Preparing for Potential Long-Term Care Costs

Overview: Because of the costs involved, an argument could be made that all individuals should prepare for potential long-term care needs. Generally, individuals with assets ranging from $250,000 to $3 million should consider taking steps to prepare for long-term care costs, in the event there is a need for such care. Contrary to the common misconception that it covers nursing home care exclusively, long-term care can cover many different types of assistance. The following article contains general information and suggestions about planning options for individuals who wish to customize a prudent retirement plan that includes a strategy for potential long-term care.

Introduction

According to the U.S. Census Bureau, there were more than 290 million people living in the United States, as of July 1, 2003. Nearly 36 million were older than age 65, and more than 4 million were older than age 85.[1] Further, it is estimated that almost half of all Americans will need long-term care (LTC) at some time after age 65.

Therefore, it is prudent to explore the subject in the same manner that individuals might approach financial planning or risk management decisions — by educating themselves about the subject, identifying potential risks and preparing accordingly. The issues discussed in this article include:

- LTC coverage and related risk
- Financial independence
- Tax laws surrounding LTC
- Various coverage options
- Elements of LTC contracts

Answering Frequently Asked Questions about Long-Term Care

What is long-term care?
LTC refers to an array of services aimed at helping people with chronic conditions cope with limitations in their ability to live independently. One of the most common misconceptions about LTC is that it only means nursing home care. Instead, it is personal and/or custodial care for an extended period of time, which can include any of the following services: 1) nursing home care, 2) assisted living facilities, 3) home health care, 4) adult day care or 5) respite care.

When does an individual qualify for long-term care assistance?
An individual can qualify for LTC coverage when he or she cannot perform at least two of six activities of daily living (ADLs), including the following: 1) bathing, 2) eating, 3) dressing, 4)

transferring, 5) toileting and 6) maintaining continence. If an individual requires substantial assistance (or hands-on, stand-by or supervisory assistance), he or she qualifies for LTC. Again, the notion that LTC applies only to nursing home care is incorrect. For example, an individual who needs stand-by supervision with two ADLs will be eligible for care. Note that LTC contracts would cover an individual who develops Alzheimer's or dementia.

How is risk defined when discussing long-term care coverage?
Risk — as it pertains to risk management and LTC — refers to spending all available assets to pay for care. It also means there is a chance that some individuals may not be able to afford personalized care (such as home health care) or may need to rely on friends and family for assistance.

Should financially independent individuals self-insure for possible long-term care needs?
If an individual is financially independent, one option is to self-insure. However, it would be a mistake to assume that this strategy is the only one available for such individuals. There are several reasons why self-insuring might be inappropriate, including an individual's intention to preserve his or her assets and/or leave assets to heirs.

An individual who is not financially independent might consider planning for LTC needs by examining the following planning options: 1) change a portfolio's asset allocation, 2) reduce spending, 3) increase savings or 4) consider LTC coverage.

What are the tax laws regarding long-term care?
The Internal Revenue Service views LTC as health care. Therefore, under current law the normal taxable threshold applies when deducting long-term care premiums, which is 7.5 percent of adjusted gross income.

Why is it important to check the quality of a long-term care provider?
Individuals should pay close attention to the quality of the LTC provider they choose because the financial strength of the provider will likely have an impact on the quality of the LTC contract and the cost of premiums. In recent years, several large providers have failed to anticipate the level of risk associated with insuring individuals for LTC. As a result, those providers stopped issuing new LTC contracts and raised premiums on those LTC contracts already issued. "Losses on long-term-care-insurance policies are driving insurance companies out of that business. … The net result is that financial advisers will find it more difficult to find reasonably priced long-term-care policies for clients in the future."[2]

Five Alternatives for Long-Term Care Coverage

Although LTC contracts are not the only option, they can be an appropriate solution for those wishing to protect their assets. This section discusses each of the following options individually, but some individuals may be able to use a combination of these options to meet their needs: 1) self-insuring, 2) Medicare, 3) Medicaid, 4) health insurance or 5) LTC coverage and a combination of other options.

Option 1: Self-insuring
Self-insuring against potential LTC costs may sound like a simple and sensible answer. For example, if the need is $200 per day for three years, an individual could deposit $219,000 in an account.

However, the costs associated with long-term care continue to increase. Therefore, individuals should seek an investment vehicle that will allow their savings to grow while keeping pace with the changing costs of care. Even if an individual has sufficient assets, it would be incorrect to assume that every individual who can self-insure should do so. Factors to consider when making this decision include the potential impact on the quality of life during retirement or inheritance for heirs. One option may be to insure some of the cost with a LTC contract and self-insure for the remainder.

Option 2: Medicare
Medicare covers skilled care with a maximum 100-day coverage period. An individual must meet the following requirements before receiving Medicare: stay at a skilled facility, enter that facility within 30 days of needing care and spend three days in a hospital. He or she must show improvement during the covered period. There is no custodial care associated with Medicare.

Option 3: Medicaid
Medicaid requires that individuals spend down their assets to a certain level, after which the program will begin to pay for care. Each state has different requirements for Medicaid. In addition, LTC options within Medicaid are quite limited.

Option 4: Health insurance
In most cases, an individual's personal health insurance will not pay for services normally associated with LTC, such as custodial care. Such coverage is limited to skilled care (generally meaning round-the-clock care from a doctor or registered nurse).

Option 5: Create a personal plan
A customized plan would rely on a combination of several options mentioned above in addition to LTC contracts, depending on the individual's unique situation and specific needs. An advisor can be a valuable ally when deciding how to design such a plan.

Defining Long-Term Care Policy Basics

Most LTC contracts are constructed with six elements: 1) designated daily benefit amount, 2) stated amount of home health care to be provided, 3) method by which benefits are paid, 4) benefit period, 5) inflation protection and 6) elimination period.

Designated daily benefit amount
The allowable spending amount can be expressed as a daily or monthly benefit ranging from $50–$500 per day ($1,500–$15,000 per month). Individuals should consider their age, lifestyle, location and total assets when deciding on a daily benefit amount. By 2004, the average rate for a private room in a nursing home was rapidly approaching $200 a day, or about $70,000 a year, and the average rate for a semi-private room in a nursing home was almost $170 per day, or about $62,000 a year.[3] Some questions to ask regarding daily benefit amounts include:

- Are friends or family able to help with care?
- Do potential caregivers live in close proximity to the individual needing care?
- Is home health care the preferred choice?
- Generally, can the individual afford to pay for home health care?

- Specifically, can he or she continue to live at his or her current residence and still receive appropriate care?

Home health care
One of the first decisions when designing a plan is to determine how much care will be provided through home health care. The average rate for one hour of home health care is about $18, with an eight-hour shift averaging almost as much as a full day in a semi-private room in a nursing home.[4] Should an individual designate 100 percent of his or her daily benefit for home health care? Some individuals may not need any home health care. For example, individuals without family or friends able to provide assistance may wish to direct their coverage toward nursing home care.

Receiving benefits
There are three methods to receive benefits:
- **Reimbursement** — A reimbursement plan requires individuals to save receipts and submit them to the insurance company for reimbursement on a monthly basis. This type of plan is the least expensive, but generally considered the most cumbersome.
- **Indemnity** — An indemnity plan allows an individual to receive benefits for care received without having to submit receipts. Once an individual establishes the need for care and begins to receive a minimum amount of licensed care, the insurance company would send reimbursement for the daily or monthly benefit.
- **Cash plan** — A cash plan is the most expensive type of benefit option. This plan would pay the individual the full benefit amount regardless of receipts remitted or whether care received is licensed. This type of plan also allows family or friends to assist in providing care.

Benefit period
The definition of a benefit period varies with each company (typically between two and 10 years). A lifetime option is also available, but individuals should consider many factors before choosing a benefit period.

Some people may try to use life expectancy data as a guide when calculating how long they will need assets to last for retirement or potential LTC costs.[5]

Although this information can be useful, it may be imprudent to use life expectancy data because the odds of living longer than expected are much greater than most people assume. By definition, half of individuals will live longer than expected, meaning that many individuals would outlive their savings if they planned using life expectancy data.

Instead, individuals may wish to examine family history and their individual levels of wealth and available assets to help with this decision. Lifetime benefits are the most expensive because life expectancies are increasing. A financial planner or investment advisor can add value by working with an individual to find a solution that incorporates assets and an appropriate benefit period.

Inflation protection
This LTC policy feature has three options. The first is simple inflation protection, which would add 5 percent to the daily benefit amount each year. (For example, $100 becomes $150 in the 10th year; $175 in the 15th year; and $200 in the 20th year.) The second option is compound inflation

protection, which would add 5 percent to the daily benefit amount **and** compound each year. (For example, \$100 becomes \$163 in the 10th year; \$208 in the 15th year; and \$265 in the 20th year.) The third option is to choose no inflation protection of any kind. (One reason why an individual might decline inflation protection would be if the costs of including such a feature would prevent the individual from being able to afford coverage.)

Simple inflation would double the benefit amount every 20 years while compound inflation would double the benefit amount every 15 years. An individual's age can sometimes dictate which inflation protection to select. For example, simple inflation might be the prudent choice for an individual in his or her late 60s (or older) while younger individuals would typically have enough time to reap the benefits of a compound inflation feature. Keep in mind that assessing an individual's age is just one factor to review when deciding to add inflation protection to a LTC contract. An individual with a substantial asset base may choose simple inflation to save on premium costs. Conversely, an individual who could benefit from compound inflation may not be able to afford the feature, and thus choose simple inflation protection (or no inflation protection).

Elimination period

An elimination period can be viewed as a deductible. Essentially, an elimination period refers to the period of time an individual wishes to pay out-of-pocket for care before an insurance company begins to provide coverage. Elimination periods can range from immediate coverage to an elimination period of one year (such as 0, 30, 60, 90, 100 or 180 days). A typical elimination period is 90 days.

Conclusion

Individuals can protect themselves by preparing for the possibility of a need for LTC by securing the appropriate type and amount of coverage. Securing LTC coverage via LTC insurance is one way to ensure that individuals have sufficient assistance in the event there is a need for care. It is important to ensure that the plan ultimately meets the plans and expectations of the individual and to seek an advisor who is aware of LTC issues. Further, an advisor should be sensitive to family concerns, respect a family's wishes regarding care options and design an appropriate plan to meet specific needs.

1 **Older Americans 2004: Key Indicators of Well-Being**. Federal Interagency Forum on Aging-Related Statistics, January 13, 2005. Available at http://www.agingstats.gov/chartbook2004/population.html. Accessed August 30, 2005.

2 Jeff Benjamin, **For More Insurers, It's LTC Ya Later**. *Investment News*, September 1, 2003.

3 **The MetLife Market Survey of Nursing Home & Home Care Costs**. MetLife, September 1, 2004.

4 Ibid.

5 Life expectancy increases as we age. At birth, males have a life expectancy of 74 and females have a life expectancy of 80. However, life expectancy for adults age 65 is 16 years for males and 19 years for females. This means that, if they reach the age of 65, the life expectancy for males changes to age 81, an increase of seven years. For females, the comparable figure is age 84, an increase of four years. **Life Expectancy at Birth, at 65 Years of Age, and at 75 Years of Age, According to Race and Sex: United States, Selected Years 1900–2001**. *Health, United States, 2003,* Centers for Disease Control and Prevention, 2003.

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