



Long Term Care Insurance Opportunities Under The Pension Protection Act

Presented [by/for]:
[Type Your Name Here]

Long Term Care Insurance Underwritten by
Genworth Life Insurance Company,
Richmond, VA

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- Introduction

Agenda

1 The Pension Protection Act of 2006

2 New Opportunities

All guarantees provided by insurance products are based on the claims paying ability of the issuing company.

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- In this presentation we'll give you information regarding long term care insurance provisions under the Pension Protection Act and the opportunity it presents for your clients and your business.

Long Term Care Insurance Opportunities Under The Pension Protection Act of 2006 (PPA)

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- **Speak to Slide**

Long Term Care Insurance Under the PPA

Provisions Of The PPA Affecting Long Term Care Insurance (LTCI)

- 1 Retired Public Safety Officers
- 2 Qualified LTCI Within A Linked Benefit Product
- 3 Tax-free Exchange Rules Under IRC Section 1035

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- **Much of the Pension Protection Act is devoted to Defined Benefit and Defined Contribution plans addressing**
 - Pension Funding
 - Safe Harbor Rules
 - Automatic Enrollment
- **Our discussion today, though, will focus on the provisions of the Act that impact long term care insurance. Most of these provisions had a delayed start date, not taking effect until Jan 1, 2010.**
- **One provision that took effect almost immediately permitted pension plans to directly pay up to \$3,000 per year for medical expenses, including long term care insurance premiums, for retired public safety officers.**
- **The provisions that go into effect on Jan 1, 2010 that could have a large impact in the long term care insurance market place.**
 - long term care insurance offered as a rider in a linked benefit annuity contract can be Tax-Qualified
 - Internal charges to pay the qualified long term care insurance rider in a life insurance policy or annuity contract are not treated as taxable distributions
 - Life insurance policies and non-qualified annuities can be exchanged tax-free for traditional long term care insurance policies
- **Why are the 2010 changes important?**
 - These provisions address the top two concerns consumers have about building a long term care plan with insurance. Those are:
 - Cost of traditional long term care insurance
 - Fear of putting assets into an insurance product they may never use. I.e., “Use it or lose it”
- **Let me give you a little more detail.**

Long Term Care Insurance Under the PPA

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Linked Benefit Products

Prior to 1/1/2010

- LTC Benefits and Charges From Annuity-LTC Are Taxable



Key Changes Beginning 1/1/2010

- A Tax Qualified LTCI (QLTICI) rider under a non-qualified annuity contract will be treated as a separate contract, thus QLTICI benefits paid from these riders are tax free
- LTCI rider charges against the account value are not a taxable distribution, although they reduce the client's cost basis (but not below zero)

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Why is it important that long term care insurance be tax qualified in a Linked Benefit Annuity Contract?

- Put simply, there are two advantages
 - The biggest advantage is that benefits used to pay for long term care expenses are tax-free
 - Also, rider charges that fund the long term care insurance portion of the contract are not treated as taxable income to the consumer. Rider charges do, however, reduce the client's cost basis.
- **Before 2010, benefits and charges from an annuity long term care insurance contract are taxable.**

Long Term Care Insurance Under the PPA

Current 1035 Rules*

Life → Life
 Annuity → Annuity
 Life → Annuity
 Annuity to Life is not Allowed

New 1035 Exchange Rules

1035 New Tax Free Options:

- Annuity → LTCI
- Life → LTCI
- QLTCI → LTCI

New, Tax Advantaged Opportunities For LTCI Planning



*Endowment Contracts may also be exchanged for other endowment contracts, annuity contracts or QLTCI, but are mostly legacy contracts.

**Traditional LTCI or Linked Benefit Products with a QLTCI Rider¹¹

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The third part of the Pension Protection Act that relates to long term care insurance is a change in the section 1035 exchange rules of the Internal Revenue Code.

Most of us are familiar with the current 1035 exchange rules:

- 1035 Rules are generally limited to non-qualified life and annuity contracts

The new rules coming into effect Jan 1 allow for full/partial 1035 exchanges from a non-qualified annuity into a long term care insurance contract.

Pulling it all together, consider the following:

- After 2010, a consumer holding a non-qualified annuity will be able to move funds from that annuity to a traditional LTCI policy or an annuity/LTCI linked benefit product without being taxed. Furthermore, when it comes time to receive benefits from either insurance contract, they will be tax free.

Note: The new 1035 rules also allow you to exchange a life insurance policy for a traditional LTCI policy but suitability must be carefully considered.

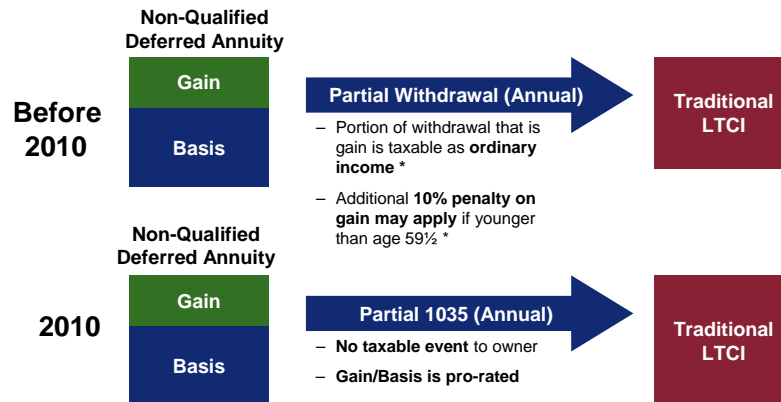
Tax-free exchanges from a life insurance policy to a life-LTCI or annuity LTCI linked benefit product are also permitted. These will usually be replacements.

Let's look at a few examples of how you might use these new rules to plan for long term care insurance funding.

PPA – LTCI Planning Options

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Non-Qualified Annuity Funding Of Traditional LTCI



Fund LTCI Without Immediate Tax Consequences

*Partial withdrawals from non-qualified deferred annuities bought after August 13, 1982 are taxed as ordinary income to the extent of gain in the contract (LIFO). Partial withdrawals from contracts entered into before that date may be treated as first coming from principal (FIFO).

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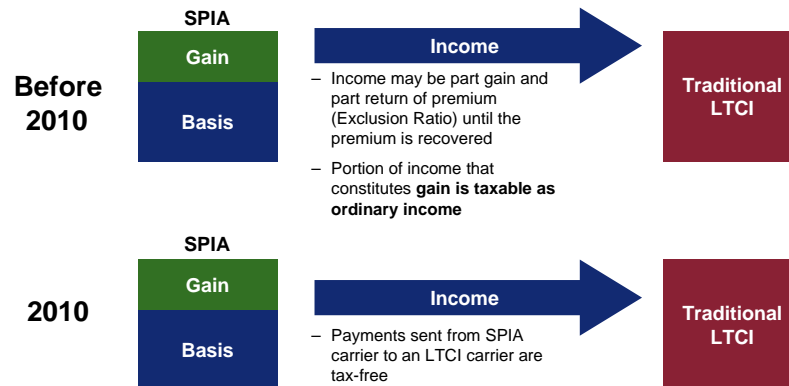
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- This slide represents annuity funding of traditional long term care insurance before and after January 1, 2010.
- Prior to 2010, if you were to take money out of an annuity to fund traditional LTCI premiums, you could have two tax consequences
 - First, any portion of that money that constitutes gain would be taxed at ordinary income tax rates
 - Second, if the annuity holder is under age 59 ½, an additional 10% penalty may apply
- After 2010, the movement of funds is tax free to the annuity owner and the gain/basis within the annuity will be reduced pro-rata.

PPA – LTCI Planning Options

SPIA Funding Of Traditional LTCI



Use a SPIA To Fund LTCI

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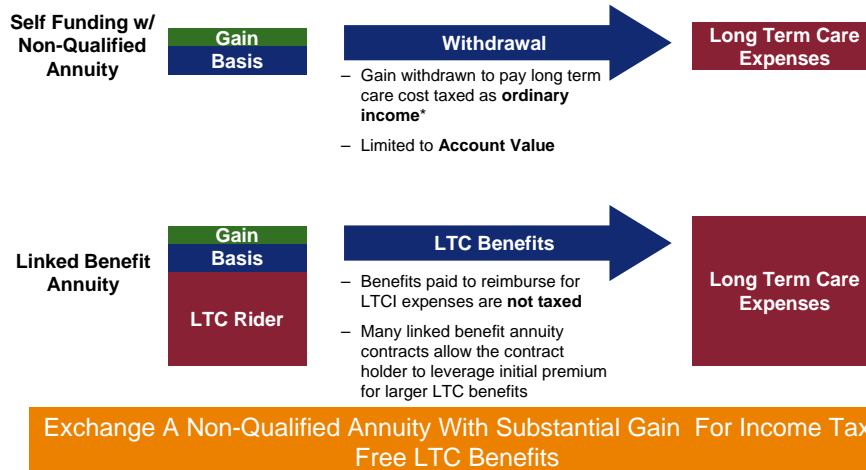
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- Using SPIA payouts to fund long term care insurance is a strategy that is used today. However, the portion of income that is gain is taxable as ordinary income.
- After 2010, income from a non-qualified SPIA that is used to pay for qualified long term care insurance is tax-free regardless of how much of the income is gain or basis. This is accomplished by having the SPIA carrier send payments directly to the LTCI carrier.
- SPIA payments directly funding long term care insurance will be considered a partial assignment of the SPIA contract in a 1035 exchange.

PPA – LTCI Planning Options

1

Using An Annuity To Pay For Long Term Care Expenses



*In some cases, long term care expenses paid out-of-pocket may be deductible as unreimbursed medical expenses for federal income tax purposes

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- In the first two examples I've explained how to fund a traditional long term care insurance policy with an annuity.
- Now, I'd like to talk about linked benefit annuity products. In order to illustrate the advantage of linked benefit annuity products, I need to explain how this slide differs from the previous slides.
 - First, we are assuming that the long term care claim occurs after December 31, 2009.
 - The top portion of the slide represents a person who liquidated an annuity to pay for long term care expenses
 - The bottom portion of the slide represents a person who has a linked benefit annuity
 - Also, please note that the right hand side of the page represents the amount of money available to pay for a long term care expense
- With that in mind, let's look at surrendering the annuity to pay for a long term care event.
 - The first issue with the annuity is that, upon surrender, any amount that constitutes gain will be taxed at ordinary income tax rates.
 - Second, the annuity holder will be limited to the Account Value of the contract and the amount available to pay for long term care will be the account value less any ordinary income tax due, and applicable surrender charges.
- Next, let's assume that, in order to plan for long term care, the annuity holder took advantage of the new 1035 rules and transferred assets into a linked benefit annuity. Please note that a new surrender charge period will likely apply for the new Linked benefit Product.
 - First of all, since the long term care rider is tax qualified, all benefits that pay for long term care expenses will be tax free, regardless of how much gain was in the underlying annuity contract. These LTCI claims payments may reduce basis in the annuity contract .
 - Second, most linked benefit products offer riders that will allow the policy holder to leverage their initial premium 2 or 3 times. That means, in the event of a long term care event, the policy holder will have up to 300% of their initial premium to pay for Long Term Care Expenses
 - Finally, LTCI Rider charges are not treated as taxable distributions to the policyholder. However, the charges used to fund the LTCI Rider will reduce basis (but not below zero). For example, if the annuity had \$100,000 of account value and \$50,000 of basis, an LTCI rider charge of \$1,000 would result in the account value being reduced to \$99,000 and the basis to \$49,000. The amount of gain (\$50,000) in the contract has not changed, but ratio of gain to basis has been increased.

PPA – Linked Benefit Life Changes

1

Using A Life Policy To Pay For Long Term Care Expenses



- After 2010, long term care insurance rider charges reduce the cost basis but not below zero.
- Before 2010, such charges may have been taxable.

Any LTC benefit paid from a linked benefit life contract will reduce both the contract cash value and death benefit.

If You Use For Life Or Long Term Care Benefits, Then No Tax Consequences

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It is important to note another change occurring on 1/1/2010 that impacts linked benefit life policies.

- Prior to 1/1/2010, internal LTCI rider charges are taxable if the contract is a MEC and there is policy gain.
- The Key Change Effective 1/1/2010 is that Tax Qualified LTCI Rider Charges deducted from cash values are not treated as taxable distributions to the policy holder. These charges will reduce basis in the policy, but not below zero, and such a reduction may have tax implications if the policy is surrendered.

The Opportunity

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- **Now let's see what the PPA means to the linked benefits market.**

Consumer LTC Strategy

All Consumers Fall into One of 3 Categories

Long Term Care Insurance Purchasers 7% Market Penetration*

- Recognize need for LTCI protection and willing to purchase a traditional policy as solution
- Solution = traditional LTCI policy

Self-Insuring

- Expect to use existing assets to fund LTC need
- Don't like idea of paying premiums if they never have a long term care event
- Solution = Linked Benefits Product

Medicaid

- No private insurance solution

93% of the Market is Uncovered by Traditional LTCI

*SRI Macro Monitor 2006 - 2007

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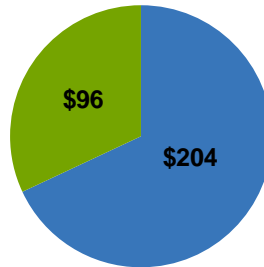
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- **Currently, there are three types of people when it comes to long term care planning**
 - People who purchased insurance to plan for a long term care event
 - Self-insurers who set aside money for a long term care event and
 - Finally, those who have no plan and Medicaid may be the only option available
- **Previously, I mentioned (on slide #3) that the top two objections to long term care insurance are:**
 - Cost
 - "Use it or lose it"
- **93% of the market is not covered by traditional LTCI**
- **The Pension Protection Act offers a unique opportunity to tap into the market. Specifically, the "Won't Buy" consumers who object due to cost or control of assets ("use it or lose it")**

Annuity Linked Benefit Market Assessment

Nonqualified Fixed Annuities

- \$300 Billion Assets as of 2007
- \$96 Billion Outside the Surrender Charge Period



*Source – LIMRA, 2008 "The 2007 Individual Annuity Market"

*Outside of Surrender Charge figures based on Genworth Financial companies' experience. Actual industry may be different.

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Also, to speak to the opportunity of a linked benefit annuity product, consider that there were \$300B (Yes that is "B" for Billion) of assets in non-qualified fixed annuities in 2007

Also consider that \$96 Billion (again with a "B") are outside of the surrender charge period

Of this population of annuity contract owners, how many are suitable for a linked benefit annuity product that

1. Has significant tax advantages
2. Still accumulates assets and offers substantial leverage if a long term care event occurs
3. And, allows the client to retain control of their assets

Is it 10%? 5%? 1%?

Whatever your assumptions, the Pension Protection Act may provide new opportunities for your business and, most importantly, your clients.