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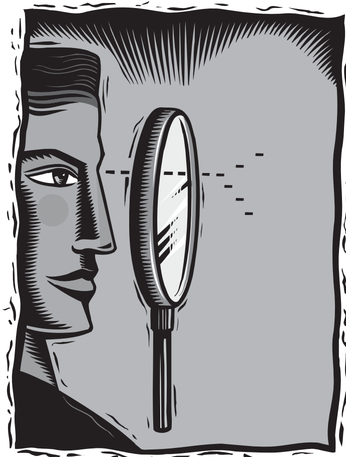
LTCI Pricing and Product Development Trends

by James C. Berger

Long-term care insurance (LTCI) is not a dull way for an actuary to spend his or her day. Change within this line seems to outpace other insurance lines. Perhaps this is due to the newness of the products, but it could also be the regulatory need of the senior marketplace that transforms yesterday's product standards into a brand new presentation today. Since LTCI lives at the actuarial crossroads of life and health insurance, any actuary lingering for awhile must gain fluency and give acceptance to the contravening matters of lifetime level premiums and ever-changing care delivery, and consider long-term asset management vs. not-well-understood liabilities.

The future can be viewed through a mirror as we look behind us at the past. While this limits our perspective by the range of vision that mirror allows, some guidance can be found. It was for this purpose that LTCI actuaries were queried for their opinions on pricing and product development issues with respect to LTCI. The results were presented at the June 2002 Spring Meeting of the SOA in San Francisco and the highpoints are presented in this article. The survey was the joint effort of Greg Gurlik, Peggy Hauser and the author.



Survey Introduction

The nature of an opinion-base survey is that the results are anything but definitive. It is believed that the targets of the questions are too mobile for definitive responses, and the variation in survey responses seemed to verify this thought. Rather, the goal in doing such a survey was to find out what people thought today and how they think the LTCI industry has changed in recent years — five years being the survey's benchmark. The reader should expect two-thirds of the results to be respondent thoughts and the other one-third to be the opinions and biases of the survey compilers.

The 31 respondents represent many of the more knowledgeable actuaries practicing in the LTCI industry. Ninety percent of the respondents had 10 or more years of experience in the insurance industry. Eighty-four percent had six or more years of LTCI experience. Seventy percent spend more than three-quarters of their time on LTCI. Fifteen of the respondents work for direct writers of LTCI, six practice as consultants or third-party administrators and five are employed by reinsurers. Several respondents were anonymous.

Items that the author views as key findings are presented in *italics*.

Product Development Trends

As companies seek to differentiate themselves in the marketplace, benefit period and elimination period options provide a way to do so. *The general opinion of the respondents was that there are more elimination period and benefit period options than there were five years ago, but not many more*. Differences must be meaningful. Offering a 10-year benefit period and an 11-year benefit period seems to be unnecessary and is confusing to both consumers and agents in the marketplace, as the premium differential would be very small. One respondent noted that the number of earned premium (EP) offerings is reducing due to lack of interest from the marketplace.

Items that the author views as key findings are presented in *italics*.

Comprehensive LTCI policies have varying home care benefit levels such as 50 percent or 100 percent of the nursing facility daily benefit. While there may be one more option (75 percent), this is not a standard and may once again add to market confusion. Home care relativities to facility levels may get "strange" in the group market, where one respondent theorized that consultants have wanted to "add value" by fine-tuning the home care percentage.

Assisted living facility (ALF) benefits are felt to be offered and adjudicated more liberally than they were five years ago. They are more likely to be offered at par with the nursing facility daily benefit and there are fewer restrictions as to what an ALF is at time of claim.

There seem to be more riders today than five years ago. What isn't clear is if this apparent trend has to do with older riders not being pulled from the market even though their sales have been low. There may be little motivation to pull such a rider and if one successful agent liked the rider, it would remain. A rider that has picked up steam is the "shared-care" benefit in which a couple can

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dip into the same bucket of money, either from the first day of claim or perhaps, for example, after their individual two-year bucket was exhausted. "More" of the shared-care rider still does not seem to mean a majority.

The return of premium (RoP) rider comes in several forms. It may return premium only on death or on both death and lapse (respondents thought this latter form to be less popular). It may grade to zero at an age such as 70, or it may run for life thought to be more popular. It may return premium every 10 years, or only once in the life of the policy. It may return premium less claims or return a maximum amount of premium such as 80 percent. RoP is desired in the employer market since if the sponsor is paying the premium they would like returned if the employee opts to drop coverage on leaving employment. Several states require some sort of nonforfeiture benefit for limited-pay policies — the RoP can meet this need as can a shortened benefit period nonforfeiture rider. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) has made this rider less popular since many believe such a benefit is not completely consistent with tax-qualification.

Inflation protection appears to need more scrutiny as well, especially as lapse rates appear to be below that of coverage without inflation protection.

LTCI is known to be complex as an insurance product. The opinion expressed in this survey is that it hasn't become less so. Even with HIPAA standardizing benefits, there is much variability in the marketplace. Thus, complexity goes hand-in-hand with product differentiation. Riders are a major tool in this differentiation through complexity. Still, even though the products may contain the same or more complexity vis-à-vis five years prior, some of the complexity is thought to be counterbalanced by better agent and consumer education.

Compensation structures may be changing with more companies varying first-year commissions by age band, paying higher first-year commissions at younger ages to give agents a "sufficient" level of compensation no matter what age they sell. This does encourage younger-age sales, though this author wonders if this is consistent thinking with the knowledge that younger ages have more risk due to claim cost changes, persistency concerns, with inflation protection and investment risks.

Small groups are commonly written using individual forms, perhaps in a franchise filing. This can include the increasingly targeted carve-outs of employers' executives as an extra employer-offered benefit to them. Underwriting is liberalized, perhaps using a simplified issue form or the actively-at-work criteria toward the extreme. *While the survey respondents were evenly split as to whether underwriting of applicants was tighter, the same, or looser, there was consensus that underwriting of the sponsor had become tighter*.

In the "true group" marketplace (a master contract with certs), individual underwriting appears to be decreasing, but as with small groups, the underwriting of the sponsor has increased. Pricing in the market has been decreasing but may have bottomed out according to one respondent. The feeling exists that this market is saturated. Effort is going more to the small groups than the large groups.

Product Pricing Trends

Two-thirds of respondents felt ratebooks are more factor driven. The zero-day EP and the lifetime benefit are both thought to be more conservatively priced. The industry has begun to view these benefit parameters as antiselective. Inflation protection appears to need more scrutiny as well; especially as lapse rates appear to be below that of coverage without inflation protection. *Half of respondents believe that both five years ago and today inflation protection has been subsidized by coverage without inflation*. While the phrasing in the survey indicated that it was "intentionally" subsidized, there seems to have been ambiguity in what this might mean.

Has the claim cost data that actuaries work from improved? Forty-five percent felt general population data was somewhat improved. Seventy percent felt that inter-company data was somewhat improved. When it comes to internal company data, the actuaries seemed to feel they were doing a better job with 94 percent saying that internal company data was somewhat improved to greatly improved. Consultants had the greatest optimism concerning internal data while reinsurers had the least confidence.

Many tools have been used to price LTCI. But what we "think" is being used isn't quite what "is" being used. For purposes here, software packages will refer to industry tools such as TAS, PTS, and ALFA. *The perception is that 33 percent of pricing work is done with these software packages, 42 percent with spreadsheets running macros, 12 percent with spreadsheets with no macros and 13 percent use something else such as internally written programs. Perception isn't quite in line with respondents' confessions. The true story appears to be that eight percent of pricing work is done with these software packages, 53 percent with spreadsheets running macros, 15 percent with spreadsheets with no macros, and 24 percent use something else*.

Pricing goals were queried in the survey. The trend is to price with profit measures at a cell level, then to validate an overall loss ratio target. This should be expected to continue as states adopt the NAIC rate stabilization regulation that does away with the loss ratio target for initial filings.

Competitive positioning may cause a

company to price some cells at profit levels below the target. S*eventeen percent of respondents felt that less than 10 perccent of pricing cells fell below profit targets. The rest were evenly split between the 10-20 percent selection and the 20 percent or more selection for cells that do not meet the profit target*. Direct writers tended to believe that 20 percent or more of pricing cells were subsidized, while consultants and reinsurers gravitated to the 10-20 percent range.

Seventeen percent of respondents priced using a pre-tax measure as their first metric. Thirty percent used pre-tax as a secondary goal. The author speculates that multiple product lines within a company may mean the corporate actuaries ask for pre-tax measures and then work the after-tax magic themselves. *The primary pricing goal for 66 percent is ROI. Twenty percent use percent of premium profit margin, 11 percent GAAP ROE and six percent value added*. Secondary measures run 40 percent as percent of premium, 33 percent as ROI and 27 percent as GAAP ROE.

Management and Product Positioning Trends

While the general consensus is that underwriting is getting more conservative, direct writers had less of a conviction than the other survey segments. This may be due to the ambiguity of the question when cognitive screening is getting tighter at the same time that some conditions, such as cancers, are being seen as less of a risk due to shorter claims. As for the use of medical records, it seems consultants and underwriters are divided into two camps — one believing that fewer medical records are being order while the other sees more. Reinsurers saw no change.

Claims practices appear to have become somewhat more conservative over the last five years through more appropriate scrutiny. Post-claims underwriting is a diminishing practice. *There is a strong suggestion from respondents that external claim management services have become even more popular due to their proven track record*. However, other voices in this survey and in actuarial meetings believing there is evidence to the contrary have increased. These contrarians say the cost of the services is as much if not more than the savings.

The survey respondents' view of the alternate plan of care found somewhat of an increase in its utilization. Some thought it has led to increases in claims perhaps because of market pressures to use this benefit. Others thought alternative plans of care are useful when focusing on cost effectiveness, especially when claims departments are more skilled.

For many survey questions, the consensus result was consistent with what the three reviewers believed, but when asking about distribution channel trends, we could only lean back in our chairs and ponder what to think. Of those respondents that felt "very confident" in their answers, 57 percent said sales increases were more from independent agents while 43 percnet said sales increases were more from captive agents.

Home Care Only (HCO) plans are leaving the marketplace. Eighty-one percent said there are fewer of these plans. Additional comments were that those companies that still have a HCO plan are not trying to sell them. The question was raised as to whether any company had seen acceptable experience with these plans. Nursing Home Only (NHO) plans also seem to be dwindling in number offered, but not as much as HCO. There may always be a market for NHO policies due to the lower cost and spouses that intend to give all care when at home or singles that don't have support networks to supplement formal care at home. Some wonder if the cost is really much lower than the comprehensive plan with 50 percent home care coverage.

Companies appear to be ceding more to reinsurers than five years ago, but it may be at the smaller company end. Larger companies tend to cede less today. The style of ceded business indicates more use of excess loss vs. quota share coverage. Offshore deals appear to be more popular, unless it is a reinsurer answering the question.

Non-consultants felt that there was more use of consultants than there was five years ago. Curiously, consultants did not concur, seeing levels of engagement at about the same as five years ago. One can surmise that there simply may be more LTCI consultants than five years ago.

Finally, 75 percent of actuaries responding feel that rate stabilization efforts by regulators will cause an increase in pricing levels. When asked about greater scrutiny of initial rate filings, there was a split on what this would do to pricing levels. One respondent did not believe there would be greater scrutiny, as how can scrutiny increase without more information given in filings? Along the same vein, another respondent saw any regulation as simply transferring more responsibility to the pricing actuary. Actuaries feel the trend of states toward limiting elimination period and benefit period offerings has subsided. Overall, there was a level of frustration voiced. One can imagine this is not just among pricing actuaries, but also with regulators.

Perhaps the greatest message for actuaries reviewing results of this survey is that there is a diversity of opinion. Actuaries need to continue to dialogue to gain as much understanding as they can about this challenging marketplace. As actuaries that are new to the LTCI field begin their practice, they should be aware of these differing opinions and ask many questions before arriving at their conclusions. ♿

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