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Combination Products: A One-Stop Solution?

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With the aging population in the United States, is long-term care (LTC) a crisis in the making, or is it already at our doorstep? Clearly, LTC is a growing concern. Half of people turning 65 today will require some form of LTC support during their lives.[1] Yet, many people lack the financial resources, including insurance, to pay for this care. While consumers recognize the need for LTC coverage, few actually purchase it.

With limited ownership of private LTC insurance, financing will continue to come from personal assets and Medicaid. This problem will only worsen as Baby Boomers age. Both public and private stakeholders recognize the need for a viable LTC insurance marketplace. More companies are developing an alternative to stand-alone LTC insurance. One of the few primary insurance alternatives is a life combination product that offers the ability to cover some costs related to LTC by adding riders to a base life insurance product.[2]

This executive summary is drawn from our full report, *Combination Products: A One-Stop Solution?* and highlights the key findings.

To be successful in the combination product market, companies must address five key challenges, ranging from consumer perceptions to regulatory compliance to risk management. Some are concerns triggered by legacy issues inherited from the stand-alone LTC market.

1. CONSUMER PERCEPTION

In general, consumers have a negative impression of stand-alone LTC insurance, and this mindset influences their perception of combination products. They deem the coverage as expensive, and there is uncertainty surrounding the costs and benefits. Due to the challenges insurers have had with experience, combined with changing policyowner behaviors during the life of the policy, premiums may increase significantly. There is also the feeling of loss if LTC expenses are not incurred. Significant premiums can be paid with no benefit payments in return. There is also a widely held assumption that government programs will pay for LTC.

Combination products address the "use it or lose it" attitude, thanks to the underlying life insurance death benefit. When permanent life insurance is the base of a combination product, the insured, in essence, is funding a benefit that may or may not be paid with a benefit that will be paid. The coverage flexibility can meet the evolving needs of the policyowner. In addition, compared to a stand-alone LTC policy, there is less risk that the premiums, or more specifically the nonguaranteed policy charges, will rise with a combination product.

Education is key. The need to fund potential LTC expenses will not go away, and consumers should be aware of the alternatives to stand-alone LTC solutions.

2. PRODUCT VIABILITY

The concept of product viability revolves around marketplace acceptance. Will financial professionals want to sell it and will consumers buy it? We know there is a recognized need for LTC coverage as more than 4 in 10 retirees view LTC costs as a "major" concern. In fact, they are more fearful of LTC expenses than longevity risk, a prolonged stock market downturn or inflation.[3]

As financial professionals work with clients to develop comprehensive financial plans, they should be sure to incorporate coverage of unanticipated health-care costs in such plans. For all but the most affluent consumers, the choice may be to get at least some coverage rather than none.

Combination products provide the opportunity to meet multiple needs—protection against untimely death and coverage of some long-term care costs—in a single policy, likely for less than it would cost to purchase both policies separately.

Looking forward, we expect to see experimentation around affordability, with insurance companies innovating around product design.

3. REGULATORY AND COMPLIANCE CHALLENGES

Training financial professionals is a key priority due to the distinctions among the various products. Further, financial professionals may require in-depth education to understand how these benefits work.

The various types of combination products can be confusing, so companies put a lot of effort into their field training programs. Successful manufacturers provide advisers with a level of comfort and understanding of the products and how to sell them. Insurers also work with their distribution partners to teach selling concepts. Combination products may be a viable

product in a comprehensive retirement plan as a way to effectively shield assets from an LTC event.

Life insurance policies that fall under Section 7702(b) of the Internal Revenue Code, including those with LTC and LTC with extension of benefit (EOB) riders, have the same training and continuing education requirements for financial professionals as stand-alone LTC. Insurers should continue to work with regulators in order to provide meaningful education standards that benefit advisers as well as consumers.

4. OPERATIONAL FRICTION

Operational friction is largely a function of legacy system constraints and has two major components: manual claims processing and the interaction between the base policy and the rider.

Insurers in the combination product market widely rely on a manual claims process but realize the need to shift to an automated process.

Talent management and support is an associated struggle related to claims. The claims process for the living benefit portion of a combination product differs greatly from the claims process for the death benefit. Clinical staff (nurses or social workers) are necessary to adjudicate claims. At the time of the claim, it must be verified that the insured needs substantial assistance with two of the six activities of daily living (ADLs).[4]

Legacy systems built to make one death benefit payout have difficulty with the living benefit payments. Insurers commonly use “bolt on” solutions to address this issue. For some carriers, it is hard to justify making investments in system upgrades for a product that does not currently have significant scale.

When addressing operational friction, the question for insurance companies is, should they buy, build or rent? The best option will be based on where each carrier believes the overall market is heading, its own new business projections, as well as product design. Renting or outsourcing the work to a third party could be a shorter-term solution. As insurers gain scale or differentiate by product design, building or buying may be a better, longer-term solution.

5. RISK MANAGEMENT CONCERNS

Risk management responsibilities are not contained within a particular unit but are spread across the organization, including product design and pricing, underwriting (risk selection) and capital management.

As industry standard assumptions are lacking, assumption setting is typically a do-it-yourself exercise.

Product Design and Pricing

Product design and pricing is a significant issue for insurers in the combination product market. Currently, there is no actuarial valuation table for LTC like there is for life insurance and disability insurance. Due to the nature of the product, LTC experience is slow to emerge, so there is limited insured data available.

As industry standard assumptions are lacking, assumption setting is typically a do-it-yourself exercise, with insurers building their own expertise while leveraging consulting firms or reinsurers, who have more data. These firms have experience working with insurers that offer combination and stand-alone LTC products.

Funding the benefit is also a risk that must be managed, especially for EOB products. The extension piece is only paid out once the death benefit has been fully accelerated. As such, EOB products during the extension period perform more like stand-alone LTC policies, as there is little built-in cash value in the policy to fund the benefit payments. This is especially risky for fully guaranteed policies funded with a single premium.

Underwriting (Risk Selection)

Some companies are entering the combination product market with little to no experience in underwriting LTC, notably those marketing life insurance policies with chronic illness (CI) riders. In fact, the majority of products with a CI rider do not require additional underwriting for the CI protection. In general, there are no plans to change underwriting requirements in the near term. We expect to see an increased level of automation in the process, which will increase underwriting speed with the goal of also maintaining quality.

Capital Management

Life insurance is capital intensive, requiring careful planning. As a result, capital management is an issue. Setting reserves for combination products is not easy and is open to regulatory interpretation, especially in a "pre-principle-based reserving" environment. With no industry data to rely on, experience is limited, so there is a greater granularity of focus on individual company performance.

A final challenge for managing capital is that reinsurance options are limited due to a lack of capacity.

Despite the challenges outlined above, the outlook for combination products is positive.

Consumers are faced with meeting a multitude of current financial priorities, while simultaneously under pressure to adequately fund their retirement needs. Through combination products, the industry can help consumers satisfy multiple priorities with a single solution. The growth in new sales of life insurance combination products has been healthy the last several years, and we believe it will continue in the near term.

Consumer need for LTC is on the rise, yet the existing private LTC insurance failed to address this need. Life insurance combination products can be part of the solution to this growing problem. The opportunity for the industry is to create products that are attractive and affordable to help consumers address this financial need.

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ENDNOTES

1 *https://aspe.hhs.gov/basic-report/long-term-services-and-supports-older-americans-risks-and-financing-research-brief.*

2 Although not covered in this report, there are also combination annuity products.

3 2016 LIMRA Secure Retirement Institute Consumer Survey.

4 The six activities of daily living are: bathing, continence, dressing, eating, toileting and transferring.