Long-term-care insurance market sees rapid decline

A slew of factors, including low interest rates, increasing longevity and insurance company pricing blunders, have led to an industry on the skids. Will hybrid products save the day?

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By **Greg Iacurci**

The traditional long-term-care insurance industry is **in a difficult spot**.

Sales have dropped precipitously over the past several years, due to factors outside insurance companies' control — such as persistently low interest rates and demographic trends — as well as those within their discretion, such as cost increases on in-force blocks of business.

In 2000, Americans purchased 750,000 new stand-alone, traditional LTC policies. That number was a paltry 105,000 in 2015, according to the American Association for Long-Term Care Insurance.

The market “is kind of a mess, to put it bluntly,” said Scott Witt, owner of Witt Actuarial Services, a fee-only insurance advisory firm. “There are a number of headwinds that have been in place for a long time.”

EXPENSIVE POLICIES

Much of the problem boils down to policies becoming more expensive, which naturally discourages would-be consumers from buying.

“Nobody likes to pay more for anything, whether it's cable television, a gallon of gas or insurance. But things change and sometimes those changes result in a need to change costs,” said Jesse Slome, executive director of AALTCI.

Rock-bottom interest rates over the better part of a decade, which have hurt returns on insurers' portfolios, as well as increasing longevity, which ups the insurance claims companies have to pay, have made it a tough go for the industry, experts say.

Further, there was some mispricing going on among insurance companies in the early LTC insurance days, with companies being “over aggressive” and pricing their policies low partly to be competitive, said Todd Parker, vice president and director of long-term care at Lenox Advisors Inc.

“The long-term-care insurance companies have realized where their pricing was probably a little off early on, and their underwriting standards were a little easier than they are now,” he said.

Most LTC policies are lapse-supported, meaning insurers use some of the profits from investors who lapse their policies to subsidize benefits for those who hang on to them, said Mr. Witt, a life insurance actuary who formerly worked at **Northwestern Mutual**. However, lapse rates early on were lower than insurers expected, putting further pressure on their ability to pay claims, both Mr. Witt and Mr. Parker said.

As a response, a slew of insurers have had to suddenly raise premiums on in-force LTC policies, leaving investors paying more to keep coverage, reducing their coverage to lower their premiums, or, in rare occurrences, lapsing their policies altogether.

On July 18, the Office of Personnel Management announced a rate increase averaging 83% — and a maximum 126% — for policyholders in the Federal Long Term Care Insurance Program. That's an increase of $111 per month in premium costs on average, according to the National Active and Retired Federal Employees Association.

The increases, which go into effect in November, affect all but 10,000 of the more than 270,000 people in the program.

For comparison, approximately 7 million Americans have traditional LTC policies through the private insurance market, according to AALTCI. A male and female couple, both age 60, will pay anywhere from $2,000-$3,500 per year, or roughly $83-$146 per month each, in LTC premiums.

“I think it's always going to be a difficult market,” Mr. Witt said. “It's a very difficult model to price, and if it's priced appropriately it's not appealing. You price yourself out of the market for what people are willing to buy.”

Mr. Slome paints the cost increases as an unfortunate consequence of Americans' increasing longevity, but one that's a bit misunderstood by the investing public, because high lapse rates don't necessarily follow a cost increase on in-force business.

A report by the U.S. Government Accountability Office found a 1.6% lapse rate among those in the Federal Long Term Care Insurance Program after the last rate hike in 2009. Those numbers are largely consistent in the private insurance market, according to Mr. Slome.

“The insurance industry has done a terrible job of making consumers aware of why rate increases are needed, how they pay claims, and how people actually act when a rate increase takes place,” he said.

However, many advisers and investors see the “use it or lose it” argument as another knock against traditional LTC insurance. Much like car insurance, investors can sock away premiums over years and ultimately not get anything in return if benefit claims aren't necessary or a policyholder lapses a policy.

Some see it as wasted money, even though they get peace of mind from knowing they have coverage in the occurrence of a claim-paying event.

But Mr. Slome takes issue with this perspective, because investors don't necessarily get nothing in return if they lapse a policy. Depending on specific policy features, insurers could give some investors' money back in the form of a return of premium or by paying the aggregate premium amount toward a qualifying benefit claim, for example.

COMBINATION POLICIES

Of course, LTC insurers haven't raised a white flag over the ramparts or gone quietly to their grave just yet. They've been able to **pivot to combination life insurance-LTC policies** and bolster otherwise flagging sales.

Sales of these hybrid policies have gone up markedly since 2007, when there were 15,000 new policies sold. In 2015, there were 220,000 new policies sold, according to Limra, an insurance industry group.

These policies **offer features LTC insurance generally doesn't**: liquidity and some sort of return on investment (heirs still get a death benefit if LTC benefits aren't used, for example), according to Mr. Witt. These features have popularized these products at the expense of traditional LTC insurance.

They do come with a caveat — those concerned with hedging against long-term-care risk would likely get more bang for the buck with a traditional policy.

“The standalone policy is much more efficient, in my opinion,” Mr. Witt said.

Ultimately, there remains a definite place for traditional LTC insurance products in the market, Mr. Parker said.

“The adviser has to do a good job setting expectations,” he said.