Guide to Hybrid Long-Term Care Insurance

By Ted Stevenot

*"The impediment to action advances action.
What stands in the way becomes the way."*

Marcus Aurelius (121-180 A.D.)
Meditations, Book 5.20

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Introduction

Dear Reader,

Thank you for requesting this **Guide to Hybrid Long-Term Care Insurance!**

The unknown cost of healthcare is one of the biggest risks to retirement security. All retirees face the possibility of unforeseen future debilitating illness that may result in large, unexpected costs over time.

Unfortunately, when it comes to the issue of long-term care, the risks don't end there.

Without suitable planning, the consequences for loved ones – especially those forced by necessity to shoulder the burden of care for a struggling spouse or partner – can lead to additional, irreparable physical and emotional harm.

Insurance intended to help relieve risks associated with long-term care first appeared in the 1970s.

Unfortunately, the history of long-term care insurance has also been fraught with difficulty.

For *traditional* long-term care insurance policies,

- Policy premiums are high because of the increased likelihood for claims to occur.
- Accurately estimating the cost of future risk has been difficult for insurers – causing premiums to be raised on many "classes" of policyholders.
- Covered individuals must pay costly policy premiums for life – *often for decades* – even though they may never end up using the insurance.
- Premiums paid into the policy are lost if a traditional long-term care insurance policy is not used to pay for care.

Obstacles like these can make the cure feel worse than the disease.

But there is good news!

There is an alternative to traditional long-term care insurance known as "hybrid" or "asset based" long-term care insurance. A child of two key federal laws, hybrid long-term care insurance solves several of the chief problems associated with traditional long-term care insurance – including greater price stability, guaranteed premiums that can be "paid-up" and not continue for a lifetime, and the opportunity for heirs to recoup premiums if a policy is unused.

I am pleased to have you join me on this journey into exploring one of the most important concerns for retirees today. It is my sincerest wish that you, and those you love, gain mastery over the issue of long-term healthcare and achieve the happiest, most successful, and fulfilling retirement.

Regards,

Ted Stevenot
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Part 1: Long-term care defined.

"Long-term care" may be broadly defined as,

> *The delivery of essential services for the aid, comfort, and safety of seniors impacted by extended and debilitating physical and/or mental impairment.*

Long-term care as we know it today has been shaped by social changes and advances in healthcare.

In the past, families often lived their entire lives in the same region of the country. Some extended families even lived together in the same household. When an individual became old or infirm, the family took responsibility for providing necessary care.

"Family-based care", as this is known, was more viable in the past because healthcare was less costly and more limited in scope. Along with this reality, people didn't live as long, and they did not survive with many of the chronic conditions with which they can survive now.

In contemporary times, families are more geographically dispersed, and, in many ways, life has become more complicated. Often, in households of adult children, both spouses work and have children of their own to raise. Such demands make the logistics of reliable family-based care more difficult.

The overall cost of providing long-term care – not just nursing home care - has also increased dramatically. It used to be that spending hundreds of thousands of dollars caring for an elderly individual wasn't possible.

But those days are gone.

It is a wonder and a blessing that people can live longer and more comfortably through many debilitating health concerns but doing so comes with a price.

Types of long-term care services.

Many people hear the words "long-term care" and mistakenly think "nursing home care". The issue of long-term care reaches far beyond potential confinement in a nursing facility.

Examples of long-term care over and above nursing home services include,

- Assisted living
- Home care
- Adult day care
- Respite care
- Alzheimer's care

Other related services frequently consist of,

- Paying for modifications to a home
- In-home help
- Custodial services
- Housekeeping services
- Therapist visits
- Private nursing services, and more.

Long-term care insurance defined.

For some individuals, it can be beneficial to leverage the power of insurance to help cover and/or defray the costs associated with long-term care.

> *Long-term care insurance is insurance that helps protect against financial consequences associated with the delivery of care resulting from chronic, debilitating ailments in older age.*

- In general, the cost of most long-term care services is typically *not* covered by health insurance.
- Such expenses can be substantial and have the power to overwhelm plans for retirement income and legacy giving (i.e. funds earmarked for heirs or charity).
- Specifically, difficulty occurs when money otherwise planned for retirement income or legacy *must be diverted* to cover the cost of long-term care expenses.

It is estimated around 70% of people now age 65 will need long-term care services at some point before they die. For those who do end up requiring care, it is difficult to anticipate *how much* care will be needed, *when* that care will be required, and for *how long*.

How benefits from long-term care insurance are paid.

To be eligible for benefits under long-term care insurance, an insured must be chronically ill and receiving qualified long-term care prescribed by a licensed health care practitioner. Benefits are "triggered" when an insured cannot perform two of the six "Activities of Daily Living" (or ADLs).

The six ADLs are as follows,

- Bathing
- Maintaining continence
- Dressing
- Eating
- Toileting (getting on and off a toilet)
- Transferring (i.e. moving from a chair to a bed)

Generally, policies will include some type of waiting period before benefits are paid. For example, a "90 day waiting period" may stipulate that qualifying care be self-paid for the first 90 days. After the 90-day waiting period is met, insurance claims payment begins.

Understanding long-term care insurance policies.

Many seniors – and their family members – are unaware of the details of how long-term care insurance policies function. There is often confusion about qualifying benefit triggers, what types of services may be covered, when a waiting period begins, ongoing care management, and how long benefits will last. Some seniors are fearful to use their policies from worry about running out of benefits too soon.

For the most part, all of these concerns can be reduced substantially with a simple phone call to your insurer. Things to do before and after your call,

- Write down a list of your questions.
- Request a copy of your policy.
- Ask what is required to authorize a trusted family member(s), friend, or fiduciary to help you access and manage your long-term care insurance in the future.

- Place relevant policy information (i.e. policy, policy number, insurance carrier contact information, billing information, etc.) in a place where trusted family members can access it.

If you are still uncertain, call your insurer again to clarify. It is an exceptionally good idea to find a trusted person to help you access and manage your policy in the future. Typically, insurers require written permission in advance to authorize another person access to your policy information.

When does owning long-term care insurance ***not*** make sense?

For some people, it does not make economic sense to purchase long-term care insurance because *premiums will consume too much of their available savings or income*.

For such individuals, the cost of upkeep on long-term care insurance premiums is a major concern. Most traditional long-term care policies expect premiums to be paid for a lifetime (hybrid long-term care insurance policies work differently – more on this later). I have heard multiple seniors speak unhappily about bearing the weight of ongoing long-term care insurance premiums, especially in their later years.

- Individuals below certain asset and income levels may qualify for state Medicaid programs that assist in paying for long-term care.
- However, qualifying for such help frequently requires an individual to "spin down" his or her assets to extremely low levels.

Spinning down assets is no fun.

Even after doing so, choices for care can be limited. Individuals may get "what's available, when it's available," with reduced power to choose. Most will want to avoid this path, especially those with a surviving spouse who must live on after assets are spun down. There are provisions in Medicaid for some funds to remain with a surviving spouse, but the thresholds can be onerous.

The special long-term care risk to women.

In couples, the cost of providing long-term care can be detrimental to both spouses, but it can be especially damaging to a surviving spouse.

More often than not, this means that *women* will be the most at risk.

This is a fact because on *average*,

1. Women tend to live longer than men.
2. Women tend to marry men slightly older than themselves.

Healthcare spending dramatically increases and becomes more volatile with age. This risk can overwhelm a retirement portfolio. It's no mystery that dying can be extremely expensive. Medical bills, home care, custodial care, nursing care, and other end-of-life expenses add up.

As a result, the *first* spouse to die in many couples – more frequently, men – will inadvertently take the lion's share of the couple's retirement nest egg with them when they go. When this occurs, what happens to the future security of the surviving spouse?

Beyond the physical and psychological impact of experiencing such a difficult loss, many are predicting a poverty crisis among women in the coming years.

Roadblocks to securing long-term care insurance.

Long-term care insurance can be a great way to help defray the costs associated with long-term care, but there are several challenges with insuring this risk.

A few examples,

- Because long-term care expenses can be considerable and have a higher probability to manifest, premiums for long-term care insurance are costly.
- You can’t wait until you are already sick and in need of care to purchase long-term care insurance. Individual policies are medically underwritten and must be put in place *before* debilitating conditions occur.
- Buying long-term care insurance requires the ability to anticipate far in advance of ever needing benefits. Many people – especially men – feel invincible and avoid such planning, believing, “It won’t happen to me!” Such feelings align well with human nature and survival instincts but are unreliable as a basis of predicting the future need for long-term care.
- A person buying long-term care insurance in their 50s may pay premiums for *30 years or more* before ever seeing a benefit. This is an exceedingly long haul, and many are tempted to throw in the towel along the way.
- Some end up shouldering the burden of expensive long-term care insurance premiums throughout the entirety of their senior years and *never* need to file a claim. In the case of traditional long-term care insurance policies, decades of premiums paid are lost.

In addition to the above issues, in the past, insurance companies offering traditional long-term care insurance have struggled to estimate the cost of future claims correctly. Many factors contributed to this such as longer life spans, medical inflation, and improvements in the scope of long-term care services, and more. The end result, however, forced insurers to substantially raise premiums on current “classes” of policyholders.

The good news is there are ways to protect yourself from the risk of long-term care costs and avoid at least some of the above pitfalls. It may even be possible under certain circumstances for loved ones to “get your premiums back” if you don’t end up needing care.

Part 2: Paying for long-term care.

Beyond government intervention in dire circumstances, there are generally *three* main ways to cover the cost of long-term care. These are,

1. Self-funding.
2. Traditional long-term care insurance (sometimes called *health-based* long-term care insurance).
3. Hybrid long-term care insurance.

Self-funding.

With *self-funding*, the strategy is evident – if long-term care expenses are incurred, they must be paid for out of pocket. Investments can be set aside to help cover this possibility. When care is needed during a long-term care event, set-aside funds are liquidated.

Three *pitfalls* of self-funding are,

1. The absence of leverage – or risk pooling – achieved through insurance.
2. Taxes due on savings liquidated to pay for care – as capital gains or ordinary income.
3. Care paid for with long-term care insurance receives favorable tax treatment that is unavailable with self-funding (more on this later).

Two *upsides* of self-funding are,

1. Total control of your funds.
2. If you don't end up needing care, unused funds aren't lost and can be spent, left for heirs, or left to other beneficiaries.

Traditional long-term care insurance.

With *traditional long-term care insurance*, an individual must qualify for a policy and pay premiums on that policy for life. If long-term care services are needed, the policy makes benefit payments according to the policy guidelines.

Three *pitfalls* of traditional long-term care insurance are

1. Premiums, in general, must be paid for a lifetime – even in advanced senior years.
2. Though rates cannot be raised on an individual policyholder, they can be raised on a *class* of policyholders. This has happened many times in the past causing policy premiums to substantially increase over time.
3. If no care is needed, policy premiums are lost.

One potential *upside* to traditional long-term care insurance is initial outlays for annual premiums may be lower in earlier years. However, paying premiums for life, the possibility that premiums may substantially increase in the future, and getting nothing back if you don't use the insurance tends to offset this advantage.

Hybrid long-term care insurance.

The third way to cover long-term care risk is through hybrid or “asset-based” long-term care insurance.

Hybrid long-term care insurance is an alternative to traditional long-term care insurance protection. It protects against long-term care costs while *simultaneously* protecting insureds from the risk of lost premiums should care not be needed.

Part 3: Hybrid long-term care insurance.

Hybrid long-term care insurance is created by *combining* an underlying life insurance policy or annuity with a *rider* or add-on amendment(s) to cover long-term care expenses.

With traditional long-term care insurance, if no long term-care event is experienced, premiums paid into the policy are lost. With hybrid long-term care insurance, if no care is needed, life insurance death benefits or underlying annuity values are available for heirs.

Hybrid long-term care insurance offers fixed, guaranteed premiums and guaranteed benefits. Hybrid long-term care insurance is also available with improved payment options - including single-premium or fixed-period payments (i.e. policy paid for in ten years, fifteen years, etc.).

Key characteristics of hybrid long-term care insurance.

- Lock in benefits - benefits guaranteed not to decrease.
- Lock in premiums - premiums guaranteed not to increase.
- Pays *you* if you need care and pays *heirs* if you don't need care. Or, if necessary, pays partial benefits between you and your heirs.
- Pays you a refund – less expenses – if you cancel or surrender the policy.
- Eliminates "use it or lose it" element of traditional long-term care insurance.
- Eliminates the lifetime bill of traditional long-term care insurance policies, if desired.
- Hybrid long-term care policies offer the option to purchase a policy in one lump sum or over a fixed amount of time. This means no more worry about paying a lifetime of future premiums in advanced age.
- Hybrid long-term care policies utilize *both* tax advantages and the leverage of insurance to help cover long-term care costs.
- With *a life insurance-based* hybrid long-term care policy, if there are no long-term care claims, the insured's beneficiaries receive the policy death benefit income-tax free.
- With an *annuity-based* hybrid long-term care policy, if there are no long-term care claims and the contract has not been annuitized for income, the insured's beneficiaries receive the underlying values of the annuity – any untaxed policy gains will be subject to tax.
- With at least one insurer, *both* spouses can potentially be covered by the same hybrid policy.
- Hybrid long-term care policies are medically underwritten – in general, answers to medical questions, medical exams, and cognitive screenings are common to determine level of risk.
- Annuity-based long-term care insurance offers opportunities for some less healthy individuals who may be denied coverage through other policy types.
- Hybrid long-term care insurance helps those who favor self-funding gain access to more tax efficiency than standalone self-funding.
- Tax favorability of hybrid long-term care policies make them similar to Roth IRA type savings but *without* the restrictions and distribution requirements connected to such accounts.
    - ✓ The cash reserves of hybrid long-term care policies grow tax deferred.
    - ✓ Qualifying long-term care benefit payments are income tax free.
    - ✓ Death benefits of life insurance-based hybrid long-term care policies are income tax free to beneficiaries.

Price stability and hybrid long-term care insurance.

As mentioned earlier, many traditional long-term care insurance policies have had a history of requiring significant premium increases over the lifetimes of policyholders. Ask anyone in their 80s who has owned traditional long-term care insurance for the last few decades about this, and they will likely have a related story to tell.

- With traditional long-term care insurance, premiums cannot be raised on an individual policyholder, but they can be raised on a *class* of policyholders.
- Hybrid long-term care policies avert this problem by pairing the volatility of long-term care insurance pricing with the stability of life insurance and annuity pricing.
- Hybrid long-term care insurance policies prepay a definable claim amount which is much easier than calculating the more undefinable risk in a traditional long-term care policy.

With hybrid long-term care policies, maximum exposure is better known and accounted for which helps makes pricing more stable. This protects both policyholders and insurers.

The origin of hybrid long-term care insurance.

The birth of hybrid long-term care insurance can be traced to two key federal laws; the Health Insurance Portability and Accountability Act (HIPAA), and the Pension Protection Act (PPA)**.**

- ***HIPAA*** – If a qualified policy meets certain triggering events, then benefits can be paid without income tax. HIPAA provided for the first "combination contract" or what is now known as a hybrid or asset based long-term care policy. HIPAA said that life insurance and long-term care could be combined into a single policy. As long as the policy provisions comply with the law, benefits will be received by policyholders tax free. Further, if the policy pays no benefits for long-term care, the life insurance proceeds can be received by heirs tax free. Each payment of long-term care benefits reduces the face amount of the life insurance policy until death benefits are depleted.
- ***PPA*** – This act expanded the tax favored treatment of long-term care combination contracts to "deferred annuity long-term care combination contracts". Similar to life insurance-based long-term care contracts, benefit payments reduce the annuity account value. Payments made from an annuity-based long-term care policy for qualifying long-term care expenses are paid income tax free. At death, funds remaining in the annuity contract (provided the contract has not been annuitized to provide annual income) are ordinary income to beneficiaries when taxable gains remain in the contract.

1035 Exchanges from older permanent life insurance for hybrid long-term care insurance.

For individuals with older life insurance policies that are no longer suitable for their current financial plans, there is an opportunity to "roll over" or exchange values from an older policy to a new hybrid long-term care policy. This is accomplished by making use of what is known as a "1035 Exchange".

- The cash value of an old life insurance policy is transferred to the new hybrid long-term care policy *without* forcing current taxes to be due on untaxed gains.
- Qualifying long-term care expenses covered by the new hybrid long-term care policy are paid tax free.

- As noted, when premiums are paid lump-sum for a hybrid long-term care insurance policy, it eliminates the lifetime bill associated with traditional long-term care insurance.

Continuation of Benefit (COB) riders for hybrid long-term care policies.

An additional benefit called "continuation of benefit" coverage can be added to most hybrid long-term care polices. This benefit kicks in when the balance of the original long-term care policy is exhausted as a result of qualifying benefit payments.

- Combining a hybrid long-term care policy with a COB rider is similar to raising your deductible on a car insurance policy.
- The base policy is effectively funded with the insured's money. The COB only becomes involved in the case of an extended claim.
- The net effect is a *lower* overall cost of insurance when compared to extended coverage available through traditional long-term care policies.
- COB riders are available for an additional cost and are medically underwritten.
- COB benefits can be inflation protected.
- COB payments continue for a specified period of time beyond the base coverage period (for example - three additional years, five additional years, or for a lifetime).
- COB coverage isolates a risk that is potentially catastrophic, but also an outlier. An average stay in a nursing home is roughly 2.5 years. The number of individuals who enter and stay in a nursing home for more than 5 years hovers around 5%.

Buying hybrid long-term care insurance with an IRA.

If you are over the age of 59-1/2, it may be possible for you to purchase a hybrid long-term care policy with funds from an IRA. At least one insurer has a program through which periodic annual premium withdrawals are coordinated through an IRA account.

How it works.

1. An individual or both spouses are covered by one policy.
2. A portion of IRA account funds are "rolled over" tax-free into a qualified ten-year-certain deferred annuity.
3. Each year for ten years, funds are dispersed from the annuity to pay the annual premium on a 10-year-pay hybrid long-term care policy.
4. Annually, the policyholder receives notification of the reportable income amount for taxes.
5. Once the ten years are up, the deferred annuity will be depleted, and no additional hybrid long-term care premiums will be due.
6. For older retirees, annual withdrawals used to pay premiums can help meet RMDs (Required Minimum Distributions).
7. Lower annual withdrawals spread out over ten years generally creates a reduced tax impact when compared to making a large, one-time withdrawal to fund a single-premium or lump-sum policy.

Part 4: Solving the dilemma of long-term care.

Whether care is in a facility or at home, planning ahead can reduce the stress and toll of providing care on loved ones. Long-term care solutions based on life insurance and annuities offer the reassurance of benefits if long-term care is needed. But, if you don't end up needing care, your asset passes to your heirs and becomes a part of your legacy.

Imagine, living out your last days as comfortably and with as much dignity as possible and protecting your loved ones from the physical, financial, and emotional burden of caring for you.

- Protect your assets from being drained by the cost of long-term care.
- Leverage the claims-paying ability of insurance to help you cover the potential cost of care.
- Take advantage of the current preferential tax treatment of benefits that are paid for through a long-term care policy.
- Retain independence and potentially leave a legacy for loved ones.

Hybrid long term care policies present a practical alternative for persons looking for a long-term care insurance solution - death benefit, long-term care protection, and potential positive impact on legacy.

Additional resources.

Long-term care insurance is a complex topic. There is no "one size fits all" solution and long-term care insurance is not suitable for every situation. You will have to study the options, weigh the benefits, and decide what works best for you.

A publication advised to anyone considering the purchase of long-term care insurance is the National Association of Insurance Commissioners', *A Shopper's Guide to Long-Term Care Insurance*.

The guide is available for free online at the following link,

https://www.naic.org/documents/prod_serv_consumer_ltc_lp.pdf

If you wish to contact me for more information about hybrid long-term care insurance, I can be reached through my Milford, OH office below or via email: ted@mccarthystevenot.com

To request a preliminary proposal for hybrid long-term care insurance, please complete and return the attached form by mail, email, or fax.

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Important Disclaimers:

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Annuities and insurance contracts are not deposits. They are not FDIC or NCUA insured. They are not insured by any federal government agency. They are not guaranteed by any bank or savings association. Any guarantees are based on the issuing insurer's ability to pay. The exact terms of an annuity or life insurance policy are contained in the contracts and any attached riders, endorsements, and amendments, which will control the issuing company's contractual obligations.

There is no additional tax-deferral benefit for annuity or insurance contracts purchased in an IRA or other tax-qualified plan since these are already afforded tax-deferred status. The earnings of annuities and any pre-tax payments are subject to taxes when withdrawn. Annuity payments or withdrawals before age 59-1/2 may be subject to a current federal tax penalty of 10%.

The information provided through this guide is not intended to recommend that you purchase life insurance, an annuity, QLAC, deferred annuity, or other insurance product. To determine whether an annuity or other insurance is right for you, you should consult with a competent professional advisor and complete a suitability review. Products and features are subject to state availability. Limitations and exclusions may apply. Always read any proposed insurance or annuity contract carefully and be sure all of your questions are clearly answered before making any purchase.

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Preliminary Proposal Request for
Hybrid Long-Term Care Insurance*

Name: ____

Date of birth: __________________ Smoker? Y / N

Spouse's name: ____

Date of birth: __________________ Smoker? Y / N

Address:____

City, State, ZIP:____

Email: ____________________________________ Phone: ___________________________

Complete this form and return by mail, email, or fax to:

Ted Stevenot
McCarthy Stevenot Agency, Inc.
209 Main St.
Milford, OH 45150

Email: ted@mccarthystevenot.com
Fax: 513-891-3088
Phone: 513-891-9888

**Important! This request form is for preliminary proposals only. Hybrid long-term care insurance policies must be medically underwritten prior to approval and issuance of final rates. Long-term care insurance is not appropriate for every situation and requires a suitability review. Thanks!*