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Manulife's long-term U.S. headache

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From Saturday's Globe and Mail

When the Canadian company bought John Hancock, the aim was to become a global powerhouse. But the subsidiary's policies to care for the elderly have wreaked havoc

In the Williams Auditorium of a quaint government building in the Michigan state capital, Marianne Harrison, a senior executive at Manulife Financial Corp. MFC-T , has taken the stage.

This quiet spot, 140 kilometres from Detroit and some 1,290 kilometres from her office in Boston, is an unusual place to find Ms. Harrison. But she's got some explaining to do.

For customers of Manulife's U.S. subsidiary, John Hancock Financial Services Inc., the message she brings is an unpleasant one. Thousands of them have been writing cheques each month for a product known as long-term-care insurance. These policies are designed to help people pay for someone to take care of them when they can no longer take care of themselves. For some Hancock clients, the insurance is an important part of their financial plan for their golden years.

For Manulife, it represents something else: The policies are a money pit, and also an illustration of how much has gone wrong since it vaulted itself to the top of the Canadian financial services industry in 2003 with the $15-billion acquisition of Hancock. Which is why Ms. Harrison is here in Lansing - to make the case for why the company should be allowed to raise prices on long-term-care insurance as much as 90 per cent.

This, she understands, is not a popular thing: Someone who bought a policy 15 years ago when he was 50 could see his annual premium rise from $983 to $1,740, just to maintain the same benefits. The company is attempting to do this throughout the U.S., imposing average rate increases of about 40 per cent on long-term care. But first it must persuade regulators in each state.

"We recognize the difficulty that these premium increases may pose for those affected," Ms. Harrison says from the podium. The room is virtually empty. That might have something to do with the fact that the insurer has not yet been required to directly contact customers and tell them about the proposal.

While many people remain unaware, John Hancock has asked regulators from coast to coast for rate hikes that would affect roughly half a million policy holders, according to filings with state regulators. It is all part of a much bigger effort by Manulife chief executive officer Don Guloien to revive Hancock - and to lift the fortunes of Canada's biggest life insurer, which has stabilized but is still suffering a mighty hangover from the pre-crisis boom years.

Once viewed as the boldest foreign acquisition in Canadian financial services history, Hancock has become

Manulife's albatross, sucking up resources to such an extent that some analysts think it might be time for the company to sell it and flee the U.S. for the promise of Asia. Manulife took a $1-billion writeoff last year because of diminished prospects for its U.S. business; John Hancock takes up almost half of Manulife's equity capital, but, as National Bank Financial analyst Peter Routledge has noted, produces only one-third of its earnings.

The company's large variable annuity business in the U.S. became a major problem during the financial crisis because of the massive amount of exposure to stock markets that it built up. With the rebound in equities, that is no longer the problem that it once was. But Mr. Guloien has nevertheless pledged to remake the company's business - to put more emphasis on fee-based products like mutual funds, to wring better earnings out of its insurance business, and to take less risk so that it will better withstand the next market meltdown.

Those goals, while laudable, won't be easy to meet. It will take time and grunt work of the kind that Ms. Harrison is engaged in. The long-term-care business has been a big part of John Hancock's problems: In fact, it was the main factor cited by Moody's when the rating agency downgraded Manulife in November.

A longer lifespan

At a time when a number of U.S. insurers are running away from the long-term-care business, Manulife, through John Hancock, has redoubled its commitment to it. The insurer has become such an entrenched player that it alone holds the long-term care contract for U.S. government employees, the biggest contract in the game.

But to repair the operation and transform it into a money maker for the decades to come, John Hancock is looking to perform a difficult feat - make hundreds of thousands of people pay a lot more for something they have already bought.

Bob Robison, a retired government employee in Oregon, bought a policy from John Hancock a few years ago after his wife convinced him it would be a good idea. Unlike many consumers, he was well aware that price increases were possible, but he remembers the question on the application that said: "Have you considered whether you could afford to keep this policy if the premiums went up, for example, by 20 per cent?"

Assuming that was the worst-case scenario, he bought the policy. Then he read in a newspaper that John Hancock was seeking rate increases averaging 40 per cent.

"I was shocked," he says. "When I applied for the insurance, I was told to expect a 20 per cent increase over the life of the policy. Forty per cent, a couple of years into it, seemed to me like a bait-and-switch." (Mr. Robison said he still hasn't received any information from the company, so he isn't sure what, if any, increase it is seeking on his particular policy.)

For insurers, it's far from an exact science figuring out when they will have to begin paying claims, and for how long. Benefits generally kick in once policy holders can no longer do a number of basic activities by themselves, such as eating, going to the bathroom, or getting out of bed. Various types of care tend to be covered, including nursing homes or in-home assistance.

Back in Michigan, Ms. Harrison told the nearly vacant auditorium that the company, which appears to be a victim of longer lifespans and advances in medicine, is currently paying out more than $1.5-million (U.S.) in long-term-care claims each day.

"While increasing lifespan is a good thing, for the long-term-care industry it means that people are living longer and reaching the age where frailty and dementia are more likely to occur, and [insurance] carriers are consequently paying far more claims than originally priced for," she says.

In other words, when the product was being created, actuaries made an educated guess about how many claims there would be, and didn't come close. Higher-than-expected claims caused Manulife to take a $755-million charge in the third quarter of last year, and to push for the price increases.

John Hancock is not alone in having misjudged this business. But it is now making one of the largest bets that selling long-term-care policies is a good gamble. Guardian Life Insurance Co. of America got out of the business earlier this year and MetLife Inc. exited last fall. Indeed, Hancock is one of the two biggest providers left of U.S. long-term-care policies, said Moody's analyst Laura Bazer. "It's increasingly a smaller universe of players because

it is a risky business."

It wasn't supposed to be this way. Hancock and others got into the business because they saw the potential for profiting from North American demographics.

"Initially you had an industry of dreamers, including insurance agents and companies, that looked and said 'Six million baby boomers in the United States are all going to buy this product and we all have to get out there because look at the market potential,' " said Jesse Slome, executive director of the American Association for Long-Term Care Insurance.

"Well, there are still people who believe that, but most people today look and say 'This is a niche market.' It's a very defined market."

More than eight million Americans now hold long-term-care policies but business has been stagnating, and sales haven't really grown in years. About 234,000 Americans bought coverage last year, on average paying an annual premium of $2,235, according to Limra, an association of insurers and financial companies.

John Hancock has already pushed some smaller price increases through in recent years. It has also raised the prices it is charging new customers who are looking to buy policies, and stopped selling long-term-care policies to corporations and other groups that want to offer them to their employees.

But price increases take a toll. Thelma Ogden, a John Hancock customer in Portland, Ore., got into a dispute with the insurer after temporarily going into a nursing home last summer. She alleges they should have paid her more, and held back paying her premium when it came due. But she is worried that her rate will be going up now as she reinstates her policy, which she originally bought in December, 1997.

Now 80, Ms. Ogden said a good chunk of her savings were wiped out in stock market crashes since she first bought the coverage, and the $2,000-plus per year that she pays is stretching her budget, making it tempting to drop the policy. "But I have already paid $26,000 to them," she said.

The push in Canada

Back in Michigan, Ms. Harrison walked regulators through the factors that have been weighing on the business. The biggest challenge is that claims often aren't made until 20 to 40 years after the customer bought the policy. Much can change over a period of decades, "such as medical advances, care delivery systems, changes in family dynamics, and the general health of the population," she said. "Advancements in medical care have caused a lengthening of claims, as many medical advances tend to extend lives."

Complicating matters, the industry didn't have much data to use when it first started selling the policies. Insurers originally assumed that between 3 and 6 per cent of policy holders would let their coverage drop (either because they died or stopped paying premiums), meaning those people would never make a claim. But the figure turned out to be less than 1 per cent and, which makes a huge difference to the profitability of the business.

Compounding the problem: Low interest rates, which make it more difficult for insurers to generate the returns they need to make policies profitable, said Ms. Bazer of Moody's.

Ms. Harrison took pains to point out that poor investment returns were not a factor in the insurer's decision to seek a rate increase. Insurers put their money into bonds and other investments to help pay future claims. The stock market plunge of 2008-09 wreaked havoc on those returns. "We are absorbing the loss completely," Ms. Harrison said.

Manulife's struggles in the U.S. long-term-care business are also being closely watched by competitors and regulators in Canada. That's because aging populations, coupled with penny-pinching governments, are prompting more insurers to look at launching the product in other countries, with Canada having been one of the first test markets.

"It is around the world a fairly new type of a product, as are a lot of the other health products," said Paul Fryer, vice-president of individual insurance at Sun Life, which is the biggest player in Canada's decade-old long-term-care business. Manulife, Desjardins and RBC Insurance are also big players in this country in that line of

insurance. "It's certainly an area where we see tremendous opportunity."

But they are learning from Manulife's errors. For instance, insurers in Canada are pricing the product based on assumptions that fewer people will cancel their policies. They are also using cognitive testing before they write new policies.

"We have someone call up the insurance applicant and they ask a series of questions and really try to get at things like memory, early onset of Alzheimer's, and so on," Mr. Fryer said. The lack of that testing in the U.S. led to a high number of policy holders staying on claims for a long period of time, he said.

Insurers have begun putting great effort into promoting their long-term-care coverage in Canada - and raising the spectre of government cuts to persuade consumers it's something they need.

"Most Canadians mistakenly believe that the government will care for us in old age," Manulife's website quotes financial planner Mark Halpern as saying. "But our rapidly aging population suggests we have a false sense of security ... Instead of putting their heads in the sand, people need to take some responsibility now, while they are healthy. The financial impact on many families could be devastating."

Still, the product has not flourished on this side of the border. A survey Limra conducted of the six main long-term-care providers in Canada found that just over 73,500 Canadians owned individual long-term-care insurance policies at the end of 2010, up 5 per cent from the prior year.

But Mr. Fryer is confident sales will grow.

"We're really seeing a lot of interest as the baby boomers near retirement. A lot of these individuals are helping their parents in situations where they may require assistance and seeing the impact it has on them emotionally and financially."

About three weeks after Ms. Harrison's presentation, the state regulator approved the increases in Michigan, making it one of 15 states where the authorities have given Manulife permission to raise rates. In almost all of those cases the company has been given "virtually" all of the rate hikes it asked for, Manulife's chief financial officer Michael Bell told analysts on the company's first-quarter conference call Thursday.

But it's too early to declare victory yet, he added. "There are obviously another 35 states to go."

While Manulife is willing to let its long-term insurance sales slide in order to muscle through price increases, in an interview, Mr. Guloien said he does hope that the company will continue to be a big player in this business going forward.

"It's a very critical need of people," he said. "It's a need that we think we can satisfy. But we can only do it if we have some adjustability of premiums to meet the benefits."

JOHN HANCOCK AT A GLANCE

Manulife bought Boston-based John Hancock Financial Services Inc., which was founded in 1862, seven years ago for $15-billion. The blockbuster deal put Manulife, and Canadian financial institutions, on the map.

John Hancock has 6,178 employees (Manulife has 24,819 employees globally) and $260.8-billion in funds under management.

The U.S. business now comprises roughly one-third of Manulife's overall business, which is divided between Asia, Canada and the U.S.

John Hancock sells a wide range of products under two main divisions: wealth management and insurance. To protect its profitability and decrease its exposure to stock markets and interest rates, it is looking to emphasize products where the earnings come from fees or spreads, and it's jacking up the prices on products that increase its troublesome exposures.

RANKINGS

As of 2010, Hancock says it was:

No. 1 in variable life products in the U.S.

No. 1 in small-business 401(K) retirement savings plans.

No. 1 in individual long-term-care insurance.

No. 4 in total life.

No. 4 in fixed annuities.

No. 5 in mutual funds.

No. 6 in college savings.

No. 10 in variable annuities.

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