

## Safeguarding Clients from Long-Term Care Costs

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As your clients' most trusted adviser, how can you protect them from the financial threat and high costs of long-term care?

You basically have two initial choices. Let's assume your client is under age 75, relatively healthy and understands that an unexpected, unreimbursed long-term care expense is a real threat that can unravel their and their spouse's retirement plans and lifestyle. You can talk about "what if" scenarios, including the purchase of a long-term care insurance policy. Or you can avoid the fact that costs for care at home or in an assisted living community are in the \$60,000 to \$75,000 range, and that costs in a skilled nursing facility are in the \$125,000 to \$175,000 range

and are both increasing by 4 percent annually.

Should you have this unpleasant, difficult conversation with your clients? Since the odds of this problem affecting a client over age 80 is approximately 70 percent, it could make a great deal of sense to get your clients thinking about a solution to a problem they may one day likely face.

Where will the necessary funds come from to pay for these costs? Is there a readily accessible source of sufficient funds that will not trigger a large unnecessary taxable event when liquidated? Should the client self-insure against this threat or would it make more economic sense to purchase a long-term care insurance contract from one of the major insurers?

Having a long-term care insurance contract will not only provide your client with the dollars necessary to pay for some or all of the expenses associated with their care, but will provide them with independence and peace of mind, knowing they'll never be a burden to their kids or spouse. But will the costs be justified if they never need the coverage?

For clients who own businesses, depending on your client's particular corporate structure and age, they may be able to deduct the entire premium or a part of it. At a minimum most states have a 20 percent state tax credit for any individual. This is also one of the few times that an insurance benefit can be paid for on a totally discriminatory basis, i.e., for all officers and spouses, and then be taken as a 100 percent deduction in various corporate settings.

The second question becomes should I consider keeping all or a part of the exposure to a long-term care expense? Should I self-insure or share the risk with an insurer? Is it less costly to self-insure? Is this the best

use of my assets? What type of an investment of my asset is this? Keep in mind, the premiums paid for this coverage isn't an investment at all, Instead it's a cost of protecting assets against a likely loss.

A long-term insurance contract can be purchased to provide a set dollar amount of \$100 to \$500 on a daily basis. The coverage can pay a benefit for a minimum of two years, up to a maximum of six years, after a 90- to 100-day waiting period. Most contracts are of a comprehensive nature, meaning they will pay for care in an insured's home, an assisted living facility, or in a skilled nursing facility. They will pay for all three levels of care, custodial care, as well as skilled care and anything in between.

The primary reason why many individuals are reluctant to purchase such a contract is because they're concerned about the waste of annual premium dollars if they pay a premium and then never need to collect the benefits. Many others are under the impression that they'll be better off if they merely self-insure.

In an effort to encourage private individuals to purchase a long-term care contract, and overcome the preceding two concerns, the insurance industry, in conjunction with the federal government, recently enacted legislation effective Jan, 2011, as part of the 2006 Pension Protection Act. This act allows an individual to access up to \$120,000 in 2015, annually adjusted for inflation, on a tax-free basis from the death benefit of a life insurance contract, if it's used to pay for a qualifying long-term care expense.

If your clients are healthy enough to purchase a long-term care insurance contract, they now have three choices:

1. They can purchase a stand-alone traditional long-term care contract ideally suited for the younger client aged 45 to 60.
2. They can choose one of the newer hybrid/combo policies combining a life insurance contract with a long-term care rider or a chronic care rider.

Although each option allows for a tax-free distribution of death benefits for a qualified long term care expense, there are significant differences between the two options. The long-term care rider has an upfront charge, but no additional cost when the benefit is used. In contrast, the chronic care rider has no upfront charge, but an interest charge is imposed if and when the benefit is actually used. Clients should not inadvertently confuse these two cost structures, as that would be like comparing apples and oranges. They're ideally suited for clients aged 60+ who have an existing need for permanent insurance and secondarily a desire to have access to a tax-free withdrawal to pay for long-term care expenses if needed.

3. Also available as of Jan, 1 2011 is the ability to avoid tax on the gains of an annuity contract if it is used to purchase a long-term care contract.

For example if an individual started with a \$50,000 single premium deferred annuity and it grew to \$100,000, previously an individual would first have to pay the tax on the \$50,000 gain. If, however, that same individual placed the same single premium annuity into a linked/combo annuity, he or she would have the full \$100,000 available as there would be no tax due. Plus they would have the leverage of a long-term care insurance policy, which for a 65 year old would bring the net amount available to pay for long-term care expenses up to approximately \$350,000 to \$400,000.

Lastly the adviser should be aware that as a result of many insurers having priced their long-term care contracts incorrectly over the last 20+ years, primarily due to erroneous assumptions regarding earnings, drop rates and utilization rates, many of these companies are now attempting to raise rates. One such company is in the process of obtaining a historic 50 to 60 percent rate hike. My concern is they will use that significant increase as a bargaining chip to encourage older existing policyholders to give up and scale back various benefits they previously have purchased, i.e., a larger daily dollar benefit, a longer benefit period, a 5 percent annual compound inflation rate. In any event it will cast a further negative and worrisome message to those currently considering purchasing a long-term care insurance policy.

If at all possible, a client should not give up these valuable benefits on a wholesale basis and should carefully consider which if any benefits to drop, and pay the higher cost. Once they give up these higher benefits, they will never again be able to replace them, which is exactly what the insurers are hoping to accomplish with these significant rate hikes.

In my opinion a client should consider purchasing a long-term care insurance contract in their mid to late 50s, when their youth and good health will allow them to purchase this valuable protection at a lesser cost. One way to offset the fear of increasing future rate hikes is to purchase an individual or second to die combo/hybrid policy, or a traditional policy that pays a future dividend to offset future increases.

*Henry Montag is an independent Certified Financial Planner in practice since 1976. He is a principal of the **TOLI Center East**, which provides independent fee-based performance evaluation for trust owned life insurance for private trustees and their advisers. He has had articles published by the New York State Bar Association and the New York State Society of CPAs. He has lectured extensively on the proper utilization of financial products to protect and preserve assets to the NYSBA, the NYSSCPA, the American Institute of CPAs and the National Conference of CPA Practitioners. He has been a source for The Wall Street Journal, Investor's Business Daily, Investment News, and Newsday, and has recently co-authored a book for the American Bar Association, "The Life Insurance Policy Crisis," to be released later this year.*