

Reprinted from

HARTFORD BUSINESS JOURNAL

June 27, 2011

EXPERT CORNER

Long-term care insurance: A more efficient approach

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Much data supports the argument for acquiring long-term care insurance (LTCI). Indeed, the Internal Revenue Code not only makes part or all of the premiums tax deductible, but also excludes the benefit payments from taxation as income.

Notwithstanding such legislative subsidies, the cost of such coverage can be expensive. One factor is the possibility that one could pay premiums for many years and never need to make a claim. Some issuers of LTCI policies have addressed this risk by offering so-called "return of premium" riders, which typically pay the cumulative premiums paid during life as a death benefit that may be subject to income tax. Often, the cost of such a rider is about equal to the premium for the basic, underlying policy. In other words, the rider doubles the premium cost.

A new and less expensive way to obtain coverage for long-term care involves adding an LTCI rider to a permanent life insurance policy. Presuming the insured has a need for life insurance in general, the addition of an LTCI rider would allow for the acceleration of payment of the death benefit as a lifetime benefit, thereby reducing the amount of insurance available at death, for long-term care services.

The rationale for acquiring a life insurance policy with such a rider is that if one never qualifies for LTCI benefits, the life insurance death benefit not only will be paid at death, but also the cost of the LTCI rider is lower than the cost of a traditional LTCI policy.

Because accessing the benefits of an LTCI rider will reduce the life insurance death benefit, it is important for individuals to carefully evaluate their estate planning and retirement needs to decide whether they should purchase additional life insurance or a standalone LTC policy.

An LTCI rider is added to a life insurance policy, selecting a percentage of the policy death benefit to be paid as a benefit each



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month. For example, a \$1 million life insurance policy could have a 1 percent, 2 percent or 3 percent monthly LTCI benefit (\$10,000, \$20,000 or \$30,000 per month) up to 200 percent of the daily limit imposed by the Health Insurance Portability and Accountability Act. The HIPAA Limit for 2011 is \$300 per day, which would be \$109,500 annually (\$300 per day times 365 days) or \$9,125 per month.

The cost of health care has increased at a rapid rate and is expected to continue to do so. Having a larger LTCI benefit, depending upon the individual's circumstances, might be prudent. In the case of the 2 percent benefit, for example, the insurer would pay \$20,000 per month (2 percent of \$1 million) for up to 50 months. If the insured were to die before the benefit was exhausted, the remaining amount would be paid as a death benefit that generally would not be subject to income tax. Whether benefits are payable under a conventional LTCI policy or under a rider to a life insurance policy, the basis for determining eligibility for benefits is the same, that is, whether the insured is a "chronically ill individual."

Two types of life insurance policy riders provide long-term care benefits. In the first type, the insurance carrier charges an additional premium for a LTCI rider. If benefits are payable, the policy's death benefit is accelerated and the death benefit is reduced dollar-for-dollar by the amount of benefits paid. In the other type of rider, which technically is a chronic illness rider, the carrier does not charge an additional

amount unless and until the benefits are payable. If benefits were to be payable, the carrier imposes a mortality and interest charge so that the benefits paid reduce the death benefit at a rate that is greater than dollar-for-dollar.

By way of example, an individual eligible for benefits at age 75 would have a smaller reduction in the same death benefit than would an individual age 65. There may also be a waiting period before the benefit is payable.

The LTCI rider is better tailored to meeting the needs of an individual requiring long-term care. Yet the chronic illness rider goes a long way to providing protection at no cost until the benefit is needed. An individual considering either type of policy rider should consult with a qualified professional advisor before making a decision.

Beyond the question of which type of life insurance policy rider is more attractive, there is another application for such riders in the case of individuals who have high earned income. Since such riders pay the benefits in cash, they can serve as a catastrophic disability policy for individuals who cannot acquire more disability income insurance either because of the limits available or the amount of unearned income they receive precludes additional disability income coverage.

What many planners find attractive is that the cost of LTCI can be reduced significantly by using a rider to a life insurance policy. Moreover, because almost all traditional LTCI policies are now reimbursement rather than indemnity policies, a life insurance policy with an LTCI rider offers greater flexibility if benefits should become payable. The cash payments can be used without the restrictions that apply in the case of a reimbursement benefit. ■

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