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## Long Term Care Insurance Is Too Legit To Quit

**T**True or false: The number one reason consumers are not buying traditional long term care insurance today is because it is too expensive.

Answer:

False. The number one reason consumers are not buying traditional long term care insurance today is because they are afraid it will **become** too expensive.

The legitimacy of the LTCI market is being challenged. Advisors are hesitant to recommend traditional solutions even though there is consensus that the need for LTCI continues to outpace the protection purchased. There is no doubt about the benefits provided. Claims satisfaction rates are extremely high and customers continue to retain their policies more often than any other insurance product. There is also government support for new product purchases. LTCI enjoys myriad tax-favorable purchasing options as well as benefit enhancements from the state partnership programs. Traditional LTCI remains the least expensive way to access these rich ben-

efits. The challenge for advisors is addressing the concerns about the stability of prices into the future because the continuing noise about rate increases from legacy products drowns out all of the positives.

Most advisors are aware that modern LTCI products have dramatically sounder pricing than the prior legacy products. However, these advisors seek product guarantees and hard evidence having been burnt by prior expectations. There is good news. Product guarantees have re-emerged in the form of new single-pay and 10-pay traditional LTCI plans as well as lifetime benefit periods being offered once again. Evidence has also accumulated showing that modern lifetime-pay plans will be much more price stable than any prior product generation. The evidence comes from two LTCI paradigm shifts that differentiate modern price stable LTCI products from legacy LTCI products.

The first paradigm shift has been increasingly sound pricing to address a variety of possible future economic and demographic

scenarios. The Society of Actuaries (SOA) recently published a pricing study<sup>1</sup> showing that the underlying actuarial pricing assumptions for modern products has been effectively de-risked. For new products, both the likelihood and magnitude of possible future rate increases are under control. The logic behind this is intuitive. The single biggest factor that drove the underpricing of legacy products was the assumption that a small percentage of people would drop their policy each year. New pricing for today's products assumes that virtually nobody will drop their policies. By definition, this past pain point will not cause a future rate increase. Similarly, expected investment rates are now priced in using today's record low rates making it much more likely that rate stability could actually improve from increasing rates years from now.

The second paradigm shift has been regulatory protections requiring price stability. This effectively began with policies issued after 2004 with the implementation of LTCI rate stability regulations that incentivize LTCI companies to price policies more responsibly. With the passage of time, there is now accumulated evidence that modern policies sold after rate stability regulations (Post-RS) have outperformed policies sold prior to rate stability regulations (Pre-RS). Public rate increase data shows that over 90 percent of rate increase filings have occurred on Pre-RS policies.

It is important for advisors to understand how modern LTCI products differ from legacy products, so they do not quit on the product at a time when the protection is needed the most and is safest for the consumer to buy. Advisors need to encourage consumers who are wise enough to plan for this need to get asset protection while still young and healthy enough to qualify.

#### Paradigm Shift #1—Pricing Rate Stability

Consumers' caution about LTCI is understandable in light of the rate increases that are now occurring on legacy products. The SOA pricing study analyzed pricing assumptions from legacy policies sold in 2000 (pre-RS), modern policies sold in 2007 (post-RS), and the latest generation pricing assumptions used in 2014. The pricing of

policies sold today is more conservative across *every* major pricing assumption:

- 1. Lapse Rates:** The biggest reason that companies needed rate increases on legacy policies is because everyone held on to their policies. LTCI struggled under the weight of its own popularity! Companies now use a lapse assumption of less than one percent per year, leaving no room for this assumption to cause a rate increase.
- 2. Investment Returns:** The second biggest reason that companies have needed rate increases is continually decreasing interest rates. Interest rates are now running into a fundamental economic floor such that it is much more likely to trend up rather than down.
- 3. Claim Rates:** Claim assumptions were more aggressive during the 1990s as companies sought to maximize market share. Since then, companies have shifted emphasis to creating a profitable product line. Today, claim assumptions are very conservative estimates of actual experience, with an additional margin for error required by regulation.
- 4. Increased Confidence:** There is 16 times more policy data and 70 times more claims data available now as compared to 15 years ago. This lowers the variability of future results and increases confidence in price stability.
- 5. Likelihood of Future Rate Increases:** The SOA pricing study forecasted the chance of a rate increase for each generation of product pricing. The study concluded that for the latest generation product pricing there is less than a 10 percent chance that LTCI products issued today will ever need

a rate increase. Furthermore, if a rate increase were to occur, the average amount of the increase is likely to be only 10 percent.

#### Paradigm Shift #2 – Regulatory Rate Stability

The National Association of Insurance Commissioners passed the Rate Stabilization Model Act in 2001, and 41 states have adopted a variation of this Act. The first new rate stabilized products were offered for sale between 2004 and 2006 depending on the insurance company. As the name implies, companies are required to price more conservatively and are penalized should a rate increase be needed. The direct result is more conservative pricing across the industry to help protect consumers from large future rate increases. The following are all consumer protections for policies filed under Rate Stability Regulations:

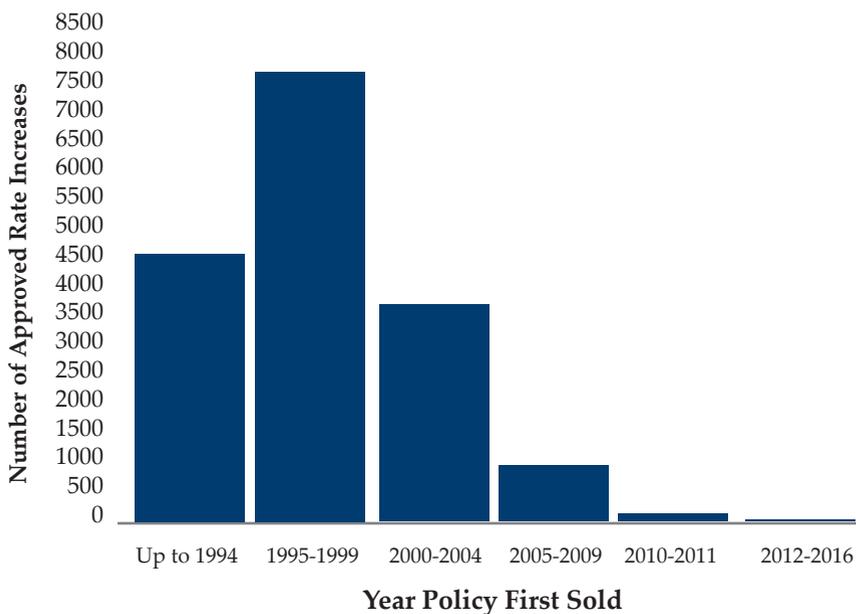
- 1. Consumer Value:** Rate increases cannot make the price of the in-force policy higher than the rates for applicants of new policies.
- 2. Company Penalty:** There is a significant penalty associated with future rate increases, so insurers are motivated from the start to price each policy form very conservatively. The formula requires the company to pay out at least 58 percent of the initial premium as benefits. Any rate increase amount must provide at least 85 percent of the increased premium as benefits. This makes it difficult for a company to profit from the rate increase.
- 3. Margin for Error:** Pre-RS, insurance companies were prohibited from pricing in any "margin for adverse experience." Post-RS requires the use of the most current actuarial assumptions

#### Average Industry Pricing Assumptions on New Products

Year	Pricing Lapse Rate	Pricing Interest Rate	Likelihood of Rate Increase
2000	2.8%	6.4%	40% Chance
2007	1.1%	5.9%	30% Chance
2014	0.7%	4.6%	10% Chance

## Analysis of Rate Increase Filings

Rate Increase Filings by Year Policy Sold



and must include an additional margin for error.

- 4. Certification:** As part of the premium increase approval process, a qualified actuary must certify that no future premium increases are anticipated for the remaining life of that policy form, even if future experience is moderately adverse.

We recently reviewed rate increase data across all states and companies, which was

published by the California Department of Insurance in December, 2016. We reviewed 22 different companies and their subsidiaries selling both pre-RS and post-RS, which together encompass 88 percent of all in-force LTCI policies. In those states which have enacted the Rate Stabilization regulation, over 91 percent of the rate increases have been on policies that were sold pre-RS. This includes by definition all policies issued prior to 2004. Less than nine percent of the rate increase approvals

have been on policies sold Post-RS.

Also, we reviewed the cumulative percentage amount of the rate increases. The average, cumulative rate increase for policies sold pre-RS was more than double that for policies sold post-RS. Virtually all of the largest companies have had pre-RS rate increases, but only a few have had post-RS rate increases. This data suggests that policyholders have been better protected by the Rate Stabilization regulation. It is important to note that self-funded government programs, such as the Federal LTCI Program or CalPERS, are not subject to Rate Stabilization regulations and can change premiums at the discretion of the self-funding entity.

There is strong evidence that modern LTCI policies will have more stable pricing than legacy LTCI policies. We expect rate increases on pre-RS LTCI products to continue. Policies sold in the earliest years of post-RS will likely need modest rate increases that should be less disruptive for consumers. The latest generation of policies are unlikely to have a rate increase based on the SOA pricing study, but if they do, the rate increase will likely be small. Companies are now motivated to create stable blocks and profitable business. This follows the path of individual disability insurance, which also faced parallel issues 20 years ago, but has since rebounded.

This paradigm shift in LTCI comes just in time, as the need is now greater than ever. Advisors would be well-advised not to quit on LTCI now that the product has been legitimized and the opportunity to offer the product is the greatest. 🌐

**Reference:**

1. <https://www.soa.org/Files/Sections/ltc-pricing-project.pdf>