

A Primer on Long-term Care Insurance

What Is It?

Long-term care insurance (LTCi) provides a daily financial benefit to cover the cost of long-term custodial care (LTC) for those who are unable to take care of themselves. Individuals qualifying for LTC benefits may not be sick in the traditional sense of the word, but must be unable to independently perform two or more of the basic activities of daily living such as dressing, bathing, eating, transferring, and using the bathroom, or need supervision due to severe cognitive impairment. Policies may provide for home care, adult day-care, assisted living and nursing home facilities.

Why Buy It?

This is not a benefit that is provided by health care insurance or by Medicare. LTC benefits are provided by Medicaid for those who have virtually exhausted their financial resources, but the benefits are limited in size and it is often the least desirable facilities that have space for Medicaid patients.

Most people will need it. Approximately 60%ⁱ to 70%ⁱⁱ of those over age 65 are likely to need long-term care in the future. Roughly 40% of those receiving LTC today are between 18 and 64 years old.ⁱⁱⁱ

Costs of long-term care are very high. The average annual cost, nationally, for a one-bedroom assisted living unit is about \$40,000^{iv}, while a nursing home runs over \$60,000. These services can be twice as expensive in high cost of living areas.

Key Policy Terms

The policies typically offer a specific daily or monthly payment (the **benefit amount**), which lasts for a stated number of years (the **benefit period**), that may increase with **inflation**, and which starts after a certain waiting period (the **elimination period**).

The benefit amount may be a reimbursement of certain actual expenses (which is most common), or a fixed daily payment (which is more flexible). In the case of the reimbursement model, when the maximum benefit is not fully used each day, the balance will typically carry forward into the future, thus extending the length of the benefit period.

Finally, it is important to understand any **exclusions** of the policy—meaning any ailments or treatments that are not covered. For example, some policies may exclude mental and nervous conditions, such as manic depression or bipolar disorder.

Advantage of Applying Early^v

Annual premiums are based on the age and health of the person insured at the time that the policy is originated. The premium levels are not guaranteed, and may increase in the future, although any increases must apply to all policy holders owning the same coverage. The statistics below illustrate how much easier it is to obtain discounted coverage at an earlier age.

	% Receiving Good Health Discounts	% of Applicants Declined
Under 50	67	7
50-59	52	14
60-69	42	23
70-79	24	45
Over 79	13	70

Who Needs It?

According to ConsumerReports.org, "...if you have a net worth below \$200,000 to \$300,000 (not including your home and depending on the cost of care in your region), an LTC policy won't be an affordable option and you will probably rely on government programs should you need long-term care. If you have assets of about \$2 million or more, you should be able to pay for care yourself. If you fall in between, you're a more likely candidate for an LTC policy".

Those with a history of family members needing LTC may be more likely to benefit from the coverage. Women are considerably more likely than men to need long-term care, and to need it for longer. The projected need for those turning 65 in 2005 was as follows^{vi}:

	% of People with LTC Need (A)	Average Yrs of LTC Need (B)	Wtd. Avg. Years of LTC Need (AxB)	<u>Distribution by years of LTC need (% of people)</u>				
				None	1 year or less	1-2 years	2-5 years	over 5 years
Men	58%	2.2	1.3	42	19	10	17	11
Women	79%	3.7	2.9	21	16	13	22	28
All	69%	3.0	2.1	31	17	12	20	20

According to another source, the average nursing home claim is 2 ½ years and the average home care claim is just over 4 years.^{vii} The average claim is made at age 79^{viii}.

Types of Policies^{ix}

Traditional LTC Policies. These represent the majority of the long-term care policies. Like health insurance, these policies offer certain specified benefits in exchange for an annual premium. Though designed to stay constant, premiums may increase over time, and may be paid in an accelerated manner to reduce or avoid the risk of future rate increases.

LTC Combined with a Life Insurance Policy. LTC benefits may be included as either an alternative, or supplement, to the death benefit provided by a life insurance policy. If the insured dies before needing long-term care, the death benefit is paid. If LTC is needed, those payments typically reduce the death benefit. Since the underwriting standards for life insurance are more stringent than those for long-term care insurance, many who might qualify for traditional LTCi, may not be eligible for this type of policy.

LTC Combined with a Single Premium Deferred Annuity. In this scenario, the insured makes a lump sum payment, typically \$50,000 or more, to purchase a deferred annuity (one that accrues interest and pays out in the future). The annuity may earn a guaranteed minimum rate of interest, and may also promise LTC benefits that are a multiple of the original investment. To the extent that the LTC benefits are used, the value of the annuity is reduced. While it may appear that there is no cost for the LTC coverage if the benefits are not used, the LTCi premiums are actually being paid with a portion of the pre-tax earnings of the annuity. While the investor is guaranteed a modest positive return, the annuity is not completely liquid, and any withdrawals reduce the potential LTC benefits.

Combined With A Disability Income Policy. When the insured reaches age 65, the insurance converts from a disability policy to a long-term care policy.

Combining LTCi with an annuity, life insurance or disability insurance can be an attractive option for those interested in both features. The cost of the combined insurance is likely to be less than that of taking out two separate policies. The total benefits under a combined policy are also likely to be less than those of two separate policies.

How Much Does It Cost (for a traditional policy)?

Monthly Premium for Federal Long-term Care Insurance Program (with John Hancock Ins.)^x

Age When Start Policy	\$200/day, 3 Years, 5% inflation, 90 day wait	\$200/day, 3 Years, 0% inflation, 90 day wait	\$150/day, 3 Years, 5% inflation, 90 day wait
	45	139	35
50	166	47	125
55	203	65	153
60	250	89	187
65	317	129	238
70	331	190	248
75	524	342	393

These rates were available for employees of the military and the Federal Government as of October, 2010, and may be better or worse than the rates available to the general public. Those who are able to get group coverage through work or a professional association may have the advantage of not having to be in good health to obtain the coverage. For those taking out individual (as opposed to group) policies, discounts are typically available for those in good health, and if both husband and wife are insured together.

The older you are when you take out coverage, the more the coverage will cost. Once you take out a policy, the rates are set and do not continue to increase annually as you age. However, the insurer can still increase rates for all existing policy holders. Such increases are unusual, but they can be sizeable. John Hancock recently proposed raising its rates by an average of 40%.

Financial Analysis

Presented below is an analysis of the projected lifetime costs and potential benefits for a 55 year old taking out an LTC policy with \$200/day coverage for up to 3 years, with 5% compound annual inflation protection. The projected benefits are based on a 60% likelihood that the insured uses two years of maximum benefits (reduced by a 90-day waiting period), starting at age 79. The initial premium is 10% higher than quoted in the previous section, and is assumed to increase 2% per year. No premiums are charged while benefits are being paid.

Year	Age	(A) Projected Costs	(B) Projected Benefits	(C) Net Benefit or (Cost) (A + B)	(D) 3% Inflation Index	(E) Net Benefit in Today's Dollars (C / D)	(F) Cumulative Net Benefit (or Cost)
1	55	(2,680)		(2,680)	1.00	(2,680)	(2,680)
2	56	(2,734)		(2,734)	1.03	(2,654)	(5,334)
3	57	(2,788)		(2,788)	1.06	(2,628)	(7,962)
4	58	(2,844)		(2,844)	1.09	(2,603)	(10,565)
5	59	(2,901)		(2,901)	1.13	(2,577)	(13,142)
10	64	(3,203)		(3,203)	1.30	(2,455)	(25,659)
15	69	(3,536)		(3,536)	1.51	(2,338)	(37,580)
20	74	(3,904)		(3,904)	1.75	(2,227)	(48,933)
25	79		105,945	105,945	2.03	52,118	(5,507)
26	80		148,322	148,322	2.09	70,840	65,332
30	84	(4,759)		(4,759)	2.36	(2,020)	57,135
35	89	(5,255)		(5,255)	2.73	(1,923)	47,327
Total		(125,278)	254,267	128,989		47,327	

Note that not every year in the projection is shown, that these projections are subject to many assumptions, and that actual results will undoubtedly vary from these assumptions and projections.

The analysis shows that the projected benefits (in today's dollars) are expected to be more than the projected costs. In other words, under these assumptions, the policy turns out to be a good investment for the insured (it generates the equivalent of about an 8% annual return). Actual average costs to insurance companies would be less due to some policy holders dropping coverage before receiving benefits, some paying higher rates, etc.

Tax Benefits

Most long-term care policies are tax qualified, meaning that any benefits paid are not taxable to the recipient. If the policy is paid for through a business or a health savings account, it may be possible to pay the premiums in large part with pretax dollars. For a high tax bracket individual, it can be a big benefit to pay the premiums with pretax dollars, and receive the benefits tax free.

Asset Protection

In order to receive LTC benefits from Medicaid, a person must first "spend down" virtually all of their assets. There is one exception which was created to encourage the purchase of LTCi. In Colorado, and several other states, each dollar a person receives in LTC benefits is exempt from the Medicaid spend-down rules. This means that an individual can retain this much in additional assets and still qualify for Medicaid.

Risks/Concerns

Consumer Reports is a notably tough critic of the LTCi industry. One article states that "the coverage has many drawbacks. It can be expensive, especially because you might be paying for it for decades before you use it—if you use it at all. And it often provides only limited benefits with many restrictions and conditions that might leave much of your cost unreimbursed. Some insurers have hiked premiums by double digits, forcing policyholders to drop their coverage and lose part or all of the money they had paid."

"You might have to be evaluated by your insurer's physician, not your own, to decide if you are frail enough. If you don't require enough assistance, in his or her opinion, you'll have to pay for care out-of-pocket. Many who need assisted living (because they can't function independently) still may not qualify for LTCi benefits."

The article also suggests that if the goal is to leave more assets to heirs, life insurance could be a better option, since with life insurance, the policy owner doesn't run the risk of paying a lifetime of premiums and potentially not receiving any benefit.

A final risk is that the company providing the LTC insurance may go out of business and be unable to honor its obligations. For this reason, it is important to consider the financial strength of the company offering the policy.

Conclusion

Most people will need long-term care at some point during their lifetimes. The burden of caring for someone with this need is substantial in many ways: emotionally, physically, and financially. LTC insurance helps pay for needed care. The benefits of the policy can significantly exceed the cost, but as with many types of insurance, it is also possible the benefits will never be needed. If you wish to receive a personalized quote from a third party firm (our company does not sell insurance), we would be happy to introduce you to a knowledgeable specialist, and to help you review the policy proposal.

The data in this report is collected from sources believed to be reliable, but we cannot guarantee its accuracy. The sources used are listed below:

ⁱ Wikipedia.org on Long-term care insurance, October 2010

ⁱⁱ American Association of Long-term Care Insurance

ⁱⁱⁱ Wikipedia.org on Long-term care insurance, October 2010

^{iv} ConsumerReports.org, Long-term Care Coverage, August 2008

^v American Association of Long-term Care Insurance

^{vi} Based on research by Peter Kemper, Ph.D., Dept of Health Policy, Pennsylvania State University.

Published by the American Association for Long-term Care Insurance, 2009

^{vii} Infolongtermcare.org

^{viii} ConsumerReports.org, Long-term Care Coverage, August 2008

^{ix} Law.freedvice.com

^x Ltcfeds.com

We also consulted various local insurance professionals who specialize in this industry including Michael Belmont of Long-term Care Insurance Professionals, and Russ Porter of Porter Insurance.