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# Long-Term Care and Hybrid Policies

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Welcome to the latest edition of our quarterly education pieces aimed at providing our clients additional insight into some of the issues we address throughout the year. As you read through this article you may have questions about how these matters affect you. We are ready to answer your questions or discuss your thoughts at your convenience.

# Five Questions about Long-Term Care

## 1. What is long-term care?

Long-term care refers to the ongoing services and support needed by people who have chronic health conditions or disabilities. There are three levels of long-term care:

- Skilled care: Generally round-the-clock care that's given by professional health care providers such as nurses, therapists, or aides under a doctor's supervision.
- Intermediate care: Also provided by professional health care providers but on a less frequent basis than skilled care.
- Custodial care: Personal care that's often given by family caregivers, nurses' aides, or home health workers who provide assistance with what are called "activities of daily living" such as bathing, eating, and dressing.

Long-term care is not just provided in nursing homes--in fact, the most common type of long-term care is home-based care. Long-term care services may also be provided in a variety of other settings, such as assisted living facilities and adult day care centers.

## 2. Why is it important to plan for long-term care?

No one expects to need long-term care, but it's important to plan for it nonetheless. Here are two important reasons why:

**The odds of needing long-term care are high:**

- Approximately 52% of people will need long-term care at some point during their lifetimes after reaching age 65*
- Approximately 8% of people between ages 40 and 50 will have a disability that may require long-term care services*

**The cost of long-term care can be expensive:**
For many, the cost of long-term care can be expensive, absorbing income and depleting savings. Some of the average costs in the United States for long-term care* include:

- $6,844 per month, or $82,128 per year for a semi-private room in a nursing home
- $7,698 per month, or $92,376 per year for a private room in a nursing home
- $3,628 per month for a one-bedroom unit in an assisted living facility
- $68 per day for services in an adult day health-care center

**U.S. Department of Health and Human Services, October 10, 2017*

### 3. Doesn't Medicare pay for long-term care?

Many people mistakenly believe that Medicare, the federal health insurance program for older Americans, will pay for long-term care. But Medicare provides only limited coverage for long-term care services such as skilled nursing care or physical therapy. And although Medicare provides some home health care benefits, it doesn't cover custodial care, the type of care older individuals most often need.

Medicaid, which is often confused with Medicare, is the joint federal-state program that two-thirds of nursing home residents currently rely on to pay some of their long-term care expenses. But to qualify for Medicaid, you must have limited income and assets, and although Medicaid generally covers nursing home care, it provides only limited coverage for home health care in certain states.

### 4. Can't I pay for care out of pocket?

The major advantage to using income, savings, investments, and assets (such as your home) to pay for long-term care is that you have the most control over where and how you receive care. But because the cost of long-term care is high, you may have trouble affording extended care if you need it.

### 5. Should I buy long-term care insurance?

Like other types of insurance, long-term care insurance protects you against a specific financial risk--in this case, the chance that long-term care will cost more than you can afford. In exchange for your premium payments, the insurance company promises to cover part of your future long-term care costs. Long-term care insurance can help you preserve your assets and guarantee that you'll have access to a range of care options. However, it can be expensive, so before you purchase a policy, make sure you can afford the premiums both now and in the future.

## Long-Term Care Annuities

When planning for the potential cost of long-term care, you've probably considered long-term care insurance. But premiums can be expensive and if you do buy the coverage, you probably hope you never have to use it. The prospect of paying costly premiums for long-term care insurance that you might never use might discourage you. Enter the long-term care annuity.

### What is it?

This hybrid product is a nonqualified annuity that provides long-term care benefits. These policies allow you to use the annuity proceeds for long-term care, and if you don't use the long-term care benefit, you still have typical annuity options. For instance, you can convert the annuity to a stream of income payments (annuitization), redeem the annuity at its maturity (e.g., cash in the annuity), or, at your death, you can pass the remaining balance of your annuity to your named beneficiaries.

While policy provisions may differ from company to company, generally you put money into the annuity, usually in a lump sum or through a series of premium payments. You may also exchange another annuity or cash value life insurance for a long-term care annuity via a Section 1035 exchange. The annuity typically pays a fixed rate of interest each year. In addition, the annuity provides a long-term care benefit amount, usually equal to two or three times your annuity cash value, subject to a maximum benefit period, which is the maximum length of time that you may receive long-term care benefit payments from the annuity. Long-term care annuity benefits are usually paid monthly.

## How does this product work?

Typically, long-term care annuities have the same qualification requirements as most stand-alone long-term care insurance policies. You first have to be considered "insurable" by the annuity company, which means you have to answer questions relating to whether you have suffered any major illness such as cancer or heart disease, or whether you have a significant cognitive impairment like Alzheimer's disease. But you usually don't have to undergo a physical, and the underwriting is generally less stringent than with stand-alone long-term care insurance, meaning it's a little easier to qualify for the long-term care annuity.

Like most stand-alone long-term care policies, in order to be eligible for long-term care benefits from the annuity, you must either suffer from cognitive or mental incapacity or be unable to perform at least two of six activities of daily living that include feeding, bathing, dressing, transferring, continence, and toileting.

Say you pay $75,000 to purchase a long-term care annuity. You select a long-term care benefit equal to 200% of your annuity's cash value, with a 5-year benefit period. Initially, your long-term care benefit equals $150,000 ($75,000 x 2). Let's assume the annuity earns 4.5% per year and the cost of the long-term care provision is 0.5% per year. At the end of 20 years (presuming you take no withdrawals) the annuity is worth about $163,622 and the long-term care benefit amount is $327,244. This will provide maximum long-term care benefit payments of $5,454 per month for as long as 5 years. And even if cumulative long-term care payments exceed the annuity's contract value ($163,622), the long-term care payments will continue until you either exhaust the long-term care benefit amount ($327,244) or you no longer need long-term care. (This is a hypothetical example. It does not represent a specific product. Product terms and conditions may differ. Check with the annuity issuer for specific product details.)

## What about taxes?

Beginning January 1, 2010, potentially favorable tax treatment applies to certain withdrawals from annuities purchased after 1996, if the withdrawals are used to pay for qualified long-term care insurance coverage. This means you won't have to pay income tax on the benefits you receive from your long-term care annuity used to pay for long-term care expenses.

## Pluses/minuses

As with most insurance products, there are pluses and minuses to consider in determining whether a long-term care annuity is right for you. On the plus side:

- Long-term care annuities allow for tax-free withdrawals if used to pay for qualified long-term care coverage

- With typical long-term care insurance, if you don't use the coverage, you generally don't get a return of your premiums; but with a long-term care annuity, at your death you can pass any remaining annuity balance to your beneficiaries
- If you're not in the best of health and you want some long-term care protection, you might not be able to qualify for stand-alone long-term care insurance. But, it's generally easier to qualify for a long-term care annuity (e.g., you probably won't need a physical)
- Once you put money in the annuity, you don't have to make any more premium payments as you would with stand-alone long-term care insurance policies

On the other hand:

- Most long-term care annuities are funded with a single premium payment of at least $50,000, so you may need to have at least that much available in a lump sum
- Long-term care annuities, like most deferred annuities, come with surrender charges, so taking money out of the annuity that's not used for long-term care expenses may be subject to surrender charges, income tax, and a penalty of 10% if taken before age 59½
- Currently, long-term care annuities do not qualify as partnership plans, which otherwise afford some asset protection when trying to qualify for Medicaid
- If you don't deposit enough money into the long-term care annuity, you may not have enough protection to cover your long-term care expenses
- There's a cost to purchase the long-term care benefit which can range from 0.4% to 1.25% of the annuity's account value
- Since the cost of the long-term care portion of the annuity is deducted from your investment in the annuity (and not the earnings), you can't take the cost of long-term care as a medical expense deduction

## Life Insurance Riders that Pay for Long-Term Care

Life insurance has many uses, including income replacement, business continuation, and estate preservation. Long-term care insurance provides financial protection against the potentially high cost of long-term care. If you find yourself in need of both types of insurance, a life insurance policy that combines a death benefit with a long-term care benefit may appeal to you.

### Here's how it works

Some life insurance issuers offer life insurance with a long-term care rider available for an additional charge. If you buy this type of policy, you can pay the premium in a single lump sum or by making periodic payments. In any case, the policy provides you with a death benefit that you can also use to pay for long-term care related expenses, should you incur them.

The amount of death benefit and long-term care allowance is based on your age, gender, and health at the time you buy the policy. The appeal of this combination policy lies in the fact that either you'll use the policy to pay for long-term care expenses or your beneficiaries will receive the insurance proceeds at your death. In either case, someone will benefit from the premiums you pay.

## Long-term care riders

The long-term care benefit is added to the life insurance policy by either an accelerated benefits rider or an extension of benefits rider.

Accelerated benefits rider --An accelerated benefits rider makes it possible for you to access your death benefit to pay for expenses related to long-term care. The death benefit is reduced by the amount you use for long-term care expenses, plus a service charge. If you need long-term care for a lengthy period of time, the death benefit will eventually be depleted. This same rider also can be used if you have a terminal illness that may require payment of large medical bills. Because accelerating the death benefit can have unfavorable tax consequences, you may want to consult your tax professional before exercising this option.

Example: You pay a single premium of $50,000 for a universal life insurance policy with a long-term care accelerated benefits rider. The policy immediately provides approximately $87,000 in long-term care benefits or $87,000 as a death benefit. If you incur long-term care expenses, the accelerated benefits rider allows you to access a portion, such as 3% ($2,610), of the death benefit amount ($87,000) each month to reimburse you for some or all of your long-term care expenses. Long-term care payments are available until the total death benefit amount ($87,000) is exhausted (about 33.3 months). Whatever you don't use for long-term care will be left to your heirs as a death benefit.

(The hypothetical example is for illustration purposes only and does not reflect actual insurance products or performance. Guarantees are subject to the claims-paying ability of the issuer.)

Extension of benefits rider --An extension of benefits rider increases your long-term care coverage beyond your death benefit. This rider differs from company to company as to its specific application.

Depending on the issuer, the extension of benefits rider either increases the total amount available for long-term care (the death benefit remains the same) or extends the number of months over which long-term care benefits can be paid. In either case, long-term care payments will reduce the available death benefit of the policy. However, some companies still pay a minimum death benefit even if the total of all long-term care payments exceeds the policy's death benefit amount.
Continuing from the previous example, if the policy's extension of benefits rider increases the long-term care benefit (the death benefit--$87,000--remains the same) to three times the death benefit ($261,000), the monthly amount available for long-term care increases to $7,830. On the other hand, if the extension of benefits rider extends the length of time the monthly long-term care benefit is available, then the monthly payments ($2,610) are extended for an additional 24 to 36 months beyond the initial number of months (33.3) available.

## Other provisions

Typically, qualifying for payments under a long-term care rider is similar to the requirements for most stand-alone long-term care policies. You must be unable to perform some of the activities of daily living (bathing, dressing, eating, getting in or out of a bed or chair, toilet use, or maintaining continence) or suffer from a severe cognitive impairment.

## Is a combination policy right for you?

Deciding whether a combination policy is right for you depends on a number of factors. Do you need life insurance and long-term care insurance? How much life and long-term care insurance will you need? How long will you need it? Will the long-term care part of a combination policy provide sufficient coverage?

A long-term care rider may not provide as many features as a stand-alone long-term care policy. For example, the combination policy may not cover assisted living or home health aides. It also may not provide an inflation adjustment, an important feature considering the rising cost of long-term care. The tax benefits offered by a qualified long-term care policy may not apply to the long-term care portion of combination policies, which could result in taxation of long-term care benefits received from the policy.

What if your life insurance needs change as you get older and you find that you no longer want life insurance protection? It's not uncommon for people to drop their life insurance in their later years if there's no compelling need for it, but if you surrender the combination policy, you're also forfeiting the long-term care benefit it provides, usually at a time when you are most likely to need it.

And keep in mind that as you use your long-term care benefits, you're depleting the death benefit--a death benefit you presumably wanted to pass on to your heirs or perhaps use to pay for estate taxes.

Finally, compare costs of combination policies to other forms of life insurance, such as term insurance, and stand-alone long-term care policies. Depending on your age and health, the cost for the combination life policy may actually be higher than the total premiums paid for separate life insurance and long-term care policies, especially if your life insurance need is temporary (such as income replacement during your working years) rather than permanent.

The appeal of this combination policy lies in the fact that either you'll use the policy to pay for long-term care expenses or your beneficiaries will receive the insurance proceeds at your death.

## Is either hybrid policy right for you?

Whether a long-term care annuity or combination policy is right for you depends on a number of factors. Understandably, many people put off planning for long-term care. But although it's hard to face the fact that health problems may someday result in a loss of independence, if you begin planning now, you'll have more options open to you in the future.

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