With little track record on which to base decisions, potential purchasers need to thoroughly examine their needs, as well as the claims and provisions of competing policies.

A Reality Check: Do You Need to Buy Long-Term Care Insurance?

By Peter Katt

While "live long and prosper" may be Star Trek Spock's dictum, "live too long and face financial uncertainty" has become the long-term care insurance marketers' slogan.

Long-term care refers to the costs some seniors may face due to the infirmities of aging. Typically, long-term care insurance will cover some or all of the costs associated with nursing home care, home care or adult day care. Generally, long-term care insurance benefits are triggered when an insured is no longer able to perform two or three common activities of daily living (dressing, eating, bathing, toileting, mobility and taking medicine) or has a cognitive impairment or a medical necessity. The amount of benefit, the length of time it is paid, inflation protection, and the waiting period before benefits commence after a triggering event are variables that each insured selects for himself. Obviously, a larger benefit, a longer benefit payment period, the purchase of inflation protection, and a shorter waiting period will all increase the premium cost.

Long-term custodial care due to chronic infirmities 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 supplemental insurance covers some of the gaps in Medicare coverage. But neither Medicare nor supplemental insurance covers long-term custodial care costs.

Some studies indicate that many Americans are confused about this issue, believing that Medicare will pay some long-term care costs. It doesn't. Medicaid, on the other hand, may pay for some or most long-term care costs if the claimant's income and assets place them at or near the poverty level.

A Needs Analysis

Potential long-term care needs should ideally be evaluated around age 50, a time when it is likely that retirement resources can be reasonably estimated. Such an analysis would make an estimate of income available from pension sources (including Social Security), income that could be derived from *income investments* (for instance, bonds), the amount of *growth investments* (for instance, equities), and *use investments* (for example, a home). Retirement goals and plans might be considered, especially in estimating income needs. Typically, there are three retirement phases. First is a very active phase during which more income may be desired for travel and such. Second is a less active phase that may require less income. The third phase is where there is the potential need for custodial care.

Since the largest cost associated with long-term care is custodial nursing home care, this is the cost that should be planned for. Obtain the cost of living in a nursing home in the area where you are most likely to retire. Typically, nursing home costs will range from $3,000 to $9,000 per month depending on the area and quality of the facility. Determining whether you should purchase long-term care insurance, consider another funding method, or forgo either option can best be explained by looking at four typical examples:

- Dr. and Mrs. Welby: Both are in their mid-50s. Dr. Welby wants to retire in about five years. As a self-employed physician, he has been able to accumulate a large pension fund that, when combined with Social Security, will provide them with income of around $15,000 per month. They have growth investments and "use" investments of some $3.0 million. The Welbys have no need for long-term care insurance, or any other funding method, since it is nearly certain that their current income plus converting some of their growth investments to income investments if necessary can easily cover nursing home care for both of them.
- Mr. and Mrs. Woods: Both are in their early 60s. Mr. Woods intends to retire in three years from a career as a research administrator with a pharma-

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ceutical company. His pension plus Social Security will provide them with income of $4,500 a month that will continue at about the same level if Mrs. Woods survives him. They have growth investments and "use" investments of some $600,000. Nursing home costs at the best facility in their area are $5,000 a month. They decide to forgo long-term care insurance because they plan to liquidate growth investments if needed to pay for nursing home costs. They figure that the potential increase in nursing home costs will be balanced by the growth of their investments. If one or both were to need nursing home care, they could purchase a joint life immediate annuity with the proceeds from liquidating some or all of their investments. In conjunction with this planning, they decide to purchase a joint life insurance policy with a level death benefit of $250,000 to ensure that their two children will receive an inheritance even if they have had to annuitize all their investments to pay nursing home costs. The projected annual cost of this life insurance policy is $3,500.

- Mrs. Stanton: A widow aged 65, she worked in the local paper mill and has no pension benefits. Her Social Security of $1,000 per month is her only income. She has a nest egg of about $15,000. Mrs. Stanton needs long-term care insurance, but she can't afford it. Mrs. Stanton will have to depend on Medicaid after her nest egg is used up in the event she needs long-term care assistance.
- Mr. and Mrs. Moore: Both are school teachers in their mid-50s. They estimate their combined income in retirement will be around $5,500 a month, which will continue at about the same level for the survivor. They have little in the way of growth investments because they put four children through college. At retirement, they plan to sell their house and move to Scottsdale, Arizona, where they will rent an apartment. This will then give them growth investments of some $150,000. They figure they can handle a situation where one of them dies and the survivor then needs to live in a nursing home. However, they aren't equipped to handle the situations in which one of them is in a nursing home while the other remains in the apartment or they both need nursing home care. They decide to purchase long-term care insurance. The question is: Should they buy a policy for each of them, or can they cover their risk only insuring one of them? Unfortunately, they need to buy a long-term care policy for each because it isn't possible to know which one might be in a nursing home with the other surviving.

The next section that follows will continue with the Moores' example to illustrate the more important long-term care insurance decisions.

Long-Term Care Policy Structure

Here are the policy benefits that are the most important for you to focus on:

- ***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. For example, if the per-day nursing home cost is currently $200, this might be the benefit amount you select.
- ***Waiting Period***—The usual range is zero days to one year. Get a range of premium costs for different waiting periods. Take the waiting period with the best percentage savings, which may not be the maximum waiting period.
- ***Benefit Period***—The usual range is one year to lifetime. I would recommend the lifetime benefit period to avoid a traumatic disruption in living standards at a time you would be most vulnerable. Of course, a lifetime benefits provision is more expensive.
- ***Inflation Protection***—The usual inflation factor is 5%. Some policies figure this as simple interest, and others figure it as compound interest. The inflation protector increases the benefit from the first day of the policy, not from the first day that benefits are received. Simple interest inflation protection increases the policy cost by about 45% to 85%, depending on your age. Compound interest inflation protection increases the policy cost by about 65% to two-fold depending on age.

The Moores decide to purchase long-term care insurance policies for each of them with benefits of $6,000 a month ($200 a day for nursing home care and $100 for home care), a 90-day waiting period, and lifetime benefits with a simple interest inflation protector. The current premiums for both policies are about $3,000 annually, including a 10% discount because both spouses are buying policies. These premiums can change.

Premium Variability

Table 1 provides typical premiums for long-term care insurance. Long-term care insurance is guaranteed renewable, which in insurance jargon means that the company cannot terminate the coverage as long as the premium is paid, but the company can increase the premiums of all such policies. This pricing

Table 1.
Typical Annual Premiums* for Long-Term Care Insurance

	Age 55	60	65	70	75
No Inflation Protection ($)	1,340	1,740	2,600	4,160	7,500
5% Simple Inflation Protection ($)	2,680	3,130	4,240	6,530	10,880
5% Compound Inflation Protection ($)	2,850	3,480	4,680	6,860	11,250

** Premiums are based on $200 per day nursing home coverage and $100 per day home care coverage; and lifetime coverage with a 100-day waiting period.*

variability is really a good thing because fixed pricing would almost certainly result in insureds being overcharged. Alternatively, if too little premium is charged it could cause company insolvency, leaving the payment of benefits in doubt. But pricing variability needs to be understood and planned for, so that pricing increases, should they occur, are already built into your budget.

There are three factors that might contribute to current premiums being too low, which would inevitably cause the premiums to rise.

First, the investment yield being projected by sellers of long-term care insurance may not be met. For example, if an investment yield of 8.5% is estimated by the insurance company, but five years later it is determined that a yield of only 7.5% can be sustained, this would certainly cause a premium increase.

Second, I am unaware of any authoritative study regarding the probabilities of benefits being triggered for the socioeconomic group typically buying long-term care insurance policies. Therefore, calculating estimated benefit costs may be far more of a guesstimate than companies would wish to admit. Also, I am not sure to what extent companies have taken into account the inherent increase in benefit claims simply because people have the coverage. That is, without coverage, someone might be willing to put up with the inconveniences of his own or a spouse's old-age infirmities, but after paying out all of those premiums, insureds may be far more motivated to get a return on their premium costs. For example, if a company is expecting one in five to eventually need benefits, but actual experience is that one in four receive benefits, this would also cause premiums to increase.

Third, variable insurance premiums in a competitive selling environment have a tendency to be set too low so salesmen can offer a better price than their competition. As long as companies can increase premiums, selling for prices that may be too low becomes a problem for the insureds.

For these reasons I suggest anyone buying long-term care insurance anticipate premium increases on the magnitude of 50% just to be safe with your budgeting.

Miscellaneous Issues

Here are other long-term care issues you should be aware of and research if you intend to buy long-term care insurance.

- Tax consequences: There may be some tax advantages to buying long-term care insurance that would not apply to other funding methods. Long-term care insurance premiums are deductible if, when combined with qualifying other medical costs, the total exceeds 7.5% of adjusted income. This isn't likely for most taxpayers. Typically, long-term care insurance benefits are received tax-free.
- Reimbursement or per diem benefits: A long-term care insurance policy can either pay the full daily benefit regardless of the actual charges for long-term care services, or it can pay the actual long-term care charge up to the maximum benefit purchased allowed by the policy. Reimbursement policies generally have a different benefit amount for nursing home care and home care. For example, if the nursing home reimbursement maximum is $200 a day, the home care reimbursement maximum would be $100.
- The life insurance alternative: Some life insurance marketers are trumpeting the use of life insurance living benefits as a better alternative to long-term care insurance. Some policies allow the policyowner to obtain cash from the life insurance policy while the insured is still alive. The advance is repaid at death from the life insurance proceeds. While this method may provide an alternative for short-term care needs, it is my view that it should only be used when no other options remain and not if the care need may exist for a good deal of time.
- Sales pressure: Insurance salesmen will sell insurance to those who need the coverage and those who can afford it without distinguishing between the two. A salesman has a commission incentive to sell a long-term care policy, so their claim that you must have the coverage may not be accurate and promised benefits may not be exactly as explained.
- Cheaper is better: Long-term care insurance premiums are variable and there is little experience with this type of insurance. Companies *promising* lower cost may be offering it because obscure policy provisions may not be favorable, or it is a bait-and-switch gambit and the premiums will

Table 2:
For More Information: Articles and Publications on Long-Term Care

"Long-Term Care Options Proliferate on Tax Breaks," prepared by the staff of Best's Policy Reports, *Best's Review*, March 1997/Volume 97, No. 11, pp. 64–67.

"The New Tax Rules Governing Long-Term Care Insurance—Part I," prepared by John T. Adney, JD, and Craig R. Springfield, JD, LLM, *Journal of the American Society of CLU & ChFC*, September 1997/Volume LI, No. 5, pp. 56–66.

"Long-Term Care—A Vital Product in an Evolving Environment," prepared by Jacquelyn S. Coy, CLU, and Paul J. Winn, CLU, ChFC, *Journal of the American Society of CLU & ChFC*, September 1997/Volume LI, No. 5, pp. 68–75.

"The Long Term Care Handbook," by Jeff Sadler, published by National Underwriter. (Note: This handbook was written by an agent, for agents, with the intention of promoting the product.)

almost certainly be raised.

• Best companies to buy from: This is a difficult issue because this is such a new type of insurance that we don't have much experience with the full cycle of selling, administering and paying benefits. Rather than guessing which companies may be better, we will have to wait and see.

Table 2 lists several publications you may want to obtain and study before making a decision to purchase long-term care insurance.

Conclusion

We are living longer and families no longer tend to remain geographically close, both of which create a new dimension to our financial lives. There is the need to plan for the financial reality that we may live long enough to have to pay for assistance from others.

Long-term care costs will likely be covered in one of several ways: the old-fashioned way of paying these costs yourself; by purchasing long-term care insurance; with a social safety net in which taxpayers pick up the tab; or a combination of these three. Because of little experience with long-term care insurance, I would advise those with the resources to provide for their own long-term care costs to forgo insurance; however, future events (especially better tax incentives) may cause long-term care insurance to become a more rational choice even for the more affluent.

Stay tuned.