Wealth Planning **Update**

# The many roles of life insurance in your plan

## New hybrid policies offer long-term care coverage for you and benefits for your loved ones.

The role of life insurance in wealth planning continues to evolve, most recently with the advent of life insurance riders that pay for long-term care. These riders allow you to supplement your life benefits with long-term care coverage—all in a single policy. This may be more cost-effective than purchasing life and long-term care insurance separately, particularly if you have significant cash value in an existing life insurance policy that you can use to purchase the rider.

While a hybrid policy can offer many benefits, it's not appropriate for everyone. Below we review the key features of a hybrid policy and also discuss other forms of life insurance that can play an important role in securing your financial future.

## How does a hybrid policy work?

A hybrid policy combines standard life insurance with a long-term care access rider. The policy can be structured in a variety of ways. For example, a hybrid policy might include:

**A guaranteed death benefit.** A long-term care access rider to use 90% of the death benefit for home health care, assisted living nursing home care, adult day care or other qualified long-term care service.

**A residual death benefit (the remaining 10%).** At your death, your spouse or other beneficiaries receive the unused portion of the long-term care coverage plus the residual death benefit.

## How do I add a rider to my policy?

If you have a permanent life insurance policy, you can use a tax-free 1035 exchange to transfer the value to a new policy that includes a long-term care rider. You must exchange for an equivalent new policy. If you transfer all the proceeds from the existing policy to the new policy, and you don't have an outstanding loan on the policy, you will owe no tax on your gain.

Let's look at an example. Suppose you have a whole life insurance policy with a $1.2 million death benefit and $500,000 in cash value. You transfer the policy to a new one with the same death benefit and a long-term care access rider, resulting in no tax liability. You use the $500,000 cash value to pay the rider premiums, giving you a fully paid policy with no ongoing premium costs. You can then use up to 90% of the death benefit (or $1.08 million) on long-term care expenses for yourself.

### A hybrid policy may make sense if you:

- Have significant wealth to pass to your heirs apart from the death benefits of your existing life policy
- Want to avoid depleting your wealth if a medical event occurs
- Have fully paid up your life insurance policy and it has substantial value

Long-term care policies can be costly and a hybrid policy may be more affordable, particularly if you have a mature life insurance policy with a substantial cash value. However, there are situations when a hybrid policy may not be appropriate

**A few words of caution:** If you take any proceeds from the exchange in cash, transfer any of it into a non-like-kind contract, or use it to pay off a loan, the proceeds will be taxed as ordinary income. Therefore, if you would like the new policy to be in someone else's name, consider changing ownership before you do the 1035 exchange. In addition, if you have taken a loan on the policy, it's often wise to pay it off before the transfer or, if you don't have the funds to pay it off, reduce the face amount of the policy by the amount of the loan.

## Is a hybrid policy right for you?

Long-term care policies can be costly and a hybrid policy may be more affordable, particularly if you have a mature life insurance policy with a substantial cash value. However, there are situations when a hybrid policy may not be appropriate. For example, the cost of a combined policy may be more than the premiums you would pay separately for life insurance and a long-term care policy, especially if your life insurance needs are temporary rather than permanent. You'll also need to consider whether the hybrid policy covers all the features you may want from long-term care.

If you already have long-term care insurance or if you don't feel a hybrid policy is right for you, keep in mind you can purchase a whole life policy with a long-term care access rider for children or grandchildren. Premiums tend to be low at younger ages, and the child would have coverage from a policy that will grow over time. In this case, you could consider funding the purchase with required minimum distributions from your IRA or some other source of funds.

## Other forms of life insurance to suit your needs

While long-term care access riders are now available with many permanent life policies, there are many forms of insurance that can play an important role in your wealth plan. Below is a brief rundown of these policy types and their key features.

### Term insurance

If you're looking for low-cost insurance to protect your family and assets at a time when your income is low and start-up costs are high (for a home purchase, student loan debt, or a newborn child, for example), term insurance may be appropriate. These policies typically offer coverage for 10-20 years. A key feature to look for is the ability to convert term insurance into a permanent policy. Conversion offers two benefits:

- You avoid the need for another medical exam, which can be key if you have an adverse health event
- You lock in the policy premium for the duration of the policy

Be sure to confirm how long the conversion option is available. If you miss out on this opportunity, you could face significantly higher premiums later in life, putting a strain on cash flows in retirement.

### Permanent coverage

Unlike a term policy, permanent coverage lasts a lifetime. There are three general categories: universal life, variable universal life, and whole life.

**Universal life** is low-cost and, unlike a term policy, remains in force (with no premium increases) as long as you continue to pay the premiums. In the early years, the policy may build cash value, which you can use later on to help offset premiums. You can also build flexible premium payments into the policy to help meet your income needs later in life.

**Variable universal life** policies also offer flexible premiums that you can shift up or down over time, within certain limits, in order to meet your needs. These policies have two parts: a death benefit and an investment component. You invest your premiums into mutual-fund-like investments through subaccounts that are part of your policy. The death benefit fluctuates based on how the premiums are paid and on how the investments in the subaccounts perform. Therefore, with a variable life policy, a downturn in the market may mean a decline in your death benefit. In serious cases, you may have to fund the policy to keep it in force.

**Variable life** policies can be an effective tool if you are highly compensated and have reached the maximum of tax-deferred savings in other investment options. Because they have higher internal costs, they become most cost-effective at higher levels of investment.

**Whole life insurance** also has a death benefit and an investment component. However, with whole life, the investment vehicle is the general account of the issuing insurance company rather than subaccounts within your policy. You receive dividends and your cash value can increase based on the performance of the general account. The investments are more conservative, with returns typically in line with those from a bank certificate of deposit. They are not tied to the performance of the stock market.

You can use the dividends to purchase more life insurance (increasing the death benefit and cash value of the policy) or to reduce your premiums and the overall cost of the policy. At some point, the dividend may exceed the premiums, making the policy self-sufficient.

From long-term care and temporary coverage to life-long policies with investment growth potential, insurance can meet a variety of your needs. Hybrid policies with long-term care access riders can be a viable way to protect your assets and assure your well-being in retirement, but they only make sense if the benefits outweigh the costs. Ask your financial professional to help you evaluate your existing insurance coverage, identify any gaps, and decide if a hybrid policy is right for you.

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