SO MANY CHOICES, *SO MUCH CONFUSION*

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The expanding universe of alternatives for leveraging chronic illness (long-term care) risk is creating considerable confusion, marketing hyperbole, and attempts at stress avoidance in a quest for easy answers. In order to achieve clarity, two important historical notes need to be made.

Two sections of the Internal Revenue Code (IRC) were grafted to create the growing branches of this new and vigorous tree we call hybrid and linked (combo) long-term care planning solutions. The Health Insurance Portability and Accountability Act ("HIPAA"–1976) created two ways to provide tax-free dollars for chronic illness. Tax–qualified long-term care *health insurance* was created and defined under IRC §7702(b). HIPAA also referenced IRC §101(g) and expanded allowable definitions for terminal illness accelerated death benefit life insurance riders to include critical illness, disability, nursing home illness, and chronic illness, providing yet another source of tax-free dollars to pay for long-term care.

A third graft was made in 2010 by the Pension Protection Act (PPA) that changed the basic structural dynamics of dual-purpose combo products. Simply stated, the internal cost for the long-term care rider is now tax-free. PPA also expanded the use of 1035 Exchanges in long-term care planning.

These new options have begun to transform the LTCi marketplace and to readjust our thinking about indemnifying this risk. Life insurance companies without chronic illness options on their products, who are concerned about increased 1035 Exchange exposure on their existing blocks of premium, have created sales momentum for combo products. Analysis of recent LIMRA statistics by the Society of Actuaries indicates that hybrid and linked products are the fastest-growing segment of life and long-term care insurance.

Before reviewing the differences in combo products, it would be prudent to visualize what our product and sales future may look like. The recently published *Society of Actuaries "Land this Plane" Survey* of industry thought leaders (in which we participated) gives us a view of possible new options.

- The most significant product enhancement is the introduction of high-deductible plans providing catastrophic cover for claims such as Alzheimer's and Parkinson's.
- There was substantial support for the creation of a separate tax-advantaged LTC Account, allowing tax-deferred earnings, thus encouraging individuals to save for their own long-term care.
- In recognition that most claims are of short duration, a majority of experts advocate short-term care product options.
- There was majority support for adding a long-term care benefit to Medicare.

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- This suggestion was tied to creating some form of Social Insurance option for the middle class.
- There is support for a "Term-LTCi" product with a tax-deferred side fund. This would create a new "universal life-style" long-term care insurance product.
- There was also majority support for developing mutual insurance strategies. This is a private risk-sharing strategy that would provide for level non-cancellable premiums.

The most important conclusions from the *Land This Plane Survey* were as follows:

- The high cost of caring for the Boomer generation is upon us and must be addressed.
- Private insurance must be part of the solution
- The public and private sector should focus on their strengths to solve the LTC financing conundrum.
- Some form of mandatory "social insurance" offer for the middle class may be inevitable to guarantee participation and limited underwriting.
- The risk problem needs to be attacked from the top and the bottom: catastrophic top-cover is more important than basic fundamental coverage.

The proliferation of combo products has created opportunity and confusion in our agencies. Independent life brokerage agencies need to recognize they are in the long-term care planning business, whether they like it or not. One-third of all life policies have some sort of chronic illness rider. Therefore, understanding traditional and the new long-term care insurance options in your product portfolio is in order.

Getting a handle on definitions is a good place to start. The terms combo, hybrid, and linked are tossed around with reckless abandon. Combo is a good general term but lacks specificity. 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).

Hybrid and linked LTCi planning solutions are designed to provide liquidity when the insured suffers a chronic illness, however, they often comply with different sections of the Internal Revenue Code, are subject to different regulations, and have subtle but significant design differences.

Hybrid life insurance products are generally filed using IRC §101(g) and are also subject to NAIC Model Regulation 620 and the Interstate Insurance Compact ("IIPRC"). The latter two regulations clarify IRC §101(g) and differ in significant ways from traditional and linked long-term care insurance products that fall under IRC §7702(b). For instance:

- §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 §101(g), an ADBR must be attached to a policy that is guaranteed renewable for life;
- §101(g) plans do not require a plan of care;
- §101(g) does not require an offer of inflation protection, an outline of coverage or, with a few exceptions, agent continuing education.

In order to clarify the Internal Revenue Code on accelerated death benefit riders, the NAIC issued Model Regulation 620; and the Interstate Insurance Product Regulation Compact (IIPRC) has also 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.

IIPRC guidelines stipulate that policies:

- Must meet the requirements under §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);*
- Chronic illness is expected to be permanent, so by implication, it meets the 90-day requirement under §7702(b)(c)(2);
- Expense reimbursement is not allowed;
- Lump sum benefits must be offered.

Is there a cost for accelerated death benefit riders? While there may not be an explicit premium for the ADBR, at time of claim, the amount accelerated (usual-

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ly 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 §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. This approach includes interest and administrative charges. This method is exclusive to §101(g) accelerated death benefit riders.

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%, 2%, or 3% of the death benefit or a certain dollar amount per month. This type of policy can fall under either §101(g) or §7702(b).

Linked life/long-term care insurance policies that fall under §7702(b) are generally single premium universal or whole life insurance with an ADBR for chronic illness *and* an extension of benefit rider 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.

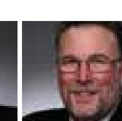
Do Linked and Hybrid Products Spell the End of Traditional LTCi?

While they are an important and growing segment of the chronic illness insurance spectrum, distributors and agents need to be circumspect. One misconception is that hybrid alternatives are more affordable than traditional long-term care insurance. On closer inspection, however, traditional LTCi provides the most premium-to-benefit leverage for a long-term care claim. Therefore, determining which product is suitable for each consumer is critical. General rules of thumb include:

- 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.
- One concern with hybrid life insurance products is: 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 their family while the former is alive. The death benefit is received one way or the other and provides more options to the policyholder.
- Linked products are for those who want to self-insure the risk but see the value of some insurance leverage.

Finally, while benefits from all policies providing chronic illness benefits are received tax-free, the premiums for combo policies are not deductible as accident and health insurance like traditional LTCi. Tax deductibility of LTCi premiums is a significant benefit for many business owners and should not be overlooked.

Planning for chronic illness has never been more important and we've never had more options. Long term care is the risk that will not go away and the best solutions will always remain insurance. Agents and advisors involved in the planning conversation must remain knowledgeable and prepared to respond with all of the choices at hand.



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