

The Insider's Guide to Buying Long Term Care Insurance

8 Mistakes You Can Make When Buying Long Term Care Insurance –

And how to avoid them!

By Philip Davis

President, Corporate Compensation Plans, Inc.

&

Craig Davis

President, Retirement Guard, LLC



P. O. Box 1686 – Lakeville, CT 06039
860.435.6622 – www.retirementguard.com



Corporate Compensation Plans, Inc.
457 Main Street - Danbury, CT 06811
203.792.7300 - www.wealthsecure.com

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Introduction

70% of all Americans who become age 65 will need some kind of extended health care during their lifetimes – and 20% will need care for more than five years⁽¹⁾. Equally important: the cost of care can run over a million dollars and it is increasing at close to 5% a year⁽²⁾. These costs can decimate your retirement income and force you to liquidate your hard earned assets to pay them. At best, there will be less for your family; at worst, you can run out of money completely.

As a result, owning long term care insurance should be one of your financial and retirement plan priorities. Unfortunately, buying the right kind of policy at the right price is very difficult because most long term care insurance contracts contain a bewildering array of exclusions, limitations, and restrictions.

Understanding what these limitations and exclusions mean – or even knowing they exist – is very difficult because they are written in legal and technical jargon that few of the insurance carriers' own sales people understand. As a result, many buyers of long term care insurance will not collect the insurance benefits they thought were purchased – or may experience far more difficulty in collecting benefits than they had expected.

This article identifies 8 of the more serious mistakes you can make when buying your long term care insurance – and what to do to avoid them!

(1) U.S. Department of Health & Human Services – www.longtermcare.gov 2008.

(2) See the 2010 MetLife Mature Market Study of the costs of extended health care.

Mistake # 1 – “Service Day” Elimination Period

When Guy bought his long term care policy he noticed that it included a 90-day *elimination* period. He thought it meant that, *after* 90 days of needing care, he would qualify to receive his benefit payments.

Of note, to *qualify* to receive long term care insurance benefits you must prove that you are *chronically ill*, meaning that either you have a severe cognitive impairment or that an injury or illness prevents you from performing two or more of the *activities of daily living* – which are eating, bathing, dressing, moving around, toileting, and continence.

Two years after purchasing his policy, Guy suffered a severe back injury in an automobile accident. After being discharged from the hospital he returned home to begin a regimen of care and therapy that was given every third day. After 90 days, he called the insurance company to verify that he was now eligible to receive benefits.

To his surprise, Guy learned that only 30 days had been accumulated toward his elimination period. The reason: to count as a day satisfying the elimination period, *qualified reimbursable* services had to be incurred. Therefore, Guy had to acquire an *additional* 60 qualified service days before his benefit checks would be sent to him.

A service day requirement can stretch out an elimination period far beyond 90 days, especially if care is received at home. And some policies contain an even more stringent elimination period requirement – the need to accumulate 90 *consecutive* service days. This could mean that the loss of just one service day could restart the entire 90-day period.

What you need to do:

Insist that your policy has a *calendar day* elimination period. This means that, once you are eligible to receive benefits (because you have been deemed *chronically ill*), *each* day counts towards the elimination period *regardless* of whether or not there are reimbursable expenses.

Mistake # 2 – The Daily Insurance Benefit

When Ellen bought her long term care insurance policy she chose a *daily* benefit of \$300 – which she thought would provide her with \$9,000 a month of benefits (\$300 x 30 days). Five years later she qualified for long term care insurance benefits and, in the first month, needed home care for 20 days at the rate of \$500 a day – a total of \$10,000.

Ellen fully expected to be paid \$9,000, but instead she received a check from her insurance company for \$6,000. When she asked for an explanation the insurance company representative explained that since she had a *daily* benefit, payments were capped at \$300 per day. Therefore, her payment for the month was 20 days times \$300 – a total of \$6,000.

What you need to do:

Make sure your policy has a provision that reimburses costs on a monthly basis. Had Ellen's policy contained this provision, she would have been paid \$9,000 instead of the \$6,000 she actually received.

Mistake # 3 – Buying a “Reimbursement” Policy

When Bill bought his long term care insurance policy, he chose a monthly benefit of \$9,000. Four years later, he suffered a stroke and could not move about without help. After his hospital stay, he returned home where he received care from a licensed caregiver 8 hours a day, 7 days a week. His wife and other family members then provided the necessary care for the balance of the time. The caregiver charged \$4,000 a month. At the end of the first month, Bill submitted his receipts for \$4,000 to the insurance company and waited to receive his \$9,000 check.

Instead Bill got a check for \$4,000. When he complained to the insurance company, he was told that the \$9,000 a month benefit did not necessarily mean he *would* be paid \$9,000 – it meant he *could* be paid *up to* \$9,000 because only *actual* and qualified costs that were approved by the insurance company would be reimbursed.

At first blush that seems fair – after all, why should one be paid more than his or her direct expenses? However, many basic expenses related to long term care may *not* be qualified, approved expenses. By far the most important of these is care given by family members, but there are a number of others:

- Medical and prescription co-payments
- Household upkeep and maintenance
- Medical equipment
- Cost of transportation to adult day centers or doctor appointments
- Cost for technology such as robotics and smart medicine dispensers
- Hospital care not covered by Medicare or private health insurance
- Medical equipment not covered by health insurance

- Psychiatric treatment
- Money to cover future technologies to maintain lifestyle at home

In addition, with a reimbursement model you have to *account* for all of your expenses, pay them, and then submit the receipts to the insurance company to be reimbursed.

What you need to do:

Make sure you buy either a *cash* or *indemnity* policy.

A cash plan *prepays* 100% of the daily or monthly benefit *regardless* of the amount and type of long term care expenses incurred. This means your policy will pay you 100% of your benefit once you have qualified for care (by being deemed *chronically ill*) – even when *no* expenses are incurred.

This eliminates the reimbursement model's need for recordkeeping and anticipates that you could incur substantial long term care costs that may not be covered by that type of policy. As a result, cash is the *ideal* LTCI plan to own, particularly if you want to be cared for in your own home.

If you cannot obtain a cash plan, then insist on an *indemnity* plan, which will pay the full daily benefit as long as there is at least \$1 of approved expenses in a month. For example, if you have a \$9,000 monthly benefit and incur \$1,000 of approved care costs in a month, you will receive a check for \$9,000.

Note: Some insurance companies are now offering a *combination* reimbursement and cash policy – while they are not as desirable as the 100% cash or indemnity policies, they provide far more flexibility than pure reimbursement.

Mistake # 4 – The 50% Home Care Model

Jane has Alzheimer's and her family wants her to receive care at home. They arranged for a home caregiver to provide services for 16 hours a day at \$20 an hour – \$9,600 a month – and were relieved to see that Jane's policy had a \$9,000 monthly benefit.

At the end of the first month of care the family submitted the caregiver's bill for \$9,600 to the insurance company fully expecting to be paid \$9,000. Instead they got a check for only \$4,500.

The explanation from the insurance carrier was that Jane's policy has a *50% home care* provision. That means when she receives care at home her \$9,000 monthly benefit is reduced to \$4,500. As a result, the family may need to move Jane to a nursing home in order to collect her \$9,000 benefit.

A reduction of benefits clause for home care is particularly egregious because few people who have one are even *aware* of it. In addition:

- Most people who need long term care want to receive it in the *privacy* of their own homes.
- A reduction in home care benefits can actually *force* people into nursing homes in order to collect the full benefit payment – the very place they are trying to avoid.
- Under certain conditions, it can actually be more economical to receive care at home rather than in a facility.

What you need to do:

Buy only long term care insurance policies that provide 100% benefits wherever you need care.

Mistake # 5 – Electing a Future Purchase COLA Option

When George enrolled in his group long term care insurance plan he was pleased to see that it had an inflation protection provision. George knew this feature was important because he had read that the costs for long term care, like all medical expenses, had been *increasing* at a rate faster than inflation.

George assumed this important cost of living adjustment (COLA) provision was part of his policy. Therefore, 3 years later, he was surprised to be offered the *option* to *buy* additional insurance benefits to compensate for the increase in long term care costs – for an *additional* premium rated at his *new* and older age.

When George examined his certificate more closely, he saw that continuing to exercise his inflation protection option would increase his premium to the point that, at some time in the future, he could no longer afford to continue it.

What you need to do:

The *Future Purchase* option approach to inflation protection makes it difficult, if not impossible, for most people to afford COLA protection as they become older because of the constantly increasing premium rates. In addition, the option may provide just an *illusion* of inflation protection. Therefore you should give strong consideration to buying policies that have a COLA feature *included* in them at *level* premium rates. This means the insurance benefit *automatically* increases *each* year *without* an increase in the

premium (of course, if the COLA protection is not affordable, an option to purchase it in the future is far better than no option at all).

Mistake # 6 – Buying a Compound COLA

Irene's *insurance agent* is recommending that she buy a \$9,000 a month benefit payable for 6 years with a 5% *compound* interest COLA. The annual premium for the policy (at age 50) is \$2,890. However, when her *financial planner* looked at the proposal she recommended that Irene take the \$2,890 premium and buy a policy with a \$12,900 monthly benefit payable for six years with a 5% *simple* interest COLA. To prove her point she showed Irene the following comparison:

Age	\$2,890 Annual Premium	
	Annual Benefit	
	<u>5% Simple</u>	<u>5% Compound</u>
50	\$156,950	\$109,500
60	\$227,578	\$169,871
70	\$306,053	\$276,703
74	\$337,443	\$336,334
80	\$384,528	\$450,717

In other words, for the same premium, Irene will have *more* coverage with the simple COLA than with the compound model for a period of 24 years.

When Irene's insurance agent saw the comparison, he pointed out that she was more likely to need long term care after age 75. That may be true, but it overlooks the fact that nearly 9% of all long term care insurance claims begin before age 69 and 40% begin prior to age 79⁽¹⁾. Further, although insurance companies can predict the

percentage of claims by age, individuals cannot. Therefore trying to outguess actuarial statistics based on one individual's odds is an impossible task.

(1) "A Special Report on Long Term Care Insurance Protection", American Association for Long Term Care Insurance, 2010.

What you need to do:

If you are considering adding a 5% compound COLA to your long term care insurance, compare the amount of protection a 5% simple interest COLA will give you for the same premium.

Mistake # 7 – Not Taking Advantage of Tax Subsidies

Roger is a partner in a law firm who shared the details of his firm's long term care insurance offering with his financial planner. His planner commented that the insurance might qualify for an *above the line*, self-employed health insurance *tax deduction*. Furthermore, the deduction is *indexed* to the cost of medical care and has been increasing each year by about 3%.

The Planner went on to mention that, as a resident of New York State, Roger can also obtain a 20% *tax credit* on his long term care insurance premium – and that *both* the tax deduction *and* the tax credit should be available for Roger's wife and other family members.

When Roger factored in these tax subsidies, he discovered that nearly 40% of his premium expense, and that of his wife, could be paid with tax subsidies.

What you need to do:

If you are a sole proprietor, a partner in a partnership, or a 2%+ shareholder in a Sub-Chapter S corporation, you probably will be entitled to Federal Tax deductions for your long term care insurance. And many states – such as New York – also provide tax subsidies.

In addition, if you are a shareholder/employee in a Sub-Chapter C, your company can deduct 100% of the premium it pays for you, your spouse, and other family member dependents – without tax to you!

So if you own long term care insurance – or are considering purchasing it – make sure to check with your accountant to see if you can qualify for any of these significant tax savings.

Mistake # 8 – Not taking advantage of the Premium Refund Feature to conserve wealth

The prevailing wisdom is that affluent individuals do not “need” long term care insurance because they have enough wealth to self-insure the risk. After all, they say, why should we spend a lifetime of premiums and then never need extended health care at all?

The answer is to add a Refund of Premium (ROP) feature to your policy that will refund all of your premiums at your death, less any benefits you have received. This means that if you never need extended health care, the maximum cost of your insurance will be the opportunity cost of money – the interest you could have earned had you invested the premiums instead.

What you need to do:

Ask your financial planner or insurance agent to prepare a long term care insurance presentation for you – with an ROP feature – that compares these two alternatives:

- The financial results of buying long term care insurance and never needing long term care.
- The financial results if you did not buy insurance but needed care.

You'll find his or her presentation to be of great interest!

Next Steps

The costs of long term health care can decimate your income and force you to liquidate hard earned assets. The end result will be less for your family and the possibility that you might run out of money completely.

Long term care insurance is the answer to this threat and you need to give serious consideration to buying it.

However, many long term care insurance policies are riddled with exclusions, limitations, and restrictions in their small print that may take away many of the benefits you think were purchased.

What you need to do:

Use this article as a check list when you sit down to talk about long term care insurance with your agent – and make certain you do not make any of the eight mistakes we have discussed in it! For further information contact Tasha Mayberry at 203.792.7300 or email tmayberry@corpcompinc.com.

About the Authors

Philip Davis is President and Founder of Corporate Compensation Plans (CCP) and WealthSecure. His articles have appeared in Employee Benefit News as well as other industry magazines and have been featured in The New York Times, Business Week, CFO Magazine, and the Institutional Investor. As a Life Member of the Million Dollar Roundtable and 19-year qualifier for its Top of the Table, Phil continues to guide CCP and WealthSecure with his creative expertise. Phil Davis' email address is ptdavis@corpcompinc.com.

Craig Davis has been helping people protect their assets from the devastating costs of long-term care since 1992. Based in the foothills of the Berkshires in Northwest Connecticut, Craig is a co-founder (with his wife Sandy) of RetirementGuard. RetirementGuard specializes in the design and communication of long-term care insurance benefit plans for employees of colleges, universities and medical schools. Craig's institutional clients include Yale University, Brown University, the University System of New Hampshire, and several Harvard teaching hospitals. Craig Davis' email address is craig@retirementguard.com.

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