Future Purchase Options: Worthy or Worthless?

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Doug’s Opening Argument

Claude’s Opening Argument

1. Inflation is a serious risk
2. So it is important to maintain purchasing power
3. FPOs (future purchase options) do a poor job of maintaining purchasing power
4. If we sell FPOs too much we’re not doing our job well and it will come back to haunt the industry
5. If we sell right, we WILL generally sell CBIO (level premium permanent compound benefit increases)

Urban Institute Study
May 2007

- Intermediate scenario: 333% as many commercial home care hours in 2040 as 2000
- Despite presuming that old-age disability rates drop from 30% to 28% due to education & income

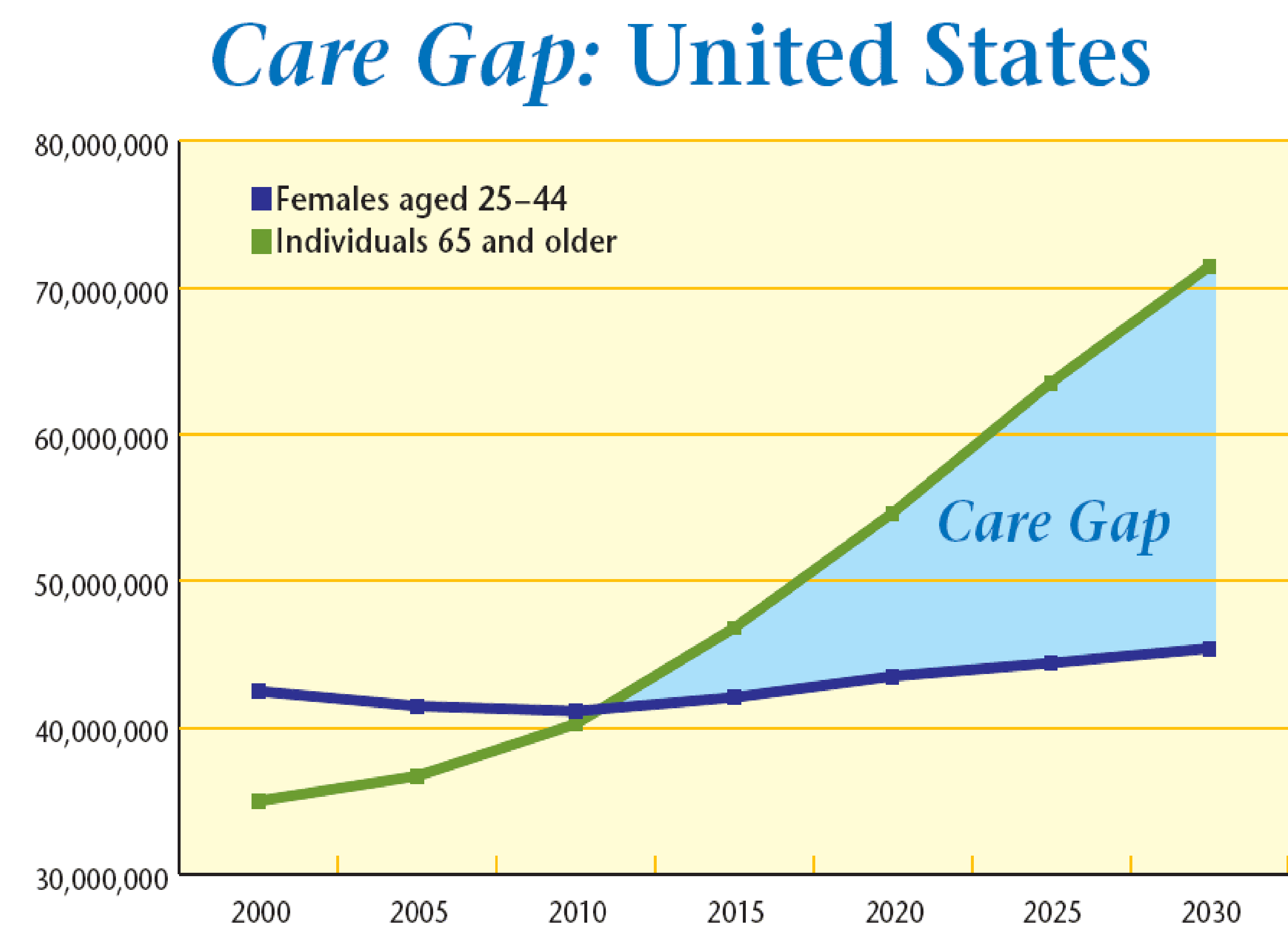
    (Note: disability = any ADL & IADL need)

- Disability among younger people may increase due to obesity and diabetes
- # of people needing care will more than double, but # of able-bodied people ages 25-64 will increase only 26%

A National Shortage of Long Term Caregivers

Between 2000 and 2030, the number of US elders will increase by 104 percent. During the same period, the number of women aged 25 to 44 – the group from which most direct-care workers have traditionally come – will increase by only 7 percent.

Source: www.coverageiscritical.org, a web-site by PHI which advocates for health care for health care workers.



In the face of Assured Inflation

It is critical to maintain purchasing power as best we can.

Something is better than nothing IF, and ONLY if, LTCi and other resources satisfy needs until benefit period runs out.

Something is **NOT** better than nothing if combined resources are insufficient to keep the client off Medicaid!

If clients' expectations are not met, the LTCi industry will have a problem.

Value of $4500/month at age 80
Basis: $4500* current cost/5% inflation

Issue Age	Initial Benefit: Client Expects 100% coverage	LTC Cost at age 80	% Covered When Claim Occurs
35	$4500	$40,433	11%
45	$4500	$24,822	18%
55	$4500	$15,239	30%
65	$4500	$9,355	48%

*Presumes 100% of cost covered at issue

% Covered at age 80 Depending on Inflation Rate*

Issue Age	5% Inflation	6% Inflation
35	11%	7%
45	18%	13%
55	30%	23%
65	48%	42%

*Presumes 100% of cost covered at issue

Level Premium Benefit Increase Features

	2004	2008
5% Compound Lifetime	42.2%	47.6%
5% Equal Lifetime	18.3%	18.3%
CPI for Life	0%	6.0%
Other	4.0%	6.6%
Total	64.5%	78.5%

When is FPO Appropriate?

- Case #1: Young person trying to assure lots of future coverage
  - Can’t afford lots of coverage with CBIO now
  - Expects substantial increases in spendable cash
  - Fears a change in health
  - Costs of increases are low initially

Needs bail-out option before increases get too expensive relative to cash flow.

When is FPO Appropriate?

- Case #2: A person is anxious to get coverage that would help in case of an immediate need and expects future income that could allow more purchases for the future.

  There is little risk of a short-term LTC need for someone who passes underwriting, especially at young ages. At older ages, the ability to purchase more coverage in the future is questionable. This is NOT a common situation.

When is FPO Appropriate?

- Case #3: A person has an occupation or avocation that will expose him to a high short-term risk of LTC that he wants to insure.

  This is NOT a common situation.

When is FPO Appropriate?

- Case #4: Affluent person who can afford to self-insure. Why not let them self-insure inflation portion?
  - OK if they want to do so.
  - But generally not the most efficient use of money if they are concerned about LTC.

This case is not so much “appropriate” as it is “acceptable”

FPO Increases

- If a 45-year-old is paying $50/month and
- She exercises each option and
- Increases are equivalent to 5% compound,
- How much is she likely to pay each month by age 85?

FPO Increases

- If a 45-year-old is paying $50/month and
- She exercises each option and
- Increases are equivalent to 5% compound,
- How much is she likely to pay each month by age 85?
  - $2500 or more
  - at least **50** x as much per month.
- Does she understand that when she buys?

Premium gets OUT OF CONTROL!

Will She Exercise Her Increases?

- AALTCi Sourcebook: 37% of FPOs were exercised in 2008
- Is that good?
- Do you think the percentage exercising will change as people get older?

Will She Exercise Her Increases As She Ages?

- Costs increasing much faster than her income is likely to dissuade her.
- Especially if on fixed income, disposable income may be decreasing.

Impact of a [illegible]7% Election Rate on Coverage Assuming 5% Inflation

Issue Age	Initial Benefit	LTC Cost	% Covered
35	$4500	$40,433	44%
45	$4500	$24,822	48%
55	$4500	$15,239	56%
65	$4500	$9,355	67%

*Presumes 100% of cost covered at issue

Risk of Losing FPO Option

- Generally not available while on claim
- May be lost if rejected more than x times over life of policy or y consecutive times. Exercising 37% my forfeit future options.
- May no longer be available after a particular age
- The maximum # of FPOs may be limited (e.g., can't increase coverage beyond twice initial amount)

Is there sufficient disclosure?

- Premiums are not projected out (far enough)
- Risk of losing FPO option while on claim, etc.
- Forfeiture of potential Partnership benefits
- “More affordable” does not mean “suitable for less affluent people”
- Is a 20-yr. CBIO an “adequate safety net for most people”?
- Some FPOs have charged 120% of corresponding issue age rate.

Sell the Client What They Want to Buy

- Brokers generally show the client $150 of benefit with, and without, 5% CBIO.
- Clients often do not want to pay the higher premium.
- So it is logical to conclude that the client wants to buy the flat benefit.
- Right?

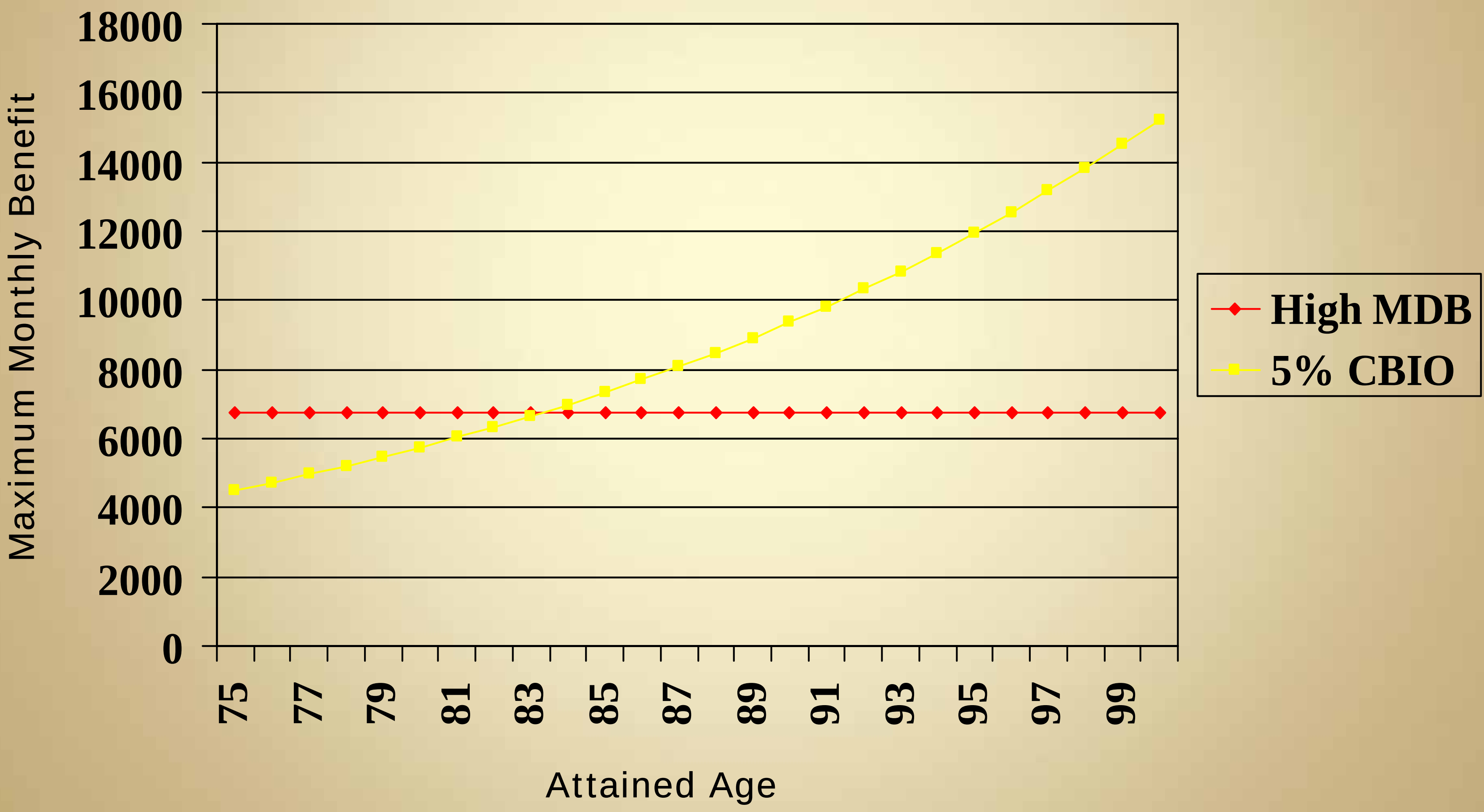
Sell the Client What They Want to Buy

- Wrong!
- Show the client the same premium
  - High flat benefit vs.
  - Lower initial benefit increasing 5% per year
- Compare the future benefits each way. Will the client want the higher initial, flat benefit?
- I have no problem with an FPO sale *IF* the client has been properly educated and prefers FPO

Buying a Higher MDB without CBIO at Issue Age 75

- I’m using age 75 because the argument to buy withOUT CBIO is strongest at that age
- Compare “same” premium with:
  - High MDB but NO CBIO
  - Lower MDB **with** CBIO
  - Based on $4500/month with CBIO

Buying a Higher MDB without CBIO
At Issue Age 75



Is LTCi Expensive?
Is CBIO Expensive?

Time	Age	5% CBIO	Flat Benefit
Now	55	$1950	$3000
In 5 Years	60	$2489	$3000
In 10 Years	65	$3176	$3000
In 15 Years	70	$4054	$3000
In 20 Years	75	$5174	$3000
In 25 Years	80	$6603	$3000
5 Yr Clm in 25 yrs	80-85	$437,855	$180,000

My clients would rather buy the lower initial benefit

- They want the higher later benefit*.
- This approach more realistically causes them to realize that they would be under-insured, hence they typically buy a larger monthly benefit, resulting in a larger premium.

*Sometimes the numbers are not so obvious as regards 5% simple vs. 5% compound, probably because of pricing interpolation methodology.

Rebuttal

Claude's Rebuttal

- "Something is better than nothing": I've addressed that already: not if the client needs Medicaid soon.
- "It is less expensive". "You need to sell what the client is willing to buy." I've addressed that: show them equal premium with and without CBIO.
- "Life insurance isn't 'one and done', so why should LTCi be 'one and done'? OK, let's answer the question.

Why are Life Insurance & LTCi Purchased?

- Life insurance is bought to cover the risk of “premature death”.
- LTCi is purchased to cover the cost of LTC in the distant future.

LTCi is substantially different from life insurance and that difference makes CBIO important.

Does the Amount of Life Ins. Needed Increase Over Time?

Reasons for buying life insurance:

- Family income needs if bread-winner dies
  - Kids' education and daily needs may increase annually
  - But present value of (lost income; needs) decreases over time
- Mortgage protection: generally reduces over time
- Buy-sell agreement: need expires when business sold
- Estate taxes: quite variable; assets might increase or drop; tax rules and rates might change; kids generally need less inheritance as they age

Long-Term Need for Life Insurance vs. LTCi

- The amount of life insurance needed might disappear, decrease, stay level or increase over time.
- The monthly benefit needed for LTCi increases dramatically over time.

LTCi is substantially different from life insurance and that difference makes CBIO important.

Term Insurance

- Indeed, many life insurance policies are term insurance, underscoring the short-term nature of the need compared to LTCi.
- We would NOT even be ALLOWED to sell term LTCi.

LTCi is substantially different from life insurance and that difference makes CBIO important.

Which is likely to stay in force?

Life Insurance Replacements

- Insurers report 10% of sales are replacements.
- Consumers report 1/3 are replacements.

Long Term Care Insurance Replacements

- Very rare (admittedly, under-reported)

It makes less sense to worry about inflation if the policy won't stay in force.

Life Insurance vs. LTCi
Lapse Rates

Lapse Rates

- Life insurance lapses much more than LTCi.
- Does it make sense to pay more up-front for later life insurance if you won't have the policy?
- LTCi lapses rarely (1%/year). It becomes MORE important over time. Why let its value dwindle?

How the Product is Sold

1. We talk about the cost of care when we sell LTCi.
2. The client believes that their LTCi will meaningfully address their future cost of LTC.
3. Therefore it should do so.

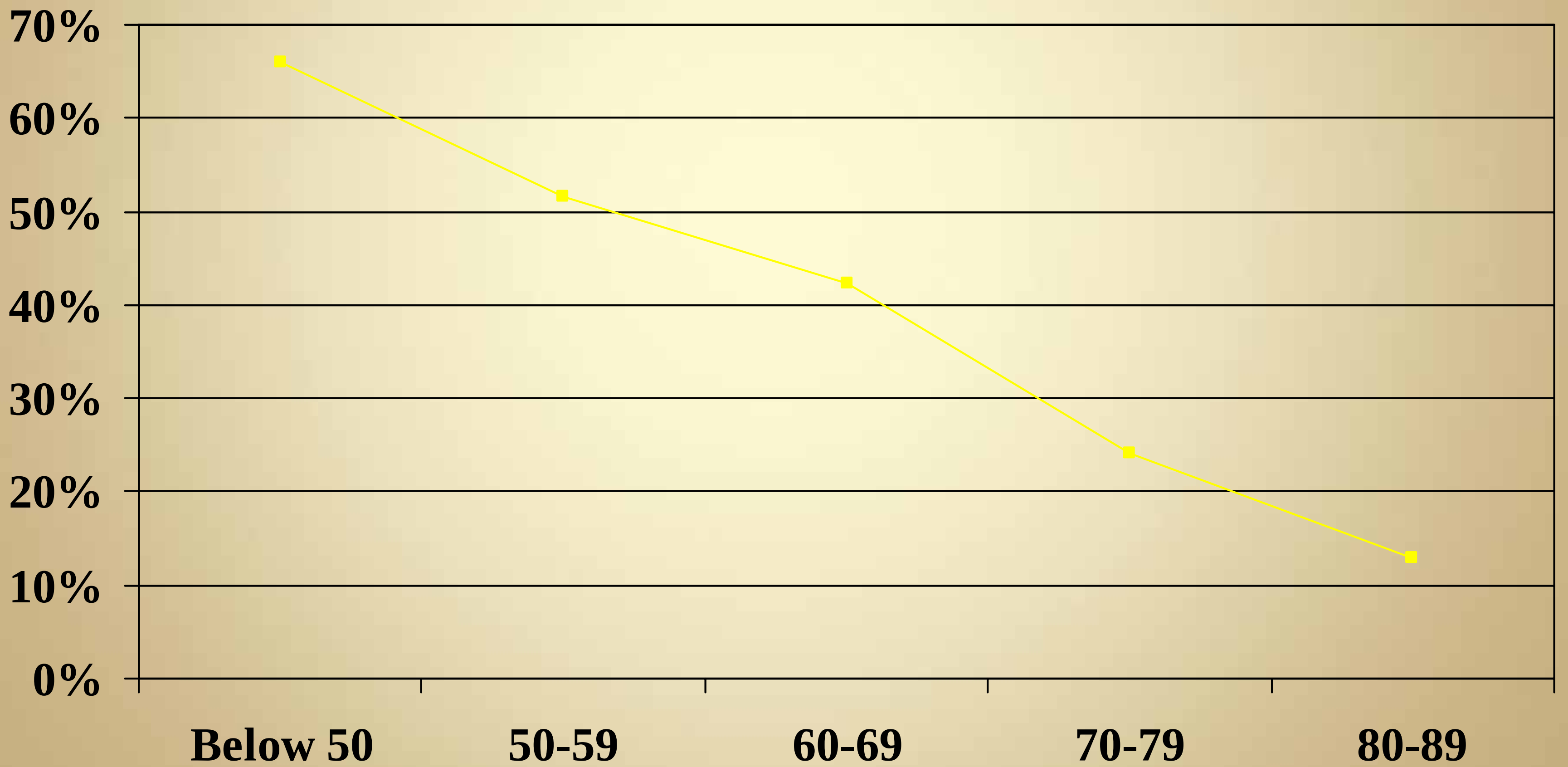
Life insurance is not sold that way.

LTCi is substantially different from life insurance and that difference makes CBIO important.

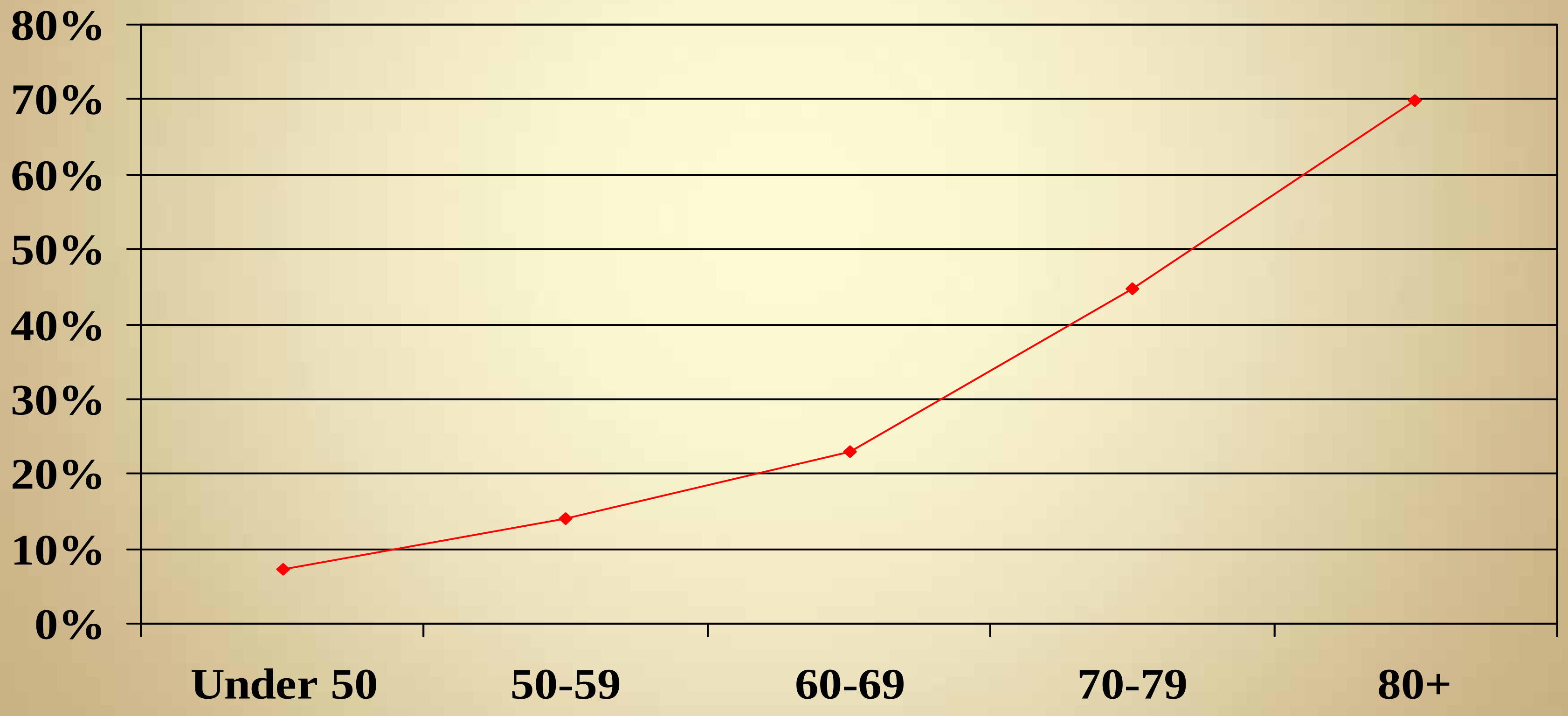
Future Purchase Options in Life Insurance

- Comparison to life insurance is interesting as life insurance lacks FPO after age 40
- So the comparison relates, not to FPO, but rather to buying a flat benefit and applying for a series of independent purchases over time.

Less Likely to Get “Preferred” Rates



Sell a Series of Coverages? More Likely to be Refused



Historic Trend in Pricing

- Life insurance: downward
- LTCi: upward
- In which product line would clients be likely to want to defer a purchase to a later date?

Reviews of In Force Policies

- Most common lament? Not having purchased compound benefit increases.
- If the client buys new coverage at that time to increase their benefits, do they buy from the original insurer?

Unwise for Carrier to Sell Flat Benefit

- Anti-selection on FPO elections: How will that impact claims?
- Double benefits if add-on bought from another insurer: How will that impact claims?
- Bad PR if benefits don't match expectations
- FPO is underpriced if reflects higher lapse experience
  - Higher lapse rate assumptions presume product design determines lapse rather than sales person & buyer

Conclusion

- Hands down --- Even if they buy multiple policies, clients are better off with CBIO than with FPO or flat benefits