THE WALL STREET JOURNAL.

http://www.wsj.com/articles/SB10001424052702304393704579530130606718764

ENCORE

'Hybrid' Long-Term-Care Policies

How to Tell If They're Right for You

By ANNE TERGESEN

May 4, 2014

Buyers of long-term-care insurance are snapping up hybrid policies, which package long-term-care coverage with other forms of insurance. These policies allow heirs of consumers who die without using their long-term-care coverage to get at least a partial refund of their premiums, and are insulated from the premium increases that have given the insurance industry a black eye in recent years. But buyers need to understand the trade-offs involved.

"There is no right or wrong answer," says Claude Thau, an insurance broker in Overland Park, Kan., who helps financial advisers with long-term-care planning for their clients. "While hybrids provide a death benefit for heirs, traditional policies provide more long-term-care insurance" for each dollar in premiums.

Academic research shows that up to 70% of individuals 65 and older will need some form of long-term care. While Medicaid is available to help those with little money cover nursing-home costs, Medicare doesn't pay for continuing care in nursing homes. Nor does it cover assisted living or home health aides, who provide help with dressing and other personal care for a national median rate of about $160 per eight-hour day.

Currently, there are two long-term-care options: a traditional policy covering only long-term care, and a hybrid policy, which typically packages long-term-care coverage with a universal life-insurance policy or a fixed annuity.

Hybrids are increasingly popular: While sales of traditional policies fell by 23% to 233,000 in the five years that ended in 2012, sales of hybrids rose almost fivefold, to 86,000, according to Limra, a nonprofit insurance and financial-services research organization.

Which is right for you will depend on factors including your net worth, your tolerance for investment risk, and whether you want two forms of coverage or just one.

Experts say the first thing to consider is what you can afford. With hybrids, carriers often require a single, upfront premium—the average consumer spends $130,000, says Mr. Thau. While some carriers allow policyholders to spread payments over two to 10 years, the average premium on a traditional policy is far lower, at $2,311 a year. (Be aware, though, that these payments continue for life.)

Because $50,000 is typically the minimum needed for a hybrid with a meaningful long-term-care benefit, the policies "are ideal for higher-net-worth people," says Jesse Slome, executive director of the American Association for Long-Term Care Insurance, a trade group for agents.

Hybrids can also make sense for people with appreciated annuities or life insurance, because it's possible to transfer money tax-free from these policies to a hybrid through a so-called 1035 exchange, says David Wolf, who owns a long-term-care insurance-planning firm in Spokane, Wash.

Sometimes, applicants in poor health who are rejected for traditional long-term-care coverage are able to qualify for a hybrid, particularly one with an annuity, adds Mr. Wolf.

But there are also reasons to stick with a traditional long-term-care policy. For one thing, because hybrids offer two forms of insurance, they levy two layers of fees: the administrative and "mortality" expenses (based on your life expectancy) that carriers generally assess on life-insurance policies, plus the "morbidity" charges (based on the likelihood that you'll get sick) in traditional long-term-care insurance policies, says Mr. Wolf.

While policyholders pay no tax on the benefits they receive from either type of policy, only individuals with traditional policies can deduct their premiums, says Michael Kitces, director of planning research at Pinnacle Advisory Group in Columbia, Md.

And only traditional policies with certain features—that are approved by each state and meet certain guidelines for inflation protection—can qualify for the government-endorsed Long Term Care Partnership Program, which allows those who exhaust their long-term-care coverage to protect some of their assets and still qualify for Medicaid, says Mr. Wolf.

Investment returns are yet another consideration. One big allure of a hybrid is that, by paying an upfront premium, the consumer isn't at risk for future premium increases. But buyers also lock in a return that's determined by interest rates at the time of purchase. With interest rates near all-time lows, the annual return on these policies is currently around 3.5%, says Mr. Slome.

Those who think they can do better by investing their money on their own may come out ahead by putting the money into a diversified portfolio and using the returns to pay the premiums on a traditional long-term-care policy, says Mr. Wolf.

Consider a 60-year-old man who puts $150,000 into a hybrid policy with a maximum death benefit of $169,265. If he eventually needs long-term care, the policy will pay $5,519 a month for up to four years, a benefit that compounds at 5% a year, says Mr. Wolf. If he dies having never received long-term care, his heirs receive the death benefit, which declines to $150,000 after nine years.

But if he puts his $150,000 into an investment with a 4% return, he will earn $6,000 a year—enough to buy a four-year traditional policy with a monthly benefit of about $11,000 that compounds at 5% a year, says Mr. Wolf. That's about double the hybrid's monthly benefit—and the man can always leave the $150,000 in principal to his heirs. The risk, of course, is that the investment returns won't cover his premiums.

Email: encore@wsj.com