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New Hybrid Long-term Care Insurance – Right for You?

Insurers are rolling out new products that combine life insurance or annuities with long-term-care insurance, prompted by a new law that will soon make distributions from life insurance and annuities tax-free when used to pay nursing-home costs. But do these new offerings make sense for consumers? That's the big question. The following article contributed to MarketWatch on July 16, 2009 by Robert Powell, a journalist covering personal finance issues for more than 20 years, analyzes these new products.

The new law goes into effect on Jan. 1, 2010. Already, four companies -- United of Omaha, Genworth Life, Bankers Life, and OneAmerica -- have introduced hybrid products that combine annuities with long-term-care insurance, according to a report in Retirement Income Journal. Experts predict that a rash of products will emerge later this year. "These first-wave hybrids differ in their details but share certain basic elements," said Kerry Pechter, editor of Retirement Income Journal, in the report. "They each consist of a fixed deferred annuity, funded with non-qualified money, wedded to a long-term-care rider that pays out two or three times the value of the initial premium, or for a specific number of years, or for life."

The annuity assets are there to serve as a huge deductible to be tapped for long-term care first, Pechter said. "If and when long-term-care bills exhaust the annuity assets, the insurance coverage begins," he said. "In the interim, about 1% of the annuity is deducted each year to cover the long-term-care rider. Hybrids have the potential to significantly reduce the cost of long-term-care coverage."

The other type of hybrid -- the one combined with life insurance -- works this way, according to AARP: "The buyer would make a single large premium payment to purchase a cash-value life-insurance policy. The policy specifies a guaranteed death benefit. If the policyholder does not use any long-term-care benefits, the death benefit is paid to the beneficiary when the policyholder dies. However, the policy can also pay for long-term-care services and supports, with a corresponding reduction in the death benefit."

Hybrids have the potential to reduce the cost of long-term care. But experts say these products are best suited for certain types of buyers and should be purchased only after a thorough cost-benefit analysis by an independent intermediary.

Will you need long-term care?

For many people, the question of whether to buy long-term-care insurance hinges on the question of whether they'll ever need to pay for services at a nursing home, assisted living facility or for

home-based health care. That's hard to predict. But a fairly high percentage of older Americans will need long-term care for at least two years -- and that care is expensive, studies show.

Two in five Americans turning 65 today will need more than two years of care at an average cost of \$68,000 a year, according to the Georgetown University Long-Term-Care Financing Project. Right now, most people pay for long-term care out of pocket (often called self-insurance) or by using Medicaid. A portion of Americans own long-term-care insurance, and that figure is likely to rise given the government's efforts to make it a household product.

Eight million Americans owned a LTC insurance policy in 2007, according to the American Association for Long-Term Care Insurance. Some 180,000 Americans, two-thirds of them women, received benefits from an LTC policy in 2008, according to AALTCI. The five most common reasons for a long-term-care insurance claim are Alzheimer's disease, stroke, arthritis, circulatory issues or injury.

There are many reasons why Americans don't buy long-term-care insurance. Some view the premiums, which average about \$2,200 per year in 2007, as costly. Indeed, that's the case if you don't ever need to file a claim. "The desire to insure against long-term-care risk competes with the need to insure against the many other risks we face in life, and many people decide that purchasing long-term-care insurance is not a viable option," said Marc P. Freiman, Ph.D., of RTI International in an AARP research paper in 2007.

Hybrids to the rescue

But Americans are in a bit of a bind. They don't want to spend down their nest eggs on nursing homes. They don't want to go on Medicaid. And they don't want to risk losing money on LTC insurance premiums. So, as far back as 2002, insurers set out to design a better mousetrap. Prudential, New York Life, The Hartford and Golden Rule designed annuity and life-insurance products with riders that allowed owners to use the product to pay for long-term care if need be.

But with the passage of the Pension Protection Act in 2006 and with the 2010 date for tax-free distributions looming, many insurers are now fast at work designing hybrid products that will allow the buyer to have their cake and eat it too.

A couple of years ago, before the current stable of hybrids was launched, experts said these products might be a hard sell. Yes, they allow you to buy one policy to insure against two risks, but these products are complicated. "Hybrid insurance products will require a better educated consumer in order to make the financial decision that is best for him or her," Freiman wrote in 2007.

Fast forward to today. The products are still complicated, but more is being learned about the target audience. "These products are not for everyone," said Beth Ludden, senior vice president of long-term-care product development at Genworth Financial. And Chris Cooper, a certified financial planner and president of Chris Cooper & Company, said: "This product is not a good fit for most middle-class people."

Hybrids are not right for everyone, but they could be right for some, experts said. For instance, they could be a good fit for someone who planned to self-insure and set money aside in a rainy-day fund for long-term-care costs, or someone who doesn't qualify to purchase a stand-alone LTC insurance policy, or someone who wants to do a 1035 exchange to switch from a paid-up policy into the hybrid.

According to Ludden, someone who has \$100,000 or so set aside in a CD earmarked for long-term-care costs could take that money and purchase a hybrid product that would produce up to three times the amount of initial premium in long-term-care benefits or up to six times in life insurance death benefits. "You are taking an asset or part of an asset and leveraging it," Ludden said.

But, to be fair, it's not quite as simple as that. Even if you fit the best-buyer profile, there's plenty to consider before plunking down \$100,000. You'll need to crunch the numbers to determine whether buying a hybrid is a better financial deal than buying two stand-alone products. (As a rule of thumb, Ludden said it might make sense to buy the hybrid product if the length of time you need long-term care is likely to be short, and to buy the stand-alone product if the length of time you need long-term care is long.)

You have to read the fine print to determine if the hybrid has the right features, just as you would with stand-alone products. For instance, some hybrid products' long-term-care policies might cover "facility-only" costs instead of all types of long-term-care costs.

You must consider whether you're willing to lock in the relatively low returns (about 2.5%) and costs (about 1%) associated with hybrids.

Also, you need to consider that distributions from annuity and insurance contracts used to cover the cost of long-term care will reduce the owner's "investment in the contract (but not below zero) when determining gain on future taxable distributions," wrote Michael Kitces, editor of the Kitces Report, in Steve Leimberg's Employee Benefits and Retirement Planning Newsletter in 2006.

Also, "you could diminish or eliminate the long-term-care benefit if you decide to annuitize," Ludden said. And, according to Kitces, you have to make sure that the long-term-care policies are considered "qualified" under government rules.

You should do all of this due diligence with the help of a disinterested intermediary who doesn't stand to gain from the sale of the product, Pechter said. After all, the insurance agent stands to earn in commission an amount equal to the initial surrender charge. In other words, if you purchase a \$100,000 hybrid and the initial surrender charge is 9%, the agent stands to earn \$9,000 on the sale. "That's a big incentive to close a sale," Pechter said. "The agent would not be last person that I would talk to."

In the end, Pechter said, hybrids could either be a cheaper or a more expensive way to buy long-term-care insurance. Which it is depends at least in part on the answer to this question: Are you buying the hybrid or is it being sold to you?

For the entire article, including links to the reports and resources listed in it, go online at:
<http://www.marketwatch.com/story/new-products-may-ease-bite-of-long-term-care-costs?pagenumber=1>

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