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## Combo Long-Term-Care Products: A Solution to Address Market Needs

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Long-term care in the United States is a market whose demographics demand a private solution from the insurance industry, but that demand is not being adequately met now. This article will review the recent history of the private market and suggest a near-term solution to address this need.

It is common knowledge that the wave of baby boomers has begun hitting retirement age. Regular debates occur about the funding of Social Security and Medicare, but neither address long-term care (LTC), which is too often ignored when evaluating what our seniors will need for a comfortable and respectful retirement. While measurements and estimates vary, it is commonly expected that 50 per cent to 70 per cent of Americans will need LTC at some point in their lives.

The median annual cost of nursing home care is currently \$84,000 per year and has been growing at 4.3 per cent per annum over the last five years.<sup>1</sup> Ancillary cost such as medications can easily bring this cost to over \$100,000 per year, which means that a half-million-dollar nest egg would be wiped out within five years.

### Medicaid and LTC

There is a widespread belief that Medicare will cover LTC. Too many people find out when it is too late that this is simply not the case—nor is it likely to change. Cost containment discussions for Medicare are common and necessary to maintain its solvency. It is not reasonable to expect that Medicare can be expanded to cover LTC. For those people who have employer-provided retiree health care, this also will not provide for the cost of LTC.

Medicaid thus becomes the provider of last resort for LTC. However, in order to qualify for Medicaid LTC services, the individual must be deemed impoverished, defined in most states as having less than \$2,000 in assets. This is obviously not a respectful outcome for our seniors, yet one-third of middle-class people with assets will end up in this situation after those assets have been depleted by the high cost of LTC.<sup>2</sup> The impact on Medicaid expenditures is significant, as 28 per cent of Medicaid's total costs in 2011 were for LTC.<sup>3</sup> Medicaid is a large proportion of total government spending: 23.6 per cent of all spending at the state level and 7.6 per cent of all spending at the federal level.<sup>4</sup> As baby boomers age and longevity continues to rise, these expenditures will only grow—along with a devastating impact on state and federal budgets—unless a private means to address this need is found in the near future.

### Other governmental programmes and LTC

Quasi-public and private programmes have attempted to address the costs of LTC, but with little success. Part of the Affordable Care Act created the Community Living Assistance Services and Support (CLASS) Act, which was

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<sup>1</sup> *Genworth 2013 cost of care survey*, available at [https://www.genworth.com/dam/Americas/US/PDFs/Consumer/corporate/130568\\_032213\\_Cost%20of%20Care\\_Final\\_nonsecure.pdf](https://www.genworth.com/dam/Americas/US/PDFs/Consumer/corporate/130568_032213_Cost%20of%20Care_Final_nonsecure.pdf)

<sup>2</sup> AARP.

<sup>3</sup> Dept. of Health and Human Services, "2012 Actuarial Report on the Financial Outlook for Medicaid," available at <http://medicaid.gov/Medicaid-CHIP-Program-Information/By-Topics/Financing-and-Reimbursement/Downloads/medicaid-actuarial-report-2012.pdf>.

<sup>4</sup> *Ibid.*

intended to create a national, voluntary LTC programme. But it was deemed to be financially unsustainable and was repealed in January 2013.

State Partnership LTC plans have developed over the last 20 years to encourage private ownership of LTC insurance. A typical structure would allow individuals to shield \$1 of assets from the Medicaid “impoverishment” rules for each \$1 of private insurance that they buy. Although the majority of new policies automatically qualify for Partnership status, these programmes have had a limited impact on increasing the market penetration for LTC policies.

### The insurance industry and LTC

The insurance industry remains the primary source of private solutions to address this growing need, by offering LTC insurance policies. Years ago it was relatively easy to find insurance company providers for LTC; 94 companies offered retail LTC policies in 2002.<sup>5</sup>

Even with this level of offered capacity, market penetration of LTC insurance remains low, hovering at around 10 per cent of people over age 65 owning LTC policies.<sup>6</sup>

Over the last few years insurance companies, for the most part, have experienced financial difficulties with their LTC business. The economic fundamentals behind this experience have been the following:

- (1) Reduced investment earnings caused by historically low interest rates—LTC policies typically have level premiums that are invested by the insurance company then held in reserve to pay benefits many years down the road. Interest rates are much lower than anticipated, resulting in insufficient funds to pay for future benefits.
- (2) Higher costs of providing LTC—this is consistent with the broader issue of rapidly rising medical costs in the United States.
- (3) Strong persistency—Insurance companies typically estimate what proportion of policies will ultimately stick around long enough to be eligible for benefits. These estimates were generally too low for LTC policies, and more policies than anticipated are eligible for benefits.

These financial difficulties have caused most insurance companies to raise the premium rates on existing policies by double-digit percentages. Premium increases of 20 per cent to 50 per cent have been common. Even though the terms of these existing policies allow for premium increases, and state regulators need to approve them, they are unexpected by the policyholders and harm the credibility of the insurance companies. A large number of companies have *stopped* selling new LTC policies or suppressed their sales volume. By 2011 the number of insurance company providers for retail LTC policies was down to 20.<sup>7</sup> Over the past five years, 10 of the top 20 LTC providers have exited the market.<sup>8</sup> This has dramatically reduced the current availability of stand-alone LTC policies.

It is indisputable that U.S. consumers do not currently have sufficient private insurance solutions available for their LTC needs. The range of solutions is limited, and the volume of supply is constrained.

### LTC combos

Increasing the volume and variety of private insurance solutions requires fundamental risk profile changes. If that is accomplished, additional insurance companies will be motivated to offer products, thereby unleashing product creativity as well as consumer access to these solutions. LTC combos, products that combine LTC benefits with either life insurance or annuities, are the most promising product solution for this consumer need.

The Pension Protection Act of 2006 (PPA) contains provisions favourable to LTC combos. Under the PPA, funds in a life insurance or annuity policy can be used to pay for qualified LTC premiums without creating a taxable event to

<sup>5</sup> America’s Health Insurance Plans, Research findings: long-term care insurance in 2002, available at <https://www.ahip.org/Long-Term-Care-Report-2004/%E2%80%8E>.

<sup>6</sup> Forbes.

<sup>7</sup> Broker World, “2012 Long-Term Care Insurance Survey,” available at [www.thechittendens.com/Content/Content/85/Documents/201207Broker%20World%20LTCI%20Survey.pdf](http://www.thechittendens.com/Content/Content/85/Documents/201207Broker%20World%20LTCI%20Survey.pdf).

<sup>8</sup> LIMRA.

the policyholder. Prior to PPA, use of these funds would generate a Form 1099 for taxable income. An LTC product is “qualified” if it satisfies several benefit and consumer protection provisions created by the Health Insurance Portability and Accountability Act (HIPAA) and codified in IRS Section 7702B(b). In essence, this requires that an individual must be receiving care pursuant to a plan of care prescribed by a licensed health-care practitioner, and that the individual be certified by a licensed health-care practitioner as being “chronically ill” by either being unable to perform at least two activities of daily living (ADLs) or requiring substantial supervision due to a severe cognitive impairment. Because of this regulatory requirement, these have become the standard benefit triggers.

The Society of Actuaries published a study in 2012 entitled “Quantification of the Natural Hedge Characteristics of Combination Life or Annuity Products Linked to Long-Term Care Insurance”. This study illustrates how the risk profile of LTC combos is dramatically lower than that of stand-alone LTC products.

The SOA study conducted stress tests for the financial results of stand-alone LTC, Life and LTC combos, and Annuity and LTC combos in relation to

- LTC incidence
- active life mortality
- investment earnings
- LTC claim termination rates
- persistency.

Risk profiles, as measured by profitability reduction in these stress tests, were dramatically lower for combos than for stand-alone LTC. A sample from this study is shown in Table 1.

**Table 1: Percentage change in present value of after-tax profits**  
(Two-year accelerated benefit, four-year extension of benefit, with inflation)

	<b>115 % of LTC Incidence</b>	<b>115 % of Active Life Mortality</b>	<b>Decreased Investment Earnings</b>	<b>90 % of Claim Termination Rates</b>	<b>50 % of Standard Lapse</b>
Stand-alone LTC	-61 %	13 %	-39 %	-58 %	-15 %
Life and LTC combo	-30 %	15 %	-15 %	-24 %	-34 %
Annuity and LTC combo	-7 %	-2 %	1 %	-7 %	12 %

In this example, the first column shows that an increase in LTC incidence of 15 per cent caused a 61 per cent reduction in profitability for stand-alone LTC. But the same increase in LTC incidence caused only a 30 per cent reduction in profitability for life and LTC combos (reducing the sensitivity by half). Annuity and LTC combos had only a 7 per cent reduction in profitability (reducing the sensitivity by 86 per cent).

The middle column illustrates the sensitivity to investment earnings. stand-alone LTC experienced a 39 per cent reduction in profitability, while life and LTC combo experienced only a 15 per cent reduction in profitability, and Annuity and LTC combo actually showed a 1 per cent gain in profitability.

Finally, the last column illustrates the sensitivity to lapse. Reducing lapse rates to 50 per cent of the standard assumption caused stand-alone LTC profitability to decline by 15 per cent. Life and LTC combo did worse, with a 34 per cent profitability decline. Annuity and life combo showed a 12 per cent gain in profitability.

The favourable policyholder taxation changes under the PPA became effective January 1, 2010. This timing coincides with the ongoing financial challenges being experienced on stand-alone LTC. Yet sales of combo LTC products have been muted. While \$2.0 billion of life & LTC combo premium was sold in 2011,<sup>9</sup> 85 per cent of this was attributable to Lincoln National's single-premium *MoneyGuard* product. By its nature, a single-premium product is targeted toward the high-net-worth consumer. combo LTC products have not yet significantly penetrated the middle market.

<sup>9</sup> Ibid.

### The future of LTC benefits

Insurers have proceeded cautiously when deciding whether to offer LTC benefits of any type. Accelerated benefits on life insurance policies are beginning to be commonly offered, where the triggering event is similar to that found in PPA—typically the inability to perform two of six ADLs or severe cognitive impairment. The policyholder is allowed to accelerate the death benefit that would otherwise have been payable, often structured as a percentage of the death benefit on a monthly basis.

This type of accelerated benefit allows an insurer to provide policyholders with access to cash when care is needed. The risk to be managed is the payment of benefits sooner than would have occurred upon death, and potentially additional benefits in the case where a policy would have otherwise lapsed before death benefits would have been paid.

But these accelerated benefits will not normally satisfy a LTC needs-based analysis of the consumer. Using the figures cited above, a \$100,000 life policy would be exhausted in about a year, and average LTC needs are far longer. Thus, the size of the benefit is often inadequate relative to needs, and it cannibalises the death benefit needed for other purposes. In fact, insurance regulators do not allow an accelerated benefit to be marketed as “long-term care.” Most states regulate accelerated benefits under their version of NAIC Model Regulation 620—Accelerated Benefits Model Regulation, so the product does not fall under state regulations dealing with LTC.

### Extensions of benefits

To provide more substantive benefits, combo LTC products—whether combined with life insurance or annuities—will typically add an extension of benefits (EOB) to the accelerated benefit. The consumer can select and pay for varying benefit durations of benefits. This can match up the product benefits with the needs-based analysis plus affordability.

Once an EOB is added, the insurance company is venturing further into LTC risks that must be managed. But as illustrated by the referenced SOA study, the risks are muted relative to stand-alone LTC. Because of this risk mitigation, insurance companies should be more comfortable offering combo LTC products to the consumer. In addition, insurance companies may be willing to offer premiums that are less subject to future increases. These premium guarantees could be full or partial, where partial could be expressed as either for a period of time after issue, or by stating the maximum amount by which rates could rise. Any actions along these lines will help to rehabilitate the image of the insurance industry in this market, and to encourage reluctant consumers to consider the purchase of LTC products.

### Conclusion

For the insurance industry to provide a sufficient range and supply of private LTC financing solutions, combo LTC products appear to be the primary near-term answer. Combining an acceptable risk profile with sufficient consumer benefits will enable the market dynamics of volume and creativity to address this critical and growing public need.