PATRICK H. YANKE, CFP® | Financial Planning

Handling Modern Long-Term Care

Retirement planning must include the costs associated with the diminished capacity for self-care. It's generally accepted that couples tend to take care of each other as much as possible as they age. What then, is a surviving spouse to do when left alone? That part requires planning.

WHAT IS LONG-TERM CARE?

To plan for a need, we must define it. Long-term care (LTC) is not medical care. Medical care is about returning to normal functioning after treatment. The LTC problem is one of diminished capacity for self-care. It can be a temporary need but most people in retirement experience it as a terminal condition. Neither health insurance nor Medicare covers this need.

A LTC need is usually defined as a disability to independently conduct two of five activities of daily living (ADL). These basic activities consist of eating, dressing, bathing, using the toilet and grooming.

WHO CAN AFFORD IT?

Those at the extremes of financial resources don't usually rely on insurance to meet the LTC need. The rich may choose to fund the need from what they have saved. The poor may turn to Medicaid for support. In the middle are those not wealthy enough to meet the need on their own yet too wealthy to qualify for state programs. This is why we have Long-Term Care insurance.

LONG-TERM CARE INSURANCE

Decades ago, LTC insurance was sold like life and health insurance—the insured paid ongoing premiums until there was a claim against the policy. It was generally understood that a 65-year-old had a nearly 50% chance of claim before death. Some policies paid as long as the need continued—even if the need continued for decades.

Recent history has proved claims expectations correct and insurance companies have adjusted to this reality. No company has an unlimited benefit anymore and only four insurance companies still offer the traditional pay-as-you-go coverage model. Within the pay-as-you-go model, premiums are rising and benefits are generally limited to 3-5 years of benefits (the average used by claimants). Essentially, an insured purchases a pot of money to be used for LTC needs until exhausted.

MODERN LONG-TERM CARE COVERAGE

This doesn't mean insurance companies have given up on selling LTC coverage. Most have shifted to hybrid policies that provide LTC coverage as part of an annuity or life insurance contract. In many cases, an insured invests a sum of money up-front into a policy to provide a specified benefit—often as much as three times the premium. These funds are disbursed tax-free to meet LTC claims.

ADVANTAGES AND DISADVANTAGES

There are advantages for both the insurance company and the insured in these hybrid policies. The insurance company takes on less risk since it has more money from the insured to help fund claims. The insured benefits by a more streamlined underwriting process and ownership of an asset that will either provide LTC benefits or pass to heirs at death. Instead of having a bill to pay throughout retirement, LTC insurance becomes an asset in their portfolio.

The greatest disadvantage to this type of policy is the need for a significant amount of cash up-front to purchase the coverage. It's best to invest at younger ages when there is a lower actuarial risk of claim—but this also tends to be a time in life without significant cash resources. Since the surviving spouse is the one with the greatest need, LTC insurance could be a target for a portion of life insurance proceeds—provided the spouse is both young and healthy enough to qualify.

These policies have exclusions and/or limitations. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. There are expenses associated with the purchase of life insurance including mortality and expense charges. If a policy is surrendered prematurely, there may be surrender charges and tax implications. Guarantees are based on the claims paying ability of the insurance company.

Understanding a problem is the first step to a solution. Please consult with a licensed financial professional when considering insurance options.

Patrick Yanke is a Raleigh-based financial advisor. Opinions expressed here are mine and not necessarily those of Raymond James. The information is not a complete summary or statement of all data necessary for making an investment decision and does not constitute a recommendation. Please consult with appropriate professionals for tax and legal issues. www.yankefinancial.com.

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