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**LONG-TERM CARE LIFE
THE BRAVE NEW WORLD APPROACHES**

By

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The central idea of life insurance has always been to protect the insured from the risk of dying too early. On the positive side, the “death benefit” paid to beneficiaries provides a cushion for a family facing the economic loss of a breadwinner. On the negative side, a policyholder could callously observe that premiums paid while alive purchase an economic benefit that can only be realized once deceased.

For decades, life insurance marketers have searched to develop a compelling “living benefit” to life insurance. Traditional whole life policies were defined to create a “cash value” internal to the policy with the special advantage of income tax-deferred appreciation. The policyholder while alive was allowed to access the policy’s accumulated value through loans or withdrawals. Beginning in the 1980s, creative marketers found ways to increase the appeal of tax-deferred internal build-up by making the yields more competitive with investment returns. Yet even Universal Life failed to hit the mark as precisely as did annuities.

The tax-deferred annuity as rediscovered and marketed by banks throughout the 1990s abandoned altogether the attempt to market any “death benefit.” Marketing the tax-deferred internal buildup of the annuity accumulation account, the life insurance industry found an appealing product to sell. Absent a death benefit, annuities had no need for medical exams or attending physician statements. Anyone with funds to invest could purchase an annuity regardless of their health. Moreover, the annuity focused on the benefits the policyholder could expect to receive in their own lifetime.

A further transformation has begun. Accelerated death benefits, until recently a relative arcane concept, has begun to redefine life insurance to focus a policyholder on important insurance benefits that can be realized while yet alive. As the power of accelerated death benefits are appreciated in the life insurance industry, we may reach a point where the

only life insurance policies or annuities that can be sold are those enhanced to include “living benefits,” in particular long-term care protection.

What Are Accelerated Death Benefits?

Simply defined, accelerated death benefits involve the payout of a life insurance policy’s maturity value while the insured is still alive. The first accelerated death benefits to appear on the market involved terminal illnesses. If the insured developed any of a set of pre-defined terminal illnesses, such as cancer or heart disease, payment of all or a substantial portion of a life insurance policy’s death benefit could be triggered while the insured was still alive.

Accelerated death benefits began hitting the US market about the same time as Viatical Settlements were moving to center stage. Both initiatives stemmed from the same impulse – the desire to allow the insured to access life insurance maturity values in life’s last stages, permitting the insured to realize value from the “death benefit” while yet alive. The US Congress and the IRS went along, redefining accelerated death benefits and Viatical Settlements as income tax-free, the same status that had traditionally been afforded to death benefit payments themselves.

By the end of the 1990s, industry experts had identified some 200 life insurance companies that were offering some type of accelerated death benefit protection to approximately 18 million policyholders. Still, the limiting characteristic of these accelerated death benefits was typically the requirement that the policyholder be diagnosed as terminally ill to receive the “living benefit.” Still, the process had begun – living benefits, not simply “death benefits,” promised to make the marketing of life insurance more palatable.

The Emergence of LTC Life and LTC Annuities

Seniors are increasingly aware of the need for long-term care insurance. Still, paying expensive premiums for indemnity insurance remains a barrier, especially when premiums become dramatically more expensive in the advanced years when a person may finally appreciate the need for the coverage. Long-Term Care Life Insurance (LTC Life) seeks to overcome the barrier by defining long-term care as a condition that will trigger the payout of the death benefit. To appreciate the power of LTC Life marketing, consider the following example:

- A 65-year old, non-smoking woman has \$110,000 in assets that could be used to pay for long term care.
- She decides to invest \$50,000 in a Single Premium LTC Life policy. This provides her with a death benefit of \$103, 522 in death benefits that are income tax-free under IRC Section 101(a)(1).

- Additionally, she receives a \$310,566 benefit for long-term care that is income tax-free under IRC Section 104(a)(3).

The long-term care provisions of the policy are generally triggered by a physician's certification that the insured is chronically ill and unable to perform a specified number of daily living activities. The long-term care provided may involve a deductible period, but it can be defined to cover care in an assisted living facility or home health care as well as confinement in a nursing home. LTC Life policies can also be defined to cover both Alzheimer's Disease and similar forms of irreversible mental disability. A policy rider may be required to get the LTC benefit to exceed the amount of the policy's maturity value.

The long-term care payout provisions of LTC life can be generous. In the example above, the monthly maximum LTC benefit at the time of purchase is defined as \$4,313, increasing by 5%, or \$215 beginning on the first anniversary. Depending upon the policy, annual increases in the monthly benefit can be defined to continue indefinitely, or until a maximum benefit is reached.

LTC Life enjoys an important advantage over traditional long-term care insurance. Defined as an accelerated death benefit payout, LTC Life "adds on" the benefit to a life insurance contract. The insured no longer needs to face expensive indemnity premiums that are often viewed as simply "lost" if the long-term care benefits are never needed. In LTC Life, if long-term care is never needed, the full death benefit remains to be paid to beneficiaries. Any portion of the death benefit not used to pay long-term care benefits also remains to be paid as an income tax-free death benefit. Some LTC Life policies define a "residual death benefit," perhaps 10% of the original death benefit that will remain as a death benefit for beneficiaries even if the entire original death benefit amount has been used to cover long-term care expenses.

Increasingly, LTC Life has been marketed as a single premium product configured as a Modified Endowment Contract (MEC). Why a MEC? Simple. In a MEC the amount of pure insurance purchased in relation to the premium invested in the product is the minimum required to qualify the policy as a life insurance contract under the Internal Revenue Code. Granted, the policyholder loses the advantage of income tax-free borrowing of the cash value, but this is rarely a disadvantage in the senior market where policyholders are ill disposed to borrowing generally. In the view of many seniors, a MEC functions much as an annuity with a death benefit added on. A MEC derives an additional advantage in that it may have easier to meet health underwriting requirements precisely because the contract reduces the amount of pure risk involved.

Several major insurance carriers already have LTC Annuities under development. The concept is similar to LTC Life. In an LTC Annuity, for example, the 65 year-old, non-smoking woman investing \$50,000 in a single premium would receive a Tax Deferred Annuity (TDA) with an initial \$50,000 maturity value. The long-term care provision of the LTC Annuity would add on a \$300,000 long-term care benefit that would function exactly as the similar provision in LTC Life. The full \$300,000 would be available to be

accessed in a long-term care situation. Any of the \$50,000 initial maturity value of the LTC Annuity that had not been used in paying out the long-term care value would remain as an annuity maturity value. In any event, a residual annuity value, say 10% of the original maturity value, would be available to be paid to annuity beneficiaries even if all the original maturity value were used to pay long-term care benefits.

Unlike traditional annuities, an LTC Annuity will require health underwriting. The contracts being prepared contemplate simplified underwriting, involving the answering of a limited number of health questions, avoiding altogether the need for physical exams or attending physician statements.

LTC Life and LTC Annuity Marketing Advantages

Selling in the retirement market promises to be the hot prospect of the new millennium. The retirement of the baby boomers is likely to be just the first demographic bubble of an expanding retirement market. Continued advances in medical science promise to extend ordinary life expectancies to and beyond the century mark. LTC Life products and LTC Annuities may be the first redesign of traditional insurance concepts that reflect the need for 21st Century insurance products to be robust in retirement financial planning advantages.

LTC Life is a three-dimensional product. As with traditional life insurance, LTC Life has a continued death benefit that passes to beneficiaries income tax-free. LTC Life thus continues to provide a wealth transfer vehicle valuable in the estate planning setting. Second, the accumulation value of LTC Life continues to operate as a savings vehicle from which needed funds can be accessed. Third, LTC Life provides protection in the long-term care situation certain to confront many seniors in their final days. When the LTC Life policy is sold with a refund of premium guarantee, a policy provision that offers to return all premiums paid (minus long-term care benefits paid out) to the policy holder as a minimum benefit even if the policy is cancelled, the product offers distinct advantages over indemnity long-term care policies where there is no monetary return to the policyholder should long-term care benefits never be used.

The LTC Annuity provides an additional engine to drive an already booming TDA market. The TDA appeals to seniors in large part because it shields interest earnings from current income-tax erosion, permitting substantially greater appreciation through tax-deferred appreciation. The LTC Annuity adds an additional layer of protection. Funds are now available through the long-term care provisions of the annuity to protect other assets from liquidation should a long-term care situation otherwise trigger the need for a pre-Medicaid spend-down of assets.

Marketers can easily position LTC Life and LTC Annuities as “Enhanced Life Insurance” and “Enhanced Annuities” to emphasize the long-term care benefits. If guaranteed and current yields on LTC Life and LTC Annuities are competitive with yields on traditional products, it is hard to see why any senior who could pass the underwriting requirements would not to buy the “new and improved” versions. The strength of this marketing

appeal holds the promise to force a sea change in life insurance and annuity marketing. Any product with does not carry long-term care provisions may rapidly become non-competitive in the senior marketplace.

LTC Life and LTC Annuities have clearly come full circle with the concept of accelerated death benefit. No longer is the accelerate death benefit an arcane term appreciated only by actuaries. When LTC Life and LTC Annuities hit the mainstream of financial services marketing, life and annuity products enhanced with long-term care features could well become the rage.

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