

Combo Products

What's going on in the Annuity/LTC Combo market?

Steve Cox, OneAmerica

Carl Friedrich, Milliman

Moderator: Claude Thau, Thau Inc.



Questions we intend to discuss



1. What products constitute the Combo Annuity/LTC market? How are they designed?
2. How does the Pension Protection Act impact Combo Annuities? In particular, what opportunities exist for §1035 exchanges?
3. How big is this market in terms of current sales and potential?
4. What does a typical buyer look like?
5. Why create/sell Combo Annuities? How will these reasons change?
6. How does LTC risk vary between traditional LTC, Combo Life/LTC and Combo Annuity/LTC?
7. What is holding the market back from stronger growth?

If you'd like the panel to respond to your specific question(s) or you have a comment to offer, please complete a card and give it to one of our helpers in the aisles. Thank you!

Pension Protection Act - High Level



- Allowed for tax favored status beginning 1/1/2010
- 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)
- Requires an element of LTC risk – waiving of SC is not sufficient
- 1035 exchanges are now possible

Combo Annuity/LTC Designs



- Tail design vs. coinsurance
 - Both link lifetime max & monthly LTC benefits to AV at initial claim
 - Inflation option rounds out the coverage
- Separate extension premium vs. fund-based charges for extension
- Indexed deferred combo annuities now available as well as fixed
- Pot of money design
 - LTC benefits defined at issue, not linked to AV
 - Facilitates periodic premium combo annuity that can provide meaningful LTC benefits immediately
- Solutions for Tax-Qualified Annuities



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
 - “Doublers” 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, and not a TQ LTC benefit

What is the current size of the Combo Annuity market?



Size of the Total *Deferred* Annuity Market

Table 22 — Deferred Annuity Sales by Market Type (Dollars in **Billions**)

	2010	2011	2012	2013	2014	2015	Percent Change 2015/2014	Average Annual Growth 2015/2010
IRA	\$99.8	\$109.6	\$102.4	\$105.4	\$109.8	\$112.9	3%	3%
Nonqualified	77.0	84.6	71.9	80.4	84.5	80.9	-4%	1%
Employer Plan	32.2	31.0	31.7	28.2	24.8	24.6	-1%	-5%
Total	\$209.0	\$225.2	\$206.0	\$214.0	\$219.1	\$218.4	0%	1%

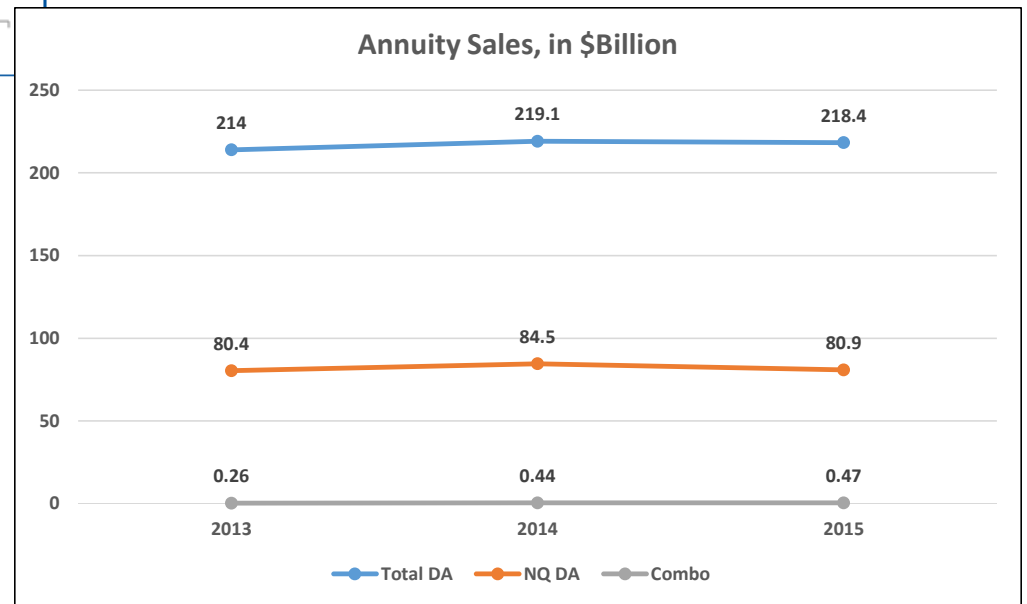
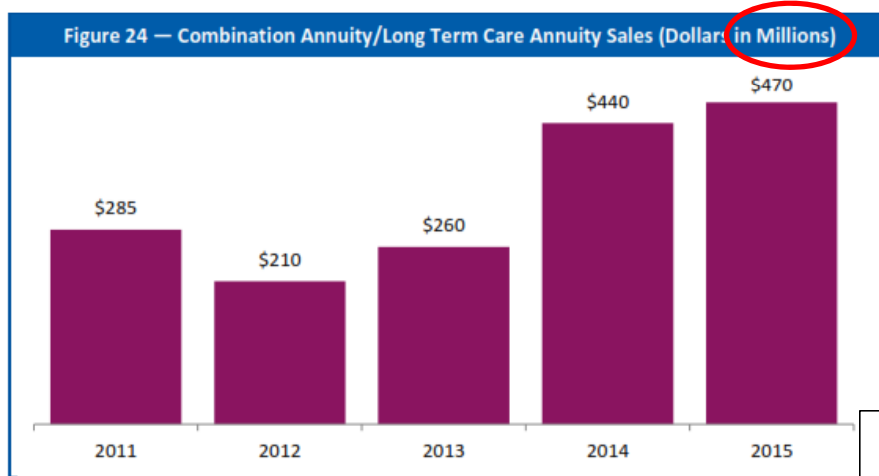
Note: IRA is defined as traditional IRA and Roth IRA sales. All other qualified monies, including SEP, SIMPLE, 403(b), 401(k), individual (k), deferred compensation, Keogh, and pension trust sales are reported as employer plans.

Source: LIMRA's U.S. Individual Annuity Yearbook

What is the current size of the Combo Annuity market?



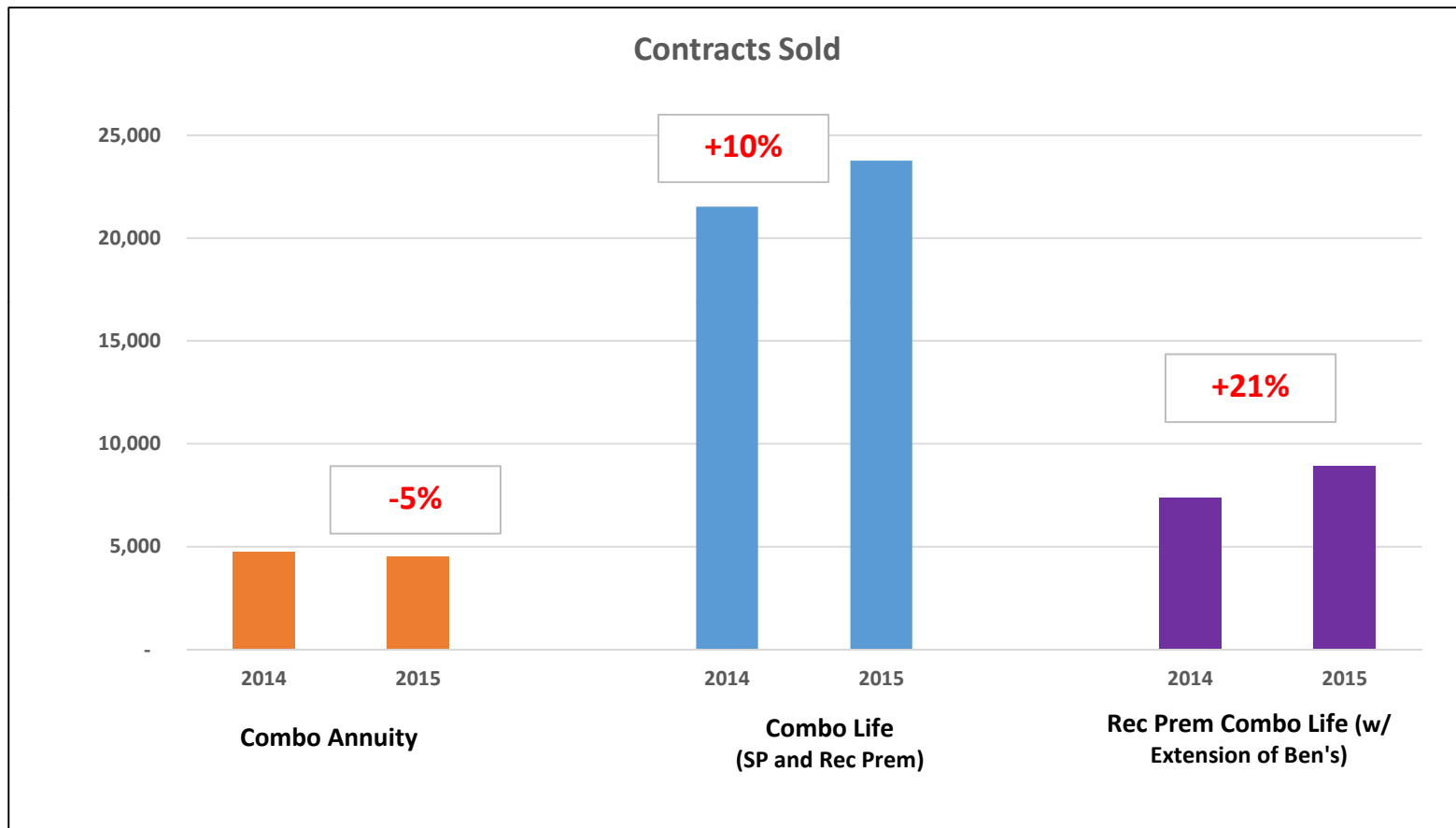
Size of the Total **Combo Deferred** Annuity Market



Growth of the Combo Annuity Market



Growth of the Total **Combo Deferred** Annuity Market



Sources: LIMRA's U.S. Individual Annuity Yearbook & LIMRA's Individual Life Combination Products Survey

Annuity Industry Assets - 2015



Non-Qualified Deferred Annuities

Fixed Annuities	Variable Annuities	Total (per Morningstar/IRI)
\$394B	\$544B	\$938B

Qualified Deferred Annuities

Fixed Annuities	Variable Annuities	Total (per Morningstar/IRI)
\$389B	\$1377B	\$1766B

Product Sales Statistics - 2015



Product	Count	First Year Premium
Stand-alone LTC	About 100,000	About \$300M
Deferred Annuity Combos	About 5000	\$470M
Life Combos	>200,000	\$3.1B
Total Non-Qualified Annuities	?	\$81B
Annuity Doublers	?	?

Typical Buyer Profile



- Average issue age: 71.5
- Average single premium: \$110,000
 - With a very tight range for the 10th to 90th percentiles
- \$2,500 to \$3,500 monthly benefit
- 75/25 gender mix (Female / Male)
- Relative to Life Combo products, more single life (widowed?) than joint / shared pool
- Inflation option take rate: minimal (85% with no inflation)
- Largely an “asset repositioning” sale to address LTC
- Typically the “last stop” for money

Pension Protection Act - Add'l Info

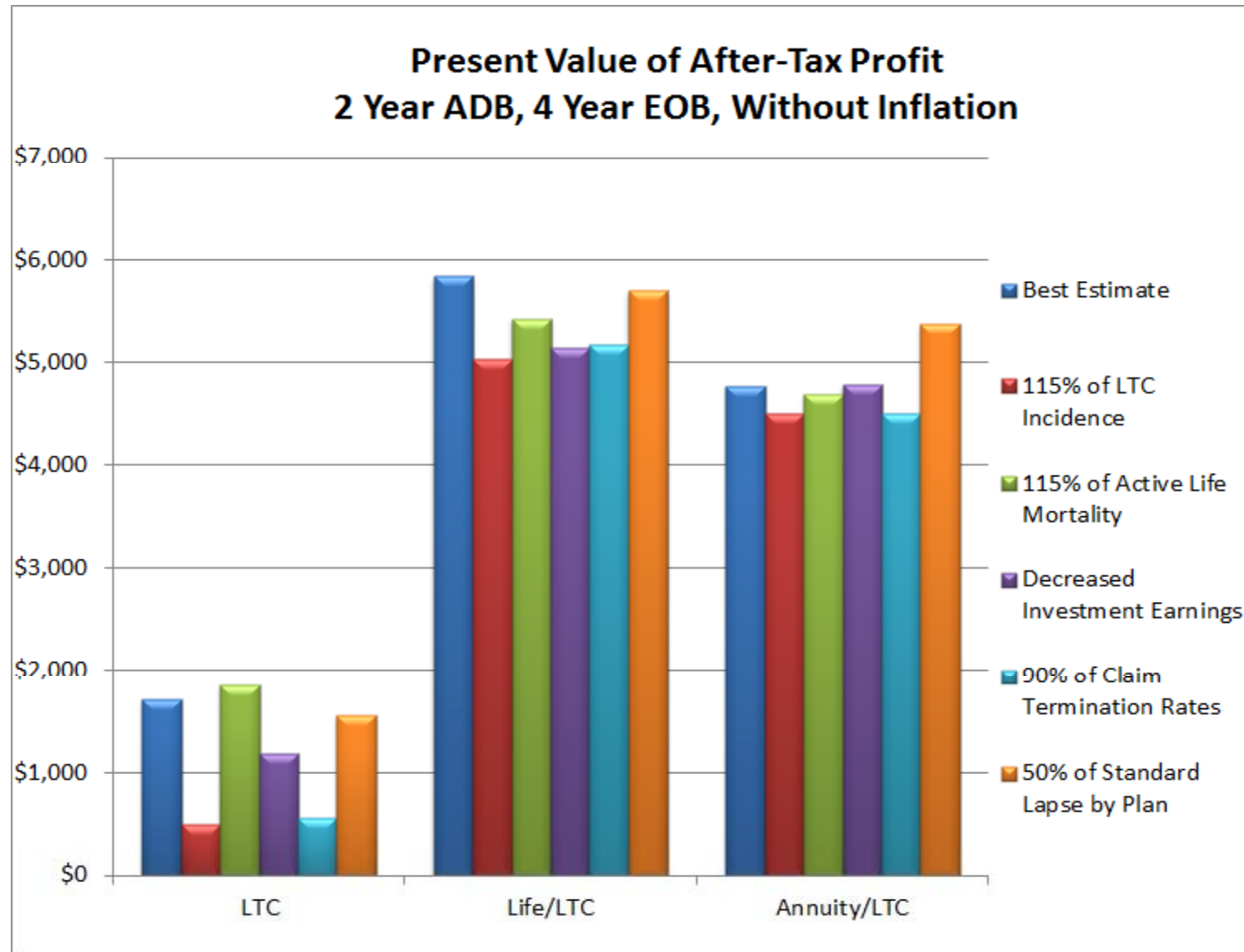


- Allowed for tax favored status beginning 1/1/2010
- Tax Qualified LTC (QLTC) riders under a non qualified annuity contract will be treated as a separate contract, thus QLTC benefits tax free
- LTC rider charges against the account value are not a taxable distribution. They reduce the client's cost basis (but not below zero)
- 1035 exchanges are now possible
- 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)
- Requires an element of LTC risk – waiving of SC is not sufficient
 - *PLRs have answered several open questions after PPA, including reducing the concern about whether the IRS might view acceleration riders with short EBR tails as having insufficient amounts at risk to secure favorable tax treatment*



- Sponsored by the SOA and the ILTCl Conference Association
- The report addresses the natural hedge characteristics of combination products that link life insurance or annuities with long-term care
- 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

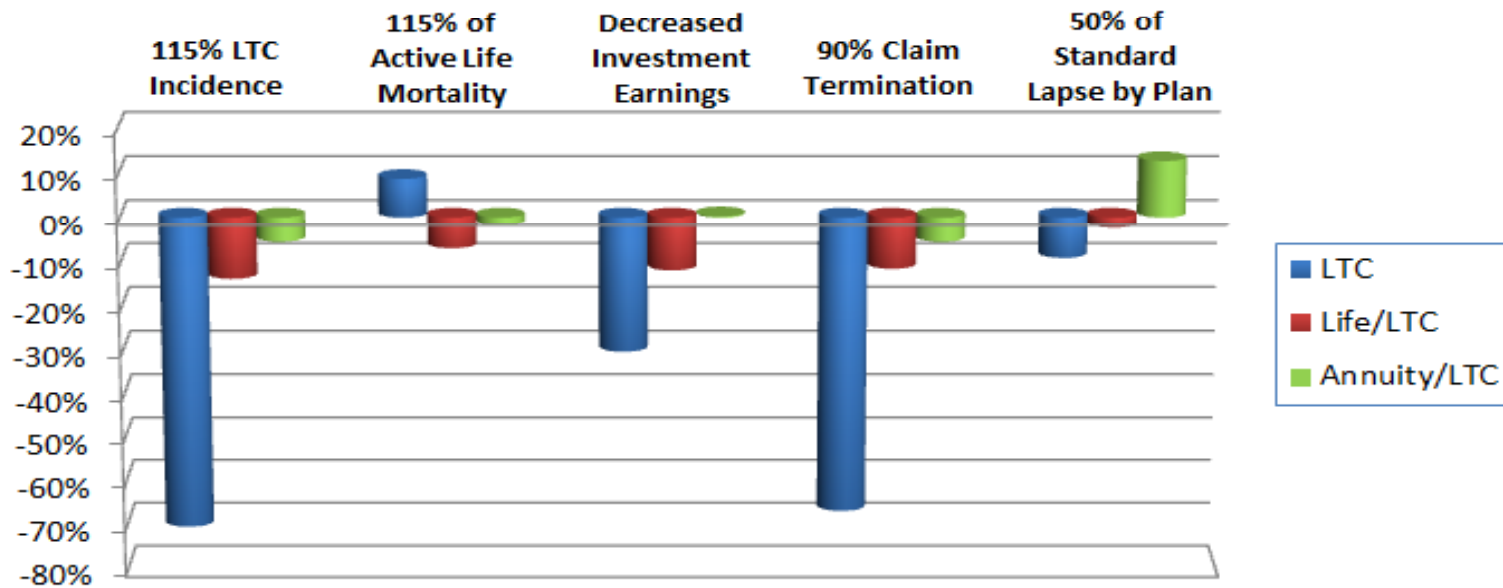
SOA/ILTCl Hedging Research Report - 2012



SOA/ILTCI Hedging Research Report - 2012



**Percentage Change in Present Value of After-Tax Profit
from Base Case, by Scenario
2 Year ADB, 4 Year EOB, Without Inflation**



	115% of LTC Incidence	115% of Active Life Mortality	Decreased Investment Earnings	90% of Claim Termination Rates	50% of Standard Lapse by Plan
LTC	-71%	9%	-30%	-67%	-9%
Life/LTC	-14%	-7%	-12%	-12%	-2%
Annuity/LTC	-6%	-2%	0%	-6%	13%

Annuity Combo Market Challenges



- Low interest rates
 - Rider charges eat into principal under some designs
 - LTC Fund rate, while higher than cash, still lacks appeal
 - Suitability of potential 1035 exchanges
- Marketing
 - Traditional annuity producers may not be accustomed to underwriting process
 - Licensing and CE requirements
 - Traditionally focused on accumulation/income
 - Typically seen as the “last destination” for previously mobile money
 - Spouses may not have equal funding sources
- Gray area on cost basis impact from LTC benefits
 - May limit potential carriers without clear guidance
- Some carriers fear cannibalization of inforce
 - Some buffer from high gtd rates on IF, but PPA benefit exists with a rollover
- Claims and underwriting processes are a hurdle for companies without an LTC experience (as is pricing)

Annuity/LTC Combo Outlook



- Per IRI/Morningstar, \$938 billion of IF NQ annuity AV @12/2015. Most surrender charges go to zero in 5-10 yrs
- Deferred annuity combo sales have been growing steadily, but lagging life combo sales
- Doublers are of growing interest but provide limited benefits, no tax leverage, & face some pricing challenges
- Design variations, including indexed plans, can address some of the challenges of low interest rates
- Higher interest rate environment would avoid invasion of principal risk and allow the product to work better
- Higher interest rate environment would remove an obstacle to 1035 exchanges. Producers could enhance clients' annuity values via interest yield, LTC benefit and/or tax leverage

What Lies Ahead?



- Deferred income LTC combos?
- More variable annuity combos with protections to avoid reductions in LTC benefits
- Clarification from the IRS on the basis question and some minor issues???
- Higher interest rates?
 - A \$100K SP 2yrAB/4yrEB combo contract paying a net 1.5% interest rate grows to \$145K in 25 years with \$435K max LTC benefit
 - At 3% per year the AV grows to \$209K and \$628K max LTC benefit
- Emerging regulations to allow for more meaningful Doubler benefits?
- “Next Generation” Fiduciary-like rules?

Questions?



Steve Cox, OneAmerica

Carl Friedrich, Milliman

Moderator: Claude Thau, Thau Inc.