



James  
Sullivan



Brian  
Gordon

## Combination Plans in Long-Term-Care Insurance

Are there any benefits?

October 19, 2009

by James Sullivan, CPA, PFS and Brian Gordon, CLTC

Will the Pension Protection Act of 2006 (PPA) help insurance companies broaden the market for long-term-care (LTC) insurance? The PPA changed, for the better, the income tax treatment of combination plans (life insurance and annuity contracts that include an optional LTC insurance rider) beginning in 2010.

Insurance companies are betting that the tax law change will translate into renewed interest in LTC insurance and in particular, combination plans. Combination plans, unlike the older standalone plans, can be better tailored to meet the needs of different market segments. Older buyers may prefer annuity/LTC plans, while younger buyers who still have a need for life insurance may prefer life/LTC plans.

My last article divulged the basic structure of combination plans was introduced followed by a discussion of the changes to the tax treatment of these plans. This article reveals the nontax benefits and what issues to consider when determining if a combination plan makes sense for your client.

### Nontax Benefits

Combination plans are not new. They appeal to consumers for a number of nontax reasons, including potentially lower premium cost and less restrictive and simpler underwriting standards.

Combination plans are able to offer lower premiums and less restrictive underwriting for a number of reasons including:

1. *Combination plans are typically sold with an extended waiting period before claims can be filed.* Waiting periods can range from as little as 90 days to two years or more. The waiting periods of two or more years may not be attractive to consumers but provides additional claims protection for the insurance company. The waiting period also allows for a less restrictive underwriting process. An individual with a mild impairment unable to obtain a standalone policy may be able to secure coverage under a combination plan.
2. *Combination plans have a built in element of self-funding that reduces claims.* Under the terms of some riders, the first dollars used for LTC expenses come from the cash value of the plan; only after the cash value is depleted are benefits paid from insurance company reserves. The cash value equals the premium paid into the contract less insurance costs and expenses plus earnings. For example, assume a client pays a \$100,000 initial premium into an annuity. After a two-year waiting period, the policyholder is eligible to receive up to \$300,000 in LTC protection (or three times the cash value). *LTC costs come first from the annuity value.* In this example, we will ignore account earnings. If the annuity beneficiary goes on claim and submits a reimbursable bill for \$1,000, the

payment is made from the cash value of the annuity. As further claims are submitted payment is made from the cash value until it is depleted. Claims in excess of \$100,000 are paid by the insurance company from its reserves until a total of \$300,000 in claims has been paid (consisting of \$100,000 paid from the policyholder's cash value — the self funded portion — and \$200,000 from insurance company reserves).

For clients concerned about LTC costs but unwilling to consider a standalone policy, the combination plan may be preferred. Should they never file a claim, the contract may be annuitized or paid out in a lump sum. At death, the annuity value may be bequeathed. For clients who may already be self-funding for LTC costs, they can take advantage of tax-deferred growth by shifting the funds — which cannot come from an IRA or other tax favored retirement plans — to a combination plan.

### **Rider Features**

Combination plans have been introduced on a variety of platforms — from simple term and whole life insurance plans to universal and variable life products, to deferred and immediate annuities. The riders themselves vary in the features offered.

When comparing products for a client, note differences among the following features:

1. Does the base plan require a single premium payment or multiple payments?
2. How are initial LTC claims paid? From the cash value in the plan until depletion and then paid from insurance company reserves? Alternatively, are initial claims shared based on a stated formula between cash values and independent benefits paid from insurance company reserves?
3. If it is a life/LTC plan, initial claims are typically paid from the death benefit with a pro rata reduction of the cash value. How much of the death benefit can be used toward LTC costs? 50 percent? 75 percent? Is there a minimum death benefit payable even after payments for LTC costs are exhausted? Is there an extension of benefits rider (EOBR) which continues monthly payments after accelerated benefits are fully depleted? How long are extended benefits paid? Is there a maximum monthly benefit?
4. What is the inflation protection provision(s) and how is it paid for?
5. Is there a return of premium feature?

This list is by no means exhaustive and will change as new products appear on the market. According to Carl Friedrich, a principal at the international actuarial firm, Milliman, Inc. and leading expert on the design of combination plans, the variety of new products continues to expand and many more are on the drawing boards.

### **Does a Combination Plan Make Sense for Your Client?**

A combination plan may make sense if your client:

1. Expresses a preference for self-insuring the potential cost of LTC.
2. Is unable to deduct as an itemized deduction, premiums paid on a LTC policy.
3. Has an unmet need for both life insurance and LTC insurance.
4. Has a minor health concern that would prevent them from meeting the underwriting standards of a stand-alone plan.
5. Has net-worth sufficient to set aside the money in the combination plan without financial hardship.
6. Understands how the combination policy impacts their spouse or partner should the policyholder die first, especially if the policy was depleted due to LTC claims.
7. Owns a life or annuity contract with significant tax deferred gains making a 1035 exchange into a combination plan attractive (the PPA expands the definition of insurance contracts eligible for a 1035 tax-free exchange — last month's article).

For clients, combination plans offer a viable alternative to standalone LTC plans. A combination plan, however, may only provide a partial solution to a client's LTC insurance coverage needs. The client should clearly understand the extent of the coverage provided and decide whether it provides the level of protection desired.

Friedrich notes that the coming changes offer opportunities as well as threats to insurance companies. While the opportunity to expand their line of business with combination plans is clear, the new 1035 exchange rules make insurance companies vulnerable to losing business as customers move existing life and annuity policies to combination plans offered by competitors. LTC carriers will also see encroachment by life and annuity carriers into their line of business.

As insurance companies create new and more complex combination plans CPAs must be prepared to provide guidance to their clients.

---

*[James Sullivan](#), CPA, PFS, MAS, is an investment counselor at Core Capital Solutions LLC. He has almost 25 years of experience in individual tax, investing and personal financial planning. Before joining Core Capital Solutions, Sullivan spent 20 years at Arthur Andersen LLP. He is a member of the AICPA PrimePlus/ElderCare Task Force. [Brian Gordon](#), CLTC, is president of MAGA, Ltd. Established in 1975, MAGA is a family owned and operated insurance agency that focuses exclusively on Long-Term-Care Insurance with offices in Illinois, California and Arizona.*