BROKER WORLD

Hybrid And Linked Long Term Care Planning Solutions

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Bright, shiny objects catch your attention. With traditional long term care insurance markets in a consolidation and reinvention mode, "the talk" is all about linked and hybrid products. A linked or hybrid product is something other than traditional LTCI—for example life, annuity, critical illness or disability insurance—whose primary purpose is to indemnify some other risk. However, a linked or hybrid product's secondary purpose is to provide liquidity in case the insured suffers a chronic illness.

Is there a difference between linked and hybrid products? Insurance companies and commentators often use these terms interchangeably. In our marketing organization we use the term hybrid to refer to life insurance products with accelerated death benefit riders (ADBRs). Linked policies have an ADBR and an extension of benefit rider (EOBR).

The fastest growth in hybrid product designs is occurring in life insurance. The underlying product is intended to pay a death benefit, but if the insured suffers a chronic illness he can access some or all of his death benefit while he is alive. ADBRs are now available on term, universal and whole life policies. To be fluent in this class of policies, agents need to learn some new terminology and to understand how these riders work.

Generally, when a life insurance policyholder dies, the death benefit is received income tax-free by his beneficiaries. With an ADBR, the life insurance benefit can be paid prior to death if the insured qualifies for these benefits. How is a death benefit taxed, if paid out while the policyholder is alive? There are numerous Internal Revenue Codes (IRCs) and other regulations concerning this, but the short answer is: When a life insurance benefit is accelerated for chronic illness, it, too, will be received tax-free.

IRC Section 7702(b) of the Health Insurance Portability and Accountability Act (HIPAA) established the tax-free nature of long term care insurance benefits for traditional long term care insurance. IRC Section 101(g) allows accelerated death benefits to be tax-free if they are received because the insured qualifies as a chronically ill individual. Both these sections of the IRC refer to each other, but there are significant differences between Section 101(g) accelerated death benefit riders and Section 7702(b) traditional long term care insurance plans:

- Section 101(g) assumes the insured is going to die; therefore a terminal illness trigger is always present.
- In order for accelerated life insurance benefits to be tax-free under Section 101(g), an ADBR must be attached to a policy that is guaranteed renewable for life.
- Section 101(g) plans do not require a plan of care.
- Section 101(g) does not require an offer of inflation protection, an outline of coverage or agent continuing education.

In attempting to clarify the IRC on ADBRs, the NAIC has issued Model Regulation

620, and the Interstate Insurance Product Regulation Compact (IIPRC) has issued guidelines. The latter is more significant because it clearly lists chronic illness as a qualification for benefits and allows insurers to get products approved in 43 states in a relatively short period of time.

The IIPRC:

- Must meet the requirements under Section 101(g).
- Explicitly lists chronic illness as a benefit trigger. However, the rider cannot be marketed as long term care insurance unless the policy provides an extension of benefits rider (EOBR 45679).
- Chronic illness must be expected to be permanent, so by implication, it meets the 90-day requirement under Section 7702(b)(c)(2).
- Expense reimbursement is not allowed.
- Lump sum benefit must be offered.

Is there a cost for ADBRs? Some companies would like you to believe their riders are free, but smart agents know this is too good to be true. While there may not be an explicit premium for the ADBR, at time of claim the amount accelerated (usually a lump sum) will be discounted based on the insured's anticipated life expectancy at that time. This method is referred to as a "discounted death benefit" approach and will always fall under Section 101(g).

An acceptable but rare method of paying for the ADBR is referred to as a "lien" against either the cash value or death benefit of the policy. Part of this approach includes interest and administrative charges. This method is exclusive to Section 101(g) ADBRs.

Finally, some companies charge an additional premium for the accelerated benefit, but at time of claim the policyholder will receive a defined monthly benefit such as 1 percent, 2 percent or 3 percent of the death benefit, or a certain dollar amount per month. This type of policy can fall under either Section 101(g) or Section 7702(b).

While linked and hybrid products are an important and growing segment of the long term care planning spectrum, agents need to be circumspect. There is a misconception that hybrid alternatives are more affordable than traditional long term care insurance. Traditional LTCI provides the most premium-to-benefit leverage for coping with a long term care claim. Hybrids are for people who need life insurance and/or who want to make sure someone will receive a benefit if they never use the policy for long term care expenses.

Another concern with hybrid life insurance products is this: If the policy is sold for a death benefit need and then gets accelerated for chronic illness, the beneficiaries will get a smaller death benefit than they expected. The counterpoint is that it's merely a trade-off of dollars. Does it make a difference if the death benefit is accelerated to pay for chronic illness costs? Maybe the ADBR will lead to enhanced quality of life for the insured and his family while the former is alive. The death benefit is received one way or the other and provides more options to the policyholder.

Finally, the premiums for these linked policies are not deductible as accident and health insurance like traditional LTCI is. Tax deductibility of long term care insurance premiums is a significant benefit for many business owners and should not be overlooked.

Including an accelerated benefit for chronic illness to a life insurance policy is a great idea for clients under 50. The costs are minimal, but the added flexibility provides the insured and his family with valuable choices if a chronic illness occurs prior to death.

Linked life/long term care insurance policies that fall under Section 7702(b) are generally single premium universal or whole life insurance with an ADBR for chronic illness *and* an EOBR for claims that go beyond 24, 36 or 48 months. These products are primarily marketed to clients age 60–75 with a very specific profile:

- They've considered traditional long term care insurance in the past but are bothered by the question, "What if I never need long term care?"
- Because of this, they've decided to self-insure the risk by setting aside a "rainy day" (sinking) fund to pay for long term care costs.

When you have a client with this profile, it may make sense for them to reposition a portion of their "rainy day" fund into a linked single premium life product, thus leveraging $1 up to $5 or $6 for long term care. If he doesn't use his policy for long term care, a beneficiary will receive a death benefit that is larger than the original sinking fund, and it will be income tax-free. Also, most of these policies include a return of premium benefit if the insured wants his money back later. These products are a win-win for older, self-insurance-minded individuals.

When discussing long term care planning with your prospect, should you show him every possible product option? *No!* You'll confuse him—and yourself. With all these new choices, suitability is the key driver and will primarily be based on your prospect's stage of life and his "entry point" in the planning process.

Today's product environment will no longer allow most consumers to do "one-and-done" long term care planning. We are now in the world of a lifetime of long term care planning. Preparation for chronic illness is not just for old people. Each time you sit down with a client you should discuss his long term care exposure and recommend the most suitable product.

Some general guidelines are:

- Under age 50, life insurance with some chronic illness acceleration features.
- Late 40s through early 60s, traditional long term care insurance, especially for business owners who can take advantage of premium deductibility.
- Those 60+ who've chosen to self-insure part or all of their long term care risk should consider leveraging-up their "rainy day" fund by repositioning it into a single premium life insurance option.

None of these programs are mutually exclusive. Many clients will purchase several different products over their lifetime. We have not come to the end of long term care planning. The journey is just becoming more interesting.