A New Strategy for Paying for Long-Term Care

One option: Figure out how much you can afford to pay on your own and buy insurance to fill the gaps.

By **Kimberly Lankford**, December 2012

Elizabeth McLeod, an investment adviser in Overland Park, Kan., primarily works with people who want help investing for retirement income. But before she draws up an investment plan, she asks her clients what they plan to do if they need long-term care. She tells them that they should factor about $230,000 into their financial plan for potential long-term-care costs -- the current average daily cost of care multiplied by the average claim of about three years.

Even when her clients can afford to pay that amount out of pocket, they usually don't want to. "They find it hard to stomach the thought of spending that much of their retirement savings," she says. But McLeod's clients don't want to pay today's high premiums for a long-term-care policy, either. Low interest rates and higher-than-expected claims have led most long-term-care insurers to raise rates or leave the business over the past few years. So instead of buying a fully loaded policy that covers all of the potential expenses, her clients are figuring out how much they can comfortably pay out of their savings and buying long-term-care policies to fill in the gaps.

In fact, that's exactly what McLeod did. When she turned 53 this year, she and her husband, Roger Davis, 64, did an analysis of their own finances and bought long-term-care policies from Genworth. They chose to minimize the premiums, but their policy will still protect hundreds of thousands of dollars of their savings.

Strategic choices. Over the past few years, long-term-care policies have become more restrictive and premiums have spiked. Generous benefits -- such as lifetime payouts and 5% compound inflation protection -- are extraordinarily expensive or have disappeared from policy menus. But every year a new wave of baby-boomers watch their parents and aging relatives write checks for more than $7,000 each month for care -- blowing through their retirement savings.

Financial advisers know that long-term-care costs can be one of the biggest threats to a retirement plan. If you don't deal with the long-term-care risk, "it can decimate the plan," says Keith Moeller, a CPA and wealth-management adviser with Northwestern Mutual in Minneapolis.

With the cost of long-term-care insurance soaring, however, many people are taking a new approach to covering the risk. McLeod and Davis each bought a policy that provides a daily benefit of $100, which increases by 3% per year compounded. The average cost of a private room in a nursing home in Kansas City is $157 per day, according to the MetLife Mature Market Institute, but the couple figure they can afford to pay the difference from savings.

They pay about $3,000 per year for the two policies combined, including a shared-benefits rider, which can provide total benefits of up to $300,000 (in today's dollars) if they need care for up to eight years between the two of them. If Davis needs care for, say, two years, then McLeod could still use six years of coverage. Adding shared benefits tends to increase premiums by about 10% to 15% but can extend the benefit period for one spouse. Even though the average claim is about three years, people who need care for a longer period tend to need it for *much* longer -- sometimes a decade or more if they have Alzheimer's.

Some insurers offer policies with benefits that rise with the consumer price index, and such policies can cost a lot less than ones that offer 5% compound inflation protection. A 55-year-old who wants a three-year benefit period, a $150 daily benefit and a 90-day waiting period would pay $4,320 per year for a John Hancock policy with 5% compound inflation protection; for coverage that rises each year with changes in the CPI, the annual premium is $2,175.

Another key feature is the insurer's home-care requirements. It's better to buy a policy that doesn't require you to use only licensed caregivers from an agency, who tend to cost more than informal caregivers. McLeod and Davis's policies allow them to hire anyone other than a relative. "If you're in a nursing home, it doesn't matter very much what company you use -- they send a check. But home care is where the rubber meets the road when I evaluate a policy," says Mike Ashley, of Senior Benefits Consultants, in Prairie Village, Kan.

Also, look at how the policy counts days of care toward the waiting period, which is often 60 or 90 days. Some policies start the clock as soon as your doctor certifies that you need help with two out of six activities of daily living (such as bathing and dressing) or have cognitive impairment. Others count only the days that you receive care. Note that if you use less than your maximum daily benefit, you can extend the benefit period.

Some insurers are a lot stricter than others about which medical conditions disqualify you for a policy. John Ryan, of Ryan Insurance Strategy Consultants, in Greenwood Village, Colo., recommends that agents review your medical history and then find companies likely to provide the best deal for someone with your health conditions. For his clients, Ryan tends to work with Genworth, United of Omaha and MassMutual. John Hancock, New York Life and Northwestern Mutual are also big players in the long-term-care insurance business.

Premiums vary wildly, so it's essential to comparison shop. Recently, a policy for a 55-year-old with a $150 daily benefit, three-year benefit period and 3% compound inflation protection had an average premium of $2,110 -- but there was a 50% difference between low and high premiums, according to the American Association for Long-Term Care Insurance 2012 Price Index.

More changes on the way. Last summer, Genworth made some big changes to its policies: It suspended preferred-rate discounts in most states, shrank the couples' discount from 40% to 20%, and suspended lifetime benefits and limited-pay policies (such as policies that are paid up in ten years). The company said it will be bringing some of the options back with its new product next year.

The company plans to make more changes with a new policy in 2013 -- and because Genworth is the largest long-term-care insurer, many companies are expected to follow suit. The company will switch from unisex to gender-specific rates, which will cause rates to rise for women buying coverage on their own (Genworth expects rates to even out for couples). The company will also expand medical underwriting, so your health will play a bigger role in the premiums you pay.