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What's An ABR And Why Should You Care?

The Transmogrification Of Life And Long Term Care Insurance

You might be wondering why a dyed-in-the-wool long term care insurance guy is writing about a topic related to life insurance. *You might also be scratching your head over my use of the word transmogrification.*

If you are a fan of the old comic strip *Calvin & Hobbs*, you know that the precocious Calvin would fantasize from time to time about transmogrifying into different creatures or inanimate objects. According to *Dictionary.com*, transmogrification means "the act of changing into a different form or appearance (especially a fantastic or grotesque one)."

In a moment you will see how life insurance will soon take on many of the characteristics of traditional long term care insurance. It will become a potential boon for long term care planning as well as a possible snake pit for agents and consumers.

ABRs, or *accelerated benefit riders,* are nothing new. Over the years they have appeared in various life insurance policies with a promise to pay part of the death benefit (generally 2 to 4 percent monthly) if a qualifying event other than death occurs (e.g., disability, critical illness, cancer, terminal or chronic illness).

Section 101(g)(1) of the Internal Revenue Code governs the accelerated payment of death proceeds on the life of a terminally or chronically ill insured. The Health Insurance Portability & Accountability Act (HIPAA–IRC Section 7702B) added the chronic illness definition to the Internal Revenue Code.

Essentially, if the qualifying event for benefits matches the chronic illness definition established by HIPAA, the early payout of the death benefit for long term care expenses will not be taxed as income; however, the payments cannot exceed the per diem limits ($280 in 2009) and must comply with other provisions of the NAIC Model for long term care insurance.

The Pension Protection Act of 2006 (PPA), like HIPAA, is an enormous piece of legislation that addresses hundreds of disparate issues. Also like HIPAA, a very small portion deals with long term care insurance and riders that are part of life insurance or annuity contracts (Section 844). PPA affirms HIPAA as it pertains to life insurance contracts and extends this favored status to annuity contracts beginning January 1, 2010.

While much of what follows pertains to annuity contracts after that date, I will focus this article on life insurance ABRs and expand my discussion of annuities with linked long term care benefits in future commentary.

While qualified long term care ABRs have been part of some life insurance contracts since HIPAA, there hasn't been a stampede to include them in products. However, PPA has the potential to increase 1035 exchange activity between life insurance and annuity contracts with qualified long term care insurance components. Additionally, after January 1, 2010, cash values from life and annuity contracts can be 1035 exchanged to a traditional qualified long term care insurance contract.

This proliferation of ABRs as well as annuity contracts with linked long term care benefits and cash values that can be used to pay for a stand-alone long term care insurance policy is likely to cause a massive movement of money from contract to contract and planning opportunities will abound.

With this January 1, 2010 deadline approaching, life insurance companies are realizing that PPA provides them an opening to expand their businesses if they proactively develop and market qualified long term care ABRs. Carriers that don't do this could face a mass exodus of insureds who want the additional security and benefit of an LTC rider on their life insurance policies. As we move toward this brave new world of long term care planning, agents and consumers need to be mindful of a number of different issues and their implications. Following is a short list:

1. Financial advisors, life insurers, annuity and long term care insurance agents will find it difficult to hide in their respective "silos." A life insurance or annuity sales discussion will have to include a conversation about long term care planning. LTC insurance specialists will need to become fluent in life and annuity products. All will have to master the right solution or combination for each client.

2. As ABRs proliferate, a marketplace uncertainty may occur regarding "qualifying events." Since the ability to do a 1035 exchange hinges on a qualified long term care definition under HIPAA, everyone involved in the transaction will need to be certain that the new policy being exchanged is compliant. Also, if the policy complies, does the agent have to be certified to sell it as they do with traditional long term care insurance?

3. If life insurance agents sell policies with long term care ABRs, they must help clients answer the following question: "If I take an advance of my death benefit for long term care expenses, will I leave enough life insurance for my family?"

4. A life insurance or annuity ABR will probably not provide enough long term care coverage if the insured does need it until his 80s (which is likely). Some combination of products, including traditional LTC insurance, may be part of the appropriate solution.

5. While we are likely to see term life insurance policies with qualified long term care ABRs, what happens when the policy terminates or needs to be converted? What's the cost, and does it make sense to purchase a permanent life insurance product plus ABR in conjunction with another long term care insurance solution?

6. How do agents and consumers evaluate the cost of a long term care ABR? There is no such thing as free insurance! Currently, when a long term care ABR is added to a life insurance policy there is a monthly risk charge, an administrative charge when the benefit is paid, or both. You can bet that insurance company actuaries will burn the midnight oil to minimize their risk and generate profitability.

7. What happens in a universal or variable life plus LTC insurance policy when cash value growth and/or morbidity and mortality charges don't live up to current assumptions?

8. As 1035 exchange opportunities materialize, will insurance companies reintroduce underwriting concession programs (you remember those, don't you?) in an effort to attract new business?

9. How will the addition of long term care ABRs on life insurance policies impact lapse assumptions, particularly on policies currently in force?

Answers to these questions will come in due time. What is certain is that successful financial planners and insurance agents will be on a steep learning curve. They will be required to develop and implement new planning models. The understanding of suitability and proper fit will be essential to consumers and the agent's prosperity and survival.

The Pension Protection Act transmogrifies life insurance policies with ABRs into a form of qualified LTC insurance; however, the results could be fantastic or grotesque.

PPA will change the way we plan for consumers' long term care needs, and it is coming to your town in the coming months.

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