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THE PLUSES AND MINUSES
of the Long-Term Care Insurance Market

The current state of the LONG-TERM CARE INSURANCE MARKET has quite a few people wondering about its viability. But are these concerns warranted?

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THE LONG-TERM CARE INSURANCE (LTCI) MARKET has had its share of media attention recently—or perhaps more than its share. From relatively rapid growth in its early days to declining sales in the late 2000s, LTCI has consistently been portrayed as a market with great potential. Recently, the market has attracted some high-profile news stories with several carriers raising in-force business premiums or ceasing sales of new LTCI business altogether. What is behind these stories? Do they paint the whole picture? What does the LTCI market really need to turn the corner?

Regardless of conditions at any given time, the market's potential is apparent. The aging of society in the United States, and in many other countries for that matter, will create significant challenges and opportunities with respect to long-term care (LTC). As the saying goes, demographics is destiny. The cost of care continues to grow as shown in the graph in Figure 1.

Medicaid is the primary payer of LTC in the United States. According to 2008 CMS data,[1] Medicaid pays for about half of LTC expenditures, Medicare pays for 22 percent, LTC insurance and other private sources pay about 9 percent, and the rest is covered by other public sources and out-of-pocket expenditures. The value of informal care provided by friends and family members is not part of these cost estimates, but some estimate that the value of informal care is at least equal to the total value of formal care. While Medicaid pays for most LTC in the United States, the tremendous pressure from state budgets is such that Medicaid will not be able to fund the lion's share in the future. Currently, many states are looking for ways to scale back their LTC programs. The need for privately funded LTC is clear and persistent. Unfortunately, many people today do not have a plan for managing their LTC needs. So when an event happens, they scramble to determine what to do and how to pay for care. In many of these situations, Medicaid ends up paying the bill—either after asset spend down or lenient Medicaid rules that allow individuals to shield assets and qualify for Medicaid. Addressing this issue and getting more people to develop a plan for future LTC needs would reduce budget pressure on Medicaid.

HISTORICAL GROWTH

LTCI experienced several years of robust growth in its early existence. For several years, however, new sales have declined, and have been much lower than anticipated by many in the industry. Total sales for the industry were almost $700 million in 2010.[2] Figures 2 and 3 (on page 19) show historical new business growth rates for the individual and group market segments, respectively. The group market comprises about one-third of the total in-force lives, but only 20 percent of the total in-force premium—this difference is largely because the group market is primarily sold to younger individuals with an average issue age in the lower 40s versus upper 50s for the individual market, and the average premium for younger individuals is much lower.

Despite not performing up to its potential, the market is not insignificant or small as some think. As of the end of 2010, the LTCI market included almost $11 billion of in-force premium and covered more than 7 million people.[3] The American Association of Long Term Care Insurance currently estimates that the total potential market for LTCI is about 15 million to 18 million people.

In the past couple of years, general economic weakness undoubtedly shares at least part of the blame for slow sales. Individual buyers have less income to spend on a form of insurance that they largely view as discretionary (at least until they approach retirement age). Employers, one of the stalwarts of LTCI growth through sales of group policies of various kinds, have cut back on employee benefits of all kinds including LTCI. The explanation can't rest there, however, since LTCI market declines started long before the 2008 economic crisis.

Figure 1: Average Daily Rates by Type of Care

Trend Data (2004 – 2010)

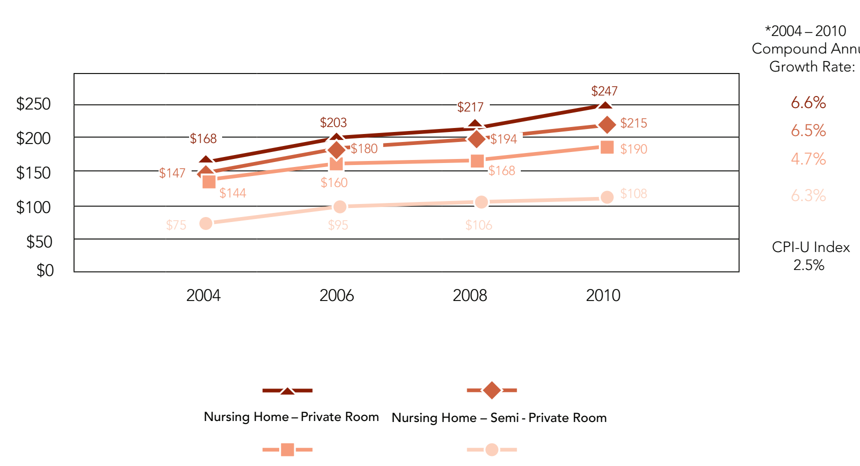
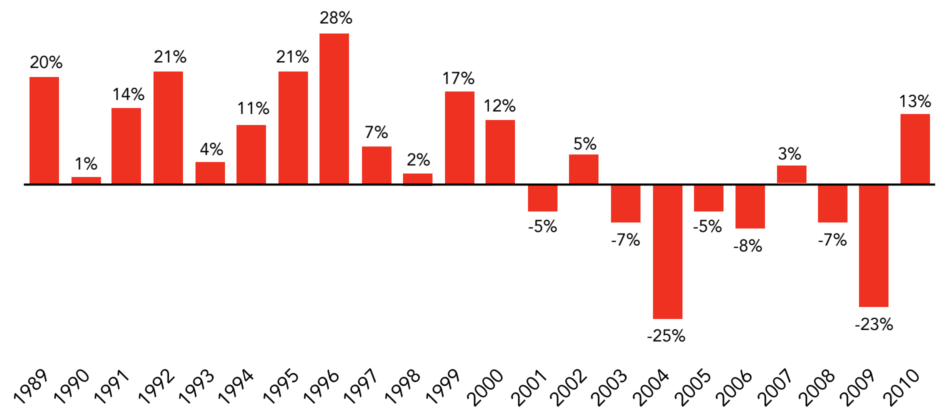
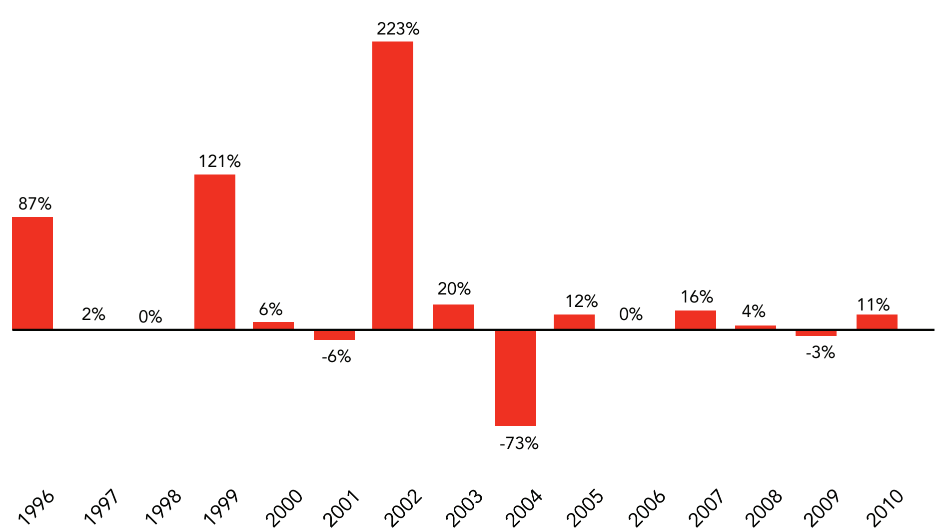


Figure 2: Individual Long-Term Care Insurance Sales Trends*



*Percent change in premium
Source: LIMRA, *Individual Long-Term Care Insurance Annual Review*, preliminary 2010 data

Figure 3: Group Long-Term Care Insurance Sales Trends*



*Percent change in premium
Source: LIMRA, *Individual Long-Term Care Insurance Annual Review*, preliminary 2010 data

Mispricing is probably one major factor in the downward trend. When LTCI first came on the market, carriers did not have experience with lapse rates and therefore used assumptions from products in the nearest adjacent space, such as other health products. These lapse assumptions turned out to not fit very well for LTC insurance policies, as more people than originally expected kept their policies due to the value the policies provide—resulting in more policies in force to claim benefits. Also, many policies were sold with lifetime benefits, which have been shown to have very poor experience for most carriers (this is due to adverse selection towards plans with richer benefits and because individuals have no incentive to conserve their benefits as they do with a smaller benefit period). Many policies were also priced based on interest rate expectations that turned out to be too high, especially given today's historic low rates. Insurers also face an increasingly tight regulatory environment, reducing their flexibility and making it more difficult to manage their LTCI business. Over time, new business pricing increased in response to carriers' experience, reducing LTCI's attractiveness to potential buyers. For example, according to the annual Brokers World survey, the average annual premium from the top 10 carriers based on 2009 sales for a three-year benefit period, 90-day elimination period plan with inflation for a single individual issue age 60-year-old was $1,707 in 2009 and $1,428 in 2004. Premium levels vary significantly by issue age and plan; for example, the average annual premium for the same plan above without inflation coverage was $714 in 2009.

MANAGING RISK

Carriers face limited options when trying to manage the risk created by mispriced in-force policies. Those that wish to sell their block of business may find a less-than-vibrant market for their in-force business, particularly if expected future premiums are low relative to expected future claims. The result is an unattractive potential transaction, particularly in cases where the carrier selling would need to book a large loss on the business for the sale. A similar story follows for placing business with reinsurers.

The discrepancy between expectations and results reached a state of crisis for a number of carriers. Several have announced that they would stop selling new LTCI policies,

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at least temporarily. Others have applied for significant rate increases of 40 percent or more for in-force policies. These events garner headlines and add to buyers' sense of uncertainty. Matters are not helped by news stories about denial of claims on older policies due to stricter requirements than are common today.[4] All of this negative press might be fueling the apparent carrier exodus, as insurers wonder if their peers know something they don't.

However, just because some carriers have chosen to exit the market doesn't mean the market is not viable. Despite the risks—low interest rates, persistency, morbidity, regulatory changes, and the long tail inherent in policies that may stick around for decades—there is still a market for LTCI and that market has its good points. Items such as persistency, that have led to rate changes, are much better understood than they have been in the past. The exit of big market players actually creates significant opportunity for others who are willing to learn from past growing pains. As the economy continues its recovery, individual buyers will have more disposable income to spend on LTCI. While education has a long way to go, awareness of LTCI as an asset protection strategy has grown significantly as more individuals begin to understand the need to take more responsibility for their future LTC needs. With the "baby boom" generation turning 65, the potential LTC market is vast. And, in a hopeful sign, LTCI sales have seen an uptick in the past year.

CLASS ACT IMPACT

One major unknown factor going forward is the impact of the Community Living Assistance Services and Support Act (CLASS Act), part of the 2010 Patient Protection and Affordable Care Act. The CLASS Act creates a government-administered LTCI program that is both voluntary and guaranteed issue. The combination of these two features leads many to believe that the program is likely to be unsustainable in its present form. Voluntary guaranteed-issue insurance programs are inherently unstable because they enable individuals to join when they are at greatest risk of needing benefits without paying into the program long enough to fund those benefits.

Changes may be made to the CLASS Act that will make it more viable, it may be scrapped, or it may fail partway through its life. If it gets up and running, it might open opportunities for private insurers through increased consumer awareness about LTCI and potentially through supplemental coverage. Insurers are watching the matter closely and waiting to decide how to react.

FUTURE OUTLOOK

More broadly, there are several things that must happen in the LTCI market for it to move in a positive direction. Efforts to educate consumers and employers about the value of LTCI should continue. The industry needs to continue to look for innovative ways to design products that are sustainable, yet sufficiently affordable to be attractive to a wide variety of potential buyers. Combination products that include LTC coverage as part of a life or annuity plan are one potential bright spot that could grow beyond a niche market. Insurers also need some leeway to manage risk; if regulations become too strict, carriers will not be able to react with enough agility to market changes. The number of agents that sell LTCI has been declining; the market needs more agents. Health care reform may drive some health insurance agents toward other products such as long-term care insurance because of the need for health insurers to cut expenses such as agent commissions to lower loss ratios and be in compliance with the medical loss ratio requirements under health care reform.

Just as with any other investment, psychology plays a big role in the LTCI market. When one carrier exits, others wonder if they should stay in the market or cut their losses. Beyond the sound bites that sell papers, organizations should make an informed decision based on the fundamentals such as growth potential, profitability, and competitive advantage to determine how—or whether—to participate in the LTCI market today and tomorrow. A

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ENDNOTES

1. CMS data as analyzed by Conning Research and Consulting Insurance Segment Report on Long-Term Care – 2010.
2. LIMRA, *Long-Term Care Insurance Annual Review*, preliminary 2010 data.
3. LIMRA, *Long-Term Care Insurance Annual Review*, preliminary 2010 data.
4. "The Latest Long-Term-Care Snafu," *Wall Street Journal*, Jan. 22, 2011, *http://online.wsj.com/article/SB10001424052748703951704576091983237454732.html.*