



Marketing Linked Benefits - 1035 Exchanges

THE ELEVENTH ANNUAL INTERCOMPANY LONG TERM CARE INSURANCE CONFERENCE

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Marketing Linked Benefits

1035 Exchanges

Agenda

- **Long-Term Care Planning**
Mark Pellicano – Lincoln Financial Group
- **Life and Annuity – LTC Combination Plans**
Carl Friedrich – Milliman, USA
- **Linked Benefits**
Doug Burkle – Genworth Financial
- **Q&A**



Long-term care planning

Mark Pellicano

Not a deposit
Not FDIC-insured
Not insured by any federal government agency
Not guaranteed by any bank or savings association
May go down in value



Case study: focus on long-term care



Goal: Ensure that long-term care costs do not derail retirement plans.

Jim and Janet Johnson

Current ages: Both age 56

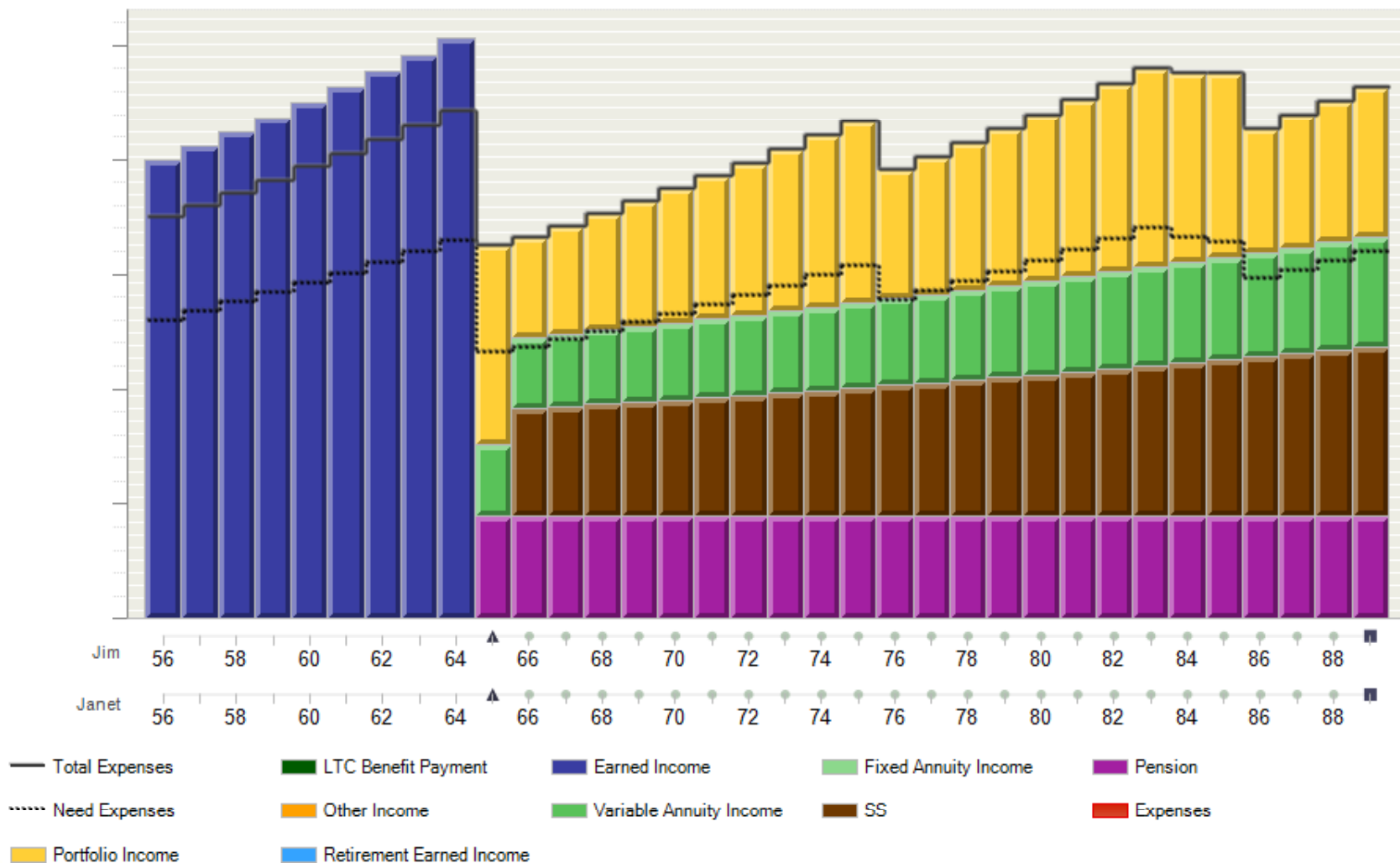
Years until retirement: 9

This hypothetical case study is for illustrative purposes only and does not represent any actual investment.



Case study: focus on long-term care

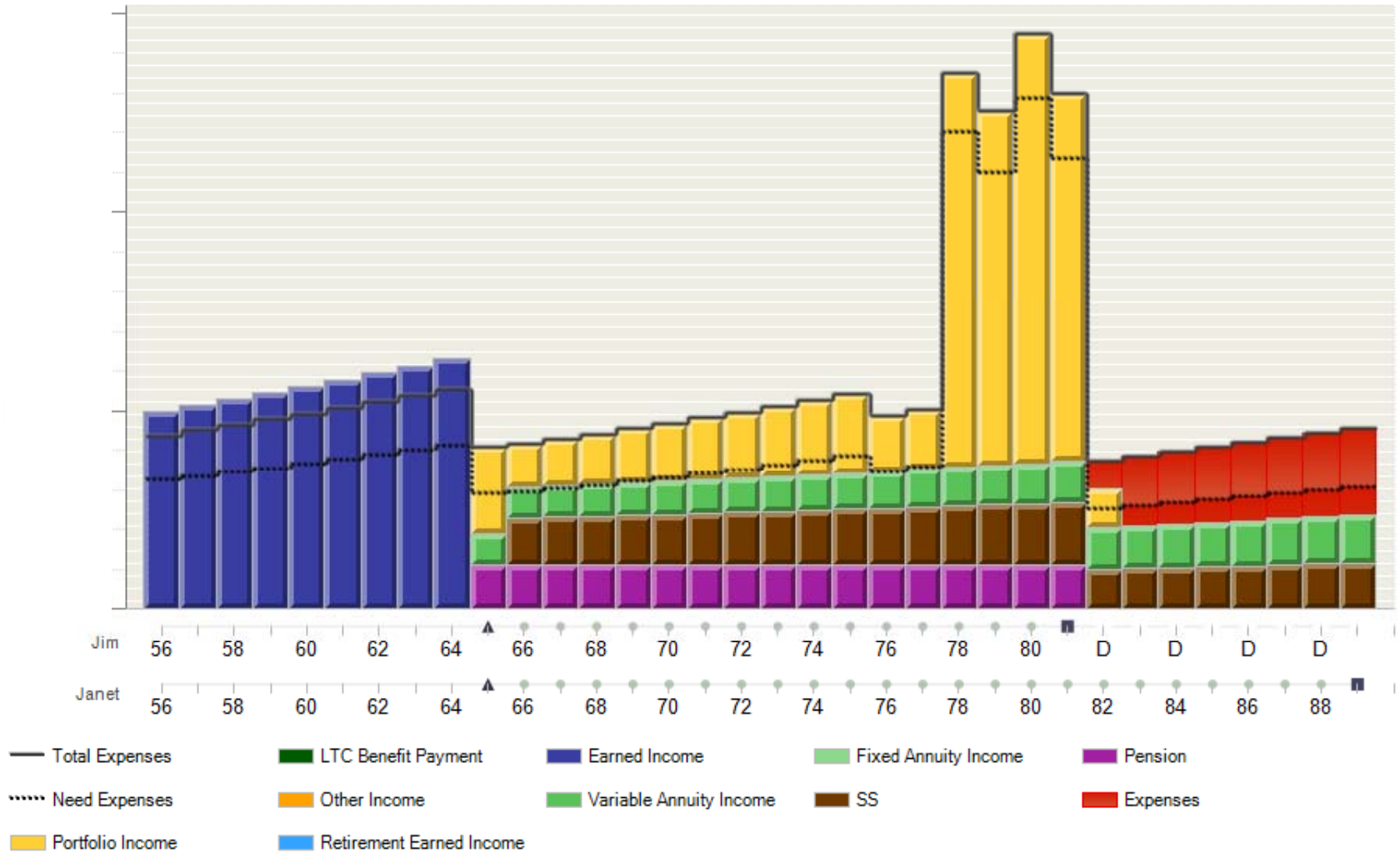
Retirement Picture





Case study: focus on long-term care

Retirement Picture





The importance of long-term care expense planning

70% of people over age 65 will require long-term care¹



There are **44 million** family caregivers in the U.S. today²

80% of longer term support and services is provided by family and unpaid caregivers.³



41% of family caregivers have children under 18 living at home.⁴



¹ DHHS, 2008. Statistics taken from www.longtermcare.gov. Administration on Aging: 202 619-0724.

² National Alliance for Caregiving/AARP, 2004. "Caregiving in the US: Findings of a National Survey".

³ (Shirley, L. Family Caregivers (Issue Brief): Georgetown University Healthy Policy Institute, Washington, DC, 2003.

⁴ "Caregiving in the US" NAC/AARP.



The facts about long-term care



National average LTC costs

Assisted living	\$3,369 per month \$40,428 per year
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Nursing home	Semiprivate room: \$5,931 per month \$71,175 per year
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	Private room: \$6,570 per month \$78,840 per year
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Home health aide	\$20.27 per hour
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LifePlans Long-Term Care Market Summary: Cost of Care Update 2010; www.LincolnFinancial.com; Research & Analysis; 2010.
For a printed copy of the report, call 877 ASK-LINCOLN.



Impact on Retirement Income



75% would use their savings

56% would sell their homes

21% would be willing to go into debt

Long-term care costs can easily exceed \$60,000 a year. This would quickly drain the average U.S. family's savings of \$120,000.

Lincoln Financial Group Long-Term Confidence Study, November 2010.



Impact on Retirement Income

- Worked hard and made smart decisions to prepare for retirement
- Pave the way to achieve financial independence and security
- They don't want to give up what they have spent their lives trying to accomplish

3/4

claim that their lifestyles would change if they needed to pay for long-term care services





Government options for long-term care

Choices	Advantages	Disadvantages
Medicare	It typically offers coverage or limited coverage only for medically necessary nursing facilities or home healthcare.	It does not pay for custodial care or support services for daily living. You must meet specific requirements to qualify for payment of LTC services.
Medicaid	This program can pay for certain nursing home and healthcare services for older individuals with limited means.	Eligibility is usually based on your financial resources. Services and eligibility varies from state to state.

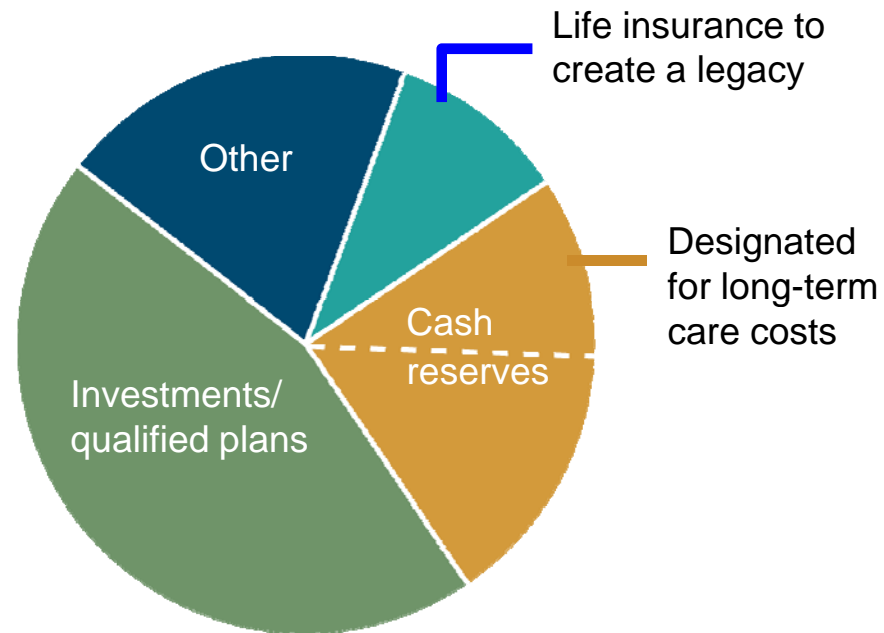


Elective options for long-term care

Choices	Advantages	Disadvantages
Medigap (Medicare supplemental insurance)	Medicare beneficiaries can purchase this supplemental protection to cover expenses not paid for, or only partially covered by, Medicare.	While benefits are standardized among providers, costs can vary. Insurers may increase premiums as a result of high claims, costs or inflation.
Traditional LTC insurance	It covers future long-term care expenses.	No money back guarantee. Premiums can be expensive, may increase and vary based on benefits and time period.
Self-insuring	You can buy the type of caregiving you prefer.	If you need LTC, you could spend down your savings relatively quickly.
Family assistance	Relatives take on the responsibility of your LTC management or expense.	This can cause financial and emotional stress on family members.
Hybrid Products aka Asset Based LTC Annuity and Life Insurance Based	You could have more money to pay for long-term care than the actual premium paid. Some hybrid LTC policies feature a one-time premium and return of premium riders (for an additional cost).	You may have to pay for care up front and then be reimbursed by the insurance company.



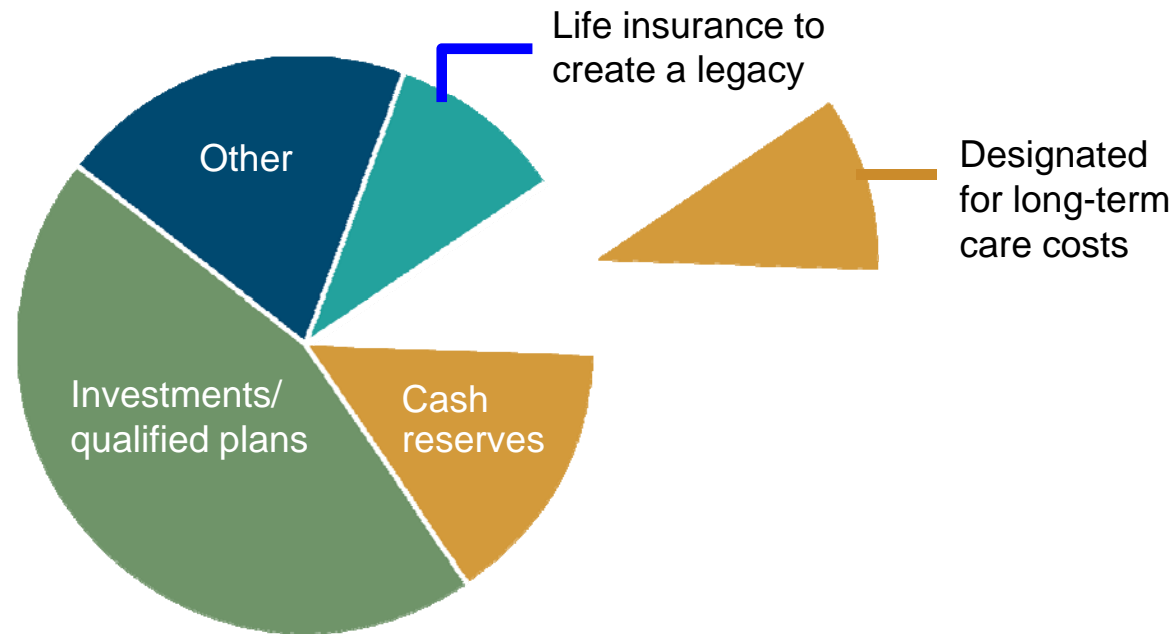
How to position Linked Benefit Products



While the actual proportions in this chart will differ based on a specific individual's needs, it does show the different types of assets in a typical retirement-oriented portfolio.

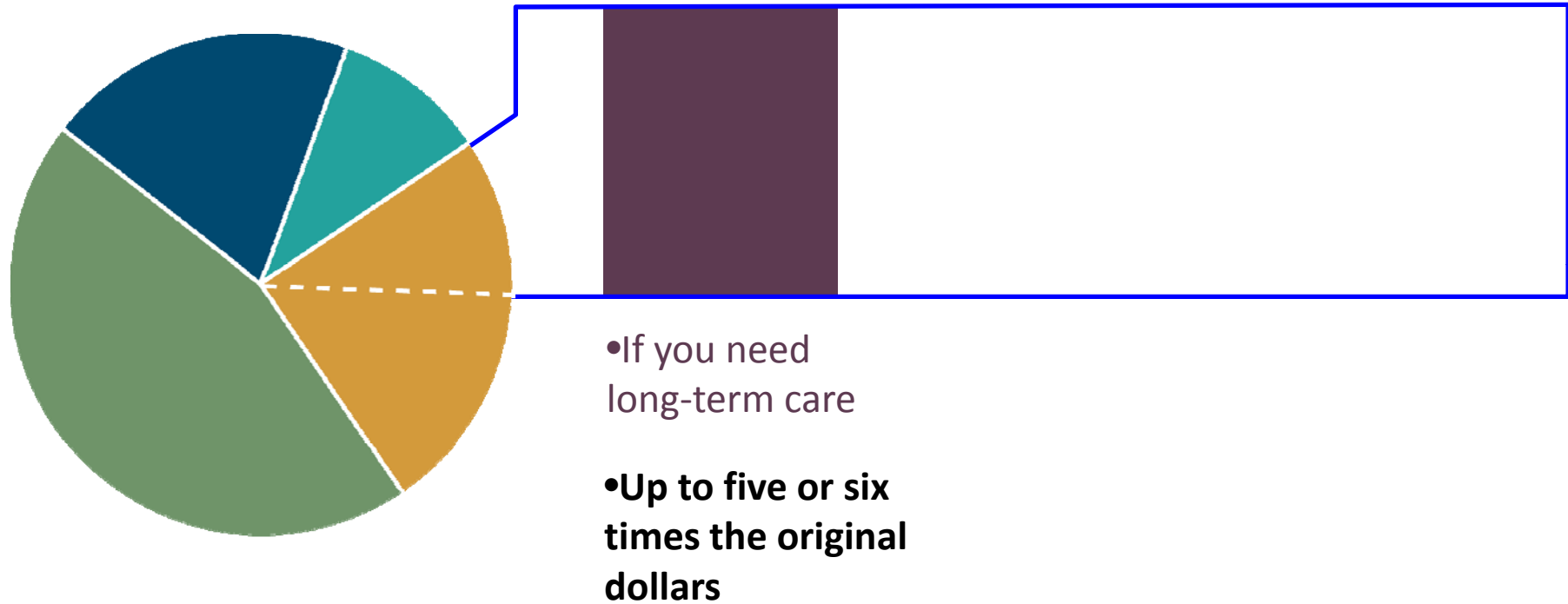


How to position Linked Benefit Products





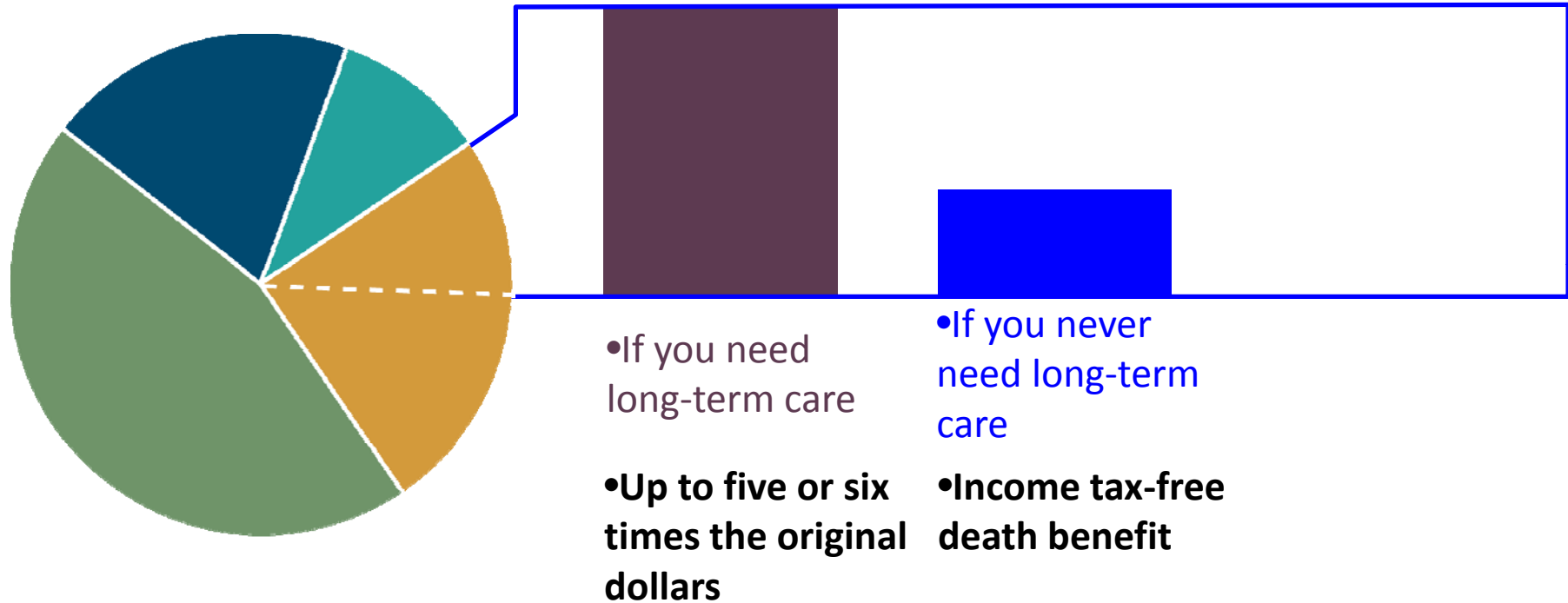
How to position Linked Benefit Products



Long-term care reimbursements are generally income tax-free under IRC Section 104(a)(3)



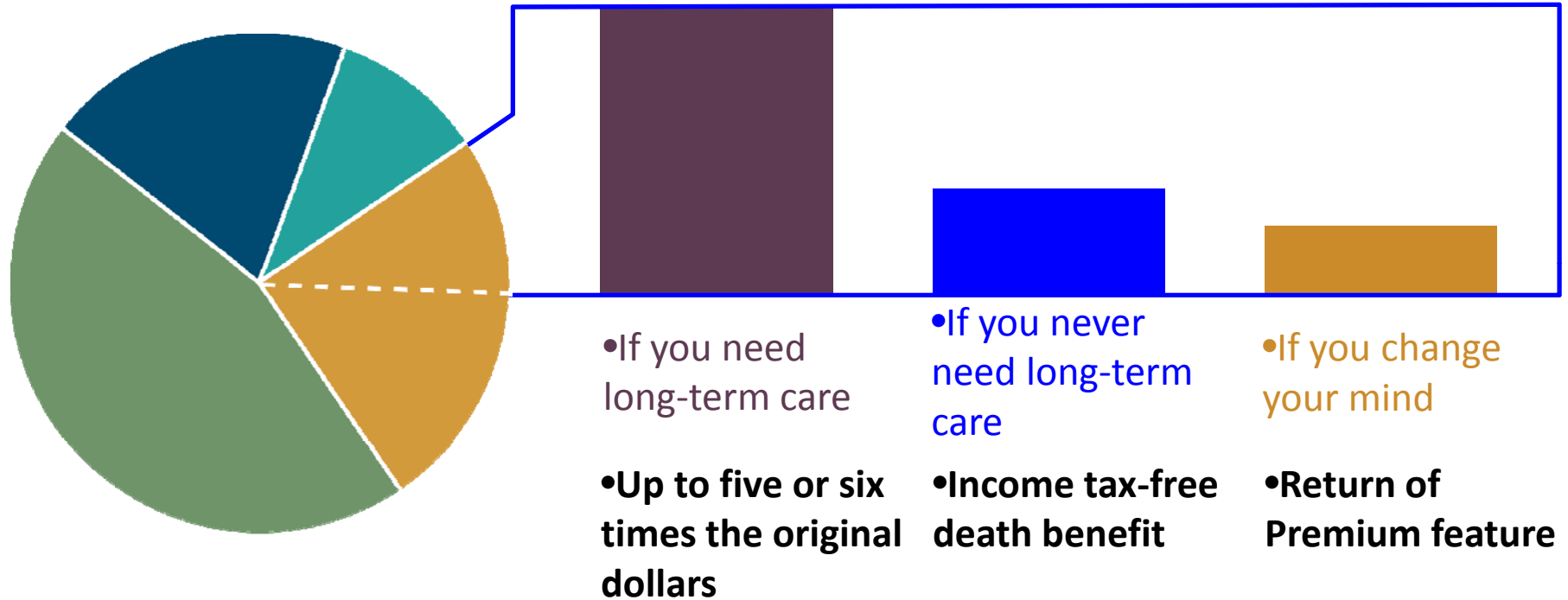
How to position Linked Benefit Products



Beneficiaries receive death benefits income tax-free under IRC Section 101(a)(1).



How to position Linked Benefit Products



NOTE: This may have tax implications, so check with your tax professional.



Asset Based long-term care solution

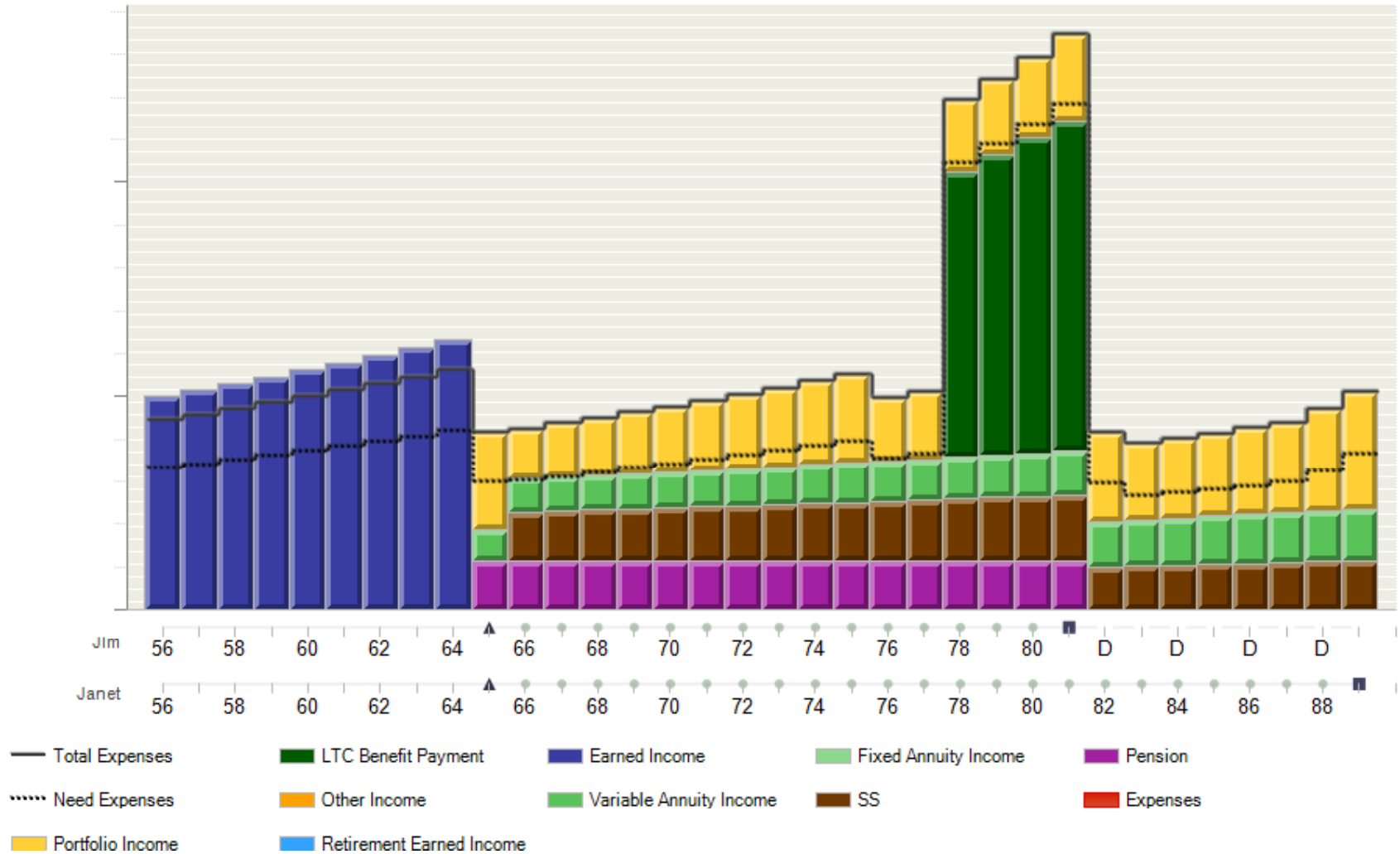
Advantages

- Asset control
- More for your long-term care dollars
- Benefits whether or not your clients need long-term care



Case study: focus on long-term care

Retirement Picture





Impact on Retirement Income

1 in 8

Americans Age 40-60

- Unanticipated expenses
- Loss of savings
- Postponed retirement





Start the long-term care discussion





Next steps

- Make long-term care planning part of your client's overall financial strategy.
- Bring up long-term care planning early and often with your clients.
- Consider a funding solution that has all of the features your clients will need.



Life and Annuity - LTC Combination Plans

Carl Friedrich
Milliman, Inc.
March 7, 2011



2010 Developments

- Pension Protection Act of 2006 and changes to tax laws effective 1/1/2010
- Increasing number of carriers offering LTC riders to life policies, and more including extended benefits that continue LTC coverage beyond the acceleration of life coverage
- Fifteen of twenty nine 2011 Milliman UL survey respondents have now or expect to develop LTC riders to life in the next 12 to 24 months, and five of those expect to enhance their plans
- Only six to eight annuity combos being marketed currently, but more than that number are in the product pipeline, and more insurers are researching through market analysis, gap analysis, and preliminary design and pricing and are expected to start development in the near term



2010 Developments

- Reasons for slow start-up of annuity combos
 - Carriers busy de-risking old annuity portfolios
 - Uncertainty regarding best distribution outlets, as many annuity producers are not trained in LTC and not used to underwriting requirements
 - Significant interest being seen among banks, LTC producers, and financial planners
 - Some companies have developed annuity combos but have not introduced, hoping the product won't become popular
 - Most companies need time and third party assistance (pricing, compliance, underwriting, and claims) to develop and support these plans



2010 Developments, and Future Outlook

- Reasons for slow start-up of annuity combos
 - A few gray areas still exist in the tax law, and some companies are waiting for the Treasury's response to the ACLI request
- Future Outlook
 - Many companies are developing these products, for offensive and defensive reasons
 - An increase in the interest rate environment would remove many concerns regarding suitability of 1035 exchanges to combo products
 - The market need for LTC insurance is huge
 - Resolution of the tax issues, even if not totally consistent with ACLI arguments, would remove uncertainty and give comfort to companies and producers in selling the product



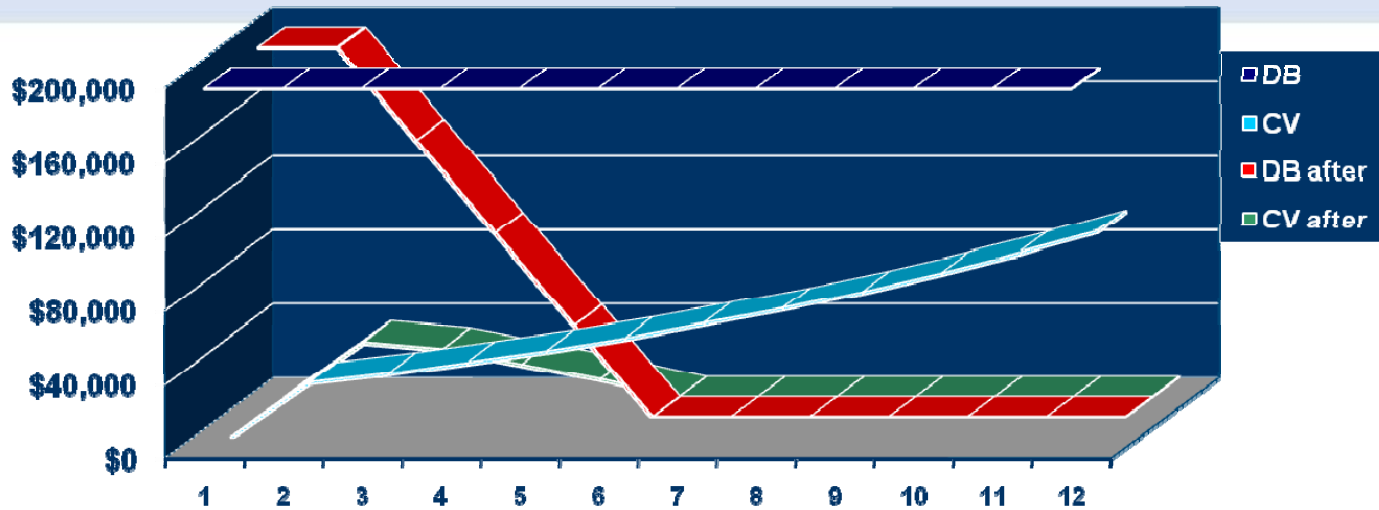
Life/LTC Product Basics

- Various base plans including single premium universal life, flexible premium UL, WL, and VUL
- First Generation - Accelerated Death Benefit LTC rider (ADB)
 - Pays out a specified portion of DB per month with a proportionate reduction to CV's
 - Charge structure typically YRT per thousand of NAR, but a growing number of states (at least 5 including FL, NC, OH, CO, and HI) are imposing level charge requirements
- Second generation - Adds Extension of benefit (EOB)
 - Asset re-positioning: Return assets, a multiple of assets (DB), or a multiple of DB (EOB)
 - Inflation option rounds out the coverage and addresses the comprehensive LTC need

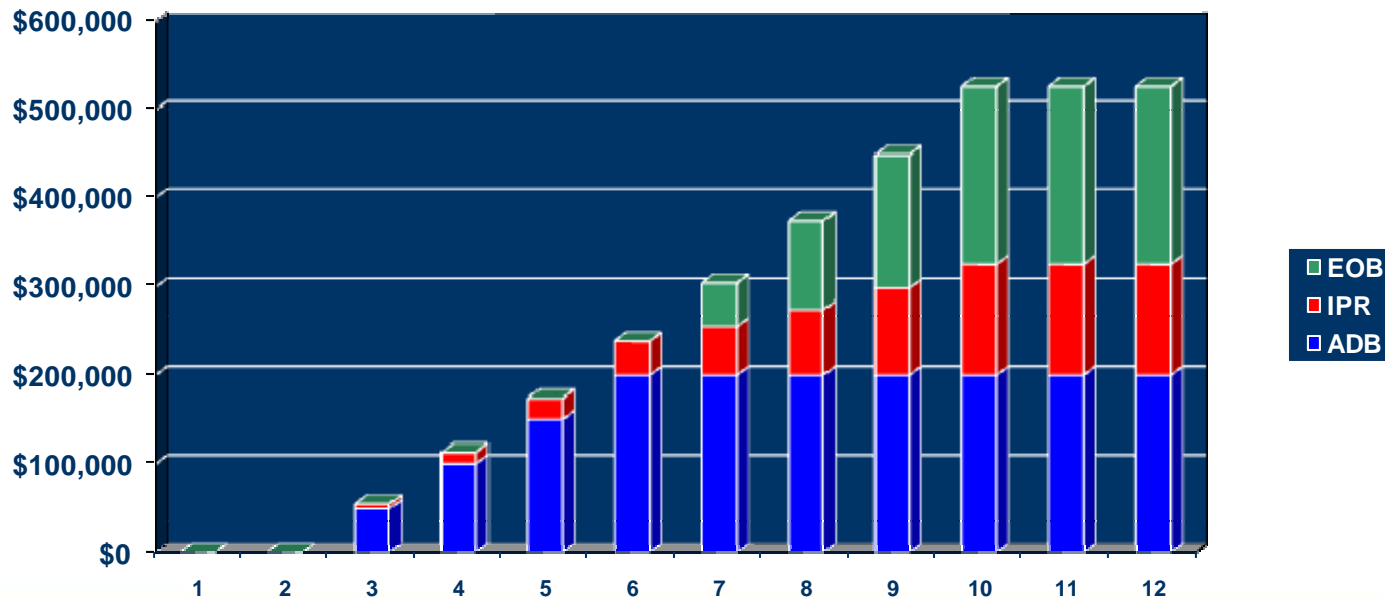


Life/LTC Product Basics

Life Insurance Values (Year 3 claim)



Cumulative LTC Benefits (4 Year ADB + 4 Yr EOB)





Annuity/LTC Product Variations

- Deferred annuities
 - Designs: Payout of AV as LTC benefit, without SC, with extension of benefits for a specified period after that (Tail design), or pay out accelerations and independent benefits concurrently (Coinsurance design)
 - Either features monthly pay-outs tied to AV at the time of initial claim
 - Another variation links monthly pay-out to a lifetime LTC pool amount that is independent of the AV (Pool of money design)
- Most feature charge structures that are typically level amounts, in basis points
- IPR requirement for Inflation Protection



Annuity/LTC vs. Life/LTC

- Higher cost, Life Combos (paying for life NAR); compounded by GPT & CVAT issues
- Guarantees – more offered on life
- DB payout tax free on Life (SPUL popular at old ages)
- Underwriting – tighter on life generally – natural tie to life underwriting
 - Waiting period constraints on annuities with limited underwriting
- Inflation structures; most annuities have a more natural built-in mechanism as LTC benefits tied to AV growth
 - Makes life vs. annuity comparisons apples to oranges



Annuity/LTC vs. Life /LTC

- DAC tax; same for life and LTC combos as for life only, but incremental cost on annuity combos higher than for annuity only
- Persistency effects & pricing synergies greater for annuity
- Premium tax – annuities lower
- Level premium mechanisms - life structures better
- Life accelerations more real value to consumer (NAR is advanced, not just CV as for annuities)



Risk Assessment and Risk Management

- ADB
 - True costs of most designs are very modest
 - Coinsurance designs on annuity combos feature reductions to account values that are less than the dollars of benefits being paid (see PPA), so risk increases somewhat
- EOB/IPR
 - Best viewed as layers of LTC benefits being purchased based on account value
 - As account values grow, new layers of LTC coverage are added
 - Charges are level basis points on AV
 - Charges for new layers are based on original age cost structure
- Persistency based pricing synergies



Risk Assessment and Risk Management

Product	IRR	PV Profits	ROA	Break-even year
Annuity only, std lapses	10.9%	\$611	17 bp	7
Annuity only, low lapses	11.4%	\$1093	25 bp	6.5
Annuity plus LTC, low lapses	12.9%	\$1094	30 bp	6



Investment Characteristics

- Single premium adds certainty to returns vs. annual premium
- Current low interest rate environment a challenge
- ROP adds to risk of product
 - But product hard to replace after a few years since cost of new policies increases with issue age
- Stochastic analysis and hedging strategies can be used to minimize the investment risks



Exchange Programs

- Exchange opportunity to annuity combos greater. Can't exchange annuities into life combo. Can exchange life or annuities into annuities combo.
- Exchanges from annuities to stand-alone LTC
 - At least one successful program in market
 - Some B-Ds view as too cumbersome
 - Supervision and suitability requirements
- Easier to move into single premium combo annuity
 - Low interest rate environment makes suitability a challenge
 - Many producers monitoring that situation and looking for broader availability of annuity combos



Exchange Programs

- Upgrades and exchanges to add LTC to inforce annuity policyholders
 - Enhance persistency
 - Protect inforce business
 - **Provide the only mechanism that allows gain in an annuity contract to be paid out on a tax-free basis**



Linked Benefits

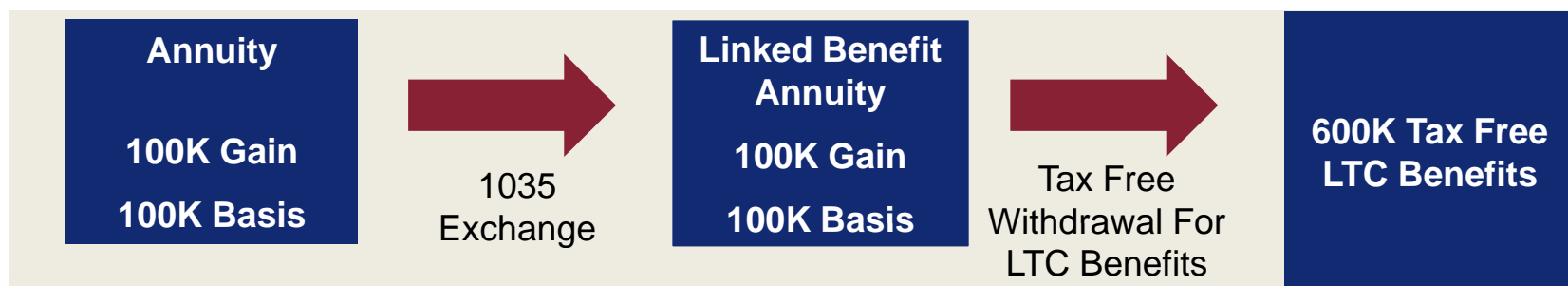
Doug Burkle – Genworth Financial



The Pension Protection Act (PPA)

As of 1/1/2010

- Tax Qualified LTC (QLTC) riders under a non qualified annuity contract will be treated as a separate contract, thus withdrawals for QLTC benefits from these riders are considered tax free benefits.
- LTC rider charges against the account value are not a taxable distribution, although they reduce the client's cost basis (but not below zero).
- 1035 exchanges are now possible to QLTC contract or Linked Benefit contracts with QLTC rider.
- Entire Annuity Linked Benefit contract requires 7.7% DAC Tax vs. 1.75% for a standard annuity contract.





Linked Benefit Marketplace

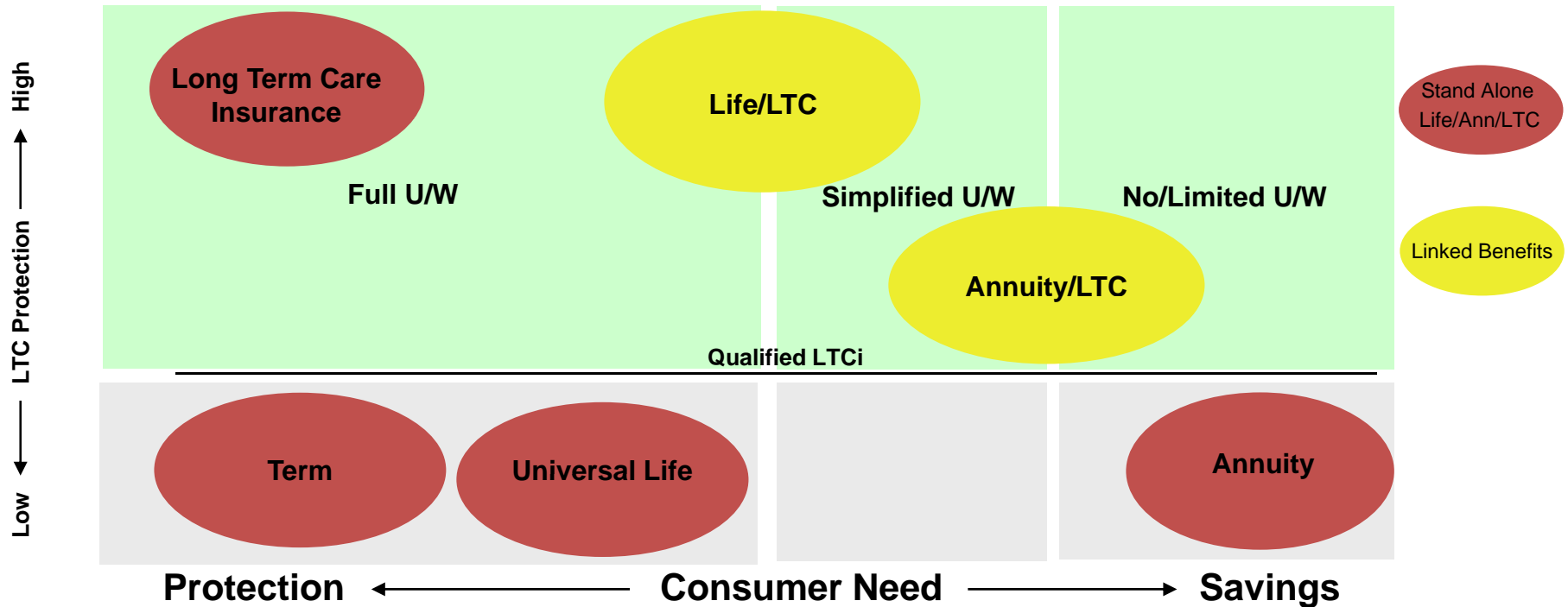
Consumer

Blended Products Create Value for Consumer

Risk

Hedged Risk with Linked Benefit Products

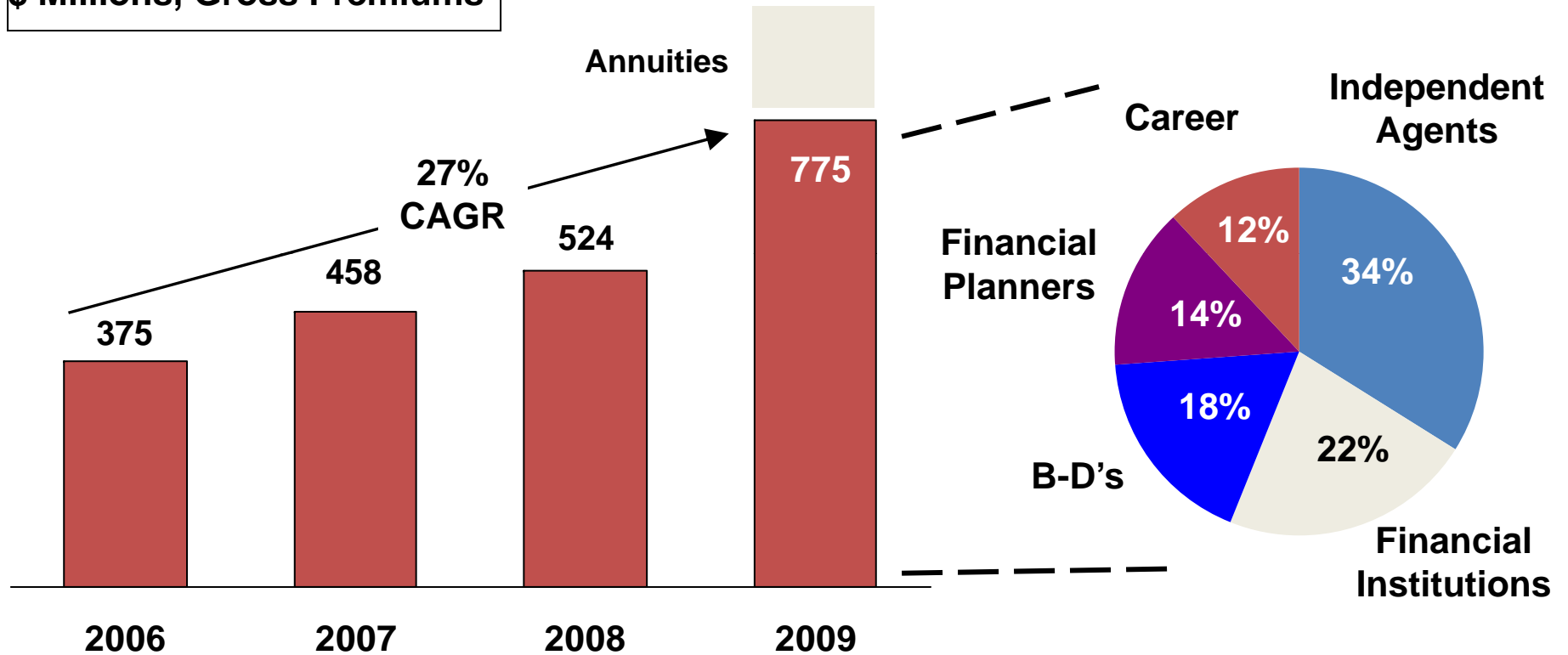
LTC Planning Solutions





Linked Benefit Market Growth

\$ Millions, Gross Premiums



Source: LIMRA & Management Estimates as of August 2010. Sales Includes UL and Whole Life Linked Products. Distribution Splits Include UL, Whole Life and Variable Life.



Consumer Long Term Care (LTC) Strategy

All Consumers Fall into One of 3 Categories

Long Term Care Insurance (LTCI) Purchasers - 7% Penetration*

- Recognize need for LTCI protection and willing to purchase a traditional policy as solution
- Solution = traditional LTCI policy

Self-Insuring

- Expect to use existing assets to fund LTC need
- Don't like idea of paying premiums and if die receive nothing
- Solution = Linked Benefit Product

Medicaid

- No private insurance solution

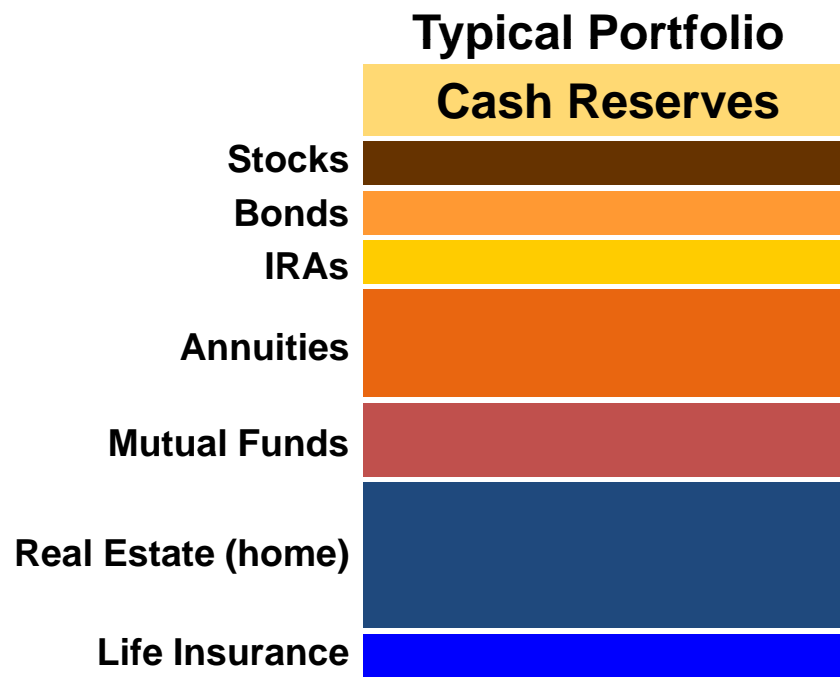
93% of Population is Not Covered by Traditional LTCI

*SRI Macro Monitor 2006 - 2007

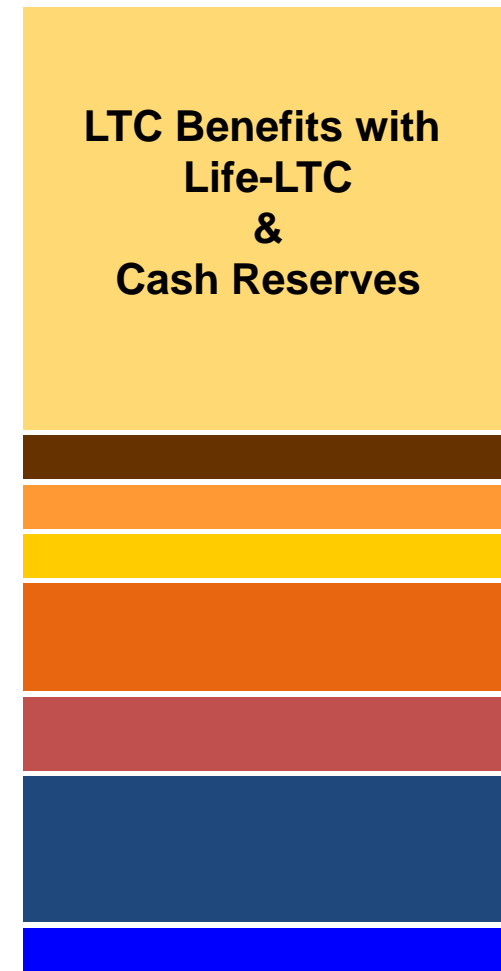


A More Effective Way To Self-Insure

An Asset-Allocation Approach



Life-LTC Portfolio





Long Term Care Benefits

Benefit Triggers:

- Cannot perform two of the ADLs (activities of daily living):
 - Bathing
 - Dressing
 - Eating
 - Contenance
 - Toileting
 - Transferring
- Or has a severe cognitive impairment
 - Dementia, Alzheimer's disease

Deferral Period:

- 0/1 year from policy effective date for Life/Annuity Linked Benefit Product
- LTC expenses are not covered during this period
- LTC charges are deducted from the AV each month, including year 1

Elimination Period:

- Can only be satisfied after any Deferral Period
- 0-day EP for Home Care; 90-day EP for Facility
- Only has to be met one time



LTC Benefits: Types of Covered Care

Home Care

- Home health aides
- Personal care services
- Homemaker and chore services
- Adult day care
- Hospice care
- Care from nurses and physical, occupational, respiratory, and speech therapists
- Informal care providers

Facility Care

- Nursing homes
- Assisted living facilities
- Bed Reservation
 - Up to 60 days per year



LTC: Additional Covered Care and Services

Respite Care

- Gives an unpaid caregiver a care break by paying the cost of a temporary facility stay
- Up to 30 days per policy year

Supportive Equipment

- Examples: grab bars, ramps
- Lifetime maximum of 2x the LTCR monthly maximum

Caregiver Training

- For an unpaid caregiver
- Lifetime maximum of 20% of the LTCR monthly maximum

International Coverage

- Pays for nursing home stays outside the United States



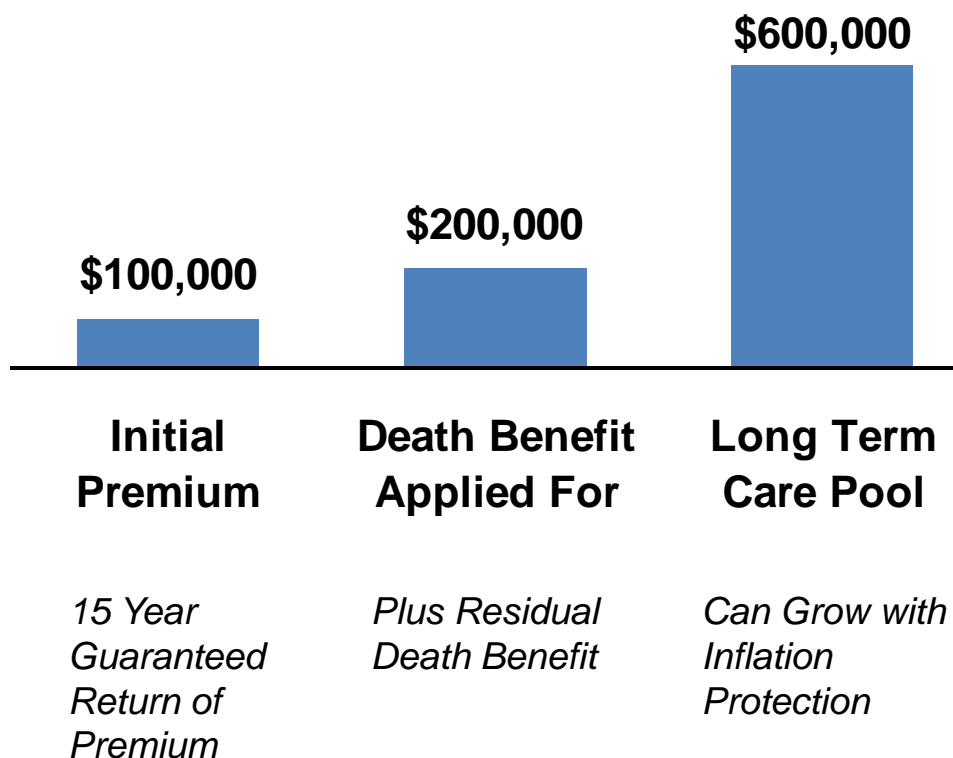
UL-LTC Linked Benefit Policy Mechanics

	Policy Components	Additional Descriptions	Credits (+)/ Charges (-)	
Base Chassis	UL Contract	Account Value Generally Funded With Single Premium Intended To Carry Policy For Life	(+) Interest Credited (-) Premium Load (-) Monthly Admin Fee (-) UL COI Charge	Normal UL Charges
Built-In	ABR Rider	Accelerates Specified Amt For Covered LTC Benefits	(-) ABR COI Charge	Linked Benefit Charges
	Waiver Of Charges	Waives All Charges While Policy On LTC Claim		
	Guaranteed Minimum Benefit Rider	Secondary Guarantee At Lower Benefit Levels		
	Residual Death Benefit	10% Of Initial Specified Amount		
Optional	EBR Rider	Insurance Benefits After ABR Exhausted	(-) EBR COI Charge	Linked Benefit Charges
	ABR & EBR Inflation	3% or 5% Simple Or Compound	(-) Inflation Rider Charge	
	Return Of Premium	Varies From None To Lifetime	(-) Any ROP Charge	



UL-LTC Linked Benefit Example Policy

Typical Value Example



Note: Average case portrayed

Simple Steps

- 1 Determine Initial Premium
- 2 Decide On Inflation Protection (0 To 5% Compound)
- 3 Determine Length Of LTC Coverage (4 Years To Lifetime for Majority of Cases)



Compared Side by Side, Both Work Well

Profile	Life Linked Benefit (LB) Client	Traditional LTCI Client
Female	<ul style="list-style-type: none"> \$123,249 repositioned into Life-LTC 	<ul style="list-style-type: none"> \$123,249 available assets
Age 65	<ul style="list-style-type: none"> Life-LTC (2+4) Benefits 	<ul style="list-style-type: none"> \$4,966 annual LTCI premium funded w/ 4.0% after-tax earnings
Single	<ul style="list-style-type: none"> – \$232,800 specified amount 	<ul style="list-style-type: none"> Principal still available at time of death
Preferred Health	<ul style="list-style-type: none"> – \$9,700 LTC monthly maximum 	<ul style="list-style-type: none"> \$9,700 LTC monthly maximum for 6 years
No Inflation	<ul style="list-style-type: none"> – \$23,280 residual death benefit 	<ul style="list-style-type: none"> Premium waived while on LTC claim

Let's follow the cash, since all LTC benefits are at the same level

Event	Life-LTC <u>Death Benefit</u>	Traditional LTCI <u>Principal + Waiver</u>	LB – LTCI <u>Benefits</u>
Die w/out LTC claim	\$232,800	\$123,249	\$109,551
Die w/ 0-2 yr. LTC claim	\$116,400	\$128,215	(\$11,815)
Die w/ 2+ yr. LTC claim	\$23,280	\$143,113	(\$119,833)

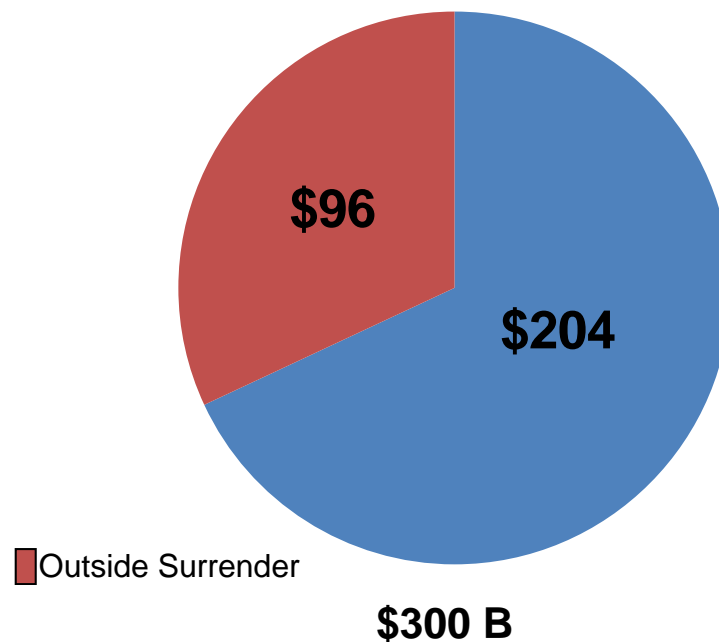
Understanding Customer Attitude Will Help Determine The Correct Product



Annuity Linked Benefit Opportunity

NQ Fixed Annuities

- \$300 Billion Assets as of 2007
- \$96 Billion Outside the Surrender Charge Period



* Source – LIMRA, 2008 “The 2007 Individual Annuity Market”



1035 Exchange Opportunity

Gallup 2009 Survey of Owners of Non-Qualified Annuity Contracts

- Policyholders age 64+ account for **72%** of NQ annuity value.
- Of the age 64+ group, **76%** state that they intend to use their annuity value as an emergency fund in case of catastrophic illness or nursing home care.
- **83%** state that they intend to use their annuity value to avoid being a financial burden on their children.



1035 Exchange Disclosure

Prior to engaging in a 1035 exchange, your clients should carefully consider a number of factors including the features and crediting rate(s) of their current product, applicable surrender charges, any new surrender charge period on the purchase of a new product, as well as the various features and crediting rate(s) of the new product. Representatives should carefully consider whether a replacement is in the best interest of their client before making a recommendation to replace the client's existing product.



Linked Benefit Annuity Example – Tax Benefits

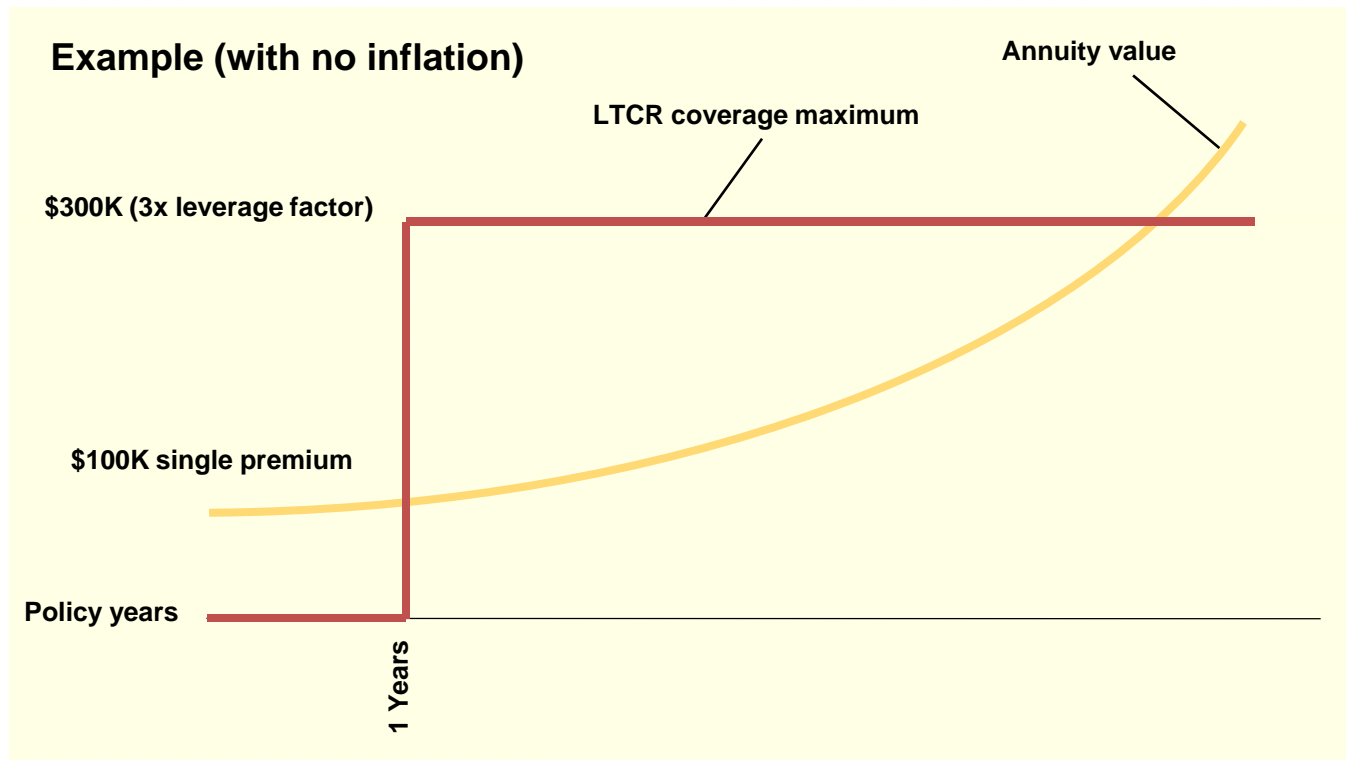
Product Examples	Fixed Deferred Annuity (3%)	Linked Benefit Annuity (3%) 3X	Linked Benefit Annuity (3%), 2X w/ 5% Compound
Initial Premium (Age 65)	\$100,000	\$100,000	\$100,000
Account Value (Age 80) ¹	<u>\$155,797</u>	<u>\$128,372</u>	<u>\$122,335</u>
Taxable Gain	\$55,797²	\$50,018³	\$48,799⁴
Amount Available To Beneficiary In The Event Of Death ⁵	\$135,710	\$110,366	\$104,767
Amount Available For a Long Term Care Event ⁶	\$135,710 - \$155,797*	\$300,000	\$415,786

*Depends on amount of itemized medical expenses above Adjusted Gross Income threshold

- 1 Assumes that no withdrawals have been taken.
- 2 Assumes cost basis of \$100,000 and full distribution of annuity account values at age 80 and a possible offsetting medical expense deduction. Actual client tax liability may vary based on federal and state income tax rates, ability to deduct expenses as itemized medical expense deductions, and other factors.
- 3 Assumes cost basis of \$78,354 and full distribution of annuity account values at age 80. Basis is reduced dollar for dollar each year by LTCI rider charges.
- 4 Assumes cost basis of \$73,536 and full distribution of annuity account values at age 80. Basis is reduced dollar for dollar each year by LTCI rider charges.
- 5 Assumes no withdrawals prior to death and that beneficiary takes a lump sum distribution and pays taxes equal to 36% of the proceeds. Actual client tax liability may vary.
- 6 Amount available from each example contract at age 80 to pay LTCI expenses. Assumes death has not occurred and no withdrawals other than to pay qualified LTC expenses beginning at age 80.

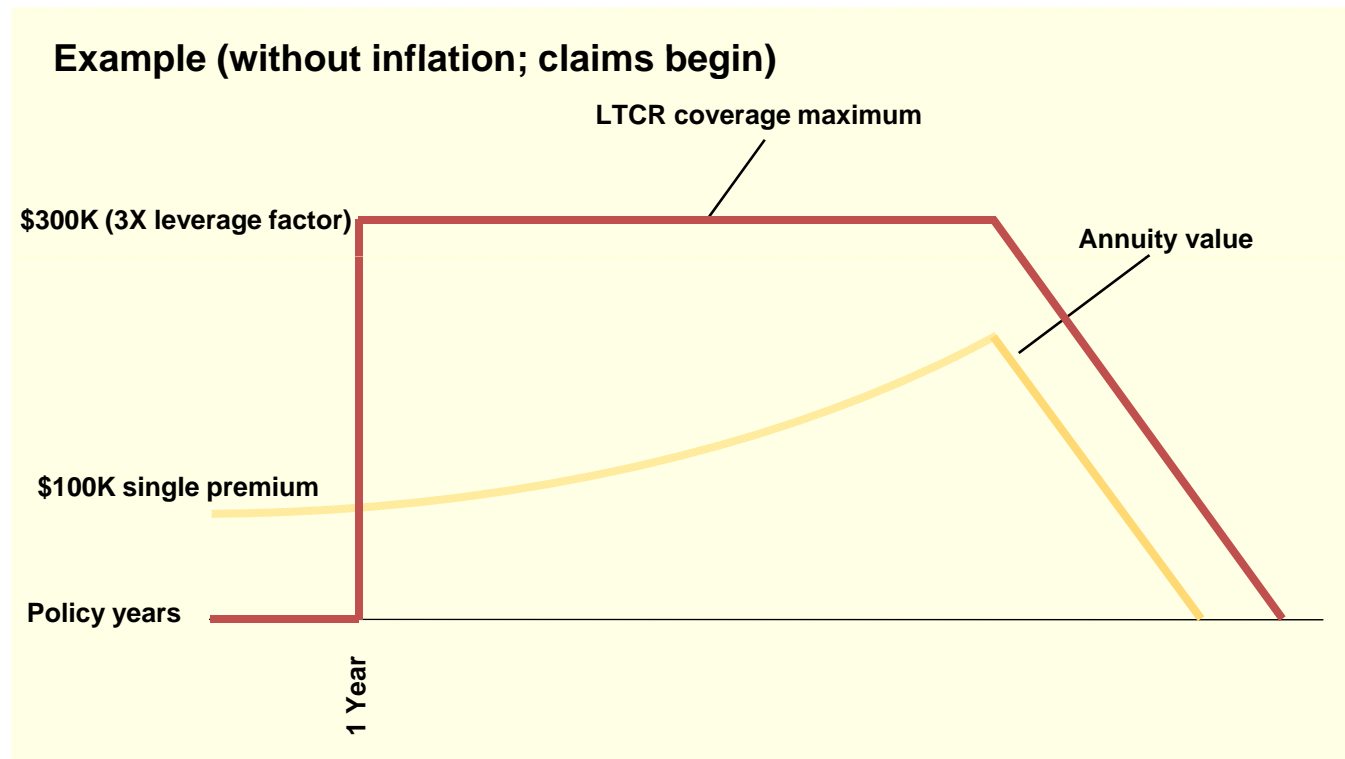


How Linked Benefit Annuity Works





How SPDA-LTC Works (continued)





Questions and Answers