Is Hybrid Long-Term Care Insurance Right for You?

If you hate the idea of paying for long-term care insurance you may never use, a hybrid policy could be for you. The money you paid in premiums doesn't just evaporate if you never need the benefits: Your heirs could get most of it back as an inheritance.

A growing number of Americans are approaching the age at which they must consider how to pay for long-term care. For many, a hybrid insurance policy, which combines life and long-term care insurance, continues to be an attractive option. These policies help protect a retirement nest egg from being depleted by expenses incurred when retirees can no longer care for themselves. And, if the insurance is not needed, there is a death benefit that can be passed on to their heirs.

Here's a great example of how it can work:

I recently met with a couple in their late 50s who planned to retire soon. Both have enjoyed successful careers and saved enough to accumulate a retirement nest egg that should support them for the next 40 years.

They didn't have long-term care insurance, but earmarked about $200,000 from their savings to cover any possible long-term care needs. However, after viewing the benefits of a hybrid life/long-term care insurance policy, they changed their minds.

In this case, a hybrid policy will cover long-term care needs for both spouses and cost them $164,400 in premiums, with payment being made upfront in a lump sum. In exchange, they will receive long-term care insurance for payments of up to $5,000 each month per person. This policy has an unlimited benefit period, so as long as they qualify to receive benefits they will receive them — which is something that is not even available anymore in traditional long-term care policies — and that benefit will grow by 4% per year for as long as they live.

And here's the kicker: If neither person ever needs long-term care, their heirs will receive a tax-free life insurance benefit of $125,000, effectively "reimbursing" 76% of the premiums paid for the coverage. In essence, this policy shifts the risk and financial burden to an insurance company at little cost to the couple.

I have often heard clients express concern about potentially spending a significant amount of money over many years for a traditional long-term care insurance policy and risk never needing the coverage, though the statistics would indicate they probably will. A hybrid long-term care policy helps address this issue. If long-term care is never needed, the policy's life insurance death benefit is often similar to the amount paid for the policy. On the other hand, if long-term care is needed, the amount of money available can exceed the death benefit, often several times over.

Is your retirement plan missing an essential piece?

Long-term care insurance covers the costs of care for people with a chronic illness or disability who cannot care for themselves for an extended period of time. Examples include dementia or Alzheimer's disease, arthritis, cancer, nervous system diseases and diabetes.

If a person cannot perform activities of daily living on their own — bathing, dressing, grooming, eating, etc. — the insurance will help cover the costs of hiring help.

And while healthy people today often can't envision needing such care, seven out of 10 people turning 65 will need long-term care at some point, according to the Centers for Medicare and Medicaid Services.

Without any long-term care insurance, the cost of care is not inexpensive and continues to rise. Cost of care calculators estimate the median national cost of a home health aide at nearly $55,000 annually and a semi-private room in a nursing home at $93,000.

Features and Benefits

For financially well-off individuals who might otherwise consider self-insuring for long-term care, here are some of the attractive benefits offered by a hybrid long-term care policy:

No Increase in Insurance Premiums: The cost of a policy can be locked in from the initial purchase date and not subject to an increase. Unfortunately, this has not been the case with traditional long-term care policies, causing financial strain for some people as premiums can increase significantly over the life of the policy.

Substantial Return of Premium: The death benefit protects people who end up not needing long-term care. While data indicate there is a high likelihood long-term care will be needed, a policy owner should know that the money spent for long-term care insurance will not be wasted. In most cases, a policy's death benefit will pay back most of the premium dollars spent.

Leverage: A person could set aside $150,000 in an investment account earmarked for future long-term care needs, or instead use that $150,000 to purchase a hybrid long-term care policy. If they spend $150,000 to purchase a hybrid policy, at the very least it will return most of these funds at death. But because the potential long-term care benefits paid out could significantly exceed $150,000, there is tremendous leverage available in placing that sum of money in the policy.

Purchase with “Inefficient” Funds: Some hybrid long-term care plans offer the ability to purchase a policy in one lump sum — a feature no longer available with traditional plans. This presents an attractive opportunity for people who may have permanent life insurance policies that are no longer a good fit in their financial plans.

These legacy policies often have large cash values and subsequently large gains (the difference between the cash value and premiums paid) that would be subject to income taxes if the policy were to be surrendered or canceled. By taking advantage of what is referred to as a 1035 exchange (named after section 1035 of the Internal Revenue Code), one can “roll over,” on a tax-free basis, the cash value of the old life insurance policy to the new hybrid policy.

This feature offers the ability to repurpose funds into a product that has significant potential value in the future. Moreover, this can be done in one lump sum, so the purchaser never has to worry about paying premiums again. In addition, taxes can be avoided on any gains from the surrender of the life insurance policy, potentially saving tens of thousands of dollars in tax.

As with any insurance, there are considerations to be mindful of. Most importantly, the insurance company must have the long-term financial strength to remain in business for decades into the future and pay claims. Additionally, some people may not like the idea of giving up control of funds that were earmarked for long-term care by instead purchasing an insurance policy.

In the end, hybrid life/long-term care policies are providing people with valuable coverage, whether they need to use them for long-term care benefits or not. If you are in your 50s or 60s, you should begin planning how best to pay for long-term care. Each person’s health, finances and objectives differ, so consider all options, including whether a hybrid policy makes sense.