Hybrids Aren't Just Cars

In the realm long term care there is undoubtedly one major push back that we frequently hear, "What if I pay all those expensive premiums never need long term care?" I have a one word answer to that – GOOD! Have you ever heard someone complain about their house not burning down and having to pay their property insurance year after year? Or, that they wish they broke their leg so they could have taken advantage of the medical insurance they paid? Regrettably, "good" is sometimes not good enough of an answer and the insurance industry has created products to help offset the potential loss of premium payments. In this month's article I will discuss insurance products (called hybrids) that have been developed to leverage your premium(s) into long term care dollars as well as offer the opportunity to call the deal off and get your money back.

The Quick and Dirty of Hybrid Long Term Care:

There are more hybrid long term care insurance products available than you shake a stick at, so trying to sort through them is no simple task. In summary, insurance companies have taken many of the traditional long term care benefits that we are familiar with and structured them into annuity and life insurance contracts. The way they do this is by stripping down the benefits of annuities and life insurance policies to bare bone minimums (as much as they can legally) and then allowing you to access the contract value and more (something they often call an extension of benefits) for long term care needs. The nice part about these contracts is if you end up wanting your money back (or heaven forbid you pass away without needing long term care), your premiums are not lost! From experience I can tell you that each insurance company tries to stand out with little tweaks to make their product stand out, therefore no two policies are the same. However, for the sake of this article let's talk in generalities about the benefits and drawbacks of these hybrids.

The Pros:

There are many pros to hybrid long term care policies. Here are a few to consider:

- *Return of premium* – As mentioned already, your money is not lost if you do not use the insurance. When your premiums are invested into an annuity hybrid you are able to access a guaranteed minimum account value (typically equal to your premiums), and if you pass away without using the benefits your account value is passed on to your heirs. In life insurance hybrids you are able to access your premiums through a "return of premium benefit," and if you pass away without using the benefits your heirs receive a life insurance payment. Note that any long term care benefit that you end up needing will reduce your account values dollar for dollar.
- *Leverage* – Of course, these policies leverage your premiums into higher long term care benefits, otherwise people would just keep their money invested or in a savings account and "self-insure" if they needed to. Depending on the hybrid and the types of benefits that it offers, we have seen these policies leverage premiums by more than four times. That is, you can make one dollar of premiums stretch into four dollars of long term care benefits. The amount of leverage that you get will typically vary depending on how you structure your maximum monthly benefit or the tweaks that the insurance company offers (for example: a higher guaranteed death benefit will lower your total long term care benefits)

- *Fixed premiums* – Generally with these policies you don't have to worry about the insurance company hiking your premiums. You can typically pay a onetime premium or stretch your premiums for up to ten years (and with some products over a lifetime).
- *Tax benefits*[1] – Insurance payments for long term care benefits are received tax free as long as they do not exceed maximums set forth under HIPPA guidelines.

The Cons:
Of course, there are many downsides to these policies. These include:

- *Lack of growth*/opportunity – Undoubtedly, your returns will be meager if anything at all. Annuity hybrids often offer some guaranteed rate of return, but any gains you are credited will be chewed up by rider fees that leverage your premiums into long term care benefits. Life Insurance hybrids just don't buy you much life insurance. Indisputably, any premium you pay loses the opportunity to be invested elsewhere and what you get in return is a leveraged long term care benefit rather than principal growth or large death benefits.
- *Steep premiums* – While fixed premiums are a benefit of these policies, most of them require that you pay your full premium upfront or over ten years rather than paying for it over your lifetime. Basically what this means is that you have to pay large premiums from your assets rather than smaller premiums from your income, which leads into the next con of these policies.
- *Not very IRA friendly* – If you simply wanted purchase one of these hybrids with funds from your IRA you will have to take a distribution from your IRA. That is, you will get hit with ordinary income taxes, possibly a higher tax bracket because these premiums are typically large outlays, and if you are under 59½ you will be penalized for early withdrawal from your IRA. Yes, there are a few new annuity hybrid polices that allow for IRA funds to be used as a premium, however there are many caveats that come along with taxes and Required Minimum Distributions that make these so called IRA friendly hybrids less attractive and more complicated.
- *Possible penalties* – Some of these policies will not allow you to take your full return of premium until the contract has been open for a specific period of time. It's important to look at the penalty schedules so you understand how this works.
- *Need for underwriting* – For the most part these policies have an accelerated underwriting, however you still have to go through a medical underwriting (even with the annuity hybrids). Rather than trying to estimate your life expectancy (as they do with life insurance underwriting) they are trying to estimate if and how long will you need long term care services. Depending on the insurance company and your age you will have to go through a phone or in person interview where they ask general health history questions and test for cognitive impairment. They will

[1] Note that taxes can be complex and vary depending on many different factors. In addition to the benefit listed above there are other tax benefits that may be applicable as well as times that taxes may apply to gains in the account. This is not intended to be a guide on taxes and if you have any questions it is recommended that you discuss this further with your CPA or financial planner.

also order up your medical records and prescription history to help them understand your medical condition.

Key Takeaways:

If there is one thing to take away from this article it is that these annuity and life insurance hybrids really are not intended to be used for the benefits that annuities and life insurance are known for. These products are designed and should only be used for insuring the likely possibility of needing long term care. They are long term care policies in the guise of annuities and life insurance. If you want the benefits of annuities, don't by a hybrid. If you want the benefits of life insurance, don't by a hybrid. If you want the benefits of long term care insurance, a hybrid is one of the many options.

Next, takeaway is that these are not investments. With these hybrids insurance companies will protect your premiums and allow you to access them, but these policies should not be considered an investment and you will likely not see any gains to your principal. If you are considering a hybrid long term care policy you should only be thinking about using the return of premium benefit for a worst case scenario or as a return of premium at your death. Any draws on your premium will reduce your long term care benefits, as well as open up the chance that your policy could lapse entirely.

Finally, there are life insurance policies that have long term care riders that are really not long term care hybrids. Depending on how the rider benefit is filed with the state, the policy may have a long term care benefit that is based on the standard triggers under HIPPA guidelines or you may have a long term care benefit that is based on what insurance carriers call a chronic illness. Without getting into the gritty details, both benefits would be triggered if you are unable to perform two of six activities of daily living for more than 90 days. However, if your long term care benefit is based on you having a "chronic illness," any chance that you may recover from your health condition (i.e. hip fracture) your insurance policy will not any benefit. We will talk more about this nuance in a future article.

I hope this article has gotten you thinking about other ways to look at long term care. As always, if you have any questions or comments on this article please feel free to reach me at Justin@jimhelps.com