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Solving the LTC Crisis in 20 Minutes

by Roger Loomis

The long-term care (LTC) system in the United States is in a state of crisis: a tsunami of baby boomers is now hitting retirement. Most of them don't have enough money or insurance to pay for a long-term care event, and Medicaid doesn't have the money to pay for it either. Your job is to come up with the best solution to this challenge, which will entail overhauling the insurance industry, the regulatory environment and the government's safety net. You have 20 minutes. Go!

THINK TANK ON STEROIDS

On Sept. 12 at DI and LTC Insurers' Forum in Las Vegas, 45 industry leaders gathered for a 75-minute session titled "Think Tank on Steroids." We divided into five groups and were given a simple assignment: design an insurance product that would meet

the needs of a representative middle-mass market family,¹ adjust the regulatory environment to make this product work, overhaul Medicaid, and come up with proper incentives for families and individuals to take responsibility for themselves. After spending 20 minutes coming up with a solution, each group presented its solution to the entire think tank, and we then voted on which solution was best. The objective was to come to a consensus decision about what ought to be done.

Of course 75 minutes wasn't enough time to debate the merits of every idea, perform an actuarial analysis on the plan's financial viability, and come up with a true consensus plan. But certain themes did emerge from the various groups, which provided a sense of what the consensus plan might look like.

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This article will now present an approximation of what we came up with.

Our ideal plan for dealing with LTC can be thought of as a three-legged stool. The legs are private savings and assets (including tax-advantaged LTC savings accounts), long-term care insurance (LTCI; including smaller, more affordable products) and support from the family. The Medicaid system ought to be reformed so that it is only available to people who have exhausted all other options.

RE-ENGINEER THE LTCI INDUSTRY

There are basically two reasons that the middle-mass market hasn't embraced LTCI: a lack of understanding the risks that LTCI mitigates, and the fact that LTCI is expensive. Both of these issues will be addressed through a two-pronged system—a tax-advantaged savings component and an insurance component.

SAVINGS COMPONENT

People will set up long-term care accounts (which I will arrogantly refer to as LTCAs) that will be used to finance LTC. LTCA accounts will function like an IRA or a 401(k) with features such as investment choices and ownership of the account. People will be free to roll over money from their 401(k) plans and IRAs into their LTCA.

Not only can individuals contribute to their own accounts, children may contribute to the accounts of their parents.

LTCAs may be set up by individuals or employers, and ideally will become a standard piece of compensation packages, like a 401(k). Appropriate tax incentives will be provided to employers to set up these plans.

TAXES ON SAVINGS COMPONENT

Money is invested into LTCAs on a pre-tax basis. Unlike 401(k) plans or IRAs, there is no requirement to start making withdrawals at a certain age. Money in the account may be spent on LTCI pre-

miums or directly on LTC expenses. In either case, the expenses are tax-free. The money could also be withdrawn, but income taxes and penalties would apply.

When the owner of an LTCA dies and there is still money in the account, it can be rolled over into an LTCA belonging to a spouse or child, or it can be withdrawn into their estate. If it is withdrawn, the money will be taxable.

INSURANCE COMPONENT

While any existing LTCI policy can be financed through an LTCA, the existence of a well-funded LTCA also makes it more feasible to offer universal LTCI (which I will arrogantly refer to as ULTCI). ULTCI just might be a great insurance product for the middle-mass market.

ULTCI will function similarly to universal life insurance. For example, every month a cost of insurance (COI) charge would be charged to the account, which would pay for the expected claims of that month. The policy could be structured so that the money in the LTCA account would be used to pay for care during an elimination period. So, a policy could be designed with an elimination period (EP) that increases over time. The increasing EPs would mitigate the increase in the COI charges, which would help extend the lifetime of the policy.

The basic policy will have a “short-and-fat” benefit structure with coinsurance. It would only offer basic coverage of services performed by licensed providers. The coinsurance piece can be paid with money in the LTCA. It will cover services performed by licensed professionals only.

COST SAVINGS

At least five factors have led to expensive LTCI: low interest rates, high morbidity, high margins due to rate stability regulations, high inflation rates for LTC services, and low lapses. A plan based on LTCAs and ULTCI deals with the first four issues.

Interest risk transferred to policyholder: Under a ULTCI policy, the interest risk is transferred from

the insurance company to the policyholder, so the insurance company won't have to manage this risk.

Policyholder incentives: Because the policyholder owns the money in the account, there will be a natural incentive to only use benefits when absolutely necessary. Rather than use-it-or-lose-it, it will be use-it-or-save-it. This should result in significantly lower claims.

Lower margins: The insurance company can operate on smaller margins because it will be assuming less risk: the plan is designed so that policyholders assume the interest rate risk, the LTCA savings component pays for a significant part of the care, and the family has a financial incentive to keep morbidity rates low (more on this last point below).

Mitigation against inflation: Inflation in LTC services can be attributed to many things, including low reimbursement rates by Medicaid beds being subsidized by higher rates on the non-Medicaid beds, and perhaps by people with rich LTC plans trying to maximize the benefit they receive. The LTCA and ULTCI approach allows more freedom to choose your own plan of care and hence avoid subsidizing Medicaid. In general, it provides market-based incentives to minimize costs. By giving the family financial incentives to be frugal in how they spend on LTC services, providers will be more likely to compete and innovate on price as well as on quality.

MEANINGFUL BENEFITS

A legitimate problem with current insurance products is a dilemma involving informal care. On the one hand, it would be an economical use of benefits to pay family members to provide informal care. But on the other hand, such benefits invite higher utilization rates and sometimes fraud. A ULTCI plan opens a way to allow family members to be compensated for providing care without higher utilization rates and without inviting fraud. Specifically, if a parent needs care and a child provides it on an informal basis, they will be preserving the value of LTCA, which they can then eventually inherit.

A possible concern with transferring the investment risk to policyholders is what happens if the invest-



ment results are disappointing. An environment where interest rates are low for an extended period of time should be correlated with a low-inflation environment, so if the fund doesn't grow as large as would have been hoped, it should be okay because it's likely that the actual cost of care will not have increased as much as originally feared, either. ²

Even if higher interest rates are expected in the future, insurance companies couldn't price on that assumption—prudence forces them to price on low interest rate assumptions, and then get a windfall if interest rates rise. By passing interest risk onto the account holder, account holders get the upside benefit of higher interest rates in the future. Furthermore, since disappointing investment returns are a systematic risk, insurance companies can't spread it across a large group of individuals anyway.

REFORMING THE GOVERNMENT SAFETY NET

Medicaid

The question of how Medicaid ought to be reformed

A legitimate problem with current insurance products is a dilemma involving informal care.

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The three legs of providing long-term care are savings and other assets, LTCI and help from the family.

is relatively simple, and the group agreed to the following.

Tighten eligibility: This idea is not new. As Stephen Moses has evangelized, “Medicaid limits non-exempt assets for LTC recipients to \$2,000. But, exempt assets are practically unlimited.”³ There should not be exempt assets. Medicaid ought to be a welfare program for the poor and should only be available to those without assets. If you need LTC services and own a home that you don’t want to sell, take out a reverse mortgage.

Loosen the Partnership program: Currently, the Partnership program is geared toward people in the affluent mass market, who purchase Cadillac LTCI plans to protect a significant amount of assets. Smaller plans that are more affordable to the middle-mass market don’t qualify as Partnership plans. If somebody in the middle-mass market makes the sacrifice to purchase a smaller LTCI plan that they can afford, they ought to have some protection of their assets—such as they are—that Partnership plans offer the more affluent.

MORE HEAVY-HANDED MOTIVATION

Several members of the Think Tank on Steroids supported the government taking a more assertive role in motivating the middle class to take more personal responsibility for their LTC needs. If people choose to not participate in the LTCA program by buying at least a nominal amount of insurance or saving enough assets to self-insure, they will face a reduction in their Social Security benefits, which will help finance their default insurance plan, Medicaid.

CLARIFY FAMILY RESPONSIBILITIES

The *de facto* LTC plan of many families is the legitimate plan of seeking help from the family—if mom or dad can no longer perform their own activities of daily living, their spouses, children, children-in-law and grandchildren will step up and help. While this can be a burden, taking care of your own family is an ethic that Americans ought to embrace and celebrate.

The advantage of the LTCA and ULTCI plan described here is that it provides coverage that blends with the level of care that a family is willing and able to provide. The ability of children to make tax-deductible contributions to their parents’ LTCA helps clarify the ethic that children do in fact have some responsibility to take care of their aging parents. If you don’t want to worry about your parents moving in with you when they can no longer perform activities of daily living (ADLs) without assistance, then you ought to talk to them about the state of their LTCA, and start contributing to it if you need to.

Likewise, if your children *do* want to take care of you, under this plan they won’t be financially penalized for doing so—by taking care of your parents rather than hiring professional care, the value in the LTCA account (and other assets) is preserved for future generations.

The three legs of providing long-term care are savings and other assets, LTCI and help from the family. With the proper systems, incentives and education in place, Medicaid becomes what it should be: a program for the truly poor who have no other options.

LTC THINK TANK

The above ideas are what came out of a 75-minute session at an industry conference. In contrast, the official Long-Term Care Think Tank (sponsored by the Long Term Care Section) has spent the last seven-and-a-half years brainstorming about ways to improve LTC in the United States. Ideas have been as big as covering everybody through “Medicare Part E,” to as small as tweaking benefit eligibility for Medicaid so that it is reserved for the truly indigent.

As a nation, we’ve come to the point where grown-up decisions need to be made. The tsunami of baby boomers is going to hit the shore. The only question is whether or not we will do what we still can to prepare for it, or whether we will ignore the issue because it isn’t pleasant to think about.

As thought leaders on this issue, the think tank needs to take a leadership role in actually solving this challenge. Our next goal is to come to a consensus decision on how to address this challenge in a

way that is both economically viable and actuarially sound. We will then publish the solution in a white paper. This will at least give policymakers a starting place for use when they find the political fortitude to actually deal with these issues.

If you have fresh ideas, good judgment, and care about this issue, we invite you to join the think tank and help us work out the solution. If you are interested, please drop an email to either myself or Ron Hagelman at Roger.Loomis@arcval.com or ron@rmglctci.com. ■



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END NOTES

- ¹ For a definition of “the middle-mass market,” See Anna Rappaport’s presentation, “Segmenting and Defining the LTC Market” in the report of the 2010 think tank (<http://www.soa.org/professional-interests/long-term-care-insurance/think-tank.aspx>).
- ² See “Aspirin, not Morphine” by Bruce A. Stahl in Long-Term Care News Issue 32, September 2012.
- ³ See “Save Medicaid LTC \$30 Billion Per Year AND Improve the Program,” by Stephen A. Moses, [http://www.centerlctc.com/pubs/Save_Medicaid_LTC_\\$30_Billion_Per_Year_AND_Improve_the_Program.pdf](http://www.centerlctc.com/pubs/Save_Medicaid_LTC_$30_Billion_Per_Year_AND_Improve_the_Program.pdf).