Retirement income planning: long-term care considerations

Wealth Management

Of the many ways you may imagine spending your money in retirement—traveling, enjoying favorite pastimes, helping grandkids pay for college, supporting charitable interests and so on—health care may be one of the most important expense categories to include in your retirement income plan. Indeed, according to recent figures, a 65-year-old couple will spend approximately $662,156 to cover health care costs during retirement.[1]

But did you know that this estimate does not include costs for nursing home care? The U.S. Department of Health and Human Services estimates there is a 60% chance of one partner of a couple needing long-term care (LTC).[2]

The high probability of needing long-term care may be a fact of life for many retirees. For this reason, it may be prudent to consider long-term care in your retirement income planning.

Definition

Long-term care planning is not the same as long-term care insurance.

Key facts

Before determining how to address potential long-term care expenses, understanding how long-term care is delivered may help you make informed choices.

- 90% of those who receive long-term care assistance live at home or in a community setting[3]
- Women and men will need, respectively, 3.7 years and 2.2 years on average of long-term care[3]
- 69 is the average age of a care recipient, while 49 is the average age of the caregiver[3]
- Approximately 25% of caregivers are "sandwich generation," providing care to children as well as older adults with Alzheimer's or other dementias[3]
- 70% of caregivers have suffered work-related difficulties because of their caregiving duties.[3]

The costs for long-term care may vary depending on how it is delivered. Compare the 2020 national rates for different types of care.[4]

- Assisted-living facility = $51,600 annually
- Homemaker services = $53,768 annually
- In home health aide services = $54,912 annually
- Nursing home (private room) = $105,850 annually, or $391,645 over average stay (3.7 years)

Key take-away

While many people receive home- or community- based care, which may have lower annual costs compared with nursing home care, the longer average need for home- or community-based care can make it nearly as expensive as nursing home care when considering the full period of care needed.

Planning solutions

Just as long-term care can be delivered in various ways, there are multiple approaches to paying for it. Some approaches may afford you greater choice and control over how care is delivered. And some approaches offering fewer choices and less control may be elected by default due to lack of planning or because of personal circumstances. From having the least control to the most control over care decisions, the approaches are:

- Government pays for care
- Family pays for care
- Self-funding pays for care
- Private insurance pays for care

Government care

Many people mistakenly believe long-term care is covered under Medicare. This government program pays for only short periods of care (up to 100 days) after discharge from the hospital. It does not cover any condition diagnosed as long-term care. In addition, it is often difficult to qualify for this short-term care, because hospitals often discharge patients before they qualify for the Medicare coverage.

Medicaid is a government welfare program serving impoverished people. To qualify for benefits, a person must first spend nearly all of their money and liquidate most of their property and investable assets. To help prevent fraud, there is a five year "look back" period prior to applying for Medicaid; program administrators will look for—and take custody of—assets that were transferred to other individuals or legal entities that may be able to provide financial support to the individual. Medicaid patients have very little control over where and how they receive care. At death, any assets still owned by a Medicaid patient generally are transferred to Medicaid to help offset program costs.

Family care

Some people choose to move in with a family member when they are no longer able to take care of themselves. Beyond perhaps passing on some or all of the financial consequences to loved ones, asking them to also assume the burden of care may impact their lifestyle, personal commitments and work responsibilities. In addition, it may take a toll on their emotional and physical well-being. The person who is depending on family members also loses his or her independence and may suffer from self-esteem issues and other psychological problems as a result.

Key take-away

No matter how close family members may be, depending on a child, sibling or other relative for long-term care may cause personal resentments, ruin favorable family dynamics and damage relationships.

Self-funding

Some people choose to set aside savings to cover anticipated long-term care expenses. One drawback is that self-funding can limit spending flexibility and potentially subject assets to unfavorable tax implications as well as timing with sequence of returns. Some people use home equity, such as a reverse mortgage, or establish a Credit Access Line (CAL) for more strategic, short term liquidity needs. Like any form of leverage, this approach offers flexibility with risks that are important to understand.

Key take-away

Self-insurance may be an appropriate solution for financially successful individuals and families who are both sophisticated and disciplined enough financially to understand and manage potential consequences.

Private insurance

Some people choose to share the risk by purchasing long-term care insurance. Policies cover three levels of care.

Skilled care — Continuous, around-the-clock care to treat a medical condition ordered by a physician and performed by skilled medical personnel. The patient is often expected to recover from the underlying condition.

Intermediate care — Intermittent nursing and rehabilitative care provided by registered nurses, licensed practical nurses or nurse's aides under supervision of a physician.

Custodial care — Designed to help one perform activities of daily living (such as bathing, eating and dressing). Caregivers may or may not be medical professionals but are supervised by a physician.

Generally, there are three common long-term care insurance solutions:

- Traditional long-term care insurance
- Asset-based long-term care
- Life insurance with long-term care rider

Traditional long-term care insurance

This type of policy is designed specifically to cover long-term care expenses. Policies define a daily benefit amount and length of benefit period. Daily benefits may range from \$40 to \$400 for tax year 2021 per day. Length of benefit period may include an elimination period with common benefits ranging from one to six years. Premium prices depend on the benefits chosen as well as the age at which premiums begin, the health of covered person(s) and whether any riders, such as inflation protection, are added. Qualifying long-term care benefits are paid income tax-free.

Premiums paid on "qualified" long-term care policies (as defined by state or federal guidelines, depending on when they were issued) may be deductible in whole or in part on federal income tax returns. Plus, policies that are issued in states that have enacted partnership programs combining private insurance with Medicaid coverage may offer dollar-for-dollar protection of assets from Medicaid spend-down requirements (based on the value of the policy purchased) after long-term care benefits are exhausted. Such policies may help policy holders receive long-term care while preserving family assets.

There are some caveats. Similar to term life insurance, policies do not accumulate cash value. And if there are no long-term care claims while the policy is in force, there is no death benefit. This means that policyholders who do not require long-term care pay for a benefit they may never use. There is a high probability premiums will go up in the future.

Key take-away

This is "pure insurance" intended only to pay for qualifying long-term care expenses. It may be appropriate for people seeking a protection strategy offering both peace of mind regarding long-term care expenses and greater control over how long-term care is delivered.

Asset-based long-term care

Asset-based long-term care can provide a combination of life insurance and long-term care, or annuity and longer term care. Both products focus on longer term care as the primary benefit, with the life or annuity as the secondary benefit, should there be no claim.

This allows one to consider purchasing long-term care coverage when there may be concerns of never needing care.

Premium may be made based on single or ongoing contributions.

Similar to traditional long-term care policies, premiums paid for qualifying asset-based long-term care policies will receive favorable income tax treatment. Unlike traditional long-term care policies and life insurance policies with long-term care riders, asset-based long-term care policies may offer simplified underwriting.

Key take-away

This solution may be appropriate for people looking to repurpose existing assets, such as cash, conservative investments intended for care, or life insurance and/or annuity cash values no longer needed.

Life insurance with long-term care rider

Another more common way to pay for long-term care expenses is to purchase your life insurance and long-term care benefits together. This may be more cost-effective than buying a separate life insurance and long-term care policy.

The long-term care rider gives the insured the option to elect to use all, some or none of the life insurance benefit while he or she is still living, to help pay for long-term care expenses. Beneficiaries receive any life insurance benefit not used for long-term care expenses, as long as the life insurance policy remains in force.

Depending on the provisions of the rider, qualified services often include nursing home benefits, assisted-living benefits, bed reservation benefits, home health care benefits, adult day care, respite care, alternative care and hospice. Evidence of insurability is necessary when purchasing.

Even though this solution offers value, flexibility and convenience, a long-term care rider may not be a good fit if the death benefit is needed to satisfy other obligations.

Life insurance with a long-term care rider allows for benefits to begin when the insured needs assistance with two of the six basic activities of daily living.

When considering a long-term care solution, it is important to understand the qualification requirements to trigger benefits.

Key take-away

This approach may help accomplish wealth transfer goals, while also protecting wealth from being consumed by long-term care costs.

Comparing insurance strategies

The following table may help illustrate how the features of different insurance strategies stack up against each other.

Traditional long-term care insurance	Life insurance with a LTC rider	Asset-based LTC plan
Provides a pool of dollars for long-term care needs	Provides a death benefit that can be accelerated for an LTC need	Provides a death benefit and a pool of dollars
Inflation protection available	No inflation protection available	Inflation protection available
Can be state partnership qualified	Does not qualify for state partnership	Does not qualify for state partnership
Limited pay options are not available	Multiple pay options available up to lifetime premium	Multiple pay options available up to lifetime premium
No death benefit	Includes an initial death benefit	Includes an initial and residual death benefit
Shared care is an option	Shared care is not an option	Shared care is an option
Daily or monthly benefits	Monthly benefits	Daily or monthly benefits

Talk with your financial advisor

Preparing for possible long-term care expenses is an important part of your retirement income plan. And the good news is, you have many choices. Your RBC Wealth Management financial advisor can help you evaluate your options while considering your overall financial goals to help you determine which approach is most appropriate for your specific needs. Contact him or her today.

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1. 2021 Retirement Health Care Costs Data Report, Healthview Services, Dec 2020
2. Longtermcare.gov, U.S. Department of Health & Human Services, 2021
3. Morningstar, Dec 8, 2020
4. 2020 Genworth Cost of Care Study

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- You will be required to deposit additional cash or securities, or pay down the line of credit, should the value of your securities decline below the percentage equity you must maintain or the percentage equity you must maintain increase. During a market downturn in which the securities in your portfolio decline in value, the percentage equity you must maintain will cause your losses to be greater than if there were no loan against your portfolio. Your losses can exceed your original collateral amount.
- You are not entitled to an extension of time to satisfy equity percentage requirements.
- Should you be unable to maintain the required percentage equity, some or all of your securities may be sold without prior notice to you. In the event of such a sale, you will not be entitled to choose which securities are sold, your long-term investment strategy may be interrupted and you will be responsible for all resulting fees and tax consequences.
- Royal Bank of Canada may increase equity percentage requirements at any time without prior notice to you and may require you to pay down your line of credit, in part or in full, at any time and for any or no reason.
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