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$875 Billion! *And We Aren't Talking Bailout*

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According to NAVA, the National Association of Insured Retirement Solutions (NAVA), just under $900 billion dollars currently reside in non-qualified fixed and variable annuities. This is the amount of money that will be up for grabs as annuity products with qualified long term care insurance benefits, enabled by the Pension Protection Act of 2006 (PPA), begin to appear in the marketplace.

Insurance companies will be scrambling to protect their current deferred annuity blocks of business; attract consumers away from their current contracts with better returns, pricing, benefits and provisions; and attract new customers to annuities because such combination contracts are not available with other financial instruments. This could be a boon for agents, advisors and marketers who embrace the notion that the long term care planning process will now involve multiple products; life plus accelerated benefit riders, annuities with qualified long term care payouts, and traditional long term care insurance policies.

For the first time, annuity carriers will design products that contain qualified long term care benefits. Per PPA, the premiums (or charges) for this coverage can be deducted from the internal growth of the annuity without a taxable event (income) to the annuitant. In addition, if the annuitant qualifies for care, the long term care benefits payments from the annuity will be received income tax free. One of the central points is that the long term care benefits must comply with the long term care provisions of the Internal Revenue Code Section 7702B. If the long term care provisions of a contract meet the section's requirements, they are considered qualified long term care insurance, and the favorable tax provisions apply.

An illustrative product design for a single premium deferred annuity (SPDA)/LTCI combo will provide a long term care benefit that is generally a multiple of the annuity account value. The payout will be delivered over a certain number of months—24, 36 or 48. While examples will vary by insurance carrier, age and health conditions, let's say that the insured wants $6,000 per month of benefit for 48 months ($6,000 x 48 = $288,000). In order to get that $288,000 benefit, our hypothetical policyholder deposits $100,000 into the SPDA combo and the balance of the $288,000 (or $188,000) is provided by the insurer. A risk charge will be taken from the contract's accumulation value to cover the cost of the additional $188,000 coverage.

The first money out of the SPDA to pay the long term care benefit will be the insured's initial premium to the plan. If the policyholder dies before his contribution is exhausted, a beneficiary will receive the balance of the annuity. *(Thus, key objections to the standalone contract, such as "use it or lost it," are overcome.)*

Once benefits are paid beyond the initial premium, the insurance company will continue to pay benefits until they are exhausted. The risk charge for the benefit beyond the premium will generally be between 40 and 75 basis points. In other words, if a typical SPDA was paying a return of 5.5

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percent the combo plan may only pay 4.75 to 5.1 percent. Again, since the long term care benefit under the program qualifies under HIPAA (7702(b)), the cost of the long term care benefit will not be a taxable event to the insured. Designs can differ from the example shown. For instance, a company may prefer to provide some first dollar insurance coverage, rather than wait until the accumulation value is exhausted.

Long term care benefit payments reduce the basis of the annuity for income tax purposes. However, this is a minor price to pay in light of the potential long term care leverage provided by the SPDA/LTCI combo plan. When a gain is paid out, however, it will permanently *(and legally)* be free from tax. Consequently, the presence of a qualified long term care rider transforms a tax-deferred annuity into a tax-free annuity when the gain is paid out as a long term care benefit.

Medical underwriting, or lack thereof, will impact the actual cost of the long term care benefit (risk charge) as well as potential deferral of benefits for a specific period of time. Unlike today's typical single premium deferred annuity (where there is no medical underwriting), companies will likely compete for 1035 exchange and new premiums based on the client's ability to qualify for coverage. More liberal underwriting will translate into higher risk charges or the need for the insured to wait a number of years before the long term care benefit can be accessed—a deferral period, so to speak.

Immediate annuities with qualified long term care benefits will also provide underwriting opportunities, particularly in a health-impaired environment. As with substandard immediate annuities of the past, an opportunity will exist to help older clients with an imminent need for additional cash flow to pay for long term care expenses.

We are also likely to see annuity products with joint (partner) benefits along with a commensurate reduction in risk charges—similar to the joint or spousal discounts we currently see in traditional long term care insurance policies. As one might expect, the presence of a healthy spouse translates into deferred and/or lower benefit utilization.

Many of the "red flags" raised in last month's article regarding life insurance policies sold with long term care accelerated benefit riders will also need to be considered with combo annuity and LTCI products:

1. How will insurance agents and financial advisors who have been hiding in their narrow specialties help clients navigate this new world of long term care planning choices? Will annuity/LTCI combos provide a large enough benefit at time of claim? What sorts of inflation options will be available to consumers when balancing the annuity and long term care benefit? (Companies will be required to offer inflation options.) Coordinating various solutions will be the advisor's challenge as well as opportunity. Suitability and disclosure will become even larger issues and suggesting the suitable solution will be critical.

2. One should assume that agents will need to be certified to solicit long term care insurance under state licensing rules. This could mean a special license and/or continuing education. In many states, where a joint life and health license is applicable, there will be no additional license requirement; however, there will be some modest continuing education requirements.

3. While we presume that annuity/SPDA combos will provide comprehensive long term care benefits (nursing facility, assisted living and home care), variations on this general theme may exist. Will plans reimburse for incurred cost or provide some sort of indemnity (per diem) benefit based on a day of service incurred? What assessments and plans of care will the claims process require?

4. Underwriting nuance will lead to choices of deferral periods based on insured's health issues. This deferral period could actually be in addition to an elimination period. This will be a special challenge to annuity agents, marketers and wholesalers not attuned to underwriting issues in the current SPDA environment.

5. 1035 exchange "wars" are likely to occur as competition heats up. How insurance carriers approach annuities still in the surrender charge period will add creativity to the marketing and sales arena.

6. Which type of SPDA: fixed, indexed or variable will be best suited to combo products for specific clients? What if they do not perform as anticipated? Will consumers who purchase a combo plan be faced with a lower level of benefits if the underlying annuity pays the guaranteed rate as opposed to the current rate? Will there be "true-up" provisions which give the insured an ability to "reinforce" their long term care payout in the event that product investment performance doesn't reach expectations?

7. What options will be available to a policyholder who is already "annuitizing"? Will their ability to qualify for long term care benefits be forfeited? A soundly structured design should address this issue, but disclosure to the insured will be critical.

8. The law is unclear as to whether partial withdrawals from existing annuities can be used to pay for a traditional long term care insurance policy on a tax-favored basis. What sort of tax issues will be raised if an annuity policyholder chooses this method, and how will it impact surrenders beyond that allowed by the annuity carrier?

The provisions enabling annuity/LTCI combo products take effect January 1, 2010. However, we anticipate seeing PPA qualified annuity/long term care combo products by the end of the first quarter of 2009, even though the tax-favored provisions do not become effective in 2009.

Sorting through the benefit provisions, underwriting requirements and exchange rules will present a learning curve but not an insurmountable challenge. Agents, advisors and marketers who are up to the task will accept this opportunity to expand the field of long term care insurance and help consumers protect their retirement income, assets and lifestyles against the ravages of an unplanned long term care event. Those who remain in their "silos" are likely to lose business to more adept competitors, and at worst could face serious questions pertaining to the long term care recommendations they make to consumers.

Which category do you plan to be in?

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