Assessing Long-Term-Care Risk and Long-Term-Care Options

by Mary Helen McSweeney, PhD
Assistant Professor
Department of Health Care Programs
Iona College
New Rochelle, New York 10801

and

Peter Gomori, PhD
Professor
Management Department
St. Francis College
Brooklyn, New York

Presented at Managing Retirement Assets Symposium
Sponsored by the Society of Actuaries
Las Vegas

March 31–April 2, 2004

Copyright 2004 by the Society of Actuaries.

All rights reserved by the Society of Actuaries. Permission is granted to make brief excerpts for a published review. Permission is also granted to make limited numbers of copies of items in this monograph for personal, internal, classroom or other instructional use, on condition that the foregoing copyright notice is used so as to give reasonable notice of the Society's copyright. This consent for free limited copying without prior consent of the Society does not extend to making copies for general distribution, for advertising or promotional purposes, for inclusion in new collective works or for resale.

1. Introduction

Private long-term-care insurance was first established in the individual product market in the 1960s in response to a perceived need to provide financial reimbursement for skilled nursing home care. Qualification for benefits required a previous hospital discharge, and benefits infrequently covered any community-based services. The product was viewed as a private supplement that assisted individuals in preserving their assets. This market quickly evolved, adding a group insurance product that could be offered to individuals at their place of employment, to public sector employees as well as associations. Long-term-care insurance has now evolved from being "nursing home insurance" to its third generation of product design, providing reimbursement for a variety of institutional and community-based long-term-care services along with more flexible policy designs. This paper examines the risk associated with long-term care, as well as a variety of insurance-based vehicles that can assist consumers in protecting them from this risk.

2. Assessing Long-Term-Care Risk

What is long-term-care risk, and why purchase long-term-care insurance? Under the traditional theory of demand for insurance, people would purchase long-term-care insurance to protect themselves from the risk of financial loss if they become ill and need long-term-care services. They could save for the possibility of a serious long-term-care incident, but for some illnesses, the probability of occurrence is low and the amount saved would be very large. By paying a long-term-care insurance premium, people can protect themselves while not having to save a large amount for a possible catastrophic loss. This conclusion also assumes that long-term-care risk can be defined and assessed. The pure premium for such a product would be a function of both the size of the expected loss and the probability of it occurring. A key problem in the demand for long-term-care insurance is that many consumers are unaware of the true size of the expected loss from long-term care, and there is limited available information with which to make informed decisions. Since the expected loss from long-term care may not occur until very far in the future, the consumer may be willing to pay less over the pure premium than for other, more immediate, probabilities.

There are external factors that affect the potential loss from long-term care. Some of these include: the potential for Social Security insolvency, continued private pension plan terminations and mutual fund investment turmoil. The U.S. population is also aging rapidly, and many people may outlive their assets. There is also greater incidence

of chronic disease, and in the case of Alzheimer's and related dementias, nearly 40 million are predicted to develop some form of this illness by 2015.

3. Long-Term-Care Insurance in the United States: An Overview

Throughout much of the discussion about long-term-care insurance is a debate about the role of the private and public sector. Those arguing for a system with a large public role and social insurance model focus on the market failures and challenges of private long-term-care insurance, and the fact that most individuals who cannot afford to pay for long-term-care services also cannot afford to pay for private insurance (Wiener, Illston and Hanley, 1994). Those arguing for a private-based system emphasize that a public system would lead to inflation in the price of long-term services as evidenced when Medicare was first implemented in the 1960s. In addition, a study by Cohen and Weinrobe estimated that a 100 percent, above-the-line federal tax deduction for long–term-care insurance would provide annual savings to each purchaser of $343, and a nominal savings to Medicaid for each purchaser of $4,258 ($2,243 in real terms) (Cohen and Weinrobe, 2000). Those pushing for a blended public-private insurance system believe they had arrived at a compromise that would incorporate the best features of the public approach and the best features of the private approach (Knickman in McCall, 2001). The decision about how to organize a system of financing long-term care in the United States will continue to be debated, and choices need to be considered such as: Should there be risk sharing with the elderly (i.e., should they be forced to make some type of contribution for payment of long term care services)? Second, should the U.S. population be encouraged to save for long-term-care services at earlier ages? And third, should younger generations in the United States be forced to pay for the long-term-care expenses of generations that preceded them through a mechanism like Social Security? (Knickman in McCall, 2001.) At this point, there is no conclusive answer to financing long-term-care services in the United States. However, the value of private insurance is that it allows individuals greater choices in types of long-term-care services they can get access to, keeping them out of governmental systems, and permits those that need the coverage from social insurance systems to collect their necessary benefits.

The market for long-term-care insurance in the United States exploded during the 1990s and has continued to grow throughout the early portion of the 21st century. This market has two segments: one for individual policies; the other for employer-sponsored and other group products. At the end of 2002, there were nearly 3.9 million individual long-term-care insurance policies in force, a 10 percent increase over 2001, with just under $6 billion in premium in force (Life Insurance Marketing and Research Association (LIMRA International) 2003). In addition, for the first time, over $1 billion

worth of annual benefits have been paid to Americans who possess long-term-care-insurance protection (LIMRA International, 2003) In the employer-sponsored market, collected premiums from policies totaled $900 million in the year 2002 , while new premiums increased by 149 percent (LIMRA International, 2003). Over 5000 employers now offer long-term-care insurance as a workplace benefit with total group participants exceeding 1.5 million. A survey of insurance industry executives by LIMRA International also confirms these trends, with 52 percent of respondents seeing strong growth in the group long-term-care insurance market.

What factors account for growing interest in the long-term-care-insurance market? Legislative changes, such as the passage of the Health Insurance Portability and Accountability Act of 1996 (HIPAA), which defined tax qualified long-term-care policies, and the visibility and success of the new Federal Government Long-Term-Care-Insurance Program, which initiated the sponsorship of long-term-care benefits for federal employees, the military and their families, are key factors. Enhanced tax incentives for employers who sponsor products and individual tax deductions for premiums are important as well. Growing awareness of the aging of the U.S. population, in addition to increasing numbers of employees with eldercare responsibilities, have also elevated awareness, understanding and interest in insurance products that could alleviate their financial pressures, and facilitate payment for quality long-term-care services. A MetLife study found that caregiving by employees impacts employers' bottom lines: informal caregiving costs U.S. employers between $11.4 billion and $29 billion a year due to lowered productivity (MetLife, 2001). Providing employees with the opportunity to purchase long-term-care insurance for themselves and family members could greatly reduce this cost.

Long-term-care insurance has evolved from its early form as nursing home insurance into current policies capable of meeting a variety of consumers' needs. There are two dominant models: a reimbursement model under which policyholders incur expenses and then get payment, and a disability model where policyholders meet certain benefit triggers (usually three out of five activities-of-daily-living (ADL) limitations), then get a fixed cash payment monthly for their expenses. The traditional approach of long-term-care insurance has been asset protection insurance coordinated with financial planning services. This has evolved into a newer concept of lifestyle-protection insurance where a cash benefit is paid to the policyholder who can purchase formal and informal long-term-care services. Under the latter concept, choice of long-term-care services and options and the ability to stay away from state Medicaid services are critical.

While individual policies form the foundation of the long-term-care insurance market, recent attention has been on the group or employer-sponsored segment due to

its sustained growth and affordability for the majority of individuals. Policies can be explained in terms of eligibility, plan design and administrative components. In employer-sponsored plans, active employees and their spouses, parents and parents-in-law, retirees and their spouses typically are eligible for coverage; some groups like the Federal Government plan extend benefits to adult children of employees. Most group long-term-care insurance is offered on a voluntary, employee-pay-all basis, is fully portable, and the majority of policies are HIPAA tax-qualified, paid through payroll deduction. A key aspect of today's product is that in most plans, actively-at-work employees can enroll without medical underwriting, i.e., on a guaranteed issue basis, during their initial eligibility period (either when the plan is first offered or as they are newly hired). Family members may be subject to medical exams, although spouses of active employees may go through a simple interview to determine that they have no immediate long-term-care needs. Waiting periods for benefits, or an elimination period, are typical, and can range from 30 to 180 days.

Under group plans, policies are subject to satisfaction of benefit triggers, which are typically two or three out of five ADL limitations (limits in ability to bathe, dress, transfer, toilet and eat) or the presence of cognitive deficits such as Alzheimer's or related dementia, which may act as a separate, independent cause for benefit payment. Today's policies offer a rich array of benefits coverage for nursing home services, home care (both skilled and custodial) and nursing home alternatives such as assisted living, personal-care homes and adult day care centers. Some plans cover respite and hospice care, and many offer an alternate-care benefit, which is designed to provide reimbursement for services of providers not covered by the policy when it may be required by the consumer. Other common benefits are case-management services, homemaker or chore services, bed reservation reimbursements, durable medical equipment coverage, home-delivered meals, spousal discounts, survivorship benefits, restoration of benefits (the maximum lifetime benefit is restored to its original maximum if benefits have been paid under the policy, and the policyholder does not require care for a designated period of time) and caregiver training. The range of benefits offered depends on the plan desired by the employer, as well as the needs of the employee population (McSweeney, 2002). Benefits may also be supplemented by certain consumer protection benefits, such as inflation protection (adjusts benefits by a fixed percentage in any given year) or nonforfeiture options (employees receive a certain portion of premiums back if they decide to terminate the policy). Other policy models coordinate long-term-care insurance with other benefits, such as life insurance or long-term-disability coverage. Premium or rate guarantees to protect employees from future increases may also be negotiated by employers for these policies (McSweeney, 2002).

Who purchases long-term-care insurance? According to surveys by the Health Insurance Association of America, the average purchaser of individual policies is 67. However, the average age of purchasers of employer-sponsored policies is 43, well-educated, has more income, plans for the future and chose to participate in the plan because of employer sponsorship (Coronel and Stucki, 2001). A survey of 93 large employers conducted by the Lewin Group found that employees enroll in long-term-care plans when education and communication about the benefit is clear, and when senior management is actively involved in the process (Lutsky, Corea and Alexhis, 2000).

4. Product Innovations

A number of product innovations have been introduced into the long-term-care insurance marketplace. Some companies have instituted a "cash and counseling" variety of disability policy under which the consumer receives a cash benefit for unpaid or direct-hire workers as well as other informal care benefits. This type of policy evolved from the successes of the National Cash and Counseling Demonstration in Arkansas, Florida and New Jersey, which instituted a consumer-directed model of financing and delivering supportive long-term-care services (Foster et al., 2003). While the flexibility of these policies may appeal to the consumer, their pricing tends to be higher than more traditional reimbursement model products.

In 1988, planning grants were made to establish public-private partnerships for long-term care between private insurance companies and the Medicaid program under the Robert Wood Johnson Foundation (RWJF) Partnership for Long-Term Care; four of the original eight states (California, Connecticut, Indiana and New York) still have operational programs (Merrill in McCall, 2001). Under the Partnership programs, sales of policies are coordinated with their state Medicaid programs; policyholders have a guarantee of lifetime coverage of long-term-care services if their policy benefits are exhausted, and their estates are not subject to Medicaid estate recovery (known as the Waxman Amendment) upon their demise. A number of states have expressed interest in starting their own Partnership programs, but are hesitant until the Waxman provisions can be repealed.

Newer product innovations include long-term-care insurance combination products and core/buy-up plans. There are three types of combination products: (1) life insurance with a long-term-care insurance rider; (2) deferred annuities with a long-term-care insurance rider; and (3) immediate annuities for long-term-care expenses. Combination products account for an estimated 3 to 5 percent of the long-term-care insurance market, and have strong appeal for buyers over the age of 60 who are looking

for more flexibility in coverage of potential long-term-care services. These products are appealing to the consumer because they avoid the "use it or lose it" approach of traditional long-term-care insurance and allow policyholders to reposition their current assets versus spending fixed income on product coverage. Companies like the combination products because they allow for risk sharing with clients: the policyholders are using their own money to cover long-term-care expenses, so they don't have an incentive to utilize benefits.

Core/buy-up long-term-care insurance is an innovation where a blurring of individual and group product markets has occurred. Under these plans, the "core" is a long-term-care-insurance plan that is employer-paid coverage, and the policyholder has the option of a "buy-up" of enhanced coverage that is a voluntary, employee-pay-all benefit. The key attraction of this product is the 100 percent participation of employees (under guaranteed issue) within the core group. There are standardized and customized designs, and the target market for this product is small to middle market accounts, many of which have fewer than 100 lives. This product is also appealing to the executive market, where the base plan can be for executives only, with a richer plan for executives and spouses provided through the buy-up provision.

5. Legislative Initiatives

Recent proposals from the Bush administration may change the market for long-term-care insurance. The recent passage of the Medicare Prescription Drug Legislation provides for the creation of health-care-spending accounts (HSAs) that are tied to a high-deductible health insurance plan. Under the HSA, the policyholders can reimburse themselves for purchases of long-term-care insurance. However, the typical deduction for a 45-year-old policyholder under these accounts is $260—a limited amount which may not induce large purchases of long-term-care insurance (Holubinka, 2004). In addition, employers may be hesitant to introduce the HSA concept in the workplace due to the potential unpopularity of high-deductible health insurance for their employees. The Bush FY2004 budget also has an above-the-line, full deductibility provision for long-term-care-insurance premiums; however, this provision hinges on the passage of the current Federal budget proposal. U.S. Senators Larry Craig (R-ID) and Evan Bayh (D-IN) recently introduced S. 2077—the Long-Term Care Insurance Partnership Program Act of 2004—which would amend Title XIX of the Social Security Act to permit additional states to enter long-term-care partnerships under the Medicaid program; the House of Representatives has HR 1406, a companion bill that was introduced last fall. There is also discussion of a national partnership for long-term care that would repeal the Waxman provision on Medicaid estate recovery and offer a

uniform model for partnership policies that would eliminate the potential for 50 state versions of the provisions.

6. The Future of Long-Term-Care Insurance

What is the future outlook for long-term-care insurance? In the United States, legislators have introduced proposals to promote the purchase of long-term-care insurance by federal Government employees, retirees and their dependents, as well as deductions for premiums paid for these policies. In a recent survey by the American Council of Life Insurers (ACLI), it was found that 35 percent of companies with 5,000 or more employees last year offered long-term-care insurance as an employee benefit, as did 25 percent of businesses with 1,000 to 4,999 workers. Moreover, at least 26 state governments offer the insurance to their employees, and one-third of policy owners—many of them blue-collar workers—purchased the insurance before age 65 (ACLI, 2003). Researchers say this is evidence of a shift to the view of long-term-care insurance as a retirement-protection or financial-planning tool. Senior management "championship" of employer-sponsored long-term-care insurance, as well as a comprehensive pre-enrollment education campaign on the value of long-term-care insurance, are also key indicators for a successful plan enrollment. While pretax purchases of long-term-care insurance cannot be offered as part of a flexible benefits program in the U.S. workplace, passage of pending legislation in Washington as well as state initiatives to offer tax credits or deductions for policy premiums and, ultimately, full deductibility of long-term-care premiums for the consumer, may open the market considerably for this benefit.

References

American Council of Life Insurers. 2001. *Long-term care insurance at work: The retirement link and employee perspective*. Washington, D.C: American Council of Life Insurers.

Cameron, K. and Firman, J. 1995. *International and domestic programs using "cash and counseling" strategies to pay for long term care*. Washington, D.C.: National Council on Aging.

Cohen, M.A. 2002. *Benefits of long-term care insurance: Enhanced care for disabled elders, improved quality of life for caregivers and savings to Medicare and Medicaid* (research findings). Washington, D.C.: Health Insurance Association of America. www.hiaa.org.

Cohen, M.A., and Weinrobe, M. 2000. *Tax deductibility of long-term care insurance premiums: Implications for market growth and public LTC expenditures* (summary of research findings). Washington, D.C: Health Insurance Association of America. www.hiaa.org.

Coronel, S. 2002. Long-term care insurance in the workplace: A study of why employers choose to enroll or not to enroll in long-term care plans. Presentation at the 15th Private Long-Term Care Insurance Conference, Miami, Fla.

Coronel, S. 2002. *Long-term care insurance in 1998-1999*. Washington, D.C.: Health Insurance Association of America. www.hiaa.org.

Feldstein, M. *The economics of health* (3rd edition).

Foster, L., Brown, R., Phillips, B., Schore, J., and Carlson, B. 2003. Improving the quality of Medicaid personal assistance through consumer direction. *Health Affairs*, March 26, 2003.

Health Insurance Association of America. 2002. *2000-2001 Who buys long-term care insurance in the workplace?* Washington, D.C.: HIAA.

LIMRA International. 2003. *LTC insurance and Medicare supplement 2002*.

LIMRA International. 2003. *U.S. group long-term care insurance 2002*.

Lutzky, S., Corea, J., and Alecxih, L. 2000. *A survey of employers offering group long-term care insurance to their employees*. The Lewin Group, May 31, 2000.

McCall, N., ed. 2001. *Who will pay for long term care? Insights from the partnership programs*. Chicago, Ill.: Health Administration Press.

McSweeney, M.H. 2002. *Long-term care: An emerging employer benefit*. Scottsdale, Ariz.: WorldatWork, Inc.

MetLife Mature Market Institute. 2002. *The MetLife study of employed caregivers: Does long-term care insurance make a difference?* Westport, Conn.: MetLife Mature Market Institute.

MetLife Mature Market Institute. 1999. *The MetLife juggling act study: Balancing caregiving with work and the costs involved*. Westport, Conn.: MetLife Mature Market Institute.

MetLife Mature Market Institute. 2002. *2001 MetLife study of employee benefit trends*. Westport, Conn.: MetLife Mature Market Institute.

Stucki, B. 2002. Long-term care insurance at work: The role of retirement planning. Presentation at the 15th Private Long-Term Care Insurance Conference, Miami, Fla.

Tilly, J. 1999. *Consumer-directed long term care: Participants' experiences in five countries*. Washington, D.C.: AARP Public Policy Institute.

Wiener, J.M., Illston, L.H., and Hanley, R.J. 1994. *Sharing the burden: Strategies for public and private long-term care insurance*. Washington, D.C.: The Brookings Institution.