AARP® Public Policy Institute

IN BRIEF

In Brief: Can 1 + 1 = 3? A Look at Hybrid Insurance Products with Long-Term Care Insurance

Introduction and Purpose

This *In Brief* summarizes the findings of the AARP Public Policy Institute report, *Can 1 + 1 = 3? A Look at Hybrid Insurance Products with Long-Term Care Insurance*, by Marc Freiman. Few people have purchased private long-term care insurance, but there is continuing interest in increasing the number of persons who have such insurance. One approach to increasing its appeal is the offering of "hybrid" products that combine long-term care insurance with other insurance products. For example, the Pension Protection Act of 2006 includes provisions that make the tax laws more hospitable to hybrid products involving long-term care insurance and annuities or life insurance. This report discusses hybrids of long-term care insurance with life insurance, annuities, and disability insurance.

Principal Findings

Almost all of the individual insurance components discussed here are complicated in their own right. Therefore, 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. These types of insurance also present potential issues from a consumer perspective. This is one reason why long-term care insurance, life insurance, disability insurance, and annuities are regulated at the federal level, the state level, or both.

Currently, there are a limited number of types of hybrid long-term care insurance products in the marketplace. One simple type of hybrid of life insurance with long-term care insurance is an *accelerated death benefit*, 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 long-term care services). 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.

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.

For full report, see AARP Public Policy Institute Paper #2007-11
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INB141

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

In one example of a combined disability/long-term care coverage 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 of the consumer at the time of conversion.

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, and many people decide that purchasing long-term care insurance is not a viable option. This outcome is 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.

One potential appeal of hybrids may be that they allow the consumer to purchase one policy that insures against two risks, even though coverage is likely to be limited should both risks occur. 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. By incorporating another insurance product that is perceived to have value, hybrids may also overcome some psychological barriers for those consumers who may feel that they have “lost” or “wasted” all of their premium payments if they do not make claims against their long-term care insurance until decades after the initial purchase of the policy, if at all. And some hybrid products may also have a benefit of encouraging purchase of long-term care insurance earlier in life, when one is usually less likely to be denied coverage.

Nevertheless, it is highly doubtful that insurance hybrids alone can solve the basic societal problem of how to pool long-term care risks. For one, 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.

Hybrid insurance products will require a better educated consumer in order to make the financial decision that is best for him or her. Providing government protections to consumers in the face of increasingly complex decisions regarding long-term care insurance is a real need that must be addressed.