## Actuarial & Finance

Presenters: Shawn Britt, Mohammad Reza, Claude Thau

Moderator: Al Schmitz

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April 2021 - ILTCIconf.org

# Changing World of Combination Products

# Question # 0: Please indicate your category

1. Producer/advisor
2. Home office marketing or sales
3. Home office other than marketing & sales
4. Regulator
5. Other

# Definitions

- Combination products: Generic overarching terms of all products that have LTC benefits as part of an life insurance or annuity product.
- Acceleration rider: Provides LTC payments that offers early payment of a death benefit upon meeting an LTC benefit trigger.
- Extension of Benefits: Benefits beyond the acceleration of a death benefit. Typically creates a separate pool of LTC benefits.
- Hybrid / Linked Benefit product: Product that offers an extension of benefits or inflation compounding or both.
- Asset Based product: Similar to linked benefit products, but often single premium and also often includes a return of premium benefit from day one of the product.

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# Changing World of Combination Products

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# Disclosures

When evaluating the purchase of a variable annuity, your clients should be aware that variable annuities are long-term investment vehicles designed for retirement purposes and will fluctuate in value; annuities have limitations; and investing involves market risk, including possible loss of principal.

This information assumes that the life insurance is not a modified endowment contract, or MEC. As long as the contract meets the non-MEC definitions of IRC Section 7702A, most distributions are taxed on a first-in/first-out basis. Surrender charges may apply to partial surrenders. Loans and partial surrenders from a MEC will generally be taxable, and if taken prior to age 59 ½, may be subject to a 10% tax penalty. Loans and partial surrenders will reduce the cash value and the death benefits payable to your beneficiaries, and withdrawals above the available free amount will incur surrender charges. If your contract were to lapse with a loan outstanding, the loan amount in excess of basis will be treated as a distribution and all or a portion will be subject to income tax.

The underlying investment options to a variable annuity or life insurance product are not publicly traded mutual funds and are not available directly for purchase by the general public. They are only available through variable annuity/variable life insurance policies issued by life insurance companies.

NFM-XXXXX8AO (XX/XX)

# Disclosures

As your clients' personal situations change (i.e., marriage, birth of a child or job promotion), so will their life insurance needs. Care should be taken to ensure these strategies and products are suitable for long-term life insurance needs. You should weigh your clients' objectives, time horizon and risk tolerance as well as any associated costs before investing. Also, be aware that market volatility can lead to the possibility of the need for additional premium in the policy. Variable life insurance has fees and charges associated with it that include costs of insurance that vary with such characteristics of the insured as gender, health and age, underlying fund charges and expenses, and additional charges for riders that customize a policy to fit your clients' individual needs.

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# History of Changes in Linked Benefits LTC Policies

## Follow the "MoneyGuard" …………… Lincoln MoneyGuard led the way!

- First Penn Pacific (now part of Lincoln) builds first combo product (1987) on UL chassis
- 1st to expand to a large wholesaling force
- Redefines product with <u>Simplified (Streamlined) Underwriting with Cognitive Testing</u>
  - becomes more of a transactional sale
- Relaunches multi-pay during low interest rate environment
  - moving needle to more affordable multi-pay sales
- Grows business - to where other companies notice and join the market
- Lincoln first to offer day 1 Return of Premium (ROP) - Others follow.
- Lincoln drops day 1 ROP and proves it is not necessary to sell product - Others follow.
- Lincoln expands past 10 year premium schedule … others follow

# Structure defines extent of tax advantages

All linked benefit LTC products are IRC Section 7702B………

## *Original Structure*

Premium is paid

Premium

deposited into

**Cash value**

Charges paid from

Cash value

LTC rider

(acceleration) cost paid

Extension of Benefit

Rider cost paid

Inflation Rider cost paid

Pension Protection Act 2006 limited some tax advantages of this structure

# Challenges of original structure

## Pension Protection Act 2006 clearly lays out limitations for certain LTC products tied to life insurance and annuities

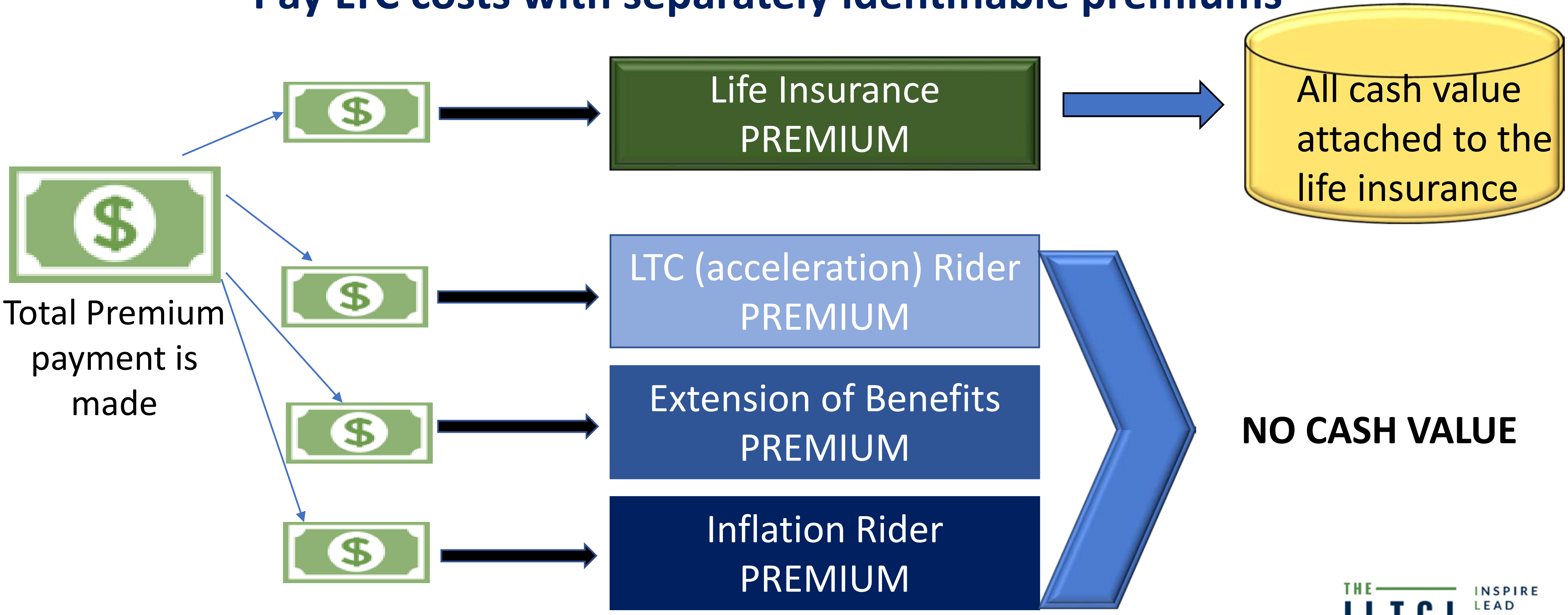
- LTC charges paid from cash value are treated as "non-taxable distributions"
  - Reduces the cost basis in the policy by the amount of the "distribution"
    - No tax is due as long as the policy remains in force
  - Upon surrender, cost basis could be lower than premiums paid
    - Creates a challenge when ROP is implemented.
    - **Phantom gain appears** – equal to total LTC costs – and is subject ordinary income tax

- Though marketed as **"long-term care"**…. LTC rider costs paid from cash value:
  - are not tax deductible to individuals or in business applications
  - are not eligible to be paid for with HSA dollars

# Solution

Update the structure of Linked Benefit Policies…………

## Pay LTC costs with separately identifiable premiums



# Results of newer linked benefit structure

1 Tax deductible LTC premiums for individuals up to age based-limits

- Federal deductions subject to 10% floor of AGI and must itemize
- Some states offer tax deductions or tax credits

OR – Distributions from HSA account can pay for LTC premiums

- Subject to age-based limits – no floor to meet or itemization needed

2 Tax deductible LTC premiums for businesses

- C-Corp owners and non-owner employees – business deducts full policy premium
    - Life insurance premium amount deductible to business as “compensation paid”
    - LTC insurance premium deductible to business as accident and health insurance
    - Life insurance premium amount is included in owner/employee’s income as “compensation received”, but LTC premiums fully excluded from income
- Pass-through entities – Above the line deduction for LTC premium up to age-based limits

3 No phantom gain if ROP is implemented

- No reduction of cost basis since LTC charges paid with premiums

# Progression of Premium Schedules

- Single premium
  - With day one ROP - sold as "asset based"
  - Market was more affluent clients with liquid assets ….. Or…
  - Older clients with "savings" that could be accessed (i.e. a CD)
- Multiple premium
  - Options of up to 10 years
  - Opened up more sales…. but still required larger premiums
    - Also helped insurance company pricing in a low interest rate environment
- Extended pay premium schedules
  - 15 year premium schedule
  - Pay to age 65
  - Pay to age 100
  - More affordable – opens market to many more clients

# Progression of Claims Models for Linked Benefits

- **Reimbursement** was the only linked benefit claims benefit model used by insurance companies **for over 2 decades**

- Linked benefit LTC using a **cash indemnity** model was introduced for the first time in 2013
  - More have followed

- **Dual choice** benefit model was introduced
  - Policy owner chooses benefit model at claim time
  - If indemnity is chosen, LTC benefits are reduced to reflect appropriate pricing

# The Future of Linked Benefit LTC

## Linked Benefit LTC has taken root in the industry

- Guarantees and protected premium make it a winner with clients
- Simplified underwriting is a proven concept
- Product innovation has continued to build momentum
- Affordability has improved dramatically
- Newest iteration is market based linked benefit policies

***What's next in the future of linked benefit LTC?***

# Question # 1: Market Based Linked Benefit

How do you feel about a market based linked benefit design where the investment risk and ultimate LTC pool of benefits is with the client?

1. Like it for any client
2. Like it for younger clients
3. Don't like
4. No opinion

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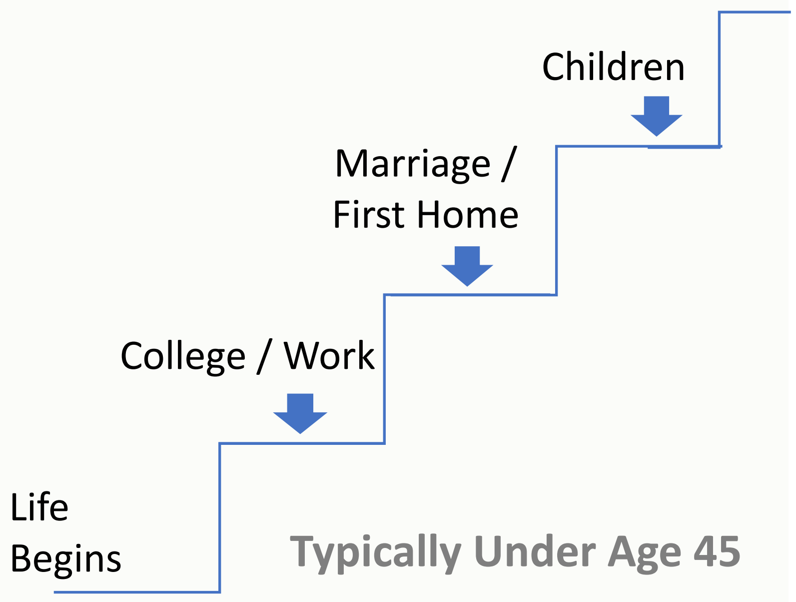
# Changing World of Combination Products

# What is the right solution?

# Knowing Your Customer…

**First Phase - Protection**



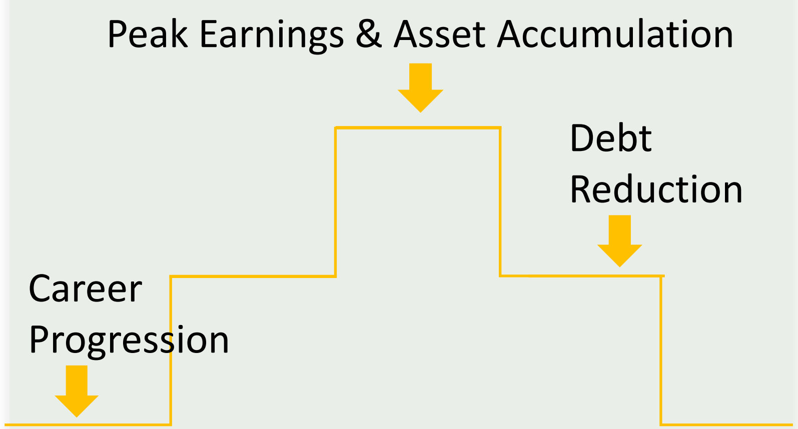

Top of Mind Financial Concerns:

How much life insurance do we need?

Will I be OK if my spouse dies?

# Knowing Your Customer…

**Second Phase - Growth**




**Typically Between Ages 40-55**

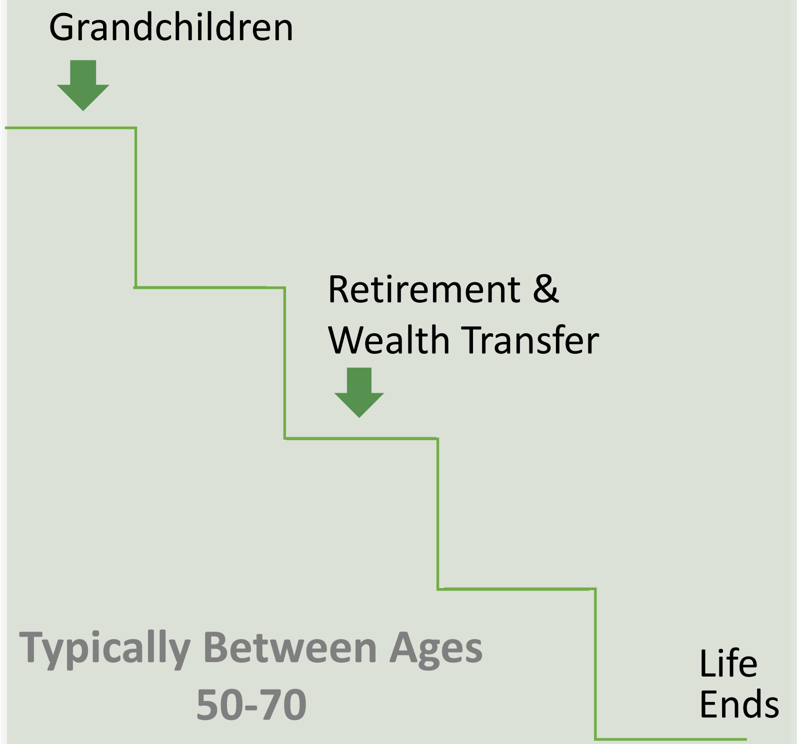
Top of Mind Financial Concerns:

How can you help me make sure my career is a success for the long term?

How can I diversify my income?

# Knowing Your Customer…

**Third Phase - Lifestyle Maintenance**




**Typically Between Ages 50-70**

Top of Mind Financial Concerns:

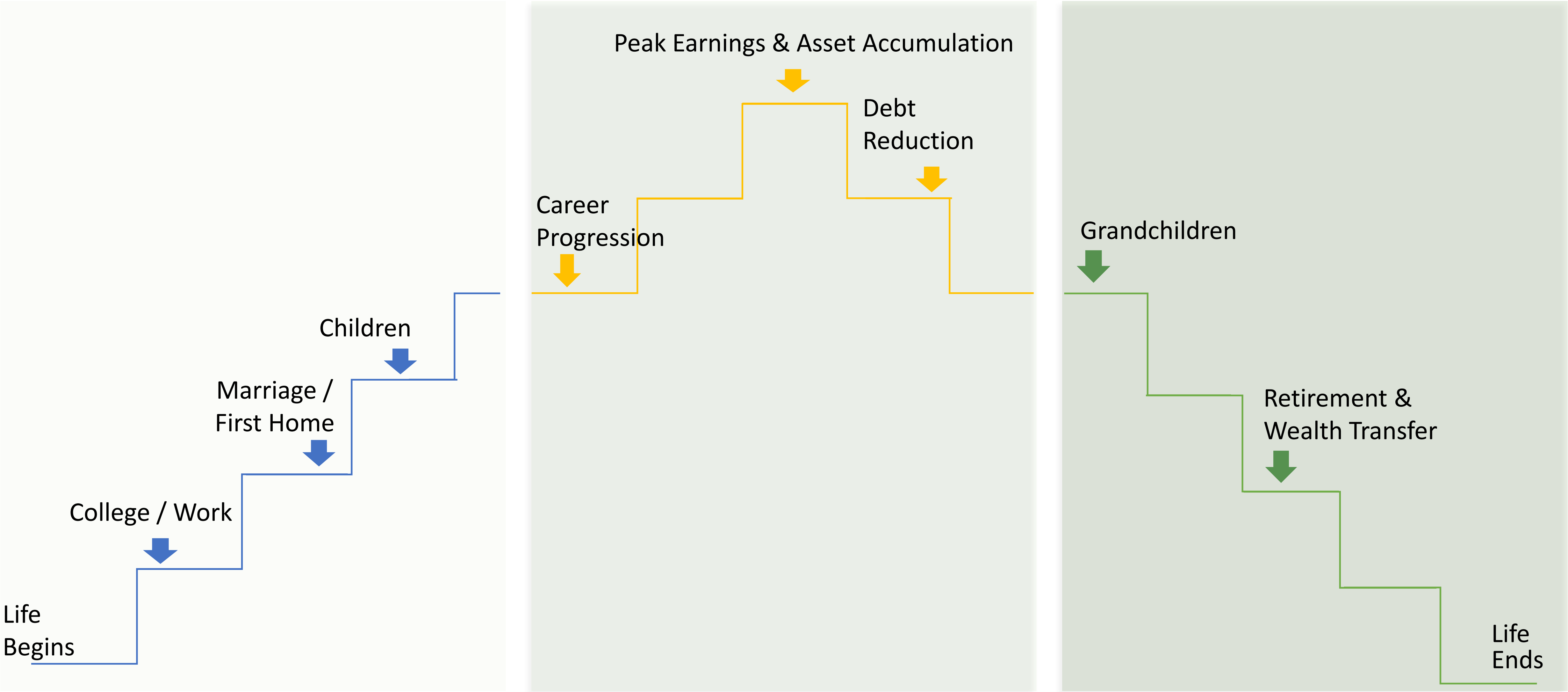
What can I do now to make sure I'm prepared for retirement?

How do I turn my assets into income?

How will I pay for large health care costs in retirement?

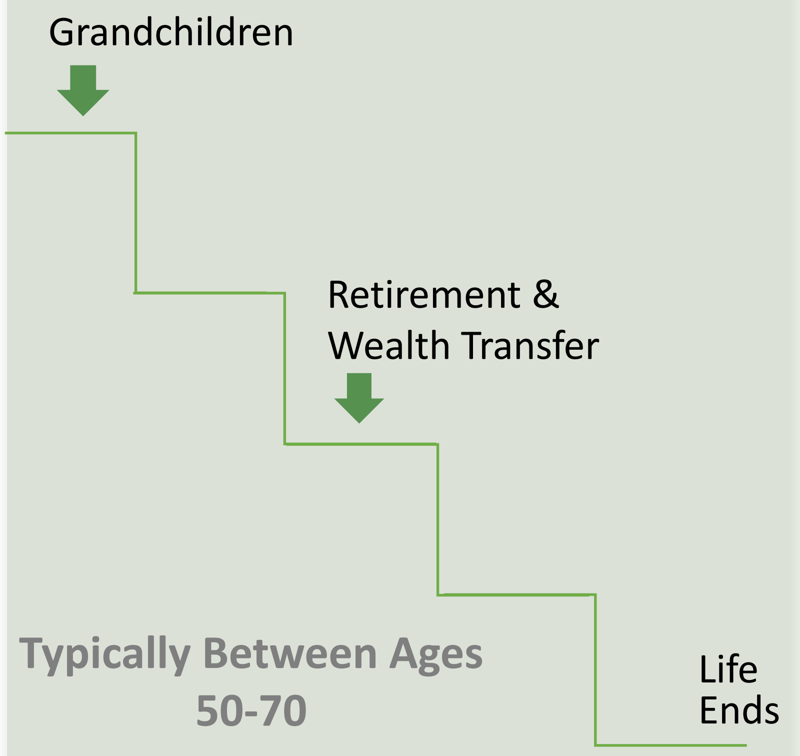
Do I still need life insurance in retirement?

# Knowing Your Customer is Important



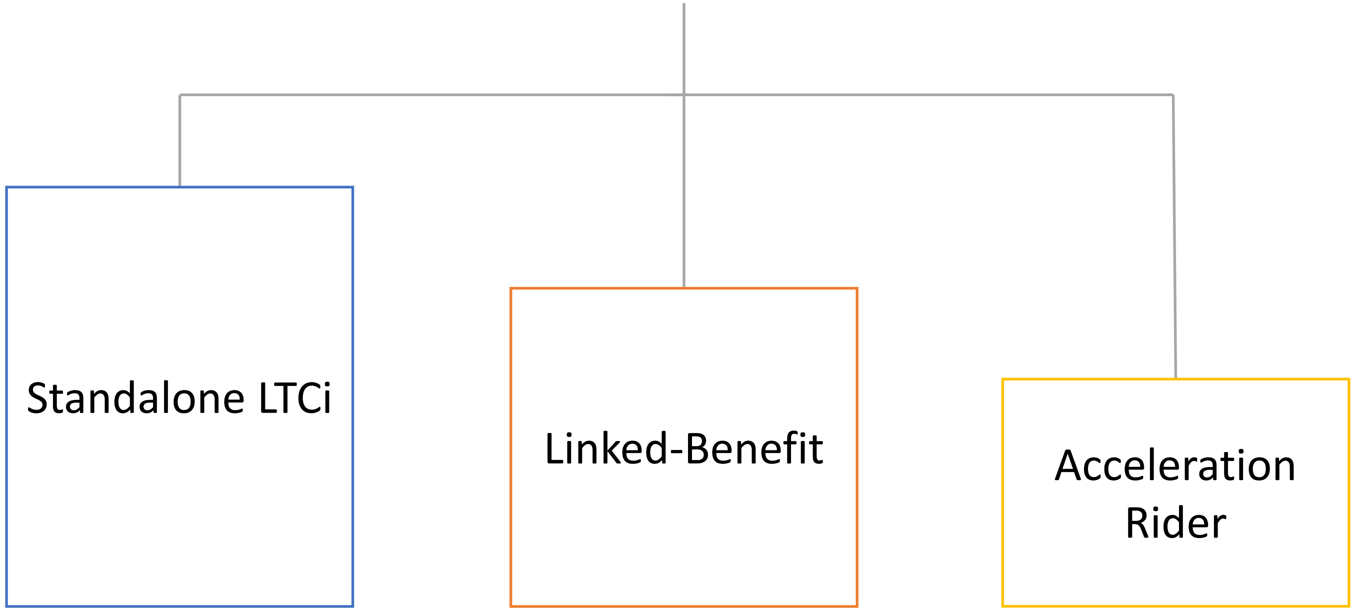
# What is the right LTC Solution?

**Third Phase - Lifestyle Maintenance**




Which one is Cheapest:

- Benefit per $1 of premium?



# Question # 2: LTC plan options

Which type of LTC solutions do you discuss or hear the most about?

1. Standalone / Traditional LTC
2. Linked-Benefit
3. Acceleration Only Rider
4. Other

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# Changing World of Combination Products

# Two Topics

- Comparing Linked Benefit Plans to Each Other
- Disparate treatment of §101(g) vs. §7702(b)



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# Topic 1: Comparing Linked-Benefit Products

- Illustrations show:
  - Death benefit if you never need LTC
  - LTCi bucket
- What is missing from such a comparison?
  - What if you need care for 1 year then die?
  - Two years, then die?
  - etc.?

# Why we should illustrate various LTC lengths

1. Elimination period differences
2. Wrap-around compounding
3. Different benefit periods

For the following issues, different lengths are relevant ***only if*** less than the maximum benefit is used in a month

4. Treatment of benefit increase varies
5. Cash vs. reimbursement

# Elimination Period: 90-day vs. none

- Generally, no difference shows up in the illustration
  - The illustrated Death Benefit is the same regardless of EP
  - The LTCi bucket is the same regardless of EP
- Cash flow while on claim
  - If there is no EP: 1st 90 days of claim are paid early in claim

# Elimination Period: 90-day vs. none

- Generally, no difference shows up in the illustration
  - The illustrated Death Benefit is the same regardless of EP
  - The LTCi bucket is the same regardless of EP
- Cash flow while on claim
  - If there is no EP: 1st 90 days of claim are paid early in claim
  - With a 90-day EP (example using 2+4 design & full $ ea month):

| Years of LTC then Death | Impact of EP |
|---|---|
| 2 years or less | 90 days of benefits deferred until death |
| 2 years to 6 years | 90 days of benefits lost |
| Between 6 years & 6.25 years | Lose up to 90 days of benefits |

# Which carrier would you select?

- 2014 comparison (but the issues are still pertinent)
- $100,000 Single Premium

| | Company A | Company B |
|---|---|---|
| Additional annual premium: | $980 | $0 |
| Death Benefit: | $200,000 | $116,256 |
| Initial Maximum Monthly Benefit: | $4,000 | $4,844 |
| Compounding: | 5% | 3% |
| Long-Term Care benefit period: | Endless | 6 years |

# Total Benefits based on Length of LTC Need

## Total of LTC Benefits Plus Death Benefit

| # of Years of LTC * | Carrier A | Carrier B | Carrier A Advantage |
|---|---|---|---|
| 0 | $200,000 | $116,256 | $83,744 |
| 1 | $200,000 | $116,256 | $83,744 |
| 2 | $200,000 | $225,327 | ($25,327) |
| 3 | $200,000 | $340,048 | ($140,048) |
| 4 | $200,000 | $458,210 | ($258,210) |
| 5 | $335,454 | $579,917 | ($244,463) |
| 6 | $506,126 | $705,276 | ($199,149) |
| 7 | $685,332 | $705,276 | ($19,943) |
| 8 | $873,499 | $705,276 | $168,223 |

* Presumed to be followed by immediate death

Wrapped inflation provision is a big contributor toward this comparison

If LTC needs continue longer than 8 years, Carrier A pulls WAY ahead. For a 15-year need using the full benefit each month, the advantage is $1,776,876.

# Question #3: Linked-benefit life insurance illustrations

Should linked-benefit illustrations show how much benefits would be paid if the insured uses full LTCi benefits for 1, 2, 3, … years, then die?

1. It should be up to the insurer, but I think insurers should do it.
2. Insurers should do it and if it not common in the industry within a few years, regulators should require it.
3. Regulators should require it without waiting for the industry.
4. No, it is too complicated.
5. Other

# Topic 2: § 7702(b) vs. § 101(g) Accelerated Benefits

- §7702(b) and §101(g) Accelerated Death Benefits (ADBs) sometimes have identical triggers.
- §7702(b) ADBs may be reimbursement or indemnity designs.
- §101(g) are cash benefits, hence may be superior LTC solutions
- But regulators don't allow §101(g) to be called "LTCi"
- Puts advisors in a tough bind & not good for consumers
- Why?
  1. §101(g) does not require LTCi certification (significant?).
  2. Some protections are required only for §7702 (significant?)

# Topic 2: Protections that § 101(g) lack

- Lapse protection
- Reinstatement
- Extension of benefits (not the second bucket of the linked benefit plan)

# Question #4: Permitting §101(g) to be called "LTCi"

Re: §101(g) coverages with distinct benefits and the same triggers as TQ LTCi, regulators should:

Allow such policies to be called "LTCi" without modification.

1. Still not requiring LTCi certification to sell.
2. But require LTCi certification to sell.

Allow them to be called "LTCi" if they have adequate additional protection:

3. Still not requiring LTCi certification.
4. But require LTCi certification.

Retain the status quo (such policies can't be called "LTCi"):

5. Still not requiring LTCi certification.
6. But require LTCi certification.
7. Other