Presenters

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- Bill O'Sullivan, General Counsel
- Paul Peterson, Vice President

Long Term Care Group
- Vince Bodnar, Chief Actuary

Faegre Baker Daniels
- Kevin Griffith, Partner
- Pat Hughes, Partner
Overview

• LTC Background
  – Role of Private LTC Insurance
  – LTC 1.0: Traditional LTC Products
  – LTC 2.0: Hybrid Products
  – LTC 3.0: Push for Innovation

• Solvency Implications
  – Risk Exposure

• Implications for the GA System
  – Assessable Premium
LTC Background:
Role of Private LTC Insurance
US spending on LTC was $246 billion in 2015

- 63% was funded by two social programs:
  - Medicare: Limited post-acute care
  - Medicaid: Once assets are spent down

- 20% from direct out of pocket spending
  - Most represents asset spend-down

- Only 3% from private LTC insurance
  - 7 million insureds out of 89 million age 55+

Source: National Health Expenditure (NHE) Amounts by Type of Expenditure and Source of Funds: Calendar Years 1965-2015, Centers for Medicare & Medicaid Services
The need for private LTC insurance

• Asset spend-down most common funding scheme
  – Savings are first exhausted or moved via loopholes
  – Migration to public welfare (Medicaid) afterwards
• Strain on social program funding
  – Medicaid’s mission is to provide a safety net to the poor
  – Not meant to fund lack of LTC planning for the middle class
• Clear need for individual financial planning / private insurance
  – Demographics result in an unsustainable burden on public resources
  – Preserve assets / legacy funding
  – Higher quality of care when privately funded
Consumer attitudes

- Biggest fears about retirement\(^1\):
  - 11% Will have too much debt
  - 18% Won’t be able to afford daily expenses
  - 23% Exhaust savings
  - 28% High medical (LTC) expenses

- Private financing of LTC is strongly preferred\(^2\):
  - 59% agree that individuals should be responsible
  - 66% agree that owning private LTC insurance would give them peace of mind
  - 51% don’t trust the government to run an LTC insurance plan

- Knowledge of LTC costs and risks is relatively low\(^2\):
  - Most greatly underestimate the chance of needing LTC
  - 20% can correctly estimate costs in their state
  - 44% have “other priorities” for money other than LTC insurance

\(^1\)Bankrate.com Money Pulse Survey, Feb. 18, 2015
\(^2\)2014 Survey of Long-Term Care Awareness and Planning, U.S. Dept. of HHS
Unique distribution challenges

Challenges:
• 177 carriers entered the LTCI market; 56 sold 10,000+ policies; 74 sold <1,000
• Extreme example of a product that is “sold not bought”
  – In spite of high initial consumer interest in LTC insurance
  – Lack of consumer awareness of level of risk and costs
  – Sticker shock of high premium rates
• Broad distribution channels do not push LTC products
  – Lack of understanding of product; discomfort selling
  – Already successful selling other products

Response:
• The successful carriers utilized “LTC specialists” to sell their products
  – Agents that are trained to sell LTC almost exclusively
  – Small distribution pockets produced a majority of sales
  – Initial specialists were captive; independent specialists later emerged
• Specialists are trained to:
  – Patiently sit with customer leads – often several hours
  – Educate customers about risks and complex products
  – Have rational responses to premium amounts
LTC Background:
LTC 1.0: Traditional LTC Products
Long-term care insurance 101

- Relatively new product: modern version born in late 1980s
- Patterned after disability income plans
- Most have a defined benefit trigger: requires assistance with 2 out of 6 activities of daily living (“ADLs”) or requires supervision due to a severe cognitive impairment
- Once trigger is met: qualified services are covered up to a daily maximum benefit
  - Usually care received in a nursing home, assisted living facility or by a qualified home health care professional
  - Some plans do not require expenses to be incurred
- Specified benefit and elimination periods
- Inflation protection option: e.g., daily benefit increases 5% each year
- Issue age rated: premiums are intended to be level for life
  - Guaranteed renewable: insurer cannot cancel as long as required premiums are paid
  - Premium increases are by class and must be approved by regulators
Level premium pre-funds an increasing cost

- Four forces contribute to increasing claim costs:
  - Older people more likely to need long-term care
  - Wear-off of underwriting effect
  - Benefits increase for policies with inflation protection
  - Married people becoming widows and widowers (which have higher costs)
Cash flow pattern

- Level premium rates and increasing claims costs results in a cash flow mismatch
- Companies must hold an active life reserve that builds and releases over time
Sales volumes

• Early success!: 20%+ growth during the 1990s
• Short-lived: Sales began to decline in 2001
  (after netting out 2002-2003 FEP enrollment)

Source 1999 – 2015 Broker World Surveys
Leading carriers...then and now

- Compression: top 10 carriers went from 66% to 92% of sales
- 7 of the 10 top carriers have since dropped out

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<thead>
<tr>
<th>2001 Sales</th>
<th>Company</th>
<th>Premium</th>
<th>Share</th>
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<tbody>
<tr>
<td>GE Capital</td>
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<td>23%</td>
<td></td>
</tr>
<tr>
<td>Bankers L&amp;C</td>
<td>$83M</td>
<td>8%</td>
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<tr>
<td>John Hancock</td>
<td>$74M</td>
<td>7%</td>
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<td>C.N.A.</td>
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<td>6%</td>
<td></td>
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<td>UNUM</td>
<td>$55M</td>
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<td>Penn Treaty</td>
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<td>5%</td>
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<td>Allianz</td>
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<tr>
<td>IDS</td>
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<td></td>
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<tr>
<td>Fortis</td>
<td>$26M</td>
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<tr>
<td>Life Investors</td>
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<td></td>
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<tr>
<td>Top 10</td>
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<td></td>
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<tr>
<td>Others</td>
<td>$349M</td>
<td>34%</td>
<td></td>
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<tr>
<td>Total</td>
<td>$1,033M</td>
<td>100%</td>
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<table>
<thead>
<tr>
<th>2015 Sales</th>
<th>Company</th>
<th>Premium</th>
<th>Share</th>
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<tbody>
<tr>
<td>Northwestern</td>
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<tr>
<td>Mutual of Omaha</td>
<td>$39M</td>
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<tr>
<td>Genworth(^1)</td>
<td>$33M</td>
<td>13%</td>
<td></td>
</tr>
<tr>
<td>Transamerica(^2)</td>
<td>$25M</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>John Hancock(^3)</td>
<td>$22M</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>New York Life</td>
<td>$16M</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>MassMutual</td>
<td>$11M</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Thrivent</td>
<td>$10M</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>LifeSecure</td>
<td>$10M</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>MedAmerica(^3)</td>
<td>$8M</td>
<td>3%</td>
<td></td>
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<tr>
<td>Top 10</td>
<td>$236M</td>
<td>92%</td>
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<tr>
<td>Others</td>
<td>$21M</td>
<td>8%</td>
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<tr>
<td>Total</td>
<td>$257M</td>
<td>100%</td>
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</table>

\(^1\)Genworth is a former division of GE Capital  
\(^2\)Excluding single premium sales  
\(^3\) Companies stopped writing new LTC in 2015 or later

Source 2002 and 2016 Broker World Surveys
New policy pricing challenges

• Key factors driving the need for higher premium rates
  – Low interest rate environment
  – Lapse rates are virtually zero in later years
  – Decreasing mortality rates
  – Capital requirements
  – Regulatory requirements for conservative assumptions

• Carrier exits
  – Less need to price competitively

• Product offerings becoming more limited
  – Unlimited benefits have essentially disappeared
New premium rate trends

LTCI premiums have climbed above a middle income price point

Average Market Premium - 3 Year Benefit Period with BIO

PA hearing consumer question: “Is LTCI only for the 1%?”

Source: 2002-2015 Broker World Surveys
A changing target market

- Target market’s generation turned over since the 1990s:
  - Issue age 72 in 1995: Born in 1923 (GI Generation)
  - Issue age 59 in 2015: Born in 1956 (Baby Boomer)

- New consumer attitudes:
  - Want immediate value, or ability to “cash out”
  - Less time for / patience with old distribution methods
  - Less interested in wealth transfer

Source: U.S. Census Bureau
LTC Background:
LTC 2.0: Hybrid Products
Life insurance hybrids

- 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 hybrids

### Deferred annuity hybrids:

- 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 hybrids:

- 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
Hybrid 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:**
- 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
- Easy to distribute
  - “Add-on” to the base policy sale; can be sold by broad distribution
- Decreased regulatory, reserve and capital requirements
Hybrid product sales

Hybrid products comprised

15% of new life insurance premium issued in 2015
(up from 12% in 2014)

200,000+ policies and $3.1b issued in 2015

Compared to 104,000 policies and $257m in the stand-alone LTC market

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

Sources: LIMRA's 2015 Individual LTC Sales and 2015 Life Combo Sales Surveys
Shift to Hybrid Products (2\textsuperscript{nd} Generation LTCI)

- Premiums for hybrid plans have overtaken traditional plans
  - Important to note that most hybrid premiums are single premiums

Sources: 2001-2014 Broker World Surveys and LIMRA’s Individual Long-term Care and Life Combo Products Annual Reviews
Looking forward

• Expect increased volume of hybrid sales via:
• Target market expansion
  – Historical focus on affluent market
  – Companies are expanding to middle market via worksite and direct marketing channels
• Distribution and marketing shift
  – With some exception, hybrid sales are currently add-on options presented at the sale of life and annuity products
  – Specialty distribution, focused on hybrids as a primary LTC financing solution, will likely emerge and greatly increase sales volumes
LTC Background:
LTC 3.0: Push for Innovation
Emerging product concepts

Given all of the challenges, the next generation of products must consider:

Insurance carrier goals:
- Need to better “box the risk” being insured
- Mitigate or eliminate traditional risks, such as long-term incidence, mortality and interest rates
- Emerging risks of care delivery changes

Consumer desires:
- Remove the “use it or lose it” features
- Allow flexibility when care is needed
- Help reduce / control personal costs and risks
Looking forward

- NAIC LTC Innovation Subgroup focused on three tasks:
  1. Advocate for federal tax policy changes to encourage private LTC financing
  2. Increase awareness of hybrids and other existing alternative products
  3. New section of the LTC model regulation to enable Savings Based LTC products

- Third Generation of LTCI products is likely to emerge
Alternative products
Using existing insurance products to fund LTC in new ways…

• Care Annuity (UK version of LTC insurance)
  – Underwritten SPIA issued to newly disabled persons
  – Health conditions result in higher monthly benefit payments than traditional SPIAs
  – Removes longevity risk for the annuitant
  – Large segment of 80+ year-olds have enough assets to fund LTC in this manner

• Life settlements
  – Assign death benefit from existing life policy
  – Greater value than cash value; can annuitize for life
Savings Based LTCI

- Would require modifications to NAIC LTC Models
- Shifts investment, lapse and future uncertainty risks to consumer
- Resembles universal life, but with LTC as the insured event:
  - Cash / account values
  - Flexible premiums
  - Annual cost of insurance charges
  - Investment income credits
  - Modular coverage
  - Payout options at LTC event (e.g., annuitize)
Possible public policy changes

- Public catastrophic coverage
  - Universal coverage after a long elimination period (2 or 3 years)
  - Private insurance can be purchased to provide earlier benefits

- Allow 401k to fund LTC / LTC insurance
  - Without tax penalties, up to a maximum amount per year

- Expand Medicare / Medigap to include more LTC
  - Auto-enrollment
  - Minor benefits are mandatory; buy-ups are voluntary
  - Benefit vesting as a substitute for underwriting
Solvency Implications: Risk Exposure
What went wrong with LTC 1.0?

- Low interest rates
- Low lapse rates
- Increasing longevity
- Evolving care delivery
- Regulatory uncertainty
- Carrier exits
- Distribution contraction
- Wary consumers

- 8% became 3%
- 5% became 1%
- 5 to 10 year increase
- Emergence of ALFs
- Political not actuarial
- 100+ to about 10
- 45k+ became ~2,000
- Smart buy to risky buy

1 million policies sold in 2001 vs. <100k in 2016
Losses become difficult to overcome

- LTC premium base decreases while claim costs increase
- Rate increases needed to offset deviations grow dramatically over time
- Regulators resist large rate increases (>25%); require benefit reduction options
- Often impossible to offset losses completely, resulting in reserve corrections
- Solvency risks increase in relation to company’s concentration of LTC 1.0 writings

<table>
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<tr>
<th>Deviation</th>
<th>Yr. 5</th>
<th>Yr. 10</th>
<th>Yr. 15</th>
<th>Yr. 20</th>
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<tr>
<td>+10% Claims</td>
<td>7%</td>
<td>11%</td>
<td>18%</td>
<td>27%</td>
</tr>
<tr>
<td>-1% Lapse</td>
<td>10%</td>
<td>16%</td>
<td>24%</td>
<td>34%</td>
</tr>
<tr>
<td>-1% Interest</td>
<td>8%</td>
<td>14%</td>
<td>20%</td>
<td>27%</td>
</tr>
<tr>
<td>All Three</td>
<td>28%</td>
<td>44%</td>
<td>64%</td>
<td>92%</td>
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Cash Flows By Year Since Product Launch

Rate Increase Required to Offset Future Losses
Key items to watch

- Actuarial assumptions used in reserve models remain aggressive:
  - Will interest rates return to “normal”? 
  - Will mortality continue to improve? 
  - Will disability incidence rates improve? 
  - Will care delivery continue to evolve, making LTC less of a stigma?
- Financial metrics and ability to absorb an increase in LTC reserves (e.g. +20%)
  - Premium rate increases may be needed 
  - Decrease in surplus if required premium rate increases cannot be achieved 
  - Relationship between insurer’s LTC reserves and total reserves
- LTC spin-offs 
  - Several carriers would like to follow CNO’s lead (spin-off SHIP) 
  - Isolate LTC within a legal entity; sell off or reinsure other lines
- Diminishing LTC expertise within carriers
- Suitability of emerging acquirers
### Financial metrics of largest LTC carriers

#### Top 25 LTC Carriers – Data as of 12/31/2015

<table>
<thead>
<tr>
<th>Company</th>
<th>Still Selling?</th>
<th>Policies 000s</th>
<th>LTC Prem. $millions</th>
<th>LTC Rsvs. $millions(^1)</th>
<th>Total Liabs. $millions</th>
<th>Surplus $millions</th>
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<tr>
<td>Genworth Life Ins Co</td>
<td>Yes</td>
<td>1,120</td>
<td>2,461</td>
<td>14,659</td>
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<td>John Hancock Life Ins Co Usa</td>
<td>No</td>
<td>873</td>
<td>1,543</td>
<td>12,910</td>
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<td>Metropolitan Life Ins Co</td>
<td>No</td>
<td>501</td>
<td>753</td>
<td>10,005</td>
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<td>14,485</td>
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<tr>
<td>Continental Cas Co</td>
<td>No</td>
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<td>498</td>
<td>9,007</td>
<td>32,808</td>
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<td>Unum Life Ins Co Of Amer</td>
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<td>531</td>
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<td>Allianz Life Ins Co Of N Amer</td>
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<td>Northwestern Long Term Care Ins Co(^2)</td>
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<td>New York Life Ins Co</td>
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<td>Medamerica Ins Co</td>
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<td>58</td>
<td>89</td>
<td>854</td>
<td>856</td>
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<tr>
<td><strong>Total Top 25</strong></td>
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<td><strong>6,086</strong></td>
<td><strong>10,264</strong></td>
<td><strong>95,676</strong></td>
<td><strong>2,096,336</strong></td>
<td><strong>125,886</strong></td>
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\(^1\)Policy reserves only. The inclusion of disabled life reserves would raise values considerably.

\(^2\)Northwestern LTC is reinsured to its parent company Northwestern Life.

Source: 2015 NAIC Statutory Annual Statements
Acquisition landscape: high interest; few deals

• Seller motivations:
  – General industry trend to dispose of closed blocks
  – LTC administrative activity increases with an aging block
  – Sophisticated IT platforms required
  – Very specialized product management
  – Risk of future reserve adjustments
  – LTC viewed as an “earnings drag” by market analysts

• Buy-side dominated by private equity backed reinsurers
  – Attracted by amount of assets and ability to increase portfolio yields
  – Additional spread used as a mitigant of LTC volatility
  – Move administration to a place with scale
  – Implement best practice claims and inforce management

• Difficult to find price points that both parties can agree with
  – Sellers reserve with optimistic future state assumptions
  – Buyers price with data-driven historical state assumptions
Implications for the GA System
NAIC Model GA Act Coverage Structure

• Three “Categories” of Policies Covered by GAs
  – Life Insurance
  – Annuities
  – Health Insurance

• Each Coverage Category Has Different Coverage Levels
  – Life Insurance: Death Benefits—$300,000; Net Cash Surrender Value—$100,000
  – Annuities: Annuity Benefits—$250,000 of Present Value
  – Health Insurance: Limits Depend on Type of Health Insurance
    • Hospital, Medical, Surgical or Major Medical Insurance—$500,000 in Benefits
    • Long Term Care and Disability Insurance—$300,000 in Benefits
    • All Other Health Insurance—$100,000 in Benefits

• Other Coverage Limits and Exclusions Must Also be Considered
NAIC Model GA Act Assessment Structure

• Each Coverage Category Also Has a Different Assessment Account for Allocating Assessments Among Member Insurers in the State
  – Life Insurance and Annuity Account with up to three Subaccounts
    • Life Account
    • Allocated Annuity Account
    • Unallocated Annuity Account (If Unallocated Annuities are Covered in the State)
  – Health Insurance Account

• The Financial Burden for GA Assessments to Meet a GA’s Coverage Obligations are Allocated among Member Insurers Based Predominately on Two Factors:
  – Category of the Policies Covered by GA
  – Premiums in the Assessment Account Reported by Member Insurers in the State Over a Three Year Period:
    • The ratio of (A) the premiums received by an assessed member insurer in the account for the three (3) most recent calendar years for which information is available preceding the year the insurer was placed under an order of liquidation to (B) premiums in the account received during those same calendar years by all assessed member insurers
NAIC Model GA Act—Application to LTC 1.0

• LTC 1.0 Products Have (Without any Known Exception) Been Regulated under State Insurance Law as Health Insurance

• The GA System has Handled Three Prior Insolvencies of LTC 1.0 Issuers:
  – American Integrity Insurance Company (1993)
  – Life and Health Insurance Company of America (2004)

• Today the GA System is Handling the Insolvencies of Two Affiliated LTC 1.0 Issuers: Penn Treaty Network America Insurance Company (“PTNA”) and its subsidiary American Network Insurance Company (“ANIC”)
  – Largest failure of LTC 1.0 Issuers to Date
  – Many different benefit designs and optional benefit riders issued
  – Premium rate increases actuarially justified even at GA Coverage Levels
  – Major Medical Premium Dominates Health Insurance Account
NAIC Model GA Act—Application to LTC 1.0

Issues Raised in PTNA and ANIC

• Major Medical Insurance Premium Dominance in Health Account
  – Allocates Significant Assessment Burden to Health Insurers that do not write LTC 1.0
  – Most Life Insurers and Annuity Issuers also do not have significant LTC 1.0 Policies

• Many providers of Major Medical Coverage are not GA Member Insurers and Bear no Assessment Burden (e.g., HMOs, Health Service Corporations, Self-Funded Plans)

• Application or Not of the Moody’s Limit (Model GA Act 3B(2)(c)) to Inflation Benefits

• Need for Premium Rate Increases and Alternative Benefit Options for Policyholders

• Managing Liability Funding and GA Assessment Timing Approaches in Light of the Magnitude of the GA Covered Obligations
NAIC Model GA Act—Application to LTC 2.0

• How Should Hybrid LTC Benefits be Categorized?
  – Hybrid Benefits under Life Insurance
  – Hybrid Benefits under Annuities

• Issue Impacts Both GA Coverage Levels and Responsible Assessment Account

• Are Clarifying Amendments Needed?
GA System Health Account Capacity*

* Preliminary Information Responsive to NAIC Questions
Estimated Current Health Account Capacity – 2015 *

• Total member companies – 1,131

• # member companies with Health Account assessable premium - 842

• Estimated Health Account assessable premium - $ 265,015,644,150 (approximately 70.7% of gross Health Account premiums in licensed states)

• Estimated Health Account capacity – $ 5,201,867,362

* Above amounts and counts include PR which is no longer a member of NOLHGA. Ignores multiyear averaging

Source: Assessable premium data as compiled by NOLHGA
Estimated Current Health Account Capacity

Assessment information can be found on NOLHGA’s website:

- www.NOLHGA.com
- Facts & Figures
- Assessment Data

- Various summary reports reflecting nationwide capacity, assessments called and refunded activity by account, year and insolvency case

- Various reports for above by state level
Estimated Health Account Capacity – HMO -2015*

• # HMOs not currently in assessment base – 760 **

• Estimated Health Account assessable premium for HMOs (if included) –
  - $245,814,389,000 (approximately 69.5% of gross HMO health premiums and 92.8%
  of current Health Account assessable premium)

• Estimated Health Account capacity related to HMOs (if included)
  - $4,720,798,810 (approximately 90.8% of current Health Account capacity)

* Above amounts and counts include PR which is no longer a member of
  NOLHGA
** Does not include 100 HMO’s in California under the Dept. of Managed Health
  Care

Source: Above are preliminary results of data as compiled by NOLHGA from
AMBest Global Insurance Database. Data has not been reviewed in detail by
NOLHGA.
## Estimated Health Account Capacity – Comparison

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<tr>
<th></th>
<th>Current Members</th>
<th>Nonmember HMO’s</th>
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<td># companies</td>
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<td>760</td>
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<td>Health Account Capacity Estimates</td>
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<td>4,720,798,810</td>
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By State Comparison

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<tr>
<th>State</th>
<th>Year</th>
<th>Current Health Account Premium</th>
<th>Estimated Health Account Capacity</th>
<th>% HMO Estimated Health Account Capacity</th>
<th># HMOs</th>
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</tbody>
</table>

All States  | 2015 | 359,091,484,148              | 283,498,186                       | 3                                      | 1      |

Source: Preliminary results of data as compiled by NOLHGA from AMBest Global Insurance Database. Data has not been reviewed in detail by NOLHGA.