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Landing Spots: Offsetting premium increases through changes to inflation protection

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Long-term care (LTC) insurance carriers continue to look for ways to balance premiums and costs—especially on older, closed blocks of business that were priced before significant LTC experience was available.

Premium increases are the most basic way to stop the hemorrhaging of losses and attempt to achieve plan solvency, but they are typically restricted by state insurance departments and are usually the least appealing option for customers. Insurers continue to seek creative solutions that support policy viability over the long term while minimizing the pain to insureds.

Inflation protection is one plan feature that can be changed to offset or eliminate higher premiums resulting from rate increases. Insureds typically have the option of reducing inflation protection at any time, even if no premium increase is on the horizon. In some cases, consumers may have overbought inflation protection given the current low-inflation environment, making inflation protection reductions significantly more attractive than premium increases or other benefit reductions.

One approach taken by insurers with increasing popularity is to offer a "landing spot." A landing spot is generally a new inflation protection level that partially or perfectly offsets a potential rate increase. In most cases, the policyholder's current daily benefit is kept at the same level, with the insured keeping the inflation protection accrued to the date on which the landing spot comes into effect. After that point, benefits increase at a new, lower inflation rate. Landing spots have also recently been used with other benefit characteristics, such as benefit period. This article focuses on inflation protection landing spots.

ADVANTAGES OF LANDING SPOTS

Regulators have looked with favor on the landing spot approach because it is simple to describe and easy for policyholders to understand. A priority of insurance departments is to require insurers to communicate clear options to customers.

Other inflation protection approaches that revert the daily benefit and maximum benefit pool to the amounts at issue have not been so favored. With a landing spot, policyholders get to keep inflation protection increases to date, avoiding a situation where insurers can be seen as taking something away that the insured has "earned."

Because of today's economic environment, it is possible that some policyholders have accrued more daily benefit than they need through their inflation protection. Those who are paying extra premium for 5 percent compound inflation growth may not end up needing the additional benefits. Of course, inflation rates over 5 percent are not unheard of, and LTC policies are long-term instruments, so risk and reward must be carefully evaluated by the customer.

Ultimately, landing spots are attractive to both policyholders and insurers. For policyholders, they are a clear, easy-to-understand alternative to increasing premiums and they do not represent an additional financial burden. For insurers, they are a way to provide customers with options while balancing risk and sometimes gaining the ability to release reserves.

DISADVANTAGES OF LANDING SPOTS

A landing spot as a change to inflation protection that perfectly or partially offsets a rate increase also has some disadvantages. First, the insurer must develop the new rates and riders and file them with insurance departments wherever they plan to offer the landing spot. This can be costly and time-consuming. They must make technical and legal decisions such as whether inflation protection changes should vary by attained age, which is due to the varying amounts of growth in daily benefits that can be expected by the time the landing spot is offered. They must also choose the level of refinement at which inflation rates should be calculated. Some choose to stick to the product level, but others may look deeper to more precisely vary landing spots based on benefit characteristics or issue age.

Once the landing spot is filed, policyholders accepting the change must be managed separately based on the rate of inflation in daily benefits. This adds to the company's administrative burden because these policy features were not generally anticipated when the administrative system was originally developed.

Additionally, in many cases insureds will not have purchased inflation protection at all, in which case a landing spot would not be a viable option. These insureds will either have to find other means of offsetting costs, pay the increased premium, or lapse their policies.

Finally, there is the matter of Medicaid partnership plans. The Long Term Care Partnership Program, a cooperative effort between state and federal governments, is intended to encourage people to purchase private LTC insurance and give more people access to it. The key benefit of partnership-qualified (PQ) policies is the protection of a policyholder's assets over the Medicaid coverage threshold.

However, in many cases, achieving PQ status requires a high level of inflation protection, typically 5 percent compound. Some states are relaxing these limits in response to changes in the marketplace. Figure 1 shows the example of Connecticut, which significantly lowered its inflation protection requirements early in 2015.

Figure 1: Connecticut Partnership Requirements, Effective April 13, 2015

Old Requirements	New Requirements
5 percent compound inflation protection	3.5 percent compound inflation protection
No inflation protection required if over age 65	No inflation protection required if over age 65 (no change)
Inflation protection required regardless of cumulative historical increases	No inflation protection required if cumulative rate increase exceeds 50 percent

Source: Regulation of the Department of Insurance Concerning Conditions for Approval to Participate in the Connecticut Partnership for Long Term Care, Sec. 38a-475-4. See http://www.sots.ct.gov/sots/lib/sots/regulations/recentlyadopted/ecopy_reg_6180.pdf.

Nevertheless, insurers should evaluate current PQ rules for relevant blocks of business before pursuing a landing spot. The impact of landing spots on the PQ status should be disclosed, where applicable, in policyholder communications regarding the rate increase.

THE CHALLENGE OF ADVERSE SELECTION

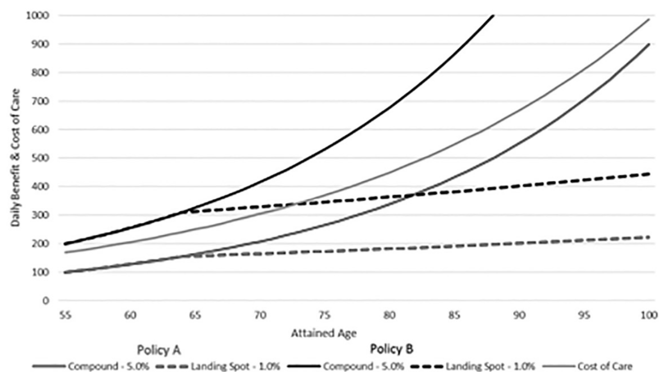
Under reimbursement policies, which are the most common in the LTC industry, insurers typically reduce costs with landing spots if the cost of care is higher than the daily benefit. If a policy currently has a higher daily benefit than the cost of care, a landing spot may not lower expected claims to the extent anticipated when an insured elects a landing spot.

The example in Figure 2 demonstrates how this works. The light gray line represents the cost of care. The dark gray line represents Policy A, with a $100 original daily benefit, and the black line represents Policy B, with a $200 original daily benefit. Policy A's daily benefit starts at a dollar amount that is lower than the cost of care, while Policy B's daily benefit starts higher than the cost of care. A compound growth rate of 4 percent is assumed for the cost of care while the daily benefits for both Policy A and Policy B inflate at 5 percent compound.

Both policies elected a landing spot option and reduced their inflation protection to 1 percent compound at age 65. The dotted lines represent the post-landing-spot daily benefits. The difference between the solid and dotted black and dark gray lines represents the potential savings from the landing spot. However, for Policy B, the insurer only recognizes savings from the light gray cost of care line down to the dotted line. The potential savings above the cost of care to the solid black line for Policy B represent savings, which are due to salvage, that would have been obtained even without the landing spot.

As illustrated in Figure 2, taking a landing spot can impact policyholders differently based on how their current daily benefits compare with the current cost of care. This introduces the opportunity for adverse selection, where policyholders that overbought inflation coverage are able to avoid a rate increase without sacrificing much coverage. It is important to consider this opportunity for adverse selection by accounting for policyholders most likely to accept a landing spot in lieu of a rate increase when calculating the estimated claim savings of the landing spot.

Figure 2: Potentials for Adverse Selection



ALTERNATIVES TO LANDING SPOTS

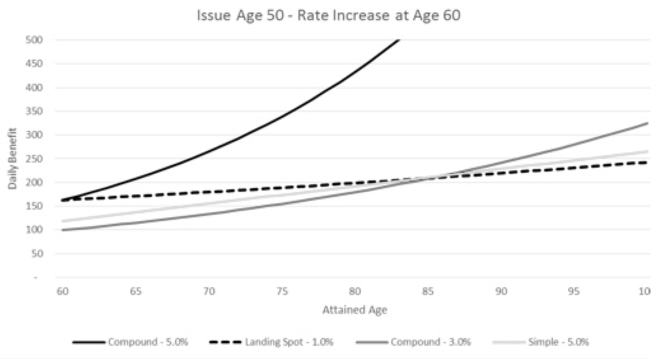
Calculating and filing one or more landing spots is not a trivial undertaking, even for carriers that are actively engaged in the LTC market. LTC actuaries must develop the rates in compliance with state regulations, and forms or riders must be filed with state departments of insurance. Additionally, administrative systems must be updated to reflect the changes. For smaller insurers or those that are not actively engaged in the industry, these activities may be prohibitive in terms of time and cost required to file a landing spot.

There are simpler ways for insurers to accomplish the same goal as a landing spot without the challenge of calculating and filing an inflation rate that perfectly or partially offsets a premium increase. Most carriers already have both simple and compound riders and rates on file, and contracts typically allow insureds to reduce inflation protection from a higher level to a lower level at any time. In combination with a reduction in daily benefit, it is possible in many instances to use a change from compound

to simple inflation protection to offset or eliminate a premium increase. Similarly, a policyholder may switch to a lower compound inflation rate, such as 3 percent compound inflation, if one is already on file for the policy.

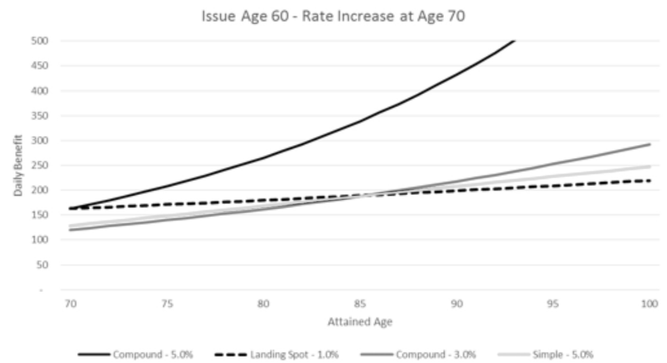
Figures 3 to 5 show three hypothetical scenarios to demonstrate this approach. In each case, the solid black line represents the original plan, with the daily benefit level accrued to date and 5 percent compound inflation protection. The dotted black line represents the landing spot option, which is assumed to be 1.0 percent compound inflation in this example. The dark gray line shows a landing spot alternative in which the daily benefit level accrued to date is decreased and inflation protection is changed from 5 percent compound to 3 percent compound. The light gray line is a landing spot alternative in which the daily benefit amount is decreased and the inflation protection rate is changed from 5 percent compound to 5 percent simple. Each figure shows a different policy issue age and assumes that the rate increase and landing spot offer comes 10 years from policy issue. Tables corresponding to each graph show the key statistics for each graph.

Figure 3: Issue Age 50, Rate Increase at Age 60



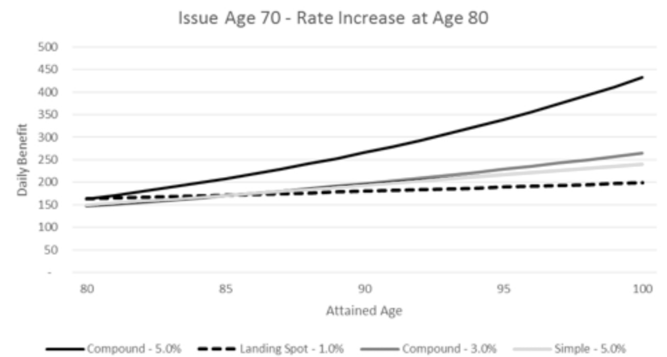
Attained Age	Daily Benefit			
	Compound - 5.0 percent	Landing Spot - 1.0 percent	Compound - 3.0 percent	Simple - 5.0 percent
60	163	163	99	119
65	208	171	115	137
70	265	180	134	155
75	339	189	155	174
80	432	199	179	192
85	552	209	208	210
90	704	220	241	228
95	899	231	280	247

Figure 4: Issue Age 60, Rate Increase at Age 70



Attained Age	Daily Benefit			
	Compound - 5.0 percent	Landing Spot - 1.0 percent	Compound - 3.0 percent	Simple - 5.0 percent
70	163	163	121	129
75	208	171	140	148
80	265	180	162	168
85	339	189	188	188
90	432	199	218	208
95	552	209	252	227

Figure 5: Issue Age 70, Rate Increase at Age 80



Attained Age	Daily Benefit			
	Compound - 5.0 percent	Landing Spot - 1.0 percent	Compound - 3.0 percent	Simple - 5.0 percent
80	163	163	147	148
85	208	171	170	171
90	265	180	197	194
95	339	189	228	216

In each example, the landing spot is replicated fairly closely, especially at the key claim ages of 80 and beyond, with the other options. These examples show that it is possible to achieve the benefits of a landing spot without the burden of having to develop and file one. This could be very appealing to carriers that do not have the expertise needed to file the rates and forms associated with a landing spot. Although the landing spot is replicated fairly well with the inflation protection reduction and reduction to daily benefit, this benefit reduction strategy is not as easy for a customer to understand and may not offset the rate increase perfectly.

LOOKING FORWARD

As insurers continue to seek ways to manage spiraling costs on older LTC blocks, some have turned to landing spots as an option for customers to offset or eliminate premium increases. Recognizing the need for changes to these policies, regulators have relaxed some requirements to make inflation protection changes more viable. At the same time, filing landing spots is complex, and it can be easier for companies to use a combination of inflation protection reductions, using previously filed inflation protection riders, and daily benefit reductions in order to replicate the results of a landing spot. Today's plans tend to be priced more accurately, so hopefully the need to change in-force plans will abate over time. Until that point, insurers must carefully balance convenience for policyholders, the cost of changes, and compliance with regulatory requests. For some—not all—a landing spot can be the most attractive option. ■

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