

Department of Labor and Department of the Treasury

Re: RIN 1210 – AB33

Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

These comments are submitted by Cary Lakenbach FSA, MAAA. These comments represent my personal comments and do not reflect the views of any group that I am currently or have been affiliated with. Information about me is included as Exhibit A.

I wish to commend the Department of Labor and the Department of the Treasury for issuing this Request for Information. These issues are complex and particularly important to individuals who have only DC plans.

Question 15 requests commentary regarding the advantages and disadvantages of approaches that combine annuities with other products, and requests guidance regarding their prevalence in the marketplace.

My firm, Actuarial Strategies, and I have specialized in the area of combination life and long term products for some fifteen years, and specialized in the area of combination annuity and long term care products since approximately 2003. We believe we are a leading developer of such contracts within the United States.

These time frames are primarily tax act related. HIPAA, the Health Insurance Portability and Accountability Act of 1996, became effective in the beginning of 1997. While the provisions of the Act are broad, the specific provisions of interest here gave rise to the definition of a Qualified Long Term Care Insurance Contract (QLTCI). HIPAA stated that both standalone long term care insurance contracts (i.e., contracts which only cover long term care needs) and appropriately defined riders to life insurance contracts could be considered QLTCI by law. If the LTC (standalone or riders) contracts meet the relevant requirements, their benefits are received income tax free.

In 2006 the Pension Protection Act (PPA) became law. Certain provisions of it relate to long term care and became effective January 1, 2010. Most importantly, these provisions have enabled the sale of qualified long term care riders within annuities. Such annuities may be either immediate (i.e., paying regular income)

or deferred (effectively a tax-deferred accumulation account with provisions for annuitization.) A key consideration, however, is that the legislation enabled QLTCI to be sold only in non-tax qualified accounts. Annuities sold within Tax Sheltered Accounts (403(b)), 401(k)'s, and IRA's, for example, are excluded from the provisions of the law relating to combination annuities.

I believe that consideration should be given to enabling the use of combination annuities within such tax-qualified accounts. Why is this desirable? The discussion can be grouped into these categories:

- A. Demographic Considerations**
- B. Experience with the Standalone Long Term Care Policy**
- C. A Discussion of the Combination Annuity**
- D. Specific Issues Relating to the RFI**

A. Demographic Considerations

1. **Americans are aging.** It is well known that the first of the Baby Boomers are reaching what has been considered normal retirement ages (e.g., 65.) This population overall is huge. In 2010, there are approximately 55 million Americans 55 and above, and that number will grow to 70 million by 2020.
2. **Americans are living longer.** Life expectancy has moved up to approximately age 83 (for those aged 65.) Americans can thus expect to live longer during retirement.
3. **Americans incur significant long term care expense.** The national average cost in a nursing home for a private room was \$74,000 in 2009. Huge geographic variations exist, however. Perhaps the highest average state cost is Hawaii's, where the cost is a staggering \$152,000. It is known that Americans prefer to live in their own homes as long as possible. Costs, while high, there are more moderate, with a national average of \$24,000 for an individual who receives 5 services 5 times a week.

B. Experience with the Standalone Long Term Care Policy

4. **Standalone Long Term Care Insurance is very expensive.** A 65 year old wishing to buy 4 years of coverage that would provide a range of benefits at levels sufficient to cover the national average for nursing home expense in 2009 would pay at least \$2,500. (The policy benefits would not grow with inflation.)

5. **Standalone Sales have plummeted in the last few years.** Individual sales have fallen from a level of 750,000 policies in 2002 to about 200,000 in 2009. The drop has been consistent over this time period, not sudden.
6. **Reasons for Sales Drop.**
 - a. As noted these policies are very expensive, and economic factors certainly do come into play.
 - b. It is hard for Americans to make a choice to address issues that may not surface for ten or more years when they have other pressing needs.
 - c. Furthermore the vast majority of these policies do not build any internal value (such as a return of premium provision) so should the insured die without having incurred any long term care expenses, he will not have received any benefits. (This is known as “Use it or lose it”, and is a commonly stated reason why individuals choose not to purchase this coverage.)
 - d. The underwriting for this product is very difficult and very lengthy, and Americans feel the likelihood of acceptance by the insurer is not great.
 - e. Over the past ten years especially, there have been a number of high profile very significant rate increases by insurers.

C. A Discussion of the Combination Annuity

7. **Combination Annuity Design.** A combination annuity as noted can be a deferred annuity and an LTC rider, or an immediate annuity with an LTC provision. All sales are currently of the single premium type.
8. **Deferred Annuity with LTC Rider.** This is the prevailing product currently being developed. The deferred annuity may have the very same features of annuities which do not include the LTC rider, or there may be some special annuity features. The point is that all the purposes for which an annuity is purchased continue to apply when a combination annuity is purchased. These include tax-free growth in the account, potentially some valuable investment guarantees, and potentially a death benefit guarantee of some sort.
 - a. **The LTC benefit provides additional value (beyond that of the annuity) when the insured becomes chronically ill.**
 - b. **In most contracts developed to date, when insureds become chronically ill, such additional value is paid out after the annuity value is paid out.** Although this may seem like a disadvantage, after all the insured is simply getting his value back first, the design addresses two extremely important objectives. The first is that it **lowers costs**, as the insurer’s exposure to loss is

deferred or lowered, much the same way as a deductible in auto insurance works. Secondly, the deferral of risk payment enables the insurer to offer the coverage using simplified underwriting techniques **enabling a bigger portion of the population to qualify for coverage.**

- c. **The annual cost of such an annuity is much lower than the standalone.** The coverage described in section 4 would cost approximately \$700, compared to the standalone cost of \$2,500. This makes the product affordable for more Americans.

9. Immediate Annuity plus LTC. This kind of design is potentially of much greater interest in retirement plans.

- a. **The sale of immediate annuities generally has some pockets of significant success, but overall sales are tepid.** One major reason from a consumer point of view is the loss of an inheritance value (annuities offer options that provide some insurance proceeds upon “early death”.) A second reason is the lack of flexibility in such offerings. They do not adjust when an annuitant’s circumstances would call for changes.

- b. **LTC provisions.** Combination immediate annuities are at an early stage of development. A typical design would increase the otherwise determined periodic payout (e.g., \$1,000 monthly) to some higher amount (e.g., \$4,000 monthly) should the insured become chronically ill. Coverage can stay at such level while the insured is chronically ill or may be subject to a limited benefit period. The issue is one of cost.

10. Who can buy a combination annuity?

- a. The target market for this business is perceived to be 55 to 70. In other words, we are talking about pre-retirees and retirees.
- b. To buy such an annuity an applicant must have some amount of assets that he is able to invest in a combination annuity. A considerable number of Americans would be able to buy such an annuity, but clearly many others would not have the requisite assets.

D. Specific Issues Relating to the RFI

- 11. **Enabling defined contribution plans to purchase combination annuities would free up a major source of assets not currently available to prefund for one’s long term care costs. As noted, current law does not allow for combination annuities in qualified plans.** The only way one can pay for LTC using qualified funds is if the

retiree takes a withdrawal from the qualified plan to fund LTC insurance. Taxes would have to be paid, and as noted the coverage is expensive.

- a. **One could correctly point out that an applicant could take a withdrawal today to fund a (cheaper) combination annuity.** I believe this is unlikely. There are simply too many steps.
 - b. **Freeing up such money within the qualified plan makes sense.** After all, the purpose of the accumulated assets is to help the retiree address his living expenses during his retirement years.
 - c. **In the annuity marketplace approximately half of all funds held by insurers are funds held in qualified plans.** Thus, the impact would be significant.
12. **Specific issues relating to immediate combination annuities.** I believe that it would be feasible to develop a combination annuity for use within certain qualified plans that would not require underwriting. There may need to be some limiting conditions present to preclude the effects of anti-selection, but employment relationships would do much to limit, although not necessarily eliminate, such anti-selection in the first place.

Exhibit A

Cary Lakenbach, F.S.A., M.A.A.A.

Cary Lakenbach is an actuary, consultant, writer, and speaker, and is a nationally and recognized expert on the subject of combination annuities, and combination products generally.

Cary Lakenbach founded Actuarial Strategies in 1991. Actuarial Strategies has gained recognition for its creative product development capabilities as well as its solid core actuarial, financial, and marketing and distribution expertise. It is a leading firm in the area of combination products.

Cary's recent work has centered on such Integrated Annuity and Long Term Care offerings, a natural continuation of the work the firm has done on life and LTC combinations since HIPAA became effective in 1997. The services provided by the firm in this market segment are comprehensive and are both actuarial and non-actuarial, including (a) Market Research, (b) Feasibility Studies, (c) Contract Designs, (d) Pricing / Financial Analysis, (e) Development of Underwriting and Claims Operations (Directly or with Vendor), (f) Tax Analysis, and (g) Systems and Testing Support.

Cary is a member of the Hartford Actuaries Club, a charter member of the Society of Actuaries Foundation, a member of NAVA, and has served on a number of industry group task forces. His education includes a BS degree from the City College of New York and an MA degree in Mathematics from Syracuse University. Cary writes for the National Underwriter and other publications and presents often at LIMRA, IRI-NAVA, and SOA conferences.