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LONG-TERM CARE

Navigate a Course for Long-Term Care

The long-term-care insurance business is in turmoil. But these options can help you steer through the turbulent marketplace.

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YOU'VE FINALLY decided to buy an insurance policy to protect your nest egg from the staggering costs of long-term care. But now insurers are pulling out of the market, while the remaining sellers are boosting costs. And if you already hold a policy, you may be facing steep premium hikes.

Don't despair quite yet. You still have many ways to cover long-term-care costs. Several strong insurance companies continue to sell policies, and there are new strategies for reducing the premiums. Meanwhile, insurers are introducing alternatives, in particular policies that bundle long-term-care coverage with annuities or life insurance — an option that offers a payoff whether you need care or not.

The potential costs of long-term care are just too large for most people to ignore. In 2011, nursing-home care topped more than $87,000 a year.[1] And home care can cost even more. "Your financial plan is not complete unless you have some kind of protection for long-term care built into it," says Peter D'Arruda, an investment adviser and president of Capital Financial Advisory Group, in Cary, N.C.

But the long-term-care insurance industry is in disarray. In setting their premiums years ago, insurers underestimated the number of people who would file expensive claims. Low returns on the insurers' investments have made it tough to make up for pricing mistakes.

In the past few years, several major long-term-care companies stopped selling new policies. MetLife left the market in 2010,[2] and Prudential announced its exit from the individual business in March 2012.[3] Plus, most major insurers raised rates for current policyholders at least once over the past few years. In late 2010, John Hancock announced it would ask state regulators for permission to increase rates for most policyholders by an average of 40%[2] — and some as high as 90%.[4] Then Genworth asked for an 18% rate hike for one-fourth of its policyholders.[2] These hikes are just kicking in now.

This state of affairs leaves current policyholders and prospective ones in a quandary. People who are in their fifties and sixties balk at the high prices of traditional policies. And they worry that they'll be trapped into paying ever-rising premiums. "People understand the cost and the odds because they're living it with their parents," says Mari Adam, a certified financial planner in Boca Raton, Fla. "But the problem is the long-term-care business really is in turmoil."

Here are some options to navigate this turbulent marketplace.

[1]*Market Survey of Long-Term Care Costs*, October 2011, www.metlife.com, accessed June 12, 2012.
[2]*Met Leaves LTC Market, Hancock and Genworth Raise Rates*, January 28, 2011, www.agentenews.com. Accessed June 12, 2012.
[3]CBSnews.com, MoneyWatch, *Prudential Quits Individual Long-term Care Biz*, March 8, 2012, www.cbsnews.com, accessed June 12, 2012.
[4]*Long-Term Care-Less: An Insurance Nightmare as Premiums Nearly Double*, March 20, 2012, www.dailyfinance.com, accessed June 12, 2012.

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■ For current policyholders. If you're socked with a premium hike, resist the temptation to drop the policy. You'll lose all the benefits that you spent years paying for. And newer policies are much more expensive, especially now that you are older. "I've been doing long-term care since 1990, and I think I've replaced one policy in 22 years," says John Ryan, a consultant in Greenwood Village, Colo., who helps fee-only financial planners find suitable coverage for their clients.

Ryan recently compared prices for a couple who purchased long-term-care insurance policies in 2003 with a 5% inflation rider, when they were 48 and 54. Their original monthly benefit was $6,000 and increased over the nine years to be worth $9,300 a month. The combined premium before a recent rate increase was about $3,000 a year; after, it rose to $5,900. But now Ryan's clients are 57 and 63, and when he shopped around for a new policy with a $9,300 monthly benefit, the premium was $10,400 a year.

If you get a notice of a rate increase, ask about your options. You may be able to continue at your current premium by cutting back on the benefit period. Reducing a lifetime benefit period to five years still provides more coverage than the average nursing-home stay of three years. If you have a short waiting period before benefits kick in, you can lengthen it to 90 days or so.

Also consider lowering your inflation protection to 3%, from 5%. Before you make that move, find out how big a pool of benefits you would have in your eighties, when you're likely to need care. If you're in your mid sixties and likely won't need care for another 20 to 25 years, lowering the inflation protection could reduce your benefits pool by thousands of dollars. But if you're in your late eighties or older, it may make sense to reduce, or eliminate, the inflation protection rather than change the benefit period.

If you learn that your insurer is pulling out of the market, don't worry. The company is still on the hook to pay benefits. And if the company sells its long-term-care business to another insurer, that company will be required to make the payments.

■ Hedge your bets. Instead of buying enough long-term-care insurance to cover the full risk, you can keep the premiums more manageable by making some trade-offs. "You don't need to cover every last dollar of need, but pay for what you can. It's okay to scale back benefits," says Adam.

Rather than buying a policy that provides lifetime benefits, go with a plan that offers benefits anywhere from three to five years. Advisers also prefer "shared benefit" policies for married couples. A three-year shared-benefit policy provides a pool of six years of coverage to divvy up between spouses. If you need five years of care and your spouse needs one, you're both covered. Such a policy costs about 15% more than two separate policies with three-year benefit periods.

Because you may wait 20 or more years to tap your policy, your daily benefit should keep up with rising costs. The 5% compound inflation protection is the gold standard, but some companies are offering cheaper policies that boost benefits by 3% a year. The 3% annual boost has kept up with general inflation recently, although the cost of care often rises faster than general inflation. A 55-year-old couple with a three-year shared-benefit policy that has a $150 daily benefit and 3% inflation protection starts out with a pool of coverage worth $340,000 that grows to more than $700,000 by the time they are 80.

It's important to work with an agent who deals with many insurers, because the price differences can be huge. Consider this example offered by the American Association for Long-Term Care Insurance, a trade group: A healthy 55-year-old couple wants a policy with a $150 daily benefit, three-year shared-care benefit period, 90-day waiting period before benefits start and a 3% inflation adjustment. Insurers offer a range of prices from $2,027 to $3,574 a year.

Ryan says the major long-term-care insurance companies include Genworth, John Hancock, Mutual of Omaha, MassMutual, New York Life and Northwestern Mutual. "Make sure you give your agent as much of your medical history upfront, so the agent can match your risk with the company that can make the best offer," Ryan says. (You can find a long-term-care specialist at www.aaltci.org or by calling 818-597-3227.)

Even with these cost-saving moves, Ryan says policyholders should be prepared for a premium increase of up to 20% every five years. To cap your future premiums, you can buy a "ten pay" policy. You pay more each year, but premiums end after ten years. Make sure you ask the insurer that it won't impose new charges after ten years.

Consider a 60-year-old who wants to buy a policy from Northwestern Mutual with a three-year benefit limit, $6,000 monthly benefit, 12-week waiting period and 5% inflation protection. A person who buys a regular policy would pay $5,316 a year in premiums, compared with $11,130 a year for the ten-pay policy.

■ New source of money. If you already own a permanent life insurance policy or a deferred annuity, there's good news: Under a new tax law, it's now easier to move money tax-free from these products to pay long-term-care insurance premiums.

Erik Jensen, 66, is a professor at Case Western Reserve University, and his wife, Helen, 63, is a legal specialist at a law firm in Cleveland. The couple bought permanent life insurance policies in 1985, and with dividend reinvestments, the policies have built up significant cash value.

But now that their daughter is in college, their insurance needs have changed. After the economic downturn in 2008, they worried that their retirement savings were no longer large enough to cover potential long-term-care expenses. "The stock market crash contributed to us taking the insurance more seriously," says Erik.

To meet potential long-term-care expenses, they bought a long-term-care policy. They have stopped reinvesting dividends in Helen's life insurance policy and now automatically shift the dividends to pay their long-term-care premiums. Because of the new tax law, they don't have to pay taxes on the transferred money.

You always were able to withdraw the amount of your past life insurance premiums without owing taxes, but you owed tax on any earnings you withdrew. The new law allows you to transfer as much as you want tax-free to a long-term-care policy. The law also applies to transfers from tax-deferred annuities to a long-term-care policy.

To get the tax break, you must transfer the money directly from one insurance product to the other — a process known as a 1035 exchange. If two different companies are involved, ask the recipient of the money — in this case, the long-term-care insurance company — for help with the transfer. The insurer that is losing your assets may erect some hurdles, but the long-term-care insurer will help ease the way.

The move was simple for the Jensens. They have both policies at Northwestern Mutual. They simply filled out a form. Being able to transfer the money tax-free was a "terrific benefit," Erik says.

Hybrid policies. As companies flee the standalone long-term-care insurance business, many are developing new kinds of policies to protect against long-term-care costs. These products combine long-term-care insurance with either life insurance or annuities.

The most prevalent are life insurance hybrids. You invest a lump sum or pay premiums for ten years, and you get either long-term-care payouts or your heirs get a death benefit.

For example, a 60-year-old man who invests $50,000 in Lincoln Financial's MoneyGuard policy could get payouts of up to $216,000 (up to $3,000 a month for six years or more) for long-term care in a nursing home, assisted living or at home. If he dies before he needs long-term care, his heirs will receive a $72,000 death benefit. Any money you use for long-term care reduces the death benefit.

With these hybrid policies, it can be easier to pass the medical underwriting test than with an individual long-term care policy. But a passing grade depends on your medical condition. For instance, it may be tougher to qualify for a life insurance hybrid if you have a heart condition, which can shorten your life.

Adam, the Boca Raton planner, bought this type of policy in her late forties with money from an inheritance. Adam is a single parent whose mother had Alzheimer's. "I clearly understand the need for the coverage," she says. "What a great way to take the money, put it aside and cover my long-term-care needs. And if I don't need it, then it goes tax-free to my kids as life insurance."

Melissa Spickler, a senior financial adviser with Merrill Lynch in Bloomfield Hills, Mich., began recommending combination policies to her clients after her mother developed dementia 18 months ago. "I went to all of my clients and I started to tell the story of what happened to my mother, with the expense of $8,000 to $11,000 a month coming out of my pocket," she says. Spickler's mother recently died.

Spickler recommends Lincoln Financial's MoneyGuard because it offers beneficiaries a long-term-care benefit of three to six times the amount of the original investment. It also offers a guaranteed return of premium[5] if the policyholder ever needs the money back. If the policyholder dies before she needs long-term care, her beneficiaries will receive a life insurance benefit.

To calculate how much her clients should spend on a policy, Spickler looks at the cost of long-term care in the area and at their retirement-income cash flow. "When we know what the shortfall will be, we figure out how much we need to cover that gap," she says.

Insurance for the long term. Another financing option is longevity insurance. You invest a relatively small amount of money with an insurance company at about 65 and get a relatively large payout at 85. You can use the money for any purpose, including for long-term-care expenses.

Longevity insurance may be a better choice than a standalone long-term-care policy if you are healthy and expect to live well into old age, says Barry Gillman, principal of Longevity Financial Consulting, which advises asset managers. Assume you're a 65-year-old man who invests $100,000 in a longevity product. At age 85, you'll start getting $5,600 in monthly benefits. If you live to 87, you'll get $134,000 in total payouts. If you live to age 95, you'll get more than $670,000. You'd get no payouts if you die before 85.

The payouts provide extra cash flow at a perfect time to help cover any monthly long-term-care bills for the rest of your life. With most standalone long-term-care policies, payments end after three to five years. "Longevity insurance gets to be a better deal very quickly for those in better than average health," says Gillman.

Keep in mind, however, that the $5,600 monthly benefit will not be adjusted for rising costs, unlike a long-term-care policy with an inflation adjustment. And part of these longevity-insurance payouts will be taxable.

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[5] Adjusted for any benefits paid; and only available on flexible pay policies once all planned premiums are paid.

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