SPIA/LTC Hybrid Still Just a Concept

By Editor Test *Wed, Jul 8, 2009*

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None of the LTC/annuity hybrid products that have been introduced so far this year reflect Mark Warshawsky's vision for a product called the "Life Care Annuity," which combined a single premium immediate annuity, disability insurance, and LTC insurance.

Back in 2006, in several presentations as Retirement Research director at Watson Wyatt (now Towers Watson & Co.), Warshawsky described a product for which a 65-year-old individual would pay roughly $169,000 (or about $250,000 if he wanted automatic inflation adjustment).

Of that sum, $140,000 (or $178,000 with inflation adjustment) would produce a $1,000 per month retirement income for life with 10 years certain, while the balance would pay for long-term care insurance that would cover partial disability expenses to $3,000 per month or complete disability expenses to $5,000 a month.

This hybrid product would cost about 10% less than the two forms of insurance would cost when purchased separately, Warshawsky calculated, because the adverse selection factors that plague both LTC insurance and immediate annuities would partially cancel each other out.

Because the offsetting risks would bring lower prices, immediate annuities would become attractive to a wider range of people, including those not in perfect health. At the same time, underwriting standards for the LTC component could be relaxed, and fewer people would be denied coverage on the basis of health risk factors.

"The proposal is an application of economic theory—a hopefully practical attempt to produce a self-sustaining pooling equilibrium that is superior, by lowering prices and increasing available insurance coverage, to the separating equilibrium currently in existence," Warshawsky wrote in one presentation.

"The Life Care Annuity works so as to blend the longevity risk of annuity buyers with the morbidity/disability risk of those desiring, but denied access to, LTCI coverage, combining these population pools of risk classes."

Warshawsky's concept was one of eight proposals appraised in a June 2007 report from the Health Policy Institute at Georgetown University called "Long-Term Care Financing: Policy Options for the Future."

The report noted that Warshawsky's product would be too expensive for most Americans, and its advantages might not outweigh the usually objection to income annuities as illiquid. “Based on data on household net worth of people ages 65 to 69 in 2000, roughly 10% to 20% of households in this age group have enough financial assets (excluding home equity) to make one such purchase at retirement-and fewer could afford two policies for a couple.”

“A reasonable estimate is that perhaps as many as one-fourth of those who could afford this product might become newly covered,” the report continued. “Thus, perhaps up to an additional 5 percent of people age 65 and older would obtain coverage under this proposal, or at most an additional 1.8 million people.”

On the other hand, the report said, 98% of 65-year-olds would pass the screen for the hybrid product because of the lighter underwriting standards, compared with 77% under current long-term care insurance underwriting practices.

None of the insurance companies that have introduced LTC/annuity hybrids—United of Omaha, OneAmerica, Genworth Financial, and Bankers Life—have considered combining LTC insurance with an income annuity.

Such a product, one executive said, would likely cost much more than a fixed deferred annuity/LTC hybrid, and would lack two important features: liquidity in case of unexpected spending needs, and the transfer of unused assets to beneficiaries.