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# Inflation Protection: Is it Art or Science?

By Tom Riekse Jr.

Deciding which inflation rider to add to a long-term care (LTC) insurance policy is an inexact science at best. If you overestimate the inflation rate, you'll end up with too much benefit and you can't do much with excess LTC coverage. On the other hand, not having enough coverage to pay the actual cost of LTC because inflation wasn't accounted for at the time a policy was purchased is also a problem.

We recently analyzed over 25,000 LTC insurance policies that our business has participated in since 2011 to identify trends in inflation coverage. We included individual, group and linked life/LTC plans from a variety of carriers. The following chart shows the percentage of policies by year that fell in to each of five inflation categories.

Here are a few observations about each of the categories in our analysis:

1. **GPO or no-inflation.** These are plans that include a guaranteed purchase option (GPO) that allows people to buy inflation periodically, such as every three years, at attained age rates. Some products don't offer this option and clients simply buy a big initial benefit instead. Many group offerings default to GPO and allow buyers to get in at a more affordable premium. As polices have become more expensive, we've seen a big increase in choosing a GPO. In addition, many popular linked life/LTC plans are purchased without automatic inflation protection included.
2. **Three percent compound automatic increase.** The automatic three percent compound rider has been the most popular inflation option for the last several years and represents almost half of the coverage purchased. There are a couple of reasons why three percent compound is so popular. First, it is easy to understand and tracks long-term historical inflation well—although, for the past decade, three percent has been greater than the average rate. Second, in many cases plans with a three percent rate meet the criteria for state partnership protection. An issue is cost—the rider is expensive compared to other options.
3. **Five percent compound automatic increase.** Despite the fact only a handful of people still purchase this coverage, carriers are still required to offer five percent compound inflation coverage by law. Until 2013, five percent compound was the most popular inflation coverage selected. However, five percent compound coverage in new products is priced so high that very few people now purchase it. Many people who originally bought five percent compound coverage have comfortably reduced their inflation percentage. The insurance industry is lobbying regulators to remove the mandatory five percent compound offer.
4. **Increasing premium products.** This inflation option represents almost 15 percent of the riders chosen in 2016. What constitutes increasing premium LTC products? These products increase the benefit pool and premium. One example of these products are step-rated products, such as those offered by Transamerica and Genworth. Step-rated products increase the premium and benefit each year. In some cases, consumers have the opportunity to stop and re-start the increase options. For example, if the benefit increase has outpaced the cost of care it might be wise to stop the premium increases. Another type of increasing premium product allows the underlying performance of the insurer's investments to be offset against the premiums. Examples of these policies include Northwestern Mutual issuing dividends and more recently John Hancock with its Performance LTC product. Increasing premium policies can give more control to the policyholder to adjust

LONG-TERM CARE INSURANCE INFLATION OPTION SELECTED AS A % OF TOTAL POLICIES

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| No Inflation or GPO | 2% | 4% | 8% | 14% | 16% | 29% |
| 3% Compound | 25% | 34% | 43% | 53% | 45% | 45% |
| 5% Compound | 52% | 48% | 30% | 12% | 4% | 3% |
| Increasing Premium | 0% | 0% | 0% | 1% | 10% | 15% |
| All Others | 29% | 21% | 23% | 19% | 30% | 8% |

Source: Selected policies issues through LTCI Partners

to inflation trends. These policies are rapidly increasing in popularity and may represent the smartest purchase.

5. **All other options:** In doing our analysis, there have been well over 100 different types of inflation coverage options offered by carriers over the last five years! Examples of the other inflation choices include one percent, two percent, and four percent compound inflation; three or five percent inflation that compounds at a simple rate; inflation that is "capped" at some percentage of initial benefit, such as 2x; "tailored inflation" that starts out at five percent, moves to three percent, then stops at a certain age; automatic CPI coverage (which is no longer available) and other options.

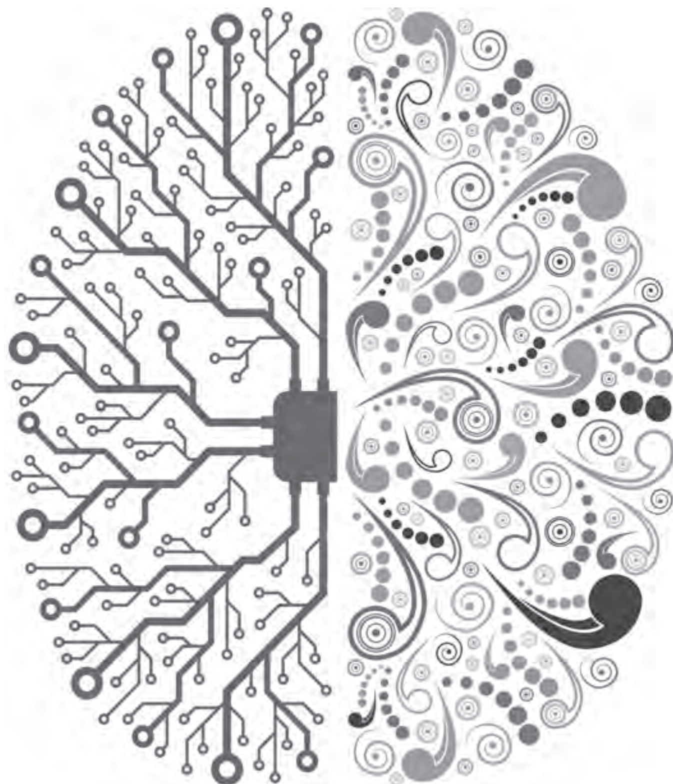
What are some conclusions from our findings and how can you help consumers make better decisions?

- Don't confuse the Health Care Inflation Rate with the cost of long-term care. Although some long-term care covered by policies is impacted by hospital and doctor charges, the majority of custodial care is a function of labor and real estate rates and those costs have been similar to overall CPI. The exception is nursing home rates, which have increased due to factors such as cost shifting in response to low Medicaid reimbursement. However, since more care is private pay at home or assisted living, advisors should design plans based on those costs.

- It's more critical than ever to periodically schedule an in-force policy review. Because of the greater flexibility of many inflation options, policyholders should not just buy their policy and forget about it. Instead, they should talk to their advisor periodically to make sure that the current plan is keeping up with the cost of care so that the right decisions can be made. Some companies are sending annual policy statements or providing better online policy information to make that easier.

- People are changing their inflation protection over the life of their policy. With all the in-force premium increases occurring, many carriers have created "landing-spots" to allow policyholders to adjust their inflation percentage. For example, a family might have started with five percent compound inflation on the policies they purchased several years ago. By adjusting their inflation coverage down to a 0.5 percent compound rate, they may be able to keep their premium the same even though their policy series has been through two rate increase cycles. They may be comfortable with that choice if their policy has more than kept up with cost of local care.

- Many state partnership plans require inflation protection. It varies by state, but many states have reduced their minimum inflation requirements.



- Innovation is good. Although choices are confusing, it is important to allow the best ideas to come to the marketplace. For example, if long-term care policies were standardized with a five percent compound inflation requirement, the impact on the market would be dire. Many seasoned insurance advisors are used to selling five percent compound plans and they need to learn about the new options.

- Focus on premium first. You can design long-term care plans to cover the most expensive care in the world and compound benefits at five percent, but the premiums will be unreasonable. Instead, consider a "good, better, best sales approach" so that people can select a policy that reflects their budget.

It's difficult to predict what the cost of care will be in the future. The only thing for certain is those without any plans will be the most negatively impacted. ■

Tom Riekse Jr., CEBS, ChFC, is managing principal at LTCI Partners, a brokerage general agency specializing in long-term care insurance. He can be reached at *tom.rieksejr@ltcipartners.com.*