Adopted by Long-Term Care Innovation (B) Subgroup
July 19, 2017

PRIVATE MARKET OPTIONS FOR FINANCING LONG-TERM CARE SERVICES

The **National Association of Insurance Commissioners** (NAIC) is currently involved in an effort aimed at increasing the number of affordable asset protection product options available for Americans, potentially paving the way for the private market to play a more meaningful role in financing the long-term care needs of our society. Part of this effort involves identifying and addressing potential regulatory barriers to innovation in the private market, in order to spur innovative private market solutions to financing Americans' long term care needs. At the same time, it is important to recognize that a variety of options currently exist to help consumers finance their long term care needs.

This document is intended to provide regulators, policymakers, consumers, and other stakeholders an overview of the landscape of long term care financing mechanisms currently available in the private market. These options are in addition to traditional long term care insurance, in which the consumer pays a regular premium in return for coverage for long term care services, if needed. Additional options outlined below include various hybrid products that combine life insurance or annuities with coverage for long term care needs, and life settlements, which allow consumers to sell an existing life insurance policy in order to pay for long term care services.

The information that follows is offered as a high-level summary. As with any insurance/financial product, there is no single "best" product design. Before making any decisions, prospective insureds and their families should have a frank discussion about their plans and location for retirement, their potential family and community care options, and their need for long term care if the need arises. They should also have a frank discussion with a trusted advisor about their long term goals and financial resources, and at a minimum consider current and anticipated future financial resources, their health, and possible tax advantages or disadvantages or various options for financing future care.

Background - Traditional Long Term Care Insurance

By way of background, long-term care (LTC) insurance is an insurance coverage that consumers can access individually or through a group, such as employer.1 This coverage typically requires regular premium payments in return for coverage for long term care services, if needed. LTC coverage is generally either offered on a reimbursement basis, reimbursing the insured for eligible services, or on an indemnity basis, paying the insured a set daily dollar amount once the insured qualifies for the benefit. Typically, a policy pays benefits when the insured is unable to perform two of the activities of daily living (ADLs): bathing, continence, dressing, eating, toileting, and transferring.

When buying a policy, consumers typically make several choices to customize the policy to meet their needs and budget. Those choices include: a maximum daily benefit (the maximum amount the policy will reimburse, or pay out directly if it's an indemnity policy, per day); the number of years of benefit that will be paid; the length of the elimination period, which is a period of time that the policy won't pay the cost of LTC services, and the consumer may owe the cost; and whether, and at what level, to buy inflation protection, which protects the policy's value from being eroded by inflation over time.

Traditional LTC insurance sales have fallen precipitously in recent years, from 754,000 individual policies in 2002 to 129,000 in 2014. Likewise the number of insurers offering the coverage has diminished from slightly over 100 in 2002 to about a dozen today, and premium rates for newly issued policies have risen as the remaining writers have refined their pricing. These numbers reflect the fact that in many cases, insurers struggled to accurately price LTC insurance initially and made a number of assumptions that turned out to be inaccurate. The result has been significant losses for many companies selling this line of insurance and many LTC insurance consumers facing significant premium increases they did not anticipate. Ultimately, LTC insurance has proved to be a more expensive product as many insurers have refined their pricing. Hence, many consumers may be interested in exploring alternatives to traditional LTC insurance as they consider ways to finance their potential LTC needs.

[1] The NAIC document "A Shopper's Guide to Long-Term Care Insurance" provides an excellent introduction to LTC insurance, and is available at: http://www.naic.org/documents/prod_serv_consumer_ltc_lp.pdf.

Hybrid Life and Annuity Products

As mentioned previously, sales of traditional LTC insurance have fallen significantly in recent years. In contrast, sales of hybrid products that combine life insurance or annuities with long term care benefits have increased in recent years. Hybrid products can appeal to consumers who are reluctant to purchase traditional LTC insurance due to its history of rate increases and the absence of death or surrender benefits.

Although many forms of premium structures are available, the more popular hybrids are funded through a single premium, which eliminates the risk of future premium increases but requires considerable liquid assets to pay the premium. Hybrids give the consumer the option to receive benefit dollars for necessary LTC services and, to the extent not used for LTC benefits, as death benefits or withdrawal/surrender benefits. Life/annuity LTC hybrid products may be either reimbursement or indemnity products, and may be marketed as providing LTC benefits.

Consumers can also purchase life/annuity products with a "chronic illness" benefit feature, which provides acceleration of death benefits or other benefit enhancements. While these products may provide a consumer with important benefits, they do not provide bona fide LTC insurance benefits, cannot be marketed as providing LTC benefits, and should not be compared directly to LTC products. Differences between life/annuity LTC hybrid products and life/annuity products with a chronic illness benefit feature include benefit triggers, benefit design, and, potentially, tax treatment. LTC hybrid products generally provide coverage when an insured requires substantial assistance with at least two ADLs for at least 90 days; in contrast, a chronic illness benefit feature generally will require a physician to certify that the qualifying conditions are likely to persist for the remainder of the insured's lifetime. LTC hybrid products typically provide a defined benefit, whereas the dollar amount of benefit offered through a chronic illness benefit feature may not be known in advance, as it may be calculated as a function of the death benefit (or other defined covered amount) at the time the chronic illness benefit is triggered. Lastly, products with a chronic illness benefit feature may not qualify fully for favorable tax treatment for which LTC hybrid products may qualify.

Single Premium Permanent Life Insurance Policies

The most common life insurance-LTC hybrid is a single premium permanent (whole or universal) life insurance policy sold with a long term care acceleration rider and a long term care extension rider. The acceleration rider will allow the policyowner to access the death benefit, typically in level monthly amounts over a 20 to 50 month period, in order to pay for qualified long term care services. The extension rider, which if added on the acceleration rider, will continue such payments for a set period of time after the acceleration rider has exhausted the death benefit. It is important that the life insurance policy be a permanent policy, that is, either a fully paid-up whole life policy or a universal life policy with a fully funded death benefit guarantee. This ensures that the policy will have value if LTC benefits are needed. Other types of life insurance policies, depending on variables such as the extent of future premium obligations or policy loan activity, may have little or no value when LTC benefits are needed. The life insurance-LTC hybrid products available today generally have more stringent underwriting requirements than annuity-LTC hybrids, and, as a result, may offer greater long-term care benefits per dollar of premium compared to annuity-LTC hybrids.

One currently available life insurance-LTC hybrid product is a single premium whole life policy with both acceleration and extension riders that can provide three possible benefits to the owner or beneficiary. First, the policy can provide long term care benefits where the first two years of claim are covered by the acceleration rider and up to four more years are covered by the extension rider. Second, the policy can provide a death benefit if such benefit has not been fully accelerated. Finally, if LTC benefit payments or other partial withdrawals have not occurred, and presumably in the event of some pressing financial need, the policyowner can surrender the policy and receive a return of premium. The above sample policy returns 90% of the single premium in the first two policy years and 100% of the premium thereafter. Exercising the return of premium option would eliminate the coverage provided by the policy, but provides consumers with future financial flexibility.

Annuity-LTC Hybrids

The most common annuity-LTC hybrid is a single premium deferred annuity that allows penalty-free withdrawals from the account value (i.e., the accumulation of premiums plus interest, net of expense charges and cash withdrawals) for qualified long term care services. Similar to life insurance hybrids, claim payments continue after the exhaustion of the account value if the consumer has purchased an extension rider. This type of product generally has less stringent underwriting requirements than the life insurance-LTC hybrid and, as a result, may not offer quite as much LTC value per dollar of premium compared to life-LTC hybrids.

There are also some annuity products with a chronic illness feature that can be viewed as analogous to life insurance policies with an acceleration of benefits feature triggered by chronic illness. These annuity products offer withdrawal benefits (i.e. cash payments to the owner that reduce the account value), that, in the event of chronic illness, are somewhat higher than those payments supported solely by the account value. As in the case of a life insurance policy with an acceleration feature triggered by chronic illness, these products should not be compared directly to bona fide annuity-LTC hybrids. The annuity products with a chronic illness feature generally have the least stringent underwriting requirements and may incorporate a short waiting period.

One currently available annuity-LTC hybrid is a single-premium deferred annuity with long term care benefits. The single premium is credited with interest in a fund until the account value is annuitized (i.e. converted to a lifetime payment stream). If the policyowner dies prior to annuitization, the account value is paid to the beneficiary as a death benefit. If the policyowner needs long term care services prior to annuitization, then the account value covers LTC services for the first two years of claim. After the annuity's account value is exhausted, LTC expenses can be covered by an extension rider for 4 years. At any time prior to annuitization, the policyowner may take withdrawals (subject to withdrawal charges and penalties) or surrender the annuity and receive any remaining fund value net of surrender charges.

Impaired-risk Payout Annuities

Impaired-risk (substandard, as determined by medical underwriting) single-premium immediate annuities (SPIAs) have long been available, primarily for the retirement income market. The impaired-risk product could be of particular interest to an individual who retired early owing to disability, where higher periodic income payments can be anticipated in comparison to a standard-risk SPIA. However, the larger market segment appears to be directed toward achieving tax-efficient wealth transfer goals.

An increasing number of life insurance companies are developing products intended for individuals who are already receiving, or will soon be receiving, long-term care services and who have the financial resources to pay a large single premium but need to guard against the risk of needing care longer than their personal finances can support. Individuals do have to go through underwriting – so the insurance company can assess the person's anticipated longevity. In this circumstance considerable medical documentation is usually readily available regarding the insured person's health, so companies can evaluate the degree of elevated mortality and establish higher payout rates with minimal inconvenience to the individual receiving care.

As such products are currently structured, the annuitant may, but does not have to, apply any portion of the benefit payments to fund long-term care. The benefit payments may be higher or lower than the cost of care, and such payments continue for life regardless of any change in health status. Some products have an optional, and very limited, return of premium feature upon early death which differs from the traditional option found in a standard payout annuity. In the case of a standard SPIA, any return of premium benefit would diminish gradually and over a longer period of time.

It must be kept in mind that even if the payout rate is 50% higher than a standard annuity, based on the insurer's determination of reduced longevity, the required single premium is still only within reach for those who already have substantial ability to self-fund. As a result, the market is primarily those wishing to manage family assets efficiently and to preserve a much more predictable portion of an estate. This may suggest that only a modest redeployment of private assets to fund long-term care can be anticipated with increased availability of impaired-risk payout annuities.

Life Settlements

Life Settlements – the sale of an in-force life insurance policy for a market-based settlement value in excess of the cash surrender value (i.e., the account value less any surrender charge) – is one option seniors might use to generate resources to pay for their long-term care needs. Some elder care providers and professional advisors recommend that their clients consider using life settlement proceeds to fund an account with a bank and trust company to make monthly payments directly to a designated long-term care provider. Upon death, in addition to a modest reserve to defray final expenses, any remaining balance in the account is paid to a designated beneficiary.

Policyowners who sell their policies receive a lump sum payment that is generally four or more times greater than if they lapsed or surrendered their policy, according to government[2] and university[3] studies. In particular, where there has been deterioration in the insured's health since the life insurance policy's issue date, the owner can sell the policy for an amount substantially greater than the cash surrender value. Additionally, consumers with policies that have a minimal to zero cash value and low to moderate required premiums may be able to sell their policies for a settlement value that substantially exceeds the cash surrender value of the policy. In some cases the owner may be able to sell a portion of the policy, thus retaining a portion of the original death benefit for their beneficiaries, while reducing or eliminating future premiums. In the past, it was more difficult for sellers to find a buyer for smaller-face life insurance policies (as low as $100,000), but over the past few years the market has increasingly been purchasing these policies. The payment upon settlement can vary among life settlement companies, so policyowners should shop around to find the highest available offer net of transaction expenses.

Buyers of policies (known as life settlement providers) and brokers are generally required to be licensed in the state where the seller resides. Life settlement companies are generally required to provide sellers with consumer disclosures that include: alternatives to entering into a life settlement, financial risks associated with entering into a life settlement (tax consequences, loss of government benefits, claims of creditors), financial information about the specific settlement transaction, privacy protections and a notice that sellers should consult with appropriate tax and financial advisors. Policyowners in immediate need of long-term care can sell their policies and receive the proceeds of the sale free from federal tax (Internal Revenue Code §101(g)). To find out more information on how life settlements and life settlement providers and brokers are regulated in a specific state, consumers can contact their state Department of Insurance.

Over the past few years, there has been some movement toward the standardization of disclosure requirements around life settlements. For example, the National Conference of Insurance Legislators adopted a model law and a number of states have adopted laws or rules to improve disclosure to seniors regarding alternatives to the lapse or surrender of a policy. In addition, a handful of states have considered or adopted laws that would require the state Medicaid agency to advise seniors to consider selling their policies as a means to fund their long-term care needs, reducing the financial burdens on the senior, their families and the state treasury.[4]

---

[2] Life Insurance Settlements: Regulatory Inconsistencies May Pose a Number of Challenges, United States Government Accountability Office (2010) Appendix III

[3] Empirical Investigation of Life Settlements: The Secondary Market for Life Insurance Policies, Afonso V. Januario, Narayan Y. Naik, London Business School (2013)

[4] GWG Presentation to NAIC Long-Term Care Innovation (B) Subgroup, (August 25, 2016) Slides 14-19; see also Your Texas Benefits: Medicaid and Life Settlements; and Florida Agency for Health Care Administration Accelerated Life Benefits Technical Advisory Workgroup Final Recommendations Report with Proposed Legislation (January 15, 2013)