The Additional Guarantee on an Indemnity Linked Benefit LTC Policy

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Linked Benefit LTC products are a welcome alternative to traditional forms of insuring the risk of long-term care expenses. This type of design is a melding of the best features of both life insurance with a LTC Rider and traditional long-term care insurance (LTCi). And while there's a death benefit, this type policy isn't intended to provide the typical "family protection" you normally associate with life insurance, but rather, it's designed to be a LTC sale with cost recovery and offers the following guarantees*:

- Guaranteed LTC Benefit Pool
- Guaranteed Death Benefit
- Guaranteed Premium

But only an Indemnity Linked Benefit Policy can offer the following additional guarantee* -

- **GUARANTEED monthly LTC benefit amount**

Indemnity vs. Reimbursement

Linked benefit policies paying by the reimbursement model will generally offer a larger benefit pool than an indemnity policy for the same premium paid. This is because reimbursement policies have the potential to pay benefits more slowly, thus in the end may *pay less* benefits in total than an indemnity policy. To understand this, let's look at how each claims payment model works.

Reimbursement Model

Most linked benefit LTC policies pay claims though reimbursement. The reimbursement benefit model pays a monthly LTC benefit that equates to the *lesser* of –

a. The maximum monthly LTC benefit issued on the policy – OR
b. The actual LTC expenses incurred

Bills and receipts need to be submitted each month but only qualified LTC expenses will be reimbursed, thus the amount paid each month may differ with the monthly LTC expenses incurred. If reimbursed expenses are less than the maximum monthly LTC benefit, it will take longer to exhaust the entire LTC benefit pool than policy's issued benefit period. Thus, an advantage of the reimbursement model is that benefits could last longer than the actual issued benefit period. However, a disadvantage is that there is no flexibility since there are never any excess benefits for uncovered miscellaneous expenses. In addition, when collecting less than the maximum monthly LTC benefit amount, less total benefits may be collected from the policy if the claim doesn't last long enough.

Indemnity Model

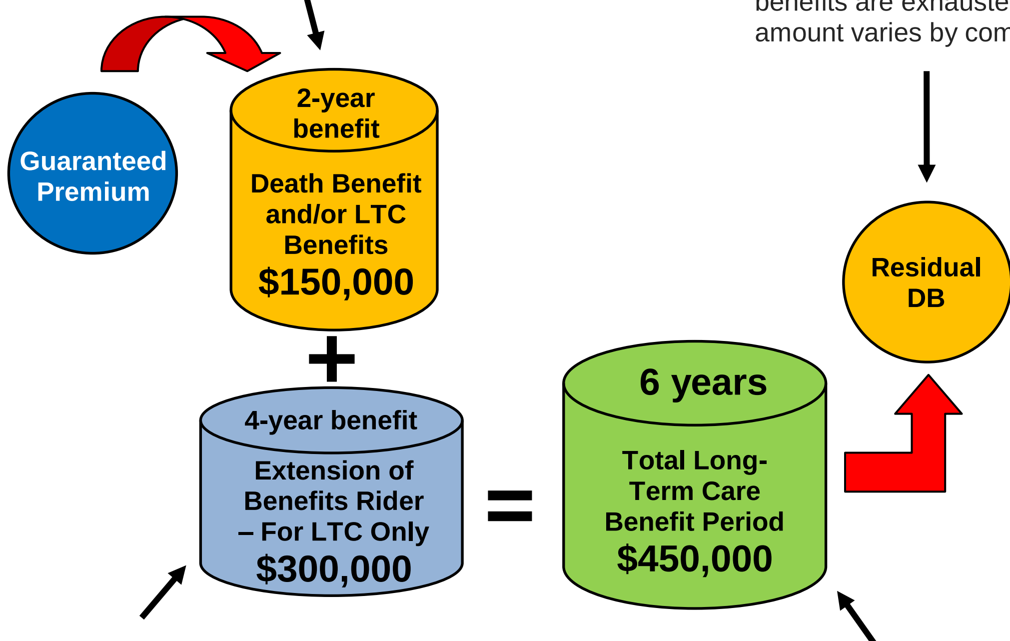
On the other hand, when purchasing a policy with Indemnity benefits, the policy owner is guaranteed to receive the same benefit each month – which is the maximum monthly LTC benefit determined at policy issue*. Benefits are *not* linked to expenses and because full benefits are paid each month, there is a potential for more total benefit dollars to be paid on many claims. While taking less benefit than needed is allowed, it is generally wiser to take all benefits available and bank excess amounts not needed for LTC expenses. This way, you have maximized taking receipt of the benefit dollars. Your banked dollars can be used to pay LTC expenses when your benefit period is exhausted, supplement your monthly benefit if costs increase later, or if not needed for LTC – use for other purposes. At death, the unused banked dollars can be left to loved ones.

How Linked Benefit Policies Work

For a guaranteed premium, you are provided a guaranteed LTC benefit pool. But keep in mind that LTC benefits are actually paid from two separate benefit pools that added together provide the total amount of LTC coverage. The following graph illustrates how linked benefit LTC policies work.

1. The 1st pool is a guaranteed death benefit pool, which must be accelerated first upon going on LTC claim. The amount in this pool is guaranteed to be paid, either as a LTC benefit - and/or - a death benefit if LTC is not needed. If only a small portion of this benefit pool is used for LTC, the remaining amount not needed for LTC monthly benefits will be paid upon death to the beneficiaries.

4. The residual death benefit is the minimum amount guaranteed to be paid as a death benefit even is all LTC benefits are exhausted. This amount varies by company.



2. Upon exhausting the first LTC benefit pool, if you are still alive and in need of care, your LTC benefits will begin to be paid from the 2nd LTC benefit pool, generally referred to as an Extension of Benefits Rider (EBR). You **must** use up the first benefit pool before you can access benefits from the second benefit pool (EBR). Remember, this pool is for LTC benefits only, and any benefits not paid from the EBR pool are forfeited at death. Thus, with an <u>indemnity benefit</u>, you will potentially get to this pool of money faster since you have collected full benefits from day one. That in turn gives you a better chance of collecting more EBR benefit prior to death.

3. The total amount available for LTC benefits is the total of the two benefit pools added together. But remember; only the amount in the first benefit pool is guaranteed to be paid whether long-term care is needed or not.

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Our hypothetical example is not intended to compare policy pricing, but rather, to show how an indemnity policy may be able to pay more total LTC benefits even when the benefit pool is smaller than a reimbursement plan offering the same maximum benefit period. The insured in this example purchased the policy when 52 years old and will go on claim for home health care at age 82. Our example assumes the Indemnity policy has a total LTC benefit pool of $450,000 and a 90 day elimination period - while the Reimbursement policy has a total LTC benefit pool of $540,000 and a zero day elimination period. Both plans are for a six year benefit period using the same "2 plus 4" design as shown on the previous chart. For the sake of simplicity, we will not consider the residual death benefit at death. We will also assume a Home Health Claim for 4 years at a level cost (for simplicity) of $4,000 per month.

Case Study Reality Check - Before examining the numbers, let's do a reality check on the case. Typically, a claim that lasts one year will average 3.9 years[1]. Carriers today are reporting home health care claims at 51-70% of all claims filed[2]. Home health care cost inflation averaged on a national basis an annualized average of 1.67% between 1996 and 2012[2]. and only 1% the last 6 years.[1] The majority of home health care patients aged 82 receives 4 hours of care per day 3.5 days a week[2]. Current average cost of a home health care aid is $21 per hour.[1] The national average cost today for home health care providing 3.5 days per week of care for 4 hours day would cost $1274 per month. Inflated at a rate rounded up to 2% annually for the next 30 years, the cost of home health care for the insured in our example at age 82 would be projected to be $2308 per month. However, to guard against the chance that inflation could rise above 2%, that an insured may need more hours of care than the average, or that the insured lives in an area where costs are higher than the national average, we will use $4,000 a month as our potential home health care expense in this example.

Less may be MORE- let's do the math

	Reimbursement	Indemnity
Total Available Benefit Pool	$540,000	$450,000
Policy Benefit Duration	6 years	6 years
Maximum Monthly LTC Benefit	$7,500 per month	$6,250 per month
Elimination Period	0 days	90 days
Annual HHC Costs	$48,000 ($4,000 per month)	$48,000 ($4,000 per month)
Benefits Paid Months 1-3	$12,000	$0
Benefits Paid Months 4-12	$36,000	$56,250
Benefits Paid Year 2	$48,000	$75,000
Benefits Paid Year 3	$48,000	$75,000
Benefits Paid Year 4	$48,000	$75,000
TOTAL BENEFIT PAID	**$192,000**	**$281,250**
Difference in Total LTC Benefits		**Extra $89,250**

The Indemnity policy paid out **$89,250 more in total benefits** than the Reimbursement policy was able to pay. In this scenario, for the Reimbursement policy to pay more total cumulative LTC benefits than the Indemnity policy, the claim would have to exceed 9.375 years.

[1] American Association of Long Term Care Insurance, 2015 Sourcebook, AALTCI
[2] American Association of Long Term Care Insurance, 2014 Sourcebook, AALTCI

In Summary

Only an indemnity style linked benefit LTC policy can provide the additional guarantee of monthly LTC benefits that are guaranteed to be the maximum LTC monthly benefit allowed for by the policy. The flexibility of such a policy can allow excess benefits to be utilized for number of purposes that would not be covered on a reimbursement policy. In addition to flexibility of use, it is important to remember that sometimes less is more – and while indemnity policies may have less of a total benefit pool, they also may have the potential to pay a more total LTC benefits during the claim period of the insured.

When choosing a product, make sure that life insurance needs are covered. Because personal situations may change (i.e., marriage, birth of a child or job promotion), so can life insurance and long-term care insurance needs. Care should be taken to ensure these strategies and products are suitable. Associated costs, as well as personal and financial objectives, time horizons, and risk tolerance should all be weighed before purchasing insurance. Life insurance, and long-term care coverage linked to life insurance, has fees and charges associated with it that include: costs of insurance which varies based on characteristics of the insured such as gender, tobacco use, health and age; and additional charges for riders that customize a policy to fit individual needs.

Qualified long-term care benefits paid as an acceleration of the death benefit can be received tax-free under IRC Section 7702B. Other distributions such as partial surrenders and outstanding amounts on loans upon lapse may be subject to taxation. Federal tax laws are complex and subject to change. Neither the company nor its representatives give legal or tax advice. Taxpayers should seek the advice of their own tax and legal advisors regarding any tax and legal issues applicable to their specific circumstances.

*Guarantees assume that all planned premium payments have been made, that there have been no withdrawals from the policy, and there is no loan balance on the policy.

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NFM-12878AO.2 (10/15)