Life Insurance – LTC Combination Policies

Providing for health care is a key part of retirement planning. For most Americans age 65 and over, the federal government's Medicare program, and its various components, provides most of the resources to take care of a typical retiree's health care needs.

One health care need that is only minimally covered by Medicare is that of long-term care (LTC). LTC is the term used to describe a variety of maintenance or "custodial" services required by individuals who are chronically disabled, ill, or infirm. Depending on individual needs, LTC may include nursing home care, assisted living, home health care, or adult day care.

Not everyone will need LTC in retirement. For those that do, LTC is expensive. In 2019, for example, the national median cost for a resident in an assisted living facility was $48,612 per year; the national median cost for a semi-private nursing home room was $90,155 per year.[1] The problem, then, is how to pay for an expensive need that may, or may not, occur.

One answer has been that of a stand-alone, long-term care insurance policy. Should the need arise, a LTC policy can furnish some or all of the resources needed to pay for care. LTC insurance can be expensive, however, and most policies allow for the possibility of future rate increases. Plus, if an individual uses few (or none) of a policy's benefits, there is a sense that the money was not well spent.

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One alternative to a traditional LTC insurance policy is that of a "combination" policy that links a cash-value life insurance policy with a tax-qualified, long-term care benefit. These combination policies take advantage of federal[2] income tax law which allows for payment of "accelerated death benefits," up to the policy's death benefit, should the insured need long-term care. If LTC services are required, the policy death benefit can be used to help pay these costs. If LTC services are not needed, or only a portion of the death benefit is used to pay LTC expenses, any remaining policy death benefit (less any policy loans) passes to beneficiaries named by the insured. Such a combination policy is most appropriate when there is a need for both life insurance and long-term care protection.

[1] Source: The Genworth 2019 Cost of Care Summary, page 3. Downloaded November 5, 2020.

[2] The discussion here concerns federal income tax law. State of local income tax law may differ.

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- **Long-term care "riders":** In return for paying an additional premium, a "rider" can be added to a life insurance policy which allows the insurance carrier to advance the policy's death benefit to the insured, if long-term care is required. With some policies, a second rider can be added to increase the total dollar amount available to pay for LTC services, beyond the policy's original death benefit.

- **Benefit "triggers":** Under federal law, tax-free, accelerated death benefits can be paid from the policy when the insured is considered to be either "terminally ill" (death is expected within 24 months) or "chronically ill." For long-term care purposes,[1] an insured is considered to be chronically ill when he or she is either (1) expected to be unable to perform for 90 days two of six activities of daily living (eating, toileting, transferring, bathing, dressing, and maintaining continence), or (2) suffers from a cognitive impairment such as Alzheimer's, dementia, or Parkinson's disease.   With some policies, a more restrictive definition requires the underlying chronic condition to be permanent.

- **Elimination period:** Once the insured is determined to qualify, long-term care payments can begin after a waiting, or "elimination" period, which can range from 60-100 days. The elimination period usually only has to be satisfied one time.

- **Monthly LTC benefit amount:** The monthly LTC benefit is a set percentage of the total death benefit, typically selected by the policy owner when the policy is purchased. The table below shows the payment amount and length of time for a hypothetical policy with a $100,000 death benefit:

Payout Percentage	Exemption Amount	Payout Length
1%	$1,000 per month	100 months
2%	$2,000 per month	50 months
3%	$3,000 per month	33 months
4%	$4,000 per month	25 months
5%	$5,000 per month	20 months

[1] See IRC. Sec. 7702B(c)(2).

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- **Effect of LTC payments on policy death benefit:** As LTC benefits are paid out, the policy's death benefit is reduced dollar-for-dollar.
- **Indemnity vs. actual expenses:** Some policies pay benefits on an *indemnity* or *cash* basis, meaning that once payments begin the monthly payment is the same regardless of the dollar amount of LTC expenses incurred. Policies that pay benefits on an *expense* basis pay the lesser of the monthly benefit or the actual LTC expenses incurred. If LTC expenses are less than the normal monthly payment, any unused balance is held over, potentially extending the benefit period.
- **Paying for the policy:** In many cases, a life insurance policy with LTC benefits is funded with a large, single premium. A few policies are paid through periodic premium payments. If appropriate, an existing cash-value life insurance may be exchanged tax-free for a new combination policy.
- **Underwriting:** Some policies, typically those funded with a large, single premium, use a streamlined, simplified underwriting process, with no medical exam. Other policies may require a medical exam and a complete health history.
- **Taxability of benefits:** Depending on the type of policy, long-term care benefits are received income-tax free under either IRC Sec. 101(g) or IRC Sec. 7702B.
- **Rate guarantees:** With many life insurance policies, because the death benefit is a pre-defined amount, the premiums are often guaranteed not to change. With a few types of life insurance, the premium rates may increase under certain conditions, but normally within a specified range.
- **Guaranteed return of premium:** Certain single-premium policies provide for a return of the premium paid (within a specified period of time) if the insured decides not to keep the policy. Life insurance policies which are paid for through periodic payments typically do not have this feature.
- **Residual death benefit:** In some instance, a policy may include a "residual" death benefit. If this feature is included, even though the policy's death benefits are exhausted through LTC benefit payments, the policy will still pay a small amount (typically 5% - 10% of the initial death benefit) at the insured's death. This benefit allows the survivors to pay for funeral and other final expenses.

Other Factors to Consider

There are a number of other factors to keep in mind when considering a life insurance-LTC combination policy:

- **Not considered state "partnership" LTC policies:** Life-insurance-LTC combination policies generally do not qualify as state "partnership" LTC policies. An insured individual with a partnership LTC policy can keep a much larger dollar amount of assets, while still qualifying for Medicaid, once the partnership LTC policy benefits are exhausted. Normally, an individual must be nearly destitute before Medicaid will pay for long-term care.

- **Effect of inflation:** Over time, the cost of LTC, like many other things that we buy, will increase. Since it may be many years in the future before long-term care is needed, consider a combination policy that offers a cost-of-living (COLI) rider. Without such a rider, there is a risk that a policy's LTC benefits will not keep up with increases in the cost of long-term care. Generally, once a policy is in force, the death benefit does not increase. Certain types of policies (variable life, variable universal life) have a death benefit that may increase, depending on investment results.

- **Most funded with a large, single premium:** Most life insurance-LTC combination policies are funded with a large, single premium payment. In many instances, a minimum of $25,000 - $75,000 is required to purchase a significant LTC benefit amount.

- **Is this the right tool?** A combination life insurance-LTC combination may not be the right tool if, for example, the insured is already covered by adequate life insurance. If there is a potential need for additional retirement income, a deferred annuity-LTC combination may be a better fit. For some individuals, a stand-alone LTC policy is more appropriate.

Seek Professional Guidance

One key part of a well-prepared retirement plan is looking ahead to the possible need for long-term care. The advice and guidance of trained financial and insurance professionals, in sorting out the various options for meeting this need, is strongly recommended.