

Long Term Care Insurance

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Do you ever think about all the bad stuff that could happen to you?

- You could be struck by lightning.
- Attacked by a shark
- Gunned down in an errant drive-by shooting
- Your house could burn down.

We live with many risks of disaster every day, but we don't worry too much about them because the probability of their occurrence is so small. We usually don't insure against them either for the same reason, although, for some low probability events, like your house burning down, there is an active insurance market, and almost everyone takes advantage of it.

At the same time, there are other risks that have a far greater chance of happening, yet we ignore them. Typically, this is because we just don't want to think about them, and/or because there is no worthwhile insurance available to protect against them anyway.

Long Term Care

The need for long term care services is one such risk. Long term care is the assistance you may need as a result of a disabling or long term medical or physical condition, be it at an assisted living facility, nursing home or in your own home. **WAIT! Don't stop reading yet.** About the last thing you want to think about today is being an old helpless person in a nursing home. Why worry about that now? Actually, there are good reasons, and here they are:

- **High probability risk** - The chances of you and/or your spouse needing expensive long term care services at some time in your lifetime are far, far higher than most of the other risks you routinely insure against. According to several studies, if you live to age 65, there is more than 70% chance that you and/or your spouse will one day qualify for long term care services!¹ This figure sounds incredibly high I admit, but even if it is several times too high, it is still much more likely to occur than other risks that we regularly obsess about and sometimes insure against.
- **Costs are high and getting higher** - The costs of long term care services are very high, and are growing rapidly. Currently, it would probably cost you over \$70,000 per year to provide daily long term care for one person. And these costs have been growing much faster than inflation, and will likely continue to do so.

¹ This figure comes from a study by the Brookings Group, published in 1992. It is cited in a consumer publication by the California Department of Aging, "Taking Care of Tomorrow – A Consumer's Guide to Long-Term Care", p. 16.

- **Insurance products are available** - There is now an active and growing insurance market to mitigate the financial risks of needing long term care.
- **Now is the time** - It probably doesn't pay to wait until you are older to buy a policy, even if you don't think you'll need it until you are in your 70's or 80's. This last point sounds counterintuitive until you think about it like an insurance company. Unless they price their policies to be more attractive for younger people to buy, how would they ever be able to sell their policies to people who are not close to needing them? Well, they couldn't. As a result, they price the policies so that the cumulative cost of coverage is usually less if you start paying at a younger age than if you wait.

What Does LTC Insurance Cover?

Long term care (LTC) insurance benefits are triggered when you are unable to perform two or more “activities of daily living” on your own, including eating, bathing, dressing, transferring, toileting and/or continence, or when you need help due to severe cognitive impairment (like Alzheimer's disease). The insurance generally pays for the services of caregivers and can cover care in your own home as well as in nursing homes, assisted living facilities and other places. It may include coverage of nursing, personal care assistants, homemaker services, hospice services, respite care and adult day care. Generally, such long term care services are not covered by Medicare or regular private health insurance. A portion or all of LTC premiums may be tax deductible, while benefits received (currently up to \$220 per day) are not taxable.

What Are the Important Features of an LTC Policy?

The customer can custom design his/her LTC policy along several dimensions. Married couples generally buy one policy to cover both people. The key features include the following:

- Level of Coverage (“daily benefits”), which determine the maximum the policy will pay once invoked, stated in dollars per day.
- Inflation Rider option, which increases the daily limit every year by a pre-specified percentage, currently set at 5% per year.
- Length of Coverage (“maximum benefit period”), ranging from one year up to lifetime coverage.
- Waiting Period (“elimination period”), which is the period of time you must wait, after qualifying for LTC benefits to actually start receiving them. This is in effect a deductible, and can range anywhere for 0 days up to 180 days.

If you select a coverage level of \$200 per day, which is about what long term care services currently run in high cost areas like the Bay Area, the insurance would cover you up to \$73,000 per year per person. Since you are likely to hold an LTC policy for a long time, and because the cost of LTC services have been and will likely continue rising faster than general inflation, I would strongly recommend paying for the 5% compounded inflation rider.² With

² Currently, in all the policies I have seen, your choices are 0% or 5% inflation protection, and you can get it with or without compounding.

this feature, in 25 years your policy coverage will grow to \$667 per day, or \$247,000 per year. Even if we assume general inflation of 2 ½% per year, the value of the coverage would grow to about \$135,000 per year per person in today's dollars. If both you and your spouse needed services, you could collect as much as \$270,000 per year.

The expectation, though not a guarantee, is that your premiums will remain level for as long as you hold your policy. So assuming the inflation rider, the benefits go up, but the costs remain constant. If you waited 10 years to buy a policy, today's \$200 daily coverage level will have risen to \$326 per day. So to buy an equivalent policy in 10 years, not only will you have to pay higher rates based on your then ten year older age, you will have to buy a higher coverage level policy as well. Based on the quotes from one company, your premiums would be almost three times as high if you wait to buy at age 65 as if you buy at age 55.

As for the length of coverage I would recommend selecting lifetime coverage, or at least five years worth. This is based on the philosophy that insurance should be designed to cover the most catastrophic outcomes, not the first few dollars of cost. For this reason, I would prefer to skimp on the waiting period, which is a kind of deductible, rather than the length of coverage.

How Much Does It Cost, and Should I Buy It?

The decision to buy or not buy long term care insurance is not a slam dunk in my opinion. Despite the compelling benefits of long term care policies, there is one big drawback: they are very expensive! To cover a couple in their 50's with a high end policy such as I have discussed will probably cost between \$3,000 and \$6,000 per year.

Other than current costs, you may worry about the long term viability of the policies. As I said, there is an expectation and near promise that your policy's rates will never increase, but no guarantee. However, the company can never raise the rates on your policy unless they raise the rates on all policies in the same class as yours. And since the industry is closely regulated, especially in California, such a move would not be taken lightly (and has not happened to date). Another worry is that the insurance company itself might not be around or might exit the industry prior to your needing the coverage. In the latter case, there is no real worry, since a company cannot just abandon its commitments. Some other company would have to be sold or assigned the policies (as happened when GE bought the LTC business of Fireman's Fund). As for company survival, most of the companies selling LTC insurance are blue chip, household name type companies, like GE, TIAA-CREF, Metropolitan Life and State Farm Insurance. Still, you should check the company's AM Best rating, which assesses its financial strength, and stick to companies with an A+ or A++ rating.

I have now studied the LTC insurance issue in some depth by evaluating the decision for my own family. After speaking to multiple insurance agents, attending presentations, and reading many articles, advertisements and analyses, it was still not an easy decision. But in the end I decided that in my case it was worth buying LTC insurance, and I bought a policy for Renee and myself a few months ago.

Whether you will come to the same decision is not clear in advance. Policy costs and features available change constantly, and depend on your age, health and other personal circumstances, as does the potential tax treatment of your premiums and benefits. The decision also depends on your willingness or ability to self-insure, your cash flow situation and on how you assess the various uncertainties mentioned above.

But whether you end up buying it or not, it would be prudent for you to look into it now, as opposed to waiting five or ten years. One reason is cost, as I mentioned above. Even though buying the insurance now means you will likely be paying premiums for a much longer time than if you waited, the pricing is such that the cumulative cost you pay, by the time you reach say age 75 or 80, will usually be higher if you wait to buy it later. Another reason to look into it now is your health status. LTC policy issuance is preceded by medical underwriting, and not everyone qualifies for coverage. If you wait, there is always the chance that changes in your health status down the road will cause you to no longer qualify for the insurance.

Long term care insurance is a hot topic in the financial planning field these days. Most financial planners would probably recommend that anyone in their 40's to 60's who can afford it should buy long term insurance. I think it is probably a good idea for many of us, but it is a close call, and I'm not ready to endorse such a blanket recommendation. And do keep in mind that some of the popularity of the product may derive from the commissions associated with it. As a fee only advisor, I have absolutely nothing to gain from getting a client to buy any kind of insurance product. But many advisors who hold themselves out to be "fee based"³ (as opposed to "fee only") are actually licensed to sell insurance, and stand to earn healthy commissions from doing so.

All things considered, I recommend that you at least consider the issue of long term care insurance. I'd be happy to sit down and talk over the basic issues with you, and then recommend one or more insurance people who can take the issue to the next level of specificity for you. Please give me a call or note if you are interested in taking the next step.

³ Seems like a small semantic distinction, but "fee only" and "fee based" can mean very different things when used to describe an advisor's or planner's practice.