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Before the Senate Finance Committee
"An Overview of the Long Term Care Insurance Market: Opportunities and Challenges"
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Private long-term care insurance provides one of the few available mechanisms for the elderly to protect themselves against the catastrophic costs of long-term care. Although long-term care insurance currently pays for only a small portion of the total cost of long-term care, it could become more important in the future. Federal and state governments have an interest in this market to help potentially reduce their own expenditures for long-term care and to ensure that consumers receive adequate protection from products they purchase.

In my testimony, I provide an examination of the current long-term care insurance market. I describe the evolution of the market, provide an in-depth look at current products and choices, discuss underwriting and premiums, examine long-term care insurance regulations, outline consumers' ability to make informed decisions; and assess the adequacy of protection for purchasers against the costs of long-term care and the ability of products to meet consumer needs. I conclude by offering conditions that must be met in order to expand the role of long term care insurance and potential directions that the federal government might pursue.[1]

I. BACKGROUND

Long-term care insurance incorporates aspects of health, disability, and life insurance into a unique, relatively new form of insurance. Like health insurance, it offers coverage for health-related needs typically on a fee-for-service basis. Like disability insurance, policies cover a wide array of services that are necessitated by a long-term disabling functional or cognitive impairment; in addition, some policies provide monthly cash payments. Long-term care insurance, like life insurance, depends on prefunding a benefit typically needed many years in the future. The hybrid nature of the product has implications for regulation, purchasing decisions by consumers, the likelihood consumers will have coverage for services they desire, and pricing of the product.

Insurers began offering long-term care insurance widely in the mid-1980s. By 1998, 5.8 million policies had been sold. Current policyholders are dominated by purchasers of individual policies. However, recent growth in new sales has increasingly come from employer-sponsored products. The federal long term care insurance offering is expected to double the number of employer-sponsored policyholders by the middle of the decade.

Current long-term care insurance policies typically include nursing home, assisted living facility and home and community-based care coverage. The purchaser generally can select a daily

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[1] This testimony borrows heavily from the executive summary of a report I co-authored, "Key Issues for Long-Term Care Insurance: Ensuring Quality Products, increasing Access to Coverage, and Enabling Consumer Choice," prepared for the Office of Research and Demonstrations, Health Care Financing Administration, February 1996. More recent information has been incorporated as appropriate.

amount of coverage up to which the policy will pay benefits if the policyholder receives services from a certified provider and meets the insurer's disability eligibility criteria. Purchasers also have the option of automatically increasing the level of coverage over time or buying increased coverage at specified intervals (inflation protection). In some cases, purchasers also have the option to purchase nonforfeiture benefits that return some of the insured's investment in his or her policy if he or she stops paying premiums (lapses). Typical features purchased have changed over time with many more purchasers opting for more complete coverage (see ***Exhibit 1***).

Exhibit 1:
Characteristics Of Individual Long-Term Care Insurance Policies Purchased In 1990, 1994 and 2000

Policy Characteristic	**1990**	**1994**	**2000**
Policy Type			
Nursing home only	63%	33%	14%
Nursing home and home care	37%	61%	77%
Home care only	---	6%	9%
Daily Benefit Amount for Nursing Home Care	$72	$85	$109
Daily Benefit Amount for Home Care	$36	$76	$106
Nursing Home Benefit Duration[a]	5.6 years	5.1 years	5.6 years
Individuals Choosing Inflation Protection	40%	33%	40%
Annual Premium	$1,071	$1,505	$1,677

[a] Lifetime policies were assumed to provide benefits for 10 years in calculating average benefit duration.

Note: Based on an analysis of 14,400 individual long-term care insurance policies sold in 1990 and 6,446 sold in 1994, and 5,407 sold in 2000.

Source: Health Insurance Association of America, ***Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers*** prepared by LifePlans Inc., 2000.

Over the past five years, most insurance companies have switched to offering a single pool of money rather than separate pools that can only be used for certain services (i.e. nursing home or home- and community-based care). This single pool maximizes the flexibility of service-based benefits because an insured can apply the money to services and facilities she or he needs and desires, as long as it is for a covered service. The benefit duration under this model is dependent on how long it takes the insured to spend his or her pool of money rather than a certain specified time period. For example, a policy with separate pools of money with four years of coverage for nursing home care at $100/day and home care at $50/day would allow the insured to receive up to $100 a day in a nursing facility or $50 a day of home care for only four years. On the other hand, the same policy with a single pool of money policy would offer $219,000 that could be used for either type of care. Thus, the policy could be stretched out to cover 12 years of home care coverage if an average of $50 a day were spent or it could cover six years of nursing home care if the facility cost $100 a day.

II. THE BUSINESS OF LONG TERM CARE INSURANCE

Three key issues that could determine the success of long-term care insurance include how adequately companies: 1) screen poor risks (underwriting), 2) set premiums, and 3) manage claims. Underwriting is the process through which insurance companies determine if someone applying for a policy should be issued a policy. Companies underwrite policies to avoid adverse selection by using written health questions, medical record review, interviews, and assessments. The depth of the assessment done on an applicant generally increases with age. Insurers generally have a more difficult time screening for mild to moderate cognitive impairment than physical impairment and severe cognitive impairment.

The premiums that insurers charge influence whether consumers will purchase the policies and whether the product is profitable for the company. Premium levels vary significantly depending upon the level of benefits, age of purchaser, and risk factors, such as smoking (as well as claims expectations, interest rates, and profit margins). Most long-term care insurance policies are sold with level premiums, i.e., premiums are set to remain the same over time as long as the assumptions used to develop the premiums are borne out. Premiums can range from $274 annually for a four-year policy with no inflation protection that covered nursing home, assisted living and home care and was issued at age 40 to $7,022 per year for a policy with similar benefits, but that includes inflation protection and benefits if th purchaser stops paying premiums (nonforfeiture) issued at age 79 (see ***Exhibit 2***).

Exhibit 2
Average Annual Premiums for Leading Long Term Care Insurance Sellers in 1997

Age	Base	With 5% Compounded Inflation (IP)	With a Nonforfeiture Benefit (NFB)	With Inflation Protection and Nonforfeiture
40	$274	$595	$357	$770
50	$385	$888	$485	$1,110
65	$1,007	$1,850	$1,232	$2,305
79	$4,100	$5,880	$4,779	$7,022

Source: Coronel, Susan A., ***Long-Term Care Insurance in 1997-1998***, Health Insurance Association of America, 2000.

Insurers ability to manage filed claims also determines the profitability of the product. Insurers have to balance two costs: 1) the costs associated with determining if someone should receive benefits; and 2) the costs associated with providing benefits to people who may not need or be eligible for them. Insurers will probably want to avoid regularly denying benefits without a thorough in-person review because of the negative word-of-mouth and lawsuits this practice would likely generate. The insurer which can find the most efficient balance between paying for in-depth assessments and paying for inappropriate benefits will have an advantage in the market because of the ability to offer lower premiums.

III. REGULATION

Similar to other insurance products, states regulate and monitor the long-term care insurance market to ensure that companies have sufficient reserves to pay claims in the future (solvency) and that policy provisions and marketing practices are fair (consumer protection). The National Association of Insurance Commissioners (NAIC) recommends specific regulatory provisions related to all forms of insurance for state adoption.

State adoption of NAIC provisions for long-term care insurance has been inconsistent. All states and the District of Columbia have instituted, or in the case of DC initiated the process of instituting, long term care insurance regulations. However, members of Congress and others have criticized states for failing to institute the most recent provisions of the NAIC long-term care model act and regulation.

While the NAIC model has strongly influenced states' long-term care insurance regulations, a significant number of the provisions have not been adopted by many or most states. The NAIC long-term care regulations have changed frequently since they were introduced in 1986 and adherence to the NAIC models by states is voluntary. More states have adopted NAIC provisions related to benefit requirements and limits on policy restrictions than those related to marketing and business practices. Some noncompliance is attributable to lag time between NAIC adoption of a provision and state adoption due to the nature of legislative cycles. So many differing regulations increases the burden on insurance companies that operate nationally and can be particularly problematic for large employers considering the product.

In addition, while not a regulation, the Health Insurance Portability and Accountability Act (HIPAA) of 1996 defined qualified plans for the purpose of tax deductibility, including an eligibility trigger floor to control the tax revenue loss associated with this provision and refers to 1993 NAIC model regulations related to consumer protection. Consequently, although HIPAA's benefit triggers are more restrictive than those that the NAIC recommends for long-term care insurance policies, almost all insurers have modified their benefit eligibility requirements to reflect HIPAA's requirements. While HIPPA brought tax deductibility for long term care insurance, it also has burdened insurance companies with inflexible criteria that cannot adapt easily to the continuing innovation of the product.

State insurance departments' available resources and expertise to regulate the long-term care insurance market vary considerably. States generally have ample ability to review whether long-term care insurance policies meet regulatory requirements regarding product features and presentation of materials in outlines of coverage. On the other hand, a lack of resources and the nature of the sales transaction makes it difficult for states to oversee marketing practices. The combination of limited resources and staff expertise in state insurance departments and limited claims experience data in the industry results in states having restricted ability to assess initial premium rate filings and rate increase requests. A recent review of state insurance department capacity and regulations related to rate review found that many states do not use actuaries to review rate submissions and most states do not request the breadth of information necessary to conduct a thorough review of initial long term care insurance premiums and rate increase requests. Substantial increases in premiums charged by some companies in recent years have raised concern about the stability of long term care insurance premiums and the adequacy of regulatory review.

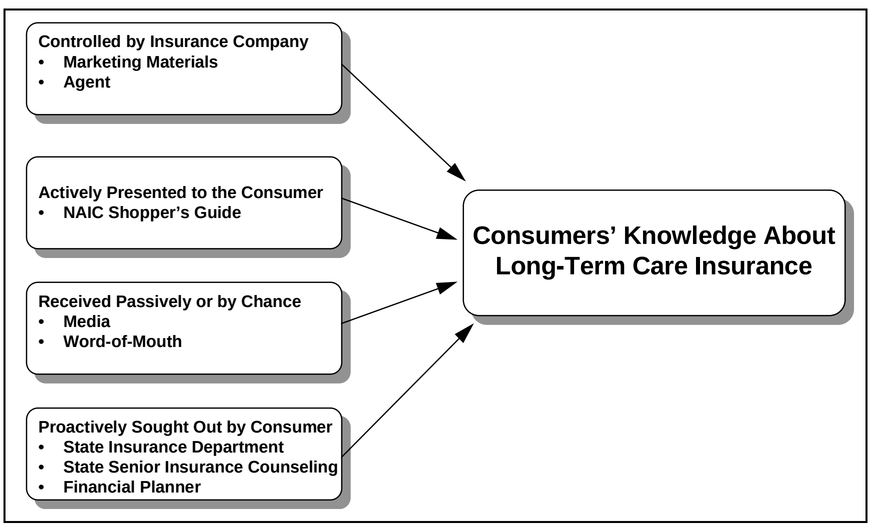
IV. CONSUMER AWARENESS

Consumers can make informed choices only if they have an understanding of the nature of the risk associated with needing long-term care and the potential for protection from that risk offered by insurance. Consumers must first decide whether purchasing a product is appropriate given their personal circumstances. Many consumer groups and regulators argue that long-term care insurance is not appropriate for certain people and should not be sold to them, particularly those who would quickly qualify for Medicaid if they were to require long-term care services.

However, industry representatives contend that the population for whom long-term care insurance is appropriate is unclear and that while some general suitability guidelines may help consumers make an informed choice, anyone should be able to purchase long-term care insurance if they choose to do so. Purchasers of long term care insurance are on average in their late 60s, married, highly educated relative to the general population and have substantial income and assets.[2]

Once a decision on the suitability of purchase has been made, consumers are faced with difficult and confusing choices related to product features. The ability of consumers to compare policies and make informed choices is hampered by: 1) numerous policy options and features; 2) the complexity of the product; 3) the rapid changes occurring in products; and 4) a lack of easy-to-obtain, unbiased sources of information. Currently, insurance agents serve as the primary mechanism for translating arcane language and providing advice on which policy to buy and options to choose (see ***Exhibit 3***). Consumer groups question whether agents always have the best interest of the purchaser in mind because they earn commissions.

Exhibit 3:
Sources of Information About Long Term Care Insurance



Source: Lutzky, Steven and Lisa Maria B. Alecxih, "Enabling Informed Consumer Choice in the Long-Term Care Insurance Market," ***Journal of Aging and Social Po***licy, vol. 10, no. 3 (1999): pp.27-44.

The regulation of long-term care insurance often requires tradeoffs between protecting consumers and allowing them to make choices. Consumer groups express concern that long-term care insurance is too complicated for the typical consumer too understand and efforts should be directed at making policies easier to compare, such as standardizing definitions and eligibility triggers for benefits. These groups also advocate that certain provisions, such as inflation protection, be included in all long-term care policies. Industry representatives contend

[2] Health Insurance Association of America, ***Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers*** prepared by LifePlans Inc., 2000.

that the consumer should be permitted as much freedom as possible in tailoring policies to his or her own circumstances. While most parties generally support improved consumer information and agent education, only selected consumer groups support standardizing policy choices at the national level in a fashion similar to Medicare supplemental insurance.

V. ADEQUACY OF LONG-TERM CARE INSURANCE PROTECTION

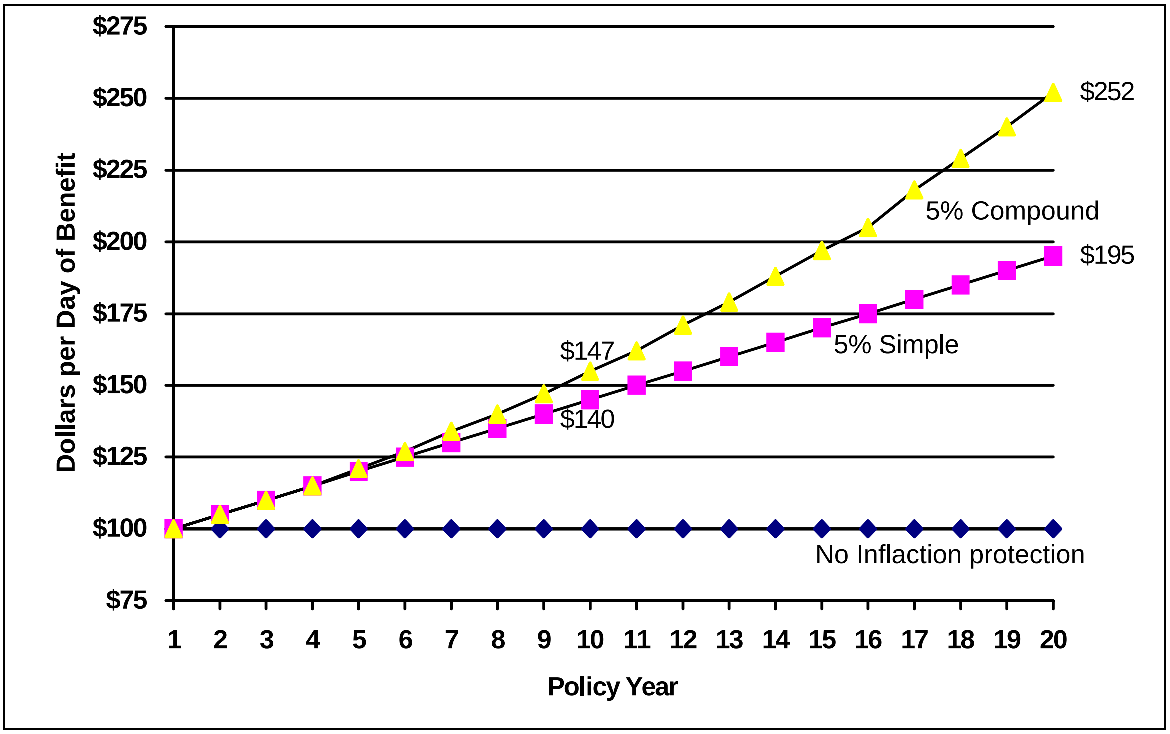
In order for a policy to offer adequate protection against the cost of long-term care four conditions must be met: (1) the person must pay premiums and retain the policy (not lapse); (2) the policy must offer enough benefits to cover a reasonable portion of the costs of long-term care when the person needs it; (3) the person must qualify for benefits under the insurer's criteria when she or he is in need of care; and (4) the long-term care services the person needs must be covered by the policy.

While current long-term care insurance policies appear to offer significantly better coverage than their predecessors, there is still reason to be concerned about the adequacy of the protection this form of insurance offers. Many people will not have protection against the costs of long-term care because they will not have active policies when they need benefits. The limited data available suggests that 30 to 50 percent of all individual purchasers of long-term care insurance lapse within five years. Unfortunately, current data does not allow us to fully understand why people lapse and whether these lapses result mostly from mortality and people upgrading their policies, or whether they reflect people paying premiums for a time and dropping their policies. There are a number of ways that regulatory mechanisms may reduce lapse rates, including consumer education, agent training, limits on commissions, suitability standards, and mandating nonforfeiture benefits. However, some of these mechanisms limit consumers ability to choose which features they want and also can increase price.

To assure adequate protection from the financial risk associated with long-term care, a person must purchase a benefit that provides enough coverage for a long enough period of time to prevent erosion of assets. This level of coverage needs to account for increases in the cost of long-term care. "Adequate coverage" differs depending upon the individual's aversion to risk and willingness to self-insure. While some people look for complete protection against all the costs of long-term care, others would rather keep premiums low by only insuring against catastrophic costs (i.e., an extended stay in a nursing home).

Among those who keep their policies until they need benefits, some may experience substantial out-of-pocket payments because: 1) purchased benefit amounts are lower than typical nursing home costs; and 2) over one-seventh of policyholders who go into a nursing home could be in an institution longer than the duration of their policy. Those who do not purchase inflation protection could have significantly greater out-of-pocket expenses (see ***Exhibit 4***).

Exhibit 4:
Comparison of Benefits Offered by Long-Term Care Insurance Policies With No, Simple and Compound Inflation Protection



The benefit triggers a company uses and how it assesses whether an individual meets its criteria will strongly influence whether or when a person receives benefits. Companies using functional impairment triggers base them almost exclusively on impairment in activities of daily living (ADLs) and cognitive impairment and nearly all policies sold today comply with the HIPAA criteria to be a "qualified" plan. To be qualified, long-term care insurance benefits are only "triggered" when a person needs substantial assistance in performing at least two of six activities of daily living and the assistance is expected to last at least ninety days, or requires substantial supervision resulting from a severe cognitive impairment.[3]

VI. THE FEDERAL OFFERING OF LONG TERM CARE INSURANCE

Employer-based sales can reduce premiums by: 1) marketing to younger purchasers who have lower premiums; 2) reducing administrative costs through reduced marketing (especially no or extremely limited agent commissions); and 3) reducing the potential for adverse selection if sufficient sales are generated. By October of next year, the Office of Personnel Management (OPM) will offer the long term care insurance to approximately 20 million active and retired federal employees, U.S. Postal employees and uniformed services personnel, and their qualified

[3] See 26 U.S.C. § 7702B (c)(2)(A)(iii). The law also authorizes a third trigger for a level of disability comparable to the inability to perform two of six activities of daily living. See id. § 7702B (c)(2)(A)(ii). However, this standard has been extremely difficult to develop and apply.

relatives (e.g., spouses, parent and dependents). OPM expects between three and five percent of the potentially eligible to enroll, or 600,000 to one million individuals.

The federal offering will be the largest employer-sponsored offering by over tenfold. Congressional inclusion of long term care insurance in the federal benefit package may encourage other employers to offer the benefit. Like most employer-sponsored products, employees and others will be responsible for the full premium. It is expected that the federal experience may become a standard for other employer-sponsored offerings. OPM is attempting to balance the need to offer a competitive well-designed and adequately priced product with the desire to be inclusive of individuals with existing disabilities and explore innovative benefit structures.

VII.CONCLUSIONS

In order for long-term care insurance to finance a substantial portion of services in the future, the following conditions need to be met:

- Consumers must realize that they need to protect themselves against the costs associated with long-term care.
- Consumers need to purchase long-term care insurance early enough that they can prefund their care.
- Consumers need to purchase long-term care insurance policies that account for the increased costs of care between when the policy is purchased/and when benefits are needed.
- Consumers must purchase policies that match their needs for protection.
- Premiums cannot increase sharply.
- Insurers should consider the use of benefit triggers for community-based services that are more responsive to the need for care than finite triggers based on having impairment in a particular number of ADLs.
- Policyholders need to be able to adapt their policies to account for changes in their circumstances and the service delivery system.

The federal government has four general directions it can pursue if it wishes to increase the proportion of care for which long-term care insurance pays:

1. The government could do nothing and allow market forces and existing NAIC/state regulation to resolve the obstacles to sales and adequate coverage.
2. The government could intervene to enable more informed consumer choice.
3. The government could intervene to try to encourage the sale of long-term care insurance products.

4. Finally, the government could intervene to try to ensure that products are of high quality.

The particular course chosen will depend upon the philosophy of the decision makers and the value placed on expanding the number of people covered by long-term care insurance relative to the quality of coverage.

The federal government could improve knowledge and information available about long-term care insurance by:

- Providing unbiased, neutral information. HCFA has recently embarked on a Congressionally mandated information campaign about long term care.

- Providing information that actively promotes the purchase of long-term care insurance.

- Requiring agents to have a thorough knowledge of the product through licensing and continuing education.

The federal government could improve states' ability to regulate the long-term care insurance market by:

- Increasing states' ability to oversee the long-term care insurance market (e.g., by supplying them with funds to hire an actuary).

- Developing better mechanisms for monitoring rates and marketing practices (e.g., by establishing an acceptable range of rates for products).

The federal government could provide incentives for the purchase of long-term care insurance by:

- **Providing tax breaks to consumers and employers who purchase long-term care insurance** -- Tax incentives would have the effect of lowering the price consumers face for policies. Tax incentives could: 1) reduce the imbalance in tax treatment relative to acute care benefits; 2) possibly increase sales through the employer market; and 3) theoretically reduce Medicaid expenditures. In addition, tax incentives could increase sales by sending a signal that long-term care is the individual's responsibility. However, sales may not increase substantially because consumers who would benefit from tax breaks would likely have purchased a policy without the incentive. Moreover, the revenue loss from these tax deductions would likely exceed any Medicaid savings because tax incentives benefit those with moderate to high income and those likely to need Medicaid generally cannot afford long term care insurance.

- **Developing and expanding public-private partnerships designed to provide easier access to Medicaid benefits for consumers who purchase long-term care insurance** -- The most extensive current initiative is the Robert Wood Johnson (RWJ) Foundation's Public/Private Partnership for Long-Term Care Insurance. These programs allow individuals who buy certified long-term care insurance policies to become Medicaid eligible while keeping more of their assets than normally allowed. Four states currently run these programs and one more is developing a program. While the RWJ Partnership polices have had little direct effect on increasing long-term care insurance sales, they may have had an indirect effect of increasing the public's awareness of the need to protect against the costs associated with long-term care and improving the quality of policies.

- **Tightening Medicaid eligibility requirements** -- More people may be induced to buy long-term care insurance if they view Medicaid as less of an option for paying their long-term care costs. However, making eligibility criteria more stringent may expose more people to poverty and tightening Medicaid estate planning requirements appears to have had little, if any, impact on the sale of long-term care insurance.

The federal government could provide standards and regulations for long-term care insurance by:

- Offering a seal of approval for policies that have certain features. The federal seal of approval could be made more attractive by tying it to tax incentives.

- Developing standard definitions and benefit triggers to be used in all policies.

- Requiring the inclusion of certain features (e.g. nonforfeiture, inflation protection) in all policies.

- Standardizing policies and allowing only a limited number of types to be offered, similar to the Medicare supplemental insurance market.

In conclusion, long-term care insurance appears to be headed towards providing high quality coverage to a limited, but potentially growing, number of people who can afford the premiums and are knowledgeable enough to purchase a good product. Another group of individuals will buy products that provide only limited coverage that may not defray large portions of the costs of long-term care. Even with full government support, private long-term care insurance is not likely to provide coverage to most people needing long-term care. However, government intervention may be able to significantly enable informed consumer choice, ensure the purchase of high quality products, and increase the number of people purchasing products.