Long-Term Care Insurance 101

Long-Term Care ("LTC") is often the most volatile uninsured risk in our lives. Your, or a relative's, need for LTC disrupts family lifestyles and has financial and emotional impact. The negative impact can be reduced if you (and your family) plan ahead.

Long-Term care insurance ("LTCi") transfers the financial risk of a long-term care ("LTC") need from a family to the insurance company. LTCi can be a major part of your plan to deal with the risk of LTC. The key issues are how much risk to transfer and how much it costs to do so.

Because there are many options, LTCi can seem complicated. The biggest consideration is whether to get a traditional stand-alone LTCi policy or a linked-benefit (generally life insurance combined with LTCi) policy. Adding the death benefit will typically more than double the cost.

There are many subtle differences between products, so it is important to get expert advice, but the following key aspects are common across products (except for the major difference of life insurance being included in the linked benefit products).

What does LTCi cover?
LTCi provide benefits when someone ***either*** (either, not both):

a) Has "severe cognitive impairment", which means they are in danger to themselves or others. Merely forgetting where you put the car keys or forgetting people's names are not severe cognitive impairments. But being prone to leaving the gas stove on or walking out of the house improperly clothed or getting lost and confused indicate severe impairment.

b) Is unable to perform 2 or more of the Activities of Daily Living ("ADLs": bathing, dressing, eating, transferring, toileting, continence) without human help for a period expected to last 90 days or longer. Think about what you do after turning off the alarm clock in the morning – you get out of bed (transfer), toilet, bathe, dress and eat. Note: the legally required 90-day expectation disqualifies most knee surgeries and other conditions with temporary impact.

LTC usually starts at home, but can be in an adult day care facility, an assisted living facility, or a nursing home, etc. Some policies offer benefits when unlicensed family members or friends provide care, but those benefits are often limited to 30%-40% of the normal benefit available.

Policy Variables:

Initial Maximum Monthly Benefit: Insurers reimburse up to this amount each month. The price for a $6,000 monthly benefit is generally double the price of a $3,000 monthly benefit, so it makes sense not to purchase LTCi that would cover your extreme cost; some self-insurance is generally optimal. With adequate compounding (see below), a good initial maximum might be equal to, or a bit more than, the cost of an assisted living facility. Elsewhere on this website, you can find the current cost of care anywhere in the USA where you (or a relative) might be likely to receive it.

Benefit increase options: A LTC need can occur at any age, due to strokes, MS, accidents, violence, etc. However, most LTC needs begin when people are in their upper 70s or 80s. A $4500 monthly benefit might cover 180-200 hours of non-professional home care currently, but its purchasing power would deteriorate over time. As the baby boomers age, the cost of LTC is likely to inflate faster than the CPI (consumer price index). Perhaps in 2045 and later, the cost will increase more slowly than the CPI. Thus, it is important to arrange for the Maximum Monthly Benefit to compound automatically each year, whether you are "on claim" or not.

Today, the most common benefit increase feature is 3% compounding. The price of LTCi is intended to stay level, so compounding adds a lot to the price. Unfortunately, there is significant risk that the cost of care will grow faster than 3%. You might address that risk by choosing a higher compound rate, by increasing the Maximum Monthly Benefit to a higher level, or by absorbing that risk yourself.

Compounding is generally required for a policy to qualify for the State Partnerships for LTC (NA in AK, DC, HI, MA, MS, and VT). The Partnerships are government incentives for the middle class to purchase LTCi. Ask your advisor about them and also about tax incentives for purchasing LTCi.

Benefit period is how long the policy will pay benefits if you use the maximum benefit every month. If your maximum monthly benefit has grown to $7,700 and you use only $7,000 in a month, the additional $700 will allow your benefits to last longer.

Benefit periods can vary from two years to “endless” (generally called “lifetime benefit periods”) but many insurers won’t sell more than a six-year benefit period. A current rule-of-thumb is that an endless benefit period costs twice as much as a 3-year benefit period.

Many people seek a 3-year benefit period because they hear that the average length of care is 3 years. However, the low “average” is because many people need LTC for a short time, in which case LTCi may be immaterial. Historically, about 75% of the people needing LTC need it for a year or longer. Those people average nearly 4.5 years of care. A 5-year benefit period can cost significantly less than 5/3 of the cost of a 3-year benefit period. If your LTCi runs out after 3 years, you might have a major financial crisis at that time. Therefore, you might prefer a lower monthly maximum (self-insuring more of your LTC cost each month) to enable you to afford a longer benefit period.

Shared Care is a great feature for couples. Shared Care lashes two policies together so the clients have a combined [10] year benefit period instead of two [5] year benefit periods. If one person has an unusually long claim, he/she can dip into the other’s policy. For example, if one spouse uses two years of benefits, then dies, the other spouse has an 8-year benefit period. As with other features, Shared Care provisions differ between products. Ask your advisor.

Elimination period (“EP”): The EP is a form of deductible and is sometimes called a waiting period. The insurer will NOT pay benefits for care received during the EP. Almost all buyers choose a 90-day EP. At additional cost, the EP can be waived for home care and with some provisions, the home care days can reduce the facility EP, so by the time you enter an ALF or nursing home, the EP may have disappeared. A 0-day Home Care EP is nice, but if you can absorb the cost of a 90-day EP for a facility, you can absorb the cost of a 90-day EP for home care. Often, it makes more sense to increase the monthly maximum or the benefit period rather than selecting 0-day home care EP.

EP provisions also differ between products. For example, some policies have service-day elimination periods—a day counts toward the EP only if a paid service is received that day. Other policies have calendar-day elimination periods, usually the EP ends 90 days after the first service day, even if family members provided all the care in the interim.

Premiums are generally paid for the rest of your life except that they are waived when you are on claim. The insurer’s actuary has to certify that the premium is expected to stay level even in the face of moderately adverse experience. However, the prices are not guaranteed. If an insurer wants to increase premiums for existing insureds, the insurer must treat everyone in the same class (age, gender, policy form, year of issue, features, etc.) consistently. Almost all states require insurers to provide comprehensive justification for a price increase. People who purchased LTCi policies long ago endured horrendous price increases. However, now insurers and regulators have more much data upon which to base prices and have taken numerous steps to make today’s prices tremendously more stable than past prices. Guaranteed prices are available with some linked-benefit policies.

More information is available in policy illustrations and this website has videos that discuss Self-Insurance, The Advantage of Buying Now, etc. Your advisor also has access to a Range of Exposure program which projects how likely you are to incur various ranges of LTC cost in your lifetime. The Range of Exposure tool can also be used for other family members, for example those for whom you might provide care.