Developing the UK long-term care insurance market

US lessons learned

Vincent L. Bodnar and Stuart Butler

TOWERS WATSON

Overview

1. **The UK LTC insurance market**
2. **US lessons learned**

The UK LTC insurance market

Demographics point to a clear need for LTC insurance

Growing market: 31% growth in people of pension age by 2037

Proportion of people over 75 will grow from 8% to 13%

Increased demand of services
+
decreased supply of service labour
=
increased consumer demand for protection products

Aging trend

Many Baby Boomers have experienced LTC through parents and grandparents
=
increased awareness of need for protection

Pressure on public financing (public LTC spending forecast to be over 10% GDP by 2030)
= **increased support for private solutions**

Government encouragement for financial products

- Government encouragement

> ***"Some people may choose to plan their finances by using financial products. The current options for people to protect themselves are limited to immediate needs annuities….. The Government expects the financial services industry to work creatively to amend existing products and develop new products that support people in making choices about how to plan their care costs."***
>
> — Department of Health policy statement

- Openness to new design concepts

2014 budget proposal (new permissions for pensions)

Pension funds previously required to annuitize freed up

New source of premium funding for a LTC proposition

Need/desire to protect assets from costs of LTC

LTC can be part of a proposition suite at retirement

- Insurers are re-tooling offerings to capture new opportunities at retirement
- LTC can be a differentiator for first-to-market carriers

2014 Care Act reforms – the need for private provision

Clarification of government role

- **Funding beyond a £72,000 "cap"**

Leaves significant gaps that can be filled by a private insurance plan

- **Out-of-pocket expenses will greatly exceed £72,000 cap**

	Weekly cost	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Excess above Local Authority rate	£200	Self-funded for life									
Local authority rate for care costs (excl. living costs)	£300	Personal costs to meet before the cap					State funding support				
Living costs	£230	Self-funded for life									
Total	£730										

Challenges for a UK LTC market

Consumer awareness and attitudes

- Lack of awareness of coverage gaps (Dilnot cap confusion)
- Tendency to ignore / defer consideration of the risk
- Fear of investing in a product that might not be used

Distribution challenges

- Difficult to “push” new products through a predominantly independent distribution system
- No critical mass of LTC specialists

Stigma of prior attempts

- Almost no penetration with earlier pre-funded products

US LTC market successfully responded to similar challenges

US lessons learned

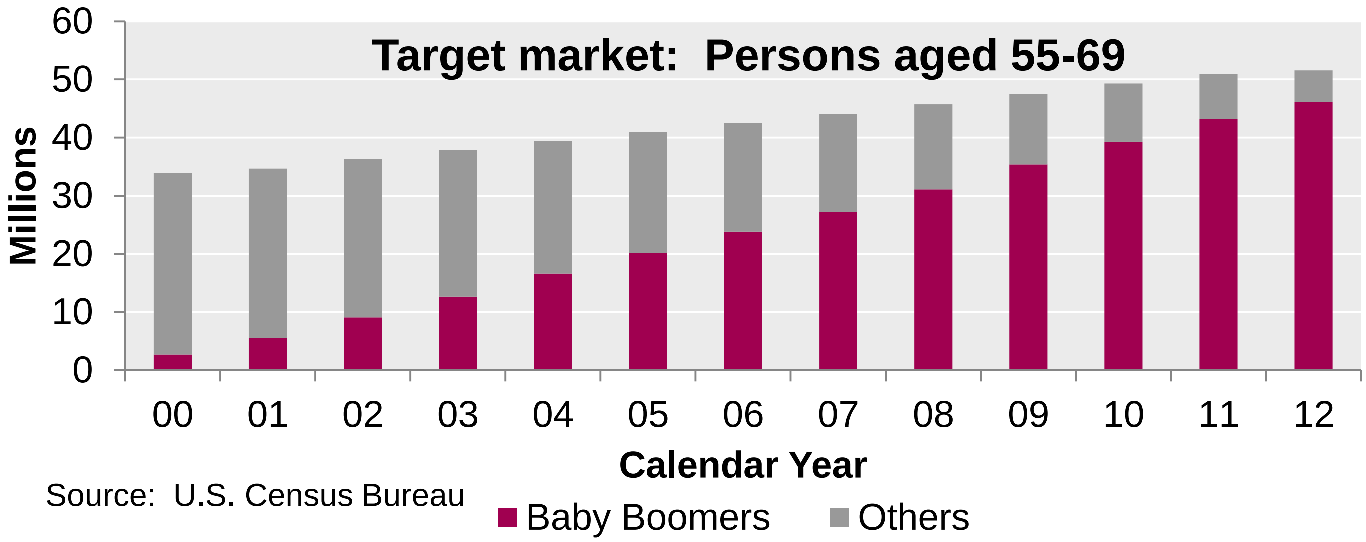
TOWERS WATSON

Overcoming consumer attitudes

- Early success in the US LTC market faced challenges in the mid 2000s:
  - New regulatory requirements for conservative pricing
  - Carrier exits resulting from emerging experience
  - Shrinking distribution focused on LTC
  - Transformation of target market as Baby Boomers aged into it
- Older, “stand-alone” LTC sales dropped and remain stagnant
- The US market responded with new plan designs that successfully address challenges

A changing target market

US target market grew and transformed over the past 15 years:



- Baby Boomers have different values and buying patterns than parents:
  - Less risk averse, less interest in wealth transfer, less patience with sales
  - Want a product they can “cash out” from

The industry responded:
shift from stand-alone to “combo” products

Life insurance combo products

- Often a rider that can be attached to any type of permanent life product
- Insured can accelerate all or a portion of face amount for LTC benefits
- Must meet eligibility requirements
  - Unable to perform 2 ADLs or cognitive impairment that requires supervision
- A small percentage (2%-4%) of face available per month until face exhausted
- Extension of benefits option: more than face is available for LTC
  - Two or three times face are most common options
- Feature is financed via an additional premium or account charge

Annuity combos

Deferred annuity combos:

- Account value (e.g., $50k) available for LTC benefits
  - Reduced or no surrender charge
- Additional LTC benefit (e.g., $100k) available after account value is exhausted
- Payment structure / eligibility requirements similar to life acceleration
- Financed through additional premium or account charge

Immediate annuity combos:

- Base monthly annuity benefit (e.g., $2,000) starts immediately for life
- Increases to a higher benefit (e.g., $4,000) while LTC eligibility is met
- Financed through additional single premium charged at issue

LTC combo product appeal

Customers:

- Easy to understand: Access to a pot of money (death benefit)
- Cost effective: Add-on premiums are generally less than stand-alone
- Equity exists in base product's account value

Carriers

- Easy to distribute
  - "Add-on" to the base policy sale; can be sold by broad distribution
- Decreased regulatory, reserve and capital requirements
- Mitigated risks
  - Exposure limited to life policy net amount at risk
  - Insured's equity in base coverage acts like a "co-pay"
  - Low mortality offsets life insurance risk

Growth of LTC combo products

Combo products comprised **13%** of new life insurance premium issued in **2011**

(up from 6% in 2010)

72,000 policies

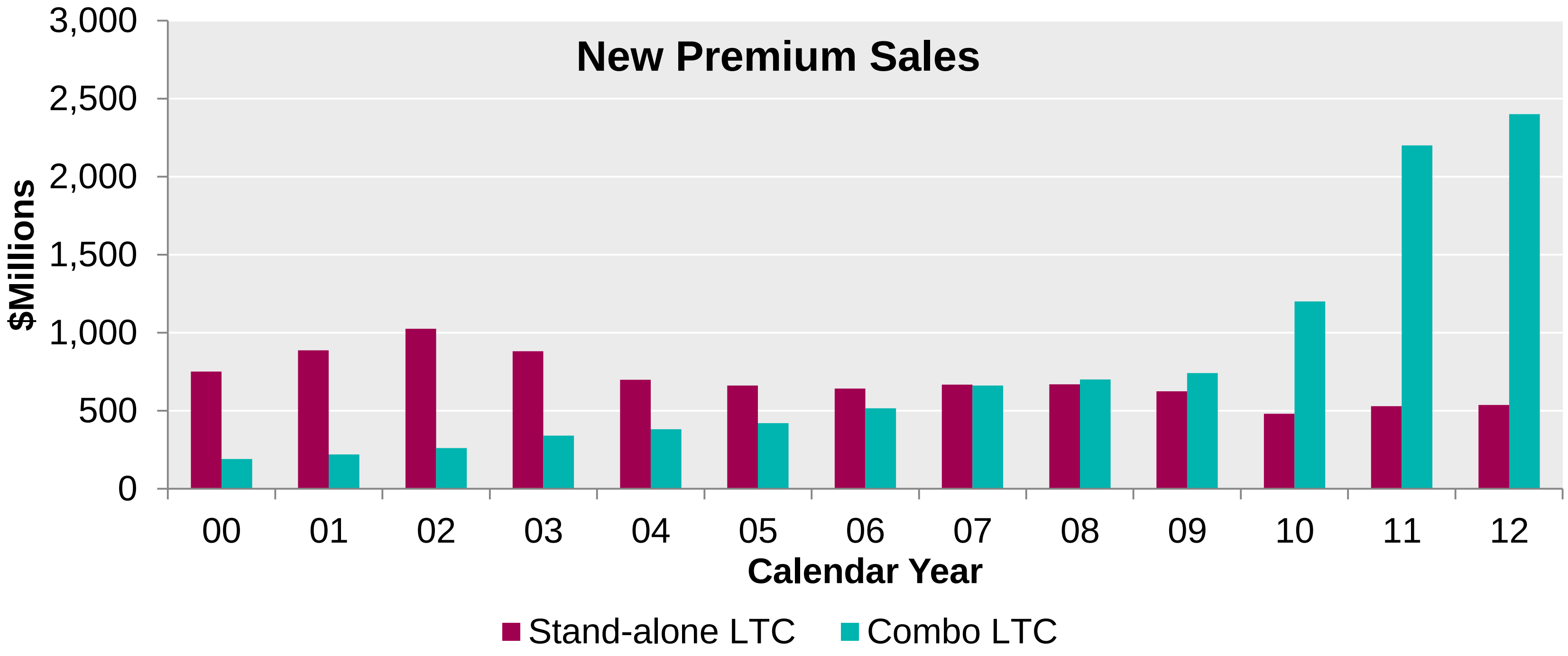
and **$2.2 bn** issued in **2011**

Compared to **231,000** policies and **$537m** in the stand-alone LTC market

Carriers are entering the combo LTC market as opposed to continued exits in the stand-alone LTC market

LTC combo vs. traditional growth

- Premiums for combo products have overtaken stand-alone LTC
  - Important to note that a significant portion of combo premiums in 2010-2012 are single premiums
- Dominant combo product carrier uses specialist distribution to push as an LTC solution



Sources: 2001-20012 *Broker World Surveys* and *LIMRA's Individual Life Combo Products Annual Reviews*

Room for additional innovation

US regulatory restrictions have stifled product creativity and have disallowed certain appealing and risk-mitigating designs:

- "Universal" LTC
- Term LTC
- Increasing premium products
- Coverage restrictions by level of care

UK regulators are encouraging innovation, opening the door for such proposition designs

Stand-alone LTC distribution lessons

US challenges are similar to UK

Extreme example of a product that is "sold not bought"

- Lack of awareness of risk and gaps in coverage
- Early versions were unfamiliar, complex and expensive
- Broad distribution channels did not push
  - Lack of understanding of product; discomfort selling
  - Already successful selling other products

Stand-alone LTC distribution lessons

1

The US answered this challenge with specialty distribution

- Agents that are trained to sell LTC almost exclusively

2

Small distribution pockets produced a majority of sales

- Initial specialists were captive (employed by insurers)
- Independent specialists later emerged and dwarfed captives

3

Agents were trained to:

- Patiently sit with customer leads – often several hours
- Educate customers about risk, gaps in coverage and a complex product
- Have rational responses to premium amounts

4

Specialists often worked with broader distribution to chase leads they encountered (split commissions or referral fees)

Trained distribution became a key to sales successes

177 companies entered the **US LTC market**
(source: NAIC LTC Experience Exhibits)

74 sold less than **1,000** policies.
Only **56** sold more than **10,000**

Most carriers **did not train or access trained distribution**

Early market exit

Carriers that used **trained distribution, particularly specialists**, saw **large sales volumes**

These succeeded in the market

Distribution lessons

1 **Many specialist LTC independent marketing organizations (IMOs) emerged in the US**

2 **Specialist IMOs take on the risk of recruiting and training agents**

- They often create their own collateral that supplements carrier materials
- Financed by overrides on business sold by the agents they train

3 **It is possible to leverage this experience for deployment in the UK**

4 **May fit nicely with current thoughts of bringing distribution in-house in response to RDR**

- Particularly in conjunction with training agents to sell a suite of point-of-retirement propositions

Actuarial lessons …1

1

Many carriers exited the market as they realized unfavorable results:

- Low interest rates, very low mortality rates
- Emerging levels of care, particularly assisted living facilities (“ALFs”)
  - Very long stays that suggest improved health, increasing portion of facility claims
  - Continue to evolve to attract Baby Boomers

2

Flaws in early pricing efforts

- Improper modelling of inflation benefits, “wear-off” of marital effect; active and disabled lives

3

Experience monitoring lacked robustness

- Leading indicators not tracked

4

Forecasting models not properly validated against emerging experience

Actuarial lessons …2

US actuarial knowledge can be applied to the UK in several ways:

1. **Actuarial models and pricing techniques**
2. **Credible experience data**
3. **Experience monitoring best practices**
4. **Asset / liability matching**
5. **Development of stress testing scenarios**

Other US lessons learned

Best practices have evolved in several administrative areas

1. **Standardized benefit triggers and policy language**
2. **Technology platforms designed for LTC product features**
3. **Specialized third party administrators**
4. **Claim adjudication**
5. **Underwriting protocols**

Conclusions: Timing is right to re-think LTC

Recent budget proposals have created opportunities:

- Clarified government's role: it will be very limited
- Made room for and encourage private coverage of gaps
- Freed up monies for premiums at the point of retirement
  - LTC can be part of a comprehensive product suite

Key US lessons can be applied in the UK

- Combo products addressed similar challenges in the US
- Specialist distribution model may fit well with a point-of-retirement suite
- Plan design, pricing and administrative experience can be leveraged

Any Questions

TOWERS WATSON