Long-Term Care Insurance: Barriers to Purchase and Opportunities for Growth

Information Brief #2

Presented to
The Colorado Health Foundation

By
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Introduction

In an effort to assist the Colorado Health Foundation with gaining a better understanding of the long-term care insurance (LTCI) marketplace and the Foundation's potential role in encouraging Colorado citizens to plan for their long-term care needs, LifePlans has prepared a series of three briefs to inform the development of a strategy for the Foundation to consider. In the first brief, we provided background information on the long-term care insurance market and product, as well as summarized the current long-term care insurance industry in Colorado.[1]

In this second brief, we compare the costs of long-term services and supports (LTSS) in Colorado and nationally as well as review a number of common barriers to planning for not only the potential costs of long-term care, but for aging and retirement in general. We will also touch upon some of the challenges faced by the current long-term care insurance market.

In the third and final brief, we provide an overview of what other foundations are currently doing to encourage and educate individuals to plan and prepare for the risks associated with LTSS during retirement. We focus in particular on the area of long-term care insurance. In addition, we discuss ways that the Colorado Health Foundation can assist and encourage Coloradans to meet this goal.

[1] For the full first brief, see Long-Term Care Insurance: An Overview.

Long-Term Care Insurance: Setting the Stage

In 2011, the total number of individuals with LTCI coverage was about 7.3 million. According to the NAIC, the total number of individuals with LTCI coverage in Colorado was 137,973. This does not represent all people who have ever had policies, only those who still have them. Changes in covered lives reflect both growth in annual sales as well as changes in the number of policyholders who maintain their coverage over time. When one considers that the target market is comprised of tens of millions of middle income individuals age 50 and over, that the industry has been selling policies for well over 30 years, and that the costs of long-term services and supports have been steadily increasing, this is a very low market penetration indeed. In fact, estimates suggest that among the age 65 and over with incomes greater than $20,000, roughly 16% of the target market has purchased a policy.

Of equally important concern is the fact that market trends in sales of new policies have been going in the wrong direction. The first half of the 1990s represented the fastest growth over the 20 year period and coincided with the proliferation of policies covering home care and nursing home care. The precipitous decline in sales in the early part of this century coincides with a growing number of companies exiting the market, the general declines in the stock market which affected demand, and the significant price increases in new policies offered by insurers.

Clearly, as policies became more attractive to consumers in the 1990s, the market grew significantly both in terms of covered lives and insurance premium. It is also worth noting that during the 1990s, there were minimal changes in the underlying pricing assumptions of policies. In fact, between 1990 and 2000, the average value in policies – as measured by changes in average value of policy benefits – increased more quickly than the average premium during the period.[2] This trend foreshadowed a later criticism and concern with LTC policies expressed by ratings agencies that early designs of policies offered benefits that were too generous relative to factors like actual benefit utilization.[3,4]

Knowing the Cost of Long-Term Care Services

In 2010, Americans spent almost $208 billion on long-term care – the majority of which was paid for by Medicaid (62%) or by individuals and their families (22%). Private long-term care insurance paid for only about 10% of these costs – not surprising given the small market penetration. [5] The lack of financial preparation for possible functional

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[2]Authors calculations based on policy design data from more than 10,000 policies in 1990, 1995 and 2000.
[3] Bazer, L. (2012). An Outsiders View: The State of the LTCI Industry – Long Term Care from a Rating Agency Perspective. Presentation at the 12th Annual Intercompany Long Term Care Insurance Conference, Las Vegas, March.
[4] Meyer, D. (2012). Why Get in? Why Get out? Ratings Agency Perspective on Long-Term Care. Fitch Ratings, presentation at the 12th Annual Intercompany Long Term Care Insurance Conference, Las Vegas, March.
[5] O'Shaughnessy, CV. The Basics: National Spending for Long-Term Services and Supports. National Health Policy Forum, February, 2012.

impairments in the future can force people to compromise their lifestyles in order to pay for necessary services and supports in a time of need. It also hurts the larger society by making claims on public budgets that are already stressed by economic pressures and demographic changes. A recent set of estimates by Webb and Zhivan suggest that, for a couple turning 65, the expected out of pocket spending on LTC costs over the remaining life years is $63,000.[6] The estimates also show that couples turning age 65 face a 5% risk of incurring costs of over $260,000 for LTC alone. These figures emphasize that unprotected financial risks associated with LTC are likely to result in households having to reduce their standard of living, as well as accumulated savings, in order to pay for LTC. Equally important, in the absence of greater saving and/or insurance, more middle income Americans are likely to make claims on safety net programs, like Medicaid, something of major concern to state and federal policyholders. Encouraging those who can afford it to purchase private long-term care insurance would ease some of the expected public payer burden.

While there is an understanding that, as a nation, we spend billions of dollars on long-term care, what does that mean for an individual? In 2012, the average cost of a semi-private room in a nursing home was $6,771 dollars per month – a yearly cost of roughly $81,000. [7] This represents a 4% increase over 2011 and in general, nursing home costs have been increasing steadily by 3-5% over the last four years. While assisted living facility (ALF) costs were only about half of that of a nursing home - $3,550 monthly or about $43,000 annually – people tend to stay in ALFs longer due to the more community like setting and the tendency to move to an ALF before one begins to need help with daily activities. The hourly rate for a home health aide - $21 per hour in 2012 – has remained relatively constant over the last several years. It is difficult to estimate a yearly cost for home care since this type of care can vary widely depending upon the recipient's health and the availability of supplemental family care over the course of a year. Needless to say, the potential overall cost to an individual who needs long-term care is significant and would most likely consume a large part of any retirement savings that had been accumulated (usually to pay for the cost of living).

The cost of long-term care in Colorado is similar to that of the national average for all but home care. Figure 1 shows the yearly cost of care for a semi-private room in a nursing home and a one bedroom apartment in an assisted living facility based upon the data that LifePlans collected in 2012.[8] The potential yearly cost that a Coloradan would face in a nursing home or assisted living facility, while high, is about the same as that faced nationally.

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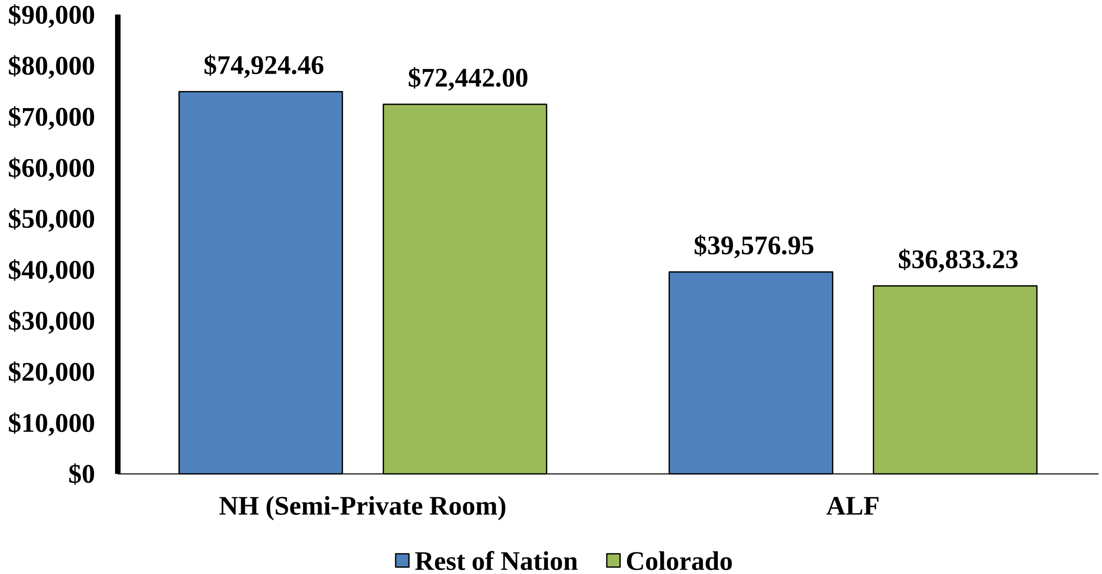
[6] Webb A, Zhivan N. How Much is Enough? The Distribution of Lifetime Health Care Costs. Center for Retirement Research Working Paper CRR WP 2010-1. 2010.

[7] The 2012 MetLife Market Survey of Nursing Home, Assisted Living, Adult Day Services, and Home Care Costs. MetLife Mature Market Institute, November, 2012.

[8] Colorado rates were removed from the national data so as to be able to make comparisons between Colorado and the rest of the nation.

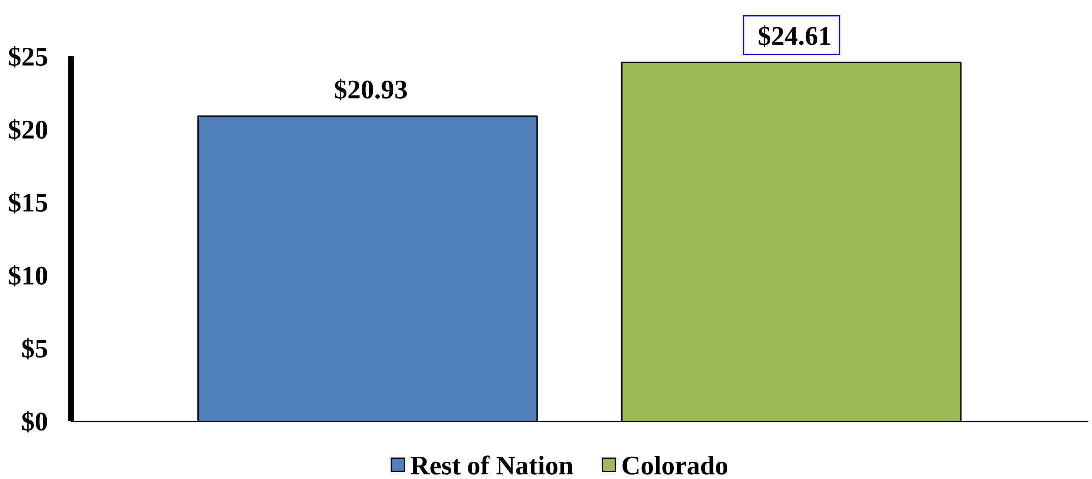
Figure 1: Yearly Cost of NH and ALF Care for Colorado



Source: LifePlans analysis of survey data collected in 2012.

However, Figure 2 shows that the average hourly rate for a home health aide in Colorado is significantly higher than that of the rest of the nation. A home health aide in Colorado averages about $25 per hour which is roughly 20% higher than that of the rest of the nation. This may be a function both of demand – greater demand for care in the community – as well as supply – fewer home care workers available to care for the disabled in Colorado.

Figure 2: Average Cost of HHA in 2010 (Hourly Rate)



Source: LifePlans analysis of survey data collected in 2012. Boxed rate indicated a statistically significant different at p=.05 level

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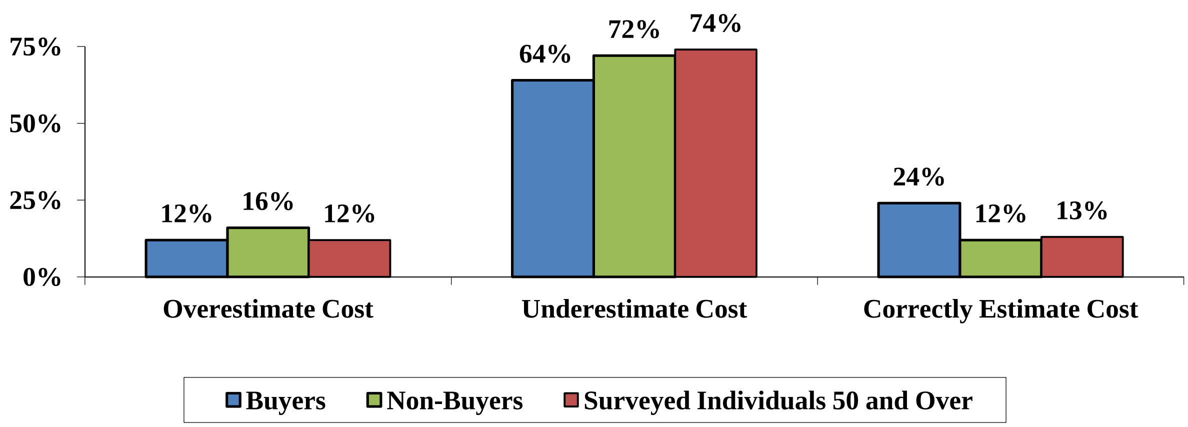
Perception of Cost

Since 1990, LifePlans (with funding from America's Health Insurance Plans [AHIP]) has been conducting a series of surveys of LTCI buyers (defined as someone who has purchased long-term care insurance and paid at least 1 month's premium) and non-buyers (defined as people who have investigated the purchase of the insurance by either contacting an agent or actually applying for the insurance but then declining) in five-year intervals. The surveys are designed to understand the attitudes and opinions of these two groups regarding LTCI, the risk and cost of long-term care, the government's role in long-term care and general knowledge about who pays for care. As well, a survey of individuals in the general population age 50 and over has been conducted over the period.

Research indicates that having an accurate understanding of what long-term care costs does translate into action. In 2010, we asked surveyed individuals what they though a private room in a nursing home cost in their area. Responses were then compared to the actual cost in that area and we determined whether respondents overestimated, underestimated or correctly estimated the monthly cost of a private room in a nursing home.[9] Figure 3 shows that non-buyers of insurance and individuals age 50 and over who do not have LTCI are more likely to underestimate the cost of nursing home care than buyers. In fact, buyers of the insurance were twice as likely to correctly estimate the cost of care. This would suggest that one potential barrier to purchase is the underestimation of (or perhaps lack of knowledge of) the potential local cost of long-term care and that as the estimate of financial risk increases, this barrier to purchase would decline.

[9] This analysis was done by using data from the MetLife Market Survey for 2010 and the AHIP buyer/non-buyer survey. We were able to match each buyer and non-buyers estimate to the matching average for their zip code. For the general population, we compared their responses to the state average as we did not have zip code data for that sample.

Figure 3: Relationship between Actual Costs of Nursing Home Care and Estimated Costs of Care among Buyers and Non-Buyers, 2010



Source: AHIP, 2011 and LifePlans, Inc. analysis of 1,000 respondents in the general population

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The data did contain a small sample of buyers and non-buyers from Colorado and when analyzed, their perceptions of the cost of nursing home care in Colorado were on par with the nation. Although Figure 3 suggests that a better understanding of the correct cost of care is correlated with being an insurance purchaser, in general there is a lack of understanding of the actual, individual level, local cost of long-term care across all groups. As well, not knowing the cost of care you may face is not likely the only barrier to purchase.

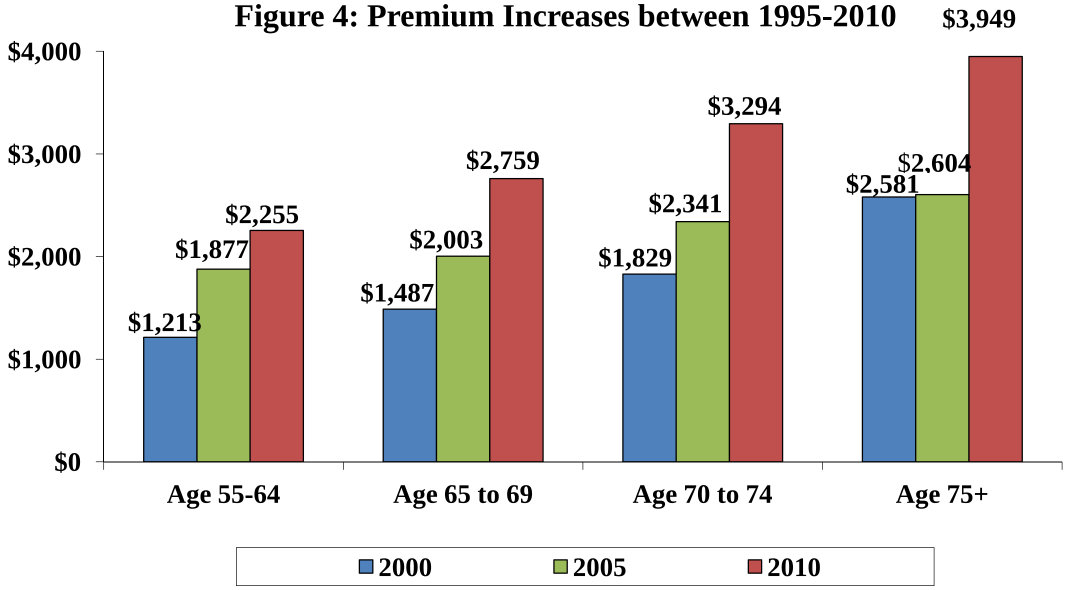
The Cost of a Long-Term Care Insurance Policy: A major barrier to purchase

As mentioned in the first brief, some of the most sophisticated LTCI plans have made extremely optimistic (and sometimes unjustifiable) pricing assumptions that led to premiums that were too low relative to the benefits in the policy. This has caused major challenges for both companies selling long-term care insurance and consumers who have purchased or are still deciding if they should purchase a policy.

In order to correct for these miscalculations, long-term care insurance companies have increased premiums significantly. It is not uncommon for current policyholders to experience rate increases of 30% or more. For example, the CalPers LTCI that covers state and local government employees in California had premium increases of 29% in 2009 and over 80% in 2013. The implication is that households considering buying LTCI face risks of rate increases in the product that they may not be able to afford at a time when they are at their highest risk for needing LTSS. These key attributes affecting the stability and performance of the product being purchased are largely unobservable to consumers.

As shown in Figure 4, premiums have increased across all age categories to correct for incorrect pricing assumptions, most of which were related to interest rates and voluntary lapse rate projections. From 1995 to 2010, premiums increased 145% for those between the ages of 55-64, 134% for those between the ages of 65-69, 116% for those between the ages of 70-74 and 84% for those ages 75 and older. These large premium increases have not only contributed negatively to sales but have also damaged the reputation of both the product and the companies selling it. According to buyers in 2010, an insurance company's reputation was important in the decision to purchase LTCI. Furthermore, (as will be shown in Figure 5) two-thirds of non-buyers indicated that one of the reasons for choosing not to buy a policy was because of the concern the insurance company would raise premiums after the policy was purchased.[10] Clearly the pricing and cost of policies have caused mistrust in the industry, and this has led consumers to reconsider the product.

Figure 4: Premium Increases between 1995-2010



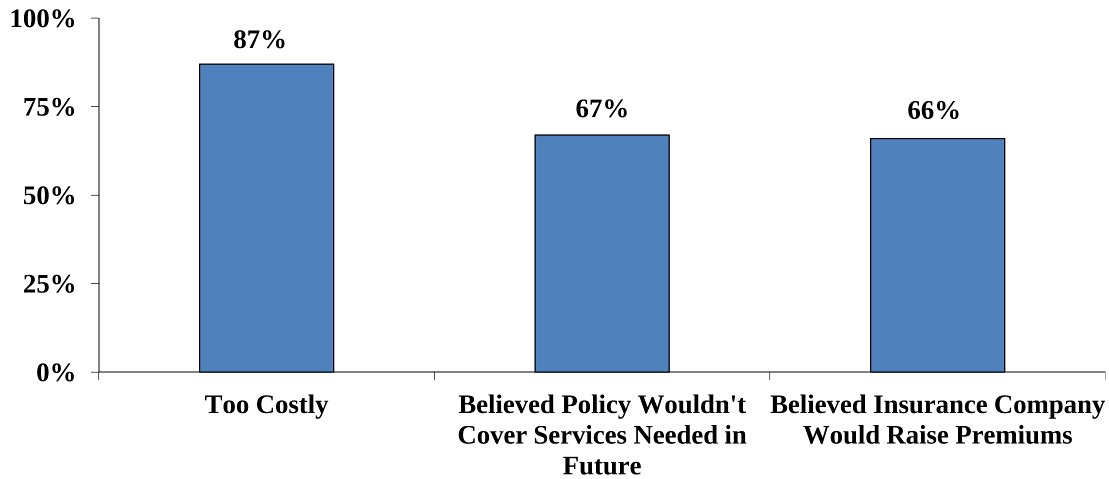
Source: AHIP, 2011.

Figure 5 displays reasons that non-buyers gave for not purchasing a policy. While most chose not to buy policies because they were viewed as too costly, there were other reasons that contributed as well. Clearly, the industry faces a challenge regarding the uncertain future of the service delivery system. As mentioned in the previous brief, when LTC policies were first introduced, they were designed to pick up where Medicare coverage left off – to cover nursing home care. Even when policies evolved to cover home care, anyone who purchased an early policy would not have been able to anticipate

[10] America's Health Insurance Plans (AHIP). Results from 2010 Survey of Long-Term Care Insurance Buyers and Non-Buyers. 2010. Washington DC.

the ALF. The insurance companies had to find ways that older policies could keep up with the changing service delivery system and design new policies that could cover benefits in the current (and possibly) future delivery system. This inevitably led to increases in the cost of policies.

Figure 5: Why Non-Buyers Did Not Purchase Policies in 2010



Source: AHIP, 2011.

Not shown in Figure 5 is the fact that over the past 15 years, when asked what the single most important reason why they did not buy a policy, over half of non-buyers consistently indicated it was because of the perceived high cost. The biggest challenge faced by LTCI agents and insurers is assuring that the relationship between policy cost and value is positive and then translating consumers' understanding of the issue and their desire to plan and prepare for the future into concrete action (purchasing a LTC policy).

Premium vs. Benefits

For most, LTCI is viewed as a discretionary purchase – something that isn't necessary and may have a low probability of being used. It therefore falls to the very bottom of the list of items to purchase with any discretionary income. However, helping people to understand the financial risk of long-term care and the amount that would be offset by LTCI policy benefits relative to the cost of the policy is one way that the industry can counteract the policy cost barrier. Using policy design data from 2010 buyers, we estimated the lifetime premium amount that a policyholder would pay if they purchased a long-term care insurance policy at 55, 65 and 75 years of age. Table 1 shows the average yearly premium, daily benefit amount and percent of the age group that choose inflation protection.

Table 1: Selected Policy Design Characteristics of Buyers in 2010

	Premium	Daily Benefit NH	% with IP
Age Category			
55-64	$ 2,261.00	$153.00	82%
65-69	$ 2,781.00	$148.00	75%
70-74	$ 3,421.00	$151.00	61%
75+	$ 4,123.00	$121.00	22%

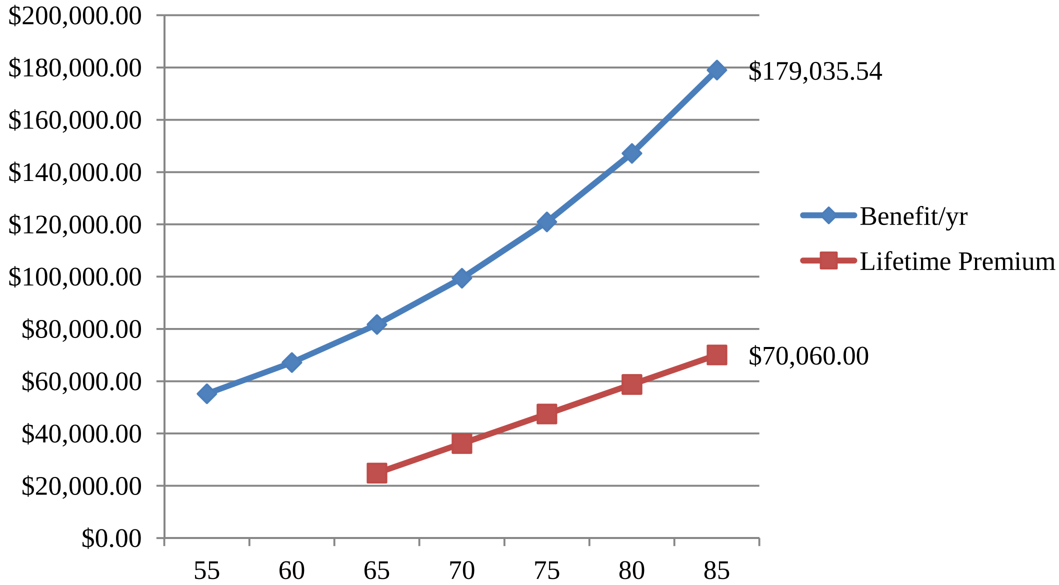
Source: AHIP, 2011

We used these assumptions to calculate the aggregate amount spent on premiums that a person would pay over the course of their lifetime. We then compared this to the yearly amount of benefits they would be entitled to if/when they filed a claim. Figure 6 shows that a policyholder buying a policy at age 55 will have paid approximately $70,000 for their policy by the time they are 85 years old. If they were to file a claim at age 85 for care, they would be entitled to a yearly payout of around $180,000 (a monthly benefit of around $15,000).[11] This would mean that a claimant who bought this policy at age 55 and filed a claim at age 85 would break-even on their 30 years of premium payments after only five months of service use. Research suggests that the projected length of time a person over age 65 is likely to need LTC services is around 3 years.[12] Even if a policyholder claimed as young as 75, they would still only need to incur long-term care costs for 5 months to recoup the lifetime premium. More importantly, this would suggest that attempting to save for potential LTC expenses would be less pragmatic and an inefficient way to prepare for the risk, given the alternative of insurance. In order to save $180,000 by the age of 85 (starting at age 55), one would have to set aside $500 each month for the 30 year period while the average monthly premium for a policy that would pay out these benefits would only be $188. Setting aside $500 per month would be difficult for most Americans, especially when it is in addition to any other savings plans that they might have (such as 401k, college funds, vacation savings, other retirement savings, etc.).

[11] These are simple models, not designed to take in to account the possibility of rate increases or what a policyholder might be earning on the premium amount should they invest it some other way. Benefits were inflated at a compound rate calculated based upon the proportion of the age cohort that selected inflation protection. It is also assumed that the payment would be made on an indemnity basis – meaning they would be able to collect the entire benefit regardless of the bill for service.

[12] Kemper, P., Komisar, H. and Alecxih, L. Long-Term Care Over an Uncertain Future: What Can Current Retirees Expect? Inquiry 42: 335-350. Winter 2005/2006.

Figure 6: Lifetime Premium and Yearly Benefit Payout of LTCI policy purchased at age 55



Source: LifePlans analysis of AHIP buyer data from 2010.

The same analysis was conducted for purchase ages of 65, 70 and 75 and a similar pattern emerged for all purchase ages. However the gap between lifetime premium and benefit payout started to decline slightly for those who purchase at age 70 (if claiming at 85, they would need to use benefits for a total of 8 months in order to recoup their lifetime premium) and was the most pronounced for 75 and over purchasers (using care for 11 months at age 85 would offset lifetime premium for this age group).

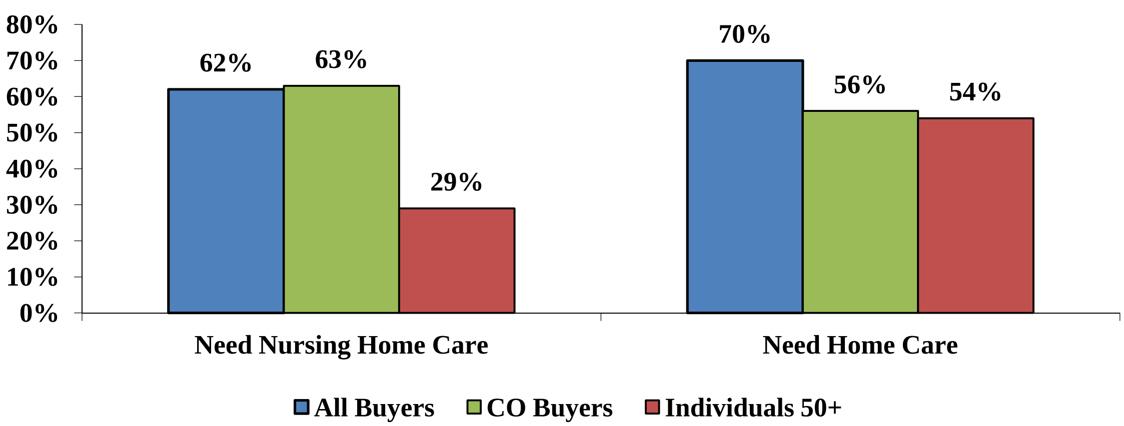
Premiums increase as one ages and therefore those who buy at older ages typically offset this increase by lowering benefit amounts or declining inflation protection. This and the fact that they have fewer years to accumulate benefits (and also pay premiums) contributes to a general increase in the length of time that a policyholder would have to use benefits in order to recoup lifetime premiums paid. However, given that the average length of time spent needing long-term care is 3 years, the data clearly show that premiums paid for long-term care insurance policies would likely be recouped within 6-12 months of filing a claim. Helping people to think long-term and understand the financial implications of the policy purchase (as opposed to attempting to save for potential LTC costs in particular) could go a long way toward encouraging the purchase of this insurance and challenging the “cost” barrier, which is actually a “cost-to-value” barrier.

Additional Insights gained from surveying Buyers and Non-buyers of LTCI

Being a "planner" -- one who believes that it is important to plan for the possibility of needing services -- is positively associated with the purchase of long-term care insurance. Buyers (63%) have been much more likely than non-buyers (41%) to strongly agree with the statement, "It is important to plan now for the possibility of needing long-term care services." These statistics suggest that a person's thoughts and beliefs about saving and planning for potential long-term care may play an important role in a person's decision to purchase a LTC policy. Therefore, encouraging individuals to adopt a planning mindset and then converting that in to action could serve to boost the purchase of LTCI. Clearly, however, the challenge is to identify strategies and approaches that encourage planning in general and for long-term care in particular.

There is also a widespread tendency to underestimate the risks of needing long-term care. Studies of the general population found that only 29% of individuals aged 50 and over believed they had at least a 50% chance of needing nursing home care. A higher proportion said they might need home care (54% in the general population). The proportion of buyers believing the same thing was much higher (see Figure 7) suggesting that people who believe that there is a higher risk are more likely to buy insurance. The chance of needing some form of long-term care services after the age of 65 is around 70%.[13]

Figure 7: Self-Assessment of Greater Than 50 Percent Lifetime Chance of Needing Nursing Home Care in 2010



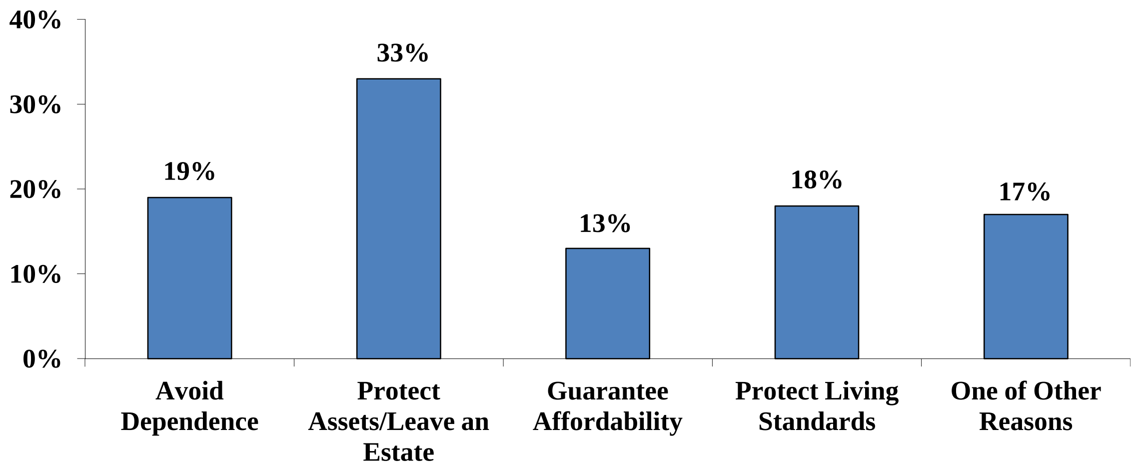
Source: AHIP, 2011

While the cost of a policy and assessment of risk for care play key roles in determining whether a person will purchase a LTCI policy, it is interesting to note that most people buy policies to maintain lifestyle and consumption and not just to protect their assets

[13] Kemper, P., Komisar, H. and Alecxih, L. Long-Term Care Over an Uncertain Future: What Can Current Retirees Expect? Inquiry 42: 335-350. Winter 2005/2006.

(Figure 8). This is important because it suggests that even individuals without a high level of assets are in the target market; most people want to maintain living standards and the insurance is a mechanism to help them accomplish this.

Figure 8: Reasons for Purchasing Policies in 2010

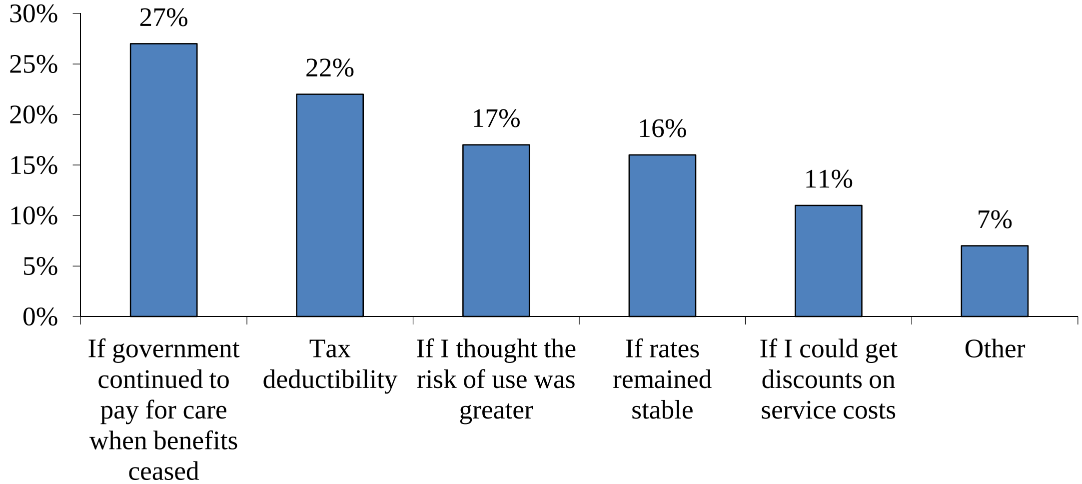


Source: AHIP, 2011.

Non-buyers were asked what might make them more interested in purchasing LTCI policies. Given that cost is a major impediment to purchase it is not surprising that almost 90% of non-buyers would be more interested in buying a policy if they could deduct premiums from their taxes. As well, the same percentage would be more interested if they felt premiums would remain stable over time. Additionally, 80% of non-buyers said that they would be more interested in buying a policy if they thought the government would continue to pay for care after they have used up their long-term care insurance benefits -- similar to the Partnership policy design -- or if they could get discounts on the cost of services covered by their policy.

Non-buyers were also asked to identify the *single most important factor* that would make them much more interested in buying a policy (Figure 9). A government program that continued to pay for care after long-term care insurance benefits ran out and tax deductibility are the two most important factors that non-buyers say would make them more interested in buying a policy. Furthermore, rate stability has become an increasingly important issue for individuals, as the proportion that cite this as the single most important factor that would lead them to consider buying a policy has almost doubled over the last five years.

Figure 9: Most Important Factors That Would Lead Non-Buyers to Consider Buying a Long-Term Care Insurance Policy, by Purchase Year



Source: AHIP, 2011

The Challenge: Seeing your Future Self and Planning

Given the financial risks associated with long-term care discussed here, only people in the wealthiest 10% to 20% of older adult households have savings that could absorb risks of high spending (top 5% of risk). The expected costs of LTC would account for about 31% of the net worth of households with a head 65 to 74 years of age. Thus, the typical household is not in a position to both pay for LTC and to maintain basic consumption levels. This situation is likely to be aggravated in the coming years due to increases in longevity and changing demographics that will reduce the availability of supplementary non-paid care from family and friends.

Policymakers have been encouraging the purchase of LTCI because of the belief that if more people are insured, reliance on public programs will decline thus leading to a reduction in public expenditures. Given the fact that the largest payer of LTC -- Medicaid – is a state and federally funded program, the growth in and success of the private LTCI market is of particular importance to state policymakers. Despite state and the Federal government efforts to encourage the purchase of this insurance through tax deductions, education campaigns and LTC Partnership Programs, sales of private LTCI have continued to decline and the number of companies selling this type of insurance is dwindling.

Given that current public programs that pay for long-term care are only available to those who meet certain (low) income standards, it is surprising that more middle income Americans have not purchased LTCI as they would have to essentially spend all of their savings and assets before they could access Medicaid. There is cause for hope. Fifteen percent of non-buyers in 2010 indicated that they planned to buy LTCI in the future and 53% said they were undecided about whether or not to buy a policy. Only a third of those asked indicated that they did not plan to buy a policy at all. Among people age 50 and over in the general population, 40% indicated that they have considered buying LTCI. Addressing the challenges mentioned here and identifying meaningful ways to encourage the purchase of LTCI, particularly among the middle income Americans, will serve to better prepare the country for the cost of aging and disability. In the third and final brief we will discuss potential activities that the Colorado Health Foundation can undertake to help increase LTCI ownership in Colorado.