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What You Need to Know About Long-Term Care Insurance

By Paula Hogan

Custodial care is not a topic that any of us deals with easily.

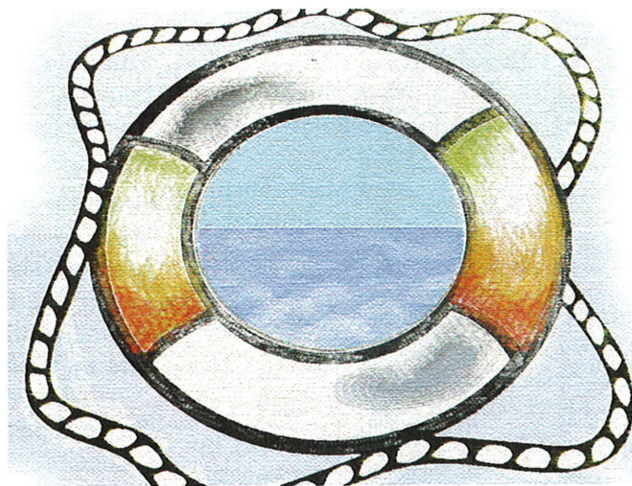
First of all, no one likes to think about incapacity. It's hard enough when the health of your parents begins to fail, but the idea of planning for one's own incapacity is, for most people, literally unspeakable.

Secondly, our intuitive sense about the nature of aging and the available modes of care is outdated. Most people equate custodial care with nursing home care and think they have only a small chance of needing nursing home care. But the nature of aging is changing as longevity increases; the amount of time we spend in adulthood has more than doubled in the last century. It is now typical to need some part-time, in-home assistance in early old age, with sporadic periods of full-time care in an assisted-living facility interspersed. Then, farther into old age, there may be a need for full-time care in an assisted-living facility, and toward the end of life some full-time care in a nursing home.

However, the frightening prospect that many face today is that custodial care is expensive and can easily drain financial resources. Because of this, the decision to buy long-term care insurance has become an important financial planning issue.

Long-Term Coverage

Most people do not realize that long-term care insurance offers good value. In contrast to the old nursing home policies that many of us still have in mind, long-term care insurance has evolved into a product that supports people staying at home as long as it makes sense for the insured, or living in a facility when full-time care becomes appropriate.



In addition to nursing-home fees, excellent long-term care policies pay for homemaker and companion services, modest home renovations to facilitate handicapped living, adult day care, and assistance—in the insured's home or in a facility—with bathing, dressing, eating, continence, toileting, and transferring.

A useful way to think about long-term care insurance is that in exchange for an annual premium, you get access to a large pot of money that you can use to pay for care, either in your home or in a facility, and with no tax liability on the benefit payments. Usually, there is a waiver of premium once care begins and a spousal discount for couples. Also, some portion of the annual premium may be tax-deductible.

Buying coverage earlier rather than later not only captures a relatively lower premium, it also protects against the possibility of becoming uninsurable. You can buy inflation protection by purchasing an inflation rider that will make the benefits grow, for example, at 5% compounded each year. Premiums are not scheduled to increase from year to year.

However, there are strong inflationary pressures in this

industry, and insurers do have the ability to raise rates by class of insureds if they gain approval from the regulators. Thus, insured persons should anticipate the possibility of a price increase during their lifetimes. However, policies are guaranteed renewable—once you are insured, the company cannot change the benefits.

The Costs

Premiums increase with age and also vary by health status but interestingly not by gender. Premiums are also expensive—as expected, given the high and growing cost of custodial care.

- For example, a single 69-year-old in excellent health would currently pay about $6,000 to $6,500 a year for a typical policy from one of the top carriers. (A typical policy is assumed here to offer $5,000 per month of benefits, a six-year benefit duration period, 5% per year compounding of benefits, and a 90-day elimination period [the number of days for covered services before the policy pays] for facility care and a zero-day elimination period for home health care.)
- For this same coverage, a healthy 48-year-old would pay about $2,500 per year; and
- For the same coverage, a healthy 75-year-old would pay $10,000 to $12,000 per year.

It's true for all of us: The language of long-term care insurance policies is confusing. The policies use the language of traditional insurance products for a non-traditional, new service.

For example, if you buy a $5,000 per month, six-year policy it could—and almost certainly will—last longer than six years. What these terms mean is that you may draw up to $5,000 per month for care as long as the pot of money lasts. If you are in full-time care, the policy will run out in six years. But if, as is more likely, you draw funds more slowly than $5,000 per month (for example, part-time care at home), then coverage may last for many years.

Thus, what this policy actually provides is access to a "bucket" of money equal to $360,000 (or $5,000 per month × 12 months a year × six years) that you can use with no income tax liability to pay for custodial care expenses at the rate that makes sense for you, but not faster than the inflation-adjusted $5,000 per month benefit level.

Note that the 5% per year inflation protection means that both the monthly maximum benefit payment *and* the remaining "bucket" of money at your disposal grows at 5% per year compounded.

Table 1. 2004 Caps for Deducting LTC Premiums

Attained Age at Year-End:	IRS Eligible Premium Deduction:
40 or younger	$260
Ages 41-50	$490
Ages 51-60	$980
Ages 61-70	$2,600
71 and older	$3,250

Amount of Coverage

How much coverage to purchase is a judgment call, but most people only insure a portion of potential expense. As you decide how much coverage to purchase, remember that most, if not all, of your income will still be available to pay for care.

Also, what you now pay in income taxes will likely be at least partially available if you need care. That's because custodial care expenses are tax-deductible medical expenses to the extent that they exceed 7.5% of adjusted gross income. In full-time care, the result is that funds formerly used for income taxes are in effect often redirected to long-term care costs.

And finally, if you move into an assisted-living or nursing home facility, the proceeds from the sale of your former home will also be available to pay for care.

The Tax Angle

There are some potential income tax–advantaged ways to purchase long-term care insurance.

The smallest tax advantage, which is admittedly available to only a small portion of taxpayers, is that premiums can be deducted as a medical expense on Schedule A of the federal tax return to the extent that the premiums exceed 7.5% of adjusted gross income and after being capped by the IRS maximums. These IRS maximum figures are adjusted annually and are also used to determine how much of a person's long-term care insurance premiums can be paid with funds withdrawn from a Health Savings Account. The IRS maximums for the 2004 tax year are listed in Table 1. Long-term care insurance premiums may also be deductible in full or in part on your state income tax return.

Further means of deducting premiums are available for workers, depending on the type of firm where you work. Check with your tax advisor for detailed information, but be aware, for example, that sole proprietors can take the IRS maximum premium deduction referenced above as an above-the-line deduction for themselves and their spouses on the front of the IRS 1040 tax form, as can partners whose partnership pays for long-term care insurance coverage, as long as there is "a written plan providing for the medical coverage."

Sole proprietors and partners can get full deductibility of premiums if they offer coverage as an employee benefit to their staff and also have their spouses work in the business. C Corporations can deduct premiums paid in full as ordinary and necessary business expenses, since employer-provided long-term care insurance qualifies as an accident and health plan within the meaning of the tax code. Coverage can also be offered on a discriminatory basis, i.e. with eligibility determined by employee class. Thus, a professional

Table 2. Distinguishing Features of a Good Long-Term Care Contract

Contract Feature	Excellent Contract	Less Than Satisfactory Contract
How easy is it to satisfy the elimination (the number of days for covered services before the policy pays) period?	Insured must satisfy the elimination period only once while the policy is in force. There is no requirement for consecutive days of care and no limited period in which it must be satisfied. Plus, a day of home care will equal 7 days of care for purposes of calculating the elimination period.	The insured may be required to satisfy the elimination period multiple times because days of care count toward the elimination period only if they are sequential or occur within a specified time period.
How is "need for care" defined?	"Hands-on assistance or standby help or reminding."	"Actual hands-on physical assistance" from someone who is "continuously present."
Who sets the care plan?	The insured may choose who develops the care plan.	The insurance company requires the use of its own care manager.
What conditions are excluded from coverage?	A few clearly defined conditions, such as "alcoholism, drug addition, or chemical dependency, except for an addiction to [prescribed medicine]."	Ambiguous language such as "conditions primarily due to mental disorder, including depression and anxiety, or to substance abuse or dependency." This language leaves open the question of whether the insurance company will pay for care subsequent to the broken hip from a fall after an evening cocktail.
How are benefit levels specified?	As a certain dollar amount per month.	As a certain dollar amount per day. (If the benefit level is $150/day, and you use $300 on one day and $100 the next day, the benefit for these two days will be $300 versus the $400 of actual expenses.)
When is the premium waived?	Whenever there is a day of care that is covered or that counts toward the elimination period.	Waiver only for in-patient care or if a specified number of days of care occur within a set period.

service firm structured as a C Corporation might choose to pay premiums for the senior professional staff in full; for other staff members, they may offer just the ability to pay premiums via aftertax payroll deductions—but with an attractive group discount offered by the insurance company. Employers can also offer their staff the ability to purchase coverage for dependents, such as parents, in addition to spouses.

One appealing aspect of long-term care insurance coverage as an employee benefit is that it can be structured so that each insured person is covered by an individual contract that is portable beyond employment, and for which there is a group discount (which is often available when several individual contracts are purchased together). Group discounts are particularly appealing because they remain in place even after the insured leaves the group, for instance by retiring. Also, in the current marketplace, individual coverage tends to be more comprehensive than group coverage with little cost difference if the insured is relatively young and healthy, or is applying with a partner and so is eligible for a partner discount. Thus, in the current environment the most cost-efficient way to purchase coverage is with a partner, under an individual contract, purchased with pretax dollars through a group eligible for a group discount. Partners can be spouses, non-spouses in a long-term committed relationship, two siblings living together, or a parent and child living together. The key is that you live with someone who could and would help to take care of you.

Note that it is increasingly common to choose to pay premiums on an accelerated "quick-pay" basis—for example, by paying higher premiums through age 65 or for a specified 10-year period. The advantage of such

quick-pay modes of premium payment is to make full use of tax advantages during one's peak earning years, to complete a major fixed payment before retirement and, perhaps most importantly, to avoid premium increases that might occur beyond the specified payment period. "Quick-pay" premium levels are substantially higher than the pay-as-you-go premiums that are due until the insured dies or needs custodial care, and so are only suitable in particular instances.

Unfortunately, there are no gift tax planning strategies that are relevant for purchasers of long-term care insurance. Gifts of long-term care insurance premiums beyond the amounts eligible to be taken as itemized deductions are subject to the annual gift exclusion amount, currently set at $11,000 per person per year.

When Should It Be Bought?

When to purchase long-term care insurance is an important decision, with several trends pointing to the wisdom of purchasing earlier rather than later—for instance, in one's 40s and 50s instead of at the more traditional purchase ages of 50s to 70s.

Purchasing earlier rather than later not only captures a relatively lower premium, it also protects against the possibility of becoming uninsurable. Potential tax advantages support paying premiums when earnings are high, which is usually before retirement age. Furthermore, long-term care insurance can be an important complement to disability insurance, which at best offers partial replacement of family income but not replacement income *plus* reimbursement for custodial care expenses for the breadwinner.

Financial professionals increasingly point to lowered expectations for investment returns, and advise that it is very appropriate to take an insurance approach to funding potential custodial care expenses.

Finally, some industry commentators offer the opinion that current long-term care contracts may look relatively appealing in retrospect if, as seems reasonably possible, future contracts omit such potentially attractive features as a lifetime benefit duration or have more managed care language inserted in them in order to keep costs down for the insurance companies. (Managed care language can include restricting benefit payments to a "reasonable and customary level" as defined by the insurance company or requiring that the plan of care be specified by the insurance company instead of by a neutral outside professional.)

Who Should Buy It?

Who should buy long-term care insurance? There are a variety of good candidates, including:

- ***Parents trying to protect themselves and conserve funds for heirs:*** People who can afford to pay for some but not a lot of custodial care with private funds, but who are worried about outliving their money, or are concerned that their children's inheritance will be diminished by custodial care costs. If they cannot pay premiums out of regular income, these people pay premiums with cash from the portfolio, not regular income. They view long-term care insurance as portfolio insurance.
- ***Couples with one spouse in poor health:*** Couples where one spouse is unwell and who want to free up personal funds for the spouse with medical problems but still preserve financial security for the healthy spouse.
- ***Executives seeking peak earnings protection:*** Executives entering their peak earning years who have adequate disability insurance but not so much disability insurance or wealth that they could pay for their own care in a nursing home and still maintain the family's standard of living. (Of the people receiving long-term care services now, 40% are under the age of 65.)
- ***Wealthy people:*** Wealthy people who can afford to pay long-term care expenses with private funds, but who do not want to do so. Precisely because they are wealthy, they are also able to choose to pay long-term care insurance premiums and get the "pop-up" portfolio that long-term care insurance provides to pay care expenses with pretax dollars.
- ***Children caring for parents:*** Adult children buying long-term care insurance for their parents as a cost-effective way to uphold family values.
- ***Spouses in second marriages:*** Spouses in second marriages who require in the prenuptial agreement that they each maintain long-term care insurance in order to preserve individual assets for children from a prior marriage.
- ***People worried about managed care:*** And finally, people who look at the long-term care industry and anticipate that managed care trends might shift from acute to custodial health care purchase coverage in order to maintain choice.

What to Look For

What should you look for in a long-term care insurance policy?

Insurance Company Rating

First of all, it may be many years before the long-term insurance company is asked to provide benefits. Consequently, purchasing coverage from a strong insurance company is important. An evaluation of company strength should include the financial strength of the insurance company—a high rating by A.M. Best, as well as presence in the market. Companies with a large and growing book of business, everything else equal, have more financial resiliency, and more ability to negotiate substantial group discounts for their insureds from care providers.

Benefits and Restrictions

To estimate the amount of coverage you might need, investigate the cost

in your area, or the area you intend to retire to, or where your children might live, since a common pattern is for older people to get care near family.

Make sure you understand the conditions that must be met to qualify for coverage. Typically, a policy will require a cognitive or physical impairment to qualify for benefits. And you should know who decides whether or not you qualify.

Also, make sure you understand how the benefits are specified. A long-term care insurance policy can either pay the full daily benefit regardless of the actual charges for long-term care services, or it can pay the actual long-term care charge up to the maximum benefit purchased allowed by the policy. Reimbursement policies generally have a different benefit amount for nursing home care and home care.

In addition, make sure you understand the "elimination" or waiting period. The usual range is zero days to one year. However, some contracts require that these days be satisfied sequentially or within a specified time period.

And of course you need to understand any restrictions or conditions that are excluded from coverage and who is responsible for determining the plan of care.

Inflation Protection

The usual inflation factor is 5% per year. Some policies figure this as simple interest, and others figure it as compound interest. Compound interest offers substantially more protection and so costs substantially more than simple interest.

The inflation protector increases the benefit from the first day of the policy, not from the first day that benefits are received. Unless you are highly sensitive to cost and also far into old age and so not too worried about the impact of long-term inflation, aim to purchase the 5% per year compounded inflation protection.

Also, a growing development is for companies to offer a pay-as-you-go method of inflation protection, where you buy incremental units of insurance throughout your coverage period at rates current at that time. This can be a more expensive means of purchasing coverage, but might make sense for someone, for instance, who is buying early before income increases and with the perhaps heroic assumption that rising income will cover rising premiums. However, read the fine print carefully. For example, if you can only purchase additional units through age 65, you have no means of inflation-protection for the potentially long period from age 65 onward.

In general, remember that the key benefits of long-term care insurance are inflation protection and the ability to share risk across a large number of insured. If you skimp on inflation protection, you are potentially missing a substantial part of the value of the long-term care policy.

Finding & Comparing Policies

Typically when purchasing coverage, you work with an agent to get quotes and comparisons for the coverage you need from several companies. Be sure to work with an insurance agent who is specialized in the long-term care field and who represents several different companies. A good agent will help tailor a contract to your particular circumstances and also steer you toward the company whose contract offers the best financial value for you given your health and financial circumstances.

For your own protection, skip the marketing brochures and focus on reading the actual contract—the only document that matters.

Everything else being equal in the current marketplace, expect individual contracts rather than group coverage to offer the best value.

When comparing one or more policies, ask for a "specimen" or "sample" contract and take the time to review several specific provisions.

Contracts differ from each other in important ways. Table 2 shows some distinguishing features of excellent contracts in the current marketplace.

Summary

Long-term care insurance, while still an evolving field, has become part of the standard insurance coverage that each individual must consider to prudently manage personal finances. ▲

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Long-Term Care Information on the Web

There are numerous Web sites you can turn to for more information on long-term care insurance, as well as long-term care in general. The resources listed here are divided into:

- Sites that provide useful guides to buying a long-term care insurance policy;
- Sites that provide useful information on long-term care facilities' services. These sites can help you get a better understanding of the likely costs of long-term care in different areas of the country.

GUIDES TO LONG-TERM CARE INSURANCE

America's Health Insurance Plans (AHIP)
www.ahip.org

AHIP is a national association representing 1,300 health insurer companies. In the Consumer Information section, AHIP offers a downloadable 20-page Consumer Guide to Long-Term Care Insurance.

LongTermCareLiving.com
www.longtermcareliving.com

Sponsored by the American Health Care Association and the National Center for Assisted Living, this Web site provides consumer information concerning long-term care and long-term care insurance, including "Understanding Long-Term Care Insurance." Also includes useful links to other helpful Web sites.

National Association of Insurance Commissioners (NAIC)
www.naic.org

The National Association of Insurance Commissioners (NAIC) is an organization of insurance regulators from the 50 states, the District of Columbia and the U.S. territories. Although insurance is regulated on a state-by-state basis, the NAIC provides a forum for the development of uniform policy when appropriate. The Web site includes resources for consumers about the purchase of long-term care insurance.

It also provides links to all of the state insurance regulator Web sites. The state insurance regulator Web sites often have considerable information about long-term care insurance that is specific to the state.

Although it is not available for viewing on the Web site, you can request to receive a copy of the NAIC's "A Shopper's Guide to Long-Term Care Insurance," which includes an overview of long-term care, as well as payment and purchasing options, worksheets, shopping tips, and the various policy and benefit plans available to the public.

LONG-TERM CARE—INFORMATION ON FACILITIES AND SERVICES

American Health Care Association
www.ahca.org

Provides information and help on selecting nursing homes or assisted-living facilities in specific areas.

Assisted Living Federation of America
www.alfa.org

Provides information and help for finding assisted-living facilities in specific areas.

Medicare
www.medicare.gov/NHCompare/home.asp

The National Nursing Home Compare database from the Centers for Medicare & Medicaid Services (CMS) contains information on every Medicare and Medicaid certified nursing home in the country.

National Center for Assisted Living
www.ncal.org

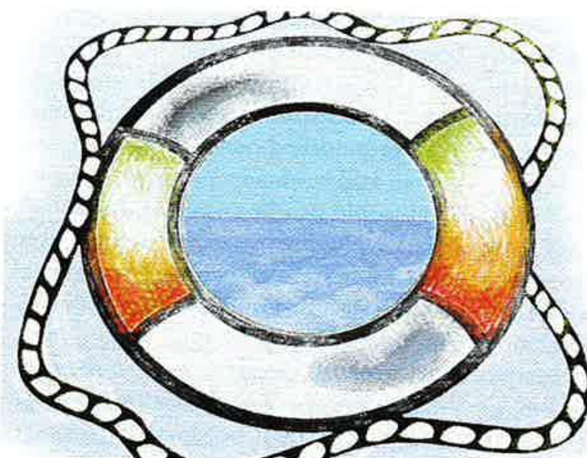
Provides information on selecting an assisted-living facility, including a consumer guide to selecting a facility and links to finding facilities located in specific states.

National Association of Professional Geriatric Care Managers
www.caremanager.org

Provides information and links for finding a care manager in a specific area.

Protect Your Assets: Don't Neglect Disability Insurance

By Michael P. Franks



Suppose you had spent months training for a marathon and on race day, as you prepare to go to the starting line, you discover that your shoes—your most critical piece of equipment—have a huge rip in them, or they are just plain missing. And ... you don't have any other backup pair.

It may be hard to believe that anyone would be so careless as to leave their most important asset unprotected.

Yet according to the Bureau of Labor Statistics less than a third of all workers in private industry have long-term disability insurance, and only 40% of professional workers have disability coverage.

Individuals insure their homes and all their possessions. Many people would not leave their driveway unless their car insurance is paid up. And, most wage-earners insure their own lives—and sometimes even their pets!

But for those who are working, it is not unusual to neglect the insurance of their most valuable asset—the ability to earn a living.

Excuses often used are: "I am covered at work," or "It won't happen to me."

But the chances of it happening are greater than many people realize. The most frightening statistics show that the probability a 25-year-old will be disabled for at least 90 days before the age of 65 is 54%. For a 40-year-old the odds are only slightly lower at 48% (see, for example, the Web site www.disabilitycanhappen.org). The consequences can be dire—almost 50% of mortgage foreclosures are due to disability.

Disability insurance can also be thought of as protection for your current investment holdings, including any retirement plan assets, since you would be forced to use up these assets should the worst-case scenario play out.

Employer-Sponsored Plans

Many employers offer group disability coverage as a standard part of their benefits package. It's worth taking some time to understand the details.

Disability insurance may be one of the few benefits where, if given the chance, you should pay with aftertax dollars. If premiums are paid with pretax dollars, benefits are fully taxable. Paying premiums with post-tax dollars, in contrast, results in tax-free benefits.

Group benefits can appear to be more ample than they are. Most group plans have caps on the amount of income they will replace, expressed as a maximum dollar amount or, for example, by excluding bonus income or limiting the benefit period. Plus, policies offered through work may not be portable. Leaving a job could cause you to lose coverage.

Purchasing extra coverage to supplement employer-provided coverage is often appropriate. To do so, remember that even with supplemental individual insurance, your combined potential disability benefit will likely be less than your current earned income.

In order to avoid making disability more attractive than actually working, companies set participation limits on how much insurance you can buy. In most cases, those limits are set at around 70% of your income, although recently wage earners may have tighter limits.

Physicians, in particular, may have a difficult time replacing 70% of income. Doctors historically have been one of the most active professions in making disability claims. To protect themselves, insurance companies began to limit the monthly benefit available. Most companies will offer benefits to physicians up to $10,000 a month, although some are increasing the maximum potential benefit to $15,000 per month.

When you apply for an individual disability policy, the carrier will look at existing group plans when setting your coverage limits. Group carriers, however, do not incorporate individual plans. A planning implication for job changers—for example, doctors or lawyers moving from sole practices to larger employers—would be to maximize your individual coverage before being offered the group plan.

In general, unless you have other means of paying personal bills, consider purchasing as much supplemental insurance as the companies will allow.

Staying on Course

Knowing the lingo will help you understand the available coverage.

To collect benefits, your disability must match the definition described in the language of your policy.

There is a broad range of definitions, of which the most difficult to qualify for is the definition used for Social Security disability benefits.

The "own occupation" definition is the most generous to the insured, with "modified occupation" and "any occupation" declining in favorability:

- With ***own occupation*** you are considered totally disabled if you are unable to perform the exact duties of your current job.
- ***Modified occupation*** references the duties of a job for which you are trained or qualified, and
- ***Any occupation*** would be just that—any gainful employment.

Not surprisingly, the stricter the definition of disability, the higher the premiums.

To illustrate, suppose you were a marathoner whose love of running grew from studying physical therapy in school. After college, you developed into a world class runner earning a living racing. But one day, you ruptured your Achilles tendon, and now you can never run competitively again.

With own occupation coverage, you would qualify as totally disabled. Under modified occupation, since you could still work as a physical therapist, you would not be considered disabled. And, as long as you can still ask "Do you want fries with that?" you would not be disabled under the any occupation definition.

You can combine two of the coverage options. Split-definition coverage might offer own occupation coverage for the first five years, and then loss of income coverage thereafter. The result is a cheaper premium and a chance to retrain and re-enter the job market in a new role.

Watch the Clock

Other key terms have to do with timing issues.

The probation period is the time in which the policy must be in force before certain conditions are covered. It usually lasts two years, and is used to protect the insurance companies from having to pay for pre-existing conditions.

The elimination period is the time from when the disability occurs until benefits begin. It is most often set somewhere between 30 to 365 days. Needless to say, the longer the elimination period, the lower the premiums.

The benefit period is how long benefit payments last. A short benefit period—e.g. of two or five years, has a relatively low premium and can function at best as a transition fund. More useful policies are more expensive, but offer benefits up to age 65 or 70.

When you are reviewing your disability policy, make sure that you confirm that the benefit periods in your policies are adequate.

It is also important to realize that disability benefits will help pay regular expenses up to retirement, but rarely provide sufficient funds to maintain a retirement savings program.

Going the Distance

A crucial piece of the contract to understand is the durability, or the right to continue your policy. You want language that will protect you if you become in some way uninsurable.

The most desirable language is non-cancelable guaranteed renewable. Under this type of policy, the insurance company cannot change your premium, monthly benefit amount, or benefit period regardless of any change in your health status.

Simple guaranteed renewable policies are growing in popularity because of lower expenses, but they don't provide as much protection. While the insurance company cannot cancel guaranteed renewable policies, they can, with the approval of the state regulator, raise rates by class of insured. Conditional renewable policies offer less protection because the insurer can disallow coverage or raise premiums if certain conditions are met.

It is rare, and not usually recommended or possible, for someone returning from disability to immediately resume a full work schedule. Thus, the best policies offer partial disability coverage or residual benefits. These are designed to replace a portion of income lost, as you make a gradual return to work.

Certain riders can also be attached to your coverage to create additional protection. A guaranteed insurability

rider allows the insured a chance to increase coverage at certain specified times, regardless of health status, as long as the earned income requirements are met.

The cost-of-living adjustment rider periodically increases the benefit payments to prevent the loss of purchasing power.

These riders can be particularly helpful to young buyers whose income is expected to grow and who will need increasing coverage for a long time regardless of health status.

Lastly, when choosing a provider, you want someone who will be there when you need them most.

A.M. Best, Moody's and other services rate the financial strength of insurance companies. You can also check complaint records with the National Association of Insurance Commissioners at www.naic.org.

For background reference, the larger players in the market today and candidates to begin comparison shopping are UNUM Provident, Northwestern Mutual, Mass Mutual, and Berkshire.

Leaders of a Pack

Business owners, whether sole proprietors or partners, must make special considerations for protecting against injury or illness. Not only should they think of their own family's expenses, but how a prolonged time away from work would impact the viability of their business.

Sole proprietors of professional businesses are able to buy disability overhead expense insurance to help cover rent, insurance, and payroll expenses typically for 12 to 24 months.

Partners in successful businesses should be talking with their insurance agent about purchasing disability buyout insurance as protection in the event a partner becomes disabled. These policies provide either a lump sum or a series of payments that can be used to buy out the partner's share.

Teaming Up

Teaming up of employees from the same company to buy supplemental disability insurance can often lead to a discount. When a group of employees (sometimes as few as four) from the same company buy insurance, it can be considered a multi-life policy and qualify for unisex rates. Unisex rates are lower than regular male and female rates, in most cases substantially lower for females. With the risks spread across a greater pool of people the insurance companies are able to charge lower premiums.

This planning strategy works best if team members all purchase coverage around the same time. Policies already in place are not adjusted once the member limit is met, and only a new applicant would qualify for the discounts. Again these are individual policies, bought with aftertax money, not group insurance paid for by employers, so the benefits would be received tax-free.

Summary

Disability insurance protects a valuable asset—a worker's ability to earn a living.

Purchasing coverage well involves paying attention to details, and working with a strong company.

Some potholes to avoid are:

- Paying premiums with pretax dollars,
- Having a cancelable policy that leaves you uninsured,
- Purchasing a policy that does not last long enough,
- Not increasing benefits as your income rises, and
- Neglecting to protect a business from the impact of losing a key person.

If disability or incapacity strikes, disability insurance won't be the elixir that fixes everything.

But ample disability coverage can significantly ease the great financial burden that usually accompanies an inability to work. ▲

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CPA Wealth PROVIDER
January 2007 *For a Successful Financial Planning Practice*

Permission Slip

One estate planning attorney's lesson in retirement/wealth replacement helped him overcome major losses in the stock market and increase his post-retirement income by 35 percent.

By Edwin I. Grinberg

When I walked in the door with my client and his CPA, I couldn't help but wonder, what am I doing here? So many times before, financial planners from around the country had approached my clients, claiming wonderful strategies that would increase their net worth. I was generally "underwhelmed," to say the least. Here we go again, I thought, another salesman trying to sell a client financial products that would only increase the financial planner's retirement. I wanted to run, not walk, back to my office, where I was swamped with tax and estate planning cases, and messages from clients who wanted immediate legal advice.

But then it happened. As I listened to the financial strategies presented to my client, something clicked. Could this guy be on to something? As he proceeded to unveil what he called an innovative wealth replacement strategy, I must admit I became intrigued. As I began to understand what he was proposing, I soon realized the impact this concept could have on many of my high-net-worth clients...CPAs... and even me. Little did I know then, that this meeting would change my life forever, and increase my retirement income by 35 percent.

Shortly after that meeting, I found myself returning to this financial planner's office, spending several more hours trying to understand why this retirement approach was so powerful and different than anything else I ever knew. It certainly was contrary to what I, as an estate planning attorney, believed, practiced, or advised my clients for 30 years. After all, retirement planning and wealth management, protection, and preservation belonged to financial advisors, certainly not attorneys.

So what exactly happened that day?

To my surprise, I learned a life-changing retirement strategy that has since benefited many of my clients and friends. In fact, it made such an impact, that at age 59, I made a major change to my retirement plan that will: 1) effectively replace the 30 percent I lost during the Enron, WorldCom, and Tyco scandals and the stock market nose dives of this new Millennium—with minimum risk; 2) allow me to actually spend part of my investment principa instead of living on only the interest, as many of us do, in our senior years; 3) increase my retirement savings,

simultaneously; 4) erase the fear that many of us have, that my money will run out before I die; and 5) offer a sizable, tax-free, guaranteed death benefit to pass along to my wife and children.

Simply put, this wealth replacement strategy is a twist on an old, conservative financial vehicle that has been around for many years that: 1) protects financially from premature death; 2) provides liquidity to pay for estate and inheritance taxes; 3) funds children's educations and buy/sell agreements; and 4) replaces the large, supplemental retirement benefits corporations and banks give to senior level executives.

The concept is guaranteed whole or permanent life insurance. When linked with three or more other retirement investment strategies, this tool will serve as an economical, wealth replacement strategy that will provide me with three key benefits while I am alive: flexibility, financial freedom, and peace of mind. In addition, whole life insurance provides cash value, which will grow, over time, tax-free.

My philosophy before hearing this strategy was the popular "buy term and invest the difference." However, this concept did not work for me, since I didn't save and invest the difference. I spent it. In fact, many pre-retirees and retirees will suffer from that common advice since most do not invest the difference. In addition, term life often expires before retirement.

As far as I'm concerned, the lessons I learned in changing my thinking and adopting this plan is one that CPAs should consider for themselves and for their higher-net-worth baby boomer clients as they try to recover from their stock market disappointments and face the following reality: Will Social Security, my 401k and my investments be enough for post retirement?

LIVING LONGER: CAN WE AFFORD IT?

Before we take a closer look at this concept, consider the following statistics from a 2005 U.S. Census Bureau report, which was commissioned by the National Institute on Aging:

- The population of Americans over the age of 65 is expected to double by the year 2030, to an estimated 72 million. I hasten to think what that will mean for the level of Social Security benefits available in 24 years.
- The fastest-growing group of Americans is the elderly, aged 85, and older. That means we're living longer—making running out of money a major concern of retirees.
- The wealthiest fifth of U.S. seniors had a net worth of only $328,432, excluding home equity. This means an annual income of little more than $16,000 for those who preserve their principal and earn a net gain of at least five percent annually.
- Fourteen-million senior U.S. citizens reported disabilities, largely connected to heart disease, arthritis, and other chronic and debilitating conditions. Such conditions, of course, can drain retirement income substantially—and that's not even considering illnesses that require long-term nursing or other assisted-living care.

Add to that, volatility of the future stock market and interest rates, which can negatively affect conservative mutual funds and even the most conservative of municipal and other lower-risk bonds; inflation threats, the financial impact of war, ever-changing tax increases, especially for higher-net-worth individuals, the disappearance of employee pensions and even the unforeseen maintenance expenses for vehicles, homes, and other assets.

Admittedly, I didn't foresee the so-called Dot-Com bubble burst and neither did any of my clients. I certainly felt the impact on my portfolio—not something I, or many of my CPA clients, wanted to face, with retirement only a few steps away. For me, it was a disturbing wake-up call. A few of my clients panicked and pulled out their investments from the stock market altogether. But after my own initial shock, I tried to be more thoughtful in my own response.

GUARANTEED WEALTH REPLACEMENT ASSET

Here's what I did. My original portfolio contained tax-free municipal bonds which earned five percent interest annually. Previously, I re-invested this interest into more bonds. When I learned about this economical, wealth replacement plan, I purchased a whole life insurance policy with a $1 million guaranteed, income tax-free death benefit, with the interest from my existing bonds paying most of the annual premium. As a result, I now have a dividend-paying, cash-value asset with a guaranteed permanent death benefit.* The net effect is that my wife will get $1 million upon my death which gives me "a permission slip" at retirement to choose one or more of the investment alternatives discussed below.

FREEDOM TO CHOOSE

Under my original retirement plan, I could spend only four percent of my principal in retirement for fear of running out of money, a common concern of retirees. Once I had a guaranteed death benefit, I could choose other investment options, such as the following, which would increase my retirement income. These alternatives are now part of my retirement strategy, which I will use when I begin to live off my assets:

1. Spend your principal. The most obvious option is to

spend down a portion of your principal. The guaranteed death benefit gives you a "permission slip" to tap into the principal because the death benefit replaces the principal you spend. If you have a $1 million guaranteed policy, you could spend $1 million of your other assets, and upon your death, your spouse would have it replaced.

2. An annuity. Between the ages of 65 and 70, you could, for instance, invest $1 million into an annuity, which when annuitized, would pay out $76,000-$80,000 annually for as long as you live. This bets that you'll live longer than the 10 years it would take to recoup your entire investment. You can't really lose because if you die earlier, the $1 million death benefit kicks in for your spouse or beneficiary.

3. A reverse mortgage. This investment tool allows you to use the equity in your home to provide a regular income during retirement. Instead of obtaining a mortgage to buy your home, you slowly sell your home to the mortgage company, one income payment at a time over a period of years or for the rest of your life. The death benefit gives your family the liquidity to repurchase the family home or merely replace the value of the asset.

4. A Charitable Remainder Trust. If you're philanthropic, this is a great option. You can leave some of your financial assets to your favorite charity upon death. This trust works basically the same as an annuity. You turn over a predetermined amount of your assets to a trust which you create. In return, the trust pays you a set income each year based on the amount in the trust. When you die, the charity then keeps the remainder of the trust fund. Your family gets your life insurance death benefit...a win-win situation for everyone.

There are several tax advantages with all of these strategies including an income tax-free death benefit for the insured's beneficiary. In addition, you can now offer a value-added service to *your* clients to help them increase their post-retirement income so they can maintain their accustomed lifestyle far into their senior years.

I must add, that since this wealth replacement strategy helped so many clients and friends, my new professional mission now is to spread the word. I have become so passionate about what this can do for others, I left the law practice that I helped found 30 years ago to preside over a company that focuses both on protecting and preserving retirement portfolio principals and on wealth-replacement for clients' retirement needs—and dreams.

People like me who have adopted this strategy now have "permission," in retirement, to stop worrying about how they're going to live, and to dream—and dream bigger. That's something that the stock market and the Enrons of the world cannot take away from me. CPAWP

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