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New Strategies for Long-Term Care

By Kelly Greene

When it comes to long-term-care insurance, families generally fall into two camps: They're either afraid to let their elders go without it, or they're afraid to spend their savings on steep premiums.

Changes in federal law that took effect Jan. 1 could make it cheaper for both groups to hedge their bets.

Long-term-care insurance typically covers home-health, assisted-living or nursing-home care, which protects you and your heirs in the case of a long-term chronic illness. But as with most decisions involving insurance, there are drawbacks to consider. The premiums on traditional long-term- care policies can be steep about $2,200 a year per person, on average. And if you buy a policy you don't wind up using, you could be pouring money down a hole instead of leaving it to your kids.

A lesser-known way to get coverage is to buy a deferred fixed annuity in which an initial investment grows throughout your lifetime packaged with long-term-care benefits. You can also buy a life-insurance policy combined with long-term-care coverage, in which a portion of the policy's death benefit is paid out to cover long-term-care expenses and the death benefit is reduced accordingly.

Before this year, a person who bought an annuity or life-insurance policy with long-term-care benefits was taxed on any payouts. Now, thanks to changes enacted in the Pension Protection Act of 2006 and taking effect this year, that money is distributed free of taxes. Other investors can also benefit under the new rules: Funds they transfer directly from an annuity or the cash-value portion of a life-insurance policy to pay for long-term-care insurance are no longer taxable as income.

"If you bought a $50,000 annuity, and it's now worth $150,000, you're getting 25% to 30% more out of your money if you use it to pay your long-term-care premiums," says Henry Montag, a certified financial planner in Syosset, N.Y.

The new rules are prompting insurers to design and hawk more "hybrid" policies that offer the benefits normally associated with an annuity or life insurance, plus protection against long-term-care expenses. Sixteen insurers are now selling life insurance with long-term-care benefits, and six companies are offering annuities with a long-term-care component, according to insurance research firm Limra International Inc.

Genworth Financial Inc., one of the country's largest long-term-care insurers, introduced an annuity product with long-term-care benefits nationwide late last month that would pay holders up to three times the annuity's value for long-term care.

For example, if a 65-year-old buys a $100,000 deferred annuity that earns 3% a year, that product could provide up to $300,000 in long-term-care benefits. If that person died at age 80 without tapping the account, the beneficiary would get $128,000 before taxes, says Katherine Liebel, head of Genworth's linked-benefit products.

On the surface, these products sound like a way to meet two needs at once: You can leave life insurance to your heirs, or create a nest egg for yourself, and cover your long-term-care needs at the same time. But they aren't without their drawbacks. They typically involve a single and very steep lump-sum payment ($100,000 isn't uncommon), and can be numbingly complex. Also, you might get more-comprehensive benefits by buying each product separately. And your money may be locked up in a low-return investment for years.

Keep in mind that with such combo products, using up your benefits on long-term care leaves your beneficiaries with only a small, residual amount upon your death. So it's important to let your family know the worst-case scenario, in case they would otherwise be counting on that money.

Still, if you're averse to paying steep premiums for long-term-care insurance you might never use, these products could help plug a hole in financial and estate plans. And it could be marginally easier to get: The health questionnaire for linked products typically uses about 10 questions, compared with 50 for traditional long-term-care insurance, including more about your family history, Mr. Montag says. "If you have cancer or Alzheimer's, you're still not going to qualify, but if your health is borderline, you might."