

# Intelligent Money

Current thinking from Haven Financial Advisors

## Long Term Health Care Issues



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### Special Notes of Interest:

New home sales in January 2009 were at 309,000 - down more than three quarters from their peak in July 2005

In 2008, the United States spent 17 percent of its gross domestic product (GDP) on health care. It is projected that the percentage will reach 20 percent by 2017.

With political discourse focused on the economy in the past six months, a key issue has been pushed to the background. Health care remains our number one fiscal and public policy problem. One area of health care, long term care for seniors, is poised to require exponentially more financial resources.

Long term care is situated at the intersection of spiraling health care costs and a rapid increase in our aged population. These are the ingredients of a financial time bomb. The baby boomers born from 1946 to 1964 are entering their retirement year with a vastly expanded life expectancy – the tail end of which will likely require outside supervision.

Long-term care differs from traditional medical care and it is not covered by Medicare. Traditional medical care treats physical problems directly in an attempt to cure or control them. Long-term care services help maintain one's ability to perform "activities of daily living" (ADLs) such as dressing and bathing. These basic abilities tend to erode with age. The range of services could include custodial care and skilled care provided in the home, an adult day care center, a nursing home, or an assisted living facility.

### What do the numbers look like?

While many associate long term health care with nursing homes, nursing facilities comprise only a fraction of services involved – especially for younger retirees. Assisted living facilities and home health care visits are considered less comprehensive but essential components of long term health care.

The number of seniors in Texas is expected to triple from 2.7 million to 8.1 million between 2000 and 2040. The demographic story indicates a pressing need for elder care. Today, there is a 60% chance that any individual reaching age 65 will require long term care at some point in their lives. There is a 43% chance that that individual will spend time in a nursing home. The need is especially great

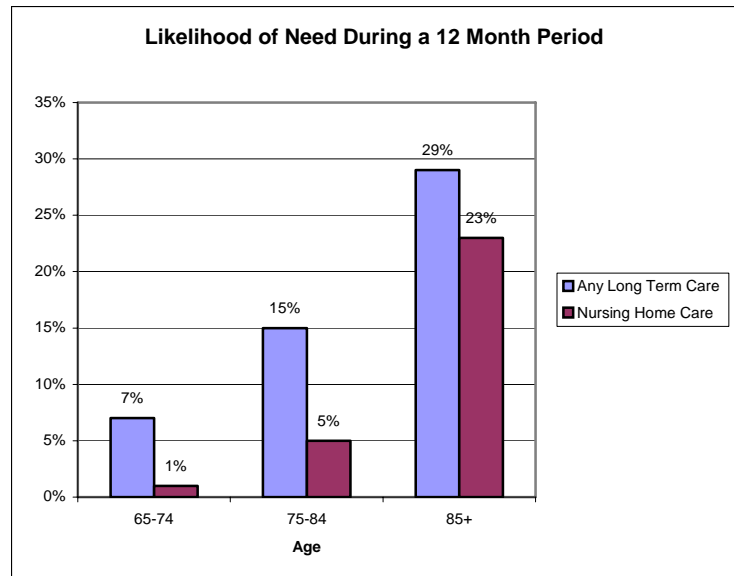
for women who tend to outlive their spouse. The data in the chart below, prepared by the Urban Institute, demonstrate that the need for outside supervision increases dramatically as the individual ages.

The costs of long term care have risen at least as fast as the general inflation rate since the 1990s. The Texas Department of Insurance estimates that nursing home care in Texas can range from \$30,000 to \$50,000 or more per year – lower than most parts of the country. Assisted living can cost \$11,000 to \$36,000 annually in Texas, with costs even greater in urban areas and for upscale facilities. Regular home health care visits by qualified professionals can be more costly than an assisted living facility. Consider that the average cost for these visits in Texas is \$17/hr

### The Financial Response

There are a number of financial responses to an emerging long term health care requirement. Many seniors self insure. The average nursing home stay is two years and those with substantial assets can weather that storm. Some seniors enter into a reverse mortgage that allows them to convert the equity in their homes to cash.

Life insurance policies can provide financial





resources prior to death. A viatical settlement is the sale of a life insurance policy by a policyholder who has a catastrophic or terminal illness or condition. In this case, money is often needed to pay for end-stage care. The policyholder must be diagnosed as having a life expectancy of two years or less. A life settlement, on the other hand, is one in which a policyholder who does not have a terminal illness sells a policy. Under federal law, all earnings from a viatical settlement are tax free. Earnings from a life settlement are taxed at the normal rate.

For those with limited funds, a public program known as Medicaid serves as a backstop. While there are ways to shelter some resources, a senior must generally spend down their financial assets to qualify for a Medicaid care facility. These facilities tend to be of lower quality.

The private insurance market began addressing the issue of long term care in the 1970s. These policies helped to defray nursing home costs. Most of the early entrants have since exited the business. Modern policies must correspond to state model laws and thus offer a wide range of benefits which are discussed below.

**Long-Term Care Insurance – A primer**

Most long-term care policies sold in Texas are individual policies. Some employers offer group policies to their employees. The trigger for coverage is typically the insured's inability to perform two or more activities of daily living (ADLs). Once qualified for coverage, the insurance company will either pay the caregiver or the insured for eligible services rendered. There are typically lifetime caps to the amount of money to be paid out. For example, many policies are structured to pay a specific daily benefit for up to three years.

The most common long-term care benefits are nursing home, assisted living care, home health care, and adult day care. To receive benefits, one must receive care in licensed nursing homes or assisted living facilities or through licensed home health or adult day care agencies.

Premium levels are set as a function of age and health. The earlier one obtains coverage, the lower the premium levels. Underwriting become problematic as an individual enters their 70s. Once underwritten, however, premiums are modeled to stay level indefinitely. If they do increase, it will be for the whole class of policyholders, not because an individual ages or deteriorating health.

While there is considerable variability in policy features, it helps to have an idea about overall premium levels. The table above right describes premiums for an average policy in place in 2005.

Age	Average Annual Premium in 2005
55 to 64	\$1,877
65 to 69	\$2,003
70 to 74	\$2,341
75+	\$2,604
<b>All ages</b>	<b>\$1,973</b>

This "typical" policy paid a daily benefit of \$143 for 5.5. years.

Due diligence is helpful when comparing policies, How many customer complaints has an insurer received? To check, visit the state insurance department website or the NAIC website at [www.naic.com/cis](http://www.naic.com/cis). Some state regulators also compile histories of insurer premium hikes

Long term care policies are long term liabilities of the insurance companies issuing them. A prospective buyer under 70 years old might have doubts about the financial stability of the underwriter over the coming decades. This is especially true in our current economic climate. Individual states offer guarantee funds to guard against insolvency on the part of individual insurers. Texas, for example, will pay up to \$300,000 on a failed long term care policy.

The funding for the guarantee comes from the incumbent insurance companies. As such, it is unlikely that the guarantee fund could survive systemic failure in the insurance industry. Isolated failures of individual carriers should be effectively guaranteed, however.

**Final Thoughts**

There is no doubt that elder care will become a critical public policy issue in the years to come. Long term care policies can help offset the financial burden of end stage health care. But there is no free lunch. Many early entrants to the long term care field have since exited the industry as their liabilities became clearer. Newer policies retain the right to increase premiums and often include lifetime caps on payouts.

These are sensible innovations from the insurer's standpoint but create uncertainty for the consumer. What if a nursing home stay exceeds the policy's lifetime cap? What if an insurer sells its book of business to a new carrier who raises prices drastically? At best, long term care insurance is one piece of long term care strategy. However, newer policies are more consumer friendly with more services covered and inflation protection. They may be worth a look.

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