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Mistakes to Avoid When Shopping for Long-Term-Care Insurance

How to Pick the Best the Policy for Your Needs and What to Avoid

By
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It's a decision many baby boomers are grappling with: Should I buy long-term-care insurance?

The decision has never been more difficult. According to researchers at Georgetown University and Pennsylvania State University, about 70% of individuals 65 and older will need long-term care—whether at home or in an assisted-living facility or nursing home.

At the same time, however, the price of long-term-care insurance keeps going up. A 55-year-old couple, for example, can expect to spend about $3,275 in annual premiums for $164,000 of coverage for each that grows by 3% a year, according to the American Association for Long-Term Care Insurance, a trade group for insurance agents.

For some people, of course, long-term-care policies make no sense. Medicaid is there to help people who have little money. (Medicare doesn't typically cover continuing care.) People with assets of $2 million or more, meanwhile, can probably afford to pay for long-term care out of pocket, although a policy may still make sense to ensure they have money to leave to their heirs.

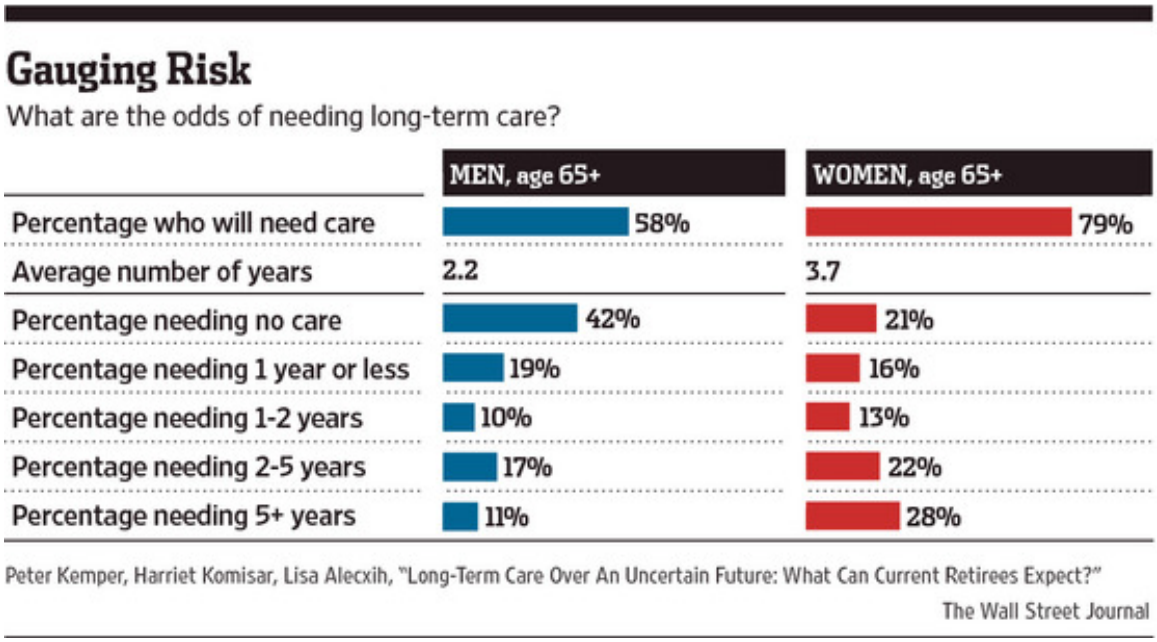
But for people who fall between those two extremes, the decision whether to buy long-term-care insurance is a tricky one, especially since the policies are complicated and the business is in a state of flux, with carriers raising prices and exiting the business. "The industry is changing so rapidly," says Howard Gleckman, a resident fellow at the Urban Institute, "it's hard to keep up."

Here are six mistakes consumers commonly make when purchasing long-term-care insurance, and advice on how to avoid these pitfalls.

1. WAITING TOO LONG TO BUY

Many people don't even start *thinking* about long-term-care insurance until they reach 60. And by that time, it may be too late—either because the insurance is too costly or they simply can't qualify for health reasons.

As a result, for most people, the 50s are the best time to buy a policy. That's typically when premiums are most affordable and coverage is easiest to obtain, says Mr. Gleckman.



For each year applicants in their 50s delay buying coverage, carriers typically raise premiums by 3% to 4%, simply because they are a year older, says Dawn Helwig, a principal and consulting actuary at Seattle-based Milliman Inc. In contrast, for every year someone in their 60s waits, they can expect to pay an additional 6% or more, she adds.

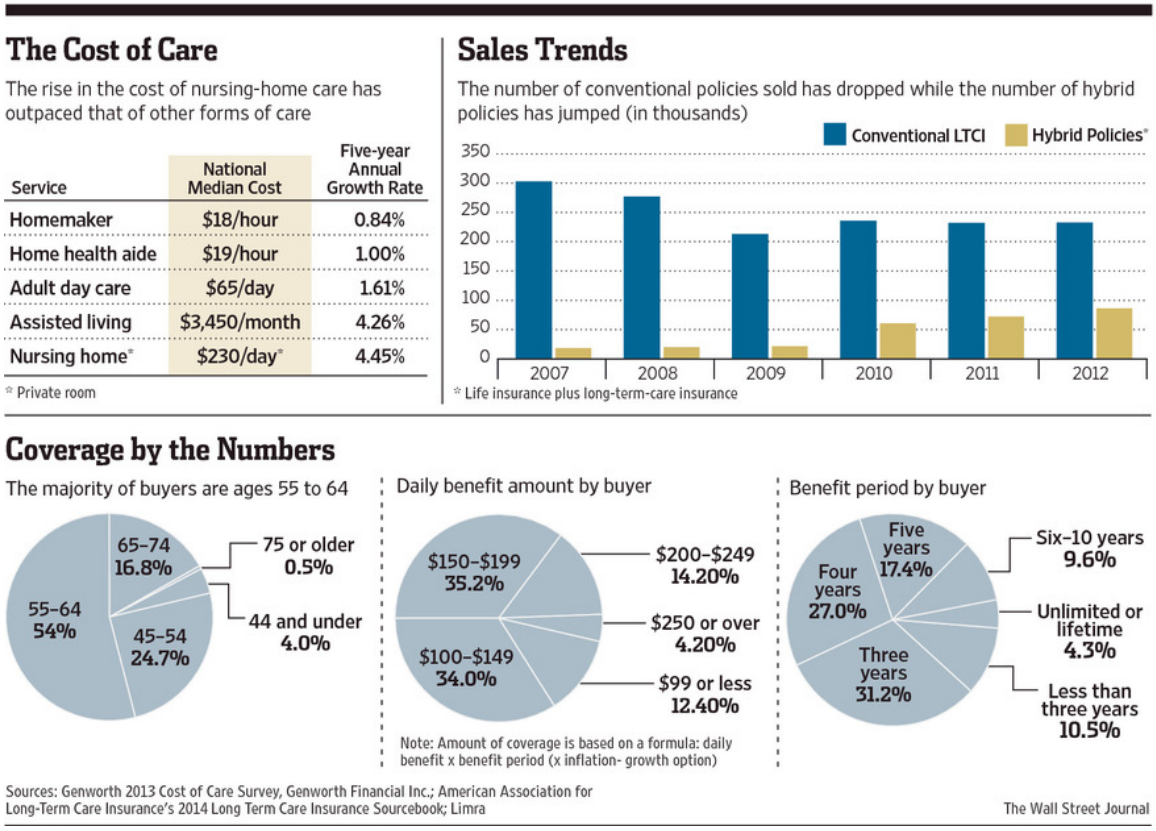
Those who wait may pay higher premiums for other reasons, too. Over the past decade, carriers struggling with losses on existing policies have raised the premiums on new policies an average of 4% to 8% a year, depending on the features, according to Milliman.

Consider a 65-year-old man who purchases $110,000 of coverage with benefits that grow 5% a year. To secure the same coverage 10 years earlier, at age 55, he would have paid approximately $1,032 in annual premiums, says Ms. Helwig. But because he waited, his annual premium is now about $2,770. Assuming he lives to age 85, he will pay a total of about $55,400 in premiums—or some $24,400 more than he would have spent had he bought at age 55 and lived 30 years.

Those who wait also run the risk that their health may deteriorate. Carriers, which have become stricter about how they underwrite policies, reject about 25% of applicants between ages 60 and 69, according to the American Association for Long-Term Care Insurance. They also charge those in relatively poor health as much as 40% more, says Ms. Helwig.

2. BUYING ON PRICE ALONE

The gap between the least- and most-expensive policies can be wide. According to the American Association for Long-Term Care Insurance, a 60-year-old couple can expect to pay an annual premium that ranges from $3,025 to $6,500 for $164,000 of coverage that grows 3% a year.



The Cost of Care

The rise in the cost of nursing-home care has outpaced that of other forms of care

Service	National Median Cost	Five-year Annual Growth Rate
Homemaker	$18/hour	0.84%
Home health aide	$19/hour	1.00%
Adult day care	$65/day	1.61%
Assisted living	$3,450/month	4.26%
Nursing home*	$230/day*	4.45%

* Private room

Sales Trends

The number of conventional policies sold has dropped while the number of hybrid policies has jumped (in thousands)

* Life insurance plus long-term-care insurance

Coverage by the Numbers

The majority of buyers are ages 55 to 64

Daily benefit amount by buyer

Note: Amount of coverage is based on a formula: daily benefit x benefit period (x inflation- growth option)

Benefit period by buyer

Sources: Genworth 2013 Cost of Care Survey, Genworth Financial Inc.; American Association for Long-Term Care Insurance's 2014 Long Term Care Insurance Sourcebook; Limra

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But while price is important, so is reliability, says Michael Kitces, director of planning research at Pinnacle Advisory Group Inc. in Columbia, Md. Mr. Kitces says consumers should buy from a large, stable carrier with the resources to still be around when the coverage is needed. He recommends people limit their shopping to big diversified carriers with claims-paying-ability ratings of single-A or better.

Mr. Kitces suggests that prospective buyers work with agents who specialize in long-term-care insurance. (Some carriers, including Northwestern Mutual Life Insurance Co. and New York Life Insurance Co., generally work only with their own agents, so consumers may need to consult with more than one agent.) Consumers also should check the agent's license status and disciplinary history with their state's insurance department.

3. OVERLOOKING SHARED BENEFITS

Fewer than half of couples purchase a rider that allows them to share benefits. But doing so is an inexpensive way to "double the benefits available to one spouse," says Jesse Slome, executive director of the American Association for Long-Term Care Insurance.

Consider a couple with two policies that each covers up to three years of benefits. If the policies are linked and the husband needs four years of coverage, he can use his policy plus a year of his wife's coverage. The downside, of course, is that this would typically leave the wife with only two years of benefits.

While a shared-care rider on a contract that provides five years of benefits typically boosts premiums 10% to 15%, it is far cheaper than buying an additional five years of coverage for both spouses, says Claude Thau, an insurance broker who helps financial advisers with long-term-care planning for their clients and is also a consultant to insurers.

Some couples also overlook the fact that they can get discounts of as much as 30% when they purchase policies together, says Mr. Slome.

4. UNDERESTIMATING INFLATION

Inflation protection is key. After all, if you buy in your mid-50s and don't need coverage until your mid-80s, Mr. Gleckman says, "30 years of inflation is going to eat into the benefit."

Buying inflation protection can add 50% or more to the cost of a premium. Perhaps for that reason, 94% of people who buy hybrid policies, which package long-term-care coverage with a life-insurance policy or an annuity, and nearly one-third with conventional policies forego the protection or opt for skimpy coverage.

In the past, 5% compound inflation protection was the default for many policyholders. These days, with the rate of inflation for home care at 1% and for nursing homes at 4% to 4.5%, carriers and agents are pushing new and less-expensive options—including coverage that keeps pace with the consumer-price index or that grows 1%, 2%, 3% or 4% a year.

Many agents recommend that most applicants stick with compound inflation protection. To see why, consider a policy with $100,000 of benefits that grows at a 5% compound rate. The $100,000 benefit rises to $162,889 by the end of year 10, to $265,330 after year 20, and to $432,194 after year 30. With simple inflation protection, the $100,000 initial benefit grows by a flat $5,000 a year, to $150,000 in year 10, $200,000 in year 20 and $250,000 in year 30, according to Mr. Thau.

How much inflation protection is ideal? Consider the following comparison between policies with 3% and 5% inflation protection. To run the numbers, Mr. Thau recommends the following approach: Take the amount of coverage you want—for example, $360,000 over five years—and price a policy with 5% compound inflation protection. For a 55-year-old couple, Mr. Thau says he obtained a price quote of $7,238 for the annual premium.

Then, take that $7,238 and shop instead for a policy with benefits that grow by 3% compounded a year. With such a policy, a 55-year-old couple willing to spend $7,238 a year can secure $619,560 in benefits over five years—or 72% more than the 5% policy's initial $360,000 benefit.

Still, the 5% policy's benefit will grow at a higher rate than the 3% policy's benefit. By the time the couple is 84, the 5% policy's benefit will be higher, Mr. Thau says. As a result, if the couple think they are likely to incur most of their claims after age 84, they'll be better off with the 5% policy, says Mr. Thau. But if they think they will submit most of their claims before reaching 84, the 3% policy is the better solution.

Another type of inflation protection that is becoming more popular is a so-called guaranteed-purchase, or future-purchase, option. These allow the insured to buy inflation protection in installments over time.

Bonnie Burns, training and policy specialist for California Health Advocates, a nonprofit education and advocacy organization, warns against this approach. While initially much cheaper than policies that lock in inflation protection at the outset, the premiums become significantly more expensive as inflation coverage is bought at older ages, says Ms. Burns.

5. FAILING TO READ THE FINE PRINT

Some families with long-term-care insurance policies encounter claims denials that can prevent or delay the collection of benefits. But there are ways to avoid future problems. The key: Before buying, be familiar with the definitions and terms of the contract so you will know when and how you can use the benefits, says David Wolf, who owns a long-term-care insurance planning firm in Spokane, Wash.

The vast majority of long-term-care contracts pay benefits under one of two conditions: The policyholder must be unable to perform two out of six basic "activities of daily living," such as dressing or bathing, or have a cognitive impairment requiring "substantial supervision," says Betty Doll, an independent agent in Asheville, N.C. These conditions are found in all tax-qualified policies, meaning the benefits won't be taxed as income and the premiums have the potential to be deducted as medical expenses. For tax-qualified policies, which are virtually all policies sold today, a health-care professional, such as a doctor, nurse or social worker, must certify that the disability is expected to last at least 90 days.

Still, just because you qualify for benefits doesn't mean your insurer will pay your claims right away.

To reduce premiums, policyholders typically choose a waiting, or "elimination," period of up to 90 days before benefits kick in. (Some newer policies sell waivers of this elimination period for home-based care.)

Moreover, some policies calculate the elimination period using a "calendar-day" method. This requires someone with, say, a 90-day elimination period to wait 90 days before receiving benefits. But others use a "service day" approach in which the insurer counts only the days the policyholder foots the bill for his or her care, using licensed caregivers.

All things being equal, Mr. Wolf says he would go with the calendar-day approach. But most carriers sell inexpensive riders that either convert policies to the calendar-day method or give policyholders who pay for one day of care credit for the entire week, he says. So, if a policy with the service-day approach were to fit a client's needs best, he recommends simply buying one of these riders.

Some contracts mandate the use of home-care agencies with specific licenses. Mr. Wolf favors policies that give beneficiaries the flexibility to hire "home-care" agencies, which provide help with dressing, bathing and other forms of personal care. These agencies generally charge less and are more abundant than "home-health-care" agencies, which dispense skilled medical care, he says.

Mr. Wolf also recommends a rider that lets policyholders choose a monthly, rather than a daily, benefit. That way, someone with a $150 daily benefit can spend more than $150 some days, and less on other days. Because home care can be just as expensive as facility care, Mr. Wolf says it is important to purchase the same daily coverage amount for both.

6. FAILING TO COMPARE HYBRIDS AND CONVENTIONAL POLICIES

These days, affluent buyers are flocking to hybrid or combo policies, which package long-term-care coverage with a life-insurance policy or an annuity. While sales of traditional policies fell 23% to 233,000 in 2012 from 303,000 in 2007, sales of hybrids have risen sharply, to 86,000 from 15,000, according to Limra, a nonprofit insurance and financial-services research organization.

One attraction to hybrid policies: Customers can pay for the entire premium up front, and so effectively lock in a price for the benefits. With conventional policies, buyers theoretically lock in a steady, stable premium, but in reality, carriers have raised premiums on these policies in recent years. In addition, when hybrid policyholders die without using their long-term-care coverage, their heirs receive a death benefit.

But there are downsides to hybrid policies. For one thing, they levy an added layer of fees—in the form of the mortality and administrative expenses carriers generally assess on life-insurance policies—on top of the morbidity charges in traditional long-term-care insurance policies, says Mr. Wolf.

Also, when policyholders start to receive long-term-care benefits, they must deplete the death benefit before they can access any of the additional long-term-care coverage they purchased. Thus, there is no guarantee that their heirs will receive any life insurance, he says.

While the benefits on both types of policies are tax-free, only individuals with traditional policies can deduct their premiums, says Mr. Kitces. And only traditional policies can qualify for the government-endorsed Long Term Care Partnership Program, which allows those who outlive their coverage to protect some of their assets and still qualify for Medicaid, says Mr. Wolf.

If interest rates rise, Mr. Kitces says, consumers considering a hybrid are likely to come out ahead by keeping their money—and using the investment returns to purchase a traditional policy.

Consider a 60-year-old man who puts $150,000 into a hybrid policy with a maximum death benefit of $159,500. If he eventually needs long-term-care, the policy will pay $5,200 a month for up to four years, a benefit that compounds at 5% a year, says Mr. Wolf.

But if he instead puts his $150,000 into an investment with a 4% return, he will earn $6,000 a year—or enough to buy a four-year policy with a monthly benefit of about $11,000 that compounds at 5% a year, says Mr. Wolf. That's more than double the hybrid's monthly benefit and the man can always leave the $150,000 in principal to his heirs. The risk, of course, is that the investment returns might not cover his premiums.

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