Actuarial

Selling Blocks of Business

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ILTCI

15th Annual Intercompany Long Term Care Insurance Conference

Overview

Vince Bodnar

Overview Agenda

- Who is selling and buying?
- What should sellers expect?
- What information should sellers offer?

Who is Selling?

- Most interest comes from carriers with completely closed blocks
  - General industry trend to explore outsourcing and selling of closed blocks
- LTC closed blocks have unique challenges
  - Administrative activity increases
  - Sophisticated IT platforms
  - Very specialized product management
  - Risk of future reserve adjustments

Who is Buying?

- Virtually no interest from traditional carriers and reinsurers
- Private equity backed reinsurers dominate
  - Some are attracted by anticipated pricing
  - Some are attracted by size 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

What Should Sellers Expect?

- Transaction with a non-traditional buyer
  - Unauthorized reinsurer; reserve collateralization
  - 100% coinsurance deal; credit worthiness
  - Likely mismatch of RBC and taxation
  - Sale of entire legal entity with LTC business
- Interest from many potential buyers
  - About 6 to 9 serious entities
  - Motivated, but not over-eager
  - Requests for exclusives

What Should Sellers Expect?

- Buyer typically has less understanding of LTC than seller, but will hire strong experts
  - Nevertheless, some basic education occurs
- Rigorous evaluation (more later)
- Low tolerance for theories about future changes (more later)

What Information Should be Offered?

- Transparent actuarial projection model
- Demonstration of reserve adequacy
  - Disabled life reserves by care setting, incurral year for several historical points in time
- Support for assumptions
  - Methods used to develop assumptions
  - Demonstration that application of assumptions is consistent with development
  - Comparisons of assumptions to benchmarks

What Information Should be Offered?

- Demonstration of historical model fit
  - Not just in aggregate, but by calendar year
  - Claim cost components
  - Policy termination rates
- Good launching points
- Ability to test sensitivities efficiently
- Education of reported vs. restated results
  - Statutory and GAAP
  - Historical and emerging, as process unfolds

LTC Transactional Pricing

Ben Keslowitz

LTC Transaction Value Elements

- What are companies willing to pay for?
- What are companies not willing to pay for?
- Additional pricing considerations

LTC Transaction Value Elements

- What are companies willing to pay for?
  - Investable Cash and Asset Transfer
  - Cash Flow Certainty and Long Tail
  - Company Licenses, Distribution, Name & Rating

Investable Cash and Transferred Assets

- Dependent on investment restrictions and assets transferred
- Challenges due to low interest rates and ALM requirements
- Challenges due to market value trust reserve credit requirements

Cash Flow Certainty and Long Tail

- Less variability with more mature blocks
- Less optionality if most lives already disabled
- Provided that earned rate is higher than cost of funds, long tail can lock in ongoing profits

Licenses, Distribution, Name and Rating

- Purchasing company with licenses could lead to future new business optionality
- Purchased distribution channels can supplement existing ones or expedite entry into a market
- Completing transaction with well-known company can boost industry exposure and help future sales
- Acquiring highly rated company may lead to uptick in future sales and quicker speed to market, but will also require excess capital

LTC Transaction Value Elements

- What are companies not willing to pay for?
  - Rate Increases
  - Morbidity Improvement
  - Expected Experience

Rate Increases

- Filing Efforts
  - Expensive / Time-consuming
  - Uncertain Results
- Trends
  - Recent decreases in increase approvals
- Woodworks Effect / Anti-selection
  - Additional claims and selected lapses may materialize due to higher premiums and policyholder communications

Morbidity Improvements

- Lack of comprehensive information
- Studies not completed on insured population
- Is morbidity improvement keeping up with mortality improvement?
- Assisted Living Facility utilization

Expected Experience

- Conservatism already built into valuation
- Pricing team must review experience studies and determine if additional is required
- Must weigh competitiveness of quote against uncertainty of future
- ALR/claims reserve mix important in factoring in uncertainly
- Risky benefit types (e.g. Restoration of Benefits, COLAs, lifetime benefits, lifetime waiver) must be considered

Additional Pricing Considerations

- Capital required
- Investment Restrictions
- Structure
- Domicile
- Employees
- Taxes (DAC, Excise, NOLs)
- Product Distribution

Questions?

Wall Street's View of Long Term Care

Eric Berg

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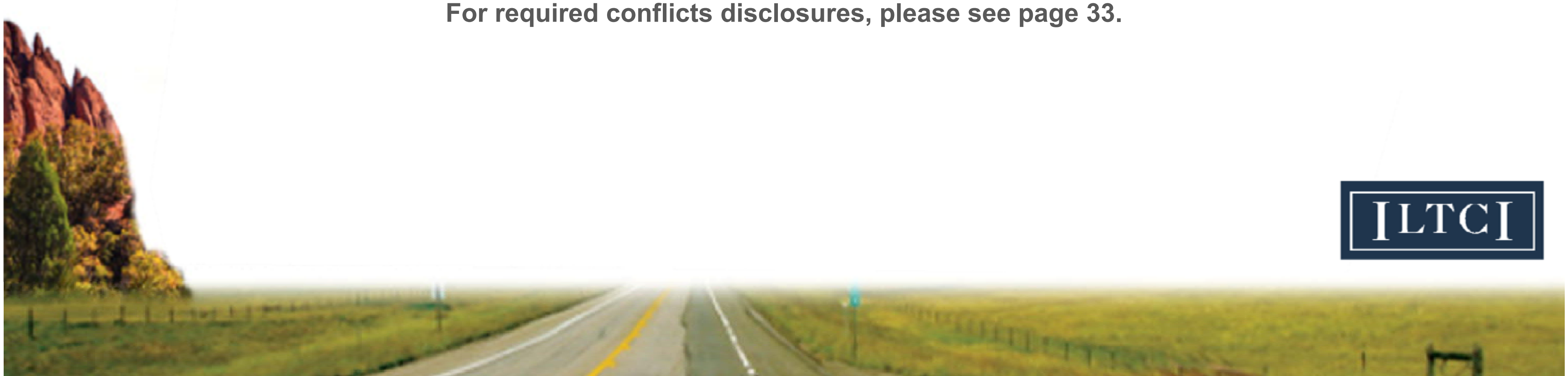

ILTCI

15th Annual Intercompany Long Term Care Insurance Conference

What Wall Street Analysts Do

- Provide analysis and commentary on publicly traded life insurers and on major industry issues.

- Rate Stocks: Buy, Sell, Hold

- Meet with institutional investors (Fidelity, Putnam, MFS) to help guide them through the maze of investment options in the life insurance sector.

What Has Been the Impression LTC Companies Have Given Wall Street?

Actions Speak Louder than We Ever Could:

•Met – OUT

•Prudential – EXITED

•Unum – DEPARTED

•Ameriprise – LEFT THE BUSINESS

•Guardian Life – EXITED

•TIAA-CREF – EXITED

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ADIOS

Further, Unum and Genworth announce LTC reserve increases exceeding in aggregate $1 billion

We can't think of another way to say it: From Maine to California, leading life companies have been calling it quits in LTC. How could this be a good business?

What Does NOT Matter to Us in Evaluating LTC Transactions

- EPS Lift
- ROE Lift

ACCRETION to EPS or ROE, as it is called on Wall Street, does not really speak to whether an LTC transaction is value creating or value destroying

What is the right interest rate at which to discount LTC cash flows?

- 5 percent?
- 8 percent?
- 10 percent?

Point: Cash flows, with different riskiness, need to be discounted at different rates.

Long term care, presenting among the most volatile and therefore riskiest cash flows, should be discounted at 20 percent, in our view.

What DOES Matter to Us in Evaluating LTC Transactions

- IRR
- IRR
- IRR

It's the expected return on an acquired block of LTC policies relative to a company's cost of equity capital that will drive our evaluation of an LTC acquisition

Economic Value Added (EVA)= Return on Invested Capital - Cost of Equity Capital

Disclosures that are NOT Helpful

- "Morbidity was favorable."
- "Claims incidence was up."
- "Recovery experience improved."

Key Points:

- Wall Street likes numbers. Disclosures that are qualitative in nature and bereft of numbers come across as soft.
- Failure to complete comparisons (ie. More dentists prefer Crest) is not only bad grammar, it leaves the reader scratching his head (ie. LTC claims were worse in the quarter.) Analyst's note: Worse than what?

The Type of Disclosure We Would Find Helpful

Useful disclosures:

- A/E incidence
- A/E claims duration
- Actual mix of claims -- home health versus assisted living versus nursing home -- compared with expected mix
- A/E mortality

Bottom line: Wall Street does not like to be patronized. Treat us like the actuarial wannabes that we are.

One more thing…

For us to view LTC block acquisitions favorably, we need to feel this is not the insurance equivalent of whack-a-mole, with one gremlin after another surfacing to cause carriers to stumble.

Summing up

- Acquisitions of LTC blocks of business are no different than any other acquisitions: They are either value creating or value destroying.

- The yardstick we use to evaluate value creation in the LTC world is no different from how we evaluate value creation in any merger or acquisition: What is the IRR on the acquired block relative to the company's cost of equity?

- Qualitative statements about acquired blocks such as "It's a seasoned block," "It's a nicely performing block," and "claims experience is good" are not only patronizing, they leave investors with a bad taste. Why is management hiding behind generalities?

- Numbers, data, figures on actual results versus expected results -- this is what Wall Street feeds off. Give us the tools to evaluate deals fairly!

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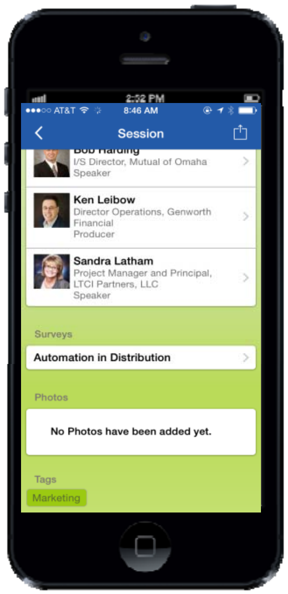

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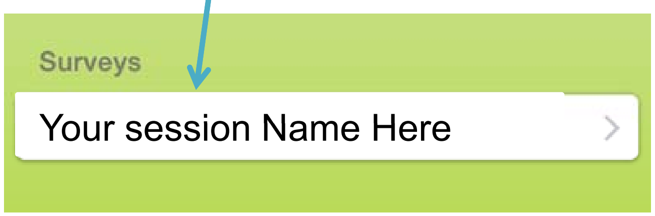

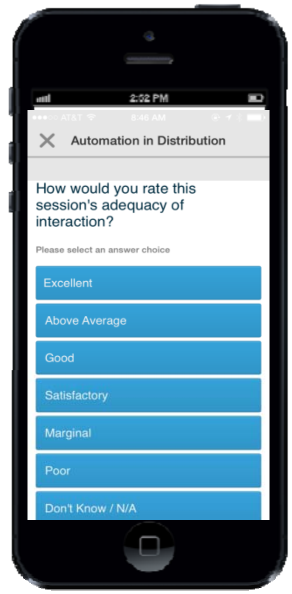

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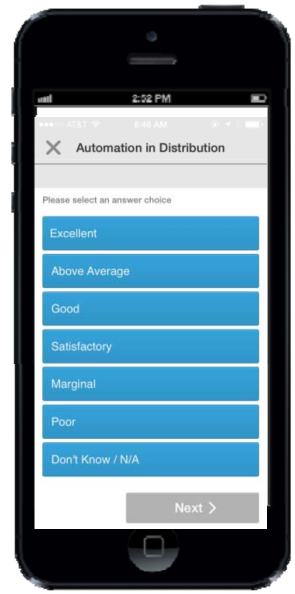

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