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Dear Actuary: Facing Rate Increase

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Every situation is unique, so always have your clients consult their long-term care, legal or tax adviser. The views discussed in this article are opinions of the author and not those of National Guardian Life (NGL), LifeCare Assurance or CLTC.

Dear Actuary,
My most important client just received a long-term care insurance rate increase. What should he do with his existing policy and should I consider a new carrier for his LTCI coverage?
Fearful in Florida

Dear Fearful,
First of all, let me empathize with your client. Nobody wants to receive a rate increase letter. Now that you have the details in front of you, you have a chance to be a hero for your client. The best solution is probably to doing nothing more than reinforce the value of the original plan.

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Most LTCI rate increases were a result of the original coverage being underpriced. It is likely that more claims will be paid out than originally anticipated. It turns out few people lapsed their policies each year and more people will eventually claim benefits. At the same time, the insurance carrier investment portfolios are earning much less than originally expected because of today's low interest rates. This means that the carrier needs to request extra premiums to fund the extra cost of future claims. Analogously, it is even more difficult to self-insure an extended-care event as an alternative to dealing with the rate increase when low-risk investments are earning low rates of return.

One positive of the current lapse and interest rate expectations is that new products being sold today are much more likely to be price stable. A recent Society of Actuaries study[1] estimates that even under adverse circumstances, today's products have less than a 10 percent chance of needing a future rate increase. So, despite higher prices, new LTCI products still provide significant protection against a catastrophic long-term care need and with more price stability. Traditional LTCI remains the least expensive way to fund an LTCI plan.

Carriers that are filing for rate increases on their legacy products are trying to improve the adequacy of premiums to be more in line with today's new products. However, the price after the rate increase is usually still lower than today's price for the same benefits! This is despite the fact that the lower original prices have been paid for many years. This demonstrates that the insured have typically received an extremely good value on their existing coverage as long as the increased premum is at a level they can still afford to pay.

INSIDE THE NUMBERS

This leads us to the method of analyzing the value of your client's original plan by using new product pricing. It is very likely that the reasons for the client's original purpose for LTCI protection are even more relevant today now that the person is older. We are going to use the price of today's new policies to assess whether the client is best served maintaining the current plan. This will at the same time highlight the value of the original plan even after considering rate increases.

Let's go through the analysis with a sample client who purchased LTCI 10 years ago when she was 55 years old. Let's assume she paid a premium of $2,000. Now at age 65, she has paid $20,000 into the plan. The client received a 50 percent rate increase bringing her annual premium up to $3,000. She is planning for her long-term care needs to begin in another 20 years at age 85.

Run two new quotes from a current LTCI carrier's product. Both quotes should match the original benefits. If you are recommending that a client reduce benefits, you can also compare new quotes at that reduced benefit level. Run the first quote using the client's original issue age and the second quote using the client's current age. You will use the first quote as the hypothetical cost of a plan reflecting current actuarial assumptions. You will use the second quote to represent the replacement cost of a plan should the client have any thoughts of forgoing their current coverage.

LTCI premiums are around 2.5 times more expensive for the *same benefits* compared to plans sold 10 years ago.[2] The increase will be less noticeable for males compared to females because of the industry shift to gender-specific rates. Yet, the average LTCI premium of about $2,500 purchased today is almost the same average price as 10 years ago after adjusting for inflation[3]. The reason for this seeming anomaly is that lower benefit periods and/or lower inflation rates are purchased on plans today. Lifetime benefits and 5 percent compound inflation used to be the most commonly purchased plan. Three- or five-year benefit periods and 3 percent compound inflation are more commonly purchased today. Reducing benefits instead of paying a rate increase results in the client having benefit structures that are more in line with today's policies.

The cost for our sample client's coverage today at her original age and rate class would be closer to $5,000 instead of the $2,000 she originally paid. At this point, it should be clear that the $3,000 it will cost her to continue her current plan is still a great value compared to the $5,000 that she would spend buying a new policy today with the same benefits.

Use the first quote you ran to evaluate your client's actual situation. Each situation will be unique based on gender, product, state and carrier.

Now let's assess the client's current alternatives.

Scenario A—Client decides to lapse her current coverage:
The $20,000 already paid into the plan is a sunk cost. She is likely to be eligible to receive a very limited benefit (contingent nonforfeiture) should she lapse the policy.

If a new policy is 2.5 times more expensive at the client's original age, it will almost certainly be even more expensive now that the client is 10 years older. If the client originally purchased 5 percent compound inflation protection, also keep in mind that she has already accrued significantly higher benefits during the first 10 years of owning the policy. Also, it is possible that the client may no longer qualify at the same preferred health class or may not qualify at all because of a change in health during the 10 year period.

You might think it makes sense to replace her coverage with another type of plan like a combo policy that combines a life or annuity product with an LTC rider. This might be attractive

if the client's needs or preferences have changed. However, it will be very difficult to replace the value paid into the original policy, especially considering that the life or annuity plan is typically much more expensive than the traditional LTCI plan for the same level of LTCI protection.

Scenario B—Client decides to keep her current coverage:
She has another estimated $60,000 ($3,000 x 20) remaining to fund the plan assuming no additional future rate increases. The value of the existing coverage will continue to increase as she pays premiums, even if she prepares for the possibility of needing to fund an additional future rate increase.

Scenario C—Client decides to reduce policy benefits:
Most LTCI rate increases provide for a "landing spot" approach that allows the policyholder to reduce benefits while keeping the premium close to the original level. This way, the client may be able to both lock in the value already paid, still retain significant benefits, and keep the premiums at an affordable level.

Out of the three scenarios, real-world data suggest that most clients keep their current coverage. Individual situations differ based primarily on the magnitude of the rate increase(s). This author estimates that roughly 70 percent of people pay the full increase premium, 25 percent reduce their benefits, and only 5 percent lapse their policies.[4] After paying the rate increase, those policyholders tend to be even less likely to lapse their policies in the future. This indicates that most clients are making rational decisions and most LTC advisors are giving solid advice.

The main ongoing question is will there be additional rate increases? There is now significant rate increase data to assess this risk. The California Department of Insurance[5] publishes data for rate increases across all states. The majority of rate increases have occurred on policies issued prior to the adoption of rate stability regulations in the early to mid 2000s. In the California report, you can review both the rate increase amount approved and also the amount that was *originally requested* by the company. It is more likely that another rate increase will be requested if the full amount of the original filing was not granted. Be aware that this is not an exact science because company experience continues to develop and actuaries can refine pricing assumptions and models.

Some advisers also question the viability of the existing carriers. However, there is a robust regulatory framework that reviews every carrier's ability to pay claims and takes action accordingly.

IN CONCLUSION

Insurance by its nature will always have those who are *fortunate* enough to receive little or no benefits, while others will receive large amounts of benefits due to the misfortune of requiring care. Yet, this is the primary reason for buying LTCI coverage. The insurance funds help ease the financial and emotional burden that comes with a need for extended care. Those who have received rate increases and have not yet received benefits should not feel as if their money went to waste. Just like term life, health, auto, or homeowners, the insurance provides peace of mind. They are still better off being healthy and not having a need for long-term care. In fact, these policyholders had great foresight to lock in the once-in-a-lifetime value offered by low premiums and the wide availability of richer benefits. You see this phenomenon clearly when those who purchased 10-pay receive a rate increase on their last remaining premiums. Their phone call to the adviser is usually one of gratitude.

It is hard to take the emotion out of receiving an unanticipated rate increase. Luckily, they have their trusted adviser to count on to help them keep their best options on the table. Usually, this is the plan they already have in place. Add value by asking them if they own a profitable business. They may not have considered that the rate increase could be an additional business expense deduction. In fact, they may not yet be deducting the premium at all! See the April 2018 "Dear Actuary" *Broker World* article for more details. After your conversation, it may even be possible that they will look to add more LTCI coverage to supplement their existing plan. Taking that initial phone call from the client that may make you feel like the goat may prove instead in their eyes to be the G.O.A.T. (Greatest of All Time). You will be surprised how addressing their fears the right way will open many doors to getting clients coverage in the future.

Do you have any LTCI questions for the actuary? Please write to Marc Glickman, FSA, CLTC at *marc.glickman@lifecareassurance.com*. ■

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ENDNOTES

1 *https://www.soa.org/Files/Sections/ltc-pricing-project.pdf*

2 Based on *Broker World* Survey data

3 Based on LIMRA Survey data

4 Based on major carriers that have reported these statistics in public statements

5 For Inactive Companies: *https://www.insurance.ca.gov/01-consumers/105-type/95-guides/05-health/01-ltc/rate-history-inactive.cfm*

For Actively writing carriers: *http://www.insurance.ca.gov/01-consumers/105-type/95-guides/05-health/01-ltc/rate-history-active.cfm*