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The True Cost of Long-Term Care Insurance

Help clients understand if the newer products are really better.

James G. Blase | Jun 25, 2018

Advisors and their clients need to understand the true costs associated with the newer hybrid long-term-care insurance products when compared with traditional (usually partnership program) LTC insurance products. A partnership program LTC policy is one that works in conjunction with a state's Medicaid program to ignore the insured's assets, equal in value to the total LTC insurance benefit, as an available resource for Medicaid-qualifying purposes after the LTC insurance funds

are exhausted.

Hybrid Products

Hybrid products are promoted over traditional LTC products for three reasons: First, hybrid products guarantee the insured that an amount equal at least to what the insured deposits into the policy will be available in LTC benefits, cash surrender value and/or death benefits. Second, the premiums on a hybrid policy are said to be guaranteed to never increase. Third, the underwriting for hybrid products may be easier than traditional LTC products in certain situations.

Although the above statements are true, does the analysis end there? Are the new hybrid LTC products really the no-brainer option over traditional LTC products? On closer analysis, this may not be the case.

Three Options

Let's assume a married couple, residents of Missouri and aged 61, both desire to purchase an LTC product. They're both in preferred health. Their goal is to have at least $1 million in LTC protection each, available when they reach aged 90. Let's look at three different options (and insurance companies) for insuring the couple (two hybrid and one traditional) and for simplicity, focus only on the husband's policy, but with the typical spousal premium discounts built-in. There are also other available options that fall somewhere among these three, but these three choices will give the reader a good idea of how to analyze each available option.

Option 1: The Lincoln "MoneyGuard" Approach

The basic concept behind the Lincoln National Life Insurance Company "MoneyGuard" product is to make a deposit with the insurance company, either all at once or over up to 10 years and, in this case, choose a 3 percent compound inflation option. A $105,000 one-time initial deposit (or $129,500 payable over 10 years at $12,950 per year) will produce approximately $1 million in LTC protection at aged 90. The guaranteed death benefit amount if the policy isn't used for LTC

expenses is $134,500. Thus, if the policy is never used to pay LTC expenses, the insured's family is guaranteed a return of $134,500. If the policy is used to pay LTC expenses, however, this "refund" amount is reduced, dollar for dollar.

All sounds good, but what's the opportunity cost involved?

Option 2: Traditional Product

Assume that, instead, the insured chose to purchase a traditional LTC product, in this example, the Mutual of Omaha partnership program traditional LTC product, designed to produce at least $1 million in available LTC benefits at aged 90. This plan would cost the insured only $2,750 per year, and no initial deposit would be required. The benefit amount would be $90,000 per year, for five years, with a 3 percent compound inflation feature.

Under this traditional LTC policy approach, the insured could take the $105,000 that would have been deposited into the policy under the MoneyGuard hybrid approach, and instead purchase a $105,000, 3 percent, 30-year AAA Municipal bond that would throw off $3,150 annually in federal and state income tax-free interest, or any other investment projected to generate at least a 3 percent after-tax return. The insured could then use the tax-free interest to pay the annual $2,750 premium on the partnership program policy, with enough interest left over to eventually compound to approximately the $134,500 stated refund amount in the MoneyGuard policy.

Unlike the MoneyGuard hybrid LTC policy approach, using the traditional LTC policy approach effectively guarantees the insured's family the return of the entire $105,000, regardless of whether any LTC expenses are actually incurred. Under the MoneyGuard hybrid approach, this amount is refundable only to the extent the insured doesn't incur any LTC expenses. Also, under a traditional LTC insurance plan, the insured and/or the insured's family potentially receives both the LTC benefits and the $105,000 (or eventually, $134,500), whereas under the MoneyGuard approach, it's an either/or situation: the insured eventually receives the LTC benefits or the $134,500, never both.

Is it possible that what was originally thought to be the major advantage of the MoneyGuard form of hybrid LTC insurance policy, when compared against a traditional LTC policy, actually is its principal disadvantage?

Option 3: The John Hancock Accelerated Death Benefit Approach

This hybrid LTC insurance approach is actually more of a life insurance policy than anything else. For an additional premium, the insured retains the ability to accelerate all or any portion of the death benefit and use it to pay LTC expenses.

For an initial deposit of $282,000, $1 million of LTC benefits would be available for the insured at aged 90 on a non-guaranteed basis. Any portion of the $1 million death benefit under the policy that isn't used to pay LTC expenses will be payable to the insured's family at the insured's death.

Probably the most significant disadvantage of this approach to paying LTC expenses is that the insured will typically be "robbing Peter to pay Paul." For example, if the insured's primary source of funds to pay the $282,000 premium is his individual retirement account, after federal and state income taxes the insured may need to liquidate as much as $500,000 of his IRA just to pay the $282,000 premium. This may be satisfactory if the focus is only on the insured's LTC and the benefit his family will receive at his death, but what about the insured's typical retirement living expenses?

Remember the alternative is to pay just $2,750 in annual premiums under a traditional LTC policy, until aged 90, or less than $50,000 on a present value basis (discounted at 3.5 percent). This leaves the balance of the insured's IRA or other savings for typical retirement living expenses.

Other Relevant Factors

The premium on a traditional LTC insurance policy may be income tax deductible, in whole or in part, thus further reducing the cost of this form of insurance. The

premium on a hybrid form of LTC insurance policy typically isn't deductible.

A partnership program form of traditional LTC insurance policy may qualify the insured to have a state's Medicaid program pay all or a portion of the cost of LTC if the insured's pool of LTC insurance money is exhausted. This benefit typically isn't available with the hybrid forms of LTC insurance.

The premium on a traditional LTC insurance policy could increase in the future, whereas this may not be the situation with certain hybrid forms of LTC insurance. Proponents of the hybrid forms of LTC insurance will point to this as the major advantage of their product. Those favoring traditional LTC insurance products, on the other hand, will point out that actuaries have had more than 25 years to figure out how to properly price traditional LTC insurance and are much closer now to getting this right, and that regardless, premiums would need to increase substantially over time before the above-described economic advantages the product retains over hybrids are offset.

Finally, note that if an individual owns a significant non-qualified annuity, the annuity owner may be able to do a tax-free exchange of his existing taxable non-qualified annuity for a hybrid annuity or traditional LTC insurance policy, thereby potentially turning taxable funds into nontaxable to the extent used for LTC.

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Advisors Fail to Cover These Key Topics with Clients

HNW clients want to discuss estate planning and philanthropy with advisors, Everplans introduces “Sharing After Death” and Emperor Investments launches for U.S clients.

WealthManagement.com Staff | Jun 26, 2018

Advisors might be gradually moving away from just being investment managers

toward offering more holistic advice to clients. However, they're failing to discuss topics that are important to high-net-worth clients, according to the recent U.S. Trust's *2018 Insights on Wealth and Worth* study. The high-net-worth clients surveyed said the top five subjects they wanted to discuss more with their advisor were estate planning and strategic philanthropy. But only 48 percent of clients said they're currently discussing estate planning with their advisor and only 16 percent were discussing strategic philanthropy.

Everplans Launches SAD Feature

Now After Death Never
Will
Financial Accounts
My Passwords
Letters to Friends and Family

Digital personal archival service Everplans has implemented one of its most-requested upgrades called Sharing After Death, or SAD. The new feature allows users to designate certain sections of the plan to be shared only upon Everplans' receiving a notification of death. Instead of relying on official documentation of the client's passing, such as a death certificate or an update to the Social Security's Death Master File, the firm relies on a special, trusted user called an "Unlocker" to provide notice of death. Everplans noted that many users had asked to keep their financial details, wills, letters to friends and family, and passwords to online accounts from the eyes of anyone else with access to the user's information—a group of users called "Deputies." The firm suggests naming a professional as an Unlocker. "Sharing After Death works on the basis of trust," the company stated. "Your unlockers should be individuals you trust and [who] understand your wishes. They should be in good health and be able to take on this responsibility when the time comes."

New Robo Investment Firm Launches

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Robo firm Emperor Investments launched this week, targeting U.S. retail clients, specifically called "high-earners-not-rich-yet," who want to invest in equities over ETFs. The Toronto-based robo, founded by University of Guelph economics professor, Dr. Francis Tapon, and his former student, Brenna Casserly, charges a 60 basis-point annual fee and has a $500 minimum to open an account. The firm takes a goals-based approach to investing and focuses on equities that exhibit "uninterrupted dividend payments, ethical management, and low share prices." "We strongly believe that if you love a company, you need to invest directly in it, not simply in a basket that holds that particular company along with many others, which you may not want exposure to," said Casserly, who serves as CEO, founded the equity portfolio designer, Investment Portfolio Design Limited, with Dr. Tapon in 2011. "We're value investors who focus on top dividend-paying names that we select from some of the world's greatest companies," added Dr. Tapon, the firm's CIO. Emperor is partnering with custodian Folio Investments.

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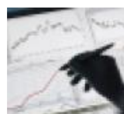

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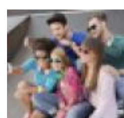

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