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White paper

The four tiers of long-term care clients

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Key highlights

- The benefit of dividing your clients into tier groups for specific LTC conversations
- Understanding the LTC risks and concerns of different wealth tiers
- Self-insure vs. self-assure
- The benefit of using an LTC rider or linked benefit policy in an ILIT

Many advisors find themselves having the same long-term care (LTC) conversation with all of their clients only to find many clients say they can "self-insure". Most people, regardless of how affluent they are, can benefit from LTC coverage – but how and why a client can benefit depends on the specifics of the wealth they possess.

You may find more success by dividing your client's into tiers of wealth classifications, and then taking a customized approach to conquering the unique set of circumstances, needs and consequences each wealth group faces should they choose to ignore the opportunity to insure the risk of LTC expenses. For purposes of LTC discussions, clients can be divided into the following four tier groups:

1. Medicaid likely
2. Middle class
3. Affluent – with no estate tax liability concerns
4. High net worth – with estate tax liability concerns

Each tier group is deserving of its own discussion, and by doing so you have a better opportunity to showcase the advantages of LTC planning that are specific to each group.

Medicaid likely

Individuals or couples in this tier group will likely comprise little of your clientele. This tier group relative to your practice are more likely to be the parents, relatives or family friends of clients who have brought these people to you hoping you can assist. These newly acquired clients likely cannot afford (or qualify for) any type of LTC coverage, so you may want to help them prepare by recommending a good elder care attorney in your circle of influence.

These individuals or couples have little choice but to hold their breath and hope nothing happens; but if a LTC need does occur, the elder care attorney can help set up a Medicaid rescue plan that can help keep a spouse financially afloat, or help set up an individual in a cost share plan with Medicaid that has a possibility of preserving a little bit of inheritance for loved ones if death ensues relatively quickly.

Your role will likely be limited to following the lead of the elder care attorney by providing the client the financial products needed, such as a Medicaid compliant annuity.

Middle class

These are the clients we most often associate with the purchase of LTC coverage. The goal for this group of clients is to protect income and assets from devastating depletion due to LTC expenses. It's important when speaking with this group to open the conversation by avoiding the phrase "long-term care" since that term is so often associated with "nursing homes". Instead, direct the discussion towards providing funds that can "keep you in your home as long as possible should you need help". Since the highest percentage of claims begin with home health care,[1] this approach is valid and may resonate better with clients.

The goal for middle class clients is to protect income and assets from devastating depletion due to LTC expenses.

Insuring the risk of LTC expenses provides this group with;

- More likelihood of being able to receive care at home by a paid provider
- A better chance at being able to sustain the lifestyle of a surviving spouse
- Protection that can help preserve assets for loved ones and help avoid Medicaid and the loss of choices that comes with it.

LTC coverage could come from a traditional LTC insurance (LTCi) policy, life insurance with a LTC rider, or a linked benefit LTC policy. The solution ultimately chosen will revolve around the client's budget, or around available assets that could be repositioned. Clients with little assets available to reposition may find annual premiums for a LTCi policy or life insurance with a LTC rider a good path to pursue. While LTCi policies are initially less expensive than other solutions, they do not have guaranteed premiums and have a "use it or lose it" stigma with some clients.

On the other hand, life insurance with a LTC rider can provide coverage using guaranteed premium products, and will pay a benefit whether the insured uses LTC benefits or not since LTC benefits are simply an acceleration of the death benefit. Any amount not used for LTC is paid to the beneficiary as a death benefit. This solution is a good fit for people who need life insurance now, but like the idea of owning a policy that can provide LTC benefits if needed. Whether for younger clients needing family protection, or older clients looking to protect/enhance wealth from LTC expenses, this solution can help.

Clients who have assets to reposition, or have the ability to make larger premium payments and pay up a policy in short period of time may want to consider a linked benefit LTC policy. Premiums are guaranteed, and these policies have features and benefit choices more consistent with traditional LTC policies, but without the "use it or lose it" risk. This policy is not for people with a life insurance need, but purely with LTC concerns. The death benefit will always be equal to or more than premiums paid.

Affluent clients with no estate tax liability concerns

This group of clients generally falls into an asset bracket of $1.5 million to $4 million net worth for singles and $3 million to $8 million for couples. Many of these clients not only hope they will never need care, but believe if they do, they have enough money to self-insure their care. Thus, a "traditional" LTC discussion will not go far with this group of people.

This tier group of clients may better respond to a discussion about *"insuring the portfolio against an unexpected LTC event at a time when the market and account values are down".* These clients have likely lived through the Dot Com crash of 2000, the 2008 crash blamed on the real estate and banking industry debacle, and perhaps even the market crash referred to as "Black Friday" on Oct. 19, 1987. And while one cannot predict how and when an account will recover from such events, one thing is most likely true – *it's hard to build an account value back up when you are withdrawing substantial amounts of money from the account*. Thus, while these people can likely afford to self-insure their potential LTC expenses, there is no guarantee such an event will come at a time that is convenient to the market performance of the portfolio.

Self-insure vs. self-assure

It all comes down to how to "self-insure" in the most efficient manner. Agree with your client that they can afford to self-insure, but then add that there is more than one way to self-insure and you would like to show them a more cost efficient way to do it.

Self-insure

A traditional way some clients plan to self-insure is to set aside some money and place it a secure liquid investment. This money may even be put in a conservative investment earning a low interest rate - such as a money market account - to ensure principal protection. Upon needing LTC, those funds (plus any gains) will be used to pay for LTC expenses. But if that individual is still alive and needing care when those set funds exhausted, they would have to tap other personal resources to continue paying LTC bills.

The advantage to this method is that if and when the time comes to need care, the person in need simply retrieves their money (cash), and spends it on the type of care they wish to have. The problem is that if and when the money set aside is exhausted, funds from income and/or accounts that were not planned for this use must now be accessed. An individual, or a couple both in need of LTC services for an extended period of time may be stunned at the amount of assets they have gone through, leaving far less for loved ones than planned. However, there is another way of self-insuring for LTC – which could be referred to as "self-assuring".

Self "assure"

First, consider showing your client a linked benefit LTC policy that pays cash indemnity benefits, as that may better resonate as an "apples to apples" comparison to self-insuring. By choosing a cash indemnity policy, additional flexibility is provided that will allow for any level of care they desire without having to worry if a service will be covered, including certain "concierge" level services; because with a cash indemnity policy, the insurance company places no restrictions on how the LTC benefits are used.

Using a hypothetical example, we have a married 55-year-old female who is in good health. Keeping the numbers in this example easy, let's assume she has $100,000 ready to be earmarked for potential LTC expenses she may face in the future. If she were to self-insure, she might place the $100,000 into a safe and liquid investment such as a money market account. Upon needing LTC, she would spend that $100,000 (plus interest) on her LTC expenses. She is able to spend this money in any way she desires since it is her own cash. However, if she is still alive and needing care when that $100,000 of savings (plus interest) is exhausted, she would have to tap other personal resources to continue paying her LTC expenses.

- Conversely, with the "self-assure" option, she could simply reposition her $100,000 into a cash indemnity linked benefit LTC policy. Since these policies generally offer some form of a return of premium feature, she has the knowledge that she could retrieve this money some time into the future if needed. Her $100,000 will purchase approximately $540,000 of LTC benefits, with a death benefit of $180,000 if the policy is never used. And the benefit is "cash" that she controls, just like the self-insure plan.
  - In theory, upon qualifying for a LTC claim, the first $100,000 of LTC benefits received would essentially be coming from her own premium dollar money, much like the self-insure plan.
  - But once that $100K is exhausted, in this example, there is up to $441,257 in additional LTC benefits available from the policy to pay for LTC expenses.
  - In addition, there is a small guaranteed residual of death benefit for heirs.

The bottom line is that the cash indemnity linked benefit policy provides a level of "stop loss" that self-insuring cannot provide. When a person self-insures LTC, they are liable for every dime that needs to be spent out of their own pocket. However, with the "self-assure" method using a linked benefit policy strategy, the policy provides a stop of asset loss until the benefits are exhausted. Discussing this strategy using more of a financial spin may resonate better with your more affluent clients.

High net worth - with estate tax liability concerns

This group of people have a different risk to discuss – the cost of "getting lucky". Your conversation with this client is to show them how self-insuring places them in the unique position (compared to people of less wealth) of their estate potentially being taxed on the money set aside for LTC if they pass away needing

little or none of said funds. Let's start by looking at the potential effects of how self-insuring LTC may not be the best solution for many high net worth people.

In order for the high net worth client to self-insure, they must have assets available to them that are liquid and accessible inside their estate in the event they encounter a LTC situation that needs funding. Let's assume this client sets aside $1,000,000 for this purpose.

- If the client actually needs LTC and spends through most or all of the $1,000,000, then the "self-insure" plan worked well enough.
- However, if the client needs none of, or very little of the assets set aside, there is a cost to being "lucky" enough to not need LTC as these funds could be left subject to estate taxation.
- Assuming a 2017 maximum estate tax rate of 40%, up to $400,000 of the $1,000,000 could be taxed if it was never needed for LTC expenses (assuming holding on to this additional $1,000,000 puts the client's estate over the exempt amount).

But there is a way to potentially avoid the financial risk of self-insuring. A LTC rider can work inside an irrevocable life insurance trust (ILIT) if the rider pays indemnity benefits. An indemnity plan pays the LTC benefit directly to the owner of the policy; in this case it is the trust/trustee. The life insurance policy is essentially funding the ILIT with cash via payment of an accelerated death benefit. Keep in mind, the LTC benefit reduces the final death benefit dollar for dollar, but the total cumulative payout would remain the total death benefit amount. The insured (grantor) must never have the LTC benefit directly in hand nor can they have claims against the trust for such monies. So the big question is – how do you get the money out of the ILIT without creating incidents of ownership? That is where a collateralized arm's length loan comes in.

The trust is made "defective" for the purpose of being able to access funds from the ILIT using arm's length fully collateralized loan provisions. The loan is secured by property pledged by the Grantor/Insured. It is essentially an exchange of assets, dollars for the loan obligation – backed by the collateral. The loan must be legitimate with collateral pledged, interest charged, and an agreement to fully pay back the debt. Collateral can be anything that covers the debt; a house, artwork, coin collections, etc., as long as the asset has a legitimate fair market value. The interest rate charged should be at least equal to the interest charged on the life insurance policy (although in this concept there will be no loan taken against the policy itself). In most cases, the loan interest is allowed to accrue. Ideally, the loan interest should be paid back prior to the death of the Grantor/Insured to avoid income taxation on the interest paid to the trust. Some plans call for the repayment of interest on a periodic basis to hedge against the risk of all interest being taxable at death, though this will impact the overall accrual of debt. At the death of the Grantor/Insured, the loan principal and accrued interest is deductible from estate assets. Remember, estate taxes are not figured until the estate has repaid all debt. So in this case, both the loan principal and the accrued loan interest are considered debts that can be deducted. If the interest is paid back prior to death, it will remain tax free to the trust. If paid after death, the interest will be considered income to the trust and be taxed.

A reimbursement plan will generally not work in an ILIT because bills for the long-term care of the insured are submitted to the insurance company by the trustee of the ILIT (which owns the policy). The insurance company then pays the bill to the nursing home or care provider on the behalf of the insured or reimburses the trustee for expenses paid for the benefit of the insured. This chain of events provides a direct monetary benefit from the ILIT to the insured and destroys the integrity of the trust.

For more information on how this concept works, please request the white paper "Using Long-Term Care Riders in Estate Planning"; *NFM-3880.11AO*.

Summary

How you discuss LTC with a client is really a matter of where the client falls in regard to their wealth classification. By dividing up your clients into the aforementioned wealth tiers and focusing the discussion specific to the needs and challenges each tier possesses, you may find LTC an easier conversation to have, and with more success for all tiers of clients in your practice.

[1] American Association of Long Term Care Insurance – AALTCI Sourcebook 2015-2016

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