



Long Term Care Combination Products

What, Why and How

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AGENDA AND APPROACH

- Product Definition
 - What are we talking about here?
- Underlying Tax Considerations and Issues
- Demographics
 - What is the market need?
 - What is the potential market size?
- Design Concept
- Major Issues

PRODUCT DEFINITION

- **Combination Annuities provide long term care coverage within an annuity**
- **Generally speaking, the long term care benefits provided include a (partial) “distribution” of contract values and a bonafide additional LTC risk element**
- **Combination annuities can exist on any annuity chassis (fixed, indexed, variable) and type (deferred or immediate)**

TAX CONSIDERATIONS

- **Standalone LTC and Life and Long Term Care Combination contracts enjoy favorable income tax-free tax treatment of benefits because of HIPAA (effective 1997)**
- **The Pension Protection Act of 2006 (effective 2010) provides the same treatment to annuities**
- **Thus gain paid out as an LTC benefit will escape income tax**
- **The PPA provides for tax-free exchanges of post – HIPAA annuities into combination annuities**
- **Thus potentially large mounts of gain within existing contracts can avoid income tax**
- **LTC can make a tax-deferred annuity into a tax-free annuity when values are used to pay for LTC**

OTHER TAX CONSIDERATIONS

- The LTC provisions in the annuity have to satisfy the requirements for Qualified Long Term Care Insurance (QLTCL), as defined within the Internal Revenue Code (7702B)
- Charges to pay for QLTCL coverage are not taxable, even if paid from gain
- The government imposes a higher DAC tax on combination annuities (7.70% compared to 1.75%)
- Combination annuities exist only within the context of non-qualified retirement annuities

MARKET NEED FOR LONG TERM CARE

Size:

- Population 65 and over will grow
- by 80% to 55 million in 2020 and then
- to 71 million by 2030

Group Characteristic:

- Life Expectancy at 65 now: 83.4 years
- Life Expectancy at 65 in 1940: 77.8 years
- Live longer, greater chance of being seriously incapacitated

Cost of Care-2007:

- National Average – Nursing Care (SP)-\$68,985
- National Average – Home Care (5x5)-\$24,700
- National Average – Assisted Living-\$35,628
- National Average – “Alzheimer” Facilities-\$51,240

WHY ANNUITY-LTC?

- **Market forces driving consumer interest in LTC**
- Aging of population
- Need for self-reliance
- Desire not to rely on children for weighty choices
- **Past solutions have problems**
- Standalone is expensive
- Underwriting is difficult
- Use it or lose it design is a major negative
- **Combination annuities are a better solution**
- Avoids use it or lose it feature
- Gain is excluded from income
- Self-funding can moderate cost

PRODUCT DEVELOPMENT ACTIVITY

- Several “transitional” products (fixed, indexed, variable)
- Fixed – product provides confinement coverage equal to multiple of AV
- Indexed – provides confinement coverage as multiple of (non-LTC) income benefit
- Variable – provides confinement coverage equal to multiple of GMWB
- Why “transitional”?
- Product doesn’t comply with PPA
- Product doesn’t cover all LTC
- Payments are not income tax free
- VA product activity
- Fixed development activity
- Companies need to protect in-force

GLWB-LTC ILLUSTRATIVE DESIGN

THE SITUATION:

- GLWB (5% income for life)
- Deposit = \$100,000
- GLWB pays out \$10,000 per year while annuitant is healthy
- This is small for LTC purposes
- LTC BENEFIT BASE
 - Annually, Benefit Base = GLWB Benefit Base
 - Annual GLWB=5% of GLWB BB
 - Additional Protection Amount = 2 times GLWB
 - Payable for life
- Suppose BB=\$200,000
- Then Total Protection=\$30,000

LTC ISSUES

MARKET STRATEGY

- Preserve in-force from outside attack
- Provide attractive vehicle to attract 1035 business (flip-side of above)
- Integrate with living benefits
- Illustration support
- Wholesaler positioning and training
- Knock-out questions, potentially (What is this?)

TAX ISSUES

- Law imposes Qualified Long Term Care Insurance requirements
- Insurance means there must be a risk amount
- How much risk is enough?
- Examples
- Low likelihood of IRS guidance

LTC ISSUES

PRODUCTS

- Early focus is on deferred, but immediate annuities will have a major role
- Strong interest in non-variable offerings, including fixed and indexed
- Strong interest in integrating with living benefits, as noted

PRICING

- LTC Benefit is a function of investment performance
- DAC tax impact is a major drag, although it makes adding more LTC seem relatively inexpensive
- AG CARVM may apply to LTC in VA's
- For companies with existing LTC, there may be cultural issue in addressing new product
- Inclusion of LTC raises likelihood LTC will be in the money (living benefit)
- DAC tax impact is a major drag, although it makes moving up a multiple seem relatively inexpensive

REINSURANCE

- Few reinsurers
- Bigger problem for variable business given LTC arms of reinsurers aren't as familiar with VA considerations

ASSUMPTIONS

- Lower lapses than without LTC
- Mortality during claim
- LTC associated claims expenses (underwriting and claims)
- DAC

LTC ISSUES

UNDERWRITING

- This is a big issue
- In major market research study Field (many reps form various distribution segments) has embraced business concept, and has willingly accepted moderate underwriting
- Moderate underwriting – one definition:
- Reasonably fast (no more than a few days)
- Non-invasive
- Can include tele-underwriting
- Prescription Data Base
- One size is not likely to fit all
- Use of TPA's likely

CLAIMS

- Use of TPA's likely
- Number of TPA's and market interest in offering suggest a potential capacity issue