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When Hybrid Long-Term Care Insurance Makes Sense

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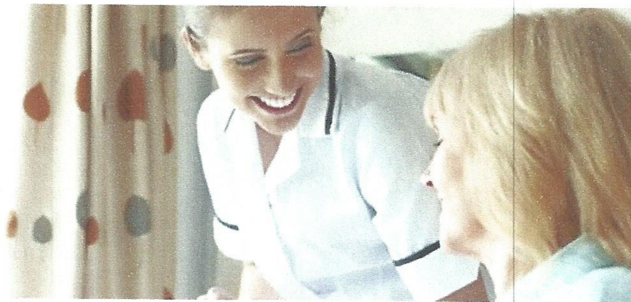

The prospect of debilitating illness late in life is not a pleasant one, but it's wise to protect yourself and your family from the financial hardships that could result from it. A common way to prepare yourself is by purchasing some form of long-term care insurance.

Long-term care insurance works like this: You pay an annual premium, and if you need long-term care due to age or illness, the policy pays out a daily or monthly benefit. Some people look askance at these policies because, if they die without needing long-term care, they feel they've "wasted" the premiums.

As a way to counter that, so-called hybrid policies have become popular. These policies

combine long-term care insurance with permanent life insurance policies such as universal life insurance (which, like whole life insurance, includes a savings-investment component that builds up over time).

In the hybrid scenario, a policyholder would withdraw funds from the policy when they are needed for long-term care, and the insurance company pays for care when those funds run out. And if the policyholder dies without having needed expensive long-term care, the heirs receive a death benefit — therefore the premiums paid into the policy are not "wasted."

We asked Damon Gonzalez, a financial advisor and a member of NerdWallet's Ask an Advisor, about the pluses and minuses of long-term care insurance and hybrid plans.

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What are the main advantages of a hybrid policy over a traditional long-term care plan?

I find that some clients can't get past the "use it or lose it" nature of traditional long-term care insurance. It is emotionally difficult to buy an insurance policy that may cost $4,000 to $8,000 per year and will pay out nothing if you pass away in your sleep. I had a client pass away last year in his mid-80s. He paid about $3,250 per year in premiums for 19 years. That is more than $60,000 that he and his family didn't get to use for something else.

That is the nature of insurance, however — you pay money to protect yourself from a risk that you hope never happens. If you pay for 20

years on a term life insurance policy and walk away with nothing, you don't wish you had died during that period. Likewise, I never think that I wasted money on car insurance if I didn't get in a car accident that year. For some reason, though, many people think differently about long-term care insurance.

Hybrid policies reduce people's fear of wasting premiums by offering two exit strategies. The first exit strategy is that after the surrender charge period (usually 10 years), you can get most of your premiums back if you decide to cancel the policy. The illustration you receive from the insurance company shows that you will not make a return on your cash if you cancel it, but it is comforting to know that you can at least get a do-over if you change your mind down the road and want to cancel the policy.

Secondly, there is a death benefit that is paid to your heirs when you die. Leaving an inheritance is really important to a lot of people. They like knowing that some of the money they paid in premiums to the hybrid policy will be given to their kids.

The last major advantage is that the benefits are guaranteed. If you pay your premiums (usually for 10 years or less), you will have a contractually guaranteed death benefit, guaranteed cash value and a guaranteed amount of long-term care coverage.

Traditional long-term care insurance policies, on the other hand, do not have these guarantees. In fact, insurers can petition the state departments of insurance to raise your premiums, sometimes as much as 50% per year. Some retirees with limited assets can't afford these increases.