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Protecting Consumers and Medicaid from Catastrophic Long-Term Care Costs:

How financial challenges in the long-term care insurance industry may shift costs to policyholders and Medicaid.

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The long-term care insurance (LTCi) market has been on a twenty year downward spiral, driven by an unfavorable (i.e., declining) interest rate environment, higher than expected benefit costs, and lower than expected voluntary lapse rates.¹ Some carriers have exited the industry entirely, whether voluntarily or via insolvency. Those carriers who have remained in the market have turned to premium increases in order to remain viable.²

LTCi is a financial product that promises over 7 million policyholders benefit payments for long-term services and supports (LTSS)—such as home and community-based services (HCBS) or services provided in assisted living and nursing home facilities—should they experience a high need for these services.³ While LTCi pays for only about 5% of all LTSS nationally, it plays an important role in protecting beneficiaries against the risk of spending their income and assets on expensive LTSS, and relying on Medicaid. The Medicaid program, in contrast, finances a little less than half of national LTSS spending but limits eligibility to high-need individuals who either have very low income and assets or exhaust (i.e., “spend-down”) financial resources on care costs.⁴

For several reasons, LTCi industry challenges—such as rate hikes and insolvencies—increase the chance that some LTSS spending otherwise covered by LTCi will shift to state Medicaid programs.

- **The LTCi policies most at risk of rate increases and insolvency – those sold in the 1990’s – are owned by policyholders at the greatest risk of Medicaid spend-down.** The relative affordability of LTCi sold in this time period attracted buyers whose income and asset profile makes them more likely to exhaust their resources than recent buyers, should they require significant care and not have their LTCi coverage.
- **LTCi policies most at risk from carrier insolvency are more likely to include generous “lifetime” benefit structures.** Buyers of earlier policies were more likely to select generous benefit packages, which are more protective of financial resources than the benefit options available today, but also more expensive for resource-constrained carriers to maintain.
- **Regardless of income and assets, all Americans are at risk of experiencing catastrophic LTSS costs.** A 2015 report found that adults turning 65 face a 15% chance that their lifetime LTSS costs will exceed \$250,000,⁵ increasing their probability that they will exhaust financial resources and rely on Medicaid to fund long-term care.

Following sizable carrier insolvencies, in 2017 the National Association of Insurance Commissioners (NAIC) enacted changes to the Life and Health Insurance Guaranty Association Model Act,

legislation that originally provided guidance to states on how to structure their guaranty funds.[‡] The 2017 adjustments were meant to further strengthen and protect state guaranty funds from assuming millions of dollars of liabilities related to insolvent carriers. Part of what motivated this action was the fall of Pennsylvania-based Penn Treaty, a regulated insurer who became insolvent and unexpectedly saddled multiple states with sizable liabilities and left tens of thousands of policyholders in limbo regarding their coverage.

The good news is that adopting the Model Act provisions will strengthen the structure of state guaranty funds to reduce consumer risks and minimize additional liabilities to Medicaid, should consumers need to rely on that program in the absence of their coverage. In addition to strengthening guaranty funds, states can further address risk by considering policy options to strengthen LTSS financing outside of the Medicaid program (e.g., considering models similar to Washington state's new "public long-term insurance").

[‡]State guaranty associations, commonly known as guaranty funds, are funding pools created at the state level and funded via payments from insurers doing business in that state. In the event of a carrier insolvency, these funds are disbursed quickly to ensure there are no gaps in coverage, and thereby offer critical protection for policyholders. (Anthem Public Policy Institute, 2018)

Long-Term Care Insurance Industry - Historical Context

Our nation's long-term care system relies heavily on personal savings and Medicaid to fund services such as home care, assisted living, and nursing homes. Demand for these services, commonly referred to as LTSS, is rising as the 65+ age demographic cohort becomes a larger percentage of the total population.

Evolution of Private LTCi

Private LTCi, as a financing option for LTSS, developed and evolved in the 1970-80's as life expectancy increased, and with it, a recognition that longevity increases the likelihood of needing LTSS before death. Baby boomers entered middle age in the 1980's and 1990's and began thinking about their future financial security.

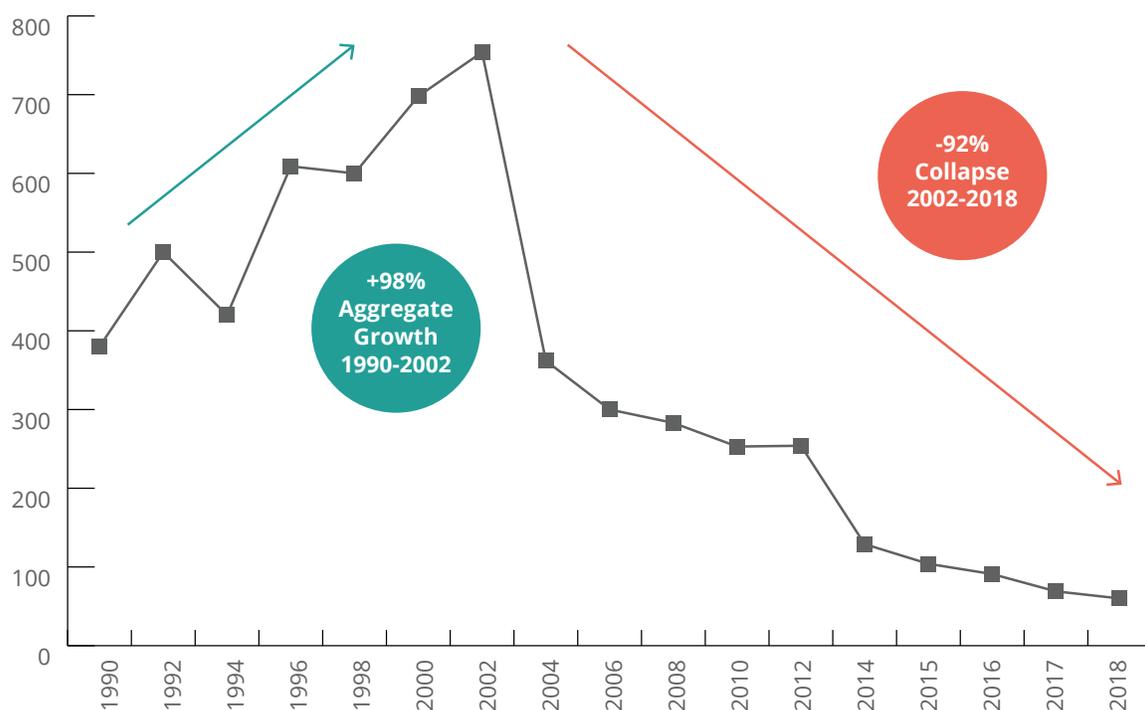
Policymakers and experts debated the role of public and private insurance in financing LTSS, with some advocating for policies to spur growth of private insurance (LTCi) and others for various forms of social insurance.⁶ Both camps recognized that Medicaid, the safety net program serving as a de facto national LTSS insurer, would not be able to handle the future demand in spending, if left on its own. Moreover, the program ensured access to care, but not financial protection against LTSS costs.

The 1990's represented a "hey-day" for LTCi as sales increased steadily, and buyers purchased generous benefit packages (Figure 1). Actuarial assumptions regarding expected return on assets (overestimated), cost inflation on lifetime benefit plans (underestimated), mortality rates (overestimated), and policy lapse rates (overestimated) contributed to a situation whereby premiums were actually artificially low, leading to fairly "affordable" premiums. Thus, relatively low premiums for generous benefit packages attracted more middle-income buyers to the LTCi marketplace.

A Turning Tide

The tide turned for the industry starting in the 2000's (Figure 1). Between 2002 and 2018, individual policy sales declined by an average of 15% per year.^{7,8} Many unanticipated factors affected the financial reserves held by companies, and carrier profitability declined. Of the actuarial assumptions discussed above, two factors in particular contributed to policy mispricing and financial instability: (i) interest rates declined below levels anticipated, which given that LTCi policies are priced on a level funded basis, made the "future promise" of policy benefits more expensive today, and (ii) voluntary lapse rates were lower than what was priced for (and lower than any other voluntary insurance product). Existing policyholders had little appetite for relinquishing a product whose replacement cost far exceeded what they had originally paid.⁹

Figure 1: New Sales of Individual LTCi Policies (000's)



Source: LifePlans analysis based on AHIP, LIMRA and LifePlans sales surveys, 1990-2018. Beginning in 2009, LTC Partners data for annuitants included in counts. 2017 and 2018 data based on "Sales Of Traditional Long-Term Care Insurance Policies Continue To Fall" (Forbes).

In addition, the combination of increasing morbidity and decreasing mortality proved problematic for insurers: many "lifetime" benefit policyholders were living longer with greater needs, especially those with Alzheimer's or dementia diagnoses, massively compromising carrier reserves. Regulatory requirements made it difficult for carriers to sufficiently reprice policies to account for this challenged environment, while increasing capital requirements drove the need for higher reserves – all of which put further pressure on margins. By the 2010's, benefit payments began exceeding predicted levels and reserves dropped below regulatory requirements.

Industry Responds to Challenges

The LTCi industry responded to challenges with a variety of measures.

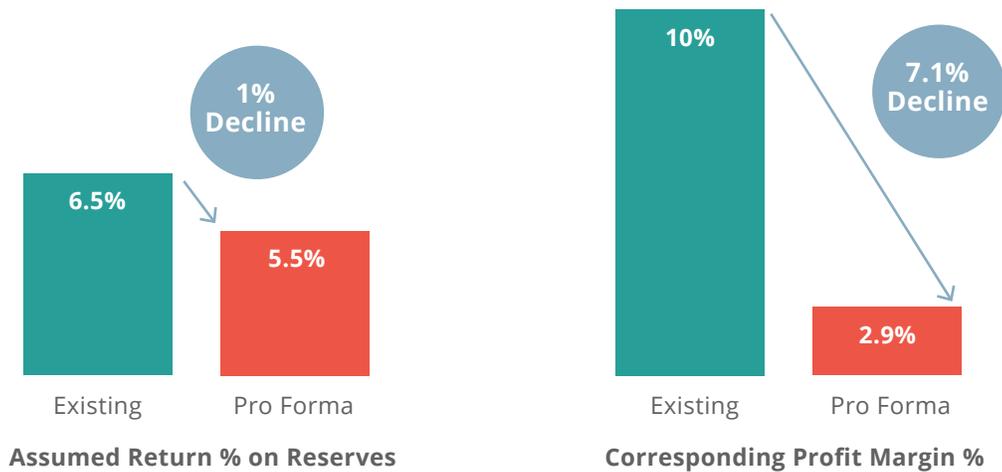
- **Rate Increases.** One of the notable responses from carriers has been to request rate increases for outstanding policies from state regulatory agencies. LTCi is typically a "level premium" product, which means that the premium levels are set at the age of purchase, unless state insurance agencies approve an increase to reduce carrier losses or ensure solvency when policy liabilities exceed anticipated revenues. In an effort to protect policyholders, state insurance regulators have moved to prevent future rate increases by tightening the pricing requirements

insurers must meet. Nonetheless, the generally unpredictable nature of pricing factors such as interest rates and longevity have forced carriers to reprice, or risk under-accumulated reserves.¹⁰ On the new policy front, between 2005 and 2010, changes in policy benefits and the declining average age of new buyers (everything else held constant) should have led to a 12% decline in new policy premiums. However, premiums instead increased 19% over this period, suggesting that changes in the lapse and interest rate assumptions for newly issued policies overwhelmingly drove premium levels up, which from the consumer's perspective, meant less policy value for the premium dollar.¹¹ From the insurers' perspective, it meant that policy value and premium dollars were more in alignment.

- **Closing Blocks of Business.** By 2018, the number of carriers actively selling a meaningful number of policies was down to only ~15 versus 125 in 2000, and five of them accounted for more than three-quarters of the market, as measured by premiums.¹² This massive exodus of LTCi carriers has resulted in a majority of policyholders (55% as of 2010¹³) having policies managed by companies no longer selling the product. These are known as “closed” blocks of business. Even though carriers continue to service these policyholders, there are negative implications for how these blocks are managed or invested in over time, which could increase the risk to policyholders of not being able to access the full value of their policy benefits or of having to absorb very large rate increases. In 2010, closed block companies represented 53% and 57% of annual and cumulative total claims costs, respectively, and these percentages have only increased as the market has contracted.¹⁴
- **Insolvency.** To date there have been several large carriers placed into rehabilitation, a process that enables state insurance regulators to intervene and potentially save a troubled insurance company. One of these companies is Penn Treaty, which with its sister company American Network Insurance Company, helped create the modern U.S. LTCi market.¹⁵ Penn Treaty was in rehabilitation for almost a decade before being forced to liquidate in 2017. In January 2020, regulators placed Senior Health Insurance Company of Pennsylvania (SHIP) into rehabilitation. With almost \$6 billion worth of liabilities between them, together these companies demonstrate the risks and challenges shared by the industry as a whole.¹⁶ More recently, in May 2020, Wisconsin regulators placed Time Insurance Company, which had been in run-off since 2014, into rehabilitation in order to protect nearly 200,000 policyholders.¹⁷

The long duration of policy contracts, whose financial stability is impacted by small variations in actual vs. expected performance, makes underwriting these contracts particularly difficult. Each individual pricing assumption can have major impacts on product profitability. Figure 2 highlights the precarious nature of carrier margins, where a hypothetical carrier earning a 10% profit margin would see its profitability fall over two-thirds to 2.9% by assuming only a 1% decline in its existing return on reserves. In order to offset these declines, premiums would have to increase in this scenario (if permitted at all) by 5%-10% in order to maintain adequate levels of profitability.¹⁸

Figure 2: Impact of Reserve Assumptions on Carrier Profit Margins



Source: HHS Office of the Assistant Secretary for Planning and Evaluation.¹⁹

Note: Pro Forma profit margin shown of 2.9% reflects midpoint of study results of 0.5% - 5.2%.

Reserve returns are in part driven by risk-free interest rates, which have been on a steady march to zero over the last twenty years⁵; the magnitude of these declines is yet another headwind faced by LTCi carriers that could precipitate further insolvencies, even if (as previous experience has shown), it takes years for problems to materialize. Though Penn Treaty was forced to liquidate in 2017, the carrier's issues dated back to 2001, when it first noticed claims were exceeding expectations. Today's products are perhaps priced for greater rate stability, but they are still based on multiple assumptions, any of which can occur outside of the forecasted range. Outside of these risks, medical claims remain a big uncertainty, especially as technology and drugs prolong life of policyholders. This suggests that the carriers mentioned above are not likely to be the last carriers to face solvency issues.

Long-Term Care Insurance Today

The LTCi industry of 2020 looks radically different from that of the turn of the century, as both the number of insurers and sales and marketing of policies have declined. Sales have declined both to individuals and to employer groups (the latter being a very small market today) and the benefit coverage of today's products is more limited than ever. Americans bought only about 60,000 stand-alone LTCi policies in 2018, an annual drop of 13% from 2017.²⁰

Today's policyholder experiences uncertainty about accessing their benefits. For example, in response to Genworth's recent premium increases, 9% of policyholders chose to cut their benefits

⁵The average yield on 10-year U.S. Treasuries, which stood at 6.03% in 2000, was down to 3.22% in 2010, and has declined ever further to 1.18% in 2020. (Macrotrends.net)

to keep their premiums the same, and 6% opted to drop their policies altogether. In the event of canceling policies, some companies (such as Genworth) will pay claims up to the amount of premiums already paid, but this is not mandatory, so some former policyholders will never be able to recoup their premium investments.²¹ Reducing benefits and feeling forced to drop an existing policy places more pressure on older adults financing their own care, which is problematic when 50% of Medicare beneficiaries have total savings of \$74,450 or less (in 2016 dollars)²²: this is less than one year in a nursing home.

Challenges for Medicaid

The LTCi market challenges – rate increases, growing risks of insolvencies, and declining sales – have the potential to shift some costs from private insurance to Medicaid. Medicaid is, by far, the largest third-party payer of LTSS, covering a little under 50% of total spending.²³ Furthermore, LTSS spending consumes more than 40% of state Medicaid budgets today, and this percentage is expected to increase as the age 80+ population grows rapidly over the next two decades.²⁴ The program provides a crucial long-term care safety net for individuals with low income and assets, or those whose resources are not adequate to cover high medical or LTSS costs (i.e., the “spend-down” population).

LTCi helps protect policyholders from Medicaid spend-down: in 2015, policyholders had 43.3 months of a potential nursing home stay covered by LTCi and 6.7 months covered by personal savings. Given the average length of claim for a nursing home (2011) was 17.8 months, this suggests insurance greatly reduces the chance of Medicaid spend-down, as without LTCi benefits, personal savings would cover less than 40% of the length of the average stay.²⁵

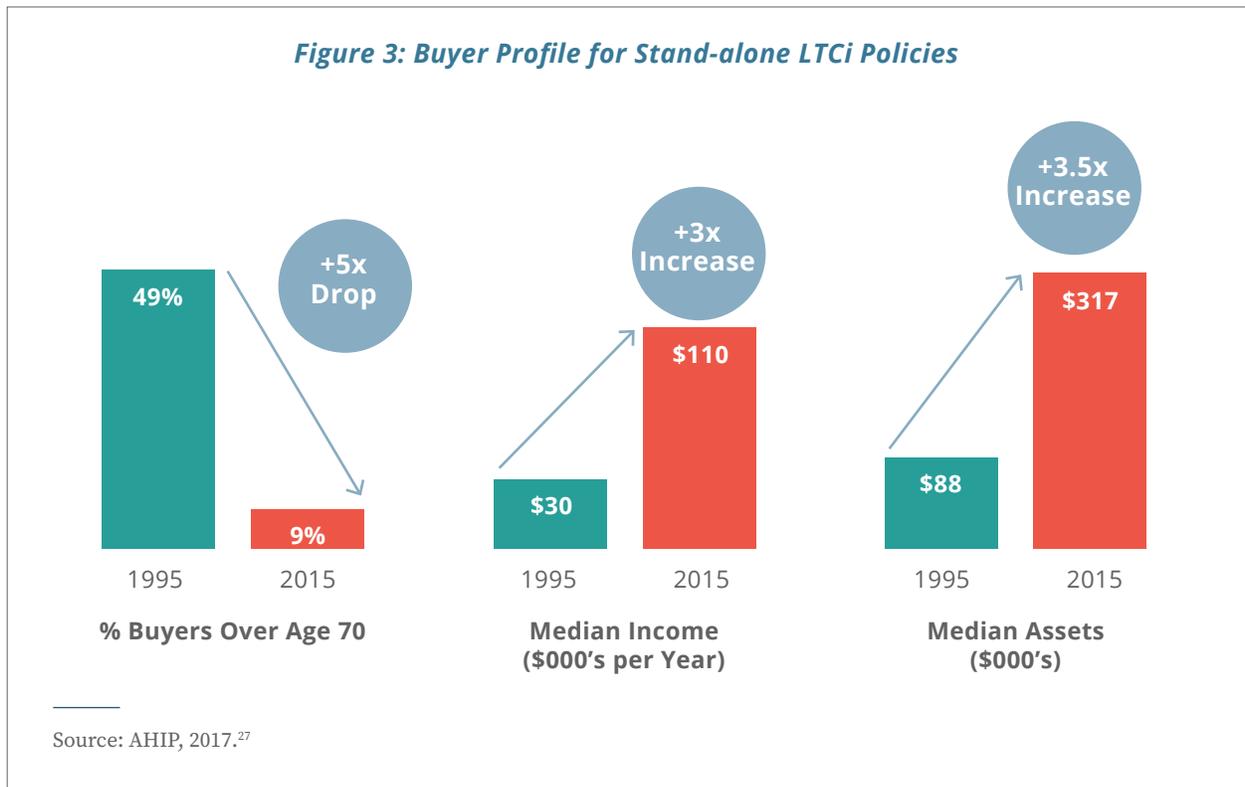
Indeed, data show that spend-down rates for nursing home users decrease significantly in the presence of LTCi. The projected Medicaid savings for the average policyholder in 2014 dollars is about \$10,000. This means that on average, Medicaid saves \$10,000 for every LTCi policy in place, given private insurance policyholders are less likely to spend down their assets and then require Medicaid to fund LTC.²⁶ This amount will be even higher for policyholders with costs at the high end of the distribution. For that and other reasons, states have been desperately searching for ways to reduce pressure on Medicaid budgets either through promotion of private or public insurance. The notion that there exists a risk that some sub-set of current privately insured individuals might need to access the social safety net should be a source of concern to states.

LTCi Policyholders and Benefits at Risk

The current LTCi environment threatens Medicaid spend-down protections for policyholders who experience rate increases. The top reason for industry challenges today – underpriced premiums relative to higher than expected benefit costs – attracted modest-income buyers in the 1990’s who in the absence of their policy would be more likely to spend down to Medicaid. They also purchased high coverage levels more likely to protect them and thus ease the burden on Medicaid. These buyers are now entering their 80’s – the age band at the highest risk for LTSS need.

- **Yesterday’s LTCi Buyers at Risk of Medicaid Spend-down Today.** The policyholders and claimants whose benefits are at greatest risk today are likely to have purchased LTCi when the buyer profile skewed more towards middle-income purchasers than it does today. In the last two to three decades, the typical profile of a stand-alone LTCi purchaser has skewed significantly to younger, wealthier buyers, suggesting premium pricing has made

LTCi inaccessible for the older, retired and more middle-income population (Figure 3). In the absence of LTCi coverage, they would be at much higher risk of Medicaid spend-down than today's purchasers.



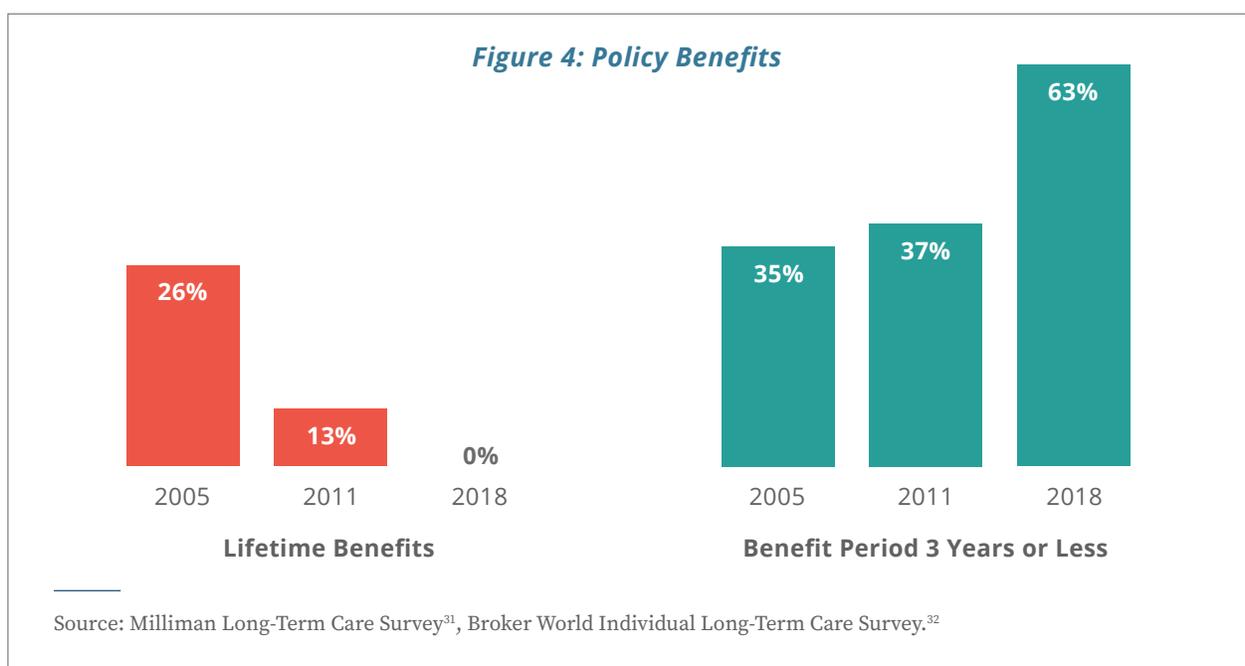
This coverage is vulnerable to erosion in two respects. First, when insurers increase premiums unexpectedly, policyholders may choose, rather than paying more for the same coverage, to reduce benefit levels or cancel their policy. Second, even those who maintain policies at the original benefit levels are at risk that the carrier with whom they have a policy may be at greater risk of insolvency, especially if the rate increase request was denied in full or partially denied.

Each state has a *guaranty fund* that is triggered when a carrier goes into insolvency, ideally to provide a backstop so that policyholders do not experience a disruption in coverage. However, contrary to their name, these funds cannot always guarantee that policyholders will recoup the full value of their policy under these scenarios. States set pre-determined limits for each policyholder, and for many states this amount is \$250,000 – \$300,000.²⁸ If the policyholder's cash value is higher than this amount, they essentially forfeit years of paid premiums at a time when it is too expensive (if even possible, given their age) to buy coverage to replace the value lost. This is particularly true for policyholders with lifetime coverage, who are likely to reach the pre-determined limits of the guaranty fund and hence be at a higher risk for running out of financial resources. Individuals facing rate increases or holding a policy from a company facing insolvency – particularly those who end up needing “catastrophic” levels of LTSS – are also at risk of having to rely on Medicaid to fund long-term care.

- Medicaid Liabilities are Diminished When Older, More Generous LTCi In-force Policies are Protected.** Long-term care insurance policies vary in the amount of coverage they provide. Buyers have the choice in the amount of daily benefit coverage they select (and whether this amount will increase over time) and in the length of coverage – these two factors translate into a total policy value (e.g., \$150 a day for three years is \$Y value).

Carriers in the past offered lifetime benefits, a win for policyholders who could potentially – especially in the event of catastrophic costs – have total claims in excess of \$1 million.²⁹ However, as Figure 4 demonstrates, new lifetime coverage has evaporated since 2005 as these policies are the hardest for carriers to price and the most likely to result in significant uncapped claims liability. Between 1990 and 2000, when carriers were most likely to sell lifetime policies, the average value in policies – as measured by changes in average value of policy benefits – increased more quickly than the average premium during the period, an unsustainable trend for the carriers.³⁰ Capped benefits is not the only difference in policies being sold today versus those available to consumers in the 1990’s. Historical sales trends are also increasingly showing tighter durations of coverage. While these trends are the result of shifting variables such as consumer preference, insurer pricing, and more restrictions on carrier offerings, the outcome is the same in that more consumers than ever are holding policies that have limited time periods during which benefits can be claimed. Nearly two-thirds of policies sold in 2018 provided three years or less of LTCi coverage, essentially a reversal from 2005 when two-thirds of policies sold had more than three years of coverage (Figure 4).

As long as these “generous” older policies are in force and protected, policyholders are less likely to “run out of private long-term care benefits” and spend-down to Medicaid.



Consequences

Medicaid programs face risks ahead if private policies in force today, particularly those high value (i.e., lifetime benefits) policies sold in the 1990's to middle-income buyers, are reduced or cancelled through carrier insolvency. In such instances, there may be significant unfunded liabilities, which the state guaranty funds will have to manage. Industry giant Genworth alone has >1 million policies³³ – a lot of risk for one carrier to shoulder. While state guaranty funds serve an important backstop, in the current model, it is not clear that reserves are strong enough to withstand the requirements needed to support these policyholders, suggesting a potentially significant risk to Medicaid budgets.

The Penn Treaty insolvency demonstrates the massive amount of liabilities just one carrier can generate across many states. California's guaranty fund faces a liability of \$401 million, Florida \$360 million, Pennsylvania \$270 million, Virginia \$197 million and New Jersey \$145 million. The >\$1 billion impact from this one carrier alone is problematic and foretelling.³⁴

In the face of this, states should move proactively to protect their budgets and residents.

Paths Forward – Public and Private Options Offer Solutions

Activity in both public and private sectors has revealed concerted movement towards establishing a long-term care model that is accessible to consumers and sustainable for state Medicaid funds. On the public side, states have shown varying levels of progress with some introducing legislation and others in the process of developing their own long-term care offerings. For states that have not yet made changes, federal organizations such as NAIC provide an important road map that can serve as a guide.

Combination long-term care and life insurance products have continued to shore up the private market, providing consumers with more options around financing their long-term care, albeit at a price that may or may not be accessible to a broad population.³⁵ Though fewer stand-alone policies are being sold today, carrier assumptions related to interest and voluntary lapse rates have been more appropriately aligned with prices. This is especially evident compared to the now deemed underpriced policies sold in the 1970's and 1980's.³⁶

However, LTCi consumer and state regulator discomforts persist; even as rates have adjusted, the misaligned methodologies of the past (and subsequent rate increases) serve as an important reminder of the potentially precarious nature of the LTCi environment. With that in mind, in April 2019, the NAIC formed a LTCi-focused task force as part of its Executive Committee that is focused on improving protection and options for consumers, as well as standardizing the market for regulators.³⁷ The task force's key goals include developing a nationally consistent approach to reviewing rates (with a focus on eliminating cross-state subsidization), identifying options to provide consumer choice regarding modifications to LTCi policy benefits when rates increase, and delivering a comprehensive proposal by Fall 2020. The group is prioritizing a multi-state review, which has the advantage of standardizing methodology used to treat similarly positioned policyholders equitably. This is important as it is not uncommon today for a carrier to have policies for a single product with rates that vary as much as sevenfold to tenfold between states.³⁸ This focus and support from the NAIC is promising for consumers and regulators alike regarding today's sales of LTCi products.

State Policy Making Some Headway

State policy responses moving forward must be commensurate with the challenges outlined above. First, states must strengthen the structure of state guaranty funds in order to reduce risks to policyholders and state Medicaid programs. Second, states need to consider alternative ways to finance long-term care outside of the Medicaid program.

However, not all states have adopted the new provisions, and even with adoption, some states are implementing individual programs to serve as additional protection. For example, Washington has become the first state to pass its own version of public long-term care insurance.^{43,44} Other states, including Michigan and Illinois, are looking to create similar long-term care financing models, while California is considering a ballot initiative on a public long-term care financing program.⁴⁵ Minnesota has been exploring options for private LTSS financing vehicles.⁴⁶

Not all proposals have been successful; in Maine, a tax-funded Universal Home Care Ballot Initiative that was put forth to voters and intended to provide in-home assistance to all residents of Maine aged 65 and older and those with disabilities was rejected in November 2018.⁴⁷ Maine has since adopted the Model Act revisions.

As shown above, prior to COVID-19 there was significant movement forward on these state-based models. While that momentum has generally slowed as stakeholders re-focus their efforts, these problems will persist post the pandemic, as will the need and drive for solutions.

Conclusion and Next Steps

While continued public and private activity will hopefully offer more options to a wider range of consumers for financing their long-term care coverage, continued challenges in older policies and the absence of full adoption of the NAIC Model Act amendments leave consumers and Medicaid at risk. The extent of this risk requires additional analysis and work.

Acknowledgement

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