The Case for Life Insurance to Cover Long-term Care Expenses

by Bob Larkins CLU, ChFC

Being well into my third decade in the financial services industry, I have become aware of an almost universal concern for clients of my generation and older, "How am I going to pay for long-term care?"

Almost everyone over the age of 60 has had personal experience with an older relative or friend that needed some kind of assistance with what is known as "Activities of Daily Living". It is not unusual for people needing this assistance to end up spending down, either partially or totally, assets that they have worked a lifetime to accumulate. And it doesn't matter how much someone is worth, the concern of their not wanting this to happen to them is consistent.

Since the early 2000s my practice has focused on the concept of **wealth transfer**. I use that term very specifically as opposed to "estate planning". Estate planning is what individuals do with their attorney, such as wills, trusts, powers of attorney, etc. This is very important, but it is a legal exercise. When I talk about wealth transfer, I'm not referring to a legal exercise or even a financial exercise. I view wealth transfer as an **emotional exercise with financial and legal consequences**.

As I talk to people about how their assets will transfer to their children and grandchildren after they are gone, clients always raise the question, "What can I do to keep my assets from being spent down if I should need home health care or long-term care?"

There are 3 primary ways to pay for long-term care expenses, which today can reach $12,000 per month in some facilities. They are 1) self-funding, 2) traditional stand-alone long-term care insurance, and, 3) life insurance policies with long-term care riders. I will briefly compare and contrast these 3 options.

1. Self-Funding - Self-funding is self-explanatory. You don't buy insurance of any kind but pay for incurred expenses from either income or spending down assets. Some people may set aside certain funds, figuring that if they don't need care these assets will at least be left over for a surviving spouse or for their heirs. The downside to self-funding is that for a long-term event such as dementia or Alzheimer's, it can cost $80,000 or more for eight to 10 years. I've seen high 6 figure holdings completely spent down, resulting in inheritance that was intended for children to be wiped out.

2. Stand-Alone Policy - Insurance companies started offering stand-alone long-term care coverage in the 1980s. There have been different iterations, but basically the benefit is designed to pay a pre-determined amount per day for a pre-determined period of years. Without paying for a "return of premium" benefit, if you don't end up needing the care that you're paying for, the premiums that you've paid stay with the insurance company when you die. This is commonly referred to as "use it or lose it". Many people decide not to purchase these policies because they think that they are expensive, complicated and there's a chance that they won't need the benefits. Furthermore, the premiums for these policies are not guaranteed. In other words the premiums can, and have increased significantly over the past couple of years for policies that have been inforce for many years.

3. Life Insurance with Long-Term Care Rider - Starting in the early 2000s, insurance companies began offering a much more popular alternative. They designed life insurance policies with riders that give the insured access to the entire death benefit for long-term care use. Most commonly a policyholder has access to up to 2% per month for assistance with the "activities of daily living". For example, a $500,000 policy would provide up to $10,000 per month for long-term care expenses, and this would last for up to 50 months (or a little over 4 years). If no long-term care assistance is needed, the surviving spouse or heirs receive the $500,000 income tax free. If benefits from the policy are accessed, the death benefit is just reduced on a dollar for dollar basis. Either way, the family benefits by $500,000 either when they die or during their lifetime.

Premiums are priced so that the internal rate of return on the death benefit to the beneficiaries is very attractive compared to self-funding. Many people who can truly afford to self-fund find it far more prudent to transfer their risk to a life insurance company. Furthermore, there is no "use it or lose it" scenario as with stand-alone policies.

Life insurance with long-term care has become so popular that most insurance companies have stopped offering stand-alone policies. They now offer long-term care or chronic care riders on life policies for individuals up to age 80. Of course, as with any financial planning tool, life insurance with a long-term care benefits is not for everyone. In addition to medical underwriting, financial underwriting is just as important. The prospective insured must have clear financial wherewithal to reposition excess assets or streams of income that aren't needed for general lifestyle expenses into the policies in a lump sum or over a period of years. A thorough analysis of the client's medical and financial profile is required.

The most important issue from my perspective is for people to get enough information to decide which course of action is most appropriate for them. If you share the concerns addressed in this article, please feel free to contact me either directly or through the advisor that shared it with you.

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