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Long-term care

4 experts offer insights into one of the industry's newest products

As the first of 76 million U.S. baby boomers enter their 50s, a surge of interest has appeared in senior citizen issues. The statistic that 40% of individuals who reach age 65 will need long-term care at some point in their lives could create a huge market for long-term care insurance (LTC). Qualified LTC plans were given tax advantages under the Health Insurance Portability and Accountability Act of 1996 (Kassebaum-Kennedy bill), possibly adding to LTC's market potential. Yet LTC is a relatively new product. How are actuaries facing the challenges of pricing, marketing, and regulation with little reliable data for claims, persistency, and other elements? Four SOA members active in the LTC market discussed this critical issue in a conference call with The Actuary.

The Actuary: From an actuarial perspective, how does long-term care compare to other products? It isn't health, life, or disability. It seems to be a little of each, but also goes beyond them.

Gary Corliss: It's a product unto itself. I think it's closest to disability in both pricing and underwriting. But it has some highly individual features, not the least of which is that it lacks 200 years of tables like life insurance or 50 years of health and disability tables. The first-ever intercompany study was released in January 1995, and that only had five years of experience.

So this is a very new product. It calls for a lot of creativity, thinking, digging, analysis, and all those things an actuary needs to do to "substitute facts for impressions."

One of the impressions in the insurance business 12 years ago was that you couldn't create a profitable LTC product. I think actuaries have proved that impression wrong. We've moved to something most would now agree is a manageable product line.

Loida Abraham: I think it's closer to life than disability, but I agree with Gary that it's a product unto itself. It's not like disability in that disability claims tend to rise and fall with economic cycles. Disability insurance is a function of income and, therefore, employment, whereas LTC claims are not subject to economic cycles and tend to be more stable. To date, the limited long-term care claims experience has been favorable for most companies. Long-term care is similar to life when you look at some of the continuance curves. Because of the prefunding involved, most life or long-term care products tend to bundle the mortality or morbidity risk with the investment risk. Both also exhibit low disintermediation risk. But there are differences: the life market is growing slowly; there's rapid growth in long-term care. With respect to underwriting, it's not like life. In fact, someone who may be a bad risk for life could be a good risk for long-term care. Nor is its underwriting similar to disability, which attracts a younger audience. LTC insurance really has its own identity.

Bart Munson: I agree with both of you. Though it also somewhat resembles health insurance, I have said publicly that it's not health insurance, particularly to people who say, "I've worked in health insurance for a long time and therefore know long-term care." It's not like health at all in its prefunding. It's similar in the uncertainty of the risk. I support the contention that it's a product unto itself.

The Actuary: What's the status of the market?

Corliss: Over time, I think there will be a huge marketplace. Globally, the population's getting older. Governments don't have as much money, people are fed up with taxes, and that will leave people to their own resources. Therefore, LTC insurance will be one solution.

This year is going to be hard, however. We're going through a lot of counterproductive activity because of the Kassebaum-Kennedy bill and having to refile all kinds of products. That's taken us away from analysis of the product.

Abraham: The industry saw slow growth in the first years and then an explosion in '94, '95, '96, and even in the first few weeks of '97. I agree with Gary that eventually it's going to be even bigger, because although it's growing at a healthy pace, it's not as huge as some might have expected, given the demographics.

Munson: I think another impetus to growth will come when we figure out what to do with this risk and marry it, merge it, mix it with other risks. As we find ways to merge risks and products and set off living too long or being incapacitated for too long with dying too early, we'll find ways to grow the LTC market.

Tom Foley: Many actuaries may not be aware that the NAIC is working toward changes in the nonforfeiture law. In general, we're trying to make things a lot more flexible and bring all products under the nonforfeiture law. Someone could buy in one policy form what today looks like a death benefit policy, tomorrow looks like long-term

care, next week looks like an annuity, and so forth. I think that flexibility is coming. We want to make the nonforfeiture law applicable to life, annuity and health products — all products — and have a degree of flexibility unlike this country has ever seen. I think we'll have to do that if we're going to be able to meet customers' needs.

Also, and more importantly, I think we need to find a way to design products that have the insurance principle in them and not just dollar-trading products. What we have to discover in long-term care insurance are identifable, insurable needs. The insurance principle says many pool their money but only a few suffer the tragedies which that money can help relieve. Now, we're heading toward a consumer belief in entitlement, where most (rather than a few) people would receive benefits and where the insureds are receiving less than they've paid in. That's not insurance. That's dollar trading.

Munson: I think it's hard to disagree with that, Tom. We need true insurance. We don't need dollar trading. Perhaps we can improve on that as we understand the risk better.

Corliss: The idea I heard from Tom was flexibility — a policy that's one thing today could be another thing tomorrow. That's tremendously important for the future development of long-term care.

Abraham: I'm glad to hear that the NAIC is thinking about those kinds of products because we are, too, in my company. And as with any new product, we're always a little concerned about how the public — and in particular, regulators — might view them. So it's really exciting to hear that regulators are taking a lead on this very innovative concept.

The Actuary: What are some of the pricing challenges and concerns?

Abraham: I think premiums could become more stable as the market grows. At some point, there'll be less concern about the data because we'll have more experience and a bigger volume of exposure.

Munson: I'm not at all sanguine about rates staying where they are, let alone getting lower. As we do a better job of designing products and understanding how we market long-term care and to whom, any stabilization in the morbidity will be outweighed by persistency. In my opinion, morbidity won't be reduced, not to the point where it would make up for companies' doing a good job of staying in the market rather than looking at the short term.

Foley: The thing that overwhelms me about the pricing of long-term care is the

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Panelists for *The Actuary*'s long-term care conference call

Loida Abraham is general director of John Hancock Mutual Life Insurance in Boston. She directs development of long-term care insurance (LTC) products for the company nationwide. She was a member of the 1994-95 SOA Long-Term Care Insurance Valuation Task Force.

Gary Corliss chairs the SOA's Long-Term Care Experience Committee. He is a member of the Long-Term Care Committee of the Health Insurance Association of America. He is executive officer of Duncanson & Holt, Inc., Avon, Conn., in charge of the firm's U.S. and international long-term care facilities. The firm is the largest accident and health reinsurance organization in North America.

Thomas Foley is a regulatory actuary with the North Dakota Insurance Department. He chairs the Life and Health Actuarial Task Force and is vice chair of the Life Disclosure Working Group of the National Association of Insurance Commissioners.

Bart Munson heads the Long-Term Care Task Force of the Actuarial Standards Board. He was 1985 president of the American Academy of Actuaries. He has led and served on several SOA committees and currently is a member of the Committee on Health Benefit Systems Practice Advancements. He heads his own consulting firm in Sturgeon Bay, Wis.

What's your view?

The panelists invite readers to comment on this article or on any aspect of LTC insurance. Contact them at their *Directory* addresses or through *The Actuary*, 475 N. Martingale Road, Suite 800, Schaumburg, IL 60173 (phone: 847 / 706-3566; fax: 847 / 706-3599; e-mail: jbitowt@soa.org).

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uncertainty of the claims level. I'm not convinced that the product's evolution is over, and I'm also not convinced that we have any real sense of what claims levels are going to be 5, 10, or 15 years from now. In fact, if we take those oft-quoted statistics of an individual having a 40% chance of using a policy and 70% chance for one member of a couple, I wonder whether as a society we can afford to have that percentage of people involved in nursing home and home health care. So when I review filings, I ask the actuaries how much confidence they have that the claims costs we're developing now are going to come about. That's really critical.

I've heard there are 20 million voluntary caregivers in this country, and I think this may have to expand. We need to design products that encourage people to use voluntary caregivers so that we can keep the overall cost manageable. We may end up with some kind of barter system down the road to provide this needed care because there won't be enough money. Could such a system be supported by insurance products?

Corliss: Everybody started down the LTC path with the same public studies, keeping an eye on what other insurers were offering in the marketplace. Eventually, every company will develop its own set of experience for which it needs to price, whether it's the resulting morbidity due to its underwriting, or persistency due to the affinity of its clients, or its administration.

Indications are that prices are going to go up. With higher persistency and today's lower interest rates than people priced for in the late 1980s, premium rates should tend to rise. Intercompany data I've seen shows that while underwriting had improved incidence rates between 1984 and 1991, more recent results may be starting to show induced demand. Maybe we have an indication that morbidity will cause an increase in rates as well.

Abraham: You're right. Each company will have different claims experience. It's interesting that you think that despite the differences, rates are going to go up. Some of us don't think that will happen. As people get more comfortable with LTC insurance, I would hope that rates will actually go down. In the 1995 National Nursing Home Survey, the trend of nursing home utilization actually went down about 17%.

Foley: I would note that in this decade we have significantly increased alternatives to nursing home stays.

Abraham: In fact, the study's author concluded that the reason for the decline was probably greater use of home health care. My understanding of another study, though, is that it's not just nursing home usage that's declining but the total disabled population.

Munson: I think this points out that actuaries need to discern the differences between the institutional and non-institutional sites of care, the statistics that relate to each, where people want to be. And who makes the decision where the insured is? It's often not the insured but the adult children. There are so many interesting things like that which affect "just" the morbidity.

The Actuary: Some research shows that people are not only living much longer but also are healthier. It isn't true that we're keeping less-healthy people alive longer. Wouldn't that general trend have some effect on morbidity?

Munson: Yes, people are living longer and healthier with regard to the benefit triggers for this product. But we shouldn't get too bullish because of that. If we're successful in selling enough, I'm concerned about induced demand, certainly for home care.

Foley: So much of the claim status of people, especially as they get older, is attitude. And we have to find some way to deal with that. We know that the insurance business, like most, is a pass-through business. We take whatever claims we experience and we pass the costs and some expenses on to the policyholder. The nature of this particular product — including the age range of its customers and their fixed income situations — demands that insurers find ways to reduce pass-through costs. What can we do with product design, with agent education, with continual monitoring, with interaction with insureds, with case management? All these things indicate the company is making a concerted effort to keep claims manageable, which keeps premiums manageable.

I think this is necessary if long-term care is ever really going to be a viable, large-scale product, one that could be successfully sold to the masses. You just can't make major rate increases. People on fixed incomes won't be able to afford rate increases that come at ages 75 and up. Also, those increases will impede making the initial sale and taking care of policyholders, as Gary mentioned. There's at least one company with a major block of business sold in the mid-1980s that's been raising rates 40% a year. Premiums that were $900 in 1987 are now averaging over $7,000, and I fully expect any day to see the 1997 rate increase another 40%, which will take the average premium to over $10,000. If that becomes the way we do business, there's no help for us.

Corliss: You are dead on. Of course, every insurer basically adds up the cost of "ingredients," their expenses, and hopefully some profit to come up with their premiums. But insurers who don't try to affect the outcomes and manage their products won't be successful. Stratospheric rate increases hurt all of us. Insurance is the pooling of resources so the unfortunates' financial circumstances are a little bit mitigated with help from others, not just a bunch of people paying themselves. I think we'll see changes over time, reflected in product design and administration.

Munson: I think all of us are doing things to work in that direction. Companies have to ask, why are we in this business? What is our goal? If you

look at some of the assumptions for which they're pricing, allegedly, I'd like to hear what their answer is. The goal has to be ultimately for the good of the consumer and the industry, which is for the good of the company, too.

Could I ask my fellow panelists here about monitoring? What should the actuary monitor, and how soon can you expect to learn from it? How does one monitor claims experience when we all hear that if it's underwritten well, and it must be, one doesn't expect many claims for a while.

Abraham: It's almost like a focus group, where it's not statistically significant but it raises the issues you should watch for in the future. For instance, a lot of companies in the early years saw many dementia claims, although the number wasn't statistically significant. Still, this signaled the need for better underwriting on the cognitive trigger. You also might learn from claims monitoring that you might want to change your plan design. Some early plans, for instance, focused on benefit periods rather than benefit dollars, and a lot of companies are now moving toward benefit pools, recognizing that

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Questions remain on tax treatment of LTC insurance

Growth often comes with favorable tax treatment, and that was the insurance industry's hope for LTC products under provisions of the Health Insurance Portability and Accountability Act of 1996 (better known as the Kassebaum-Kennedy bill).

Under the new law, LTC premiums are tax-deductible as part of medical costs, and benefit payments are not taxed (with certain provisions). Yet the law still needs so much clarification, said *The Actuary's* conference call panelists, that it's too early to tell how it will affect LTC sales. Adding to the uncertainty and the work load, it's not entirely clear what an LTC plan needs to offer to finally receive federal approval for the new tax treatment. So insurers are revising their LTC products or developing new ones along the health reform law's guidelines — and these plans must be filed with state governments and receive their rulings this year.

Under Kassebaum-Kennedy:

- Qualified LTC insurance plans are treated for tax purposes like accident and health (A&H) insurance, meaning premiums (with certain limits) can be counted as health care dollars to meet tax deductibility requirements, and benefits, for the most part, are nontaxable.
- Factors are listed that define "qualified" plans. Factors include benefit eligibility requirements that appear more stringent and consumer protection standards.
- Nonqualified LTC contracts can be exchanged for qualified LTC contracts before January 1, 1998.
- 1099 reporting requirements are given for all LTC benefits.
- Policies sold before January 1, 1997, are "grandfathered" for favorable tax treatment.

The uncertainty over what plans will finally be judged qualified or nonqualified — and the enormous amount of state filing work that must be done this year — raised questions among the panelists.

"I have a hard time envisioning that Treasury is ever going to require people in nursing homes or other types of long-term care to report benefits in their income," said regulator Tom Foley. Insurance executive Loida Abraham agreed, but she added, "I've also heard that Treasury does not want to make it abundantly clear that they won't tax benefits from nonqualified plans. Otherwise, why make the distinction?"

Panelists wondered whether the law would stifle product development. "Had lawmakers clarified LTC insurance less and simply defined its tax treatment, that might have made future product development less complicated," Abraham noted.

But in general, panelists took a positive view. Said executive Gary Corliss, "The United States had the only LTC product structure with a split personality. Was it a medical program to deal with acute care or a long-term care program to support chronic care? The law's definitions have helped bring us in line with the rest of the world, and that's important to be able to compete globally." Corliss and LTC consultant Bart Munson also saw the law as beneficial in its tax treatment of reserves. "The way we were being taxed on reserves was very unfair," Corliss said, "so to have that changed was worth all the trouble."

Abraham, Corliss, and Munson noted that LTC experts have wanted a tax law change for years. "I think we largely got what we asked for," Munson said. "I think we need to understand that federal legislators aren't full-time 'LTC people' and accept that they did a decent job. We can't get the quid without the quo — favorable treatment without rules for what plans qualify. I'll bet that eventually there won't be any nonqualified plans sold, maybe because they won't be allowed. But we'll struggle and suffer with uncertainties for a long time."

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this can give individual consumers a better choice.

Munson: There probably are other elements to monitor. Gary alluded earlier to interest rates. One can also learn pretty early on what persistency looks like. There are things to watch for, and if need be consider a price change. Don't wait until it gets out of hand, which it surely will if you wait.

The Actuary: How are delivery systems affecting the product?

Foley: I think it would be a great idea for the innovative companies to design products that today we might call bizarre — ones that interact with caregivers. If we're going to provide real, meaningful choices to applicants, the way we deliver this product will be critical. Today we have some professional LTC agents and we have some who are not providing all the counseling that they could. So we need ideas about how to get more and better information to applicants and, after they become insureds, to communicate on an ongoing basis.

Abraham: Today there are so many kinds of distribution channels: the traditional career agent, independent financial planners, your local bank, your broker-dealer, the Internet. This is true for all insurance products. Consumers are demanding better or different access during times that are more convenient for them. But some nontraditional channels aren't used to the long underwriting process, the high decline rates associated with older ages, the huge state variations due to different state mandates or requirements, the verbiage in benefits, multiple disclosure forms. These diverse channels almost seem to demand different types of products. And clearly, there's a demand for better training tools.

Corliss: Certainly the actuary needs to consider how all goals of the product are going to be accomplished, including distributing the product, in order to price the program. I agree with Loida: there should be different kinds of products for different distribution methods. Marketing is key to getting the spread of risk that we need, to getting enough lives insured. I think right now, in this early stage of public knowledge, we need very intensive educational methods to market LTC products, and we're having to pay for that in the compensation that brokers and agents get. Maybe the Internet will be one delivery channel. Direct response may become a more acceptable way for people to purchase coverage.

The Actuary: Do the commissions for agents help persistency? If lapse is so important in the pricing structure, does the agency system help or hurt?

Foley: That's a dynamite issue. This product is very much lapse supported. That means the higher the lapse is, the lower the premiums can be because any fund that's been developed by level premium prefunding is then forfeited to the company. If indeed it turns out to be the case — and I haven't seen any real evidence of this — that because agents' primary compensation is at the front end, there develops a significant replacement of policies after several years (and some things would mitigate against that, such as increasing age and level premiums), then that would certainly have a major effect on the lapse or persistency assumption. Interestingly enough, the tendency that I've seen has been for persistency to be better than companies anticipated in the late 1980s and early '90s. More than one company has filed for rate increases not because of adverse claims but because persistency is better than anticipated, and therefore they're expecting aggregate claims to be higher downstream.

Abraham: I'd like to think that most companies are more concerned about keeping their policyholders, and with that intent in mind, I know some companies have persistency bonuses even if it is a lapse-supported product. The customer's best interest has to be considered.

The Actuary: Is any long-term care insurance offered as single premium?

Corliss: Yes, there are some single-premium products available.

Foley: We don't approve single premium. If you sell somebody single premium, does that mean that if claims experience turns out to be far worse than expected, that the continuous-pay premium people should subsidize the single premium people? Or are we going to come back, like we have with vanishing premiums, 5 or 10 years later and say, no we really didn't mean it, we have to charge a new premium now? Are there nonforfeiture benefits provided if an owner wants out after a few years? I keep raising these issues and haven't gotten much response.

Munson: And while that's happening, there are also companies and other industry representatives who say we can't use noncancellable long-term care; it has to be guaranteed renewable and contain the right to raise rates. So who's right? I support, as problematic as that is, asking those questions. If one wants to do single premium and can do certain things with design and assumptions that tend to insulate that, fine. But one has to agree that maybe that's tacit approval of some forms of "noncan," which generally is anathema to the industry.

I think this story will help put all this in perspective. Less than 10 years ago, our profession swore that to successfully price LTC insurance, you had to have a three-day prior hospital stay before benefits could be triggered. For years now, we've been at the point of saying that's the most foolish thing we could have done. A, that doesn't relate. B, that's where you get sick, the hospital. C, they'll put mom there if that's what they need to do to get this policy to pay off. We all see the wisdom now of not using the three-day prior hospital stay. I just cite that as one example of how new this product is. Who knows what we'll be talking about 10 years from now?