Consumers and Long-Term Care Insurance[*]

Chapter Outline

Like many types of insurance, long-term care insurance is a consumer product. Consumers include the public at large, those who decline coverage (referred to later as nonbuyers), and those who purchase or are in the process of purchasing long-term care insurance. Just as with homeowners insurance, automobile insurance, and other health insurance products, consumers must perceive long-term care insurance as offering needed financial protection. In addition, the product must be affordable and understandable so that

[*] Reprinted from *Meeting the Financial Need for Long-Term Care*, 2nd edition (The American College, 2006), by Burton T. Beam, Jr., and Thomas P. O'Hare.

consumers can make intelligent choices among policies and policy options and be satisfied with their purchase.

Making long-term care insurance appealing to consumers is especially important because of the product's market challenge. Persons who are more able to pay the premiums and obtain coverage because they are working and younger perceive less need to protect themselves from the consequences of a financial risk they often believe is distant. Persons who feel a greater need for the insurance are frequently less able to pay premiums and obtain coverage because they are often retired, older, and more likely to have chronic medical conditions.

In the final analysis, success requires that, over time, long-term care insurance play a meaningful role in meeting the financial need of long-term care for many (if not most) Americans, especially those who are elderly. In the meantime, progress toward that goal can be measured by the growth in the number of policies issued and increases in covered services and benefit levels. On one hand, consumers need the availability of an easily understood process to select policies and policy features. On the other hand, consumers must be able to tailor the product to their specific needs, resources, and preferences. Unfortunately, these two objectives are often in conflict.

This chapter discusses consumers and long-term care insurance as they relate to consumer attitudes toward long-term care insurance, the purchasers and purchase patterns of available policies, and the decision-making process in the selection of coverage, benefits, and other policy features.

CONSUMER ATTITUDES

Long-term care insurance is a relatively new product developed to meet a real and growing risk that is gradually surfacing in the public's consciousness. Consumer attitudes toward long-term care insurance grow out of their perceptions of the potential need for long-term care and the means to pay for it as much as from their perceptions of the long-term care insurance products themselves. Surveys show that many consumers are significantly uninformed.

Considerable consumer education is required to increase public awareness of the likely need for long-term care, correct broadly held misconceptions on how to pay for it, and provide an understanding of the value of long-term care insurance. This education, essential to informed decision making, is ongoing; progress has been made in many areas. Indeed, as the following discussion points out, consumers are much more informed today than previously.

Perceptions of the Need for Long-Term Care

Unless individuals believe they are likely to need long-term care sometime in their lives and to be personally responsible for the high cost associated with it, they will not seek an insurance plan to protect themselves. Many Americans are not looking for a solution to a problem they do not perceive. Most people give the need for long-term care very little or no thought, and only 12 percent claim to give it a great deal of thought. Interestingly, over two-thirds are unconcerned or only somewhat concerned about affording long-term care in the future.[1] However, there are signs of growing awareness.

A recent survey reports an increased perception of the need for long-term care among nonbuyers, defined as those who chose not to buy long-term care insurance after a solicitation and presentation of policy details. From 1990 to 2000, the percentage of such nonbuyers who believed they had a greater than 50 percent chance of needing nursing home care in their lifetimes more than doubled, increasing from 27 percent to 55 percent. Comparable statistics for home health care went from 31 percent to 56 percent.[2]

(Note that many statistics in this chapter are based on surveys that use 2000 data. Many of these surveys are conducted at 5-year intervals, and new surveys with 2005 data should be available in 2006.)

Perceptions of Available Means of Payment

Consumers also have significant misconceptions about the financial aspects of long-term care, including its cost, sources of payment, and available insurance coverage.

Cost of Care and Sources of Payment

Americans, including many who profess at least some familiarity with long-term care services, often do not know what long-term care services cost. For example, a majority significantly underestimates the cost of nursing home care.[3] Not surprisingly, consumers also have a limited understanding of how long-term care costs are paid.

Most people believe Medicare covers nursing home stays for 3 months or more for age-related or other chronic conditions. In fact, Medicare does not cover extended nursing home stays for such conditions. Four in 10 erroneously believe Medicare covers assisted living.[4] In addition, nonbuyers of long-term care insurance are more than twice as likely as buyers to agree with the statement that . . ."the government will pay for the cost of long-term care if services are ever needed."[5]

However, some misconceptions are giving way to reality. The percentage of nonbuyers who cite their belief that Medicare and Medicaid will pay for long-term care services as an important or very important reason for not buying coverage has declined from almost 60 percent to less than 25 percent over the 10-year period from 1990 to 2000. Indeed, 85 percent of nonbuyers and more than three-quarters of other surveyed individuals who generally have less experience with long-term care policies agree with the following statement: "Whatever health reforms come about in the next few years, it is more likely that individuals will have to rely on themselves to plan and pay for long-term care."[6]

Perceived Insurance Coverage

Many Americans believe they have long-term care coverage, when in reality they do not. Surveys indicate that from 25 to 30 percent of Americans claim to have some type of long-term care coverage. On closer examination, only one-quarter of this group actually has coverage through a specific long-term care insurance policy or the availability of an accelerated death benefit. More than half (54 percent) of those claiming to have coverage mistakenly believe that their medical insurance pays for long-term care. Among the remainder of this group, there are erroneous assumptions about coverage under disability income insurance and Medicare supplement insurance, as well as Medicare and Medicaid.[7]

Because so many people mistakenly believe they are already covered for long-term care or simply do not know how long-term care services will be paid, one study concludes that this may explain, in large part, why the market for long-term care insurance has not grown more quickly than it has.[8]

Perceptions of Long-Term Care Insurance Policies

Industry reports document that there is a growing awareness of long-term care insurance policies. In 1995, approximately 40 percent of those surveyed from the general population were aware of insurers that offered long-term care policies. By 2000, that recognition level was over 60 percent. Significantly, in 2000, almost half of this group had been approached to buy long-term care insurance or had considered buying it, nearly twice as many as in 1995.[9]

Although awareness and even interest in long-term care and long-term care insurance is increasing, in most cases it is insufficient to motivate consumers to purchase the product. The reluctance to purchase long-term care insurance, even among those who are aware of it, has many reasons. Undoubtedly, many of these reasons are based on a lack of understanding about long-term care and the sources to pay for it. There are also other reasons that can generally be grouped as psychological/emotional considerations and practical considerations.

Psychological/Emotional Considerations

More than one industry report points out that many Americans are simply ignoring the long-term care issue, even when they are realistic about the likelihood of needing long-term care and being affected by its financial ramifications.[10] Researchers attempt explanations. Some believe that reluctance to purchase coverage continues to be a matter of awareness and that long-term care insurance is simply an undiscovered necessity for some people. Other researchers believe that many older adults are in denial. Indeed, some study participants expressly admit they are ignoring the issue.[11] Just the consideration of their dependency and the loss of dignity associated with long-term care may repel those who are healthy and physically active from thinking realistically about the protection being offered. More important, they do not see that coverage for these services makes any real difference to them in the quality of care they can expect to receive.

Another group of researchers observe that, in spite of more recent restrictions, Medicaid's rules remain generous and flexible, and typical middle-class elderly persons who need long-term nursing home care can qualify for public benefits even without elaborate Medicaid planning. Because Medicaid provides a safety net, it is argued that many individuals can effectively ignore the financial risk of long-term care. Thus, these researchers conclude that trying to overcome consumer reluctance to purchase long-term care insurance by emphasizing asset protection is misplaced. In the current Medicaid environment, only an emphasis on access to quality care that long-term care insurance provides can be effective.[12]

Practical Considerations

There are important practical considerations that make people reluctant to purchase long-term care insurance. Although cost is the biggest obstacle, there are other challenges, such as those related to confusion and credibility.

Cost. Cost in terms of premiums appears to be the greatest practical obstacle to the purchase of long-term care insurance. In many cases, consumers unfamiliar with actual long-term care insurance premiums overestimate the premiums by as much as five to 10 times because they assume the cost of care is the cost of coverage. Consumers in this category become more interested in coverage when informed of actual premiums.[13]

In addition, over 80 percent of nonbuyers, who by definition are presented with detailed policy information, consistently report that cost remains the most significant barrier to purchase. Less than 20 percent of nonbuyers would pay the premium for policies selling to their age group. Thus, typical nonbuyers are assumed to believe that the policy value is less than its cost, or they are not convinced of or do not understand the value of the policy relative to its cost.[14]

Confusion. Industry reports consistently identify what can only be labeled as confusion about evaluating policies and the many options and features that accompany them. In addition to the complexity of long-term care insurance, financial planning experts' mixed messages about its value and the timing of its purchase have heightened consumer confusion. There is reason to be optimistic, however, because this situation, while by no means satisfactory, is improving significantly. In 1990, 87 percent of nonbuyers indicated an important or very important reason in their decision not to buy long-term care insurance was confusion that prevented them from determining which policy was appropriate. By 2000, this figure had dropped by almost half to 46 percent.[15]

Credibility. The lack of trust consumers have in the integrity of insurers and their representatives relates to the issue of confusion. Here, too, there is reason to be optimistic because confidence is growing in the integrity of insurance companies that provide long-term care insurance. In 1990, over 70 percent of nonbuyers did not believe that companies would pay benefits as stated in the policy; in 2000, this figure had dropped to 44 percent.[16]

PURCHASERS AND PURCHASE PATTERNS OF AVAILABLE POLICIES

Over 6.2 million Americans currently have long-term care coverage.[17] Approximately 68 percent or 4.2 million persons obtain this coverage through individual policies of long-term care insurance. The balance are covered under group plans, which an employer or association group may sponsor.[18] Nearly 30 percent, a percentage that is growing, have employer-sponsored long-term care insurance plans, with around 2 percent covered under association group plans.[19] The characteristics of purchasers and their purchase patterns, reflected in the policy design features buyers select, reveal important insights into the consumer/purchaser attitudes toward long-term care insurance.

Purchasers

People with long-term care insurance coverage share many characteristics. They are typically older, more affluent, and more highly educated than the general population. They are also somewhat more likely to be married, and in the vast majority of cases, each spouse has coverage. About 56 percent of the population with long-term care insurance are women.[20]

In contrast to the general population (discussed earlier), people with long-term care coverage are significantly more realistic with respect to the need for long-term care and their personal responsibility to pay for it. Virtually all insureds agree that it is important to plan now for the possibility of needing long-term care services sometime in the future. As might be expected, they do not look to the government and other types of health insurance as major payment sources for long-term care services. Buyers generally have the same objectives in deciding to acquire long-term care coverage. Protecting assets, leaving an estate, preserving financial independence, and guaranteeing the affordability of needed services are their most important reasons for obtaining coverage.[21] Easing the long-term care burden on one's family and choice of long-term care providers are also important considerations.

Purchase Patterns of Individual Policies

Studies show that the purchase patterns of buyers of individual long-term care insurance policies vary by income and age. Changes in purchase patterns have occurred over time and are likely to continue. Employer-sponsored plans exhibit their own purchase patterns.

Table 8-1 presents the policy design choices and premiums paid by individual long-term care insurance buyers by income levels.

Not surprisingly, as income increases, individuals are more likely to buy policies at higher premium levels with greater coverage, benefit levels, and additional features. Elimination periods are an exception to this rule because they are longer for those at higher income levels, presumably because these insureds can more easily afford to pay for the initial periods of long-term care out-of-pocket. Table 8-2 profiles by age the same policy choices and premium levels in table 8-1.

Older buyers tend to purchase less coverage, lower benefits, and fewer optional features. Age and income factors are interrelated, and both are often present in many decisions. For example, older individuals pay a much higher premium than their younger counterparts, usually at a time in their lives when they are retired and their incomes are lower. Thus, those who lack home care coverage tend to be older insureds.[22] Older buyers also tend to select shorter benefit durations and/or lower daily benefit amounts and are less likely to buy the automatic inflation-protection feature. This may be a rational choice for these buyers, who expect to access benefits sooner than younger insureds and anticipate that inflation will be less of a problem.

Table 8-3 shows how purchase patterns change over time.

Overall, coverage, benefits, and the purchase of optional features have increased during the period shown in table 8-3—in some cases significantly. Despite this growth, premiums reflect a surprisingly small increase, averaging only 11 percent over the period from 1995 to 2000.[23] More recently, however, premiums are increasing more rapidly. In 2004, new insureds paid on average an annual individual policy premium of $1,924, a 6 percent increase over 2003. During the same period, all individual insureds paid $1,612, a 3 percent increase over the previous year.[24]

TABLE 8-1
Key Policy Design Parameters Chosen by Individual Long-Term Care Insurance Buyers, by Level of Income

Policy Features	Level of Income			
	Less than $20,000	$20,000–$34,999	$35,000–$49,999	$50,000 and Over
Benefit Duration				
Average	3.7 years	4.6 years	4.8 years	6.2 years
1–2 years	37%	22%	21%	9%
3–4 years	42	45	42	33
5–6 years	12	11	14	18
Lifetime	10	21	24	40
Nursing Home Benefit Amount				
Average	$95	$96	$98	$117
Up to $40	5%	4%	2%	2%
$41–$50	3	7	8	2
$51–$70	8	11	11	8
$71–$90	19	10	11	10
$91 and Over	66	67	68	80
Home Care Benefit Amount				
Average	$95	$92	$98	$113
Up to $40	5%	2%	1%	2%
$41–$50	7	11	10	6
$51–$70	10	13	7	6
$71–$90	15	14	13	13
$91 and Over	64	60	68	73
Percentage with Inflation Protection	31%	31%	37%	53%
Average Elimination Period	60 days	61 days	72 days	70 days
Percentage with Home Care	86%	80%	79%	95%
Average Annual Premium	$1,656	$1,675	$1,619	$1,860
Monthly Premiums				
Up to $50	6%	7%	10%	3%
$51–$75	22	18	15	14
$76–$100	7	15	18	15
$101–$125	24	13	14	16
$126–$150	12	12	8	12
$151 and Over	29	35	35	40

Source: Health Insurance Association of America.[25]

TABLE 8-2
Key Policy Design Parameters Chosen by Individual Long-Term Care Insurance Buyers, by Age

Policy Features	Age Category			
	55–64	65–69	70–74	75 and Over
Benefit Duration				
Average	6.4 years	5.3 years	4.8 years	3.7 years
1–2 years	11%	18%	20%	31%
3–4 years	29	37	44	51
5–6 years	15	16	14	8
Lifetime	45	29	22	10
Nursing Home Benefit Amount				
Average	$117	$108	$104	$95
Up to $40	1%	1%	2%	6%
$41–$50	2	7	9	8
$51–$70	7	11	9	11
$71–$90	8	9	14	14
$91 and Over	82	72	66	61
Home Care Benefit Amount				
Average	$113	$105	$97	$95
Up to $40	1%	2%	4%	3%
$41–$50	5	6	9	8
$51–$70	8	7	11	11
$71–$90	12	12	15	15
$91 and Over	74	73	61	63
Percentage Choosing Inflation Protection	59%	46%	32%	14%
Average Elimination Period	62 days	69 days	72 days	66 days
Percentage with Home Care	92%	85%	85%	77%
Average Annual Premium	$1,213	$1,487	$1,829	$2,581
Monthly Premiums				
Up to $50	8%	7%	4%	2%
$51–$75	28	16	10	4
$76–$100	20	19	14	5
$101–$125	19	16	12	13
$126–$150	9	14	10	10
$151 and Over	17	28	50	66

Source: Health Insurance Association of America.[26]

TABLE 8-3
Individual Long-Term Care Insurance Policy Designs Selling in 2000, 1995, and 1990

Attributes of Policies	Percentage of 2000 Sales	Percentage of 1995 Sales	Percentage of 1990 Sales
Types of Policies Sold			
Nursing Home Only	14%	33%	63%
Comprehensive Policies	77	61	37
Home Care Only	9	6	—
Nursing Home Duration			
1–2 years	17%	24%	23%
3 years	23	20	12
4 years	14	18	15
5 years	11	6	12
6 years	5	2	5
Lifetime Benefits	30	30	33
Average Duration	5.5 years	5.1 years	5.6 years
Nursing Home Daily Benefit			
Up to $30	1%	1%	2%
$31–$59	5	12	25
$60–$89	17	40	51
$90–$119	43	38	18
$120 and Over	34	9	4
Average Daily Benefit	$109	$85	$72
Home Health Care Duration			
1 year	5%	20%	N/A
2 years	14	31	
3 years	22	21	
4 years	13	5	
5 years	10	10	
6 years	7	1	
Lifetime Benefits	30	12	
Average Duration	5.4 years	3.4 years	
Attributes of Policies	Percentage of 2000 Sales	Percentage of 1995 Sales	Percentage of 1990 Sales
Home Health Care Daily Benefit			
Up to $30	1%	3%	25%
$31–$59	8	26	60
$60–$89	17	33	13
$90–$119	41	31	2
$120 and Over	33	8	—
Average Daily Benefit	$106	$78	$36

Table 8-3 continues on next page.

Elimination Period			
0 days	23%	28%	25%
15–20 days	3	17	41
30–60 days	16	16	12
90–100 days	55	39	22
More than 100 days	3	—	—
Percentage Choosing Inflation Protection	41%	33%	40%
Simple	17	14	N/A
Compound	22	15	
Indexed to Consumer Price Index	2	4	
Total Annual Premium			
Up to $500	5%	10%	19%
$500–$999	24	29	40
$1,000–$1,499	26	23	21
$1,500–$1,999	18	15	11
$2,000–$2,499	9	9	5
Greater than $2,500	18	14	4
Average Annual Premium	$1,677	$1,505	$1,071
Source: Health Insurance Association of America.[27]			

Variations for Employer-Sponsored Coverage

Purchasers who obtain coverage through employer-sponsored plans often choose policy characteristics that differ from those of individual buyers, largely because, on average, these purchasers are younger (in their 40s versus their 60s). Table 8-4 shows these differences. On average, new insureds with an employer-sponsored plan paid an annual premium of $522. The low and declining average annual premium for group coverage is undoubtedly due to the increasingly younger population of insureds under employer-sponsored plans.[28]

The younger ages of buyers of employer-sponsored coverage, combined with generally higher income levels, enable these buyers to purchase more comprehensive coverage, higher benefits, and more other features than individual buyers at less than half the individual premium.

CONSUMER DECISIONS

Consumers are faced with many decisions when purchasing long-term care insurance. Helping them make these decisions intelligently requires that insurance agents and other financial advisers have the knowledge to guide

TABLE 8-4 Policy Design Characteristics in the Long-Term Care Group and Individual Markets		
Policy Characteristics	Group Market	Individual Market
Policy Type		
Nursing Home Only	3%	14%
Comprehensive (Nursing Home and Home Care)	97	77
Home Care Only	—	9
Average Daily Benefit Amount		
Nursing Home	$124	$109
Home Care	$ 79	$106
Average Elimination Period (NH & HC)	63 days	65 days
0 days	5%	23%
30 days	36	12
60 days	3	6
90 days	56	59
Average Benefit Duration	6.3 years*	5.5 years
Nursing Home Duration		
1–2 years	10%	17%
3–5 years	51	48
6–9 years	—	5
10 years to lifetime	39	30
Home Care Benefit Duration		
1–2 years	6%	19%
3–5 years	21	44
6–9 years	21	7
10 years to lifetime	52	30

Table 8-4 continues on next page.

consumers through the maze of questions that must be answered. These questions include the following:

- Is coverage appropriate?
- When should coverage be purchased?
- Is it better to purchase a tax-qualified policy or a non-tax-qualified policy?
- Is it better to purchase a per diem policy or a reimbursement policy?
- What types of coverage should be purchased?
- What is the appropriate amount of coverage?
- What is the best way to plan for future inflation?
- Is a nonforfeiture option needed?
- How should policies be compared?

Percentage with Inflation Protection** Simple Compound CPI Indexed Future Increase Options	88% — 40 — 48	41% 17 22 2 —
Percentage with Nonforfeiture** Return of Premium Shortened Benefit Other None	29% 2 26 1 71	Less than1%
Average Annual Premium	$722	$1,677

Source: Health Insurance Association of America.[29]

*Average benefit durations are calculated based on the total benefit cap and the chosen daily benefit amount. Because home care benefits were typically chosen as a percentage of nursing home benefits, the amount of time needed to exhaust the total benefit pool when using home care benefits is typically greater. For home care benefits, we calculate the average benefit duration to be 7.6 years.

Note: For the purposes of determining average policy duration, lifetime policy durations were set to 10 years. Elimination periods for the individual market were adjusted to fit the closed categories for the group market. Therefore, for the individual market, 0 days is equal to 0 days, 30 days is equal to 1–30 days, 60 days is equal to 31–60 days, and 90 days is equal to 61–100 days. The average elimination period reported for the individual market is only for nursing home benefits; however, the percentages represent both nursing home and home care benefits.

**It is important to note that this represents the percentage of enrollees with these particular policy design features. It is not possible to make a statement about whether the employee chose these options or if they were automatically included in the basic plan design chosen by the employer.

Note: All but one of the participating employers offered long-term care plans on a voluntary basis. Thus, employees were responsible for paying the entire premium if they chose to enroll. Only employees who chose to “buy up” from the employer-funded base plan were used for comparability.

- What are the considerations for switching policies?
- How should premiums be paid?
- How can insurers be evaluated?

Long-term care insurance is relatively expensive, and for many consumers the amount of premium they will pay is an important factor. As the following discussion addresses each of the above questions, it takes cost considerations into account when appropriate. The closing sections of this chapter summarize and expand upon these cost considerations.

In the final analysis, however, many of these questions do not have precise answers. The way in which they will be answered lies with the consumer’s personal preferences.

Appropriateness of Coverage

The first major decision in purchasing long-term care insurance is to determine whether such coverage is appropriate to meet an individual's needs. From the standpoint of the insurer, the agent, and financial adviser, this process is often referred to as *suitability.*

suitability

The NAIC Long-Term Care Insurance Model Regulation addresses the issue of suitability. The regulation requires any insurer marketing long-term care insurance to develop and use suitability standards and to train its agents to use the standards. These standards must take the following into account:

- the applicant's ability to pay for the proposed coverage and other financial information appropriate to its purchase
- the applicant's goals or needs with respect to long-term care insurance and the advantages and disadvantages of insurance to meet these goals and needs
- the values, benefits, and costs of any of the applicant's existing insurance compared to the values, benefits, and costs of the recommended purchase or replacement

The insurer or agent, if one is involved, must make a reasonable effort to obtain the preceding information. This includes the presentation to the applicant of a long-term care insurance *personal worksheet.* The information on the worksheet and the questions asked vary among insurers, based on their practices and state insurance regulations. Insurers in some states are allowed to use a brief worksheet that the applicant signs to acknowledge that he or she has considered the following information:

personal worksheet

- the current and future obligations for keeping the policy in force
- the current costs of nursing home care, home health care, and community-based services in the area where the applicant lives
- the average use of services covered by the policy. For example, these include the average length of stay in a nursing home and the average number of home health care visits in a week.

Other states require the use of a much more comprehensive worksheet that is in line with what the model regulation recommends. Such worksheets contain information about the premium for the coverage being considered, the insurer's right to increase premiums, and the insurer's history of rate increases. Worksheets also ask the applicant to answer the following questions:

- How will you pay each year's premium—from income, from savings and investments, or with family help?

- Have you considered whether you can afford to keep the policy if the premium goes up by 20 percent?
- What is your annual income?
- How do you expect your income to change over the next 10 years—increase, decrease, or not change?
- Will you buy inflation protection? If not, have you considered how you will pay the difference between future costs and your daily benefit amount?
- What elimination period are you considering, and how do you plan to pay for your care during this period?
- Other than your home, what is the approximate value of your assets?
- How do you expect your assets to change over the next 10 years?

The applicant must sign a statement that the insurer or agent has reviewed the worksheet with him or her. In addition, the applicant must indicate that the answers to the questions describe the applicant's financial situation or that he or she chooses not to provide the information.

The insurer then compares the applicant's financial information with its suitability standards. For example, the insurer may have adopted standards that premiums should not exceed more than 7 percent of an applicant's income and that the applicant should have an annual income of at least $35,000 and assets (excluding a home and automobile) of at least $75,000. In addition, the applicant should be able to absorb an increase in future premiums of up to 30 percent.

If an applicant does not meet an insurer's suitability standards or does not choose to provide financial information, the insurer may decline the application or send the applicant a letter stating that the insurer has suspended the final review of the application. If the applicant believes the policy is what he or she wants, however, the applicant, within the next 60 days, can check the appropriate box on the letter and return it to the insurer. The insurer will then continue to review the application and issue a policy if the applicant meets its underwriting standards.

Although many persons who fail to meet the insurer's suitability standards could rely on Medicaid, there are still reasons to purchase long-term care insurance, including the following:

- the protection of assets and income, even though modest
- independence from the financial support of others
- the ability to choose where and how long-term care services are received
- the ability to avoid reliance on public assistance (Medicaid)
- peace of mind from knowing that long-term care needs are met

It is important to point out that many individuals who are unable to afford long-term care insurance may have family members who are willing to pay part or all of the cost. After all, it is these same family members who may otherwise be called upon to provide long-term care services if and when these services are needed.

Suitability standards focus on determining minimum standards for the appropriateness of long-term care insurance. There are individuals, however, for whom coverage might not be appropriate—for example, individuals who have purchased alternative types of coverage, such as residence in a continuing care retirement community. There are other individuals whose wealth makes it possible to self-fund their long-term care expenses. Nevertheless, as mentioned in chapter 4, these individuals may still have valid reasons for purchasing long-term care insurance. Finally, there are the very elderly for whom a short life expectancy and the very high cost of coverage make the purchase of long-term insurance financially questionable, assuming they are even eligible for coverage.

Time to Purchase Coverage

It can be argued that an individual is never too young to buy a long-term care insurance policy. Even a young person can need long-term care services as the result of an accident or illness. In addition, the younger an applicant is, the less likely it is that the applicant will fail to meet the insurer's underwriting standards.

Most purchasers of individual long-term care policies postpone buying coverage until they begin to near, or are past, retirement age. In some ways, this is understandable. At earlier ages, these persons still have the expenses of supporting a family and are more concerned with purchasing life insurance and disability income insurance to replace lost income should they die or become disabled.

Postponing the purchase of long-term care insurance, in addition to increasing an individual's likelihood of being uninsurable, also confronts him or her with increasing premium costs. For example, one insurer sells a tax-qualified, facility-only policy that has a $100 daily benefit, a 5-year benefit period, a 90-day elimination period, and a 5 percent compound inflation rider. The annual premium is $510 at age 50, $690 at age 55, $980 at age 60, $1,330 at age 65, and $2,000 at age 70. Moreover, as the following example shows, the situation is actually much more dramatic when the benefit amount needs to be adjusted for inflation.

Example: Betsy, aged 50, purchased a tax-qualified comprehensive long-term care insurance policy that has an unlimited elimination period and a 5 percent compound inflation rider. Her annual premium is $1,100.

Betsy's friend Rosemary, also aged 50, decides to wait until she turns 60 to purchase her policy even though she knows that the insurer's annual premium for an identical policy with a $100 daily benefit will be $1,900 for an insured aged 60. However, what Rosemary fails to realize is that in 10 years, Betsy's daily benefit will have increased to $163 because of the inflation rider. Therefore, a policy identical to Betsy's at that time will require Rosemary to pay a premium of $3,097 for a daily benefit of $163 at the rates for a 60-year-old. In addition, during that 10-year period, it is also possible that the insurer will make matters even worse for Rosemary by raising its premium rates.

The lower premiums at younger ages also make it financially easier for many applicants to elect broader benefits, as shown in table 8-4, which compares characteristics in the group and individual marketplaces. Note that the average annual premium is markedly lower for the group coverage. This is primarily due to the significantly younger average age at which coverage is purchased under group plans. As the table shows, this leads to insureds having higher daily benefits, shorter elimination periods, and longer benefit durations. There is also an increased likelihood that both inflation protection and nonforfeiture benefits are purchased.

Tax-Qualified versus Non-Tax-Qualified Policies

Since the passage of HIPAA, there has been disagreement over whether consumers should purchase tax-qualified or non-tax-qualified policies. However, most insurers now offer only tax-qualified policies, and these policies account for about 96 percent of long-term care insurance policies sold.[30] The two types of policies differ with respect to tax treatment and benefit triggers.

Tax Treatment

The primary reason for the predominance of tax-qualified policies seems to be their more favorable income tax treatment. As pointed out in chapter 5, a policyowner who itemizes deductions may be able to deduct a portion of the premium cost if medical expenses exceed 7.5 percent of his or her adjusted gross income. In addition, benefits are received tax free, with the possible exceptions of benefits from per diem contracts that exceed $240 per year (in 2005).

Premiums for non-tax-qualified polices are not deductible. Furthermore, there is uncertainty over the tax status of benefits received from non-tax-qualified policies. There is no specific provision in the Internal Revenue Code that allows for tax-free receipt of benefits. There are arguments that such a provision is unnecessary because the policies qualify as accident and sickness insurance, but not all tax experts agree with this position. To make matters worse, the IRS has so far not issued a ruling on this matter, and IRS employees' stated opinions have been inconsistent. With this uncertainty, many consumers naturally shy away from non-tax-qualified policies. Many agents are also reluctant to sell these policies because of the potential legal liability of selling a policy whose benefits are subject to such ambiguity. However, some advocates of non-tax-qualified policies note that an agent might be just as liable for not letting a client know about the existence of such policies.

Benefit Triggers

HIPAA requires specific benefit triggers for tax-qualified policies. Most non-tax-qualified policies have somewhat less restrictive benefit triggers that make it easier to qualify for benefits. As a result, insurers that offer both types of policies tend to have premiums that are 5 to 10 percent higher for non-tax-qualified policies.

Although the two types of policies may differ with regard to the number and types of ADLs that an insured must be unable to perform, the majority of non-tax-qualified policies use the same criteria as in tax-qualified policies. The major differences are in the time period for which an insured must be expected to be unable to perform ADLs and the use of a medical necessity trigger.

90-Day ADL Period. As mentioned in chapter 5, a chronically ill person for purposes of a tax-qualified policy must be expected to be unable to perform at least two activities of daily living for at least 90 days. Non-tax-qualified policies do not have this 90-day requirement.

Example: Ian has a comprehensive long-term care insurance policy with a 20-day elimination period. He recently broke both his arms as a result of a freak accident. His physician certified that he would need help with several activities of daily living but only for the next 50 to 75 days.

If Ian has a tax-qualified policy, he will not be eligible for benefits because his disability is not expected to last for at least 90 days. However, if he has

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a non-tax-qualified policy, he can start receiving benefits after 20 days.

Although advocates of non-tax-qualified policies often emphasize this distinction, there are those who point out that it is of little or no significance to most insureds. First, as shown in table 8-3, the majority of insureds are subject to elimination periods of 90 days or longer. For them, claim payments will begin at the same time under either type of policy. Second, as explained in earlier chapters, coverage for certain long-term care services of short duration is provided under Medicare and private medical expense insurance. (However, the coverage might not pay for the type or duration of care needed.) Finally, many insureds have the resources to pay for long-term care services for relatively short periods of time.

Medical Necessity. Perhaps a more significant distinction is that many non-tax-qualified policies use medical necessity as a benefit trigger. Such a benefit trigger is not allowed in a tax-qualified policy. From a consumer standpoint, there are individuals, particularly the frail elderly, who do not meet the benefit triggers of tax-qualified policies but who still require long-term care services.

Per Diem versus Reimbursement Policies

A consumer must decide whether to purchase a policy that pays benefits on a per diem basis or a reimbursement basis. Note, however, that most policies pay benefits on a reimbursement basis, and many insurers do not offer per diem policies.

In general, a per diem (or indemnity) policy will be 10 to 15 percent more expensive, particularly if the daily benefit is high and there is the possibility of its exceeding the actual costs that would be paid under a reimbursement policy. One advantage of a per diem policy is that if the insured receives a benefit in excess of the cost of long-term care services, he or she can use this additional money to pay extra costs associated with such services. These costs might include payments to informal caregivers, payments for prescription drugs, or family support because of lost wages. The latter, however, is better provided under some type of disability income insurance. The insured could also save the money to pay for future long-term care services that might exceed the daily benefit.

Another advantage of a per diem policy is that the claims process tends to be somewhat simpler and faster. With a reimbursement policy, the insured must submit actual invoices to the insurer in addition to verification that he or she qualifies for benefits. With a per diem policy, it is only necessary to show that eligibility for benefits has been satisfied.

In addition to a per diem policy's higher premium, benefits are subject to federal income taxation if they exceed more than $240 per day (in 2005) and are used for anything other than the payment of qualified long-term care services.

Type of Coverage

Only a few years ago, most buyers of long-term care insurance policies purchased coverage only for care in facilities like nursing homes. As shown in table 8-3, there has been a significant change in recent years, with a large majority of buyers now selecting comprehensive policies. The public has become more aware of the need for long-term care services in the home environment and wants protection for this need even though it may increase the cost of a facility-only policy by 60 to 70 percent.

There are situations in which a facility-only policy may still be appropriate, however. It is a viable alternative if cost is a consideration, particularly if there are family members or others who will provide necessary services in the home. It may also be an appropriate choice if an insured has some resources that could be used to pay for home health care services before nursing home care becomes necessary.

There are also situations in which a stand-alone home health care policy may be a logical option. For example, an individual with limited resources may wish to remain at home for as long as possible. Once the person needs nursing home care, he or she may have no qualms about relying on Medicaid. Residents of continuing care retirement communities sometimes purchase stand-alone policies so they can obtain care in their independent-living units rather than having to move to the facility's assisted-living portion.

Amount of Coverage

The decision about the amount of long-term care coverage to purchase actually involves a series of decisions about the size of the daily benefit, the elimination period, and the benefit duration. Such factors as an applicant's age, income, assets, and tolerance toward financial risk also influence the decision. There are no precise answers. Each situation is unique, and the final amount of insurance selected in many cases is a balance between what the applicant feels is appropriate and what he or she can afford.

At one extreme, an individual could purchase a policy with a daily benefit equal to the cost of long-term care services (and appropriate increases for inflation), a 0-day elimination period, and lifetime benefits. However, such a policy would be unaffordable to many applicants and is also unnecessary. Virtually all applicants have some resources that can be used to finance at least a portion of their long-term care needs. As explained in chapter 4, these resources may also include accumulated assets and financial support from family members.

Daily Benefit

The first step in selecting the proper daily benefit is to find out the cost of care in the geographic region where care might be received. It should be noted that this might be a different region from where an applicant currently lives. For example, an applicant may feel that the city where a child lives might be a more appropriate location for long-term care if it is needed.

The average daily cost for nursing home care varies significantly from one geographic region to another. For example, one study of nursing home costs shows that in 2004 the average cost was $192 for a private room and $169 for a semiprivate room.[31] However, there are significant cost differences among regions, with the average daily cost of a private room averaging less than $107 in New Orleans to over $400 in Anchorage. Even within regions, the variations from the average cost are sometimes greater than 50 percent. Although an applicant might prefer to be in the most expensive nursing home in town, he or she might be able only to afford insurance that will pay for care in a less expensive facility. Although published averages are helpful, they are no substitute for relying on an agent who is familiar with local nursing home costs. It may also be helpful to actually visit nursing homes to determine if they are acceptable and to obtain their rates. Nursing home rates can also be obtained from the local area agencies on aging, which were established by the Older Americans Act.

Other statistics in the same study show that the hourly cost of home health care provided by a home health aide working for a licensed home care agency was $18. Again, there are significant variations from one region to another and within regions. Even with these figures in hand, an estimate must be made about the need and frequency of home health care services. For example, if around-the-clock care is needed, the cost of home health care can exceed the cost of nursing home care. Most insurers, agents, and financial planners recommend that the daily home health care benefit be equal to somewhere between 75 and 100 percent of the daily nursing home benefit. As shown in table 8-3, individual policies are near the 100 percent figure ($106 versus $109). Note, however, that reducing the percentage of home health care benefits to 80 percent of nursing home benefits will usually lower the premium about 10 percent. A decrease from 100 percent to 50 percent often results in a premium saving of 25 to 30 percent.

The next step to determine the appropriate daily benefit is to subtract the daily costs that the applicant has determined can be made from other resources.

It should be pointed out that the cost of long-term care insurance is essentially proportional to the daily benefit chosen. All other things being equal, a policy with a daily benefit of $200 per day will cost twice as much as a policy with a daily benefit of $100.

Elimination Period

As shown in table 8-4, applicants for both individual and group long-term care insurance policies have elimination periods that average just over 60 days. Averages are deceiving, however, because many applicants elect an elimination period of either 90 days or 30 days or less. If all other factors are equal, an increase in the elimination period from 20–30 days to 90–100 days will usually result in a premium saving of between 10 and 20 percent. It is necessary to balance this saving in premium against the potential cost that an insured must assume if he or she needs long-term care. For example, with a 90-day elimination period, the insured would have to pay $18,000 before benefits commence if nursing home costs are $200 per day. This figure may increase substantially by the time an insured needs long-term care several years in the future, whereas the insured’s available resources remain stable or decrease during retirement years. Although the premium saving for the longer elimination period is significant, so is the potential out-of-pocket cost.

Benefit Duration

As indicated in chapter 1, the average stay in a nursing home is 2.5 years. Although different statistics are often cited, it appears that somewhere between 10 and 20 percent of nursing home stays exceed 5 years. As table 8-4 indicates, many insureds have a benefit duration that exceeds 5 years, but an even larger percentage do not. If these persons have long-term care needs that exhaust their benefits, they will need to liquidate their assets, rely on financial support from relatives, and possibly apply for Medicaid.

Ideally, a policy would have an unlimited benefit period, but the realities of cost often dictate otherwise. Many long-term care experts feel that, at a minimum, a person should have a benefit period somewhere in the neighborhood of 4 to 6 years. However, even that might be unaffordable to some insureds. As a general rule, the cost to increase a benefit period from 2 to 4 years is approximately 50 percent. Going from a 2-year benefit to a lifetime benefit requires a premium increase in the range of 70 to 80 percent.

Inflation Protection

The amount of long-term care insurance coverage may be perfectly appropriate at the time a policy is purchased. The initial amount of coverage may be inadequate in the future, however, because of the effect of inflation on long-term care costs.

Example: Five years ago when she retired at age 65, Sylvia purchased a long-term care insurance policy with a $100 per day nursing home benefit. The policy included no increase in benefits for inflation. At that time, the benefit amount was equal to the average cost of nursing home care in her community. However, nursing home costs there have risen at a rate of 6 percent over the last 5 years, and the average nursing home cost is now $133 per day. If this inflation rate continues, daily nursing home costs will increase to $179 in another 5 years and to $240 in 10 years. Sylvia's assets are currently insufficient to cover this increase in nursing home costs if she has a nursing home stay of more than a few months.

Sylvia's twin sister, Salvia, bought a similar long-term care insurance policy at the same time. However, Salvia purchased a policy with a 5 percent compound inflation rider even though the extra premium meant that she would have to manage her retirement expenses more carefully than her sister would. After 5 years, Salvia's daily benefit has risen to $128. (See table 6-1 in chapter 6.) It will continue to rise to $163 in another 5 years and to $208 in 10 years. Although Salvia's benefit has failed somewhat to keep up with the actual increase in costs, she is in a better position than her sister to make up the shortfall out of her assets because the difference is much smaller.

This example illustrates two very important points. First, protection against the effects of inflation may be a determining factor in whether an individual's long-term care protection adequately meets future needs. Second, the inflation protection in many policies may not keep benefit limits in line with the real inflation in long-term care costs.

There may be some policyowners who feel that they have other resources to offset the effects of inflation. Although this may be true in some circumstances, many policyowners may change their minds when the true magnitude of inflation's effects is explained to them.

There are two ways to plan for inflation in long-term care costs. One is to purchase some type of automatic benefit increase; the other is to periodically purchase additional benefits. The characteristics of these types of inflation increases are described in chapter 6.

Automatic Benefit Increases

The election of an automatic benefit increase results in a significantly higher premium, and the magnitude of this increase varies widely among insurers. However, the increased premium remains level over the life of the contract unless an insurer increases rates by class. The cost of adding automatic inflation protection varies by insurer because of such factors as age and the particular type of plan selected. The authors of this book randomly picked three different comprehensive long-term care insurance policies from three different insurers and found that premiums increased by the factors in table 8-5 if 5 percent compound inflation protection was included. For example, a factor of 2.0 indicates that a policy with the inflation protection would be twice as expensive as a policy without it.

TABLE 8-5
Increase for 5 Percent Compound Inflation

Age	Insurer 1	Insurer 2	Insurer 3
40	3.3	2.5	2.0
55	2.4	2.0	1.9
65	2.0	1.5	1.8
75	1.6	1.4	1.6

Insurer 2 was the only insurer in table 8-5 that also offered a 5 percent simple inflation option. The factors for this option are 1.9, 1.6, 1.4, and 1.3, respectively. Unfortunately, benefits will eventually fall significantly behind those of a policy with 5 percent compound inflation protection, as shown in table 6-1 in chapter 6. However, a simple inflation option does result in a lower premium and may provide adequate future protection if an insured has (or expects to accumulate) other resources that can be also be used to finance future cost increases if long-term care is needed or if the insured has a very short life expectancy.

Future Purchase Options

Many insurers allow insureds to increase benefits periodically on a pay-as-you-go basis without evidence of insurability. This means that the initial premium will be much lower than that of a policy with an automatic benefit increase. However, each election of a benefit increase raises the premium, and the price for the increased benefit is determined by the insured's attained age. Eventually, the premium will surpass that of a policy written with an automatic benefit increase, and these increases will grow steadily larger.

As indicated in table 8-4, future (or guaranteed) purchase options have not been popular in the individual marketplace. This is largely due to the age of applicants. Many of these persons, who are in or near retirement, are unwilling to face large premium increases at a time when they will be living on fixed incomes. If they can afford to purchase inflation protection, they prefer the more predictable premiums of a policy with an automatic inflation increase.

The situation is very different in the group insurance market, where coverage is being purchased at a significantly lower average age. These applicants often feel that they will have future wage increases to pay their additional premiums, at least for several years. Upon retirement, however, insureds with a future purchase option will face ever-increasing age-rated premiums with incomes that are likely to be lower.

There are some drawbacks to purchasing additional benefits in the future. At some point, the cost of these increases may become unaffordable. Furthermore, some insurers place an aggregate limit on the amount of benefit increases or have an age limit beyond which benefit increases cannot be purchased. Finally, the failure to purchase a specified number of either consecutive or cumulative scheduled benefit increases typically terminates the right to exercise future benefit increases without evidence of insurability.

Nonforfeiture Benefits

In addition to deciding what, if any, type of inflation protection to include in a long-term care insurance policy, an applicant must decide whether to elect some type of nonforfeiture benefit. As shown in table 8-4, less than one percent of purchasers of individual policies elect such an option. There are several reasons for this. One reason is cost. For example, including a shortened benefit period option will typically increase premiums by 20 to 40 percent, depending on the insurer and the insured's age at which the policy is purchased. A refund-of-premium rider to a non-tax-qualified policy may increase premiums by 50 percent or more if 100 percent of the premiums are refunded. Applicants who are on tight budgets are probably better off if they use their limited resources to purchase an adequate benefit amount and include inflation protection.

Another reason most purchasers do not elect a nonforfeiture option seems to be that most applicants purchase long-term care insurance to meet future needs and do not plan to let a policy terminate later in life—a time when they are much more likely to need coverage. Therefore, they see little value in a nonforfeiture benefit, particularly when they realize the extra premium required. Moreover, they are not used to receiving any type of benefit when most other types of insurance terminate.

Finally, some financial planners question whether a nonforfeiture option makes good financial sense. They argue that if the policyowner can afford such an additional premium, he or she would be better off in the long run to invest the additional premium. In this way, additional funds will be available in the future whether a policy terminates or not.

It should also be noted, as shown in table 8-4, that purchasers of group coverage are much more likely to have a nonforfeiture benefit. These purchasers tend to be considerably younger than purchasers in the individual marketplace and, therefore, have significantly lower premiums. This, coupled with the fact that these buyers are typically working (because most group coverage is provided under employer-provided benefit plans), makes the cost of a nonforfeiture benefit more affordable.

Policy Comparisons

Consumers and financial services professionals are often faced with the daunting task of comparing long-term care insurance policies. Although most consumers are not interested in comparing every available policy, they are often presented with proposals from more than one agent or more than one proposal from a single agent. If the agents or insurers have done a proper evaluation of their client's needs, the policies will have many similarities, but there will also be differences. Thus, a systematic approach to compare the policies is needed. Note, however, that an agent's presentation of too many policies to a client can be overwhelming and may actually discourage the client from purchasing coverage. As a result, many agents are trained to ask probing questions at the onset of the sales process so that a limited number of policies can be presented, based on such factors as affordability and client needs.

Several insurance companies, consumer groups, and financial publications have prepared what are referred to as checklists or worksheets for this purpose. Perhaps the best known of these is the worksheet in the NAIC's *A Shoppers Guide to Long-Term Care Insurance.* This worksheet is reproduced in figure 8-1 below.

FIGURE 8-1
How to Compare Long-Term Care Insurance Policies

Fill in the information below so that you can compare long-term care insurance policies. Most of the information you need is in the outline of coverage provided in the policies you are comparing. Even so, you will need to calculate some information and talk to the agent or a company representative to get the rest.

Insurance Company Information	**Policy 1**	**Policy 2**
1. Name of the insurance company's agent		
2. Is the company licensed in your state?	yes/no	yes/no
3. Insurance rating service and rating		
What levels of care are covered by this policy?		
4. Does the policy provide benefits for these levels of care?		
• Skilled nursing care?	yes/no	yes/no
• Personal/custodial care?	yes/no	yes/no
(In many states, both levels of care are required.)		

5. Does the policy pay for any nursing home stay, no matter what level of care you receive?	yes/no	yes/no
• If not, what levels aren't covered?		
Where can you receive care covered under the policy?		
6. Does the policy pay for care in any licensed facility?	yes/no	yes/no
• If not, what doesn't it pay for?		
7. Does the policy provide home care benefits for:		
• Skilled nursing care?	yes/no	yes/no
• Personal care given by home health aides?	yes/no	yes/no
• Homemaker services?	yes/no	yes/no
• Other ___________________?	yes/no	yes/no
8. Does the policy pay for care received in:		
• Adult day care centers?	yes/no	yes/no
• Assisted living facilities?	yes/no	yes/no
• Other settings? (List)		
How long are benefits paid and what amounts are covered? (You may be considering a policy that pays benefits on a different basis, so you may have to do some calculations to determine comparable amounts.)		
9. How much will the policy pay per day for:		
• Nursing home care?	$	$
• Assisted living facility care?	$	$
• Home care?	$	$
10. Are there limits on the number of days or visits per year for which benefits will be paid? If yes, what are the limits for:	yes/no	yes/no
• Nursing home care?	days	days
• Assisted living facility care?		
• Home care? (days or visits?)		
11. What is the length of the benefit period that you are considering?	years	years
12. Are there limits on the amounts the policy will pay during your lifetime? If yes, what are the limits for:	yes/no	yes/no
• Nursing home care?	$	$
• Assisted living facility care?	$	$
• Home care? (days or visits?)	$	$
• Total lifetime limit	$	$
How does the policy decide when you are eligible for benefits?		
13. Which of the "benefit triggers" does the policy use to decide your eligibility for benefits? (It may have more than one.)		
• Unable to do activities of daily living (ADLs)	yes/no	yes/no
• Cognitive impairment (Older policies may discriminate against Alzheimer's; newer ones don't.)	yes/no	yes/no
• Doctor certification of medical necessity	yes/no	yes/no
• Prior hospital stay	yes/no	yes/no
• Bathing is one of the ADLs	yes/no	yes/no

When do benefits start?		
14. How long is the waiting period before benefits begin for:		
• Nursing home care?	days	days
• Assisted living facility care?	days	days
• Home health care?	days	days
• Waiting period—service days or calendar days	service days	calendar days
15. Are the waiting periods for home care cumulative or consecutive?		
16. How long will it be before you are covered for a pre-existing condition? (Usually 6 months)	months	months
17. How long will the company look back in your medical history to determine a pre-existing condition? (Usually 6 months)	months	months
Does the policy have inflation protection?		
18. Are the benefits adjusted for inflation?	yes/no	yes/no
19. Are you allowed to buy more coverage? If yes,	yes/no	yes/no
• When can you buy more coverage?		
• How much can you buy?	$	$
• When can you no longer buy more coverage?		
20. Do the benefits increase automatically? If yes,	yes/no	yes/no
• What is the rate of increase?	%	%
• Is it a simple or compound increase?		
• When do automatic increases stop?		
21. If you buy inflation coverage, what daily benefit would you receive for: Nursing home care:		
• 5 years from now?	$	$
• 10 years from now?	$	$
Assisted living facility care:		
• 5 years from now?	$	$
• 10 years from now?	$	$
Home health care:		
• 5 years from now?	$	$
• 10 years from now?	$	$
22. If you buy inflation coverage, what will your premium be?:		
• 5 years from now?	$	$
• 10 years from now?	$	$
• 15 years from now?	$	$
What other benefits are covered under the policy?		
23. Is there are waiver of premium benefit? If yes:	yes/no	yes/no
• How long do you have to be in a nursing home before it begins?		
• Does the waiver apply when you receive home care?	yes/no	yes/no
24. Does the policy have a nonforfeiture benefit?	yes/no	yes/no
If yes, what kind?		
25. Does the policy have a return of premium benefit?	yes/no	yes/no

26. Does the policy have a death benefit?	yes/no	yes/no
If yes, are there any restrictions before the benefit is paid?	yes/no	yes/no
27. Will the policy cover one person or two?	one/two	one/two
Tax-qualified status		
28. Is the policy tax-qualified?	yes/no	yes/no
What does the policy cost?		
29. What is the premium excluding all riders?		
• Monthly	$	$
• Yearly	$	$
30. What is the premium if home care is covered?		
• Monthly	$	$
• Yearly	$	$
31. What is the premium if assisted living is covered?		
• Monthly	$	$
• Yearly	$	$
32. What is the premium if you include an inflation rider?		
• Monthly	$	$
• Yearly	$	$
33. What is the premium if you include a nonforfeiture benefit?		
• Monthly	$	$
• Yearly	$	$
34. Is there any discount if you and your spouse both buy policies?	yes/no	yes/no
• If yes, what is the amount of the discount?	$	$
• Do you lose the discount when one spouse dies?	yes/no	yes/no
35. What is the total annual premium including all riders and discounts?		
• Total monthly premium	$	$
• Total annual premium	$	$
36. When looking at the results of questions 29 through 35, how much do you think you are willing to pay in premiums?	$	$

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Switching Policies

Policyowners are sometimes faced with the situation in which they would like a "better" long-term care insurance policy—possibly because their existing policy has less-than-adequate benefits or more restrictive policy provisions than are currently available in the marketplace. Should they terminate the old policy and switch to a new policy? Such a change must be made with a careful and thorough determination that the new policy is better than the old policy and that the insured will qualify for the new policy. The difference in premiums must also be considered because the new policy will be written at attained-age rates that may be higher than those used for the old policy. In addition, an old policy should never be terminated before a new policy is actually issued. An insured must also be aware of any preexisting-conditions provision in the new policy, whereby benefits otherwise payable under the old policy would be denied. Finally, the insured must take into account any difference in the tax status of the old and new policies.

There are many reasons for considering a new policy. For example, an insured may wish to increase the daily benefit, add inflation protection, or add home health care. It is always prudent to determine if the existing insurer will raise its benefits at a lower cost than the additional premium for a new policy. Such increases in benefits require evidence of insurability, and the additional premium is usually based on attained-age rates. The rates that apply to the original benefits, however, will remain at the old issue-age level.

As mentioned in chapter 5, insurers have continued to enhance their newer policies, and the ability of and cost to existing insureds to obtain these benefits varies among insurers. However, it is always worth the effort to explore the possibility of upgrading an older policy before replacing it with a newer policy. In some cases, replacing an older policy may be justified; in other cases, it may not.

A final alternative to switching policies is to purchase an additional policy. For example, an insured with an acceptable facility-only policy may have decided that he or she would like benefits for home health care. The insurer, however, may be unwilling or unable to add this coverage for reasons that include jeopardizing a grandfathered policy's tax status or state laws that no longer allow issuing the home health care rider formerly used with the policy. Rather than purchasing a new comprehensive policy, the insured may find that it is less expensive to buy a separate home health care policy. An additional policy may also be a viable alternative if an insured is unable to increase daily benefit amounts under an existing policy.

Premium Payments

One of the final steps in the purchase of long-term care insurance is the determination of how to pay the premium. There are three basic options: Pay it over the applicant's lifetime, pay it periodically over an accelerated period, or pay it in a single lump sum. The most appropriate method is the one that best fits the applicant's financial circumstances and attitude toward uncertainty. A large majority of insureds have elected to pay premiums over their lifetimes.

Lifetime Payments

Most applicants elect to pay their premiums over their lifetime in annual, semiannual, quarterly, or monthly installments. The periodic payment is level and predetermined, but it might increase if the insurer raises premiums on a class basis. The insurer bills the insured unless an election is made at some point to have payments made automatically from a bank account—an approach that is often required if payments are made monthly.

Premiums for long-term care insurance are initially expressed as annual amounts; modal factors are used to determine the amount of less frequent payments. For example, one insurer's modal factor (identical to that of many other insurers) for semiannual payments is 0.52. This means that semiannual payments of $520 are required if the policyowner elects this mode of payment rather than a single annual premium of $1,000. The result is that the policyowner pays an additional premium of $40 to postpone payment of $500 for 6 months—an effective interest rate of 16.7 percent.[32] The modal rates for quarterly and monthly payments are 0.27 and 0.09, respectively. These result in quarterly payments of $270 and monthly payments of $90. In either case, the policyowner is paying $80 per year to make premium payments less than annually.

A policyowner who writes periodic checks for long-term care premiums should realize the high cost of paying premiums more than once a year. If resources are available, a single annual check is financially prudent unless the policyowner is earning a significant return on his or her investments.

An insurer's rate structure assumes that premiums are paid at the beginning of the year. Clearly, the company's investment earnings are decreased if the receipt of these funds is postponed, and levying a charge for this postponement is appropriate. It is also important to point out that a major portion of the additional charge is to compensate the insurer for the costs of sending bills and processing premium payments more than once a year.

Accelerated Payments

Some insurers allow applicants to make premium payments over limited periods of time, such as 10 years or until age 65. After that time, no more premium payments are required to keep coverage in force. In addition, an insured will not be subject to any rate increases that an insurer might impose for policies that are still in the premium-payment period. Such options are increasingly popular with younger purchasers of long-term care insurance who want a paid-up policy by the time they retire, possibly with a lower income than they had during their working years. Other purchasers like the peace of mind that having a paid-up policy will give them.

The major drawback to accelerated payments is cost. For example, one insurer offers 55-year-old applicants a policy that will be paid up at age 65 if they make periodic premium payments for 10 years that are 2.1 times the annual premium payments for a policy with a lifetime payment period. This factor is 2.3 at age 45 and 1.9 at age 65. Needless to say, many applicants are unable to afford such increased premiums. Moreover, accelerated payments are likely to cause otherwise tax-deductible premiums to exceed the annual deduction limits identified in chapter 5. The loss of a tax advantage for premium amounts above these limits effectively serves to increase a person's premium costs even further.

As a result, some financial planners feel that the applicant would be better off by investing this additional premium and would need only modest return to generate enough income to make premiums payments for life.

One final point is worthy of mention. Premiums during an accelerated-payment period, like those paid over an insured's lifetime, can be made in annual or less frequent modes.

Single Payments

Some insurers allow an applicant to purchase a paid-up policy with one single payment at the time of purchase. If an applicant has liquid resources that are not earning a sufficient return, this will enable him or her to avoid future premiums and rate increases.

Again, a major obstacle to this option is cost. For example, the insurer mentioned previously charges a premium at age 55 that is 16.8 times as much as a premium paid over the insured's lifetime. The policyowner also loses potential future income tax deductions if the policy is tax qualified. Furthermore, the insured's estate will be reduced if the insured dies in the near future unless the policyowner purchased some type of nonforfeiture or return-of-premium option. As mentioned earlier, such an option would have resulted in a significant further increase in the premium.

Evaluating Insurers

In addition to comparing and evaluating the provisions of long-term care insurance policies, it is important for a consumer to ensure that he or she is purchasing a policy from a reputable company at an appropriate price. In many cases, the consumer will rely on the advice of an insurance agent or financial planner who specializes in long-term care insurance and is perhaps in a better position to make this evaluation. The evaluation should focus on three basic considerations: financial strength, reputation, and cost.

Financial Strength

Probably the single most important criterion in evaluating an insurer is financial strength. Because the basic function of an insurer is to pay claims, care must be taken to select only those insurers that are most likely to have the financial strength to do so if and when the need arises. In light of past insolvencies and near insolvencies among insurers, this claims-paying ability cannot simply be taken for granted.

Detailed financial information can be obtained from the annual reports that insurance companies must file with state insurance departments. These reports are public information. Although an evaluation of this information is beyond most individuals' ability, it has been performed by several rating organizations that publish the financial history, ratings, and analyses of individual insurers. These organizations include A.M. Best Company, Fitch Ratings (formed by a merger of Duff & Phelps and Fitch IBCA), Moody's Investors Service, Standard & Poor's, and Weiss Ratings. A few words of caution are in order with respect to reliance on ratings assigned by these organizations, however. First, the criteria and methodology differ among the rating organizations, so an insurer may receive different ratings from different organizations. Second, a rating of A, which many people associate with excellence, may not be particularly good. For example, Best's has two ratings higher than A, and Standard & Poor's has five ratings higher than A. Third, some rating agencies seem to be more generous in their ratings than others. Fourth, not all insurers are assigned ratings by all of the rating organizations. In light of all of these differences, it is probably wise advice to choose insurers that have very high ratings from at least two or three of the rating organizations.

These ratings may be available from state insurance departments, public libraries, the Internet, or insurer brochures.

Reputation

With approximately 100 insurers writing long-term care insurance, there is no reason to purchase coverage from any insurer that has other than a good reputation. Reputation arises from many factors. For example, are current customers satisfied with the insurer? What is the insurer's reputation for fair and prompt claims settlement? How are insureds treated when the insurer introduces new or improved policies? What commitment and experience does the insurer have with long-term care insurance products? Does the insurer have a reputation it wants to protect and thus may be willing to "do the right thing"?

A good insurance agent or financial planner, through experience and interaction with colleagues, should have a feel for an insurer's reputation within the insurance industry. Another source of information is the records about consumer complaints that state insurance departments receive. There are also consumer publications that periodically evaluate insurers on the basis of costs, claims handling, consumer satisfaction, and other factors.

It should be noted, however, that reputation is of little value if an insurer does not have adequate financial strength. Unfortunately, a few insurers that were once highly regarded have become insolvent.

Cost

Many earlier sections of this chapter mentioned the effect of cost on various consumer decisions, focusing primarily on how alternative choices might affect an overall premium. It is also important to look at the variations among insurers for similar policies. One recent survey compared 42 policy forms from 30 insurance companies with respect to cost under varying assumptions.[33] Table 8-6 shows the premium variations for policy forms from 10 of these companies at selected ages for one particular set of policy assumptions. The comparison is based on the insurer's best preferred rates for a single-life comprehensive policy with the following characteristics:

- $100 daily benefit for both facility care and home health care
- lifetime benefit
- 90-day elimination period
- 5 percent annual compound inflation increase

As this table shows, there are substantial premium variations among insurers, and the array of companies from lowest to highest premium is not the same at different ages. In addition, the same pattern of price variation by insurer may differ significantly for other policy assumptions.

TABLE 8-6
Premium Comparisons among Insurers

	Age 55	Age 60	Age 65	Age 70
Insurer 1	$1,474	$1,923	$2,629	$3,961
Insurer 2	1,594	2,025	2,475	3,544
Insurer 3	1,646	2,032	2,481	3,251
Insurer 4	1,713	2,162	2,868	4,371
Insurer 5	2,019	2,643	3,490	5,359
Insurer 6	2,088	2,784	3,792	5,688
Insurer 7	2,181	2,786	3,703	5,335
Insurer 8	2,229	2,661	3,260	4,387
Insurer 9	2,339	2,860	3,686	5,077
Insurer 10	2,550	3,052	3,870	5,113

Cost comparisons must be used with care for several reasons. First, it is important that they are for identical policies, and any two policies are rarely identical. This fact is even indicated by the survey from which the above premiums were taken. For example, do the policies in the above example all apply the same elimination period in the same manner, or do they all have the same provision for preexisting conditions? Does waiver of premiums apply if the insured receives any long-term care services, or does it require that the insured be in a facility? Are the policies comparable in their provision of a bed reservation benefit or care coordination? Or will an applicant be acceptable at the best preferred rates from each of these insurers?

Second, what is the financial strength of each of these insurers? Low premiums may be an indication that an insurer has inadequate reserves or is trying to increase revenue in the short run because of a poor financial position.

Third, are the levels of service from the insurers the same? For example, an insurer with a low premium may have the reputation of being very strict in its claims-paying practices.

Last, but not least, what is the likelihood of future premium increases? Insurers with premiums that are among the lowest might be new to the business and have little experience in pricing long-term care insurance policies, or they might be using a low premium as a method for increasing market share. In either case, they may increase premiums in the future and make policies unaffordable for some insureds. It is worth asking an insurer about past rate increases; some states also provide this information. Some insurers with low premiums have a reputation for frequent price increases, while other insurers with somewhat higher premiums have infrequent or no increases because of more realistic pricing assumptions.

All of this is not to say that price differentials are not important. However, they must be analyzed with care.

A Final Example

The effect of cost on consumer decisions has been woven throughout much of this chapter. However, the discussion has focused on the way in which one factor, such as the length of the elimination period or the inclusion of inflation protection, affects the final premium. As this final example illustrates, an insured must often make several decisions before the final selection of a long-term care insurance policy.

Example: Fred, aged 65, has decided that he needs long-term care insurance. Five years ago, he and his wife sold their small jewelry store and were able to retire comfortably. Their plans of a leisurely life during retirement years were soon shattered when Fred's wife had a serious stroke. For 3 years, Fred was able to care for her at home with the assistance of professional caregivers. After she was totally paralyzed 2 years ago by a second stroke, Fred found it necessary to put her in the nursing home where she recently died.

Having spent almost $250,000 to provide his wife with the best care possible, Fred is fully aware of the effect that long-term care can have on a family's assets. He wants to make sure that any long-term care expenses he might incur will not further deplete the $500,000 in remaining assets that he and his wife spent a lifetime accumulating and intended to leave to their children and grandchildren.

Fred has contacted a well-respected insurance agent whom he has known for several years and asked her to help him find a long-term care insurance policy that meets his objectives. Fred has indicated that he would like a policy that provides these benefits:

- a daily facility benefit of $150. A top-quality nursing home in Fred's town will cost about $250 per day, but Fred feels he can afford to pay $100 from his Social Security and retirement income.
- a home health care benefit of $150 per day
- a lifetime benefit period
- a 20-day elimination period
- 5 percent annual compound inflation protection

Fred's agent calculates that such a policy will have an annual premium of $5,060. Fred feels that this is somewhat more than he can pay without withdrawing funds from his assets and asks her what can be done to reduce the premium to about $4,000 per year. She comes up with the following alternatives:

- If Fred lowers the daily benefit to $130 per day, the premium will drop to $4,380. A further decrease to $120 per day will result in a premium of $4,050. Fred decides to consider this option.
- If Fred decreases the home health care benefit to 50 percent of the facility benefit, the premium will drop to $4,130. Fred realizes how costly home health care can be and doesn't like this option.
- If Fred elects a 5-year benefit period, the premium will drop to $4,135. For a 4-year benefit period, the premium will be $3,800.

Fred is aware of some patients in his wife's nursing home who had been there for as long as 10 years and doesn't like this option either.

- If Fred increases the elimination period to 90 days, the premium will drop to $4,150. The premium for a 180-day elimination period will further decrease the premium to $3,750. Fred is willing to think about a 90-day elimination period, but he feels that 180 days is too long.
- If Fred changes the inflation protection from compound interest to simple interest, the premium will drop to $4,260. Fred hopes to live for many more years and realizes the effect that inflation will have on long-term care costs. This option doesn't appeal to him.

Fred decides to take a day or two to think about his options. He calculates that the longer elimination period will increase his out-of-pocket costs by $10,500 (70 days times $150) over what they would otherwise be if he needs long-term care. He also calculates that the lower benefit amount of $120 will increase his annual out-of-pocket costs by $10,950 (365 days times $30). Fred realizes that these additional out-of-pocket costs will come from his accumulated assets. He also understands that he could afford the benefits he originally desired if he were willing to reduce his assets by about $1,000 per year to pay the $5,060 premium.

Fred finally decides that the policy with the $5,060 premium is the most appropriate choice. Its benefits will make it more likely that his family will provide the level of care he wants if he is unable to make decisions for himself.

NOTES

1. *Long-Term Care Insurance: An Undiscovered Necessity*, American Council of Life Insurance, 1999, and Roper Organization Survey of 1990 Americans, 1998, figures 12, 13, and 15.
2. *Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2000, p. 23.

3. *The Costs of Long-Term Care: Perceptions Versus Reality*, AARP, Washington, DC, December 20, 2001, Executive Summary, p. 5, and Report, p. 22.
4. Ibid., Report, pp. 26, 36.
5. *Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2000, p. 21.
6. Ibid., pp. 35, 40.
7. *The Costs of Long-Term Care: Perceptions versus Reality*, AARP, Washington, DC, December 20, 2001, Executive Summary, p. 5, and *Long-Term Care Insurance: An Undiscovered Necessity*, American Council of Life Insurance, 1999, and Roper Organization Survey of 1990 Americans, 1998, figure 10.
8. *Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2000, p. 22.
9. Ibid., p. 41.
10. *Long-Term Care Insurance: Consumer Perceptions*, a report by LIMRA International, Inc., Windsor, Connecticut, and the Health Insurance Association of America, Washington, DC, 2002, p. 3, and *Long-Term Care Insurance: An Undiscovered Necessity*, American Council of Life Insurance, 1999, and Roper Organization Survey of 1990 Americans, 1998, figure 13.
11. *Long-Term Care Insurance: Consumer Perceptions*, a report by LIMRA International, Inc., Windsor, Connecticut, and the Health Insurance Association of America, Washington, DC, 2002, pp. 3, 4.
12. *The Myth of Unaffordability: How Most Americans Should, Could, and Would Buy Private Long-Term Care Insurance*, Center for Long-Term Care Financing, Seattle, WA, September 1, 1999, pp. iv, 11, 35.
13. *Long-Term Care Insurance: Consumer Perceptions,* a report by LIMRA International, Inc., Windsor, Connecticut, and the Health Insurance Association of America, Washington, DC, 2002, p. 3.
14. *Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2000, pp. 3, 34, 39.
15. Ibid., p. 34.
16. Ibid., p. 3.
17. *Long-Term Care and Medicare Supplement, Executive Summary, Annual 2004,* LIMRA International, Inc., 2005, p. 2, and *U.S. Group Long-Term Care Insurance, Executive Summary, Annual 2004,* LIMRA International, Inc., 2005, pp. 2–4.
18. Ibid.
19. Ibid.
20. *Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2000, p. 16, and *Who Buys Long-Term Care Insurance in the Workplace? A Study of Employer Long-Term Care Insurance Plans,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2001, p. 14.
21. Ibid. pp. 2–3, and Ibid., pp. 3–4.
22. *Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2000, p. 27.
23. Ibid., p. 23.
24. *Long-Term Care and Medicare Supplement, Executive Summary, Annual 2004,* LIMRA International, Inc., 2005, p. 2.
25. *Who Buys Long-Term Care Insurance in 2000? A Decade of Study of Buyers and Nonbuyers,* prepared for the Health Insurance Association of America by LifePlans, Inc., October 2000, p. 26.

26. Ibid., p. 27.
27. Ibid., p. 24.
28. *Long-Term Care and Medicare Supplement, Executive Summary, Annual 2004,* LIMRA International, Inc., 2005, p. 2, and *U.S. Group Long-Term Care Insurance, Executive Summary, Annual 2004,* LIMRA International, Inc., 2005, p. 3.
29. *Who Buys Long-Term Care Insurance in the Workplace? A Study of Employer Long-Term Care Insurance Plans*, prepared for the Health Insurance Association of America by LifePlans, Inc., October 2001, p. 19.
30. *Long-Term Care and Medicare Supplement, Executive Summary, Annual 2004,* LIMRA International, Inc., 2005, p. 2.
31. *MetLife Market Survey of Nursing Home & Home Care Costs,* September 2004, MetLife Mature Market Institute, p. 2.
32. To determine the annual percentage rate, assume that the insured has initially paid $520 of the $1,000 premium in advance and is financing the other $480 for 6 months. Therefore, $40 of the second semiannual payment represents the interest for this loan.
33. "Seventh Annual Long-Term Care Survey," *Broker World,* July 2005.