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CHAPTER 6

LONG-TERM CARE INSURANCE

INTRODUCTION

Although most adults expect to remain healthy and independent throughout their lives, some develop chronic illnesses or conditions that require care over a prolonged period of time. Such care can range from assistance at home to more extensive care in assisted living facilities or nursing homes. Long-term care in any setting can be expensive. For example, the median costs in Massachusetts for a licensed home health aide is $24 per hour, for an assisted-living facility is $59,400 per year, and for a private room in a nursing facility is a staggering $133,225 per year.

Unfortunately, Medicare, Medicare Supplements and ordinary health insurance generally do not cover long-term care expenses. As a result of this gap in coverage, the cost of long-term care is often borne by the individual who is forced to either private pay or apply for MassHealth (Massachusetts Medicaid) coverage when the individual can no longer pay through his or her own financial resources. Due to the costs associated with long-term care and the strict asset requirements of MassHealth eligibility, many adults are seeking private long-term care insurance (LTCI) to help pay for these costs. LTCI helps consumers pay for the cost of care in both private home and private facilities to preserve the retirement nest egg, protect income streams and to promote greater choice in the market for care.

Also, unfortunately, in the last few years many major insurers have stopped offering traditional LTCI to consumers due to many factors, including low return on investment in the current economy and miscalculated underwriting with more and longer claims than originally anticipated. In addition, some companies have increased premium rates substantially on existing policies. These premium increases, while bad news to seniors on fixed incomes, often come offered with what are known in the industry as "landing spots." These are options allowing the policyholder to pay the same premium, but reduce policy benefits such as the daily amount paid or length of time the policy will pay. That said, as the industry has changed and policies have become more expensive, it may be advisable to give greater consideration to hybrid life/long-term care insurance contracts and fixed annuities with long-term care insurance provisions *(see Section D of this chapter)*. These can provide an alternative to traditional long-term care insurance. This chapter will discuss both options in detail.

A. What are the Benefits of Long-term Care Insurance?

Modern long-term care policies can offer coverage for long-term care expenses not otherwise covered by medical insurance. Policies may provide a cash benefit or offer reimbursement for the cost of care up to the policy limits. Many policies today will cover care in the home and in facilities, providing flexibility for the insured elder. As custodial care can be quite expensive, the insurance can provide the funds necessary to pay for care without exhausting assets or liquidating retirement plans. Oftentimes, liquidating retirement plans can create income tax issues, further accelerating the degradation of the elder's nest egg. Furthermore, if care expenses exceed interest earned on the retirement assets, the elder can rapidly reduce principal, leaving fewer assets available to generate future income or leave to loved ones.

A significant benefit to a traditional LTCI policy is that Massachusetts law and regulations allow for an exemption against a post-death claim by MassHealth for recovery of MassHealth benefits paid during the life of the policyholder. This exemption protects the primary residence (the "home"), providing the policy meets certain minimum requirements. The minimum policy benefits must be in place at the time the policy is purchased (the policy could certainly exceed these and still qualify), and must include:

- Coverage for nursing home care for at least 730 days;
- Pay at least $125 per day for nursing home care; and

- Policy must begin paying benefits within one year, or have a substantial deductible.

If the policy did not have the minimum benefits in place when purchased, but due to inflation riders the policy did have the minimum benefits in place when the person is institutionalized, the exemption would not apply.

In addition to these basic provisions in the policy, the following actions must be taken to take advantage of the exemption:

1. An application for MassHealth Long-Term Care must provide that the applicant does not intend to return home.
2. The policy must still be in place at the time of institutionalization, and some minimum policy benefits must still be in place. The exemption only covers long-term care costs such as nursing home or hospice costs. MassHealth payments for medical bills such as hospitalization during life are not protected. The exemption only applies to the person(s) who is, or are, the named insured(s) under the LTCI policy. For instance, if only one spouse has an LTCI policy, unless the policy covers both spouses, the exemption will not protect the house against the MassHealth costs of the spouse who does not have the policy.

Because current hybrid LTCI policies allow for a return of premium paid by the policyholder during the term of the policy (you can get your cash paid for the policy back), they do not qualify for the exemption.

B. Potential Tax Advantages

For individuals who do not itemize deductions, no income tax deduction is available for long-term care insurance.

Under IRC Section 7702B (a)(1), LTCI is treated as an accident and health insurance benefit. For those who itemize deductions, premiums may be deductible up to the eligible LTCI premium limit. For example, the individual who turns 71 before the beginning of 2017 can claim a deduction for up to $5,110 in long-term care premiums on his or her 2017 return, but the deduction, combined with other deductible medical expenses, may be deducted only to the extent they exceed 7.5 percent of adjusted gross income (for 2018, the premium limit is $5,200).

Please note, policyholders who own a business may well have the ability to deduct a greater portion of the premium depending upon how the business is structured. Consult your tax adviser for more information.

When benefits are received, the reimbursement for care under a policy brought by an individual is not included in income (IRC Section 104(a)(3), 7702B(a)(2) but if the contract provides for a per diem reimbursement, the exclusion is limited to $360 in 2017 and 2018. Different provisions apply to LTCI provided through an individual's employer. If the premiums paid are not includable in the employee's income currently, benefits will be taxed when received. Thus, it is normally beneficial to be taxable currently on employer-paid premiums. However, if LTCI is provided through an individual's employer, and the premiums are not includable in the employee's income when paid, benefits will be taxed when received.

C. When to Purchase Long-term Care Insurance

As with any other type of insurance, it is necessary for consumers to purchase LTCI before they need it. The main advantage of purchasing LTCI earlier in life is the reduced cost of premiums. For example, the premiums for a policy purchased for a female, non-smoker, aged 55, would be approximately $3,000 per year. The same policy for the same person at age 75 would be approximately $8,000. Purchasing LTCI earlier in life, however, carries its own risks. First, LTCI is generally an unwise investment for those who cannot afford to pay the policy premiums for the remainder of their lives because policyholders often pay premiums for many years before needing services. When retired and on a fixed income, premium payments may become difficult.

In addition, long-term care premiums can and do increase over time. Significantly, just this past year a prominent insurance company raised rates an average of 83 percent for federal employees on the plan. Most policies are guaranteed renewable, not non-cancelable, allowing the insurance company

flexibility to raise premiums on a class basis. In fact, over the last decade, many carriers have had rate increases, in many cases increasing rates by more than 40 percent. Such increases can make keeping the policy in place for elders on fixed incomes very difficult. In Massachusetts, rates have not been raised in the past several years, but are expected to be subject to increases in the coming year. Companies are looking at ways to provide so-called "landing-spots," amending policies so that benefits are reduced but premiums remain affordable.

D. What to Consider When Comparing Policies

- **Limits on Benefits**

  LTCI policies generally feature both daily (expressed in dollars) and lifetime maximum benefits (expressed in days). Daily maximum benefits vary in terms of the amount of money the insurance company pays for each day or month a policyholder is covered by an LTCI policy. If the cost of care is more than the policyholder's daily or monthly benefit, the policyholder will need to pay the balance out of his or her own pocket. Please note, some insurance companies offer monthly benefit options rather than daily.

- **Length of Benefit Period**

  LTCI policies cover different periods that measure the length of time policyholders can receive benefits from their policy. In Massachusetts, LTCI benefit periods may last as little as two years or as long as a lifetime. While lifetime policies offer the greatest security, many consumers cannot afford the premiums. For most individuals, four years of coverage is more than sufficient, as the average nursing home stay is approximately 2.5 years.

- **Length of Elimination Period**

  LTCI elimination periods are waiting periods before benefits begin. Just as health insurance beneficiaries usually pay for a portion of their treatment out of pocket before they are eligible for benefits, LTCI beneficiaries must pay their long-term care expenses out of pocket during the elimination period. Policies may have no elimination period at all, or may have an elimination policy lasting a full year; typically, the longer the elimination period, the lower the premium.

- **Eligibility to Begin Receiving Benefits**

  Insurers determine whether a policyholder is eligible to begin receiving policy benefits in different ways. The more common methods center on the policyholder's ability to perform various activities of daily living (ADLs). Insurers typically consider a policyholder's ability to eat, walk, move from a bed to a chair, dress himself or herself, bathe and use the bathroom. Ordinarily, a physician or licensed health care practitioner chosen by the insurer evaluates these skills and a policyholder becomes eligible to begin receiving benefits when he or she cannot perform two or more ADLs. When comparing LTCI policies, the consumer should evaluate which ADLs a prospective insurer will consider. Consumers are prudent to consider only those policies that mention bathing specifically, since most elders with long-term care needs require assistance with this task.

E. LTCI/Life Insurance Policy (Hybrids) Contrasted with Traditional LTCI

In recent years, many of the major insurers have exited the individual LTCI industry. With fewer providers and less competition, pricing has become less competitive. Because many elders have concerns about long-term care issues, planners in the industry are developing alternatives. One such alternative is hybrid life insurance/LTCI combination policies. With life insurance/LTCI hybrids, insureds can accelerate access to the death benefit if they need long-term care. The named life insurance beneficiaries receive either the full death benefit if the long-term care benefits are not used, or what remains of the death benefit if the policy has been tapped for long-term care (less any service fee assessed per the insurance contract). These types of policies often offer guaranteed level premiums for life (providing stable costs), while traditional LTCI premiums are subject to change. Also, certain elders with morbidity issues may be able to qualify for coverage in cases in which they are declined for LTCI as many of the hybrid products are underwritten on life insurance (mortality standards) not long-term care (morbidity) criteria.

Some contracts offer amounts greater than the death benefit to pay for long-term care, and even if the death benefit is exhausted by long-term care expenses, some products offer a residual death ben-

efit payable to beneficiaries. In most cases, however, with an accelerated death benefit, one cannot expect substantial insurance payouts for both an expensive long-term care episode and death. The consumer must continue to pay the life insurance premiums while receiving the accelerated benefit.

These policies do not offer joint benefits for spouses (as some so-called joint and survivor traditional LTCI contracts do), since each spouse would have his or her own individual policy.

Hybrid policy premiums generally are not tax deductible, though benefits are usually received tax-free. Generally, stand-alone LTCI policies provide a wider range of benefit options than a combination policy. Also, hybrid policies may not have inflation protection, which would significantly erode the purchasing power of the benefits in the future. Consumers are encouraged to purchase a benefit which is sufficient to cover needs after accounting for potential increased costs of care later.

Recently, insurance companies are beginning to offer fixed annuities with embedded long-term care insurance-like protections and whole life policies, which are funded by a one-time lump sum and provide long-term care insurance benefits. As these options evolve and to determine which asset to use, please be sure to discuss their applicability to your situation with your experienced and trusted advisor.

CONCLUSION

Currently, LTCI plays only a small part in the overall long-term care financing system, covering only about 10 percent of all long-term care costs. However, as individuals live longer, the applicability of insurance options as an estate-planning tool is likely to grow. Remember that it may not be affordable to purchase a policy large enough to cover the entire cost of care. In such cases, one may do well to employ a co-insurance principle in which the consumer purchases a policy which covers some of the risk, and commits to cover the difference (if care is needed) from assets or income. This way the premium is more manageable but the risk is still addressed.

As LTCI is a complex product, consumers should gather information and begin discussing these options for payment of their long-term care costs with family members and experienced advisors well in advance of when they might need long-term care.

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