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Benefit Reductions to Offset LTC Premium Increases: Evaluating Options

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Rate increases in the U.S. long-term care (LTC) insurance market have been a fact of life for at least the last decade, and they are not going away any time soon: 75 percent of companies currently writing new LTC policies¹ and 52 companies that have ceased issuing LTC business² have filed for rate increases in the past decade. In fact, it appears that many regulators have come to the conclusion that rate increases, especially on older blocks of business that were priced before insurers had significant LTC experience, are justified from an actuarial perspective. In other words, the policies are not financially viable without rate increases. Because of this, regulators appear to be shifting some attention away from attempting to eliminate rate increases toward limiting the impact of increases on policyholders.

Part of this is ensuring that policyholders have viable options for keeping coverage and ensuring that past paid premiums were not in vain. Benefit reductions that offset a premium rate increase are a key part of this approach, enabling trade-offs between policy cost and policy benefits. To this end, regulators are devoting growing resources to understanding

and controlling benefit reduction options offered by insurers seeking a rate increase.

BENEFIT REDUCTIONS: COMMON AND LESS COMMON

There are several possible benefit reduction options that insurers can—and in some cases, must—make available to policyholders. Most are subject to regulatory minimums and maximums.

Some options are required under the National Association of Insurance Commissioners (NAIC) Model Regulation.³ These include reduction in daily, weekly, or monthly benefit, and reduction in maximum benefit (benefit period or benefit pool). These options are available to policyholders, even if no rate increase is expected, as a means to reduce premiums at the policyholder's discretion. Another common benefit reduction option is to remove or reduce inflation protection. This is a complex option and is treated in more detail below.

There are at least three other benefit reduction options that are offered, although typically they are less common than those already mentioned for a variety of reasons. These benefit reduction options include:

- Increasing the elimination period: In other words, increasing the amount of time a policyholder must meet the requirements to be eligible for benefits (and in some cases be receiving care) before expenses are reimbursed. This option generally does not have a large impact on rates, and policyholders are often reluctant to change elimination periods as they have already chosen their elimination periods, often based on significant consideration.
- Reducing home care coverage: For comprehensive policies, the percentage of home-based care compared to nursing home care that can be reimbursed under the policy can be reduced. Newer comprehensive policies tend to offer purchasers a wider range of home-based benefits. However, LTC customers tend to put a lot of thought into their policies, meaning they have already decided that they will need a certain level of home-based care coverage and prefer that option over moving to a care facility.
- Contingent benefit upon lapse: Also called a contingent nonforfeiture benefit, with this option policyholders who cannot or choose not to continue paying for their policies receive significantly reduced benefits. Many states require by regulation that insurers offer contingent nonforfeiture

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What regulators look for

When it comes to benefit reductions, actuarial soundness and regulatory compliance are key factors for regulators. However, they also look out for the interests of policyholders more generally by asking the following questions and requiring insurers to make adjustments where necessary:

- By what means are benefit reduction options going to be communicated to policyholders?
- Are the communications clear and easy to understand?
- How are premiums calculated when a policyholder reduces benefits? Is it done in an “actuarially equivalent” manner? Regulators do not generally define what “actuarial equivalence” means in regards to benefit reductions. One possible interpretation using the approved rate tables has been acceptable to regulators and is described in this article.
- Is telephonic counseling available to help policyholders understand their options and make a decision?
- Is the possibility of future rate increases adequately disclosed to policyholders?

benefits for LTC policies based on the policy issue date, attained age, and size of the rate increase. A recent NAIC Model Bulletin, which has been adopted by some states, broadens the contingent benefit upon lapse requirement to apply regardless of rate increase size for policies that have been in force for at least 20 years and reduces the trigger for a substantial increase to 100 percent for all policies.⁴ Additionally, we have seen many carriers voluntarily offer a similar benefit to all policyholders regardless of policy issue date or the size of the rate increase. In some cases, states have required this benefit to be available to all policyholders after a rate increase.

INFLATION PROTECTION: SEVERAL APPROACHES TO CHOOSE FROM

A change to inflation protection is a common type of benefit reduction. However, the implementation can be complex and requires insurers to tread carefully and work closely with regulators. Approaches mainly differ in terms of what happens to the daily benefit as well as the maximum benefit pool. There are three typical ways in which inflation protection changes are used as a method of benefit reduction.

Approach 1: The premium is set based on the lower inflation protection premium rate according to the original daily benefit level. The current daily benefit amount reverts to the *original* level and inflates according to the new lower in-

flation protection option from issue.

- Section 27, Subsection A.(3) of the NAIC Model Regulation requires that the policyholder be allowed to continue the benefit amount in effect at the time of the reduction or elimination of the inflation protection provision. Carriers using this method allow the insured to pay a higher rate for the current daily benefit rather than reducing to the original daily benefit.

Approach 2: The premium is set based on the lower inflation protection premium rate according to the *current* daily benefit level. The current daily benefit amount is locked in and inflates at the new, lower level of inflation protection going forward. This approach is similar to the first approach except that the default is to keep the current daily benefit and pay the associated premium rather than reverting to the original daily benefit.

- Regulators in some states have had issues with this method, characterizing it as unfair to policyholders because they are seemingly losing any benefit from previous premiums that paid for inflation protection. Unfortunately, limitations to administrative systems often mean that carriers have no other options, and contracts often require the insurer to allow policyholders to reduce their inflation protection. In these cases, we have seen insurers and regulators settle on a compromise to

allow the reductions if the insured requests them, but not actively market a reduction to inflation protection as an option in the policyholder rate increase notification letter.

Approach 3: The premium is set based on the lower inflation protection premium rate according to the *original* daily benefit level. The current daily benefit amount is locked in and inflates at the new, lower inflation protection option rate going forward.

- This is the most advantageous approach to policyholders. Companies need to watch out for situations in which policyholders purchase inflation protection and then drop the rider after a few years as a way to get a higher daily benefit amount at a lower rate.

LANDING SPOTS: A CLEARER METHOD OF INFLATION PROTECTION REDUCTION

Recently, some insurers have begun offering a benefit reduction option known as “landing spots.” Landing spots are essentially a more structured version of inflation protection reductions. Landing spots allow insureds to reduce their current inflation protection amounts to lower amounts in such a way as to offset the rate increase. The policyholder’s current daily benefit keeps the inflation-based increase accrued to date and then begins inflating at a new, lower rate.

Landing spots have found favor with some regulators be-

cause they make things clear and easier to understand for insureds. Some policyholders may have actually overbought inflation protection, given the recent low-inflation environment, so they have less to lose in choosing a landing spot benefit reduction option. This is especially true for those who purchased the richest plans with the highest levels of inflation protection, typically at 5 percent annually. Policyholders get to keep inflation protection increases accrued to date, which avoids some of the issues inherent in other inflation protection approaches that retroactively remove increases to the daily benefit and maximum benefit pool.

The landing spot method is not a perfect solution. The changes to inflation protection rates can be difficult to administer. Insurers typically incur some costs based on the need to develop landing spots that are actuarially sound and the requirement that they file for additional rates and riders. Insurers need to consider salvage and utilization, if and how premium increases will vary based on attained age and the amount of inflation protection gained to date, and the granularity of rates developed to offset the premium increase. And, of course, landing spots are not an option for insureds who did not purchase inflation protection to begin with.

ACTUARIAL EQUIVALENCE IN BENEFIT REDUCTIONS

The NAIC Model Regulation, in Section 27, Subsection C.(2), states that the premium for reduced coverage should be con-

sistent with the approved rate table. Each rate in the current rate schedule represents a “value” for its corresponding benefit that is actuarially equivalent to the “value” of other rates in the current schedule. A uniform increase in rates maintains this relationship. Adjusting the premium charged for an alternative benefit option in a way that is proportionate with the proposed rate scale has been considered an actuarially equivalent approach by regulators. Examples of benefit reductions calculated in this manner are provided in the next section.

Often, rate increases do not vary by policy characteristics such as benefit period, elimination period, inflation protection, or issue age even though the company may believe that experience shows significant differences based on these factors. However, if the increase does vary based on policy characteristics, it raises an issue with great significance for benefit reduction calculations: is the premium increase based on the benefit amounts before or after the benefit reduction takes place?

There are three fundamental approaches to this issue:

1. Base the premium increase on benefits as they exist before benefit reduction. This method prevents the insured from obtaining a lower increase by reducing benefits. Also, the system used for administering policies may “tag” the insured with an increase amount and then fail to “retag” them if they decide to reduce benefits af-

terward, requiring additional work on the part of policy administrators.

2. Base the premium increase on benefits as they exist after benefit reduction. In this case, insureds in a given class get the same premium rates regardless of how they get to the rating cell.
3. Use a combination of pre-reduction and post-reduction benefits to calculate premium rates. Here, the insurer uses the “after-reduction” method if the reduction happens within a certain amount of time after the rate increase, for example 60 days. This avoids complications that are due to the fact that

systems may not be able to “remember” benefit changes indefinitely and over the course of multiple rate increases over the years.

EXAMPLES OF BENEFIT REDUCTION IMPACT ON PREMIUM INCREASES

Understanding the contributions of various benefit reductions on premium increases can be aided by numerical examples. The examples in this section are based on a policy using published new business rates for a comprehensive policy in the state of Florida.⁵

The tables in Figures 1 and 2 show variations in rate increase according to typical mitiga-

tion strategies, including daily benefit reduction, two levels of benefit period reduction, and a combination of daily benefit and benefit period reduction. Inflation protection changes are not included as the published new business rates do not include rates for policies with inflation protection.

The table in Figure 1 shows the results for a policy issued at age 65 and the table in Figure 2 shows the results for a policy issued at age 75. These examples do not perfectly offset the rate increase amount. The “Resulting Rate Increase” column shows the increase or decrease to premium that remains after the benefit reduction.

Figure 1
Effect of Mitigation Strategies on Premium Increases for a Policy Issued at Age 65

Issue Age 65					
Scenario/ Mitigation Strategy	Rate Increase	Premium	Daily Benefit	Benefit Period (years)	Resulting Rate Increase
Original Policy	0.0%	\$ 1,736.36	\$ 100.00	5	N/A
No Mitigation	30.0%	\$ 2,257.27	\$ 100.00	5	30.0%
Daily Benefit Reduction	30.0%	\$ 1,738.10	\$ 77.00	5	0.1%
Benefit Period Reduction	30.0%	\$ 1,815.42	\$ 100.00	3	4.6%
Benefit Period Reduction	30.0%	\$ 1,498.72	\$ 100.00	2	-13.7%
Combination	30.0%	\$ 1,742.81	\$ 96.00	3	0.4%

Figure 2
Effect of Mitigation Strategies on Premium Increases for a Policy Issued at Age 75

Issue Age 75					
Scenario/ Mitigation Strategy	Rate Increase	Premium	Daily Benefit	Benefit Period (years)	Resulting Rate Increase
Original Policy	0.0%	\$ 4,820.81	\$ 100.00	5	N/A
No Mitigation	30.0%	\$ 6,267.05	\$ 100.00	5	30.0%
Daily Benefit Reduction	30.0%	\$ 4,825.63	\$ 77.00	5	0.1%
Benefit Period Reduction	30.0%	\$ 4,988.85	\$ 100.00	3	3.5%
Benefit Period Reduction	30.0%	\$ 3,995.43	\$ 100.00	2	-17.1%
Combination	30.0%	\$ 4,839.19	\$ 97.00	3	0.4%

Figures 1 and 2 demonstrate some interesting characteristics of benefit reduction offsets to premium increases:

- A daily benefit reduction sufficient to offset the premium increase does not equal the size of the rate increase. Rather, the new daily benefit to offset the rate increase is equal to the daily benefit before the rate increase, divided by the rate increase as a percentage plus 1. So, for this example, the daily benefit to offset the rate increase would be \$76.92 (which is equivalent to \$100.00/1.30).
- Benefit period reductions will not generally be able to perfectly offset the rate increase, as shown with the benefit reductions above. A benefit period reduction can be combined with a daily benefit reduction to more closely offset the increase.
- Comparing the two tables shows that the impact of a benefit period reduction will vary by issue age and other characteristics. This is common for other benefit reductions as well, such as inflation protection reductions.

LOOKING FORWARD

Unfortunately, rate increases are likely to continue, especially on older, closed blocks of business that were developed before significant experience with LTC products was available. Insurers have a responsibility to policyholders to clearly communicate their options at

the time of a rate increase, and regulators are increasing their scrutiny of these communications. At the same time, regulators are showing increased willingness to work with insurers to provide options that allow policyholders to keep some benefits and avoid the full impact of a premium increase. In this imperfect environment, the right benefit reduction approach can enable policyholders to maintain some protection for the premiums they have already paid, and enable insurers to reduce liabilities and release some amount of reserves. ■



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ENDNOTES

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