DUAL PURPOSE LIFE INSURANCE

A RADICAL NEW APPROACH TO INCREASE CONSUMER RESPONSIBILITY FOR LONG TERM CARE FINANCING THEREBY FREEING UP RESOURCES FOR HEALTH CARE REFORM

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CONVERTING LIFE INSURANCE TO DUAL PURPOSE INSURANCE (LIFE/LONG TERM CARE)

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Overview:

For more than four decades as a Long Term Care (LTC) Senior Executive, now the CEO of a 720-bed multicare nursing center, as an active member of New York State Health Facilities Association as well as the Southern New York Association, I have studied, researched and evaluated the very obvious need for reform of this country's approach to financing the ever-increasing cost of long-term care. This paper proposes a logical, cost-effective and manageable way to restructure long term care funding (LTC): **the conversion of life insurance policies to "end-of-life" contracts**. Savings resulting from the proposed approach could be diverted for such urgent priorities as New York State's Child Health Plus Program and Healthy New York. They could also help fund health care reform initiatives and offset costs of providing heath care for the uninsured. This conversion will enable each person to utilize his/her life insurance policy's death benefit to pay for long term care, to the benefit of all parties and at no fundamental loss to all parties affected. The proposed conversion entails a basic and understandable use of funds that damages no financial concerns – not the individual, not the insurance company, not the health care provider, and not the taxpayer. Moreover, all of the above who are involved in long-term care will see unpredictable costs eradicated and anticipated costs brought under control.

The present LTC system places all parties involved at great disadvantage. LTC costs are astronomical for low and middle income American families. Older consumers have few practical options other than to apply for Medicaid to pay for such care. If they have assets, they face losing the savings accumulated over a lifetime; once they exhaust their own assets, they are compelled to apply for Medicaid. The Medicaid application process is notoriously subject to manipulation, even outright fraud--including illegal asset transfer to other family members or the creation of trusts to hide assets. Recently regulators have been effective in closing such loopholes, but the underlying dilemma remains the same: we have an extraordinarily expensive system that

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burdens older adults, the health care system, and the taxpayer, and one that ultimately diverts energies and resources that could be better utilized to provide care: from the family members/ caregivers who devote enormous amounts of time and energy to navigating the LTC/ Medicaid system, the social workers and counselors who spend precious time filling out paperwork rather than counseling and supporting aging and ailing adults, the LTC providers that must maintain huge financial management operations to monitor and account for the public funding they manage and to cope with persistent under-reimbursement for services provided, and from the often inefficient and duplicative Federal, State and local government health care bureaucracies whose efforts would be far better utilized on health care reform and the development of best practices.

Baby Boomer Generation & LTC

There is no question that the United States faces enormous and unprecedented challenges in providing LTC for the huge Baby Boomer cohort. Recently this concern has been overshadowed by the global economic crisis, but future LTC costs could foment a fiscal crisis that would bankrupt our health care system and impoverish many families. The proposed conversion of life insurance contracts would make trillions of dollars available for LTC.

We are just beginning to experience the leading edge of a demographic avalanche as the 78 million Americans born between 1946 and 1964 reach retirement age. To put this demographic into perspective: there are 32 million older adults in the US today; by 2020 that number will more than double - and by 2030, 20% of this country's population will be over 65. Currently, about 70 percent of individuals over age 65 will require at least some type of long-term care services during their lifetime, and 40 percent will need care in a nursing home

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for some period of time (on average, 2.5 years) at annual cost of $208 billion. By 2020, when the full cohort of Baby Boomers reaches retirement age, long term care costs will balloon to more than $400 billion annually.[1]

LTC Defined

Long-term care serves individuals that have a chronic illness or disability that requires assistance with Activities of Daily Living (ADLs). There are variations in such costs based on the type and amount of care needed, the provider used, and geographic area of the provider, but taken individually or collectively, these LTC costs are formidable.

In 2008, the average costs for LTC services in the United States were:

- $187/day for a semi-private room in a nursing home
- $209/day for a private room in a nursing home
- $3,008/month for care in an Assisted Living Facility (for a one-bedroom unit)
- $29/hour for a Home Health Aide
- $18/hour for a Homemaker services
- $59/day for care in an Adult Day Health Care[2]

Who Pays for LTC

On an aggregate basis, the largest share of LTC costs, (69%) is provided by Federal and State funding.

Medicaid, which provides 49% of public LTC funding, is a joint Federal and state government program that helps pay medical costs for people with limited incomes and resources. People with Medicaid may get

[1] American Association for Long Term Care Insurance, 2008 LTCI Sourcebook
[2] National Clearinghouse on Long Term Care, DHHS (NCLTC)

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coverage for services such as nursing home and home health care, if they meet eligibility requirements. Eligibility is based on income and personal resources.

The remaining 20% is of public funding is provided by three programs, which provide limited LTC services to specific populations.

Medicare will pay for a maximum of 100 days of LTC care under specific conditions:

- after a 3-day hospital stay;
- after admission to a Medicare-certified nursing facility within 30 days of a hospital stay;
- if diagnosed as needing skilled nursing and/or physical therapy care.

If all these conditions are met, Medicare pays a portion of LTC costs--for up to 100 days.

The Older Americans Act provides funding for a range of services that include nutrition programs in the community and for homebound elderly; programs for Native American elders; services for low-income minority elders; health promotion and disease prevention activities; in-home services for frail elders; services that protect the rights of older persons such as the long-term care ombudsman program; and services and supports for family caregivers. While there are no specific financial eligibility criteria for Older Americans Act services, they are generally targeted for low-income, frail seniors over age 60, and minority elders and seniors living in rural areas.

The Department of Veterans Affairs (VA) may provide long-term care to veterans who meet established disability criteria, or to those who need care because of service-connected disabilities.

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The remaining 31% of LTC cost is paid by individuals who either use their own financial resources or "spend down" to qualify for Medicaid. Because most American simply cannot afford to pay $200 per day for nursing home care, public funding is a necessary last resort. Still, LTC can drain a family's resources. The insurance industry correctly regards paying for long term care as the greatest financial risk facing individual Americans and their families.

The Economic Crisis and the Boomer Generation

Certainly American Baby Boomers are already at great financial risk. The global economic crisis has swept through America with breathtaking speed. Most of us have experienced unprecedented decline in assets, retirement savings, and home equity. This is especially concerning for those nearing retirement. Baby Boomers have been far less prudent than their parents, most having saved very little for retirement. (On average, Boomers have savings that equal only one year's worth of retirement costs). They also tend to be risk-takers. Adults over 50 accounted for 28% of all mortgage delinquencies and foreclosures in 2007. Growing numbers of adults over 50 are raiding their retirement accounts to make ends meet.

Alternate Approaches

Over the past twenty years, there have been major efforts to address LTC costs. Chief among them is the Robert Wood Johnson Foundation's Partnership for Long Term Care, established in 1992.[3] The Partnership collaborated with the insurance industry to encourage the purchase of LTC insurance. It developed LTC model products, negotiated federal and state tax incentives, established partnerships in four states (California, Connecticut, Indiana, and New York), and conducted a major public awareness campaign about LTC issues. The huge growth in information outlets now available to educate older adults about LTC and counseling their families is due largely to the Partnership's work. However, after decades of effort, the actual number of LTC

[3] "Long Term Care Partnership Expansion: A New Opportunity for States." Center for Health Care Strategies. Issue Brief, May, 2007.

policies is far below what the Partnership expected and what is needed: currently there are only 7 million LTC insurance policies – for 2.2% of the population - in effect nationwide.

An effort with similar goals was the development of the Home Equity Conversion Mortgage Program, (HECM), which essentially created a federal government-based reverse mortgage program that required the participants to pay for a qualified LTC insurance policy in exchange for favorable pay-out terms.[4] The effort entailed extensive actuarial research, pilot programming, and the development and enactment of federal legislation and regulations. Enacted in 2003, the HECM Program also failed to meet expectations: there are only 400,000 HECM loans in place this year.

Both the Partnership and HECM accomplished a great deal, but were unable to prompt consumers to anticipate LTC needs and take responsibility for LTC and end-of-life costs. Research conducted into consumer behavior found that these programs were able to increase awareness about LTC issues, but noted that awareness did not translate into action. The Partnership found that consumers did not take the steps needed to obtain LTC coverage. The HECM Program has had a similar experience with consumers. Despite the favorable terms HECM offered, consumers did not take the action needed to avail themselves of its benefits.

A related example of a good effort with little traction is that of the accelerated death benefit, a rider than can be purchased in some life insurance policies, which allows the owner to access death benefits to pay for long term care. However, not all life insurance policies offer this benefit, and, common to the other approaches described, few consumers go out of their way to purchase the ADB. Relatively few policies with ADB riders are in effect.

[4] "Linking Reverse Mortgages and Long Term Care Insurance". The Brookings Institute. 2006.

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There are certainly very understandable reasons for consumer behavior around these issues; people are reluctant to face aging, dependency and their own mortality. Still, there are important lessons to be learned from these initiatives: policymakers cannot rely on programs to succeed when they depend on the initiative of individual consumers. To achieve the radical change we need to fund future LTC, we need a wholesale industry-wide and nationwide approach to the problem.

The Life Insurance Contract Conversion Plan

The life insurance conversion plan that I am proposing provides access to a potential LTC funding stream in the trillions, because the one thing that most Americans have is life insurance. In 2007, 78% of Americans were covered by some form of life insurance, and policies have an average face value of $130,000. In aggregate, the nation's total life insurance protection is $10 trillion.[5] Over half of such policies are individual policies, usually intended to provide a death benefit to a dependent spouse and minor children. Of these 55% is some form of permanent or whole life insurance, nearly 30% of the aforementioned $10 trillion.

Life insurance is a relatively safe proposition. The industry is extensively regulated, and individual companies are required to maintain financial reserves mandated by the State in which they sell policies. Such regulations insulate it during economic downturns. To date, even AIG's life insurance division has remained solvent and profitable. (Apparently the same cannot be said for the long term care insurance industry: a 3/18/09 Wall Street Journal article ("Worry Grows Over Insurers as Ratings Slip") reported on the rising number of long term care insurance companies taken over by State Insurance Commissions because of their financial instability. LTC insurance is also subject to premium increases; LTC policyholders have experienced (and are now experiencing) unpredictable rises in premium costs.

The need for life insurance often changes as one ages and minor children reach adulthood. Often the death benefit is inherited by beneficiaries or included in the owner's estate. The conversion of such policies

[5] Annual Report, 2007. American Council of Life Insurers

into flexible "end-of-life" policies would create a major funding stream for long term care. Converted policies could be designed to provide flexibility: they can be used to pay LTC costs, which would otherwise be charged to Medicaid – and ultimately to the American taxpayer. They can be used to provide a death benefit. The remaining death benefit would still be passed down to beneficiaries, minus the insured's LTC expenses.

One important advantage to conversion is that life insurance policies purchased twenty or thirty years ago are likely to be well-funded, and with substantial cash values, because the actuarial assumptions are based on mortality rates that do not reflect the U.S.'s marked increase in life expectancy. U.S. mortality rates and life expectancies have improved dramatically since 1949, when the first baby boomers were born. At that time, male's life expectancy was 66, females, 71; in 2006, males had an average life expectancy of 75; females, 81. A policy purchased by a 30 year-old male in 1960 might assume a life expectancy of 65. Thirty years later the life expectancy may be 68; but the policy would set aside cash value as if the mortality expectations were unchanged. In addition, mortality rates used for life insurance nearly always lag behind actual experience, for they are calculations based on census data, which are at least 10 years out of date.

There are precedents and experience to draw on that argue for the conversion plan's feasibility:

- The federal HECM Program successfully links two types of financial products: the reverse mortgage and long term care insurance.
- The Partnership for Long Term Care managed to work with 50 state insurance commissioners to approve policies and create incentives for the purchase of long term care insurance.
- Life insurers have decades of experience developing hybrid life insurance policies that combine family income protection with other financial goals. Further, the sector's support of the proposed conversion

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- would advance one of its major marketing strategies. A recent study declared that "the most significant opportunity for organic growth in the life insurance industry is represented by the retiring baby boomers.
- As they shift to retirement, they will seek opportunities for low-cost income-producing financial products.[6]" Policy conversion could help open doors to potential customers.

Who Benefits and How

This proposal provides strong incentives for public and private support.

Individual Consumers: the end-of-life policy would provide flexibility to the consumer: s/he would be able to pay for LTC as well as life insurance through one contract. In addition, a converted policy would offer protection for the consumer's insurability for LTC insurance coverage. Many consumers simply cannot afford LTC insurance as they grow older and if they are in poor health. Chiefly, though, older consumers would have peace of mind, in knowing that they can pay for LTC and preserve remaining assets for their beneficiaries.

Government: The proposed plan would greatly reduce Medicaid costs, a clear advantage to states facing draconian budget shortfalls in the immediate and foreseeable future. Reducing the enormous costs of Medicaid would create a new funding stream to support health care reform.

Insurance Industry: would benefit from the opportunity from the marketplace expansion life insurers could experience through this plan:

- the strong consumer incentive to purchase additional insurance in end of life policies. The average life insurance policy death benefit is $130,000, which may be sufficient for estate purposes, but insufficient to cover the average 2.5 year needed for LTC—a clear argument for the purchase of additional insurance. Consumers seeking coverage for LTC as well as life insurance.
- The opportunity to market new products to aging Baby Boomers, good prospects for annuity and other retirement distribution products.

[6] 2008 Life Insurance Industry Outlook, Ernst and Young.

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LTC Providers: LTC institutions would benefit from a reduction in the costs associated with collecting, managing and reporting on Medicaid funds, enabling them to better focus on the provision of high quality and compassionate care.

Implementation Steps

The following outlines the steps needed to make the conversion concept a reality.

- Recruit an advisory council that includes representation from state and federal governments, the insurance industry, state insurance commissions, health care finance commissions, the long term care sector, and the network representing aging consumers and aging services, such as AARP and the Robert Wood Johnson Foundation;
- Conduct actuarial research to set industry-wide standards for policy conversions,
- Develop and pilot a conversion program prototype,
- Formulate a budget to support the nation-wide conversion,
- Develop legislation necessary to implement nationwide conversion,
- Conduct public information and legislative lobbying to further the enactment of legislation, and
- Establish benchmarks, monitor achievement, and revise strategies to meet program goals

Summary

The proposed life insurance conversion plan is a bold and high stakes program, but it needs to be addressed now, if we are to have any control over the LTC funding problems that are bearing down on us. If we are ever to truly make significant changes in our health care system and address the needs of the uninsured, we will first need to reduce the monumental burden of LTC. One of the advantages of the breathtaking, turbulent economic crisis is that we are becoming used to astronomically high numbers and the huge and sweeping actions required to stabilize the economy. We need approaches that are scaled to the enormity of the problems we face. This life insurance conversion proposal responds to the very real dangers this country faces in caring for the elderly as well as the challenges it faces in reforming its health care system.

SUMMARY

Proposal for Increasing Consumer Responsibility for Long Term Care
Converting Life Insurance to Dual Purpose Insurance (Life/Long Term Care)

Front End Consumer/insurance co. responsibility	Supplement Consumer/insurance co. responsibility	Back End Government responsibility
• $100-130,000 dual purpose insurance[7] [8] (*) • if tax qualified, then can be employer sponsored[9] (*) • optional death benefit rider (in event payout is used for Long Term Care) (*) • optional rider to protect income after Partnership kicks in (see Back End Column) (*)	• Dual purpose insurance or stand alone Long Term Care Insurance (*) (depending on geographic cost of Long Term Care as well as consumer affordability)	• Long Term Care Partnership --New York State Model Preferred (3 yrs nursing home, 6 yrs home care or combination) • Consumer assets protected • Insurance company responsibility ceases. • Optional rider to protect income (see Front End Column) **(*)**

[7] Death benefit can be stripped out at age 65 if chosen
[8] Mostly already purchased.
[9] Current tax qualification capped at $50,000 term life insurance.

(*)INSURANCE COMPANY INCOME OPPORTUNITY