MARC GLICKMAN

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Glickman has a Bachelor of Arts degree in economics from Yale University and is a speaker at national meetings on topics in insurance company investments and LTCI.

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LTCI Linked Products Come Full Circle

LTCI actuaries tasked with reviewing the past in order to try and predict the future get a unique glimpse into the successes and failures of different product designs. More emphasis is placed on the failures, since insurance is a business of managing risks. Yet failures are often tied to collective wisdom, which is a difficult trap to escape. Among the challenges of creating a "new" successful product: The most cleverly designed products may never get off the ground if the benefits cannot easily be explained to clients; a unique design, though superior, may fail because the benefits cannot be lined up side by side with existing popular products; and sometimes the product must conform to the consensus of the times, even if that consensus is incorrect.

Much has been made of the design limitations on past products for the LTCI market in particular, such as:

- Benefits that are "use-it-or-lose-it" upon death
- Premiums that are forfeited upon lapse
- Limited benefits, especially when they are needed the most
- Rates that can (and did) increase when those increases can least be afforded by the policyholder

Recently my company reviewed the experience of our first product series from 25 years ago. It suffered much less from the limitations and faulty assumptions of subsequent LTCI products. It offered an array of innovative benefits that were well ahead of their time:

- GAC: Guaranteed Assistance Care paid a reduced annuity benefit starting at age 85 to cover any personal assistance not already covered under the nursing home policy and without any activities of daily living (ADL) requirements to qualify. This helped pay for any costs associated with becoming elderly and frail.
- ROP with COC: This benefit provided a return of premiums, without claims offset, to the beneficiary upon death of the insured, and provided for a continuation of coverage nonforfeiture option upon voluntary lapse.
- Lifetime Benefit Period: The policy only offered lifetime benefits.
- CPI Indexed Inflation Protection: The daily benefits increased each year with increases in the CPI, but the premiums remained level.
- Payment Options: Ten-pay plans and non-level premium options (higher first year, lower renewals) were offered to remove the risk of unaffordable premiums in the later retirement years.

Talk about full retirement protection! Surprisingly after 25 years, the experience on this product compared to expectations was reasonable. It did not suffer as much as other products in the declining lapse and interest rate environment for the following reasons: First, payment options, by nature, were already expected to have lower or no lapses. Second, the premiums collected were invested long term from the outset because of the built-in incentives to retain the policy. This mitigated some of the interest rate risk. Third, with death and annuity benefits, the product was less sensitive to the mortality assumption. Finally, and most important, the product utilized rigorous LTCI-specific underwriting. This significantly reduced morbidity anti-selection and kept the risk pool pristine for the eventual benefit of the carrier *and* its policyholders. Limiting early duration claims had an unforeseen benefit for those policies that elected lifetime pay premiums. The rate increases that occurred because of lower than expected lapse rates were lower in magnitude than other policies of that generation.

Yet sales were not spectacular because richer benefits made the product less competitive. In the late 1980s and early 1990s, premiums were quite expensive compared to competing products without the extra riders. However, by today's standards, premiums were relatively inexpensive for the protection that they provided. Interestingly, this product shares many similarities with the combination products offered in the market today.

Life and annuity products with LTCI combo riders have become a focus for many companies even if they do not consider standalone LTCI as a product they would consider selling. The insurance industry sees the need for an LTCI product solution for retirement age boomers with no semblance of a public solution on the horizon.

The high-level strategy for combination products in today's market is to offer very limited LTCI benefits, which enables simplified LTCI underwriting. With only 5 to 15 percent of the policy costs attributable to the LTCI benefits, the life or annuity products to which they are linked can absorb a reasonable amount of morbidity anti-selection. Since the credited interest rate can still be adjusted, these products can still deliver the profitability of the underlying life or annuity product.

There are at least four variations of the life/"LTCI" combo idea, although the last one is the most prevalent:

1. The least expensive is an acceleration of the death benefit, usually in a lump sum, to pay for a death expected within six months to one year. This variation is usually about 3 percent more costly than the life policy to which it is attached.

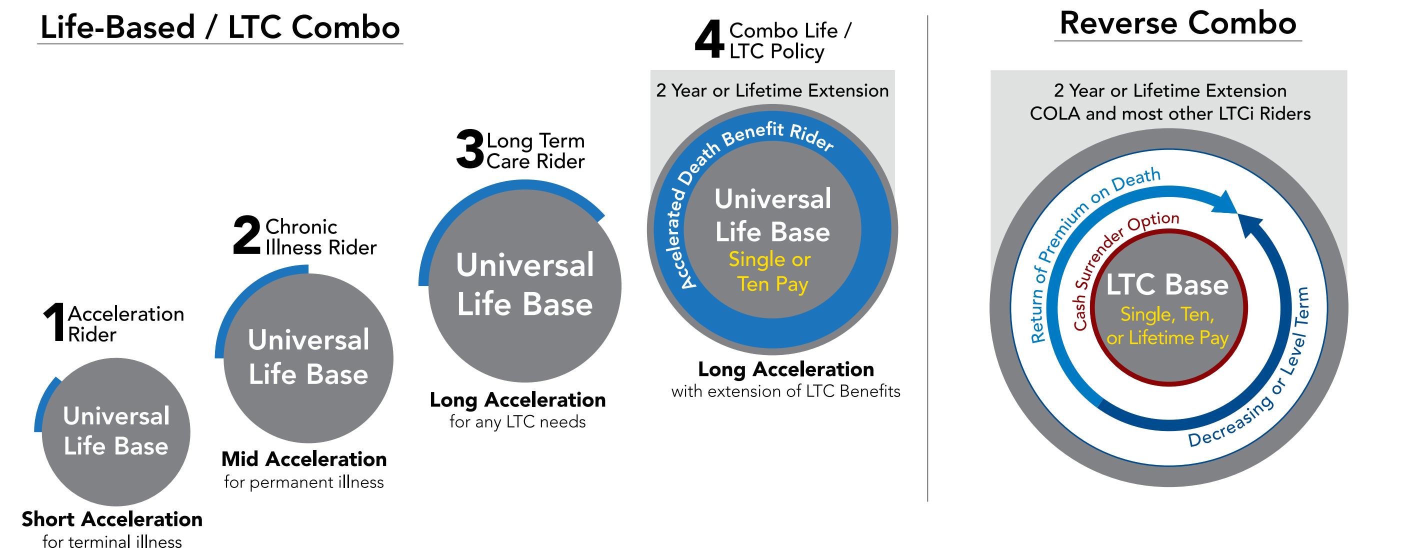
2. The next least expensive is the chronic illness rider. This benefit is usually payable monthly based on the occurrence of a permanent long term care event requiring either loss of two of six ADLs or severe cognitive impairment. Typically, this rider reduces the death benefit dollar-for-dollar, while reducing the cash value on a pro-rata basis. This variation typically costs about 5 percent more than the underlying life policy.

3. The long term care rider, unlike the two riders described above, is considered LTC insurance for regulatory and agent education purposes. It typically provides for a payout of X percent of the death benefit based on LTCI benefit eligibility without requiring permanent disability. Often, benefits are paid out until the death benefit is exhausted. This variation typically costs about 7 percent more than the underlying life policy.

4. The most comprehensive version of the life/LTCI combo policy typically builds the long term care rider into the life policy and then offers the policyholder an extension of benefits rider. The policyholder continues to receive LTCI benefits after the death benefit is exhausted, for either limited or unlimited benefit extensions. Typically, this variation costs about 10 to 15 percent more than the underlying life policy.

It is estimated that new sales of the fourth type of life/LTCI combo products reached about $2 billion last year. However, the portion of the premium attributable to LTCI protection is only about 15 percent of the

Comparison of Various Life / LTC Combo Products



total with the vast majority of it collected on a single premium basis. This $300 million of long term care single pay premium is equivalent to about $30 million of annual pay premium. When compared to annual pay premium of $400 million for standalone LTCI, this only represents about 7 percent of total new LTCI premiums generated. This segment of LTCI premiums, while still small, is growing quickly. Many carriers find themselves needing to offer some type of life/LTCI combo product, even if it is only to prevent losing existing life and annuity product sales to agents who want to offer some type of long term care protection for their clients.

Is there a solution that offers both more LTCI protection and provides carriers with significant profit potential at less risk than LTCI products of the past?

I think so. The potential solution harkens back to the product of 25 years ago. Instead of building a life-based/LTCI combo product, a company could instead build an LTCI-based/life combo product or what might be termed "reverse combo." This reverse combo would use an LTCI standalone policy and then add on an ROP rider together with a cash surrender option. Because the base policy is LTCI, this approach allows the addition of any type of inflation protection, any type of premium payment pattern, and any amount of decreasing or level term insurance to customize the LTCI benefits and death benefit as desired. In addition, the cash surrender option is not required to meet any minimum cash value tests, and therefore can be much lower or zero for several years.

The higher pricing on life-based/LTCI combo products with limited benefits offers an attractive entry point for a carrier to compete using the reverse combo concept with richer LTCI benefits. Risks on LTCI-based products are lower than ever because the downside risk of the critical lapse and interest rate pricing assumptions have been virtually eliminated. Morbidity risk may still be significant, but when the product is combined with rigorous LTCI-style underwriting, this risk can be mitigated as well. The products can even be designed so that there is little to no risk of future rate increases. Finally, the design of the reverse combo is more efficient than the life-based/LTCI combo counterpart because:

- Life-based products still carry the burden of having to meet both the modified endowment contract (MEC) and life insurance corridor tax rules. This makes it difficult to design 5 percent compound inflation protection or lifetime premium payments with tax efficiency into the life structure.
- Assets can be invested long term with no disintermediation risk, since the cash value structure discourages policyholders from early withdrawal of funds regardless of interest rate changes.
- Death benefits can be customized to policyholder specifications so they can choose the level of LTCI and death benefit they desire.
- Death benefits can also be designed with no claims offset as well as on a last-to-die basis.

It will be interesting to see how emerging boomers will benefit from these merged products in the future.