Long-term care insurance

Experts project that two-thirds of those who reach age 65 will require some amount of long-term care before they die. Yet only 10% of the elderly have purchased long-term care insurance, according to Financial Planning magazine. What are the obstacles?

Cost. When many people buy insurance, but few make claims, the premium cost for each insured person can seem very modest. Term life insurance fits this model. On the other hand, when most of the people who are insured will make claims, premiums must be higher. The insurance becomes as much about setting aside money for an expected expense as it is a risk-sharing endeavor. That describes health insurance pretty well, and long-term care insurance falls at that end of the insurance spectrum.

The cost of an individual policy today can easily run $3,000 or more annually. Couples may enjoy some discounts, but the cost for a couple will be close to double that for an individual. What's more, the cost can be uncertain. Reportedly, insurer John Hancock asked regulators for a 40% premium increase on existing policies after it was hit by a deluge of increased claims and reduced policy lapses in a time of very low interest rates.

Lack of perceived need. Of those elderly folks who do require long-term care, only half will need such care for 90 days or more. Depending upon their policy terms, such people might not be eligible to make a claim if they do have insurance. (See below for details on elimination periods.)

Alternatives. Some people have enough financial resources to self-insure for their long-term care. Others are hoping that Medicare and Medicaid will pick up the tab. However, eligibility for government assistance has become increasingly restrictive, and it is expected to become more so as the federal government struggles to bring deficits under control.

Complexities of the policies. Long-term care insurance is tricky to understand and evaluate. Someone who has become comfortable with the ins and outs of car or homeowner's insurance may be forgiven for being baffled by a presentation of the variables to be weighed in funding long-term care.

Glossary of concepts

Here are some of the key variables that are integral to every long-term care insurance policy.

Maximum benefit. This is the maximum amount that will be paid once benefits are triggered. May be expressed as a daily, weekly or monthly amount.

Benefit period. This is the maximum number of months or years that the benefit will be provided. The maximum benefit multiplied by the benefit period yields the total amount of coverage being provided.

Premium drivers

Four choices influence the cost of a long-term care insurance policy.

Source: M.A. Co.
More total coverage requires a higher premium.

**Elimination period.** This is the number of days that the insured must pay for long-term care out of his or her own resources before the benefits begin. It may range from none to 100 days. Like the deductible in homeowner's insurance, the longer the elimination period is, the lower the premium will be, because the likelihood of making a claim is decreasing.

**Inflation protection.** The cost of nursing home stays has been rising faster than inflation, so including an inflation-adjustment clause makes it more likely that the benefits will be sufficient when they are needed. In fact, some states now require that inflation protection be offered for long-term care policies. However, adding this feature may boost premiums by 25% to 40%.

**Cash benefit.** Many policies follow a reimbursement model for benefits, but some will pay a portion of the benefit in cash, to be used without restriction, once benefits have been triggered.

**Tax-qualified plans.** Premium payments for long-term care policies that meet federal guidelines are eligible for tax deductions, and when benefits are paid, they will be tax free.

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### The role of living trusts

Recently, we received this question on the consequences of having a living trust:

**If Mom and Dad put all their investments into a living trust, will just their Social Security income be available to the nursing home?**

No, the living trust does not normally protect one's assets from the claims of creditors. That's because most living trusts are revocable, meaning that the grantor can change the terms at any time. Any assets that a trust beneficiary has control over are available to the beneficiary's creditors, which would include nursing homes and unreimbursed medical expenses. An irrevocable trust may, in some circumstances, shield some assets, but Medicaid's look-back rules will come into play. Consult an experienced elder law attorney to learn more, if this issue is important to your family.

What the living trust does provide when long-term care is needed is uninterrupted financial management following incapacity or admission to a nursing home. Other benefits include:

- professional, unbiased portfolio management;
- uninterrupted financial protection of successor beneficiaries;
- financial privacy at death.

To learn more about how a living trust may be integrated into your retirement planning, please arrange for a meeting with one of our officers at your earliest convenience.

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**Benefit trigger**

Benefits from a long-term care policy begin (subject to the elimination period) when the insured is unable to perform two activities of daily life without assistance, or when the insured needs assistance because of severe cognitive impairment. “Activities of daily life” is a term of art in the insurance world and refers to:

- eating;
- dressing;
- bathing;
- transferring;
- toileting; and
- continence.

A doctor must provide and supervise a plan of care, which may be provided in the home, an assisted living facility, or a skilled-nursing facility.

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**Partnership plans.** Most states now offer the partnership plan, which integrates the plan with Medicaid eligibility. Each dollar of benefits paid from a partnership policy does double duty because it also protects an additional dollar from the spend-down requirements.

**See your professional advisors**

A period of long-term care will be the conclusion to a great many retirements. How one plans to meet those expenses depends upon estate planning goals as well as one's financial resources. In a sense, a long-term care insurance policy is an inheritance protection plan because it decreases the chance that one’s assets will be exhausted before death. It has been asserted by some that the risks of self-insuring for long-term care are larger than the risks of investing in the equities markets. In that analysis, insurance is a risk mitigation tool.

This is a complicated area of financial management but a necessary one. See your professional advisors to learn more, and we’ll be happy to consult on the estate and investment management angles as well.

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College funding

The Higher Education Price Index is an annual report that documents the relentless rise in the costs of college in the USA. The report for 2011 shows that, once again, higher education costs are growing faster than inflation, 2.3% versus 2.0%. The cumulative effect of this price growth can be discouraging for those who are trying to build a college fund. According to the report, if we set 1983 equal to 100, the consumer price index for 2011 would be 225.3, and the higher education price index would be 288.4. That is, while prices have generally doubled in that period, college costs have nearly tripled.

On the other hand, in its annual report, How America Pays for College, the student loan specialist organization Sallie Mae reveals that in the 2010-2011 academic year, students paid on average 9% less than they did the year before. The graph at right shows the varying costs for different income groups. A combination of factors led to this result:

- a shift by some families to lower-cost schools;
- an increase in scholarships and grants for funding;
- an increase in the number of lower-income students going to college;
- a sharp rise in the number of federal Pell grants.

Most of the Pell grant growth was found in middle-income families, whose participation rate went from 30% to 49%. Some 26% of students from higher-income families received Pell grants, up from 12%. The proportion of families overall who apply for federal financial aid for education has grown to 80%.

Better choices

The heavy reliance upon debt to meet college expenses is unfortunate, both because it may reduce the choices available to the student and because the total cost of the education is much higher with that strategy. The better course is to save early, earning interest before the expenses are incurred, instead of paying interest on the loans as they are paid off after the education is complete.

Parents or grandparents who are accumulating funds to help a future college student should explore three approaches that carry with them the benefit of tax deferral and potential tax freedom for investment earnings (but no tax deduction is permitted for contributions):

- Coverdell Education Savings Accounts;
- 529 plans; and
- Roth IRAs.

Each of these choices has advantages and disadvantages to be weighed, so consult with your tax advisors to learn more. The most important factor influencing the success of a savings program is starting early. If the tax advantages of these accounts spur earlier or more systematic habits of setting aside money for education, so much the better.
Reprieve for 2010 estates

2010 was almost the year without a federal estate tax. Instead, in December 2010, Congress enacted a retroactive estate tax, coupled with a $5 million exemption. Thus, the majority of 2010 estates were excused from estate taxation.

Larger estates also were excused, on an optional basis. Those who so choose will subject their heirs to carryover basis, and the possibility of higher capital gains taxes in the future. The election is made by filing Form 8939, a new form invented just for this purpose.

Trouble is, the IRS hasn’t released the Form yet. Initially, tax practitioners expected Form 8939 to be due April 18, but the IRS announced an extension of time in March. Over the summer, the IRS set a due date of November 15, but now a new date has been issued. Form 8939 for 2010 estates will be due January 17, 2012. Given the complexities and uncertainties surrounding analysis of the estate tax opt-out, the due date for 2010 estate tax filings has been extended as well.

Looking ahead

The December 2010 estate tax law also included a new provision that lets married couples pool their federal estate tax exemptions (“portability”). Basic trust strategies have long been available to make certain that each spouse’s exemption is fully utilized. Under the new law, which makes unused exemption amounts inheritable by a surviving spouse, the same result is possible without using a trust.

Estate planning experts are recommending that affluent families stick with the traditional trust approaches rather than rely on the new provision. They advance several reasons for such advice:

- Portability is temporary and is set to expire in 2013. The chances of extending the law are uncertain.
- There is no inflation adjustment for inherited exemptions. With a trust plan, assets are excluded from the spouse’s future estate, and asset appreciation is excluded as well.
- The trust approach provides creditor protection and asset protection in the event of a future divorce.
- The trust approach provides better inheritance protection for children and other heirs.

If you have questions about the adequacy of your estate plans under the new, temporary estate tax law, please consider us to be a resource for answers.