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LONG-TERM CARE INSURANCE: Product Design 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 financing long-term care services and supports (LTSS) through private insurance, the report provided a number of observations, including that the long-term care insurance industry has played only "a minor role in financing LTSS—only 10 percent of the potential market of Americans age 50 and above is currently insured."

To address this small percentage, the Commission suggested allowing greater flexibility in both pricing and product design of long-term care insurance (LTCI) policies.

As part of a series on long-term care, the American Academy of Actuaries' Long-Term Care Reform Subcommittee developed this brief to highlight issues involved with flexibility in product design.

PRODUCT DESIGN FLEXIBILITY CHALLENGES

There are a number of challenges to designing LTCI products to provide policyholders with greater flexibility, including (1) state laws and regulations, (2) Partnership plan requirements,[3] and (3) federal tax qualification standards.

State laws and regulations

State laws and regulations governing LTCI that have an impact on design features are those that:

- Require LTCI products to be in effect for the life of the policyholder, unless the policyholder otherwise terminates coverage. Therefore, an individual does not

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

3 For more information on the LTCI Partnership Program: http://www.ahcancal.org/facility_operations/medicaid/pages/ltcipp.aspx

have an opportunity to purchase a policy that ends coverage at a specified attained age.

- Impose specified benefits, such as care in an assisted living facility. Generally, adding benefits adds to the total cost of the insurance.
- Require benefit qualification to include deficiencies in at least two activities of daily living (ADLs), which include eating, bathing, toileting, dressing, and functional mobility. They do not permit minimum benefit triggers at the higher disabled levels of at least three or four ADLs. Federal tax qualification standards allow for the stricter criterion, but states generally do not.
- Impose restrictions on the size of specific policy provisions, such as elimination periods (i.e., a period of time when the policyholder pays expenses out-of-pocket before being eligible for policy benefits). For example, some states cap LTCI policy elimination periods at 365 days or even shorter periods. However, some consumers wish to pay more expenses out-of-pocket and purchase an insurance policy for potential disabilities that last longer than they would otherwise plan to absorb from their own savings or income. According to the Commission's report, of those turning 65 in 2005, 16 percent were expecting to use paid care in excess of $100,000, 12 percent between $25,000 and $100,000, and the remainder less than $25,000, with 42 percent anticipated spending nothing at all due to either exclusive use of informal caregivers or lack of need at all. Some individuals may prefer to extend insurance benefits to higher amounts of LTC services after a relatively long elimination period in lieu of paying for insurance coverage in the early period of a disability.

Partnership plan requirements

State Partnership programs, which are designed to protect both policyholders from spending down assets and the states from paying unnecessary Medicaid assistance, also impose requirements that can limit who can afford coverage. For example, some Partnership programs have required the 5 percent compound automatic benefit increase provision that is otherwise offered as an option. This provision is relatively expensive. While it allows an individual to protect benefit amounts from being counted toward qualifying for Medicaid, an individual may find the extra premium a deterrent to purchasing any protection at all. Allowing lower-cost options consistent with non-Partnership policies may still protect many of the assets and the state budgets to a lesser degree.

Federal tax qualification standards

Federal tax qualification standards effectively require that qualification for benefits be stated in terms of deficiencies in ADLs or cognitive impairment, eliminating other potential criteria for identifying degrees of disability.

LTCI policies that are "not federally tax-qualified" subject the insurance company to establishing smaller reserves for tax purposes than for statutory financial statements, requiring the insurers to report artificially high profits and pay the federal taxes thereon. Consequently, many insurers do not issue anything other than tax-qualified plans, which may preclude the availability of policies based on other reasonable criteria or providing some services.

FLEXIBLE PRODUCT DESIGN OR FUNDING MECHANISM EXAMPLES

- **401(k) Expansion**. Allow the use of 401(k) and other similar funds to pay LTCI premiums without incurring a tax penalty. Life insurance and annuity cash values already are permitted to be used for this purpose, and the U.S. Treasury Department recently allowed similar funds

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to be used to purchase annuities that delay distributions to as late as age 85.

- **Term coverage.** Limiting the coverage term can reduce the cost of insurance materially. For example, a product considered in Taiwan offered premium payment years of 10, 15, or 20 years, with the coverage period ending five years beyond the premium-paying period. (An individual might plan to use other sources of funding thereafter.)
- **Deferred coverage**. Allow individuals to purchase benefit coverage that begins after retirement by paying premiums in advance of retirement. Such an option could allow the insured to avoid any concern about redundant benefits with disability income insurance and locks in the insurability of the individual up to retirement.
- **Higher criterion for benefit eligibility**. A number of other countries have set higher disability standards in LTCI for qualifying for benefits. For example, rather than requiring deficiencies in at least two ADLs, they may require at least three, four, or even five ADLs. Often these products are designed with death benefits.
- **Size of indemnity or cash benefit depends on degree of disability**. Product designs in Japan and France provide either a lump sum or periodic cash benefits, the size of which depends on an assessment of the degree of disability. Because a U.S. home health care claimant's plan of care is designed according to the need, the U.S. LTCI market implicitly provides different degrees of benefits for different levels of disability; the policy needs to reimburse actual expenses and have sufficiently high daily maximum benefits to allow for higher degrees of disability.
- **"Universal LTC."** Similar to the transition in the life insurance industry from permanent whole life insurance to universal life products, LTC benefits could include similar design features. In universal life products, the policyholder accepts more of the investment and mortality risk, with a minimum guaranteed interest crediting rate and maximum mortality and expense charge guarantees. The same principles can apply to "Universal LTC" insurance, substituting the LTC benefit costs for the mortality costs and allowing the policyholder to benefit from favorable market conditions.
- **"Care sharing."** An individual chooses the number of days of care per week (or month) an informal caregiver would provide care before the insurer becomes responsible for paying for formal care. If an individual wanted to pay a higher premium, he or she could purchase the "zero day informal care" option, which would correspond to existing LTCI policies. To retain a lower premium, however, he or she may choose between one to six days of informal care per week. This arrangement would provide an incentive for family involvement in the purchase of the policy and in planning for care.
- **Monthly deductible**. The insured would pay a fixed amount per month out of his or her own pocket before the policy covered the cost of services that month. In concept, this design is similar to "care sharing" using dollars instead of days of care as the monthly sharing mechanism. It also provides an incentive for family involvement.
- **Decreasing lifetime maximum**. As an individual reaches a specified age, allow the lifetime maximum to decrease. The design assumes that the likelihood of long periods of care declines as one ages. Due to the erosion of value from inflation, many LTCI policies have been issued with effective decreases in the lifetime maximum. This design would accelerate the decreases beyond the effect of inflation.

CONCLUSION

There are a number of challenges and considerations when designing LTCI products, including state and federal laws/regulations, federal tax qualification standards, and other requirements (i.e., those associated with Partnership programs). Addressing some of these challenges may result in the development of more flexible product designs or funding mechanisms to ensure more choices to meet the needs of policyholders.