



Retirement income planning: long-term care considerations

Of the many ways you may imagine spending your money in retirement—traveling, enjoying favorite pastimes, helping grandkids pay for college, supporting charitable interests and so on—health care may be one of the most important expense categories to include in your retirement income plan. Indeed, you may already know that according to recent figures, a couple will spend approximately \$245,000 to pay for health care costs during retirement.¹

But did you know that this estimate does not include costs for nursing home care? The U.S. Department of Health and Human Services estimates there is a 70% chance one of the partners in an average married couple may need long-term care (LTC).² Other reliable sources estimate 50% of Americans will need some type of long-term care during their lifetime.³

So the high probability of needing long-term care may be a fact of life for many retirees. For this reason, it may be prudent to consider long-term care in your retirement income planning choices.

Point of view

Long-term care planning is not necessarily the same as long-term care insurance.

Key facts

Before determining how to address potential long-term care expenses, understanding how it is delivered may help us make informed choices.

- Nearly three out of four people (73%) receive long-term care at home or from services such as assisted living or adult day care.⁴
- The average length of care outside a nursing home is 4.5 years.⁵
- More than one out of four people (27%) receive long-term care at a nursing home.⁴
- The average length of care in a nursing home is 2.5 years.⁵
- About 10% of people in nursing homes will stay five years or more.⁶

But did you know long-term care is not just a concern for older people? Forty percent of those receiving long-term care are between the ages of 18 and 64.⁷

Furthermore, the costs for long-term care may vary depending on how it is delivered. Compare the 2015 median national rates for different types of care.⁸

- Community adult day health care = \$17,904 annually or \$80,568 over average stay (4.5 years)
- Assisted Living-facility = \$43,200 annually or \$194,400 over average stay (4.5 years)

- Homemaker Services = \$44,616 annually, or \$200,772 over average stay (4.5 years)
- Home health aide services = \$45,760 annually or \$205,920 over average stay (4.5 years)
- Nursing home (semi private room) = \$80,300 annually, or \$200,750 over average stay (2.5 years)
- Nursing home (private room) = \$91,250 annually, or \$228,125 over average stay (2.5 years)

Key take-away

While many people receive home- or community-based care, which may have lower annual costs compared with nursing home care, the longer average need for home- or community-based care can make it nearly as expensive as nursing home care when considering the full period of care needed.

Planning solutions

Just as long-term care can be delivered in various ways, there are multiple approaches to paying for it. Some approaches may afford you greater choice and control over how care is delivered. And some approaches offering less choice and control may be elected by default for lack of planning or because of personal circumstances. From having the least control to the most control over care decisions, the approaches are:

- Government pays for care
- Family pays for care
- Self-insure pays for care
- Private insurance pays for care

Government care

Many people mistakenly believe long-term care is covered under Medicare. This government program pays for only short periods of care (up to 100 days) after discharge from the hospital. It does not cover any condition diagnosed as long-term care. In addition, it is often difficult to qualify for this short-term care, because hospitals often discharge patients before they qualify for the Medicare coverage. As a result, it is generally agreed that Medicare pays less than 8% of the nation's nursing home costs.

Medicaid is a government welfare program serving impoverished people. To qualify for benefits, a person must first spend nearly all of their money and liquidate most of their property and investible assets. To help prevent fraud, there is a 60-month "look back" period prior to applying for Medicaid; program administrators will look for—and take custody of—assets that were transferred to other individuals or legal entities that may be able to provide financial support to the individual. Medicaid patients have very little control over where and how they receive care. At death, any assets still owned by a Medicaid patient generally are transferred to Medicaid to help offset program costs.

Family care

Some people choose to move in with a family member when they are no longer able to take care of themselves. Beyond perhaps passing on some or all of the financial consequences to loved ones, asking them to also assume the burden of care may impact their lifestyle, personal commitments and work responsibilities. In addition, it may take a toll on their emotional and physical well-being. The person who is depending on family members also loses his or her independence and may suffer from self-esteem issues and other psychological problems as a result.

Key take-away

No matter how close family members may be, depending on a child, sibling or other relative for long-term care may cause personal resentments, ruin favorable family dynamics and damage relationships.

Self-insurance

Some people choose to set aside an additional \$80,000 to \$230,000 to cover the current average range of long-term care expenses. Depending on when they may expect to need long-term care, they may need to adjust these figures up to account for inflation and increasing costs. One drawback is that self-insuring can limit their spending flexibility while putting at risk a significant portion of their retirement savings and/or the wealth they intended to transfer to others through their estate. Some people use home equity, such as a reverse mortgage or a home equity line of credit. Like any form of leverage, this approach offers flexibility that comes with risks that are important to understand.

Key take-away

Self-insurance may be an appropriate solution for financially successful individuals and families who are both sophisticated and disciplined enough financially to understand and manage potential consequences.

Private insurance

Some people choose to pool the risk and potentially reduce the cost of paying for long-term care with others by purchasing long-term care insurance. Policies cover three levels of care.

Skilled care — Continuous, around-the-clock care to treat a medical condition ordered by a physician and performed by skilled medical personnel. The patient is often expected to recover from the underlying condition.

Intermediate care — Intermittent nursing and rehabilitative care provided by registered nurses, licensed practical nurses or nurse's aides under supervision of a physician.

Custodial care — Designed to help one perform activities of daily living (such as bathing, eating and dressing). Caregivers may or may not be medical professionals but are supervised by a physician.

Generally, there are three long-term care insurance strategies:

- Traditional long-term care insurance
- Life insurance with long-term care rider
- Asset-based long-term care

Traditional long-term care insurance

This type of policy is designed specifically to cover long-term care expenses. Policies define a daily benefit amount and length of benefit period. Daily benefits may range from \$40 to \$300 or more per day. Length of benefit period may include an elimination period and may range from one to six years. Premium prices depend on the benefits chosen as well as the age at which premiums begin, the health of covered person(s) and whether any riders, such as inflation protection, are added. Qualifying long-term care benefits are paid income tax-free.

Premiums paid on “qualified” long-term care policies (as defined by state or federal guidelines, depending on when they were issued) may be deductible in whole or in part on federal income tax returns. Plus, policies that are issued in states that have enacted partnership programs combining private insurance with Medicaid coverage may offer dollar-for-dollar protection of assets from Medicaid spend-down requirements (based on the value of the policy purchased) after long-term care benefits are exhausted. Such policies may help policy holders receive long-term care while preserving family assets.

There are some caveats. Similar to term life insurance, policies do not accumulate cash value. And if there are no long-term care claims while the policy is in force, similar to a term life insurance policy that has expired, there is no death benefit. This means that policyholders who do not require long-term care (beyond what is covered by Medicare, for qualifying circumstances) or who surrender the policy by stopping premium payments wind up paying for a benefit they may never use. There is also a chance that the premiums may go up in the future.

Key take-away

This is “pure insurance” intended only to pay for qualifying long-term care expenses. (Use it or lose it.) It may be appropriate for people seeking a simple tool offering both peace of mind regarding long-term care expenses and greater control over how long-term care is delivered.

Life insurance with long-term care rider

Another popular way to pay for long-term care expenses is to purchase your life insurance and long-term care benefits together. This may be more cost-effective than buying two separate life insurance and long-term care policies.

The rider gives the insured the option to elect to use all, some or none of the life insurance benefit while he or she is still living, to help pay for long-term care expenses. Beneficiaries receive any life insurance benefit not used for long-term care expenses income tax-free, as long as the life insurance policy remains in force. Qualifying long-term care benefits are also paid income tax-free.

Depending on the provisions of the rider, qualified services often include nursing home benefits, assisted-living benefits, bed reservation benefits, home health care benefits, adult day care, respite care, alternative care and hospice. Evidence of insurability is necessary. Some products may also offer a guaranteed death benefit.

Even though this strategy offers value, flexibility and convenience, a long-term care rider may not be a good fit if the life insurance policy is owned by a business or a trust. And if there is no life insurance need, purchasing a stand-alone long-term care policy may make more financial sense. Stand-alone policies may also offer greater

opportunity to customize coverage with riders that are unique to long-term care insurance policies.

Another important detail to understand is that there are two types of riders. A chronic illness rider will pay long-term care benefits only if a doctor certifies that the insured will never recover. A long-term care rider will pay benefits as the insured may need them throughout his or her life. Like traditional long-term care insurance, benefits for both types of riders begin when the insured needs assistance with two of the six basic activities of daily living.

These riders are determined as part of the underwriting process. Before paying the first premium on a long-term care rider, it is a good idea to know the qualification requirements.

Key take-away

This “hybrid insurance” approach may help accomplish wealth transfer goals, while also protecting wealth from being consumed by long-term care costs.

Asset-based long-term care

This is a special life insurance policy with long-term care rider package that offers many of the features outlined in the previous section. However, it offers some different benefits that may make it an attractive solution for financially successful individuals and families.

Premiums may be paid in as little as one installment. The death benefit offered by the life insurance policy is generally lower than with comparably priced life insurance policies with long-term care riders. The trade-off is a much more substantial long-term care benefit. Depending on the age and health of the insured, long-term care benefits may be one and a half to four times the initial investment.

The reason this strategy is called “asset based” is that the policy can be considered as an asset on the balance sheet of the insured. This is because of the return of premium available. Since the insured has cash-like access to the premium payment(s), he or she retains control over the asset allocated to long-term care coverage. Of course, requesting the return of premium will cancel the policy and the ensuing benefits.

Similar to traditional long-term care policies, premiums paid for qualifying asset-based long-term care policies will receive favorable income tax treatment. And like traditional long-term care policies, asset-based long-term care policies offer greater choice of customization than do life insurance policies with long-term care riders. Unlike traditional long-term care policies and life insurance policies with long-term care riders, asset-based long-term care policies may offer simplified underwriting, sometimes as easy as a one-page form.

Key take-away

This strategy may be appropriate for people who wish to retain control over assets allocated to future long-term care expenses and also provide some death benefit for beneficiaries.

Comparing insurance strategies

The following tables may help illustrate how the features of different insurance strategies stack up against each other.

Traditional long-term care insurance	Life insurance with a LTC rider	Asset-based LTC plan
Provides a pool of dollars for long-term care needs	Provides a death benefit that can be accelerated for an LTC need	Provides a death benefit and an extension of benefits for an LTC need
Inflation protection available	No inflation protection available	Inflation protection available
Can be state partnership qualified	Does not qualify for state partnership	Does not qualify for state partnership
Limited pay options are not available	Multiple pay options available up to lifetime premium	Limited pay options available; lifetime premiums not available
No death benefit	Has a death benefit	Has a death benefit
Return of premium is not an option	Return of premium is not an option	Return of premium is a built-in feature
Shared care is an option	Shared care is not an option	Shared care is a limited option
Daily or monthly benefits	Monthly benefits	Monthly benefits
Exams may be required (carrier specific)	Fully underwritten, exam required	Simplified underwriting (product-specific)
No residual benefits	Some have residual death benefit (product-specific)	Residual death benefit

Talk with your financial advisor

Clearly, preparing for possible long-term care expenses is an important part of your retirement income plan. And the good news is, you have many choices. Your RBC Wealth Management® financial advisor can help you evaluate your options while considering your overall financial goals to help you determine which approach is most appropriate for your specific needs. Contact him or her today.

Sources

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