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Managing the Twin Risks of Death and Long-Term Care

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Asset-based long-term care insurance can help clients build a financial "woodshed" to address multiple needs in retirement.

When New England farmers say it is time to "shed wood," they refer to putting fuel in storage for the winter. There it stays safe and dry and remains instantly available to provide heat to cook food and warm the house during the cold blizzards that come with winter.

The concept of "shedding wood" also has a practical application for people approaching retirement. The twin financial risks that all seniors face are of dying too soon (unexpected death from an accident, heart attack, stroke, and so on) or living long enough to require long-term care (LTC). Both risks require setting aside funds for future delivery at the time they might be needed most.

Let's examine each risk separately and see how insurance can "shed money" for seniors' future needs.

Life insurance can:

- Replace income a spouse might lose when a partner dies.
- Provide additional cash to pay final expenses and retire debt.
- Replace assets that might be lost to estate taxes.
- Convey income tax-free, probate-free legacy assets to named beneficiaries.

Most readers already are aware of the power of life insurance as a tool to protect and transfer assets. It can create substantial death benefits from relatively modest premiums. Put another way, a life insurance policy "woodshed" provides access to cash value while the client is alive, and it multiplies the value of those premium dollars when the client dies.

LTC Expenses Pose Second Risk
The woodshed analogy also applies to the financial risk of LTC. According to recent LTC cost research, the average cost of a private nursing home room was a little more than $70,000 a year.[1]

Recent research on assisted living costs revealed the average hourly rate for a home health aide was $18. When home care evolves to a need for round-the-clock services, annual costs will grow to $157,000 — more than double the cost of nursing home care. Costs in many metro areas are much higher than these averages.[2]

A usual two- to three-year stay in a private nursing home room will cost uninsured persons (and their beneficiaries) $140,000 to $210,000. Assuming 5% inflation, the costs of care services will double in less than 15 years.

That is why it is important to remind mature prospects, including people who can afford to pay those bills, that the first step to estate planning is planning to preserve the estate. Every dollar lost to LTC expenses also is lost to beneficiaries. Seniors' children eventually foot all uninsured expenses.

Advantages and Disadvantages of Traditional LTC Insurance
Conventional wisdom, and a good strategy for many, is to shift the LTC risk to a good LTC insurance (LTCi) policy. Unspent investment income often can be used to pay the annual premiums. That makes LTCi affordable to healthy seniors who have sufficient assets to disqualify them for Medicaid, but whose nest eggs could be devastated by a need for two to three years of care.

We consider three things before recommending traditional LTCi to senior prospects:

1. Premium payment risk. Usually, premiums are paid until the client needs LTC. There is no way to pre-determine how many premiums will be paid, nor is there a guarantee that the premium amounts will remain level for the rest of the client's life.

2. Lack of liquidity. LTCi has no cash value. That means it is not suitable as a "woodshed" for emergency money.

3. Benefits are not paid if LTC is not required. A 60-year-old prospect contemplating a $3,000 annual premium is likely to pay at least $60,000 over his or her remaining lifetime. If he never needs care, the insurance company usually keeps all of his money.

Return of premium riders are available with many LTC policies, but their incremental cost can be substantial. The prospect might be better advised to spend that money on an annual premium universal life policy. The life insurance death benefit, paid regardless of the need for LTC, usually exceeds the value of an LTC policy's return of premium guarantee.

Is Self Insurance a Wise Option?
Self-insuring the risk of LTC requires a two-prong approach to investing. First, because it is impossible to time the need for care services, it is important to keep enough emergency money in cash and short-term debt instruments to pay for one or two years of care. This "rainy day" money lessens the risk of having to liquidate securities at a loss if LTC bills arrive during a down market. But maintaining that cash position also

entails opportunity cost.

Second, it is important to establish an inflation hedge. That requires investing additional funds in a diversified portfolio of securities with long-term potential to provide an after-tax growth rate that exceeds the care cost inflation rate, which has been hovering around 5%. Considering the combined effect of federal and local taxes, a 5% after-tax return requires before-tax earnings of at least 8% to 9%.

When the needs for emergency cash, an inflation hedge, and maintaining retirement income all are combined, self-insuring the risk of LTC might prove a tough challenge for the most astute investment adviser.

Asset-Based LTCi: A Financial “Woodshed” for the Twin Risks of Death and LTC

Another approach is to shift part or all of the twin risks of premature death and LTC to an insurance company that underwrites asset-based LTCi — a “linked benefit” life insurance policy with an LTCi rider (see chart on page 60 of the July 2005 issue of LIFE INSURANCE SELLING).

Asset-based LTCi can be a suitable choice for healthy senior prospects who keep $100,000 or more of emergency cash on the sidelines. These policies often are funded with a single premium, which eliminates the recurring premium payment risk associated with most traditional LTCi policies.

Some single-premium linked benefit insurance policies also provide lifetime money-back guarantees. That means clients remain in complete control of all the cash that they put in their retirement “woodshed.”

The policies provide substantial additional funds (including optional extra cost inflation protection) if they ever need LTC. If LTC is not required, the policy pays an income tax-free death benefit to named beneficiaries.

Suitable Sales Opportunities

We have found these policies to be especially popular with affluent seniors who can afford to pay for their own long-term care. We use policies that provide a money-back guarantee, so the client retains control of his or her money after purchasing the policy. The money-back guarantee applies as long as the policy owner makes no loans or withdrawals and maintains benefits at guaranteed levels.

We also look for policies that provide LTC benefits that exceed the value of the life insurance. If the policy simply pre-pays the death benefit for LTC, beneficiaries eventually will pay for the care costs one way or another.

Last, for prospects in their 60s or younger, we recommend policies that provide inflation protection. We believe that they are well worth the extra cost for the reasons discussed earlier.

Asset-based LTC policies also can be suitable for tax-free exchanges of cash value life insurance policies that were purchased years ago. They are an option to consider when the producer does insurance reviews for his or her clients. He should be alert for surrender charges that might apply to any tax-free policy exchange, however, and carefully examine the linked benefit policy for any new loads and surrender charges that might apply.

The producer always should consider the suitability of his or her product offerings for senior prospects. Assets and income can vary widely from prospect to prospect, so no single financial model can be used to determine suitability. The goal is to meet the financial needs of senior prospects most effectively, and the goal of the asset-based strategy is to position senior prospects' savings properly for the most leverage possible.

The appropriate senior prospects are self-insuring against potential LTC needs, with liquid assets in interest-earning accounts. These "rainy day funds" are kept in such vehicles as money market accounts, bank certificates of deposit, or savings accounts that usually earn low interest. Their plan is to use the "rainy day fund" in the event an LTC need arises.

Their real belief, however, is that they never will need LTC and expect that their savings will become part of their legacy plan. Only a portion of this "rainy day fund" would be necessary to fuel an asset-based LTCi product and provide tremendous leverage for either the LTC need or legacy plan.

In addition to determining insurable need and financial objectives, there are some general questions to ask that can help determine suitability:

- Does the prospect spend the income from the asset that would be used to purchase the policy? If the proposed insured spends the income, either a replacement source for that income or another premium source should be found.

- Does the prospect have a short-term use planned for the asset that would be used to purchase the policy? If yes, and the planned use still is to be carried out, another premium source should be found.

- Is the asset that would be used to purchase the policy intended for accumulation, unforeseen emergencies, or eventual transfer to children? If yes, the asset probably is suitable for an asset-based LTCi purchase, assuming that the two previous questions are resolved.

- If the senior prospect is considering replacing an existing traditional stand-alone long-term care policy, the producer should consider two additional suitability concerns:

    1. The policy might provide a longer benefit period or higher benefits than the proposed asset-based LTCi. These and other possible differences should be weighed against the death and long-term care benefits provided by the LTCi policy.

    2. The senior prospect might never have a claim for benefits under the policy, but an asset-based LTCi policy would provide a death benefit, long-term care benefits, or both.

Future Trends
Asset-based LTCi policies have been around since the late 1980s, but they have exploded in popularity in recent years. Most senior buyers are affluent persons who have said "no" to traditional LTCi. Many of the major life companies, including leaders in traditional LTCi, offer linked-benefit products. Those companies know, as we do, that linked benefit products do not detract from traditional LTCi sales. In fact, by offering choice, we have attracted additional business.

These policies are well worth your attention if you seek to grow your practice, especially in the senior market.

Footnotes:
1. The Mature Market Institute, The MetLife Market Survey of Nursing Home and Home Care Costs, September 2004, Executive Summary, on the Internet at www.metlife.com (visited May 23, 2005).

2. The Mature Market Institute, MetLife Market Survey of Assisted Living Costs, October 2004, Executive Summary, on the Internet at www.metlife.com (visited May 23, 2005).

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