

# *Combination Products*

## **Annuity Combos**

Jeff Drake, OneAmerica

Carl Friedrich, Milliman

Jeff Funderburk, Genworth

March 23 3:45PM



15th Annual Intercompany Long Term Care Insurance Conference

# *Combination Products*

Jeff Funderburk



15th Annual Intercompany Long Term Care Insurance Conference

# The Pension Protection Act (PPA)



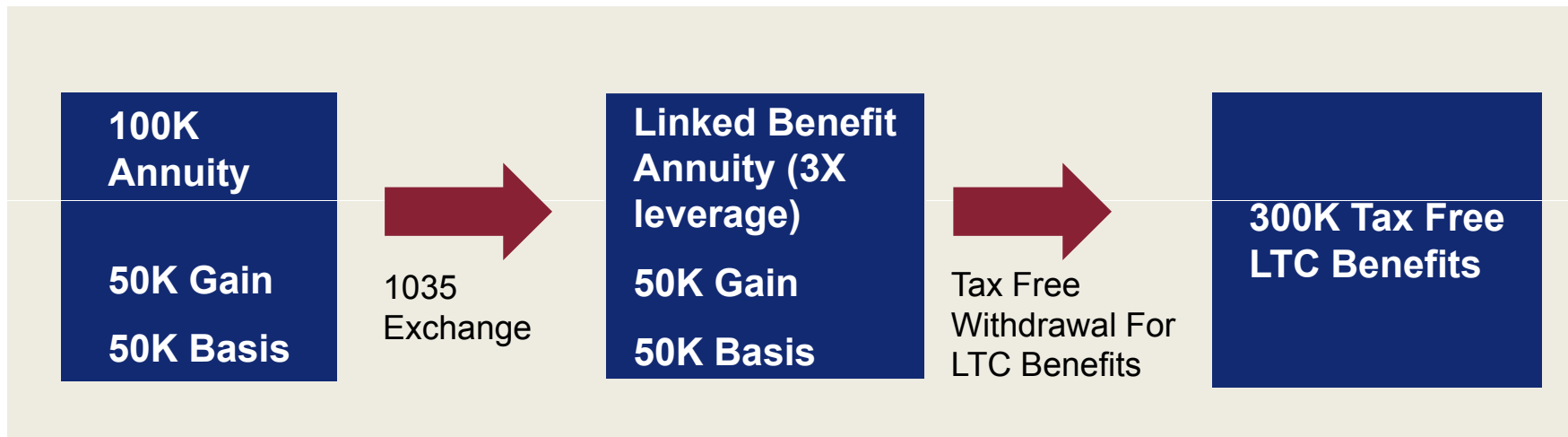
## As of 1/1/2010

- Tax Qualified LTC (QLTC) riders under a non qualified annuity contract will be treated as a separate contract, thus withdrawals for QLTC benefits from these riders are considered tax free benefits.
- LTC rider charges against the account value are not a taxable distribution, although they reduce the client's cost basis (but not below zero).
- 1035 exchanges are now possible to QLTC contract or Linked Benefit contracts with QLTC rider.
- Entire Annuity Linked Benefit contract requires 7.7% DAC Tax vs. 1.75% for a standard annuity contract.

# The Pension Protection Act (PPA)



## 1035 Exchange Example



- Significant Opportunity for clients with existing non-qualified life insurance or deferred annuity contract



## Client Profile

- Age 55-75, retired or close to retirement
- Have already solved for income needs
- Healthy, generally optimistic about the future
  - Doesn't think long term care will be needed, but recognizes the risk of needing long term care is great and the cost is too high to ignore
- Looking for a tax-advantaged way to plan for the potential costs of long term care.
- Looking for asset-based LTC solution
  - Covers the need for LTC benefits
  - Assets are protected and can grow tax deferred
  - Assets can be withdrawn or available as death benefit if not used for LTC
  - May already have non-qualified savings, annuities

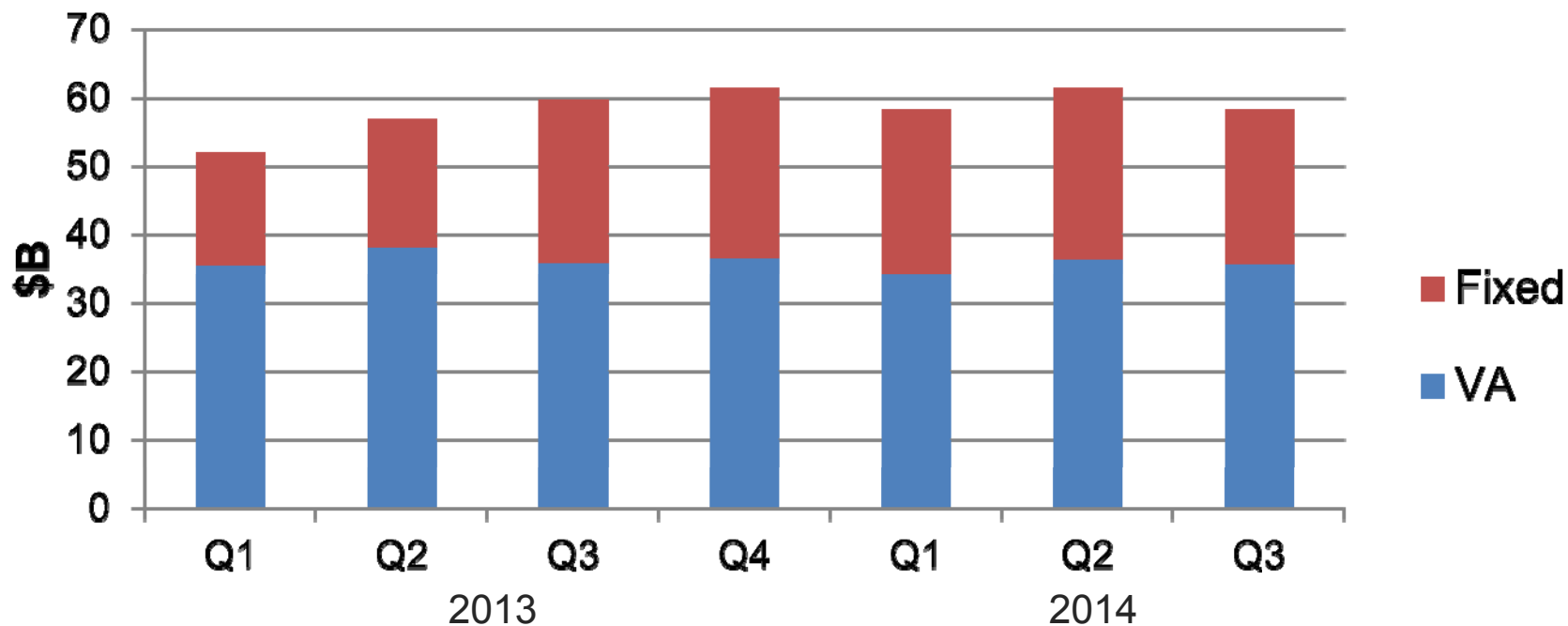
# Annuity/LTC Combo



Base Contracts	Typical Features
Product Type	BV and MVA, Recent Index
Premium Type	Non-Qualified (direct), few qualified (not tax adv.)
Surrender Periods	5 – 10 years
Minimum Guaranteed Rates	1%
Free Withdrawal	10% (after 1 <sup>st</sup> Year)
Death Benefit	Account Value

LTC Rider	Typical Features
Claims	Reimbursement
Acceleration Benefit	24-36 month
Ext./Continuation of Benefit	Available
Leverage Available	2 to 3 times typically (AV or LTC base)
Inflation Protection	Optional

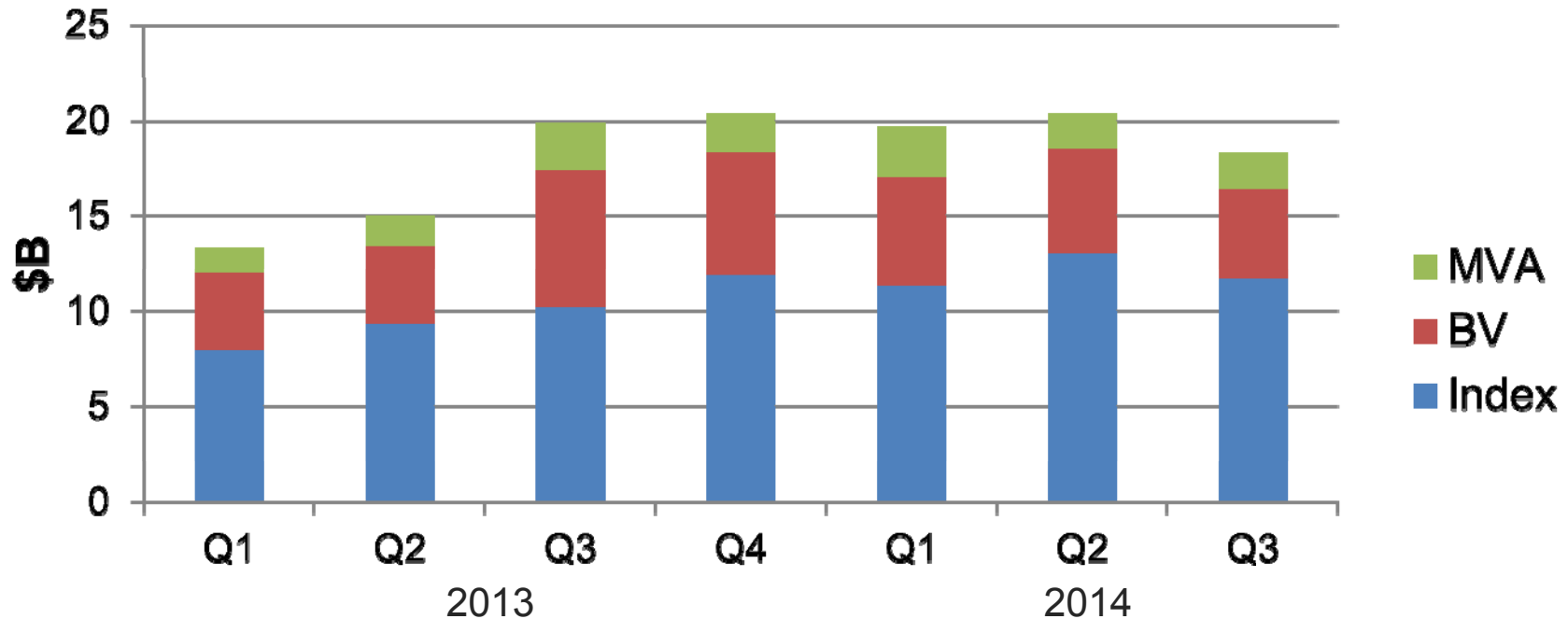
## Individual Annuity Sales



- Variable annuity continues to represent larger share
- Fixed driving recent sales growth

Source: LIMRA U.S. Individual Annuities Report, Q3 2014

## Fixed Deferred Annuity Sales



- Sales continue to be strong in recent years, driven by Index
- Annuity/LTC combo products growing, but still very small portion of market

Source: LIMRA U.S. Individual Annuities Report, Q3 2014





## Guaranteed Living Withdrawal Benefit (GLWB) Income “Doublers”

### Increases the annual income available under the rider for specific conditions

- Triggers may include Confinement to Medical Care Facility or Inability to perform 2 of 6 ADLs
- May be limited for specific number of years and/or other requirements such as positive contract value
- “Doublers” many may double the annual income, others may have specific withdrawal factor increases.

### Income enhancement, substantially lower benefit than traditional LTCl or Annuity/LTC combo products

## **Popular on Fixed Index Annuities**

- Several carriers currently offer, on at least one rider/product

## **Typically a feature that is included with GLWB**

- No separate or explicit charge, included in pricing of GLWB
- No underwriting other than meeting issue requirements of income rider

## **Available on qualified and non-qualified contracts**

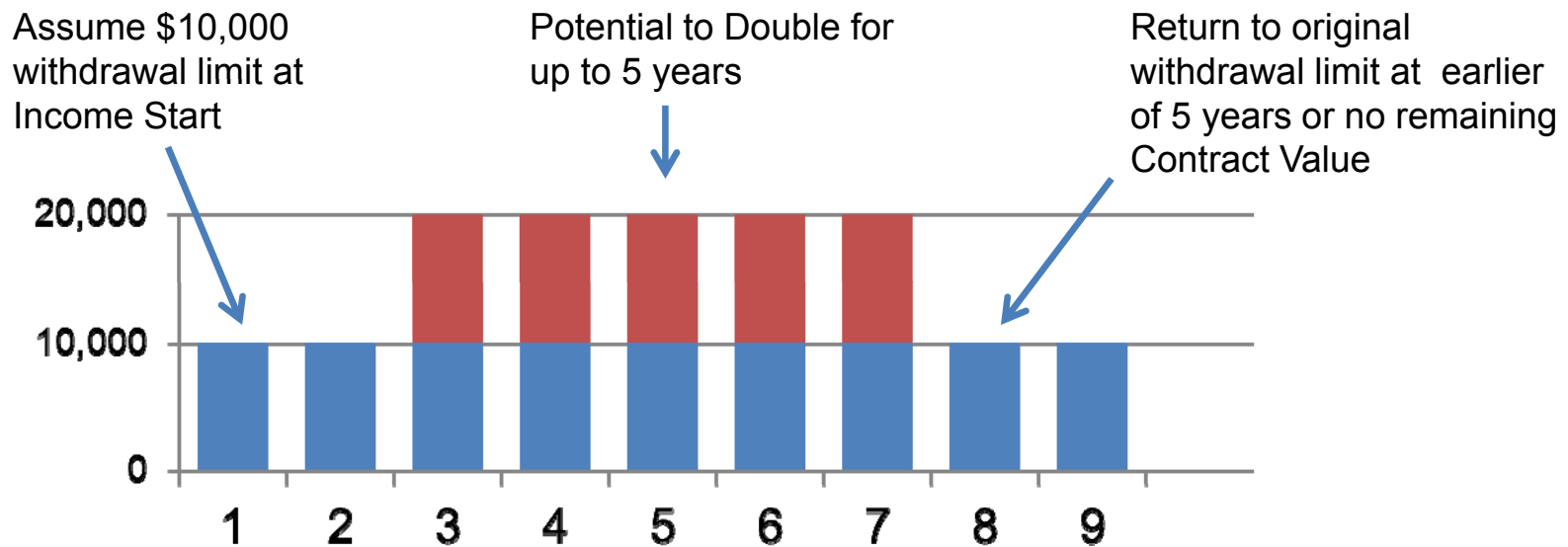
- Not QLTC, withdrawals are taxed as normal withdrawals

# Income Rider Doubler



## Example Income Doubler Design

- Annual withdrawal limit under rider doubled for up to 5 consecutive years for confinement prescribed by physician to a medical care facility.
- Available for single or joint annuitants
- Available two years after contract issue.



# Annuity Combo Market Challenges

## Low Interest Rates

- Less accumulation potential after rider charges
- Suitability of potential transfers

## Sales

- Underwriting process that traditional annuity producers may not be accustomed to.
- Licensing and CE requirements
- Additional Product Features/Complexity
- Traditionally focused on accumulation/income

## Gray Area on Cost Basis

- May limit potential Carriers without clear guidance.

# Important Information



This content was written to help you understand the ideas discussed and to support marketing of the product(s) identified in the material. Any examples are hypothetical and are used only to help you understand the ideas. They may not reflect your client(s)' particular circumstances. Your clients should carefully read their contract, policy and prospectus(es), when applicable. What we say about legal or tax matters is our understanding of current law; but we are not offering legal or tax advice. Tax laws and IRS administrative positions may change. We did not write this material for use by any taxpayer to avoid any Internal Revenue Service penalty and neither you nor your clients may use it for that purpose. Your clients should ask their independent tax and legal advisors for advice based on their particular circumstances.

Prior to engaging in a 1035 exchange, your clients should carefully consider a number of factors including the features and crediting rate(s) of their current product, applicable surrender charges, any new surrender charge period on the purchase of a new product, as well as the various features and crediting rate(s) of the new product. Agents/Producers should carefully consider whether a replacement is in the best interest of their client before making a recommendation to replace the client's existing product.

# *Combination Products*

Jeff Drake



15th Annual Intercompany Long Term Care Insurance Conference

- A Sample LTC Annuity Combo Product
- One Opinion on LTC Annuity Combo Products:
  - Who buys
  - Why they buy
  - Why it's sold
  - Alternative designs
  - Underwriting
  - What is the market potential

# A Sample LTC Annuity Combo Design



- Single Premium goes into two accounts
  - Cash & Death Benefits (AV)
  - LTC Benefits (LTC AV)
    - Credits (projected) a higher interest rate than AV
    - LTC pays out over
      - 24-months for Single Life
      - 30-months with Spouse
- LTC 90-Day Elimination – Reimbursement
- Continuation of Benefits (extension)
- Issue to Age 80
- 9-Year Surrender Charge (9%)
  - 10% Free Partial after year one
  - LTC Withdrawals always free





- Monthly COI Charge based on the LTC AV
  - 36 Months
  - 72 & 108 – not available at older ages
- COI Charge taken from AV
  - Percentage of LTC AV
  - Monthly COI Charge may exceed interest credited
  - LTC AV proportionally reduced
  - Issue Age based COI



- Optional Single Premium Riders
  - Required for TQ Status
  - Inflation Option on COB 5%
  - NonForfeiture
    - Shortened Benefit Period
    - Including optional rider premiums
- No ROP on this product

# Values Examples – Assumptions

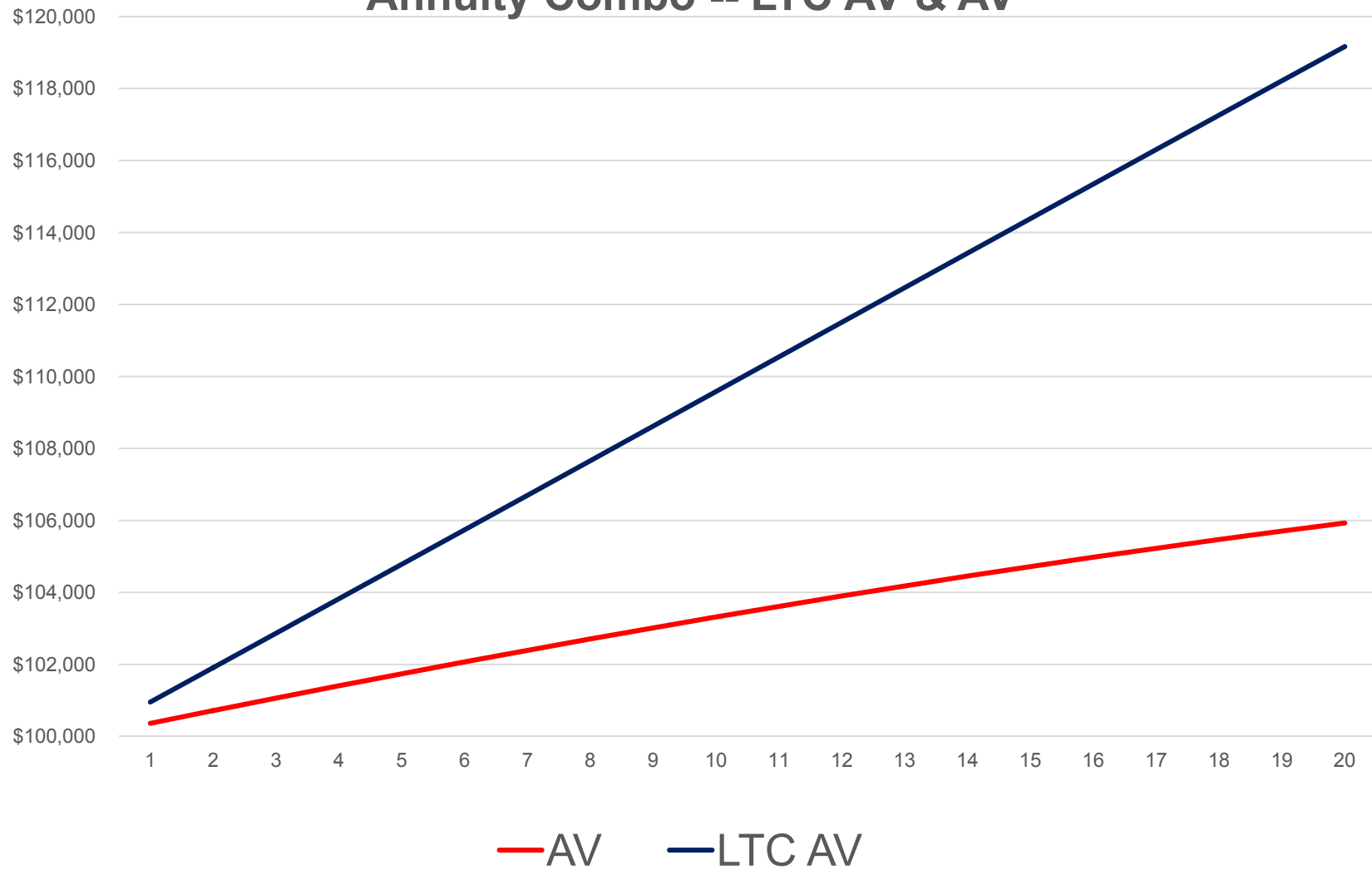


- \$100,000 Single Premium Female 70
  - 2.2% LTC AV – 1.6% AV
- Base LTC of 24 Months
  - Monthly LTC \$4,167
- Extension (COB) of 36 Months
  - \$4,167
  - No NFF / No Inflation
  - 0.10% Monthly (~1.30% Annual)
- \$250,000 of LTC Coverage at Issue

# Graph AV & LTC AV



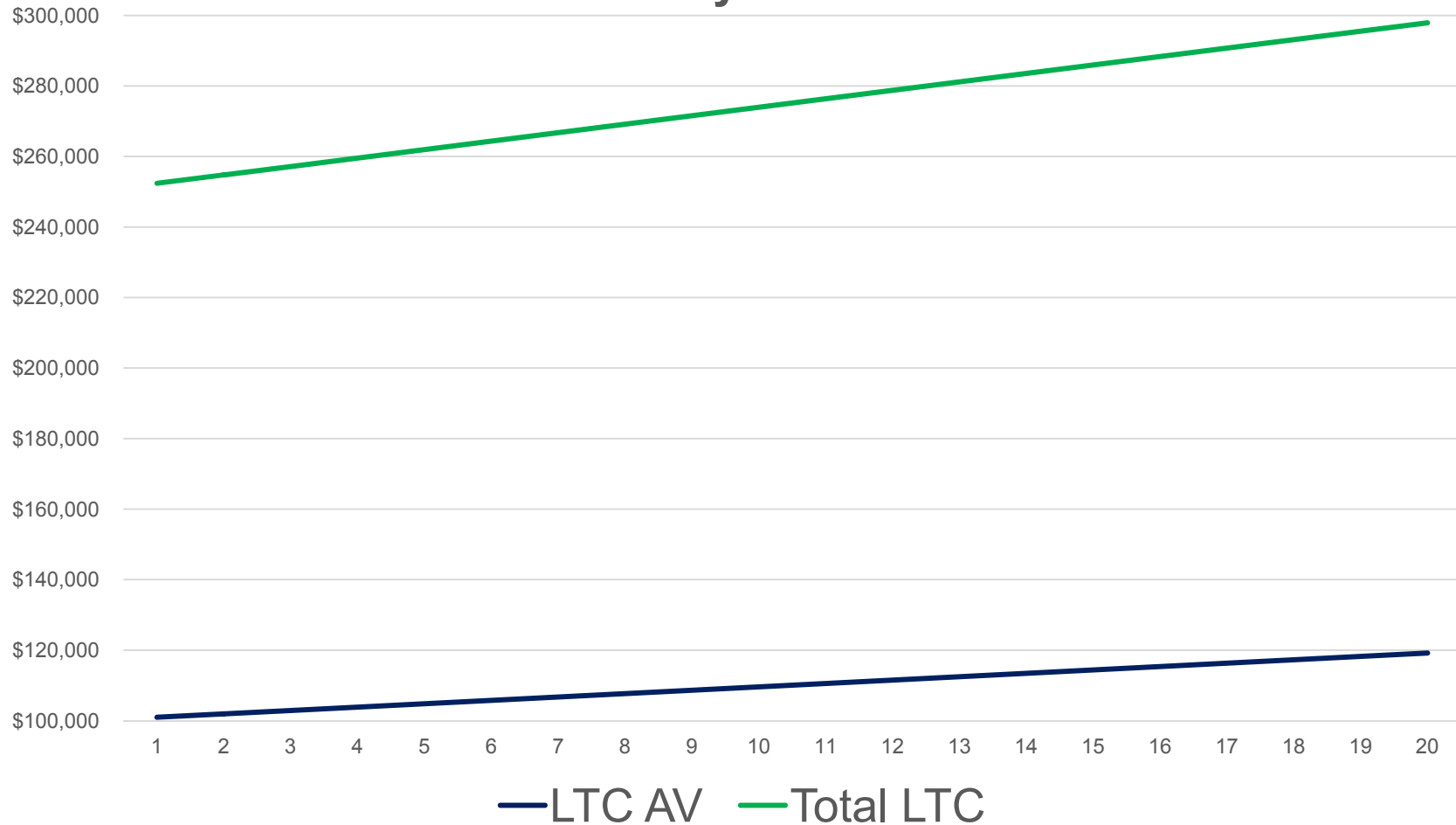
## Annuity Combo -- LTC AV & AV



# Graph LTC AV & Total LTC



## Combo Annuity – LTC AV & Total LTC



# Who Buys?



- Average Age 70
- Single – 73%
- Joint – 27%
- COB Options
  - 36 month COB ~ 71%
  - 72 & 108 ~ 29%
- Inflation & NFF – minimal
- Average Size ~ \$100,000

# Why are they buying?



- They are Retired
- They have finally gotten LTC nearer the top of the list
- They are repositioning money already intended for LTC
  - Double or more for LTC
  - More Tax Efficient
  - Their heirs get what they don't use
  - They still can move the money if desired
  - Can even annuitize for income

# How do Pre-Retirees & Retirees differ?



- 2013 Risks and Process of Retirement Survey Report of Findings
- SOA Sponsored
- Prepared by Mathew Greenwald & Associate



# Issues of Concern (in retirement)



Question	Pre-Retirees	Retirees
1	77%	58%
2	73%	46%
3	68%	52%
4	66%	41%
5	65%	41%
6	53%	45%
Very Concerned or Somewhat Concerned		
other choices --- Not Too Concerned or Not at All Concerned		
2013 Risks and Process of Retirement Survey Report of Finding (2013 SOA)		

# Issues of Concern (in retirement)



Question	Pre-Retirees	Retirees
The value of savings.. not keep .. Inflation	77%	58%
You might not ... money ... health care	73%	46%
You might not ... money ... nursing ... home care	68%	52%
You might deplete all of your savings	66%	41%
You might not be able ... std ... living ... life	65%	41%
There might ... incapable of managing your finances	53%	45%
Very Concerned or Somewhat Concerned		
other choices --- Not Too Concerned or Not at All Concerned		
2013 Risks and Process of Retirement Survey Report of Finding (2013 SOA)		

# Why is it being sold?



- Client is ready to discuss LTC
- Producer gets paid adequately
- Like low transaction time
  - Except for fact product is underwritten

# Underwriting a Sample LTC Combo Annuity



- Clients have minimal questions to answer
- There are no medical exams
- The underwriting process is generally completed with 72 hours
  
- List of conditions for decline
- MIB
- Rx screens
- Phone interview
- Accept/reject

- Not using at this time, although I'm personally interested in the topic
- I wonder how you interpret purchases from a 70+ Female at Athleta?
  - Are they for her, or her daughter or granddaughter?

# Over 15 Years of LTC Annuity Combos



- Self-selection evidence in my experience, richer benefits – increased incidence
- This includes size, but to a much lesser effect
- Much of my experience is when taxation was less efficient

- LTC AV equals the AV (base LTC)
- Sex distinct extension rates
- Multiple rate classes
  - Different COI rates for extension
  - Simplified Classes
    - 2x product – standard class
      - Slower payout of base (lower LTC benefit for longer)
      - Extension longer elimination period & shorter extension
    - 3x product – best class
      - Higher monthly LTC on base (shorter period)
      - Extension shorter elimination period & longer extension

- SOA Report Segmenting the Middle Market: Retirement Risks and Solutions Phase I Report
  - ‘Mass Middle’ & ‘Middle Affluent’
  - 2004 Federal Reserves Board’s Survey of Consumer Finances
- Mass Middle & Middle Affluent
  - 25<sup>th</sup> to 85<sup>th</sup> percentiles measured by income
  - Ages 55 – 74
  - Excludes the top 15%



- Mass Middle & Middle Affluent (Ages 55 – 74)
- Add back the next 13 percentile
  - Does the top 2% really need to purchase?
- Model
  - 30% of Net Worth to LTC Combo Annuity
  - Maximum purchase \$125K
  - 25% would purchase if approached
  - We approach less than 1% this group annually



**\$5 Billion per year**

# *Combination Products*

Carl Friedrich



15th Annual Intercompany Long Term Care Insurance Conference

- SOA is sponsoring a research report (not yet published) on a wide range of living benefit riders with medically related triggers on life or annuity products, including a survey with preliminary responses from 33 companies, reflecting the following numbers by rider
  - Terminal illness - 35
  - Chronic illness - 23
  - LTC accelerated benefits - 9
  - Life linked benefits (includes extension of benefits) - 7
  - Annuity linked benefits - 5
  - Critical illness accelerated benefits - 3



- Basic designs
  - Pot of money (2) – LTC lifetime benefit is a fixed multiple of initial premium
  - Tail design (2) – LTC lifetime benefit is a fixed multiple of AV at time of claim, claims paid first from AV
  - Coinsurance (0) – As tail, but monthly benefits come partly from AV and partly from insurance until AV used up
- Target markets are those seeking insurance and tax leverage on funds to cover LTC needs

# SOA Research - Annuity/LTC Combo Survey



Base plan chassis	Number of plans
Book Value Annuity	3
Market Value Annuity	2
Variable Annuity	1

Premium for base	Number of plans
Single Premium	4
Recurring Premium	1 (very limited renewals)

# SOA Research Report - Annuity/LTC Combos



Benefit Structure	Number of plans
Expense Reimbursement	3
Indemnity	2

Maturity Provision for LTC	Number of plans
Policyholder can extend maturity date by one year on a year by year basis	2
Ends at base plan maturity date	2
LTC paid up at base plan maturity date	1

# SOA Research Report - Annuity/LTC Combos



Underwriting	Number of plans
Supplemental or expanded app	4
Prescription Drug Database screen	4
Policyholder Interviews (PHI)	3
Cognitive screen	3
Face to face exam	2
Medical records	1





- LTC ABR/ EBR charge structure
  - Charges based on level bp assessed against AV (2)
  - Charges based on COI assessed against NAR (3)
  - All charge structures are currently unisex
- Only one plan is reinsured (coinsurance)

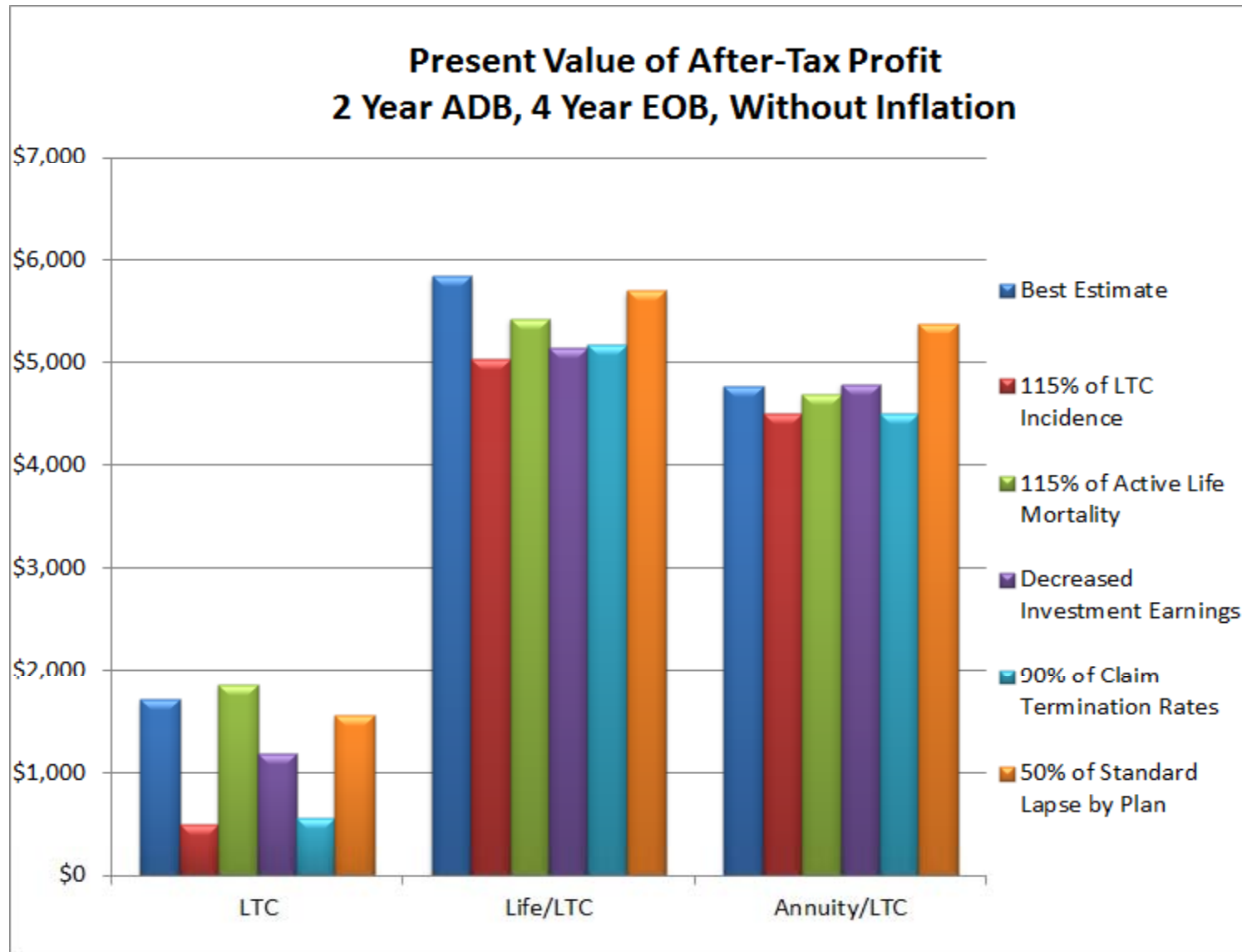
# SOA Research Report - Annuity/LTC Combos



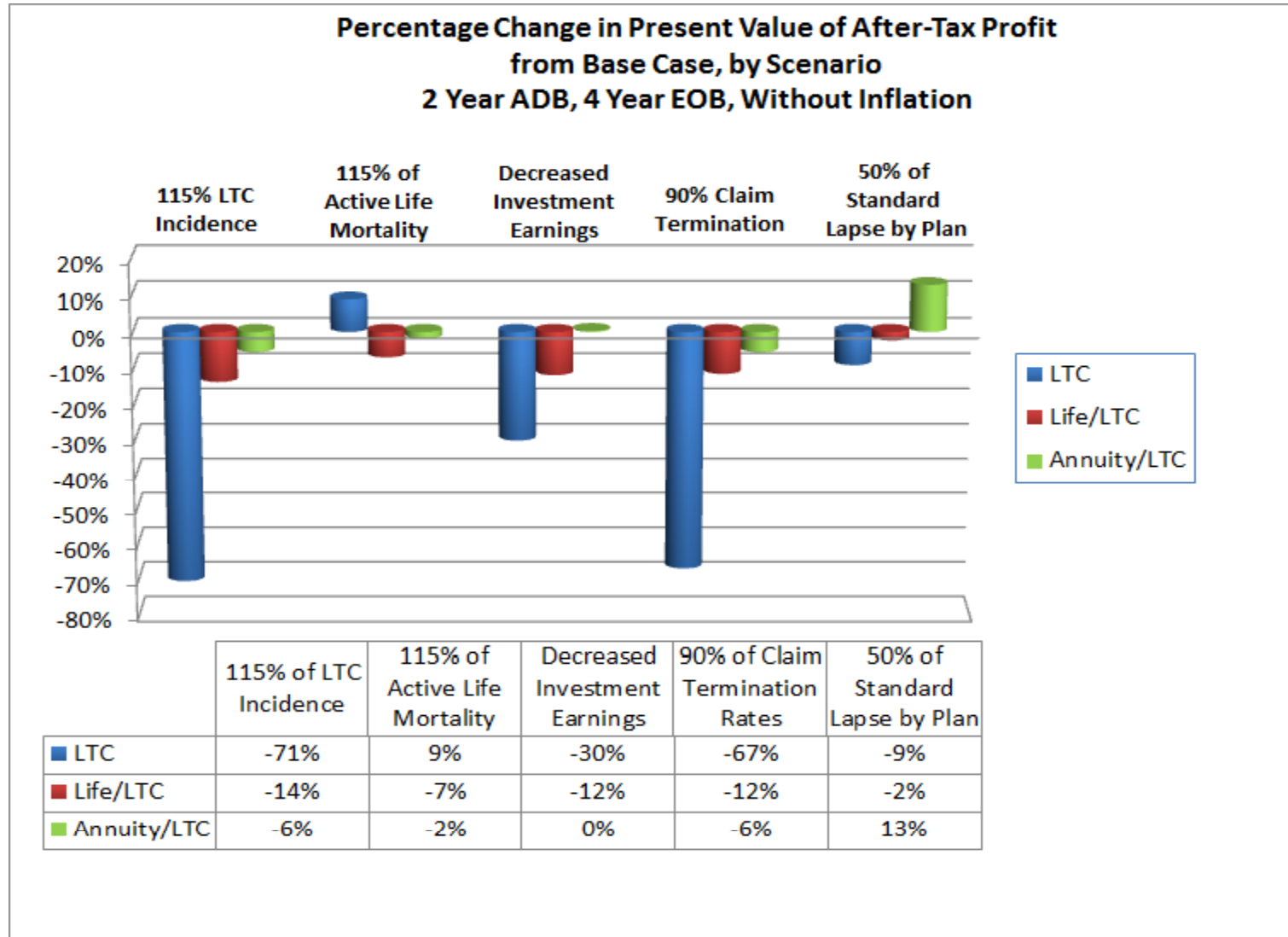
Charge for Inflation rider	Number of plans
No charge	1
Level bp against AV	1
Annual pour-in on anniversary	1
Bps charge against the initial guaranteed amount less withdrawals other than for LTC benefits	1
Single charge at issue	1



- Sponsored by the SOA and the ILTCI Conference Association
- The report addresses the natural hedge characteristics of combination products that link life insurance or annuities with long-term care
- Market outlook and summary of the key design considerations
- Key pricing considerations
- Quantification of the natural hedge within these products, as measured by the impact of lapse rates, interest rates, mortality and LTC incidence and claim termination rates
- Profit measures quantified and presented: IRR, present value of post-tax profits



# SOA/ILTCI Hedging Research Report - 2012



# Annuity/LTC Combos

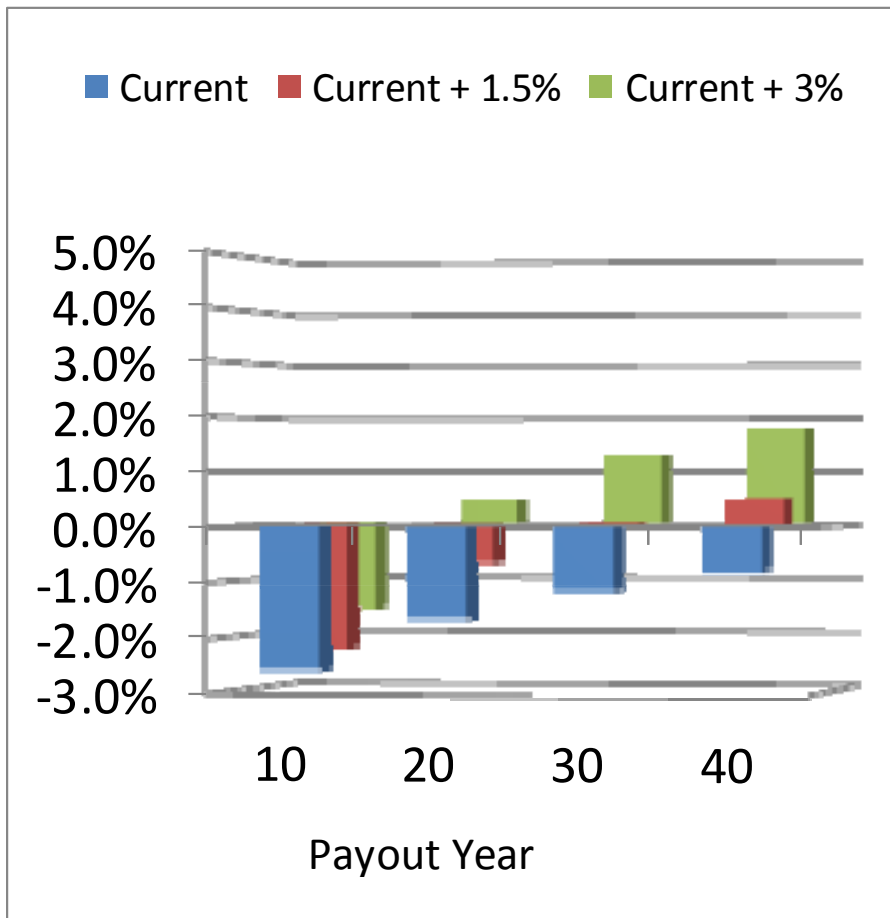


- Life combos vs. annuity combos

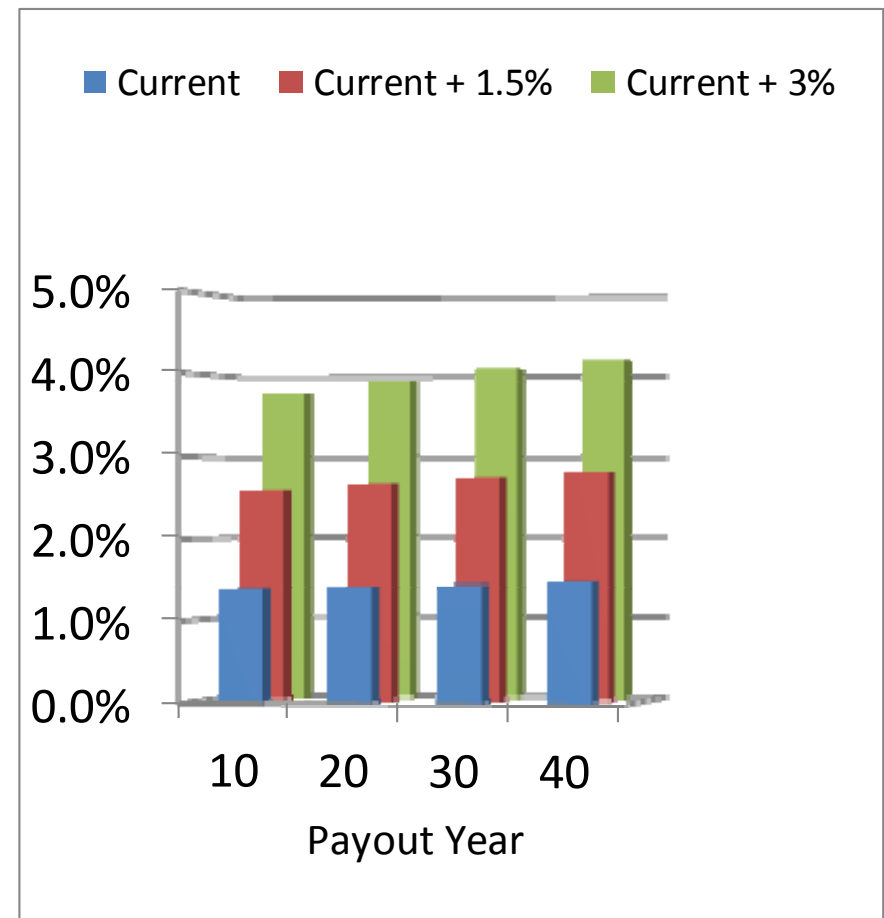
Feature	Annuity combo	Life combo
<b>COI charge for base plan</b>	None	Yes, for life insurance
<b>LTC coverage</b>	From AV first, then independent	From DB first, then independent
<b>Inflation benefits</b>	Built into most via LTC benefits linked to AV - 5% compound costs more	Optional rider, expensive
<b>Taxes (note HIPAA limits)</b>	LTC benefits tax free, else gains taxed at surrender or death	LTC benefits tax free, DB tax free, surrender gains taxed
<b>Return of Premium (death or surrender)</b>	Unusual but moot after first few years	Becoming less common

## After-tax ROI to Policyholder, Male 65, 2YR ABR + 4 YR EBR Annuity Combo minus Life Combo with 5% Simple IPR

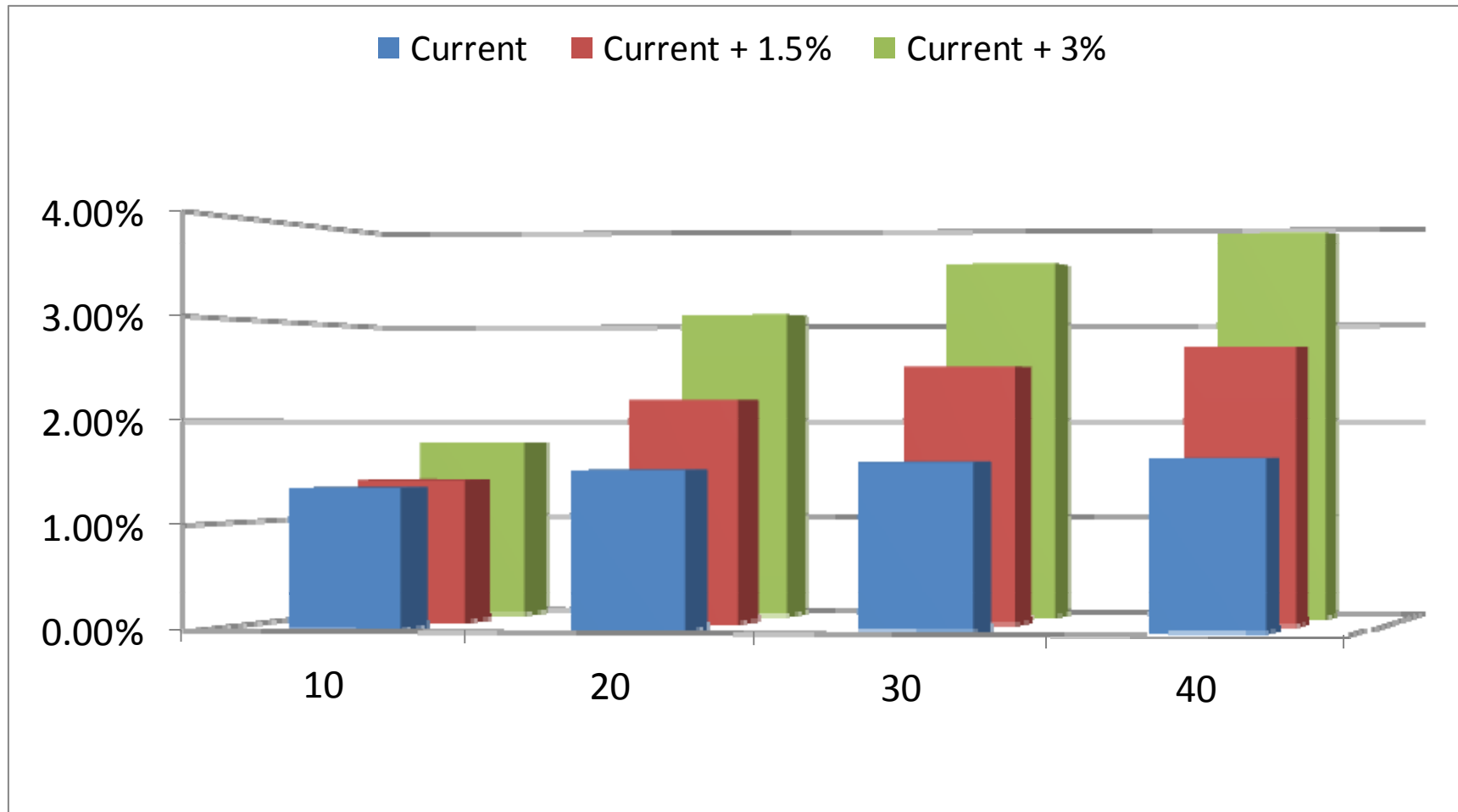
### Upon Max LTC Claim



### Upon Surrender



## After-tax ROI to Policyholder, Male 65, 2YR ABR + 4 YR EBR Annuity Combo minus Life Combo with 5% Simple IPR





- Further Personal Perspectives

- Several other plans in the market are not included in the survey, and at least two more plans under active development
- Several more carriers expressing interest, with major concerns being low interest rates and gray areas of tax law regarding impact of LTC payments on basis in the contract
- Pricing synergies are tremendous, as 80% or more of the volatility of earnings is reduced compared to stand-alone LTC across four major risks (interest, mortality, lapse, incidence rates, and morbidity rates)
- An opportunity for insurers to lock in a revenue stream as annuity combos will rarely lapse
- Annuity/LTC combos represent the only vehicle that allows gain in an annuity contract to be paid out on a tax-free basis (as LTC benefits)

# Annuity/LTC Combos



- Outlook

- Per LIMRA, \$1.86 trillion of NQ annuity AV inforce @12/2013, and most of that will be inforce until surrender charges go to zero over the next 5 to 10 years
- Sales have been growing steadily, but lagging life combo sales
- Higher interest rate environment would avoid invasion of principal risk and allow the product to work better
- Design variations can address some of the challenges of low interest rates
- Higher interest rate environment would remove an obstacle to 1035 exchanges and allow producers to enhance their clients' annuity values via tax leverage and insurance leverage in annuity combos

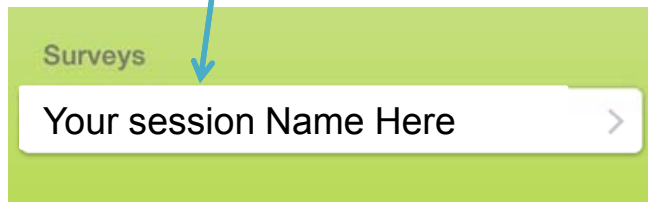
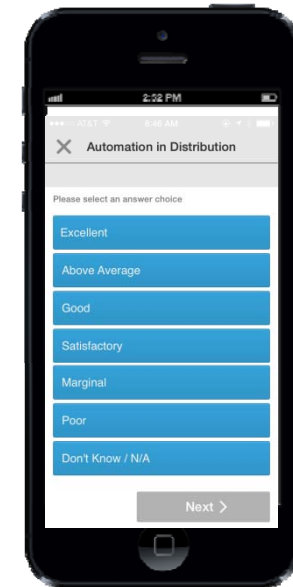
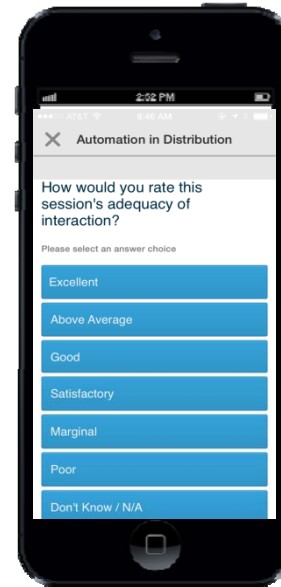
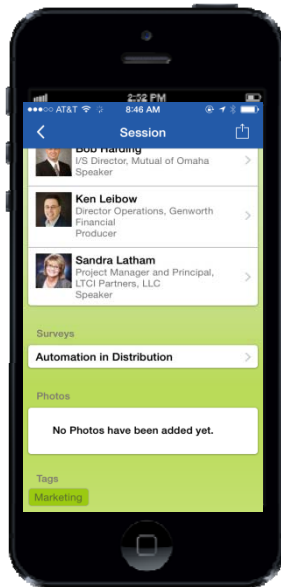
# Don't forget to fill out the survey



1<sup>st</sup> you must have download the ILTCI Mobile App  
- Go to your app store; search ILTCI. It's free.



1. Find the session
2. Scroll to the bottom
3. Tap on the session name below the survey



Tap on the answer you wish to submit

Click Next