

## July 2008 Issue

### In This Issue...

- [How Will You Deal with Long-Term-Care Costs?](#)
- [Regularly Review Your Life Insurance](#)
- [Assessing Your Investment Risk Tolerance](#)
- [Dealing with Bond Price Fluctuations](#)
- [Spousal IRAs: Contributing Together](#)



## How Will You Deal with Long-Term-Care Costs?

Life expectancies have increased significantly and are expected to continue to increase in the future. As people age, however, they are more likely to develop conditions that limit their ability to live independently. Thus, as life expectancies increase, so does the need to make provisions for long-term-care costs. If you are wondering how likely it is that you will need to deal with long-term-care costs, consider the following:

- Almost 70% of those who are currently age 65 will require long-term care before they die. Care will be needed for an average of three years, with 20% requiring care for five years or more (Source: Center for Retirement Research, April 2007).
- Currently, the average annual cost for home care service is \$34,000 and for a private room in a nursing home is \$75,000 (Source: Center for Retirement Research, April 2007).
- Approximately half of private-pay nursing home patients run out of funds during their stay and must then use Medicaid funding (Source: Center for Retirement Research, April 2007).
- Almost 72% of nursing home patients are women (Source: *Financial Planning*, April 2007).
- By 2005, only 6 to 7 million people had purchased long-term-care insurance (Source: Center for Retirement Research, September 2007).
- The average age to purchase long-term-care insurance was 61 in 2005 (Source: Center for Retirement Research, September 2007).
- In 2006, approximately 20% of applications for long-term-care insurance from individuals aged 60 to 69 were declined, while 42% of those aged 70 to 79 were declined (Source: *Financial Planning*, April 2007).

### What Are Your Options?

Health insurance policies typically don't pay for nursing home care, while Medicare only pays for 100 days of skilled nursing home care, if admission follows a hospital stay. Medicaid pays a

significant portion of all nursing home costs, but the government has enacted tougher rules to qualify for assistance. Typically, you need to deplete most of your assets before you qualify for assistance.

Many elderly individuals rely on family members for help, but the personal toll can be huge. Currently, long-term-care insurance pays a small percentage of all long-term-care costs. That percentage may increase in the future as more people become aware of the risks of long-term-care costs and look to insurance as a way to fund those costs.

In 2005, Medicaid paid 49% of all long-term-care costs, Medicare paid 20%, individuals paid 18%, and private insurance paid 7% (Source: Center for Retirement Research, April 2007).

Do you need long-term-care insurance? If your assets, not including your home, equal at least \$2 million, you can probably fund long-term-care costs with those assets, although you may not want to deplete your assets for this care. Those with very few assets will probably be covered by Medicaid. It is the people between these two extremes who should consider long-term-care insurance. This coverage may be especially important for women, who tend to outlive their husbands.

## What Should You Consider?

If you're thinking about purchasing long-term-care insurance, consider these points:

- **Purchase at a relatively young age.** You should probably purchase the insurance by the time you are in your late 50s or early 60s. After that, the premiums get much more expensive. You also run the risk that you could develop a serious health condition that would prevent you from purchasing the insurance. On the other hand, don't purchase the insurance too soon, or you could end up paying premiums for decades.
- **Check for inflation provisions.** Since you may not receive benefits for many years and long-term-care costs have increased significantly in recent years, make sure your policy has inflation protection. You can obtain simple or compound inflation protection. Simple protection increases the benefit amount by a specific percentage of the original benefit each year. Compound inflation increases the benefit on a compounded basis, so it provides substantially more protection.
- **Obtain insurance from a stable insurance company.** You want to obtain insurance from a company that is sure to be around for the long term.
- **Select an appropriate benefit period.** Many people choose a benefit period of three years, to cover the average nursing home stay. However, due to the substantial costs associated with long-term care, you may want to select a longer period. Lifetime coverage, however, probably isn't necessary. Only 1.5% of policyholders with five years of coverage exhausted their benefits (Source: *Financial Planning*, April 2007). Look for a provision where the insurer continues to pay benefits if you haven't reached the policy limit during the maximum benefit period. For instance, if your policy pays a maximum of \$200 daily for three years, but you only use \$150, the company would continue to pay benefits until you reached the policy limit.
- **Make sure the policy terms are reasonable.** Benefits should be paid in as many situations as possible, including skilled care, intermediate care, custodial care, home health care, and adult day care. Many people prefer to remain at home as long as possible, so make sure the policy covers a wide range of home services. Review the waiting period carefully to ensure a good balance between premium costs and out-of-

pocket costs.

- **Understand the level of assistance needed to qualify for benefits.** Typically, benefits are paid when you are unable to perform two of five activities of daily living, including bathing, eating, using the bathroom, moving back and forth from a chair to a bed, and remaining continent. Typically, benefits are also triggered when a cognitive impairment, such as Alzheimer's disease, requires substantial supervision.
- **Determine how benefits are paid.** Some policies pay a set daily amount, regardless of your actual costs. This may be a good alternative if you are staying at home and want to compensate a friend or family member for helping you. Other policies will only pay your actual out-of-pocket expenses up to a daily limit or may only pay reasonable and customary costs. Find out how you prove that you're entitled to benefits. Some plans require an in-house doctor to review your health, while other plans allow your own doctor's review.
- **Review new policy provisions.** Long-term-care policies are relatively new, so policy riders are evolving. Make sure to check out new provisions, such as the ability to combine a life insurance and long-term-care policy, an accelerated premium provision that allows you to stop making premiums after a certain number of years, or a provision that returns premiums if you die without using benefits. Also look into partnership policies, which allow you to qualify for Medicaid after exhausting the policy's benefit, while keeping more assets than normally allowed by Medicaid.
- **Consider sharing a policy with your spouse.** Some companies now offer policies that allow spouses to share policy benefits, which can operate in several ways. Spouses may take out separate policies, with a rider allowing them to use each other's unused benefits. Another alternative is to purchase one policy that both spouses can use. A third alternative gives each spouse a specified amount of benefits plus a third amount that can be drawn on by each spouse. However, be sure that one spouse doesn't use all the benefits, leaving the other spouse with no benefits.
- **Check the policy's tax status.** A qualified policy allows you to deduct a certain percentage of the premium, depending on your age, as a medical expense on your tax return. Medical expenses are deductible to the extent they exceed 7.5% of your adjusted gross income.

[Back to topics.](#)



## Regularly Review Your Life Insurance

Periodically, you should review your life insurance policies to ensure that they still meet your insurance needs for your current situation. A divorce, change in income, or death or illness in the family are all factors that significantly impact the amount of life insurance you need. Consider the following points during that review:

**Are your policy limits still appropriate?** Whether you took out the policy 20 years ago or

four years ago, it makes sense to revisit the initial selections you made. You may now find that you need more or less insurance than you originally purchased. However, if you have too much coverage, don't cancel the policy without further analysis. The policy's return may make it a worthwhile investment on its own, or you may be able to convert to a smaller, paid-up policy.

**Is the projected rate of return still competitive?** If you have a cash-value insurance policy, ask the insurance company for an in-force illustration based on current dividends and interest rates. Even if you aren't satisfied with the projected return, don't replace the policy without careful analysis. Cash values typically accumulate at a faster rate after the first few years, and there may be tax consequences to surrendering the policy. Also, a policy change may require a medical examination and may incur fees and costs.

**Is the insurance company financially sound?** Check your insurance company's ratings to make sure its financial strength has not deteriorated.

**Is the policy owned by the appropriate party?** Changes in your estate needs may necessitate changes in the policy's ownership. For instance, you may want an irrevocable trust to own the policy so the proceeds won't be included in your taxable estate. Or business owners may find it more beneficial for the company to own the insurance policy. Consider all tax and estate factors before deciding who should own the policy.

**Are your beneficiaries still appropriate?** People's lives are constantly changing. Sons and daughters become adults, get married, have children. Family members die. Husbands and wives divorce. Such events have an impact on your life insurance beneficiaries, so you may want to change your beneficiaries due to changes in your personal situation. While it would seem unlikely that an insured would want his/her ex-spouse as a beneficiary, it is quite common for individuals to forget to update beneficiary designations. During your insurance policy review, make sure to review your designated beneficiaries.

[Back to topics.](#)



## Assessing Your Investment Risk Tolerance

Your individual risk tolerance will significantly affect the look of your portfolio, so you should have a good understanding of what it means and how it is applied to your investments.

While a high-risk portfolio may look good on paper, how those investments will affect your behavior and emotional state should be taken into consideration. If high-risk investments cause you significant worry or anxiety over potential market declines, you won't be comfortable

owning them.

One approach to developing an investment portfolio that reflects your individual risk tolerance is to consider your investment income needs and your attitude about the potential changes in investment values. If your standard of living is dependent on investment income, your portfolio should be concentrated in investments that provide stable and predictable income. However, if your living needs are covered through employment income, it may make more sense to take a little more risk with your investments, choosing investments with greater growth potential over the long run.

While there is no simple way to determine what risk level fits your emotional makeup and attitude, there are some questions you can ask yourself to gain a better understanding of what type of investor you are:

- Are you confused about investment basics?
- Are you more comfortable with saving than investing?
- Do market fluctuations cause you anxiety? Is that anxiety enough to disturb your day-to-day activities or your sleep?
- Do you require income from your investments?
- Are you investing for the short term?
- Is your financial situation unable to handle short-term losses?
- Are you fearful of losing your assets?

If you answered yes to most of these questions, you are likely to be a conservative investor - someone who is better off with lower-risk investment choices. On the other hand, if you answered no to most of these questions, you may be an aggressive investor and investments with higher return potential may be a better fit for you. Higher reward potential is subject to greater risk of loss of principal.

By knowing yourself and understanding your financial needs and goals, you will be better able to gauge how you may react to market fluctuations. In turn, this will help you determine what levels of risk to assign to your portfolio to help you meet your financial goals.

[Back to topics.](#)



## Dealing with Bond Price Fluctuations

There are two primary factors that affect bond prices - interest rate changes and credit rating changes. Interest rate changes typically will cause a bond's value to fluctuate more than credit rating changes.

As interest rates rise, a bond's price adjusts down, while the bond's price will increase when rates decrease. Simply put, bond prices and interest rates move in opposite directions. Also, bonds with longer maturity dates are more vulnerable to interest rate changes, since the difference will impact the bond for a longer time period. One of the reasons longer-term bonds typically pay higher interest rates is because there is more risk that interest rates will change during the bond's life.

Credit ratings also influence a bond's price. When a bond is issued, rating agencies assign a rating to give investors an indication of the bond's investment quality and relative risk of default. Typically, higher-rated bonds pay a lower interest rate than lower-rated bonds. After the bond is issued, the rating agencies continue to monitor it, making changes if warranted. A bond's price tends to decline when a rating is downgraded and increase when a rating is upgraded. The price change brings the bond's yield in line with other bonds with similar ratings. However, these price changes are typically minor if the rating changes by only one notch. Certain downgrades are more significant, such as a downgrade that moves a bond from an investment-grade to a speculative rating, a downgrade of more than one notch, or a series of downgrades over a short period of time. In those situations, you should review whether you want to continue to hold the bond.

If you want to minimize the risk of price fluctuations, consider these tips:

- If you hold a bond to maturity, you receive the full principal value, so you won't be affected by any price fluctuations. Thus, consider purchasing bonds with maturity dates that match when you will need your principal.
- Consider investing in bonds with shorter-term maturities, which are less susceptible to interest rate changes.
- Design your bond portfolio using a ladder, so you'll have bonds coming due every year or so. This strategy typically lessens the effects of interest rate changes. Since the bonds are held to maturity, changing interest rates won't result in a gain or loss from a sale. Bonds are maturing every year or two, so your principal is reinvested over a period of time instead of in one lump sum. If interest rates rise, you have principal coming due every year or so to reinvest at higher rates. In a declining interest rate environment, you have some funds in longer-term bonds with higher interest rates. A bond ladder keeps your bond portfolio invested in a range of maturity dates, evening out your interest income over time.
- Choose bonds that match your risk tolerance. Safer bonds, such as U.S. Treasury bonds or investment-grade corporate bonds, are less susceptible to credit rating risks.

[Back to topics.](#)



## Spousal IRAs: Contributing Together

Perhaps you are a stay-at-home parent. Or your spouse is a professor on an unpaid sabbatical. Maybe your spouse decides to take time off to write a book. Even though you are not working, you still need to consider retirement plans. A spousal individual retirement account (IRA) allows a nonworking spouse to contribute to an IRA, even though the spouse has little or no earned income. Here are the basics:

- To be eligible to contribute, the couple must be legally married at tax year-end and file taxes jointly. The couple's combined earned income must equal or exceed the combined IRA contribution.
- Contributions can be made to traditional IRAs as long as the owner is under age 70 1/2, while there is no age limit for Roth IRAs.
- In 2008, the maximum contribution to an IRA is \$5,000 with an additional \$1,000 catch-up contribution for individuals age 50 and over.
- For traditional IRAs, if the working spouse is covered by a qualified retirement plan but the nonworking spouse is not, the contribution for the nonworking spouse is phased out once adjusted gross income (AGI) is between \$159,000 and \$169,000 in 2008 and totally phased out once income exceeds \$169,000. If you both have earned income equal to at least the maximum IRA contribution amount and are both covered by a qualified retirement plan, your contribution is phased out at joint AGI between \$85,000 and \$105,000 in 2008. If neither of you is covered by a qualified plan, both of you can make a deductible contribution regardless of your AGI.
- For Roth IRAs, eligibility is phased out for AGI levels between \$159,000 and \$169,000 in 2008. It doesn't matter whether your spouse is covered by a qualified retirement plan at work.

Contributing to a spouse's IRA may be as beneficial to the working spouse as to the nonworking spouse, since the assets are likely to be shared during retirement.

[Back to topics.](#)

---

Copyright © 2008. This newsletter intends to offer factual and up-to-date information on the subjects discussed, but should not be regarded as a complete analysis of these subjects. The appropriate professional advisers should be consulted before implementing any options presented. No party assumes liability for any loss or damage resulting from errors or omissions or reliance on or use of this material.