Long Term Care Insurance in the United States

Interview with Claude Thau

Based on Gustav Klimt, Tree of Life, Stoclet Frieze, Lebensbaum, 1905

By Jean Galiana

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THAU INCORPORATED

Interview with Insurance Expert Claude Thau
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Biography

Claude Thau is the president of Thau Incorporated, which provides consulting services to insurers, employers, regulators, and businesses that offer services to the long term care insurance industry. He also helps financial advisors decide how best to reduce the exposure to long term care risk for their individual and employer clients. He has been the lead author of the Milliman LTCI Survey each year since 2005 and was named one of the ten "Power People in LTCI" by Senior Advisor magazine. Before founding Thau Incorporated, Claude held various posts at Transamerica Occidental Life Insurance Company, culminating with Senior Vice President and Senior Officer, Long Term Care Insurance.

Interview

Jean Galiana (JG): What is the history of long term care insurance in the United States?

Claude Thau (CT): Long term care insurance in the USA began when an insurance distributor asked Fireman's Fund to provide a product. That business eventually became part of Genworth. Interest blossomed in the 1980s. As a mature industry, insurers saw long term care insurance as an opportunity to provide a new service and profit by doing so. Generally, life and health insurers are risk managers, not risk takers. With long term care insurance, they inadvertently took much more risk than they anticipated. For the past fifteen years, insurers have been reducing their long term care insurance risk.

JG: Please explain the risk taking issue further.

CT: People reduce their risk by buying insurance. Although the risk of an individual is volatile, life and health insurers have predictable results. For example, although the death of an individual could be unexpected, a predictable number of people will die each year, giving insurers reliable profit. Insurers generally have low price earnings multiples in the stock market. Because investors like reliable earnings, they accept a lower return on their investment.

Brave insurers basically flew blind into long term care insurance, as it had not existed before. They lacked the vast data that makes life insurance so predictable. Many insurers entered the long term care insurance business in the late 1980s, presuming it would be profitable. Unfortunately, they have incurred huge losses.

The actuaries did well predicting some aspects, but results unfolded dramatically differently than the industry expected.

Perhaps the easiest issue to understand is the impact of low interest rates, which has affected all insurance lines that develop meaningful reserves. Insurers place premium dollars into reserves and invest those reserves. Over time, due to the investment income growth, the investment income is a larger part of the reserves than the premiums. It's like a retirement account. By the time you retire, the account is mostly made up of interest.

No one could have possibly anticipated the investment income yield climate we have experienced in the last decade. For example, although I had a track record of being conservative relative to investment yield assumptions in pricing, I do not remember challenging my actuary about our investment assumptions. In the mid to late 1990s, we priced long term care insurance, assuming we would earn seven point seven percent net investment income forever. The industry is suffering because they are short by approximately three to four percent in investment income each year. That is particularly important because long term care insurance requires high reserves, because it is such a back ended risk. Even in the low interest rate environment of today, the reserves used to pay claims are composed mostly of interest rather than the premiums themselves.

The lapse impact is more unique to long term care insurance and is even larger than the interest rates.

JG: Please explain the reserves and the lapse problem.

CT: Insurers are legally required to set aside large amounts of money to pay future claims but, to keep prices down, it is important that the insured receive nothing back if they voluntarily terminate their long term care insurance policy. When people lapse policies, those large reserves are released, hence can be used to help pay claims of other insured customers. In good faith, insurers lowered prices, recognizing the value of expected lapses. Unfortunately, the actuaries expected buyers to voluntarily terminate ("lapse") their policies much more frequently than has occurred, which created a double problem. More people stayed insured, leading to more claims while fewer reserves were released to help pay those claims.

JG: How far off were the lapse assumptions?

In the mid to late 1990s, reinsurers (companies that insure insurance companies) and consultants recommended that insurers assume eight percent lapses each year after the first few years. According to a study of 2014 pricing by the Society of Actuaries, that assumption averaged seven tenths of a percent per year, reflecting what has actually occurred. That is a big difference! It means that four times as many policies are in effect twenty years later, resulting in a substantially higher number of claims than expected. A one percent difference in lapse rate hurts profits as much as a one percent reduction in investment income. Even if insurers forego profit and simply try to break even, a large increase in premium dollars is required to offset the low lapse rates.

JG: Are policies expensive today because people are not letting their policies lapse?

CT: Yes, the lower lapse rates and the lower investment yields have pushed prices higher. Nonetheless, the 'use it or lose it' nature of long term care insurance helps make it a good way to reduce risk. The "use it or lose it" design allows insurers to take all of the money that they set aside for people who never need care and some of the money they set aside for people who need only a little care, and allocate it to the people who need a lot of care. Furthermore, they insure hundreds of thousands of individuals.

JG: Is it beneficial for people to purchase a long term care insurance policy at the higher rates?

CT: The law of large numbers, coupled with "use it or lose it," allows insurers to set aside much less money for you than you would have to be prepared to set aside if you self insure. If you self insure, you have to be prepared for a lengthy need. Insurers can hold less money because they know some people will never need care and those reserves will be redirected to people who do need long term care.

JG: How did insurers respond when they realized the long term care insurance was losing money?

CT: Two major insurers dropped out of the business saying they would reenter the market when it rationalizes. They both have reentered the market. I give them a lot of credit for that.

Those who remained in the market raised the prices each time they priced a new product. They have reached the point today where they feel that the rates are priced appropriately. As I noted earlier, investment assumptions are much lower now. Instead of being a drain on insurers, I believe they will have favorable deviations in investment income in the future. Because the renewal lapse assumptions are down to seven tenths of a percent, there is little downside risk in that regard now.

Unfortunately, a lot of insurers dropped out of the market. They innocently had thought that the business model was sound. Some property and casualty lines of business have good years and bad years, but, as I mentioned earlier, life and health insurers do not experience volatility. If you are managing a life or health product line and lose money, your career is in jeopardy. It would have been a big risk for a manager to suggest to top level executives that the problem could be solved immediately. A second failure would blemish their record. A common reaction was to be prudent by discontinuing long term care insurance sales. Companies entered the business when no data existed and expected to earn money. Ironically, they left the business when it was becoming more predictable. That does not seem logical, but it is human nature.

JG: Why are other insurers, that had not been involved in long term care insurance, not entering the market now that it is predictable?

CT: One positive sign is that a new insurer did enter the market in summer 2016. Perhaps others will enter the market when existing insurers demonstrate long term profitability. However, another deterrent is that, as a result of higher prices, the market is smaller than in the past. Rather than entering the stand alone long term care insurance market, insurers are trying to find other ways to protect people against their long term care insurance risk.

JG: Do people think the insurers are taking advantage of them with the higher prices?

CT: Yes, unfortunately people do think the insurers are taking advantage of them. It may be helpful to consider Genworth as an example, as they have the most existing long term care insurance business. Genworth has set aside hundreds of millions of additional dollars in order to secure their ability to pay future claims. That money belonged to the shareholders before being reallocated to protect insureds. At the beginning of 2007, Genworth stock was worth thirty four dollars per share. At the beginning of 2014, it was worth fifteen and a half dollars per share. On January 1, 2017, it is worth less than four dollars per share. The share price has fallen so much because even with price increases, it does not generate the desired profit for Genworth. Although the price increases are undesirable, people who can afford to continue to pay the premiums are definitely getting a better deal than any insurer would knowingly have offered them.

JG: Have regulators reacted as well?

CT: Yes. For example, the attestations that the actuaries have to make when they file long term care insurance products are different today. Rules relative to price increases are also different.

JG: You have indicated that the pricing is much sounder now than in the past. Because investment yield assumptions and lapse assumptions are low, there is dramatically less risk of a rate increase. Does the market understand that?

CT: Unfortunately not. Outside their area of expertise, people tend to look in the rear view mirror rather than through the windshield. For example, when I began in long term care insurance, I was worried about the risk of future price increases. To avoid making it sound as though I am trying to brag, I want to be clear that it ended up being a lot worse than what I feared. When I spoke with financial advisors and consumers at that time, almost no one put weight on my concerns. They thought I was a nerdy actuary, which may have been true, and that I was just turning over stones until I found a problem. They observed that there had never been any price increases on long term care insurance to that point, hence they assumed there would not be any in the future.

Now people make the reverse error. Financial advisors say, "I am not going to talk to my clients about long term care insurance because if they buy it, they'll experience high price increases." But interest rates will probably rise eventually, giving insurers additional margins, rather than creating large shortfalls. People do not understand that the lapse risk has been removed. People are disadvantaged when they and or their financial advisors focus their attention solely on the rearview mirror. It is important to look at the past but then recognize the likely differences in future conditions.

JG: Do actuaries have a big responsibility?

CT: Yes, they do. Generally, they have done their jobs superbly. Insurers take much longer risks than banks or credit unions, yet have been more stable. Thanks to actuaries and state regulators, we have had very little problem in terms of insurer insolvency.

When I returned to actuarial work, the Society of Actuaries' motto was "Turning impressions into facts." I thought actuaries did the exact reverse. They look at past facts to project their best impressions of the future. In terms of the recent problems, I do not blame actuaries for having failed to predict the low interest environment. I pushed for lower lapse assumptions, but I would not have expected the lapse rates to be anywhere near as low as they have been. Some early data suggested high lapse rates, but that data was unreliable.

JG: Are people increasingly purchasing long term care insurance from the insurers who offer it?

CT: The short story is that it has always been a difficult market and the higher prices today discourage potential buyers, making it more difficult to serve the middle class. The increased stability has not grown the market because people assumed prices would be stable in the past. Ironically, the fear of unstable prices hurts the stable market today but did not hurt the market when prices actually were unstable.

In addition, people do not want to plan for an event that may or may not happen. They do not want to think about or prepare for what will likely not happen for decades. Many would like to believe that the government will take care of them, one way or another, if necessary. Consider how difficult it is for people to save for retirement, which is more certain, predictable and pleasant than long term care.

JG: Are you are suggesting people are not buying the policies because of denial?

CT: They are not willing to pay the price. Some people think it is not going to happen to them, perhaps because they think cures will be developed for Alzheimer's and other chronic illnesses. Others may think the government or family members will take care of them. Some people might be in denial. I think that even though people know that they will most likely have long term care needs in the future, they have more immediate concerns. This is likely why they choose to worry about funding long term care later.

Many people bemoan the fact that citizens are not as self reliant as they used to be. I applaud greater self reliance but I suspect that many of our earlier self reliant people would not have routinely purchased long term care insurance, even if they had anticipated the longevity that exists today.

It is important to understand that, while purchases of traditional stand alone long term care insurance policies have reduced, purchases of other insurance products that can address long term care needs are increasing.

JG: What percentage of Americans has stand alone long term care insurance?

CT: There is not good data on that. Some people estimate that seven percent have long term care insurance. It might be higher because those estimates deal only with the standalone products. There are also many combination products.

In general, statistical data can be hard to find or misleading. For example, what do you think is the average length of the time that people need long term care?

JG: Two and a half years?

CT: That number originated from a 1985 nursing home study. The question they asked nursing homes at that time was, "How long have your people been living in the nursing home?"

JG: They did not ask the average length of stay?

CT: Correct. On average people had been at a nursing home two point four years. They were not dead. What if your dad was in a nursing home for two years and then something changed and he went into another nursing home for two years? How long was he in a nursing home? Each nursing home reports individually.

JG: In that instance, was the same person reported twice for staying for two years?

CT: Yes. They counted two people with two years each. As I mentioned, much of what is published is unreliable. Boston College published a widely read paper in November 2014 claiming that everyone had been wrong about long term care estimates. They claimed that there are many more incidents of long term care than we think, but they are very short needs, proving there is little reason for long term care insurance. One aspect of the study is that the lead author told me they did not consider homecare or assisted living facilities because they were unable to obtain such data. They only measured nursing home stays. I asked, "Do you not think you are understating the length of care substantially if you are only looking at one piece of the pie?" He thought it was not a problem. Subsequently, a more junior person on the project told me that he felt they had made an adjustment for the lack of home care data, but the paper makes no mention of that and when I asked for more information about an adjustment, I received no answer. Clearly many people use home care or adult day care services, then migrate to a facility and back. One must consider the full spectrum of care when measuring the length of long term care time.

JG: Could nursing home stays also be rehabilitation?

CT: You just identified another big problem with their study. Their data contained a lot of rehabilitation data. Boston College said they would update the study to correct that but predicted that it would not make any difference. That correction has not been published. How could it not make any difference to have data polluted with rehabilitation data and to not reflect home care and assisted living care. People read it and believed the report.

JG: How do you address the question of the average length of care?

CT: I tell people that I do not know, but that "average" is not very meaningful. Very few people will ever be average. If everyone knew they would be average, there would be no insurance industry of any type. The purpose of insurance is to protect you against having a worse result than being average.

Cost of care may be more relevant than length of care. A person may need a little bit of care for a long time or may get by with family care, not spending any money. I recently hired consultants to create software that projects the likelihood that an individual will experience future long tem care in various cost ranges. While it has some limitations, I think it is meaningful and is customized to several personal characteristics. The software program is interactive, so you can change your assumptions.

Additionally, length of care considerations for long term care insurance are different than for long term care in general.

JG: How are length of care considerations different for long term care insurance?

CT: Past statistics indicate that sixty nine percent of sixty five year olds will need long term care. But one quarter of those people, about seventeen percent,will need it for less than a year. Of the seventeen percent who need long term care less than a year, approximately eight percent will need long term care less than ninety days. Long term care insurance usually has a ninety day elimination period, so if you go into a nursing home and die in three weeks, you do not receive any long term care insurance benefit.

JG: You have to be in the facility for ninety days before insurers start to reimburse?

CT: People chose to have a deductible to have a lower premium. Policy terms vary, but more than ninety five percent of policies sold in 2015 had an elimination period (i.e., deductible) of eighty four or more days. About a quarter of the policies had a zero day deductible for homecare and a ninety day deductible for facility care. If your policy does not pay for the first ninety days, the sixty nine percent reduces to about sixty percent.

Furthermore, those who need care for four or five months and then die, are reimbursed for one or two months. That is not a good return for paying the premiums for many years.

Once people stay in skilled nursing or assisted living for seven months or so, they are likely to be there a very long time. According to past data, which may or may not apply in the future, if you are sixty five years old, you have slightly more than a fifty percent chance of needing care for a year or more. On average, people who need care for a year or more need care for close to four and a half years. Long term care insurance is of value to those who need care for a year or more. If you consider a couple age sixty five, there is more than seventy five percent chance, according to past data, that one of them will need care for at least a year and that care will average four and a half years.

JG: What do you advise people about purchasing long term care insurance?

CT: If you are younger than forty and ask about long term care insurance, I ask if you have disability insurance. I explain that the present value of lost income is greater than the present value of your long term care expenses at those young ages. Disability could cost your family thirty or forty years of income. Sadly, disability is a very under insured risk.

It might sound heartless but if a husband or wife of a young family with two children dies, the impact on the family is probably not as severe as if one of them becomes permanently disabled. Consider the emotional and lifestyle impact as well as the financial impact. Family caregivers endure many challenges. They have much worse health than non caregivers because of the physical and mental stress of caregiving. They lack time to take care of themselves, to sleep and to exercise. They eat more fast food and junk food, drink more and smoke more. They go to the doctor more, but not for themselves; instead they take their family members to the doctor. Caregivers need more long term care eventually than non caregivers, even though they also die younger. Caregivers die younger yet need more long term care. Normally people who die younger need less long term care.

JG: When is the best time to buy long term care insurance?

CT: The best time to buy long term care insurance is today if you are confident that you can afford to maintain the premium payments. If you are not sure, maybe you should buy a lower monthly maximum benefit, or none at all. The last thing you want to do is pay for long term care insurance for years, then lose the coverage before needing it. If you know that you eventually want to have long term care insurance and you can afford to buy it now you should buy it now.

JG: Why?

CT: One major reason is that it is like opening up a bank account for your grandchild when they are born. These policies should be sold with benefits that compound over time. Getting that compounding started now can lead to hundreds of thousands of additional dollars being available to pay for care when you need it.

If you wait to buy the exact same policy at an older age, assuming nothing else changes other than your age, it will cost you more money each year than if you buy now. Why would you want to spend more money each year for hundreds of thousands of dollars of less protection?

Of course, there is also a risk that your health could change, making long term care insurance more expensive or making it unavailable. Worse, you could have a long term care need that is not covered because you did not buy the insurance.

There can be other reasons, such as tax reasons, to buy now.

JG: Please describe the care coordination piece of long term care insurance.

CT: Most insurance companies will cover some costs of care coordinators, such as geriatric care managers. These coordinators can help interpret the needs of the person, encourage care, and coordinate the recommendations. We paid for those services in my family twice for relatives who were uninsured. I have trouble describing them without tearing up. Care coordinators provide powerful and meaningful support. Some people think I could have provided those services to my family myself, but I could not have done so because I did not have the care coordinators' detailed knowledge of local care providers.

JG: What are your thoughts about employers providing long term care insurance?

CT: Many people encourage employers to buy a small amount of long term care insurance for all of their employees. Under some circumstances, such a program makes sense, but one must consider whether employees are likely to continue coverage when they leave the company. If not, the investment is lost. The younger and less affluent employees are less likely to continue to pay for coverage, which their employer had provided at no cost.

On the other hand, employer paid long term care insurance makes lots of sense for employees who earn enough to be likely to continue the policy after they leave. A key attraction is that there are tax breaks if the employer pays for long term care insurance. These tax breaks apply to coverage purchased for the employee and their spouse or partner.

The work site can be a great place to provide coverage for middle class employees or their relatives who are interested in buying long term care insurance. The state Partnerships for long term care bring extra value to middle class purchasers.

JG: Is there an inequity in access to long term care because lower income people cannot afford the insurance premiums?

CT: Most care is provided by family members. Such family care may be a bigger burden for less affluent families.

Medicare covers only a small amount of long term care. But generally speaking, Medicaid is a great system for helping less affluent people receive commercial long term care services. A person who relies on Medicaid is much less likely to be able to receive commercial home care services and has fewer choices of facilities. It is difficult for a facility to provide outstanding care if it is heavily reimbursed by public funds because, at best, Medicaid reimburses a facility for their marginal expenses without overhead.

Long term care insurance can make sense for middle class families, but the industry tends to offer them policies which they find too expensive. It is a good idea to buy a small policy to cover the cost of home care, relying upon Medicaid to provide facility care. A two thousand per month policy would currently provide about ninety hours of home care per month, which is about three hours per day. Such home care could make a big difference. If a forty five year old in excellent health bought such a policy with three percent compounding, then needed care at age eighty, the person could receive two hundred and ninety five thousand and two hundred dollars in benefits over a fifty month period. Long term care insurance can save that amount a second time because the state partnership programs let them avoid having to spend down that much in assets before subsequently qualifying for Medicaid. Such a policy, purchased through work, would cost fifty five dollars per month if the spouse also purchases coverage.

JG: Do facilities that are paid largely by Medicaid offer less quality of care?

CT: The government tries to keep that from happening, but Medicaid funded facilities have trouble retaining staff, which increases costs and can have a deleterious effect on quality of care.

On the other hand, some facilities, particularly ones run by religious orders, provide excellent care.

JG: Does the fact that care costs continue to rise and older people continue to live longer with multiple chronic conditions affect long term care insurance pricing?

CT: If, for those reasons, you feel a need to buy a policy with a higher maximum monthly benefit or a longer benefit period, it will cost more. Those issues have been as major as lapse rates and interest rates because policies are sold with a fixed maximum benefit. The insurer will not pay more than the maximum monthly benefit at the time care is provided. It is important to design the policy so that the maximum amount increases each year to try to maintain purchasing power.

JG: Would the individual be responsible for the rest of the costs over the maximum monthly benefit?

CT: Yes.

JG: Have you studied long term care insurance in other countries?

CT: I have some familiarity, but I would not say I have studied it. Basically all countries are trying to understand what to do. Some have created public programs but they are running into problems because their public programs are not funded well enough. Public insurance programs, almost without exception, end up being underfunded and then increasingly means tested over time.

JG: Who do you think will pay for all the older individuals who will need long term care in the future?

CT: Families will probably continue to bear most of the burden, directly or indirectly. The cost of commercial care is probably going to rise faster than the Consumer Price Index. I expect government programs to pay for a lot of the care but they will become increasingly means tested in a variety of ways. Means testing has been added to Social Security and Medicare, and will increasingly apply to those programs. Regardless of whether you live in a Republican or Democratic led state, most people will agree "If we can not make good on our promises to our citizens, we must at least help those who lack the resources to purchase the care they need."

JG: What are your thoughts about universal long term care insurance?

CT: I have mixed feelings about it. I am not a big government person. The Affordable Care Act had a long term care insurance program called the CLASS Act. Many of us kept telling the Administration that it would not work, but the Administration insisted it would work until the act passed. Later, they admitted that it would not work and terminated the program. It was attractive to keep the long term care insurance program in the Affordable Care bill, because when projecting costs, the Community Based Organization is required to only look at the next ten years. Long term care insurance claims occur more than ten years into the future, and CLASS did not establish any reserves. The long term care insurance premiums were presumed to offset other Affordable Care Act costs. Such accounting would be considered to be criminal if done in the private sector. Once the bill was passed, it was easier for the Administration to cancel the program.

JG: If people do not buy their own insurance, the government will be forced to incur the costs?

CT: Not for people who have sufficient income or assets to pay for long term care. Even when the government pays the bill, it puts a lien on your home. The government will have to pay for those with insufficient assets and income.

JG: Please describe the various long term care products on the market today.

CT: There are a number of different dimensions. All long term care insurance policies, except for single premium policies, have the ability to share negative deviations from expectations by raising premiums with the approval of the State Insurance Department. Only a few insurers would share positive deviations from expectations. Insurers that share positive deviations price more conservatively, creating higher initial premiums, which reduce their risk and justify lower profit margins. With the more conservative pricing assumptions and the current low investment yield climate, we have today, the possibility of negative deviations is much lower and the possibility of positive deviations is higher.

There are also products that insure for more than long term care. These products have been growing rapidly, while sales of standalone long term care insurance policies have been decreasing. These policies consist of life insurance and annuities, which allow their benefits to be accessed to cover long term care costs. In some cases, if you use up the death or annuity benefit, the insurer will continue to pay for your long term care costs (called an "extension of benefits" or "continuation of benefits"). Buyers like the fact that these products are not "use it or lose it". The extension of benefits approach lets you self insure your more likely costs using the death benefit then to have a catastrophic type of stop loss coverage kick in. These policies are called "combo" or "hybrid" or "linked" products.

JG: Are there only a few long term care insurers left in the market today?

CT: More and more companies sell linked products, while fewer sell stand alone long term care insurance. Financial advisors ask me if I can guarantee that stand alone long term care insurance will be available in the future. I respond "No, but if stand alone long term care insurance is not available in the future, your clients will be glad to have their policies. A lack of long term care insurance providers would mean that the insurers were unable to sell the product profitably. If that is the case, your clients would have received a good deal."

In the future, people may use a variety of product options, so sales of all of these product types are likely to increase. The government cannot afford to pay for long term care, but Medicaid will have to cover the indigent, while other people will be left to fund their own care. I think the cost of home care will increase noticeably faster than the cost of inflation. The cost of facility care will probably increase somewhere in between the two, because it is more closely tied to the cost of real estate.

JG: Thank you for this interesting discussion.

CT: Thank you, Jean.