

PUBLISHED ARTICLES

LONG-TERM CARE INSURANCE – A LONG TERM PROBLEM

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The average life expectancy in the United States in 1970 was 70.8 years, just over a one year increase from the average life expectancy in 1960 (1). It is against that backdrop that Long-Term Care Insurance (LTCI) was originally conceived and marketed in the 1970's. At the time the product was developed, interest rates were high and assumptions regarding investment income were made based upon the thought that interest rates would remain at high levels. However, past performance is no guarantee of future results, and interest rates have been at historical lows since 2008. LTCI gained popularity in the late 1980's and the early 1990's, while at the same time the average life expectancy grew steadily and at rate that far outpaced the decade of the 1960's. By 2013, the average life expectancy in the United States had ballooned to 78.8 years. Today, financial planners continue to suggest LTCI as an essential element of a retirement plan.

A closer look at LTCI beyond average life expectancy and interest rates reveals other stresses to the pricing of this product. The frequency and severity of LTCI claims is increasing; a 2014 study performed by AON indicated that frequency was increasing 3% annually and severity was increasing 2% annually (2). The lapse rate for these policies has also been lower than expected. The same AON study showed that the overall loss ratio was expected to grow 5% annually. This perfect storm has caused long-term care insurance to be a long term problem for insurers, regulators, and policyholders.

According to an S&P Global Market Intelligence analysis of statutory filings, the insurers with the largest LTCI reserves at December 31, 2016 included the following chart (3):

As can be seen on the chart, several insurers had significant adverse development in their reserves during 2016. MetLife Inc., CNA Financial Corp., Unum Group and Prudential Financial, Inc. all stopped writing LTCI years ago, and Manulife Financial Corp. stopped writing these policies in 2016 (4). Genworth Financial Inc. continues to be a leader in writing LTCI, but realized that it will require additional capitalization to turn its business around and is in the midst of being acquired by a private investor to gain additional capitalization (5).

Many of these insurers are actively working to file rate increases. In 2016, Northwestern Mutual initiated rate increases for the first time, obtaining approval for rate increases that would affect over 43,000 policyholders and result in approximately \$23 million in calculated premium increases. Genworth Financial Inc. is aggressively working to obtain rate increases, and the MetLife Inc. group of companies had the most filings approved in 2016, with 33 filings approved (6).

There are only about 15 companies that continue to write LTCI (4). Many insurers have changed their product structure in efforts to return to profitability. One new product structure includes riders providing for accelerated benefits clauses on life insurance products. The NAIC is also looking into new structures such as shorter duration products, annuity hybrid products, and the potential for favorable tax credit on LTCI savings accounts or purchases of LTCI from retirement plans (7).

Reserve development at US long-term care writers with largest reserves
For year ended Dec. 31, 2016

Top-tier entity	Reported reserves on individual and group policies (\$M)	Development based on present value of incurred claims (\$M)
	2016	1-year
Genworth Financial Inc.	17,524.9	361.5
Manulife Financial Corp.	16,038.7	240.1
MetLife Inc.	14,192.5	101.5
CNA Financial Corp.	9,442.7	(58.6)
Unum Group	8,020.2	41.4
AEGON NV	4,947.3	(47.0)
Prudential Financial Inc.	4,840.7	(68.4)
Thrivent Financial for Lutherans	4,438.0	(51.3)
Ameriprise Financial Inc.	3,727.7	(385.8)
CNO Financial Group Inc.	3,216.0	385.6

Data compiled April 17, 2017.
Rank based on total reported reserves as of year-end 2016. Top 10 entities shown.
Based on data reported in the supplemental sections of annual statements filed with the NAIC. U.S. filers only. Data on the reported policy reserves is taken from the Long-Term Care Experience Reporting Form 2, and the amounts shown are a summation of individual and group policy reserves. The development data is sources from the Long-Term Care Experience Reporting Form 3, Part 4.
Positive amounts of reserve development indicate reserve strengthening. SNL Financial calculated the 1-year reserve development by summing the reserves recorded in 2016 for incurred years 2015 and prior, then subtracting the amounts recorded in 2015 for those same incurred years.
SNL's top-tier designation reflects the consolidation of data, based on SNL-defined group structures, from individual P&C, life, health and fraternal filers.
Source: SNL Financial, an offering of S&P Global Market Intelligence

Given the risks present in the industry, the regulator is challenged with whether to limit rate increases to allow the policyholders to retain coverage at a reasonable price or to allow the increases to mitigate solvency issues.

Trends in rating practices

Insurers have aggressive and specific targets for rate increases, often with a goal of 100% or lower lifetime loss ratio. To achieve this goal, double-digit rate increases have been common. These increases often have the potential for cross-block and cross-state subsidies, since some states approve only small increases and others approval much larger ones. There have also been offers of reduced benefits when rate increases have been high, in an effort to retain coverage for those who cannot afford such high rate increases.

Trends in reserving practices

In an effort to reign in rate increases, insurers have taken measures such as including morbidity improvement assumptions in assessing reserve adequacy. They have also taken a more aggressive stance in including future non-approved rate increases and increases in investment income (based on a more illiquid or lower quality investment mix) in cash flow testing. Although in most cases state regulators have allowed some reflection of approved (but not implemented) rate increases, the amount by which regulators allow reflection of future non-approved rate increases varies greatly by state. Companies base these assumptions on state specific historical experience, which contains a significant level of uncertainty. Given this, and given the long term model used to project LTCI reserves, companies should include significant margins in their assumptions and should reflect those unapproved increases at the state level, if possible. As noted below, the NAIC is scheduled to adopt a new actuarial guideline (effective 12/31/2017) to specify how companies are required to perform their asset adequacy testing for long-term care business.

As new industry morbidity experience emerges, companies must decide whether or not to reflect this new experience and how to do so. They must consider to what degree the experience in the study is applicable to the Company's own business mix. For example, does the experience from the industry study apply to how a company's specific business is marketed and under-

Although very well capitalized, and with a diversified book of products, Thrivent Financial for Lutherans poses another challenge. As a Fraternal, it is not covered by guaranty associations. In the very unlikely event it were to fail, it would need to either assess its members or the policyholders would suffer significant losses.

The Penn Treaty group of companies, which has recently had significant press with its insolvency, is not listed on the chart above. It is estimated to have a net liability of almost \$2.7 billion (7). The responsibility to provide funds for the benefits to the Penn Treaty policyholders now rests with the life and health insurance guaranty associations. The Penn Treaty insolvency is having a major impact on life and health guaranty associations across the country, which have assessed their members to cover the cost of the insolvency. As pointed out above, only a limited number of companies have written business in the LTCI market, leaving many companies that never wrote these types of policies with an assessment obligation to cover the cost. If another major insolvency of a long-term care insurer were to occur, it could have a devastating impact on the market.

written? Does the study provide experience based on product features that align with those features at the company? How well or poorly the study data fits the company's business, will impact the level of credibility used when the Company blends its own experience with the new industry table. These are important considerations for one of the key assumptions used in LTCI reserving.

Other strategies which could increase risk

Due to the continued low interest rate environment, some insurers have been investing in riskier assets in an effort to increase investment return to better support their liabilities. This could make the company more susceptible to market risk and volatility in investment markets, potentially resulting in increased losses in a significant or sustained market downturn.

Consumer issues

Consumers are caught in the middle of the long-term care battle. When they bought a policy and thought that they understood what the premiums and benefits would be, they likely made it an element of their retirement planning. The reality today is that the premiums are either increasing or the benefits are being reduced. Furthermore, they are finding that the way the benefits were stated in the policy doesn't meet current needs or preferred methods of care, resulting in the policy not providing the needed coverage.

Further complicating the problem for consumers, if the insurer becomes insolvent most state guaranty associations have a limit of \$300,000, and a nursing home can cost upwards of \$90,000 per year (7).

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Areas the regulator should look at when evaluating rate increases

We believe that areas that regulators may want to focus on when reviewing requests for increased rates include:

- Determining if there were appropriate assumption margins based on the level of uncertainty for each assumption.
- Evaluating the extent to which the insurer may be trying to recoup past losses.
- Evaluating the lifetime expected loss ratio on the business if the increase is approved.
- Ensuring that sensitivities to test the materiality of each assumption have been provided in the actuarial memorandum and reviewing those sensitivities.
- Requesting a dynamic validation of the projection model to ensure that the historical pattern of claims and premium is reasonably aligned with the projected pattern of premiums and claims.
- Checking for consistency of assumptions between those used in the premium rate request and those used in the asset adequacy analysis.
- Determining the materiality of the projected results at the tail end of the projection by requesting an alternate projection which excludes the last five to ten years of the projection.
- Requesting an external review of the actuarial memo supporting the requested premium increase.

NAIC Groups Addressing LTCI

Long-Term Care has been gathering a considerable amount of regulatory attention, and several NAIC working groups are looking into ways to address increasing problems and risks associated with LTCI. Some of the key current NAIC activities are listed below.

Long-Term Care Innovation (B) Subgroup

The Long-Term Care Innovation (B) Subgroup has been focusing on approaches to financing LTCI and has developed a list of federal policy changes that could help to increase private long-term care financing options for consumers. As of the writing of this article, these options still require approval by the NAIC's Government Relations Leadership Council before they are presented to Congress. The options include (8):

- Option 1: Permit retirement plan participants to make a distribution from 401(k), 403(b) or Individual Retirement Account (IRA) to purchase LTCI with no early withdrawal tax penalty.
- Option 2: Allow creation of LTC Savings Accounts, similar to Health Savings Accounts (HSAs) and/or Enhance use of HSAs for LTC Expenses and Premiums.
- Option 3: Remove the HIPAA requirement to offer 5% compound inflation with LTCI policies and remove the requirement that DRA Partnership policies include inflation protection and allow the States to determine the percentage of inflation protection.
- Option 4: Allow flexible premium structure and/or cash value beyond return of premium (HIPAA and DRA).
- Option 5: Allow products that combine LTC coverage with various insurance products (including products that “morph” into LTCI).
- Option 6: Support innovation by improving alignment between federal law and NAIC models (HIPAA and DRA).
- Option 7: Create a more appropriate regulatory environment for Group LTCI and worksite coverage (HIPAA and DRA)
- Option 8: Establish more generous federal tax incentives.
- Option 9: Explore adding a home care benefit to Medicare or Medicare Supplement and/or Medicare Advantage plans.
- Option 10: Federal education campaign around retirement security and the importance of planning for potential LTC needs.

Long-Term Care Actuarial (B) Working Group

The Long-Term Care Actuarial (B) Working Group’s broad charges are to provide recommendations, as appropriate, to address issues and provide actuarial assistance and commentary with respect to model rules for appropriate LTCI rates, rating practices, and rate changes.

Long-Term Care (B) Valuation Subgroup:

Currently there is a lack of uniform practice in the implementation of tests of reserve adequacy and reasonableness of LTCI reserves. The Health Insurance Reserves Model Regulation (#010) and the NAIC Valuation Manual (VM-25) contain requirements for the calculation of LTCI reserves. The Model Regulation states, “a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts”; BUT some apply at contract level while others do this at the major block level (and everywhere in between).

The NAIC (B Committee) Long-Term Care Valuation Working

Group has been working on a draft LTCI guideline to address how LTCI carriers perform Asset Adequacy testing. The draft LTCI Guideline is called “The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves”. The draft was exposed in February, 2017 and was expected to go into effect December 31, 2017. However, outstanding questions relating to whether this will be a new guideline or incorporated into existing regulations may result in a delayed effective date.

The Draft Guideline establishes the following uniform guidelines and limits to certain assumptions to be used in Asset Adequacy Testing (AAT):

- Requires asset adequacy analysis (AAA) if LTCI business falls within scope of guideline
- Specifies form of AAA as either Gross Premium Valuation (GPV) or Cash Flow Testing (CFT) and points to Actuarial Standard of Practice No. 22 (ASOP 22, Statements of Opinion Based on Asset Adequacy Analysis by Actuaries for Life or Health Insurers)
- Specifies a process and timeframe by which additional reserves are established due to reserve inadequacy
- Uniform approach for future rate increase assumptions
- Assumption documentation requirements for key risks

- Standalone AAT results documentation requirements
- Phase In guidelines if additional AAT reserves are required

The scope of the guideline includes any insurer with long-term care insurance contracts with over 10,000 in-force lives as of the valuation date, both direct and assumed; and excludes accelerated death benefit products or other combination products where the substantial risk of the product is associated with life insurance or an annuity.

Long-Term Care Pricing (B) Subgroup:

The Long-Term Care Pricing (B) Subgroup has been charged with providing recommendations to address long-term care rates, rating practices and rate changes. One issue that has been a significant topic of discussion whether to allow recoupment of past losses in implementing rate increases. What has generally been determined is that past losses should not be recouped; however, projected future losses can be addressed by premium increases.

The Subgroup has been evaluating how to categorize into "buckets" the sources of past LTCI premium deficiencies and sources for recouping those past deficiencies. The Subgroup's primary goal is to create a resource document that would indicate how states would treat each of these "buckets". This has been led largely by Texas and Minnesota. States could use this resource document to help them in their review of LTCI rate increases depending on how they view the acceptability of recouping past losses and how these past losses are recouped (i.e., which policyholders, if any, should bear the burden of paying for these past losses and which ones). The Subgroup's discussion highlights the problems with lifetime loss ratios especially as they may be applied to shrinking blocks of LTCI policies if the company is allowed to recoup all of the past losses from persisting active policyholders.

Receivership Model Law (E) Working Group

Applicable charges of the Receivership Model Law Working Group include 1) to evaluate and consider the changing marketplace of LTCI products and the potential impacts on guaranty funds; and 2) evaluate the needs for amendments to the Life and Health Insurance Guaranty Association Model Act (#520) to address issues arising in connection with the insolvency of long-term care insurers.

Conclusion

Long-term care insurance is being carefully watched by both regulators and insurers, and both are working to find feasible means to shore up reserves on legacy business. There continues to be a need for this type of product in the marketplace, and regulators and insurers are also working closely on how the need can be met with a product that is designed and priced to achieve profitability. In the meantime, regulators are closely watching the impact that losses and reserve strengthening are having on the capitalization and solvency of insurers with legacy business on their books since another major insolvency could have a devastating impact on the market.

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