IDI Déjà Vu: Optimism For The LTCI Industry

XIAOGE FLORA HU

ASA, MAAA, is a business development actuary with LifeCare Assurance. Hu developed the pricing models for LifeCare's innovative LTCI products. She also analyzes competitive market offerings, pricing and sales for LTCI in support of existing and prospective client carriers.

Hu joined LifeCare Assurance in 2008. Her actuarial experience includes working as senior retirement associate at Buck Consultants and senior life actuary at CalPERS. Hu's experience covers numerous areas in the LTCI field, including LTCI product pricing, rate filings, and GAAP, statutory, and tax valuation for LTCI products.

Hu graduated from Temple University with a master's degree in actuarial science in 2005.

MARC GLICKMAN

FSA, MAAA, LTCP, is vice president of investments and business development at LifeCare Assurance. His responsibilities span multiple areas, from growing LifeCare's financial partnerships to reviewing product experience, pricing and investment strategy. He has ten years of experience in the actuarial field.

Prior to joining LifeCare, Glickman assisted Fortune 500 companies with their benefits programs as compensation consultant and pension actuarial analyst for Watson Wyatt.

Glickman has a bachelor of arts degree in economics from Yale University.

Hu and Glickman can be reached at LifeCare Assurance Company, 21600 Oxnard St., Suite 1500, Woodland Hills, CA 91367. Telephone: 818-867-2296. Email: ***Flora.Hu@LifeCareAssurance.com*** *and* ***Marc.Glickman@LifeCareAssurance.com.*** *Website:* ***www.lifecareassurance.com.***

In the early 1990s, the Individual Disability Insurance (IDI) industry faced consolidation. Profitability turned negative. Policies sold began to decline. Carriers withdrew from the marketplace. It was a tumultuous time. Now, twenty years later, the standalone long term care insurance (LTCI) market has met a strikingly similar trend. Carriers are leaving the marketplace because of near-zero lapse and unfavorably low interest rates. Prices have been increasing and sales have been declining. Attempts to capture market share have been all but abandoned. Fortunately, an analysis of the DI industry foretells optimism for the LTCI industry. In fact, there may never be a better time for new carriers to enter the LTCI market.

IDI Market from 1980 to Current

The number of IDI policies sold began declining in 1990 due to the financial losses beginning in 1986. Profits as a whole dipped negative from 1986 to 1998. Some companies began to re-assess the viability and potential profitability of the IDI market. Other companies withdrew from the marketplace entirely. Adding to the dismal business climate, the IDI industry had been consolidating—the combined market share for the top 10 companies was 49 percent in 1980 and jumped to 76 percent in 1995. Total sales in 1995 were 23 percent below the highest year of sales in 1988.

Beginning in the mid-1990s, the IDI industry shifted toward less risky policy designs. As a result, profits began increasing. Among the many product design changes, the following became most common:

- Emphasis on guaranteed renewable policies in place of non-cancelable ones.
- Benefits limited to age 65 instead of lifetime for certain claim conditions.
- Reduction of issue and participation limits.
- Movement back to individual sex-distinct rates.
- Reduced good health discount and higher premium surcharge for substandard risk class.

As a result, loss ratios and profitability improved. Part of this improvement was due to morbidity improvement. Incidence rates have improved steadily since the early 1990s because of better underwriting and tighter contracts on new business in the IDI industry. Many companies initiated the following on all applications:

- Blood testing required.
- Greater scrutiny of medical histories with mental or nervous conditions.
- Documentation of applicants' financial income during underwriting.

By the mid-1990s, most IDI companies had also increased the professionalism in their claim areas and invested in claims management with claims investigation specialists, physicians and accountants on staff, and fraud and claim settlement units.

Through product design, tighter underwriting and claim management, IDI insurers in total have experienced more than 10

Earned Premium Growth/Pretax Margin—Industry

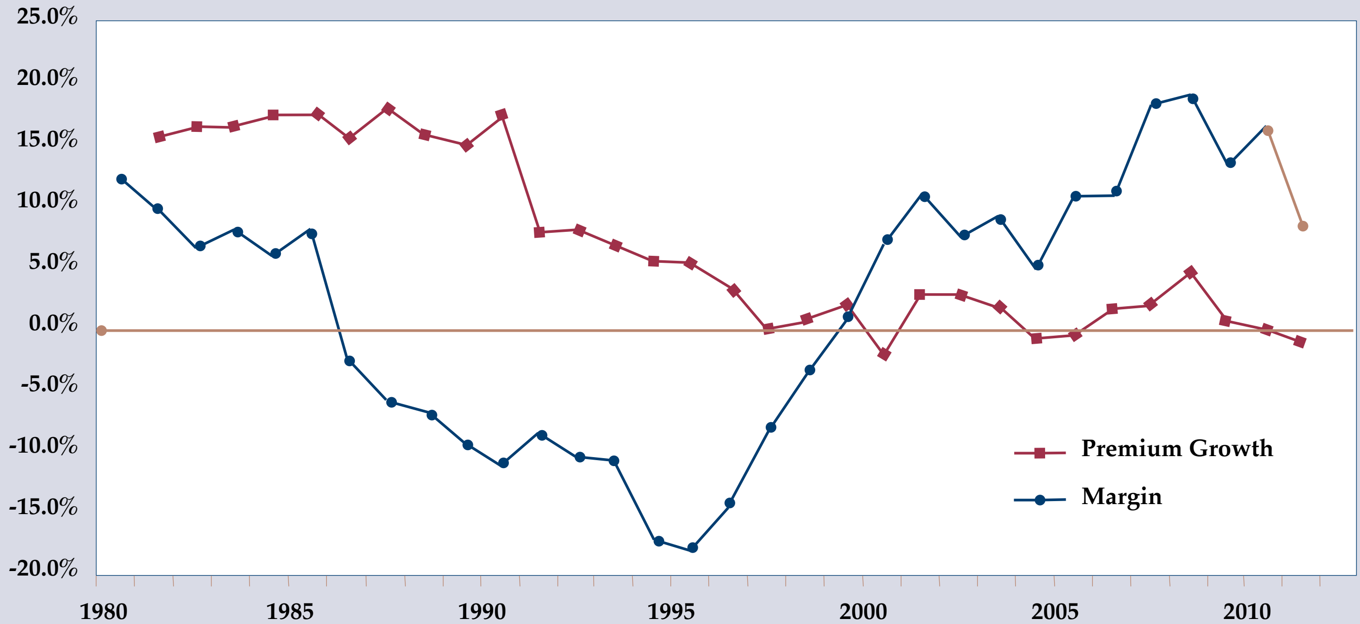


Chart source: Erika Stoddard, Spring 2013 SOA Meeting, Session 011—Profiability Analysis for Individual Disability Insurance. IDI Profitability Trends. Data source of the chart: Milliman Disability Newsletter: Non-Can DI: 2011 Financial Results by Mark Seliber and Duane Kidwell.

years of solid profitability since 1999. Sales results in 2003–2012 have been steady, with a small recent dip during the financial crisis that has recovered.

Primarily because of these changes, IDI experienced a revival of profitability and interest from carriers throughout much of the 2000s. This resulted in a steady rise of revenue for almost a decade. Even though companies have tightened underwriting rules, rates have risen, and sales have slowed, profits have increased because of investments in less risky benefit designs and improved claims experience.

LTCI Market Current Status

The long term care insurance market has faced rising claims trends, continuing low interest rates, carriers exiting the market and a host of other factors. This resembles the IDI market in the 1990s. For the LTCI industry, of the 125 carriers that once sold LTCI, there are only 16 insurers selling stand-alone LTCI products today. Annual sales of individual LTCI policies have been declining since 2002. In 2013, approximately five major carriers issue more than 75 percent of all the LTCI sold in the United States, while ten carriers represent more than 95 percent of the current market. Even though prices are increasing, policyholders are purchasing less-robust benefit policies, resulting in a decrease in average premium per new sale and masking the full impact of price increases. Comparing the pricing for the same benefits shows a marked increase in pricing over the past decade. (See LTCI Market Trends Chart on page 72.)

The LTCI industry is following a similar path as IDI to respond to the current market challenge. LTCI offerings are less risky for carriers through:

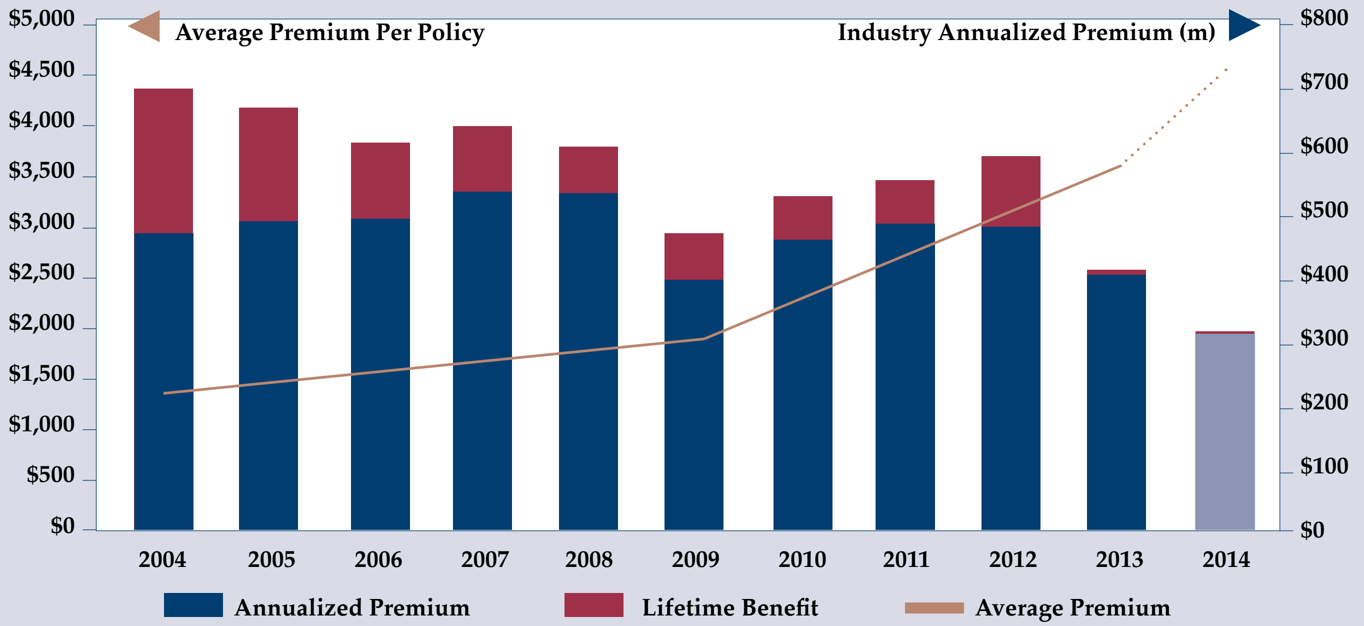
- Movement to individual sex-distinct rates.
- Reduced good health discount and spousal discounts.
- Virtual elimination of the unlimited benefit periods and limited payment plans.
- Increased pricing on COLA policies incentivizing lower inflation protection.
- Lowered max issue and participation limits.

In addition to product changes, the LTCI industry has reduced sales on higher risk riders, tightened policy language and, most important, increased rigor in LTCI medical underwriting. Medical record verification is now a more universal underwriting requirement for LTCI applicants. Many companies also require face-to-face cognitive assessments at certain ages, prescription drug checks and paramedical exams.

Ironically, because of the industry's increased focus on underwriting, the most popular benefits of the last decade—unlimited benefits and limited payment plans—can now be priced at healthy levels for carriers. Early results from the recently released actuarial intercompany experience study show a significant reduction in claim frequency using now standard underwriting practices to avoid anti-selection.[1]

LTCI Market Trends from 2004 to 2014 ***(New Sales)***

(Annualized Premium, Average Premium and Lifetime Benefit Sold)



* *The new policy sales information from 2004 to 2013 is from LIMRA Individual LTCI Participant Report. 2014 new policy sales information is estimated.*

** *Data source: Broker World Magazine and online product filing information. Average annual premium is for a Male and Female couple both with issue age 60, $100 Daily Benefit Amount, 90 Day Elimination Period, and 5 percent Compound Inflation Protection. The premium information is based on the average premium of 3 large carriers.*

While policyholders do continue to use benefits for longer stays, and the need for catastrophic protection remains, the most expensive claims are concentrated in cognitive conditions for which there is now better pre-screening. As important, policies are now priced at such low lapse and interest rates that there is little chance for these assumptions to cause adverse results. New carriers can offer these features at a higher margin and capture significant market share because existing carriers are cautious due to legacy experiences.

Conclusion

The IDI of twenty years ago bears a remarkable similarity to today's LTCI market. IDI legacy issues caused by growing pains in new markets initially resulted in poor financial results. This caused carriers to de-risk products or pull out entirely, which led a new group of carriers to profit from lessons learned. Similarly, the LTCI industry is experiencing de-risking of products and increase of prices. Should this opportunity entice new carriers into the market, especially with the benefits most popular among agents, growth in the industry will likely return. Consumer demographics will continue to be a driving force for both LTCI and IDI. If consumer education follows, the demographics point to the potential for significant future growth.

Footnote:

1. *https://www.soa.org/Research/Experience-Study/Ltc/research-ltc-study-2000-11-aggregated.aspx*