



CURRENTS

OCTOBER 2011

Long Term Care Expenses: What You Need To Know

By Lis Zimmerman and Cindy Kuppens

"About 70 percent of people over age 65 will require some type of long-term care services during their lifetime. More than 40 percent will need care in a nursing home."

Source: U.S. Department of Health and Human Services National Clearinghouse for Long Term Care Information

Fostering Trust
Building Wealth
Educating Clients

In the August issue of [Currents](#), we covered the potential high costs of health care in retirement and provided an overview of Medicare coverage. We will now switch to the topic of long term care expenses, how they could affect your retirement assets, and how to be prepared. We will examine the difference between self insuring and purchasing a long term care insurance policy, considerations related to purchasing a policy, and discuss several new long term care products that you may want to review.

Long term care services are household and personal care services that are not covered under your health insurance policy. They can range from non-skilled care in the home, helping with daily chores such as grocery shopping, to highly-skilled care in a nursing home. Care can be received in the home, an assisted living facility, an adult day care, or a nursing home. After a qualifying hospitalization, Medicare covers the first 20 days in a nursing home and partial coverage during the next 80 days. Beyond 100 days, there is no coverage. Your primary consideration is how to pay for this care, if needed. Your choices are to self-insure or to buy a long term care insurance policy.

Self Insure or Buy Insurance?

A long term care insurance policy works a bit differently than most other insurance policies. With a long term care policy you are purchasing a pool of money. This pool of money represents an estimate of what you expect to spend on (or would like to insure for) care that would not be covered under your health insurance policy. This includes nursing home care, home health care, and assistance with household tasks, adult day care, and assisted living. For example, in 2010 the average annual cost of a private room in a nursing home in the Boston area was approximately \$138,000, according to John Hancock's 2011 Cost of Care study. If you want to insure for a three year stay in a nursing home, then you might buy a pool of money worth \$414,000. Once you determine your estimated need (in today's dollars), the next step is determining how that need is to be funded. Your choice is either to self insure or to transfer the risk to an insurance company by buying a long term care insurance policy.

*The greatest
compliment you
can pay is the
referral of friends
and family. Thank
you for your trust!*

Self Insurance

Let's first look at self insuring. This means you forgo insurance and decide that you will pay out-of-pocket for long term care costs. To do this you must be able to afford to set aside a pool of money (\$414,000 in our example) and still meet your retirement goals with your remaining assets and other income sources, such as Social Security benefits or a pension. The easiest way to test this is to remove \$414,000 from your retirement asset pool and look at the long term implications without that pool of money. The \$414,000 will be dedicated to long term care costs. If you do not use the funds for long term care, then any remainder will go to your heirs after your death. That is the purest way to look at self insuring, but of course it is not always this straightforward. There are multiple other variations, including partially self insuring. By purchasing some long term care insurance, even if it doesn't cover your entire need, you will protect your current assets longer than if you had no insurance.

Purchasing a Long Term Care Insurance Policy

If you decide that you don't want to self insure for all or part of the cost of long term care then you would begin to look at long term care insurance. To help ensure that you are presented with the best policies for your situation, you should work with a broker who is independent and authorized to purchase insurance from any company.

If you purchase a long term care policy, you will be eligible to receive benefits when a medical professional certifies that you are not capable of performing two to three "activities of daily living" such as feeding, bathing, walking and transferring (e.g., from a bed to a chair), bladder or bowel control, or dressing. In addition, a cognitive impairment will also qualify you in most cases.

In evaluating long term care insurance, you will need to consider a number of factors, including the type of policy, the amount of benefits, and the insurance company.

POLICY SPECIFICS: There are a number of decisions you will need to make regarding the policy you choose. With each choice you make you are weighing the cost of the care, the benefit of the care, and the risk to which you expose yourself if you do not have the coverage and need it at some point in the future.

Daily Benefit/Benefit Period: You will need to decide the amount of your daily benefit, and for how many years you would like to have that benefit. In order to make this determination, you should look at costs of care in the area you are likely to live in during retirement. You also want to consider your family history regarding health and longevity. Keep in mind that you are purchasing a pool of money equivalent to a benefit and not the actual benefit. For example, if you purchase a pool of money equivalent to a daily benefit of \$300 for 3 years it is possible that once you begin using the funds they may carry you longer than 3 years.

Elimination Period: This is the waiting period from the time you qualify for benefits until the benefits begin. The range varies and can be immediate to 60, 90, or 120 days. The longer the elimination period, the lower the premium. However, the risk of a longer elimination period is that you must cover all costs during that period.

Coverage: It is important to be clear about what type of care is covered in the policy. In the past, policies could be purchased similar to an à la cart menu. That is, you could purchase a policy that would only cover nursing care. Most of the policies today cover all types of care including home care, nursing care, adult day care, and assisted living. You should read the policy carefully to understand what is covered and be aware of any gap in coverage or any items with partial or limited coverage.

Inflation: Keep in mind that whatever coverage you choose, you must consider the effects of inflation. According to the U.S. Centers for Medicare and Medicaid Services, over the next decade health care expenses will rise at an average annual rate of 5.8 percent, or 1.1 percent more than anticipated U.S. economic growth. Inflation protection can be added to a long term care policy via a rider, and you will pay extra for this coverage. There are a number of choices as to what type of inflation protection is best for your situation, but our feeling is that some sort of inflation protection is essential. In many cases long term care insurance is not used until well after the policy is purchased. If you purchase a policy with the equivalent of \$300 per day coverage at age 60 and need care 20 years later at age 80, that \$300 per day cost of care, taking expected health care inflation rates into account would have grown to \$ 927 per day. Without the inflation rider, you would have to pay the difference of \$627 per day out of your own funds. Therefore, the pool of money you purchase to cover your care will not last very long if the benefit is not adjusted for some type of inflation.

Additional Features: There are additional riders and policy features that are worth considering. These range from shared care, waiver of premium benefits, and nonforfeiture benefits. In addition, most policies offer discounts to spouses.

Insurance Company Strength: What is the financial strength of the insurance company? What is the history of claims paid versus the claims made? These are two critical questions to ask when evaluating a long term care insurance company. You would expect to own the policy for a long time and therefore the financial strength of the company is imperative. Insurance companies are rated by several companies such as Standard and Poor's, Fitch, and AM Best. In addition, each company has a "Comdex score" which is a composite of the company's ratings. The Comdex score ranks each company based on their percentile; strong companies have higher Comdex scores than weaker companies.

Affordability and the Alternatives: Given the high cost of the policy premiums, some feel that they can't afford to purchase long term care insurance. You certainly want to consider the effect the premium payments will have on your budget. You also want to weigh the risks. What would happen in a worst case? Could you move in with a family member? More important, is that person willing and/or capable of helping to care for you? Would you want to be cared for by this person? If you do run out of assets due to long term care costs, you would rely on Medicaid, a Federal and state program for those with limited resources and income. Another option is to use the value of your home to help with the costs by taking a reverse mortgage.

Some people feel long term care insurance is a waste of money. If you can afford to self insure you may not need to buy insurance. However, you may want to consider whether you want to leave an inheritance to your heirs. If this is important to you, you might consider purchasing a policy that will help protect a portion of your assets.

Hybrid Products: Over the past several years some additional approaches to funding long term care expenses have been introduced, including combination policies, transferring old insurance policies to long term care policies, and life insurance policies with accelerated benefits for long term care services. One type of policy serves two purposes, life insurance and long term care. If you die without needing any long term care, the proceeds of the policy can be paid out as a death benefit. In addition, some old annuity policies or permanent life insurance policies with cash value can be converted to long term care insurance with no negative tax consequences. Finally, another option is to purchase a life insurance policy with accelerated benefits for long term care services. This means that if you are ill and need long term care services, a part of the death benefit of the policy

CURRENTS

October 2011
Page 4

can be used to pay for these services. There are specific guidelines as to when the death benefit can be used for long term care costs and what services qualify so it is important to know what you are buying.

Deciding how to cover long term care costs can be a difficult process. Like any financial decision, it must be made in conjunction with your goals. Careful planning in this area will allow you more flexibility, comfort, and preparedness when the time comes. We would be happy to discuss your long term care needs, the details of an old policy, and potential options for you.



O'Brien Management
INVESTMENT STRATEGY & MANAGEMENT

124 Mt. Auburn Street, Cambridge MA 02138 www.obrienmanagement.com

Phone: 617-547-6717