RETIREMENT SAVI VS. LONG-TERM C

Which Will Come Out on Top?

Employers can help educate employees about the potential impact of long-term care costs on their retirement savings and their options for protecting against that risk.

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by | **Christine McCullugh**

Although employee benefits can help attract and retain great employees, ultimately the purpose of the benefits package is to protect employees against risks they face. Life insurance, health insurance, disability coverage and a 401(k) plan or similar retirement plan each protects against a risk—death, illness, disability or the loss of income in retirement.

But workers often are not protected against another risk: Statistically, two out of three Americans will, at some point in their lives, need long-term care.

According to the federal government's long-term care website, longtermcare.gov:

- 69% of people will need, on average, three years of care, either at home or in a facility.
- Women, who tend to live longer, need an average of 3.7 years of care and men 2.2 years.
- While one-third of those turning 65 today may never need long-term care, about 20% will need it for more than five years.

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The costs can be substantial. MetLife Mature Market Institute reported in 2012 that the average cost of a private room in a nursing home was $90,520 per year, slightly more than the average amount of retirement savings ($89,000 as of late 2013, according to Fidelity Investments), and the average stay is 2.4 years.[1,2] Nursing home care may follow a period during which care is provided at home, in an assisted living facility or both. Home care averages about $55,000 per year for three years,[3] and assisted living care is roughly $42,000 per year with an average stay of three years.[4]

While the length of a nursing home stay may, due to death or recovery, be shorter than the averages indicate, many people who need care are continuing on a path that started much earlier than their entry into the nursing home. For example, an elderly person who lives alone may need weekly help with groceries, housekeeping and medication management. Later, she may need a caregiver to visit daily for four hours to help her with some of her daily living needs. As her requirements increase, a move to an assisted living facility could provide the right amount of support. And if her condition exceeds the amount of care provided at the assisted living facility, she may have to move to a nursing home. Each of these steps has different costs and, depending on how long each lasts, may or may not be affordable out of pocket.

Each individual's situation is unique. Unfortunately, none of us knows how our own will play out. Neither do we know the full impact of inflation on the prices of care at the time we need it. But for the person whose life mirrors the averages mentioned above—three years of paid care at home followed by three years in an assisted living facility followed by 2.4 years in a nursing home—the cost could exceed $500,000 in today's dollars.

What Are the Options for Paying for Long-Term Care?

Many employers dedicate time and resources to educating employees about the need to save for retirement—and rightfully so. Employees need to understand and appreciate their workplace retirement plan. But a long-term care event places retirement savings at risk, even though employees may not know it. The average amount of retirement savings is less than the average cost of a long-term care event.

How will employees pay for care once their retirement savings are exhausted? And how will their spouse live if they use up their retirement savings? Employees may assume that the government will pay for long-term care, or they may succumb to the very human tendency to "think about it later," leaving them unprepared when later comes.

Employers are in a good position to help employees protect themselves against the risk of long-term care by educating them about the risks and potential costs as part of their education about the benefits program.

Essentially, there are three options for paying for long-term care:

1. Medicaid, which is a safety net for the impoverished
2. Self-funding, which may work for high earners who are also dedicated savers
3. Insurance, which can work for the majority of employees. (See the sidebar, "How Does Long-Term Care Coverage Work?")

Following are three myths about long-term care coverage.

Myth #1: My Employees Don't Ask for Long-Term Care Coverage

If employees are not asking about the availability of long-term care insurance, it's likely because they're not aware of or don't understand the risk—They don't know what they don't know. Just because they aren't asking does not mean they or their spouse won't need long-term care—and that realization may come too late. Employers can help educate them just as employers educate about the need to save for retirement.

The *Wall Street Journal* recently reported a 70% chance the average person who reaches the age of 65 will need long-term care. For women, the likelihood is 79%. If the first year of care exhausts a person's retirement savings, how will the person pay for a second year of care?

As an individual's savings disappear, he or she may be forced to rely on Medicaid to pay for care, and the employee's spouse will face the loss of the family nest egg. Any inheritance the person wishes to leave to children will no longer be forthcoming.

Reality #1: Employees need education about the risks of long-term care because it affects their retirement savings and the assets they will leave behind.

Myth #2: The Government Will Pay for Long-Term Care

Employees often are surprised to learn that their health insurance or disability insurance will not pay for long-term care. If they have not saved for it on their own, they may be forced to rely on Medicaid. Employers have long told employees that saving for retirement will give them more choices about their future. Similarly, by preparing for a long-term care event, employees will have more choices about the care they will receive if it becomes necessary. In contrast, spending down to the poverty level so they can access Medicaid limits their choices.

For those who have the ability and the discipline to save enough to pay for long-term care, personal savings are a viable option. But most people find it challenging to set aside the money they need for all of life's other demands *and* long-term care. For them, insurance may be an option that can protect the savings they have.

Medicare, the government's health insurance system, pays for a maximum of 100 days of skilled nursing or rehabilitative care when that care is provided immediately following a hospital stay. It does not cover custodial care. Medicaid is the government's means of paying for the care of those who have no other means to pay, having spent down their assets to a level the government defines as impoverished.

To guard against fraud, the government has the right to review five years' worth of an individual's finances to make sure assets have not been transferred into someone else's name during that time. The Medicaid system is under tremendous financial pressure, shouldering 40% of the nation's long-term care spending. In fact, Medicaid spending has increased more than fivefold in the last two decades, from $75 billion to more than $400 billion per year.

The results are increased scrutiny of applicants, tightening of qualification rules and a new emphasis on recovery of money spent. This emphasis means the government looks to the estates of Medicaid recipients to recover amounts paid for care. Heirs who counted on inheriting the family home may be forced to sell it to repay the system for the cost of the loved one's care. As the government's costs go up, this is becoming more and more common.

Reality #2: Medicaid pays for long-term care only in extreme circumstances.

Myth #3: There No Longer Are Any Good Long-Term Care Products

When long-term care coverage first became available, the products were designed and priced based on educated assumptions, some of which have been refined over time. Americans are older now, on average, than they were in the 1970s, turning 65 at a rate of about 8,000 per day, according to AARP. Many of us have real-life experience with the long-term care needs of our parents or other loved ones, and it causes us to look closely at our own future needs. Claims experience has provided information that has led to product improvements that consider consumer preferences such as in-home or assisted living care.

These and other factors have brought about changes in the long-term care industry—in pricing, products and carriers. The media has reported on people who saw large price increases on long-term care policies they had held for many years and, due to the premium increases, no longer thought they could afford the coverage.

takeaways >>

- It's estimated that two-thirds of Americans eventually will need some type of long-term care.
- The average annual cost of long-term care is higher than the average amount people have saved for retirement.
- Medicaid pays about 40% of the nation's long-term care costs but covers only people who are impoverished.
- Long-term care insurance carriers have improved product design and are pricing products more realistically.
- By offering long-term care insurance as a benefit, employers can get modified or simplified group underwriting, protecting against adverse selection.

How Does Long-Term Care Coverage Work?

When is the right time to buy long-term care coverage? The day before you need it!

This may sound flippant but isn't meant to be. The truth is that no one knows when he or she might need the coverage—but the younger a person is when he or she purchases it, the less expensive the premium will be.

When a person needs help with two of the six activities of daily living—bathing, dressing, eating, toileting, transferring and continence—or when the individual has a severe cognitive impairment such as Alzheimer's or a traumatic brain injury, he or she becomes eligible for a long-term care benefit.

There are still policies available that pay only for nursing home care, but they are rare. Instead, today's long-term care policies pay benefits that can be used to pay for nursing home care, assisted living facilities and even at-home care, allowing recipients the choice of where and how they want to live. Benefits are paid in the form of a per day rate, which can range from about $50 to $500 per day, or a per month rate such as $5,000. Benefits generally begin 90 days following the triggering event.

Premiums are based on age at the time of purchase and the amount of benefit. Some individuals choose to purchase inflation protection, which increases the daily rate over time. Others prefer to buy a higher daily rate up-front to protect themselves against inflation.

For example, a 40-year-old purchases a long-term care policy that:

- Pays a benefit of $5,000 per month for up to 36 months toward care in a nursing home, in an assisted living facility or at home
- Has a 90-day *elimination period* (the period between a triggering event and the start of coverage)
- Includes a 5% simple inflation benefit, so that the benefit increases by 5% per year during the time premiums are paid.

Although this example is not specific to an individual, for a male, this policy might cost roughly $115 per month. A female of the same age and circumstances might pay a premium of about $160 per month.

If the policyholder were to suffer a triggering event in 20 years (at the age of 60), the male would have paid $27,600 in premiums and would receive $360,000 in benefits, assuming he used it all. The female would have paid $38,400 in premiums and received the same $360,000 in benefits. These are averages, not pricing for any specific individual.

When purchasing long-term care insurance, it is important to understand that health is more important than money. The longer a person waits to buy long-term care insurance, the more likely he is to be denied coverage because of declining health. By offering group coverage, employers are giving employees an advantage that they can't get individually: Groups often are eligible for reduced medical underwriting standards, allowing better access to the coverage.

Employees with group coverage generally get more attractive rates and may be able to pay for their coverage through payroll deduction, an easy option for many. The coverage is portable, so they can take it with them if they change jobs. And they may be able to use health savings account money to pay premiums.

Because of the complexity of long-term care products, employers that offer it should work with someone who thoroughly understands the products and can clearly communicate with employees so they can make appropriate decisions about products and timing.

In fact, the design of long-term care insurance is better now than it was when it was introduced, and the pricing is more accurate. Why? There are several reasons, but three of the most important are economic factors, regulatory factors and experience.

Economic Factors

Long-term care insurance is a long-term product. It should be viewed in a similar way to investing. It represents a big risk to the insurance company because the policy may pay out well into the future, and it can pay out for a long time. To account for the risk, the insurance company must calculate expected interest rates into its premium prices.

About 40 years ago when long-term care products first entered the market, actuaries priced the policies in line with "usual" economic trends. At the end of 2008 and the beginning of 2009, the recession resulted in a dramatic drop in interest rates, surprising nearly everyone. In 2010, some long-term care insurance carriers announced they would no longer enroll new employees, were raising premiums significantly or were leaving the long-term care business entirely.

The insurance companies that remain in the business have now adapted pricing for the "worst-case scenario," including the current very low-interest-rate environment. Current pricing is now very conservative, and insurance companies now understand the product thoroughly—both of which should protect the pricing for several years into the future. The author believes prices may increase in the future, perhaps every five to ten years, but that the price increases likely will be in the 5-15% range.

Regulatory Factors

When a health insurer increases premiums, it generally does not have to seek permission from each state's insurance commissioner. When a long-term care insurer wants to increase its rates, it needs the permission of each state in which it operates. Because of having to file state by state for an increase, which takes time and incurs a great deal of legal and related expenses, carriers try to set rates that will last for many years.

And long-term care rates have been relatively stable, especially in comparison with health insurance premiums. Economic and other factors have meant long-term care products did see significant price increases of between 25% and 75% beginning in 2010 and continuing today depending on the carrier and the specific product. These have been the first price increases in the group market in 25 years; the individual market saw some pricing increases beginning about ten years ago. Compare the increase in the cost of long-term care coverage with the cumulative increase in the price of health insurance (about 172% between 1999 and 2012[5]), and the increases in the cost of long-term care may seem more palatable.

Experience Factors

A few carriers exited the business and others increased prices because of experience factors. *Lapse rates*, or the number of people who purchase the coverage and later drop it, are very low at between 0% and 1%. At the same time, claims rates are higher than anticipated when they were set back in the 1970s. Policies have adapted to the needs and desires of the marketplace, now including home care and assisted living care, which in turn increases utilization.

The product has changed in terms of underwriting, too. When it was introduced, a person could buy a policy with no underwriting requirements. While there are a few of these policies available today, they generally exist only in companies that already offered guaranteed issue policies to their employees. Instead, employers can get modified or simplified underwriting for their employee groups. This helps protect against adverse selection.

All of these changes, while disconcerting for some policyholders, have resulted in an industry that is strong and committed, products that reflect well the needs of consumers and pricing that provides a good value that accurately reflects risk.

Reality #3: Pricing is realistic, and companies remaining in the long-term care business are committed to it.

Taking on the Difficult Discussion

No one likes to think about the possibility of needing help to care for the most basic of needs. But educating employees in a straightforward way about that possibility—and of ways they can protect their savings—can be a valuable service for an employer to provide. Employers may want to consider including the possible need for long-term care insurance in their retirement plan education. Even if an employer decides not to include group long-term care coverage as part of its benefit offerings, it will be providing a service to employees by simply educating them so that they can choose for themselves whether they want the protection this coverage provides.

Endnotes

1. MetLife Mature Market Institute, *The 2012 MetLife Market Survey of Nursing Home, Assisted Living, Adult Day Service, and Home Care Costs.*
2. "Fidelity® Average 401(k) Balance Nearly Doubles Since Downturn," February 2014 press release, available at www.fidelity.com/inside-fidelity/employer-services/fidelity-average-401k-balance-nearly-doubles.
3. The estimate of the average cost of home care of $55,000 is based on $19-$21 per hour for eight hours a day, every day.
4. Genworth *2013 Cost of Care Survey,* Tenth Edition.
5. *Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2012,* May 13, 2013; available at http://kff.org/health-costs/slide/cumulative-increases-in-health-insurance-premiums-workers-contributions-to-premiums-inflation-and-workers-earnings-1999-2012.

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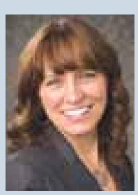

Christine McCullugh is the president of LTC Solutions in Redmond, Washington. A speaker, consultant and member of America's Health Insurance Plans' (AHIP's) Long-Term Care Curriculum Review Committee, McCullugh provides insights to employers, carriers and industry associations in an effort to guide and develop the future of long-term care insurance. She holds a bachelor of arts degree in business management and marketing from Rochester Institute of Technology in New York.