Long Term Care Insurance in the U.S.

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Carl Friedrich Biography

- Broad experience in the life insurance industry, with a focus in the area of product development. Prior to joining Milliman's Chicago office in 2002, he was the senior financial officer for CNA's life and group operations and president of its international life division. At Milliman, Carl has provided consulting services to a wide variety of life insurance companies, reinsurers, banks, and other financial services organizations.
- Carl specializes in the design and pricing of life insurance, long-term care, and annuity insurance products, with an emphasis on emerging combination multi-line products spanning over 50 separate combination plan projects. He also advises clients on reinsurance, mortality, and financial management issues.
- Frequent speaker at industry meetings, and has had various articles published in *National Underwriter*, *The Actuary*, and various financial publications. He has also co-authored several recent research reports for the Society of Actuaries.
  - Life and Annuity Living Benefit Riders: Considerations for Insurers and Reinsurers, April 2015
  - Quantification of the Natural Hedge Characteristics of Combination Life or Annuity products Linked to Long-Term Care Insurance, March 2012
  - Premium Persistency Assumptions Study of Flexible Premium Universal Life Policies, May 2012
- Three research studies sponsored by Milliman between 2007 and 2015 on Combination products, and annual studies for the last eight years on Universal Life/Indexed Universal Life Issues

Long-Term Care Insurance (LTCi) – the Need

- Growing market of elderly needing Long Term Care services
  - Demographic shift to older ages
  - Natural caregivers of the past (children and spouses) are less able or willing to meet needs due to relocation, divorce, work requirements, or other societal factors
  - Alternative services emerging that increase willingness of the elderly to utilize non-family care, including assisted living facilities, retirement communities, and home health care
- Individual and to a lesser extent group LTCi policies emerged 30-40 years ago to provide coverage for such care
- Quality of policies and breadth of coverage improved over the years

LTCi – the Need

- Health insurance policies rarely cover costs for LTC services
- Medicare, a federal program providing health insurance primarily to the 65 and over market, only pays for LTC for very short periods of time, addressing a very small percentage of LTC costs
- Medicaid (state run programs providing health coverage to low income, disabled, and others) will pay for care only under certain rules governing maximum income/asset levels
  - Requires individuals to spend down assets before they qualify for Medicaid benefits to pay for LTC services
  - Look-back rules apply, so assets would need to be transferred years in advance of care needs to qualify for Medicaid
  - Financial planning to work around spend-down rules have been challenged by tightened regulatory requirements
- Just under 60% of total LTC cost is covered by public programs
- Significant financial strain on governmental programs, especially Medicaid
- Attempts to include LTCi in the Affordable Care Act (ObamaCare) were eventually rejected due to costs and other challenges

LTCi – the Need

- LTCi policies only cover 8% of current LTC costs
  - Estimates are that only 10% of the population that needs LTCi owns such a policy
  - Most of the population underestimates the cost of LTC, or mistakenly think that government programs will cover them
  - Many are in denial that they may need LTC in the future, or they continue to defer the decision to purchase LTCi because it is viewed as an issue to be dealt with later in life
- Private pay covers 33% of the costs
- Average daily costs for private nursing home room is $253, about $120/day for assisted living facility, with hourly home health care (HHC) costs of $13 to $30 (so 4 hours per day would be $52 to $120 per day)
  - Significant variation in nursing home costs by state, and even within a state
  - E.g., median private room nursing home costs are $165/day in Oklahoma, $440/day in Connecticut, and an outlier figure of $816 in Alaska
  - Much less variation in home health care and assisted living facility costs

Highlights of Model Regulations and Tax Law

- National Association of Insurance Commissioners (NAIC) Model Law and Regulation for LTCi
  - No pre-scheduled premium increases above attained age 65
  - No cash values higher than Return of Premium
  - Requires inflation option to be offered to all applicants
  - Requires Nonforfeiture benefit option be offered (paid-up benefits at fairly low levels)
  - Standards for benefit triggers, including special standards for tax qualified long term care
- Health Insurance Portability and Accountability Act (federal law)
  - Defines tax qualified long term care and sets limits on payment amounts that can be made as tax-free health benefits (greater of expenses incurred or tabular daily limit updated by index annually)

Stand-alone LTCi

- Sales peaked at about $1 billion in first year premium around 2005
- Sales have fairly steadily eroded year by year since then
  - 2016 sales dropped to $220 million in first year premium
  - 17 companies writing new business, versus twice that in 2005
- Characteristics of Stand-alone LTCi
  - Steep claim cost curve by age contrasted with level premium requirement implies the product is lapse-supported; if expected lapses don't occur, profitability erodes dramatically
  - Same factors imply a high level of sensitivity to investment returns on assets built up in early years needed to fund claims in excess of premiums expected in the later durations
  - Products were priced for many years in a higher interest rate environment than seen in recent years, and original lapse assumptions were higher than the emerging experience, which has dropped to levels of 1% per year or lower for many companies
  - Some companies didn't underwrite the coverage sufficiently

Factors Impacting Stand-alone LTCi Sales

- Significant rate increases on inforce policies, especially this decade
- Agent backlash to rate increases and lack of confidence in pricing of new business
- Companies withdrawing from the market due to past losses, negative rating agency views of LTCi, and fear of compounding their exposure to the LTCi risk
- Consumers don’t like the risk of rate increases, and the fact that if they decide they don’t want the coverage at some point they get nothing back under most policies, sacrificing the high level premiums paid in the past
- Combination products have emerged that eliminate many of these risks

More Tax Law

- Deficit Reduction Act of 2006 (DEFRA)
  - Included a section (effective 1/1/2010) addressing plans that combine life insurance or non-qualified annuities with LTC
  - Acceleration of base plan values in the event of a qualified LTC need are tax-free LTC benefits
  - Charges are tax-free distributions, but reduce basis in the contract
  - Allows 1035 exchanges into combination products (annuity plans to annuity combos, life plans to any combo)
    - Taxes are not payable on gains in the contract under these 1035 exchange rules, continuing to be deferred until withdrawal or death on annuity combos, or until surrender (if any) for life combo policies
  - The only way to get otherwise taxable gains out of an annuity contract is if cash values are paid out as accelerated benefits for LTC

Combination plans

- Life with LTCi accelerated benefit rider (ABR)
  - Pays out a specified portion of the death benefit (DB) and cash value (CV) as monthly payments in advance of death when LTC triggered, usually until DB depleted
  - Governed by LTC Model Act and Reg, with a few exemptions
- Life with chronic illness ABR rider
  - May be structured as above, but can’t be presented as LTCi since requirements of LTCi regulations are not fully met (even though the trigger for benefits may be the same)
  - Governed by NAIC Model Regulation for Accelerated Benefits on Life Insurance
    - Payouts are treated as death benefits for federal income tax purposes
  - Can also use a discounted death benefit approach with no charges up front, but reduced payouts to insureds

Combination Plans

- Life with LTCi ABR and extension of benefits rider (EBR) – "Hybrid life/LTC"
  - EBR governed by LTC Model Act and Reg
  - Continues paying monthly benefits for specified number of years when care is needed after the face amount has been fully accelerated, often up to two or three times the life face amount
  - Can be single premium, x year pay, lifetime pay
  - A couple of plans on the market for over 20 years
  - Early versions included a full return of premium guarantee upon surrender
  - Created an attractive marketing theme
    - If the client wants to surrender at any time, they get their money back (or more)
    - If they die before an LTC claim, they get the death benefit which exceeds the premium (by a lot for younger issue ages)
    - If they have a catastrophic LTC event, they may get a multiple of the death benefit as tax free LTC benefits
- Annuity with LTCi rider
  - Pays out monthly amounts for LTC until CV depleted, then continuing x years such that the total payout may be two to three times the CV

Combination Plans – Financial Characteristics

- Accelerated benefits represent a form of self-insurance, as insureds are accelerating base plan amounts, including cash values, that they own and eventually would receive as surrender benefits, or their beneficiaries would receive as death benefits
- Reduces the cost of those benefits to primarily “time value of money” costs in paying out benefits in advance of death
- Insured’s incentives are impacted as well, as combo claims experience shows much lower incidence rates than stand-alone LTCi, as insureds choose to defer claims in order to preserve their assets for the beneficiaries or for more significant claim events
  - Average length of combo claims is longer since the shorter term claims are less likely to be submitted
- As is true for stand-alone LTCi, claims costs reflect the incidence rates and claim termination rates
  - Disabled life mortality rates tend to be very high, especially in the first year of claim, but recoveries do occur
  - Disabled life mortality can be 50 to 100 times standard mortality at younger ages, grading down to as low as 2 or 3 times mortality at very advanced ages
  - Conservation of mortality principles suggest that for an insured pool, the number of deaths from disabled lives plus deaths from active (non-disabled) lives should reproduce the total deaths expected for the insured pool; active life mortality rates calculated in this fashion can at times be extremely low

Combination Plans

- Reduced risks to insurers on combination plans vs. stand-alone LTCi
  - 2012 SOA Study (by Milliman) quantified the reduction in losses triggered by several adverse events, including higher incidence rates, lower claim termination rates, lower mortality, lower lapses, and lower interest rates
  - Life/LTCi volatility dropped by 75% vs. stand-alone LTCi under many scenarios
  - Annuity/LTCi volatility dropped by even more
  - For example, higher persistency hurts LTC rider profits, but helps annuity base plan profits
  - Higher mortality hurts life base plan profits, but helps LTC rider profits
- Reduced or no rate increase risk for insureds (some riders are non-cancellable, with guaranteed rates)
- Eliminates the “use it or lose it” characteristic of stand-alone LTCi which typically offers no cash value
- Tax benefits are beneficial to insureds, but have not been a major driver of the popularity of the products

MoneyGuard

- Lincoln modified their underwriting on their hybrid product, MoneyGuard, around 2006
  - No Attending Physician’s Statements
  - Reduced underwriting turnaround time to a few days
  - Used alternative tools, eventually including prescription drug database checks, telephonic interviews and underwriting, and cognitive impairment testing over the phone
- They also expanded their distribution platform, via wholesaler specialists
- Sales started to ramp up significantly
- Has held the position as number one product in the market in terms of sales for over a decade

Hybrid Life Sales

- Total sales
  - $500 million in 2009
  - $1 billion in 2011
  - $1.5 billion by 2014
- Primarily 3 companies through 2010
- Figures only include hybrid life products that offer both ABR and EBR
- Primarily single premium business

2015 - 2016: Product Restructuring, New Players

- Per Life Insurance Marketing and Research Association data for 2015, life combo sales in total (including chronic illness riders) were $3.1 billion in new first year premium, a 14% growth rate, despite a significant shift toward limited pay plans versus single premium
- New counts for life combos were over 200,000, with a growth rate of over 20%
- In 2016, life combos had $3.6 billion first year premium, and over 250,000 policies
- Over ten carriers offering full hybrid products, and over 30 companies offering accelerated benefits for chronic illness or LTC
- Females own 57% of combo policies by count, 49% by face
- Almost half the policies are owned by insureds under age 50, but a high proportion of sales (especially for hybrid LTCi plans) are issued in the 50 to 65 age range

Current Status of Annuity Combos

- Annuity combo sales were about $500 million in 2016
- Annuity market is currently limited to 3 or 4 carriers
- Still some unanswered questions about what if any impact LTCi benefits have on basis in the contract
- Low interest rates have made the product difficult to illustrate
- At older issue ages, charges can exceed net interest being credited, creating a declining cash value over time

Future Outlook

- Some combo product repricing for new business in light of continuing low interest rate environment
- Claims experience has shown very low incidence rates, but longer average claims versus stand-alone LTCi
  - Policyholders view the product as an asset to be saved for later, or for their beneficiaries, unless they face a need for care that is long term
  - Milliman is conducting the first industry study of combo experience
- More life combo players expected to enter the market
- Annuity combos offer even greater long term growth potential
  - Again, annuity combos offer the only way to get tax-deferred gains in an annuity out on a tax free basis
  - Further clarification of tax law treatment would be helpful
  - An increase in interest rates would enhance the product’s appeal significantly, and likely trigger large amounts of exchanges from the $750 billion in non-qualified inforce annuities in the US to new combination annuities

Milliman

Thank you

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