WITT Actuarial Services LLC
6010 Preston Lane | New Berlin, WI 53151 | www.wittactuarialservices.com
p 414.525.8212 | f 414.433.1864 | scottwitt@wittactuarialservices.com

Long-Term Care: Do You Need It, and If So, Then What?

Despite the best efforts of companies and agents throughout the industry, Long-Term Care insurance (LTC) policy sales have yet to blossom as much as the industry had hoped and predicted. As the Baby Boomers continue to move through the "sweet spot" of the target market for LTC, companies will no doubt redouble their efforts in pushing LTC. Two obvious questions arise. First, is LTC right for you or your client, given the particular financial circumstances, family circumstances, and family history? Second, even if it is determined that LTC makes sense, how do you wade through the myriad of companies and policy options that are available and determine the best fit?

LTC Insurance Overview

LTC insurance covers some or all of the costs associated with nursing home care, home care, or adult day care. Generally, LTC insurance benefits are triggered when an insured is no longer capable of performing two or more of the common activities of daily living (i.e., bathing, dressing, eating, continence, toileting, and transferring) or when an insured has a severe cognitive impairment.

LTC refers to custodial care due to chronic infirmities and should not be confused with full-time or intermittent skilled nursing care associated with acute medical episodes. Skilled nursing care, whether in a facility or at home, is covered in part by Medicare. Medicare Supplement insurance covers some of the gaps in Medicare coverage, but neither cover LTC costs. Some studies indicate that many Americans are confused about this issue, believing that Medicare will pay some LTC costs. It won't. On the other hand, Medicaid may pay for some or most LTC costs if the claimant's income and assets place them at or near the poverty level.

Is LTC Needed?

It is not a foregone conclusion for every buyer that LTC insurance should be purchased. Marketing propaganda that suggests that virtually everyone will need LTC is meant to scare and may not be very accurate. Indeed, if that many LTC insurance buyers collect benefits on their policies, then the premiums would (or will be) much more expensive.

For those approaching the poverty level, LTC makes little sense. Premiums would likely be prohibitively expensive, but more importantly, Medicaid may be able to cover LTC costs.

For those beyond a certain level of wealth – say several million dollars – they likely have the means to view themselves as being self-insured. But we have found that even

those that have the ability to self-insure may wish to protect their assets from a significant depletion due to LTC costs.

Clearly there is no hard and fast rule – the threshold is somewhat subjective and depends on a host of factors such as the type of assets currently held, marital status, family resources that are available, and family history – but LTC generally makes the most sense for those who have some intermediate level of wealth. Even then it is not simply an all-or-nothing proposition. There is a vast array of options, discussed later, that can be tailored to suit each unique situation.

So You Think You Need LTC – Now What?

Before you tackle figuring out which options are best for you, we believe it is prudent to first give some thought to which companies you should even consider buying from.

Almost all products in the marketplace today are guaranteed renewable products. That means that a company cannot terminate coverage as long as the premiums are paid, but a company does have the right to raise premiums on a class basis with state approval. If a company is losing money for whatever the reason, rest assured that they will do everything in their power to increase premiums.

Indeed, many carriers have dramatically raised premiums in recent years. Other carriers entered the market with a more cautious approach, setting premiums at what appeared initially to be extremely high levels but what now appears to be fairly prudent in retrospect. At least one carrier is likely to pay dividends on their product, increasing its competitive appeal.

Therefore, buying a product solely on the basis of the current premium is a foolish endeavor. Aside from recognizing that premiums may change down the road, one also must recognize that not all companies treat their policyholders the same when it comes time to pay a claim.

With basically no LTC claims experience in the industry, it is critical that you consider the track record of how a company has treated its policyholders in other lines of business. We have seen many horror stories in the disability income (DI) industry, and we encounter life insurance pricing on a daily basis that exploits inforce policyholders in favor of new policyholders. Because lapse-supported pricing is unavoidably an element of LTC pricing – because there are generally no surrender values when a policyholder terminates a contract – there is certainly cause for concern about what might happen if fewer policyholders lapse their contracts than the company intended. Could the pressure of all of these additional policies on the books – or just the fact that they may have underpriced the business initially knowing they could raise premiums later if necessary - make them more likely to look for ways to be stingy in the claims

area? It's certainly possible, especially given the shenanigans we have witnessed by some companies in the DI industry.

LTC Policy Structure

The amount of the monthly benefit, the length of time that benefits are paid, the amount of time that must elapse between qualifying for benefits and actually receiving benefits, whether or not the policy has inflation protection, and whether the policy is a reimbursement policy or an indemnity policy – these are all variables that affect the premium cost and are controlled by the insured at the time of purchase. Larger benefits, longer benefit periods, shorter "elimination" periods, inflation protection, and indemnity policies will all increase the premiums for LTC.

- Benefit Amount – The usual range is between $100 and $300 per day ($3,000 to $9,000 per month). The benefit amount should be directly related to the cost in your area (or the area you intend to retire to) for nursing home care. Policies with a monthly benefit are generally more valuable (and generally more expensive) than policies with a daily benefit, particularly if the insured foresees home care as a possibility. The common example that is cited is if home care services are provided several days a week, a monthly benefit may cover the entire amount, while a daily benefit may result in an out-of-pocket cost each and every day that benefits are utilized.

- Facility vs. Community Benefits – Some policies will have separate maximum benefits for qualified facilities and for non-qualified facilities such as home care (dubbed "Community Benefits"). We generally focus on the community benefits because most clients place a tremendous value on maintaining the option of continuing to live in one's own home.

- Elimination Period – This is the amount of time that must elapse between when the insured is determined to be chronically ill and when benefits will begin. The usual range is between zero days and one year, with 90 days being the most popular.

- Benefit Period – The usual range is one year to lifetime. Based on our experience with the cost/benefit tradeoffs of the various options, we generally recommend a benefit period of at least 5 years. Many LTC advocates claim that the benefit period is unlikely to last longer than 5 years or so, and therefore it is not uncommon for them to sell shorter benefit periods, which does reduce the premium.

- Inflation Protection – The usual inflation factor is 5 percent (some policies use simple interest and some use compound interest). Inflation protection increases the cost of the policy dramatically (perhaps as much as 50-100%), but it does increase the benefit from the first day of the policy and continues to increase the benefit even if benefits are being received. Sometimes the overall amount of inflation protection is capped, for instance when the benefit reaches a level that is equal to two times the initial benefit.

- Indemnity vs. Reimbursement Provisions – With an indemnity policy, the monthly benefit is paid as long as some form of formal care is being provided, even if the cost of that care is less than the monthly benefit. Like their name implies, reimbursement contracts only reimburse the expenses actually paid for care up to the maximum level of benefit. (A few carriers now offer a juiced-up policy that pays the monthly benefit once the insured is chronically ill and satisfies the elimination period – regardless of whether or not any formal care is being provided.) Indemnity policies are significantly more expensive than reimbursement policies.

- Marriage Discount – Because conventional wisdom is that married individuals will be less apt to utilize formal LTC as quickly or as heavily as single individuals, most companies offer marital discounts. Both spouses may need to apply for coverage in order to receive the discount. Discounts vary widely, but can be as much as 40% for each policy when both spouses purchase LTC.

Tax Issues

LTC policies that are "federally qualified" dominate the marketplace today, and buyers who consider "non-qualified" policies do so at their own potential tax peril. (The tax treatment for these "qualified" plans is not to be confused with the tax treatment of "qualified" retirement plans.)

If a LTC policy is qualified, then benefits received are generally tax-free. Furthermore, premiums may be deductible if a policyholder itemizes deductions and medical expenses total more than 7.5% of adjusted gross income.