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Mitchell Kauffman: Innovative Strategies for Addressing the Long-Term Care Challenge

By Mitchell E. Kauffman, Managing Director, CERTIFIED FINANCIAL PLANNER™

Mitchell E. Kauffman

When planning for retirement, all possible risks must be considered and evaluated. One of the most commonly overlooked is the potential need for long-term health care ("LTHC") for you and/or your spouse. The cost of LTHC can be staggering, and can derail even the best laid financial plans.

When evaluating the risk of the cost for LTHC, the old adage about three ways to manage risk can be clearly applied:

» 1. Avoid the Risk: Unfortunately, growing older is a fact of life and health-care concerns increase with age. Clients can embrace a healthy lifestyle to reduce the risk, but nobody can completely avoid the risk with any certainty. Clients can also choose to live in denial that a LTHC incident may never happen to them and do nothing to protect themselves. Unfortunately, the odds do not favor this approach, given that about 70 percent of individuals over age 65 will require at least some type of long-term care services during their lifetimes, and 20 percent will need five years or more of care (U.S. Department of Health and Human Services).

» 2. Retain (Manage) the Risk: Clients of sufficient wealth can self insure and plan to cover LTHC expenses out of pocket without regard to how an incident could erode their estate.

» 3. Transfer or Share the Risk: Clients can pay a credible entity, typically an insurance company, to cover some portion of the risk.

Of course, it is incumbent on us as comprehensive advisors to help clients understand these options and guide them toward making the most effective decision for their situation.

The good news is that a number of recent innovations have made LTHC insurance more economically attractive to share the risk of a LTHC incident with a financially sound insurance company. These changes can best be appreciated in the context of reviewing the major aspects of LTHC coverage:

Facility Types: These include nursing homes, day-care centers, assisted living facilities and home care. We often recommend all three be considered.

Service Level: Three types of ongoing services and support are available for those who have disabilities or chronic conditions. Here, too, we typically suggest all three be included:

1. Nursing Homes Skilled: Professional nurses, therapists or doctor's aides provide professional care 24/7.

2. Intermediate: Skilled but on a less than round-the-clock basis.

3. Custodial: Assistance provided by nurses' aides, home health workers and possibly family caregivers, that centers on supporting "activities of daily living (i.e. ADLs)" including eating, bathing and dressing.

Daily Benefit Amount: Costs range from $50 to $350 per day; clients may choose coverage that will pay a maximum amount toward these levels. Obviously the higher benefit amount, the greater the premium. Clients will often select a $150 to $250 daily benefit depending on their financial situation. In Southern California, for example, costs can range from $63,875 to $74,825 per year ($175 to $205 per day, depending on shared or single room).

Elimination Period: Describes how long after the onset of a LTHC condition before a policy begins paying benefits. Policies generally range from 30 to 180 days or more, with premiums greater at lower levels. Since Medicare coverage is for the first 100 days, clients often consider 90 days as a moderate choice.

Benefit Duration: Address how long benefits will continue to be paid from the onset of a condition, often two to five years or lifetime. Here, again, the longer the benefit duration, the greater the premium. This one is very much individualized, based on specifics such as client's age and financial resources.

Inflation Protection: Provides that the benefit amount can increase each year at a selective annual percentage, the increase can be either simple or compound. It is particularly important for younger clients to consider this so the coverage can keep pace with inflation.

Leveraged Effect: The primary reason for using insurance is to have a significantly greater amount of potential benefit, relative to the dollars paid for that coverage.

In this context, we can explore the various insurance options that are available.

Traditional Coverage: The health insurance based "pay as you go" approach is the most common plan design, in that the insured pays a premium annually for LTHC coverage. Variations on this may include "paid in full" options wherein the client pays a greater premium for a set period, say 10 years, after which no further payments

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are required. There are also riders that will waive future premiums whenever benefits are being paid out of the policy.

The downside is that this is an expense that clients must pay out of cash flow or savings, and that it is a "use it or lose it" proposition. That is to say if there is no LTHC event, premium payments have been an expense and there has been no benefit realized. In this respect, the "pay as you go" method is similar to fire insurance on a house. There is only a benefit when there is a claim.

There have been many recent innovations that address this concern and may give clients more options. These vary and can include:

Annuity Riders: Some annuity companies will offer limited flexibility should a LTHC incident occur. These may include forgiveness of surrender charges and increased access to living benefits beyond the policy's normal terms. For example, if the policy provides at age 65 that the living benefit can be accessed at 5 percent per year, a LTHC event may allow the owner to access the living benefit at a 10 percent annual rate.

Combination Annuity-LTHC Policies: Thanks to tax and accounting rules included in the Pension Protection Act of 2006 (PPA), distributions from PPA compliant annuities that are used to cover qualified LTHC expenses can be taken tax-free. This allows clients to redirect premium dollars to their portfolio, thereby giving them what amounts to a dual benefit. On the one hand, they get the tax advantage withdrawals (i.e. more after tax dollars) to help cover costs in case of a LTHC incident. On the other, they can keep dollars working in their portfolio that might have otherwise gone out as expense premiums to cover traditional "pay-as-you-go" LTHC policies. Annuity companies may offer LTHC benefits for specific time periods and could offer an extension of benefits if needed. Other companies may offer LTHC benefits that are a multiple of the initial single premium. It is important to note how inflation protection on these various options can differ.

Hybrid Life Insurance: These are permanent life insurance policies that offer LTHC in addition to life insurance benefits. The policies, mostly single premium, combine life insurance with LTHC insurance. If there is a LTHC event, the policy owner may access the LTHC benefits on an income tax-free basis. If the client has a LTHC claim, payments under the LTHC rider reduce the life insurance amount. If there is no LTHC event, the ultimate life insurance proceeds are payable income tax free to the policy beneficiary. The "hybrid" policy addresses the concerns of the "use it or lose it" policy design. Of course, policies that offer multiple benefits may not offer the same benefits as policies that are designed to meet one specific insurance need.

To illustrate, one of our clients, male 64 years old, experienced a LTHC situation with a family member and wanted to protect his estate should he have a similar incident. Following a thorough review, we identified a hybrid life insurance program whereby a $100,000 single premium would not only provide $4,354 of monthly LTHC benefit for up to six years ($313,452 lifetime) with a 3 percent compound inflation rider, but also offer a death benefit that began at $208,788 the first year and declined to $104,484 after 30 years. Additionally, the policy gave a "Return of Premium" guarantee that could allow the client to walk away with his original deposit (less benefits paid) at any time. Compared to traditional LTHC coverage whose $4,000 to $5,600 in annual premium outlays is lost if benefits are not used, the hybrid gives the option of retrieving all or a portion of the deposit as unused benefits. It thereby delivers an alternative to the "use it or lose it" proposition that traditional "pay as you go" programs provide, and allows the client to potentially preserve their assets for greater income flexibility in the future.

The solution is always contingent on each client's specific situation, including their goals, affluence and concerns. Having an awareness of these various options will help ensure we provide the optimal LTHC solution.

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