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4 Secrets to Buying Long-Term-Care Insurance

Policies are rising in price, while benefits are getting skimpier. Here's how to get the best deal for you.

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For aging baby boomers, planning for long-term-care costs becomes more pressing every day. But the insurance that helps cover those costs is surging in price, while the benefits are becoming skimpier.

As costs rise, health care experts are engaging in a fierce debate about whether the coverage is worth the years of premiums. Even when people do go into a nursing home, those bills may not be as enormous as many people believe. Half of men and nearly 40% of women who use nursing-home care never have a stay exceeding three months, according to a recent study by the Center for Retirement Research at Boston College.

The overall cost of new long-term-care coverage has jumped roughly 9% over the past year, according to the American Association for Long-Term Care Insurance, a trade group. A married couple both age 60 can expect to pay $2,170 per year for $328,000 worth of coverage, up from $1,980 last year. Adding inflation protection, which helps the coverage keep up with the rising cost of care, would boost the premium even more.

Meanwhile, the most comprehensive benefits -- such as lifetime coverage and 5% compound inflation protection -- are now out of reach of most consumers because insurers have either stopped offering the benefits or made them unaffordable. So consumers must decide whether limited coverage is better than none at all.

New data may guide their decision. Although many consumers have traditionally thought of long-term-care policies as coverage for the catastrophic scenario of a years-long nursing-home stay, about half of new claims are for in-home care, says Bonnie Burns, policy specialist at California Health Advocates. And, she says, the common perception that a person in long-term care progresses from her home to an assisted-living facility to a nursing home "is really not proving to be true" in many cases.

Although some patients with dementia could spend many years in a nursing home, they tend to be the exception. The Center for Retirement Research found that men who need nursing-home care will spend less than 11 months in care, on average, while women will spend about 17 months. Such figures, combined with the rising cost of insurance, could point many middle-income consumers in one direction: to buy a scaled-back policy that would pay enough benefits to cover a short stay in a facility or a few hours of home care a day. Many people "may be overbuying their coverage," says Michael Kitces, director of research at Pinnacle Advisory Group, in Columbia, Md. "Most people don't have the long claims period we fear."

Wealthier people -- those with financial assets of perhaps $2.5 million or more -- may decide to forgo insurance. This affluent group can cover care costs -- and given the relative rarity of long nursing-home stays, their heirs will generally be better off if they don't purchase insurance, says Anthony Webb, senior research economist at the Center for Retirement Research.

People with more limited assets shouldn't purchase long-term-care coverage if the premiums are not well within their budget. "If you're not comfortable that you can continue the premiums indefinitely, you shouldn't be buying," says Claude Thau, a long-term-care insurance consultant in Overland Park, Kan.

Most people fall somewhere in the middle: They're willing to spend a certain amount of their personal savings on long-term care but also could benefit from a more limited policy and other strategies to fill in the gaps. Bonnie Belza, 61, a technical writer in Scottsdale, Ariz., bought a policy in her late thirties, after seeing her grandmother spend seven years in a nursing home. The policy has a daily benefit of about $190, but it doesn't have any automatic inflation protection, so Belza envisions using some of her savings to help pay the bills. She's also thinking about downsizing or retrofitting her house so that she can receive care at home. "The next time I fix a bathroom, there are going to be handles put on the wall," she says. The long-term-care policy is just "part of the overall strategy."

Assess your risk. To find the right policy, first determine the type of risk you're trying to cover. Consider your health, hereditary conditions and longevity in your family, availability of family caregivers, and personal preferences.

If you want to remain at home and have family members who can provide some care, for example, you may want to buy a policy with a relatively low benefit level. With the national median rate for a home health aide at $20 an hour, the policy could provide enough to cover the cost of an aide for 2.5 hours a day to give relatives a break. A married couple age 60 and 65, for example, would together pay about $1,500 a year for a three-year policy that provides a $1,500 monthly benefit with 3% compound inflation protection, Thau says. The $1,500 monthly benefit would cover 75 hours of home care a month.

Too often, Thau says, financial advisers discuss only higher benefit levels that would cover the cost of assisted living or a nursing-home stay. "You can get a small policy that can be wondrous" in terms of allowing you to remain at home without overburdening family caregivers, he says.

A policy that would cover most of the bills at a facility costs considerably more. Genworth, for example, currently charges a healthy 55-year-old married couple more than $6,700 a year for a three-year policy with a $150 daily benefit and 5% compound inflation protection. And today, that policy would cover only 60% to 70% of nursing-home costs -- the national median rate for a semi-private room is $220 a day, while a private room costs $250 a day, according to Genworth.

You could use this richer benefit to cover home health costs. But the $150 would cover just 7.5 hours a day for a home health aide.

To find the cost of home care, adult day health care, assisted-living facilities and nursing homes in your community, go to www.genworth.com/costofcare.

Cut the cost. Once you've considered the type of risk you'd like to cover, ask yourself, "how much of that risk can you transfer to the insurance company, and how much can you tolerate on your own?" Burns says. The first step is to choose a deductible, also known as the "elimination period," which is the number of days between the time you become eligible for benefits and the time the insurer starts paying.

Many policies offer a 90-day elimination period, but prepare to spend $22,500 out of pocket for nursing-home care until benefits kick in. The longer your elimination period, the lower your premium will be. A 90-day elimination period costs about 40% less than a zero-day deductible, says James Glickman, president of LifeCare Assurance, a long-term-care reinsurer in Woodland Hills, Cal.

Choosing a shorter benefit period will also cut your cost. A benefit period of three to five years "will cover the vast majority" of long-term-care needs, says Dawn Helwig, a principal at actuarial and consulting firm Milliman. Consumers "shouldn't feel like they have to buy the Cadillac policy," she says.

One of the most effective -- and controversial -- ways to reduce costs is to choose a lower level of inflation protection. The 55-year-old couple above, for example, could cut their annual Genworth premium roughly 60%, to $2,718, simply by switching to 3% compound inflation protection instead of 5%. And an increasing number of Genworth customers are choosing even cheaper options such as 2% or zero inflation protection, says Chris Conklin, the company's senior vice-president for product design.

Some financial advisers fear that inflation protection of 3% or less won't keep up with rising long-term-care costs. But depending on your budget and the type of risk you're trying to cover, more limited inflation protection may make sense. The national median hourly rate for a home aide has grown only 1% annually over the past five years, according to Genworth, compared with a 4% five-year annual growth rate for a private room in a nursing home. Of course, inflation could pick up in the future when you need care.

When comparing options, consider the impact of various levels of inflation protection on the size of your benefit at the time you're likely to use care. A 60-year-old couple, for example, can together pay $2,170 a year for a policy with a $150 daily benefit, three-year benefit period, 90-day elimination period and no inflation protection. That benefit is worth about $164,000 per person -- and has the same total value at any age. Or they can pay $3,930 a year for the same policy with 3% annual inflation protection, and the value of their benefit will grow to $325,000 per person at age 80, for example, and $365,000 per person at age 85, according to the American Association for Long-Term Care Insurance.

Another approach: Choose a policy with a "future purchase option," which has no automatic inflation adjustment, lets you pay a lower premium today and gives you the option of boosting coverage down the road. Such a policy would cost the 60-year-old couple above $2,239 a year, according to the association. "There's a lower cost going in, and that allows some flexibility to manage inflation over time," says Kamilah Williams-Kemp, vice-president of long-term care at Northwestern Mutual. But Burns warns that the future-purchase option can be "a dangerous concept." When adding inflation adjustments in future years, "you're paying more based on your age, and at some point you price yourself out," she says.

Buy early. People who determine that they want a policy have good reason to buy sooner rather than later -- ideally while in their fifties. Premiums will climb with each year you age. The 60-year-old couple above, who would pay $3,930 for the policy with 3% inflation protection, will pay $6,177 if they wait until 65 to buy.

Buying while still in good health has become more important as insurers tighten underwriting standards. Some companies have added blood-test requirements and started scrutinizing family health history for conditions such as heart disease and dementia. One-fourth of applicants age 60 to 69 are rejected, and 44% of those age 70 to 79 are denied coverage, according to the long-term-care association. Most companies won't issue policies to people over 75, says Jesse Slome, the association's executive director.

Married couples should consider a "shared care" rider, which allows couples to share benefits. If a husband and wife each have a three-year benefit period, for example, and the wife develops dementia and uses up three years of care, she can dip into her husband's benefits.

Single women face major challenges in the long-term-care insurance market. Because women live longer than men, insurers in recent years have begun charging single women higher premiums than single men -- often about 50% more. If possible, single women interested in coverage should purchase it through an employer, because unisex pricing is still available in the employer market. You can keep the policy when you leave your job.

Determine affordability. Premiums have been rising sharply in recent years because many assumptions insurers made when pricing policies in years past turned out to be wrong. Fewer people have dropped these policies than expected, and insurers have faced more claims than anticipated. At the same time, a long period of ultra-low interest rates has left insurers with lower investment earnings than they projected.

Insurers are allowed to raise premiums even after you buy the policy, so consumers must factor future premium increases into their budget. "People are buying policies today that won't pay off for 30 or 40 years, and there are so many unknowns," Genworth's Conklin says. "People should expect that rate increases are more normal than abnormal."

Some consumers seeking to avoid the risk of premium increases have gravitated toward hybrid products combining long-term-care insurance with life insurance. You typically pay a single upfront premium for a cash-value life insurance policy that will pay benefits early if you need long-term care or provide your heirs a death benefit if you don't need care.

But some advisers warn that this can be a very costly way of getting long-term-care coverage because consumers give up the opportunity to get market growth rates on a large lump sum of money. If you put $200,000 into a hybrid product and interest rates go from today's near-zero levels to 6%, Kitces says, the product is actually costing you $12,000 a year -- and "it's the most expensive long-term-care insurance policy in the history of long-term-care insurance."

Forgoing coverage can also be a costly decision, in terms of quality of life. People who know they have to cover their own long-term-care costs sometimes won't spend money on travel and other frills during retirement, Thau says. Those who choose to self-insure may even be reluctant to get the care they need. "I've seen people terrified of running out of money, so they never get the necessary care," Slome says.

People who feel strongly about getting the type of care they want may find long-term-care coverage well worth the price. Donna McCullough, 70, bought a policy at age 51 after her mother, who had broken a hip and entered a facility for physical therapy, was diagnosed with Parkinson's. The owner of a paralegal company in Columbia, S.C., McCullough decided that if she needed care, she'd like it to be in a good assisted-living facility. She's wary of having her choices restricted by relying on Medicaid. "I'd rather have a little freedom," she says. And as a divorcee with no children, "I don't really want to be cared for at home," McCullough says. "I'm too social for that."