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Patented pricing mechanism aims to unlock LTCi hybrid market

By Editor Test *Wed, Aug 14, 2013*

Strategic Health Management has developed and Ruark Consulting will market the Flexible Insurance Pricing Option, or FIPO, which enables the calculation of rising premiums.

Yet another of the ill effects of low interest rates on life insurance companies has been to stifle the manufacture of hybrid products that combine long-term care insurance (LTCi) coverage with either life insurance or a fixed deferred annuity.

For people who have the available assets, hybrid LTCi products can significantly reduce the cost of long-term care insurance. Income from the assets of the underlying life policy or the annuity helps fund the LTCi premiums. If and when long-term care services begin, those assets are applied to the initial costs. When the assets are exhausted, the LTC insurance kicks in.

Low interest rates have hurt this market. Most if not all of the issuers of hybrid LTCi products so far have charged level premiums, which means the first premiums are larger than necessary. Part of those early premiums goes into an interest-bearing reserve, to supplement the later premiums, which are smaller than necessary.

But as the Fed lowered rates after the financial crisis, the reserves began to earn far less interest than anticipated. Life insurers responded by cutting back production of hybrid products, according to Rich Tucker, senior vice president at Ruark Consulting LLC, a Simsbury, Conn., firm that works with life insurance companies on research projects and reinsurance coverage.

Now that bottleneck may be opened by a new pricing mechanism that calculates gradually rising premiums, thereby eliminating or reducing the need for reserves. Called FIPO (Flexible Insurance Premium Option), it was created and recently patented by Strategic Health Management, an insurance product developer in Mill Valley, Calif., and will be marketed to life insurers by Ruark.

“When the product is linked to a life policy or annuity and withdraws from the annuity account value, this will withdraw less at first,” Tucker told RIJ. “It’s sloped partly because of the time value of money and partly because the actual long-term care costs incurred are increasing over time. You can think of it as yearly-renewal term [life insurance] policies instead of level-premium term life.”

The pricing mechanism is broadly applicable and can be expressed as software, hardware or a spreadsheet. It could even be used “by an actuary with a green eyeshade and a legal pad,” he said.

So far, most hybrid products have combined life insurance with LTCi. But it makes sense to combine LTCi with fixed deferred annuities, Tucker added. “It would be great to see combos with annuities get more traction,” he said. “The older demographics of the annuity buyer match up very well with the older demographics of the LTCi buyer.”

Tucker called the new product a win-win for insurers and the public. “The benefit of this design to consumers is that they will pay less initially for the LTCi benefit than for a level premium product,” he told *RIJ*. The FIPO design could also help bring more supply of insurance product to this market. “There’s not enough supply right now; the industry isn’t meeting the needs of consumers,” Tucker said. “This design has the potential to enable insurers to stay, ‘Yes, I can do this.’”