Thinking Long Term

As the long-term care market contracts and rates rise, many people either choose not to buy coverage or choose products that offer guaranteed, but limited benefits.

by Angelo John Lewis

Key Points

The Overview: While sales of life combination products are increasing, stand-alone LTC sales are declining.

The Reason: Many people buy combos because they provide a guaranteed benefit while stand-alone LTC products do not.

The Need: About 70% of people turning age 65 will need long-term care services at some point in their lives. Both types of products address a critical need.

A couple of years ago, long-term care policyholder Frank Fimmano got word from his insurance company that his premiums were going up nearly 50%.

Fimmano, a senior vice president of Aon Hewitt, had a MetLife policy that his company had offered since the early 2000s. "We got hit with a 50% rate increase a year or two ago. John Hancock did something similar and others followed by doing the same thing," he said.

This was just one of a rash of rate increases that occurred in the stand-alone and group long-term care market over the past decade. The increase in rates comes at a time when many insurers are exiting the long-term care market and consumers are showing a growing interest in hybrid products that offer a guaranteed benefit.

A few decades ago, the stand-alone market was booming. But since then, carriers such as Allianz, Prudential Financial, MetLife, CNA and Guardian Life Insurance, have abandoned the market. Those that remain have cut benefits and for the most part suffered declines in sales.

Ten of the top 20 carriers exited the market from 2009 to 2013, according to a 2013 A.M. Best Special Report, *Long-Term Care Insurers Struggle with Past Underpricing, Present Profitability*. As of today, only Genworth offers true group LTC coverage, with the market now dominated by multiline carriers, who bundle individual LTC policies to offer group discounts.

"The first ball to drop [in the true group LTC market] was Aetna, which announced in 2006 that they were exiting the business," Fimmano said. Others, such as John Hancock, MetLife and Prudential followed. "We've had all of these changes in carriers closing, stopping sales, and closing plans to new entrants. Whoever heard of an insurance company that didn't want new participants? Well, in this business, they don't want new participants," he said.

What Happened

The problem is what Fimmano calls "actuarial shock," caused by faulty interest rate and lapse rate projections.

"The actuaries got it wrong, but not for any negligence on their part. Who could have predicted such a period of low interest rates? The industry used 5% to 7% expectations and look where it's been. And persistency has been much better than the actuaries assumed. I think generally the industry expected a 10% ultimate lapse ratio, meaning that after 10 years, 10% of policyholders would have dropped their policies. The actuality has been between 1% to 2%," Fimmano said.

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Sales' Saver

The major bright spot in the industry is the rise in sales of so-called combination products, which are built on a life insurance chassis and include long-term care benefits. Although these products have been around for a while, sales of combos really took off in 2009-2010, at least partly because of changes in taxation policy outlined in the Pension Protection Act of 2006 that allow policyholders to draw on their death benefits tax free if they become chronically disabled.

As of 2013, about one-third of new sales in the LTC insurance market involved these products, according to a 2014 Society of Actuaries white paper, *An Overview of the U.S. LTC Insurance Market (Past and Present)*. Just under 100,000 of these combination policies sold in 2014, an increase of 4% over the previous year, according to Limra.

But the majority of sales are still in the stand-alone market, with about 131,000 new policies purchased in 2014, representing $316 million in new premium, adding to a total of $10 billion in-force premium, according to Limra analyst Karen D. Fisherkeller. New business premium revenue was 22% lower than in 2013, and the number of lives covered was down 24%, according to Limra.

As traditional sales have declined, the sale of hybrids has been growing, according to Michael Hamilton, vice president of MoneyGuard Product Management for the

A Closer Look at Combination Products

Although they'd already established a niche in the life industry, it took changes in tax law to boost sales of what today is the fasting growing segment of the LTC market: life combination products. Sales of these products reached $2.4 billion last year, with double-digit increases most years since 2009.

Under the Pension Protection Act's LTC provisions, effective Jan. 1, 2010, funds used for qualified LTC premiums no longer create a taxable event for policyholders with any of the four forms of combination products: life policies with an acceleration of the death benefit, those with chronic illness riders or long-term care riders, life policies with embedded LTC riders with an extension of benefit rider, and annuity/long-term care products.

Of the four, the least expensive for policyholders are LTC acceleration products, in which portions of the death benefit are paid in advance of death, expected from within six months to a year. These products typically add 3% to the cost of the attached life policy, according to Marc Glickman, LifeCare Assurance Company's vice president of investments and business development.

"The long-term care acceleration products have been around for more than a decade, but only selected carriers offered them in the beginning because the law was not clear how the benefits were going to be treated from a tax perspective," said Catherine Ho, product actuary at Limra. "The Pension Protection Act clarified that they were tax-exempt and as a result many carriers began offering acceleration products," Ho said.

Life policies with chronic illness riders require the occurrence of a permanent long-term care event or a severe cognitive impairment. Those with long-term care riders, on the other hand, do not require permanent disability, but the diagnosis of an illness or accident condition that requires substantial assistance for at least 90 days.

According to Glickman, the chronic illness rider typically adds 5% more to the cost of the underlying life policy, while the long-term care rider typically adds about 7%.

The most comprehensive combo products are extensions of benefit products, which embed the long-term care rider into the life policy and then include an extension of benefit rider.

"These are similar to some of the newer products in the individual long-term care market in that they involve a pool of money," Ho said. "So if you buy a $100,000 death benefit and receive two or three times that amount of coverage, it's because there's a specific pool of money just for long-term care benefits."

This variation costs about 10% to 15% more than the underlying life policy, according to Glickman.

The final category of combination products are annuities, which offer long-term care protection. These are usually fixed annuities with long-term care riders, in which annuitants can draw a monthly benefit if a qualified need for long-term services occurs.

"These work similar to extension products in they involve a pool of money. So if you put $100,000 into this annuity, your pool is about $200,000 to $300,000 for long-term care. However, there are very few carriers in this market, and we're not really sure where it's going," Ho said.

Limra estimates that five insurers sell annuity/LTC products versus 20 that sell the other forms of combination products.

"All products in the long-term care insurance space provide protection, be it an individual stand-alone product, a combination life-LTC product, or a combination annuity-LTC product. The IRS sets a limit on the eligible amount of tax-free benefits; anything over this limit is taxed for all of these products," said Limra analyst Karen D. Fisherkeller.

"In general, the stand-alone product pays out a daily or monthly benefit. Combination products could potentially pay out more, but policyholders would be taxed for any additional payout beyond the IRS daily max."

Lincoln Financial Group. "We expect hybrid sales to surpass traditional sales, perhaps as early as this year," Hamilton said. "From a numbers perspective, hybrids are growing, but still are a smaller segment of the market."

The Hybrid Advantage

From a broker's perspective, combo products are easier to sell than traditional products because unlike the latter, policyholders know that they're going to get something for their investment, whether they need long-term care or not.

"The hybrid product just resonates with an adviser and with a client because it always pays a benefit," said Andrew J. Bucklee, senior vice president and head of the insurance solutions distribution team for Lincoln Financial Distributors.

"First, it pays a long-term care benefit. Second, it will pay a benefit if you need your money back at some point. And, if you don't use it, your children are going to get your money back, plus a rate of interest in the form of a death benefit," Bucklee said.

One of the issues customers have with stand-alone long-term care coverage is the 'use it or lose it' problem, said Terence Martin, Conning & Company's director of life and annuity research. "People pay to insure their cars, but generally don't think of that in terms of 'use it or lose it,'" Martin said. "But with life insurance, long-term care, and other long-term products, 'use it or lose it' is something people have a hard time dealing with.

"With life insurance combination products, people think 'Well, I'm going to die someday, at least I can use my life insurance for double duty. If I actually make it to 85 and I need to go into a long-term care facility, by that point my kids are long since out and on their own and don't need my death benefit—in that case, I can use it,'" Martin said.

The Hybrid Drawback

But the problem with combo products from a consumer perspective is that they don't really offer the same benefits as stand-alone products, according to Marc Glickman, vice president of investments and business development at LifeCare Assurance Company, a reinsurer that specializes in long-term care insurance products.

"They're not really covering the true long-term care risk, which is a catastrophic claim many years from now when costs are much higher and which could last a very long period of time," he said.

James Glickman, LifeCare's president and CEO, contrasted the two types of products with some quick back-of-the-napkin calculations:

"Let's say that in the stand-alone market you're buying a $200-a-day benefit with 5% compound inflation. At age 55, you are statistically likely to be 30 to 40 years away from where most of the claim costs will occur, should you need to draw on them. So 40 years from now, that 5% compounding will increase the benefit by six-and-a-half fold. So your $200 a day is actually $1,300 a day at the time when you actually need the benefits.

"But if you buy that $200-a-day benefit inside of a life insurance policy, 40 years down the road you still have that $200 a day. So even though it feels like you're covering risks for long-term care because you're focused on today's benefit, the fact is you are covering less than one-sixth of what you actually need. That's better than nothing but that's not a lot of long-term care benefit. And most of the benefits in combo products are actually provided from your own cash values and death benefits," Glickman said.

Faulty interest rate and lapse assumptions caused many carriers to abandon the traditional long-term care market.

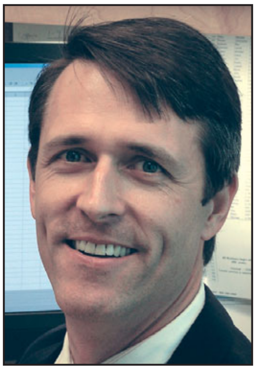
Frank Fimmano,
Aon Hewitt

LifeCare has designed a "reverse combo" product built on an LTC chassis as opposed to a life chassis, which Glickman said provides 10% to 20% more LTC benefits and 10% lower premiums than conventional combos. "One of the interesting things about the reverse combo is that it doesn't have the restrictive life insurance regulations geared toward cash values and death benefit limitations but instead is subject to long-term care regulation. The long-term care structure allows every possible scenario of premium payment and inflation options which regulation in the life structure restricts," he said.

Consumer needs should drive the choice between the competing types of LTC products, said Sharon Carson, retirement strategist, individual retirement, J.P. Morgan Asset Management.

"I wouldn't say that always traditional insurance is better, nor would I say that always a hybrid product is better," Carson said. "If somebody has the bequest motive and wants to leave something to their heirs, a hybrid product perhaps can help. But if they have no bequest motive whatsoever, I think the hybrid product may not be quite as good a fit.

"The other thing is you have to take individual clients' attitudes, needs and perceptions into account. Some clients will really be very focused on, 'Look, if I'm paying for this, I want to get some benefit out of it.' So if your client really can't get past that, the hybrid product is probably going to work better for them because you at least can get some premium back," she said.



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Terence Martin,
Conning & Company

A Tremendous Need

No matter what their views on the types of long-term care insurance people should buy, there's a consensus among many observers that these products fill a significant need.

About 70% of people turning age 65 will need long-term care services at some point in their lives, according to the U.S. Department of Health and Human Services. And there's frequently a gap between what individuals and families can afford on their own and the cost of these services.

"There is a tremendous need and demand for affordable individual LTC insurance in the United States," according to the 2013 A.M. Best special report. "Medicare and Medicaid are currently the largest payers of LTC expenditures, although these programs are under pressure from current state and federal government deficits. This will result in an increased need for LTC insurance carriers to absorb the growing demand."

Only 8.2% of U.S. LTC expenditures as of 2011 were paid by private insurance, with the vast majority of the rest covered by Medicare, Medicaid and personal resources, according to the American Council of Life Insurers.

"People know that there is a risk that they need to protect against—a genuine risk. But it's just not translating into action," said Limra's Fisherkeller. "When we ask people why they're not buying [LTC insurance] the number one reason has to do with affordability. Consumers think an individual LTC policy costs about a thousand dollars a year, which they feel is too expensive. In fact, in 2014, an individual LTC insurance policy costs closer to $2,400 a year."

Not only are consumers reluctant to buy LTC insurance, many brokers also have not been interested in selling the stand-alone product.

"When the agents have to go back to their clients who they sold policies to 10 to 15 years ago and explain to them why they're getting rate increases, when they made a lot of their initial sales on the basis that it was highly unlikely they'd get a rate increase, brokers feel they were let down," said James Glickman. "Now prices have stabilized in the stand-alone product and interest from agents is increasing once again," he added.

Because of cost, long-term insurance appeals mostly to affluent people.

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Genworth CEO Seeks to Expand LTC Middle Market, Improve Awareness Of Long-Term Care Needs

As the industry leader in traditional long-term care insurance, Genworth Financial Inc. faces the same challenges that have forced many competitors to abandon the business: unprofitable old blocks of business, public skepticism about the need for the product and difficulty making profits in a low-interest rate world.

It has not been an easy road over the past couple of years. The company, which also sells life and mortgage insurance, posted a second-quarter 2015 net loss of $193 million, after posting a net loss of $1.24 billion in 2014. The company's shares were down more than 40% in the first eight months of the year after falling about 45% in 2014.

In its long-term care business, Genworth posted net operating income of $10 million in the second quarter, compared with $10 million in the prior quarter and $6 million in the prior year.

Individual LTC sales of $8 million were lower than the prior quarter and prior year, Genworth said in its second quarter financial results released in early August.

In an interview with *Best's Review,* Genworth CEO Thomas J. McInerney said he believes that public perception about Genworth's flagship product will eventually turn around. And that more people will come to realize there's a gap between their need for long-term care and their ability to pay for it.

In the interview, McInerney discussed how long-term care coverage has evolved, the company's efforts to reach the middle market and his projections for the future.

"With our new products, we are offering a lower cost/benefit policy, because we do need to expand to more of the middle market with an income range of $40,000 to $50,000."

Thomas J. McInerney,
Genworth CEO

How has Genworth de-risked its stand-alone LTC product since the last decade, when "actuarial shock" caused many carriers to exit the market?

We've addressed the four key risk drivers for the product: Interest earned on investments, lapse rates, morbidity and mortality. Of these, the two most troublesome for LTCi carriers are interest and lapse rates. We believe our current product will significantly mitigate those risks.

Let me address these one by one, starting with investment income.

A significant challenge for LTC insurance is that all industry participants have earned substantially less in investment income than was originally assumed in pricing given the substantial drop in interest rates, especially since the crisis in 2008-2009.

Consequently, Genworth has reduced this risk in new product pricing by consistently reducing our assumptions for investment income. On our new product, we're down to a 3¼% interest assumption, which assumes a risk-free Treasury rate of a little over today's 2% rate and a spread that we earn because we generally buy bonds of A to A-quality. We believe that's a conservative assumption for the next 30 to 40 years, in contrast to the early '80s when we were assuming 7% to 8% interest.

Regarding lapse rates, LTCi is a lapse-supported product—one of those products for which lower lapses than the lapse assumption in pricing can lead to significant losses. In the '80s, we assumed in pricing that 5% to 6% of policyholders would ultimately lapse their policies. In reality, it is closer to 0.7% or 0.8%. In our new products, we assume an ultimate lapse rate of 0.5%.

Mortality and morbidity risks are hard to project over the 30-40 years that many of these policies stay in force. Accordingly, for our new products, we have made our mortality and morbidity assumptions more conservative. Additionally, we intend to seek rate increases annually when actuarially justified, with the hope that those increases would be in the low single digits, versus the large ones of the past.

How have the resulting increases in premiums and decreases in benefits affected your stand-alone LTC business as a whole, and impacted the demand for your stand-alone LTC product and the types of consumers who buy it?

We have suffered huge losses on our challenged blocks, which include all policies we sold or purchased from others from when we started in the mid-to-late '70s through the early-to-mid 2000s. To date, we've lost approximately $2 billion on those blocks—that includes additional reserves we've had to set aside plus actual losses. We will never recover those losses. Each year, we continue to lose about

$100 million on these blocks. Going forward, our goal is to get those annual losses closer to zero through large premium increases and associated benefit reductions.

Approximately 50% to 60% of our active policies are from these challenged blocks. Although the remaining 40% to 50% of our in-force policies are still profitable, many of those policies need premium increases of about 35% to bring those policies back closer to their original price for loss ratios. We recognize that our policyholders are not happy about rate increases. However, we are pleased that the vast majority of them recognize that even with significant increases, the policies still provide great value—evidenced by the fact that 87% have accepted the full increases implemented to date. Of the rest, 8% have taken reduced benefits and only 5% have chosen the non-forfeiture option. On the non-forfeiture option, Genworth voluntarily agreed that if the policyholder no longer wanted to pay any more premiums, we'll give them a paid-up policy equal to the amount of premiums paid to date. We volunteered to do that and were the first, and perhaps only, company to do that.

We believe that the large increases implemented on older long-term care insurance blocks have softened the market, resulting in a significantly lower number of LTCi carriers and substantially decreased sales. While premiums are likely to go up over time, as with other insurance policies subject to health cost inflation, we believe there will be greater market acceptance of a long-term care insurance product with annual increases. Additionally, we hope that since we have interest rate and lapses priced more conservatively, the future increases will be lower. As people get more comfortable with that, we hope there will be more demand for the product going forward.

We don't believe that the large rate increases have impacted the type of consumer who purchases long-term care insurance—we have not seen any demonstrable change in the demographics of the typical purchaser resulting from rate increases. To date, most purchasers are between the ages of 55 to 60 when they buy and tend to be more mass affluent with an income of $75,000 or higher. With our new products, we are offering a lower cost/benefit policy, because we do need to expand to more of the middle market with an income range of $40,000 to $50,000. The broad market is between 40 to 75 years of age, about 115 million people, with the core market being the 76 million baby boomers who are 51 to 69 years of age.

What do you see as the major challenges confronting Genworth and other carriers that remain in the stand-alone LTC business?

First and foremost is the severe challenge posed by the massive losses from the old blocks and receiving premium increases to bring them closer to break-even. Also, going forward, there is a need for more consumer awareness of the need to plan for long-term care financing. Many Americans, based on our polling data, don't think they need it. However, studies show that 70% of people who reach 65 will need some form of long-term care services.

Many Americans also believe that Medicare or the Affordable Care Act will cover all of their potential long-term care needs, but they won't. And while Medicaid covers long-term care, that's only if you qualify, which means you have to spend down virtually all of your assets. So, we need the large increases on the older challenged blocks, broad acceptance and implementation of the annual re-rating/small increase strategy, and a robust program to educate Americans and change public policy to encourage more of them, especially those between 40 and 75, to adequately plan for the financing of their long-term care needs. And we do need to expand the private market to make it more competitive.

What are your projections for the future of the stand-alone LTC market?

At the industry's peak, there were more than 100 long-term care insurance carriers. Today, there are only about 10 to 12. That is very disappointing. And of those, only a handful of us are really actively trying to grow the business. We think all of the noise about premium increases has hurt the market, so we are working at both the federal and state levels to increase public education of the need for long-term care insurance. We also are working with Congress on tax and other incentives that would encourage consumers to consider long-term care insurance and make it more tax efficient to buy LTCi coverage.

We expect in the near term that there will still be market drag on volume of long-term care insurance sales. In 2014, there was only $316 million of premium, compared with over $1 billion at the peak in 2002. Ultimately, we would hope to fix the back book with these large increases and then invest in more marketing and consumer education to ultimately lift sales over the next 3 to 5 years.

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"We're talking about people who have significant assets, but who are not considered the wealthiest who are more apt to self-insure. Those on the opposite end of the continuum probably can't afford the product and are more apt to go through whatever savings they have and then access Medicaid," Fisherkeller said.

Appealing to the Middle-Income Consumer

J.P. Morgan's Carson and Aon Hewitt's Fimmano believe there's a need for LTC products that would appeal to middle-income consumers.

"Insurers are trying to figure out how to create a more affordable product to attract more middle-income people who may really need it. I think that may be a bit of a puzzle. We're definitely seeing the interest from advisers," Carson said.

One possibility is to offer less expensive products with longer than the usual 90-day elimination periods most people buy. These products would not cover short-term care of less than six months, which comprise about a third of all claims, she said.

"There's a chance you'll need care and not be able to use the policy, but you've really lowered your premiums, and you're protected against the catastrophic event of something you can't afford, which really in my view should be the purpose of insurance," she said.

Fimmano believes that another way to attract middle-income consumers is to offer high-deductible plans.

"Today, long-term care insurance is far less affordable than it was. So why not give middle-income people easier access," Fimmano said. By offering plans with deductibles of $50,000 to $100,000, consumers would have to pay for the initial costs, but then the carrier would be responsible for any additional costs, which could still be significant. "You don't have to worry," Fimmano said. "And you're going to be leaving your heirs something in your estate."

While LTC carriers struggle for ways to make their products more affordable, there are some signs that the business as a whole is stabilizing. "There are a number of carriers that have been in the marketplace for a long time and remain committed to it," Fisherkeller said. "They understand the significant need for it. Whether they offer stand-alone LTC insurance or a combination insurance product, it's more important that they make these protection products available." BR

Combo products don't really cover the true long-term care risk of "a catastrophic claim many years from now when costs are much higher and which could last a very long period of time."

Marc Glickman,
LifeCare Assurance Company

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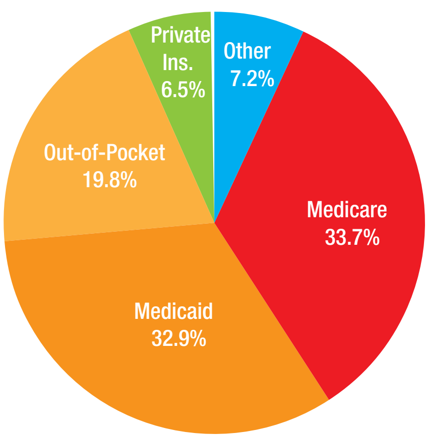
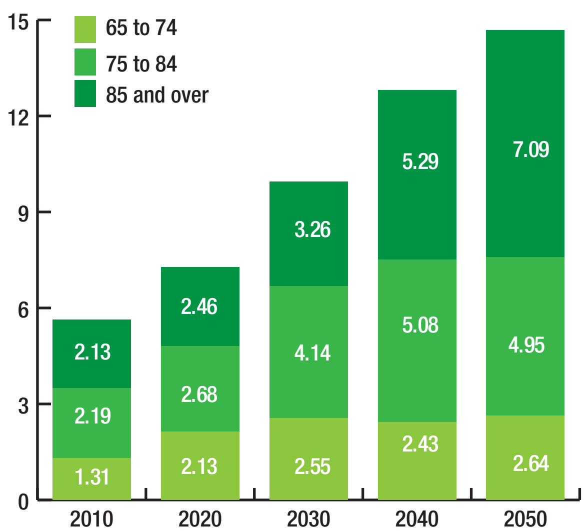
Sharon Carson,
J.P. Morgan Asset Management

Total Long-Term Care Expenditures For the Elderly



Note: In 2014 USD. Includes seniors only (age 65 and over). Based on nursing home care and home health care.
Source: ACLI calculations based on data from Harris-Kojetin et al. (2013), U.S. Department of Commerce, U.S. Census Bureau, and data provided by the Office of the Actuary, Center for Medicare and Medicaid Services via personal correspondence.

Long-Term Care Population, by Age, 2010-2050 (Millions)



Source: ACLI calculations based on data from Harris-Kojetin et al. (2013).