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Can 1 + 1 = 3?

A Look at Hybrid Insurance Products with Long-Term Care Insurance

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The AARP Public Policy Institute, formed in 1985, is part of the Policy and Strategy Group at AARP. One of the missions of the Institute is to foster research and analysis on public policy issues of importance to mid-life and older Americans. This publication represents part of that effort.

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EXECUTIVE SUMMARY

S1.0 Introduction

There is continuing interest on the part of governments and policy-makers in increasing the number of persons who have private long-term care insurance. Having such private insurance may provide peace of mind and benefits for the individual and for society by lessening the strains of finding payment for expensive long-term services and supports that may be needed over several years and possibly using up life savings in the process.

Today's reality is that few people have purchased private long-term care insurance. One approach to increasing the appeal of long-term care insurance that is gaining increased attention is the offering of "hybrid" products that combine long-term care insurance with other insurance products.[1] This report discusses hybrids of long-term care insurance with life insurance, annuities, and disability insurance.

S2.0 Descriptions of Insurance Products and Hybrids

Almost all of the individual insurance components discussed here are complicated in their own right. So the difficulty of determining the specific policy that is best for an individual may be multiplied when considering a hybrid that combines two types of insurance.

Long-Term Care Insurance

Long-term care insurance provides coverage for services and supports when the insured meets specified disability criteria. One recent analysis found that 10.2 percent of noninstitutionalized persons age 65 and over had private LTC insurance.

Life Insurance

There are many variants of life insurance. Term life is the simplest and least expensive type. It pays a lump sum to whomever the insured has designated upon his or her death. Other types of life insurance provide both a death benefit and a cash value account, and are often referred to as "cash value" policies. Accumulation in the cash value account occurs on a tax-deferred basis. Premiums are greater than term life premiums because they fund a savings account in addition to buying insurance.

One simple type of hybrid of life insurance with long-term care insurance is an *accelerated death benefit* (ADB), which may be offered as an option or rider to a life insurance policy. This benefit permits the owner of the policy to "accelerate" all or part of the death benefit payout when triggered by specified events (for example, the development of a permanent disability that requires LTC services).

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[1] These products may also be called "combined" or "linked" policies, or "combination products".

At the time of acceleration, the death benefit under the policy is reduced – if enough payments are disbursed under an accelerated death benefit, the death benefit may be completely eliminated. In general, with an accelerated death benefit one cannot expect substantial insurance payments for both an expensive long-term care episode and death.

A few companies offer another type of hybrid of life insurance and long-term care insurance, primarily designed for persons at or near retirement age who have significant assets that can be invested in a hybrid product. Typically, a person makes a single large premium payment to purchase a cash value life insurance policy. The policy specifies a guaranteed death benefit. If the policyholder does not use any long-term care benefits, then the death benefit is paid to the beneficiary when the policyholder dies. However, the policy can also pay for long-term services and supports, with a corresponding reduction in the death benefit.

Annuities

An annuity contract involves paying either a single premium or a series of premiums to purchase the annuity, and in return the annuity-holder receives a lump-sum payment or more commonly, a series of payouts. The series of payouts can last until death or for a finite period. Annuities can be *deferred*, which means that the annuity payout occurs at a later time, possibly many years in the future (such as at the death of the annuitant).

One important characteristic of annuities is that they can be either *fixed* or *variable*. *Fixed* annuities pay a specified rate of return and are regulated by state insurance departments. With *variable* annuities, the consumer can invest in a variety of securities including stock and bond funds, with accompanying increased risk in terms of payouts. Variable annuities are tax-deferred and regulated by state insurance departments and also by the federal Securities and Exchange Commission.

Hybrids of annuities with long-term care insurance are available in the marketplace. In some ways they are similar to the life insurance/long-term care insurance hybrids described above.

Hypothetical examples of hybrids of annuities and long-term care insurance have been analyzed to determine if the premium costs of the combined product might be significantly lower than the two products priced separately. These analyses found that there are combined premium savings, but that these savings are small (around 5 percent).

Disability Insurance

Disability insurance, or disability income insurance, provides benefits that are intended to partially replace the income that a person would have earned had he/she not developed a disability that caused him/her to be unable to work. The overwhelming majority of disability insurance policies are obtained through employment (36.3 million employees with group coverage in 2005), and the benefits of such long-term disability plans are generally reduced by Social Security benefits.

The logic of an insurance product that combines disability insurance with long-term care insurance is that it would protect against the income-loss associated with developing a disability as well as the costs of needed services associated with becoming disabled.

Some policies offer aspects of combined disability/long-term care coverage. In one example the policyholder can exchange the disability policy for a long-term care insurance policy without undergoing an underwriting review. The specific level of long-term care insurance premiums is based on the age at the time of conversion.

Not enough is known to estimate how many people might buy various types of hybrids of long-term care insurance with other types of insurance. But the number of people with life insurance, annuities, or disability insurance is many times greater than the number with long-term care insurance. If new products were offered and marketing and education efforts were increased, and if legislation makes hybrid policies more appealing to insurers or consumers, then even just a small shift in life insurance, annuity, and/or disability insurance policyholders to long-term care insurance hybrids would produce a noticeable increase in the numbers of persons who have at least some form of long-term care insurance. But it is highly doubtful that insurance hybrids alone can solve the basic societal problem of how to pool long-term care risks.

S3.0 Hybrid Insurance Products and Government

Long-term care insurance, life insurance, disability insurance, and annuities are regulated at the federal level, the state level, or both. In addition, different regulators within a single level of government may be responsible for different insurance products, or for different portions of a hybrid product. This range of regulation can result in markets for insurance products that are more consumer-friendly. However, the process of developing and marketing hybrid products may be more difficult as a result of a fragmented regulatory system.

On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006, which contains a section that makes the tax laws more hospitable to hybrid products involving long-term care insurance and annuities and life insurance (but it does not address disability insurance). In the past, tax-free exchanges have been possible between annuities and life insurance. This means, for example, that money in an annuity can be moved into life insurance without paying taxes, but taking money out of an annuity (by means other than the prescribed annuity payout) for other purposes would generally result in the need to pay taxes on at least a portion of the money taken out. The Pension Protection Act expands tax-free transfers to also include exchanges of life insurance and annuity contracts for long-term care insurance contracts, and for tax-free exchanges of one long-term care insurance policy for another. The Act also includes provisions related to insurance policy expenses that may result in increased corporate taxes when insurers offer hybrids, compared to the tax impact if the hybrid components were sold separately.

S4.0 The Logic of Hybrids for Consumers

Psychological Considerations

Insurance for long-term care may be viewed as covering expenses similar to health expenses, but many policyholders will not make claims against their long-term care insurance until decades after the initial purchase of the policy, if at all. Rather than viewing their premiums as having paid for insurance against a catastrophic risk that (fortunately) never came, some consumers may feel that they have “lost” or “wasted” all of their premium payments, even though they probably do not adopt similar perspectives towards home and car insurance. Hybrids may overcome some psychological barriers for those consumers, by incorporating another insurance product that they perceive to have value.

Consumer Perspectives on the Insurance Products That May Be Combined in Hybrids

Cash value life insurance is really a hybrid financial product in itself. It is insurance against the death of the policyholder combined with an investment vehicle. Some observers have questioned the quality of this investment vehicle, and as a result some consumer organizations recommend that life insurance and savings products be purchased separately. That is, a consumer should purchase term life insurance if needed, and also separately consider the range of investments available to them: 401(k)s, IRAs, mutual funds, annuities, etc. But some people may have trouble saving for a range of future needs. Having the requirement of regularly paying premiums on a cash value life insurance policy may result in savings with some positive rate of return that would otherwise not happen at all.

Annuities present several potential issues from a consumer perspective— their costs, their suitability for specific savings objectives, the attractiveness of their rates of return compared to alternative investments, and their safety. *Variable annuities* in particular have received attention in recent years. The U.S. Securities and Exchange Commission (SEC), which regulates variable annuities at the federal level, suggests that consumers also consider other investment vehicles, such as IRAs and employer-sponsored 401(k) plans that may also provide tax-deferred growth and other tax advantages. Although *fixed annuities* are comparatively more straightforward, they also need to be considered carefully relative to investment objectives and other options, including: remaining life expectancy, the desire to leave assets after death, and desire to retain flexibility to access savings in response to significant life events.

For *disability insurance* there are issues related to the long view of guaranteeing continued insurability and adequate benefits, including: whether the policy is issued by a financially sound company, since the disability insurance may be held for decades; and for employer-based policies, whether there are provisions that allow for continuation of the insurance policy after the policyholder leaves an employer.

Timing Issues

If a hybrid insurance product is to appeal to consumers, it should make sense in terms of *when* during their lifetimes consumers would want to purchase each of the components of the hybrid. Earlier purchase of long-term care insurance protects against the increasing possibility that with age one might not be eligible for this insurance due to the development of chronic health conditions.

Would hybrids encourage purchase of long-term care insurance earlier in life? Disability insurance and life insurance are typically purchased earlier in life than long-term care insurance. So if hybrids of long-term care insurance with either of these two types of insurance were marketed to persons at ages when disability and life insurance are normally marketed, these hybrids could have a beneficial effect of encouraging earlier purchase of long-term care insurance than is generally the case today. Nevertheless, some hybrids of life and long-term care insurance are marketed to older persons who have accumulated sufficient savings to be able to afford to purchase policies with a sizable single premium payment.

New employee orientations and open seasons when employee benefit options can be changed provide opportunities for improved communication about the benefits and costs of long-term care insurance that is combined with disability insurance and life insurance, especially since few employers currently offer long-term care insurance by itself.

S5.0 Conclusions

The desire to insure against long-term care risk competes with the need to insure against the many other risks we face in life. When balancing living expenses and other current needs against paying for health insurance, life insurance, disability insurance, current and future educational expenses of children, future retirement income needs, and potential future long-term care needs, many people may decide that purchasing long-term care insurance is not a viable option. This result is also more likely to the degree that some people are in denial about or have misinformation about their potential long-term care needs or the degree to which government programs will pay for long-term care.

It appears that full-fledged hybrids that substantially insure against the risks covered by *both* its insurance parts are rare in the marketplace. This may indicate that one potential appeal of hybrids is that they allow the consumer to purchase one policy that insures against two risks, even though coverage will be limited should both risks occur. Instead, the insurance provides the flexibility of paying out depending on which event occurs first and needs reimbursement. Hybrid insurance products may therefore present one way to achieve a partial and second-best solution to the problem of many important risks against which to insure, but limited funds available to do so.

Hybrid insurance products with long-term care insurance do not offer substantial pure economic appeal. It appears that at best only small premium savings may be possible by combining insurance products into a hybrid.

The few long-term care insurance hybrids with disability insurance are worthy of further study. Such hybrids can allow the consumer to evaluate in a coherent process the potential needs to replace income lost due to disability as well as to pay for services that may be needed as a result of developing a disability, and then purchase a single insurance product covering at least part of the combined risk. With the average purchase age for long-term care insurance declining and long-term care insurance being offered by more employers, the fact that most disability insurance is purchased through employers may become a less significant obstacle.

Life insurance, annuities, and disability insurance are complex products in their own right, as is long-term care insurance. As a result, hybrid insurance products will require a better educated consumer in order to make the financial decision that is best for him or her. The need is real for government to provide protections to consumers in the face of increasingly complex decisions regarding long-term care insurance.

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1.0 INTRODUCTION

While states and the federal government struggle with the costs of long-term care for the Medicaid program, there is continuing interest on the part of governments and policy-makers in increasing the number of persons who have private long-term care insurance. If more Americans purchase this insurance, then some of them may be able to avoid relying on Medicaid coverage, with its care limitations and income and asset requirements. But even if most purchasers of long-term care insurance will never otherwise end up on Medicaid, having such private insurance may provide peace of mind and benefits for the individual and for society by lessening the strains of:

- Finding payment at the last minute for expensive long-term services and supports that may be needed over several years,
- Possibly using up life savings in the process;
- Having family and other caregivers re-arrange their lives in order to provide unpaid care; or
- Doing without needed long-term services and supports.

Today's reality is that few people have purchased private long-term care insurance, and it remains difficult to sell in spite of its potential benefits. In addition, some individuals do not qualify for this type of insurance due to pre-existing conditions, and some consider it "too expensive." These facts suggest the usefulness of continuing to explore new ways to harness the benefits of risk-pooling (both public and private sector approaches) in order to make protecting against long-term care needs more appealing. The benefits of risk-pooling through insurance are substantial. Nearly half of those who turn 65 will not need significant long-term care, while others will require high levels of spending on such services and supports.[2]

One approach to increasing the appeal of private long-term care insurance that is gaining increased attention is the offering of "hybrid" products that combine this type of insurance with other insurance products.[3] Although various hybrids with long-term care insurance have been marketed for several years, the passage of the Pension Protection Act of 2006 facilitates the provision and purchase of some types of long-term care insurance hybrids and has raised interest in hybrids in general.

For the purposes of this report, a hybrid is any insurance product where the policy premiums provide insurance that can fund payments for long-term services and supports *and* some other type of insurance-related benefit (such as a death benefit or periodic payments unrelated to the health of the policyholder). Actually paying for long-term

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[2] Cohen, et al. (2005).
[3] These products may also be called "combined" or "linked" policies, or "combination products."

services and supports through a hybrid insurance policy may result in a reduction in the level of the other benefit available (e.g., using a life insurance policy to pay for long-term care may result in a reduction in the death benefit).

Hybrids might increase the purchase of long-term care insurance through several channels:

1. A hybrid of long-term care insurance with another insurance product might be priced more cheaply than when the two products are sold separately.
2. Given the many risks that a person might want to insure against, purchasing a hybrid may be an attractive way to spread around scarce dollars over several risks, even if this means that multiple types of risks cannot be fully covered should they all occur.
3. Hybrid policies might overcome the psychological barriers that some consumers have with paying for long-term care insurance, particularly the perspective that premiums paid out for such insurance are "wasted" if long-term services and supports are not needed.
4. The marketing of long-term care insurance hybrids might provide an additional platform for educating consumers about the probabilities of needing such care, and about the costs and potential benefits of purchasing long-term care insurance.

It is highly doubtful that insurance hybrids alone can solve the basic societal problem of how to pool long-term care risks. But any proposals or options that raise long-term care insurance coverage by more than a few percentage points might rightly be viewed as successes in improving private planning for long-term care needs. It has proven difficult to significantly increase voluntary long-term care insurance purchase from present levels, and insurance hybrids may provide a small carrot.

This report discusses hybrids of long-term care insurance with life insurance; annuities; and disability insurance.

One cannot estimate with certainty the degree of increase, if any, in long-term care insurance coverage that would result from supporting and publicizing the use of these three types of hybrids. However, it is possible to give some idea of the current nature of the market for each of these financial products. This understanding may shed some light on the potential appeal of hybrid products to expand long-term care insurance coverage, as well as identify any consumer concerns that would be relevant to these hybrid insurance products.

This report provides a brief description of each separate type of insurance and examples of hybrids between that product and long-term care insurance. It also examines the regulatory environment for hybrid products, including discussion of the degree to which this environment either facilitates or hampers the creation and marketing of hybrid insurance products. Finally, it explores the potential rationales for these hybrids and the concerns that have been raised about the appropriateness of the component insurance products for specific population groups.

2.0 INSURANCE PRODUCTS AND HYBRIDS

Many of the insurance components that could be combined into a long-term care insurance hybrid are complicated in their own right. Therefore, this section of the report provides a brief description of each of these components, followed by information about related hybrid insurance.

2.1 Long-Term Care Insurance

Long-term care insurance provides coverage for long-term services and supports when the insured meets specified disability criteria. Briefly, the following are the more important choices that need to be made by consumers or providers to specify a long-term care insurance policy.[4]

- What are the disability-related triggers that allow benefits to be paid?
- Over how many years or up to what total dollar amounts will benefits be paid, if triggered?
- What amount will be paid on a daily or monthly basis for care (the benefit level)?
- Is the amount of benefit a fixed dollar amount (per month, for example), or does it depend on either actual incurred long-term care costs or the type of place of residence?
- Does the level of benefit increase over time (inflation protection)?
- How long is the waiting period (elimination period) before benefits will be paid?

This list indicates that the decision to purchase a long-term care insurance policy is complicated all by itself, before it is combined with another insurance product.

Long-term care insurance is primarily sold as either an individual policy or as a group policy through an employer or association. In 2002 roughly two-thirds of policies were sold as individual policies. Over recent years the average age of individual purchasers of long-term care insurance has been decreasing, to age 60 in 2002, while the average age of policyholders with insurance provided through an employer has remained fairly constant at about age 45.[5] More detail on the age distribution of purchasers is presented in Table 1.

[4] See Burns (2006).
[5] Coronel (2004), p. 20.

Table 1: Individual and Group Long-Term Care Insurance Policies Issued, Distribution by Age, 2001

	Individual Policies (Percent)	Group Certificates (Percent)
Age:		
Under 40	2.7	33.9
40-44	2.1	13.0
45-49	4.5	14.2
50-54	12.4	15.2
55-59	19.5	11.2
60-64	20.8	6.2
65-69	16.7	3.1
70-74	11.3	1.8
75 and older	10.0	1.4
TOTAL	100.0	100.0

Source: ACLI Research Department. *ACLI Product Line Report: Long-Term Care*, May 2003.

Even though more people are buying this type of insurance earlier in life, 38 percent of individual purchasers in 2001 were still age 65 or older. Because group certificates are largely employer-based policies, these purchasers were much younger, with 87 percent under the age of 60.

Roughly 6.4 million long-term care insurance policies were in force in the United States at the end of 2002.[6] While national data on LTC insurance policies held by age are limited, 10.2 percent of noninstitutionalized persons age 65 and over had private LTC insurance.[7]

These data demonstrate the low market penetration of private insurance coverage of long-term services and supports. The percentages showing long-term care insurance coverage by age are relevant to an issue that will be discussed later—how well the purchase ages for long-term care insurance match up with the purchase ages for other insurance products.

[6] Kassner (2004).
[7] Johnson and Weiner (2006).

2.2 Life Insurance[8]

Brief Description of Life Insurance

As the name indicates, the primary focus of life insurance is providing insurance benefits in the case of death. There are many types of life insurance.

Term life is the simplest and least expensive type of life insurance policy. A term life policy has only one function: to pay a specific lump sum to whomever the insured has designated upon his or her death. One can choose to make a constant monthly premium payment over the life of the policy, but other options are available.

Other types of life insurance provide both a death benefit and a cash value account, and are therefore often referred to as *cash value* policies.[9] Accumulation in the cash value account occurs on a tax-deferred basis. Premiums are greater than term life premiums because they fund the savings account in addition to buying the insurance. The account is managed by the insurance company. Types of cash value policies are whole life, variable life, universal life, and universal variable life insurance.

Whole life insurance is the simplest type of cash value policy. Premiums remain fixed throughout the life of the policy, and the company invests at least a portion of the premiums. Some firms share investment proceeds with policyholders in the form of dividends, which can be applied to reduce premium payments. Many companies offer a relatively low guaranteed rate of return, but actually pay at a rate in excess of the guarantee. One can access the cash value of an insurance policy either through a loan or a partial withdrawal. In the latter case, or if the loan is not repaid in the former case, the death benefit will be reduced.

Variable life insurance provides greater account flexibility for a more risk-oriented policyholder—there is usually a wider selection of investment products, including stock funds. It allows one to borrow from the policy and it allows the death benefit to vary in relation to the value of the cash value account. But it offers no guarantee for the amount of cash value during the insured's lifetime. As with a universal policy described below, returns on investments can offset the cost of premiums or accumulate in the account. And depending on the type of policy, the beneficiaries will either receive the face value of the policy or the face value plus all or part of the cash account.

Universal life insurance allows policyholders to decide how much they want to contribute over and above a minimum premium. The company chooses the investment vehicle, which is generally restricted to bonds and mortgages. The investment and the returns go into a cash value account, which can be used against upcoming premiums or allowed to accumulate.

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[8] Some of this material is derived from http://www.insurancefinder.com/lifeinsurance/ typeslifeinsurance2.html, accessed on 3/14/06.

[9] These types may also be referred to as "permanent" life insurance.

Universal life insurance offers the right to borrow or withdraw from the policy during the policyholder's lifetime. Also, it allows the policyholder premium flexibility and flexibility in the amount of the death benefit, depending on investment performance. However, universal life insurance does not allow the flexibility to invest in separate accounts such as money market, stock, and/or bond funds.

Universal variable life insurance gives policyholders more control of cash value account features than other types of life insurance. It offers separate accounts for the insured to invest in such as money market, stock, and bond funds, as well as premium flexibility, and it allows the insured to make withdrawals or to borrow from the policy during his/her lifetime. However, it stipulates that if the insurance contract is terminated in early years the policyholder will receive less cash value total return than in a whole life contract. The policyholder manages the accounts. Consequently, the policy's long term value is contingent on the investments the insured makes.

Hybrids of Long-Term Care Insurance with Life Insurance

One simple type of hybrid of life insurance with long-term care insurance is an *accelerated death benefit* (ADB), which (if offered) is often an option or rider to a life insurance policy. This benefit permits the owner of the policy to "accelerate" all or part of the death benefit when of certain qualifying events or triggers occur. At the time of acceleration, the death benefit under the policy is reduced—if enough payments are disbursed under an accelerated death benefit, the death benefit may be completely eliminated. Typically, with an ADB one cannot expect substantial insurance payouts for both an expensive long-term care episode and death. The consumer must continue to pay the life insurance premiums while receiving the accelerated benefits.

Accelerated death benefit options arose in the 1990s at the same time that viatical settlements (payments derived from sale of an insurance policy by a terminally ill policy holder) became more common.[10] The option is generally associated with cash value life insurance, but may be available with term insurance. The trigger for an ADB can vary, including combinations of:

- Terminal illness, with death expected within 24 months;
- Acute illness, such as acute heart disease or AIDS, which would result in a drastically reduced life span without extensive treatment;
- Catastrophic illness requiring extraordinary treatment, such as an organ transplant;
- Long-term care needed because the policyholder cannot perform a number of daily living activities such as bathing, dressing, or eating; or
- Permanent confinement in a nursing home.[11]

Therefore, not all ADB riders can really be considered as long-term care insurance.[12]

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[10] Doherty and Singer (2003).

[11] http://www.acli.org/ACLI/Consumer/Life+Insurance/NM03-04+ADB+Questions+and+Answers.htm, accessed on 9/15/06.

[12] Indeed, one state insurance department states in a recent report that an accelerated death benefit "is not long term care insurance" and has proposed regulatory language that states that "The policy or certificate

In some cases the level of benefits may be restricted to only a specified percentage of the life insurance coverage (e.g., 50 percent). Therefore, if the amount of life insurance is small, the coverage of long-term care may be relatively small compared to the costs of several years of long-term services and supports.

Brown (2005) reported that for five companies that participated in a survey and reported that they offered life insurance policies with an accelerated death benefit:

- The policies varied as to whether the acceleration benefit was an optional rider, or was integrated into the policy itself.
- The waiting period for payment for long-term care services ranged from 60 to 100 days.
- The monthly benefit amount ranged from 1 percent to 4 percent of the face value of the life insurance policy (with a range of maximum benefits and in some cases, other limitations).
- Four companies responded that the accelerated death benefit was intended to be federally tax-qualified, and that there was an additional premium for the accelerated death benefit.

America's Health Insurance Plans (AHIP), reported in 2004 that there had been little growth since 1996 in the numbers sold of long-term care riders to life insurance policies that met the federal long-term care insurance qualifications of HIPAA (the Health Insurance Portability and Accountability Act). AHIP also reported that "many insurers in this market have significantly decreased their marketing efforts, stopped selling a long-term care rider, or totally left the marketplace."[13]

Since the 1990s, a few companies have also offered another type of hybrid of life insurance and long-term care insurance. These policies appear to be primarily designed for persons at or near retirement age who have some significant assets that can be invested in a hybrid product. Typically, a person purchases a cash value life insurance policy with a single premium payment (although paying premiums over a fixed number of years or a lifetime is also possible). The policy specifies a guaranteed death benefit, which may be allowed to increase depending on the rate at which the cash value of the policy increases. If the policy holder does not use any long-term care benefits, then the death benefit is paid to the beneficiary when the policyholder dies. If the policyholder needs long-term services and supports, then payment for these services can be made, but these payments reduce, and may eventually exhaust, the death benefit.

An example of this type of policy is as follows[14]:

shall not be advertised as long term care insurance, nursing home insurance, [or] home care insurance…." (New York State Insurance Department, 2005).

[13] AHIP (2004), p. 33.

[14] This example uses rates from the state of Florida as of December 2005.

> The investor is a 65-year-old male non-smoker. He makes a single $70,000 premium payment to purchase a universal life insurance plan with a long-term care coverage feature. This will provide him with $118,073 in income tax-free death benefits payable to his beneficiary upon his death. Should the policy-holder need long-term care services, he can receive up to $236,146 in income tax-free benefits for long-term care, which will decrease the amount of the death benefit. In many cases, a small residual death benefit is paid even if all long-term care benefits are exhausted by the policy-holder. If the policy-holder decides to cancel the policy, and if no benefits have been received, or withdrawals or loans made, he will receive back his entire initial premium, possibly plus some of the return on this premium. This plan is available to persons from 30 to 80 years of age, subject to medical underwriting.[15]

As this example indicates, a policyholder needs to have a relatively large amount of funds that he or she is willing to devote to payment to heirs and/or long-term care coverage in order to have a significant level of long-term care insurance coverage using this type of hybrid product.

2.3 Annuities[16]

Brief Description of Annuities

The range of annuities is bewildering, and it may be difficult for consumers to understand the distinctions among them. An annuity contract involves paying either a single premium or a series of premiums into the annuity, and in return the annuity-holder receives a lump-sum payment or more commonly, a series of payouts under the annuity contract. The series of payouts can last until death or for a finite specified period.

Annuities can be group or individual annuities. Group annuities are primarily used in employer-sponsored retirement plans. Individual annuities are purchased directly from a life insurer or other financial institution. This report focuses on individual annuities.

For example, in a "single premium immediate annuity" the consumer invests an amount in a single payment, which then results in a stream of payouts that starts immediately and lasts until one dies. An older person might invest in this type of annuity to hedge against the risk that she/he will live long enough to outlive their financial resources. Annuities can also be *deferred*, which means that premium payments are made for payout at a later time, possibly many years in the future (such as at the death of the annuitant).

One important characteristic of annuities is that they can be either *fixed* or *variable*. *Fixed* annuities pay a specified rate of return. This characteristic would appeal to persons who want to shelter their assets from the volatility of the stock market. Fixed annuities are regulated by state insurance departments.

[15] Merkel (2006) and phone conversation with Lincoln Financial Group on December 1, 2006.
[16] This section was largely adapted from Insurance Information Institute (2006).

With a *variable* annuity, the consumer can invest in a variety of securities including stock and bond funds. In some ways a variable annuity is like a mutual fund, but one open only to investors in the insurance company's variable life insurance and variable annuity products. Market performance (net of expenses) determines the annuity's value and the return one will get from the money invested. A variable annuity involves accepting a higher level of risk in terms of payouts, but may be considered by a person who wants to benefit from expected gains in the stock or bond market. Variable annuities are regulated by state insurance departments and also by the federal Securities and Exchange Commission.

Variable annuities differ from mutual funds in several important ways. Variable annuities usually have a *death benefit*. If the policyholder dies before the insurer has started making payments, his/her beneficiary is guaranteed to receive a specified amount – typically at least the amount of the premium payments. Also, variable annuities are *tax-deferred*. That means the insured pays no taxes on the income and investment gains from the annuity until he/she withdraws his/her money. The insured may also transfer his/her money from one investment option to another within a variable annuity without paying tax at the time of the transfer. When policyholders take their money out of a variable annuity, however, they will be taxed on the earnings at ordinary income tax rates rather than at lower capital gains rates.

Annuities can pay out for a *fixed period* or for a *lifetime* (both options are available in fixed or variable return forms). A *fixed period* annuity pays an income for a specified period of time, such as 10 years. The amount that is paid does not depend on the age (or continued life) of the person who buys the annuity; the payments depend instead on the amount paid into the annuity, the length of the payout period, and (if it is a fixed annuity) an interest rate that the insurance company believes it can support for the length of the pay-out period.

A *lifetime* annuity provides income for the remaining life of a person (the "annuitant"). One variation of a lifetime annuity continues income until the second of two annuitants dies (e.g., until *both* members of a couple die). The amount that is paid depends on the age of the annuitant (or ages, if it's a two-life annuity) in addition to the factors described in the above paragraph. There are any number of other options that can modify and/or extend these basic formats, such as a minimum payout period guarantee and a death benefit.

During the payout phase, a variable annuity contract may permit the purchaser to choose between receiving payments that are fixed or payments that vary based on the performance of mutual fund investment options. Some annuities combine both fixed and variable annuity characteristics from the beginning.

The tax treatment of annuities during the accumulation phase and of annuity payouts, and of any residual value at death that becomes part of an estate, may affect the overall appeal of an annuity to any given individual, depending on his/her specific life situation, expectations, and objectives. These factors will also affect whether an annuity is more or less appealing than a life insurance policy structured to have some similar features. However, an exploration of the complexities of such tax considerations is beyond the scope of this report.[17]

Hybrids of Long-Term Care Insurance with Annuities

The concept of a hybrid product of an annuity and long-term care insurance coverage was first rigorously analyzed (for persons at retirement ages) by Murtaugh, Spillman, and Warshawsky (2001). Their initial motivation to explore this hybrid product was to see if, by combining annuities and a form of long-term care insurance, the premium costs of the combined product might be significantly lower than the two products priced separately. This possibility exists because persons more likely to require long-term care are for the most part less likely to live a long time. In other words, from the perspective of the insurance company the financial risks of a high payout for one product (either the annuity or the long-term care insurance) will tend to be offset for an individual by a lower financial risk of a high payout for the other product.

Murtaugh, Spillman, and Warshawsky analyzed combinations of an immediate fixed annuity with a long-term care insurance benefit paid on the basis of a level of disability, rather than on reimbursing actual service costs incurred. They found that there are indeed combined premium savings, but that these savings are small (around 5 percent). So while the logic of this hybrid is compelling, they estimated the reality to be of limited magnitude. However, there may be additional savings in administrative costs and commissions.

The specific hybrid policies analyzed by Murtaugh, Spillman, and Warshawsky were expensive. For example, their one-time "estimated premium for a $1,000 monthly life annuity, with a $2,000 monthly base disability benefit and a $1,000 monthly increment for higher disability, was $156,000 at age 65 with no inflation protection and $219,000 with inflation protection."[18] However, they also found that such a combined product could be marketed with almost no underwriting (after excluding people who would already have been eligible for benefits at the time they applied).

Hybrids policies that provide both a lifetime annuity *and* coverage of long-term care needs where the use of the hybrid policy for one of the purposes does not diminish the level of coverage available for the other purpose (the type described immediately above) do not appear to be common. One question in a survey conducted by and reported on by the New York State Insurance Department (2005) asked about combination annuity/long term care products. Of the 28 insurers that responded, only one company indicated that they offer an annuity with a "long term care type" benefit, and that was offered in other states, not New York. As of the date of the report, "no formal submissions from a life insurance company have been made for the review and approval of a true combination annuity/long term care policy" for New York.

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[17] Brown and Poterba (2006) write that the "evidence on the role of tax incentives in encouraging ownership of variable annuities is mixed."
[18] Murtaugh, Spillman, and Warshawsky (2001), p. 248.

Nevertheless, hybrids of annuities with long-term care insurance are available in the marketplace. In some ways they are similar to the life insurance/long-term care insurance hybrids described above. One example is a single-premium deferred annuity that can be used to pay for long-term care expenses. It is offered by a company that states the age range of issue is from 50 to 85, but that the primary market is from 70 to 85. The product is designed to appeal to persons who attempt to "self-fund" for their risks of having long-term care expenses.[19] Some potential sources of appeal, in comparison to other ways to self-fund, might lie in the following characteristics of this product:

- As with annuities in general, the money will compound tax-free within the annuity hybrid.
- There is simplified medical underwriting and typically no exams are required.
- A higher interest rate is used to calculate the total amount available to pay for long-term care expenses than the interest rate used in the annuity that determines the cash value that will be paid to the beneficiary.

2.4 Disability Insurance

Brief Description of Disability Insurance

Disability insurance, or disability income insurance, provides benefits that are intended to partially replace the income that a person would have earned had he/she not developed a disability that caused him/her to be unable to work. The level of payment depends in part on the degree of disability, the expected duration of disability, and the feasibility of the insured returning to his/her previous line of work, or to any meaningful employment at all. This section focuses on long-term disability insurance, as opposed to short-term disability insurance where the coverage limits are expressed in terms of months, not years.

If a worker purchases his or her own policy, the disability benefits typically are not subject to income taxes. Benefits are taxed, however, if the employer pays for the disability insurance coverage. Most coverage is obtained through employers.

There are many dimensions to a disability insurance policy, including:

Renewability. A "*non-cancelable" (and guaranteed renewable)* contract locks in premium rates and benefits. A policy that is just *guaranteed renewable* guarantees continued insurance, but allows the insurer to change characteristics of the policy, including premiums, for specific reasons. These reasons cannot be related to the specific individual insured, and changes are reviewable at the state level. *Conditionally renewable* policies are those where the insurer can change conditions or increase premiums at any time.

[19] http://www.annuitycare.com/Earl-Crown/index.shtml, accessed on 12/1/06.

Definition of total disability. Definitions of disability are usually phrased in terms of being able to work in one's usual occupation (at the narrowest) to being able to work in *any* occupation (at the broadest).

Residual disability. This coverage option applies if a person experiences a disability but only partially recovers, and is determined to have failed to regain his/her previous level of income or the previous level of hours worked.

Presumptive disability. Some insurance contracts have a presumptive disability for events specified in terms of the loss of hearing, sight, speech, or the use of limbs.

Elimination period. This is the length of time (e.g., 90 days) between the development of a disability and when benefit payments can start.

Recurrent disability. If the disability recurs within a specified time period, then some policies will waive the elimination period.

Benefit period. The benefit period is the maximum time over which benefits will be paid under the policy. It can be as short as a few years or can extend until age 65, or even the rest of one's life. Age 65 is the most common option, which means that the disability payments will cease roughly when aged-based Social Security benefits begin.

Optional riders. Examples of such riders are cost-of-living adjustments and other options that allow for increases in the level of coverage over time. Also, under some policies the insurer pays for job training or other assistance one may need to return to work, such as modifications to the work environment.

Policy limitations and exclusions. Some policies may exclude paying for or set lower limits on benefits for specific sources of disability, such as behavioral health.

Because the overwhelming majority of disability insurance policies are obtained through employment, most policyholders do not have the opportunity to tailor all of these options to their individual preferences.

Also, employer-sponsored long-term disability plans are usually integrated with Social Security disability insurance. Those employees who meet the Social Security definition of disability are encouraged or required to apply for Social Security benefits. Long-term employer-sponsored disability benefits are generally reduced by the amount of Social Security benefits.[20]

Hybrids of Long-Term Care Insurance with Disability Insurance

The logic of an insurance product that combines disability insurance with long-term care insurance is that the policy would protect against the income loss associated with

[20] Ross (1999).

developing a disability as well as the costs of needed services associated with becoming disabled. The two separate products have different focuses, but are related.

Disability insurance provides income (for whatever purpose, including paying for services) that replaces a portion of the income that is lost due to the disability. This is probably why disability payments often end at age 65—on the grounds that retirement (typically at age 65), would result in zero earned income in subsequent years even in the absence of a disability, and that Social Security benefits would start at roughly this age.

Long-term care insurance provides payment for needed long-term care services, starting at the initiation of long-term care service need (whatever the age of the policyholder) and extending until the need ends or the service coverage ends, whichever comes first. Although it is probably correct that an individual who needs long-term care services has a disability, it is not the case that every person with a disability requires significant long-term care.

Because of the partial correlation between income needs that arise from developing a disability and the need for long-term care services and supports, it would seem that there would be no expected cost savings due to offsetting risks from marketing a hybrid product of these two insurance types. Nevertheless, some cost savings for the long-term care insurance portion might result from financial incentives for returning to work contained in the disability insurance portion, as well as from rehabilitation efforts and managed care provisions that may be contained in the disability insurance portion of the hybrid. Some cost savings also might result from the combined underwriting and administration of these types of insurance.

Some policies exist that offer some aspects of combined disability/long-term care coverage. One example offers disability income insurance where the policyholder can exchange the policy for a long-term care insurance policy without undergoing an underwriting review. The exchange can occur between the ages 60 and 70 if the policyholder is not disabled, or at age 65 or later if the policyholder is disabled and has received the maximum benefits allowable under the disability income policy. The specific level of long-term care insurance premiums is based on the age at the time of conversion. The long-term care insurance policy covers facility care up to a daily benefit amount of $100, and home and community-based care up to 50 percent of that amount. Policies are also offered with five percent compound inflation protection and/or non-forfeiture options. The duration of these benefits is either three or six years, depending on the disability income insurance policy that was purchased.[21]

Recently, New York approved a rider to an individual disability income policy that will:

> act as an option for the insured to elect to purchase a long term care insurance policy at some point in the future. As with the conversion option, the insured would not be subject to underwriting at the time the option is exercised. This will permit an insured to act at a time when he or she is insurable to lock in the ability

[21] E-mails with Christina Wakefield, UnumProvident Corporation, November and December 2006.

> to obtain long term care coverage …. For this option, a 45 year old, non-smoker, choosing an option to purchase 3 years worth of nursing home and home care benefits with a $200 dollar daily benefit, would pay approximately $11.50 monthly in additional premium to add this option to their disability income policy. This option differs from the conversion option in that it would be possible for the individual to retain their disability income policy and also exercise their option to purchase a long term care policy.[22]

2.5 Two Additional Hybrid-Related Approaches

This report focuses on hybrids of long-term care insurance with three other products: annuities, life insurance, and disability insurance. However, a few other long-term care services and supports programs could be viewed as hybrid-like. One of these is a *viatical settlement*, which is the sale of a life insurance policy by an individual who is terminally ill or chronically ill to a third party for an amount equal to a certain percentage of the policy's face value.

Public-private partnership programs can also be considered a type of hybrid. Partnership programs involve selling specific long-term care insurance policies that then permit policyholders to exclude a portion of their assets when determining Medicaid eligibility. This product is in essence a public-private hybrid of long-term care insurance with a version of Medicaid that incorporates a relaxed asset test in its eligibility determination (the income test must still be met).

2.6 What Do We Know About the Potential Market for Hybrids?

As the above descriptions show, insurance markets currently include a range of hybrid types. But the numbers of these hybrid policies in force appear to be small relative to total sales of long-term care insurance. A question worth asking is whether these numbers would be any larger if people were better informed about available options both for long-term care insurance and for hybrids, through more effective private and/or public informational efforts, or if hybrids were made more attractive through changes in laws (such as will be described below in the next section).

Not enough is known to estimate how many people might buy various types of hybrids of long-term care insurance with other types of insurance. But it is possible to present data on how many people currently hold these other types of insurance products. The magnitude of current sales may provide one indication of the degree to which these insurance products have been successfully marketed on their own, and these levels may relate to the potential of a hybrid to find market acceptance.

Annuities. In 2003, there were 14.5 million individual fixed annuity policies in force, and 16.4 million individual variable annuities in force – 30.9 million combined.[23]

[22] New York State Insurance Department (2005).
[23] American Council of Life Insurers, accessed at http://www.acli.com/ACLI/Newsroom/GR04-116.htm on 4/12/06.

Disability Insurance. As shown in Table 2, 39 million long-term disability income insurance policies were in force in 2005. Almost all of these policies were obtained by employees through group coverage through their employers.

Table 2: Disability Income Insurance Policies, 2005

	Number of Policies (millions)
Employees w/ group coverage through employer	36.3
Individual policies—non-cancelable	2.5
Individual policies—guaranteed renewable	0.5
Total Policies	**39.3**

Sources: JHA, 2006

Life insurance. In this discussion of hybrids of long-term care insurance with life insurance it is assumed that the life insurance involved in a hybrid is most likely whole life insurance, not term life insurance. The number of policies in force for whole life insurance has been difficult to obtain. However, at the end of 2004 the top 25 life insurance companies (ranked by individual whole life and endowment insurance issued in 2004) had almost 77 million individual whole life insurance policies in force.[24]

These estimates (30.9 million, 39.3 million, and more than 77 million for annuities, disability insurance, and individual whole life insurance policies in force, respectively) are many times more than the roughly 6.4 million long-term care insurance policies that were in force at the end of 2002. (Only a small percentage of these 6.4 million policies involved or resulted from hybrids.) It is not clear to what degree legislative and regulatory changes that would facilitate and encourage hybrids would provide a carrot for persons currently holding one or more of these other types of insurance to shift to a hybrid with long-term care insurance. In the case of disability insurance in particular, it would require employers to make the shift. However, for each of these types of insurance it would only take a shift in a minority of policyholders to hybrids in order to produce a significant increase in the numbers of persons who have long-term care insurance. And there may also be people who would purchase a hybrid product who otherwise would carry none of the individual hybrid components.

We can obtain another perspective on this question using estimates by Merlis (2003) for married couples under the age of 60. Using survey data (the 1998 Survey of Consumer Finances) rather than insurance industry data, Merlis estimated that the percentage of couples with what he considered to be "adequate" life insurance increases from 49 percent for household heads age 35 to 44 to 85 percent for 55 to 59 year-old heads (Table 3). And for each of the three age categories approximately 53 percent of the principal

[24] PPI calculation based on Insurance Information Institute, accessed at http://www.iii.org/media/facts/statsbyissue/life/ on 4/12/06.

earners have disability insurance. Merlis did not analyze annuities, but did estimate households with adequate savings, which could be a rough guide to persons who have sufficient assets for it to be feasible to purchase an annuity. These percentages range from 29 percent to 69 percent depending on the age group and whether or not home equity is included in the measure of savings.

Table 3. Percent of Married Couples[a] Meeting Each Specified Criterion of Financial Health Separately, 1998

Age of household head	Households (000s)	Has adequate life insurance	Principal earner has disability insurance	Has adequate savings	
				Including home	Excluding home
35-44	10,323	49%	52%	69%	55%
45-54	10,605	71%	53%	61%	44%
55-59	3,411	85%	53%	55%	29%
Total	**24,340**	**64%**	**53%**	**64%**	**47%**

Source: Merlis (2003).
[a] With either the household head or the spouse actively employed.
[b] Long-term care insurance.

These estimates indicate that the majority of married couples between the ages of 35 and 59 already have one or more kinds of insurance that could be combined with long-term care insurance as a hybrid. Merlis then estimates, separate from all other insurance and spending needs, what percent of married couples could afford long-term care insurance based solely on whether long-term care insurance premiums would be less than a specified percentage of income. Using this narrow criterion he finds that about three-quarters of married couples under the age of 60 could afford long-term care insurance.

While these results might appear promising for the purchase of hybrids, Merlis then analyzes these results in combination. That is, if one assumes that couples should have all of these other types of financial security and insurance before considering long-term care insurance, for what percentage would long-term care insurance be *both appropriate and affordable*? Merlis estimates that only 20 percent of the households in Table 3 satisfy all of the following: have adequate savings including home equity; *and* have adequate life insurance; *and* all family members have health insurance; *and* the principal earner has disability insurance; *and* can afford long-term care insurance.

These results highlight the problems faced by many households when dealing with risks and insurance. We face all too many risks in life, and while insurance can protect against the costs of many of these risks, insurance itself understandably has costs, and purchasing insurance necessarily limits resources available for other purposes, including living expenses, mortgage payments, saving for children's education, etc. It is therefore no surprise that most people pick and choose among the many types of insurance available.

Hybrid insurance products may present one way to achieve a partial and second-best solution to this problem of many important risks against which to insure, but having limited funds available to do so. This "partial solution" might not provide significant payments for two different types of insurable risks should they both occur during the life of the policy. But it does provide for some degree of coverage of different kinds of risks, each of which is unlikely to occur, in a package that may be easier to comprehend or market and may come at cheaper cost than individual policies sold separately.

3.0 HYBRID INSURANCE PRODUCTS AND GOVERNMENT

Insurance and stocks may be regulated at the federal level and/or the state levels. And since some aspects of these insurance products may affect the deductibility of premiums or the taxability of insurance distributions, the treatment of hybrids by government may even affect government revenues.

3.1 Federal and State Laws and Regulations

The combination of regulation at both the federal and state levels can provide a range of protections that result in markets for insurance products that are more consumer-friendly. In addition, different regulators within a single level of government may be responsible for different financial products, or separate portions of a hybrid product. The ways that this environment may make it difficult to create and market hybrid long-term care insurance products is described in the 2005 New York State Insurance Department report:

> For decades … life insurance and health insurance have been regulated by different standards, separate and distinct articles of the New York Insurance Law, and separate and distinct regulations issued by the New York State Insurance Department. … These distinct regulatory constructs for life insurance and health insurance have been developed over the years without regard to each other.
>
> Due in part to the regulatory dichotomy noted above, product development and compliance functions of insurers writing both life and health lines of business have typically been separated. It is not uncommon for a multi-line insurer to develop and establish different operating divisions, and even corporations, staffed with different personnel, for its life insurance and health insurance businesses. In addition, many companies have historically written either life insurance or health insurance to the exclusion of the other.
>
> We believe that the foregoing at least partly explains why we have not seen more of the combination-type products ….[25]

So while hybrid products present opportunities for insurers to increase sales, the process of developing and marketing such products may be difficult as a result of a fragmented regulatory system. An additional source of difficulty may be that while the markets for the other insurance products discussed here are generally mature, the long-term care insurance market is relatively young. The inability to make acceptable profits has resulted in a significant number of companies closing or leaving this line of business in the recent past. In addition, negative publicity about premium increases and denials of service (in the form of post-claims underwriting) are not that far in the distant past. These factors have affected the regulatory environment for long-term care insurance. So companies with stable and successful lines of business in other insurance products may not be entirely enthusiastic about becoming involved in a hybrid product with long-term care insurance.

[25] New York State Insurance Department (2005).

Federal Law

Federal law may present some impediments to truly hybrid insurance products. One example is the definition of a "qualified long-term care insurance contract", which allows favorable tax treatment in several areas similar to that afforded health insurance. The definition requires that such a contract generally cannot "provide for a cash surrender value or other money that can be (i) paid, assigned, or pledged as collateral for a loan, or (ii) borrowed."[26] Since annuities and life insurance (other than term) generally have a cash value, this provision makes it difficult to have a truly unified hybrid policy with long-term care insurance. However, with regard to "any long-term care insurance coverage (whether or not qualified) provided by a rider on or as part of a life insurance contract," the portion of the contract providing such coverage is to be treated as "a separate contract."[27]

Some insurance industry observers have also expressed concern that hybrids of long-term care insurance and annuities might run into difficulties related to Internal Revenue Service requirements governing minimum distributions from annuities that are part of a non-qualified retirement plan. A problem might arise if the start of a cash disability payout, as provided for by the long-term care insurance portion, were to result in a sudden increase in payouts from the hybrid policy at a time much later than the "required beginning date" for payouts under the annuity portion of the hybrid. Starting this higher payout so many years after receiving lower payouts under the annuity portion of the hybrid product might indicate that not enough of a payout was made in the earlier years (of the annuity) to meet the minimum distribution requirements. Penalties could result from such an interpretation.

The Pension Protection Act of 2006

On August 17, 2006, President George W. Bush signed into law the Pension Protection Act of 2006, which contains a section that made federal law, particularly individual tax law, more hospitable to hybrid products involving long-term care insurance and annuities and life insurance.[28]

Tax-free exchanges are possible between annuities and life insurance. This means that money in an annuity can be moved into life insurance without paying taxes, but taking money out of an annuity (by means other than the prescribed annuity payout) for other purposes generally results in the need to pay taxes on at least a portion of the money taken out. The Pension Protection Act expanded the scope of tax-free transfers to also include exchanges of life insurance and annuity contracts for long-term insurance contracts (with some exceptions), as well as tax-free exchanges of one long-term care insurance policy for another. In other words, under this law shifting money around between an annuity or a life insurance policy and long-term care insurance coverage will not result in a distribution out of the annuity or the life insurance policy that would count as taxable income.

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[26] 26 U.S.C. § 7702B (b)(1)(d).
[27] Ibid., Subsection (e).
[28] Public Law No. 109-280, Section 844. Treatment of Annuity and Life Insurance Contracts with a Long-Term Care Insurance Feature.

At the same time that changes were added to increase the ease of purchasing and offering hybrid insurance, the writers of this legislative language apparently wanted to limit the potential decrease in federal revenues that might result from the incentives generated by these new features. As a result, the Pension Protection Act includes provisions related to insurance policy acquisition expenses that replace some of the anticipated lost revenues. Insurance companies are required to capitalize a percentage of their "policy acquisition expenses" for a line of insurance, which means that they cannot write off all of these expenses in the current year (which would generally provide the greatest reduction in taxes). The percentage that insurers are required to capitalize (not immediately deduct) depends on the type of insurance:

- 1.75 percent of the net premiums for a taxable year on annuity contracts;
- 2.05 percent of the net premiums for a taxable year on group life insurance contracts; or
- 7.7 percent of the net premiums for a taxable year on insurance other than annuity or group life insurance contracts.

The Pension Protection Act specifies that an annuity or life insurance contract that includes a qualified long-term care insurance contract as a part of or as a rider to an annuity or life insurance contract shall be treated as belonging to the last of these three categories. Under the new law, for example, only acquisition expenses amounting to 1.75 percent of premiums are required to be deferred for a "plain" annuity policy. But if the annuity is a hybrid with long-term care insurance, then for this hybrid policy acquisition expenses amounting to 7.7 percent of premiums are required to be deferred, resulting in a lower expense deduction and higher current taxes. This increase in the capitalized amount decreases the financial incentives for insurers to offer such hybrids.

The Pension Protection Act deals specifically with hybrids with annuities and with life insurance, but not with disability insurance.

State Regulation

At various points during the history of long-term care insurance, issues have arisen that have brought state insurance regulators to the forefront. One outcome has been the formulation of the Long-Term Care Model Act and Regulation by the National Association of Insurance Commissioners (NAIC), which is revised at intervals by NAIC's Long-Term Care Working Group.

However, states are not required to adopt the model regulations, and even when they do there is no guarantee that any given new insurance product will be treated the same way by all those states that have adopted the regulation. Dealing with multiple state insurance regulatory responses may decrease the incentives to market new products. One firm that attempted to gain approval for a hybrid product of disability and long-term care insurance found that nine states disallowed outright this combination of coverages in the form of a single policy, seven states required the addition of a nonforfeiture option, and three states specified loss ratio requirements.[29] The complicated environment for insurers and financial institutions, including the possible need to satisfy different criteria from state to state, led the American Council of Life Insurers to state recently that "… it can take up to two years for an innovative long-term care insurance product to be approved in all 50 states and the District of Columbia and be sold nationally."[30] The NAIC Interstate Insurance Product Regulation Compact, which has now been enacted in 27 states and is therefore in force, may eventually help expedite multi-state reviews and approvals.

With a hybrid product, not only must the insurer deal with state variation, but also possibly with more than one regulatory department within a state (for example, an insurance commission and a securities regulation agency). This may create another stumbling block for insurers in that they might be required to face an additional level of regulatory review if they attempt to market a hybrid product. As the New York State Insurance Department (2005) has noted:

> Life insurers have indicated a strong disinclination to comply with many of the long term care requirements such as the requirements for minimum benefits, minimum loss ratios, minimum duration, experience rating, guaranteed renewability, extension of benefits and certain disclosure statements. Similarly, some long term care insurers are not licensed to issue life insurance and are unfamiliar with and disinclined to delve into the area of life insurance and all of the related requirements. [31]

3.2 The Effects of Hybrid Insurance Products on Federal Government Revenue and Spending

Increased sales of hybrid long-term care insurance products per se would probably have only a small direct effect on government revenues and spending. For some persons, purchasing long-term care insurance may allow them to deduct some or all of their premium costs as an itemized deduction on their income tax return, if their total health and long-term care costs exceed 7.5 percent of their adjusted gross income. Such deductions, to the degree that they occur, would decrease government revenues. As for government spending, to the degree that increased private long-term care insurance coverage resulted in increased claims payments under these policies, then there could be a decrease in Medicaid long-term care spending as a result of fewer people qualifying for Medicaid, or qualifying but for a shorter period of long-term care service need.[32]

It is not possible to produce an estimate with any confidence on whether this effect would be significant due to many uncertainties. First among these is the unknown degree to which the greater availability of hybrid insurance products would actually increase the purchase of long-term care insurance. Furthermore, if such purchases were to grow, it would be necessary to analyze the income and asset characteristics of the new purchasers

[29] Disability Insurance Specialists, LLC (2002).
[30] Jenner (2006), pp. 10-11.
[31] New York State Insurance Department (2005),
[32] There could also be decreases of a smaller magnitude in Veterans Benefits and Medicare payments.

to estimate the possibility that they would eventually have required long-term care and otherwise would have become eligible for Medicaid.[33]

The provisions of the Pension Protection Act that are intended to facilitate the purchase of long-term care insurance hybrids could affect government revenues. We can obtain some sense of these potential effects by examining HR 2830, the version of the Pension Protection Act that was passed by the House of Representative in 2005 and that included the relevant provisions related to hybrids of long-term care insurance with life insurance or annuities. The United States Congressional Budget Office (2005) reported that the Joint Committee on Taxation estimated that these hybrid-related provisions would decrease revenues by $1 billion over the 2006 to 2010 period and by $8.6 billion over the 2006 to 2015 period.

[33] The same issues will also in part determine whether or not Partnership long-term care insurance policies will result in any significant savings to the Medicaid program.

4.0 THE LOGIC OF HYBRIDS AND COMPLEX DECISIONS FOR CONSUMERS

The desire to insure against long-term care risk competes with the need to insure against the many other risks we face in life. When balancing living expenses and other current needs against paying for health insurance, life insurance, disability insurance, future retirement income needs, and potential future long-term care needs, many people may have reason to believe that spending for long-term care insurance is not a viable option. This result is also more likely to the degree that some people are in denial about or have misinformation about their potential long-term care needs and/or the degree to which government programs will pay for long-term care.

Even if we just look at post-retirement objectives, there are many trade-offs to consider. For example, the purchase of an annuity will guarantee some level of income for as long as a person lives. However, the possibility of a significant disabling event might create a desire to retain the flexibility to spend a large portion of savings in just a few years. This flexibility becomes more limited when savings are converted to annuities.

Therefore, while government policies may make hybrid products with long-term care insurance more attractive or easier to purchase, these changes may still not have an appreciable effect on the number of individuals who purchase long-term care insurance. As described earlier, only small cost savings have been estimated for an annuity/long-term care hybrid, and there is little reason to expect that savings will occur for hybrids with life or disability insurance beyond savings in administrative costs and possibly in underwriting. So if hybrid products are to increase the overall level of long-term care insurance, the appeal of this insurance needs to be based on additional foundations.

Careful thinking and analysis may be needed to determine the best combination of unrestricted savings and various types of insurance (including annuities) for each individual. But learning about the magnitude of risks that consumers face is time consuming and complicated, and a multitude of options are available to deal with these risks. Life insurance, annuities, disability insurance, and long-term care insurance are each complex products in their own right. The number of features, options, and levels of coverage can yield a bewildering array of choices, and such flexibility and choice can be daunting. With a hybrid insurance product, these choices may expand greatly, making it difficult to make confident decisions with a true understanding of the costs and benefits of each feature chosen.

Many people do make intelligent choices when buying the types of financial products discussed in this report, in spite of the complexity of the decisions they face. However, in some instances (such as the Medigap insurance market for Medicare), public policy has been exerted to simplify choices, with the expectation that this simplification will result in a clearer understanding and better choices overall.[34] Similarly, it might be the case that limiting hybrid policies to a reduced number of specific types could provide a

[34] According to Rice and Thomas (1992), one of the objectives that was balanced in Medigap reforms was "simplifying the market to facilitate comparisons among policies".

useful simplification of both a complex decision-making process and the education process that precedes it.

The first part of this section discusses issues that may make hybrids more or less appealing to consumers. The second part lays out some consumer perspectives on each of the insurance products with which long-term care insurance may be combined in a hybrid product.

4.1 Characteristics of Hybrids That Affect Their Potential Appeal

Psychological Considerations

There appear to be psychological issues at play when some people consider long-term care insurance. Most analysts believe that the most important risks to insure against are catastrophic risks – that is, an expensive and lengthy episode of medical care, a huge loss of property such as a house burning down, a permanent loss of income to a family resulting from the death of the breadwinner, etc. This is often called “back end” coverage, as it is not primarily directed at “first dollar” coverage or small levels of loss.

With health insurance, most people make claims against their insurance each year. Each year the insured may have some initial care the cost of which is not covered by the policy, but after this deductible amount is met his/her health insurance provides at least partial payment for subsequent health care expenses throughout the year (although it may not always cover truly catastrophic levels of needed care). Insurance for long-term care may be viewed as covering expenses similar to health expenses, but many policyholders will not make claims against their long-term care insurance until decades after the initial purchase of the policy, and many might not ever make any claims. Rather than viewing their premiums as having paid for insurance against a catastrophic risk that (fortunately) never came, some consumers may feel that they have “lost” or “wasted” all of their premium payments, even though they probably do not adopt similar perspectives towards home and car insurance.[35]

As noted above, some people also are in denial or are misinformed about long-term care—thinking that they will not need it, or that Medicare pays for it, or they associate it solely with nursing home placement and thus see long-term care insurance as something to avoid.[36]

Hybrid insurance products are one way to “add value” and make long-term care insurance more appealing with regard to these psychological issues. The New York State Insurance Department (2005) conducted a focus group that found that:

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[35] “… most people have only limited resources, and many are unwilling to purchase insurance where the policy offers no accumulation feature; i.e., where the premiums paid are lost to the policyholder if the insurance is not used. Without some sort of “savings” feature, consumers with limited resources often were not willing to purchase insurance, including long-term care insurance, even though they recognize its importance.” Jenner (2006), p.8.

[36] Roper ASW (2001).

> [t]he demand for long term care products would be enhanced by the availability of insurance policies combining elements of life insurance or disability insurance with long term care insurance. Many consumers, particularly those in younger age brackets, appear to be discouraged from buying traditional long term care insurance by a concern that the premium dollars are "wasted" if in fact long term care is never required.[37]

Insuring Against Competing Risks

As described above, there are many risks against which a person may wish to insure – too many for most people to fully insure against each risk. The discussions of each type of hybrid showed that the hybrids that currently exist often do not in practice provide a high level of protection against, for example, both long-term care needs and disability, should they both occur during the life of the policy. Rather, they provide a high level of protection for one risk, but at some cost to protection against the other.

It appears that full-fledged hybrids that fully insure against the risks covered by each part of the hybrid are rare in the marketplace. This may indicate that one potential appeal of hybrids is that they allow the purchaser to buy one policy that insures against two risks. The policyholder does not have full coverage should both risks occur. Rather, the insurance provides the flexibility of paying out depending on which event occurs first and needs reimbursement.

Timing Issues

If a hybrid insurance product is to appeal to consumers, it should make sense in terms of *when* during their lifetimes consumers would want to purchase each of the components of the hybrid. It is often stated that it would be beneficial for people to buy long-term care insurance earlier in life than is generally the case. One rationale for this view is that the premiums are lower when this insurance is purchased at younger ages. It is not clear that this is a strong justification: on the one hand the premiums are lower; on the other hand the premiums will likely be paid over more years. A better argument is that earlier purchase of long-term care insurance guards against the increasing possibility that with age one might not be eligible for this insurance due to the development of chronic health conditions, given insurers' underwriting practices.

Would hybrids encourage purchase of long-term care insurance earlier in life? Both disability and life insurance are typically purchased at younger ages than long-term care insurance. So if hybrids of long-term care insurance with either of these two types of insurance were marketed to persons at ages when disability and life insurance are normally marketed, these hybrids could have a beneficial effect of encouraging earlier purchase of long-term care insurance than is generally the case today. However, some hybrids of life and long-term care insurance are marketed to older persons who have accumulated sufficient savings to be able to afford to purchase policies with a sizable single premium.

[37] New York State Insurance Department (2005).

New employees often have an orientation at which they are provided with information on available fringe benefits. Employers also usually have an "open season" when employee benefit options can be changed, and during which there may be an educational component. In addition to providing opportunities for long-term care to be considered as part of overall retirement planning, these discussions might allow for improved communication about the benefits and costs of long-term care insurance that is combined with disability or life insurance, especially since few employers currently offer long-term care insurance by itself.

It is less clear whether the ages at which people might consider purchasing annuities would provide constructive incentives for considering long-term care insurance in a hybrid product. As is discussed below, a fixed annuity might not be the best investment choice for persons in their 40s or 50s, given their average life expectancy. There may also be consumer concerns about purchasing variable annuities earlier in life, especially given the investment alternatives that are often available to employed persons.

4.2 Consumer Perspectives on the Insurance Products That May Be Combined in Hybrids

Consumer Perspectives on Long-Term Care Insurance

As was briefly described in Section 2.1, the decision to purchase long-term care insurance is complicated all by itself, involving many policy characteristics before it is combined with another insurance product. As a result, long-term care insurance presents a range of consumer issues. Probably the most important is that buyers of long-term care insurance will likely make choices based on comparisons of current premiums to policy features, and on the affordability of paying premiums on a policy for many years, but they cannot be certain that premiums will not be increased by the insurer. While insurers cannot raise premiums for a specific individual, they can raise premiums for a *group* of policyholders should an insurer's underwriting calculations prove to be inaccurate for this group—that is, if the intensity of use of long-term care by those insured who need services increases at a greater rate than expected, returns on the insurer's investments are lower than expected, or more policyholders use long-term care services than were projected.[38]

Consumer Perspectives on Life Insurance

Cash value life insurance is really a hybrid financial product by itself. It is an insurance policy against the death of the policyholder combined with an investment vehicle. Therefore, it is important to consider the characteristics of the investment—in particular its rate of return—and the potential motivations for a person to purchase cash value life insurance.

Some observers have questioned the quality of this investment vehicle. For example, one media company that provides investment advice has written that "James Hunt, actuary for

[38] AARP has several publications that discuss long-term care insurance in more detail—in particular, see Burns (2006).

the Consumer Federation of America, who has analyzed thousands of policies, notes that whole life policies hardly ever yield a reasonable return unless held for 20 years or more."[39] Because cash value insurance policies may include high fees and commissions, it may be difficult to tell what the return on the investment will be.

As a result, some consumer organizations recommend that life insurance and savings products be purchased unbundled. That is, a person should buy term life insurance if needed, and also separately consider the range of investments available to them: 401(k)s, IRAs, mutual funds, annuities, etc. Premiums for term life insurance are relatively low for people in good health up to about age 50, although after that age premiums start to get progressively more expensive. Also, policyholders can cancel a term life insurance contract at any time to replace it with a less expensive equivalent—providing their health remains stable.

Nevertheless, some people may have trouble saving for a range of future needs. Having the requirement of regularly paying premiums on a cash value life insurance policy may result in savings with some positive rate of return that would otherwise not happen at all.

Term life insurance can also have its pitfalls. Companies may sell term policies that guarantee a premium rate for only a relatively small number of years. In these cases, after the initial period ends the insurer may charge one of several higher rates filed with the state insurance commissions.

The type of hybrid of long-term care insurance with life insurance that was discussed in Section 2.2, and that generally involves a large single premium, is unlikely to be a financially feasible option for most people well below retirement age. Indeed, most marketing of this type of product appears to be primarily directed at persons who have significant assets and are willing to sequester a portion of these for the combined goals of leaving a bequest and/or paying for long-term services and supports.

Accelerated death benefits represent a realistic type of hybrid between long-term care and life insurance only if one of the triggers allows for payments for assistive services and supports for persons with chronic disabilities, and if the value of the life insurance is sufficient to provide a meaningful level and duration of payment for needed long-term care. Another consideration regarding an accelerated death benefit option is that the appeal of such an option may not fit well with the need for the life insurance to which it is attached. One reason to purchase life insurance is to provide financial security for persons who were dependent on the policyholder while he/she was alive. As a person ages, the number of dependents typically decreases, thereby reducing the need for life insurance. However, the need for long-term care insurance increases with age.

The onset of a disability is roughly correlated with a shorter remaining lifespan (all other things equal). Therefore, it would seem that the probability of using life insurance is positively correlated with using long-term care insurance, meaning that there would be no expected cost savings resulting from offsetting risks for a hybrid product of these two

[39] Smart Money (2006).

insurance types. However, some small cost savings might be obtained from the joint underwriting and administration of these two types of insurance.

Consumer Perspectives on Annuities[40]

A consumer needs to evaluate several aspects of annuities—their costs, their suitability for specific savings objectives, the attractiveness of their rates of return compared to alternative investments, and their safety.

Variable annuities, in particular, have received attention in recent years. The U.S. Securities and Exchange Commission (SEC), which regulates variable annuities at the federal level, cautions that the purchase of a variable annuity may involve several types of costs in addition to the indirect payment of fees and expenses imposed by the mutual funds that are the underlying investment options for the variable annuity. These charges can include:

> *Surrender charges,* which apply if one withdraws money from a variable annuity within a certain period after it is purchased.
>
> *Mortality and expense risk charges,* which are equal to a certain percentage of the account value, typically in the range of 1.25 percent per year. These charges compensate the insurance company for the risks the insurer assumes under the annuity contract. Profits from the mortality and expense risk charges are sometimes used to pay the company's costs of selling the variable annuity.
>
> *Initial sales load charges*. These are additional sales charges made at the time the annuity is purchased.

In summary, the SEC cautions that "these charges will reduce the value of your account and the return on your investment" and that financial professionals who sell variable annuities have a duty to advise the consumer as to whether the product they are trying to sell is suitable to his/her particular investment needs.[41] For example, these costs may outweigh the benefits if the purchaser does not hold the variable annuity as a long-term investment. In addition, the purchaser may have to pay a 10 percent federal tax penalty if he or she withdraws money before the age of 59½.

For these reasons, the SEC cautions that:

> Other investment vehicles, such as IRAs and employer-sponsored 401(k) plans, also may provide you with tax-deferred growth and other tax advantages. For most investors, it will be advantageous to make the maximum allowable contributions to IRAs and 401(k) plans before investing in a variable annuity. … In addition, if you are investing in a variable annuity through a tax-advantaged retirement plan (such as

[40] Much of this section is either paraphrased or quoted directly from U.S. Securities and Exchange Commission (2006).
[41] The SEC website (http://www.sec.gov/investor/pubs/varannty.htm) presents a list of questions to ask before buying a variable annuity.

> a 401(k) plan or IRA), you will get no additional tax advantage from the variable annuity.

However, there is recent anecdotal evidence of competitive lowering of the overall level of fees and charges for some offerers of annuities.[42]

At the state level, variable annuities are treated as securities by the laws of some states, as insurance products in other states, and as both insurance *and* securities in yet other states.[43]

Although *fixed annuities* are comparatively more straightforward, they also need to be considered carefully in relation to investment objectives and other options. In the simple variant of a fixed annuity (where a person makes a single large payment and in return receives a fixed stream of benefits for however long one lives), the residual value of the annuity at the time of death is zero. If an individual has a life expectancy of several decades at the time he or she is considering a purchase, then the consumer may also want to think about the trade-offs with other options such as government bonds. Bonds may provide somewhat smaller payments but at death will have a high probability of returning to the estate almost all of the initial investment, instead of having zero residual value.[44]

Many factors come into play in evaluating fixed annuities against other financial alternatives. These factors include: remaining life expectancy, the desire to leave assets to beneficiaries after death, and the desire to retain flexibility to access savings in response to significant life events. The greater the life expectancy, or the greater the interest in leaving assets after death, or the greater the desire to retain financial flexibility, then the less appealing fixed annuities will be. This is in part because the longer the life expectancy, the smaller the difference between an annuity payout and alternative investments that provide flexibility and a significant residual value at death.

Consumer Perspectives on Disability Insurance

Several features of a hybrid product that combines coverage for both disability income replacement and disability service needs might make such a hybrid attractive. The primary one is that people might be more likely to obtain long-term care insurance earlier in their lives. It has been very difficult to get even middle-aged people interested in protection that will most likely be needed (if at all) in their 70s or 80s. However, most disability insurance is provided through employers (that is, during a person's working life), and in some cases orientation sessions are provided to assist workers in making decisions about fringe benefits and insurance elections. In this context, people might be more receptive to an insurance policy that partly covers both earned income replacement

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[42] Opdyke (2006)
[43] Struck (2006).
[44] Ronan (2006) takes a positive perspective on fixed annuities but cautions that:

> After comparing annuity quotes, it is highly advisable to compare the cash flow projections to those of a laddered bond portfolio (a series of fixed-income instruments with a range of maturities) to see where the greatest return advantage lies. … Income portfolios can also be constructed to adjust for inflation and if their owners die, the assets obviously go to heirs not the brokers who manage them.

when a disability develops and payment for long-term care service needs over a lifetime—in essence, a one-stop shop for the financial stresses of developing a disability. And as was noted, purchase at an earlier age generally lessens the probability of being rejected by underwriting criteria.

Another feature that might recommend this type of hybrid is that it could offer an appealing premium structure over an individual's lifetime. As a person nears normal retirement age, the disability income component becomes less appealing since most disability policy payouts end at age 65 when Social Security retirement benefits begin.. With simple disability insurance, this might lead the consumer to cancel the policy. However, as a person ages with a hybrid policy, a fixed premium could increasingly go towards insuring for long-term care needs, the probability of which increases with age. And because neither disability insurance nor long-term care insurance involves an investment component such as that found in cash value life insurance or annuities, some areas of consumer concern for these products are lessened.

Nevertheless, there are issues related to taking a long view of guaranteeing continued insurability and adequate benefits across a long span of years. Some of these issues relevant to disability insurance include:

- Whether the insurer can terminate or not renew coverage for an individual;
- Whether the policy is structured to allow long-term care benefits to increase over time;
- Whether and how much the insurer can raise rates over time and/or change other significant characteristics of the policy;
- Whether there are provisions in an employer-based policy that allow for continuation of the insurance after the policyholder leaves an employer; and
- Whether the policy is issued by a financially sound company, since the disability insurance may be held for decades.

5.0 CONCLUSIONS

We face many financial risks in the later years of our lives. Some of these are “positive” risks such as the financial requirements for a long healthy life after retirement. But most are “negative” risks—for example, an early death while supporting dependents, high medical expenditures, or an extended need for long-term services and supports. Individuals may choose to insure against some or many of these financial risks, and society may choose to become collectively involved through either mandatory or voluntary government programs.

Each type of risk can be insured separately, and this will generally be the clearest way to know how the cost of insurance compares to the event being insured against. Insuring separately for separate events may also may it easier to compare alternative policies.

However, there are enough significant risks that even persons of moderate means may find it difficult to insure against all of them. This is particularly true with regard to insuring against outliving one’s resources, because insuring against this eventuality through the purchase of an annuity may tie up a significant portion of one’s resources. Therefore, combination insurance and financial products may be appealing. This report has analyzed hybrids of long-term care insurance with life insurance, annuities, and disability insurance. Below are some general conclusions.

*Hybrid insurance products with long-term care insurance do not offer substantial pure economic appeal***.** Premium savings have been estimated for hybrids with fixed annuities, compared to purchasing each product separately, because of offsetting risks. But the magnitude of these savings is small. There is no clear evidence of savings in joint premium costs for other types of long-term care insurance hybrids. However, there may be savings in administration, processing, and commissions for hybrid combinations, especially those that involve similar underwriting reviews for both portions of the hybrid.

Long-term care hybrids may be appealing mostly for informational and/or psychological reasons. Since there is a range of insurance products that may be appropriate for any individual, educating oneself about these products and applying for the insurance in a single combined informational and application process may be more efficient. Hybrid products may also overcome the negative perceptions of long-term care insurance and particularly of the prospect of paying premiums to insure against events that people hope will never occur (“wasting premium payments”), especially disabilities that may not develop until decades after the insurance is purchased, if at all. Hybrids with whole life insurance or annuities allow for some benefit or residual cash value even if the policyholder never needs long-term care, and may help motivate the payment of premiums for possibly decades before a policyholder does need long-term services and supports.

All of the hybrid products can be tailored to the preferences of specific consumers. However, greater flexibility can easily translate into greater complexity, which may also lower consumers’ comfort levels generally with hybrid products.

There appear to be few long-term care insurance hybrids with disability insurance, but these are worthy of further study. Such hybrids would allow the prospective policyholder to evaluate in a coherent process the potential need for income lost due to disability and the need to pay for services that may result from developing a disability. A single insurance product could then be bought that would insure against much of this combined risk. With the average purchase age for long-term care insurance declining and long-term care insurance being offered by more employers, the fact that most disability insurance is obtained through employers may become a less significant obstacle. Hybrids with disability insurance may also present fewer consumer-related concerns in that they do not include an investment/savings component that would need to be evaluated relative to other financial options available to an individual.

If the number of people already purchasing separate life insurance, annuity, and disability insurance products indicates something about the potential market for insurance that combines any of these types into a hybrid with long-term care insurance, then well-constructed hybrid policies may have some appeal to consumers. Given the relatively low rates of long-term care insurance purchase, even a small increase in the number of people with long-term care insurance would be a significant result.

Many of the insurance products that long-term care insurance might be combined with in hybrid policies would require a better educated consumer in order to make the financial decision that is best for him or her. This is particularly true with regard to whole life and annuity products that involve saving for future needs, and where an informed choice depends on when the savings will be needed and what other options are available to the consumer, especially other tax-favored or employer-subsidized options. Similarly, hybrid products will also require better educated and trained insurance agents who are knowledgeable about more than one kind of product and how these products interact. The complexities of the various types of insurance, which may be compounded in a hybrid, can become an obstacle to good decision-making.

If the marketing of hybrid products increases, in part as a result of the Pension Protection Act, then efforts need to be made to protect and educate consumers about the pros and cons of such hybrids, in order to insure that the result is better and more appropriate choices regarding the potential costs of long-term care in later life. Some standardization of hybrid products may be one approach to lessen some of these consumer concerns.

The need for government to provide protections to consumers in the face of increasingly complex financial decisions, with respect to long-term care insurance and otherwise, is real. A recent article quoted Securities and Exchange Commission Chairman Christopher Cox as saying “protecting seniors from investment scams was an issue of mounting concern.”[45] The article specifically expressed concerns about “investment seminars” with free meals, noting that:

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[45] Farrell (2006).

> In recent years, more and more of these so-called free lunch seminars have been exposed as high-pressure sales pitches designed to get older Americans to put their assets into unsuitable investment programs, such as annuities.[46]

Similarly, Patricia D. Struck, Wisconsin Securities Division Administrator and President of the North American Securities Administrators Association (NASAA), testified before the Senate Special Committee on Aging that she and her colleagues are currently seeing a proliferation of troubling schemes in three related areas: (1) "senior specialists" who provide financial advice to older persons but who are not properly licensed by state securities regulators; (2) "unlicensed people selling unregistered securities"; and (3) variable annuities. Struck describes problems with variable annuities as follows:

> A perennial fixture on NASAA's annual list of top scams involve the sale of variable annuities to investors with little regard to whether or not the product is suitable. While these are legitimate and suitable investments for some, regulators are concerned that many investors aren't being told about high surrender charges for early withdrawals, the potential of exposure to market risk, and the steep sales commissions agents often earn when they move investors into variable annuities. Often pitched to seniors through investment seminars, these products are unsuitable for many retirees.[47]

The American Council of Life Insurers has also condemned what it termed "inappropriate sales".[48]

So far, private markets have not been able to achieve a high level of protection against the cost of long-term care needs through the sale and purchase of long-term care insurance. It appears that in order to increase voluntary private long-term care insurance purchase from present levels some additional incentives are needed. It remains to be seen whether providing a more supportive tax and regulatory environment for hybrid products with long-term care insurance provides a significant incentive. At the same time, oversight of such products will need to be strengthened, in order to make sure that improved insurance options translate into improved overall financial security.

[46] Ibid.
[47] Struck (2006).
[48] American Council of Life Insurers (March 29, 2006).

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