LTC Transactions: After So Many Years of No Interest, Why Now?

By Benjamin Keslowitz

Back in the good old days, long-term care insurance (LTCI) was a huge seller, a win-win product that was favorable both to the carrier and the policyholder. The carrier had a short expected payout, and thus a relatively low reserve, while also having a guaranteed premium stream coming in the door. On the flip side, the policyholder had the security of knowing that they would be taken care of as their bodies and minds deteriorated. Companies like Genworth, CNA, John Hancock and many others sold substantial amounts of policies to support a need for those who were appreciating in age and beginning to worry about whether their finances would support their future care needs.

So what happened? Well, like for many products we have seen in the past (and like we will undoubtedly see in the future), there was both pressure to sell in a competitive landscape and a complete lack of experience data. The combination of these potent factors made it rather challenging for a pricing actuary to stand firm on conservative pricing. Any fat left in the pricing was eventually consumed by the underwriters prior to product sale. Furthermore, as prices decreased, the vanilla LTCI products grew features like premium waivers, survivorship benefits, restoration of benefits optionality, and of course, our greatest friend of all, lifetime benefits. And what did it matter that you were offering a significantly fat tailed benefit when no one was going to live more than a few years after electing their benefits anyway?

We all know what happened next. Mortality was improving, lapses were dropping, reserves were being strengthened, and companies were leaving the market, licking their wounds. Even those still around dramatically increased prices on new business (and existing business, when hard to obtain rate increases were approved), lowered benefits, and changed benefit triggers and contract language to be significantly more robust. Only thirty or so years after the beginning of the LTC boom, the business had ended up on the bulk of its carriers' "Discontinued Business" balance sheet to shrivel away and die for the next, well, 50 years? Yikes.

And not only were the carriers dropping out of the business, but reinsurance was not exactly attainable, either. No reinsurer wanted this business that many viewed as being challenging. For the same reasons the issuing companies didn't want it, the reinsurers weren't lining up to take it away from them. And let's also keep in mind that, even if there was an interest, LTCI is not the easiest business to take on. LTCI requires subject matter expertise for many of its components and requires ongoing management of the block. Filings, especially for rate increases, are generally necessary, valuation is relatively complex, administration is expensive; suffice it to say that running LTC business off requires a whole lot more than envelope stuffing for benefits payment.

With all that said, it seems like things have again turned around. After nothing but a couple of small deals in the LTC industry in the early 2010s, Beechwood Re and two subsidiaries of CNO Financial Group consummated a $590M+ long-term care transaction, effective in 2013. And with that, all of a sudden there was some buzz around this market. In just over a year since, several key blocks are now on the market and reinsurers far and wide are coming out of the woodwork to accommodate their reinsurance needs. Almost a year to the day after the Beechwood-CNO transaction, Front Street Re closed a sizable transaction with Ability Insurance Company to the tune of $350M.

So, what happened? First, let's touch on the world we live in. You may not have heard this, but interest rates are historically low. In fact, we have all heard our compatriots make comments over the last five years that rates absolutely will be going up, after which they drop another twenty basis points on cue. Initially, the low interest rate market was somewhat of a transaction deal-breaker. After all, why sell a block of business when you need to discount using historically low rates? Companies felt that it was better to wait for some reversion, rather than pony up significant cash that was viewed as being a short-term necessity. That said, over time, the realization has slowly crept in that rates are most likely

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not going to shoot up any time soon. As a result of this, asset adequacy and premium deficiency reserves have required significant strengthening, and companies are finally realizing that it may be worth paying some money upfront, rather than slowly bleeding away for a half century in the future.

As risk transfer solutions start to become more attractive, new solutions will be required to generate additional alpha necessary to defease long-term care liabilities, since traditional reinsurers don't necessarily have the investment expertise to hit necessary hurdle rates. To this end, private equity firms, who specialize in alternative assets, are able to deploy the assets backing long-term care liabilities, both for reserves and capital, into more specialized investment vehicles. That said, finding cedants, getting regulators and insurers comfortable with non-traditional assets and working within an asset-liability management framework that is standard for the industry can be challenging. To help with this, such firms are bringing in substantial insurance knowledge in order that they can fluently understand not only the asset and liability risks they are targeting, but also how these assets and liabilities can work together in perfect harmony.

While investment management advantages are a substantial factor in the appeal of the acquisition or reinsurance of a long-term care liability, that's not to say there aren't several other appeals to buyers outside of this factor. A great example of this is morbidity compression. The theory goes that, whereas mortality is improving, so is morbidity, and furthermore, that the extension of one's lifetime does not lead to greater overall claims. Effectively, claims are first occurring later in life, and even with increased longevity, claimants are still not living long enough to utilize as much of the benefits as they had in the past. The additional advantage is that the extension of the pre-claim period lowers the present value of future payments, and thus the reserves.

Other advantages of completing a transaction are those which have existed forever. Those still selling new business would happily take on additional industry data to supplement their pricing studies. In fact, even those carriers who have discontinued new business would be interested in reviewing extra data to be used in experience study development for ongoing valuation efforts. Furthermore, acquisition of another carrier can lead to additional insurance licenses in favorable domiciles, better or complementary distribution channels, knowledgeable employees to supplement various functions within their companies, and of course name recognition and strong company rating, depending on the company acquired.

It's worth noting that private equity firms aren't the only ones interested in these liabilities either. In fact, there are several broad groups of companies that would have an interest. Examples include consolidators that can take advantage of expense efficiencies when combining new blocks into their existing administrative frameworks, pension funds that are looking to leverage their longevity data for pricing non-correlated risks, mutual companies looking to grow their balance sheet without having the typical public company worries of quarterly balance sheet volatility and strategic insurance companies looking to diversify their business mix.

While there are many aspects of long-term care insurance blocks that are becoming more appealing to the reinsurance market, and more buyers and sellers now exist in the marketplace than there were not too long ago, it's certainly not all unicorns and rainbows either. Rate increases have been trending downward, facilities are more expensive and more appealing (some assisted living facilities are glorified spas, after all), flexible benefit and rider language isn't going away anytime soon, and long-term care insurance isn't ever going to be an easy business to manage well. That said, with much momentum moving in the direction it has been, don't be shocked if a big long-term care carrier offloads its risk to a reinsurer near you. ■