THE FUTURE OF LONG TERM CARE INSURANCE: BOOM OR BUST?

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WAKELY ACTUARIAL

Introduction

- **"If I had known I was going to live this long, I would have taken better care of myself."**
  - *Mark Twain, Eubie Blake, Mickey Mantle, George Burns, et. al.*

- **"I hope I die before I get old."**
  - *Pete Townshend of "The Who" ,*
  "My Generation"

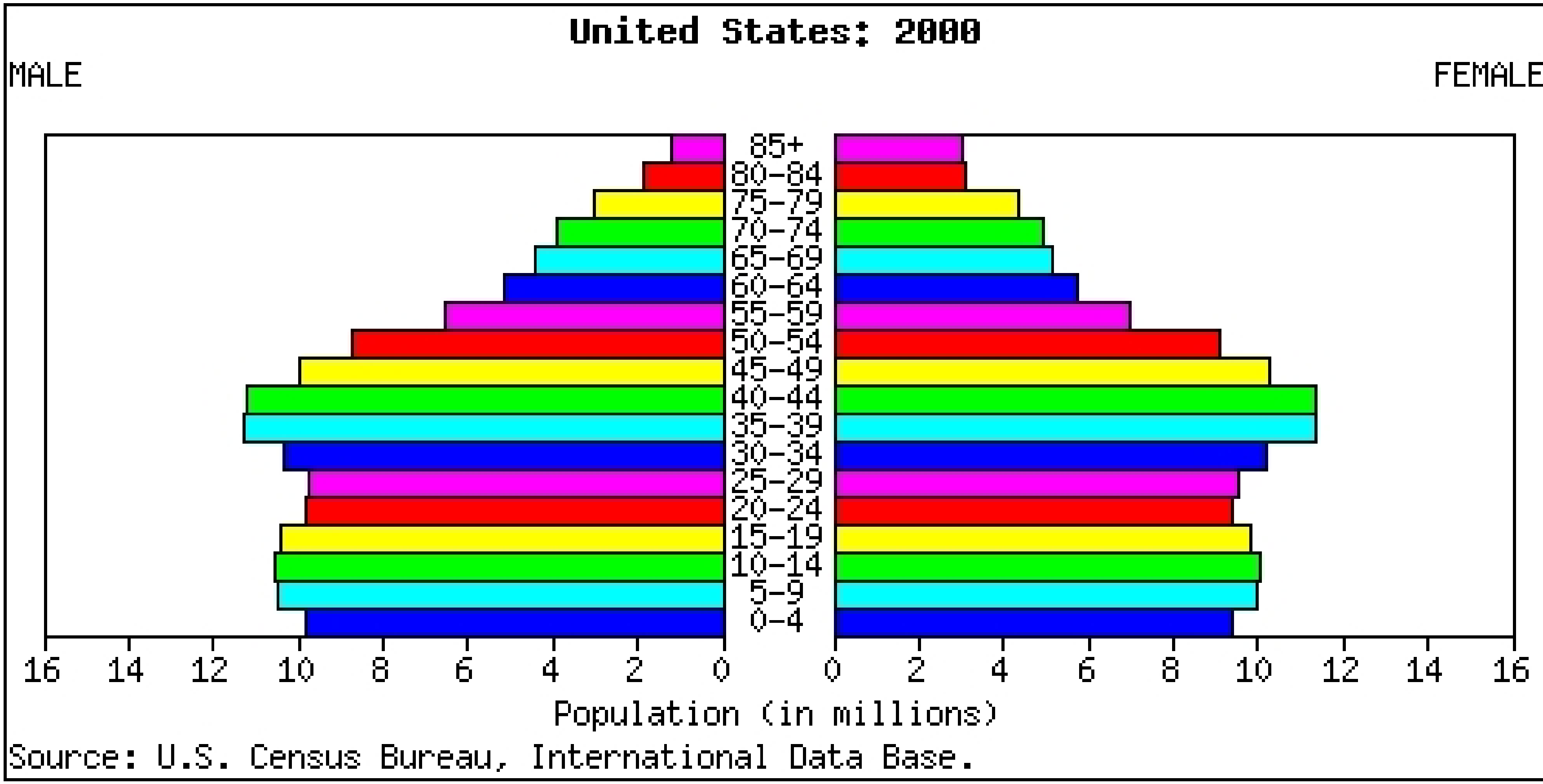
Emergence of LTCI

- Insurance coverage created to meet the needs of an aging population
- LTCI product design an "accident of history"

LTC – Boom or Bust?

- **Market Potential**
- **Bumps in the Road**
- **Trends in Product Design**
- **Regulatory Reforms Underway**

Market Potential



Market Potential

Ages	Total Population (U.S. census)	Affordability*	Penetration**	Est. Available Market
< 25	99,437,266	**N/A**	**N/A**	**N/A**
25-44	85,040,251	42,500,000	900,000	41,600,000
45-64	61,952,636	31,000,000	1,600,000	29,400,000
65+	34,991,753	17,500,000	3,500,000	14,000,000
Total	**281,421,906**	**91,000,000**	**6,000,000**	**85,000,000**

* Affordability 50% (estimated)

** Penetration <1% ages 25-44, 2.5% ages 45-64, 10% ages 65+ (estimated)

Market Potential

- **Conclusion:**
  - **Huge untapped market for LTC insurance**
  - **Insurance industry should strive to meet the need through all channels**
    - **LTC Policies**
    - **LTC Riders on Life/Annuities**
    - **New LTC designs for the future**
    - **Other solutions (e.g. reverse mortgages)**

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Bumps in the Road

- Low market penetration
- Declining interest rates
- Lower than expected lapse rates
- Large rate increases
- Class action lawsuits
- Criticism of Industry

Bumps in the Road

- Low Market Penetration
  - due to denial of need and lack of awareness
- Declining interest rates
  - reduces product profitability
  - not a good basis to request rate increases

Bumps in the Road

- Lower than expected lapse rates
  - First modern LTC products were priced with a 5% or higher ultimate voluntary lapse rate assumption
  - Today most actuaries use no more than a 2% ultimate lapse rate assumption
  - Actual mortality also lower than expected

Bumps in the Road

- Large rate increases on existing block of business – driven by:
  - higher-than-expected persistency
  - higher-than-expected morbidity
  - poor underwriting

Bumps in the Road

- **Class Action Lawsuits**
- **High-profile reports and articles criticizing the industry, such as:**
  - **1999 Conning & Co. study – "*Long-Term Care Insurance, Baby Boom or Bust*"**
  - **Consumer Reports**

Bumps in the Road

- **Conundrum facing the insurance industry:**

Having a product that is perceived as too expensive by the public, yet is chronically under-priced.

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Trends in Product Design

- **Original Nursing Home Product**
  - **Covered Skilled Nursing Facility (SNF) stays based on 3-day prior hospital stay**
  - **No coverage for Assisted Living Facility (ALF), Home Health Care (HHC)**

Trends in Product Design

- Early Product Innovations
  - Activities of Daily Living (ADL) and Cognitive Impairment Benefit Triggers
  - Inflation Protection (required to offer)
  - Nonforfeiture Benefit (required to offer, not sold in practice)

Trends in Product Design

- **Early Product Innovations (cont.)**
    - **HHC/Adult Day Care coverage**
    - **Homemaker/Chore services**
    - **Caregiver training**
    - **ALF and other residential care**
    - **Spousal discounts**

Trends in Product Design

- **More Recent Product Innovations**
  - **Tax Qualified (HIPAA)**
  - **Alternative Care**
  - **Care Coordination**
  - **Equipment Benefits**
  - **Pool of money policy maximums**
  - **Monthly/Weekly Benefits**

Trends in Product Design

- More Recent Product Innovations (cont.)
  - Preferred discounts / more underwriting classes
  - Return of premium
  - Single lifetime elimination period
  - Premium waiver for HHC as well as in Facility

Trends in Product Design

- **More Recent Product Innovations (cont.)**
  - Spousal premium waiver
  - Lifetime waiver of premium for survivorship
  - Shared Care
  - International coverage
  - Limited pay / Accelerated pay

Trends in Product Design

- Current Trends
  - Shift away from stand-alone coverages such as Home Care only
  - Carriers selling only Tax Qualified
  - More conservative pricing assumptions
  - Higher spousal discounts
  - Better coverage for informal care

Trends in Product Design

- Current Trends (cont.)
  - Elimination of options perceived to be too risky
    - single pay
    - some carriers may withdraw unlimited benefit plans
  - More sales through work site
  - Shift toward larger carriers marketing product

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Regulatory Reforms Underway

- NAIC rate stabilization regulations (adopted in half the states)
- LTC Active Life Reserves – policy termination rates based on mortality and lapse rates subject to limitations
  - Existing NAIC model
  - New NAIC model (2005)
- Risk Based Capital Formula Change
- Tax reforms (e.g. allow LTCI premiums to be above the line tax deduction)

Regulatory Reforms Underway

- **Contract reserves – <u>Existing Model</u> (Jan 1997) termination rates:**
  - **Policy Years 1-4: 80% of Voluntary Lapse Rate, or 8% if less**
  - **Policy Years 5+: 100% of Voluntary Lapse Rate, or 4% if less**
  - **Mortality: 1983 Group Annuity Mortality Table without projection**

Regulatory Reforms Underway

- **Contract reserves – <u>New Model</u> (Jan 2005) termination rates:**
  - **Policy Year 1: 80% of Voluntary Lapse Rate, or 6% if less**
  - **Policy Years 2-4: 80% of Voluntary Lapse Rate, or 4% if less**
  - **Policy Years 5+: 100% of Voluntary Lapse Rate, or 2% if less (Group insurance exception, use 3% instead of 2%)**
  - **Mortality: 1994 Group Annuity Mortality Static Table**

Regulatory Reforms Underway

- **Risk Based Capital (RBC)**
  - **Changes currently under consideration**
    - **Formula shift from percent of premium to percent of incurred claims**
    - **Better tie to risk**
    - **New formula would reduce capital requirements for new entrants**

Conclusion – the Future of LTCI

- Better education of the public is critical for success
- Currently most buyers have had personal experience with LTC – if not, less likely to purchase
- Encourage regulatory reform to allow for new benefit designs
- LTCI Industry cannot repeat past mistakes