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OCTOBER 2015

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LONG-TERM CARE INSURANCE:
Pricing Flexibility

The Commission on Long-Term Care was established[1] by federal statute to study various aspects of the delivery and financing of long-term care services. In September 2013, the Commission released its report to Congress.[2] Regarding the financing of long-term care services and supports (LTSS) through private insurance, the report provided a number of observations, including concern about pricing flexibility in long-term care insurance (LTCI). As part of a series of papers looking at aspects of long-term care financing and delivery, the American Academy of Actuaries' Long-Term Care Reform Subcommittee developed this issue brief to take a closer look at pricing flexibility in LTCI.

EXCERPTS FROM THE REPORT

The report includes the following comments on pricing flexibility in LTCI:

> "Private long-term care insurance (LTCI) could play a more substantial role in LTSS financing, but changes are needed to boost participation, including new incentives, more flexibility so insurers can offer greater variety in the structure of policies and make coverage more affordable, and educational campaigns to explain future risks and options for financial planning."

> "Allow flexibility in pricing and product design: rapid and sustained drops in interest rates induced by unusual Federal Reserve monetary policies have challenged LTCI carriers expecting a more traditional return on investment. Private LTCI carriers need greater flexibility in structuring policies, including policies with varied benefit structures (e.g., longer elimination periods) and benefit time periods, to continue to meet consumer needs for affordable policies."

1 Section 643 of the American Taxpayer Relief Act of 2012 (P.L. 112-240): https://beta.congress.gov/112/plaws/publ240/PLAW-112publ240.pdf

2 Commission on Long-Term Care Report to the Congress (Sept. 30, 2013): http://www.gpo.gov/fdsys/pkg/GPO-LTCCOMMISSION/pdf/GPO-LTCCOMMISSION.pdf

LTCI PRICING CHALLENGES

LTCI plans generally have been offered and purchased on a level premium basis for the life of the policyholder; however, some additional options are available, including limited payment options and increasing premium options. Some product limitations can arise from a restriction under model regulation of the National Association of Insurance Commissioners,[3] which includes a requirement for level premiums beyond age 65.[4] Given that inflation reduces the real value of money each year, requiring level premiums might not be an economically sustainable approach for a viable insurance market.

Additional pricing flexibility could be considered to apply to premium changes on existing policies referred to as inforce premium rate increases. The current approach to premium rate increases involves filing premium rate increase requests with state authorities, which can lead to a lengthy process with uncertain outcomes.

Finally, U.S. generally accepted accounting principles and statutory accounting principles may pose particular challenges. For many LTCI policies, insurers are required to hold reserves according to assumptions that are established in the year the policy was issued (i.e., locked in). While best-estimate assumptions change over time, the reserve assumptions remain fixed. The level of reserves may not be aligned to those needed under the current economic conditions, a risk that insurers must recognize. For example, actual medical inflation for long-term care could be substantially lower than originally assumed, which could result in higher reserve levels than current conditions warrant.

PRICING FLEXIBILITY OPTIONS

Initial premium levels for policies could be lower if premiums were allowed to increase for ages beyond 65, for instance, a premium structure in which the premiums increase with percentage of inflation and/or investment returns for all future years.

As noted, the process of obtaining inforce premium rate increases can be challenging and can result in premiums that are not adequate to cover costs. Streamlining an approach to premium rate increases, for example, could encourage additional issuers to enter or re-enter the LTCI market. A streamlined approach could base premium rate increases on a national index, such as a change to the average life expectancy for a disabled 65-year-old.

The current reserving process with its locked in assumptions can result in having reserve levels higher than needed, which leads to pressure to increase premium rates. For example, interest rates and inflation assumptions currently are at historic low levels, and these low investment returns are locked in for the remaining lifetime of policies that are being issued now. With a flexible pricing approach, if investment returns increase to higher levels, reserves could be reduced by reflecting these higher returns, and this costs savings could benefit policyholders through lower premiums or lower premium rate increases.

CONCLUSION

LTCI can be expensive, and allowing flexibility in pricing may be one way of making this product more affordable. In addition, allowing for a different approach to premium rate increases could encourage additional issuers to enter or re-enter this market.

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3 NAIC Long-Term Care Insurance Model Regulation (September 2014): http://www.naic.org/store/free/MDL-641.pdf

4 Note that addition of increases in the benefit level requiring additional premium, based on the issue age rate schedule applied at an insured's current age at the time of each increase in the benefit level, are allowed under this definition.

The members of the Long-Term Care Reform Subcommittee include: P.J. Eric Stallard, MAAA, ASA, FCA, chairperson; Bruce Stahl, MAAA, ASA, vice chairperson; Mark Billingsley, MAAA, FSA; Dave Bond, MAAA, FCA, FSA; Michael A. Boot, MAAA, FSA; Malcolm A. Cheung, MAAA, FSA; Robert W. Darnell, MAAA, ASA; Timothy D. Gustafson, MAAA, FSA; Clark Heitkamp, MAAA, FSA; David E. Kerr, MAAA, ASA; Brad S. Linder, MAAA, ASA; Steven W. Schoonveld, MAAA, FSA; Sara Teppema, MAAA, FCA, FSA; and Ali Zaker-Shahrak, MAAA, FSA.