WHITE PAPER

M Benefit Solutions™
Bank Strategies

An M Financial Group Company

A Primer on Long-Term Care

The Growing Importance of Long-Term Care and Its Financing

This paper addresses long-term care (LTC) needs and costs, as well as the critical issue of how to finance it. The paper focuses on the issues in the context of an employer-employee relationship.

What is Long-Term Care?

Put simply, long-term care is the assistance you would need if you could not perform the activities of daily living for yourself. You may need this care as a result of a degenerative condition, prolonged illness, or during recovery from a serious accident or illness. One serious misconception is that it is only the elderly that need long-term care. In fact, over 45% of those currently receiving long-term care are under the age of 65.

The Costs of Long-Term Care

In 2001 alone, $173 billion was spent in the United States on LTC, 12% of total health care expenditures.[1] The largest portion of this cost was paid by Medicaid ($76.5 billion—44%), a program for those with very limited resources. The second largest portion was paid directly out of LTC recipients' or their relatives' assets ($38.9 billion—23%). It is also reported that in 2001 insurers paid about $840 million in claims.[2] None of the above costs, however, include the substantial indirect costs associated with family caregiving, including time away from paid work and other activities.

As the population ages and health care costs continue to increase faster than the average rate of inflation, the current costs associated with LTC will only increase.

M Benefit Solutions - Bank Strategies
M Financial Plaza
1125 NW Couch Street, Suite 900
Portland, OR 97209

phone 503.238.1813
fax 503.238.1815
www.mbenefitsolutions.com/bank

Key Issues in Financing LTC Costs

There are a number of key issues to consider when anyone, whether policymaker, employer, or individual, seeks a solution to the problem of financing the costs of LTC.

- If there is no source of payment for such costs other than the individual's savings, the escalating costs of care will rapidly erode assets and retirement income that has been painstakingly accumulated during an individual's working years.
- The costs of care are already high and will only escalate. The average daily rate for a private room in a nursing home was $181/day (more than $66,000 annually) in 2003, up from $168/day (over $61,000 annually) in 2002. The average daily rate for a semi-private room in a nursing home was $158/day (over $57,000 annually) in 2003, up from $143/day (over $52,000 annually) in 2002. These increases are substantially higher than inflation.[3]
- LTC is not just a postretirement issue. The federal government reports that 47% of those currently receiving LTC are under the age of 65.[4]
- The negative impact to employers and employees of the indirect costs associated with long-term care when employees miss work to care for disabled family members is substantial. It was estimated in 1997 that American businesses lose between $11 billion and $29 billion a year in productivity costs due to workplace disruptions, scheduled and unscheduled absences, leaves of absence, reduction from full- to part-time work, opting for early retirement, or leaving work entirely.[5]
- Medicare only partially covers the cost of skilled care, and only in approved situations. Many long-term care needs are not covered by Medicare.
- Medicaid, the current primary source of funds for LTC, pays only for nursing home care and a few community-based services and requires a spend down of personal assets and retirement savings. Effectively, this is a government program for the impoverished and is not an alternative palatable to many people. It is a safety net to be used only as a last resort.
- Medicaid is a joint federal and state program. As states face fiscal crises, there is pressure to contain Medicaid spending, which currently accounts for 15% of state funding.[6]

Response to Financing Issues: LTC Insurance

The primary response to the issues raised in LTC financing is toward a greater reliance on private insurance to aid in LTC financing. A 2002 survey shows 48% of U.S. businesses currently offer LTC insurance (LTCI), an increase of 15% since 1998.[7] In 2003, the federal government itself opened a massive privately-insured, long-term care program for federal employees and their families using private insurance, which includes over 20 million eligible individuals.[8]

Not only has the federal government turned to private insurance for its employees, it is actively encouraging employers and individuals alike to purchase insurance through an aggressive tax policy favoring the purchase of LTCI. In the Health Insurance Portability and Accountability Act of 1996 (HIPAA), Congress enacted favorable tax rules for the purchase of LTCI, especially employer-sponsored LTCI programs (see *Tax Advantages of Qualified Long-Term Care Insurance*, below) and closed loopholes that permitted abuse of Medicaid benefits. In addition, there are several bills currently pending in Congress that would allow full deduction of LTCI premiums by individuals as well as the payment of premiums through cafeteria plans.

Employer-Sponsored Programs

Employer-sponsored programs are becoming more common, offering advantages to both the employer and employees.

Advantages to Employer

- Employer-paid premiums under tax-qualified LTCI plans are tax-deductible for all C-Corporations and, with respect to employees who are not more-than-2% shareholders, all S-Corporation employers
- Basic benefits can be provided with employee choice to purchase additional coverage
- Reduces absences due to employee care for relatives covered by the plan
- Improves productivity
- Increases morale
- Can be provided on a selective basis
- Can be used to retain key executives with a key executive benefit

Advantages to Employees

- LTCI more affordable; premiums generally discounted when purchased through an employer program
- Guaranteed issue makes implementation easier and more efficient
- Benefits are tax-free, whether the employer or employee pays the premium
- Spousal and family coverage is available
- Increased security and peace of mind that income and assets are protected
- Assists in purchasing long-term care insurance for relatives that can serve to reduce the amount of caregiving employees must personally provide
- Policies are fully portable

Key Features of Long-Term Care Policies

There are a number of features provided in long-term care policies that should be carefully reviewed before purchase. Some of these are discussed briefly below:

Benefits Provided

There are two broad categories of policies available.

Reimbursement policies pay no more than actual expenses incurred up to the daily benefit amount. The policyholder must submit bills for the care covered by the contract.

Indemnity contracts pay the daily benefit amount regardless of expenses incurred. Receipts are not required. Indemnity contracts fall into two categories:

- *Actual Indemnity:* The policyholder must show that he is receiving at least one visit per day by a covered individual, such as a caregiver from a licensed agency. The policy will describe who is an acceptable caregiver.
- *Cash Benefit:* The policyholder need only show that he qualifies for benefits.

Levels of Care

Policy should pay for all levels of care—skilled or nonskilled—in any setting: the home, Assisted Living Facility, Adult Day Care, or a Nursing Home. *(Nonskilled = intermediate and/or custodial care.)*

Is Policy Guaranteed Renewable?

Coverage is guaranteed renewable when the insurer will renew your policy as long as you pay your premiums on time. All tax-qualified LTC contracts must be guaranteed renewable. (See *Tax Advantages of Qualified LTCI*, below.) The insurer will have a limited right to adjust premiums for this policy form on a class basis.

Elimination Period (Waiting Period)

In essence, this is the deductible: The number of days from the date benefits are triggered until the insurance company must begin to pay benefits. These periods can range anywhere from 0 to 730 days, with 30-, 60-, 90-, and 180-day periods being the most typical.

Benefit Periods

Many policies will limit coverage to a stated benefit period, ranging in length from one year to a lifetime. The longer the benefit period, the more expensive the coverage will be.

Benefit Triggers

Benefits are generally payable when you need help to perform two or more Activities of Daily Living (six ADLs: Bathing, dressing, eating, continence, toileting, transferring) or suffer cognitive impairment requiring substantial supervision.

Nonforfeiture Options

- *Nontax-Qualified Policy:* Policy may guarantee a return of a specified percentage of premium to a beneficiary if the policy was not used after being in force a specified number of years.
- *Tax-Qualified Policy:* Policy guarantees that if you terminate your policy after three years in most states, the insurance company must pay benefits equal to the amount of premium you have paid for any future claim even though the policy is no longer in force.

Prior Hospitalization

A tax-qualified LTCI contract cannot require a hospital stay in order to qualify for benefits. Most states also now prohibit a hospital stay in any LTC policy. Such a requirement severely and unreasonably restricts the availability of benefit payments.

Rates

Virtually all policies today lock in the rate at time of purchase. Premiums will not increase unless all policyholders in a certain class receive the same increase. A less expensive policy without this feature will be more vulnerable to future rate increases.

Nursing Facility and Assisted-Living Facility Care

Provides a LTC benefit that will be paid when you are in a Nursing Facility or if you are receiving care in an Assisted-Living Facility. The benefit amount paid for these facilities can be the same, or different, depending on the applicant's specific needs.

Inflation Protection

- *Future Purchase Option:* Participant can buy extra coverage at certain intervals determined by the rate of inflation, which is lower than the medical component of the inflation rate, and offers are priced at your attained age.
- *Guaranteed Annual Increases:* A rider that automatically increases the daily benefit by 5%—compounded or simple interest—for life AND if on claim.

Waiver of Premium

After you have satisfied the Elimination Period, the insurer will waive premium payments during any period for which benefits are payable. Any premium that had been paid to the insurer during the Elimination Period will be refunded to you on a pro-rata basis. When benefits are no longer payable, you must resume premium payments.

Home Health Care

This benefit is not intended to be 24-hour-per-day home health care. This benefit is helpful when there is a primary caregiver, and a home health aide can be hired to stay with the person who is ill for an 8–10-hour shift.

Plan should pay same level of benefit for home care as for nursing home care, at least 75–80%. This benefit can help to avoid placing a loved one in a nursing home by providing financial and emotional support in order to keep loved ones at home.

Mental Conditions

Most policies cover mental conditions of an organic nature, i.e., Alzheimer's and other forms of dementia. Look for a statement about coverage for "cognitive impairments."

Tax Advantages of Qualified Long-Term Care Insurance

Congress has provided qualified long-term care insurance with numerous tax benefits affecting both benefits and premiums. In order to be a qualified LTCI, the contract must meet the following requirements:

- The only insurance protection provided under the contract is coverage of qualified long-term care services (generally, being unable to perform at least two ADLs or requiring substantial supervision due to severe cognitive impairment).
- The contract does not pay or reimburse expenses that are reimbursable under Medicare, except when Medicare is a secondary payor or when the contract makes payments on an indemnity basis without regard to actual expense.
- The contract is guaranteed renewable.
- The contract does not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed.
- All refunds of premiums, and all dividends, or similar amounts, are to be applied as a reduction in future premiums or to increase future benefits.
- Enumerated consumer protection provisions are included in the contract. For example, prohibition on requiring hospitalization prior to eligibility for benefits, notice before lapse of policy, offer of inflation protection, etc.
- The ADL loss must be expected to last for at least 90 days, as certified by a Licensed Health Care Practitioner.
- A Licensed Health Care Practitioner must provide recertification every 12 months.
- A plan of care must be provided.

The tax benefits of qualified LTCI are outlined here:

Benefits

Employer-Provided and Individually Purchased LTCI

- Reimbursement benefits are not included in income.
- Per diem or indemnity benefits are not included in income except those amounts that exceed the greater of total qualified LTC expenses, or $230/day (2004 maximum, adjusted annually for inflation).

Premiums

Employer-Provided Insurance

Employer-paid premium:

- Subject to normal reasonable compensation limitations, premiums are deductible by C-Corporation employers and S-Corporation employers with respect to employees who are not more-than-2% shareholders. Employees who are also shareholders owning more than 2% of the S-Corporation are subject to the self-employment rules described below.
- Total premium excluded from employee's income.

Employee-paid premium:

- Deductible by employee who itemizes, subject to limitations outlined below for individually purchased insurance.
- May not be paid through a cafeteria plan.

Self-Employed Individuals (Including Partners and S-Corporation Shareholders Owning More Than 2% of the S-Corporation Shares)

- Eligible for 100% self-employed health insurance deduction.
- Limited to lesser of actual premium paid or eligible LTC premium:

ELIGIBLE LTC PREMIUM IN 2005

Attained Age	Eligible LTC Premium
Age 40 or less	$270
Age 41–50	510
Age 51–60	1,020
Age 61–70	2,720
Age 71 and older	3,400

Individually Purchased Insurance

- Treated as a medical expense deduction, which is allowable to the extent that such expenses exceed 7.5% of adjusted gross income.
- Limited to lesser of actual premium paid or eligible LTC premium (see table immediately above).

Proposed Tax Legislation

The Long-Term Care and Retirement Security Act of 2003 proposed in both the House and the Senate phases in a full deduction for premiums paid by individuals on qualified LTCI, not subject to the 7.5% of adjusted gross income limitation. It also permits payment of such premiums through a cafeteria or flexible spending payment. A similar bill was introduced in the House in May 2004 called the Long-Term Care Support and Incentive Act of 2004.

Summary

The trend in LTC financing is toward the increased use of private insurance. Fiscal pressures on governmental programs, as well as tax policies favoring LTC insurance, should, for the foreseeable future, reinforce the move toward financing of LTC costs through private insurance, especially employer-sponsored programs with their inherent benefits for both employers and employees.

Notes

[1] Health Policy Institute, Georgetown University, as reported in the Georgetown University Long-term Care Financing Project, fact sheet, "Who pays for long-term care?," May 2003, ltc.georgetown.edu.

[2] S. Coronel, *Long-Term Care Insurance in 2000-2001* (Washington, DC: Health Insurance Association of America 2003), as reported in the Georgetown University Long-term Care Financing Project, fact sheet, "Who pays for long-term care?," May 2003, ltc.georgetown.edu.

[3] Metropolitan Life Insurance Company (August 2003). *The MetLife Market Survey of Nursing Home & Home Care Costs*, MetLife Mature Market Institute, 57 Greens Farms Road, Westport, CT 06880, www.MatureMarketInstitute.com.

[4] See www.ltcfeds.com for extensive information on the scope and content of the Federal LTCI program, as well as a host of other useful information.

[5] Metropolitan Life Insurance Company (August 2003). *The MetLife Study of Employer Costs for Working Caregivers,* MetLife Mature Market Institute, 57 Greens Farms Road, Westport, CT 06880, www.MatureMarketInstitute.com.

[6] Kaiser Commission on Medicaid and the Uninsured, *State Budget Constraints: The Impact on Medicaid* (Washington, DC: Kaiser Commission on Medicaid and the Uninsured, as reported in the Georgetown University Long-term Care Financing Project, fact sheet, Medicaid and long-term care, May 2003, ltc.georgetown.edu.

[7] Society of Human Resource Management 2002 Benefits Survey.

[8] See www.ltcfeds.com for extensive information on the scope and content of the Federal LTCI program.