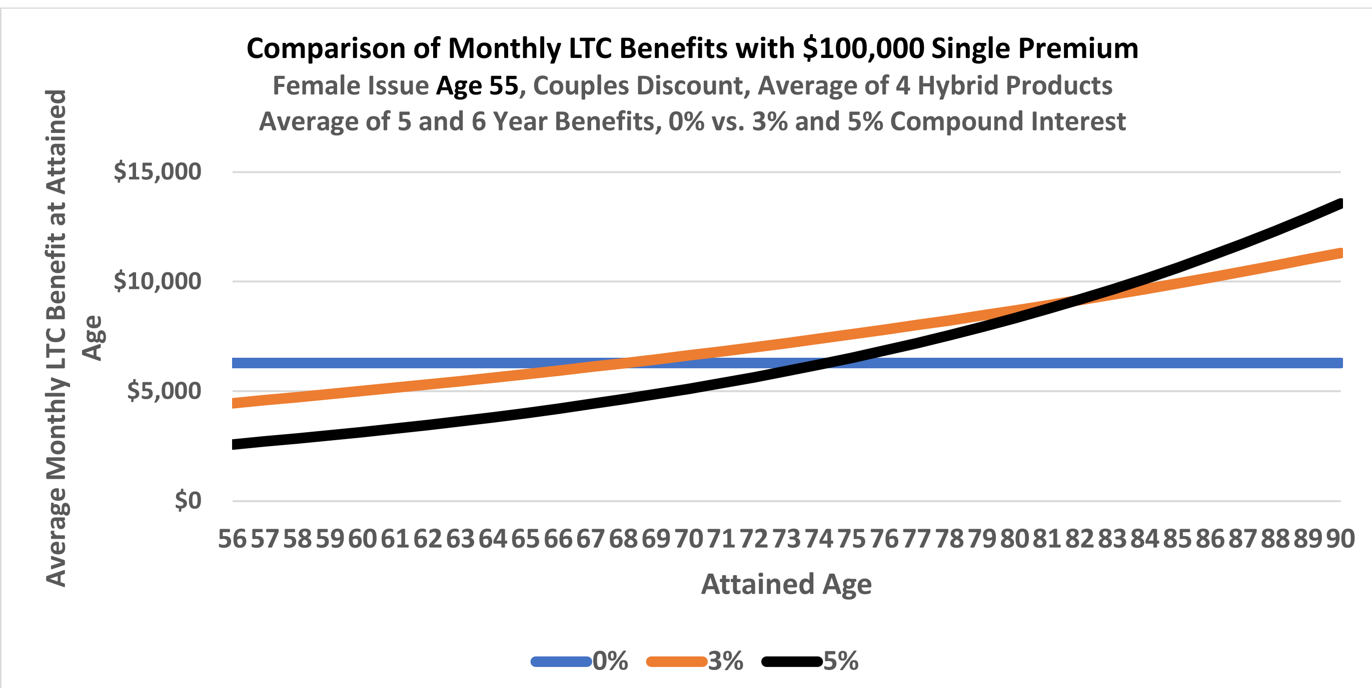
Ramona Neal, CLU, ChFC, CLTC, REBC
News - Living Benefit Review
November 10, 2021

Deciding Between Inflation Options on Hybrid-Linked Benefit Products "EOB": The Hybrid-Linked Benefit market continues to grow in popularity with advisors and clients. These products are distinguishable from LTC riders and Chronic Illness riders since they offer an additional EOB (Extension of Benefits). Specifically, they allow you to accelerate the entire life insurance death benefit for LTC needs, and then they continue paying LTC benefits, for a set number of years and sometimes even for life. They are further distinguishable from LTC/Chronic riders since Hybrids offer inflation benefits. Helping your clients choose the right inflation option is fundamental to meeting their LTC needs. Typically, the goal is to provide the maximum amount of protection - for when your clients are likely to need it most. Often this means targeting LTC benefits at age 80 and older (versus at policy issue).

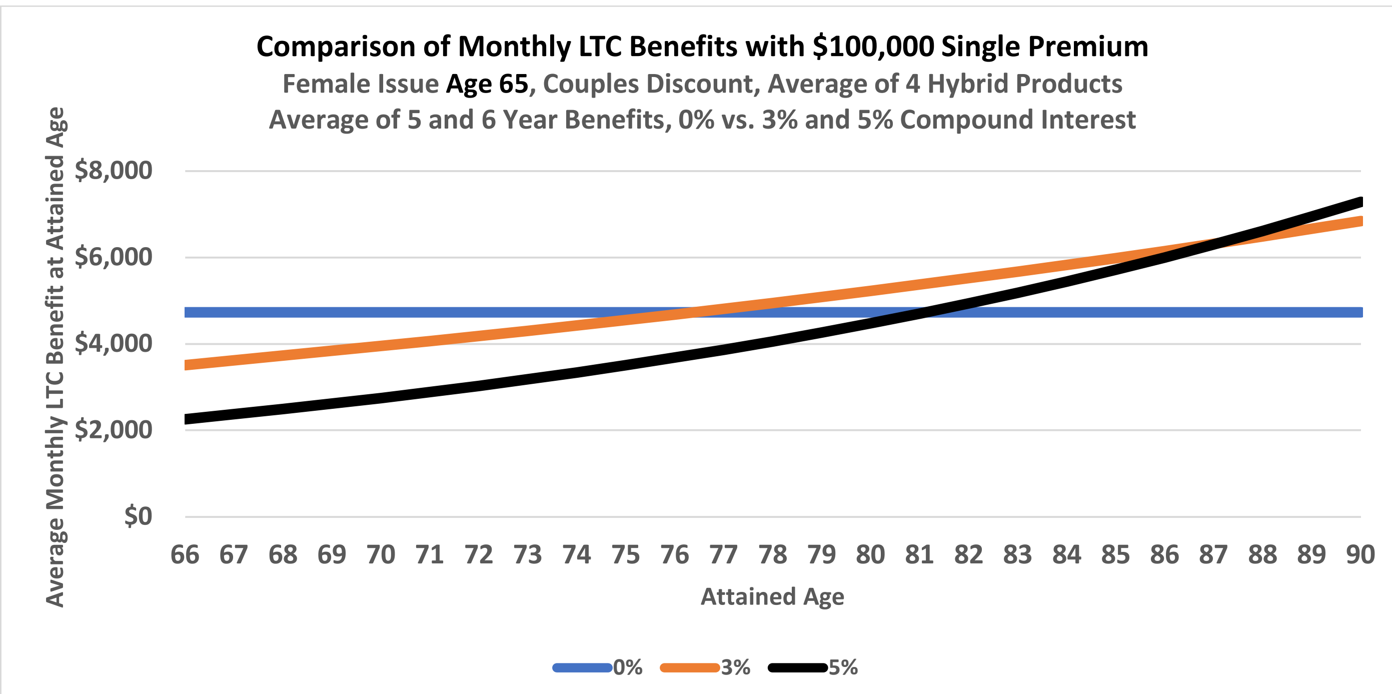
Assuming $100,000 Single Premium, which option is best: 0%, 3% or 5% Inflation? Well, it depends on who's asking? We focused on age and then benchmarked four Hybrid solutions assuming: F, $100k, SP, NT, Couples Discount, with 5–6-year benefit periods. Then we compared the average LTC benefit amounts assuming 0%, 3% and 5%.

For Clients Below age 60, Consider 5% Inflation: For a female, issue age 55, the average initial monthly LTC benefit was $6,290 at 0%, compared to $4,460 at 3%, and $2,580 at 5%. However, by attained age 69, the average 3% growth amount exceeds $6,400 in LTC benefits, and by age 80, the 3% inflation benefit exceeds $8,600. What's noteworthy is that by age 80, 5% inflation growth caught up quickly offering a benefit of $8,330. Then by age 82, 5% benefit amounts surpassed 3% – with over $9,180 in monthly LTC benefits as shown here:



Even though the goal is to maximize LTC benefits for when clients are likely to need it most, we don't have a crystal ball of when that will actually be. Above we see by the time the insured reaches age 80, the average 5% benefit is either close to or exceeding both 0% and 3% benefit amounts.

For Clients aged 60 and Older, Consider 3% Inflation: As we demonstrated above, eventually, the 5% growth option will exceed 3%. However, the challenge with the 5% option for insureds over age 60, is that it can take too long to catch up to the 3% option. For example, for a female, issue age 65, the average initial benefit at issue assuming 0% is $4,730, compared to $3,510 at 3%, while the 5% initial benefit is only $2,260. Then by age 77, the 3% benefit exceeds $4,730 and will still lead the 5% benefit amount until age 88 (on average). That may be too late for the 5% compounding option to be the most effective option. So, for clients aged 60 and older, perhaps 3% is their ideal solution.



Why is 3% Above Appealing? The reason is a function of the price points the insurance companies are using (on average). Specifically, the 5% compound benefit option often begins too low in order to be effective for insureds in their 60's or 70's. Meanwhile, the 3% benefit option starts off high enough to pull ahead of 0% while the insureds are still in their 70's. This will vary to some degree by insurer and by scenario. But with similar assumptions you can see comparable results.

When is 0% Ideal? 0% may be optimal under the following conditions: (a) when the client is in their 70's or older at issue; (b) when the client places a greater value on having a higher LTC benefit in the early years rather than later; and (c) when the premium solve amount is too low in order to meet the insurers minimum requirements to issue the policy. In addition, for some clients who are ages 60 and older, they may simply choose to gross up their initial monthly benefit at issue with the 0% option.

What about Compound Inflation vs. Simple interest? All things being equal, with identical premiums, simple interest will likely begin with a higher initial LTC benefit when compared to compound interest. However, given sufficient time, compound interest benefits will always exceed simple interest. Furthermore, by definition, simple interest limits the annual benefit growth rate to the amount of growth in the first year. This effectively lowers the percentage of growth rate the insured can achieve later on. For example, at 3% simple interest, a $5,000 monthly benefit will grow to $5,150 in year 1, $5,300 in year 2 and continue to grow by $150 annually. Therefore, in year 21 with 3% simple interest, the monthly benefit will grow from $8,000 to $8,150 – a 1.88% growth rate.

Your clients may not understand the mathematics of simple interest, and consequently not be happy to learn the impact 20 years down the road. With 3% compound interest, the benefit will grow by 3% annually at the end of each policy year, so that $8,000 will grow to $8,240 (which is more intuitive).

Summary: Helping your clients choose the right inflation option today, can help them better meet their LTC needs tomorrow. Each client's circumstance is unique, so care should be taken when choosing the appropriate LTC chassis and the ideal inflation option. When focused on age, you may want to consider:

- For younger insureds, consider inflation options including 5% (when affordable)
- For issue ages 60's - 70's, a policy with a 3% inflation may be the ideal choice
- A compounding interest benefit is often preferable to simple interest
- 0% may be the best option including for issue ages above 70 and older

This article is intended for Financial Professional Use Only. Living Benefit Review, LLC makes no warranties or representations as to its accuracy. This article should not be construed as rendering tax, insurance, investment, or legal advice. You acknowledge that any reliance on this material or any opinion, statement or information shall be at your sole risk. If you take any action based on the information in this article, you take full responsibility for the results of that action. You should independently verify its content. Nothing in this article constitutes an offer to sell or buy any insurance product or rider. Products and riders, including benefits, exclusions, limitations, terms, and definitions vary by insurance company and vary by state.

Disclosure: Certain Inflation options may not be competitively priced or affordable with certain insurers. Other factors should be considered when selecting inflation options such as health of insured, family medical history and more. The above scenarios assumed a given premium of $100,000 in order to solve for the LTC benefit amount. However, some clients may approach with a known monthly LTC benefit amount they are targeting at issue which could result in inflation options being unaffordable. Inflation options can result in lower initial specified amounts. This means that upon death, a smaller death benefit will be paid to beneficiaries.

Benchmarking assumptions: The completeness and accuracy of the underlying benchmarking scenarios are not guaranteed. Pricing from the 4 Hybrid/EOB carriers is believed to be current as of October 2021. Compounding inflation was used where available (3 out of 4 insurers). Living Benefit Review has made every effort to ensure this data is accurate. Differences between products compared were not reflected such as: indemnity, reimbursement, and guaranteed return of premium, etc. These are mere hypothetical scenarios. They are not intended to represent any specific client or situation.