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Combination Annuities And The New Retirement Landscape

*Repositioning a portion of retirement assets
can address multiple needs*

A New Retirement Landscape
Millions of retirees are facing a new retirement landscape. They're finding that they will need to rely on their personal assets for their largest expected source of retirement income—and for a greater length of time. According to the Employee Benefits Research Institute's 2007 Retirement Confidence Survey,¹ 6 in 10 retirees are now planning to rely on personal assets for their largest source of retirement income.

Because retired Americans have a greater reliance on personal assets, common risks can have a deleterious influence on their retirement income, standard of living, and quality of life. Two common risks on the new retirement landscape are longevity risk and long term care risk.

Longevity Risk

Thanks to advances in science and medicine, Americans are living longer lives—spending as many as 20, 30, sometimes even 40 years in retirement. This gives them opportunities that no other generation has ever had—the time and ability to do things like follow a new career path, serve their community, enjoy grandchildren, or pursue a whole new way of life.

But because they're relying on their personal assets for their largest expected source of retirement income, increases in longevity can also increase the risk of outliving these assets. Even if retirees have saved enough money to go the distance, their money must

face challenges created by factors such as exposure to market risks, the erosive effects of inflation, and rising health care costs. Without having the luxury of time to recoup financial losses, a catastrophe at age 70, for example, would almost preclude the possibility of financial recovery.

Long Term Care Risk

Many people, when they hear the words *long term care*, immediately think of nursing homes. However, long term care can encompass an array of services and support for people who need assistance to function in their daily lives and to help preserve their ability to live at home. For example, services may be delivered in individual homes, in assisted living or supportive housing, in adult day care centers or in nursing facilities.

A 2001 think tank sponsored by the National Endowment for Financial Education referred to the risk of needing long term care as "our next national crisis."² One of the key reasons is that the expenses associated with long term care can be catastrophic. According to the AARP Public Policy Institute, the average 2006 cost of a private room in a nursing home was \$75,000 per year.³ The U.S. Senate Special Committee on Aging projects that by 2025, when today's 67-year-old turns 86, these costs will average \$140,000 per year.⁴

Yet of the two-thirds, or 69 percent, of people over age 65 who will need some

kind of long term care services or support in their lifetimes,⁵ only about 10 percent have secured private long term care protection.⁶ Instead, most Americans rely on three solutions: (1) they attempt to self-fund, (2) they default to Medicare or Medicaid, and/or (3) they rely on informal caregivers.

Self-Funding. Many Americans believe that if they have enough money to self-fund potential long term care expenses they do not need to consider private long term care insurance options. While it's true that self-funding is an option for some people, drawing income for everyday living expenses and covering long term care expenses can quickly deplete retirement assets—even from the most carefully constructed, well-funded plan.

Medicare/Medicaid. Many Americans also believe that Medicare or Medicaid will pay for all, or the vast majority, of their potential long term care expenses. However:

- Medicare limits payment to medically necessary home health care or care in a skilled nursing home facility. It does not pay for support services such as assistance with activities of daily living, such as bathing, dressing, toileting, transferring, continence and eating.

- Medicaid, the government's long term care program for low-income Americans, only kicks in after personal assets are significantly depleted and there's little left over for a spouse or family. Relying on Medicaid may also make it harder to find the type of care or facility that's most preferred and convenient.

Informal Caregivers. About three-quarters of individuals who receive care at home rely solely on unpaid, informal caregivers like friends and family members. Of the 34 million caregivers in the United States today, the vast majority are women between the ages of 45 and 64.⁷

- Research has shown that many caregivers experience immense stress and feelings of burden, high rates of depression, and feelings of anger and anxiety.

- Informal caregiving can adversely affect one's physical health and ability to continue providing care, leaving two people impaired instead of one.

- In one study, 28 percent of non-working caregivers had quit their jobs to provide care. Others experienced increased absenteeism,

lower productivity at work, lost career opportunities and lower future earnings.⁸

Multiple Needs and Combination Annuities

With longevity risk and long term care risk on the new retirement landscape, it's clear that innovation is needed to more efficiently meet multiple needs including: (1) ensuring retirement assets that last many years in retirement, (2) protecting at least a portion of these assets from market losses, and (3) limiting the impact long term care risks can have on an overall retirement plan.

One way that the insurance industry is addressing these multiple needs is by creating combination products that address both longevity and long term care protection for consumers. With the enactment of the Pension Protection Act of 2006 (PPA), combination products are expected to increase in popularity and availability. In fact, it's already prompted the introduction of tax-advantaged combination annuity/LTC insurance products. According to the PPA, in tax years beginning after December 31, 2009, the annuity distributions used to fund long term care benefits will *not* be taxable when used to fund qualified long term care expenses.⁹

The Power of Repositioning

For example, consider what happens when a deferred fixed rate annuity is combined with a long term care insurance rider. Very simply, this product design can allow individuals to reposition just a portion of their retirement assets to meet multiple needs. In this case, it can allow certain individuals to combine longevity and long term care protection without paying extra premiums for a stand-alone long term care policy they may never use.

The deferred fixed rate annuity can address longevity risk with:

- ✓ A safe money option with a guaranteed rate of interest.
- ✓ Tax-deferred growth.
- ✓ Access to principal through partial withdrawals or lifetime income stream.
- ✓ A death benefit.

The built-in long term care rider, usually calculated from the annuity value, can address long term care risk with:

- ✓ Guaranteed long term care benefits if they're needed, usually after a waiting period specified by the contract.

- ✓ A choice of care options, some allowing individuals to remain in their own homes.

- ✓ Preservation of overall retirement savings by using a portion of assets to cover potential long term care expenses.

- ✓ Inflation protection that keeps pace with rising long term care costs (not all combination annuities include inflation protection; it's important to evaluate each contract for its specific benefits).

As you can see, by repositioning just a portion of retirement assets into a combination annuity, many individuals will have the power to address multiple needs with one product. In addition to protecting their overall retirement plan assets, if they live many years in retirement, owners of these contracts can realize tax advantages, preserve their legacy wishes and maintain their choice of care options if the need for long term care ever arises.

The New Frontier

Helping Americans ensure their retirement security may prove a daunting task as millions of retirees navigate the changing retirement landscape. Combination product designs, such as a deferred fixed rate annuity with built-in long term care benefits, can help many retirees safely explore the new frontier with lifetime income to offset longevity risk and access to affordable long term care protection. 🌐

1. Employee Benefit Research Institute and Matthew Greenwald and Associates, Inc., 2007 Retirement Confidence Survey.

2. National Endowment for Financial Education, 2001 Think Tank report, "Long Term Care: Our Next National Crisis?" May 6-8, 2001.

3. Houser, Ari, "Long Term Care Fact Sheet," AARP Public Policy Institute, 2007.

4. "Medicaid in Crisis: Could Long Term Care Partnerships Be Part of the Solution?" Testimony by Senator Larry Craig, 2004 committee chairman, before the U.S. Senate Special Committee on Aging, June 22, 2004.

5. Aging Services: The Facts. American Association of Homes and Services for the Aging. Viewed January 15, 2008. www.aahsa.org/aging_services/default.asp.

6. *Ibid*, see source 2, above.

7. *Ibid*, see source 5, above.

8. *Ibid*, see source 5, above.

9. 2006 Pension Protection Act, Section 844: Treatment of Annuity and Life Insurance Contracts with a Long Term Care Insurance Feature.