Kiplinger's PERSONAL FINANCE YOUR GUIDE TO A SECURE RETIREMENT

RETIREMENT PLANNING 2007

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Insurance for the long haul

Elder-care responsibilities spur boomers' interest in long-term-care insurance. By Kimberly Lankford

EXPERIENCE IS THE BEST—AND OFTEN HARSHEST— teacher. As more and more baby-boomers find themselves caring for elderly parents, many are developing a new appreciation for long-term-care insurance. Nancy and Ken Holm count themselves among the converted.

Ken's mother spent three years in a nursing home before she passed away in 2003. The entire family was grateful that she had a long-term-care policy so she could afford the best care available in her area. "The insurance policy simplified everything when my mother-in-law was so sick," says Nancy, 59. The experience also prompted her and Ken, 63, to buy policies for themselves so that their only child, Nancy, would be spared the burden of paying for *their* care.

The average cost of nursing-home care is currently more than $75,000 a year, according to the MetLife Mature Market Institute. If the price continues to increase by about 5% a year, the average annual cost could top $250,000 in 25 years, when today's 60-year-olds are most likely to need care. Medicare provides little long-term-care coverage, and Medicaid pays only after you've depleted most of your assets (see the box on the next page).

Although long-term-care insurance can be costly and confusing, once you understand the elements that affect the cost, you will be in a better position to decide which policy is right for you. Several insurers have introduced innovative features that can help you trim your premiums; other policies appear cheaper but could actually cost more in the long run. Here is what you need to know to make the right choice.

DAILY BENEFIT

YOUR FIRST DECISION SHOULD BE HOW MUCH coverage you need. Long-term-care costs can vary significantly by city and facility. While the national average rate for a private room in a nursing home is more than $200 a day, it is only about $150 a day in Kansas City, Mo., near the Holms' home in Prairie Village, Kan. Other levels of care cost less. Assisted-living facilities, for example, charge an average of $86 a day in the Kansas City area, and home health aides earn about $18 an hour.

After considering these costs, Ken and

TIP // To find a long-term-care agent, check out Long Term Care Financial Partners (www.ltcfp.com), which includes brokers throughout the country, and the American Association for Long-Term Care Insurance (www.aaltci.org).

TIP // **For basic information about long-term-care costs and ways to finance them, go to www.longtermcare.gov.**

Nancy decided to keep their premiums low by choosing a daily benefit of $105. They realize that if they end up in an expensive nursing home or receive round-the-clock care at home, their insurance will cover some, but not all, of their costs. They pay a total of $3,300 a year for their two policies from MetLife.

While it can be tough to find a few thousand dollars in your budget to buy long-term-care insurance when you're struggling to buy a home, save for college or put money away for retirement, you can follow the Holms' example. They waited until they were finished paying college bills for their daughter before they bought their policies. Other empty-nesters may find they need less life insurance when the kids leave home. You could shift the money you've been paying for life insurance to a long-term-care policy.

WAITING PERIOD

YOU CAN APPLY THE SAME RISK/COST CRITERIA when selecting the *elimination period,* which is the time before insurance coverage begins. The longer you wait, the lower your premium (see the table on the last page). But extending the waiting period means you will have to pay the bills on your own for a longer time. For example, if a nursing home costs $200 a day and you have a policy with a 30-day waiting period, you'll have to pay $6,000 before benefits kick in. A 90-day waiting period would cost you $18,000 out of pocket, and with a 180-day waiting period, you would have to come up with a whopping $36,000 *before* your policy would begin to pay for your care. And that's just in today's dollars.

If the price of care continues to increase by 5% per year, the daily bill could rise to $677 in 25 years. If your policy has a 180-day waiting period, you could have to pay $122,000 *before* benefits begin. Such potential out-of-pocket costs make saving a few hundred dollars a year in premiums look like small change. Most people purchase policies with a 60- or 90-day waiting period, which keeps their premiums manageable but limits future out-of-pocket costs.

When comparing policies, ask how the insurer calculates the waiting period. Some count one day a week of home care as a full week toward satisfying the waiting period; others count it as just a single day.

LENGTH OF COVERAGE

CHOOSING THE RIGHT BENEFIT PERIOD—THAT IS, how long the payouts will last—is the toughest decision of all. The average nursing-home stay lasts a little less than three years. Actuarial firm Milliman studied more than 1.7 million long-term-care policies and found that 92% of the 70-year-old claimants needed care for fewer than five years.

But some people stay in a nursing home much longer, especially if they have Alzheimer's disease. The Milliman study found

» ESTATE PLANNING

New rules make it tougher to qualify for Medicaid-paid nursing-home care

A Medicaid-reform law that took effect last year makes it much harder to qualify for government-paid long-term care. Medicaid, jointly funded by federal and state governments, is intended to provide health care for the poor. But it has become the major source of financing for long-term care, paying nearly half of all nursing-home bills. Most states require nursing-home residents to spend virtually all of their assets, down to $2,000, before they can qualify. Married couples have higher asset allowances as long as one spouse is healthy enough to remain at home.

In the past, some elders have transferred money to family members as a way to appear poor enough on paper to qualify for Medicaid while preserving a legacy for their heirs. The new law, which attempts to halt such "Medicaid planning" practices, extends the period during which the government can scrutinize financial transactions from three to five years. If you give away money or property during the five-year "look-back," it will trigger a penalty period during which you will be ineligible for Medicaid assistance.

In the past, the penalty period began the day you transferred the assets and often expired before you were admitted to a nursing home. Now the penalty begins the day you apply for Medicaid, which by definition means you have already spent virtually all your money and need public assistance to pay the bills.

To determine how long you would be ineligible, divide the amount of money or the value of the asset you gave away by the average cost of a month's stay at a nursing home in your area. Let's say you gave away $70,000 to family members and the average nursing-home cost is $7,000 a month. You would be ineligible for Medicaid assistance for ten months from the time you apply.

that 8% of patients needed care for a longer period—seven years, on average, for men and nine years for women. If that happens, you could end up with hundreds of thousands of dollars in long-term-care expenses after maxing out a three-year insurance policy.

But buying a policy with lifetime benefits can be incredibly expensive. A 55-year-old would pay about $4,500 a year for a John Hancock policy with a $200 daily benefit, 90-day waiting period, 5% compound inflation and lifetime benefit period. Most people lower their premiums by purchasing a shorter-term policy, which should be adequate in most situations. A 55-year-old would cut his premium by more than half by choosing a three-year policy. But if you have a family history of Alzheimer's or other chronic disease, you might want to consider a policy with a ten-year benefit period, which would cost $3,375 a year using the previous example.

John Hancock recently introduced a new version of its policy, called Leading Edge, that offers a five-year benefit period *plus* an extra $1 million of coverage if you still need benefits beyond five years. This policy is only available with a 100-day waiting period and variable inflation protection, and costs $3,196 per year for a 55-year-old, nearly one-third less than the cost of lifetime coverage.

If you are married, you might want to consider buying a shared-care benefit, as the Holms did. Their policy has a pool of eight years of coverage that they can split. So if one spouse needs care for just two years, for example, the other one can use the remaining coverage of up to six years.

Shared-care policies tend to cost about 10% more than buying two separate policies with the same total years of payouts. But they're a lot cheaper than buying two policies with lifetime benefits, and it's unlikely that both spouses will fall into that small group of people who need care for a very long time.

NEW INFLATION OPTIONS

INFLATION PROTECTION IS CRITICAL TO PRESERVE the value of your insurance decades from now. But it's not cheap. The typical 5% compound inflation option, which has done the best job of keeping up with rising nursing-home costs, can double your premium.

Some insurers offer guaranteed-purchase options, which start out costing about half as much as policies with 5% compound inflation protection. You can increase your coverage over time, but your premiums will rise, too, and the increase is generally based on your age when you buy the extra coverage. As a result, guaranteed purchase could cost you much more in the long run.

New York Life and some other major insurers are offering a new type of inflation protection that pegs yearly increases to the consumer price index. These policies keep premiums level but cost 20% to 25% less than those providing 5% inflation adjustment. You save money because in recent years the CPI has only increased by about 2% to 3% a year. But if inflation increases at a faster pace in the future, you could end up with a bigger pool of money at a lower cost.

WHEN TO BUY A POLICY

THE YOUNGER YOU ARE WHEN YOU BUY A POLICY, the lower your premiums will be. Even though you'll probably be paying those premiums for a longer time, your total outlay is still likely to be less. For example, if a 55-year-old bought a three-year policy with a $200 daily benefit, 90-day waiting period and built-in inflation protection, he might pay about $2,000 a year. After 30 years, when he is 85 and most likely to need care, he will have paid a total of $60,750 in premiums.

Waiting to buy a policy with the same features at age 65 would cost about $3,115 a year, and total premiums paid by age 85 would be slightly more, at $62,300. But in reality, the difference is much greater. Since the first policy had a 5% compound inflation adjustment, the $200 daily benefit he purchased at 55 would actually cover $325 per day of care by age 65. You'd have to pay nearly $5,000 a year to buy that much coverage at 65, and by the time you're 85, you would have paid just shy of $100,000 in premiums—nearly 40% more than if you had bought long-term-care insurance ten years earlier.

Another option is to pay your entire premium over ten years—and never pay another dime. A 55-year-old married man in good health would pay $1,125 a year for a three-year policy from Genworth with a $150 daily benefit, a 90-day waiting period and 5%

Help from the states

For nearly 15 years, four states—California, Connecticut, Indiana and New York—have participated in a partnership program that encourages consumers to buy long-term-care insurance in exchange for partial protection of their assets in the event that they exhaust their insurance benefits and must turn to Medicaid. For example, if you bought a policy that would cover up to $150,000 worth of long-term care, you could protect $150,000 of your assets and still qualify for Medicaid assistance.

In 1993, Congress banned other states from following suit, although more than 20 had expressed interest. The new Medicaid law lifts the ban. "This is the biggest catalyst for long-term-care insurance in years," says Phyllis Shelton, president of LTC Consultants, a training firm for long-term-care insurance agents in Hendersonville, Tenn. "People won't buy insurance to pay for long-term care if they think it's free under Medicaid. Now they'll know it's not."

But if you're thinking about buying long-term-care insurance, don't wait for your state to act. It could take years. The older you are when you buy a policy, the higher the premium.

compound inflation protection. If he bought a ten-pay policy with the same benefits, the annual premium would be $2,902 for ten years. This option makes sense for the self-employed and small-business owners, who can deduct their long-term-care insurance premiums as a business expense.

HEALTH MATTERS

ASIDE FROM HIGHER COST, THERE'S AN ADDITIONAL risk to waiting: You might not be healthy enough to qualify for coverage at any price. "About half of the people I see each week either aren't given the coverage they originally applied for, or the rate doubles because of their health, or they're denied coverage outright," says Doug Worman, a long-term-care broker in Audubon, Pa.

Worman says diabetes is the single biggest reason that potential policyholders, including those who aren't insulin-dependent, are rejected. High cholesterol, high blood pressure and osteoporosis are other common reasons that coverage is denied.

Each insurer has different underwriting standards, so it's important to shop around. "The more you tell the underwriters, the better off you are," says Mike Ashley, a long-term-care broker with Senior Benefits Consultants, in Prairie Village, Kan., who sold the Holms their policy. "If you have a medical condition, I try to find out as much as I can and include a letter from your doctor." This is your chance to provide details about how you've been managing your condition, which can make you less of a risk.

WHERE TO BUY

IT'S BEST TO STICK WITH THE BIG INSURERS THAT have specialized in this type of coverage for years and haven't imposed big rate increases on existing policyholders. Worman prefers John Hancock, Genworth, MetLife, Prudential, Mutual of Omaha and Allianz. New York Life sells through its own agents.

Prices, underwriting and coverage details vary from company to company, so it helps to work with a broker who specializes in long-term-care insurance and who can prescreen several companies before you go through the lengthy application process. If you are offered a long-term-care policy through your employer and you have health issues, you may qualify for coverage that might otherwise be denied. But if you're healthy, particularly if you're married, you may save money by buying a policy on your own. **K**

» WHAT COVERAGE COSTS

Long-term-care insurance prices and trade-offs

Annual premiums in this table are for a 55-year-old who buys a long-term-care insurance policy with a $200 daily benefit and 5% compound inflation protection. A longer benefit period increases premiums, while a longer waiting period before benefits begin reduces premiums. Policies with three to five years of coverage and a waiting period of 60 to 90 days are appropriate for most consumers.

WAITING PERIOD	BENEFIT PERIOD 3 YEARS	5 YEARS	10 YEARS	LIFETIME
30 days	$2,430	$3,166	$4,050	$5,350
60 days	$2,227	$2,902	$3,712	$4,904
90 days	$2,025	$2,639	$3,375	$4,458
180 days	$1,822	$2,375	$3,037	$4,013

SOURCE: John Hancock Insurance Co.