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The Advanced Consulting Group

White paper

Enhancing the value of your Insurance-based Income Solution with the Nationwide® LTC Rider

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When financial professionals think about educating their clients on the tax preferred advantages of using an Insurance-Based Income Solution (IBIS) to provide supplemental retirement income, they seldom think of long-term care (LTC) needs in conjunction with this particular type of planning. Among the reasons for this:

- The financial professional is explaining the use of an IBIS to a relatively young client looking for additional ways to save tax preferred dollars. It may also be assumed that the typical IBIS prospect is in an age bracket not interested in discussing LTC needs.
- The financial professional may understand in general the value of a LTC Rider, but might assume the cost of insurance on the rider could greatly drag down the cash value and thus the available income from withdrawals and loans from the policy; and that the LTC Rider may not be worth adding with the possibility of paying for something you may never use.

It may help to begin with some information about the need for long-term care. For people age 65 and older, the chance of needing LTC is around 70%.[1] Of those needing care, approximately 52% will be able to receive care from home health care services. Another 20% of patients will receive care in assisted living, and 28% in a nursing home.[2] While the costs of these services seem less expensive than nursing home care, keep in mind the following facts.

- The average annual cost today of nursing home care is $90,500 for a private room[2]
- The average annual cost today for an assisted living facility is $42,750, but claims periods are almost that of a nursing home claim[2]
- The average home health care costs today are running over $21 per hour[2]

While the typical IBIS prospect is not thinking about his or her long-term care needs, the above statistics show that some thought into these needs should be addressed and planned for. There are basically three ways to pay for long-term care – lifestyle, income and insurance; and insurance is the most cost effective way to pay. Adding the Nationwide Indemnity Long-term Care Rider (available on select Nationwide life insurance policies) to an IBIS makes sense for several reasons. The LTC Rider may possibly make a great beginning to LTC planning in that "something" is in place that allows a tax free collection of death benefit should an unforeseen tragedy occur while the insured is still young, or becomes uninsurable in later years before LTC needs are more formally addressed.

A more compelling reason to add the LTC Rider is the opportunity the rider presents to actually enhance the income value of the IBIS. The LTC Rider is less expensive to add to a maximum funded life insurance policy due to a smaller net amount at risk, and therefore has an insignificant effect on the income steam the policy may be able to provide in retirement. Of course, when implementing this concept, you'll want to use a policy that provides an opportunity to accumulate and grow cash value – which could include Variable Universal Life. The

IBIS policy with a LTC Rider will average about 2% less income per year than a policy without the rider. However, should your client actually need long term care, having a LTC Rider could allow for a significant amount of additional money to be pulled from the policy. How much this amount would be would depend on when long term care was needed in comparison to when income from the policy was taken.*

The monthly LTC benefit is paid via an accelerated death benefit – not withdrawals or loans. Cash value remains in place and has the potential to continue to grow during a LTC claim (this does not apply in NY, or V.I. where there is a pro-rata deduction from the cash value). Keep in mind when using products with varying returns, results could be different than illustrated in this article. While the insured is receiving monthly LTC benefits, no loans or withdrawals can be taken from the policy. One key to providing a possible advantageous situation is with proper design of the policy. Once loans begin, the LTC benefit available will be reduced dollar for dollar by the loan balance. However, in some cases – with proper design - withdrawals can be taken without affecting the LTC benefit pool. The Nationwide LTC rider can be issued at a lesser amount than the death benefit (note this cannot be done in NY or the V.I.). When a spread exists between the LTC rider and the death benefit, all or a portion of withdrawals can be taken without reducing the LTC benefit pool. (See ** in footnotes for exact formula).

How the plan is built

The IBIS is a maximum funded policy with several design options. One option is for the client to choose a premium amount he or she wishes to fund the policy with, and then plan for a minimum non-MEC death benefit. This death benefit can be lowered even more (to save cost of insurance) by using a "2 to 1 switch", also known as optimal switch, where by the policy begins with an increasing death benefit (death benefit option 2), then at the appropriate time is switched back to a level death benefit (death benefit option 1). Designing a case using the optimal switch death benefit option will can enhance cash values, but in the early years the death benefit may be quite low.

The LTC Rider benefit amount is based on the original specified amount of the life insurance policy. A policy designed with an optimal switch will see the death benefit increasing by the amount of cash value growth each year during the period the policy has the increasing death benefit in place; however, the maximum amount of the LTC Rider benefit pool remains the same as the initial specified amount. A plan designed in this manner may not supply a large base of dollars to pull LTC benefits from due to a lower beginning death benefit. One solution to this dilemma would be to design the IBIS with a level death benefit. The income stream will not be quite as high as with the optimal switch, however, with a larger initial death benefit, a more substantial LTC benefit pool is created for the insured to draw on. This solution could provide more total dollars available for the client should both income and LTC benefits be distributed.

One of the most advantageous solutions arises from an IBIS that is designed with a specific death benefit in mind. The optimal switch feature is then used not to reduce death benefit, but conversely to allow more premium dollars to be paid into the policy. Ideally, you want to design a policy that will allow for an annual LTC benefit that mimics the amount of annual income coming out of the policy. For example, the client purchases a maximum funded life insurance policy with $1,000,000 of death benefit. Based on the premiums paid, this IBIS is designed to pull out approximately $120,000 per year in income. The LTC Rider benefit is the lesser of 2% of the specified amount or the daily HIPAA rate times days in the month*** and is paid tax free (the daily HIPAA for 2017 is $360 per day or $131,400 per year). Adding a $500,000 LTC Rider would provide $10,000 per month in LTC benefits, which equals the income that was planned. If the insured were to become eligible to receive LTC benefits prior any applicable withdrawal or loan balance eliminating the entire benefit, there would be more total dollars paid out. Results will differ depending on when the LTC benefit begins. It is possible to take income over a time period that will reduce or eliminate the LTC benefit.

Plan example - the math

Consider the following hypothetical example, which is not intended to represent any specific client or client situation. The assumptions used are for illustrative purposes; actual results will vary.

Let's look at the case of an executive named Andrew, who is male, 47 years-old, and a non-smoker in preferred health. Andrew has decided he needs to save additional funds for retirement and has maxed out his other tax deferred opportunities. Andrew feels he will be working another 20 years. He also has a life insurance need of around $1,000,000. His investment professional suggests he use an Insurance-Based

Retirement Plan as the next best opportunity for tax preferred savings. The investment professional also suggests to Andrew that he consider adding a long-term care rider to the policy. Andrew, being relatively young, and assuming the costs of the rider would take away from his cash value, is hesitant to add the LTC feature.

The investment professional shows Andrew the following:

Assumptions are that Andrew will work until age 67, and upon retirement, begin taking income from other retirement assets first. Upon the age of 71, Andrew will plan to start taking income from the life insurance policy. This stated assumption should be followed for each illustration. The chart also illustrates what would happen if Andrew were to qualify for LTC benefits at age 68, causing delay in taking distributions for income. Keep in mind that withdrawals and loans are not permissible while on LTC claim, so in this circumstance Andrew would begin distributions for income after LTC benefits were exhausted, around age 73.

Funding insurance-based income solutions with and without the long-term care rider

	IBIS without the LTC rider		IBIS with the LTC rider	
Planned rate of return	8% (current policy charges)	0% (guaranteed policy charges)	8% (current policy charges)	0% (guaranteed policy charges)
Death benefit	$1,000,000		$1,000,000	
Annual premium for 20 years	$20,364		$20,364	
Annual LTC benefit taken at age 68 for 50 months	N/A	N/A	$120,000	$120,000
Annual income	$103,275 annually ages 71-85	$86,165 policy lapses at age 71	$102,735 annually ages 73-85	$0 policy lapses at age 72
Remaining death benefit at age 86	$107,857	Policy lapses at age 71	$106,472	$0 policy lapses at age 72
Remaining death benefit at age 100	$3,885	Policy lapses at age 71	$785,619	$0 policy lapses at age 72
LTC benefits paid out at age 68 for 50 months	N/A	N/A	$500,000	$500,000
Income paid out	$1,445,850	$86,165	$1,232,820	$0
Death benefit at age 86	$107,857	Policy lapses at age 71	$106,472	Policy lapses at age 72
Total if death at 86	**$1,553,707**	**$86,165**	**$1,839,292**	**$500,000**
Total if death at 100	**$1,449,735**	**$86,165**	**$2,518,439**	**$500,000**

This a a hypothetical example used for illustrative purposed only. This illustration assumes a Nationwide YourLife® Accumulation Variable Universal Life insurance policy is used. There is no guarantee of results illustrated in this chart. Results will vary based on product used and market volatility.

Using the LTC Rider in conjunction with the IBIS in this example allows for an extra $285,585 to be distributed from the policy assuming death occurs at age 86. Should death occur at a later age - the difference could be even more substantial. In this example, if Andrew would live to be age 100, without the LTC Rider included in the IBIS, the total pay-out would be $1,449,735. However, the IBIS with the LTC Rider included would provide a total pay-out at age 100 of $2,518,439 which is an additional $1,068,704.

Summary

As you can see from the example, incorporating the LTC Rider in an IBIS can be very beneficial not only from the standpoint of potential income provided to the insured, but also for the possibility of a larger death benefit to the beneficiary in later years. The chance of needing some form of long term care after the age of 65 is estimated to be at least 70%.[1] Your client may find the potential benefits resulting from adding a LTC Rider to an IBIS may far outweigh the risk of an approximate 2% reduction of income if LTC is not needed. With proper design, the LTC Rider can significantly enhance the value of the IBIS in some cases, and may provide additional living benefits to the insured as well additional death benefit to the beneficiary.

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[1] Longtermcare.gov – Department of Health and Human Services, December 2015

[2] The American Association for Long Term Care Insurance (AALTCI) Sourcebook, 2015-2016

* Results will differ depending on when the LTC benefit begins. It is possible to take income from the policy over a time period that will accumulate a loan balance that reduces or eliminates the LTC benefit.

** The amount of cash value that can be withdrawn without affecting the LTC rider benefit pool is the lesser of: the cost basis at time of claim or the amount of money representing the difference between the death benefit amount and the LTC benefit amount at time of claim.

*** Nationwide has several LTC solutions sitting on a life insurance chassis. Please refer to the specific policy's rider specifications since not all versions of the LTC Rider cap benefits at the HIPAA per diem. Some Nationwide LTC solutions allow for more than the HIPAA per diem to be collected, however, keeping track of any possible taxation as a result of collecting a benefit in excess of the said year's HIPAA per diem will be the responsibility of the policy owner. Neither Nationwide nor its representatives provide tax or legal advice. You should consult an attorney or competent tax professional for answers to specific tax questions as they apply to your situation.

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Keep in mind that as an acceleration of the death benefit, the LTC rider payout will reduce both the death benefit and cash surrender values. Care should be taken to make sure that your clients' life insurance needs continue to be met even if the rider pays out in full. There is no guarantee that the rider will cover the entire cost for all of the insured's long-term care as these vary with the needs of each insured.

Riders are offered at an additional cost and may not be available in all states. A life insurance or annuity purchase should be based on the life insurance or annuity contract, and not optional riders or features. The cost of an option may exceed the actual benefit paid under the option.

Please note that as your clients' personal situations change (i.e., marriage, birth of a child or job promotion), so will their life insurance needs. Care should be taken to ensure these strategies and products are suitable for long-term life insurance needs. You should weigh your clients' objectives, time horizon and risk tolerance as well as any associated costs before investing. Also, be aware that market volatility can lead to the possibility of the need for additional premium in the policy. Variable life insurance has fees and charges associated with it that include costs of insurance that vary with such characteristics of the insured as gender, health and age, underlying fund charges and expenses, and additional charges for riders that customize a policy to fit your clients' individual needs.

Before investing, please encourage your clients to carefully consider the fund's investment objectives, risks, charges and expenses, which can be found within the product prospectus and underlying fund prospectuses. Both the product prospectus and underlying fund prospectuses can be obtained by writing to Nationwide Life Insurance Company, P.O. Box 182150, Columbus, OH 43218.

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