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Long-Term Care Insurance: How to Choose It

BY NANCY F. SMITH

The village of Wimberley sits hard by the Blanco River in Texas hill country. It's an idyllic setting of craggy hills and stately live oak trees, and Betty Wright had no intention of living out her life anywhere except the rambling home she bought there in the early 1970s. For 34 years, she was on the faculty at Texas State University, just 15 miles down the road in San Marcos. Today, 85 years old and frail, she is still in that house. She has home health aides from 8:30 in the morning until 8:30 at night, and the house has been modified to accommodate limitations in her mobility. While she doesn't have family nearby, she has many friends who keep an eye on her. "Neighborly, that's what Wimberley is like," says Stephen Klepfer, the town's former mayor and a local businessman, who checks in on her every day and takes care of her affairs.

Wright has a long-term care insurance policy she bought in 1998 from what was then GE Capital Assurance, now Genworth Life Insurance. "It's the Cadillac of policies," says Klepfer: lifetime coverage, no limit, no waiting period. It pays $200 a day toward the cost of home health aides, assisted living, or nursing-home care, and includes 5% annual inflation protection. She was 68 when she bought it and had been suffering for some years with degenerative osteoarthritis, so the $3,480 annual premium wasn't inconsequential, but it was a great deal. So great, she wouldn't be able to get it today from any insurance company at any price.

It's the kind of deal, in fact, that has driven the long-term-care insurance industry to its knees. A lifetime benefit with an inflation adjustment makes no sense for the insurers, says Joshua Wiener, distinguished fellow and former director of the Aging, Disability, and Long-Term Care Program at RTI International, a nonprofit research institute. "The industry's business model depends on predicting mortality rates, disability rates, nursing home and assisted-living use rates, and interest rates 30 years into the future. Not surprisingly, they got it wrong."

The industry made some costly mistakes in the early years, admits Chris Conklin, senior vice president of product development at Genworth, the largest company still offering long-term care insurance. "We expected the number of people who would drop their coverage every year would have some relationship to other types of insurance," he says. "Turns out that, once people buy long-term care insurance, they keep it." And they make claims. The second problem: interest rates. "Who could have predicted that interest income on our reserves would be practically zero? Benefits were too generous and premiums too low," says Conklin. The result has been a major contraction in the industry and a restructuring of the policies.

Which explains why Genworth is one of only a handful of major companies -- including John Hancock, Mutual of Omaha, MassMutual, and Transamerica -- still writing long-term care policies. That's down from a high of about 100 a decade ago, according to Jesse Slome, executive director of the American Association for Long-Term Care Insurance. Those that have abandoned the business, including MetLife, Allianz, and Prudential Financial, are required to honor existing policies, but they can also raise premiums, and they have, often dramatically. State insurance regulators have granted requests for rate increases ranging from MetLife's 20.5% in New Jersey in 2012 to Allianz's whopping 75% in Texas in 2014.

STILL, MANY FINANCIAL ADVISORS and economists agree that having some kind of long-term care insurance is a prudent way to provide care and preserve wealth. Statistically, 70% of today's 65-year-olds will need long-term care at some point. "Many people make the mistake of assuming Medicare covers it, and they're wrong," says Jeffrey Brown, professor of finance at the University of Illinois, who has spent the last decade researching long-term care insurance markets. There are only three choices: out-of-pocket, Medicaid, or insurance. "Long-term care is exactly the kind of low-probability, high-cost risk that you want to insure against," he says.

There are a couple of important exceptions, Brown adds. People with very little income or savings can qualify for Medicaid. It is the single biggest underwriter of nursing-home care, but, to qualify, you must have no meaningful assets or income. And the very wealthy can simply pay for care themselves if they need it, since $100,000 a year for a nursing home won't dent their finances. It's the

middle and upper-middle-class who would benefit most. That would include "families in the top third of the wealth distribution, but below the top 1%," Brown says. "For them, a truly catastrophic event, like 20 years of care for an Alzheimer's patient, could easily burn through their assets."

In simple terms, that means anyone with $500,000 to $5 million in assets should consider long-term care insurance. But in the end, the decision is guided less by statistics and more by who you are and who depends on your financial resources, says Kathleen L. Weber, executive director of the Weber Nagan Group at Morgan Stanley in Bellevue, Wash.

Weber often recommends long-term care insurance for her clients, but first she walks them through a questionnaire that covers emotional as well as financial concerns. Some issues to consider: How much do you worry about relying on family? Does your spouse depend on your joint resources to live; what if she survives you and needs care later? Do you want to leave money behind for your heirs? Do family members who could help live nearby or far away? If far away, would you be willing to move? Are you married? Is it a first marriage or a second marriage, with multiple bequests to consider? Long-term care insurance can help ease a family through what for many is an end-of-life transition.

LONG-TERM CARE isn't about medicine; it's about life. To qualify, an individual must be unable to perform two of six basic activities of daily living -- eating, bathing, dressing, transferring to or from a bed or chair, toileting, and continence -- or suffer severe cognitive impairment that requires substantial supervision. The cost of covering those needs varies greatly. Early policies were written to cover only nursing-home expenses, but newer versions have expanded to include the more innovative kinds of care: adult day care, home health aides, assisted living. A few will even pay a small cash stipend toward "informal care" at home by a family member, far and away the most common and least expensive kind. It is also the most comfortable and reassuring for the patient, and the choice that most people would make -- to stay in their own homes.

Regional differences are considerable, both among states and within a state. The national median for a private room in a nursing home is $91,250 a year, according to Genworth's 2015 Cost of Care Survey. The same room would cost $175,000 in San Francisco but $91,300 in Merced, Calif., just 130 miles inland. In Dallas, the cost is $78,500; 90 miles down I-20 in Tyler, Texas, it's $64,800. The median cost of home health aides in California is $52,624; in Texas, $42,603.

HOW MUCH IT WILL COST to insure the risk depends on your age, your health, the level of benefits you choose, and your gender. The older you are when you initiate the policy, the more you will pay in premiums -- by a lot. A policy purchased at 65 can be well over 50% more than an identical product bought at 55. Women pay more because they live longer and use more benefits. And underwriting rules have tightened over the past decade, as the industry has struggled to stay ahead of rising claims. If your health is questionable, which is much more likely at 65 than 55, you may not qualify for insurance at all; 25% of applicants between 60 and 69 are denied coverage. In fact, most companies won't offer coverage past age 75. "The sweet spot is the late 50s," Conklin says. "The price is still very affordable, and people are starting to think seriously about retirement."

If you're in that sweet spot, shop around. Companies offer policies with various combinations of benefits at different prices, and they differ enough to make careful comparisons worthwhile. For example, annual premiums on similar policies for a single, 60-year-old woman in New York State range from $2,900 at Mutual of Omaha to $6,500 at John Hancock. No two policies are exactly alike, even when offered by the same company. Most policies offer four elements that can be tweaked in ways that affect the premiums

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Maximum monetary benefit. Usually stated as a day rate, the maximum benefit typically ranges from $100 to $500; $300 is most common. The policyholder would have access to funds up to that amount daily. In many new policies, when benefits start, premiums stop. Should you leave long-term care, which is more common than previously believed, benefits will terminate and premiums will resume. Older policies may have some variation on this theme. Premiums in Betty Wright's policy, for example, are only suspended for residential care, not for at-home services. Most policies allow the policyholder to exit and re-enter long-term care until the benefits are exhausted. Be sure to verify this.

Maximum life of a policy. The range of time a policy will cover is typically one to five years. "Lifetime" policies are no longer available. While the limits are stated in years, they are actually dollar amounts. "You're buying a pool of benefits," says Brown. A policy with a three-year cap that pays $200 a day in benefits will have a value of $219,000 (or three years x $200 x 365 days), starting on day one. If your expenditures don't hit your maximum daily rate, you can tack the leftover amount onto the end of your policy's life, extending it beyond the three years.

Elimination period. The elimination period serves as the deductible in long-term care insurance and is measured in days, rather than dollars. You can choose anywhere from zero to 365 days as the period in which you must be in care before the policy kicks in.

The most popular elimination period, 90 days, can be counted in two ways. If the tally is in "calendar days," every day after you qualify for coverage applies, so you would satisfy the elimination period in about 13

weeks. “Service days” count only those days in which you actually have care. If you have a home health-care aide three times a week, only those three days count toward the 90, pushing the elimination period to 30 weeks. Most people need care for only short periods, on average. So, 30 weeks would push many more patients beyond eligibility for benefits.

Inflation adjustments. The amount of your ultimate benefit can be adjusted according to the consumer-price index or at rates ranging from 0% to 5%; 3% is the most common. While it may not seem like much in today’s low-inflation economy, in the 25 or 30 years between buying your policy and tapping the benefits, inflation can make a huge difference. A policy with a $150 daily rate, a three-year benefit period, and no inflation protection creates a pool of $164,000. At an adjustment rate of 3%, compounded annually, the pool jumps to $325,000 by age 80 if it was purchased at age 60, according to the American Association for Long-Term Care Insurance. But inflation protection is an optional benefit that can add as much as 50% to the policy’s premium.

Within this menu are many variations. Pay a bigger premium and you can waive the elimination period for in-home care, for example, or skip the inflation adjuster in the beginning, but add it to your policy later, or restore the entire pool of benefits if you enter and leave long-term care. Among the most popular variations is the shared policy for couples. A three-year policy will get you six years of coverage, three for each spouse. But it doesn’t have to be divvied up equally. If one spouse needs four years, the other gets the remaining two. The premiums are about 15% more than a single policy but cheaper than two stand-alone policies. It is good for the industry because most long-term care is provided at home by a family member.

“When two healthy spouses apply together, the insurance company knows they’re not going to tap insurance benefits until they’ve done what they can for each other,” Morgan Stanley’s Weber says. And it’s good for the couple because the surviving spouse, who is left without a caretaker and is more likely to wind up needing residential care, will have adequate resources to get it.

WITH SO MANY COMPANIES exiting the business and with premiums skyrocketing, it’s not surprising that sales of long-term care insurance have declined. To right itself, Weber says, the industry must innovate. Among the most interesting and popular changes are policies that combine long-term care with life insurance or annuities.

“These policies have a cash value that can be used for long-term care expenses,” Weber says. “And they offer a lot of flexibility in benefit levels and premium payments.” One example is a straight universal life insurance contract with a long-term care rider. Premiums can be paid monthly, annually, or an upfront lump sum, and you can choose how much of a death benefit you want. The acceleration rider allows long-term care benefits to be paid out at a monthly rate of 2% of the death benefit until it is exhausted. A $500,000 policy would generate $10,000 a month. Most traditional long-term care policies have a benefit cap lower than that; Genworth’s is $9,000. Any amount you haven’t used would go to your beneficiaries. The riders on annuities are similar; you can tap cash values tax-free for long-term care.

Another choice that has been growing in popularity, especially among the wealthy, is the single-premium hybrid policy with a multiplier for long-term care benefits. Put $100,000 into one of these with a death benefit of perhaps $150,000. Should you need long-term care services, you can draw from the policy up to a multiple of the death benefit. If the multiplier is three, for example, the total pool of long-term care benefits would be $450,000. You can withdraw the benefits in equal monthly installments at a pace that will exhaust the death benefit in 24 months -- in this example, $6,250.

After that, the policy will continue to pay at the same pace for at least the next four years or until the remaining $300,000 is gone. So the $100,000 you put in, which would have covered a little over a year at the median rate for a nursing home, could cover up to six years -- maybe more if you don’t withdraw at the maximum rate. After you’ve owned the contract for three years, you can cancel it at any time and get your initial $100,000 back. If long-term care doesn’t exhaust the $150,000 death benefit, the balance is paid to your heirs. Again, not all policies offer the same benefits, so read the small print.

The benefits from both policies are tax- free, but the premiums paid for long-term care policies are also eligible for a tax deduction.

In addition, with traditional long-term care insurance, the only limit to the number of times you can go in and out of care is the size of your benefit pool. Most, but not all, combination products require that your infirmities be permanent.

The long-term care industry is evolving, driven by an aging population with strong ideas about independence. “Baby boomers are demanding many more choices,” Weber says. Adult day care and assisted living haven’t been around that long. In the aftermath of the insurance industry’s missteps, the products that will be available to pay for all those services are still taking shape. “I have to wonder what innovation we’re going to be seeing in the future,” Weber says.

One thing is for sure, Betty Wright’s good deal has become a lot more expensive. Her most recent communication from Genworth was a notice that her annual premium was to double.

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