



Combination Products

Combination Products: Session Goals

1. Provide background on the challenges in LTC insurance which helped drive the Combination Market
2. Provide an overview of the Combination Market
3. Share comparisons of different LTC insurance solutions
4. Provide producers' perspectives on these Combination Products
5. Discuss issues and future opportunities in this market



Carl Friedrich

carl.friedrich@milliman.com

Carl is a principal and consulting actuary with the Chicago office of Milliman.

Carl specializes in the design and pricing of life insurance, long term care, and annuity insurance products, with an emphasis on emerging combination multi-line products

Parag Shah

parag.shah@pacificlife.com



Parag is VP & Senior Actuary in Product Design for Pacific Life.

Parag oversees pricing & product development of Pacific Life's combination products

BACKGROUND ON STAND ALONE LTC

- The NEED
- The Rules
- The Original Solution

Long Term Care Insurance: The NEED

- **Health Insurance** policies **rarely cover costs** for LTC services
- What about **Medicare** & **Medicaid**?
 - **Medicare** only pays for LTC for very short periods of time, addressing a **very small percentage of LTC costs**
 - **Medicaid** will pay for care only under certain rules governing maximum income/asset levels
 - Requires individuals to **spend down assets** before they qualify for Medicaid benefits to pay for LTC services
 - **About 60% of total LTC costs covered** by public programs
 - **Significant financial strain** on governmental programs, especially Medicaid

Long Term Care Insurance: The NEED

- LTC policies **only cover 9%** of current LTC costs (2015 National Health Expenditures Data)
 - **Only ~10%** of the population that needs LTCi **owns** such a policy
 - Population **underestimates the cost of LTC**, or mistakenly think that government programs will cover them
 - **Denial** that they may need LTC in the future, or
 - **Defer the decision** to purchase LTCi because it is viewed as an issue to be dealt with later in life
- **The Reality** (2019 Genworth Study: Average Cost Monthly)
 - Private **Nursing Home** room: \$8,517
 - Cost for **Assisted Living** Facility: \$4,051
 - **Home Health Care** (HHC) costs: \$2,800
 - In addition, there is **significant variation by state** [e.g. nursing home (monthly) in Oklahoma can be \$5,627 while in Connecticut \$8,157 and you have an outlier in Alaska at \$30,219]

Long Term Care Insurance: The RULES

- National Association of Insurance Commissioners (NAIC) Model Law and Regulation for LTC
 - **No** pre-scheduled **premium increases** above attained age 65
 - **No cash values** higher than Return of Premium
 - **Requires 5% compound inflation** option to be offered to all applicants
 - **Requires nonforfeiture benefit** option to be offered (paid-up benefits at fairly low levels)
 - Standards for **benefit triggers** for **tax qualified long term care**
- Health Insurance Portability and Accountability Act of 1996 (federal law)
 - **Defines tax qualified long term care** and sets limits on payment amounts that can be made as **tax-free health benefits** (greater of expenses incurred or tabular daily limit updated annually)

The [Original Solution]: Stand-Alone LTC Insurance

Design Characteristics

- Traditionally **Level Premium**
 - There were some short pay options
- Premiums were generally **not guaranteed**
- In the past, they included **unlimited** benefits
- **No death benefit**
- Limited/**no surrender value**

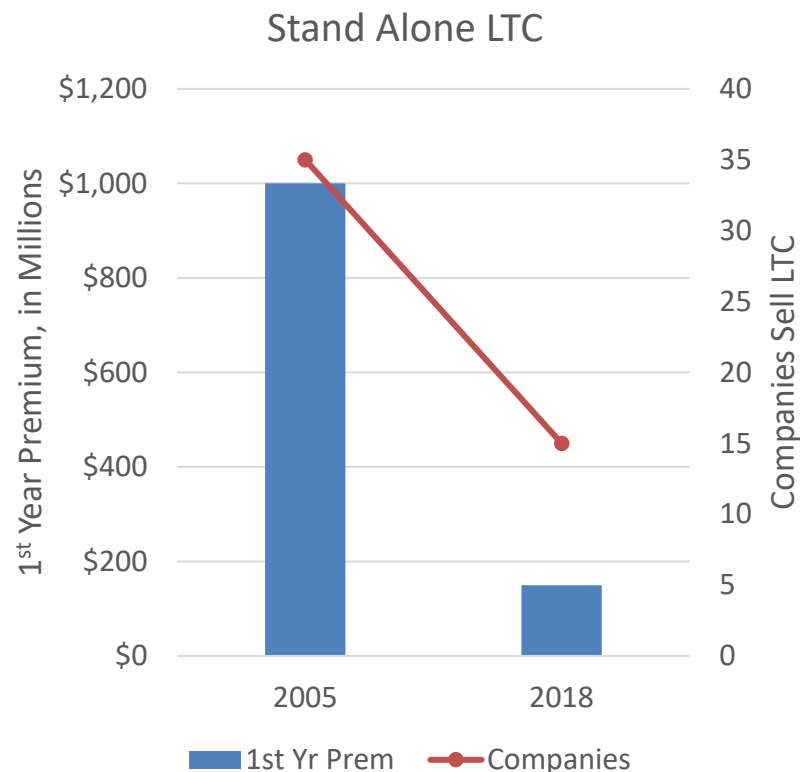
Design Challenges

- Level Premium for a steep claim cost curve generated a **lapse-supported** product design
- Steep claim cost curve required assets built up in early years needed to fund claims: high dependency in **investment returns**
- With competitive pressures, some companies didn't **underwrite** the coverage sufficiently
- With lapses and yields much lower than priced for, premiums ended up being **deficient for profitability / sustainability** requirements

The [Original Solution]: Stand-Alone LTC Insurance

Consequences

- Significant **rate increases** on inforce policies
- **Agent backlash** to rate increases and lack of confidence in pricing of new business
- Companies **withdrawing from the market** due to past losses, negative rating agency views of LTC, and fear of compounding their exposure to the LTC risk
- Consumers: Accept **rate increase or** cancel but get **nothing back** for premiums paid



Tax Catalyst for Growth of “Combination Products”

Pension Protection Act of 2006

- Has a section (eff. 1/1/10) addressing plans that **combine life insurance or non-qualified annuities with LTC**
- Acceleration of base plan values in the event of a qualified LTC need are **tax-free LTC benefits**
- Charges are **tax-free distributions**, but reduce basis in the contract
- **Allows 1035 exchanges** into combination products (annuity plans to annuity combos, life plans to any combo)
- Taxes are not payable on gains in the contract under these 1035 exchange rules, **continuing to be deferred** until withdrawal, or death on annuity combos
 - Only way to get otherwise taxable gains out of an annuity contract is if cash values are paid out as accelerated benefits for LTC

Background on
Stand Alone LTC

Combo Market
Overview

Comparison

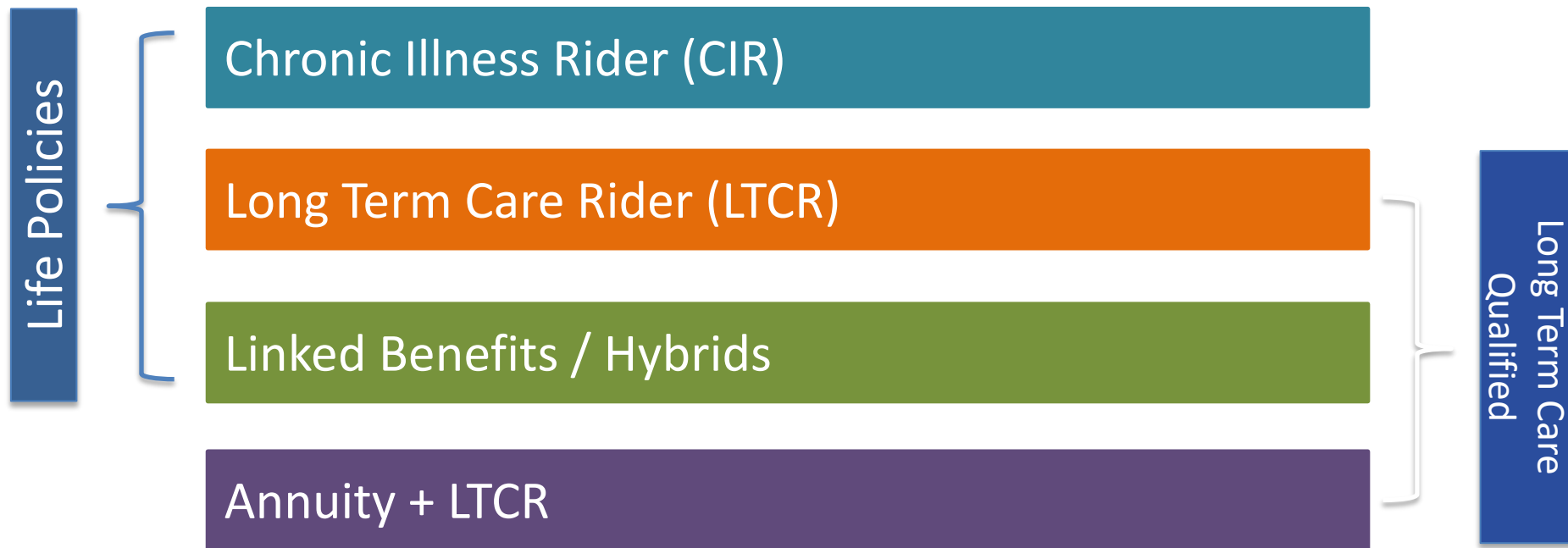
Producer
Perspective

Issues &
Opportunities

COMBINATION MARKET OVERVIEW

Life with LTC / Annuity with LTC

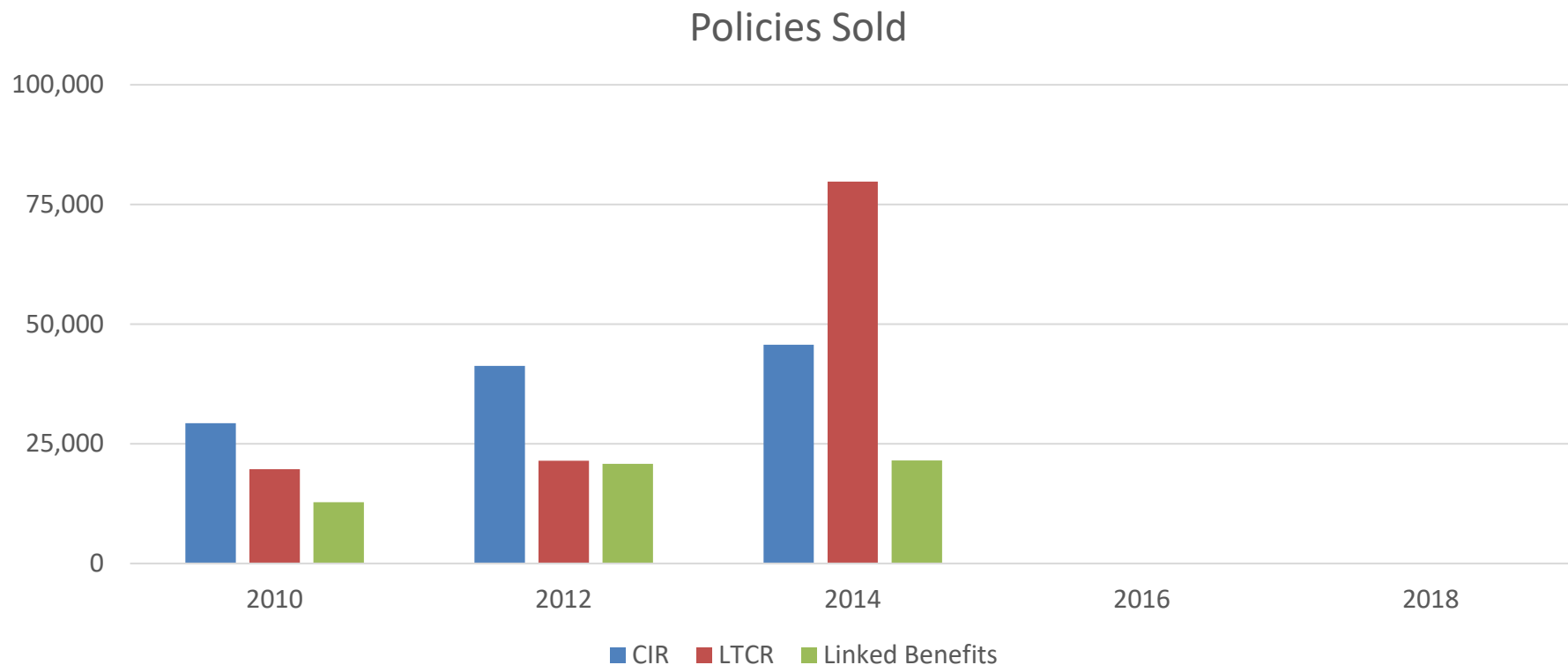
Combination Products We Will Be Discussing



Life Combination Product Comparison

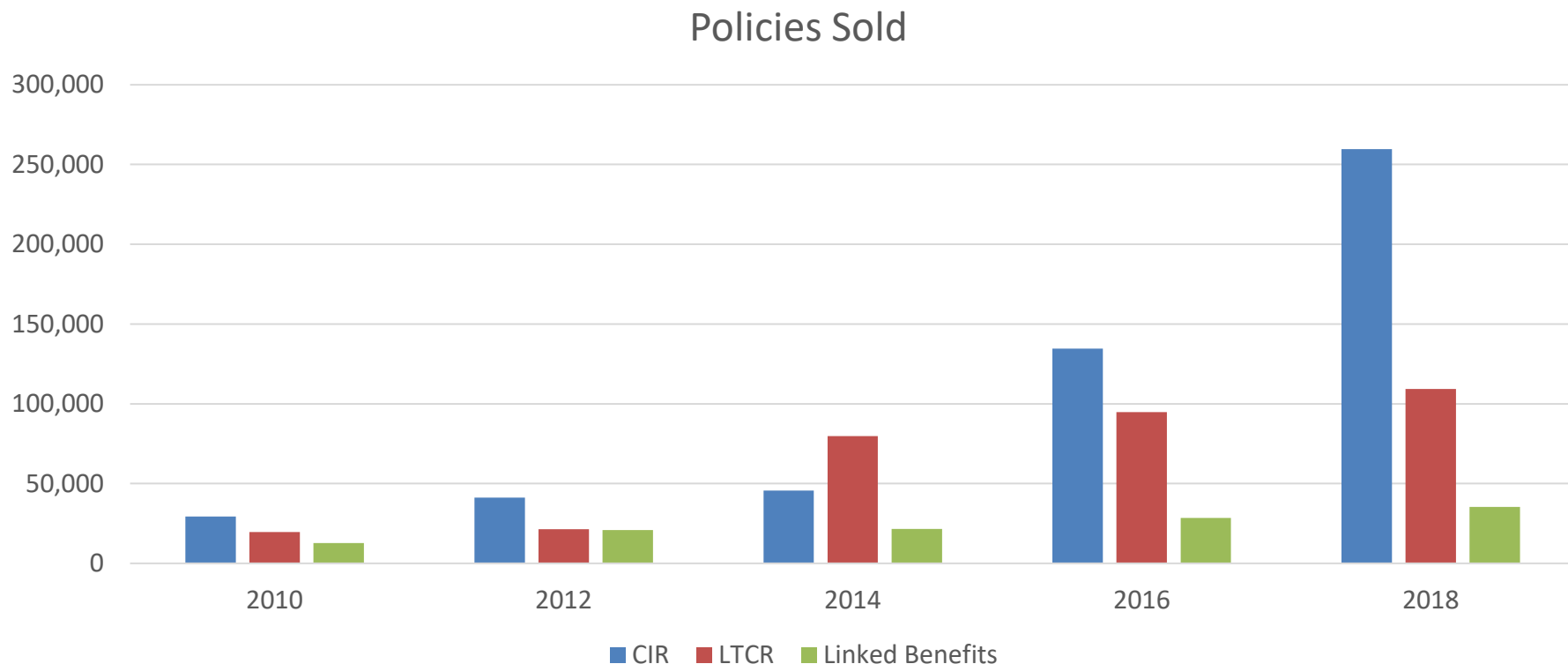
	Chronic Illness Rider	Long Term Care Rider	Linked Benefits/Hybrids
Coverage	Traditionally Permanent Coverage		
Product Type	Optional Rider attached to a base product ABR: <i>Acceleration Benefit Rider</i>		Bundled Product Base + ABR + EBR <i>Extension of Benefit Rider</i>
Tax Free for Chronic Triggers	Yes , if properly structured		
LTC Qualified	No	Yes	
Benefits Limited to Face Amount	Yes		No
Inflation Option Available?	No		Yes

Sales: Life with LTC Combinations



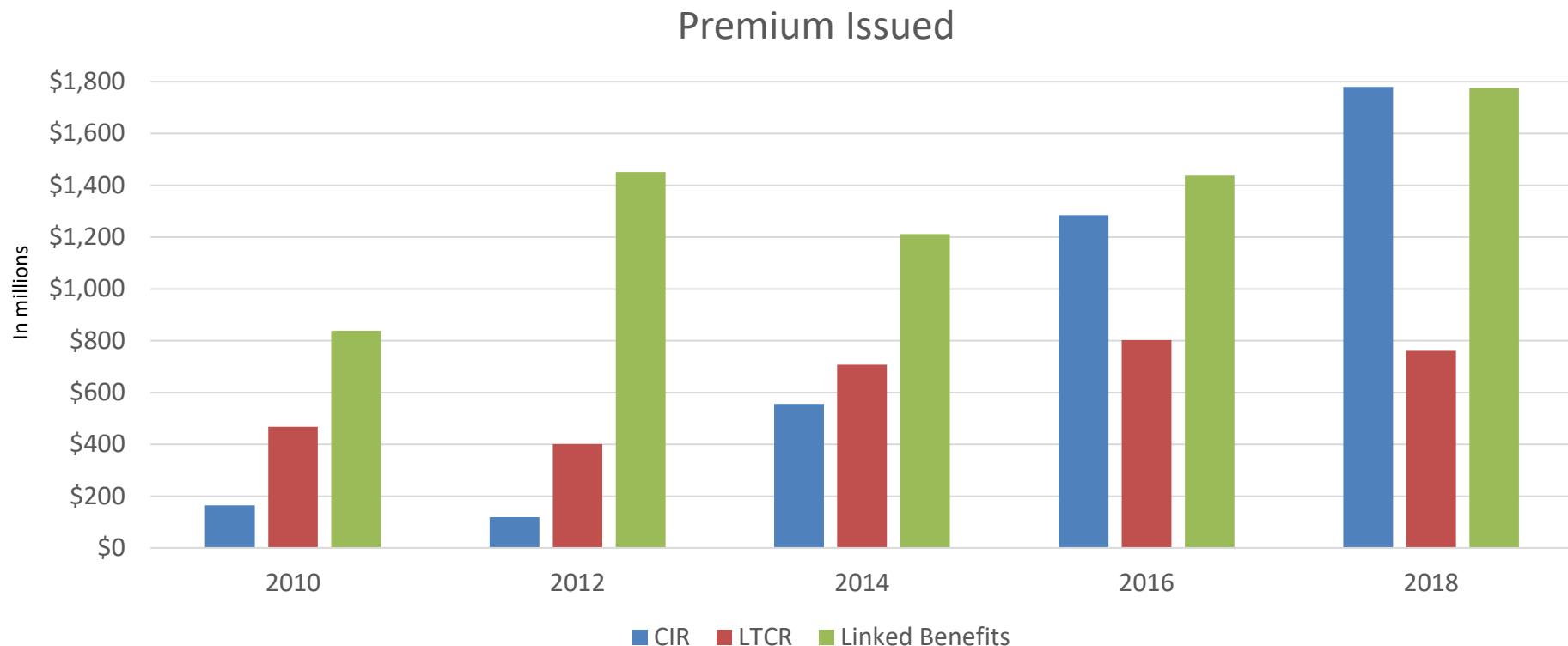
2018 LIMRA Combination Study

Sales: Life with LTC Combinations



2018 LIMRA Combination Study

Sales: Life with LTC Combinations



2018 LIMRA Combination Study

Life ABR Riders Comparison

Chronic Illness Rider

1. IRS Section **101(g)**
2. **Cannot be** described or marketed as long term care insurance
3. No restrictions are permitted on use of payments **[indemnity]**
4. Must offer **lump sum benefit**
5. Previously limited to a '**permanence requirement**'
 - ICC now allows temporary

Long Term Care Rider

1. IRS Section **7702**
2. **Can be** marketed as LTC
3. Can be **reimbursement** or **indemnity**
4. **Monthly** payments
5. **No** permanence requirement

Chronic Illness Rider-Designs

Discounted Death Benefit

- No upfront charge
- Insurer pays **discounted %** of face amount at time of payment
- Difficult to illustrate how deep those discounts may be across a range of claims scenarios

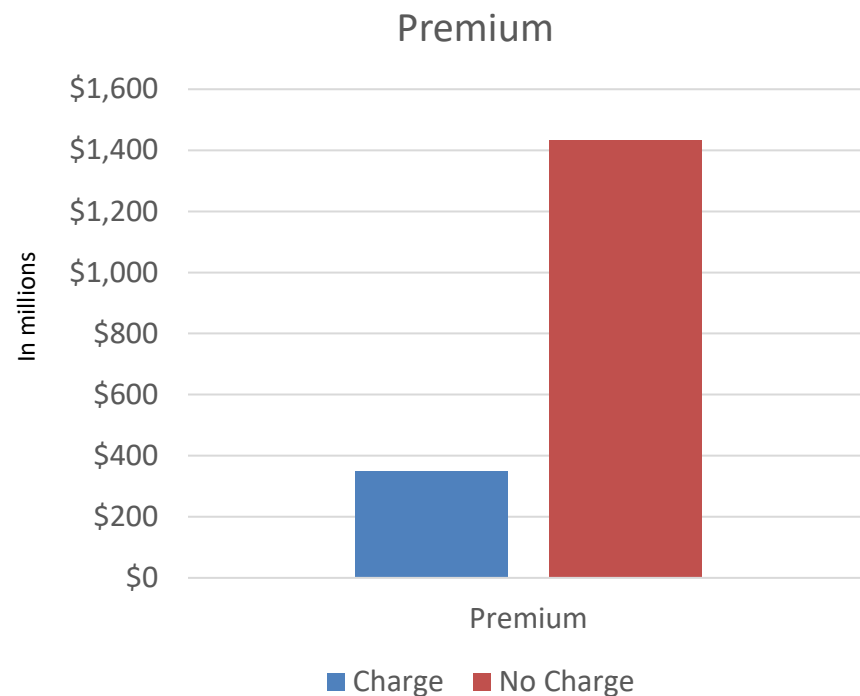
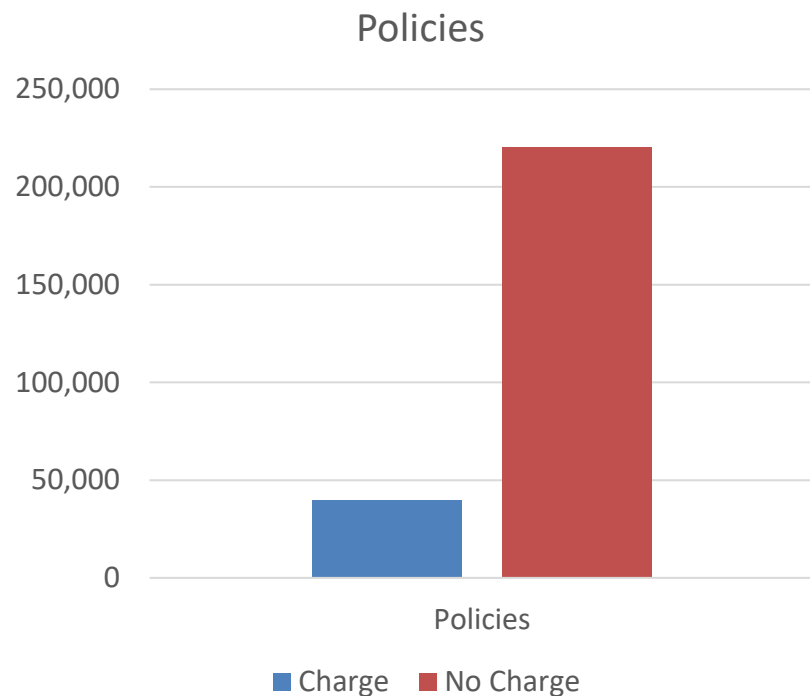
Lien Approach

- No upfront charge (usually)
- Payment of benefit is a **lien** against the death benefit of the policy
- Future premiums, charges, cash value are **unaffected by payment** and continue as if lien had not occurred

Dollar for Dollar

- **Upfront** rider **charges**
- Benefit Payment reduces Death Benefit **dollar for dollar**

2018: CIR: Charge vs. No Charge



2018 LIMRA Combination Study

LTC Rider-Design

- **Dollar for Dollar** reduction for benefit payment
- Generally **accelerates at a percentage of face amount** (e.g. 2% or 4%)
- There is a **rider charge / premium**
- **Indemnity** or **Reimbursement**
- Paid **monthly**

CIR vs LTCR: Which is Better?

CIR is Better

- For insurers and producers, maybe **easier path** as a life rider 101(g) vs. health type benefit
- **Fewer** LTC **forms** requirements
- Agents **do not need** to be **health licensed** to sell

LTCR is Better

- Can be **sold** as an **LTC solution**
- **Doesn't impose** the lump sum requirement of CIR which is more costly
- Can build in more **risk protections** such as
 - Reimbursement designs
 - Elimination period
 - Plan of Care requirement

Linked Benefit / Hybrid Design

EBR = EOB
Extension of Benefits Rider (EBR)
Extension of Benefits (EOB)

- **Bundled product** with Base + ABR + EBR
- Client gets access to the **Death Benefit plus more** (i.e. the EBR)
- Regulations require the 5% compound **inflation benefit** to be offered
- Available as **Single Pay** or **Multi-pay**
 - Multi-pay was traditionally 10 year or less
 - Seeing longer options recently
- Traditionally offers decent **return of premium** value
 - 70% to 100%
- Sold as the **Live-Die-Quit Story**
 - Self Funding alternative to Stand Alone LTC

Event	Product Use
Live	Long Term Care
Die	Death Benefit
Quit	Return of Premium

22

Stand Alone vs. Linked Benefit / Hybrid

Stand Alone

1. Predominately **Level Pay**
 - Higher interest rate risk
2. Always **guaranteed renewable**
3. **No** Death Benefit
4. **Full Underwriting** with APS
5. Highly **lapse supported**
6. **Use it or lose it** value proposition
7. Reimbursement the **only choice** in the market today

Linked Benefit

1. **Single Pay** and **Limited Pay**
 - Less reliance on future interest rates (especially Single Pay)
2. Most **Fully Guaranteed**
3. **Death Benefit**
4. Traditionally **streamlined underwriting**
 - Telephone interview eliminates some work for the advisor
5. LTC risk is **lapse supported**, but base life risk may be persistency supported, and mortality risk is also diluted due to pricing synergies (see 2012 SOA study on “Quantification of Natural Hedge Characteristics of Combination Products”)
6. Cash Value **exit strategy** for client
7. **Both** indemnity and reimbursement products **designs in the market**

Annuity with LTC Combination

- **Both** ABR & EBR [Acceleration & Extension of Benefits Riders]
- **Single Premium** Design to date
- **LTC regulations apply** to EBR
 - Must offer 5% compound inflation benefit
 - LTC Nonforfeiture benefits apply
- **Basis Designs**
 - ❖ **Pot of money**-LTC lifetime benefit is a fixed multiple of **initial premium**
 - ❖ **Tail design**-LTC lifetime benefit is a fixed multiple of **AV at time of claim**, claims paid **first from AV**
 - ❖ **Coinsurance**-As tail, but monthly benefits come **partly from AV and partly from insurance** until AV used up
- Fewer than six companies offer, as **low interest rates hurt illustrations**

Background on
Stand Alone LTC

Combo Market
Overview

Comparison

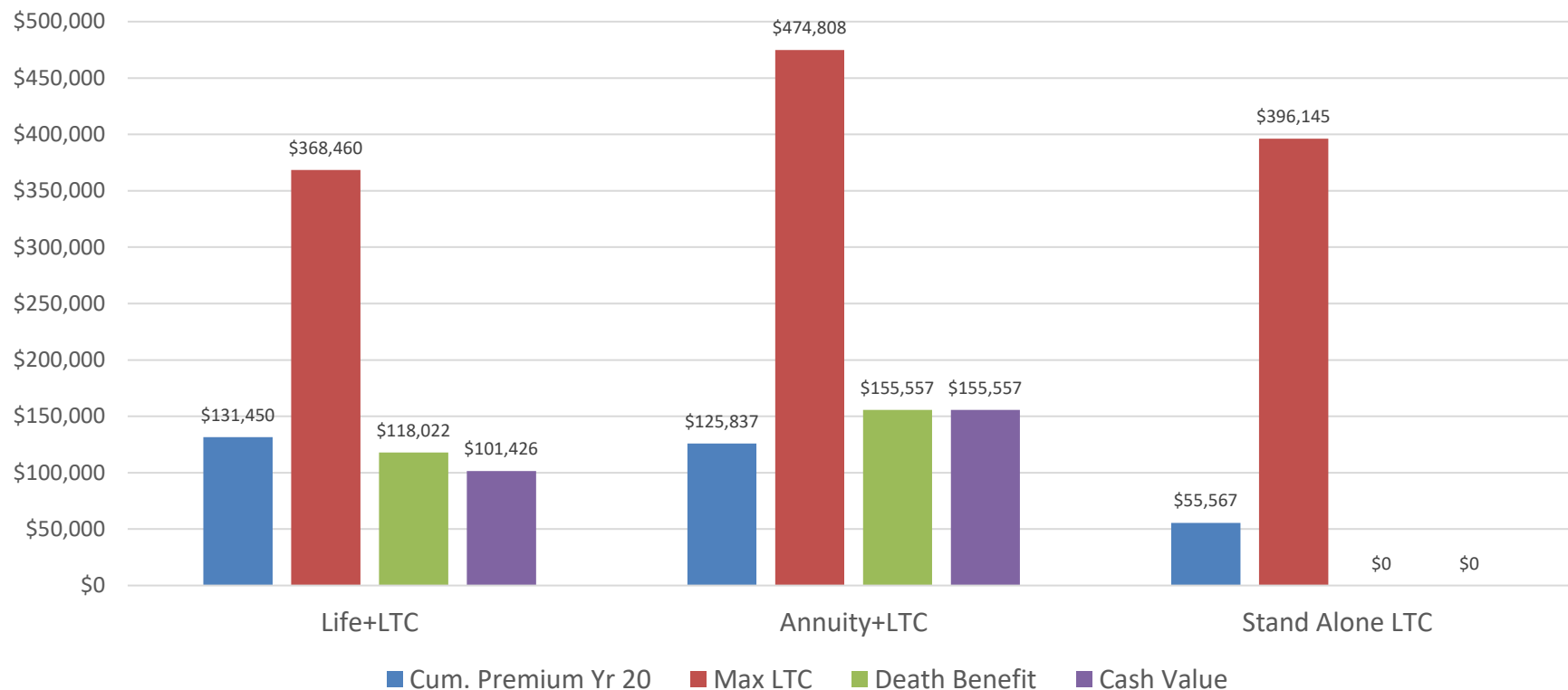
Producer
Perspective

Issues &
Opportunities

COMPARISON

Stand Alone and Combination Products

Product Comparison - Same initial Monthly LTC Benefit Male/Female Average, Issue Age 65, Duration 20



Product Comparison

Solving for the same initial Monthly
LTC Benefit
Male/Female Average,
Issue Age 65

Cumulative Premium			
Year	Life	Annuity	LTC
10	105,511	128,837	27,784
20	131,450	128,837	55,567
30	131,450	128,837	83,351

Death Benefit			
Year	Life	Annuity	LTC
10	128,944	129,706	-
20	118,002	155,557	-
30	117,072	186,721	-

Cash Surrender Value			
Year	Life	Annuity	LTC
10	82,443	129,706	-
20	101,426	155,557	-
30	104,802	186,721	-

Maximum LTC Benefit			
Year	Life	Annuity	LTC
10	283,765	355,339	294,769
20	368,460	474,808	396,145
30	482,283	640,424	532,386

Leverage Ratios (Maximum Benefit / Cumulative Premium)

Death Benefit			
Year	Life	Annuity	LTC
10	122%	103%	0%
20	90%	124%	0%
30	89%	148%	0%

Cash Surrender Value			
Year	Life	Annuity	LTC
10	78%	103%	0%
20	77%	124%	0%
30	80%	148%	0%

Maximum LTC Benefit			
Year	Life	Annuity	LTC
10	269%	282%	1,061%
20	280%	377%	713%
30	367%	509%	639%

Product Comparison

Solving for the same initial Monthly
LTC Benefit
Male/Female Average,
Issue Age 65

IRRs (Annual return to policyholder on premiums if maximum benefits are paid)

Death Benefit			
Year	Life	Annuity	LTC
10	4%	0%	n/a
20	-1%	1%	n/a
30	0%	1%	n/a

Cash Surrender Value			
Year	Life	Annuity	LTC
10	-5%	0%	n/a
20	-2%	1%	n/a
30	-1%	1%	n/a

Maximum LTC Benefit			
Year	Life	Annuity	LTC
10	17%	12%	49%
20	7%	7%	18%
30	6%	6%	11%

EXPERIENCE COMPARISON

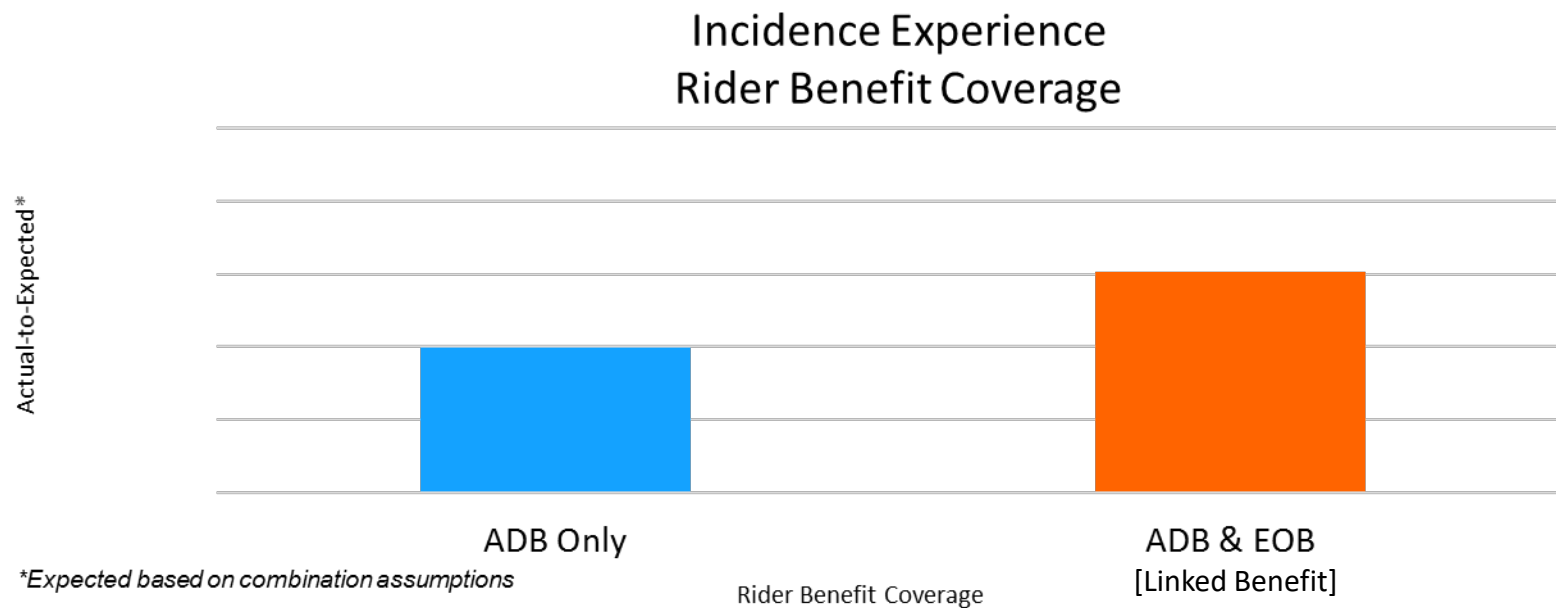
Stand Alone and Combination Products

- ✓ Incidence
- ✓ Lapse

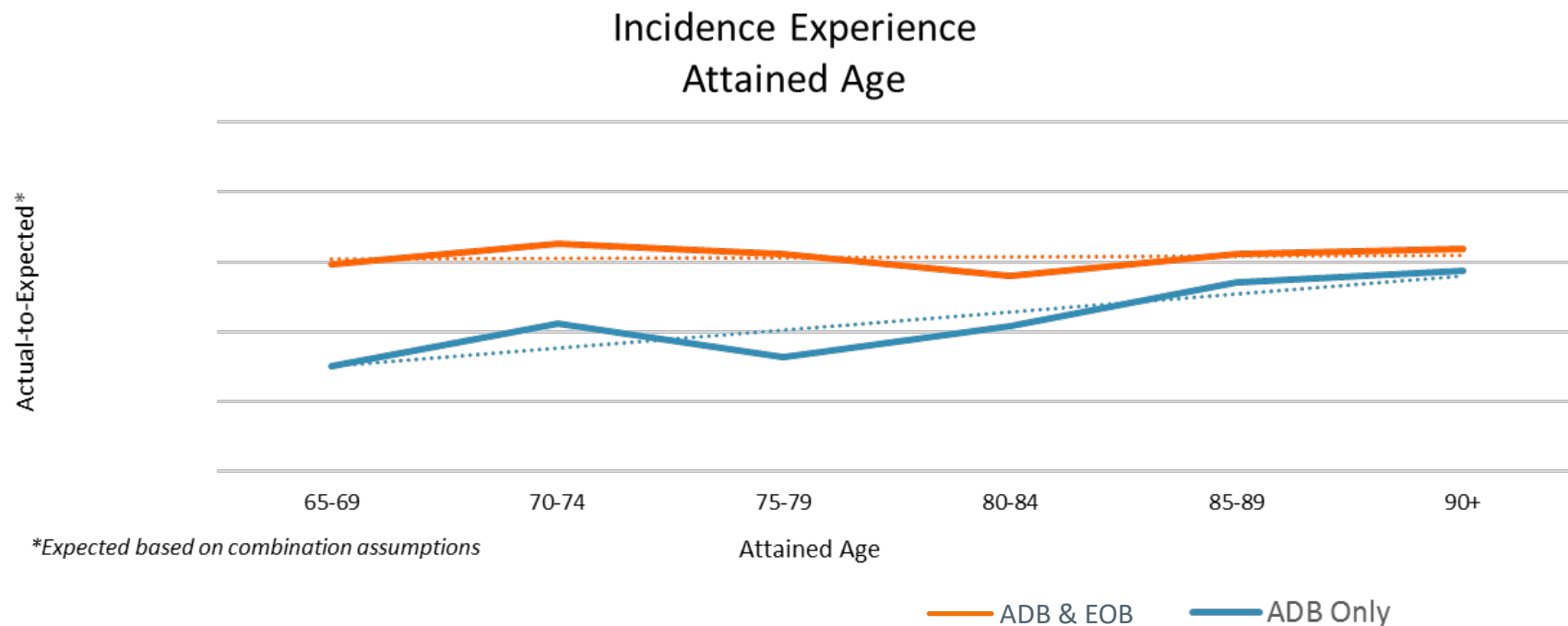
Incidence

- Combination Product **incidence** experience is **significantly better than expected**
 - Actual-to-expected (A:E) is **very low** when measured against **stand-alone LTC** assumptions
 - Also **better** than Milliman's **combination product** assumptions
- Analysis
 - Milliman 2018 Study
 - Stand-alone assumption based on \$50 billion of insured experience from many companies
 - Combo study based on a much smaller amount of insured experience from 11 companies
 - Alignment of underwriting in comparing the results

Incidence Variation by Plan Design



Incidence Variation by Plan Design



Incidence: Why & What

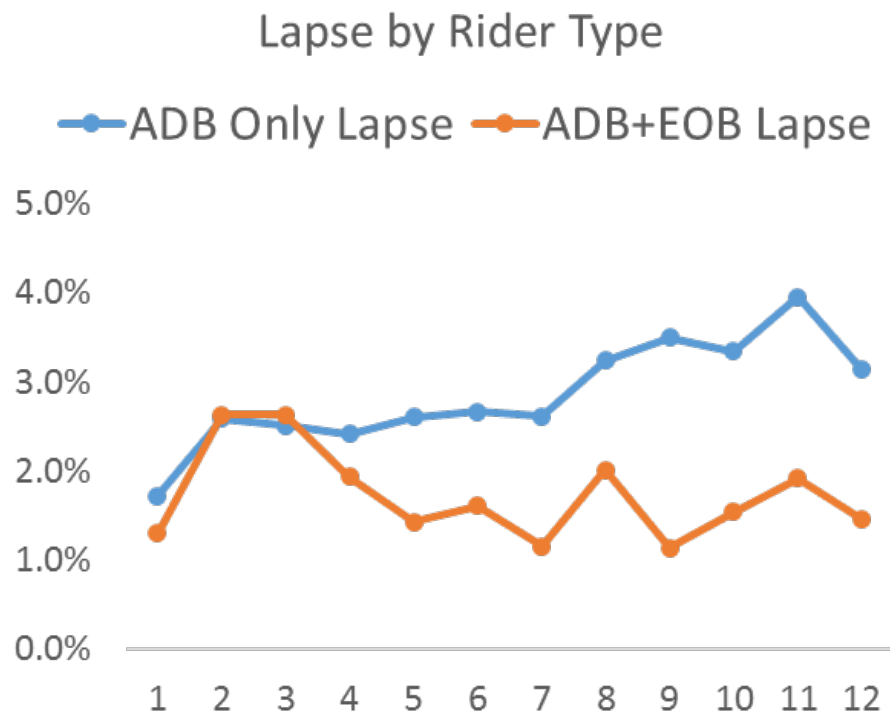
Why Lower?

- **Short-term claims** may not be filed on combination plans
- Policyholders of combination products are often **accessing their “own money”**
- May want to **preserve death benefits**
- May have **forgotten the rider** is on their policy
- Potential impact of **terminal illness rider**

What could change?

- **More utilization** since tax treatment is favorable
- The new focus on Hybrids with inflation option, **increases the importance of the LTC benefit**. Will the policyholder behavior change?
- The amount of combination **experience**, while significant, is still **not as developed** as the stand-alone market and may emerge higher than currently observed
- New riders are marketing **easier benefit accessibility** (pay your family member, etc.)

Combination Products Lapses by Duration



Background on
Stand Alone LTC

Combo Market
Overview

Comparison

Producer
Perspective

Issues &
Opportunities

PRODUCERS' PERSPECTIVES: COMBINATION PRODUCTS

Contingencies article, May/June 2019

Who is the Producer?

Protection Product Based Advisor

- ✓ Needs based approach
- ✓ Believes insurance should be part of every plan
- ✓ Understands field underwriting process and application process
- ✓ Uses comprehensive financial planning software
- ✓ Traditional LTC or Linked Benefits are possible solutions

Asset Manager

- Investment focused
- May be insurance adverse
- Not experienced with medical underwriting
- Uses asset allocation software
- Rate of return, diversification, and taxes are primary concerns
- Linked Benefits provide an opportunity to engage these advisors in LTC planning

Producers' Themes

- **Leverage**
 - Consumers like leverage of potential LTC benefits being a large multiple of premium
- **Sales motivation:** Sales are often **driven by emotional issues**
 - As one producer commented, “*statistics kill LTC sales*”, while personal experiences and **stories sell** the coverage”
- **Lower coverage levels**
 - Producers are selling lower average monthly benefits than in the past as more focus is being put on home health care services and assisted living facilities
- **Simplicity**
 - The more the industry can reduce the number of choices and decisions for the insured, the better
 - The simplicity of the new business process, including underwriting, is also very important
- **Financial strength**
 - The relative financial strength of the insurance carrier is very important
- **Producer comfort**
 - Producers are getting more and more comfortable selling combination products

Producers: Other Comments

- **Hybrid products**, those with EBR, are sold primarily to **meet the LTC insurance need**
- Illustrations:
 - Illustrations of policy values and benefits were **not particularly important** to many of the distributors
 - While some may find these detailed illustrations with IRRs insightful, several distributors felt they were of **limited value** to the average consumer
- Over the last several years LTC cost inflation has been significantly lower than 5%, the mandated inflation offer
 - One producer commented that “showing rates for a **5% compound inflation** feature is suicide... it is just **too expensive**”
 - 3% compound is selling

Producers' Perspectives: What are the Challenges?

- Several mentioned the **lack of annual premium** plans for linked benefit products
- For limited pay plans, some plans **don't provide waiver of premium**
- If interest rates increase, there is likely to be little or **no change in policy values** under most combination plans
- There is somewhat **limited availability** of designs providing **shared benefits** between a couple
- Some linked benefit plans in the **worksite market** cap home health care benefits at 50%
- Coverage for **international care** is limited
- A lack of **marital discounts** available

Background on
Stand Alone LTC

Combo Market
Overview

Comparison

Producer
Perspective

Issues &
Opportunities

ISSUES & OPPORTUNITIES

Market Development

- Seeing a **significant shift** from single pay plans to limited pay
 - Limited pay options are increasing from just 5-pay and 10-pay plans to **longer payment periods**, especially for younger issue ages
- 2017 CSO **required** for all life products as of 1/1/2020
 - This will require **more life insurance per cash value** than in the past
- Statutory principles based reserves (PBR) required for products with **substantial guarantees**
 - Most hybrid life plans have **lifetime guarantees**
 - Reserve requirements likely to be **increased** for most plans
 - Assumptions and resulting reserves will vary from company to company, especially for companies with larger exposure base featuring more credibility

Issues & Opportunities

Issues

- **Taxation** of combo policies
 - Impact of the payment of LTC benefits on the tax basis of the contract
 - ACLI submitted a letter to Treasury/IRS in 2009 requesting clarification
 - Still an open issue
 - Largely moot for life combos
 - Larger challenge for annuity combos
- Will higher **reserve costs** under PBR drive companies to develop combo life plans without lifetime guaranteed rates?
- Will **Chronic Illness Riders** with discounted death benefit designs be beneficial to insureds or a point of confusion for insureds and producers?

Opportunities

- Tax law **clarification**
- **1035 exchanges** to annuity combos
 - Biggest issue may be whether interest rates increase to levels that make illustrations more attractive
- **Joint life designs**
 - Limited availability of these structures that create a single lifetime maximum LTC benefit shared between two insureds in the combo market

Recap & Questions

- ✓ Stand Alone LTC is the most **cost effective solution** for LTC needs
- ✓ However, past experience and **rate increases** have resulted in **decreased sales** and fewer carriers offering
- ✓ Consequently, combination products, include CIR, LTCR, Linked Benefit and Annuity+LTC have **gained market appeal**
 - Combination products offer a **solution for** when **LTC benefits are not used**
 - Combination products can also provide **stronger rate guarantees**
 - Especially true for Linked Benefit designs
- ✓ Accelerated benefits create some **alignment of interests** between insureds and insurers, and include pricing synergies which reduce risks to insurers
- ✓ **Experience** has been **favorable** to date
- ✓ **Producers** are getting more **comfortable** selling
- ✓ Challenges include the **change to PBR** and the **outstanding tax question** on the payment of LTC benefits

