AGENT'S salesjournal™

NATIONAL EDITION SEPTEMBER 2007

Using Life to Prepare for Chronic Illness & Other Expenses

BY MICHAEL L. BARSKY and MICHAEL H. FLIEGELMAN

When Cyndi Martin's 76-year-old mother was diagnosed with Alzheimer's disease, she knew a nursing home was an eventuality. She began to read through the Social Security Administration's Web site and was shocked to learn that Medicare and her mother's supplementary insurance provide only very limited coverage for nursing home care. She then started calling facilities near her home on Long Island, and was surprised to hear that the costs exceeded $150,000 per year. Based on her mother's savings, this would deplete her resources in less than three years. But what could she do?

As an increasing number of baby boomers approach retirement, they gain firsthand experience in dealing with their aging parents. There is now a growing awareness of the high costs of long term care, such as home-health services, adult day care centers, assisted-living facilities, or nursing homes. Up until now, there have been three standard methods of paying for these options: self-funding, Medicaid, and long term care insurance, each with its own unique set of risks and benefits.

Now, because of recent changes in federal tax law, a new funding option exists: the prepayment of death benefits under a life insurance policy. This LTC funding method can help overcome many of the risks and uncertainties of the other, more traditional funding methods.

How it works

Life insurance is one of the foundations of many successful financial plans. People obtain life insurance for many reasons, such as providing for their families, maintaining a standard of living, for education, to secure a mortgage, or to protect a business. However, new features are being added to some policies to provide access to make part of the death benefit, which can then be used as living benefits.

And more recently, federal tax law changes have opened the door for companies to offer death benefits to insureds suffering from a chronic illness, meaning either:

- An inability to perform at least two activities of daily living (eating, bathing, continence, dressing, using the toilet, or transferring)
- A severe cognitive impairment that requires substantial supervision from another person to protect from threats to health and safety

A life insurance policy with one of these newly developed riders or a long term care rider can provide policyholders with benefit payments to help cover their care. With long term care riders and others that offer additional benefits, an insured suffering from a permanent chronic illness can "accelerate" his or her cash value plus a portion of the "net amount at risk" (difference between the death benefit and cash value). The portion of the net amount at risk that can be advanced depends on the policy and the insured's age at onset of the chronic illness: Some riders, for example, can cover up to 80 percent for illnesses starting after a specified age. Typically there is a waiting period before benefits can be accelerated (typically 60 to 90 days). Some states have different requirements; in New York, for example, there is no waiting period for policies sold in the state.

Who does this rider not work for?

There are many advantages to these types of policies and riders, and they are something that almost everyone should consider. However, for individuals with lower economic means or those who are on Medicaid, this type of policy and rider may not be appropriate.

For individuals who will potentially seek Medicaid to assist them to cover long term care costs, this rider may not be appropriate because this type of rider and the policy will build value, making it an asset that could prevent an individual from Medicaid eligibility.

These types of riders are flexible — individuals have a choice when it comes to the level of benefit that they would want to receive. In this case, the greater the desired benefit, the greater the cost of the policy and rider. This makes it ideal for individuals with modest economic means and the affluent. In the end, if payments need to be made for long term care, why pay for them out of pocket when it can be covered or partially covered by the policy and rider?

Determining suitability

Agents need to closely examine these policies and riders to determine which is the best for each client's particular situation. Because these policies are relatively new to the market, it is important to understand them thoroughly before recommending them. Although the policies and riders from different companies vary, several of the common advantages of using this approach follow.

- Unlike long term care insurance, where it is uncertain whether a benefit will ever be paid, a life insurance policy with a long term care or similar type of rider in place guarantees that benefits will be paid either as an accelerated benefit or as the death benefit.
- In most cases, bills or receipts for care need to be submitted. However, at least one company is offering this rider with no such requirement.
- Unlike long term care insurance, premiums are guaranteed and can never be increased.
- Benefits can be used in any way the insured wishes, regardless of actual expenses incurred by the insured for long-term care services.
- By limiting the amount of benefits paid in a calendar year to the "per diem" limit established by the Internal Revenue Service (currently $260 per day in 2007), the accelerated benefits may qualify for favorable treatment and be excludible from income.

In the case of at least one company there is no additional premium charge for this type of rider. With this rider there is a one-time administrative fee that is imposed at the time the rider is first exercised. In the case of long term care riders companies typically charge additional fees. These fees vary depending on the company issuing the policy and rider. The accelerated benefits are treated as an interest-bearing lien that reduces the death benefit and cash value.

For example, a traditional long term care insurance contract on a healthy 55-year-old male with a $260-per-day benefit, a 90-day elimination period, a five-year benefit period, and a 5 percent compound inflation protection costs approximately $4,370 per year. With no guarantee of using this benefit, if this policy is maintained until life expectancy of 85, there could have been a loss of $131,100 ($4,370 x 30) for this client, not taking into account the additional loss of any investment gains had this money stayed in an interest bearing account.

While not meant as a substitute for long term care insurance, this new benefit option offers additional flexibility that agents must be aware of and can discuss with clients. This is an innovative tool that can be used to assist clients to cope with the expense of chronic illnesses and long term care.

Michael L. Barsky, FSA is a Field Vice President at TIAA-CREF.
Michael Fliegelman, CLU, ChFC ,AEP, RFC can be reached at 516-677-6269 or michael@michaelfliegelman.com.

As seen in AGENT'S salesjournal™

Reprinted with permission. For Producer Use Only — Not For Use With The Public.

PUBLISHED BY
agent media™
1255 Cleveland Street, Suite 200
Clearwater, Florida 33755-4910

(800) 933-9449
Fax: (727) 446-1166
www.AgentMediaCorp.com
Email: Sales@AgentMediaCorp.com