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# LONG-TERM CARE INSURANCE

Federal Program Has  
a Unique Profit  
Structure and Faced a  
Significant Marketing  
Challenge





Highlights of [GAO-07-202](#), a report to congressional committees

## Why GAO Did This Study

Spending on long-term care services—about \$193 billion in 2004—is expected to rise. In 2000, Congress passed the Long-Term Care Security Act, requiring the federal government to offer long-term care insurance. To do so, the Office of Personnel Management (OPM) contracted with Long Term Care Partners LLC (Partners) to create the Federal Long Term Care Insurance Program. This is the second of two reports required by the act on the competitiveness of the federal program. GAO's March 31, 2006, report, *Long-Term Care Insurance: Federal Program Compared Favorably with Other Products, and Analysis of Claims Trend Could Inform Future Decisions* ([GAO-06-401](#)), found that the federal program's benefits and premiums compared favorably with other plans, but enrollment and claims experience—the amount and number of claims payments—were lower than Partners expected.

In this report, GAO compared the federal program's profit structure and marketing efforts with those of other plans and updated its analysis of the program's claims experience. GAO reviewed the contract between OPM and Partners and interviewed OPM, Partners, and insurance carrier officials, as well as actuaries and industry experts. GAO also analyzed data on claim payments for the federal program since it began in 2002.

[www.gao.gov/cgi-bin/getrpt?GAO-07-202](http://www.gao.gov/cgi-bin/getrpt?GAO-07-202).

To view the full product, including the scope and methodology, click on the link above. For more information, contact John E. Dicken at (202) 512-7119 or [dickenj@gao.gov](mailto:dickenj@gao.gov).

## LONG-TERM CARE INSURANCE

### Federal Program Has a Unique Profit Structure and Faced a Significant Marketing Challenge

#### What GAO Found

The Federal Long Term Care Insurance Program has a unique profit structure that is explicitly defined in the contract between OPM and Partners. This profit structure consists of three distinct annual payments to Partners: (1) a guaranteed payment of 3.5 percent of the year's collected premiums, (2) a payment linked to OPM's evaluation of Partners' performance of up to 3 percent of the year's collected premiums, and (3) a guaranteed payment of 0.3 percent of the average annual assets of the program. These payments are separate from other payments made to cover the program's expenses. In contrast to the federal program, profits realized by carriers offering other long-term care insurance plans generally are not based on explicit profit structures, but rather on the experience of the programs they insure.

The federal program's marketing efforts were generally similar to those used for other plans sold in the group market, but faced a significant challenge in sending information directly to eligible individuals. The federal program and other plans sold in the group market used such marketing efforts as mailing information to the homes of eligible individuals and hosting employee and retiree seminars. Of these efforts, carrier officials GAO spoke with explained that mailing to the homes of eligible individuals was critical to their marketing strategy. The federal program faced a significant challenge in mailing information to the homes of those eligible for the program because it initially did not have the home addresses for nearly all active federal civilian employees. Because of this challenge, the federal program relied heavily on marketing efforts that were less direct and less personalized, such as sending information to federal employees through agency benefits officers.

The federal program's claims experience increased in the program's fourth year, but remained lower than the expectations established by Partners in its contract with OPM. This increase was generally consistent with trends since the federal program began in 2002. Overall, the federal program has paid 44 percent of the expected amount of claim payments per enrollee and 41 percent of the expected number of claims per enrollee. As of August 2006, Partners officials had not determined why the claims experience was lower than Partners' expectations. While it is generally expected that the number of claims submitted in the first few years of a long-term care insurance program will be a small portion of the total number of claims submitted over time, a program's claims experience is one of several factors that may affect its long-term financial outlook. The results of this analysis underscore GAO's prior recommendations that OPM analyze the claims experience and assumptions affecting premiums to inform forthcoming contract negotiations.

In commenting on a draft of this report, OPM generally agreed with the report's findings.

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**Abbreviations**

NAIC	National Association of Insurance Commissioners
OPM	Office of Personnel Management

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### Congressional Committees

In 2004, about \$193 billion was spent nationwide on long-term care services, including nursing home care and other assisted-living services.<sup>1</sup> Most of this care was financed by government programs, primarily by Medicaid, a joint federal-state program that finances health insurance for certain low-income adults and children. Elderly people—those aged 65 or older—consume about two-thirds of all long-term care services. As the elderly population continues to grow, particularly with the aging of the baby boom generation, the increasing demand for long-term care services will likely strain federal and state resources. Some policymakers propose that increased use of long-term care insurance may be a means of reducing the future financial burden on public programs. In 2000, Congress passed the Long-Term Care Security Act, requiring the federal government to offer long-term care insurance to its employees, their families, and others.<sup>2</sup> Congressional committee reports accompanying the act indicated that a federal long-term care insurance program could encourage people to purchase long-term care insurance, serve as a model for other employer-sponsored programs across the nation,<sup>3</sup> and encourage private payment sources to assume some of the insurance risk.<sup>4</sup>

In December 2001, at the conclusion of a competitive bidding process, the Office of Personnel Management (OPM)—the federal agency responsible for administering governmentwide compensation and benefit systems—entered into a 7-year contract with Long Term Care Partners LLC (referred to as Partners) that allows certain eligible individuals affiliated with the federal government to apply for long-term care insurance. Individuals

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<sup>1</sup>Long-term care refers to a range of support services provided to people who, because of illness or disability, generally are unable to perform activities of daily living for an extended period. Such activities include eating, bathing, dressing, using the toilet, getting in and out of bed, and getting around the house. Some people may also need help in performing instrumental activities of daily living, which include preparing meals, shopping for groceries, and getting around outside.

<sup>2</sup>Pub. L. No. 106-265, 114 Stat. 762, 764 (2000).

<sup>3</sup>Senate Committee on Governmental Affairs, S. Rep. No. 106-344, at 18 (2000).

<sup>4</sup>House Committee on Government Reform, H.R. Rep. No. 106-610, at 8 (2000).

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eligible for the Federal Long Term Care Insurance Program include federal and Postal Service employees and retirees; active and retired members of the uniformed services; qualified relatives of these individuals, such as spouses of employees and retirees; and certain others. Partners is a joint venture formed by two large insurance carriers that sell long-term care insurance products in the private market—John Hancock Life Insurance Company and Metropolitan Life Insurance Company. The contract between OPM and Partners outlines the roles and responsibilities of all parties with respect to the program, including how payments for program expenses and profits are determined. Partners began marketing the Federal Long Term Care Insurance Program in February 2002, and the program began accepting enrollment applications on March 25, 2002. As of September 30, 2006, the federal program had 214,034 current enrollees, making it the largest private long-term care insurance program in the nation.<sup>5</sup>

This report is the second of two reports required by the Long-Term Care Security Act on the competitiveness of the federal program compared with group and individual plans generally available in the private insurance market.<sup>6</sup> Our first report found that the program compared favorably with other group and individual plans we reviewed in terms of benefits offered and premiums. However, in its first 3 years, from April 1, 2002, through March 31, 2005, the federal program's enrollment and claims experience—that is, the number of paid claims and the amount paid for those claims—were lower than the expectations established by Partners.<sup>7</sup> We recommended that the Director of OPM analyze the reasons for the lower-than-expected claims experience and, as appropriate, use the results to modify assumptions about the expected claims experience. We also recommended that the Director of OPM analyze the projections for the amount of premiums collected to pay for claims. In response to these recommendations, OPM indicated that it intended to provide updated

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<sup>5</sup>From March 25, 2002, through September 30, 2006, the federal program enrolled 231,664 people. This number includes past enrollees as well as those enrolled as of September 30, 2006.

<sup>6</sup>Pub. L. No. 106-265, 114 Stat. 768. The group market includes plans offered by employers to employees and plans offered by other groups, such as professional organizations. The individual market includes plans sold by insurance carriers to individuals, usually through agents or brokers.

<sup>7</sup>See GAO, *Long-Term Care Insurance: Federal Program Compared Favorably with Other Products, and Analysis of Claims Trend Could Inform Future Decisions*, [GAO-06-401](#) (Washington, D.C.: Mar. 31, 2006). See also Related GAO Products at the end of this report.

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information on claims experience and premium setting in its written recommendation to Congress before entering into a new contract for the administration of the Federal Long Term Care Insurance Program. Partners' current contract with OPM ends December 31, 2008.

In this report, as discussed with the committees of jurisdiction, we examined the following questions regarding other aspects of competitiveness:

1. How does the profit structure of the Federal Long Term Care Insurance Program as defined by the contract compare with that of other long-term care insurance plans?
2. How do the marketing efforts for the Federal Long Term Care Insurance Program compare with those for other long-term care insurance plans?
3. How does the Federal Long Term Care Insurance Program's claims experience, updated to reflect the program's fourth year, compare with initial expectations?

To obtain information on the profit structure of the Federal Long Term Care Insurance Program, we interviewed officials at OPM and Partners and reviewed relevant documents, including the contract between OPM and Partners. We limited our review to the payments that were defined in this contract as profits. To obtain comparable information on any profit structures used in the private sector, we interviewed officials from four of the nation's largest long-term care insurance carriers—Bankers Life and Casualty Company, Genworth Financial, John Hancock Life Insurance Company, and Metropolitan Life Insurance Company.<sup>8,9</sup> All four insurance carriers sold products in the individual market, and two of the four—John Hancock Life Insurance Company and Metropolitan Life Insurance Company—were also among the five largest carriers that sold products in the group market. We also interviewed benefits officials from four states—California, New Jersey, North Carolina, and Texas—that offered long-term

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<sup>8</sup>We selected the four carriers based on their total number of policies and total annualized premiums—the sum of enrollee premiums adjusted to reflect a full year of coverage—in effect in the individual market as of December 31, 2005.

<sup>9</sup>Throughout this report, we use the term carrier officials to refer to officials of these four insurance carriers and not to officials of Partners.

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care insurance to state employees and certain other groups,<sup>10</sup> and we interviewed industry experts and actuaries regarding the profit structures used in the industry.

To obtain information on marketing efforts for the Federal Long Term Care Insurance Program, we interviewed officials from OPM and Partners and reviewed marketing plans for the federal program. To obtain comparable information on the marketing efforts used in the private sector, we interviewed actuaries, industry experts, officials from the four insurance carriers, and benefits officials from the four states.

To describe how the federal program's claims experience, updated to reflect the program's fourth year, compared with initial expectations as established by Partners in its contract with OPM, we analyzed data from Partners on the number of enrollees, the number of paid claims, and the amount of claim payments made for the federal program from April 1, 2005, through March 31, 2006. We also included data presented in our previous report regarding the claims experience of the federal program in its first 3 years, from April 1, 2002, through March 31, 2005. We compared the anticipated claims experience for the federal program as established by Partners in its contract with OPM prior to the program's start of enrollment, with the actual number of claims paid and the amount of claims payments during the federal program's first 4 years—from April 1, 2002, through March 31, 2006. We also interviewed Partners officials about the federal program's claims experience.

We reviewed all data for reasonableness and consistency and determined that the data were sufficiently reliable for our purposes. We performed our work in accordance with generally accepted government auditing standards from May 2006 through December 2006.

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## Results in Brief

The federal program has a unique profit structure that is explicitly defined in the contract between OPM and Partners. This profit structure consists of three distinct annual payments to Partners that are separate from payments made to cover the program's expenses. Two of the three profit payments are based on a percentage of the premiums collected during the

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<sup>10</sup>In addition to offering long-term care insurance benefits to their employees, retirees, and other qualified relatives, such as spouses of employees and retirees, all four states offered benefits to other groups of public employees, such as public university employees.



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year, and one is based on the average annual assets of the federal program. One premium-based payment and the asset-based payment are guaranteed. The other premium-based payment is not guaranteed, but rather is linked to OPM's evaluation of Partners' performance, including OPM's annual evaluation in 21 measures across 4 categories: administrative expense savings, customer service, enrollment experience, and responsiveness to OPM. In contrast to the federal program, profits realized by carriers offering other long-term care insurance plans generally are not based on an explicit profit structure. Instead, carriers may realize profits according to the experience of the programs they insure.

The federal program used marketing efforts that were generally similar to those for other plans sold in the group market, but faced a significant challenge in sending information directly to eligible individuals. The federal program and other plans sold in the group market used marketing efforts such as mailing information to the homes of eligible individuals, sending e-mails to eligible employees at work, posting information on a Web site, and hosting employee and retiree seminars. Of these efforts, carrier officials we spoke with explained that direct mail is a critical marketing strategy for long-term care insurance. The federal program faced a significant challenge in mailing information to the homes of those individuals eligible for the program because it initially did not have the home addresses of nearly all active federal civilian employees. Because of this challenge, the federal program relied on marketing efforts that were less direct and less personalized, such as sending information to federal employees through agency benefits officers and working with affinity groups whose membership consists of eligible individuals.

The federal program's claims experience—the amount of claim payments per enrollee and the number of paid claims per enrollee—increased in the program's fourth year, but remained lower than Partners' expectations as established in its contract with OPM. This increase was generally consistent with trends since the federal program began in 2002. Overall, the federal program has paid 44 percent of the expected amount of claim payments per enrollee and 41 percent of the expected number of claims per enrollee. As of August 2006, Partners officials had not determined why the claims experience was lower than its expectations. It is generally expected that the number of claims submitted in the first few years of a long-term care insurance program will be a small portion of the total number of claims submitted over time. However, claims experience is one of several factors that may affect the long-term financial outlook of a long-term care insurance program. The results of this analysis underscore our prior recommendations that OPM analyze the claims experience and

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assumptions affecting premiums to inform forthcoming contract negotiations for the administration of the federal program. These negotiations may occur prior to December 31, 2008, the end of Partners' current contract.

In commenting on a draft of this report, OPM generally agreed with our findings. Regarding the program's profit structure, OPM stated that now that it has more operating experience with the program, it plans to reexamine the profit structure as it renegotiates or rebids the contract for the administration of the program. In its comments, Partners highlighted certain distinct aspects of the federal program's profit structure that we noted in our draft report, including that Partners does not own federal program assets and that a profit payment is contingent on Partners meeting specific performance standards that Partners characterized as exceptionally high for the insurance industry in general.

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## Background

Long-term care, which may include care provided in nursing homes, assisted-living facilities, or a person's home, can be expensive. In 2005, the average cost of a year in a nursing home was more than \$70,000,<sup>11</sup> and in 1999, according to the most recent data available, the average length of stay was between 2 and 3 years.<sup>12</sup> Long-term care insurance helps individuals pay for costs associated with long-term care services. Yet relatively few individuals have obtained coverage. As of 2002, about 9 million people nationwide had obtained long-term care insurance.<sup>13</sup> To help federal employees, retirees, and others obtain coverage, the federal government began offering long-term care insurance in 2002.

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## Long-Term Care Insurance

Long-term care insurance helps pay for the costs associated with long-term care services. People can purchase long-term care insurance directly from carriers that sell products in the individual market, or they can enroll in plans offered by employers or other groups. For a specified premium

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<sup>11</sup>Metropolitan Life Insurance Company, *The MetLife Market Survey of Nursing Home & Home Care Costs* (Westport, Conn.: September 2005).

<sup>12</sup>U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Health Statistics, *The National Nursing Home Survey: 1999 Summary* (Hyattsville, Md.: June 2002).

<sup>13</sup>America's Health Insurance Plans, *Research Findings, Long-Term Care Insurance in 2002* (Washington, D.C.: June 2004).

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that is designed—but not guaranteed—to remain level over time, the carrier agrees to provide covered benefits under an insurance contract.

Long-term care insurance premiums are affected by many factors, including the benefits offered and the age and health status of the applicant. Carriers review the health status of the applicant during the underwriting process.<sup>14</sup> Carrier assumptions about interest rates, mortality rates, morbidity rates,<sup>15</sup> and lapse rates—the number of people expected to drop their policies over time—also affect premium rates. Carriers set premium rates to cover the anticipated cost of enrollee benefits (which means paying approved claims),<sup>16</sup> administrative costs (which includes marketing costs, claims handling, overhead, and taxes), and profits.

Few claims are expected to be submitted during the early years of an enrollee’s long-term care insurance policy. As a result of underwriting, it is unlikely that many people could meet the eligibility requirements to buy a policy yet submit an approved claim within 3 years. Industry experts suggest that the rate of claim submissions begins to increase after about 3 to 7 years.

Claims experience is one of many factors—such as interest rates and lapse rates—that affect the long-term financial outlook of a long-term care program. While having a lower-than-expected claims experience is a positive financial indicator, if the claims experience is significantly lower than expected over the long term, then it is possible that the premiums are too high. On the other hand, in accordance with the National Association of Insurance Commissioners (NAIC) premium-setting guidelines, it may be appropriate to project the claims experience assuming moderately adverse results to protect against the need to raise premiums.<sup>17</sup>

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<sup>14</sup>Underwriting is the process of reviewing an applicant’s responses to questions, including medical and health-related questions, in an application for the carrier to determine if the applicant is insurable and the premium rate is appropriate, given the level of risk the applicant presents for the insurance coverage.

<sup>15</sup>The term morbidity refers to the incidence of illness, injury, or disability.

<sup>16</sup>For the purposes of this report, a claim refers to the series of payments made to reimburse the provider or the policyholder for the costs of an episode of care.

<sup>17</sup>State insurance regulators established NAIC to help promote effective insurance regulation, to encourage uniformity in approaches to regulation, and to help coordinate states’ activities. Among other activities, NAIC develops model laws and regulations to assist states in formulating their policies to regulate insurance.

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Insurance carriers' long-term care insurance profits—defined as the excess of revenues over expenses—are affected by many factors, including the amount of risk the insurance carrier assumes. In general, the more risk a carrier assumes, the greater the carrier's expected profits. Over time, carriers' ability to meet or exceed their initial projections regarding interest rates, mortality rates, morbidity rates, and lapse rates, as well as their ability to contain costs, ultimately affects their profits. Carriers are also subject to state requirements, which may affect their ability to realize profits.

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## Long-Term Care Insurance Marketplace

Long-term care insurance is sold in two primary markets—the individual and group markets. Of the nearly 9 million policies sold as of 2002, the most recent year for which data were available, about 80 percent were sold through the individual market, and the remaining 20 percent were sold through the group market.<sup>18</sup> Sales in the group market are growing faster than sales in the individual market.<sup>19</sup> In March 2006, 13 percent of full-time employees in private industry had access to employer-sponsored long-term care insurance benefits; 20 percent of employees of establishments with 100 or more employees had access to this benefit.<sup>20</sup>

The individual market includes plans sold by insurance carriers to individuals, usually through agents or brokers. Individuals may choose benefits from a range of options offered by the carriers, including the duration and amount of daily benefit payments. Those who purchase coverage through the individual market typically pay the full premium. The carrier generally owns program assets and bears the risk of insuring enrollees for the terms of enrollees' policies.

The group market includes long-term care insurance plans offered to individuals through employers and other groups, such as professional associations. In this market, the groups usually design the benefits, and enrollees are often given some benefit options from which to choose, including the duration and amount of daily benefit payments. However,

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<sup>18</sup>America's Health Insurance Plans, *Research Findings*.

<sup>19</sup>Jonathan Shreve and Ksenia Whittal, "Group LTC Continues Its Solid Advance," *National Underwriter Life & Health*, vol. 110, no. 37 (2006), p. 20.

<sup>20</sup>U.S. Department of Labor, Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States*, March 2006 (Washington, D.C.: August 2006).

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benefit options offered in the group market tend to be fewer than those offered in the individual market. Individuals who purchase long-term care insurance in the group market typically pay the full premium, similar to those who purchase coverage in the individual market.<sup>21</sup>

Employers and other groups typically contract with insurance carriers to provide long-term care insurance to qualified individuals.<sup>22</sup> These contracts may be time-limited, lasting, for example, 3 to 5 years. Under these contracts, carriers are usually required to bear the risk of insuring enrollees for the terms of enrollees' policies; the term of enrollees' policies may be independent from, and therefore longer than, the length of an employer's contract with a carrier. These carriers also generally own all program assets. As a result, if a carrier's contract with an employer was not renewed, the carrier would usually be required by its contract to continue insuring those individuals for whom it issued policies.

Several large carriers dominated the long-term care insurance coverage sold in the individual and group markets, as of December 31, 2005. While the long-term care insurance industry experienced 18 percent annual growth in the number of policies sold from 1987 through 2002,<sup>23</sup> the industry has experienced a downturn in more recent years, according to industry experts. Specifically, carriers faced several challenges, including higher-than-expected administrative expenses relative to premiums; lower-than-expected lapse rates, which increased the number of people likely to submit claims; low interest rates, which reduced the actual return on investments below what had been assumed; and new state regulations that limited direct marketing by telephone. As a result, beginning in 2003, for example, many carriers in the individual market raised premiums, left the marketplace, or consolidated to form larger companies. In addition, many carriers have revised the assumptions used in setting premiums, taking a more conservative approach that has led to higher premiums, while state regulators have increased their oversight of the industry.

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<sup>21</sup>In contrast, individuals who purchase health insurance plans in the group market typically do not pay the full premium because employers often pay a share of the premium.

<sup>22</sup>Alternatively, employers may self-fund their long-term care insurance plans.

<sup>23</sup>America's Health Insurance Plans, *Research Findings*.

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## Federal Long Term Care Insurance Program

The federal government began offering a group long-term care insurance program in 2002 whereby certain eligible individuals affiliated with more than 125 federal agencies may apply for coverage. Individuals eligible for the Federal Long Term Care Insurance Program include federal and Postal Service employees and retirees; active and retired members of the uniformed services; qualified relatives of these individuals; and certain others.<sup>24</sup> Almost 19 million people were estimated to be eligible for coverage as of October 15, 2001. With more than 214,000 current enrollees as of September 2006, the federal program is the largest employer-sponsored group program in the nation. When the Federal Long Term Care Insurance Program began, eligible individuals could apply for enrollment during two specified periods: an early enrollment period held from March 25, 2002, through May 15, 2002, and an open enrollment period held from July 1, 2002, through December 31, 2002.<sup>25</sup> Following the open enrollment period, eligible individuals could apply for coverage at any time.<sup>26</sup> As is typical for other plans sold in the group market, enrollees pay the entire cost of their premium. As we noted in our March 2006 report, the federal program offered benefits similar to those of other long term-care insurance products, usually at lower premiums for comparable benefits, and the federal program's early enrollment and claims were lower than initially expected.<sup>27</sup>

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<sup>24</sup>Qualified relatives include current spouses of employees and retirees; adult children at least 18 years old—including natural, adopted, and stepchildren, but not foster children—of living employees and retirees; and parents, parents-in-law, and stepparents of living employees, but not of retirees. Selected military reservists; employees and retirees of the Tennessee Valley Authority; District of Columbia government employees and retirees first employed before October 1, 1987; and employees and retirees of the District of Columbia courts are also eligible to apply for coverage.

<sup>25</sup>During the early enrollment period, enrollees' choices for some of the benefit options, such as the benefit period and type of coverage, were limited, whereas enrollees were able to select from all of the program's benefit options during the open enrollment period. During both of these enrollment periods, the program used an abbreviated underwriting application to determine eligibility for active employees and active members of the uniformed services and their spouses. For all other applicants, the program used a full underwriting application. The federal program's abbreviated underwriting application consists of fewer health-related questions than the program's full underwriting application.

<sup>26</sup>Since the open enrollment period, the program has used an abbreviated underwriting application to determine eligibility for newly hired federal and Postal Service employees and newly active members of the uniformed services and their spouses who apply for coverage within 60 days of employment. For all other applicants, the program has used a full underwriting application.

<sup>27</sup>[GAO-06-401](#).

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OPM oversees the federal program, and Partners administers the program in accordance with the requirements of a 7-year contract between OPM and Partners. The contract, signed December 18, 2001, defines key administrative requirements, including OPM's oversight of the program and how payments for the federal program's expenses, as well as payments that are earmarked as profits, are determined. Unlike other contracts between employers and carriers, the federal program's contract includes requirements for the management of federal program assets—that is, the funds collected as premiums and used to pay claims—because the federal program does not give Partners ownership of federal program assets.

By statute, OPM's contract with Partners is for 7 years and is not automatically renewable.<sup>28</sup> At the end of the 7-year term, OPM can either renegotiate the contract with Partners, or allow the contract to terminate and select a new carrier. If a new carrier is selected, Partners must transfer all federal program enrollees and assets, including any positive or negative returns related to the experience of the program, to the federal program's next carrier. However, if OPM does not contract with another carrier, Partners would continue insuring the individuals who enrolled in the federal program through Partners. In this case, the federal program's assets would remain available to Partners to pay for claims and expenses.

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## Federal Program Has a Unique Profit Structure

The federal program has a unique profit structure that is explicitly defined in the contract between OPM and Partners. This profit structure consists of three distinct annual payments to Partners to compensate Partners for the risks it assumes under the program's 7-year contract.<sup>29</sup> Of these payments, two are based on a percentage of the premiums collected during the year and one is based on the average annual assets of the federal program. (See table 1.) These three payments are allowed only if premiums are sufficient to cover the federal program's current claims and expenses. In contrast to the federal program, profits realized by carriers offering other long-term care insurance plans generally are not based on explicit profit structures. Instead, under the terms of their contracts,

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<sup>28</sup>Pub. L. No. 106-265, 114 Stat. 765-766.

<sup>29</sup>The profit payments are intended as profits, but do not ensure that Partners realizes a profit because the payments are not linked to Partners' actual costs for the program. In addition to profit payments, the federal program pays Partners for the program's expenses, such as those for marketing, underwriting, and claims administration.

carriers assume the risk of insuring enrollees for the terms of enrollees' policies and own program assets—and are thus able to realize profits or losses according to the experience of the programs they insure.

**Table 1: Profit Structure of the Federal Long Term Care Insurance Program**

Payment type	Payment amount
<b>Premium-based payments</b>	
Guaranteed	3.5 percent of the premiums collected during the year
Performance-based	Up to 3.0 percent of the premiums collected during the year—the actual amount is determined by OPM based on its assessment of Partners' performance
<b>Asset-based payment</b>	
Guaranteed	0.3 percent of the average annual assets of the federal program

Source: GAO analysis of OPM's contract with Partners.

Note: These three payments are allowed only if premiums are sufficient to cover the federal program's current claims and expenses.

The federal program guarantees one annual premium-based payment to Partners. This payment equals 3.5 percent of the premiums collected in a year. For other long-term care insurance plans offered in the group and individual markets, carriers' profits were generally not guaranteed, according to carrier officials and industry experts. Similar to the federal program, one source of carriers' revenue is enrollee premiums, which include an amount for anticipated profits. However, carriers may realize profits or losses according to the experience of the programs they insure, subject to applicable state regulations.<sup>30</sup>

The federal program links the second annual premium-based payment to OPM's evaluation of Partners' performance. This payment can equal up to 3 percent of the premiums collected in a year. Under an agreement which amended the contract between OPM and Partners and became effective beginning fiscal year 2006, OPM evaluates Partners' performance each year on 21 short-term performance measures across 4 categories: administrative expense savings, customer service, enrollment experience,

<sup>30</sup>The terms of contracts under the federal program relating to coverage or benefits, including those pertaining to carrier profit, will supersede and preempt applicable state regulations. Pub. L. No. 106-265, 114 Stat. 768, 5 U.S.C. § 9005 (2005); 5 C.F.R. § 875.107 (2006).



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and responsiveness to OPM.<sup>31</sup> Each performance measure has a corresponding payment equivalent to a percentage of the total performance-based payment of 3 percent of premiums. If Partners' performance does not meet stated expectations in a measure, the payment corresponding to that measure is placed into a retained profit account. In addition, every 3 years, OPM evaluates Partners' performance in two long-term performance measures: return on investment and claims experience. If Partners meets expectations in one measure and funds are present in the retained profit account, one-half of the amount present in the retained profit account is paid to Partners. If Partners meets expectations in both measures and funds are present in the retained profit account, the total amount present in the retained profit account is paid to Partners. As of September 2006, Partners has been awarded the full performance-based payment each year since the federal program began. Appendix I provides a complete list of the performance measures used for the federal program.

Unlike the federal program, most other sponsors of plans offered in the group market usually did not link carrier profits to performance evaluations, according to carrier officials and industry experts. Carrier officials estimated that about 10 percent to 20 percent of employers required their long-term care insurance carrier to relinquish a certain percentage (for example, 2 percent to 4 percent) of premiums if their performance did not meet agreed-upon expectations.<sup>32</sup> However, employers may require carriers to guarantee a certain level of performance in their contracts to ensure that enrollees are provided with standard levels of service, according to state officials.<sup>33</sup> These performance measures and guarantees may include those related to the timeliness of underwriting decisions and call center performance. The federal program

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<sup>31</sup>From the beginning of the program through fiscal year 2005, the federal program subjected the same portion of profit payments to OPM's annual evaluation of Partners' performance and rated Partners' performance in 10 or 11 categories as exceeding, meeting, or not meeting expectations. In fiscal year 2005, OPM and Partners renegotiated the performance evaluation agreement at OPM's request to make it more challenging. The new performance evaluation agreement, beginning in fiscal year 2006, allowed ratings of only meeting or not meeting expectations in 21 measures across 4 categories. Partners officials told us that the new performance evaluation agreement was more challenging for them to meet than the prior agreement.

<sup>32</sup>The carrier officials we spoke with explained that the carriers they represent had never had to relinquish profits as a result of a poor performance rating.

<sup>33</sup>Employers may impose nominal fines (for example, \$25 to \$50 per violation) on carriers who do not meet performance guarantees.

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used all of the performance measures that industry experts and carrier officials cited as those commonly used throughout in the group market, in addition to other measures such as administrative expense savings and claims experience.

The federal program's third payment is guaranteed and is based on the average annual assets of the program. This annual payment—0.3 percent of the average annual assets of the federal program—is defined in the contract between OPM and Partners as a profit payment. The federal program developed this payment to recognize that insurers in general are required to hold risk-based capital. Risk-based capital is the capital that an insurance carrier is required to hold in reserve, separate from any other funds used to back insurance liabilities or other lines of business, to protect the carrier from insolvency.<sup>34</sup> OPM does not require Partners to use the third payment to fund risk-based capital and both OPM and Partners consider this payment another form of profit for administering the program. Similar to the federal program, carriers use enrollee premium funds to fund risk-based capital requirements, according to OPM officials. However, risk-based capital may be considered an expense to carriers.

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## Federal Program Used Marketing Efforts Generally Similar to Those Used for Other Plans but Faced a Significant Challenge

The federal program used marketing efforts that were generally similar to those used for other plans sold in the group market.<sup>35</sup> For example, the types of marketing efforts used for the federal program and other plans offered in the group market, according to our review of federal program documents and the carrier and state officials we spoke with, included

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<sup>34</sup>Carriers determine the amount of capital to be held as risk-based capital based on their assessment of the risks they assume according to standards issued by the NAIC.

<sup>35</sup>In the individual market, carrier officials we spoke with said that they perform limited direct marketing to potential enrollees. Instead, carriers rely on individual agents to identify prospective applicants and sell a plan, at times in a one-on-one setting.

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- mailing information directly to the homes of eligible individuals,
  - sending e-mails to eligible employees at work,
  - posting information on a Web site,
  - hosting employee and retiree seminars, and
  - working with affinity groups whose membership consists of eligible individuals.

Of these efforts, carrier officials we spoke with told us that direct mail, which may include a personalized letter, is a critical marketing effort for long-term care insurance plans. One carrier official also explained that direct mail was so critical to the carrier's marketing strategy that it generally would not work with employers who neither provide the home addresses of employees nor assist in mailing materials to employees.

The federal program faced a significant challenge in sending information directly to eligible individuals, particularly through direct mail. Specifically, the federal program was initially unable to mail information directly to the homes of about 60 percent of the program's core group of eligible individuals that Partners deemed most likely to enroll in the federal program—including nearly all active federal civilian employees—because neither OPM nor Partners had the home addresses of these individuals. OPM officials told us that a centralized database of this information does not exist. According to OPM officials, OPM did not request federal employees' home address information from other federal agencies because they felt it would be too burdensome to comply with certain Privacy Act requirements<sup>36</sup> and gather accurate information from each of the agencies in a timely manner. Despite this challenge, the federal program initially mailed information directly to the homes of those for whom it had addresses, which included about 40 percent of the program's core group of eligible individuals, as well as other non-core groups such as retired military personnel and annuitants under the Civil Service Retirement System and the Federal Employees Retirement System,

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<sup>36</sup>The Privacy Act of 1974, outside a framework of specified exceptions, prohibits an agency from disclosing a record to any person or another agency, except at the request of, or with the prior consent of, the individual to whom that record pertains. See 5 U.S.C. § 552a (2000).

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according to our analysis of Partners' data.<sup>37</sup> As of October 2006, Partners officials noted that direct mail efforts were still limited because of the federal program's inability to mail information directly to the homes of most active federal civilian employees.<sup>38</sup> Before signing its contract with OPM, Partners was aware of the federal program's limitations regarding direct mail.

As a result of the federal program's limited ability to send direct mail to many eligible individuals, the federal program relied heavily on marketing efforts that were less direct and less personalized, including sending information to federal employees through agency benefits officers and working with affinity groups. Because neither OPM nor Partners has direct access to federal employees through e-mail, Partners has worked with more than 150 agency benefits officers to distribute program information to federal employees through e-mail, internal office mail, or other means.<sup>39</sup> For example, Partners relies on agency benefits officers to send e-mails about the federal program.<sup>40</sup> While Partners officials may be notified by agency benefits officers when they send program information, Partners is unable to determine whether all eligible federal employees receive this information. In addition, Partners has worked with several affinity groups, such as Federally Employed Women and the National Active and Retired Federal Employees Association, to educate their members about the need for long-term care insurance and to advertise in publications and at sponsored events. Through these efforts, Partners has gained direct access to the groups' members.

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<sup>37</sup>In total, the federal program mailed information to about 6.6 million eligible individuals during the open enrollment period, according to Partners' data. These individuals represented about 35 percent of the total estimated 18.6 million individuals eligible for coverage as of October 15, 2001.

<sup>38</sup>Partners officials told us that they had obtained addresses for about 22 percent of all active federal civilian employees as of October 2006. This percentage includes current enrollees as well as other eligible individuals.

<sup>39</sup>Partners officials also noted that increased security measures taken in the fall of 2001 in response to the terrorist attacks of September 11, 2001, and the anthrax scare temporarily reduced access to federal employees for marketing purposes during the program's open enrollment period.

<sup>40</sup>Partners is able to directly e-mail information to those who provided their e-mail address in response to a marketing solicitation.

## Claims Experience in the Federal Program Increased but Remained Lower Than Expectations

In the federal program’s fourth year, claims experience—the amount of claim payments per enrollee and the number of paid claims per enrollee—increased from that of the program’s third year, but remained lower than Partners’ expectations as established in its contract with OPM. This increase was generally consistent with trends since the federal program began in 2002. As we reported in March 2006, claims experience in the federal program’s first 3 years was lower than the initial expectations set by Partners.<sup>41</sup> Our analysis of Partners’ data showed that claims experience also remained lower than expected for the federal program’s fourth year. As of March 31, 2006, the end of the federal program’s fourth year, the federal program had cumulatively paid 44 percent of the expected amount of claim payments per enrollee and 41 percent of the expected number of claims per enrollee, across the 4 years, as shown in table 2. Figure 1 shows the amount of claims payments per 10,000 enrollees. As of August 2006, Partners had not determined why the claims experience was lower than Partners’ expectations. Claims experience is one of many factors—such as interest rates and lapse rates—that affect the long-term financial outlook of a long-term care insurance program. While it is generally expected that the number of claims submitted in the first few years of a long-term care insurance program will be a small portion of the total number of claims submitted over time, the rate of claim submissions usually begins to increase after about 3 to 7 years, according to industry experts.

**Table 2: Actual Claims per Enrollee as a Percentage of Expected Claims per Enrollee in the First 4 Years of the Federal Long Term Care Insurance Program**

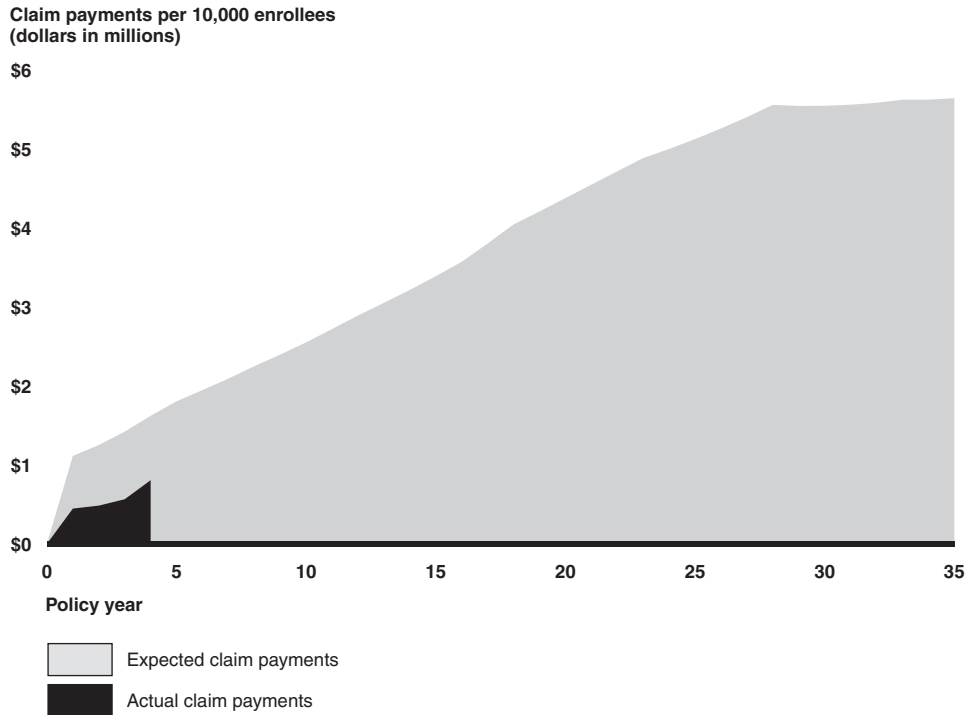
Claims experience	Year 1	Year 2	Year 3	Year 4	Cumulative
Amount of claim payments per enrollee as a percentage of expected claims per enrollee	40%	39%	40%	50%	44%
Number of paid claims per enrollee as a percentage of expected claims per enrollee	4%	37%	48%	56%	41%

Source: GAO analysis of data provided by Partners.

Notes: Partners established expectations for enrollment and claims in its contract with OPM. We reviewed claims data for the first 4 years of the federal program, April 1, 2002, through March 31, 2006.

<sup>41</sup>GAO-06-401.

**Figure 1: Actual Claim Payments per 10,000 Enrollees in the First 4 Years of the Federal Long Term Care Insurance Program Compared with Expected Claim Payments per 10,000 Enrollees over 35 Years**



Source: GAO analysis of data provided by Partners.

Notes: Partners established expectations for enrollment and claims in its contract with OPM. We reviewed claims data for the first 4 years of the federal program, April 1, 2002, through March 31, 2006.

## Concluding Observations

Our findings from two reports together show that the Federal Long Term Care Insurance Program compared favorably with other plans, has a unique profit structure, and used marketing efforts that were generally similar to those of other plans, but faced a significant challenge. Specifically, our initial report found that the federal program offered benefits similar to those of other long-term care insurance products, usually at lower premiums for comparable benefits. In this, our second report, we examined other components of the federal program's competitiveness, including the federal program's profit structure and marketing efforts. We found that the federal program has a unique profit structure, created to compensate Partners for the risks it assumed for the program. The risks borne by Partners, however, are not as great as those

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assumed by carriers selling other plans because, unlike with other plans, the federal program's assets are owned by the program, not by the insurer. Because of this structure, the program does not link Partners' profits to the overall experience of the program. Rather, the program guarantees some profit payments, links some profit payments to OPM's evaluation of Partners' performance, and requires Partners to assume a potentially time-limited risk, after which all program assets and enrollees may be transferred to another carrier. Insurance carriers' profits are linked to the amount of risk they bear, and Partners assumes less risk for insuring the federal program than do carriers for insuring other long-term care insurance plans. Therefore, the federal program's profit payments would likely be lower than the profits realized by carriers selling other plans. In addition, while the federal program used marketing efforts that were generally similar to those used for other plans sold in the group market, the program faced a significant challenge in providing personalized marketing communications directly to eligible individuals and instead relied heavily on other marketing efforts.

In our initial report we found that the federal program's claims experience—the amount and number of claims payments per enrollee—was lower than expected in the first 3 years of the program. While it is generally expected that the number of claims submitted in the first few years of a long-term care insurance program will be a small portion of the total number of claims submitted over time, a program's claims experience is one of several factors that may affect the long-term financial outlook of the program. In response to our recommendation in the initial report that OPM analyze the claims experience and assumptions affecting premiums to inform forthcoming contract negotiations, OPM indicated that it intended to provide updated information on claims experience and premium setting in its written recommendation to Congress before entering into the next contract for the administration of the Federal Long Term Care Insurance Program. Partners' current contract with OPM for the administration of the federal program ends December 31, 2008. After reviewing a fourth year of claims data, we note that the program's claims experience increased from that of the program's third year, but still remains lower than Partners' expectations. These results underscore the importance of our prior recommendations that OPM analyze the claims experience and assumptions as it considers its recommendations to Congress regarding a future contract.

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## Agency Comments

We provided a draft of this report to OPM and Partners. In its written comments, OPM generally agreed with our findings. OPM's comments are reprinted in appendix II.

With regard to the program's unique profit structure, OPM stated that now that it has more operating experience with the program, it plans to reexamine the profit structure as it renegotiates or rebids the contract for the administration of the program. OPM agreed that the marketing efforts for the federal program are more challenging for Partners than for other insurers because, among other reasons, home addresses for federal employees are generally not available. OPM noted that this will continue to be a constraint for the program in the future. In addition, OPM highlighted, as we noted in our draft report, that the ratio of actual to expected claims experience has narrowed and stated that it would continue to closely monitor the claims experience of the program. We support this effort and continue to encourage OPM to analyze the program's claims experience and ensure that premiums and actuarial assumptions about future claims reflect the experience of the program.

In its comments, Partners highlighted certain distinct aspects of its profit structure that we noted in our draft report, including that Partners does not own federal program assets and that a profit payment is contingent on meeting specific performance standards that Partners characterized as exceptionally high for the insurance industry in general. Partners also stated that profit payments are paid only if the federal program's assets are sufficient to cover the risks incurred by the program, as our draft report noted. Regarding the marketing efforts used for the federal program, Partners noted that the terrorist attacks of 2001 and the anthrax scare, which caused heightened security at federal buildings, added to the marketing challenge acknowledged in the report. We revised the report to reflect these circumstances. Finally, Partners commented, and as we noted in our draft report, that in addition to a program's claims experience, premium rates are affected by a number of factors, including lapse rates and interest rates.

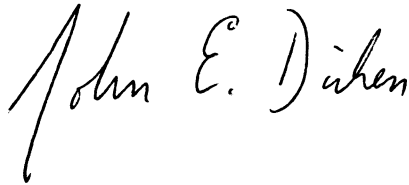
OPM and Partners provided technical comments and clarifications, which we incorporated as appropriate.



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We are sending copies of this report to the Director of OPM and interested congressional committees. We will also provide copies to others on request. In addition, this report is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-7119 or [dickenj@gao.gov](mailto:dickenj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

A handwritten signature in black ink that reads "John E. Dicken". The signature is written in a cursive style with a large, sweeping initial "J".

John E. Dicken  
Director, Health Care

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*List of Committees*

The Honorable John Warner  
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Committee on Armed Services  
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Ranking Minority Member  
Subcommittee on the Federal Workforce and  
Agency Organization  
Committee on Government Reform  
House of Representatives

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# Appendix I: Performance Measures Used for the Federal Long Term Care Insurance Program

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The Federal Long Term Care Insurance Program makes some profit payments to Long Term Care Partners LLC (Partners) according to the Office of Personnel Management's (OPM) evaluation of Partners' performance. Beginning in fiscal year 2006, OPM evaluates Partners' performance each year on 21 short-term performance measures across 4 categories: administrative expense savings, customer service, enrollment experience, and responsiveness to OPM (see table 3). Every 3 years, OPM also evaluates Partners' performance in two long-term performance measures: claims experience and return on investment (see table 4).

**Appendix I: Performance Measures Used for the Federal Long Term Care Insurance Program**

**Table 3: Federal Long Term Care Insurance Program’s Short-Term Performance Measures, Assessed Annually**

<b>Category</b>	<b>Performance measure</b>
Administrative expense savings	Actual administrative expenses compared to budgeted amounts set by OPM and Partners
Customer service	Billing: timeliness of posting payroll and annuity payments
	Billing: timeliness of processing automatic bank withdrawal reversals <sup>a</sup>
	Billing: timeliness of processing billing changes
	Billing: timeliness of sending payroll bills to payroll providers
	Call center: call abandonment rate
	Call center: call answering speed
	Call center: customer satisfaction with customer service
	Call center: timeliness of callbacks
	Call center: timeliness of response to written or e-mail inquiries
	Claims: accuracy of claims payments
	Claims: timeliness of claims payments
	Care coordination: customer satisfaction with care coordination services
	Care coordination: timeliness of benefit determinations
	Underwriting: timeliness of initial underwriting decisions
Underwriting: timeliness of reconsideration decisions	
Enrollment experience	Actual enrollment compared with enrollment goals set by OPM and Partners
Responsiveness to the Office of Personnel Management (OPM)	General working relationship with OPM
	Monitoring and reporting on industry trends to OPM
	Timeliness of submitting plans that address deficiencies reported by OPM
	Timeliness of reporting significant events to OPM <sup>b</sup>

Source: OPM.

<sup>a</sup>Individuals may allow the federal program to deduct money from their bank account to pay premiums through automatic bank withdrawal. Reversals of these withdrawals may occur as a result of insufficient funds.

<sup>b</sup>Significant events are those that may be expected to have a material effect upon Partners’ ability to meet its contractual obligations to OPM. Such events may include the disposal of 25 percent or more of Partners’ assets within a 6-month period, the termination of a contract or subcontract that may have an effect on Partners’ ability to meet its contractual obligations, or the discovery of fraud related to the federal program.

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**Appendix I: Performance Measures Used for  
the Federal Long Term Care Insurance  
Program**

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**Table 4: Federal Long Term Care Insurance Program's Long-Term Performance  
Measures, Assessed Every 3 Years**

<b>Category</b>	<b>Performance measure</b>
Claims experience	Claims experience compared with expectations, as set by Partners in its contract with OPM, adjusted to reflect the demographic characteristics of actual enrollees
Return on investment	Investment performance compared with contractual benchmark

Source: OPM.

# Appendix II: Comments from the Office of Personnel Management



The Director

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT  
Washington, DC 20415

December 15, 2006

Mr. John E. Dicken  
Director, Health Care  
Government Accountability Office  
Washington, DC 20548

Dear Mr. Dicken:

This is in response to your request for review of the draft report entitled *LONG-TERM CARE INSURANCE: Federal Program Has a Unique Profit Structure and Faced a Significant Marketing Challenge* (GAO-07-202).

The report discusses the marketing efforts by Metropolitan Life and John Hancock, the carriers that created Long Term Care Partners LLC, (Partners) which administers the Federal Long Term Care Insurance Program (FLTCIP); the claims experience for the program; and the profit structure negotiated with the contractor.

We agree with your report that the marketing effort is more challenging for Partners than other insurers. This begins with the fact that the individual market, which is the FLTCIP's true competition, employs insurance agents and brokers while group plans, including FLTCIP, do not. Compounding the situation is the fact that most employer groups can provide employee home addresses. Since home addresses for federal employees are generally not available, marketing efforts were constrained during and after the first Open Season. And, importantly, this will continue to be a constraint into the future.

As stated in this report and the earlier GAO report, *Long-Term Care Insurance: Federal Program Compared Favorably with Other Products and Analysis of Claims Trend Could Inform Future Decisions* (GAO-06-401), claims experience is an important variable in the financial health of any long term care insurance program. Because FLTCIP enrollees are subject to initial underwriting, their claims rates are expected to increase over time. To date, the ratio of actual to expected claims experience has narrowed with each successive year of policy duration. We will continue to closely monitor the experience of the program to be as informed as possible about this aspect of the program when we move into the next round of contract negotiations. But it is difficult to predict with any certainty the future claims patterns for this maturing group based on the first few years of program experience.

On the profit structure, as noted in the report, we do have a complex formula which was developed as we were implementing a new group insurance program where the costs would be borne by enrollees and where there were no reserves at start-up. In fact, we

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**Appendix II: Comments from the Office of  
Personnel Management**

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Mr. John E. Dicken

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believe that the portion of the profit formula that emphasizes contractor performance has been an excellent motivator for Long Term Care Partners to provide exemplary service to our group. However, now that we have more operating experience with this Program, we intend to reexamine the formula when we either renegotiate or rebid the contract to make sure that it continues to serve the best interests of enrollees and the Government.

We also have some technical comments for the body of the report, which we will send by email. If you have any questions on our reply, please contact John Salamone in my office ([john.salamone@opm.gov](mailto:john.salamone@opm.gov) or 202-606-1000).

Sincerely,



Linda M. Springer  
Director

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

John E. Dicken, (202) 512-7119 or [dickenj@gao.gov](mailto:dickenj@gao.gov)

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## Acknowledgments

In addition to the contact named above, Christine Brudevold, Assistant Director; Patricia Roy; Timothy Walker; and Rasanjali Wickrema made key contributions to this report.



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# Related GAO Products

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*Long-Term Care Insurance: Federal Program Compared Favorably with Other Products, and Analysis of Claims Trend Could Inform Future Decisions.* [GAO-06-401](#). Washington, D.C.: March 31, 2006.

*Overview of Long-Term Care Partnership Program.* [GAO-05-1021R](#). Washington, D.C.: September 9, 2005.

*Long-Term Care Financing: Growing Demand and Cost of Services Are Straining Federal and State Budgets.* [GAO-05-564T](#). Washington, D.C.: April 27, 2005.

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