

Randy's Annuity Notebook



Combo Product Spotlight

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Much has been written over the last several years about the Pension Protection Act (PPA) and the advantages of combination or combo products. In this article, I'll review the PPA and combination product highlights and offer different sales ideas that may be used with your clients. This discussion is for general educational purposes and should not be considered tax advice. Please consult your personal tax advisor or your client's tax advisor for specific tax advice.

At the time this article was written, LIMRA projected that 2009 fixed annuity sales numbers appeared to be on their way to becoming the highest year on record. Because of today's market uncertainty, more consumers are securing fixed annuities to help save for retirement. With the PPA changes, we'll see an even larger number of consumers purchase combo products to cover their accumulation and long-term care insurance (LTCI) needs using one policy.

On January 1, 2010 the PPA added several provisions to specifically address annuities that include long-term care benefits and riders. These new provisions have made nonqualified annuities with LTCI benefits much more attractive to consumers.¹

1. Rider charges deducted from annuities to pay for LTCI benefits are no longer a taxable event.
2. Tax-deferred growth within annuities pays for the LTCI benefits on a tax-free basis.
3. The new rules only apply to non-qualified annuities coupled with tax-qualified long-term care riders. A tax-qualified long-term care rider provides various levels of LTCI benefits, including benefits for cognitive impairments such as Alzheimer's.
4. Clients can also make a 1035 exchange into a combo annuity. This allows clients with existing annuities that do not have these types of benefits to take advantage of LTCI benefits through a combo annuity.

A relatively small number of companies have combo annuity products available for sale or in development. State approvals have been somewhat limited because of the newness of these types of products. And regulations in certain states do not allow specific design features. The biggest stumbling block has been the length of the waiting period. During 2010, we should see more states adopt methods to approve such products as more companies begin to file.

Combo annuities were created to help protect your client's risk boundaries, specifically their level of risk for retirement accumulation and insuring dollars are available if long-term care is needed.

The need for long-term care has never been greater. Despite the fact that 69 percent of people over age 65 will rely on some type of long-term care service or support during their lifetime², only 10 percent have acquired private long-term care protection.³ In 2009, the average yearly cost alone for a private pay room in a nursing home was \$79,935.⁴ And the average long-term care stay was 3.7 years for women and 2.2 years for men, with roughly 20% of Americans requiring long-term care coverage for 5 years or more.

There is great confusion with consumers about who will pay for long term care. Medicare only pays for home health care that has been deemed medically necessary or care in a skilled nursing facility.⁵ Most nursing home care takes place in an intermediate care facility which is not covered under Medicare. Medicaid on the other hand only pays for the impoverished. Therefore, many people attempt to self-fund their LTCI needs and the results can be devastating.

This chart below shows an example of self-funding for long-term care. The example uses a fairly aggressive 6% net earnings rate on assets after tax with 3% annual inflation and 5% annual increasing LTC expenses. Assume the client starts with \$500,000 of assets set aside for self funding. Each year they earn interest and take out annual income starting at \$30,000 per year. If they required LTC coverage in the first year with an annual cost of \$75,000 their assets at the end of the year would be \$421,618. They continue to take income out and their LTC expenses increase. At the end of five years their set-aside assets are depleted. This leaves no income for the remaining spouse to live on. So unless your client is quite wealthy, self-funding may not be the best option.

Self-Funding of Long-Term Care Expenses

While self-funding is an option, drawing income for everyday living and covering long-term care expenses can quickly deplete client savings. The chart below shows how \$500,000 in retirement plan assets can be depleted when long-term care expenses are self-funded.

This is a hypothetical example used for illustration purposes only. It assumes net interest earning after tax of 6%, inflation of 3% per year, and increase of LTC expenses of 5% per year. These hypothetical expenses may not be representative of the costs you may incur.

	Assets at Beginning of Year	Net Interest Earnings	Income Needs	LTC Expenses	Assets at End of Year
Year 1	\$500,000	\$28,618	-\$30,000	-\$75,000	\$421,618
Year 2	\$421,618	\$21,765	-\$30,900	-\$78,750	\$333,733
Year 3	\$333,733	\$16,335	-\$31,827	-\$82,688	\$235,554
Year 4	\$235,554	\$10,281	-\$32,782	-\$86,822	\$126,231
Year 5	\$126,231	\$3,550	-\$33,765	-\$91,163	\$4,853
Year 6	\$4,853	Depleted	Depleted	Depleted	Depleted

Purchasing a combo annuity can help consumers maintain and leverage their current retirement assets. It can also help protect a spouse and/or family members from the emotional, physical, and financial toll of care giving. And, it helps ensure clients will receive a wider choice of long-term care options. If clients do not use the long-term care benefits from their combo annuity, they can still receive the annuity benefits the policy offers, such as:

- A guaranteed rate of interest on their savings
- Tax-deferred growth
- Access to the annuity principal through partial withdrawals or lifetime income options
- A death benefit for beneficiaries equal to the annuity value
- Funds that can avoid probate

The application process for combination annuities is also simpler than that of traditional LTCI. Normally, it includes 10-12 pre-qualifying questions, a phone interview, and a check against the Medical Information Bureau and medication database. Most companies reach an underwriting decision based on this information without ordering doctor records. Some carriers report up to 80% of applicants that can answer “no” to the pre-qualifying health questions and complete the phone interview are ultimately issued a policy. Generally, policies are issued in 3-7 business days.

Applicants that have been previously declined for LTCI coverage are not generally eligible to purchase a combo annuity.

At the time of a claim, LTCI benefit payments are extracted from the annuity. The client does not incur a withdrawal charge. Typically, when the funds have been depleted from the annuity value, the policy can then offer a tail or extension of benefit for up to 48 months. Most policies make additional cost inflation benefits available that increase the monthly benefit at a stated interest factor.

Below is a chart that shows the different levels of care that are routinely covered by combination annuities. You should check each particular policy to determine coverage.

Nursing Home	Home Health Care	Alternative Care
Assisted Living Facility	Adult Day Care	Caregiver Training
Personal Care	Care Coordination Services	Homemaker Service
Respite Care	Care Planning	Hospice

Generally, those eligible to receive LTCI benefits from their combination annuity must be chronically ill and unable to perform 2 out of 6 daily living activities or have cognitive impairment, such as Alzheimer's. LTCI benefits cannot be received until the contract waiting period, which normally ranges up to 2 years, and the 90 day elimination period have expired.

Here is an example of a typical LTCI daily benefit provide by an annuity combo product

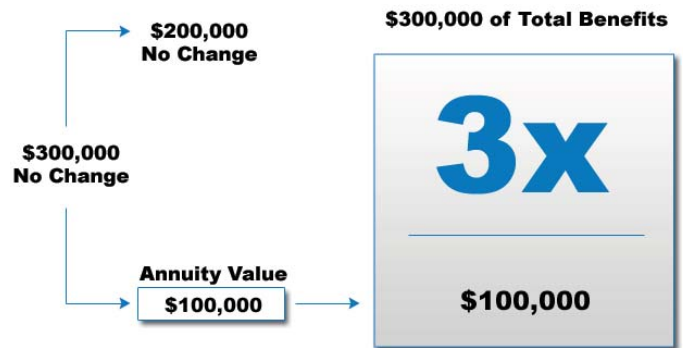
- Annuity Value: \$100,000
- Max. Daily Benefit: \$100,000 / 730 days = \$136.99 based on daily expenses incurred per day
- Max. Lifetime Benefit: \$100,000 x 3 = \$300,000

This hypothetical example provides a minimum of 6 years of benefits assuming no excess withdrawals. In this example, in years one and two of the claim the customer received benefits based on using their \$100,000 first. In years three through six, after the cash value is depleted, the policy provides the additional \$200,000 of LTCI reimbursement benefits.

Now I would like to go through five different sales spotlights. Please remember to review carrier approved marketing materials, state approvals and any product variations in your state prior to presenting a product and a product rider. None of the information contained in this article should be used with the consumer or used in advertising to the public. When considering these sales spotlights, you are strongly encouraged to obtain competent, legal advice about the licenses and registrations required in the states you where you write business, and what is considered investment or securities advice.

Spotlight #1 Pays up to 3 X the Annuity Value

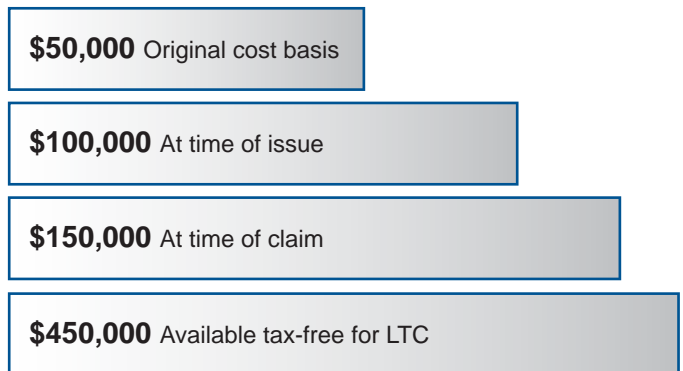
- Female age 60 has \$300,000 in non-qualified dollars set aside to be used someday if she needs long-term care
- She decides to transfer \$100,000 into a combo annuity leaving \$200,000 to be used for other purposes
- 20 years later at age 80 she has a long-term care need
- Her combo annuity continues to grow, if she requires LTC three times her annuity value is available on a tax-free basis



Above is a snapshot of her benefits at the time of purchase. \$200,000 of her assets are left alone for her to use as needed for other purposes.

Spotlight #2 - 1035 Exchange into a Combo Annuity

The Pension Protection Act also allows 1035 Exchange to a combo annuity.¹ The example below shows the dramatic tax-free benefits available when used for long-term care needs. Over \$400,000 over the original cost basis could be received income tax-free if used for qualifying LTC needs.



Spotlight #3 - IRA Enhancer Exchange

Qualified dollars cannot be used for purchasing a combo annuity. However, there are ways to reposition qualified dollars to ultimately purchase a combo annuity. This spotlight is called the IRA Enhancer Exchange using qualified money.

- Client age 70 has \$100,000 in their IRA and would like to leverage their benefit and some day use for LTC coverage
- A direct transfer is initiated into an IRA annuity with the carrier
- Over the next 5 years, the client initiates a series of automated annual withdrawals from the IRA into a new non-qualified combination annuity
- Payments from the IRA are fully taxable over the 5-year period
- At the beginning of the 5th year, all the dollars have been transferred into the combination annuity that provides tax-free benefits for long-term care
- The long-term care benefit is 3x the annuity value
- After 10 years, the accumulated value has grown and using the 3x factor over \$380,000 is available in the event of LTC

Spotlight #4 - Maximize the Leverage with a Return of Premium Guarantee

This spotlight is a combo life product. Instead of combo annuities that generally provide a 3x leverage factor, this idea can provide even more leverage plus a return of premium guarantee. The younger your client, the higher the benefit and the leverage. An example is below:

- Female age 55, non-smoker in good health has \$600,000 set aside with the sole intention of passing these dollars on to her daughter upon death
- She would like to have a LTC fund of over \$600,000 available
- She transfers \$100,000 into a specially designed single premium life policy with a tax-qualified LTC rider, the remaining \$500,000 can be positioned as appropriate for the client
- New life policy provides the following:
 - Guaranteed over \$660,000 available for LTC tax-free
 - Guaranteed lifetime return of premium benefit
 - Guaranteed income-tax free death benefit of over \$220,000

Spotlight #5 - No Underwriting Required - Nursing Home Confinement Enhancement

Many producers and clients do not like underwriting or cannot qualify for a LTCI policy. This is an alternative. This spotlight is not a combo product but a fixed annuity with an income rider with a unique benefit available in the event of nursing home confinement. Please note: all benefits described in Spotlight #5 are subject to taxation as a withdrawal, based on normal withdrawal taxation rules. The income benefits from the annuity are not-tax free. Some producers call this the no underwriting nursing home doubler.

- Husband and wife both age 80, have \$500,000 and desire to begin taking guaranteed joint lifetime income and they both are concerned about LTC
- Neither of them can qualify for traditional LTC
- No underwriting is required for this enhancement on a fixed deferred annuity with an income rider
- Upon purchase of the annuity they elect joint income for life of \$32,500 using the income rider (based on 6.5% payout factor)
- Two years later husband goes into nursing home annual income increases to \$65,000
- Five years later the husband dies, income goes back down to \$32,500 for the surviving spouse
- One year later the wife goes into a nursing home and the income goes back up to \$65,000, any remaining accumulated value goes to the beneficiary

This chapter of Randy's Annuity Notebook with additional details, is also available in a 25-minute educational webinar replay. To learn more about the companies that offer these great benefits I encourage you to e-mail me. To access the webinar replay please visit our annuity resource center on our website: www.BILTD.com.

For agent training use only, not for use with consumers.

1 U.S. Department of Labor. Viewed February 15, 2010. www.dol.gov/ebsa/pdf/ppa2006.pdf

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

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

4 Metlife 2009 Study Viewed February 15, 2010. www.metlife.com/mmi/

5 U.S. Department of Health and Human Services viewed February 15, 2010. www.medicare.gov/nursing/Payment.asp